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Department
of Health



Llywodraeth Cymru
Welsh Government



The Scottish
Government
Riaghaltas na h-Alba



Department of
Health, Social Services
and Public Safety
www.dhsspsni.gov.uk

Consultation on the introduction of regulations for standardised packaging of tobacco products – Response Form

a. Are you responding (required):

- As a member of the public (go to question b)
- As a health or social care professional (go to question b)
- On behalf of a business or as a sole trader (go to question c)
- On behalf of an organisation (go to question c)

b. Please provide your details and contact information:

Name of respondent (required)

Address of respondent (required):

Contact email address (required):

Now go to question f

c. Please provide your organisation's details and contact information:

Name of organisation (required):

Name of person providing submission (required):

Job Title (required):

Contact address of organisation (required):

Contact email address (required):

Is this the official response of your organisation? (required):

Yes

No

d. If you are responding on behalf of a business, what type is it?

Tobacco retailer (supermarket)

Tobacco retailer (convenience store)

Tobacco retailer (other type of shop or business)

Specialist tobacconist

Duty free shop

- Wholesale tobacco seller
- Tobacco manufacturer
- Retailer not selling tobacco products
- Pharmaceutical industry
- Business involved in the design or manufacture of packaging
- Other (please provide details below)

If other, please tell us the type of business:

e. If you are responding on behalf of an organisation, what type is it?

- NHS organisation
- Health charity/NGO (working at national level)
- Local Authority
- Local Authority Trading Standards or Regulatory Services Department
- Local tobacco control alliance
- Retail representative organisation
- Industry representative organisation
- Other type of business representative organisation
- University or research organisation
- Other (please provide details below)

If other, please tell us the type of organisation:

f. Does your response relate to (required):

United Kingdom

England only

Scotland only

Wales only

Northern Ireland only

g. Do you, or the business or organisation you represent, have any direct or indirect links to, or receive funding from the tobacco industry? (required)

No

Yes (please describe below)

If yes, please describe:

Imperial Tobacco is a tobacco company based in the UK.

h. If you do not wish your details to be identified in the summary report of consultation responses, please tick this box

Consultation questions

1. Do you have any observations about the report of the Chantler Review that you wish to bring to our attention?

Please see separate Submission.

2. Do you have any information, in particular any new or additional information since the 2012 consultation, relating to the wider aspects of standardised packaging that you wish to bring to our attention?

Please see separate Submission.

3. Do you have any comments on the draft regulations, including anything you want to draw to our attention on the practicalities of implementing the regulations as drafted?

Please see separate Submission.

4. Are you aware of any further evidence or information which would improve the assumptions or estimates we have made in the consultation-stage impact assessment?

Please see separate Submission.

Thank you for participating in this consultation.

The Department of Health and Devolved Administrations will only contact you should we seek further information about your response.

How to get involved in the consultation

The consultation will run for 6 weeks, from 26/06/14 to 07/08/14. Responses are invited from any interested group, company or person.

Respondents are encouraged to provide their views online, but responses can be made in any of the following ways:

Completing the online form on the Department of Health website at:

[http://consultations.dh.gov.uk/tobacco/standardised-packaging-of-tobacco-products-](http://consultations.dh.gov.uk/tobacco/standardised-packaging-of-tobacco-products-1)

[1](http://consultations.dh.gov.uk/tobacco/standardised-packaging-of-tobacco-products-1)

- **Filling in the response form by downloading it at:**

<https://www.gov.uk/government/consultations>

- **Emailing your response to:**

TobaccoPackaging@dh.gsi.gov.uk

- **Posting your response to**

Department of Health
Standardised Packaging Tobacco Consultation
PO Box 1126
CANTERBURY
CT1 9NB



Illegal, Unnecessary and Damaging for UK plc

Why standardised packaging is a bad policy idea that would not work

A response to the Department of Health consultation on standardised packaging
of tobacco products

07 August 2014

<http://www.imperial-tobacco.com>

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I. Introduction - Company background

Imperial Tobacco Group PLC ("ITG") is a FTSE top 25 company, the world's fourth largest international - and second largest European - tobacco company. ITG manufactures and sells a range of cigarettes and other tobacco products. ITG has sales in over 160 countries worldwide and is the world leader in the premium cigar, fine-cut (roll-your-own) tobacco and rolling papers sectors.

Imperial Tobacco UK ("ITUK", and, together with ITG, "**Imperial Tobacco**") is the Bristol-based trading operation of ITG which distributes Imperial Tobacco's products to the UK market. ITUK is market leader, holding approximately 45 per cent market share. ITUK's leading UK cigarette brands include Lambert & Butler, JPS, Richmond, Embassy and Regal. ITUK also distributes tobacco products on behalf of Philip Morris Ltd.

Imperial Tobacco directly employs over 1,600 people in the UK and last year collected around £5.8 billion for the Exchequer in duties and other taxes. Imperial Tobacco has around 26,000 shareholders with 53 per cent of issued shares held in the UK. Over 34,000 individuals are members of the company pension fund, and it is estimated that the tobacco industry indirectly supports the livelihoods of over 70,000 people elsewhere in the economy via the supply chain, production and packaging, retailers within the UK.¹

Tobacco is a legal product, enjoyed by around 10 million adults in the UK. This equates to around 20 per cent of the adult population and is not an insignificant minority. These adults make an informed choice to smoke. They smoke for many and varied reasons and, despite the continual stream of unreasonable and disproportionate tobacco control regulations imposed upon them and propaganda to dissuade them, many do not wish to give up.

Our commercial focus is solely on gaining the custom of the 55% of existing adult smokers – over 5 million adults - who currently do not choose our products and maintaining the loyalty of those smokers who currently enjoy our products and wish to continue smoking. We do not market our products to anyone under the age of 18 or to non-smokers. We adhere to all legislation, and where none exists, our International Marketing Standards which are published at: http://www.imperial-tobacco.com/files/environment/marketing_standard_2009.pdf. We support retailer programmes designed to discourage tobacco sales to children such as our

¹ Cogent factsheet, published Q2 2014: <http://www.the-ima.org.uk/policy-legislation/employment/>

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support for the 'No ID, No Sale' retailer awareness campaign and the CitizenCard proof-of-age scheme.

Imperial Tobacco notes that from the launch date, respondents only had a six week period to respond to the *Department for Health's Consultation on standardised packaging of tobacco products* ("DH" and "Consultation"). This was an unusually short period given: the vast number of responses received (over 665,000 in total, including 427,888 opposed to standardised packaging) to the Consultation on standardised packaging of tobacco products published in April 2012 (which itself had to be extended from 3 to 4 months); the complex and contentious nature of the policy including a detailed Impact Assessment; the diversity of interested parties, many of whom (such as small retailers) lack the significant resources required to respond to a Consultation of this nature in such a short time frame; and the fact that the Consultation response period spans a holiday period. We wrote in similar terms to request an extension to the time period for responding and this was rejected. We maintain that this was unreasonable.

Imperial Tobacco nevertheless welcomes the opportunity to respond to the Consultation. Imperial Tobacco supports sound, evidence-based, reasonable and practicable regulation of tobacco products.

ii. Executive summary

NO EVIDENCE: There is no credible or robust evidence that standardised packaging (also commonly referred to as “plain packaging”) would contribute to improving public health.

The experience of Australia to date shows that standardised packaging has been ineffective and counterproductive

Smoking prevalence has continued in line with trend and consumption is unaffected: Statistics² confirm that plain packaging has had no discernible impact with no acceleration in decline in smoking rates. National rates for youth smoking (12-17 year olds) actually increased from 2.5 to 3.4%³ between 2010 and 2013, despite the introduction of plain packaging. Smoking prevalence in both New South Wales and South Australia increased from 14.7 to 16.4%⁴ and 16.7 to 19.5%⁵ respectively. The data also suggests that consumption increased, rather than decreased, immediately after plain packaging was introduced.

Illicit trade has increased: KPMG’s report⁶ published in April 2014 found that illicit tobacco as a proportion of total consumption had increased by nearly 20% from 11.8% in 2012 to 13.9% in the year after plain packaging was introduced. This represents lost excise to the Australian Government in excess of AUD 1bn. Of particular concern is the unprecedented growth in so called ‘illicit whites’.⁷ In 2013, around 2.3% of all manufactured cigarettes consumed in Australia were illicit whites.

Retailers have been negatively affected: Plain packaging has seriously dented Australian retailers’ bottom line through significant down-trading to lower margin products, increased staff training costs, losing business to the illicit market and customer frustration.

Australian Government Review in December 2014: The Australian Government has committed to begin a review of its legislation by December 2014. The UK Government should at least wait until this review has been conducted before deciding whether or not to proceed with regulations.

Standardised packaging would lead to an increase in illicit tobacco in the UK:

Standardised packaging would increase the supply of, or demand for, illicit tobacco and other non-duty-paid tobacco in the UK. The increase in illicit trade would have a direct negative influence on public health for the following reasons:

Product differentiation: Standardised packaging would reduce the ability for consumers to differentiate between different brands and packs. The commoditisation of any category leads to an increased focus on price. The cheapest available price will be found in the illicit market.

² Australian Government 2013 National Drug Strategy Household Survey data table available at <http://www.aihw.gov.au/alcohol-and-other-drugs/ndshs/2013/data-and-references/>, July 2014

³ Australian Government 2013 National Drug Strategy Household Survey, as before

⁴ http://www.healthstats.nsw.gov.au/indicator/beh_smo_age

⁵ http://www.premier.sa.gov.au/images/news_releases/14_05May/afrescodlnng.pdf

⁶ KPMG Full Year 2013 Report on Illicit Tobacco in Australia, April 2014

⁷ Illicit whites are brands made by illegal manufacturers exclusively for smuggling into high price countries.

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Easier to produce illicit product: Criminals have welcomed the prospect of standardised packaging.⁸ Standardised packaging would provide a stimulus for illicit trade by creating a "Counterfeiters' Charter", aiding and accelerating the spread of counterfeit and other illicit products by making it cheaper and easier to mimic legitimate packaging and by creating an unfulfilled supply vacuum for branded products.

Increased availability: The opportunity for criminals to increase the availability of illicit products would expose children who cannot legally purchase the product to tobacco products. In the UK, a third of all smokers aged 14-17 years currently buy illicit. This may be a gateway to further criminal activity, including drugs, and increase the prevalence of youth smoking.

By depressing prices and effectively promoting the non-UK duty-paid tobacco trade, including the illicit trade, there is a real risk of consumption actually increasing.

The Chantler Report (the "Report") conclusions are partial, speculative and an insufficient basis on which to legislate:

The Report omitted to mention the only real world figures on smoking prevalence available at the time,⁹ despite the data being drawn to Sir Cyril's attention by the authors. That data showed no increase in the rate of decline of smoking prevalence amongst 14-17 year olds after plain packaging had been introduced. Instead the Report relied at its heart on a selection of theoretical studies, none of which showed that plain packaging would reduce smoking prevalence and which acknowledged their own very significant limitations. Nor could the Report demonstrate to what extent and within what period the policy would be expected to have an impact. In addition the Report dismissed real-world data from KPMG showing an increase in the illicit trade, based on methodology approved by the NAO, OLAF and the OECD.¹⁰ KPMG were not offered the chance to comment on the Review's accusation that their methodology was flawed, or on other figures the Report relied upon instead. Sir Cyril Chantler himself acknowledged that *"it is too early to draw definitive conclusions"* and *"data is only just becoming available"*.

ILLEGAL MEASURE - Standardised packaging would infringe national, European and international laws, treaties and agreements and create significant legal risk for taxpayers:

Standardised packaging contravenes national and European laws and would put the UK in the position of breaching important international treaties and agreements. The Australian Plain Packaging Act is subject to an on-going dispute in the WTO on grounds of eroding the protection of intellectual property rights, imposing severe restrictions on the use of validly registered trade marks and erecting an unnecessary obstacle to trade. The UK Government should at least await the outcome of the WTO dispute resolution proceedings.

Compensation:

The introduction of standardised packaging could result in legal action against the Government and lead to the serious risk of a compensation bill that could run to billions of pounds.

UK Plc closed for business:

The UK Government's brand ban could affect all business sectors. Removal of branding disrupts competition in a market economy as manufacturers would have their ability to compete

⁸ <http://www.thesun.co.uk/sol/homepage/news/5889365/Sun-Investigates-fake-cigarette-foreign-crime-gangs.html>

⁹ A Kaul, M Wolf: *The (Possible) Effect of Plain Packaging on the Smoking Prevalence of Minors in Australia: A Trend Analysis*, Saarland University / University of Zurich, March 2014

¹⁰ See glossary at the end of the submission.

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effectively for existing smokers significantly reduced. Standardised packaging would also be an unjustified interference with legitimate intellectual property rights. It would send strongly negative signals about the UK as a place to do business and could threaten future Foreign Direct Investment. Standardised packaging would be likely to have a significant adverse impact on hundreds of SMEs.

Standardised packaging would set a dangerous precedent for other sectors:

Standardised packaging would be a precedent for similar restrictions on choice by consumers in other FMCG businesses and sectors in the UK. Standardised packaging is already being called for by some campaigners for other consumer goods. Mars has expressed concerns about similar legislation being introduced in the chocolate, other food and non-alcoholic beverage industries.¹¹

UNNECESSARY NEW POLICY - Revised EU Tobacco Products Directive:

Since the original 2012 consultation on standardised packaging in 2012, a significant new law covering packaging has been introduced in the form of the revised EU Tobacco Products Directive ("TPD2"). TPD2 is subject to several legal challenges.¹² The validity of Article 24(2) TPD2, which purports to give Member States the power to adopt standardised packaging, has been challenged as part of these proceedings. If a challenge succeeds, the UK Government would be prohibited from introducing standardised packaging and, therefore, whilst this uncertainty exists the Government ought not to consider standardised packaging. In addition, the UK Government should await evidence regarding the effectiveness of that measure before considering the introduction of standardised packaging.

Existing regulatory context:

Existing tobacco control measures have not been properly evaluated for their effectiveness or for delivering the outcomes or benefits that were originally expected or promised. This falls short of better regulation principles which should not be applied selectively. A proper review of existing measures, many of which have been introduced only recently, should be undertaken before proceeding with standardised packaging.

Alternative solutions would be a better approach than standardised packaging:

The Government should follow the example of other jurisdictions that have been successful in tackling youth smoking by using the following approaches:

1. Tougher enforcement of existing legislation and additional resources to support enforcement agencies and retailers in their efforts to tackle under-age smoking;
2. Preventing youth access through greater support to proof-of-age schemes, which have contributed to a decrease in youth smoking prevalence to the lowest ever figure;¹³
3. A greater focus on education and support rather than criminalisation, as in the case of Germany which permits the advertising and display of tobacco yet has significantly fewer young people taking up smoking than the UK.

Imperial Tobacco believes any introduction of standardised packaging would be ineffective for public health and counterproductive for the reasons set out in our responses to the four questions below.

¹¹ A Mars spokeswoman reportedly said: "The 2012 response was not a comment on the specific policy. We were highlighting the need to ensure any legislation did not have unintended knock-on effects on brand equity and intellectual property within other categories." The Times, Sweet-makers warn of plan packet fears, Michael Savago, 25 July 2014

¹² a) The Plenipotentiary of the Republic of Poland filed a complaint with the Court of Justice of the European Union on 22 July 2014 and b) separately, by way of a reference to the Court of Justice of the European Union through the Courts of England and Wales, several companies are challenging.

¹³ Smoking, Drinking and Drug Use Among Young People in England – 2013

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1. Response to Question 1: Do you have any observations about the report of the Chantler Review that you wish to bring to our attention?

In July 2013 the UK Government announced that it would not make a decision on whether to proceed with standardised packaging until the evidence from Australia could be measured.¹⁴ No relevant official statistics from Australia had been published at the time, but despite that the DH announced a further review of standardised packaging on 28 November 2013, to be led by Sir Cyril Chantler (the “**Chantler Review**”).

The remit of the three month review was to examine the evidence to answer whether standardised packaging was likely to have an effect on public health, in particular in relation to the health of children. The Chantler Review expressly excluded consideration of relevant factors such as legal issues, competition, intellectual property issues, overall economic impact and freedom of choice.¹⁵

The Chantler Review report (the “**Report**”), published in April 2014, was highly partial, dismissing evidence strongly suggesting that the introduction of the policy in Australia has so far had no perceivable impact on public health, whilst it has had the effect of increasing the illicit trade. The Report went so far as to assert that Sir Cyril was not “...aware of any convincing evidence pointing the other way” (i.e. evidence that standardised packaging doesn’t work) despite being presented with specific research to that effect.

For example, the Chantler Review dismissed a KPMG study¹⁶ reporting that there had been a significant increase in illicit tobacco on the basis that it was methodologically flawed, despite the same methodology being used for a similar study on a larger scale on behalf of the European Anti-Fraud Office (“**OLAF**”) since 2006, and being based on methodology approved by the National Audit Office (“**NAO**”), OLAF and the Organisation for Economic Co-operation and Development (“**OECD**”). It is not clear from the Chantler Report whether the Chantler Review sought KPMG’s comments on other figures relating to illicit tobacco or on the draft sections of the report mentioning KPMG’s work.

¹⁴ <http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm130712/wmstext/130712m0001.htm>

¹⁵ Independent Review into standardised packaging of tobacco Method Statement, 16 December 2013, page 1

¹⁶ KPMG Full Year 2013 Report on Illicit Tobacco in Australia, April 2014

As outlined in greater detail below,¹⁷ Imperial Tobacco understands that the Chantler Review dismissed the KPMG report's findings on the basis of two pieces of evidence; one which agrees with the findings in the report,¹⁸ and another which does not compare the same time period (the KPMG data was from 2013¹⁹ while the contrasting data referenced in the Report was from a 2010 study that was not designed to assess the volume of illicit trade²⁰).

In discussing the illicit market the Report also focused on counterfeit product while ignoring the significant growth seen in Australia in illicit whites, 'chop-chop' and the emergence of a new category of illicit product in plain packaging with brand names like 'Spoonbill', 'Thunder Bay' and 'Junlong' that are created by organised criminals using plain packaging to successfully mimic a legal product. Illicit whites also benefit from being the only branded tobacco product on the market. The failure to note the creation of new illicit plain packaged brands as a phenomenon is surprising as it was specifically brought to the Chantler Review's attention by Imperial Tobacco.

At its heart the Report relies on a selection of theoretical studies, including those in the 'Systematic Review' commissioned by the Department of Health from Public Health Research Consortium ("PHRC"), none of which have been able to show that standardised packaging would reduce smoking prevalence and which themselves have had to acknowledge their very significant limitations. For example, the PHRC 'Systematic Review' could only conclude that there was "*some evidence from the studies in this review that plain packaging may affect smoking-related attitudes and beliefs,*" and importantly warned that "*....caution is required in interpreting these findings*"²¹ [our emphasis]. This academic theoretical evidence is therefore far from robust. The Report places far too much reliance on it in justifying Sir Cyril's personal conclusion. Sir Cyril Chantler himself had to acknowledge that "*it is too early to draw definitive conclusions*" and "*data is only just becoming available*".

While Sir Cyril himself expressed a personal belief that the policy would have a positive impact on public health, he was unable to demonstrate that it would. Nor could he comment on the extent to which it could be expected to reduce smoking rates other than having a "modest" effect over an unspecified period of time. The Report's reliance on "intuitive plausibility" as the

¹⁷ Section 4.3 of this submission

¹⁸ The Australian Customs & Border Protection Service Data for 2012 -2013

¹⁹ https://www.imperial-tobacco.com/assets/files/cms/KPMG_FY2013_Illicit_Trade_Report_FINAL_11_April_2014.pdf

²⁰ Analysis undertaken by the Cancer Council Victoria based on data from the National Drug Strategy Household Survey

²¹ http://phrc.ishtm.ac.uk/papers/PHRC_006_Final_Report.pdf

justification for its conclusion is an insufficient and improper basis on which to introduce a highly contentious policy with far reaching implications for the UK.

Remarkably, the only piece of published real-world data²² about underage smoking rates in Australia that was available to the Review was not even mentioned in the Report. This was despite its authors visiting the review team in London to talk through their findings. The study by statisticians Dr Ashok Kaul and Dr Michael Wolf strongly suggested that there had been no increase in the rate of decline of smoking prevalence amongst 14-17 year olds between December 2012 (when the legislation came into force) and December 2013 (when the most recent data ended):

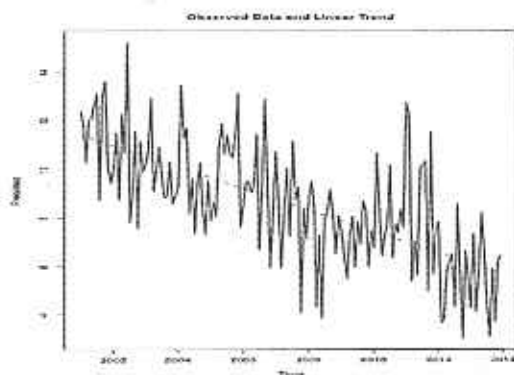


Figure 2: Time series plot of observed prevalence with fitted linear time trend.

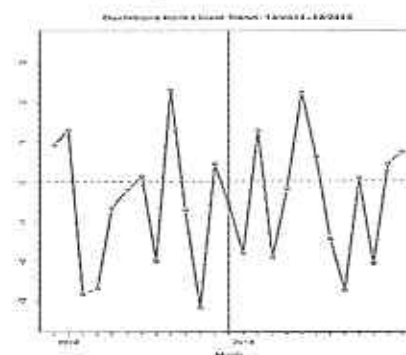


Figure 3: Deviations of observed prevalence from fitted linear time trend. The intervention month 12/2012 is indicated by a vertical line.

The data was from a large survey that has been used by tobacco control researchers in the past. When asked about this omission Dr Kaul said:

"Sir [Cyril] Chantler apparently did not feel the need to reference the only paper on plain packaging based on real-world data in his report to support his findings. In particular, a neutral reader of the review would expect to find a complete reference list of original research to be able to draw his own conclusions."

"The empirical evidence so far does not support the conclusion of a short term effect. Of course, short-term effects are important for policy makers around the world who would

²² *The (Possible) Effect of Plain Packaging on the Smoking Prevalence of Minors in Australia: A Trend Analysis*, Ashok Kaul and Michael Wolf, March 2014

*like to chose [sic] their regulatory policies from a set of alternatives that have been proven to be effective - plain packaging is so far not part of this set.*²³

The decision by the Chantler Review not to mention the only real world figures on smoking prevalence available at the time is inexplicable.

The Report also relied on an apparent increase in calls to a cessation support telephone service after Australia had introduced its legislation. But it failed to report the fact that the study "could not assess whether a change in packaging achieves the desired outcomes" and crucially that in any event ultimately callers' "intention to quit smoking remained unchanged."²⁴ Yet this was the conclusion of a review of the study by a UK Government NHS website.

The Report notes the market research and market segmentation undertaken by tobacco companies but does not provide the context that these practices are standard for all manufacturers of consumer goods. The Report seeks to suggest that there must be a spillover effect where a package designed to appeal to a young adult must also appeal to children. Any spillover effect, if true, would apply to all brands and goods, including those of other age restricted items such as alcohol and cars. Should such a phenomenon exist, it does not of itself justify banning the brands concerned.

The Report wrongly argues that a brand or pack constitutes an advert or promotion. Existing legislation²⁵ is clear about what constitutes advertising, marketing and sponsorship. Even were the assertions within the Report to be the case, tobacco products are not unique in being on public display. The same applies to other products including age restricted items like drink, games, films and magazines. What is unique about tobacco products is the very large and graphic health warnings that dominate the packs. If one considers the packs as an advertisement, it must also be the case that the very prominent health warnings act as one too. In fact, aside from trade customers, tobacco products are not even going to be visible to people who have not already purchased them, due to the UK display ban – which is already in force for large retailers and will be in force for all retailers in the UK by the end of April 2015.

The Report also wrongly suggests that the frequency of changes in pack design supports an assertion that a pack constitutes an advertisement. As Sir Cyril is not an expert in brands and marketing it is not perhaps surprising that he was unaware that increased pace of change in

²³ <http://velvetgloveironfist.blogspot.co.uk/2014/04/an-interview-with-dr-ashok-kaul.html>

²⁴ <http://www.nhs.uk/news/2013/07/July/Pages/Does-plain-packaging-help-smokers-quit.aspx>

²⁵ Tobacco Advertising & Promotion Act 2002

pack design is a known feature of consumer goods where the market is mature, saturated and declining. It is also consistent with brands competing for share of the adult smoking market.

The assertion of cigarettes as a badge product, which is conspicuously consumed while making a statement about the smoker's image and identity, ignores the fact that smokers have far fewer freedoms to consume their legal product in public because of bans – both statutory and 'voluntary' – on smoking in public places and open spaces, in addition to new proposed legislation for private vehicles where children are present. The Report contains no rigorous evidence or assessment of whether and to what extent tobacco products act as so called "badge products".

Similarly, the Report's acceptance of one academic's analysis that branded packaging *could* act as a stimulus to smoke is an insufficiently rigorous basis on which to draw a conclusion.

Given the multitude of very significant shortcomings and assertions within it, the independence and conclusions of the Report are highly questionable and cannot be relied upon to inform government decision-making.

Nevertheless, in spite of its fundamental shortcomings the UK Government has said it is minded to proceed with regulations on the basis of the Report. Yet doing so would contradict the Government's own statement to Parliament that it would measure the policy's impact in Australia before making a decision.²⁶ The Report does not do this.

The available statistical evidence from Australia so far shows no departure from the existing downwards trend, and in two Australian states smoking prevalence actually increased.²⁷ Contrary to the aims of the policy, youth smoking prevalence has also gone up,²⁸ the illegal market has increased significantly²⁹ and retailers have been negatively impacted³⁰.

The research which has been relied upon by the DH (and the Chantler Review) to date has been speculative, selective and inconclusive. The Government's own principles of regulation

²⁶ <http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm130712/wmstext/130712m0001.htm>

²⁷ New South Wales and South Australia from 14.7 to 16.4% and 16.7 to 19.5% National Drug Survey, published by the Australian Government Department of Health on 17 July 2014 http://www.healthstats.nsw.gov.au/Indicator/beh_smo_age
http://www.premier.sa.gov.au/images/news_releases/14_05May/afrescodining.pdf

²⁸ From 2.5 in 2010 to 3.4 in 2013 for people aged 12-17 years old classed as daily smokers. National Drug Survey, published by the Australian Government Department of Health on 17 July 2014

<http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco-kff>

²⁹ KPMG 2013 Full Year Report on Illicit Tobacco in Australia, April 2014

³⁰ Asian Trader special report *Australian Retailers Have Their Say*, March 2014

require the Government to provide a "robust and compelling case" before pursuing any legislation. It has failed to do so.

Undercover journalism has confirmed that people involved in organised crime welcome the introduction of standardised packaging as it would make it significantly easier and cheaper for them to counterfeit tobacco products.³¹ Tobacco smuggler Fauz Firdaus said his profits would soar when he no longer has to copy existing packaging. He was caught on video by undercover Sun reporters punching the air and cheering "*Plain packaging...I support the UK Government!*" This view of an individual involved in organised crime confirms that of serving police officers, where over 80 per cent think it would boost the black market trade.³²

While the Chantler Review noted the anticipated agreement on the revised EU Tobacco Products Directive, it failed to show how, or to what extent, standardised packaging would have an impact over and above the strict new requirements of that Directive.

The Report accepts without question the flawed premise that the impact of regulation cannot be measured when it forms part of a 'comprehensive tobacco control policy'. This 'get out clause' in terms of pre- and post-implementation impact assessments appears to be unique to tobacco policy and fails to meet the Government's better regulation principles.

Legislation should not be pursued until what is a highly controversial and unprecedented policy within the UK - with potentially very significant unintended consequences - is proven to reduce consumption amongst under-age smokers, or to assist quitters or those who have quit from relapsing. Evidence led policy requires the UK Government not to consider the introduction of standardised packaging until its effects in Australia have been properly studied and only after the outcome of various legal challenges.

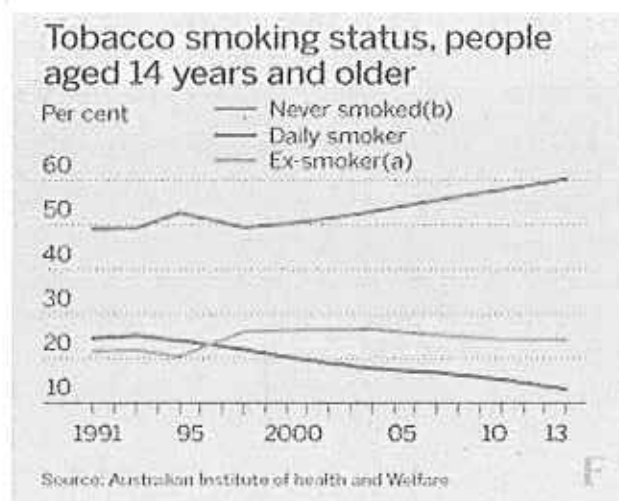
Data released by the Australian Government on 17 July 2014³³ clearly shows that there has been no acceleration in decline brought about by plain packaging.

³¹ <http://www.thesun.co.uk/sol/homepage/news/5669385/Sun-Investigates-fake-cigarette-foreign-crime-gangs.html>

³² <http://www.thesun.co.uk/sol/homepage/news/politics/5666179/plain-packaging-will-lead-to-explosion-in-tobacco-smuggling-poll-says.html>

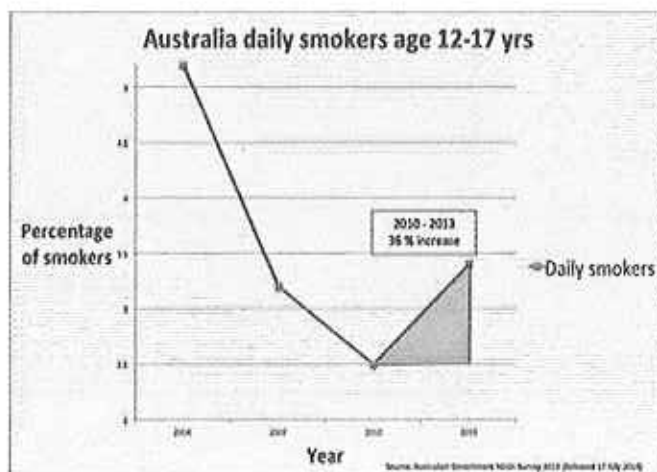
³³ <http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco-kif>

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Although that data appear to show that prevalence of daily smokers declined from 15.1% to 12.8% over a three year period (2010-2013), the rate of decline appears to be unaffected by the introduction of plain packaging in December 2012, since prevalence in 2013 continued to decrease in line with trend. Furthermore, in producing this graph, the Australian Government disregarded casual smokers.³⁴ The prevalence rate for this group of smokers has increased between 2010 and 2013.³⁵

What is striking is that between 2010 and 2013 (a year after plain packaging was introduced) youth smoking incidence has increased from 2.5% to 3.4% for daily smokers. This is despite the alleged impact plain (standardised) packaging is supposed to have on reducing youth smoking.³⁶



³⁴ Who smoke weekly or less than weekly

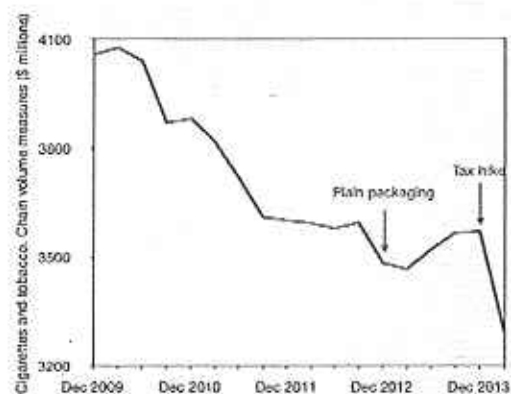
³⁵ National Drug Survey, published by the Australian Government Department of Health on 17 July 2014 <http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco-kff>

³⁶ See, for example, paragraphs 56-61 of the Impact Assessment.

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The data further show that there has been an increase in smoking prevalence in both New South Wales and South Australia from 14.7 to 16.4%³⁷ and 16.7 to 19.5%³⁸ respectively.

Data also suggest that consumption initially increased, rather than decreased, after plain packaging was introduced. Only when a planned 12.5% tax increase was introduced in December 2013 did duty-paid consumption decrease. The graph below demonstrates this but crucially shows volumes for duty-paid consumption and does not include consumption of non-duty paid or illicit tobacco; which we know to have increased.³⁹



Because the academic evidence cited in support of the policy is currently conjecture, and given the mounting real world evidence that the policy has not been effective in Australia, proceeding with the policy would be unjustified and would undermine the Government's commitment to the better regulation principles that it has so clearly laid out and on which it has repeatedly placed great emphasis.

³⁷ http://www.healthstats.nsw.gov.au/Indicator/beh_smo_age

³⁸ http://www.premier.sa.gov.au/images/news_releases/14_05May/afrescodining.pdf

³⁹ Appendix D, Australian Study on Illicit Trade (KPMG) – April 2014 states that overall consumption (including illicit) has remained stable.

2. Response to Question 2: Do you have any information, in particular any new or additional information since the 2012 consultation, relating to the wider aspects of standardised packaging, that you wish to bring to our attention?

2.1 No evidence it works

There is no credible or robust evidence that standardised packaging would contribute to improving public health. By depressing prices and effectively promoting the non-UK duty-paid tobacco trade ("NUKDP") including illicit trade, there is a real risk of consumption increasing. The Consultation ignored the established research as to the reasons why people smoke and continue smoking, specifically those under 18, which do not include packaging and branding.

2.2 Australian experience has proven that standardised packaging has had no effect

The facts from Australia, the only country to have introduced plain packaging, so far show the following effects.

2.2.1 Smoking Prevalence and Youth Smoking

Following the introduction of plain packaging in Australia, smoking prevalence has not been affected.

Data released by the Australian Government on 17 July 2014⁴⁰ clearly shows that there has been no acceleration in decline as a result of the introduction of plain packaging.

As stated above, although the data appear to show that prevalence of daily smokers declined from 15.1% to 12.8% over a three year period (2010-2013), the rate of decline is unaffected and prevalence continues in line with trend. In addition, the prevalence rate for casual smokers⁴¹ has increased.⁴²

Geoff Neideck of the Australian Institute of Health and Welfare was quoted in the Sydney Morning Herald⁴³ as saying "*the results were continued a long term trend (sic),*" and that "*the plain-packaging laws should be seen in the context of changing attitudes and cultural practices.*"

⁴⁰ <http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco-kff>

⁴¹ Who smoke weekly or less than weekly

⁴² National Drug Survey, published by the Australian Government Department of Health on 17 July 2014

⁴³ <http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco-kff>

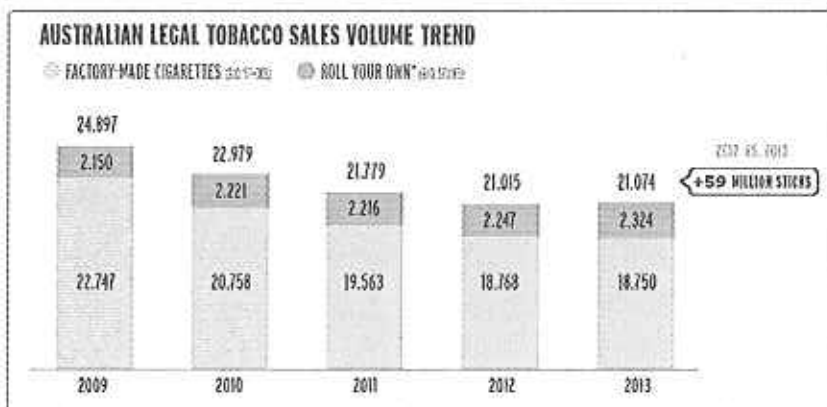
⁴³ <http://www.smh.com.au/federal-politics/political-news/plunge-in-smoking-attributed-to-plain-packaging-20140716-ztqht.html>

What is more, youth smoking incidence has increased from 2.5% to 3.4% for daily smokers between 2010 and 2013 (a year after plain packaging was introduced).⁴⁴

Furthermore, both the 1H2013 (published October 2013)⁴⁵ and FY2013 (published April 2014)⁴⁶ KPMG reports found that overall consumption (including illicit) has remained stable.

2.2.2 Industry commercial data

Contrary to the predictions of the Australian tobacco control lobby, Imperial Tobacco Australia ("ITA") has not seen an industry-wide out of trend volume decline since the introduction of plain packaging in Australia. The tobacco market largely continues to perform based on historical trends, showing no impact from plain packaging. In fact, Australian legal tobacco sales are up +59 million sticks in 2013 compared to 2012. Factory Made Cigarettes ("FMC") declined by less than -0.1% and Fine Cut Tobacco ("FCT") grew by +3.4%.⁴⁷ This is illustrated in the following chart that uses Industry Exchange of Sales Data:



This data shows a slight reversal of a long term historical trend and is driven by consumers down-trading from FMC to relatively more affordable FCT products and illicit trade.

The down-trading trend is also noticeable when one looks within the FMC segment and sees a clear shift from medium price to lower priced cigarettes, indicating that down-trading between price segments seems to become more prevalent in a plain packaging environment.⁴⁸

⁴⁴ Australian Government 2013 National Drug Strategy Household Survey data table available at <http://www.aihw.gov.au/alcohol-and-other-drugs/ndshs/2013/data-and-references/>, July 2014

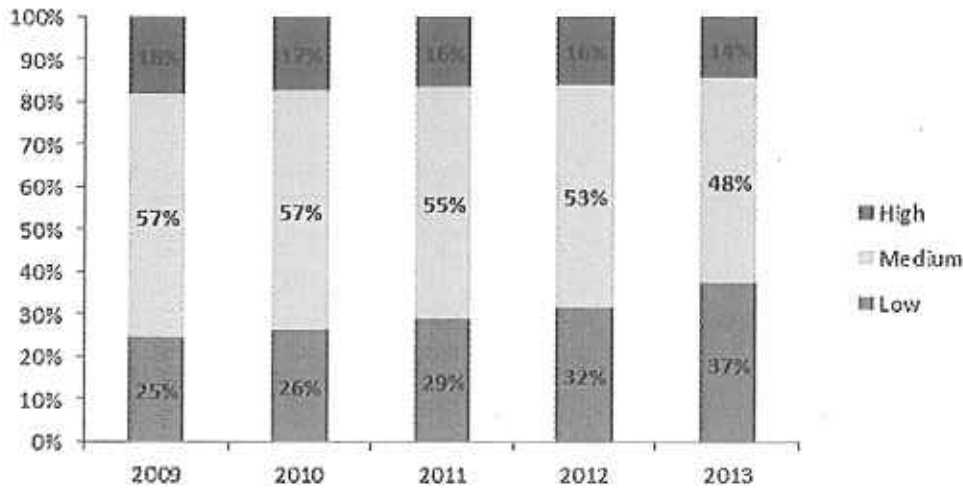
⁴⁵ KPMG 2013 Half Year Report on Illicit Tobacco in Australia, October 2013

⁴⁶ KPMG 2013 Full Year Report on Illicit Tobacco in Australia, April 2014

⁴⁷ Industry Exchange of Sales – FCT volumes have been converted to a stick equivalent amount applying the Australian Government's conversion rate of 0.8

⁴⁸ Industry Exchange of Sales – segments based on KPMG Illicit tobacco in Australia - 2013 Half Year Report (October 2013), p11

Market Share of manufactured cigarettes by price category (EOS)



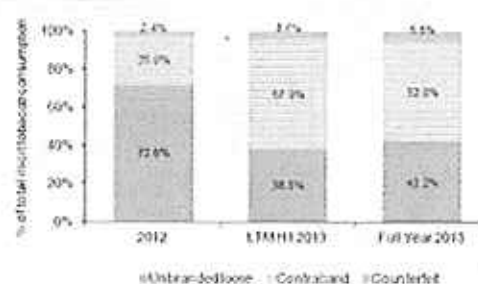
2.2.3 Increase in the Illegal market (KPMG illicit trade data)

The full year KPMG report on the size of the illicit tobacco market since the introduction of plain packaging was published in April (see Appendix D), finding that illicit trade as a percentage of total consumption has further increased from 13.3% in 1H2013 to 13.9%, representing a loss in excise tax revenue in excess of AUD 1.0 billion to the Australian Government. The report was prepared by KPMG on behalf of PMI, BAT Australia and ITA and data is based on an empty pack survey, web-based consumer interviews to gauge the prevalence of loose tobacco and rolling paper data. It finds that while the legal tobacco market has contracted slightly, overall consumption is slightly up. The graphs below illustrate the development of illicit trade since 2007 as well as the change in mix.

Consumption of illicit tobacco products by category, 2007 – 2013 (1H/2013)



Share of illicit tobacco consumption, 2012 – 2013 (1H/2013)



The report also indicates a structural shift away from unbranded tobacco (chop-chop) towards manufactured cigarettes. Illicit whites have emerged as a major form of illicit trade.

A classic example of the unintended consequences of poorly thought through legislation is the fact that illicit whites brands such as Manchester have the competitive advantage of being the only branded tobacco products on the market. Manchester is currently the largest illicit whites brand in Australia; if it were sold legally in the country it would have a 1.4% market share. If all of this illegal tobacco had been consumed in the legitimate market, it would have represented an excise amount in excess of AUD1.0 billion.

2.2.4 Increase in the illegal market

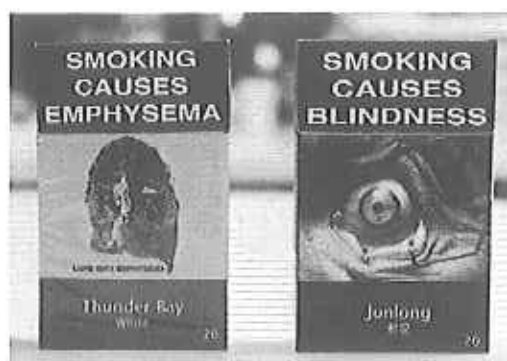
The images below illustrate the first examples of an illicit plain pack sold in Australia.



The brand Spoonbill is not officially registered anywhere in the world. Intelligence suggests that it was manufactured in Asia solely for smuggling into Australia. It demonstrates that with plain packaging regulations in force, it is not even necessary for counterfeiters to use an existing brand. Criminals can simply use a fictitious name, comply with packaging regulations to avoid obvious detection and sell cheaply. It would be impossible for a consumer to tell whether this is a genuine product or not.

The images below illustrate 'Thunder Bay', an illicit standardised pack sold in Australia and 'Jun Long' which is the first example of a counterfeit version of the 'illicit whites' brand 'Jin Ling'.

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2.2.5 Bad for Retailers

Plain packaging has seriously dented Australian retailers' bottom line through increased staff training costs, losing business to the illicit market, product handling errors, customer frustration as well as revenue and profit loss due to down-trading while having no impact on the volume of tobacco sales.

The trade press recently reported the following:

"This [plain packaging] was described by the retailers I spoke to as "expensive chaos.""

"Retailers I spoke to explained that they have to deal with open pack refund returns, training staff, lost customers who can't be bothered waiting while they are trying to find a tobacco brand, and delivery mistakes. One year on and the viewpoint I was getting is that people in Australia were still smoking, tobacco sales on the whole were the same, people were just switching to cheaper brands, oh and the rise of smuggling and illicit products."

"...the customer experience of purchasing tobacco, a legal product, had changed completely. The biggest problem is returns with up to a third of all purchases being returned as the purchase was incorrect."⁴⁹

In addition, Jeff Rogut, Chief Executive of the Australasian Association of Convenience Stores (AACS) also stated:

"...retailers have seen a dramatic shift to cheaper tobacco products as brands are devalued. In 2013, there was a dramatic 58% increase in the 'sub value' segment. These are actual sales to consumers, not wholesale sales to retailers"

"The extra financial costs for retailers as a direct result of plain packaging are associated with additional staff training, labour, product handling errors, increased inventory management procedures and increased customer frustration. These have been absorbed entirely at retailers' expense. Compounding this burden is the explosion of the illegal tobacco market."⁵⁰

⁴⁹ Asian Trader special report *Australian Retailers Have Their Say*, March 2014

⁵⁰ Jeff Rogut, Australian Association of Convenience Stores to *The Irish Times*, June 2014

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UK retailers have expressed similar concerns. James Lowman, the CEO of the Association of Convenience Stores has said:

"...it will take longer to serve customers when all packs look essentially the same."⁵¹

2.3 Australian Government Review in December 2014

The Australian Government is planning to conduct a review on the plain packaging implementation in December 2014 and we would expect other governments to wait until this review has been completed before making any policy decisions. The Australian review would present a more appropriate time for a comprehensive review to be conducted in the UK. Indeed, this appeared to be accepted by the Government when it announced, following the extensive consultation that concluded in August 2012, that it would wait until the impact of plain packaging in Australia could be properly analysed before making a policy decision. It is wholly unclear why the Government has departed from its previous stated position.

Following the one year anniversary of plain packaging, in December 2013, the following statements were made:

- **ITA:** *"One year on and there is still no evidence to support the introduction of plain packaging [...] ITA has not seen a volume decline, with demand for this legal product remaining largely unchanged."⁵²*
- **British American Tobacco Australia:** *"It's now one year on and plain packaging isn't having its desired effect. Instead smokers are now down trading to cheaper brands [...] Worse still, the illegal market is now at its highest ever level."⁵³*
- **Australian Retailers Association:** *"The plain packaging experiment is not working and has had no impact on legal tobacco volumes"⁵⁴*

⁵¹ http://www.conveniencestore.co.uk/news/regulatory-policy-committee-raises-plain-pack-concerns/369897_article

⁵² ITA media release: One year on and plain packaging shows no effect, November 2013

⁵³ BATA media release: Plain packs fail while cheap smokes grow, November 2013

⁵⁴ Australian Retailers Association media release: Plain tobacco packaging proven to have no effect but a burden to retailers, November 2013

2.4 International legal implications

The UK Government will be aware that, as a result of its decision to introduce plain packaging legislation, the government of Australia has faced claims from Ukraine, Cuba, Honduras, Indonesia and the Dominican Republic under the auspices of the World Trade Organization ("WTO") dispute resolution framework. The dispute has attracted the attention of 36 WTO trading partners, including the EU, who have joined the dispute as Third Parties.

The UK and the EU are members of the WTO and a signatory to all of the agreements which form the basis for the claims against Australia. That includes the Agreement on Trade Related Aspects of Intellectual Property Rights, the Paris Convention for the Protection of Industrial Property and the World Trade Organization Agreement on Technical Barriers to Trade.

If the UK Government decided to introduce standardised packaging, it would risk subjecting itself to: legal action at an international level, a finding that standardised packaging legislation is invalid, sanctions and undermining its reputation on an international level as a jurisdiction that respects intellectual property rights. This would deter future Foreign Direct Investment into the UK at a time when it is struggling to compete with other economies around the world.

In addition, there are first indications that the unilateral introduction of standardised packaging could lead to retaliation by other governments with the potential, in effect, of triggering trade issues. For example, it was reported in May this year that Indonesia had threatened to require Australian and New Zealand wine as well as Scottish whisky to be sold in plain packaging if the countries continued with (in Australia's case) or were to push ahead with standardised packaging including for tobacco products imported from Indonesia (see Section 2.11).⁵⁵

2.4.1 Bi-lateral Investment Treaty Arbitration

In November 2011, following the introduction of plain packaging in Australia, Philip Morris Asia brought an arbitration action against Australia under the Australia-Hong Kong Bilateral Investment Treaty claiming substantial financial injury for the loss of the real value and ability to use its intellectual property investments in Australia.⁵⁶

⁵⁵ <http://www.foodmag.com.au/news/indonesia-threatens-to-slap-plain-labels-on-austra>

⁵⁶ http://www.pmi.com/eng/media_center/company_statements/Pages/bilateral_investment_treaty.aspx

2.5 Lack of robust evidence that standardised packaging has worked

Contrary to what tobacco control lobbyists have been saying and how some media outlets have portrayed it, a study by the Centre for Behavioural Research in Cancer in Australia (funded by the anti-tobacco lobbying organisation Quit Victoria) does not support a case for standardised packaging. In fact an analysis of the study on the UK NHS Choices⁵⁷ website concludes that:

"...the study could not assess whether a change in packaging achieves the desired outcomes – of an increase in quit rates...While people smoking the plain pack cigarettes were significantly more likely to have thought about quitting and place higher priority on quitting, their intention to quit smoking remained unchanged." [our emphasis]

The effectiveness of the policy in Australia can only be properly judged on actual changes in consumption by both adults and under-age smokers, after factoring out other possible significant influences on consumption like tax increases and the reduction in travel allowances. The numbers support our previously expressed concerns that standardised packaging would be a gift to organised crime, whereas there are still no facts to show it could be an effective intervention to reduce smoking prevalence amongst young people or adults.

2.6 Packaging is not a reason why people start smoking

All the evidence suggests packaging is not a reason why people start smoking as evidenced in Australia as the only live market. Only 1% of UK smokers cite packaging as one of the various factors in their decision to start smoking.⁵⁸ Research regularly shows the most important factors involved in smoking initiation include:

- rebelliousness;
- risk taking;
- family structure, parental example;
- relationships, peer pressure;
- socioeconomic status;
- school connection; and,

⁵⁷ <http://www.nhs.uk/news/2013/07/July/Pages/Does-plain-packaging-help-smokers-quit.aspx>

⁵⁸ http://ec.europa.eu/health/tobacco/docs/eurobaro_attitudes_towards_tobacco_2012_en.pdf

- educational success.

2.6.1 Why do people smoke?

The many different benefits of smoking, including habitual behaviour, all contribute to why an individual chooses to smoke. The reasons for smoking may differ between smokers, and a smoker may smoke for different reasons throughout the day.

The benefits that smokers report include: aid to socialising, pleasure, sensory stimulation, mood regulation, and cognitive enhancement. The strong habitual behaviour aspect of smoking is supported by scientific evidence and it develops as a consequence of the benefits of smoking. Whilst such behaviour becomes repetitive and, to a degree automatic, it is still controllable. These observations are supported by scientific studies. An expert health panel report to Health Canada concluded:

- young people do not decide to smoke on the basis of tobacco packages;
- packages do not lead to smoking; and,
- changing the package would not *"have any major effect on the decision(s) to smoke or not to smoke"*.⁵⁹

This prediction was proven true by real world studies following the introduction of pictorial health warnings in Canada in December 2000. As Chris Snowdon notes in his paper *'Plain Packaging – Questions that Need Answering'*,⁶⁰

"Similarly bold claims were made by campaigners about the likely reduction of smoking prevalence if graphic warnings on cigarettes were introduced several years ago, but it has since been concluded that these warnings 'have not had a discernible impact on smoking prevalence'⁶¹ and [a]mongst young people, the impact of picture health warnings was negligible'⁶²"

2.6.2 Why young people smoke⁶³

⁵⁹ Goldberg ME, Liefeld J, Kindra K, Madill-Marshall J, Lefebvre J, Martohardjono N and Vredenburg H. *When Packages Can't Speak: Possible Impacts of Plain and Generic Packaging of Tobacco Products: Expert Panel Report to Health Canada*, Ottawa, 1995.

⁶⁰ Chris Snowdon, *Plain Packaging – Questions that Need Answering*, Institute of Economic Affairs, August 2014

⁶¹ Gospodinov, N and I. Irvine (2004), *Graphic Health Warnings on Tobacco Packaging: Evidence from the Canadian Experiment*, *Topics in Economic Analysis and Policy*, 4(1), 30

⁶² Wardle, H., D. Pickup, L. Lee, J. Hall, K. Pickering, K. Grieg, C. Moodie and A. MacKintosh (2008), *Evaluating the Impact of Picture Health Warnings on Cigarette Packets*, Public Health Research Consortium: 8

⁶³ Please refer to Section 3.3 of our 2012 Consultation response – Appendix C.

The evidence and research suggest the introduction of standardised packaging would not have a material impact on addressing smoking, particularly underage smoking, therefore providing no discernible health benefit.

2.6.3 The role of packaging

Packaging has three roles:

- Physical – providing physical protection and security of the product itself;
- Information – providing information including Government health warnings, yield measurements (tar, nicotine and carbon monoxide), recycling or disposal messages, weights and measurements, price information, manufacturer's details; and,
- Brand differentiation – branded packaging enables smokers to distinguish one brand from another. This drives effective competition between tobacco companies and allows retailers and smokers to easily identify and select their product of choice.

Pack innovations provide smokers with choice, reinforce brand differentiation, and can provide a genuine competitive advantage by leading to brand-switching behaviour among existing adult smokers.

All FMCG companies seek to evolve their brands in this way – and we are no exception.

The 2003 tobacco advertising and marketing ban did not include packaging.

British Brands Group director John Noble stated:

*"Branding fulfils many significant and positive functions for consumers and markets. Take it away and consumers lose out and markets become commoditised, with price rather than quality the influencing factor."*⁶⁴

2.7 The Impact of 'Denormalisation' policies on smoking rates

⁶⁴ <http://www.britishbrandsgroup.org.uk/upload/File/Plain%20packaging%20BBG%200311.pdf>

The smoking rate (also referred to as 'prevalence' or 'incidence') is a measure of the percentage of smokers in the population. This metric is derived from population surveys in which a sample of people are asked different questions about their lifestyle. Data is normally available for regular (daily) and occasional smokers. Data is usually segmented by age, gender and socio-economic status.

The primary stated goal of most tobacco control policies is to reduce smoking prevalence. For example, the Australian Federal Authority has set a performance benchmark to reduce smoking rates to 10% by 2018 in their tobacco control strategy for 2012 to 2018.⁶⁵ Reducing the smoking rate by an average of 2% across Europe was also set as the benchmark for the review of the EU Tobacco Products Directive. Globally, there were rapid declines in smoking rates in the 1970s and 80s which probably reflected the growing awareness and acceptance of government health messages on smoking. However, smoking rates have been levelling off in most jurisdictions since about 2000 and especially since 2005 when the World Health Organisation's FCTC was ratified.

However, against this global trend there are exceptions. For example, smoking rates in Turkey have remained largely unchanged over the last 20 years. And despite falls in the 1990s, smoking rates in France and Ireland have risen slightly in recent years – despite stringent tobacco regulation.⁶⁶

Since the ratification of the FCTC in 2005 there has been a shift in regulatory policy towards co-ordinated global population level interventions designed to change attitudes to tobacco use and to alter its social context. This social engineering approach to tobacco control is referred to as 'denormalisation'.

Denormalisation aims to work on both supply of and demand for tobacco products – seeking to reduce the production and availability of tobacco products, curtailing opportunities to smoke at work and the home, and attacking brand value and attractiveness through product standardisation. The denormalisation objective is for those who don't smoke to become less tolerant of those who do, and even those who continue to choose to smoke to become more receptive to regulation. Tobacco manufacturers are treated with suspicion and are excluded

⁶⁵ Australian National Tobacco Strategy 2012-2018:
[http://www.nationaldrugstrategy.gov.au/internet/drugstrategy/publishing.nsf/Content/D4E3727950BDBAE4CA257AE70003730C/\\$File/National%20Tobacco%20Strategy%202012-2018.pdf](http://www.nationaldrugstrategy.gov.au/internet/drugstrategy/publishing.nsf/Content/D4E3727950BDBAE4CA257AE70003730C/$File/National%20Tobacco%20Strategy%202012-2018.pdf)

⁶⁶ ERC market reports 2012

from discussion, even where their expertise could inform regulation. A 2012 review claimed that:

"The majority of studies suggest that tobacco industry denormalisation is effective in reducing smoking prevalence and initiation and increasing intentions to quit."⁶⁷

This claim is refuted by the evidence. For example, the OECD published a Factbook on Economic, Environmental and Social Statistics in early 2013.⁶⁸ They compared the change in smoking rates in a number of countries between 1990 and 2010. Their analysis shows that in the EU, Scandinavian countries including Denmark, Sweden and Norway saw the largest fall in smoking rates over this period. In contrast, Great Britain was just behind the OECD average and Ireland had one of the poorest records of all, a decline of just 3% over 20 years.

To evaluate the impact of denormalisation on smoking rates, it is most relevant to focus on the changes which have occurred since FCTC ratification in 2005. Although rates of decline have slowed in many countries since about 2000, the Scandinavian countries continued to see continuing falls in smoking rates over the same period. However for many other developed countries, FCTC ratification appears to have had little or no impact on smoking rates. When compared to the period from 1990-2010, Australia has seen a change from 17 to 13% in its smoking prevalence since 2005. Smoking rates in France and Turkey have actually increased since 2005,⁶⁹ despite both countries embracing policies of tobacco denormalisation. Most significantly of all, Ireland has also seen a rise in smoking rates since 2005 despite being the first country in Europe to introduce a comprehensive smoking ban in 2004, a display ban in 2009 and having the highest tobacco excise tax rates in the EU.

In England and Wales, smoking was banned in all indoor public places from July 2007. In 2010 the UK Government published a ten year tobacco control plan entitled 'A SmokeFree Future'.⁷⁰ The data presented in that plan suggests that rather than having no impact on smoking rates, the smoking ban may in fact have had the opposite effect. It indicates that for 2008, the year after the smoking ban was first introduced, smoking rates rose both for manual workers and in the general population. This completely contradicts the analysis made in DH's official report of the smoking ban impact in March 2011:

⁶⁷ Tobacco industry denormalisation as a tobacco control intervention: a review, Ruth E Malone, Quinn Grundy and Lisa A Bero, *Tob Control* 2012 21: 162-170

⁶⁸ OECD Factbook 2013: Economic, Environmental and Social Statistics, January 2013

⁶⁹ ERC market reports 2012

⁷⁰ 'A Smokefree Future' UK Department of Health, February 2010

"...this type of legislation has the potential to change social norms around smoking and results in changes in smoking behaviour..." [evidenced by] "...a general pattern of reduced tobacco consumption..."⁷¹

In section 2.6.1 above we have also set out how the introduction of large pictorial health warnings in Canada in 2000 has had no discernible impact on smoking prevalence.

Further evidence of the lack of any correlation between denormalisation, tobacco control initiatives and smoking rates is presented in our review 'Denormalisation, smoking rates and the way ahead for tobacco product regulation' in Appendix E. Overall, there is no evidence that smoking rates have been greatly impacted by tobacco regulation nor the policy of denormalisation pursued after ratification of the FCTC in 2005. In these terms, denormalisation is not working as an effective tobacco control policy.

Smoking rates are still falling consistently in markets where a viable choice/alternative to smoking is presented to consumers. Furthermore, we suggest that the Norwegian experience with smokeless tobacco could be a predictor of what the impact of e-cigarettes on smoking rates could be in the US and Western Europe in 10 to 15 years' time, provided that the growth of this sector is not impeded by poorly conceived regulation.

2.8 Standardised packaging would increase the trade in illicit tobacco

Standardised packaging would increase the supply of, or demand for, non-duty-paid tobacco including illicit products in the United Kingdom. The increase in illicit trade would have a direct negative influence on public health for the following reasons:

Product Differentiation - Standardised packaging would, by its very nature, reduce the differentiation between brands and packs. The commoditisation of any category leads to an increased focus on price. The cheapest available price would be found in the illicit market.

Easier to counterfeit - Standardised packaging would provide a stimulus for the illicit trade of tobacco products - which already costs the Exchequer billions of pounds each year - by creating a "Counterfeiters' Charter", aiding and accelerating the spread of counterfeit tobacco products and the trade in illicit tobacco by making it simpler to copy legitimate

⁷¹ The Impact of Smokefree Legislation In England: Evidence Review, Professor Linda Bauld, March 2011

packaging and also by creating an unfulfilled supply vacuum for branded products. Furthermore, the criminals have no qualms about selling their products to children; a clear public health issue and a significant societal problem.

Increased availability - The opportunity that standardised packaging would bring to criminals would increase the availability of illicit products, which in turn would expose more children under the age of 18, who cannot legally purchase the product, to tobacco. This may be a gateway to further criminal activity, including drugs, and have the effect of increasing smoking prevalence of youth smoking and not reducing it. In this regard, it should be noted that there is clear survey evidence⁷² that:

- 50% of the tobacco bought by 14 to 15 year olds is illegal;
- 1 in 4 young smokers are regularly offered illegal tobacco, which is far more often than adults;⁷³
- 1 in 7 young smokers have gone to a private address (or a "fag house"⁷⁴) to buy illegal cigarettes;
- Buyers of cheap illicit products smoke more, and admit it keeps them smoking;⁷⁵ and,
- A third of all smokers aged 14 -17 buy illicit and on average accounts for almost half of total consumption.⁷⁶

Increased access for children - The illicit tobacco market undermines Government and industry efforts by making it easier for children and adults to access illegal tobacco products. Peddlers of illicit products, unlike the vast majority of legitimate UK tobacco retailers, do not care or question how old a buyer is; they are happy to sell packs and even single cigarettes to minors.⁷⁷

Unregulated product is dangerous - Illicit and counterfeit products usually undermine and circumvent legislation on ingredients, smoke emissions and reduced fire risk cigarettes and may not carry mandated English language health warnings.

⁷² HMRC Measuring Tax Gaps 2011

⁷³ NEMS 2011 <http://tobaccofreefutures.org/news/illegal-tobacco-dealers-are-making-it-easy-for-kids-to-smoke-in-the-north-west/>

⁷⁴ NEMS 2011, *ibid*

⁷⁵ <http://ash.org.uk/localtoolkit/docs/clir-briefings/Illicit.pdf>

⁷⁶ <http://www.ashscotland.org.uk/media/3480/Andrea%20Crossfield%20ITS%20Sept%202010.pdf>

⁷⁷ <http://www.bbc.co.uk/news/uk-england-devon-25671824>

If the Government wants to ensure that children are unable to access tobacco products, as Imperial Tobacco does, it should not drive them into the arms of criminals who have no qualms about who they sell to.

2.9 Lack of credible or reliable evidence or research

Imperial Tobacco does not believe there is any credible or reliable evidence that standardised tobacco packaging would achieve the Government's stated objectives of reducing smoking prevalence among young people or assisting smokers who have, or are trying to, quit.

The research which is relied upon is speculative and inconclusive and fails to provide the "*robust and compelling case*" that is required by the Government's better regulation agenda.⁷⁸ Instead the 2012 and 2014 Consultations and Impact Assessments relied upon "subjective judgments" from anonymous "experts" about their views on the likely impact of standardised packaging. These judgements were not made available as part of the 2012 consultation and cannot form the basis for an evidential justification of standardised packaging. It is valid to question the independent nature and objectivity of such research and its methodology and underlying raw data. Proponents of standardised packaging ignore the substantial body of research which runs contrary to their pre-determined objectives.

The 2012 and 2014 Consultations failed to provide any explanation of how standardised packaging would address the real issues behind smoking initiation and activity by young people and attempted quitters.

2.9.1 Standardised Packaging of tobacco – A Systematic Review

The authors of the 2012 Systematic Review⁷⁹ - despite being well-known tobacco control advocates and in many cases reviewing their own work - do not show that standardised packaging would meet the Government's stated objectives. The Systematic Review provided no evidential basis for standardised packaging.

The Review Report relied on by Government is the product of selective and questionable research methods and does not present the clear and compelling evidence base that would be

⁷⁸ BIS general principles of better regulation

⁷⁹ Moodie et al: Plain tobacco packaging – a systematic review, University of Stirling, 2012

required to justify the introduction of standardised packaging. In summary, the Systematic Review:

- is not independent. Its authors have well-established links with, and receive funding from, organisations that actively pursue a tobacco control agenda and/or have been well known advocates of standardised packaging for many years. Indeed, 20 of the 37 studies included in the Systematic Review include work by the authors (and their colleagues);
- failed to demonstrate a causal link between tobacco packaging and smoking behaviour (including initiation, prevalence and consumption);
- does not demonstrate, therefore, that standardised packaging is necessary to achieve the Government's public health objectives by affecting smoking behaviour; and,
- does not comply with the Government's own guidelines and standards. The conclusion reached stated only "*there was consistency in study findings regarding the potential impacts of plain packaging.*" That, manifestly, does not provide the standard of "*robust and compelling*" evidence that standardised packaging would have any impact on smoking behaviour that is required by the Government's Better Regulation Agenda.

Contrary to how it has been presented, the PHRC 'Systematic Review' commissioned by the DH does not provide supporting evidence that standardised packaging would be an effective intervention. It concluded:

*"....caution is required in interpreting these findings, as expressed smoking-related intentions are not always predictive of future smoking behaviour⁸⁰ and perceptions of the impact of a future policy measure on the behaviour of others are of course subjective. However, there is **some evidence** from the studies in this review **that standardised packaging may affect** smoking-related attitudes and beliefs, and smoking behaviour, particularly for young people and/or non-smokers and lighter smokers."⁸¹ [our emphasis]*

Attempts to present the PHRC review as evidence supporting standardised packaging are unjustifiable. The same would be true of the subsequent subjective views solicited by the DH from an unknown group of selected academics, which itself concluded that "*there remains*

⁸⁰ Ajzen & Madden 1986, Sheeran 2002

⁸¹ http://phrc.lshtm.ac.uk/papers/PHRC_006_Final_Report.pdf

*considerable uncertainty about the likely impact of plain packaging of tobacco products.*⁸²
More recent reports by advocates of standardised packaging suffer from the same limitations.

Many of them seek to show that survey participants (including children) prefer branded packs to non-branded packs. That is not in itself surprising, but it does not show that non-branded packs would lead to actual changes in behaviour when people are deciding whether or not to smoke, particularly in a mandated standardised packaging environment where such comparisons – at least between legal products – could not occur.

In Imperial Tobacco's view, in addition to not being evidence-based it is difficult to envisage how the introduction of such a draconian measure as standardised packaging could be:

- reasonable, having regard to a full consideration of the costs of standardised packaging, including its effects on illicit trade;
- proportionate, having regard to whether there are less costly ways of realising the identified policy objectives. The Government does not address this issue at all, and has historically ignored alternative ways of limiting the access of young smokers to tobacco⁸³; and,
- effective, in terms of achieving the stated objectives of reducing tobacco consumption, particularly by the young and poor socio-economic groups. It is quite clear that the evidence for any public health benefits can at best be described as very limited, with there being no consideration of whether these benefits would be appreciable in the context of all the other anti-tobacco measures which have recently been introduced.⁸⁴

2.9.2 No contribution to improving public health

There is no credible or robust evidence that standardised packaging would contribute to improving public health. By depressing prices and effectively promoting the NUKDP tobacco trade including illicit products (with tobacco prices being lower in many other countries and illicit tobacco sold at lower prices than UK duty-paid products), there is a real risk of consumption increasing. The Consultation ignores the established research as to the reasons why people smoke and continue smoking, specifically those under 18, which do not include packaging and branding.

⁸² <http://www.blomedcentral.com/1471-2458/13/18>

⁸³ See section 2.17 Alternative Solutions

⁸⁴ Please refer to Appendix A, Current tobacco control measures.

2.9.3 No new evidence

There is no evidence that demonstrates that standardised packaging would achieve any or all of the Government's stated policy objectives. The PHRC 'Systematic Review'⁸⁵ and Impact Assessments have not shown that smoking behaviour and consumption would change as a result of the introduction of standardised packaging; still less do they provide a sufficient evidence base to justify such a draconian policy. Crucially for the terms of reference for this Consultation, no new robust evidence has been provided to date. The Systematic Review update⁸⁶ (17 studies) produced in September 2013 contained the same flaws as the previous Review e.g. self-reported intent versus real world impact and the statement that they do not show standardised packaging to be an effective intervention. Sir Cyril's Method Statement stated that he envisaged:

"...commissioning further expert evidence to assist in the qualitative analysis of what I consider to be key evidence".⁸⁷

Imperial Tobacco respectfully requests that all interested parties to the Consultation are afforded an opportunity to review and comment upon any 'new' evidence that may be submitted – either in support of or against standardised packaging. This would be consistent with the principles of a fair and open consultation process.

2.10 Government's role in public health

In January 2014, Ipsos MORI, the Social Research Institute, released the latest edition of its *Understanding Society* report.⁸⁸ In this issue, they look at the way Britons live now and how attitudes, values and behaviours compare with those in other countries. Interestingly, a poll of 19 major countries (including the UK) found that the majority of the population everywhere (with the exception of Russia) think Governments at best have a limited role in trying to "encourage healthy lifestyles". Only 30% of Britons thought it was the responsibility of Government to influence people's behaviour to encourage healthy lifestyles. The researchers also noted:

"Whether or not we support government involvement, we clearly believe responsibility for maintaining a healthy lifestyle remains in the hands of individuals, at least to a large extent.

⁸⁵ Department for Health Systematic Review, April 2012 Plain tobacco packaging : A systematic review

⁸⁶ <http://www.slir.ac.uk/media/schools/management/documents/Plain%20Packaging%20Studies%20Update.pdf>

⁸⁷ <http://www.kcl.ac.uk/health/Packaging-review/packaging-review-docs/method-statement.pdf>

⁸⁸ Ipsos MORI: *Understanding Society - Great Britain: The way we live now*, January 2014

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Only five per cent of the British public strongly believe it is the job of the NHS to keep people healthy – this compares to a far greater proportion (39%) who strongly believe it is the individual's responsibility to keep themselves healthy."

Unintended consequences are not exclusive to the tobacco category. It is therefore essential to consider the unintended consequences of irrational and disproportionate regulation; and in doing so, avoid effectively coercing members of society into purchasing from illicit, and unregulated, channels.

2.11 The measure would be illegal

We set out in detail in response to question 3 below why standardised packaging would contravene domestic, European and international law.

2.11.1 International context: World Trade Organization and Bi-lateral Investment Treaty Arbitration

As outlined above, following the introduction of plain packaging legislation, the government of Australia has faced claims from five WTO members (Ukraine, Cuba, Honduras, Indonesia and the Dominican Republic) in the WTO dispute resolution framework. The claims outline contraventions of the Agreement on Trade Related Aspects of Intellectual Property Rights, the Paris Convention for the Protection of Industrial Property and the World Trade Organization Agreement on Technical Barriers to Trade – all agreements to which the UK is a signatory.

In addition, Australia is currently defending a claim brought by Philip Morris Asia under the Australia-Hong Kong BIT.⁸⁹ The UK is subject to other relevant BITs which may give rise to a claim if the UK Government decides to introduce standardised packaging.

2.11.2 International context: USA

It should also be noted at this point that in 2012, a US court blocked a FDA initiative to introduce pictorial health warnings⁹⁰ under the First Amendment of the US Constitution which guarantees freedom of speech including freedom of commercial speech. According to the

⁸⁹ http://www.pmi.com/eng/media_center/company_statements/Pages/bilateral_investment_treaty.aspx

⁹⁰ http://www.nytimes.com/2012/08/25/business/tobacco-groups-win-ruling-on-graphic-cigarette-warnings.html?_r=0

ruling, rightful owners of intellectual property cannot be forced to give up part or all of their packaging for government messages that are designed to discourage consumers from purchasing or using a legal product.

2.11.3 National context: claims for compensation

Given the illegality of the proposed measure⁹¹ and that tobacco companies would be effectively deprived of the benefit of their valuable trade marks, any decision to enact standardised packaging would expose the UK Government to the risk of litigation being brought in the Courts of England and Wales, and which would be fought at taxpayers' expense. These legal challenges could include claims for significant compensation. A number of papers have recently quoted an Exane BNP Paribas report⁹² giving a figure of £9-11bn for compensation claims.

Therefore, if the UK Government decided to introduce standardised packaging, it risks subjecting itself to: legal action at international and national level, including for compensation; a finding that standardised packaging legislation is invalid; sanctions; payment of compensation; and undermining its reputation on an international level as a jurisdiction that respects intellectual property rights. Furthermore, and contrary to claims from tobacco control groups, there is no obligation on the parties of the World Health Organization ("WHO") Framework Convention on Tobacco Control ("FCTC") to implement plain or standardised packaging.

As reiterated during all the Conferences of the Parties ("COP"), FCTC guidelines are non-binding proposals as to how the FCTC *could* be implemented by the Parties. The guidelines do not extend the binding obligations of the FCTC and they do not constitute a subsequent agreement on the interpretation of the FCTC. This is the basis on which the guidelines are adopted.

It is therefore clear that any reliance upon non-binding FCTC guidelines will not protect the UK Government from any legal challenge.

⁹¹ See below in answer to Question 3.

⁹² Exane BNP Paribas Tobacco Regulation Note *The Plains Are Coming*, 23 June 2014

2.12 Dangerous precedent in the UK

Standardised packaging would severely curtail consumers' ability to make a choice about which products they want to buy. It would be a dangerous precedent for similar restrictions on choice by consumers in other FMCG businesses and sectors operating in the UK.

For example, this type of policy has been considered for other sectors, including by Non-Governmental Organisations ("NGOs"), of which there are plenty of recent examples of new NGO-led campaigns to target peoples' diets and lifestyles including obesity (fast food), sugar (fizzy drinks) and alcohol (binge-drinking).

Many public health groups already support cigarette-style graphic warnings for alcohol as well as a tobacco-style total ban on alcohol advertising. Campaigners in Australia have called for plain packaging and graphic warnings for junk food. As Chris Snowdon stated,

"Since the ostensible aim of plain packaging is to dissuade consumption by the young, the policy could logically be extended to alcohol and certain food. The Indonesian Government is already talking about it for alcohol."⁶³

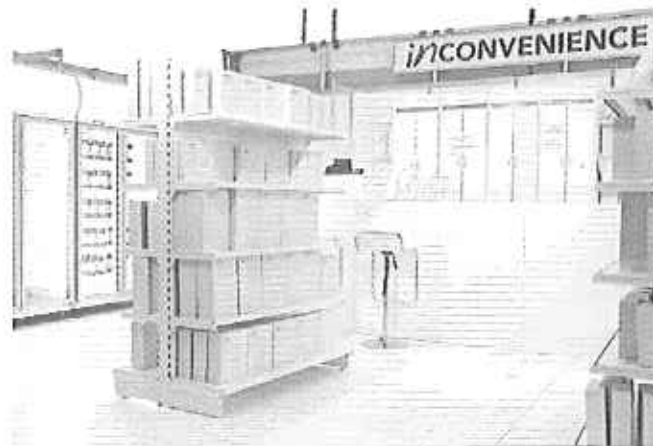
Imperial Tobacco understands that Mars submitted a response to the DH's Consultation in 2012 raising concerns about similar legislation being introduced in the chocolate, other food and non-alcoholic beverage industries.⁶⁴

Example of how shops might look in the future if brands are threatened across the FMCG sector:

⁶³ <http://www.confectionerynews.com/Regulation-Safety/Mars-complaint-over-tobacco-plain-packaging-unearthed>

⁶⁴ A Mars spokeswoman reportedly said: "The 2012 response was not a comment on the specific policy. We were highlighting the need to ensure any legislation did not have unintended knock-on effects on brand equity and intellectual property within other categories." The Times, Sweet-makers warn of plain packet fears, Michael Savago, 25 July 2014

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2.13 Risk of significant adverse impact on UK plc and businesses

Imperial Tobacco is concerned that standardised packaging could threaten existing levels of Foreign Direct Investment ("FDI") or inward investment, for the UK. Such arguments were raised directly to the Irish Government during recent discussions around standardised packaging and by their main trading partners who shared similar concerns about the impact standardised packaging could have on their sectors, and the resulting levels of investment. For the UK specifically, the FDI flowing into the UK was £35.4 billion in 2012, according to the Office of National Statistics.⁹⁵ In addition, according to the Government's recent Inward Investment Report 2012/13⁹⁶, FDI created 59,153 new jobs and safeguarded 110,943 jobs in the UK in 2012/13.

Standardised packaging is also an unjustified interference with legitimate intellectual property rights. Removal of branding disrupts competition in a market economy as manufacturers would have their ability to compete effectively for existing smokers significantly reduced.

Standardised packaging would have significant adverse impacts on hundreds of SMEs – both directly and throughout the supply chain. Cogent research⁹⁷ stated:

- over 70,000 people rely directly or indirectly on the UK tobacco companies' activities for their jobs;
- 20,000 of these are in companies who supply the industry with goods and services;

⁹⁵ <http://www.ons.gov.uk/ons/rel/fdi/foreign-direct-investment/2012-ma4/index.html>

⁹⁶ http://webarchive.nationalarchives.gov.uk/20140403154217/http://ukli.gov.uk/gb_gb/investintheuk/investintheukhome/item/553980.html?null

⁹⁷ Cogent factsheet, published Q2 2014: <http://www.the-tma.org.uk/policy-legislation/employment/>

- over 46,000 jobs are in distribution and retailing and are dependent on the industry; and
- in the UK, over 5700 people, many of them highly skilled, are directly employed by Imperial Tobacco and the other tobacco companies.

2.14 The new policy is unnecessary

2.14.1 The European context – The revised Tobacco Products Directive

Since the previous Consultation, the revised European Union ("EU") Tobacco Products Directive⁹⁸ ("TPD2") has been adopted. At the end of a long deliberation process, the institutions of the EU came to the conclusion, in December 2013, that graphic health warnings covering 65% of the front and back of pack surface are appropriate to introduce in the 28 Member States. The UK Government should await evidence regarding the effectiveness of this measure before considering the introduction of standardised packaging. The Consultation should consider not only if standardised packaging is likely to lead to a decrease in the consumption, but also if it would have the effect of achieving any decrease above and beyond what the TPD2 may achieve when it is scheduled to come into effect in May 2016. It is, perhaps, because of this that the UK and Ireland are alone among the EU Member States in even consulting on standardised packaging. At least three Member States (Bulgaria, Portugal and Slovakia) have issued detailed opinions in response to Ireland notifying the Public Health (Standardised Packaging of Tobacco) Bill 2014 to the EU Commission under the Technical Standards Directive⁹⁹ and the deadline for submitting detailed opinions has not yet passed. Amongst other issues, these opinions oppose the Irish measure because it "may create obstacles to the free movement of goods within the internal market".¹⁰⁰ The receipt of these detailed opinions extends the standstill period (and prevents the adoption of the draft measure) for a further three months to a total of six months from the date of receipt of Ireland's notification by the Commission.

TPD2 replaces and repeals the existing Tobacco Products Directive.¹⁰¹ It introduces further regulation of tobacco products and is intended to approximate the rules on the manufacture, presentation and sale of tobacco and related products between the Member States in the EU.

⁹⁸ Directive 2014/40/EU

⁹⁹ Directive 98/34/EC

¹⁰⁰ Article 9, Technical Standards Directive 98/34/EC

¹⁰¹ Directive 2001/37/EC

Significantly, despite consideration during the consultation process of whether standardised packaging ought to be included in TPD2, standardised packaging is deliberately *not* included in TPD2.

Article 24(2) of TPD2 purports to give Member States the power to adopt further requirements in relation to the standardisation of the packaging of tobacco products. However, the validity of that provision (amongst others) is already the subject of legal challenges involving several companies, including Imperial Tobacco.¹⁰² Imperial Tobacco submits that, if Article 24(2) is found to be invalid, the UK Government will be prohibited from introducing standardised packaging requirements because, contrary to Article 24(1) of TPD2, these requirements would prohibit or restrict the marketing of tobacco products that comply with TPD2.

In the legal challenge to TPD2, the Government has already accepted that the correct interpretation of Article 24(2) raises "*a fundamental issue of interpretation*" that is relevant to this consultation and that the Court of Justice of the European Union ought to rule on this question, and the validity of Article 24(2), on an expedited basis.¹⁰³ The English Court has already granted permission for the claims to proceed and observed that expedition would be appropriate.¹⁰⁴

Imperial Tobacco also understands that on 22 July 2014 the Plenipotentiary of the Republic of Poland¹⁰⁵ filed a complaint with the Court of Justice of the European Union as a direct challenge to TPD2.

Whilst this uncertainty exists, the Government ought, at the very least, to await the outcome of the legal challenge to TPD2 before considering the introduction of standardised packaging.

In any event, the introduction of standardised packaging in the UK would go *further* than the requirements of TPD2. There is no good reason for doing so and, as a minimum; it would be prudent to assess the impact of TPD2 in practice (should it be implemented) before considering whether standardised packaging is required as an additional measure.

¹⁰² The Queen on the application of British American Tobacco UK Limited –v- The Secretary of State for Health (Claim No. CO/2971/2014); and The Queen on the application of (1) Philip Morris Brands SARL and (2) Philip Morris Limited –v- The Secretary of State for Health (Claim no. CO/2969/2014)

¹⁰³ Secretary of State for Health's Summary Grounds for Contesting Claims No.s CO/2971/2014 and CO/2969/2014 dated 17 July 2014.

¹⁰⁴ Order of Mr Supperstone dated 31 July 2014.

¹⁰⁵ The Ministry of Foreign Affairs

The Consultation RIA wrongly characterises Option 1 of requiring changes to legislation to bring the UK in line with the TPD2 as “*essentially a “do nothing” option*”. This is misleading. Option 1 is better characterised as “*do nothing further*” beyond the considerable change that will affect the presentation and sale of tobacco products following the implementation of TPD2, should it survive the legal challenges to its validity.

2.14.2 Existing regulatory context and the impact on public health

The proposal to introduce standardised packaging makes no sense in the existing regulatory context. The Government has introduced a number of far reaching tobacco control measures, the last of which – the ban on display of tobacco products in retail outlets - will not fully come into force until April 2015.¹⁰⁶ The common denominator in all of these regulatory measures is that they do not address the reasons why people start or continue to smoke. The 2014 Consultation and Impact Assessment were no different and ignore all of the well-established research on the main reasons for smoking initiation by young people and the factors that influence quitters, and completely fail to provide any analysis of how standardised packaging would address those reasons.

2.15 Assess current legislation before proposing additional legislation

The Government asked in the 2012 Impact Assessment accompanying the Consultation if standardised packaging would deliver benefits “*over and above existing tobacco control measures*”.

It is incumbent on the Government to undertake a comprehensive and considered analysis of the effect of the existing regulatory framework, including a rigorous assessment of the impact of “*the existing tobacco control measures*” and their effect before it considers standardised packaging. However, the existing tobacco control measures have not been properly evaluated - either during the 2012 Consultation and Impact Assessment, the Chantler Review, or since - for their effectiveness or for delivering the outcomes or benefits that were originally expected or promised. In the UK, we are only two thirds of the way through the implementation of a ban on the display of tobacco products. Imperial Tobacco believes the impact of this measure should be properly evaluated and analysed before the Government can assess whether any further

¹⁰⁶ Please see Appendix A

tobacco control measure would have an appreciable effect on improving public health over and above existing measures and before considering the next regulatory measure.

It is therefore impossible for the Government to assess whether any further tobacco control measure would have an appreciable effect on improving public health over and above existing measures.

2.16. Alternative solutions

Imperial Tobacco believes that as part of the Consultation process the possibility of alternatives to standardised packaging must be considered. It is incumbent on the Government to assess the best and least restrictive way of achieving its policy objectives and any assessment of standardised packaging must be made in that context.

Imperial Tobacco would propose the following alternative approaches:

2.16.1 Enforcing existing legislation and providing additional resources

We do not want children to smoke and we support effective measures to ensure tobacco products do not get into the hands of children. Existing legislation should be supported with greater enforcement of current laws via the relevant enforcement agencies. The Government should provide additional resources to support enforcement agencies and retailers in their efforts to tackle under-age smoking. Imperial Tobacco supports appropriate penalties for retailers who knowingly break the law by selling tobacco to children or illicit tobacco. In addition, we would like to ensure increased enforcement, in the form of penalties and prosecutions, to tackle the illicit trade.

2.16.2 Strengthening current legislation in preventing youth access

We do not market our products to anyone under the age of 18 or to non-smokers. We adhere to all legislation, and where none exists, our International Marketing Standards.¹⁰⁷ We support retailer programmes designed to discourage tobacco sales to children such as our support for the 'No ID, No Sale' retailer awareness campaign¹⁰⁸ and the CitizenCard proof-of-age

¹⁰⁷ http://www.imperial-tobacco.com/files/environment/marketing_standard_2009.pdf

¹⁰⁸ <http://www.noidnosale.com>

scheme¹⁰⁹ which have helped prevent under-age sales. The Government should give greater support to proof-of-age schemes, which have contributed to a decrease in youth smoking prevalence (11-15 year-old regular smokers in England) from 13% in 1996 to the **lowest ever figure of 3%**¹¹⁰ in 2013, and to 3% (average 13 years old – lowest figure since 1982) in Scotland.¹¹¹

2.16.3 Education programmes – German model

Germany, which permits the advertising and display of tobacco products and has no plans for standardised packaging, has significantly fewer young people taking up smoking than in the UK, which has some of the most draconian anti-smoking laws in the world. Germany has a tobacco control strategy with intelligent education embedded at its core, and it delivers proven results. These programmes, rather than merely telling teenagers that smoking is not good for them, address the factors that trigger underage trial – rebelliousness, low self-esteem, peer pressure and parental example.

As part of the Consultation process, the DH should engage with their German counterparts - who have a significantly lower youth smoking rate than the UK - to explore how they have successfully reduced youth smoking rates, and consider how such proven measures could be implemented successfully in the UK. See Annex B for specific German statistics.

On a similar note, the recently published UN World Drug Report 2014 shows that problems linked to drug use dramatically reduced in countries where users were given support and advice rather than being prosecuted.

In summary, increasing education and retailer programmes to prevent children being able to purchase tobacco products, together with preventing access via the illicit trade and strengthened enforcement against both retailers and those attempting to purchase tobacco for others, are the most effective methods of preventing children purchasing or accessing tobacco and therefore achieving the public health objectives.

Imperial Tobacco also believes that an evidence led policy requires the UK Government not to consider the introduction of standardised packaging until its effects in Australia have been

¹⁰⁹ <http://www.citizencard.com>

¹¹⁰ <http://www.hscic.gov.uk/catalogue/PUB14579/smok-drin-drug-youn-peop-eng-2013-rep.pdf>

¹¹¹ http://www.drugmisuse.lsdscotland.org/publications/local/SALSUS_2010.pdf

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properly studied. Those studies need to be based on population-wide, independent, robust national statistics and the Australian Government has committed to such a review in December 2014.

We do not believe that legislation should be pursued until what is a highly controversial policy with potentially very significant unintended consequences is proven to reduce consumption amongst under-age smokers.

3. Response to Question 3: Do you have any comments on the draft regulations, including anything you want to draw to our attention on the practicalities of implementing the regulations, as drafted?

The draft regulations should not be implemented because they are illegal and, therefore, unenforceable.

Imperial Tobacco notes that in response to the 2012 Consultation on standardised packaging, the UK Government received detailed responses from several well-respected intellectual property organisations, including ECTA, ITMA, MARQUES, INTA and APRAM. The content of these submissions does not appear to have been taken properly into account in the draft regulations. We refer the UK Government to these submissions¹¹² and any new submissions that these or other, similar organisations may submit in response to the Consultation.

For the reasons set out elsewhere in this submission, the draft standardised packaging regulations would not work and would have very serious adverse consequences. As outlined elsewhere in this document,¹¹³ the data from Australia so far demonstrates that smoking prevalence remains in line with trend and that youth smoking has in fact increased.

Imperial Tobacco expects that this will be demonstrated further in due course by the data that emerges from Australia as part of the review to be conducted in December 2014. The Government previously committed to waiting until the evidence of the effect of the measure from Australia could be assessed. In 2013 it announced that *"[H]aving carefully considered these differing views, the Government have decided to wait until the emerging impact of the decision in Australia can be measured before we make a final decision on this policy in England."*¹¹⁴ It ought, at the very least, to maintain that position. Sir Cyril Chantler also found that *"it is too early to draw definitive conclusions"* and *"data is only just becoming available"*.

¹¹² ECTA (European Communities Trade Mark Association) - http://www.octa.org/IMG/pdf/ecta_consultation_on_plain_packaging_form_final_2_july_2012.pdf
ITMA (Institute of Trade Mark Attorneys, UK) <http://www.itma.org.uk/search?for=standardised+packaging>
Marques (Association of European Trade Mark Owners). <http://www.marques.org/PositionPapers/default.asp>
INTA (International Trade Mark Association) - http://www.inta.org/Advocacy/Documents/INTA2012_UK%20DoH%20consultation.pdf
APRAM (Association des Praticiens du Droit des Marques et Modeles, French speaking) - <http://apram.com/wp-content/uploads/2012/08/Aug-1-2014-Apram-Uk-consultation.pdf> (in response to the 2014 Consultation)

¹¹³ Particularly in answer to question 1 and in section 2.2 above.

¹¹⁴ See <http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm130712/wmstext/130712m0001.htm>

Imperial Tobacco notes that the Consultation states that *"the Government has not yet made a final decision on whether to introduce standardised packaging of tobacco products"*.¹¹⁵ We trust that this is the case and that the enactment of section 94 of the Children and Families Act 2014 does not indicate a predisposition.

Standardised tobacco packaging would be unlawful. It would contravene domestic, European and international law. The introduction of standardised tobacco packaging would, therefore, result in legal action against the Government and could lead to a compensation bill that could run to billions of pounds.

Neither the Consultation nor the IA addresses the substance of the submissions that were made by Imperial Tobacco in the previous consultation in 2012 regarding the legal implications of the introduction of standardised packaging. The Chantler Report also excluded the legal implications of the introduction of standardised packaging. These are significant omissions.

As a preliminary point, and as explained in section 2.14.1 above, the proper interpretation and validity of Article 24(2) of the revised Tobacco Products Directive (which purports to give Member States the power to adopt further requirements in relation to the standardisation of tobacco products) is the subject of legal challenges which are currently pending before the English courts.¹¹⁶ This point has important implications for the legality of the possible introduction of standardised packaging in the UK. The Government has accepted in those proceedings that this is a fundamental issue which ought to be resolved by the Court of Justice of the European Union on an expedited basis.¹¹⁷ On its own case, therefore, the UK Government should, at a minimum, await the court's determination of this point.

3.1 Legal protection of intellectual property rights

The right of the owner of any product that is lawfully manufactured and sold, to acquire, own and exploit intellectual property connected to that product is enshrined in law. Standardised packaging would affect Imperial Tobacco's intellectual property rights and most significantly its trade marks. It is recognised that trade marks enable a manufacturer to impart information to

¹¹⁵ UK Consultation on the introduction of regulations for standardised packaging of products, page 2, para 1.1

¹¹⁶ The Queen on the application of British American Tobacco UK Limited –v- The Secretary of State for Health (Claim No. CO/2971/2014); and The Queen on the application of (1) Philip Morris Brands SARL and (2) Philip Morris Limited –v- The Secretary of State for Health (Claim no. CO/2969/2014)

¹¹⁷ Secretary of State for Health's Summary Grounds for Contesting Claims No.s CO/2971/2014 and CO/2969/2014 dated 17 July 2014.

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customers about the product and to distinguish their product from those of their competitors by communicating the qualities and essential characteristics of their product.¹¹⁸

The importance of trade marks to tobacco manufacturers has already been recognised by the Court of Justice of the European Union (the "CJEU") when considering a challenge to the first European Tobacco Products Directive (Directive 2001/37/EC). It was a key aspect of the Court's finding in that case that *"the restrictions on the trade mark right ... do not constitute a disproportionate and intolerable interference, impairing the very substance of that right"*.¹¹⁹ In contrast, standardised packaging would do precisely this: completely restrict the use of the trade mark for its intended purpose, to inform and communicate with adult customers.

3.2 Property rights under domestic and European law

Standardised packaging would breach the protection of property rights afforded to Imperial Tobacco under the European Convention on Human Rights (the "ECHR") and the Charter of Fundamental Rights of the European Union (the "Charter"). The ECHR is incorporated into domestic law via the Human Rights Act 1998.

It is well established that intellectual property rights are "possessions" for the purposes of Article 1 of the First Protocol ECHR ("A1P1")¹²⁰ and section 22 of the UK Trade Mark Act 1994.

The ECHR guarantees rights which are *"practical and effective"*¹²¹ and it is therefore necessary to consider the substance of the action that is taken, and its effects, when determining whether there has been a "deprivation" of possessions for the purposes of the second rule within A1P1. As a result of the existing regime of control mechanisms on tobacco advertising and the display of tobacco products at point of sale, the last remaining opportunity for Imperial Tobacco to use its trade marks in any meaningful way (i.e. to communicate and inform the users of those products) is on its packs. The proposed legislation introducing standardised packaging would directly and wholly prevent Imperial Tobacco from using its relevant intellectual property in this way. This amounts to a clear deprivation of Imperial Tobacco's valuable intellectual property rights and would be unlawful.

¹¹⁸ Among other relevant cases, see Case 487/07 L'Oreal SA v Bellure NV.

¹¹⁹ Case C-491/01 The Queen and Secretary of State for Health, ex parte British American Tobacco (investments) Ltd and Imperial Tobacco Ltd supported by Japan Tobacco Inc. and JT International SA [2002] ECR I-11453, paras 149-153.

¹²⁰ Anheuser Busch Inc v Portugal (2007) 44 EHRR 42.

¹²¹ Airey v Ireland (1979) 2 EHRR 305

Article 17(1) of the Charter of Fundamental Rights of the European Union provides similar protection as A1P1; and Article 17(2) specifically provides for the protection of intellectual property rights.¹²² The CJEU has adopted an approach similar to that of the European Court of Human Rights in relation to A1P1.¹²³

3.3 Compensation

A deprivation of possessions without payment of an amount reasonably related to their value cannot be justified under A1P1.¹²⁴ The draft legislation put forward by the Government contains no provision whatsoever for compensation to be paid to the tobacco companies in respect of the unlawful interference with their valuable intellectual property rights.

The fundamental principle in the jurisprudence of the European Court of Human Rights underlying the award of compensation is, so far as possible, to place the applicant in the same position as if his rights had not been infringed.

The Impact Assessment is woefully deficient and inadequate in its consideration of the impact of the proposals on the intellectual property rights and costs to the tobacco industry.¹²⁵ If the Government introduced the regulations as drafted, it would face significant claims for compensation that could run to billions of pounds. The Australian Government is facing a very significant damages claim as a result of introducing similar legislation.

3.4 International legal obligations

The introduction of standardised packaging would also amount to a breach of the Government's international treaty obligations under the Agreement on Trade Related Aspects of Intellectual Property ("TRIPs").

Article 20 of TRIPS provides:

"The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as ... use in a special form or use in a manner detrimental to

¹²² Since 1 December 2009, the Charter has "the same legal values as the Treaties" (Article 6(2) TFEU).

¹²³ Case C-360/10 SABAM v Netylog NV (judgment dated 16 February 2012) at paras 41-44.

¹²⁴ Gladysheva v Russia [2012] HLR 19, para. 67; Papachelas v Grecco (2000) 30 EHRR 923 at para. 48 and R(SRM Global Master Fund LP) v Treasury Commissioner [2009] EWCA Civ 788 at para. 73.

¹²⁵ Please refer to our response to Question 4 in this submission.

its capability to distinguish the goods or services of one undertaking from those of other undertakings."

Standardised packaging would fall squarely within the prohibition set out in Article 20. The special requirements imposed by standardised packaging would include both use in a special form and use in a manner detrimental to the mark's capability to distinguish its products. For the reasons set out below, standardised packaging could not be regarded as creating a "justified" encumbrance on the use of trade marks.

Imperial Tobacco acknowledges that Article 8 of TRIPs provides that:

"Members may, in formulating or amending their laws and regulations, adopt measures necessary to protect public health and nutrition, and to promote the public interest in sectors of vital importance to their socio-economic and technological development, provided that such measures are consistent with the provisions of this Agreement."

However, Article 8 does not provide for an exception from any of the substantive obligations of the TRIPS Agreement as it applies only to measures which are "consistent with the provisions of [TRIPS]". Nor, for the reasons set out below, could it be shown that standardised packaging is "necessary" to protect public health. Accordingly, the Government could not invoke Article 8 in order to justify standardised packaging.

Standardised packaging would also constitute a breach of the obligations of the UK under the WTO's Technical Barriers to Trade Agreement. Contrary to Article 2.2, the introduction of standardised packaging would impose technical regulations which would create unnecessary and unjustified obstacles to international trade and which would be more restrictive than necessary to achieve the Government's objective. Breach of these international treaties would likely lead to WTO complaints against the UK.¹²⁶

3.5 The harmonised regime for the protection of intellectual property rights

Standardised packaging would also conflict with established trade mark law. In particular, under European law, a comprehensive and harmonised regime has been established for the protection of intellectual property rights at a national and Community-wide level.¹²⁷ That regime

¹²⁶ Please refer to section 2.4 above.

¹²⁷ Directive 2008/95/EC approximating the laws of the Member States relating to trade marks and Council regulation No 207/2009 on the Community Trade Mark.

would be completely undermined by the introduction of standardised packaging. In particular, it would undermine the unitary character of Community trade marks and establish a different regime in the UK for trade marks that apply to tobacco products in comparison to other products, and a different regime in the UK in comparison to other Member States. This would defeat the harmonising objective of the European trade mark legislation and would, therefore, be unlawful.

3.6 The right to free movement of goods

Standardised packaging would also undermine other fundamental principles of European law. The free movement of goods is protected by Article 34 of the Treaty on the Functioning of the European Union (the "TFEU").

Standardised packaging would detrimentally affect the free movement of tobacco products between Member States because (at a minimum) imported products would have to be altered to conform to those requirements. Moreover, as already noted above, following the extensive restrictions on tobacco advertising and the introduction of bans on display at point of sale, packaging is the last significant mechanism by which a tobacco manufacturer may communicate with adult smokers in order to differentiate its products from those of its competitors. It is, therefore, critical to the ability of new products and manufacturers, including from other Member States, to enter the UK market. So far, at least three Member States have issued detailed opinions in response to Ireland notifying its standardised packaging measure¹²⁸ to the EU Commission under the Technical Standards Directive¹²⁹ on the basis that the measure may create obstacles to the free movement of goods within the internal market.¹³⁰

3.7 The right to freedom of expression

Freedom of expression is a fundamental right that is recognised as an essential element of a democratic society. It is protected under Article 10 ECHR and Article 11 of the Charter. It includes the right of (a) commercial entities which manufacture and sell a lawful product to impart information about the nature and essential characteristics of that product and (b) consumers of that lawful product to receive that information. This includes, but is not limited to,

¹²⁸ Public Health (Standardised Packaging of Tobacco) Bill 2014, TSD notification number 2014/277/IRL
http://ec.europa.eu/enterprise/tris/pisa/app/search/index.cfm?fuseaction=pisa_notif_overview&iYear=2014&inum=277&lang=EN&NLang=EN

¹²⁹ Directive 98/34/EC

¹³⁰ Article 9 Technical Standards Directive

the right of a manufacturer to communicate, in the form that it chooses,¹³¹ such fundamental matters as: what the product is; who makes it; where it originates from and how it differs from its competitors.¹³² Standardised packaging would strike at the very essence of this fundamental right and would, therefore, be unlawful.

3.8 The right to conduct a business

The right to conduct a business is also an established principle of European law and recognised in Article 16 of the Charter. The Explanations which accompany the Charter state that this is based on CJEU case law which has "*recognised [the] freedom to exercise an economic or commercial activity*" and Article 4(1) and (2) TFEU which "*recognises free competition*".¹³³ This includes the manner in which a company operates and its role as a competitor in a free market economy.

Standardised packaging would also constitute a breach of this established principle.

3.9 Justification

Imperial Tobacco acknowledges that the majority of the legal rights referred to above are not absolute. In particular, depending on the legal provision, interference with those rights can in principle be justified by reference to the protection of public health. The precise nature of the tests varies according to the legal context. Imperial Tobacco also accepts that the protection of health is a legitimate objective.

However, in respect of each of the legal measures of protection set out above, the burden would be on the Government to show that standardised packaging was justified. For the reasons set out below and elsewhere in this submission, standardised packaging fails all the tests for justification.

In summary:

- it is lawful to manufacture and sell tobacco products;

¹³¹ *Women on Waves v Portugal*, Application No. 31276/05, 3 February 2009

¹³² *Markt Intern Verlag GmbH v Germany* (1989) 12 EHRR 161, [26]; *Casada Coca v Spain* (1994) 18 EHRR 1, [35]; and *Stambuk v Germany* (2003) 37 EHRR 42, [39]

¹³³ Charter Explanations, OJ 2007 C 303/23

- the ability to differentiate the nature and characteristics of products, and to communicate those differences to consumers, is an essential pre-requisite to the creation and functioning of a lawful competitive market;
- standardised packaging would completely remove the last significant means by which Imperial Tobacco and other tobacco manufacturers can impart information to adult smokers about their products, including as regards their quality, origin and brand values;
- standardised packaging would be unparalleled: there is no market for lawful products that has imposed such a restriction;
- there is no credible evidence that standardised packaging would achieve the Government's stated objectives. In fact, the evidence from Australia, if anything, points the other way;
- there are less restrictive alternatives and alternative tobacco control measures already introduced, but not yet fully in force, with the aim of meeting the objectives that are being pursued. In particular, in all material respects, the Government's stated aims behind the introduction of both the ban on tobacco vending machines and the ban on the display of tobacco products were the same as its stated policy objectives for standardised packaging. It is incumbent on the Government to assess the impact in practice of the tobacco control measures it has already introduced¹³⁴ before it considers standardised packaging. The display ban has not even been fully implemented, let alone its effects, if any, assessed; and
- standardised packaging would have significant negative and unintended consequences, including in relation to illicit trade, costs for manufacturers and retailers, and trade and competition.

For the reasons set out in this section of our response, the draft regulations would be unlawful and would, therefore, be unenforceable.

¹³⁴ The ban on the display of tobacco will not be brought into force for large shops until 2015.

4. Response to Question 4: Are you aware of any further evidence or information which would improve the assumptions or estimates we have made in the consultation stage Impact assessment?

The Consultation Stage Impact Assessment (the "IA") is flawed in a number of significant respects and does not provide an adequate basis for assessing the possible introduction of standardised packaging in the UK. In many cases, these defects are the same, or materially similar, to issues that Imperial Tobacco and the Regulatory Policy Committee have drawn to the Government's attention when commenting on previous Impact Assessments.

In this response, Imperial Tobacco has sought to focus only on the most significant comments on the IA. In doing so, we highlight the further evidence and information that is required to address the deficiencies in the IA. By way of overview:

- The IA fails to provide a credible basis for the alleged health benefits;
- The IA does not properly assess the impact of standardised packaging on competition or the implications of increasing taxation levels to try and address the impact on competition;
- the analysis of the costs that would follow from the introduction of standardised packaging is unreliable and understates the likely costs that would be incurred;
- in particular, the IA fails to assess the impact of standardised packaging on illicit trade;
- the IA fails to properly consider the regulatory context in which the introduction of standardised packaging would take place or to consider at all the alternative options to standardised packaging; and
- the IA's analysis of the losses in consumer welfare is incomplete and unexplained.

Each of these points is explained below.

4.1 The IA fails to provide a credible basis for the alleged health benefits

The IA makes no attempt to use the available empirical evidence following the introduction of standardised packaging in Australia.

Sir Cyril Chantler reached the view that *"it is too early to draw definitive conclusions"* from the introduction of standardised packaging in Australia.¹³⁵ In those circumstances, and as Imperial Tobacco has noted elsewhere in this submission, the Government's decision to proceed with

¹³⁵ Chantler, C. (2014), "Standardised packaging of tobacco: Report of the independent review undertaken by Sir Cyril Chantler", page 23, paragraph 3.21, Box 1

this consultation contradicts its previously stated position that it would wait for reliable data that emerged from Australia.¹³⁶ In contrast, the IA itself states that a ten year period would be required to appraise the impacts of standardised packaging upon smoking behaviour.¹³⁷

Instead, as matters stand, the preferred option in the IA is to proceed with the introduction of standardised packaging in circumstances where the data that is available from Australia suggests that standardised packaging would not work. Instead, the IA relies on an inherently qualitative and unreliable approach to quantify the potential benefits of the introduction of standardised packaging.

The data that has emerged from Australia is dealt with in our response to question 1 and elsewhere in this document.¹³⁸ In summary, smoking prevalence levels have remained in line with trend and there has been no acceleration in decline brought about by standardised (plain) packaging in Australia.

Against the backdrop of the evidence that has emerged from Australia on smoking prevalence levels; the IA relies on the *Pechey et al* study¹³⁹ as the basis for assessing the benefits of standardised packaging. This involved obtaining an estimate of the impact of standardised packaging on smoking prevalence from 33 so-called "experts" in North America, Australasia and the UK. These experts were asked to provide their "best guess", "upper bound guess" and "lower bound guess" as to the likely impact of the policy two years after it had been introduced.¹⁴⁰ The IA takes the median of the "best guesses" to arrive at an estimate of a reduction in smoking prevalence of one percentage point and it then applies this to its estimate on the reduced take up of smoking and improved quit rates.¹⁴¹

Imperial Tobacco makes the following comments:

- A qualitative, "best guess" approach is no substitute for reliance on actual data. A reliance on "actual data" is much more likely to reflect (potential and current) smokers'

¹³⁶ Written Statement 12 July 2013: 'Having carefully considered those differing views, the Government have decided to wait until the emerging impact of the decision in Australia can be measured before we make a final decision on this policy in England.'
<http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm130712/vmstext/130712m0001.htm>

¹³⁷ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 3, Policy Option 2

¹³⁸ Please refer to section 1 and 2.2 above.

¹³⁹ Pechey, R., Spiegelhalter, D., & Marteau, T. M. (2013) "Impact of plain packaging of tobacco products on smoking in adults and children: an elicitation of international experts' estimates", BMC Public Health 2013, 13:18, available at <http://www.biomedcentral.com/1471-2458/13/18>

¹⁴⁰ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, pages 58 - 59, paragraphs 230, 234

¹⁴¹ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 60, paragraph 237

responses to the introduction of standardised packaging than a small group of experts' guesses as to how people might respond. In particular, the use of "actual data" would allow for changes in other factors that might affect smoking prevalence over time to be explicitly, and transparently, controlled for, which is not possible when using experts' best guesses.

- Up to eighteen months of data from Australia would have been available at the time the IA was prepared. As explained above, the data that is available supports the conclusion that standardised packaging would not reduce tobacco consumption.

Imperial Tobacco has commented previously on the dangers of relying on a subjective (rather than objective), qualitative (rather than quantitative), "guess the impact" approach. In summary:

- There does not appear to be any attempt in the *Pechey et al* study at controlling for selection bias amongst the experts and there is no information about the factors that the experts took into account. If the experts are, for example, associated with or receive funding or work from anti-smoking lobbies, they would be likely to overstate the impact of the policy.¹⁴² Moreover, the best guesses of experts might have taken into account factors that an approach using "actual data" would have revealed to be irrelevant in the assessment of the impact of standardised packaging.
- There does not appear to be any attempt to control for possible self-selection bias by the experts i.e. those experts who thought there would be an impact of standardised packaging would be those most likely to respond, such that the estimate of the impact is inherently biased towards finding that standardised packaging would have a positive impact.¹⁴³
- The number of experts sampled (33) is very small. Indeed, one of the article's reviewers noted that a sample of 33 experts is "*much too small*".¹⁴⁴ This is important because it means that the weight placed on each expert's guess is very high and it increases the risk that, for the reasons explained above, the IA's reliance on the impact of standardised packaging actually reflects factors that are irrelevant and unimportant.

¹⁴² We understand that the authors of studies used in Moodie et al. "Plain Tobacco Packaging: A Systematic Review" had affiliations with anti-tobacco groups and that these links and potential biases were not controlled for in the systematic review (see "Bad for business; bad for consumers; good for criminals", Imperial Tobacco's response to the UK DH consultation on standardised packaging of tobacco products, dated 6 August 2012, page 65).

¹⁴³ This is analogous to "publication bias" in which there is a bias towards scientific journal articles only being published if the study they conducted found a statistically significant effect, while studies of the same area that did not find a statistically significant effect are not published, thereby biasing an average based on the estimate of the effect included in published articles (similar to the estimate based on expert's guesses here) towards finding an effect.

¹⁴⁴ See Matthew Rimmer's Reviewer's Report dated 3 September 2012, available at http://www.biomedcentral.com/imedia/8790882277989580_comment.pdf

- It is unclear why only experts from North America, Australasia and the UK were selected to provide their guesses. In particular, there are no experts from the same trading area as the UK (i.e. European countries), the inclusion of which would also have increased the sample size used in the estimated impact of standardised packaging.
- The identity of the experts was not disclosed.¹⁴⁵ This is very unusual and unexplained.
- The reliability of experts' qualitative views as a basis for the implementation of standardised packaging is called into question by a number of prior studies. For example, a study by Tetlock (2006) found that the accuracy of experts at predicting political and economic events was little better than an approach based on random guessing.¹⁴⁶ Trueman (1994) suggests that experts' forecasts are strongly affected by 'herding behaviour' in that a single expert might base their forecast on prior expectations, at the expense of new information, such that "*calculating a consensus [expert] forecast by averaging individual [expert] forecasts is inappropriate*".¹⁴⁷
- Ultimately, the *Pechey et al* study provides opinion, not evidence. Imperial Tobacco has explained previously that the evidence related to predictors of youth smoking demonstrates that packaging and branding is not one of the factors that cause initiation amongst young people.¹⁴⁸

The IA's approach to deriving an aggregate estimate from the individual experts' estimates is also highly questionable. The IA relies on the experts' guesses as to the impact of the policy two years subsequent to implementation and it assumes that the impact of the introduction of standardised packaging in the first year is half the impact two years after it is implemented.¹⁴⁹ However, that is inherently unlikely for a number of reasons.

Imperial Tobacco has responded previously to the 'evidence review' and refers to those comments¹⁵⁰ rather than repeat them here.

¹⁴⁵ Imperial Tobacco understands that the Department of Health deliberately used a third party employed by a not-for-profit company and hence not subject to Freedom of Information requests (see the letter from the Department of Health to Richard Ross of Imperial Tobacco dated 31 December 2012).

¹⁴⁶ Tetlock, P. (2006), "Expert Political Judgment: How Good Is It? How Can We Know?", cited in <http://freakonomics.com/2011/06/30/freakonomics-radio-hour-long-episode-4-%E2%80%9Cthe-folly-of-prediction%E2%80%9D-2/>

¹⁴⁷ Trueman, B. (1994), "Analyst forecasts and herding Behavior", *Review of Financial Studies*, paragraph 7(1)

¹⁴⁸ Please refer to section 2.6 above and Appendix C, section 3.3

¹⁴⁹ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 59, paragraph 234

¹⁵⁰ Please refer to section 2.9.1 above and to Appendix C pages 65-68.

4.2 The IA does not properly assess the impact of standardised packaging on competition or the implications of increasing taxation levels to try and address the impact on competition

Imperial Tobacco has explained previously that standardised packaging would result in increased price competition: the removal of branding from packaging limits the ability of tobacco manufacturers to distinguish their product to end consumers on any basis except quality and price.¹⁵¹ According to economic theory, the resulting increased emphasis on price competition will result in a decrease in the average price of tobacco products and in turn attract higher consumption levels.

The Impact Assessment recognises this risk but is inconsistent in the way that it treats the potential for standardised packaging to affect price competition:

- On the one hand, it seeks to positively rely on this factor because it cites downward pricing pressure resulting from the introduction of standardised packaging as a factor that mitigates a potential increase in cross-border and illicit trade.¹⁵²
- However, on the other hand, it quotes and relies upon a conclusion in the report by Sir Cyril Chantler that *"the risk of prices falling is small"*.¹⁵³ Sir Cyril Chantler is not a pricing and marketing expert. Maybe therefore, the Chantler Report concludes that the price per pack of tobacco products in Australia has increased without understanding the full history of price changes following the introduction of plain packaging in Australia. In fact, after the introduction of plain packaging, and before the price increase, there was a price war. This was partly generated by the down-trading effect of consumers moving to the economy and sub-economy segments of the commoditised market, and, in some cases, manufacturers quickly re-positioning existing mid-price brands to meet this demand. There was subsequently a planned tax increase which explains most of the increases in prices after plain packaging was introduced. Therefore, just concluding that prices have gone up is overly simplistic and does not conclude any impact of plain packaging on pricing behaviour. The Chantler Report also notes that tobacco

¹⁵¹ Appendix C, "Bad for business; bad for consumers; good for criminals", Imperial Tobacco's response to the UK DH consultation on standardised packaging of tobacco products dated 6 August 2012, pages 21 - 23

¹⁵² "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 34, paragraph 134

¹⁵³ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health, 17 June 2014, page 18, paragraph 87

manufacturers offered some "free" cigarettes along with a usual pack of 20.¹⁵⁴ Imperial Tobacco's understanding is that this initiative was only with one brand.

The IA also states that lower tobacco prices could be offset by taxation.¹⁵⁵ However, high taxation is a key factor driving illicit trade in tobacco products. We have explained elsewhere that standardised packaging would increase illicit trade levels.¹⁵⁶ Standardised packaging coupled with increases in taxation has the potential to present a very serious problem for the growth of the illicit market in the UK.

4.3 The IA fails to assess the impact of standardised packaging on illicit trade and cross border sales

The IA acknowledges that the introduction of standardised packaging could make it easier for illicit products to flourish and/or make it more difficult for consumers to distinguish between UK duty-paid tobacco and NUKDP including illicit tobacco products.

Imperial Tobacco has consistently sought to explain and emphasise the impact that the introduction of standardised packaging would have on illicit trade. This is dealt with elsewhere in this submission¹⁵⁷ but, in summary:

- The increase in, and availability of, illicit trade would make illegal tobacco more affordable and accessible, especially to young people who are particularly sensitive to price;
- it would increase general exposure to illicit products, illegal markets and dangerous people;
- due to the lack of regulation, illicit products would undermine all tobacco product regulations because their contents are unknown and unregulated; and
- it would result in a significant loss to the Exchequer in terms of tax revenue foregone (the specific treatment of this point in the IA is dealt with below).

The IA identifies the potential increase in the illicit market and cross-border shopping as "the two key risks" associated with the introduction of standardised packaging. However, the IA

¹⁵⁴ Chantler, C. (2014), "Standardised packaging of tobacco: Report of the independent review undertaken by Sir Cyril Chantler", page 38, paragraph 8.4

¹⁵⁵ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 65, paragraph 246

¹⁵⁶ Appendix C, "Bad for business; bad for consumers; good for criminals", Imperial Tobacco's response to the UK DH consultation on standardised packaging of tobacco products, dated 6 August 2012, pages 14 – 17; and sections 2.2.3 and 2.8 above.

¹⁵⁷ Sections 2.2.3-4 and 2.8 of this document

claims that there is "no means of quantification" available to assess the impact on illicit trade and adopts a "critical value approach" to explore the increase in the illicit market that would be required to yield a zero NPV (net present value).¹⁵⁸ This approach contradicts the IA's stance with respect to the impact of standardised packaging on tobacco consumption, where (as noted above) in the absence of any evidence of such an effect, despite 18 months experience in Australia, the authors of the IA were happy to resort instead to reliance on a flawed and non-transparent opinion poll, based on a small sample of experts' best guesses, for the key factor that drives the IA's overall conclusion.

It is not the case that the impact on illicit trade is incapable of quantification and the difficulty of obtaining an estimate is no justification for not attempting this task, particularly in circumstances where pure guesswork is provided as a basis for estimates elsewhere in the IA. Most obviously and importantly, the IA could, and should, have drawn on the implementation of plain packaging in Australia to estimate the impact on illicit trade. The data contained in a study carried out by KPMG following the introduction of plain packaging in Australia noted an increase of the market share of illicit tobacco of over 2% in just the first year after the implementation of the ban.¹⁵⁹

The IA refers to, and appears to rely upon, Sir Cyril Chantler's rejection of the KPMG report. The following points must be noted:

- As a starting point, the KPMG report is an independent piece of work, which gives a reliable insight into the level of illegal tobacco consumption.
- The methodology used by KPMG, criticised by the Australian Government, is adapted from methodology that KPMG agreed with OLAF, the European Commission's Anti-Fraud Office, which Imperial Tobacco understands that this methodology is widely used and independently validated. Sir Cyril Chantler refers to the comments of the Australian Government Departments of Health and Customs. They dismiss the KPMG Report on the basis of official Customs data, which – they say – shows no significant effect on illicit tobacco following the introduction of plain packaging. Imperial Tobacco's understanding is that this is simply incorrect and that the Australian Customs & Border Protection Service Data for the period 2012 to 2013 shows a rise in unbranded loose tobacco and a much greater rise in manufactured cigarettes, just as the KPMG report did.

¹⁵⁸ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health, 17 June 2014, page 34, paragraph 135

¹⁵⁹ KPMG's "Illicit tobacco in Australia", dated 3 April 2014, available at https://www.imperial-tobacco.com/assets/files/cms/KPMG_FY2013_Illicit_Trade_Report_FINAL_11_April_2014.pdf

- Sir Cyril Chantler also suggests that the Customs data is "*backed by analysis undertaken by the Cancer Council Victoria (based on data from the National Drug Strategy Household Survey) that suggests that illicit tobacco in Australia is only 10-20% of the level proposed by KPMG*". As to this, Imperial Tobacco's understanding is that data is incomparable because it covers a different period (it is taken from a consumer study undertaken in 2010 and therefore not comparable with 2013 data). Further, the National Drug Strategy Household Study was not designed to assess illicit trade. The Cancer Council Victoria makes various unreliable assumptions in order to extrapolate illicit tobacco figures from the household survey (for example it makes assumptions about daily use because the survey did not ask about amounts consumed).

In short, the data in the KPMG Report provides robust, cogent and independent evidence that the introduction of standardised packaging would have a serious impact on illicit trade. The specific features of the UK market, and in particular its position as a European trading hub, will increase the effect of illicit trade and cross-border sales in comparison with Australia. On any view, the IA's failure to quantify the impact on illicit trade is an important and serious deficiency.

Standardised packaging would also lead to an increase in cross-border trade. The IA adopts the same flawed approach to the potential increase in cross-border trade as it does in respect of illicit trade. Specifically, the IA assumes that the study on which it bases its estimate of the impact of standardised packaging on smoking prevalence already takes into account consumers switching to cross-border sales. No justification is provided for this assumption and it appears that no attempt was made to check with the authors of the study if this was the case. As explained below, an increase in cross-border sales reduces UK tax revenues. It would also impact the claimed health benefits resulting from the introduction of standardised packaging.

The IA therefore needs to properly assess the impact of standardised packaging on illicit trade and cross border sales, drawing on the evidence from Australia while reflecting the specific features of the UK market (which are likely to result in an even greater increase in illicit trade and cross border sales). The UK, as a member of the European Union, cannot restrict cross-border shopping from other EU Member States and all consumers can buy unlimited amounts of tobacco products as long as these are for private consumption or gifts (any limits are only indicative).

4.4 The analysis of the costs that would follow from the introduction of standardised packaging is unreliable and understates the likely costs that would be incurred

Imperial Tobacco notes the comments of the Regulatory Policy Committee (the "RPC"), in ascribing an amber rating to the IA, that it: "*should provide a fuller discussion of a number of the costs, along with some indication of their likely extent where possible*".¹⁶⁰

The RPC has previously stated that: "*tobacco Impact Assessments tended to provide a full analysis of benefits, but failed to estimate the full economic costs to producers and retailers*".¹⁶¹ We agree. The current IA suffers from the same failings.

4.5 The costs to tobacco manufacturers

The most striking example of this flaw is in the section entitled "Profits to the tobacco industry and retailers", the failure of the IA to appropriately account for the profits that would be lost by tobacco manufacturers. The IA appears to proceed on the basis that the lost profits of tobacco manufacturers would be minimised due to capital being re-allocated elsewhere, the fact that tobacco companies have foreign based shareholders (such that the impact of any lost profits would not be felt in the UK), and the fact that manufacturers of other products would benefit due to expenditure switching from tobacco to other goods and services.¹⁶² On this basis, the IA arrives at the conclusion that the only relevant losses to tobacco manufacturers are due to consumers switching from high price brands to low price brands at a higher rate than might otherwise occur. For the reasons set out below, this conclusion is simplistic and wrong:

- Most fundamentally, this analysis ignores the crucial role that packaging and branding plays in the ability to distinguish products to the end consumer on any basis except price¹⁶³ and the loss of brand equity and goodwill that would result from the introduction of standardised packaging. Imperial Tobacco has made a substantial investment in its intellectual property rights, which are worth billions of pounds.¹⁶⁴

¹⁶⁰ Regulatory Policy Committee opinion on Standardised packaging for tobacco products, Department of health, RPC14-DH-1229(2) dated 29 May 2014, page 1

¹⁶¹ "Improving Regulation", Regulatory Policy Committee, paragraph 2.56

¹⁶² "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 24, paragraph 89

¹⁶³ Please refer to section 2.6.3 above and Appendix C, "Bad for business; bad for consumers; good for criminals", Imperial Tobacco's response to the UK DH consultation on standardised packaging of tobacco products, dated 6 August 2012, pages 21 - 23

¹⁶⁴ Appendix C, "Bad for business; bad for consumers; good for criminals", Imperial Tobacco's response to the UK DH consultation on standardised packaging of tobacco products, dated 6 August 2012, pages 19, 46-58

- The assumption that capital can be re-allocated elsewhere to eliminate lost profits is incorrect.¹⁶⁵ It proceeds on the assumption that it will be possible to repurpose all aspects of the tobacco industry for other uses. No explanation or justification is provided for that assumption. In practice, this would require a change in the entire focus of Imperial Tobacco's business (at the same time that the same exercise is being undertaken by all of the other tobacco manufacturers).
- Even to the extent that refocusing business would be possible, the IA proceeds on the basis that it would, or could, occur straight away, which is very unlikely to be the case in practice and the transition costs would be enormous.
- The assumption of capital re-allocation does not account for the problem that any such re-allocation would inevitably be a "second choice" in comparison with the tobacco industry prior to the introduction of standardised packaging, and would yield lower revenue and profit (otherwise capital would already have been re-allocated to that alternative industry).
- The IA assumes that current consumer spending on tobacco products would be directed completely to purchasing other goods and services, such that the overall level of business profitability in the economy would remain unchanged. This relies on a number of highly theoretical assumptions, all of which would be likely to be borne out in practice. These include:
 - The assumption that the margins made by retailers and manufacturers of other products are exactly the same as those made on tobacco products. If the margins are lower, then the overall level of business profits would decrease. Moreover, it is known that tobacco drives a significant amount of "footfall" for small and medium sized retailers in particular. If the margins lost on tobacco could not be made up by increased margins on other products, the cost would disproportionately fall on small and medium sized retailers experiencing the lost tobacco revenues and reduced number of customers even entering their premises to buy other products (and if the margins obtained by larger retailers are lower than the margins obtained by smaller retailers, this allocation of expenditure away from smaller retailers towards larger retailers would result in a decrease in total business profits); and
 - The assumption that all of the money spent on tobacco products would be spent on other goods and services. Even if such switching might occur, some portion

¹⁶⁵ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 24, paragraph 89

of that money would invariably be used for other purposes, such as saving, thus decreasing the overall level of business profits.¹⁶⁶

- o The assumption that not a single consumer would switch their spending to illicit tobacco products, or legitimately purchase tobacco products from elsewhere in the EU – both of which would decrease not only UK tobacco industry profits (and therefore GDP) but would also result in losses for the Exchequer.
- The IA's assessment of the lost tax revenue arising from down-trading from high-priced brands to lower priced brands is flawed and almost certainly understated. It uses a "static" estimate based on the current difference in ad-valorem taxes and margins to estimate the losses that would arise from the implementation of standardised packaging.¹⁶⁷ In fact, the difference between high-price and low-price brands in terms of ad-valorem taxes and margins is "dynamic": it is increasing over time.

4.6 Lost tax revenue

The IA's treatment of lost tax revenue is also flawed:

- The IA assumes that all of the money switching away from tobacco products would be spent on other goods and services that are subject to an average VAT rate of 13.2%.¹⁶⁸ As already noted, even assuming that such a switching away from tobacco products might occur, it is unlikely that all of the money would be spent on other goods and services as opposed to, for example, being saved, spent on illicit products, or products legitimately purchased elsewhere in the EU. All of the VAT charged on that portion of tobacco expenditure (now-saved or taken by the illicit market) would be lost.
- The IA's analysis of the potential impact of standardised packaging on tax revenues by its impact on cross-border sales and illicit trade is fundamentally flawed. The IA merely assumes that the study on which it bases its estimate of the impact of standardised packaging on smoking prevalence already takes into account consumers switching from UK tobacco to cross-border/illicit tobacco.¹⁶⁹ No justification is provided for this assumption and it appears that no attempt was made

¹⁶⁶ The "propensity to save" underlying this argument generally refers to the proportion of additional income that is saved, but the principle (of people not spending the entirety of any "additional" money they receive) remains the same in this case.

¹⁶⁷ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 56, paragraph 218

¹⁶⁸ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 30, paragraph 119

¹⁶⁹ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, pages 32-34, paragraph 127

to check with the authors of the study if this was the case. Therefore, the IA may significantly underestimate the costs that would flow from lost tax revenue.

- The IA fails to include other potential losses in tax revenue. This includes lost corporation tax revenue from the decrease in the business profits of tobacco manufacturers (see above); increases in unemployment benefits and decreases in income tax revenues resulting from job losses from tobacco manufacturers in the UK or other industries (such as small retailers) affected by the policy. For example, earlier this year Imperial Tobacco was forced to announce the closure of its factory in Nottingham, which employed 540 people, citing in part the difficult operating environment caused by increased Government regulation and the pressures on manufacturers of genuine, UK duty paid product of the thriving illicit market and that followed the closure of its factory in Bristol in 2010.
- Tobacco products include excise and VAT at around 87% of the consumer spending. Other products include, as stated by the IA, only 13.2% average VAT. This leads to a significant loss of government revenue (70% of the consumer spending) even if all consumer spending switched from legal tobacco to other products.

4.7 The IA fails to properly consider the regulatory context in which the introduction of standardised packaging would take place or to consider at all the alternative options to standardised packaging.

As the RPC opinion notes, the Government is gold-plating the TPD2 by going beyond its minimum requirements. This is despite the fact that, as the IA acknowledges, smoking prevalence has fallen steadily in England since its peak in the mid-20th century.¹⁷⁰

The IA fails to consider how the introduction of standardised packaging would interact with - and why it would be justified in addition to - the existing regulatory measures, some of which are not even in force yet e.g. the introduction of the display ban in small retail outlets in 2015.

The IA also fails to consider alternative options, including:

- more effectively tackling the illicit trade problem which Imperial Tobacco has explained above and elsewhere;

¹⁷⁰ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 5, paragraph 9

- assessing the development of the market for electronic cigarettes which has been cited as a potential benefit to consumers who want to quit. NICE have stated: "many smokers are finding unlicensed electronic cigarettes helpful [in quitting]";¹⁷¹
- investing resources in educational programmes that are proven to work and address the root causes of smoking initiation among young people such as peer pressure.¹⁷² Imperial Tobacco has explained previously the lessons that can be learnt from countries like Germany.¹⁷³

4.8 The IA's analysis of the losses in consumer welfare is incomplete and unexplained

The IA effectively "gives up" on the consumer surplus question and states that trying to analyse the net effect of the introduction of standardised packaging is too complex.¹⁷⁴

Contrary to the suggestion in the IA, branding is very unlikely to be a "zero sum game" whereby the loss of consumer surplus is offset by potential benefits.¹⁷⁵ Imperial Tobacco also notes that, although the IA states that approximately 22% of smokers fall into the premium and mid-price segment (and hence, the IA suggests, would be most affected by the loss of consumer surplus), the graph on page 64 of the IA suggests that this figure is actually close to 40%.¹⁷⁶ The losses in consumer surplus would therefore be higher (and the gains lower) than the IA suggests. In any event, there is no justification or explanation provided for the conclusion that they would simply cancel each other out.

For the reasons set out above, we do not believe that the IA provides a coherent or accurate premise upon which to base such a draconian policy. We note that the Regulatory Policy Committee agrees.

¹⁷¹ June 2014 ASH factsheet http://www.ash.org.uk/files/documents/ASH_715.pdf

¹⁷² Appendix C, "Bad for business; bad for consumers; good for criminals", Imperial Tobacco's response to the UK DH consultation on standardised packaging of tobacco products dated 6 August 2012, page 13

¹⁷³ Please refer to Appendix B

¹⁷⁴ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health, 17 June 2014, page 40, paragraph 168

¹⁷⁵ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 69, paragraph 263

¹⁷⁶ "Standardised packaging of tobacco products", Impact Assessment produced by the Department of Health dated 17 June 2014, page 64, paragraph 242

5. Imperial Tobacco's View

Imperial Tobacco believes that public policy interventions in the tobacco sector should be both designed and shown to address the well-established reasons why people smoke. Any Government policy on standardised packaging would fail to do this. In summary, this is because:

1. the Chantler Report is partial and subjective, does not provide robust and compelling evidence that the policy would be effective, and is, therefore, an insufficient basis on which to legislate. Sir Cyril Chantler himself had to concede that "it is too early to draw definitive conclusions";
2. there is growing evidence that the policy in Australia has had no impact on consumption of genuine, duty-paid products and has, in fact, led to an increase in the illicit trade, and youth smoking has increased;
3. the Australian Government has yet to review the policy and the UK Government told Parliament that it would not take a decision until the impact in Australia had been measured;
4. the lack of robust and credible evidence supporting the policy means its introduction would breach the UK Government's better regulation principles;
5. if implemented, TPD2 would introduce major revisions to tobacco packaging, the impact of which should be measured before gold-plating EU regulation;
6. the TPD2 does not contain a provision mandating standardised packaging. Article 24(2) TPD2 (which purports to give Member States the power to adopt further standardised packaging requirements) is subject to legal challenges which are currently before the English High Court;
7. introducing the policy would infringe national, European and international laws, treaties and agreements and would expose UK taxpayers to a potential compensation bill of billions of pounds;
8. criminals have openly welcomed the prospect of the policy being introduced within United Kingdom;
9. a significant majority of law enforcement officers polled on the issue have expressed concerns about the policy;
10. retailers are against the policy;
11. introducing the policy would set a dangerous precedent for the UK. The international business community and companies in other sectors have expressed concern about the

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implications of the policy for intellectual property rights and this could, in turn, affect investment into the UK; and

12. introducing the policy could spark trade disputes with other countries.

As outlined above, there are a number of alternative solutions that would be both less restrictive and actually target the problems associated with youth smoking, in particular.

For the reasons set out in this submission, Imperial Tobacco urges the UK Government to choose Option 1. It should not, in any event, introduce standardised packaging for tobacco products.

Appendix A - Current tobacco control measures

The existing UK regulatory context includes:

- the ban on advertising (2002);
- one of the most punitive tobacco tax regimes in the world;
- the ban on smoking in public places (2006 - Scotland, 2007 - England, Wales and Northern Ireland);
- the use of pictorial health warnings (2007);
- Age of Sale of Tobacco Products increased from 16 – 18 years (2007 - UK)
- the ban on tobacco vending machines (2011 - UK, 2013 - Scotland);
- Tobacco Retailers' Register implemented and a ban on proxy purchasing (Scotland - 2011) and England & Wales (2014);
- the ban on the display of tobacco at the point of sale - despite the Coalition parties having opposed it in Opposition on the grounds of a lack of evidence, which hasn't changed (2012 - smaller shops, and 2015 - larger premises in England and Wales, 2013 - smaller shops, and 2015 - larger premises in Scotland)¹⁷⁷ and, most recently,
- a proposed ban on smoking in vehicles with children present in England and Wales.

Appendix B - Education on tobacco in Germany

According to Eurobarometer 2012, 28% of UK smokers have started under the age of 15 compared to an EU average of 17%. The German rate is also 17%. In Germany smoking among under aged people between the age of 12 and 17 has seen a significant decline from 27.5 % in 2001 to 11.7 % in 2012.¹⁷⁸ Even among elder people smoking is in decline.

Germany permits advertising and display of tobacco products and has fewer young people taking up smoking than Ireland which has some of the most draconian anti-smoking laws in the world. Germany has a tobacco control strategy with education embedded at its core and it seems to be working. The German tobacco control approach identifies three different target groups:

¹⁷⁷ <http://www.telegraph.co.uk/news/politics/3463980/Tories-to-oppose-tobacco-restrictions.html>;

http://www.24dash.com/news/Central_Government/2008-12-09-Tobacco-display-ban-nanny-state-going-too-far-Lamb

¹⁷⁸ Bundeszentrale für gesundheitliche Aufklärung, 2012

- Education for the entire population
- Education for valuable groups, for example children or pregnant women
- Education and support for current consumers

Every measure has to take into consideration:

- possible reasons for up taking
- familial environment
- gender related specifics
- age related specifics

Examples of measures that are in place in relation to tobacco

1. "Class2000" - Strong and healthy in elementary school": "Class2000" is the largest national education program to promote health, addiction and violence prevention in elementary school. Since 1991, it has reached more than 930,000 children. The educational programme is financed by donations in the form of sponsorships for individual classes (200 euros per class and school year). The most important partners is the Lions Clubs in Germany. (www.klasse2000.de)
2. "ClearSight" - Join-In Circuit on tobacco and alcohol: Education on risks associated with smoking, focused on school children aged from 12 to18. In 2012, 52 events were held. 16,089 people attended: 13,826 students and, among others, 822 educational escorts and teachers and 165 media representatives. The project is hosted by the Federal Centre for Health Education (BZgA). (www.klasse2000.de)
3. "Be Smart – Don't Start": Non-smoking competition for school classes to motivate young people to remain smoke-free. Classes of students aged between 12 and 15 agree in the competition that they'll be smoke-free for the contest period of half a year. Since its start in the school year 1997/98 130,000 school classes with more than three million students have participated in the competition. It is hosted, among others, by the Federal Centre for Health Education (BZgA), the German Cancer Aid and the German Heart Foundation. (www.besmart.info)
4. "Smoke-Free" campaigns of the Federal Centre for Health Education (BZgA): The youth campaign's goal is to continuously increase the number of non-smokers. In addition, young people are encouraged to stop smoking. Central Element of the campaign is the Internet platform www.rauch-frei.info. It offers access to information material, interactive elements as online-trainings and is a free source for media that can be used by teachers in schools. The website recorded more than 62,000 visits in 2012.

The campaign aims to promote non-smoking in the adult population. This provides information about the health risks of smoking. To promote quitting the campaign also offers various free media, including the booklet "Yes, I'll be smoke free". The "smoke-free starter pack" contains this brochure, a "calendar for the first 100 days after quitting" and a "stressball". In addition to print media, the Internet platform www.rauchfrei-info.de is a central element of the campaign. The Internet platform was accessed about 270,000 times in 2012 by a total of about 175,000 visitors.

5. Youth Movie Days "Nicotine and Alcohol - everyday life drugs in focus": 16 Events every year in various cinemas across Germany. In 2012 Youth Movie Days reached more than 140,000 participants, of which approximately 9,000 were teachers. The Movie Days are hosted by the Federal Centre for Health Education (BZgA) in cooperation with the Association of Private Health Insurances.
6. Internet based education for specific risks during pregnancy: Education and support platform "IRIS" (www.iris-plattform.de). Participants are supported on the platform for twelve weeks, the treatment is anonymous. In addition, it provides weekly e-mail contact with an e-coach. The platform is hosted by the University of Tübingen and receives financial support from the Ministry for Health.
7. Round table "Youth Protection - Improving law enforcement": The website www.jugendschutzaktiv.de additionally provides videos, flyers etc. for various groups, for example parents, teachers and retailers. The project is hosted by the Federal Ministry for Family Affairs, Senior Citizens, Women and Youth in cooperation with the associations of retail, restaurant and petrol station industry.
8. "Smoke free PLUS"¹⁷⁹ - health centers for counseling and smoking cessation: The German network Smoke-Free Hospitals & Health facilities (DNRfK) continues the pilot project funded by Ministry of Health and develops it further. This is supported by many different opportunities to non-smoking and smoking cessation.

The "Report on Drug use and addiction 2013"¹⁸⁰ published by the German Ministry for Health contains more than 100 best practice examples regarding education on tobacco and other substances. Those measures are offered by national authorities as well as non-governmental organizations.

Please see additional documents supplied:

¹⁷⁹ www.rauchfrei-plus.de

¹⁸⁰ http://drogenbeauftragte.de/fileadmin/dateien-dba/Service/Publikationen/BMG_Drogen-_und_Suchtbericht_2013_WEB_Gesamt.pdf

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Appendix C - Imperial Tobacco submission to DH standardised packaging consultation – August 2012

Appendix D - Australian Study on Illicit Trade (KPMG) – April 2014

Appendix E - 'The impact of 'Denormalisation' policies on Smoking Rates' - September 2013

Appendix F - Imperial Tobacco Submission to the Chantler Review – January 2014

GLOSSARY OF TERMS

| | |
|----------------|---|
| AITP | Anti-Illicit Trade Protocol (WHO FCTC) |
| BIS | Department of Business, Innovation and Skills (UK) |
| COP | Conference of the Parties (WHO FCTC) |
| COUNTERFEIT | Cigarettes that are illegally manufactured and that carry the trade mark / branding of a legally sold brand without the consent of the trade mark owner |
| DH | Department of Health (UK) |
| EC | European Commission |
| ECHR | European Convention on Human Rights |
| ECJ | European Court of Justice |
| ETS | Environmental Tobacco Smoke |
| EU | European Union |
| FCTC | WHO Framework Convention on Tobacco Control |
| HRT | Hand rolling tobacco (also known as roll your own - RYO) |
| HWLs | Health warning Labels |
| ILLICIT TRADE | Trade in illicit tobacco products – includes counterfeit and contraband (including illicit whites) |
| ILLICIT WHITES | A form of contraband. Illicit tobacco products that are typically not available in the country of manufacture and that are made for the sole purpose of smuggling into high tax / price countries |
| LIP | Lower Ignition Propensity |
| MS | EU Member State |
| NAO | National Audit Office |
| OECD | Organisation for Economic Co-operation and Development |
| OLAF | European Anti-Fraud Office |
| PHWs | Pictorial Health Warnings |
| PMI | Philip Morris International |
| SP | Standardised (plain) packaging |
| RYO | Roll your own tobacco (also known as HRT) |
| TAPA | Tobacco Advertising and Promotion Act |
| TCP | Tobacco Control Plan |
| TNCO | Tar, nicotine and Carbon Monoxide |
| TPD | EU Tobacco Products Directive (initial version, 2001) |
| TPD 2 | Revised EU Tobacco Products Directive (2013) |
| WHO | World Health Organization |



Bad for business; bad for consumers; good for criminals

Standardised packaging is unjustified, anti-competitive and anti-business

A response to the UK Department of Health consultation on standardised packaging of tobacco products

06 August 2012

<http://www.imperial-tobacco.com>

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1. Executive summary

Imperial Tobacco welcomes the opportunity to respond to the *Consultation on standardised packaging of tobacco products* (the "**consultation**").¹

Imperial Tobacco supports sound, evidence-based, reasonable and practicable regulation of tobacco products and encourages the Government to respect the principles of adult choice, freedom of competition and international law when doing so.

The introduction of legislation that prevents the owner of a lawful product from differentiating their product from those of their competitors, depriving them of the ability to exploit their intellectual property, would be unprecedented in the UK and would require the clearest and most cogent justification.

One would expect, therefore, the consultation to set out a rigorous and comprehensive assessment, supported by solid, credible evidence that standardised packaging will achieve the Government's stated objectives and that the benefits of introducing standardised packaging will outweigh the costs.

Any introduction of standardised packaging would be bad for business, bad for consumers and good for criminals for the following reasons.

i. No credible evidence or research

The consultation fails to provide any credible evidence or research that standardised tobacco packaging will achieve the Government's stated objectives. The research which is relied upon is speculative and inconclusive and fails to provide the "*robust and compelling case*" that is required by the Government's Better Regulation Agenda.²

Instead the consultation relies on "*subjective judgments*" from anonymous "*experts*" about their views on the likely impact of standardised packaging. These judgements have not been made available as part of the consultation and cannot form the basis for an evidential justification of standardised packaging. It is valid to question the independent nature and objectivity of such research and its underlying raw data. Proponents of standardised or plain packaging ignore the substantial body of research which runs contrary to their objective.

The consultation fails to provide any explanation of how standardised packaging would address the real issues behind smoking initiation and activity by young people and attempted quitters. It is wholly inadequate to try to argue that unprecedented legislation cannot be, by its very nature,

¹ Department of Health consultation on standardised packaging of tobacco products, 16 April 2012

² BIS general principles of better regulation

supported by credible evidence and research. Moreover, it is precisely because of the unprecedented nature of any such legislation that a "*robust and compelling case*" is absolutely vital.

ii. Will increase the trade in illicit tobacco

Standardised packaging would provide a stimulus for the illicit trade of tobacco products - which already costs the Exchequer billions of pounds each year - by creating a "*Counterfeiters' Charter*", aiding and accelerating the spread of counterfeit tobacco products and the trade in illicit tobacco by making it simpler to copy legitimate packaging and also by creating an unfulfilled supply vacuum for branded products.

The illicit tobacco market undermines Government and industry efforts by making it easier for children and adults to access illegal tobacco products. Illicit and counterfeit products usually undermine and circumvent legislation on ingredients, smoke emissions and reduced fire risk cigarettes and may not carry mandated English language health warnings.

A reduction in legitimate sales at the expense of an increase in illicit tobacco sales will further reduce future excise and VAT payments to the Exchequer to the detriment of the British taxpayer whilst failing to achieve any public health objectives.

iii. Will put the Government in breach of national, European and international law

Standardised packaging would be illegal under national, European and international law and would expose the Government to a bill for compensation for deprivation of the manufacturers' intellectual property rights. Tobacco manufacturers hold billions of pounds worth of registered trade marks.

There is no obligation on Parties to the World Health Organization Framework Convention on Tobacco Control ("**FCTC**") to implement standardised plain tobacco packaging.

The legislation in Australia is being challenged in the national courts and via International Tribunals. Ukraine, Honduras and the Dominican Republic have already filed Requests for Consultation with the World Trade Organization ("**WTO**"). Irrespective of the outcome of these challenges, the applicable legal frameworks in the UK and Australia are different.

iv. Is anti-business, anti-competitive and anti-consumer

Standardised packaging will reduce competition, lengthen retail transaction times, confuse retailers and adult consumers, create store security problems and reduce legitimate retail sales and profits across the legitimate tobacco retailing sector at a time of severe economic difficulties. It is our view that the Government should seek and request an independent

authority to undertake a detailed review of the likely impact of standardised packaging on the market and consumer behaviour.

v. The consultation process is fundamentally flawed

There is a very real concern that the Government is paying lip-service to this consultation and that it is determined to introduce standardised packaging as part of an attack on tobacco companies and their manufacture, including in the UK, of a lawful product.

The consultation asks respondents to disclose whether they have any direct or indirect links to, or receive funding from, the tobacco industry. Yet it is well known that many organisations and charities that actively pursue a tobacco control agenda and receive funding from the Government (or provide funding to individuals and organisations as part of their activities) are not required to disclose any vested interests.

The Government should conduct a root-and-branch review of how it continues to fund such lobbyists if the public are to have any faith in the political and legislative process.

vi. Goes against the Governments own principles and objectives

Standardised packaging would conflict with the Government's stated objectives of promoting economic growth; promoting freedom of choice and personal responsibility; reducing regulation and helping small businesses. Considering all of the issues and flaws summarised above, standardised packaging appears to be yet another example of tobacco control lobbyists seeking to influence Government to further extend the intrusion of the State into adults' private lives and individual choices. It is another deliberate attempt to stigmatise and bully adults who choose to purchase tobacco products.

In summary, the consultation is seriously deficient in a number of important respects. It has completely failed to make a convincing case, supported by credible evidence, for the introduction of any form of standardised packaging, including failing to understand the reasons why people smoke. In addition it fails to consider the legal implications of such an approach and the unintended consequences of introducing such a proposal. The concept of standardised packaging should therefore be rejected.

2. Introduction

2.1 Company background

Imperial Tobacco Group PLC ("ITG") is a FTSE top 25 company, the world's fourth largest international - and second largest European - tobacco company. ITG manufactures and sells a range of cigarettes and other tobacco products. ITG has sales in over 160 countries worldwide and is the world leader in the premium cigar, fine-cut (roll-your-own) tobacco and rolling papers sectors.

Imperial Tobacco UK ("ITUK", and, together with ITG, "Imperial Tobacco") is the Bristol-based trading operation of ITG which distributes Imperial Tobacco's products to the UK market. ITUK is market leader, holding approximately 45 per cent market share. ITUK's leading UK cigarette brands include Lambert & Butler, JPS, Richmond, Embassy and Regal. ITUK also distributes tobacco products on behalf of Philip Morris Ltd.

Imperial Tobacco has its headquarters in Bristol with manufacturing and distribution facilities in Nottingham. Imperial Tobacco directly employs over 1,600 people in the UK and last year collected around £5.8 billion for the Exchequer in duties and other taxes. Imperial Tobacco has around 26,000 shareholders with 53 per cent of issued shares held in the UK. Over 34,000 individuals are members of the company pension fund, and it is estimated that the tobacco industry indirectly supports the livelihoods of over 66,000 people elsewhere in the economy³.

2.2 Background to the consultation

The consultation fails to mention the fact that the Government has previously considered, and consulted on, standardised packaging.

In particular, in May 2008, the UK Government launched a consultation on a range of different tobacco control options entitled "*A Consultation on the Future of Tobacco Control*".⁴ This set out to deliver a national strategy on tobacco control focused on reducing "...health inequalities caused by smoking..." and taking action on "...the perpetuation of smoking and poor health into future generations..." by seeking ways to deter the "...uptake of smoking by young people."

Amongst the options presented was "...the potential for plain packaging of tobacco products". This was the first time that a proposal for standardised packaging (as it is now referred to) had been made by the UK Government.

³ Cogent factsheet, published Q2 2012

⁴ Consultation on the Future of Tobacco Control, Department of Health, May 2008

Imperial Tobacco responded to that consultation and carefully commented on the evidence advanced in favour of standardised packaging. We examined the factors that encourage young people to smoke; explained the unintended consequences of benefitting illicit trade and the detrimental impact on business; and set out some of the legal arguments against standardised packaging.⁵

The Department of Health ("DH") acknowledged that:

"...the research evidence into this initiative is speculative, relying on asking people what they might do in a certain situation."

As set out in our answer to question 14 of Appendix A on page 64, nothing has changed in terms of the research evidence on which the Government is seeking to rely in this consultation: that evidence remains purely speculative.

Indeed, this was acknowledged by the DH in an email dated 10 May 2011, obtained under the Freedom of Information Act, in which the DH stated: *"there isn't any evidence to show that [standardised packaging] works"*.⁶

In 2008, the DH also acknowledged that standardised packaging could make life more difficult for retailers; benefit the illicit trade in tobacco products; and encourage young people to smoke through an enhanced perception of rebelliousness, as well as setting a precedent for the alcohol and fast food sectors. Again, in our view, nothing has changed and it is wholly inadequate to try to argue that unprecedented legislation cannot be, by its very nature, supported by credible evidence and research. Moreover, it is precisely because of the unprecedented nature of any such legislation that a *"robust and compelling case"* is absolutely vital.

2.3 The existing regulatory context

The proposal to introduce standardised packaging ignores the existing regulatory context, which includes:

- the ban on advertising;
- one of the most punitive tobacco tax regimes in the world;
- the ban on smoking in public places;

⁵ Imperial Tobacco Group plc and Imperial Tobacco UK: Joint submission to the Department of Health Consultation on the Future of Tobacco Control, September 2008

⁶ Email correspondence obtained by Phillip Morris International Limited pursuant to a Freedom of Information Act request

- the use of pictorial health warnings;
- the ban on tobacco vending machines; and, most recently,
- the ban on the display of tobacco at the point of sale (despite the Coalition parties having opposed it in Opposition on the grounds of a lack of evidence, which hasn't changed).⁷

The common denominator in all of these regulatory measures is that they do not address the reasons why people start or continue to smoke. This consultation is no different. As outlined in section 3.3 and Appendix C, it ignores all of the well-established research on the main reasons for smoking initiation by young people and the factors that influence quitters, and completely fails to provide any analysis of how standardised packaging would address those reasons.

It is incumbent on the Government to undertake a rigorous and comprehensive assessment of the impact of "*the existing tobacco control measures*" and to assess the introduction of standardised packaging in that context. However, the existing tobacco control measures have not been properly evaluated - either in the consultation or otherwise - for their effectiveness or for delivering the outcomes or benefits that were originally expected or promised. It is therefore impossible for the Government to assess whether any further tobacco control measure would have an appreciable effect on improving public health over and above existing measures.

It is our strongly held view that the Government needs to develop a rational and appropriate framework within which legitimate consumer demand for tobacco and nicotine products is met and real public health goals achieved, rather than continuing to pursue an irrational approach that appeases a small minority of vested interests but achieves no public health benefit.

Please see the response to question 3 of Appendix A on page 34 for further information.

⁷ <http://www.telegraph.co.uk/news/politics/3463980/Tories-to-oppose-tobacco-restrictions.html>;
http://www.24dash.com/news/Central_Government/2008-12-09-Tobacco-display-ban-nanny-state-going-too-far-Lamb

3. No credible evidence or research

The consultation suffers from a number of significant defects which make it unreasonable, disproportionate and exposed to legal challenge.

The Systematic Review⁸ does not provide any evidence to justify the introduction of standardised packaging. This issue is addressed more fully in our response to question 14 of Appendix A, page 64. In summary, the Systematic Review:

- is not independent. Its authors have well-established links with, and receive funding from, organisations that actively pursue a tobacco control agenda and/or have been well known advocates of standardised packaging for many years. Indeed, 20 of the 37 studies included in the Systematic Review include work by the authors (and their colleagues);
- fails to demonstrate a causal link between tobacco packaging and smoking behaviour (including initiation, prevalence and consumption);
- does not demonstrate, therefore, that standardised packaging is necessary to achieve the Government's public health objectives by affecting smoking behaviour; and
- does not comply with the Government's own guidelines and standards. The conclusion reached was that *"there was consistency in study findings regarding the potential impacts of plain packaging. This consistency of evidence can provide confidence about the observed potential effects of plain packaging. If and when introduced, existing evidence suggests that plain packaging represents an additional tobacco control measure that has the potential to contribute to reductions in the harm caused by tobacco smoking"*. That, manifestly, does not provide the standard of *"robust and compelling"* evidence that standardised packaging will have any impact on smoking behaviour that is required by the Government's Better Regulation Agenda.

3.1 Subjective opinions

Presumably in recognition of the deficiencies in the Systematic Review and in order to produce *"a quantified estimate of the impact of standardised packaging on smoking behaviour"*, the Impact Assessment proposes to rely on a project being undertaken by the Policy Research Unit

⁸ [Plain tobacco packaging : A systematic review](#)

on Behaviour and Health which "will seek to elicit subjective judgements from three groups of internationally renowned experts on tobacco control" as to "what they believe to be the likely impact of standardised packaging on the number of adult smokers and the number of children trying smoking".

Subjective judgements about the "likely impact" will provide opinion, not evidence. It cannot properly form the basis for any Government action, let alone something as draconian and unprecedented as standardised packaging. The principles of procedural fairness require that those judgements, and the identity of the experts, with all relevant accompanying information, are made available for assessment and comment. To not do so suggests that the panel has been formed for the sole purpose of producing a pre-determined outcome.

Please see our response to question 14 in Appendix A on page 64 for further information.

3.2 No consideration of alternatives

The consultation does not consider the possibility of alternatives to standardised packaging, saying only that these will be considered if responses to the consultation suggest an alternative approach. It is, however, incumbent on the Government to assess the best and least restrictive way of achieving its policy objectives and any assessment of standardised packaging must be made in that context.

Please see the response to question 14 in Appendix A on page 64 for further information.

3.3 Why young people smoke

The Impact Assessment states that the objective of standardised packaging would be to deter young people from starting to smoke and to support adult smokers who want to quit (and prevent relapses among those who have quit).

However, the consultation ignores well-established research on the main reasons for smoking initiation by young people⁹ and the factors that influence smokers who are trying to quit (as detailed in our comprehensive submission to the 2008 consultation). Accordingly, the consultation fails to provide any explanation of how standardised packaging would address the real issues behind smoking initiation and activity by young people and attempted quitters.

⁹ A summary of research on why young people start smoking can be found at Appendix C on page 78

The reality is that:

- young people do not decide to smoke on the basis of tobacco branding and packaging; and
- branding and packaging do not cause smoking initiation or relapse by quitters.^{10; 11}

Every year a survey entitled "*Smoking, drinking and drug use among young people in England*" is undertaken on behalf of the NHS Information Centre.¹² It details and explains the influences on youth smoking and the factors associated with regular smoking among young people.

Packaging and branding do not feature. By contrast, sex, age, the propensity to drink and take drugs, the influence of family and friends, truancy and socio-economic status are identified as the basis for why young people start smoking.

The survey also captures information on how young people access cigarettes:

- 69% report being given them (58% by friends);
- 45% bought them from a shop; and
- 41% bought them from other people (23% from someone other than family or friends).

Other surveys¹³ also show that:

- 50% of the tobacco bought by 14 to 15 year olds is illegal;
- 1 in 4 young smokers are regularly offered illegal tobacco, which is far more often than adults; and
- 1 in 7 young smokers have gone to a private address (or a "fag house"¹⁴) to buy illegal cigarettes.

Standardised packaging would make matters worse by increasing the illegal, unregulated market in tobacco products, through which young people buy illicit tobacco from criminals in fag houses and/or on street corners at pocket money prices.

¹⁰ M E Goldberg, J Liefeld, K Kindra, J Madill-Marshall, J Lefebvre, N Martohardjono & H Vredenburg, *When Packages Can't Speak: Possible Impacts of Plain and Generic Packaging of Tobacco Products*, Expert Panel Report to Health Canada, Ottawa, 1995.

¹¹ *Tobacco packaging regulation: An international assessment of the intended and unintended consequences*, Deloitte, May 2011

¹² *NHS: Smoking, drinking and drug use among young people in England in 2010*

¹³ *NEMS market research surveys 2009 and 2011 for the North of England Tackling Illicit Tobacco for Better Health Programme*

¹⁴ See for example: *This is Nottingham*, March 2010

The same is true of relapse by smokers who have, or are trying to, quit smoking. The Government's own statistics clearly show the reasons why people say they start smoking again.¹⁵ The main reasons in order of importance are:

- as a coping mechanism for stress;
- because they enjoy smoking;
- because their friends smoke; and
- because they missed the habitual aspects of smoking.

The main factors in youth smoking are:

- *rebelliousness*
- *risk-taking*
- *family structure*
- *peer pressure*
- *socioeconomic status*
- *educational success*

Packaging and branding do not induce relapse by people who have, or are trying to, quit smoking.

Standardised packaging will not, therefore, achieve the Government's policy objectives. People smoke because they choose to do so. They do not start or continue smoking because of the packaging or branding of tobacco products. Branding helps their choice by identifying different products. Standardised packaging will not stop people from smoking.

Please see response in Appendix C on page 78 for further information.

The consultation completely ignores the reasons why young people start smoking and why people who quit smoking relapse.

Findings clearly show that education and enforcement of existing laws to reduce young people's access to tobacco products are far more likely to have an impact on smoking prevalence than standardised packaging.

The consultation avoids an assessment of whether standardised packaging would be effective or proportionate; this ignorance is a critical failing.

¹⁵ [Statistics on Smoking: England, 2011](#)

4. Will increase the trade in illicit tobacco products

"Tobacco smuggling is organised crime on a global scale with huge profits ploughed straight back into the criminal underworld, feeding activities like drug dealing, people smuggling and fraud."

John Whiting, HMRC Assistant Director of Criminal Investigations, August 2011

"Plain packaging risks fuelling tobacco smuggling.....measures that appear to benefit the criminal community must be given serious consideration before being taken any further."

Michael Waller, former Detective Superintendent; M. McAdam, former Detective Chief Superintendent (plus 22 other former senior police officers), The Times, June 2012

"...it is a sad fact that although tobacco duty raises around £9 billion a year, duty fraud costs the UK more than £2 billion a year and undermines the efforts by the Department of Health to reduce smoking prevalence. Trade in illicit tobacco makes cheaper tobacco more readily available to the youngest and most vulnerable people in society."

Chloe Smith MP, Economic Secretary to the Treasury, March 2012

Latest Government figures suggest that around 17 per cent of all cigarettes and 53 per cent of all rolling tobacco consumed in the UK is non-UK duty paid.¹⁶ The third largest supplier of tobacco in the UK is not a legal, regulated company, but criminals. HMRC estimates the cost to the UK taxpayer at up to £3 billion a year,¹⁷ or £8.2 million every day of the year.

The trade in illicit tobacco deprives the Government of tax revenues; creates uncontrolled, unregulated, unaccountable markets; and circumvents regulatory controls, including where and to whom tobacco is sold (including importantly the young). Surveys show that 50 per cent of the tobacco bought by 14 to 15 year olds is illegal.¹³ The illicit trade also damages legitimate retail and manufacturing businesses.

There is a serious risk that the introduction of standardised packaging will benefit organised crime and the illicit trade in tobacco. It will, undoubtedly, make it cheaper and easier to produce counterfeit standardised tobacco packaging, which will increase profit margins for criminals, providing them with an incentive to increase their market share.

Standardised packaging would make it easier and cheaper to produce counterfeit products for smuggling. Counterfeiters would only need one printing "blank", as the packaging of the

¹⁶ HMRC Measuring Tax Gaps 2011

¹⁷ Ibid.

different brands will become so similar that only a simple modification - to the name - will be needed to use the same packaging for every brand of cigarette.

There is no consumer demand for standardised packaging and demand for branded packs will not simply disappear as a result of legislation introducing standardised packaging. Branded illicit products could become preferable to consumers than de-branded legal products. As a result, standardised packaging would lead to an unfulfilled supply vacuum for branded products and the consequential development of even more market share under the control of organised crime.

Kieran McDonnell, President of the National Federation of Retail Newsagents, warns of:

"...the dangers of moving the control of this market from responsible retailers to the wholly unscrupulous criminal fraternity who cynically exploit any opportunity to make money."

"We are very concerned that this proposal could become a gift to the counterfeiter. Counterfeit cigarettes are already a huge and growing problem and anything that makes it easier will certainly see an escalation of the volumes of counterfeit cigarettes in distribution."

Since there is no experience of standardised packaging anywhere in the world there is no hard evidence as to its effects. However, common sense dictates that the risks are serious and that standardised packaging would damage legitimate businesses (retailers and manufacturers) as well as Government revenues, while increasing opportunities and rewards for criminals.

The Parliamentary Under-Secretary of State for Health, Anne Milton, recently stated to Parliament that existing packs are "very easy to forge".¹⁸ That is not the case.

Existing brands are regularly developed to keep pace with consumer demand. A large number of component materials are needed to form a genuine cigarette pack. The constant evolution of brand design including colour, embossing, foils, opening mechanisms, and pack sizes all serve to make it more difficult and more expensive for counterfeiters to seek to imitate legal products.

The 5 leading packaging companies are also convinced that counterfeiting would be made easier:

"On the basis of our technical expertise, we know that unbranded packets and containers will be significantly easier to counterfeit and lead to a growth in illicit cigarettes and a move away from the legitimate product manufactured in UK factories."

API Group, Parkside, Chesapeake, Weldenhammer, Amcor

Our forensics team sees large volumes of illicit product on a daily basis. We regularly see considerable effort made to copy our genuine products. However, due to the complexity of

¹⁸ Anne Milton, Parliamentary Under-Secretary of State for Health, House of Commons Debate, 17 April 2012

designs consumers can often detect genuine from fake using the naked eye. This ability would be lost in a standardised pack environment.

Standardised packaging would also make enforcement more difficult and costly:

- the cheaper counterfeit products become to produce, the less the impact of seizures on the criminal, with larger volumes being produced and pushed into the market as the relative risk declines;
- "illicit white"¹⁹ branded products become preferable in terms of price and appearance, so volumes will increase creating greater enforcement complexities;
- confused and unenforceable markets will develop. Standardised packaging could theoretically create a market with legal genuine standardised packs; legal genuine branded travel retail packs; counterfeit standardised packs; illegal genuine branded packs; counterfeit branded packs; illicit whites (branded); illicit whites (unbranded). The result: five of the seven channels/options available to consumers would be run by organised crime;
- domestic counterfeit operations can be expected to be created, allowing easier access to retail supply chains;
- with no clear differentials between brands and provenance, detection opportunities will be reduced resulting in increased enforcement and prosecution costs; and
- any attempted price increase on legitimate domestic products through higher taxation to compensate for a decline in domestic sales to illicit products would only increase the profits of criminals.

Covert track and trace systems - often presented by tobacco control lobbyists as a solution to the impact that standardised packaging would have on the illicit trade - are not an adequate or comprehensive solution because:

- covert markings are not applied by the manufacturers of counterfeit products or illicit whites;
- they are only used on genuine products, and can only be read by hand-held electronic readers; and

¹⁹ Low cost cigarettes legally produced by small independent tobacco companies but sold illegally outside their intended market(s).

- neither the general public nor retailers have access to readers, making covert markings an irrelevant system for consumers to be able to distinguish between genuine and illicit product.

Please see our response to question 9 in Appendix A on page 58 for further information.

The enforced removal of branding would create further demand for criminals to sell illicit products:

- it would make it easier for them to counterfeit products with both standardised and branded packaging;
- it would take away consumers' ability to authenticate products themselves; and
- it would increase enforcement complexity and costs.

5. Is in breach of national and EU law and international treaties

Standardised packaging would directly conflict with existing and harmonised national, European and international laws which protect, as a fundamental right, the enjoyment of property, including intellectual property.

An additional consequence would be to undermine the authority of the EU to defend and promote the protection of intellectual property, both within the EU and beyond.

The International Trademark Association makes clear that trade marks are:

"...not only words, names, and logos, but can also be colours or the very shape or design of the package itself. Any graphical component that adds to the distinctiveness of a product can be registered as a trade mark. A trade mark is regarded as an "object of property" and trade mark owners are entitled to have their trade marks accorded the consideration and protection due to all objects under national and international law."²⁰

Standardised tobacco packaging would be contrary to:

- the right to property;
- the right to the free movement of goods;
- the right to conduct a business; and
- the right to freedom of speech.

Each of these rights is subject to protection under national, European and international law. While these rights are not absolute, the Government cannot, and has not, shown that standardised packaging is a justified interference with those rights.

In particular, standardised packaging would:

- breach the protections afforded by the European Convention on Human Rights, the Charter of Fundamental Rights and the law of the European Union;
- breach UK obligations under international treaties, including:
 - the Agreement on Trade Related Aspects of Intellectual Property;
 - the Paris Convention for the Protection of Industrial Property; and
 - the Technical Barriers to Trade Agreement.

²⁰ <http://www.inta.org/Advocacy/Documents/November52008.pdf>

The introduction of standardised tobacco packaging could result in legal action by Imperial Tobacco and other tobacco companies to protect their intellectual property and fundamental rights.

Moreover, the deprivation of property rights would require the payment of compensation reflecting the value of Imperial Tobacco's intellectual property rights, a claim which could be expected to run to billions of pounds. The UK Government would also face the possibility of enforcement action at an EU and international level.

Please see our response to question 6 in Appendix A on page 46 for further information.

5.1 The European context

The consultation fails to acknowledge or take account of developments in other jurisdictions that are important and relevant to UK policy.

The European Commission's Directorate General for Health and Consumer Protection issued a consultation paper on the revision of the Tobacco Products Directive in September 2010.²¹ It included some ideas around contents, ingredients, labelling and packaging. There were 85,000 responses to that consultation, the vast majority strongly opposed to the idea of any plain or standardised packaging. Business Europe wrote a letter to European Commission President Jose Manuel Barroso opposing the idea of any standardised packaging and called attention to the grave concern expressed by major industries in this regard.

The UK is currently alone among the EU Member States in consulting on standardised packaging, and any introduction would cause significant legal issues in terms of the single market and the harmonised regime for protecting intellectual property.

The content of textual health warnings on tobacco products has only recently been amended by an EU Directive.²² It makes little sense to consider standardised packaging when the effects of those recent changes have not been reviewed.

5.2 The international context

The Government in Australia has passed legislation to introduce plain packaging. These laws will come into effect on 1 October 2012 for cigarettes and from 1 December 2012 for other tobacco products.

²¹ http://ec.europa.eu/health/tobacco/consultations/tobacco_cons_01_en.htm

²² [Commission Directive 2012/9/EU](#)

The legislation in Australia is being challenged in the national courts and via International Tribunals. Ukraine, Honduras and the Dominican Republic have filed Requests for Consultation ("RFC") with the WTO. If the issue is not resolved across the negotiating table, after 60 days the complainant's can ask the WTO to set up a panel of adjudicators to judge the case. Irrespective of the outcome of these challenges, the applicable legal frameworks in the UK and Australia are different.

5.3 FCTC guidelines

As reiterated during all the Conferences of the Parties to date, FCTC guidelines are non-binding proposals. The guidelines do not extend to the binding obligations of the FCTC and they do not constitute a subsequent agreement on the interpretation of the FCTC. This is the basis on which the guidelines are adopted.

Furthermore, the guidelines to FCTC Articles 11 and 13 are not only non-binding, they are also highly aspirational. The guidelines were adopted by individuals acting under the auspices of a public health convention, where it is openly stated that other rights and considerations are not taken into account at that level; it is for Governments to take those other national interests into account at a later date.

The consultation implies that the guidelines to FCTC Articles 11 and 13 have already resolved issues such as proportionality, basic rights and less restrictive measures. This is completely inaccurate.

The UK consultation on standardised packaging makes no sense in the current EU and international regulatory context.

Standardised packaging would put the UK in the position of breaching important international Treaties, laws and agreements.

Standardised packaging would be illegal under national, European and international law.

The deprivation of property rights would require the payment of compensation reflecting the value of Imperial Tobacco's intellectual property rights, a claim which could be expected to run to billions of pounds.

6. Is anti-business, anti-competitive and anti-consumer

Branding and intellectual property are an integral part of a lawful and free market economy. Standardised packaging is therefore anti-business, anti-competitive and anti-consumer

Packaging contains and protects a product. It also provides a mechanism for disseminating information, including information required by law (for example, in the context of tobacco products, health warnings).

However, packaging also provides a crucially important mechanism for the manufacturer of a lawful product provide information to consumers; to develop their brand and to exploit their intellectual property. The importance of branding and intellectual property cannot be overstated:²³

- **They provide information about the product to consumers** including about its quality, origin and brand values; and
- **They enable a manufacturer to differentiate their product from their competitors** which, simply put, enables consumers to make an informed choice about which products they want to buy.

Standardised packaging takes away this source of information from consumers, and thereby prevents competition between manufacturers in terms of the quality of their products. The information processing capacities are one of the most important, if not the most important, features of markets. Any reduction in the information available harms consumers and competition and impedes the normal functioning of markets. Indeed, Governments, regulators and competition authorities routinely seek to improve the information available to consumers so as to enable consumers to make informed choices about the products and services which most closely meet their requirements.

This policy measure is unprecedented and will have a seismic impact. Imperial Tobacco has invested in and owns over 1,000 trade mark registrations, or applications for registrations, effective in the UK. The owners of a lawful product would be unable to use their intellectual property or to differentiate their products from those of their competitors. The adverse impact on the UK economy in terms of consumer choice, competition and innovation, and the effect on the illicit market, will be huge as is discussed below.

These concerns are shared by others. Leading business groups such as the Confederation of British Industry²⁴ ("CBI"), the International Chamber of Commerce UK²⁵ ("ICC"), the British

²³ See generally, *Packaging in a Market Economy*, June 2012, Dobson and Yadav, 28 June 2012

²⁴ CBI communication to ASH APPG, January 2012

Brands Group²⁶ ("BBG") and many others²⁷ have expressed significant concerns about the precedent that standardised packaging would set, its potential impact on markets, and the message it would send to companies looking to invest in the UK.

Peter Lawrence, former head of the UK Patent Office's designs and trade marks division, says:

"The UK has fought hard at international level to ensure that all countries respect trade mark rights, and for the UK to take action to deprive brand owners of the right to use their marks would be an unfortunate precedent to say the least."²⁸

"Our ability to sell our goods and services across the world is critically dependent on IP - it is a critical raw material for our modern economy."

Vince Cable, speech to The British Film Institute, May 2011

"Brand marketing is hugely important. It's important to any industry sector. It's about differentiating between one product and another."

Henry Ashworth, Chief Executive, The Portman Group, Health Select Committee hearing, May 2012

"IP's contribution to the UK's economy is therefore both substantial and vital. Its wider impacts on society, in terms of culture, education and basic human rights such as freedom of expression, are no less important."

George Osborne, Vince Cable & Jeremy Hunt, August 2011

The imposition of standardised packaging would have serious implications for competition, consumer choice, and innovation in the legal tobacco products market and for the economy as a whole.²⁹

The removal of branding and intellectual property will create a situation whereby many consumers will choose brands on price alone, which in turn could result in falling prices. This will have a number of consequences which the Government does not intend and does not want.

²⁶ <http://www.international-chamber.co.uk/press/72-icc-stresses-need-for-wider-perspective-on-plain-packaging>

²⁷ John Noble, Director of the BBG, Marketing Magazine, 13 April 2012

²⁸ Including the European Communities Trade Mark Association; US Chamber of Commerce; TransAtlantic Business Dialogue; Emergency Committee for American Trade; National Association of Manufacturers; Union of European Practitioners in Intellectual Property; Marques; the United States Council for International Business and the National Foreign Trade Council.

²⁹ <http://www.packagingnews.co.uk/news/plain-packs-for-tobacco-will-damage-business-says-former-patent-chief/>

³⁰ A recent survey conducted by GfK NOP found that the general public do not believe tackling smoking rates should be the main priority for the Government. In particular, almost half of respondents thought that the Government should be focusing on reviving the economy. Standardised packaging is directly in conflict with that policy.

"The removal of brand imagery from packaging shifts consumer preferences away from premium brand products towards low-range cheaper brands."

London Economics report, January 2012

"When price is the only signal in the market consumer preferences shift towards low-range cheaper brands."

London Economics report, January 2012

Choices driven by price would lead to falling prices across the range of tobacco products; the potential elimination of premium branded products; and an acceleration of down-trading. This will lead to higher consumption, including among young people and those in poorer socio-economic groups. Attempts to offset this by even higher taxation would increase the profit margins of illicit tobacco products and lead to an increase in the illicit trade, damaging yet further legitimate businesses (manufacturers and retailers) as well as Government revenues.

Choices driven by price would also lead to the market becoming ossified. Access for new products would be very difficult because there would be no means of informing consumers about their new products. Incentives for companies to invest in product development would also be severely reduced. As a result, consumers would have less choice and less access to new products.

Standardised packaging can also be expected to compromise the ability of smaller retailers to compete because:

- tobacco makes an important contribution to the profitability and viability of smaller retailers, representing around 30 to 40 per cent of their turnover;³⁰
- retailers earn higher margins on premium brands than on economy brands; and
- it is likely to lead to more consumers switching to buying from large grocery retailers, reducing the viability of small independent retailers for whom turnover from tobacco products is proportionately much more significant.

The Impact Assessment accompanying the consultation dramatically underplays the potential impact on the market. Peter Lawrence, former head of the UK Patent Office's Designs and Trade Marks Division, recently said this in relation to the consultation and the importance of trade marks in economies:

"Trade marks underpin modern economies by helping consumers make their choices and bring rewards to firms that successfully meet their desires. When

³⁰ See for example: [NFRN response to the 'Future of Tobacco Control' consultation](#)

*Governments seek to intervene in this way, they risk undermining this fundamental aspect of how markets operate.*²⁸

The omission of any consideration of the impact standardised packaging would have on market dynamics has also been picked up in a report recently published by the British Brands Group, which states that:

*...the dynamics of industry competition and how consumer behaviour will evolve over time appear to have been largely neglected aspects.*²³

In light of all of the points raised above, it is our view that the Government should seek and request an independent authority to undertake a detailed review of the likely impact of standardised packaging on the market and consumer behaviour.

Please see the response to question 5 in Appendix A on page 38 for further information.

Standardised packaging would destroy intellectual property and prevent a manufacturer from differentiating their products.

The Government should seek and request an independent authority to consider and report on the implications of introducing standardised packaging.

7. The consultation process is fundamentally flawed

The unprecedented introduction of standardised packaging for a lawful product would be an extremely significant step for any Government to take. The Government should, therefore, take particular care to ensure that the consultation process is sufficiently fair and robust to enable a proper and informed assessment of the case for standardised packaging.

This would be consistent with the general principles of procedural fairness, and it is also reflected in the Government's own Better Regulation Agenda which provides that:

*"There will be a general presumption that regulation should not impose costs and obligations on business, social enterprises, individuals and community groups unless a robust and compelling case has been made."*²

No credible case is made for standardised packaging; certainly not a "robust and compelling" case.

7.1. Open mind?

There is a very real concern that the Government is paying lip-service to this consultation and that it is determined to introduce standardised packaging as part of an attack on tobacco companies and their manufacture, including in the UK, of a lawful product.

For example, in an interview with *The Times* to coincide with the announcement of the consultation, the Health Secretary, Andrew Lansley stated that:

*"We don't want to work in partnership with the tobacco companies because we are trying to arrive at a point where they have no business in this country."*³¹

In response to a letter from Imperial Tobacco seeking clarification of his remarks, Mr Lansley said his comments had been taken out of context. However, we still have concerns that the Health Secretary has not sought to proactively or publicly set the record straight. In our view this undermines the DH's claims that it has an "open mind" on this consultation.

7.2 Vested interests of tobacco control


The consultation asks respondents to disclose whether they have any direct or indirect links to, or receive funding from, the tobacco industry. Yet it is well known that many organisations and charities which actively pursue a tobacco control agenda and will be expected to respond to the

³¹ Andrew Lansley, 13 April 2012

consultation receive funding from the Government, and provide funding to individuals and organisations as part of their activities. If understanding links is truly important to the integrity of the consultation, disclosures should surely be made by both sides of the debate.

7.3 Bias and a lack of transparency

More than £440,000 has been provided in the South West region,³² and up to £5 million nationally,³³ by the Government on campaigns to promote standardised packaging during the consultation period. This information was only disclosed through Freedom of Information ("FOI") requests and not, as one would expect, voluntarily by the DH.



"It will come as no surprise to us if the Department of Health has funded organisations that provide the responses to consultations that the Government is looking for."

*Andrew Lansley, The Telegraph
January 2009*

Unfortunately, the use of FOIs has appeared to be the only way to achieve any degree of transparency of tobacco control's relationships, funding, research and lobbying activities. This is both worrying and disappointing and - assuming the Government are still fully committed to transparency for lobbying - a needless burden on the public purse.

Government funding of lobbyists to help promote their agenda through "*public support*" is so common, and so concerning, that the Institute of Economic Affairs has produced a detailed report which questions the vast sums of taxpayer funds being used by the Government to lobby itself on a wide range of issues - including tobacco control.³⁴

The Government should conduct a root-and-branch review of how it continues to fund such lobbyists if the public are to have any faith in the political and legislative process.

The fairness and genuineness of this consultation must be called into question.

The Government should voluntarily declare how much taxpayer-funded lobbying there has been, and continues to be, on tobacco control policy-related issues.

The Government should conduct a root-and-branch review of how it continues to fund such lobbyists if the public are to have any faith in the political and legislative process.

³² Matthew Elliott, Chief Executive of The TaxPayers' Alliance, Mail Online blog, 26 January 2012

³³ <http://dickpuddlecote.blogspot.co.uk/2012/04/government-lobbying-government.html>

³⁴ IEA 'Sock Puppets' report, 11 June 2012

8. Goes against the Government's own principles and objectives

The total lack of credible evidence demonstrating that standardised packaging would achieve the Government's objectives (see section 3.3, page 11 above) means that its imposition would breach the Government's own principles on regulation.

8.1 Reducing regulatory burden

The Government's published strategy³⁵ is to reduce the overall volume of new regulation "by introducing regulation only as a last resort." The Government has set out a clear policy² to regulate only:

- after it has demonstrated satisfactory outcomes can't be achieved by alternative, self-regulatory, or non-regulatory approaches. **This is not done, or even attempted, in the consultation nor the Impact Assessment;**
- where analysis of the costs and benefits demonstrates that the regulatory approach is superior by a clear margin to alternative, self-regulatory or non-regulatory approaches. **Neither the consultation nor the Impact Assessment demonstrate this by any margin, let alone a clear one. In fact the overall costs and benefits are not even quantified in the Impact Assessment;** and
- where the regulation and the enforcement framework can be implemented in a fashion which is demonstrably proportionate, accountable, consistent, transparent and targeted. **Neither the consultation nor the Impact Assessment demonstrate that the policy would be any of these, and especially not proportionate or targeted.**

The British Retail Consortium has called this latest proposal, especially on the back of the display ban, "crazy",³⁶ also arguing that it ignores the Government's own principles on better regulation.

8.2 Inconsistency of regulatory approach to different industry sectors

It is striking that the DH has taken a different approach in relation to alcohol. In oral and written evidence to the House of Commons Health Committee,³⁷ the DH has suggested that there is

³⁵ <http://www.bis.gov.uk/policies/bre>

³⁶ http://www.brc.org.uk/brc_news_detail.asp?id=2186

"very limited" evidence to demonstrate the effectiveness of standardised packaging for alcohol products, and are not therefore pursuing it as a potential policy option at this time.

Given the fact that the DH has already admitted that there is no evidence that standardised packaging for tobacco products would work,⁶ a similar conclusion could have been quickly and easily reached without the need to embark on a costly consultation exercise.

Please see the response to question 11 in Appendix A on page 63 for further information.

The proposal clearly breaches the Government's own strategy and principles on regulation in every respect. No policy should be taken forward when this is the case.

| | Government's policies/priorities | Standardised packaging |
|------------------------|---|---|
| Promoting growth | Supporting intellectual property rights ³⁸ | Destroys intellectual property rights |
| | Encouraging investment into the UK ³⁹ | Discourages investment into UK: brand owners will be concerned at the willingness of Government to destroy brands and use of trademarks |
| | Supporting small businesses ⁴⁰ | Damages small independent retailers by encouraging the increase of illicit trade in tobacco products which drives down legitimate sales |
| | Encouraging innovation ⁴¹ | Reduces or eliminates innovation, by making it almost impossible to differentiate products and brands |
| | Widening consumer choice ^{39; 42} | Reduces consumer choice, by making it almost impossible to differentiate products and brands |
| | Increasing competition ^{39; 42} | Reduces consumer choice, by making it almost impossible to differentiate products and brands |
| Reducing the deficit | Removing unjustified and unnecessary regulation ^{7, 43} | Adds further unjustified and unnecessary regulation with no evidence of success |
| Protecting society | Protecting government revenues and reducing the tax gap ⁴⁴ | Increases the illicit trade, thereby reducing Government revenue and increasing the tax gap |
| Empowering individuals | Reducing organised crime ⁴⁵ | Creates a counterfeiter's charter, potentially leading to more organised crime and criminal activity |
| | Giving people more freedom and control over their own lives ⁴⁶ | Stigmatises and bullies adults who choose to purchase tobacco products and smoke |

³⁷ Oral evidence taken before the Health Committee, 12 June 2012; DH written memorandum, 15 June 2012

³⁸ Government Response to the Hargreaves Review of Intellectual Property and Growth

³⁹ HM Treasury / BIS Plan for Growth, March 2011

⁴⁰ Ibid. Plus: *The Red Tape Challenge: speech to the Federation of Small Businesses Annual Conference in Scarborough* by Vince Cable, 23 March 2012; *speech to the Federation of Small Business Conference in Liverpool* by Mark Prisk, 18 March 2011

⁴¹ BIS Innovation and Research strategy for growth

⁴² Government Response to Consultation: Growth, Competition and the Competition Regime, March 2012

⁴³ *The Red Tape Challenge: letter from the Prime Minister to Government Ministers on cutting red tape*, 7 April 2011

⁴⁴ HM Treasury press release: £900 million to tackle non compliance in the tax system, 20 September 2010

⁴⁵ 'Local to global: reducing the risk from organised crime', Home Office, 28 July 2011

⁴⁶ *The Coalition: Our programme for Government*, May 2010

8.3 Bullying adults who make the choice to smoke

The Government's actions do not match their words:

"...there has been the assumption that central Government can only change people's behaviour through rules and regulations. Our Government will be a much smarter one, shunning the bureaucratic levers of the past..."

David Cameron & Nick Clegg, foreword to the Coalition Programme for Government, May 2010

"I joined this party because I believe in freedom."

David Cameron, Conservative Party Conference, October 2005

"The era of big, bossy, state interference, top-down lever pulling is coming to an end."

David Cameron, June 2008

"For too long new laws and regulations have taken away people's freedoms, interfered in everyday life, and made it difficult for businesses to get by. The state has crept further and further into people's homes, the places they work, their private lives. That intrusion is wrong; it's illiberal; it's disempowering and it's going to change."

Nick Clegg, speech on Freedom in the UK, July 2010

Standardised packaging is another attempt to stigmatise and bully adults who choose to purchase tobacco products and extend the influence of the State into their private lives and individual choices. The Secretary of State for Health has recently said that:

"There is no responsible level of tobacco consumption" and that he wants tobacco companies to have "no business in the UK".

By implication, the Secretary of State for Health is saying that adults who choose to smoke are irresponsible. This is difficult for us to understand and is an extremely surprising position for any Government to be adopting. Tobacco is a legal product, enjoyed by around 10 million adults in the UK. This equates to around 20 per cent of the adult population and is not an insignificant minority. These adults make an informed choice to smoke; they smoke for many and varied reasons and despite the continual stream of unreasonable and disproportionate tobacco control regulations imposed upon them (as outlined in section 7) and propaganda to the contrary they do not wish to give up.

The Government continually seeks to interfere in smokers' lives and often pursues regulatory proposals for tobacco that are not supported by any credible evidence, such as standardised packaging. It is a bullying attitude and we object to smokers being treated in this way.

And the evidence suggests it won't stop at tobacco products either. It is clear that the tobacco control template is being explored for other lifestyle choices,⁴⁷ despite claims from tobacco control lobbyists to the contrary.⁴⁸

It should not be the role of Government to bully adults who decide to pursue a legal activity on the basis of informed choice.

Standardised packaging of tobacco products is a dangerous precedent and presents a "slippery slope" for other businesses and sectors.

Evidence suggests that the tobacco control template is being already being explored by public health advocates for other lifestyle choices including alcohol.

9. Conclusion

The consultation is seriously deficient in a number of important respects. It has failed to make a convincing case, supported by credible evidence, for the introduction of any form of standardised packaging, including failing to understand the reasons why people smoke. In addition it fails to consider the legal implications of such an approach and the unintended consequences of introducing such a proposal. The concept of standardised packaging should therefore be rejected.

⁴⁷ UK Centre for Tobacco Control Studies Annual Report, March 2012 (pages 4; 14)

⁴⁸ Smokefree Action Coalition Briefing, December 2011

Appendix A - Imperial Tobacco's answers to the consultation document questions

1. Which option do you favour?

Imperial Tobacco favours the first option: to do nothing about tobacco packaging (i.e., maintain the status quo for tobacco packaging).

In outline:

- **There is no credible or reliable evidence** demonstrating that standardised packaging would achieve the Government's stated objectives of reducing smoking prevalence among young people or assisting smokers who have, or are trying to, quit. (Please see section 3.3, page 11 above and Appendix C, page 78 below).
- The authors of the Systematic Review - despite being well-known tobacco control advocates and in many cases reviewing their own work - do not show that standardised packaging would meet the Government's stated objectives. The Systematic Review provides no evidential basis for standardised packaging. (Please see section 3, page 10 above and our response to question 14, page 64 below).
- In fact, the reasons why young people start smoking are well documented and have nothing to do with packaging or branding. The main factors in youth smoking initiation are:
 - rebelliousness;
 - risk taking;
 - family structure;
 - peer pressure;
 - socio-economic status; and
 - educational success.

Appendix C provides more detail.

- Likewise, packaging and branding do not influence the decision of existing smokers to quit, or to relapse after they have tried to quit. The reasons adults cite for smoking again after a cessation are, in order of importance:
 - as a coping mechanism for stress;

- because they enjoy smoking;
 - because their friends smoke; and
 - because they missed the habitual aspects of smoking.¹⁵
- **Standardised packaging would boost illicit trade.** Organised criminals already cost approximately £3 billion per annum to the UK taxpayer. (Please see our response to question 9, page 58 below).
 - **Standardised packaging would breach national, EU and international laws.** (Please see our response to question 6, page 46 below).
 - The introduction of standardised packaging makes no sense in the existing regulatory context. The Government has introduced a number of far reaching tobacco control measures, the last of which - the display of tobacco products in retail outlets - will not fully come into force until 2015. The Government needs to undertake a comprehensive and considered analysis of the effect of the existing regulatory framework before it considers standardised packaging. (Please see section 2.3, page 8 above and our response to question 3, page 34 below).
 - **Standardised packaging would have significant detrimental effects on trade, competition and innovation in the market.** (Please see our response to question 5, page 38 below).
 - **The consultation process is fundamentally flawed.** There is a very real concern that the Government is paying lip-service to this consultation and that it is determined to introduce standardised packaging as part of an attack on tobacco companies and their manufacture, including in the UK, of a lawful product. The consultation asks respondents to disclose whether they have any direct or indirect links to, or receive funding from, the tobacco industry. Yet it is well known that many organisations and charities that actively pursue a tobacco control agenda and receive funding from the Government (or provide funding to individuals and organisations as part of their activities) are not required to disclose any vested interests. The Government should conduct a root-and-branch review of how it continues to fund such lobbyists if the public are to have any faith in the political process.

- **Standardised packaging would be contrary to a number of the Government's stated priorities and policies**, as well as the principles of regulation which the Government has committed to,² which include regulating only:
 - after it has demonstrated satisfactory outcomes cannot be achieved by alternative, self-regulatory, or non-regulatory approaches;
 - where analysis of the costs and benefits demonstrates that the regulatory approach is superior by a clear margin to alternative, self-regulatory or non-regulatory approaches; and
 - where the regulation and the enforcement framework can be implemented in a fashion which is demonstrably proportionate, accountable, consistent; transparent and targeted.

(Please see our response to question 11, page 63 below).

2. If standardised tobacco packaging were to be introduced, would you agree with the approach set out in paragraphs 4.6 and 4.7 of the consultation?

Imperial Tobacco does not believe that standardised packaging should be introduced at all for the reasons explained in this submission and summarised in the response to question 1 above.

There is no credible evidence to indicate that people take up smoking or continue to smoke because of tobacco packaging (please see section 3.3, page 11 above). The data relied on by the Government is the product of selective and questionable research methods and, even at its highest, does not present the clear and compelling evidence base that would be required to justify the introduction of standardised packaging (see our response to question 14, page 64 below). Proponents of standardised packaging ignore the substantial body of research which runs contrary to their objective and the significant detrimental consequences that would follow the introduction of standardised packaging.

Imperial Tobacco does not, therefore, agree with the approach set out in paragraphs 4.6 and 4.7 of the Consultation.

3. Do you believe that standardised tobacco packaging would contribute to improving public health over and above existing tobacco control measures, by one or more of the following: discouraging young people from taking up smoking; encouraging people to give up smoking; discouraging people who have quit or are trying to quit smoking from relapsing; and/or reducing people's exposure to smoke from tobacco products?

No.

The starting point in considering this question must be to undertake a proper assessment of the "*existing tobacco control measures*" and of their effect. The Impact Assessment accompanying the consultation states that standardised packaging must be based on benefits "*over and above existing tobacco control measures*".

Against a long-term trend of declining smoking prevalence, the Government has introduced:

- the ban on advertising;
- one of the most punitive tobacco tax regimes in the world;
- the ban on smoking in public places;
- the use of pictorial health warnings;
- the ban on tobacco vending machines; and, most recently
- the ban on the display of tobacco at the point of sale (despite the Coalition parties having opposed it in Opposition on the grounds of a lack of evidence, which hasn't changed⁷). The ban on the display of tobacco products will not come into force for small stores until April 2015.

The common denominator in all of these regulatory measures is that they do not address the reasons why people start or continue to smoke. This consultation is no different. It ignores all of the well-established research on the main reasons for smoking initiation by young people and the factors that influence quitters, and completely fails to provide any analysis of how standardised packaging would address those reasons.

It is incumbent on the Government to undertake a rigorous and comprehensive assessment of the impact of "*the existing tobacco control measures*" and to assess the introduction of standardised packaging in that context. However, the existing tobacco control measures have not been properly evaluated - either in the consultation or otherwise

- for their effectiveness or for delivering the outcomes or benefits that were expected or promised.

Furthermore:

- none of the tobacco control Impact Assessments make any reference to the success (or otherwise) of previous policies; presumably because the required analysis has not been undertaken or such evidence does not exist.
- previous Impact Assessments (e.g. Smokefree Aspects of the Health Bill⁴⁹) have attempted to set out clear measures of success, but these have not been met.
- in relation to the introduction of pictorial health warnings, the Impact Assessment gave an open-ended time frame for its impact. Given that this was a major health advertising campaign, a startling result would have been expected and a clear time frame for the impact should have been defined. Advertising agencies are familiar with such expectations. A study undertaken seven to nine months after the introduction of picture health warnings concluded that:

"...there were very few smoking-related behaviour changes observed after the pictures were introduced, despite high levels of awareness of such warnings."⁵⁰

As there is no evidence of their efficacy so far, it is difficult to demonstrate how an increase in the effectiveness of such warnings would be identified if branding were to be banned;

- the vending machine Impact Assessment states that:
"17% of regular smokers aged 11 to 15 report that cigarette vending machines are their usual source of tobacco".⁵¹
Further on in the Impact Assessment the figure changed to 7.5%. In any event, Government policy has had little impact on the average number of cigarettes smoked by eleven to fifteen year olds. The mean average of cigarettes consumed per day is similar to 2003 levels;¹²
- the standardised packaging Impact Assessment sets out a retrospective definition of a measureable objective for the display ban: "The full effect of the ending of tobacco displays is projected to be a fall in smoking prevalence among 11-15 year-olds from

⁴⁹ Partial regulatory impact assessment - smokefree aspects of the Health Bill, May 2010

⁵⁰ Evaluating the impact of Picture Health Warnings on Cigarette Packets, PIIRC Short Report 12, June 2010

⁵¹ Impact Assessment for the prohibition on the sale of tobacco from vending machines, May 2012

5% to 4.2%".¹² This figure does not appear in the display ban Impact Assessment; and

- the ban on the display of tobacco products will not come into force for small stores until April 2015. It is extraordinary that the Government is apparently seriously considering the introduction of standardised packaging before this measure has been fully implemented, let alone before a proper assessment of the impact of this measure has been undertaken.

In summary, there is no analysis of the success or effectiveness of prior policies, and proper post-implementation reviews of existing tobacco regulation has not been undertaken.

The premise of this question is therefore flawed: there has not been any proper evaluation of the existing tobacco control measures, and it is therefore impossible to assess whether any further tobacco control measure would have an appreciable effect on improving public health over and above existing measures.

Contribution to improving public health?

There is no evidence whatsoever that standardised packaging will contribute to improving public health or will affect smoking behaviour at all. By depressing prices and effectively promoting the non-UK duty-paid tobacco trade (with tobacco prices being lower in many other countries and illicit tobacco sold at lower prices than UK duty-paid products), there is a real risk of consumption increasing. The consultation ignores the established research as to the reasons why people smoke and continue smoking, which do not include packaging and branding (see section 3.3 above, page 11 and Appendix C, page 78 below for more information).

The evidence base that the Government puts forward is also seriously flawed and/or incomplete (see our response to question 14, page 64 below).

4. Do you believe that standardised packaging of tobacco products has the potential to reduce the appeal of tobacco products to consumers; increase effectiveness of health warnings; reduce the ability of tobacco packaging to mislead consumers about the harmful effects of smoking; and affect the tobacco-related attitudes, beliefs, intentions and behaviours of children and young people?

No.

There is no evidence that demonstrates that standardised packaging would achieve any or all of these aims (which differ from the stated policy objectives). The Systematic Review and Impact Assessment do not show that smoking behaviour and consumption would change as a result of the introduction of standardised packaging; still less does it provide a sufficient evidence base to justify such a draconian policy (see our response to question 14, page 64 below).

While there is research to show that awareness of health warnings is already high,⁵⁰ research and prevalence statistics suggest that the *effectiveness* of health warnings is highly questionable.^{52: 53} There is no evidence to suggest that standardised packaging would make any difference to either the awareness or effectiveness of health warnings on the *behaviour* of consumers.

The latest Eurobarometer on "*Attitudes of Europeans towards Tobacco*"⁵⁴ also shows that the vast majority of UK consumers - 99 per cent and 96 per cent respectively - do not consider the shape or colour of the pack to indicate levels of harm.

Even research in the Systematic Review suggests that tobacco packaging does not mislead smokers about health risks. Hammond's 2009 UK study, "*Cigarette pack design and perceptions of risk among UK adults and youth*",⁵⁵ found that most subjects, both adults and youth, found no difference between plain (standardised) and branded packs in terms of health risks.

Research by Cancer Research UK,⁵⁶ contrary to supporting a case for standardised packaging, shows that among the 15 year olds they surveyed:

"there was little awareness of different styles of tobacco packaging apart from the key brand";

"participants were seeing most of the packs used in the focus groups for the first time";

"the pack appeared peripheral compared with the cigarette in youth smoking"; and participants gave no indication they suspected the plain pack that was eventually shown to them as "anything but a genuine pack."

⁵⁰ P. Basham and J. Luik, 'Health Warnings on Consumer Products: Why Scarier Is Not Better', January 2012

⁵³ The emotional impact of European tobacco-warning images, December 2011

⁵⁴ Attitudes of Europeans Towards Tobacco, May 2012

⁵⁵ 'Cigarette pack design and perceptions of risk among UK adults and youth', December 2009

⁵⁶ The packaging of tobacco products, Cancer Research UK, March 2012

All of which serves to illustrate how packaging and branding are not important elements in young people's decisions to smoke.

5. Do you believe that requiring standardised tobacco packaging would have trade or competition implications?

Yes.

The crucial importance of considering the impact of standardised packaging on trade and competition

An obvious starting point would be to ask why this issue, which is largely unaddressed in the Impact Assessment, is relevant to the broader policy issues raised in the Consultation. The answer to this question is two-fold.

First, the Impact Assessment acknowledges that for the policy "*...to be justified the impact on smoking behaviour and consequent improvement in health needs to be sufficiently large to justify the related costs*" (page 3). However, there is no such cost-benefit analysis, which would require a full assessment of the likely costs, including the adverse effects on manufacturer and retailer competition and those associated with an increase in legal and illicit trade.

Second, turning to the hypothetical benefits, standardised packaging is a market-wide measure aimed at reducing tobacco use, with the Government identifying the importance of reducing tobacco use by young people and that smoking prevalence is greater amongst poorer socio-economic groups (page 1). Market measures have to be assessed by reference to their impact on competition and trade. However, the Consultation and Impact Assessment do not consider how the introduction of standardised packaging is likely to reduce the value and importance of brands to consumers, nor do they consider properly how the consequential commoditisation of the tobacco market is likely to depress wholesale and retail tobacco prices and increase legal and illicit trade.

Imperial Tobacco's response to this question is divided into four parts:

Part A outlines some of the key features of the UK tobacco market, which is necessary to provide a market context to assess the wide ranging market-wide impacts and to inform the necessary cost-benefit analysis;

Part B assesses how the consequential commoditisation of the tobacco market and increase in trade are likely to depress wholesale and retail tobacco prices;

Part C considers the adverse effects of standardised packaging on competition and those associated with an increase in legal and illicit trade; and

Part D sets out Imperial Tobacco's conclusions.

Part A - The key features of the UK tobacco market

There are a number of key features of the UK tobacco market which are relevant to the assessment of the competitive and trade effects of standardised packaging:

- whilst tobacco duties are very high in the UK - for example, they account some 78 per cent of the average recommended retail price ("RRP") of a packet of 20 cigarettes - there is a substantial degree of variation in prices between tobacco products. This price variation is attributable to a combination of:
 - price and non-price (brand and innovation) competition between manufacturers; and
 - different retailers having different business models, with some retailers competing on price (particularly the large grocery retailers) and some competing more on the basis of convenience (particularly smaller convenience retailers);
- considering competition between manufacturers first, a striking feature of the tobacco market is that consumers are offered a wide, competitive choice of brands, ranging from premium brands to economy brands, thereby meeting consumers' diverse preferences. For example, large grocery retailers currently sell their cheapest packet of 20 cigarettes for around £5.45 and their most expensive packet for around £7.75 (over £2 more). The relative price differences between low priced and premium brands would be even greater if tobacco duties were disregarded;
- apart from offering consumers' choice, branding also strengthens manufacturers' incentives to innovate - both by the provision of new products with distinctive characteristics and developments to existing products - because the benefits of innovation by a brand owner will be reaped by that brand owner;
- there is a substantial convenience element to tobacco retailing. In contrast to a wide range of other products, the large grocery retailers account for only around 30

per cent of the total volume of UK duty paid cigarette sales.⁵⁷ This is despite the fact that many convenience retailers sell tobacco products at prices above RRP's and the large grocery retailers sell tobacco products at prices below RRP's;

- tobacco products make a significant contribution to the profitability of many smaller retailers at a time when they are under intense competitive pressure due to the growth of the large grocery retailers;
- however, the large grocery retailers have been recognised as possessing substantial buyer power (hence the Groceries Supply Code of Practice) and this has been a factor leading to the large grocery retailers winning market share from smaller retailers; and
- reflecting the high level of taxation, the UK government derives over £12 billion in tax revenues from consumers' purchases of UK duty paid tobacco products. However, high taxes also render viable substantial illicit and cross-border trade in tobacco products, with HM Revenue and Customs estimating that 17 per cent and 53 per cent of cigarettes and hand-rolling tobacco consumption in the UK respectively is not UK duty paid.¹⁶

Part B - Impact of standardised packaging on wholesale and retail prices

This section will address the impact of standardised packaging on competition and trade in the tobacco market. The principle effect of the introduction of standardised packaging is likely to be to depress the wholesale and retail prices of tobacco brands, particularly those of premium brands:²³

- standardised packaging will remove the ability for manufacturers to differentiate their brands. This will lead to increased competition on price and the prices of premium products converging towards those of economy brands;
- standardised packaging can also be expected to lower pre-tax wholesale and retail prices due to its impact on competition in retailing and manufacturer-retailer bargaining because:
 - retailers achieve higher profit margins on premium brands;
 - the buyer power of the large grocery retailers will increase due to a reduction in consumer demand for, and loyalty to, specific brands. This will

⁵⁷ ITUK estimates based on customer EPOS data y/e 2010/2011

- increase the ability of large grocery retailers to secure lower wholesale prices in return for stocking manufacturers' products; and
- consumers are likely, with the loss of brand loyalty, to respond to widening differences in the retail prices of the large grocery retailers and convenience retailers by switching to purchasing from the large grocery retailers. This trend will be increased by the possible closure of smaller retailers due to the decline in their profitability from lost sales of tobacco products; and
- standardised packaging can be expected to increase consumers' ability and incentives to purchase legitimate non-UK duty paid and illicit tobacco products, which are substantially cheaper than UK duty paid products. Standardised packaging will make it easier for illicit suppliers to copy packaging (covert markings are irrelevant to illicit products which are not sold legally in shops), and consumers will no longer be able to buy clearly branded duty paid products in the UK. This will increase competition with legitimate retail and wholesale prices and further increase the buyer power and price advantages enjoyed by the large grocery retailers.

The consultation does not consider in any meaningful way how these effects will affect tobacco consumption patterns. For example, it does not consider whether, if standardised packaging is introduced:

- the market-wide changes outlined below could result in the higher consumption of tobacco by smoking adults; and
- lower priced tobacco products would be more affordable for young or poorer consumers.

The Impact Assessment appears to recognise this difficulty (paragraph 67) but does not reach any conclusion.

The Government has indicated that it would use the tax system to counter any reduction in prices in the market. However, there are two difficulties with using the tax system in this way.

First, the large price differences which currently exist in the UK market between premium and economy brands and between large grocery retailers and convenience retailers have nothing to do with the tax system. They are the product of manufacturer brand competition and retailers competing differently on price and convenience. Changes to tax rates cannot address these market factors. The Government cannot increase taxes in a differential way to increase the price of those brands which have

ceased to command a premium due to the introduction of standardised packaging and whose price has fallen further than other brands. Nor can the Government increase tobacco taxes purely for the large grocery retailers. All the Government can do is increase already high taxes across the board, disproportionately raising the prices of the cheapest products.

Second, high taxation is already a key factor driving the illicit market, and taxation increases coupled with standardised packaging are likely to increase the size of the illicit market. Experience in other jurisdictions (such as the Republic of Ireland) have shown that high taxes on tobacco does not reduce consumption and instead lead to the unintended consequence of an increase in cross-border and illicit trade. For example, a February 2011 report on the "*Economics of Tobacco, Modelling the Market for Cigarettes in Ireland*" by Padraic Reidy and Keith Walsh of the Republic of Ireland Revenue Commissioners found that the demand for duty paid cigarettes in the Republic of Ireland had become highly price-sensitive,⁵⁰ probably due to consumers switching to non-duty paid cigarettes:

"The most likely substitutes in the case of taxed cigarettes are non-Irish taxed cigarettes (i.e. purchased legally outside Ireland and brought into the country) or untaxed cigarettes (produced in or smuggled into Ireland and purchased illegally).

It is recognised that the consumption of untaxed cigarettes has become an increasingly important issue. Revenue estimates that currently around 20 per cent of cigarettes consumed in Ireland are not Irish taxed and this figure has been increasing in recent years. It is driven by several factors but the main cause is the price differential between cigarettes on the Irish market and elsewhere.

Given the current high cigarette price level in Ireland, the incentive for substitution to untaxed tobacco is greater in Ireland than it otherwise would be. This probably explains the high price elasticity estimate - higher prices will likely increase untaxed consumption."

Part C - The adverse effects of standardised packaging on competition and trade in tobacco markets

The extremity of the measures contemplated and the value of competition

⁵⁰ The report found that: "*The consumption variable in this study is the consumption of taxed cigarettes. So the price elasticity estimated refers to taxed cigarettes: a 1 per cent increase in price leads to a 3.6 decrease in consumption of taxed cigarettes. The most reasonable theory to explain such a large decrease in taxed consumption is that only part of the reduction is caused by lower smoking levels, the remainder must be caused by smokers switching to substitute cigarettes.*"

Standardised packaging can be expected to have substantial adverse effects on competition in the UK tobacco market. However, before addressing these points, it is appropriate to have regard to the extremity of the measures contemplated and the value of competition.

The Government is contemplating introducing a measure which does not currently apply to any other legal, consumer goods sold in the UK or anywhere else throughout the world. All other consumer goods are branded, with brands owned either by retailers or manufacturers.

Standardised packaging is being considered in the context of a market where competition and trade are already distorted by a vast array of measures, including restrictions covering all aspects of display, promotion, advertising, and access to products, as well as very high taxes, with many of these measures being introduced or tightened very substantially in recent years.

This measure is also wholly contrary to general Government policy which is to promote competition, including through reforming competition law to promote enterprise and fair markets, with this being a priority emphasised in the 2012 Queen's Speech. It is against this background that the anti-competitive effects of standardised packaging should be judged.

A reduction in non-price competition and harm to consumer choice

As identified in Part B above, standardised packaging can be expected to reduce, if not eliminate, non-price competition on brands between tobacco manufacturers since packaging is now virtually the only way in which manufacturers can differentiate their brands. In turn this will lead to even greater price competition, lower prices and convergence in the prices of premium and economy or value products.

Because packaging is an essential means of facilitating brand switching by existing adult smokers, the introduction of standardised packaging is likely to lead to market ossification (and brand consolidation) as tobacco companies will have no means of encouraging consumers to change brands and/or consumers will find it too difficult to identify alternative brands.

Price competition - not a benefit

The Impact Assessment identifies "*an additional benefit is the possible enhancement of price competition between tobacco companies*" (page 3). As explained above, increased price competition will not bring benefits to the tobacco market. Imperial Tobacco does not

understand how the destruction of brand value and choice can be categorised as "economic benefits" (page 3). This is particularly in circumstances where consumers already have the option of purchasing lower priced tobacco products and there is a general trend of consumers trading down to lower priced brands due to very high taxes. The likely effect is lower prices and more smoking.

Adverse impact on innovation

The Impact Assessment suggests that manufacturers may respond to standardised packaging through product innovation and that product innovation "may enable companies to recover some of the brand equity lost with standardised packs" (paragraph 70). This is extremely difficult to understand.

As noted above, the impetus for product innovation exists in a competitive market where a manufacturer has the ability to communicate the distinct characteristics of their product to adult consumers and to benefit from innovation. However, standardised packaging will remove this ability and with it the impetus for product innovation.

To put the point more simply: even assuming that there are viable opportunities for innovation in a standardised packaging environment (and the opportunities put forward by the Government are not viable for the reasons set out below), there would be no mechanism for ITUK to draw any such innovation to the attention of consumers.

One suggestion for innovation made in the Impact Assessment is to vary the appearance of the cigarettes themselves. It is not at all clear what the Government has in mind and it is therefore difficult for ITUK to address this proposal. However, the Consultation assumes that no branding will be permitted on individual tobacco products themselves. This hypothetical innovation may well be prohibited by any legislation that is introduced.

It is also absurd to suggest that legislation that introduced standardised packaging would permit innovation in terms of including adhesive inserts to stick on packs which allowed consumers to cover up health warnings (paragraph 71).

Variation in pack size is also a feature of the existing market. Imperial Tobacco cannot see, and the consultation does not explain, how there is any opportunity for innovation in this respect, especially in circumstances where tobacco companies will have no means of closely associating any innovation with their brands.

Impact on retailers and retail prices

As explained in Part B, standardised packaging will adversely affect retailers' margins, because retailers' margins are materially higher on premium, higher priced brands than low priced brands.

These effects will be particularly severe for small retailers who are already facing survival issues given the increasing competitive strength of the large grocery retailers. Standardised packaging is likely to increase the buyer power of the large grocery retailers by reducing the consumer demand for them to stock a wide range of tobacco brands, thereby increasing their ability to de-list brands unless manufacturers lower their wholesale prices.

In such circumstances, standardised packaging can be expected to increase the proportion of tobacco sold by the large grocery retailers, with this depressing retail prices as the large grocery retailers sell tobacco products at substantially lower prices than small, convenience retailers.

As regards the harm to smaller retailers, the Impact Assessment fails to consider this issue, but refers vaguely to transition costs (paragraph 80); Imperial Tobacco has no idea what alternative products smaller retailers could sell instead which they do not already offer. The closure of small local retailers is a serious public policy issue, particularly in rural areas and for poorer households lacking access to a car.

Impact on illicit trade and cross-border shopping

The Impact Assessment acknowledges that:

"standardised packs may provide an additional possibly powerful incentive to cross-border shopping" (paragraph 76); but

"that any greater ease of copying standardised packaging would need to be balanced against the fact that illicit trade may become less profitable if the price of premium brands falls as a result of standardised packaging (paragraph 78). However, the point about pricing must be judged against the background that over 90% of the price of the lowest priced cigarettes sold by the large grocery retailers is accounted for by duty and VAT; this will always create opportunities for illicit trade."

Imperial Tobacco's response to question 9 of Appendix A covers illicit trade in more detail. However, it is striking that bar the above brief reference to incentives to increase cross-border shopping, there is no consideration of the role of consumers' preferences for UK brands in limiting both illicit trade and legitimate cross-border shopping. The risks of cross-border and illicit trade rising are substantially increased by these proposals since a

significant element of consumers' reluctance to purchase substantially cheaper non-UK duty paid products is because they attach value to purchasing clearly branded UK tobacco products. Standardised packaging is precisely aimed at denying consumers the ability to purchase clearly branded products.

Part D - Conclusions

In Imperial Tobacco's view, it is difficult to envisage how the introduction of such a draconian measure could be:

- reasonable, having regard to a full consideration of the costs of standardised packaging, including its anti-competitive effects on manufacturers and retailers and its effects of sponsoring cross-border and illicit trade (including the loss of tax revenues);
- proportionate, having regard to whether there are less costly ways of realising the identified policy objectives. The Consultation does not address this issue at all, and ignores, for example, alternative ways of limiting the access of young smokers to tobacco, such as rendering proxy purchasing illegal or the further development of age-related ID cards schemes; and
- effective, in terms of achieving the stated objectives of reducing tobacco consumption, particularly by the young and poor socio-economic groups. It is quite clear that the evidence for any public health benefits can at best be described as very limited, with there being no consideration of whether these benefits will be appreciable in the context of all the other anti-tobacco measures which have been introduced recently (for example, the requirement for products to not be displayed by retailers which further reduces the visibility of brands). In particular, Imperial Tobacco would question whether the hypothetical benefits of this market-wide measure are likely to be realised given the anti-competitive effects of depressing wholesale and prices and sponsoring cross-border and illicit trade. It seems likely that increasing the scale of illicit trade will only increase the access of the young to tobacco products on a wholly unrestricted basis.

6. Do you believe that requiring standardised tobacco packaging would have legal implications?

Yes. The attempt to introduce standardised tobacco packaging would be unlawful and would, therefore, certainly "*have legal implications*".

In particular, standardised tobacco packaging would be contrary to:

- the right to property;
- the right to the free movement of goods;
- the right to conduct a business; and
- the right to freedom of speech.

Each of the above rights is variously subject to protection under national, European and international law. While Imperial Tobacco acknowledges that these rights are not absolute, the Government has not shown, and will not be able to show, that standardised packaging is a justified interference with these rights.

Consequently, requiring standardised tobacco packaging would put the Government in breach of its legal obligations and will result in legal action on a domestic and European level, as well as exposing the Government to a compensation bill. Imperial Tobacco will certainly take all necessary steps to protect its intellectual property, in which it has invested billions of pounds, and fundamental rights. The Government may also face enforcement action at an international level.⁵⁹

The Right to Property

The right of the owner of any product that is lawfully manufactured and sold to acquire, own and exploit intellectual property connected to that product is enshrined in law. In particular, it is recognised that trade marks enable a manufacturer to impart information to customers about the product and, beyond that, to distinguish their product from those of their competitors by communicating the qualities and essential characteristics of their product.⁶⁰

That channel of communication is made more important by the existing regime of controls on tobacco advertising and the introduction of a ban on the display of tobacco products at point of sale in almost all retail outlets in England.⁶¹ As a result, Imperial Tobacco's use of intellectual property on packaging constitutes the last significant means by which Imperial Tobacco can communicate with adult smokers and attempt to differentiate its products from those of its competitors on grounds other than price.

The importance of trade marks to tobacco manufacturers has already been recognised by the Court of Justice of the European Union ("CJEU") when considering a challenge to the

⁵⁹ Ukraine, Honduras and the Dominican Republic have already taken steps to initiate the World Trade Organisation dispute resolution process against Australia, the first country to attempt to introduce standardised packaging.

⁶⁰ Among other relevant cases, see Case 487/07 L'Oreal SA v Bellure NV.

⁶¹ Imperial Tobacco understands that it is also proposed to introduce display bans in Scotland, Wales and Northern Ireland.

European Tobacco Products Directive (Directive 2001/37/EC). It was a key aspect of the Court's finding that the effect of the Directive was to restrict the available space on the cigarette packs and that tobacco manufacturers could continue to use their trade marks. Thus, the Court held that *"the restrictions on the trade mark right ... do not constitute a disproportionate and intolerable interference, impairing the very substance of that right"*. In contrast, standardised packaging would completely restrict the use of the trade mark for its intended purpose: to inform and communicate with adult customers, thus impairing *"the very substance of the right"*.⁶²

The status of Imperial Tobacco's intellectual property under domestic and European law

Under European law, a comprehensive and harmonised regime has been established for the protection of intellectual property rights at a national and Community wide level.⁶³ That regime would be completely undermined by the attempted introduction of standardised packaging because it would establish a different regime in the UK for trade marks that apply to tobacco products in comparison to other products, and a different regime in the UK in comparison to other Member States.

Imperial Tobacco holds a number of non-word trade marks which it will be unable to use in any meaningful, consumer-facing way as a result of the introduction of standardised packaging. Not only would the proposed standardised packaging requirement deprive Imperial Tobacco of the substance of these intellectual property rights, they are also likely to be lost as a matter of form. This is because it is an essential pre-requisite that a registered trade mark be put to *"genuine use"*:

*"It follows from that concept of 'genuine use' that the protection that the mark confers and the consequences of registering it in terms of enforceability vis-à-vis third parties cannot continue to operate if the mark loses its commercial raison d'être which is to create or preserve an outlet for the goods or services that bear the sign of which it is composed, as distinct from the goods or services of other undertakings."*⁶⁴

Indeed, the requirement that a trade mark be put to use is a fundamental feature of UK trade mark law. The proposed standardised packaging requirement would deprive the relevant non-word marks of their commercial *raison d'être* and leave them vulnerable to revocation for non-use.

⁶² Case C-491/01 *The Queen and Secretary of State for Health, ex parte British American Tobacco (Investments) Ltd and Imperial Tobacco Ltd supported by Japan Tobacco Inc. and JT International SA* [2002] ECR I-11453, paras 149-153.

⁶³ Directive 2008/95/EC approximating the laws of the Member States relating to trade marks and Council regulation No 207/2009 on the Community Trade Mark.

⁶⁴ *Silberquell GmbH v Maselli-Strickmode GmbH* [2009] ETMR 28.

The protection of Imperial Tobacco's intellectual property under ECHR and EU law

As a matter of substance, the proposed standardised packaging requirement would breach the European Convention on Human Rights ("ECHR")⁶⁵ and the Charter of Fundamental Rights of the European Union (the "Charter").

Article 1 of the First Protocol ECHR ("A1P1") provides that:

"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

A1P1 comprises three distinct rules. The first rule, which is of a general nature, states the principle of peaceful enjoyment of property. The second rule covers the deprivation of possessions and subjects it to certain conditions. The third rule recognises that States are entitled, among other things, to control the use of property in the general interest.⁶⁶

Intellectual property such as trade marks are "*possessions*" within the meaning of A1P1.⁶⁷

Since the ECHR guarantees rights which are "*practical and effective*",⁶⁸ it is necessary to consider the substance of the action that is taken, and its effects, when determining whether there has been a deprivation of possessions falling within the second rule in A1P1.⁶⁹

As noted above, as a result of existing tobacco control mechanisms, the last remaining opportunity for Imperial Tobacco to use its trade marks in any meaningful way is on its packs. The proposed standardised packaging requirement directly and wholly prevents Imperial Tobacco from using its relevant intellectual property in this way:

"No branding, advertising or promotion [is] to be permitted on the outside or inside of packs, or attached to the package, or on individual tobacco products themselves. For this purpose, 'branding' includes logos, colours or other features associated with a tobacco brand."

⁶⁵ *Sporrong and Lönnroth v Sweden* (1982) 5 EHRR 35; *R (Nicholds & Ore) v Security Industry Authority* [2006] EWHC 1792 (Admin); *James v UK* (1988) 8 EHRR 123; *Allard v Sweden* (2004) 39 EHRR 14; and *Hontrich v France* (1994) 18 EHRR 440.

⁶⁶ *Sporrong and Lönnroth v Sweden* (1982) 5 EHRR 35, at para. 61.

⁶⁷ *Anheuser-Busch Inc v Portugal* (2007) 44 EHRR 42 (Ch), para. 43 (2007) 45 EHRR 36 (Grand Chamber) para. 78.

⁶⁸ *Alroy v Ireland* (1979) 2 EHRR 305.

⁶⁹ *Păduraru v Romania* (2012) 54 EHRR 18 para. 74.

This amounts to a clear deprivation of the property itself.

In any event, an interference with the peaceful enjoyment of possessions must strike a "fair balance" between the demands of the public or general interest of the community and the requirements of the protection of the individual's fundamental rights. In particular, there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure depriving a person of his possessions or controlling their use.⁷⁰ Compensation terms under the relevant legislation are material to the assessment of whether the contested measure respects the requisite fair balance, and, in particular, whether it imposes a disproportionate burden on the applicant.⁷¹ A deprivation of possessions without payment of an amount reasonably related to their value cannot be justified under A1P1.⁷²

In terms very similar to those in A1P1, Article 17(1) of the Charter provides that:

"Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law in so far as is necessary for the general interest."

Article 17(2) specifically provides for the protection of intellectual property and the Explanations to the Charter note that this reflects "... its growing importance and Community secondary legislation. Intellectual property covers ... patent and trade mark rights and associated rights".

Since 1 December 2009, the Charter has "the same legal values as the Treaties" (Article 6(2) Treaty on the Functioning of the European Union). The CJEU has, in applying Article 17 of the Charter, adopted an approach similar to that of the European Court of Human Rights in relation to A1P1.⁷³

The protection of Imperial Tobacco's intellectual property under international law

The introduction of standardised packaging would also amount to a breach of the Government's international treaty obligations under:

- the Agreement on Trade Related Aspects of Intellectual Property ("TRIPs"); and

⁷⁰ *Gladysheva v RuFormer King of Greece v Greece* [2012] HLR 19, para. 66.

⁷¹ (2001) 33 E.H.R.R. 21 at para. 89.

⁷² *Gladysheva v Russia* [2012] HLR 19, para. 67, *Papachelas v Greece* (2000) 30 EHRR 923 at para. 48 and *R(SRM Global Master Fund LP) v Treasury Commissioner* [2009] EWCA Civ 788 at para. 73.

⁷³ *Case C-360/10 SABAM v Netylog NV* (judgment dated 16 February 2012) at paras 41-44.

- the Paris Convention for the Protection of Industrial Property (the "Paris Convention"),

Article 20 of TRIPS provides:

"The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as ... use in a special form or use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings."

Standardised packaging falls squarely within the prohibition set out in Article 20: the use of Imperial Tobacco's trade marks would be unjustifiably encumbered by special requirements. The special requirements imposed by standardised packaging would include both use in a special form and use in a manner detrimental to the mark's capability to distinguish its products. For the reasons set out below, standardised packaging cannot be regarded as creating a "justified" encumbrance on the use of trade marks.

Imperial Tobacco acknowledges that Article 8 of TRIPs provides that:

"Members may, in formulating or amending their laws and regulations, adopt measures necessary to protect public health and nutrition, and to promote the public interest in sectors of vital importance to their socio-economic and technological development, provided that such measures are consistent with the provisions of this Agreement."

However, Article 8 does not provide for an exception from any of the substantive obligations of the TRIPS Agreement as it applies only to measures which are "consistent with the provisions of [TRIPS]". Nor, for the reasons set out below, could it be shown that standardised packaging is "necessary" to protect public health. Accordingly, the Government could not invoke Article 8 in order to justify standardised packaging.

Article 15(4) of TRIPs and Article 7 of the Paris Convention prohibit the nature of goods or services forming an obstacle to the registration of a trade mark. As noted above, it is a requirement of registration and continued registration that a trade mark be put to use. Standardised packaging would therefore have precisely the effect prohibited by Article 15(4) and Article 7: tobacco-related trade marks would be deprived of registration, purely as a result of the nature of the goods to which they relate.

As Peter Lawrence, former head of the UK Patent Office and current Vice-President of the OHIM⁷⁴ has stated:

"...the UK has fought hard at international level to ensure that all countries respect trade mark rights".²⁸

In this context, introducing standardised packaging in breach of these international treaties would severely hamper the UK's ability to advocate the importance of respecting intellectual property rights in other parts of the world. More immediately, breach of these international treaties would also likely lead to WTO complaints against the UK.

The Right to Free Movement of Goods

The free movement of goods is a fundamental principle of European law protected and promoted by Article 34 of the Treaty on the Functioning of the European Union ("TFEU") which provides that:

"Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States".

The meaning of *"measures having equivalent effect"* has been defined broadly by the CJEU as trading rules *"which are capable of hindering, directly or indirectly, actually or potentially, intra-community trade"*.⁷⁵

Standardised packaging would fall within the scope of Article 34 TFEU.⁷⁶ As noted above, following the introduction of bans on display at point of sale, the content of packaging is the last significant mechanism by which a tobacco manufacturer may communicate with adult smokers in order to differentiate their products from those of their competitors and, therefore, is critical to the ability of new products and manufacturers from other Member States to enter the UK market.

The Right to Conduct a Business

The right to conduct a business under domestic and European law

The right to conduct a business is also an established principle of European law and recognised in Article 16 of the Charter:

⁷⁴ Office of Harmonization of the Internal Market - the official trade marks and design office of the European Union.

⁷⁵ ECJ, Case 8/74 *Procureur du Roi v Dassonville* [1974] ECR 837.

⁷⁶ Case C-110/05 *Commission v Italy ("Italian Trailers")* [2009] ECR 519, Case C-142/05 *Aklagaren v Mickolsson and Roos* [2009] ECR I-04 273 at paras 24 and 26, *R(Petsafe Ltd, The Electronic Collar Manufacturers Association) v The Welsh Ministers* [2010] EWHC 2908 (Admin).

"The freedom to conduct a business in accordance with Community law and national laws and practices is recognised."

The Explanations which accompany the Charter state that this is based on CJEU case law which has "*recognised [the] freedom to exercise an economic or commercial activity*" and Article 4(1) and (2) TFEU which "*recognises free competition*".⁷⁷ This includes the manner in which a company operates and its role as a competitor in a free market economy. There can, therefore, be no doubt that standardised packaging would constitute a breach of Article 16 of the Charter, given that packaging will be the last significant means for tobacco manufacturers to differentiate their products from other manufacturers' products to the benefit of adult smokers.

The right to conduct a business under international law

Standardised packaging would also constitute a breach of the obligations of the UK under the WTO's Technical Barriers to Trade Agreement. In particular, Article 2.2 obliges signatories to ensure that:

"... technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective.... Such legitimate objectives are, inter alia: ... protection of human health or safety."

The introduction of standardised packaging imposes technical regulations which create unnecessary and unjustified obstacles to international trade and which are more restrictive than necessary to achieve the Government's objective. Indeed, as discussed below, there is no credible evidence that standardised packaging will achieve the Government's stated objectives.

The Right to Freedom of Expression

Freedom of expression is a fundamental right that is recognised as an essential element of a democratic society.

Article 10 ECHR protects both the right to impart information and the right to receive it:

"1. Everyone has the right to freedom of expression. This right shall include freedom to hold opinions and to receive and impart information and ideas without interference by public authority and regardless of frontiers. This article shall not

⁷⁷ Charter Explanations, OJ 2007 C 303/23.

prevent States from requiring the licensing of broadcasting, television or cinema enterprises.

2. The exercise of these freedoms, since it carries with it duties and responsibilities, may be subject to such formalities, conditions, restrictions or penalties as are prescribed by law and are necessary in a democratic society, in the interests of national security, territorial integrity or public safety, for the prevention of disorder or crime, for the protection of health or morals, for the protection of the reputation or rights of others, for preventing the disclosure of information received in confidence, or for maintaining the authority and impartiality of the judiciary."

It includes the right of commercial entities which manufacture and sell a lawful product to impart and receive information about the nature and essential characteristics of that product. This includes, but is not limited to, the right to communicate, in the form that it chooses,⁷⁸ such fundamental matters as: what the product is; who makes it; where it originates from and how it differs from its competitors.⁷⁹ Standardised packaging, therefore, strikes at the very essence of the right to commercial freedom of expression.

Moreover, as already noted, the right to commercial expression through packaging is of the utmost importance in a situation where it is the last significant mechanism by which Imperial Tobacco has the ability to communicate to its consumers.

The right to freedom of expression is also protected in European and domestic law by Article 11 of the Charter:

"Everyone has the right to freedom of expression. This right shall include freedom to hold opinions and to receive and impart information and ideas without interference by public authority and regardless of frontiers."

Justification

Imperial Tobacco acknowledges that the majority of the legal restrictions and rights referred to above are not absolute. In particular, depending on the legal provision, interference with those rights can in principle be justified by reference to the protection of public health. The precise nature of the tests varies according to the legal context. Imperial Tobacco also accepts that the protection of health is a legitimate objective.

⁷⁸ *Women on Waves v Portugal*, Application No. 31276/05, 3 February 2009.

⁷⁹ *Markt Intern Verlag GmbH v Germany* (1989) 12 EHRR 161, [26]; *Casada Coca v Spain* (1994) 18 EHRR 1, [35]; and *Stambuk v Germany* (2003) 37 EHRR 42, [39].

However, in respect of each of the legal measures of protection set out above, the burden would be on the Government to show that standardised packaging was justified. For the reasons set out below and elsewhere in this submission, standardised packaging fails all the tests for justification.

In summary:

- it is lawful to manufacture and sell tobacco products;
- the ability to differentiate the nature and characteristics of products, and to communicate those differences to consumers, is an essential pre-requisite to the creation and functioning of a lawful competitive market;
- standardised packaging would completely remove the last significant means by which Imperial Tobacco and other tobacco manufacturers can impart information to adult smokers about their products, including as regards their quality, origin and brand values;
- standardised packaging would be unparalleled: there is no market for lawful products that has imposed such a restriction;
- there is no credible evidence that standardised packaging would achieve the Government's stated objectives;
- there are less restrictive alternatives and alternative tobacco control measures already introduced, but not yet fully in force, with the aim of meeting the objectives that are being pursued. In particular, in all material respects, the Government's stated aims behind the introduction of both the ban on tobacco vending machines and the ban on the display of tobacco products were the same as its stated policy objectives for standardised packaging. It is incumbent on the Government to assess the impact of the tobacco control measures it has already introduced⁸⁰ before it considers standardised packaging; and
- standardised packaging would have significant negative and unintended consequences, including in relation to illicit trade, costs for manufacturers and retailers, and trade and competition.

Compensation

As explained above, standardised packaging would amount to a deprivation of property for the purposes of A1P1 and Article 17 of the Charter, because Imperial Tobacco would be

⁸⁰ As noted above, the ban on the display of tobacco will not be brought into force for small shops until 2015.

deprived of the ability to exploit its intellectual property rights so as to inform and communicate with its consumers. Accordingly, even if it was justified, the Government would be obliged to pay compensation reflecting the value of Imperial Tobacco's intellectual property rights, both now and in terms of lost future profits. An absence of proper compensation would render the standardised packaging requirement unlawful.

In addition, in respect of breaches of the ECHR, an action for damages would lie under section 8(2) of the Human Rights Act 1998 (the "1998 Act"). When deciding whether an award of damages is necessary to afford just satisfaction for violations of an ECHR right, the domestic court must look to the jurisprudence of the European Court of Human Rights: s. 8(4) of the 1998 Act.

The fundamental principle in the jurisprudence of the European Court of Human Rights underlying the award of compensation is that the applicant should, so far as possible, be placed in the same position as if his ECHR rights had not been infringed. Where the breach of an ECHR right has caused significant pecuniary loss, this will usually be assessed and awarded.⁸¹

In respect of breaches of EU law, an action for damages would lie against the UK (and the Secretary of State in particular).⁸² The legal framework for and consequent legal foundation for the legislation currently being challenged in Australia is different from that in the UK.

In summary, as a matter of ECHR and EU law, the Government would face significant legal claims for compensation. These claims could be for billions of pounds.

7. Do you believe that requiring standardised tobacco packaging would have costs or benefits for manufacturers, including tobacco and packaging manufacturers?

Standardised packaging would impose very significant costs on both tobacco manufacturers and packaging manufacturers (see our response to question 5, page 38 above), although it is impossible to quantify the costs without specific detail of what precisely will be required if "*standardised packaging*" is introduced.

The Impact Assessment seeks to suggest that standardised packaging would "save" manufacturers money by forcing them to abandon and not to develop their brands. This is

⁸¹ *Anufrijeva v Southwark London Borough Council* [2004] QB 1124 at para. 59 *per* Lord Woolf MR.

⁸² *Joined Cases C-6/90 and C-9/90 Francovich and Others* [1991] ECR I-5357, para. 35; *Joined Cases C-46/93 and C-48/93 Brasserie du Pêcheur and Factortame* [1996] ECR I-1029, paras 31 and 51; *Case C-445/06 Danske Slagterier* [2009] ECR I-2119, paras 19 and 20; *Case C-568/08 Combinatie Spijker Infrabouw*, judgment of 9 December 2010, para. 87.

a fundamentally flawed proposition. Principally, it ignores the crucial importance of brands and intellectual property rights in a free market economy. In the context of the existing regulatory restrictions, tobacco packaging represents the most significant mechanism by which manufacturers may differentiate their products from those of their competitors. The loss of the ability to exploit branding and intellectual property rights in this way would impose extremely significant costs on tobacco manufacturers as well as discouraging, if not eliminating, innovation.

Further, whatever money is spent on changes to packs and the machinery required to produce them will be a loss to the supply chain - machine manufacturers, packaging companies and other entities involved in brand development. The enforced destruction of the premium market will inevitably have an impact on profit margins throughout the supply chain.

Another huge cost to the industry - and the Government - will be the significant increase in the illicit trade of tobacco products that would result from the introduction of standardised packaging.

All of the above will have consequential effects on investment and jobs throughout the economy, although this is impossible to quantify at present. Please see the response to question 9 of this Appendix for further discussion of this issue.

In summary, there will be very significant costs for manufacturers.

8. Do you believe that requiring standardised tobacco packaging would have costs or benefits for retailers?

Standardised packaging would have huge costs for retailers, particularly small independent retailers. Please also see our response to question 5, page 38 above.

Around 30 to 40 per cent of small retailer revenue comes from tobacco products.³⁰ Tobacco products are also a driver of footfall for small retailers, with customers visiting a retailer to purchase tobacco products but then purchasing other products as well. In addition to loss of revenue as a result of an increase in the illicit trade, standardised packaging would have the effect of removing incentives for developing and maintaining premium brands in the market, for which smokers are prepared to pay more. As outlined in response to question 5, if standardised packaging were to be introduced, manufacturers would inevitably compete on price, leading to a depression of all prices. Therefore, the

increased profit margins premium products generate for retailers would be removed from the supply chain.

9. Do you believe that requiring standardised tobacco packaging would increase the supply of, or demand for, illicit tobacco or non-duty-paid tobacco in the United Kingdom?

Yes, without question. There is no experience of standardised packaging anywhere in the world, meaning there is no real world data in this area. However, we are in no doubt that the introduction of standardised packaging would:

- provide a significant boost to organised crime groups and the illicit trade in tobacco, as it would give them the market for branded products to themselves; would make it easier for them to counterfeit standardised packs; and would make it more difficult for consumers to identify illicit products;
- damage legitimate businesses (retailers and manufacturers), by strengthening the market share of illicit tobacco products;
- reduce Government revenues further (currently estimated to be as much as £3 billion a year); and
- create an uncontrolled, unregulated, unaccountable market that circumvents regulatory controls, including where and to whom tobacco is sold (including, importantly, young people).

We will consider four points:

1. What are the main reasons why a market for illicit/smuggled tobacco products exists in the UK and will they be strengthened or weakened by the introduction of standardised packaging?

The single most important factor contributing to the market in illicit/smuggled tobacco products in the UK is the high excise duty rates.

First, the high duty rates make legitimate tobacco products expensive for consumers. This, coupled with the current economic climate, means that those on lower incomes are more likely to down-trade from legitimate tobacco products to illicit/smuggled tobacco products, whose price would typically be between 40 per cent and 60 per cent of the price of legitimate goods.

Second, and more importantly, the high duty rates can be exploited by organised crime groups for profit. The cost of producing counterfeit tobacco products is relatively low and the high duty rates allow organised crime groups to sell counterfeit tobacco products at a substantial mark-up but at a price that is still considerably cheaper than the legitimate alternative. These high profit margins provide a valuable source of income for organised crime groups and this, combined with the low risk of being arrested and/or prosecuted, more lenient punishments and fewer individuals involved in the supply chain, make it a more attractive alternative to other forms of illicit trade, such as the drugs trade. As an indication of just how profitable the illicit tobacco market is, illicit traders can afford to lose three out of every five shipments of counterfeit tobacco imported to the UK and still make a profit. The cost of the nine million counterfeit cigarettes in a typical container is around £130,000. They would sell for about £1.8 million on the illicit retail market.

The introduction of standardised packaging will, undoubtedly, make it cheaper and easier for organised crime groups to produce counterfeit tobacco packaging:

- Currently, existing brands are regularly developed to keep pace with consumer demand and a large number of component materials are needed to form a genuine cigarette pack. The constant evolution of brand design including colour, embossing, foils, pack size and pack innovation, all serve to make it more difficult and more expensive for counterfeiters to seek to imitate legal products. Standardised packaging will, however, make the packaging of the different brands very similar, e.g. for each different manufacturers' packaging, only a simple modification - to the name - will be needed to make packaging for the different brands of cigarette. The manufacturers of counterfeit tobacco products will, therefore, need fewer machines and/or less equipment to reproduce it. This will cut down the time taken to produce the packaging, and is likely to reduce the cost of production. This reduction in production costs will increase their profit margins and provide further incentive to increase their market share in the UK; and
- the standardisation of cigarette packs in the UK would provide greater incentives for the development of new illegal or counterfeit products, potentially targeted specifically at the UK which are differentiated by their non-standardised packaging.

However, as well as potentially carrying the 'cachet' of non-standardised packaging, illegal imports tend to be much lower in price, being free of UK tobacco duties and taxes. The weighted average price of UK consumed cigarettes could therefore be expected to fall, with consequential increases in the overall volume consumed.

More generally, the encouragement of such supplies in general provides added incentives for the development of new illicit supply routes and channels, which are necessarily costly to establish and maintain. Increasing the availability of illicit products has the direct effect of encouraging greater consumption of non-duty paid cigarettes. Increasing the availability of low priced illicit products could also impact the tobacco consumption of children under the age of 18 who cannot legally purchase tobacco, and potentially poorer consumers, due to the price advantages that such products offer. In this regard, it should be noted that there is clear survey evidence¹³ that:

- 50% of the tobacco bought by 14 to 15 year olds is illegal;
- 1 in 4 young smokers are regularly offered illegal tobacco, which is far more often than adults; and
- 1 in 7 young smokers have gone to a private address (or a "fag house"¹⁴) to buy illegal cigarettes.

A further issue is that standardised packaging is likely to affect consumer incentives as regards legal and illicit imports. In particular, plain packaging may impact the social acceptability of consuming illicit products.

2. What are the main challenges in producing/selling illicit products or in selling smuggled products? Will they be made easier by standardised tobacco packaging? Why?

A big current challenge for the illicit market is producing counterfeit packaging of a high enough standard to allow illicit traders to deceive customers. They need to secure and maintain a supply chain and consumer base similar to the tobacco companies. The introduction of standardised packaging will make packet sizes, colours, fonts and materials easier to reproduce and, thus, easier for illicit traders to pass-off counterfeit products as legitimate ones.

Furthermore, as there is no consumer demand for standardised packaging and demand for branded packs will not disappear simply as a result of regulation, branded illicit product has the potential to become preferable to consumers over de-branded legal products. Imposing standardised packaging could therefore lead to the development of a whole new market under the control of organised crime. This issue is discussed further in the response to question 1 above.

3. What effect will standardised packaging have on illicit market share and price?

As set out in the response to question 9.1 above, it can be expected that standardised packaging will boost demand for illicit products and will lower the cost of such products. Standardised packaging will be easier to copy and over time consumers become less familiar with the appearance of legitimate branded products. If organised crime groups decide to cut their prices because standardised packaging has lowered production costs and enabled them to increase the scale of their activities, then demand for illicit products is likely to rise further. However, for legitimate manufacturers there is a price beyond which they cannot go because it is made up of UK duty.

Whilst depressing the prices of duty-paid products can be expected to boost duty paid consumption, due to the very high levels of taxation it will continue to be the case that illicit products can be sold at a fraction of the cost of duty-paid products. Accordingly, it seems very unlikely that any consumers currently purchasing illicit products would switch back to duty-paid products if the post-tax duty-paid prices of premium brands were to fall.

Moreover, if the Government decides to increase the duty on tobacco products to counter any price drop (and in order to prevent demand for tobacco products increasing) this will increase the profits of the illicit trader, thus increasing their market share yet further.

4. What impact will the introduction of standardised tobacco packaging have on the enforcement/regulation of illicit trade in the UK?

Our forensics team sees large volumes of illicit product on a daily basis. We regularly see considerable effort made to copy our genuine products. However due to the complexity of designs consumers can detect genuine from fake using the naked eye. This ability would be lost in a standardised pack environment.

Standardised packaging would also make enforcement more difficult and costly:

- the easier and cheaper counterfeit products become to produce, the less the impact of seizures on the criminal, with larger volumes being produced and pushed into the market as the relative risk declines;
- "illicit white"¹⁹ products become preferable in terms of price and appearance, so volumes will increase creating greater enforcement complexities;
- confused and unenforceable markets will develop. Standardised packaging could theoretically create a market with legal standardised packs; genuine branded travel retail packs; counterfeit standardised packs; genuine, illegal branded packs;

counterfeit branded packs; illicit whites (branded); illicit whites (unbranded). The result: five of the seven channels/options available to consumers would be run by organised crime;

- domestic counterfeit operations can be expected to be created, allowing easier access to retail supply chains;
- with no clear differentials between brands and provenance, detection opportunities will be reduced resulting in increased enforcement and prosecution costs; and
- any attempted price increase on legitimate domestic products to compensate for a decline in domestic sales to illicit products would only increase the profits of the criminals.

Covert track and trace systems - often presented by tobacco control lobbyists as a solution to the impact that standardised packaging would have on the illicit trade - are not an adequate or comprehensive solution because:

- covert markings are not applied by the manufacturers of counterfeit products or illicit whites;
- they are only used on genuine products, and can only be read by hand-held electronic readers; and
- neither the general public nor retailers have access to readers, making covert markings an irrelevant system for consumers to be able to distinguish between genuine and illicit product.

This all points to a need for increased enforcement at a time when budgetary constraints are impacting the capability of HMRC to tackle this difficult and growing issue.

10. Do you believe that requiring standardised tobacco packaging would have an impact on cross-border shopping?

Yes. We would expect consumers to bring back as much foreign purchased branded tobacco as they possibly can for the reasons explained above and, in particular, in our response to question 5.

Standardised packaging regulations would increase demand for imported genuine product as it would confer a significant 'cachet' on branded imported products, and cross-border

shopping would go some way to meeting the unfulfilled demand for branded tobacco products.

11. Do you believe that requiring standardised tobacco packaging would have any other unintended consequences?

Yes. It would set a dangerous precedent and send a very negative signal to potential investors highlighting that the UK does not respect intellectual property rights, with implications for all branded consumer goods companies operating in the UK.

It would send a clear signal that the Government is content to disregard the principles of better regulation that it has committed to adhering to when introducing regulation.

It would have a negative impact across the entire supply chain, from manufacturer to wholesaler to retailer and would, if our expectations about its significantly increasing the illicit trade are realised, lead to independent retail shop closures and a loss of jobs.

It would likely lead to regulatory creep, with other sectors possibly similarly affected in the future.

Standardised packaging also goes against a raft of priorities and policies across Government:

| | Government's policies/priorities | Standardised packaging |
|------------------------|---|---|
| Promoting growth | Supporting intellectual property rights ³⁸ | Destroys intellectual property rights |
| | Encouraging investment into the UK ³⁹ | Discourages investment into UK: brand owners will be concerned at the willingness of Government to destroy brands and use of trademarks |
| | Supporting small businesses ⁴⁰ | Damages small independent retailers by encouraging the increase of illicit trade in tobacco products which drives down legitimate sales |
| | Encouraging innovation ⁴¹ | Reduces or eliminates innovation, by making it almost impossible to differentiate products and brands |
| | Widening consumer choice ^{39, 40} | Reduces consumer choice, by making it almost impossible to differentiate products and brands |
| | Increasing competition ^{39, 42} | Reduces consumer choice, by making it almost impossible to differentiate products and brands |
| Reducing the deficit | Removing unjustified and unnecessary regulation ^{2, 43} | Adds further unjustified and unnecessary regulation with no evidence of success |
| | Protecting government revenues and reducing the tax gap ⁴⁴ | Increases the illicit trade, thereby reducing government revenue and increasing the tax gap |
| Protecting society | Reducing organised crime ⁴⁵ | Creates a counterfeiter's charter, potentially leading to more organised crime and criminal activity |
| Empowering individuals | Giving people more freedom and control over their own lives ⁴⁶ | Stigmatises and bullies adults who choose to purchase tobacco products and smoke |

12. Do you believe that requiring standardised tobacco packaging should apply to cigarettes only, or to cigarettes and hand-rolling tobacco?

Standardised packaging should not be introduced for any legal product, including legal tobacco products of any type.

13. Do you believe that requiring standardised packaging would contribute to reducing health inequalities and/or help us fulfil our duties under the Equality Act 2010?

No. The drivers of health inequalities are clearly set out in the Marmot review. Health inequalities arise from a complex interaction of many factors - housing, income, education, social isolation, disability - all of which are strongly affected by the subject's economic and social status. The Marmot review emphasises that:

"...attempts to reduce health inequalities have not systematically addressed the background causes of ill health and have relied increasingly on tackling more proximal causes (such as smoking), through behaviour change programmes. Part of the explanation for this emphasis lies with the comparative ease of identifying action to address behaviour, rather than the complexity of addressing social inequalities shaping such behaviours."⁶³

It is possible that standardised packaging could disproportionately impact the many small independent retailers owned and operated by members of the Black Minority Ethnic community, particularly Asian families.

The significant boost to illicit trade that will result from the introduction of standardised packaging can also be expected to impact to a greater extent on adult smokers with lower incomes as they typically have greater access to illicit tobacco products.

14. Please provide any comments you have on the consultation-stage impact assessment.

The Impact Assessment is not fit for purpose.

⁶³ Marmot Review, February 2010

A number of criticisms of the Impact Assessment have already been made in this submission and Imperial Tobacco's principal criticisms of the Impact Assessment are set out below.

By way of introduction, given the unprecedented nature of the proposal to introduce standardised packaging and the far reaching implications that it would have, Imperial Tobacco would expect the Impact Assessment to undertake a thorough and comprehensive analysis of the policy proposal, which would need to include a robust, impartial and independent review of the evidence. It palpably fails to do so.

In particular, the Impact Assessment acknowledges that for the policy "*...to be justified the impact on smoking behaviour and consequent improvement in health needs to be sufficiently large to justify the related costs*" (page 3). However, there is no such cost-benefit analysis, which would require a full assessment of the likely costs, including the adverse effects on manufacturer and retailer competition and those associated with an increase in legal and illicit trade.

Reliance on the Systematic Review

The Impact Assessment relies on a Systematic Review that does not provide any evidence to justify the introduction of standardised packaging.

The Systematic Review is not independent

The authors of the Systematic Review have well-established links with, and receive funding from, organisations that actively pursue a tobacco control agenda and/or have been well known advocates of standardised packaging for many years. Indeed, 20 of the 37 studies included in the Systematic Review include work by the authors (and their colleagues).

In particular, Dr Moodie, the lead author of the Systematic Review, prepared 5 of the 37 studies referred to in the Systematic Review and Professor Hammond, who assisted with the development of the protocol for the Systematic Review, prepared a further 7 of the studies referred to in the Systematic Review.

The Systematic Review does not assess the policy objectives

The Government's stated objectives behind the introduction of standardised packaging are to influence smoking behaviour by reducing smoking uptake amongst young people and supporting smokers who want to quit (or preventing a relapse amongst smokers who have already quit).

However, the primary aim of the Systematic Review was to assess the potential impact of standardised packaging by reference to the points set out in the FCTC Guidance, namely: the "*appeal of the packaging or product*"; the "*salience and effectiveness of health warnings*"; and "*perceptions of product strength and harm*". The secondary aims of the Systematic Review were to assess any other potential impacts of standardised packaging. The 37 studies included in the Systematic Review are grouped thematically to provide a "*narrative synthesis*" that reflects these stated aims.

The Systematic Review does not provide any evidence that standardised packaging will achieve the stated policy objectives

The Systematic Review does not provide or review any evidence whatsoever of a causal link between tobacco packaging and smoking behaviour. In particular, there is no evidence whatsoever of a causal link on the behaviour of young people or on smokers who want to, or have already, quit.

The "*evidence*" that the Systematic Review does put forward is flawed and incomplete

Of the 37 "*carefully selected studies*", only three are not opinion-based. Only two report effect sizes (e.g. statistical significance) which is a noncontroversial and basic requirement of scientific evidence. Seven of the "*studies*" referred to were not publicly available; three are conference abstracts or presentations; and two are merely masters theses.

Even the Systematic Review itself acknowledges the limitations of the studies that were selected:

"The evidence in this review is largely drawn from correlational studies, which makes it difficult to draw conclusions about expected outcomes. Many of the studies use hypothetical scenarios, and are therefore not truly able to test how individuals would react or behave if standardised packaging was to be introduced. Within the correlational studies in the review there are further limitations in that some of the surveys use samples representative of the general population, but most do not, and instead use convenience or probability sampling. This same lack of representativeness also applies to the qualitative research... [A] more relevant limitation of some of the qualitative studies included was that quite limited information about the methodology and analysis was provided... It is also worth noting that findings regarding smoking-related attitudes, beliefs and behaviour from

both the surveys and qualitative studies in the review are reliant upon self-report."⁶⁴

In short, the state of the research evidence remains exactly as the Government concluded it was following the last consultation on standardised packaging in 2008. Namely: "*speculative*".

It is no answer to say that the evidence on whether standardised packaging might influence smoking consumption is "*inevitably indirect*" because this policy has not yet been implemented in any country. Indeed, that merely reinforces the need to carry out an independent and methodologically robust analysis of the policy proposal directed at the stated objectives.

The conclusion reached by the authors of the Systematic Review cannot justify the introduction of standardised packaging

In any event, the conclusion that was reached by the authors of the Systematic Review was that:

"...there was consistency in study findings regarding the potential impacts of plain packaging. This consistency of evidence can provide confidence about the observed potential effects of plain packaging. If and when introduced, existing evidence suggests that plain packaging represents an additional tobacco control measure that has the potential to contribute to reductions in the harm caused by tobacco smoking"

"*Consistency of study findings*" does not mean that those study findings are correct, and "*potential to contribute*" does not establish that standardised packaging will achieve the policy objectives.

By any measure, this plainly fails to satisfy the "*robust and compelling*" standard which the Government has committed itself to for the introduction of regulation. Given the draconian nature of the proposal to introduce standardised packaging and the significant implications that it will have - including the possibility of *increasing* tobacco consumption - the Government simply cannot rely on the Systematic Review to justify the introduction of standardised packaging.

⁶⁴ C Moodie et al, Plain Tobacco Packaging: A Systematic Review at page 89.

Proposal to rely on subjective opinion about the impact of standardised packaging on smoking behaviour

Presumably in recognition of the defects of the Systematic Review - and in particular the fact that it does not provide any evidence for whether standardised packaging would have any impact on smoking behaviour - the Impact Assessment states that:

"A quantified estimate of the impact of standardised packaging on smoking behaviour will be based on the findings of a research project being undertaken by the Policy Research Unit on Behaviour and Health. The ... project will elicit subjective judgments from three groups of internationally renowned experts on tobacco control. Participants will be asked to state what they believe to be the likely impact of standardised packaging ..."

It is remarkable that the Government has chosen to proceed with the consultation before making the results of this proposed assessment of the quantitative behavioural impact of standardised packaging available for consideration as part of the consultation.

Imperial Tobacco nevertheless has significant concerns about this proposal:

- it will provide *opinion, not evidence*. Opinion cannot properly form the basis for the introduction of standardised packaging;
- the experts *will not be impartial and independent*. Annex 2 to the Impact Assessment states that impartiality is considered "*impractical*". Why?
- the experts will be *anonymous*. Given that impartiality is apparently impractical, this is extremely concerning. The criticisms of the independence of the Systematic Review set out above demonstrate the basis for this concern. (Indeed, Imperial Tobacco would not be at all surprised (except that it would have no way of finding out) to discover that certain of the authors of the Systematic Review are amongst the group of "*internationally renowned experts*").

Failure to give adequate consideration to the implications of introducing standardised packaging

As noted above, the Impact Assessment lacks any real or impartial evidence as to the benefits of standardised packaging. However, equally as important, it also fails to consider in any meaningful way the unintended consequences and risks of standardised packaging. When introducing a regulatory measure aimed at affecting behaviour and outcomes in any particular market, particularly one which is as draconian and unprecedented as

standardised packaging, it is important to have regard to how manufacturers, retailers and consumers will respond to such a measure, with market participants' reactions being a key driver of unintended consequences. For example, the European Commission's guidelines on Impact Assessment, states that:

"[t]he analysis of impacts involves trying to predict, across a range of different policy areas, the likely consequences - both intended and unintended - of each option".

The Commission Guidelines list a number of examples of unintended consequences of different policy measures, which focus on market participants' reactions. In the present case, the Impact Assessment fails to give adequate consideration (or, in some cases, any consideration at all) to the significant detrimental consequences that would follow the introduction of standardised packaging, including:

- the impact on the economy, innovation, consumer choice, retailers, trade and competition - see section 6, page 21; our response to questions 4, 5, 7, 8 and 9 in Appendix A; and our response to questions 5, 6 and 7 in Appendix B. Indeed, the Regulatory Policy Committee noted that *"no monetised impacts of the proposal are provided"* and that the Impact Assessment would *"benefit from further explaining"* the effect on business that would result from standardised packaging;
- the consequences that would follow from the fact that standardised packaging would breach national, European and international law - see section 2.3, page 8 and our response to question 6 above; and
- the impact on illicit trade - see section 4, page 14 and our response to question 9 above.

Some new Government regulation may be relatively low risk and also easily reversed should it prove unsuccessful. This is clearly not the position as regards standardised packaging.

Failure to give adequate consideration to the regulatory context

The Impact Assessment acknowledges the long term declining prevalence in smoking and the introduction of legislation to ban the sale of tobacco from vending machines and the display of tobacco products. It even acknowledges that standardised packaging would have to be based on expected benefits over and above the existing tobacco control measures. However:

- it omits - and the Government has never undertaken - a comprehensive assessment of the impact of the existing tobacco control measures such as the Tobacco Advertising and Promotion Act 2002;⁸⁵ the ban on the sale of tobacco from vending machines; and the display of tobacco products in retail outlets;
- it would not be reasonable and proportionate to undertake such an assessment against the "*expected benefits*" of the sale of tobacco from vending machines and the display of tobacco products in retail outlets. The Government must undertake a proper analysis of the actual costs or benefits that follow the introduction of these measures.

Again, this was reflected in the comments by the Regulatory Policy Committee who noted that:

"...while the Impact assessment does acknowledge the 'current tobacco control policies', the Impact Assessment would also benefit from explaining more clearly how this proposal will interact with these other recent proposals."

Please see section 7 and our response to questions 3 and 5 above.

Failure to consider alternative options

Option 3 in the Impact Assessment is "*a different approach to tobacco packaging*". However, the Impact Assessment does not consider option 3 at all. Instead, it states that: "*The potential of option 3 will be explored following consultation, if responses to the consultation suggest an alternative approach to reduce the promotional impact of tobacco packaging*".

The Impact Assessment therefore assumes and proceeds on the basis that tobacco packaging has a "*promotional impact*" despite the evidence to the contrary detailed above. The proper approach would be to ask whether there are any alternative and less restrictive options capable of delivering the stated policy objectives of reducing youth smoking and assisting people who want to quit smoking from relapsing.

- 15. Please include any further comments on tobacco packaging that you wish to bring to our attention. We also welcome any further evidence about tobacco packaging that you believe to be helpful.**

This document requires careful consideration in its entirety. Imperial Tobacco's response to the consultation questions should not be read independently from the full Response.

⁸⁵ [Anne Milton, Minister for Public Health, in response to Brandon Lewis MP, 16 July 2012](#)

Appendix B - Imperial Tobacco's answers to the consultation document impact and assessment

1. What would be the costs to tobacco and packaging manufacturers of redesigning packs and retooling printing processes if standardised packaging were introduced?

As outlined in more detail in our responses to questions 7, 8, 9 and 10 of Appendix A, the costs would be extremely significant, both in terms of direct financial costs to our business, and indirect costs throughout the supply chain, including in terms of potential job losses.

We are unable to provide commercially confidential information as the consultation document makes clear that confidentiality cannot be assured. We would, however, be pleased to meet DH Ministers to discuss this further.

However, without further details of the standardised packaging proposal, such as the nature, materials and format of the packaging that would be permitted, it would not be possible to answer this question with any precision.

2. Would the cost of manufacturing cigarette packs be lower if standardised packaging were introduced, compared with the current cost of manufacturing packs?

We are not in a position to provide a definitive answer to this question without the provision of further information, such as the nature, materials and format of the packaging that would be permitted; and the rotation of health warnings and so on.

A large number of component materials are needed to form a genuine cigarette pack. The constant evolution of brand design including colour, embossing, foils, opening mechanisms, and even pack sizes, all serve to make it more difficult and more expensive for counterfeiters to seek to imitate legal products. The removal of these elements through the introduction of standardised packaging would make it easier for criminals to produce counterfeit copies.

Counterfeiters are not concerned with the rotation of health warnings or covert markings, further reducing their production costs.

We are unable to provide commercially confidential information as the consultation document makes clear that confidentiality cannot be assured. We would, however, be pleased to meet DH Ministers to discuss this further.

3. How often do cigarette manufacturers amend the design of tobacco packaging for brands on the United Kingdom market, and what are the costs of doing so?

Tobacco packaging is amended to comply with relevant legislation and address, as far as possible, the problems posed by the illicit market. We also update our products to ensure they remain relevant to our smokers in this changing environment.

As explained above, tobacco packaging is also essential to the differentiation of products from competitors. We are unable to provide commercially confidential information as the consultation document makes clear that confidentiality cannot be assured. We would, however, be pleased to meet DH Ministers to discuss this further.

4. How many different types of shape of cigarette pack are currently on the United Kingdom market?

We are unable to answer this question as it is unclear what is meant by "pack shape" in this instance.

There are several different sized packs on the market (depending on the number of cigarettes the pack is designed to hold), and several deviations from the standard "flip-top" design, including but not limited to bevel-edge or soft packs.

5. Would retailing service times be affected, and if so, why and by how much, if standardised packaging were introduced?

Two reports⁶⁶ prepared by Deloitte for the Alliance of Australian Retailers suggest that retailing times would be adversely affected if standardised packaging were introduced by an additional 15 to 45 seconds per transaction and that the effect would be particularly significant for smaller retailers. The Deloitte reports also found that standardised packaging would have a number of other adverse implications for retailers. In the context of the ban on the display of tobacco products, it will be even harder for retailers to identify packs if standardised packaging were introduced. The Impact Assessment is therefore wrong to conclude that transaction times would decrease.

The Government should ensure that it collects proper evidence of the impact on retailing service times.

⁶⁶ *"Potential Impact on retailers from the introduction of plain tobacco packaging"*, Deloitte, February 2011; and *"Plain packaging and channel shift"*, Deloitte, June 2011

The study by Carter et al., "*Measuring the effect of cigarette standardised packaging on transaction times and selection errors in a simulation experiment*"⁸⁷ is widely referred to by anti-tobacco lobbyists in response to the Deloitte reports. Carter et al., suggest that the argument that standardised packaging would increase transaction times is "*spurious*" and can be "*refuted by even a modest experiment undertaken with no budget and a group of volunteers over the space of one week.*" This consisted of 52 subjects standing in front of a display of either 50 plain or coloured cigarette packets. They were then read a randomly ordered list of brands and asked to locate them. The time taken to locate each packet was recorded, as well as any selection errors. From this experiment, Carter et al conclude that: "*...rather than standardised packaging requiring an additional 45 seconds per transaction ... it will if anything modestly decrease transaction times and selection errors.*"

However, this study and "*modest experiment*":

- is unrealistic in that the authors deliberately excluded subjects who were familiar with tobacco brands. This meant that the participants were: "*quicker at locating plain packs than coloured packs because of their general unfamiliarity with cigarette brands, and it remains possible that if the experiment was repeated with experienced tobacco retailers, any advantage conferred by standardised packaging would be lost*". However, it is precisely "*experienced tobacco retailers*" who will be dealing with the implications of standardised packaging in practice;
- does not replicate the retail environment; in particular the recent (for large stores in England) or pending (for small stores and other jurisdictions in the UK) introduction of a display ban;
- even concluded that: "*our qualitative results suggest that colours and logos can serve as a useful cue to locate some tobacco brands*"; and
- misrepresents a view allegedly expressed by Deloitte that standardised packaging would add "*an additional 45 seconds*" per transaction. However, Deloitte actually concluded that standardised packaging will result in an increase in transaction times in a range of "*between 15 and 45 seconds*".

Imperial Tobacco believes that retailing service times would be adversely affected, but that the Government should ensure that they obtain evidence from retailers on this point.

⁸⁷ Carter et al., 28 September 2011

Perhaps most importantly, it should be remembered that the impact on retailing service times would be in addition to all of the other costs that would be imposed on retailers, especially smaller retailers, as identified in section 6 above; our response to questions 5 and 8 in Appendix A; and our response to question 7 below.

6. How could standardised packs be designed to minimise costs for retailers?

They cannot. Please refer to section 6 above; our response to questions 5 and 8 of Appendix A; and our response to question 7 below.

Again, however, the Government should ensure that they obtain evidence from retailers on this point.

7. Would retailers bear any other costs if standardised tobacco packaging were introduced?

Yes. The Government should ensure that they obtain evidence from retailers on this point. However, the studies conducted by Deloitte in Australia identified a number of significant costs that would impact on retailers, particularly small retailers. These included:

- channel switching: customers moving from small retail outlets to supermarkets in order to be sure that their desired brand will be available;
- increased stock management costs;
- "write-offs" costs for non-compliant products;
- increased security costs; and
- costs as a result of the growth in illicit trade.

Moreover, as explained in our response to question 5 in Appendix A (Part B), these costs are of particular significance for smaller retailers who rely on the materially higher margins on premium, higher priced brands. Standardised packaging can be expected to increase the proportion of tobacco sold by the large grocery retailers (who will exercise buyer power by refusing to stock brands and by selling at substantially lower prices than small, convenience retailers).

Please refer to section 6 above; our response to questions 5, 9 and 10 of Appendix A; and our response questions 5 and 6 in this Appendix.

8. What is the average price of a packet of cigarettes in the following cigarette market segments?

- Premium brands
- Mid-price brands
- Economy brands
- Ultra-low-price brands

It is difficult to provide an accurate answer to this question as the price segments have not been defined in the consultation. However, based on what ITUK understand the price segments to be in the UK, we can provide an unweighted average RRP of a pack of 20 king size cigarettes. These RRP's are post-2012 Budget:

- Premium: £7.60
- Sub-Premium: £6.91
- Value: £6.60
- Economy: £6.13

9. What percentage of total cigarette sales in the United Kingdom are in each of the following cigarette market segments?

- Premium brands
- Mid-price brands
- Economy brands
- Ultra-low-price brands

It is difficult to provide an accurate answer to this question as the price segments have not been defined in the consultation. However, based on what ITUK understand the price segments to be in the UK we can provide the following splits, based on May 2012 cigarette sales volume data and broken down to stick-level:

- Premium: 21.5%
- Sub-Premium: 15.2%
- Value: 25.4%

- Economy: 37.9%

10. How does the total price of a packet of cigarettes break down into manufacturing costs, distribution costs, tax, other costs, profits for retailers and profits for the tobacco manufacturer in the following cigarette market segments?

- Premium brands
- Mid-price brands
- Economy brands
- Ultra-low- price brands

We are unable to provide commercially confidential information such as this as the consultation makes clear that confidentiality cannot be assured. We would, however, be pleased to meet DH Ministers to discuss this question further.

We would also highlight that taxation represents the vast majority of the total price of tobacco products.

11. Would consumers trade down from higher-priced to lower-priced tobacco products if standardised tobacco packaging were introduced?

Yes. Please refer to our response to question 9 of Appendix A for a detailed discussion of this point.

12. Of the total cigarette market in the United Kingdom, what proportion is sold in cartons rather than in individual packs?

It is difficult to provide an accurate answer to this question without further information being provided, such as:

- What is meant by the term "carton";
- whether the proportion refers to value or volume;
- if volume, whether this means weight, stick (and equivalents), pack numbers, outer numbers, stock case numbers, and so on; and
- which part of supply chain it refers to.

However, if by "carton" the DH are referring to "outers"⁸⁸ of cigarettes, then the estimated proportion of total cigarette stick volume by Imperial Tobacco in the UK for FY11/12 to date is approximately 10%. We are unable to answer on behalf of the whole market, but would expect this figure to be broadly in line with our own estimations.

We would be pleased to meet DH Ministers to discuss this further.

⁸⁸ 10s or 20s packs of cigarettes that are typically sold as 100 or 200 multipacks (or equivalent multiples).

Appendix C - Why Young People Start Smoking

An evidence-based approach to smoking policy amongst young people in the UK would begin with a clear understanding of the factors that reliably predict youth smoking and then attempt to address each of these. Proceeding in this fashion would provide a clear, evidence-based link between causes and remedies, as opposed to an approach based on speculation and disputed assumptions.

Here we review the evidence related to predictors of youth smoking. It is clear that packaging and branding is not one of them.

Liverpool Longitudinal Study on Smoking⁸⁹

One of the longest running longitudinal studies on smoking initiation is the Liverpool Longitudinal Study on Smoking ("LLSS"), which was established in 1994. The key aim of the LLSS was to answer the question, "*Why do young people smoke?*"

To answer this question, the study has followed a single birth cohort of children from the age of 5 to 16. In its most recent report, *The Liverpool Longitudinal Study on Smoking: Experiences, beliefs and behaviour of adolescents in Secondary School 2002 to 2006*, the study focuses on the key factors that lead to trial and experimental smoking by adolescents.

Central risk factors include living in areas of high social and economic deprivation. It notes that "*between ages 14 to 16 those living in an area with a high deprivation score were 95 per cent more likely to try smoking.*" It also reports that students served by poor schools had a significantly higher risk of trying smoking, with this predictor increasing the risk of trial by 95 per cent.

Goddard 1990 Why children start smoking HMSO and 1992 Why children start smoking⁹⁰

This study by Eileen Goddard for the UK Office of Population Censuses and Surveys reports on secondary school children who were interviewed three times in 1986, 1987 and 1989 when they were at the beginning of their (then) second, third and fourth academic years. The goal of the survey was to "*see which of a range of factors were most closely associated with children starting to smoke.*" The surveys were, of course, undertaken prior to the ban on advertising of tobacco products.

⁸⁹ The Liverpool Longitudinal Study on Smoking, August 2008

⁹⁰ Why Children Start Smoking by Eileen Goddard HMSO (and OPCS (Office of Population Censuses & Surveys) 17 December 1990.

Goddard identified seven factors:

- being a girl;
- having brothers or sisters who smoke;
- having parents who smoke;
- living with a lone parent;
- having relatively less negative views about smoking;
- not intending to stay on in full-time education after 16; and
- thinking that they might be a smoker in the future.

Several of these risk factors, particularly living with a single parent and not intending to remain in school, have been identified as crucially important to smoking uptake in other studies. All the risk factors, according to Goddard, are associated independently with smoking; none has any direct connection with tobacco branding and there is no single, simple explanation as to why adolescents begin to smoke. As Goddard notes:

"...the onset of smoking in young people is a complex process - no simple combination of a small number of factors can be put together to form a good explanation of why some children start to smoke at this age while others do not..."

Goddard notes a low correlation between the brands that were most recognised and brands most likely to be smoked. Indeed, she does not identify branding or even advertising that was then permitted as a cause of youth initiation and the survey data provides no support for the claim that children smoke because of branding.

Conrad et al. 1992 Why Children Start Smoking Cigarettes: Predictors of Onset⁹¹

The research of Conrad et al. echoes the conclusions of Goddard. These authors confined their analysis of the factors associated with youth smoking to longitudinal studies that were published from 1980 onwards. The age of the adolescents in the studies ranged from 10 to 17 with the median age being 12 to 13. The studies lasted from four months to two years and were conducted in the US, Europe and Australia. They provide data drawn from a diverse range of societies.

⁹¹ Conrad et al., 1992 K.M. Conrad, B.R. Flay and D. Hill, *Why children start smoking cigarettes: predictors of onset*, Br. J. Addict. 87 (1992), pp. 1711-1724.

Conrad and her colleagues grouped their analysis of the "process of becoming a smoker" around five different categories of smoking predictors or risk factors:

- socio-demographic;
- social bonding;
- social learning;
- intrapersonal/personal/self-image; and
- knowledge, attitudes, and behaviour predictors.

They then discussed the findings by examining the predictive reliability of each group of risk factors in terms of youth smoking.

Socio-demographic predictors such as socio-economic status, age and gender were consistent with theoretical expectations 76 per cent of the time, with the strongest predictors of starting to smoke being socio-economic status and age.

Social bonding predictors, including family and peer bonding and school influences, were consistent in predicting smoking initiation 71 per cent of the time.

Social learning predictors - family smoking, family approval of smoking, other adult influences (including tobacco advertisements), peer influences and the availability of tobacco were consistent 72 per cent of the time.

Intra-personal, personal and self-image predictors which included such things as tolerance of deviance, independence, rebelliousness, risk-taking, alienation and locus of control were consistent in 77 per cent of the cases. What is particularly important is that the most reliable predictor in this grouping of risk factors was rebelliousness/risk-taking.

Knowledge, attitude and behaviour predictors, including understanding of and beliefs about the physical consequences associated with smoking; "addiction"; expected utility from smoking; approval of cigarette advertisements; alcohol and substance use were predictive in 75 per cent of the cases. Approval of cigarette advertisements was predictive in one study and non-predictive of smoking initiation in another.

Finally, one of the strongest predictors of smoking initiation in all of the studies was rebelliousness and risk-taking. Given how strongly these characteristics are associated with initiation, standardised packaging raises serious concerns about the potentially counter-productive impact of such measures.

Conrad et al.'s analysis of the longitudinal research on youth smoking initiation has been confirmed in other research that has taken predictor variables and combined them into single studies. For instance, Smith & Stutts combined the major predictor variables of youth smoking in a single study that found that all variables related to advertising and anti-smoking information ranked low as reliable predictors. They concluded that "*exposure to cigarette advertising, paying attention to cigarette ads, being familiar with cigarette characters and brands, and exposure to antismoking information are not good predictors of smoking levels.*"⁹²

Lloyd and Lucas 1998 Smoking in Adolescence: Images and Identities⁹³

In 1998 two UK researchers - Barbara Lloyd and Kevin Lucas - published a significant work on youth smoking. Their research, commissioned by the DH but never subsequently cited by the Department, was based on a decade of interviews with London and Sussex adolescents about smoking. It argued that many of the traditional anti-smoking interventions, including school-based education programmes, needed to be re-evaluated as they failed to connect with the actual causes of youth smoking. Criticising the inadequate research methods and assumptions of studies such as those employed by the UK DH, they wrote that:

"Health promotion programmes for young people must be theory driven and also based on research that uses adequate, representative samples which are capable of rigorous objective analysis. The inadequacy of strategies based on myth and popular opinion has been illustrated by the failure of many intervention programmes to date. Moreover, a danger exists whereby the adoption and promulgation of such myths by health professionals results in their being accepted as fact and threaten to produce a self-fulfilling prophecy... Sound research may sometimes yield uncomfortable truths. Such truth is the accumulating evidence that many smokers enjoy smoking."

Lloyd and Lucas also stress that the main reasons for adolescent smoking uptake are found in:

- the structures and functioning of families, and particularly the quality of parent-child relationships;
- the nature of school cultures and the academic success of children;
- the adolescent need for stress and mood control; and
- the fact that smoking provides considerable physical pleasure.

⁹² Smith, K. and M. A. Stutts. 2000. Factors that Influence Adolescents to Smoke. *Journal of Consumer Affairs*, 33 (2), 321-357.

⁹³ Lloyd, Barbara, Kevin Lucas, Janet Holland, Sheena McGrellis and Sean Arnold; *Smoking in adolescence: images and identities*; Published by Routledge, 1998 (London).

They note:

"There is now ... compelling evidence to support the view that the quality of an adolescent's home environment will impact on his or her health-related behaviour, including the likelihood of taking up cigarettes."

And:

"...poor family relationships predict teenage smoking independently of parental smoking behaviour." Furthermore, it is not simply the quality of the home environment but the quality of "relationships within a family" which "also influences the likelihood of an adolescent becoming a smoker. Adolescents value open, communicative relationships with their parents. For some, such relationships obviated the need to use smoking as a symbol of rebellion."

They observe that:

"Our evidence highlights the significance of individual school cultures. ... The contribution of school culture to health-related values and behaviour cannot be underestimated..."

And finally, with regard to stress, they found that their subjects responded to this by using cathartic coping devices and viewed "smoking as a coping resource" for stress.

Their statistical analysis showed that:

"...adolescents who smoke perceive more stress in their lives; report making less use of problem-focused coping and more use of cathartic coping strategies; perceive smoking as a coping resource."

Jessor 1977 Problem behaviour and psychosocial development: A longitudinal study of youth,⁹⁴ 1995 Protective factors in adolescent problem behaviour⁹⁵

A further alternative account of smoking uptake is found in the work of Richard Jessor and his colleagues in the US. For Jessor, as for many researchers, smoking is part of a cluster of risk-taking behaviours, rather than a unique adolescent activity. Jessor has looked at a number of these behaviours, including alcohol use and smoking, delinquency and sexual precocity, in

⁹⁴ Jessor, R., & Jessor, S. L. (1977). *Problem behaviour and psychosocial development: A longitudinal study of youth*. New York: Academic Press

⁹⁵ Jessor, R., Van Den Bos, J., Vanderryn, J., Costa, F.M., and Turbin, M.S. 1995. "Protective factors in adolescent problem behavior: Moderator effects and developmental change", *Developmental Psychology*, 31, 923-933.

order to identify the factors that serve to protect adolescents from engaging in them. He has identified seven protective factors as crucial:

- positive orientation towards school;
- positive orientation towards health;
- intolerant attitudes toward deviance;
- positive relations toward adults;
- strong perceived controls;
- friends who engage in conventional behaviours; and
- involvement in pro-social activities (e.g. volunteering).

Contrasting with these seven protective factors are six risk factors which, according to the author, increase the likelihood of problem behaviours:

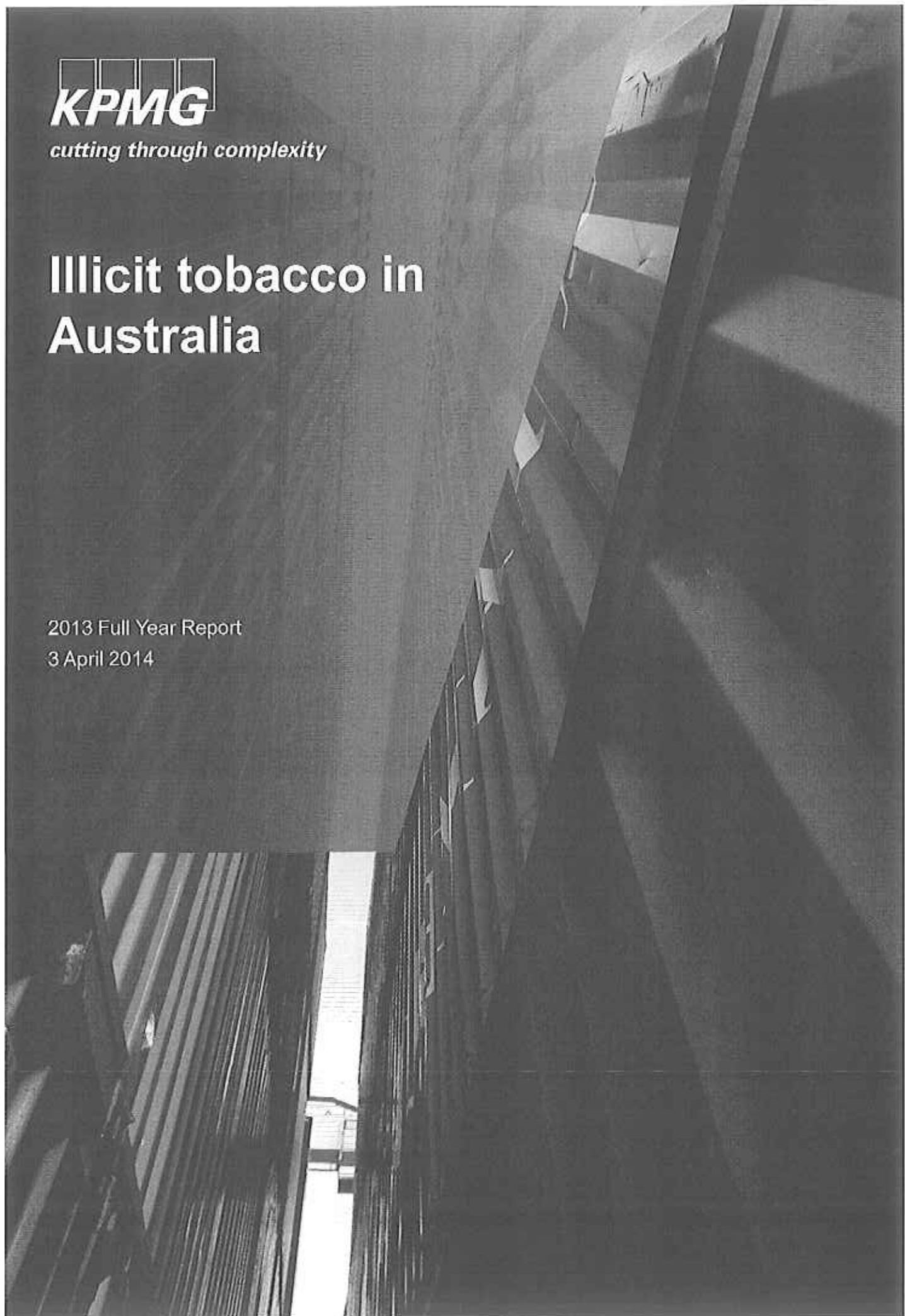
- low expectations for success;
- low self-esteem;
- general sense of hopelessness;
- friends who engage in problem behaviours;
- a greater orientation towards friends than towards parents; and
- poor school achievement.



cutting through complexity

Illicit tobacco in Australia

2013 Full Year Report
3 April 2014





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3 April 2014

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Glossary

| | |
|-----------------------|---|
| ABS | Australian Bureau of Statistics |
| ACT | Australia Capital Territory |
| AIHW | Australian Institute of Health and Welfare |
| AIT | Anti Illicit Trade |
| ATO | Australian Taxation Office |
| AWOTE | Average Weekly Ordinary Time Earnings |
| BATA | British American Tobacco Australia |
| CAGR | Compound Annual Growth Rate |
| CATI | Computer Aided Telephone Interview |
| CAWI | Computer Aided Web Interview |
| Contraband | Genuine manufactured cigarettes that are sold without the payment of applicable excise taxes in the market of consumption. Contraband cigarettes tend to have been made in a low-tax country and brought into the country of consumption illegally, or acquired without taxes (for export purposes) and illegally re-sold in the market of consumption. This includes genuine products which are brought into a country in amounts exceeding the personal allowance; in Australia this limit is 50 sticks or 50 grams of RYO per person |
| Counterfeit | Manufactured cigarettes which are illegally manufactured and carry the trademark and/or branding of a legally sold brand without the consent of the trademark owner. Counterfeit cigarettes are also known as fake cigarettes. For the purposes of this analysis, data relating to counterfeit is not included within the definition of contraband |
| CPI | Consumer Price Index |
| EOS | Exchange Of Sales data. Shipment data provided by the industry |
| EPS | Empty Pack Survey |
| FCTC | Framework Convention on Tobacco Control |
| GDP | Gross Domestic Product |
| H1 | First half of the year i.e. the period from January to June |
| H2 | Second half of the year i.e. the period from July to December |
| Illicit whites | 'Illicit whites' is a term for brands of manufactured cigarettes that are not legally available in the local market. Whilst possibly legal at the point of manufacture, these brands are typically not sold legally anywhere, and are often made exclusively for smuggling |
| Inflows | Total volume of cigarettes coming into Australia |
| ITA | Imperial Tobacco Australia |
| kg | Kilogram |
| KPI | Key Performance Indicator |
| LDC | Legal Domestic Consumption |
| LDS | Legal Domestic Sales |
| LTM | Last Twelve Months |
| LTM H1 | Last Twelve Months to the end of June (e.g. 1 July 2012 to 30 June 2013) |
| LTM H2 | Last Twelve Months to the end of December (e.g. 1 January 2013 to 31 December 2013) |
| MSI | MSIntelligence |

Glossary

| | |
|--------------------------------|--|
| ND(L) | Non-Domestic Legal is the legitimate tobacco purchased in duty free or abroad within personal allowance limits |
| Non-domestic cigarettes | Cigarettes which are not Australian (i.e. health warnings missing or not in English, brands not sold in Australia, packs with identifying marks from other markets such as tax stamps) |
| OECD | Organisation for Economic Cooperation & Development |
| PDI | Personal Disposable Income |
| PML | Philip Morris Limited |
| pp | Percentage point |
| Outflows | Legitimate tobacco purchased in Australia and taken abroad |
| RMR | Roy Morgan Research |
| RSP | Retail Selling Price |
| RYO | Roll Your Own |
| TISG | Tobacco Industry Stakeholder Group. Formerly known as the Tobacco Industry Forum (TIF) |
| Tonnes | Thousand kilograms |
| WHO | World Health Organisation |
| Unbranded tobacco | Illegal loose leaf tobacco upon which no duty has been paid and which carries no labelling or health warnings. It is sold and consumed either in RYO form (called Chop Chop) or inserted into empty cigarette tubes. Commonly sold in both bags or boxes |
| Y o Y | Year on Year |

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1. Executive summary and key findings

1.1 Key messages

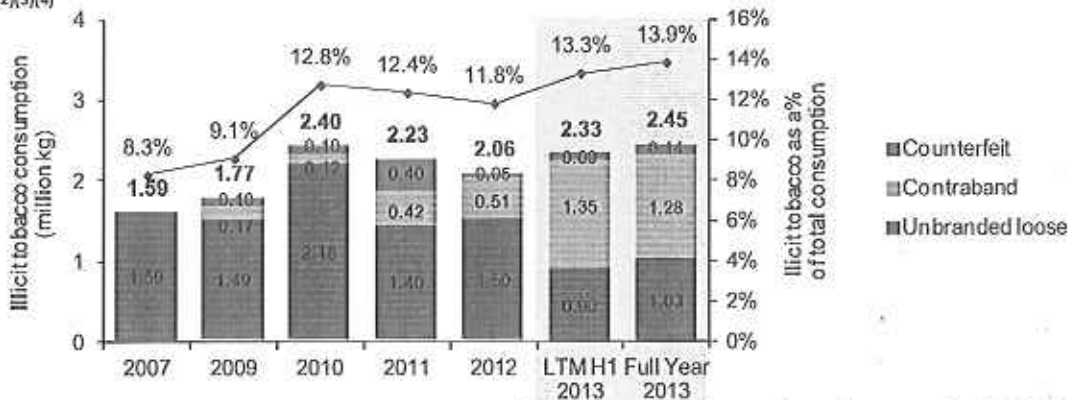
1.2 The purpose of this report

1.3 KPMG LLP's experience in measuring
illicit trade

Illicit tobacco consumption has increased, driven by a growth in illicit manufactured cigarettes

1.1 Key messages

Figure 1.1 Illicit tobacco consumption as a proportion of total consumption 2007 – 2013⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾



Introduction

This is the 2013 full year report examining the size of the illicit tobacco market in Australia for the twelve months ending December 2013. The percentage of the overall illicit tobacco consumption in 2013 has been calculated using the approach adopted in the H1 2013 report and uses all the available data captured in 2013.

Unbranded tobacco consumption has been calculated using a consumer survey whilst the consumption of illicit manufactured cigarettes has been estimated based on empty pack survey results.

Tobacco consumption in Australia

The overall level of tobacco consumption in Australia was approximately 17.7 million kilograms in the full year 2013, of which 2.45 million kilograms are estimated to be illicit. This estimate of total consumption is marginally higher than both the 2012 and the H1 2013 figures.

Illicit tobacco consumption in Australia

Figure 1.1 highlights that in the twelve months to the end of 2013, the level of illicit consumption grew to 13.9% of total consumption, 2.1 percentage points higher than in 2012, and 0.6 percentage points higher than in the twelve months ending June 2013.

If all of this tobacco had been consumed in the legitimate market it would have represented an excise amount payable to the Government of AUD1.1bn at current excise rates.

This growth in illicit consumption is driven by a slight increase in unbranded tobacco consumption volumes from H1 2013 whilst illicit manufactured cigarette consumption volumes have stabilised at levels recorded in LTM H1 2013.

There has, however, been a change in the mix of illicit manufactured cigarettes consumed with counterfeit

volumes experiencing a large increase in 2013, though when compared to the total illicit consumption, counterfeit consumption continues to be relatively small. Contraband volumes, despite witnessing a decline from H1 2013 levels, continue to account for the majority share of illicit manufactured cigarette consumption. Additionally, the consumption of illicit whites continues to be a growing issue – they accounted for more than 2.3% of total manufactured cigarette consumption in 2013. Manchester is currently the largest illicit white brand in Australia; if it were sold legally in Australia it would have a 1.4% market share.⁽³⁾

Legal tobacco market in Australia

The overall sales of legal domestic tobacco in the full year 2013 declined by 0.5% from the previous year; a lower decrease compared to an annual fall of 1.6% between 2000 and 2013. Whilst manufactured cigarette volumes have declined at an annual rate of 2.1% over the last thirteen years, loose tobacco volumes have increased at a CAGR of 3.0% over the same period, representing a shift in the mix of tobacco products consumed. In line with this trend, manufactured cigarette volumes declined by 1.1% and loose tobacco volumes grew by 3.5% between 2012 and 2013.

Regulatory changes

In August 2013 the Australian government announced excise duty increases in tobacco products of an additional 12.5% annually for the next four years. The first of these increases was implemented on 1 December 2013, with further 12.5% increases to be applied on 1 September 2014, 1 September 2015 and 1 September 2016. Additionally from 1 March 2014 excise and excise equivalent customs duty will be indexed to the Average Weekly Ordinary Time Earnings (AWOTE) instead of the Consumer Price Index.⁽⁵⁾ The Victorian government recently announced its intention to quadruple fines for retailers caught with illicit tobacco.⁽⁶⁾

Sources: (1) Deloitte, *Illicit Trade of Tobacco in Australia*, 2010, 2011, 2012
 (2) Industry data
 (3) KPMG Analysis
 (4) Euromonitor, *Tobacco Consumption in Australia*, 2013

(5) Treasurer of the Commonwealth of Australia, *Government to increase tobacco excise*, August 2013
 (6) Department of Health, Victoria

1.2 The purpose of this report

British American Tobacco Australia, Imperial Tobacco Australia Limited and Philip Morris Limited have commissioned KPMG LLP to conduct an independent report to estimate the size of the consumption of illicit tobacco in Australia. KPMG LLP had final decisions on all methodologies and messages contained in this report. The purpose of this report is:

1. To provide an overview of the nature and dynamics of the legal and illicit tobacco markets in Australia, and

2. To provide an independent estimate of the size of the illicit tobacco market in Australia.

KPMG was appointed to produce bi-annual reports on the illicit trade for the industry in Australia.

This full year 2013 report is the second of two reports that are published focusing on 2013 and is an update to the H1 2013 report that was released in October 2013.

This report covers the period from January to December 2013 and shows the 2013 results based on our methodology. The result for 2013 is also presented on a basis consistent with H1 2013 report.

1.3 KPMG LLP's experience in measuring illicit trade

KPMG LLP has significant experience in the measurement of illicit tobacco consumption across a number of markets. Our experience covers the following:

Europe

Since 2005, KPMG LLP has led a Pan European assessment of the scale of counterfeit and contraband tobacco on behalf of Philip Morris International Management S.A. (PMI) and the European Commissions Anti Fraud Office (OLAF). Project Star has been conducted annually since 2006 by KPMG for PMI, the European Commission and the 28 EU Member States.

We have worked extensively with the industry and other stakeholders on developing an approach to illicit market sizing and implementing a common, global approach to illicit trade measurement.

Latin America

In 2013 KPMG LLP led the first multi-territory study into the illicit trade in Latin America. The study focuses on the levels of inflows and outflows of both legal and illicit cigarettes and other tobacco products across a selection of Latin American countries. The work performed has allowed a variety of stakeholders access to the first picture of the cross border nature of illicit tobacco volumes in Latin America. This report was prepared for an internal use of a tobacco company and has not been published.

Oceania

KPMG LLP is currently involved in assessing the illicit tobacco trade in selected South Pacific markets for a tobacco company.

As part of this ongoing work, KPMG has a strong understanding of some of the unique issues found in the wider Oceania region outside of Australia and have developed specific methodologies designed for the purpose of sizing the illicit trade in each country.

2. Australian tobacco market

2.1 Tobacco consumption in Australia

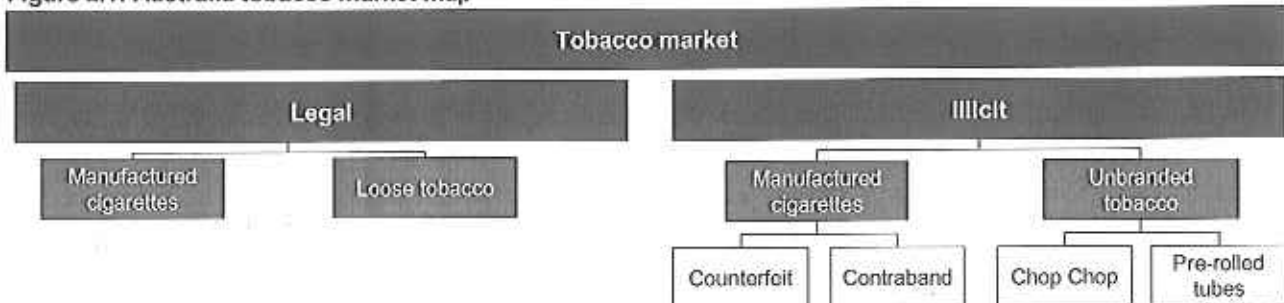
2.2 Legal tobacco market

The legal and illicit markets are made up of manufactured cigarettes and loose tobacco

2.1 Tobacco consumption in Australia

Tobacco consumption refers to total volume of consumption for all types of tobacco as mapped out in figure 2.1. This section deals with the tobacco market and related products:

Figure 2.1: Australia tobacco market map



Legal tobacco products

There are two main types of tobacco products considered in total tobacco consumption (cigars and pipe tobacco have been excluded for the purposes of this study):

Manufactured cigarettes – made for the legal tobacco market and sold in packets.

Loose tobacco – Legal loose leaf tobacco sold in pouches and used in Roll-Your-Own (RYO) cigarettes, which are consumed using rolling papers or tubes.

As shown in section 5.1, additional legal consumption is possible in the form of non-domestic legal product, that is tobacco purchased by consumers in other countries and imported into Australia legally for personal consumption.

Illicit tobacco consumption

Illicit tobacco is mainly brought into the country illegally from overseas markets without the payment of excise duties. This tobacco is sold to consumers at lower prices than Australian cigarettes, avoiding Australian tax obligations or is brought into the country in amounts exceeding the allowable personal limit. The Australian Crime Commission believes that organised crime groups perceive tobacco smuggling to be low-risk and high profitability. Penalties for smuggling illicit tobacco have been increased, with potential for a jail term of up to ten years.⁽¹⁾

Counterfeit

These are manufactured cigarettes, often specifically manufactured overseas on a large scale. Once manufactured, they are smuggled into Australia most commonly via ports on large container freight and other channels including airmail. These products carry branding without the consent of the trademark owner to imitate popular legitimate tobacco product brands.

According to the Tobacco Industry Stakeholder Group (TISG)⁽²⁾ they do not adhere to industry production

standards, they may pose additional serious health risks and are also known as fake cigarettes.⁽²⁾

Contraband

These are mainly genuine cigarettes that are manufactured legally outside of Australia adhering to local regulations and smuggled into the Australian market. This also includes cigarettes which are purchased legally outside Australia but exceed the personal import allowance and have no duty paid.

Contraband cigarettes are legitimately manufactured by the trademark owner but avoid Australian government regulations, quarantine inspections and local ingredient controls.⁽²⁾

Illicit whites, as discussed in section 6, are also a constituent part of contraband. 'Illicit whites' is a term for brands of manufactured cigarettes that are not legally available in the local market, though they could be legal at the point of manufacture. These brands are often made exclusively for smuggling.

Unbranded tobacco

Unbranded tobacco is sold as finely cut loose leaf tobacco in half kilogram or one kilogram amounts. TISG indicates that it may be grown illicitly without a licence in Australia but is most commonly smuggled from overseas countries.

This product carries no labelling or health warnings and is consumed in RYO form or inserted into empty cigarette tubes and sold in boxes which are available from tobacco retailers. The product is then sold loose in bags or pre-rolled tubes (called Chop Chop).⁽²⁾

The Australian Crime Commission believes that the majority of unbranded tobacco is imported rather than grown in Australia. It is distributed to retailers in the same way as counterfeit and contraband products.⁽¹⁾

Note: (1) Formerly known as Tobacco Industry Forum (TIF), recently changed as the result of recent changes by the Australian Taxation Office (ATO) forums

Sources: (1) Australian Crime Commission, *Organised Crime in Australia*, July 2013

(2) Tobacco Industry Stakeholder Group (TISG) formerly known as Tobacco Industry Forum (TIF)

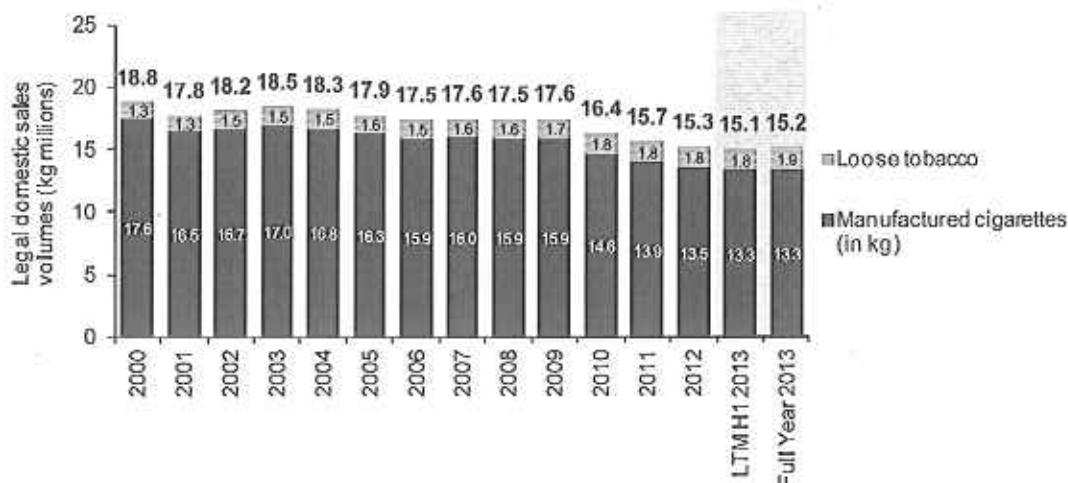
Australian tobacco market

The legal domestic sales volumes have gradually declined since 2000 but the decline appears to have levelled out in recent years

2.2 Legal tobacco market

2.2.1 Historic legal domestic sales

Legal domestic sales in Australia, 2000 – 2013^{(1)(2)(a)}



| CAGR (%) | 2000-09 | 2009-12 | 2000-12 | 2000-LTM H1 2013 | 2000-13 | 2012-13 |
|---------------------------|--------------|--------------|--------------|------------------|--------------|--------------|
| ■ Manufactured cigarettes | -1.1% | -5.3% | -2.2% | -2.2% | -2.1% | -1.1% |
| ■ Loose tobacco | 3.0% | 2.8% | 3.0% | 2.9% | 3.0% | 3.5% |
| Total market | -0.8% | -4.5% | -1.7% | -1.8% | -1.6% | -0.5% |

The overall sales of legal domestic tobacco in the full year 2013 declined by 0.5% from the previous year: a lower decrease compared to an annual fall of 1.6% between 2000 and 2013.

The legal domestic sales volumes between LTM H1 2013 and 2013 have largely remained flat, and the marginal increase witnessed has been driven by an increase in legal domestic sales volumes for loose tobacco and a slight increase in sales of manufactured cigarettes during the last quarter of 2013. This, in particular the slight increase in fourth quarter volumes, is consistent with and supported by recently released industry volume figures reflecting a small increase in sales by manufacturers into the tobacco trade.⁽³⁾

However, along with these marginal increases in legal sales between LTM H1 2013 and 2013 there was also an increase in illicit tobacco consumption.

Australian legal domestic sales volumes have gradually declined since 2000. The 25% increase in excise duties in April 2010 coincided with a 6.8% decline in legal domestic sales volumes.

Whilst manufactured cigarette volumes have declined at an annual rate of 2.1% over the last thirteen years, loose tobacco volumes have increased at an annual rate of 3.0% over the same period, representing a shift in the mix of tobacco products consumed.

Note: (a) Legal domestic sales numbers presented here are based on Euromonitor data. Through an analysis of confidential Exchange of Sales data, Euromonitor appears to underestimate actual sales and so we have taken a historic average to uplift Euromonitor manufactured cigarette volumes in each year by 2%. Loose tobacco volumes remain unchanged. Please refer to page 55 for details

Sources: (1) Euromonitor, Legal domestic sales, accessed January 2014

(2) KPMG analysis of data from Nielsen Australia and Aztec databases

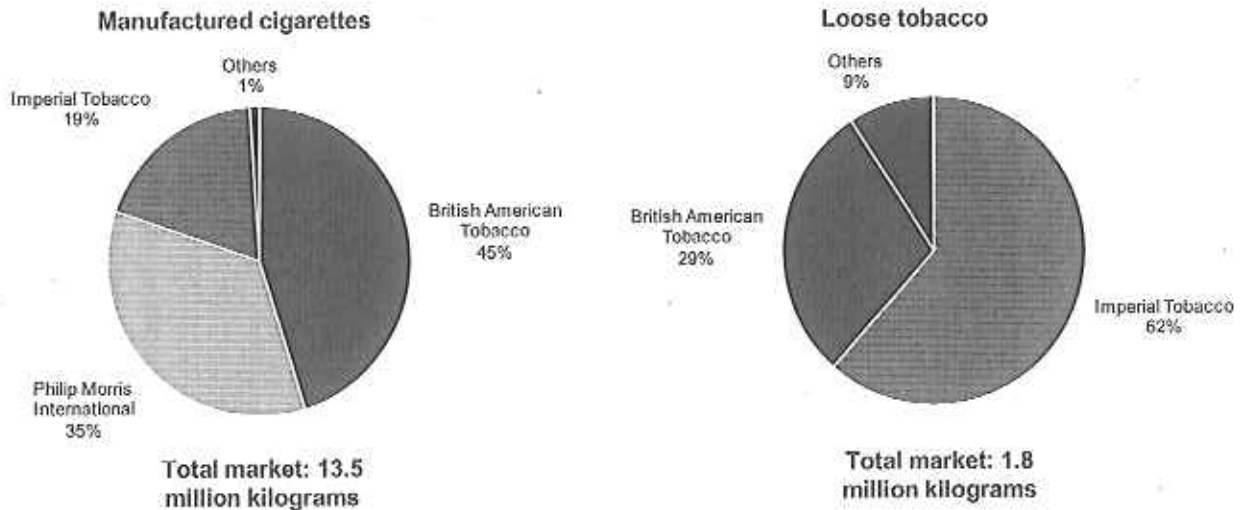
(3) Reuters, Australia tobacco sales edge up despite plain packaging, www.reuters.com/article/2014/03/24/tobacco-data-idUSL2N0M11D720140324

Australian tobacco market

BAT has the largest market share in manufactured cigarettes whilst Imperial Tobacco has the biggest market share in loose tobacco

2.2.2 Australia legal tobacco competitive overview

Market share by manufacturer, 2012^{(1)(a)}

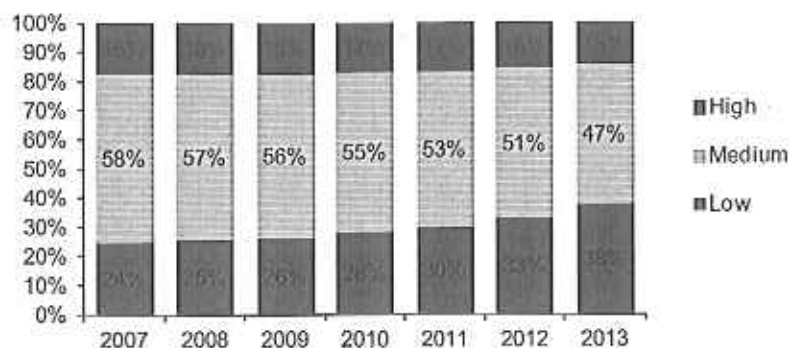


Market share

The three major tobacco manufacturers have large shares across both the manufactured cigarette and loose tobacco market. British American Tobacco has a market share of 45% in manufactured cigarettes with its brand Winfield having the largest market share of 23%.

Imperial Tobacco has the largest market share in loose tobacco with five of the top six loose tobacco brands.

Market share of manufactured cigarettes by price category, 2013⁽²⁾



Price category

Cigarettes are taxed by the stick rather than value and as a result increases in prices through excise tax do not increase the gap in price between high and low priced categories.

Since 2007 there has been an increase in the market share of low priced categories at the expense of medium and high priced cigarettes as people are switching to cheaper cigarettes. This trend appears to have developed further in 2013 as the low price segment increased by 5pp. between 2012 and 2013, the biggest increase since 2007.

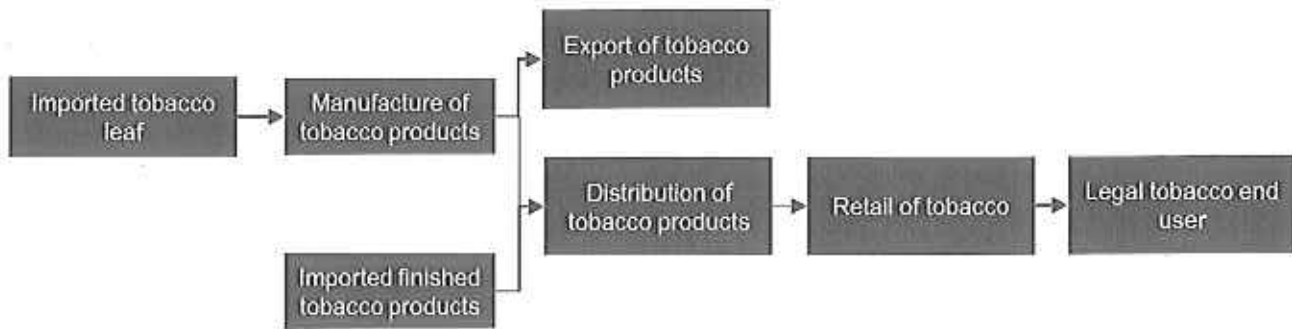
Note: (a) The market share information has not been updated since the H1 2013 report as new data from Euromonitor is likely to be available only by the mid of 2014

Sources: (1) Euromonitor, *Tobacco in Australia*, 2013

(2) KPMG analysis of Nielsen Australia - BAT Tobacco Industry database

2.2.3 Supply and distribution of legal manufactured tobacco in Australia

Supply chain for legal tobacco products in Australia, 2013



Tobacco supply chain

All manufactured tobacco products are imported into Australia as tobacco leaf or finished products. No tobacco is legally grown in Australia for commercial purposes. However, the majority of PML and BATA products are manufactured in Australia, whilst all of ITA's products are imported. Some of the products manufactured in Australia are exported to other countries in the region.

Non-domestic legal consumption channel

A small amount of tobacco is imported into Australia by consumers for their own personal consumption. Since 1 September 2012, consumers have a limit of 50 cigarettes or 50g of loose tobacco (down from 250 of each) which can be brought into Australia without paying excise duty. This volume can be brought in from the country of origin or through duty free sales channels. Given this low allowance, the non-domestic legal volume is likely to be a small proportion of consumption and is discussed further in the appendix A2.4.

3. Macroeconomic environment

- 3.1 Macroeconomic context
- 3.2 Gross domestic product growth
- 3.3 Unemployment
- 3.4 Personal Disposable Income
- 3.5 Consumer Price Index

The Australian economy has achieved steady growth over the last five years, with low unemployment rates compared with other OECD countries

3.1 Macroeconomic context

This section provides background on the Australian economy as a change in GDP growth, unemployment, personal disposable income or inflation, could impact consumer behavior and subsequently tobacco consumption.

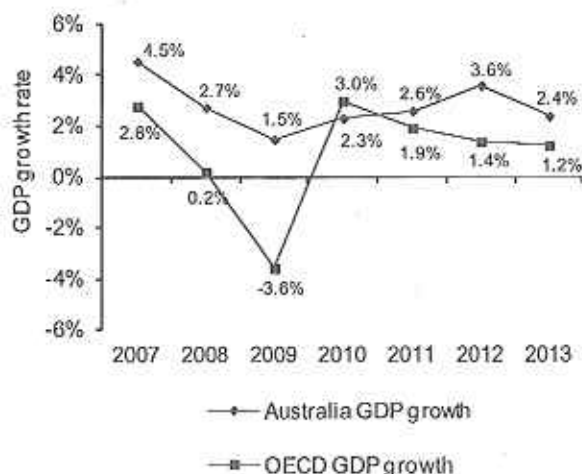
The decline in legal domestic sales since 2009 needs to be examined in the context of the affordability of tobacco products. Personal disposable income (PDI) and the consumer price index (CPI) are analysed in order to assess possible reasons for changes in consumer behavior.

3.2 Gross domestic product growth

Australia has been one of the few members of the OECD to have experienced continuous economic growth since the 1990s. The global financial crisis caused a slow-down in growth as opposed to a recession.

Between 2007 and 2012 the economy grew at a compound annual growth-rate (CAGR) of 2.5%; however, growth in 2013 appears to have slowed down.

Year-on-year GDP Growth, 2007 – 2013^{(1)(2)(a)}

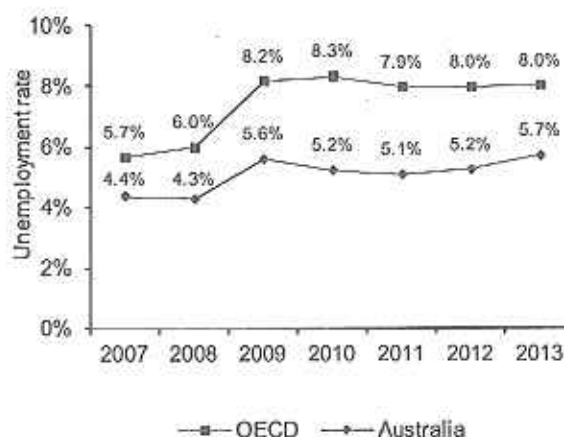


3.3 Unemployment

Unemployment in Australia is one of the lowest of all OECD countries. Unemployment increased in 2009 but remained broadly stable until 2012.

Unemployment in December 2013 was 5.9%, a slight increase from the 5.8% recorded in November 2013.⁽⁵⁾

Recorded unemployment, 2007 – 2013⁽³⁾⁽⁴⁾



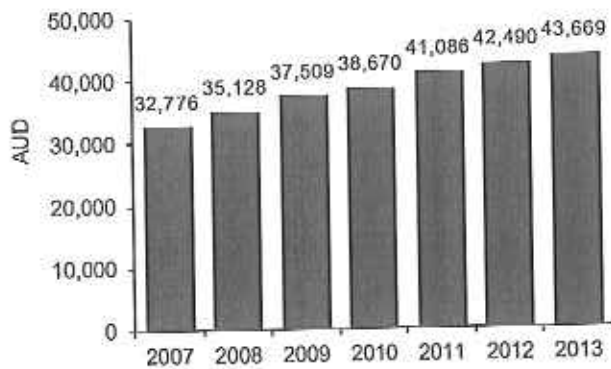
Note: (a) Historical numbers for GDP have been updated and have been based on data from the Economist Intelligence Unit
 Sources: (1) The Economist Intelligence Unit, GDP at constant prices, accessed March 2014
 (2) OECD, GDP (expenditure approach), accessed March 2014
 (3) The Economist Intelligence Unit, recorded unemployment as a percentage of total labour force, accessed March 2014
 (4) OECD, harmonized unemployment rates, accessed March 2014
 (5) Australia Bureau of Statistics

3.4 Personal Disposable Income

Australia has been through a period of increasing consumer disposable income during the past decade. Personal Disposable Income (PDI) per capita increased by 4.9% p.a. between 2007 and 2013.

Despite the global financial crisis, income levels in Australia do not appear to be considerably impacted with growth in PDI being supported by an increase in hours worked (by part-time workers) and increased hourly wages.⁽²⁾

Personal disposable income per capita, 2007 – 2013⁽¹⁾

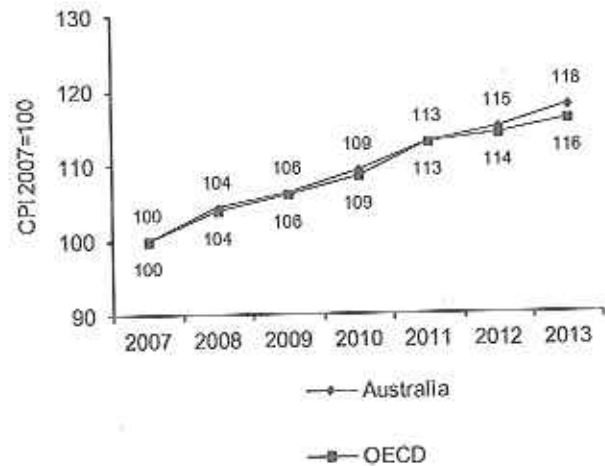


3.5 Consumer Price Index

Australia's Consumer Price Index has developed at the same pace as the OECD average, growing consistently since 2007. However, forecasts suggest that inflation will be higher than the OECD average in 2013.

The Economist Intelligence Unit forecast that annual inflation will average 2.8% in 2013-17 is subject to both upside and downside risk.⁽⁵⁾⁽⁶⁾ Interest-rate rises may relieve some inflationary pressure, but a revival in the housing market could cause inflation to accelerate.

Consumer price index, 2007 – 2013⁽³⁾⁽⁴⁾



Sources: (1) Euromonitor, Annual disposable income per capita, accessed March 2014
 (2) Productivity Commission media release, *Trends in the distribution of income in Australia*, March 2013
 (3) Euromonitor, Index of consumer prices, accessed March 2014
 (4) OECD Economics, Consumer prices, accessed February 2014, rebased to 2007
 (5) Economist Intelligence Unit, Consumer prices, accessed February 2014
 (6) Australian Bureau of Statistics, Consumer price index, accessed January 2014

4. Regulation and taxation

- 4.1 Tobacco regulation in Australia
- 4.2 Future proposed legislation
- 4.3 Recent development of excise duty and tobacco affordability in Australia
- 4.4 Regional tobacco prices
- 4.5 Relative price of illicit tobacco

The tobacco market in Australia is one of the most tightly regulated in the world

4.1 Tobacco regulation in Australia

In this section we discuss key government legislation and activities undertaken to control tobacco consumption. The advertising and promotion of tobacco is regulated by the Tobacco Advertising Prohibition Act 1992, and similar laws in each Australian state and territory. These laws set strict rules on how tobacco can be advertised, displayed and sold. The Department of Health and Ageing's National Tobacco Strategy aims to reduce smoking prevalence nationally from over 15% in 2012 to 10% in 2018.⁽¹⁾ To reduce smoking prevalence, numerous tobacco control regulations have been developed over time as demonstrated in Figure 4.1. A more detailed overview of recent legislative changes both at the Australian Commonwealth level and the state level are detailed in the appendix.

National Tobacco Strategy

The National Tobacco Strategy 2012-18 was released in January 2013. The strategy highlights nine priority areas including;

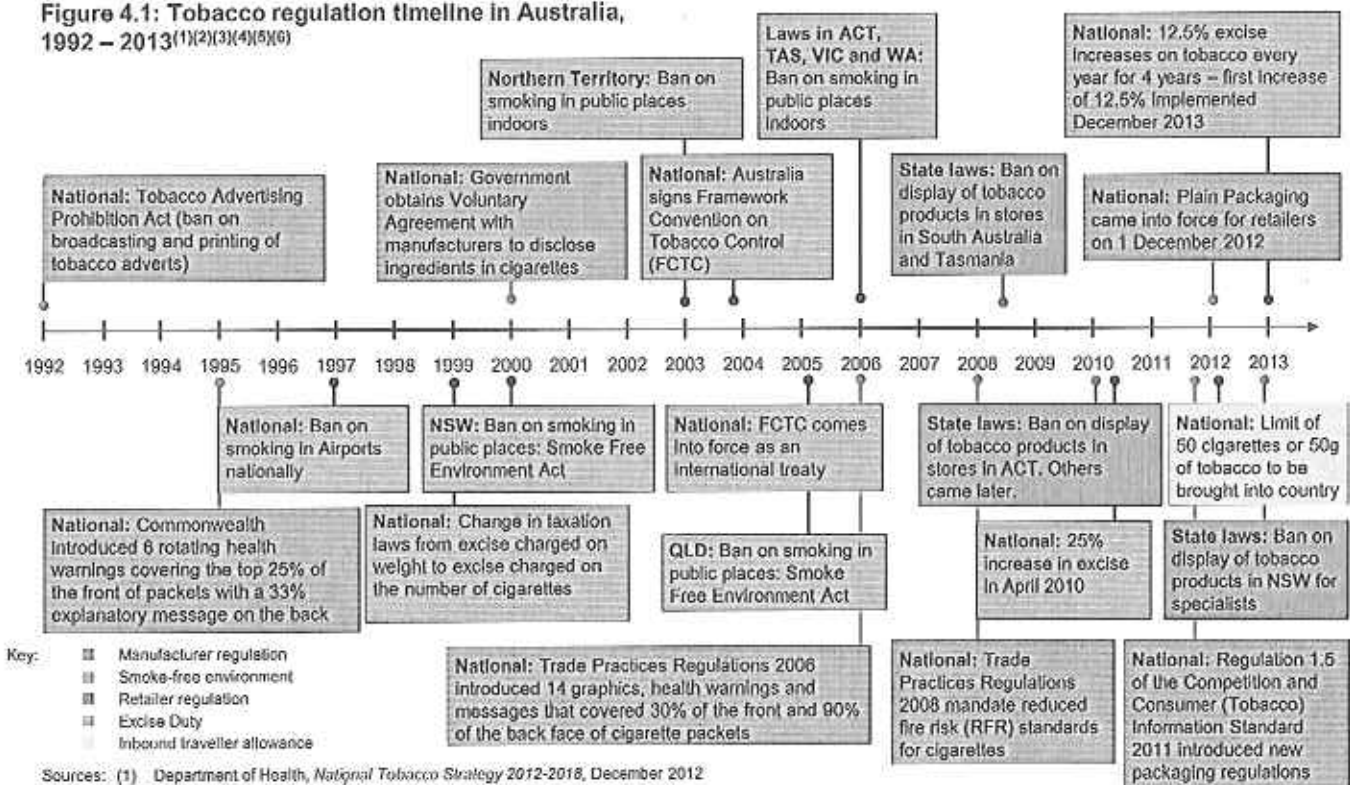
1. Protect public health policy, including tobacco control policies, from tobacco industry interference
2. Strengthen mass media campaigns to: motivate smokers to quit and recent quitters to remain non-

smokers; discourage uptake of smoking; and reshape social norms about smoking

3. Continue to reduce the affordability of tobacco products
4. Bolster and build on existing programs and partnerships to reduce smoking rates among Aboriginal and Torres Strait Islander people
5. Strengthen efforts to reduce smoking among people in populations with a high prevalence of smoking
6. Eliminate remaining advertising, promotion and sponsorship of tobacco products
7. Consider further regulation of the contents, product disclosure and supply of tobacco products and alternative nicotine delivery systems
8. Reduce exceptions to smoke-free workplaces, public places and other settings
9. Provide greater access to a range of evidence-based cessation services and support to help smokers to quit.

The strategy also proposes a number of actions to combat the illicit trade of tobacco.

Figure 4.1: Tobacco regulation timeline in Australia, 1992 – 2013⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾⁽⁶⁾



4.1 Tobacco regulation in Australia (continued)

Tobacco products regulation

Tobacco products are regulated through, amongst other things, bans on advertising and packaging restrictions. The Tobacco Advertising Prohibition Act in 1992 banned the publication or broadcast of tobacco advertisements.

Subsequent amendments to the Act have resulted in online tobacco retailers having to display health warnings and comply with restrictions on advertisement wording. Brand and variant information is permitted to be displayed.

The Tobacco Plain Packaging Act, passed in 2011, made Australia the first country in the world to implement plain packaging of tobacco products. This means that all tobacco products are required to be displayed in the same standard colour packaging with all trademarks banned and the only differentiator being the name of the brand and descriptor, printed in Lucida Sans font.

Smoke-free environment legislation

The majority of smoke-free environmental laws in Australia are determined by State parliaments and further fragmented by local council by-laws. The Australian Federal Government passed legislation to create smoke-free environments in areas within its own jurisdiction, such as airports and public transport, whilst State parliaments historically created their own laws banning smoking in some public places. State parliaments followed the Australian Commonwealth by passing legislation which banned smoking in restaurants in the early 2000s.⁽¹⁾

The establishment of the Framework Convention on Tobacco Control (FCTC) resulted in the creation of guidelines surrounding smoke-free environments which some State Parliaments adopted. In 2005 and 2006 the States passed laws which created smoke-free environments in public places including licensed premises, partially covered outdoor spaces and al fresco dining areas. States have continued to establish further smoke-free environments, including the banning of smoking on beaches, playgrounds and at stadia or other sporting events and concerts.⁽²⁾

Individual States in Australia have also passed laws which restrict smoking in cars with children under the age of 17.⁽²⁾ In November 2013, the Tobacco Amendment Act was passed by both houses of Victorian Parliament and will come into effect when proclaimed or on 1 October 2014 at latest. This bill aims to extend smoking bans to a range of areas especially where children are present.⁽³⁾

Retailer regulations

Australia has a Commonwealth wide law which bans the sale of tobacco products to anyone under the age of 18. During the 1990s, States introduced laws which imposed harsher penalties on vendors that sold cigarettes to individuals under 18 years. Some States have also undertaken surveillance programmes to ensure compliance. In order to further regulate retailers, some States have required vendors to hold licenses to sell tobacco. With the exception of Victoria and Queensland, all other States and Territories require tobacco retailers to hold a licence. In the States and Territories that do require a tobacco licence, fees range from AU\$200-AU\$302.22 per annum. In New South Wales, retailers must inform the Department of Health that they will sell tobacco products. This enables the State to have additional control over tobacco retailers, as it can threaten to withhold licenses in the event of sales to minors.⁽²⁾

States and Territories have also banned retailers from point of sale advertising and the display of tobacco products within stores. Australia Capital Territory (ACT), New South Wales, the Northern Territory, Queensland and Tasmania all have legislation in place banning point of sale displays. South Australia, Victoria and Western Australia have similar legislation; however, there are exemptions in place for specialist outlets.⁽²⁾ South Australia has an exemption until December 2014. Victorian specialist outlets who were granted exemption prior to 1 April 2014 will be able to continue displaying products, however following this date no new specialist licenses will be issued.⁽⁵⁾ There is currently no set timeframe for the expiration of the exemptions in Western Australia.

Some States and Territories have also applied restrictions on the number and operation of vending machines in licensed premises and gambling establishments.⁽²⁾ In the ACT, cigarette vending machines have been banned entirely.

The Victorian government recently announced its intent to quadruple fines for retailers caught with illicit tobacco.⁽⁵⁾

Note: (a) Customs duty is at the excise equivalent rate

Sources: (1) Tobacco Control Laws, *Campaign for tobacco free kids*, August 2013
(2) The Cancer Council Victoria, *Tobacco in Australia: Facts and Issues*, 2012
(3) Parliament of Victoria, www.legislation.vic.gov.au
(4) Australian Government, *Customs Amendment Act*, July 2013.

4.1 Tobacco regulation in Australia (continued) 4.2 Future proposed legislation

Duty free and customs allowances

In the 2012 budget, it was announced that the inbound traveller allowance from international travel would be reduced from 250g/250 sticks of tobacco per person to 50g/50 sticks.⁽⁹⁾

In 2012 Australia passed the Customs Amendment Act which conveyed new offences for smuggling or possessing illicit tobacco. It was the first time that custodial sentences were recommended for smuggling tobacco.⁽⁴⁾ Victoria has legislation pending which criminalises the possession of illicit tobacco or tobacco on which the appropriate excise duties have not been paid.⁽¹⁾

Excise duty increases

Australian excise duty has risen with inflation with the exception of a one-off 25% increase in 2010. The 2013-14 federal budget included a change to indexation of excise duty for tobacco and tobacco products from the Consumer Price Index (CPI) to Average Weekly Ordinary Time Earnings (AWOTE) commencing from 1 March 2014.

In August 2013 the Australian government announced excise duty increases in tobacco products of an additional 12.5% annually for the next four years in addition to the switch to AWOTE.⁽²⁾ The first of these increases was implemented on 1 December 2013, with further 12.5% increases to be applied on 1 September 2014, 1 September 2015 and 1 September 2016.⁽³⁾ As a result of these tax increases the excise on a pack of cigarettes in Australia will increase by 60% (compounded over four years) above the increase of AWOTE.

Framework Convention on Tobacco Control (FCTC)⁽³⁾

Australia became a Signatory to the World Health Organization's (WHO) Framework Convention on Tobacco Control (FCTC) on 5 December 2003. The Conference of Parties (COP) has adopted detailed guidelines for effective implementation of many of the broad range of legislative, executive, administrative and other measures required under the Convention. Together, the FCTC and its guidelines have the potential to help set the priorities of Australian governments, including Commonwealth, State and Territory, in relation to tobacco control policies and programmes.

The FCTC also provides a framework for international cooperation in a number of areas of tobacco control in which Australia and other Parties cannot effectively act alone. These include the regulation of cross-border tobacco advertising, promotion and sponsorship and the implementation of measures to address illicit trade in tobacco products.

Australia has the responsibility to cooperate with other FCTC Parties to address trans-boundary tobacco control problems and to assist other Parties in meeting common challenges to effective tobacco control.

The Australian tobacco industry participated in a consultation around the Anti-Illicit Trade Protocol (AITP). The AITP was adopted on 12 November 2012 and opened for signature from 10 January 2013 to 9 January 2014. When the AITP was closed for signature, it had been signed by 53 countries and the European Union. However, Australia is not among the countries that have signed the AITP.⁽⁵⁾

Continuous pursuit of smoke-free environments

State governments have continued to focus on the banning of smoking in public outdoor areas. Where States have not banned smoking in outdoor public areas, many local councils have issued the relevant bans and often play a key role in expanding public smoking restrictions. States continue to ban smoking or implement buffer zones at public events and any areas where children may be present such as open air concerts, playgrounds, sporting events and skate parks.⁽³⁾ Additionally, a number of states are also considering to impose smoking bans in prisons, with Northern Territory being the first to implement a smoking ban in prisons from 1 July 2013.⁽⁶⁾

Note: (a) Customs duty is at the excise equivalent rate

Sources: (1) Department of Health, Victoria

(2) Treasurer of the Commonwealth of Australia, *Government to increase tobacco excise*, August 2013

(3) Australian Customs Border Protection

(4) The Cancer Council Victoria, *Tobacco in Australia: Facts and Issues*, 2012

(5) Protocol to Eliminate Illicit Trade in Tobacco Products, www.treaties.un.org

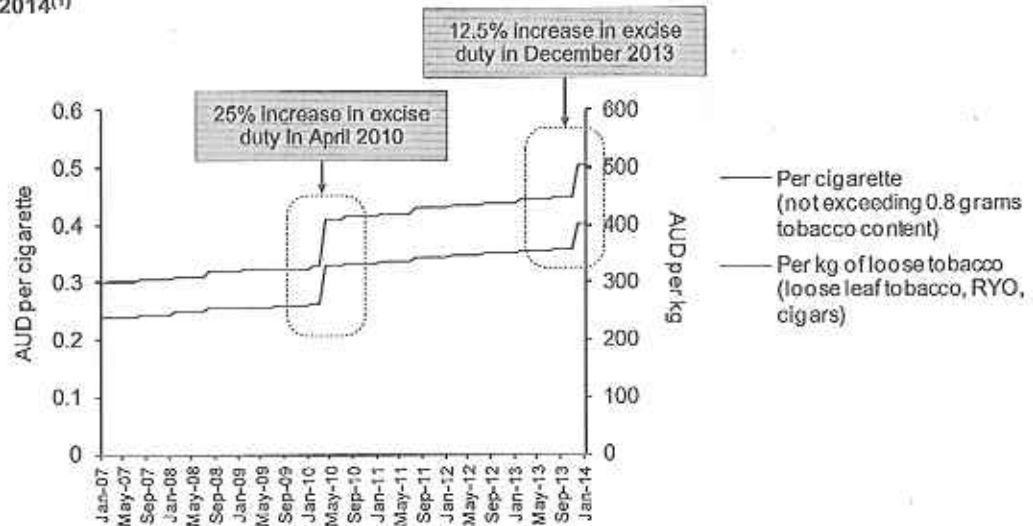
(6) Northern Territory Government Media Release, *Moving Towards a Total Smoking Ban in Northern Territory Prisons*, <http://newsroom.nt.gov.au/index.cfm?fuseaction=viewRelease&id=11006&d=5>, June 2013

Regulation and taxation

Excise rates have increased steadily in addition to two large excise increases: one in April 2010 and another in December 2013

4.3 Recent development of excise duty and tobacco affordability in Australia

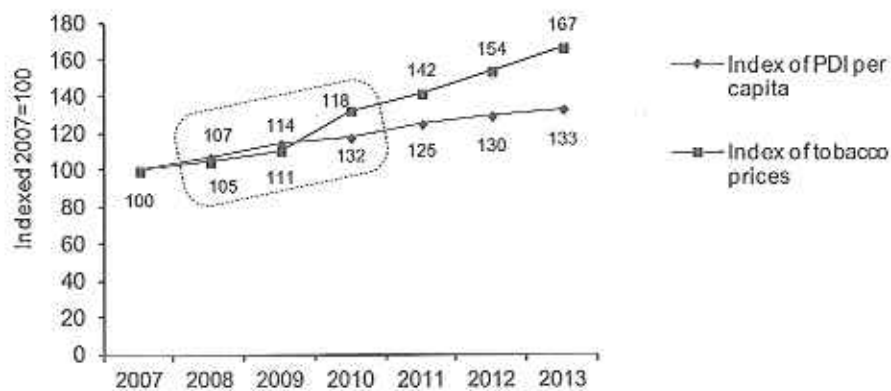
Values of tobacco excise and customs duty, Australia, January 2007 – January 2014⁽¹⁾



Excise rates are revised twice a year in February and August. Under the new regime, excise will be indexed to AWOTE in March and September.⁽²⁾ There was a one-off 25% increase in excise, introduced on 30 April 2010 in accordance with the National Preventive Health Strategy.

Excise duty on tobacco products increased by 12.5% in December 2013. The Australian government announced further successive excise duty increases of 12.5% above the rate of AWOTE in the September of each of the following three years.

Index of tobacco prices and per capita PDI, Australia, 2007 – 2013^{(3)(4)(a)}



Although PDI per capita has continued to grow, the excise rate increase in 2010, combined with subsequent increases, saw tobacco prices increase at a higher rate than PDI per capita.

This has resulted in a decline in relative affordability. This decline in relative affordability is likely to continue with the future planned excise rate increases.

Note: (a) Indexed with 2007 values taken as 100

Sources: (1) Australian Taxation Office, www.customs.gov.au

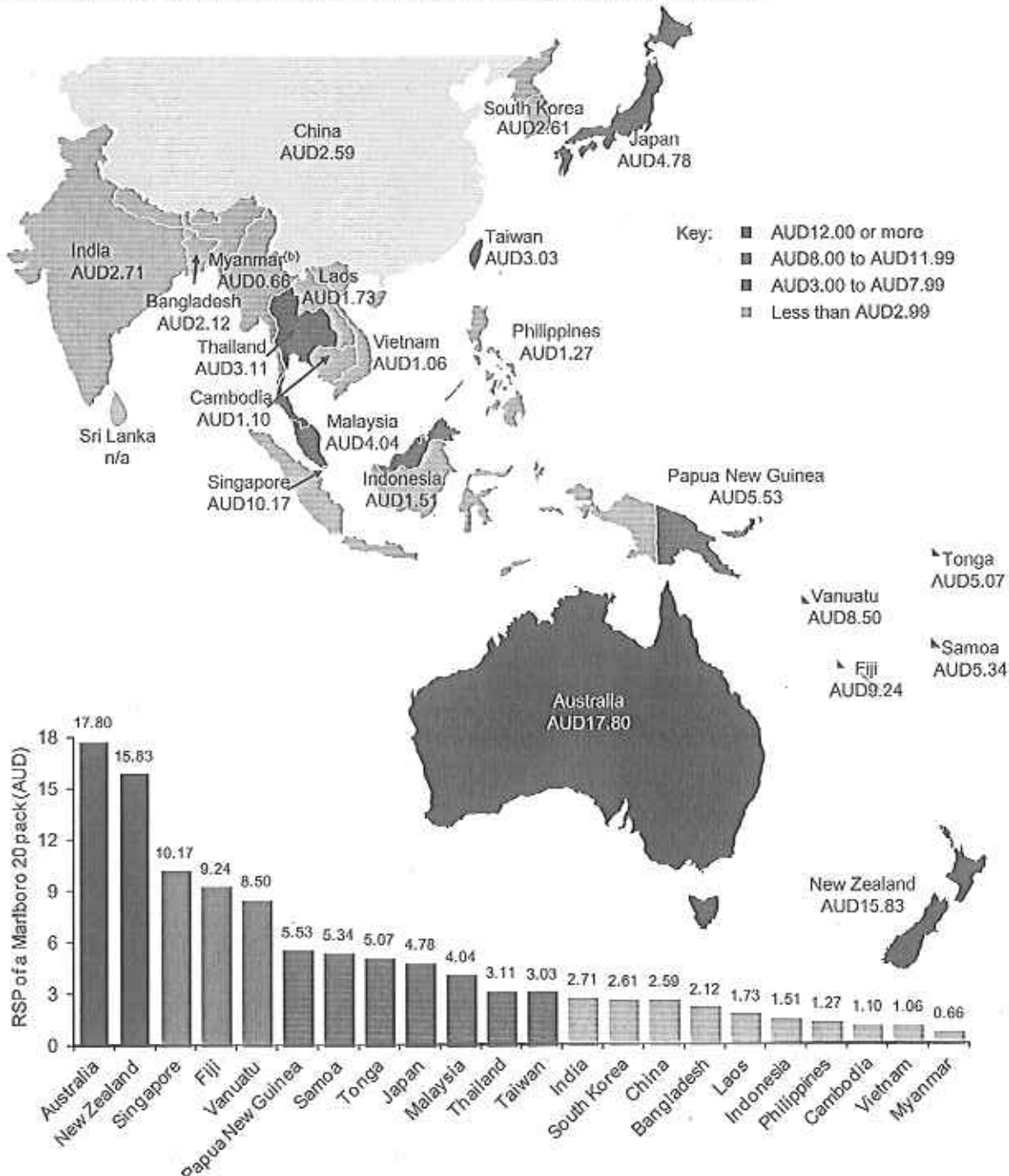
(2) Australian Government – Australian Taxation Office, *New legislation: Excise and excise-equivalent customs duty - index tobacco excise to average weekly ordinary time earnings*, 25 June 2013

(3) Euromonitor, *Index of tobacco prices*, accessed January 2014

(4) Euromonitor, *Annual disposable income*, accessed January 2014

4.4 Regional tobacco prices

Price of a pack of 20 Marlboro cigarettes – Australia and selected markets, 2013^{(1)(2)(a)}



Australia and New Zealand have significantly higher cigarette prices than surrounding markets in South East Asia, with Australian prices more than 50% higher than those of the nearest non-Australasian market.

This large price differential between Australia and other relatively nearby markets creates smuggling opportunities for those involved in the illicit market.

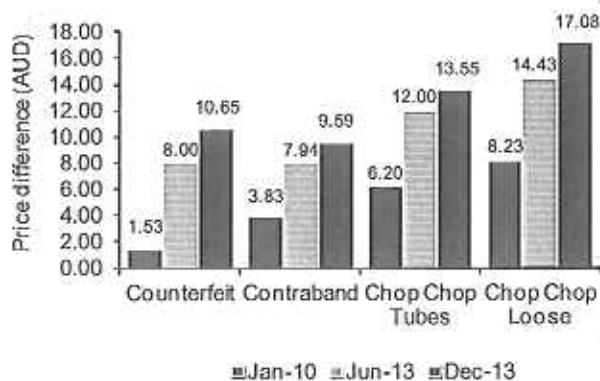
Notes: (a) Prices for a 20 cigarette pack of Marlboro (taxes included); where Marlboro is not available, a comparable premium brand has been used
 (b) In the H1 2013 report, the price of Duty Free Marlboro has been used to represent the price of premium brand in Myanmar. However, as Marlboro is not legally sold in Myanmar, the price of a comparable premium local brand, Red Ruby, has been used in this report.

Sources: (1) Industry data
 (2) www.oanda.com

The price differential between legal products and illicit products continues to widen

4.5 Relative price of illicit tobacco

Price differential of illicit products to a packet of Winfield 25s, 2010 – 2013^{(1)(a)}



Data provided by BATA based upon covert purchases made across Australia highlights the price difference of illicit products compared to legitimate products. While this data will be impacted by the split of random versus intelligence led purchases, the data will provide some insights into the size and change in the market.

The data illustrated above highlights the difference in price between different types of illicit tobacco products and a packet of legitimate Winfield 25s. The chart also shows how this difference in price has increased since January 2010.

Over the last three years, the largest relative increases have developed in counterfeit and contraband products and this price differential appears to have widened by the end of 2013. For instance, the per pack price of counterfeit cigarettes averaged AUD10.92 compared to AUD12.45 for a pack of Winfield in January 2010 (i.e. AUD1.53 price differential). By December 2013, however, although the average price of a counterfeit pack was approximately the same (AUD10.75), the price of Winfield had increased to AUD21.40 (i.e. AUD10.65 price differential).

The industry has also highlighted that prices of contraband in particular have increased by 37% since January 2010, which has likely fuelled bigger margins to smugglers and illegal retailers.

Note: (a) Contraband and counterfeit prices are an average of price for products found in Sydney and Melbourne. Unbranded prices have been converted to a pack of 25 cigarette equivalents

Source: (1) BATA intelligence data

5. Size of the illicit tobacco market

5.1 Estimating the illicit tobacco market

5.2 Illicit tobacco consumption in Australia

Size of the illicit tobacco market

We have used a robust, methodical and globally consistent approach to produce an estimate for the size of the Australian illicit tobacco market

5.1 Estimating the illicit tobacco market

Methodology and validation

As discussed in section 2.1, the illicit tobacco market is split into unbranded tobacco and illicit manufactured cigarettes in the form of counterfeit and contraband. Both of these categories taken together form total illicit consumption. It is therefore important to take account of all consumption flows when assessing the amount of illicit tobacco consumed.

The chart below illustrates how KPMG breaks consumption into a number of categories (defined in section 2.1) and how each category requires different data sources to estimate the size of the market and to validate the findings.

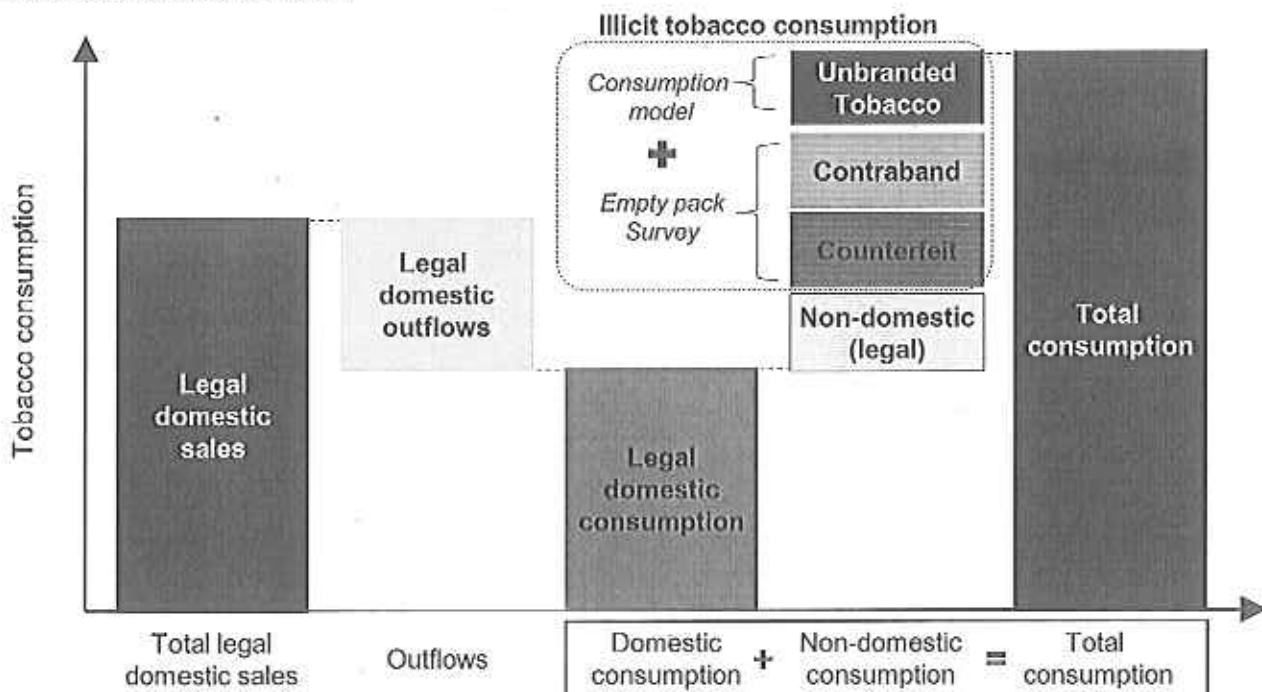
For each of these categories a separate primary approach is used in order to estimate the volume of illicit tobacco. For unbranded tobacco a consumption model approach is used, based on results from a consumer survey. This

includes Chop Chop (unbranded loose tobacco sold in bags) and unbranded tobacco sold in pre-filled tubes. For illicit manufactured cigarettes an empty pack survey analysis is used, based on the collection of discarded cigarette packs across Australia.

We believe this approach provides a robust estimate of the size of the illicit market in Australia. However, to further increase the level of confidence in this estimate, some alternative approaches are used to validate the illicit tobacco volumes generated by the consumption model and the empty pack survey analysis.

The validations can be used as alternative estimations, or to support trends and changes noted in the market. In this section each of the approaches are described before the process of estimation and validation is explained. A detailed overview of these approaches can be found in appendix A1.

Estimation of the illicit market^(a)



Data sources

Tobacco Industry database
(Nielsen, Aztec)
Euromonitor
Datamonitor
Exchange of Sales

RMR consumer survey
Tourism statistics

RMR consumer survey
Empty pack survey
Rolling papers sales data
Internal company
Intelligence data
Customs'
seizure data

RMR consumer survey
Health statistics

Note: (a) Definitions for the above sales categories can be found in the glossary on page 2

Size of the illicit tobacco market

We have used a broad range of approaches to produce an estimate for the size of the Australian illicit tobacco market

5.1 Estimating the illicit tobacco market (continued)

Primary approaches

Consumption model

This approach is based on the responses of consumers to the survey conducted by Roy Morgan Research in H2 2013. Like the LTM H1 report, the survey asks consumers about their consumption of both legal and illicit tobacco. These survey responses are then combined with other data sources to arrive at an estimate for total illicit tobacco consumption. Consumers are asked about both unbranded tobacco and illicit manufactured cigarettes.

For the purpose of this report, the consumption model number for unbranded volumes in the full year 2013 is based on the average of the H1 2013 and the H2 2013 consumer survey results. Since consumers are likely to give a more accurate estimate of their purchase behaviour over a shorter time period rather than the last twelve months, using an average of the H1 and H2 consumer survey results provide a more accurate number for 2013. Detailed results of the consumer survey are discussed in section 6.

Empty pack survey (EPS)

An empty pack survey is a study undertaken independently by MSIntelligence which collected 12,000 discarded cigarette packs across 16 different towns and cities in Australia. The brand and market of destination of each collected pack is assessed to determine whether it is a domestic or non-domestic product, and genuine or a counterfeit product. Products from different markets are labelled as non-domestic. The empty pack survey is used to extrapolate overall consumption in the market by projecting legal domestic sales. The percentages of non-domestic and counterfeit packs are added to this total in order to establish the total consumption of manufactured cigarettes in Australia.

We believe that the empty pack survey approach provides a robust and statistically significant estimate of the size of the illicit manufactured cigarette market. The results are not subject to respondent behaviour and are therefore less prone to sampling errors, whilst the 16 cities covered by the sample plan covers the equivalent of over 75% of Australia's population.

A small proportion of non-domestic cigarettes are likely to have been brought into Australia legally by Australians travelling overseas or by tourists arriving in Australia. Travel statistics from the Australian Bureau of Statistics are reviewed in order to determine the likely volume.

These non-domestic legal cigarettes are removed from the total non-domestic volume, which leaves the total illicit manufactured cigarette market, split into contraband and counterfeit cigarettes as described in section 2. The empty pack survey was used for the first time in the H1 2013 report to size the illicit manufactured cigarette consumption. The empty pack survey was not used previously because of the low levels of illicit manufactured cigarettes consumption. Recent observations that the consumption of illicit manufactured cigarettes has been growing now means that it is a required tool to gain a detailed understanding of these trends.

An empty pack survey was jointly commissioned by BATA, ITA and PML in 2012. The study was carried out by ACNielsen. Prior surveys were also run in 2009 and 2010 by ACNielsen on behalf of PML, and these have been made available to KPMG for use in this report.

For the purpose of this update report a new empty pack survey has been conducted in Q4 2013. The results from this survey have been used in conjunction with the empty pack survey results from Q2 2013 to arrive at an estimate for the illicit manufactured cigarette consumption for the year 2013. This method is consistent with the approach used by KPMG in Project STAR to assess the level of counterfeit and contraband cigarettes across the EU Member States. It is a widely accepted method for measuring the illicit market.

Means of validation

Rolling papers analysis

This analysis has been developed by KPMG and has been used with other clients to infer the volume of loose tobacco smoked from the quantum of papers sold. It compares this with the legal sales of loose tobacco to estimate a consumption gap between legal and illicit.

In order to use this approach several assumptions are made:

1. Grams per rolled cigarette
2. Wastage rate of rolling papers
3. Rolling papers used for consumption of illegal drugs

Data obtained in consumer surveys carried out by the industry and sales figures from rolling papers manufacturers are used in order to verify these assumptions, along with data from the National Drug and Alcohol Centre.

We have found from previous analyses that given the number of assumptions in this approach it is useful for providing a range of estimates for the market size to help validate other estimates.

5.1 Estimating the illicit tobacco market (continued)

Means of validation (cont.)

Seizures data

Seizures data obtained from the Australian Customs and Border Protection Authorities shows the volume and type of tobacco intercepted at ports and airports. Using seizure data to size the illicit market is often unreliable since it is difficult to ascertain the proportion of total illicit product that is seized. In addition, seizure data used to intercept tobacco products coming into Australia will not pick up loose tobacco which may have been illegally grown in Australia.

Whilst seizure data is unlikely to generate an accurate estimate for the illicit tobacco market, it can be used to indicate trends and validate any considerable changes to the illicit market. For example, an increase in manufactured cigarette flows from a country picked up in the empty pack survey could be validated with a corresponding increase in seizures from that country or in manufactured cigarettes representing a growing percentage of seizures. We also use internal tobacco company intelligence data as a validation of trends. However, since this data is commercially sensitive we are unable to publish it.

Consumption gap analysis

Consumption gap analysis is used to identify the 'gap' in consumption between legal domestic sales and total tobacco consumption, calculated based on the number of smokers known to exist in Australia and historic consumption patterns. The 'gap' between total consumption and legal domestic sales is likely to be filled by illicit tobacco consumption.

The consumption gap takes into account likely changes to the smoking population and the impact that it will have on tobacco consumption. For example, if legal domestic sales fell significantly, but there was no significant fall in the smoking population it may imply an increase in illicit tobacco consumption. Given the historic and consistent trends in tobacco consumption, significant drops are unlikely without major changes taking place in the market.

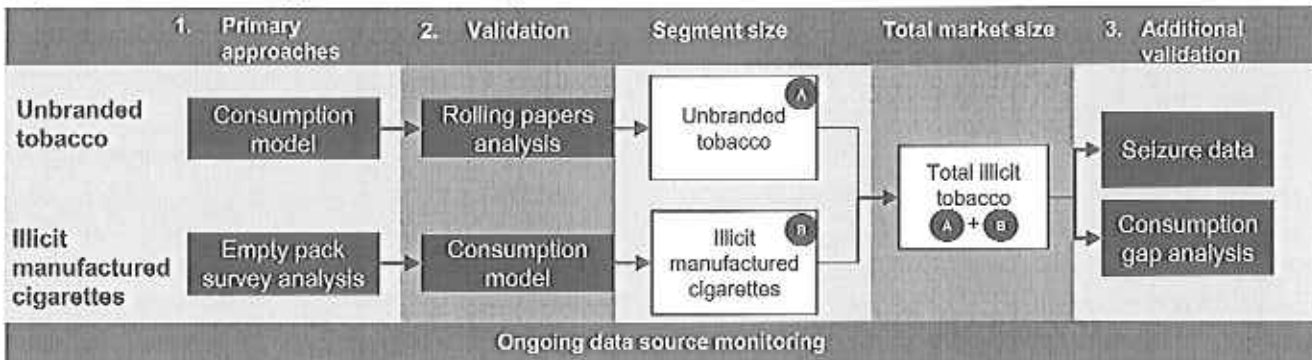
The consumption gap analysis is used in order to support any movements in the total illicit tobacco market across both unbranded tobacco and illicit manufactured cigarettes.

Size of the illicit tobacco market

The validation of our measurements with additional data sources provides confidence in the results

5.1 Estimating the illicit tobacco market (continued)

Figure 5.1 Overview of approach to estimating illicit tobacco



The empty pack survey and consumption model approaches are thought to be the most robust for estimating the illicit tobacco market. Figure 5.1 shows the process by which the consumption model and empty pack survey analysis is validated through alternative analysis.

1. Primary approaches

A Unbranded tobacco: The consumption model uses data from the Roy Morgan Research consumer survey; other external data sources such as the Australian Institute of Health and Welfare and the Australian Bureau of Statistics are taken into account to determine the result. Roy Morgan Research conducted consumer surveys in H1 2013 and H2 2013. Both surveys were leveraged to derive the estimated unbranded consumption volume in 2013.

B Manufactured cigarettes: The empty pack survey is the most reliable measure of contraband and counterfeit. It also forms the foundation for Project Star. Two empty pack surveys were conducted in 2013 (Q2 and Q4). A blended empty pack survey approach, assigning equal weighting to both surveys, has been used to size the illicit manufactured cigarette consumption volume for the year 2013.

Total illicit tobacco (A+B): The total illicit tobacco market size estimate is calculated by adding the results of the validated empty pack survey analysis for manufactured cigarettes (i.e. contraband and counterfeit) with the output of the validated consumption model for unbranded tobacco.

2. Validation

Rolling papers analysis is used in order to validate the unbranded tobacco market. Whilst assumptions relating to grams per tobacco, rolling paper leaf wastage and cannabls usage are hard to verify, rolling papers analysis is helpful to determine the likely ratio between consumption of loose tobacco and illicit loose (unbranded) tobacco.

The consumption model has historically been used in order to estimate the illicit volume of manufactured cigarettes. As

such it provides a good approach by which to validate the empty pack survey results.

3. Additional validation

Total illicit tobacco consumption (i.e. unbranded tobacco and manufactured cigarettes together) can be validated by two further data sources.

Seizures data can be used in order to validate the likely mix of illicit tobacco consumption. If the consumption model and empty pack survey show a large change in the mix of illicit products, seizures data should support this change.

Consumption gap analysis is also used in order to support the estimate for illicit tobacco consumption. Changes in total tobacco consumption tends to be a slow long-term decline, as seen by the decline recorded by the AIHW in surveys in 2007 and 2010. Given this consistent trend, the likely corresponding change in overall tobacco consumption is likely to follow an equivalent pattern. For example, large changes in total estimated consumption unprompted by external factors indicate there may be an issue in the estimation of illicit consumption.

Using this validation process enables us to understand and corroborate any major changes to illicit tobacco consumption.

Ongoing data source monitoring

We take a forward looking approach to ensuring the most appropriate data is used in the modelling process. For example, many surveys of smoking prevalence are conducted at irregular intervals whereas the actual decline is smooth over time between these periods. To avoid major future restatements that distort trends we continuously monitor the relevance of data sources and may rebase some data based on historic and forecast trends.

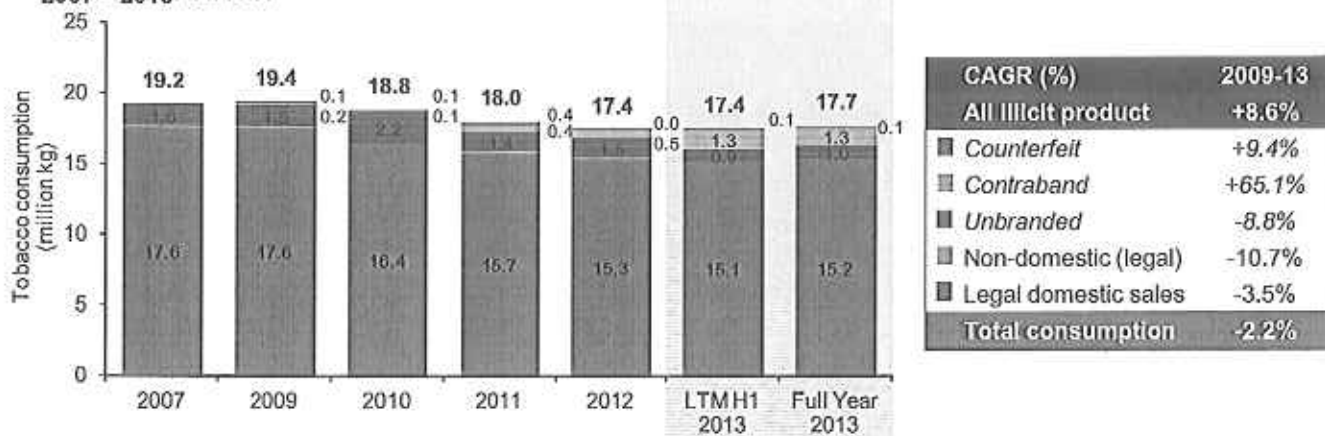
To ensure comparability with our ongoing methodology we have applied these changes retrospectively. See appendix A2 for details.

Size of the illicit tobacco market

Illicit tobacco accounted for 13.9% of total tobacco consumption in 2013, primarily driven by the increase in consumption of contraband products

5.2 Illicit tobacco consumption in Australia

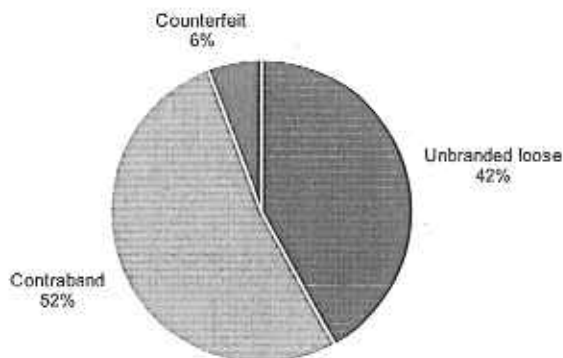
Consumption of tobacco products by category, 2007 – 2013^{(1)(2)(a)(b)(c)}



The overall level of tobacco consumption in Australia was calculated to be equal to 17.7 million kilograms in 2013, of which 2.45 million kilograms are estimated to be illicit. This estimate of total consumption is marginally higher than both the 2012 and the H1 2013 measures. This is contrary to the long term trend that shows a decline in tobacco consumption of 2.2% per annum between 2009 and 2013.

The full year 2013 consumption volumes support the structural shift within the illicit market towards illicit manufactured cigarettes and away from illicit unbranded tobacco which was highlighted in the H1 report. The growth since H1 2013, however, was driven by a slight increase of unbranded consumption whilst the illicit manufactured cigarettes consumption has stabilised. Whilst counterfeit consumption has increased in 2013, its share in total illicit consumption continues to be relatively small and contraband consumption remains the largest driver of illicit manufactured cigarette consumption.

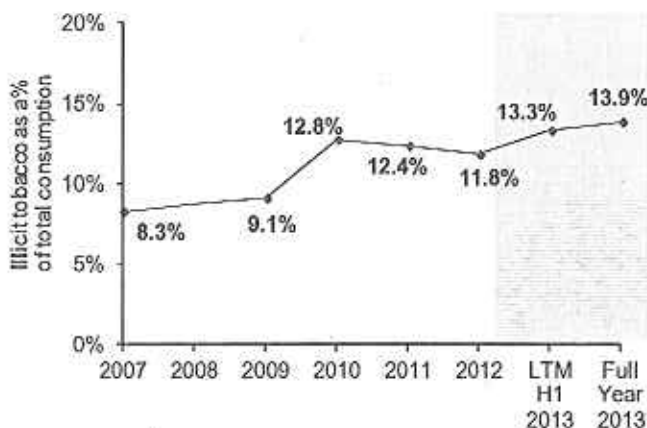
Share of illicit tobacco consumption, 2013⁽¹⁾



Since 2012 there has been an increase in both the illicit proportion of tobacco consumption and a change in mix of illicit products consumed away from unbranded tobacco and towards manufactured cigarettes. Volumes of illicit unbranded tobacco have declined by 31% whilst volumes of illicit manufactured cigarettes have increased by 151% between 2012 and 2013.

Overall consumption of illicit product is estimated to be equivalent to 13.9% of total tobacco consumption in 2013, 2.1 percentage points higher than in 2012. This is the highest level recorded and indicates a confirmation of an increase in illicit consumption highlighted in the H1 2013 report.

Illicit tobacco consumption as a proportion of total consumption, 2007 – 2013⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾



Notes: (a) H1 2013 represent consumption for the twelve months to end June 2013
 (b) Counterfeit and contraband estimations are unavailable for 2007
 (c) Non-domestic legal volumes are smaller than 0.1 million kg and volume labels have not been included for this category

Sources: (1) KPMG analysis
 (2) Deloitte, *Illicit Trade of Tobacco in Australia*, 2010, 2011, 2012
 (3) PricewaterhouseCoopers, *Australia's Illegal Tobacco Market*, 2007, 2009
 (4) Industry data

Size of the illicit tobacco market

The shift in mix towards manufactured cigarettes is supported by the consumption model. The validation process provides some certainty around the results

5.2 Illicit tobacco consumption in Australia (continued)

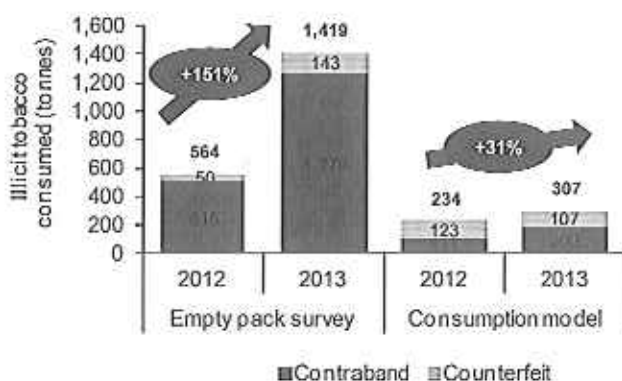
Table 5.2 Results of primary methodologies, 2012 – 2013

| 2012 and 2013 results (tonnes) | | 2012 | 2013 | % change (2012 - 2013) |
|------------------------------------|-------------|-------|-------|------------------------|
| 1. Illicit manufactured cigarettes | Contraband | 515 | 1,276 | 148% |
| | Counterfeit | 50 | 143 | 187% |
| | Total | 564 | 1,419 | 151% |
| 2. Unbranded tobacco | | 1,495 | 1,034 | -31% |
| 3. Total illicit tobacco | | 2,060 | 2,453 | 19% |

1. Illicit manufactured cigarettes

Based on the empty pack survey analysis, our full year 2013 estimation of the illicit manufactured cigarettes market is 1,276 tonnes for contraband and 143 tonnes for counterfeit. This represents an increase of 148% for contraband and 187% for counterfeit; and a total increase of 151%.

Estimates of illicit manufactured cigarettes, 2012 – 2013⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾



The empty pack survey and consumption model produce different estimates for the consumption of illicit manufactured cigarettes. See appendix A1.1 for a detailed analysis of the consumption model. There are a number of reasons that may explain the differences between the estimates:

- Consumers may have difficulty identifying if they have purchased a contraband or counterfeit product. Unbranded tobacco is much more obvious to determine. This will affect the consumption model estimate for manufactured cigarettes, but not the empty pack survey estimate.
- Some contraband and counterfeit is sold at full retail sales price which means respondents in these cases will not have an important indicator of illicit consumption. This is not an issue in the empty pack survey.
- There could be some underreporting by survey respondents who do not wish to admit to illicit activities.

However, both the empty pack survey (+151%) and the consumption model (+31%) indicate a considerable growth in the consumption of illicit manufactured cigarettes.

Given the robustness and credibility of the empty pack survey for manufactured cigarettes we have adopted the empty pack survey as our primary method of estimating illicit manufactured cigarettes consumption.

2. Unbranded tobacco

The consumption model indicates that the volume of unbranded tobacco consumed declined by 31% between 2012 and 2013, from 1.5 million kilograms to 1.0 million kilograms. This illicit volume is supported by the rolling papers analysis.

Our rolling papers analysis indicates that the unbranded tobacco market is likely to be between 0.7 million kilograms and 1.4 million kilograms. The 1.0 million kilograms sits comfortably within the mid point of this range. See appendix A1.3 for more detail.

Sources: (1) Deloitte, *Illicit Trade of Tobacco in Australia*, 2012
 (2) Roy Morgan Research, Consumer survey, H1 2013 and H2 2013
 (3) Euromonitor, Legal domestic sales, January 2014
 (4) KPMG analysis

Size of the illicit tobacco market – Key conclusions

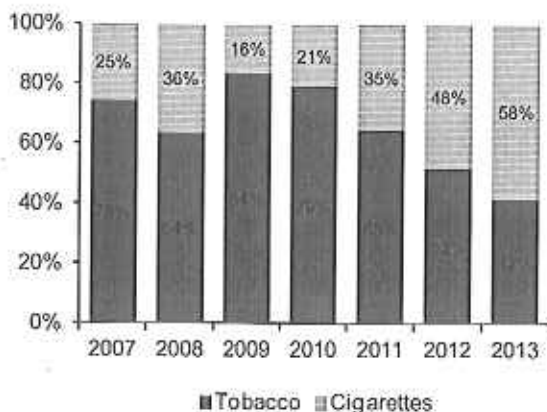
The additional validation process indicates that the trend and mix shift in illicit tobacco consumption is in line with secondary data sources

3. Overall illicit tobacco consumption

The estimated movement in the unbranded tobacco and manufactured cigarette consumption between 2012 and 2013 is an overall increase of 19.1% with illicit tobacco consumption rising to 2,453 tonnes in 2013. This increase is also characterised by a change in the mix of illicit tobacco consumed towards manufactured cigarettes. In 2013 manufactured cigarettes accounted for nearly 60% of total illicit consumption. The results are further validated by seizures data and consumption gap analysis.

Seizures data demonstrates a rise in the proportion of manufactured cigarettes as a percentage of illicit tobacco intercepted between 2009 and 2013. In 2009 16% of the volume of seizures came from manufactured cigarettes, whilst in 2013 58% of tobacco seizures were manufactured cigarettes.

Sea cargo seizures split by type of illicit tobacco, 2007 – 2013^{(1)(a)(b)(c)(d)}

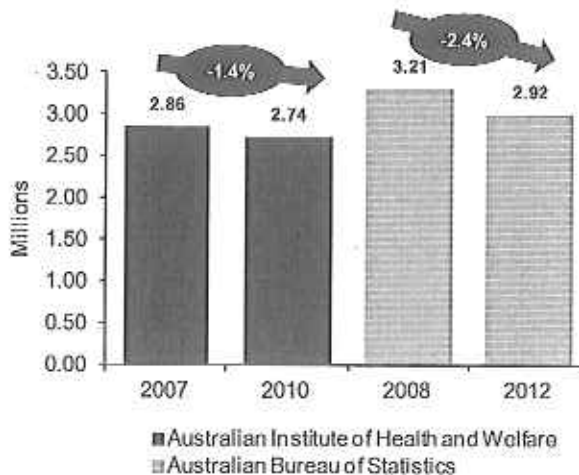


This indicates that the proportion of manufactured cigarettes smuggled into Australia appears to be growing as a percentage of total illicit tobacco, validating the growth of illicit manufactured cigarettes indicated by the primary approaches.

Recent seizures include eighty million cigarettes and over seventy tonnes of tobacco in Melbourne in October 2013.⁽²⁾ Additionally, in March 2014, the police seized 35,000 tobacco plants being grown illegally at Moorabool.⁽³⁾

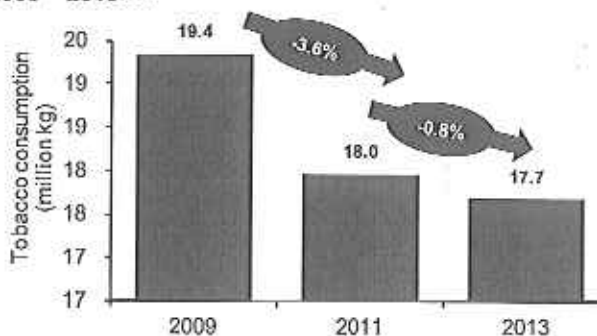
Consumption gap analysis indicates that both legal domestic sales and the smoking population have declined marginally in the long term.

Number of smokers⁽⁴⁾⁽⁵⁾



However, the smoking population has declined at a slower pace than legal domestic sales, indicating that there may be room for an increase in illicit tobacco consumption.

Estimates of year on year change in tobacco consumption, 2009 – 2013⁽⁶⁾⁽⁷⁾



The consumption gap validates the overall estimate of the volume of illicit tobacco, indicating shifts in the mix of illicit tobacco between manufactured cigarettes and unbranded tobacco. This corroborates the results of the empty pack survey analysis and consumption model.

Notes: (a) Illicit tobacco detections were also made in air cargo. However, volumes are considerably smaller and have not been included in the figures above

(b) Tobacco seizures have been converted to cigarette equivalents based on the conversion rates used for consumption modelling

(c) Numbers for 2012 have been updated and are based on data provided by the Australian Customs and Border Protection Service

(d) Percentages for 2013 are based on seizures data for the first six months of 2013

Sources: (1) Australian Customs and Border Protection Service, 2013

(2) The Age Victoria, Ten arrested in massive illegal tobacco bust, www.theage.com.au/victoria/

(3) Geelong Advertiser, Police seize 35,000 tobacco plants from Moorabool plantation, www.geelongadvertiser.com.au/news/

(4) Australian Institute of Health and Welfare, National Drug Strategy Household Survey, 2007, 2010

(5) Australia Bureau of Statistics

(6) KPMG analysis of previous reports on illicit trade in Australia, written by Deloitte between 2009 and 2012

(7) Deloitte, Illicit Trade of Tobacco in Australia, 2010, 2011, 2012

6. Drivers of results

6.1 Consumer survey results

6.2 Empty pack survey results

6.1 Consumer survey results

6.1.1 Roy Morgan Research survey overview

The consumer survey is a primary piece of research carried out to establish the size of the illicit tobacco market in Australia. The survey was again carried out by Roy Morgan Research to ensure comparability with previous years.

The survey made use of Computer Assisted Web-based Interviewing (CAWI). This enabled a sample of 2,116 adult respondents to be collected from 10,286 who responded to the email link sent out to Roy Morgan Research's pool of respondents in November 2013.

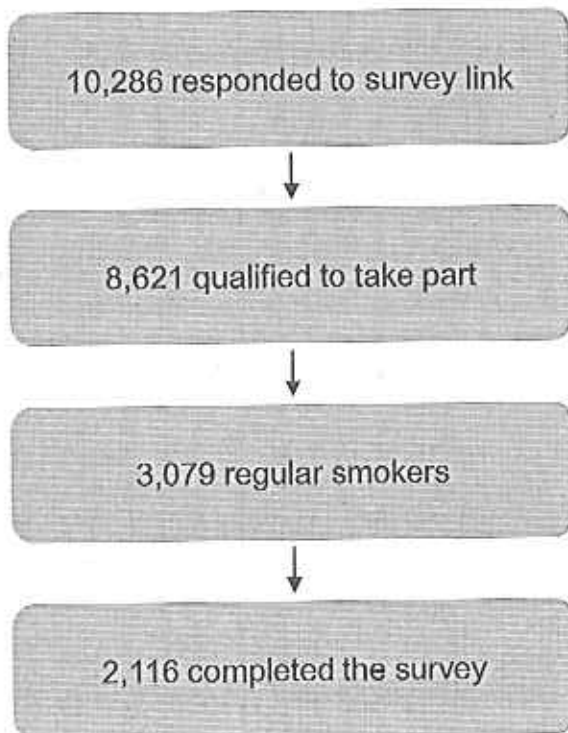
If a respondent was a regular smoker and fell into the correct demographic to be surveyed, they were considered eligible for the survey.

For the purposes of this report, a regular smoker is defined as a person who smokes tobacco products at least 5 days a week. The correct demographic is someone who is a regular smoker and above 18 years of age.

Of those who proved to be eligible for the survey, 69% completed the survey.

Founded in 1941, Roy Morgan Research (RMR) is an established Australian market research company. RMR have significant experience working with consumer surveys monitoring legal and illicit tobacco consumption and have provided the consumer research for all of the previous versions of this report.

Figure 6.1.1 Roy Morgan Research survey attrition chart



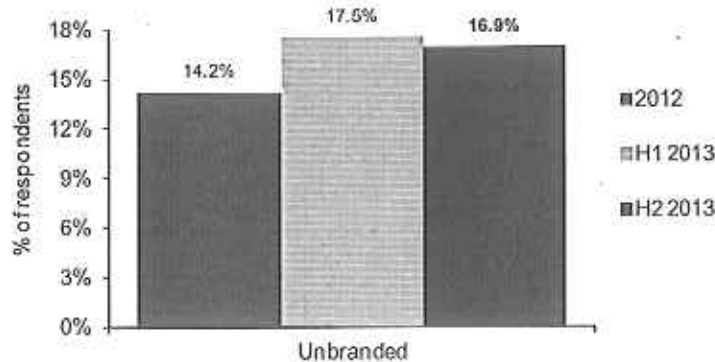
- Roy Morgan Research contact their panel by email in order to undertake the survey.
- The panel is based across a range of cities and demographics within Australia.
- The panel is filtered out with screening questions which enables the right demographics and a representative sample to be taken.
- The respondents are now broadly representative of Australia's demographics.
- The survey asks more screening questions about smoking habits and products smoked.
- This establishes that the panel are regular smokers.
- 69% of those that were filtered into the correct demographic completed the survey, reaching the target of over 2,000 respondents.
- Sample of over 2,000 respondents improves statistical significance.

Drivers of results

Whilst the proportion of smokers who purchased unbranded illicit tobacco has increased since 2012, the average frequency of purchase of unbranded tobacco declined over the same period

6.1.2 Purchasers of illicit tobacco

Proportion of respondents who reported purchasing illicit unbranded tobacco, 2012 – H2 2013^{(1)(2)(a)}

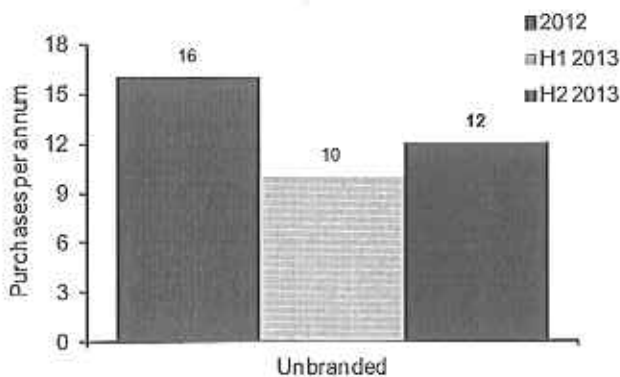


The H2 2013 Roy Morgan Research consumer survey saw a level of consistency in the key metrics between H1 2013 and H2 2013. The results showed that the proportion of respondents who said they purchased unbranded tobacco increased between 2012 and 2013, the average frequency declined whereas the average amount purchased remained broadly stable. Purchase frequency declined by approximately 25% and purchase amount by 11%.

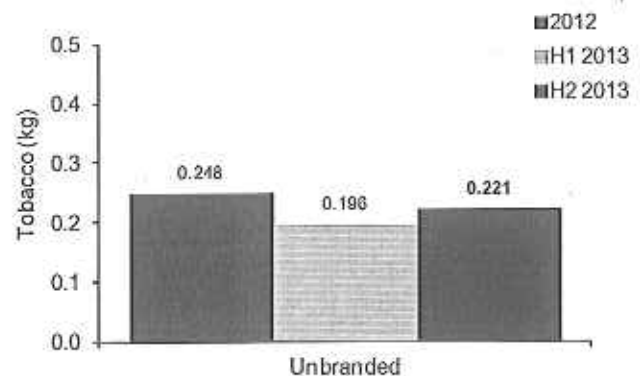
The combination of these movements in the consumption model equates to an overall decline in the amount of illicit unbranded tobacco consumed.

The change in consumption patterns may indicate a relative decline in the availability of illicit unbranded tobacco. Many respondents highlight that they purchase whenever illicit product is available.

Average frequency of purchase per annum, 2012 – H2 2013^{(1)(2)(a)}



Average volume purchased (kg) per occasion, 2012 – H2 2013^{(1)(2)(a)}



Note: (a) 2012 and 2013 analysis is based on CAWI consumer survey results

Sources: (1) Deloitte, *Illicit Trade of Tobacco in Australia, 2012*

(2) Roy Morgan Research, Consumer survey, H1 2013 and H2 2013

Drivers of results

The empty pack survey sampling plan comprised collection of 12,000 empty packs across 16 cities in Australia

6.2 Empty pack survey results

6.2.1 Australian empty pack survey sampling plan⁽¹⁾⁽²⁾

Empty pack surveys analyse discarded cigarette packets which have been collected from a set area. The aim is to collect a representative sample of discarded cigarette packets which can then be analysed to provide information about the nature of consumption of manufactured tobacco products.

Empty packs are collected on a proportionate basis from several neighbourhoods. Packs are collected from streets and easy access public bins in areas on the sampling plan.

For the purpose of this report, an empty pack survey was carried out by an independent market research agency; MSIntelligence (MSI) across October – November 2013. This Q4 2013 EPS collection was based on a sampling plan consistent with the Q2 2013 EPS sampling plan i.e. 12,000 empty packs, collected in the same neighbourhoods as in Q2 2013 across 16 cities in Australia, providing coverage for approximately 75% of the total population as shown in Figure 6.2.1.

Packs are collected from pre-determined neighbourhoods, selected to be representative of the city being sampled. Similarly, the neighbourhoods selected are also consistent with the previous surveys. Packs are collected irrespective of their brand and country of origin. Residences, offices and other locations such as stadiums have been excluded from the sampling plan.

After the collection is completed, to ensure the representativeness of the sample, packs are weighted based on the proportion of each city's population.

Founded in 2001, MSI is a private company with headquarters in Geneva, Switzerland specialising in market research. MSI have particular experience in the tobacco industry and conduct over 700 surveys a year in more than 70 countries.

Figure 6.2.1 Q4 2013 empty pack survey sampling plan

| City | Population (million) 2012 estimate ^(a) | Sample packs | Weighted packs |
|--------------------------------------|--|---------------|----------------|
| Sydney | 4.7 | 3,000 | 3,253 |
| Melbourne | 4.2 | 2,500 | 2,959 |
| Brisbane | 2.2 | 1,200 | 1,526 |
| Perth | 1.9 | 1,000 | 1,322 |
| Adelaide | 1.3 | 800 | 890 |
| Goldcoast – Tweed Heads | 0.6 | 400 | 412 |
| Newcastle | 0.4 | 400 | 292 |
| Canberra – Queanbeyan | 0.4 | 300 | 287 |
| Wollongong | 0.3 | 300 | 197 |
| Sunshine coast | 0.3 | 300 | 199 |
| Hobart | 0.2 | 300 | 151 |
| Geelong | 0.2 | 300 | 125 |
| Townsville | 0.2 | 300 | 120 |
| Calms | 0.1 | 300 | 98 |
| Darwin | 0.1 | 300 | 92 |
| Toowoomba | 0.1 | 300 | 77 |
| Total sample | 17.2 | 12,000 | 12,000 |
| Total population of Australia | 22.9 | | |

Note: (a) Population estimates for 2012 have been used as population numbers for 2013 were updated in December 2013, i.e. after the empty pack survey was conducted

Sources: (1) MSIntelligence Research, Empty pack survey, Q2 2013 and Q4 2013

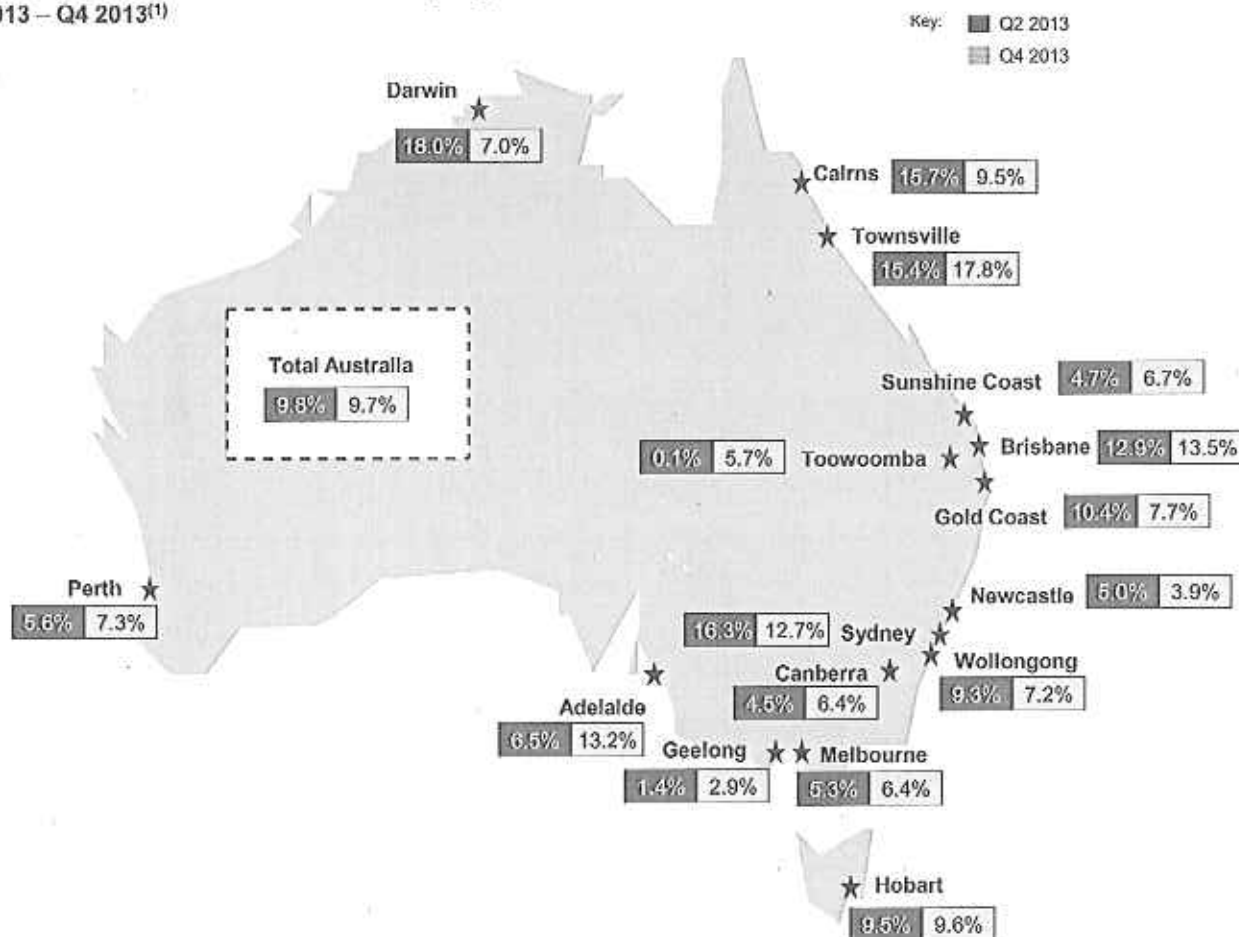
(2) Australian Bureau of Statistics

Drivers of results

The growth of non-domestic consumption continues to be a national trend with notable increases recorded in Adelaide, Toowoomba and Townsville

6.2.2 Australian empty pack survey results – non-domestic incidence by city

Figure 6.2.2 Total non-domestic incidence by city, Q2 2013 – Q4 2013⁽¹⁾



Consistent with the Q2 2013 empty pack survey findings, the non-domestic incidence was spread across the sixteen cities sampled in the Q4 2013 empty pack survey. Only Townsville recorded a non-domestic incidence higher than 15% in the Q4 2013 empty pack survey whereas Darwin, Sydney, Cairns and Townsville all recorded non-domestic consumption higher than 15% in the Q2 2013 empty pack survey.

A notable increase in non-domestic incidence was recorded in Adelaide (+6.8pp.) and Toowoomba (+5.5pp.) whilst there were notable declines in non-domestic consumption in Darwin (-11.0pp.), Cairns (-6.3pp.) and Sydney (-3.6pp.).

The pack survey shows a large increase in manufactured cigarettes from South Korea and other locations which has driven the growth in non-domestic incidence in Adelaide. In Darwin, a lower incidence of illicit whites has led to a reduction in the non-domestic incidence in the Q4 2013 empty pack survey. The share of illicit whites in Darwin declined to 23.4% in Q4 2013 from the 42.7% recorded in the previous quarter.

Additionally, the size of the city does not appear to be indicative of the non-domestic consumption as both small and large cities reported a range of incidences in the empty pack surveys for the last two years.

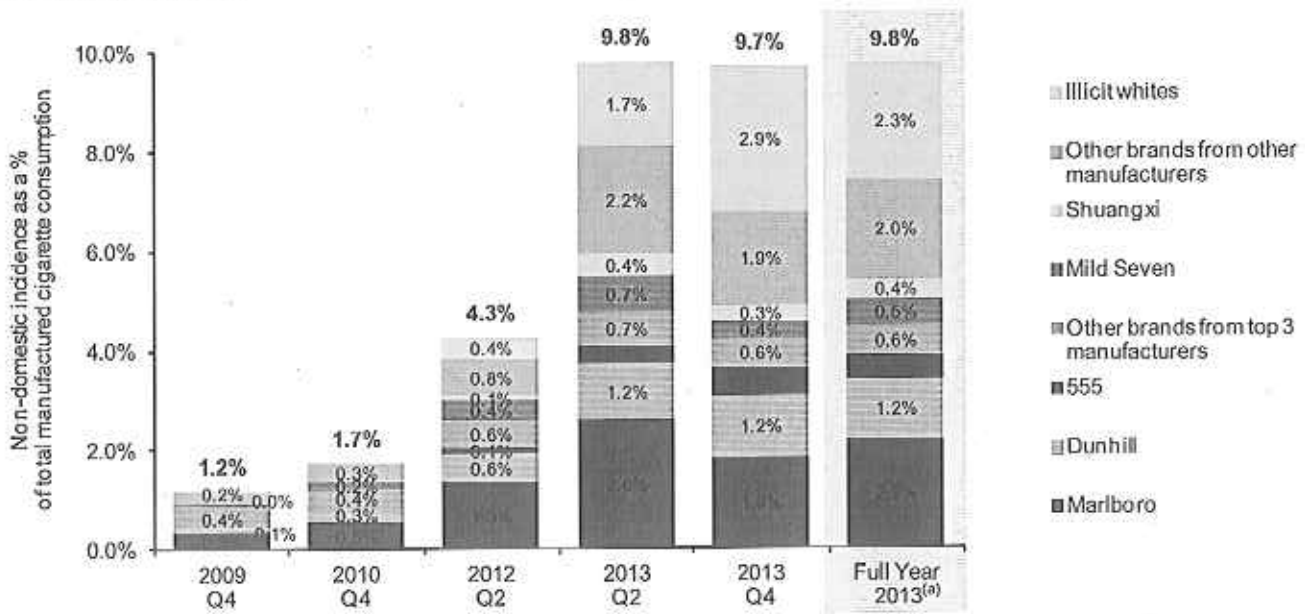
Source: (1) MIntelligence Research, Empty pack survey, Q2 2013 and Q4 2013

Drivers of results

Non-domestic incidence has increased in the past years across most brands as well as illicit white brands

6.2.3 Australian empty pack survey results – non-domestic incidence by brand

Total non-domestic incidence by brand as a percentage of total manufactured cigarette consumption
Q4 2009 – Q4 2013⁽¹⁾⁽²⁾



Two empty pack surveys were conducted in 2013 (Q2 and Q4). A blended empty pack survey approach, assigning equal weighting to both surveys, has been used to size the illicit manufactured cigarette consumption volume for the year 2013. As highlighted earlier, using the blended method is consistent with the approach used by KPMG in Project STAR to assess the level of counterfeit and contraband cigarettes across the EU Member States. A blended approach gives a more accurate view on the full year findings as each quarterly empty pack survey is reflective of market trends at that point in time only.

The empty pack survey findings indicate that the growth in non-domestic incidence since 2012 appears to be driven by an increase in the number of identified illicit white brands.

'Illicit whites' is a term for brands of manufactured cigarettes that are not legally available in the local market, although they could be legal at the point of manufacture. These brands are often made exclusively for smuggling.

Illicit white brands are not counterfeit products as they do not infringe on intellectual property rights. Illicit white volumes form part of the contraband volumes in Australia. Please refer to section 6.2.6 for further details.

The share of illicit whites has increased noticeably since 2012 and was 2.5pp higher in Q4 2013 when compared to 2012. Illicit whites account for approximately 30% of non-domestic manufactured cigarettes consumption in Q4 2013, up from 10% in Q2 2012. Legitimate brands produced by other manufacturers, including Mild Seven and Shuangxi, have witnessed a 1.3 pp increase during the same period. Marlboro remains the largest brand in terms of non-domestic consumption. However, as a percentage of total non-domestic manufactured cigarette consumption it has declined to approximately 19% from over 31% in Q2 2012.

Note: (a) The full year 2013 figures are based on the blended result of the Q2 2014 and the Q4 2013 empty pack surveys

Sources: (1) MSI Intelligence Research, Empty pack survey, Q2 2013 and Q4 2013

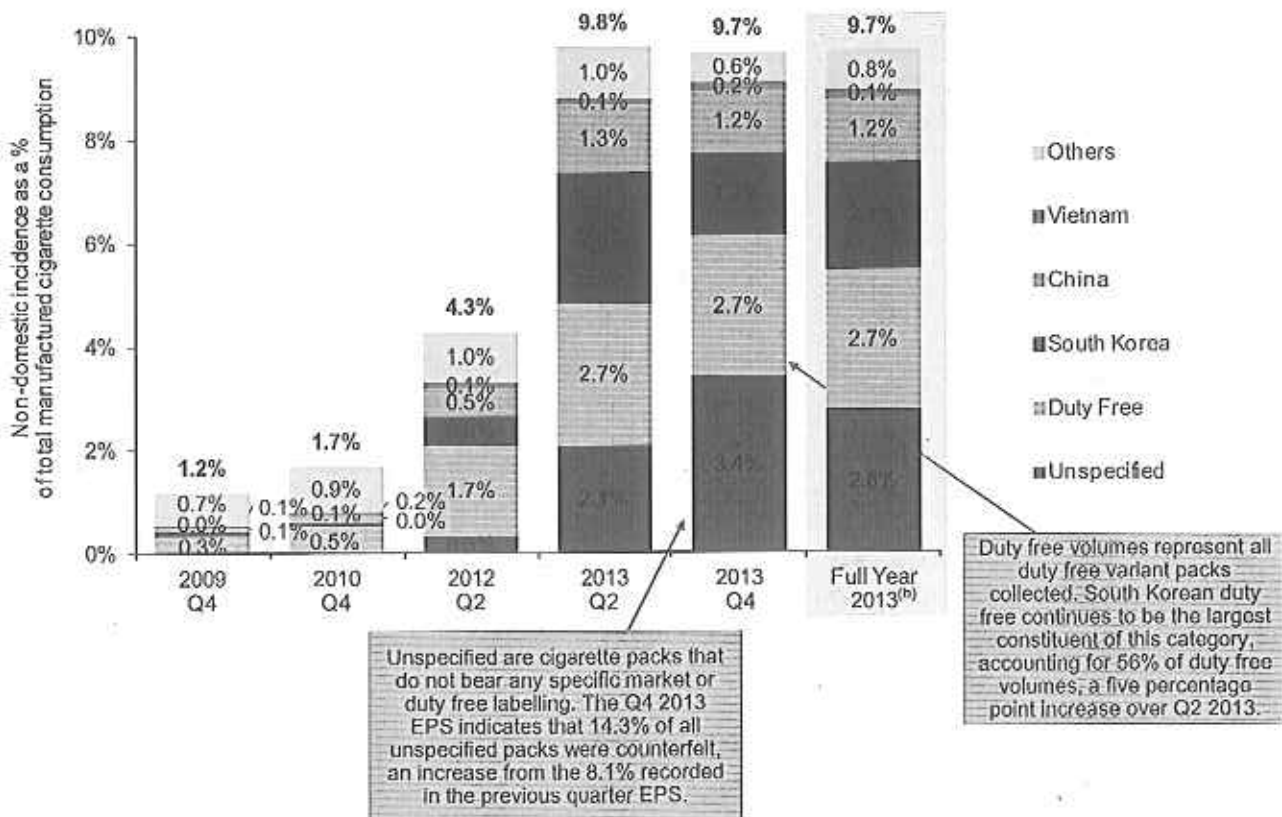
(2) AC Nielsen, Empty pack survey, 2009, 2010, 2012

Drivers of results

South Korean variant products have declined yet remain a large part of non-domestic manufactured products in the empty pack survey

6.2.4 Australian empty pack survey results – market variants

Total non-domestic incidence by market variant as a percentage of total manufactured cigarette consumption
Q4 2009 – Q4 2013^{(1)(2)(a)}



Neighbouring Asian countries continue to be the primary source for inflow of non-domestic manufactured products into Australia, with high levels of duty free products also present. South Korea (including South Korea duty free) remains the largest individual source country for non-domestic manufactured products. However, the share of South Korean products declined to 33% in Q4 2013 from the 40% recorded in the Q2 2013 empty pack survey.

Inflow of non-domestic manufactured products from unspecified destination markets have shown a sizeable increase in 2013. Unspecified destination markets were the largest constituent of non-domestic inflows in Q4 2013 empty pack survey with a share of over 35%. Unspecified are cigarette packs that do not bear any specific market or duty free labelling. Some unspecified packs are counterfeit. Based on the result of the Q4 2013 empty pack survey, 14.3% of all unspecified packs were counterfeit, an increase from the 8.1% incidence recorded in the Q2 2013 empty pack survey.

Note: (a) Vietnam has replaced Indonesia as the fifth largest constituent of non-domestic products in the Q4 2013 empty pack survey

(b) The full year 2013 figures are based on the blended result of the Q2 2014 and the Q4 2013 empty pack surveys

Sources: (1) MIntelligence Research, Empty pack survey, Q2 2013 and Q4 2013

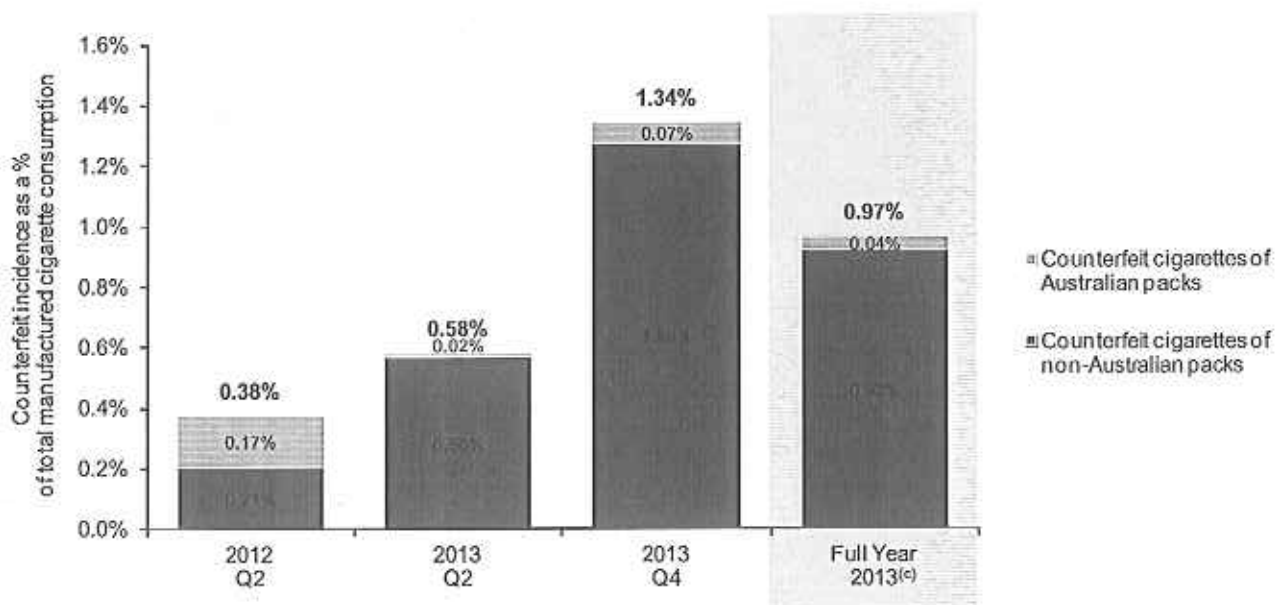
(2) AC Nielsen, Empty pack survey, 2009, 2010, 2012

Drivers of results

Counterfeit incidence has experienced a large increase in Q4 2013, more than double the Q2 2013 incidence

6.2.5 Australian empty pack survey results – counterfeit

Counterfeit incidence as a percentage of total manufactured cigarette consumption
2012–2013^{(1)(2)(a)(b)(c)}



The Q4 2013 empty pack survey indicates that 1.34% of all manufactured cigarettes consumed in Australia were counterfeit. This represents a greater than 100% increase of counterfeit incidence recorded in the Q2 2013 empty pack survey.

Although the share of counterfeit of total consumption remains relatively small, it is worth noting that this is the highest level of counterfeit incidence recorded in an empty pack survey in Australia.

Counterfeit cigarettes that were designed for the Australian market, i.e. compliant with Australian regulations, accounted for 4.6% of all counterfeit cigarettes consumed in 2013. This represents a change from 2012 where approximately 45% of counterfeit cigarettes consumed appeared to have been designed for the local market. Analysis of counterfeit packs has also highlighted that no plain packaged counterfeit packs were reported in the Q4 2013 empty pack survey.

- Notes: (a) Counterfeit incidence is not available for 2009, 2010 and 2011
(b) Counterfeit packs refer to counterfeit packs of the companies participating in the empty pack surveys only
(c) The full year 2013 figures are based on the blended result of the Q2 2014 and the Q4 2013 empty pack surveys
- Sources: (1) MSI Intelligence Research, *Empty pack survey*, Q2 2013 and Q4 2013
(2) AC Nielsen, *Empty pack survey*, 2012

Consumption of counterfeit cigarettes has more than doubled and was located in 15 out of the 16 cities sampled in the Q4 2013 empty pack survey

6.2.5 Australian empty pack survey results – counterfeit

Figure 6.2.5 Consumption of counterfeit manufactured cigarettes by city 02 2013 – Q4 2013^{(1)(a)}

Empty pack survey Q2 2013

Empty pack survey Q4 2013

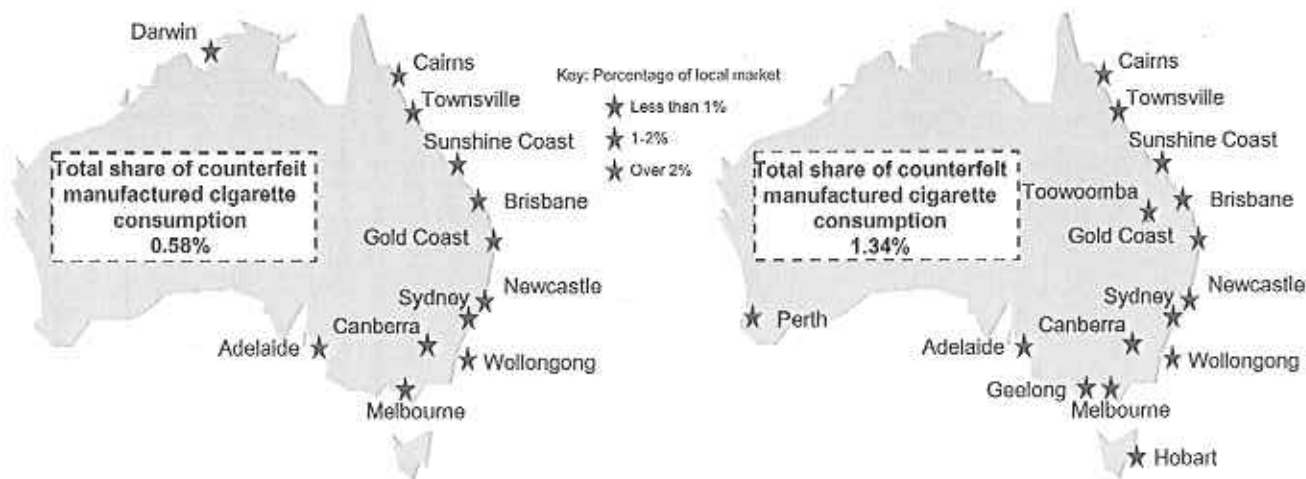


Figure 6.2.5 shows the growth of counterfeit cigarettes in Australia between Q2 2013 and Q4 2013. The empty pack survey for Q4 2013 showed that total consumption of counterfeit cigarettes had grown from 0.58% to 1.34% of manufactured cigarettes. It was located in 15 out of 16 cities across Australia, compared to 12 cities in Q2 2013.

The highest increase in counterfeit incidence in Q4 2013 was observed in Hobart and Brisbane. Incidentally, Hobart recorded no counterfeit incidence in the Q2 2013 empty pack survey and Brisbane had a share of less than 1%.

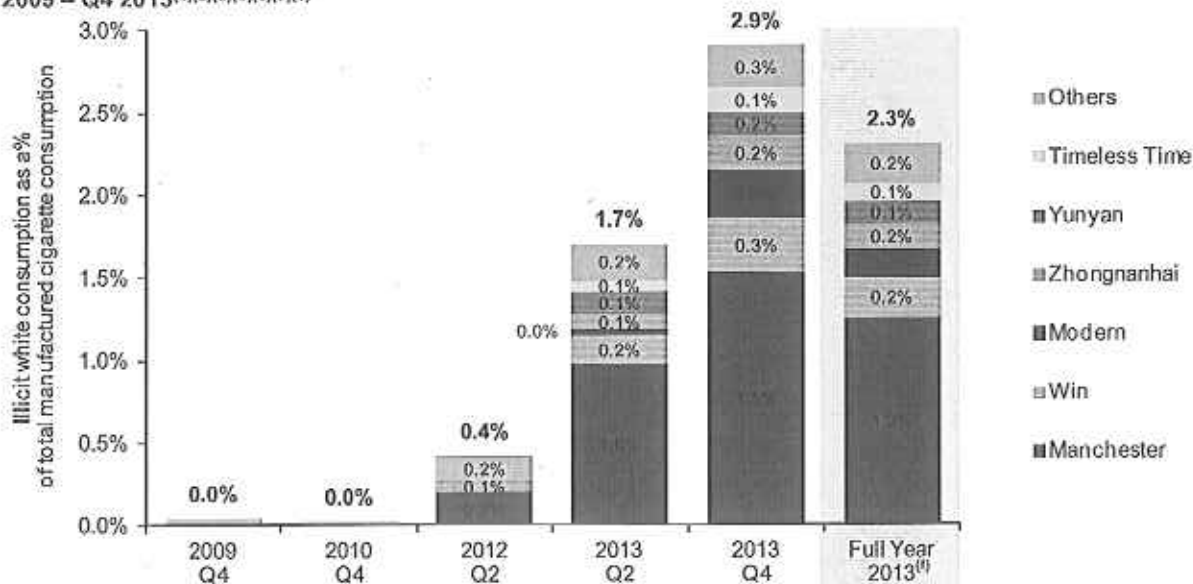
Geelong, Hobart, Perth and Toowoomba were the four new cities where counterfeit cigarettes were found in the Q4 2013 empty pack survey whilst Darwin was the only city which did not record any counterfeit incidence.

Notes: (a) Analysis is based on weighted number of sticks
 Source: (1) MSI Intelligence Research, Empty pack survey, Q2 2013 and Q4 2013.

The consumption of illicit whites continues to be a growing issue and Manchester remains the largest illicit white brand in Australia

6.2.6 Australian empty pack survey results – illicit whites

Consumption of selected illicit white brands as a percentage of total manufactured cigarette consumption
Q4 2009 – Q4 2013^{(1)(2)(a)(b)(c)(d)(e)}



As indicated earlier, 'illicit whites' is a term for brands of manufactured cigarettes that are not legally available in the local market.

Industry sales data on illicit white cigarettes shows that between July and December 2013, an illicit white pack was sold at an average price of AUD8.68. This represents a slight increase from the average selling price of AUD8.60 recorded between March and June 2013. The illicit white packs in general continue to be sold at a price which is 50% less than the cost of a Marlboro or Winfield Blue.⁽³⁾

For consistency with the rest of this report, we are expressing illicit whites as a percentage of sticks. In the H1 2013 report, it was reported as a percentage of packs. As a result, the numbers reported are slightly lower than those reported previously due to the fact that illicit whites tend to come in smaller pack sizes.

According to the Q4 2013 empty pack survey, 2.9% of all manufactured cigarettes consumed in Australia were illicit whites, an increase from the 1.7% consumption recorded in the Q2 2013 empty pack survey.

As highlighted in the H1 2013 report, this analysis is based on the combined volume of selected illicit white brands, focusing on the most prominent brands identified in 2013.

Analysis of the total illicit white volumes in a market is difficult to perform as manufacturers of illicit whites often change brand names frequently in order to avoid detection.

In addition to the brands classified as illicit whites in the H1 report, we have identified five new illicit white brands in the Q4 2013 empty pack survey. These brands are Modern, Mega, Bridgeway, Kingdom and Ashima. With the exception of Modern, all other new brands have a relatively small share and have been classified as others.

Manchester continues to be the largest illicit white brand in Australia. According to the Q4 2013 empty pack survey results, Manchester represented 1.5% of total manufactured cigarette consumption and if it were sold legally in Australia it would have an equivalent legal market share of 1.7%.⁽¹⁾

Incidence of illicit whites increased by over 500% between Q2 2012 and Q4 2013, a much larger increase than that of the total contraband incidence. According to the Q4 2013 empty pack survey findings, illicit whites now make up approximately 30% of non-domestic manufactured cigarette consumption.

Notes: (a) Others include Mega, Septwolves, Sunlite, Bridgeway, Kingdom, Ashima, Modeng, Asia Cup and Master brands
(b) The following brands were not included in the H1 2013 report because we had limited information at that time to establish their status as illicit whites: Modern, Mega, Bridgeway, Kingdom and Ashima
(c) The top six brands reported in the Q4 2013 empty pack survey are different from the ones reported in the H1 2013 report. Modern is the new brand that has come in and Sunlite has now been classified under others
(d) These brands are known illicit whites as provided by the industry
(e) The share of illicit whites is calculated based on the number of sticks, however, in the H1 report the share of illicit white brands was calculated based on weighted packs. The share of illicit whites when calculated based on weighted packs would have been: 0.1% in Q4 2009, 0.0% in Q4 2010, 0.5% in Q2 2012, 2.0% in Q2 2013 and 3.5% in Q4 2013
(f) The full year 2013 figures are based on the blended result of the Q2 2013 and the Q4 2013 empty pack surveys
Sources: (1) MIntelligence Research, *Empty pack survey*, Q2 2013 and Q4 2013
(2) AC Nielsen, *Empty pack survey*, 2009, 2010, 2012

Consumption of Manchester cigarettes continues to increase and was located in 15 out of the 16 cities sampled in the Q4 2013 empty pack survey

6.2.6 Australian empty pack survey results – illicit whites

Figure 6.2.6 Consumption of Manchester by city Q2 2013 – Q4 2013^{(1)(a)}

Empty pack survey
Q2 2013

Empty pack survey
Q4 2013

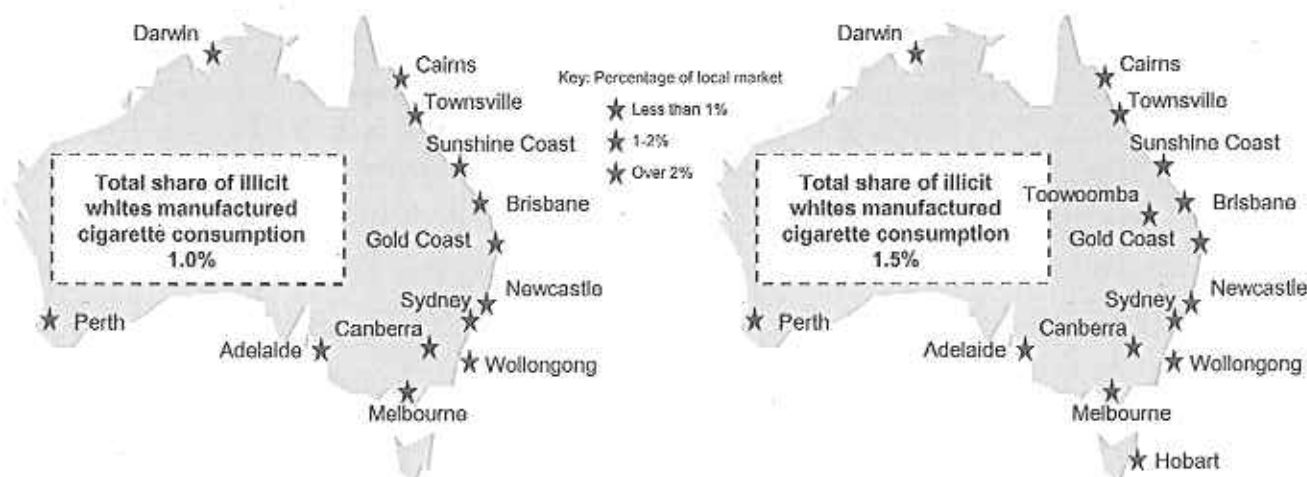


Figure 6.2.6 shows the growth of Manchester in Australia between Q2 2013 and Q4 2013. The Q4 2013 empty pack survey shows that total consumption of Manchester has grown from 1.0% to 1.5% of manufactured cigarettes, and it was located in 15 out of 16 cities across Australia, compared to 13 cities in Q2 2013.

Hobart and Toowoomba were the two new cities where Manchester was found in the Q4 2013 empty pack survey. Incidentally, Hobart along with Brisbane also reported the highest shares of Manchester in Q4 2013. Brisbane and Hobart had a share of 2.7% and 2.5% respectively.

Manchester is not sold legally in any retail outlets in Australia but Manchester appears to be available throughout the country. Whilst 73% of Manchester cigarettes collected in Q2 2013 were found in Sydney, in Q4 2013 they were distributed between Sydney (37.3%), Brisbane (21.6%) and Melbourne (13.2%). Together they accounted for approximately 72% of the total cigarettes of Manchester that were collected in Q4 2013.

Note: (a) Analysis is based on weighted number of sticks, however, in the H1 report the share was calculated based on weighted packs
Source: (1) MSI Intelligence Research, Empty pack survey, Q2 2013 and Q4 2013

7. Conclusion

Conclusion

A nation wide issue, illicit tobacco consumption rose from 11.8% in 2012 to 13.9% in 2013. Total consumption of tobacco in Australia also grew in 2013

| 2012 and 2013 results (tonnes) | | | | | |
|--|--------------------|---------------|-----------------|-----------------|--------------------|
| | | 2012 | LTM H1 2013 | Full Year 2013 | % change (2012-13) |
| Illicit manufactured cigarettes | <i>Contraband</i> | 515 | 1,348 | 1,276 | 148% |
| | <i>Counterfeit</i> | 50 | 85 | 143 | 187% |
| | <i>Total</i> | 564 | 1,433 | 1,419 | 151% |
| Unbranded tobacco | | 1,495 | 895 | 1,034 | -31% |
| Total illicit tobacco | | 2,060 | 2,329 | 2,453 | 19% |
| Illicit tobacco consumption as % of total consumption | | 11.8% | 13.3% | 13.9% | n/a |
| Equivalent excise value (AUDm) | | AUD893 | AUD1,021 | AUD1,101 | 23% |

The illicit market in Australia

Our study indicates there has been a growth in the consumption of illicit tobacco in Australia. **As a proportion of total consumption this represents an increase from 11.8% in 2012 and 13.3% in LTM H1 2013 to 13.9% in the full year 2013.** This trend is consistent with a range of secondary data sources.

If all of this tobacco had been consumed in the legitimate market, it would have represented an excise amount of AUD1.1bn at current excise rates.⁽¹⁾

This growth in illicit consumption appears to be driven by a slight increase in unbranded tobacco consumption volumes whilst illicit manufactured cigarette consumption volumes have stabilised at levels recorded in LTM H1 2013. There has, however, been a change in the mix of illicit manufactured cigarettes consumed with counterfeit volumes witnessing a large increase in 2013. The consumption of illicit whites also continues to be a growing issue – they accounted for more than 2.3% of total manufactured cigarette consumption in 2013 with a large proportion of this growth coming from illicit white brands like Manchester that are not legally sold in Australia.

The legal tobacco market in Australia

Whilst legally manufactured cigarette volumes have declined at an annual rate of 2.1% over the last thirteen years, loose tobacco volumes have increased at a CAGR of 3.0% over the same period, representing a shift in the mix of tobacco products consumed. Overall sales of legal domestic tobacco declined by 1.6% over the thirteen year period. During 2013, the decline slowed, with sales only declining by 0.5%.

Regional overview

The Australian market is the most expensive market in the region and with the December 2013 increase in excise, the gap has further widened. A packet of 20 Marlboro cigarettes is now 12% more expensive than in New Zealand; the second most expensive market. However, a packet is 75% more than the third most expensive market (Singapore) and nearly 600% more expensive than in South Korea from where the empty pack survey indicates the majority of new contraband is originating.

The Australian Crime Commission believes that organised crime groups perceive tobacco smuggling to be low-risk and highly profitable.⁽²⁾ As a result, this price differential may explain some of this growth.

Sources: (1) Based upon the average excise rate over the past 12 months for both loose and manufactured cigarettes

(2) Australian Crime Commission, *Organised Crime in Australia*, July 2013

Appendices

Appendix 1. Illicit market measurements

Appendix 2. Technical appendices

Appendix 1: Illicit market measurements

A1.1 Consumption model

A1.2 Empty pack survey analysis

A1.3 Rolling papers analysis

A1.4 Consumption gap analysis

KPMG has used a consumption based approach to size the unbranded tobacco market in Australia

A1 Review of illicit tobacco estimates

A1.1 Consumption model

Introduction

The primary methodology we have used to size the unbranded tobacco market in Australia is the consumption model approach. The approach adopted by KPMG is similar to that used in previous reports on the illicit tobacco market in Australia.

The consumption model utilises the results of the Roy Morgan consumer survey to determine the core inputs to the model, combined with publicly available information on the legal tobacco market and smoking population.

For the purpose of this report, the consumption model number for unbranded volumes in the full year 2013 is based on the average of the H1 2013 and the H2 2013 consumer survey results. Since consumers are likely to give a more accurate estimate of their purchase behaviour over a shorter time period rather than the last twelve months, using an average of the H1 and H2 consumer survey results provide a more accurate number for 2013.

The consumer survey

The consumer survey was based on the responses of 2,116 smokers in Australia to a CAWI web based questionnaire. Respondents were selected from across the country, from both metropolitan and non-metropolitan areas, in a sampling plan consistent with the survey carried out by Roy Morgan Research in the first half of 2013.

The survey was conducted in November 2013. Consumers were asked about their consumption and purchase of legal and illicit tobacco products; namely Chop Chop (unbranded loose tobacco sold in bags), pre-rolled unbranded tobacco as well as counterfeit and contraband manufactured cigarette products.

The consumer survey is used as one tool to form an estimate of the illicit market

The consumer survey responses are used to obtain several core inputs for the consumption model process. These core inputs are based on consumer responses and include;

- How many smokers purchase the different types of illicit tobacco,
- How often these illicit purchasers purchase illicit tobacco, and
- How much illicit tobacco these illicit purchasers purchase on each purchase occasion.

These responses generate the core assumptions which are used in the consumption model and are illustrated on figure A1.1 overleaf.

Additional assumptions

In addition to the results generated by the consumer survey there are some additional assumptions and data-points which are used:

- Total adult smoking population – we assumed that the total smoking population was 2.6 million. This is based on AIHW data updated for the decline in smoking population numbers since the last official estimate.
- Quantity of legal tobacco purchased – we have obtained this data from Euromonitor and estimate the total legal sales volume to be 15.2 million kilograms.

The consumption modelling calculation relies on the results of the Roy Morgan Research consumer survey and publicly available data

A1.1 Consumption model (continued)

The core inputs from the consumer survey and publicly available information are used in the consumption model, illustrated in table A1.1. These core inputs are factored together to produce an estimate of the amount of illicit tobacco product consumed by the representative population sampled in the Roy Morgan Research consumer survey covering the steps outlined:

- Steps 1 and 2 are used to calculate the total annual volume of illicit consumption per consumer in step 3.
- The number of illicit tobacco users is calculated using the percentage of illicit tobacco users noted in the consumer survey in step 5.
- This is multiplied by the total number of smokers in Australia in Step 6 which is multiplied by the average quantity purchased to give the total quantity of illicit tobacco consumption in Australia in step 7.

The consumption model approach measures illicit tobacco consumption by utilising consumers' responses. It is not possible to accurately break down illicit consumption into its constituent parts of loose unbranded and branded tobacco as consumers may be unable to tell the difference in the way in which the tobacco is sold.

The 2013 consumption model process and relevant data sources are shown in detail overleaf.

Table A1.1 Consumption model data sources and process

| | | Consumption model inputs |
|---|---|---|
| Quantity of illicit tobacco purchased per occasion (g) | ① | Roy Morgan consumer survey |
| Frequency of illicit tobacco purchased per annum | ② | Roy Morgan consumer survey |
| Quantity of illicit tobacco purchased per annum (g) | ③ | ① × ② = ③ |
| Total adult smoking population ('000) | ④ | Extrapolated Australian Bureau of Statistics smoking prevalence data ^(a) |
| Illicit tobacco users as % of Australia tobacco users | ⑤ | Roy Morgan consumer survey |
| Number of illicit tobacco users, Australia ('000) | ⑥ | ④ × ⑤ = ⑥ |
| Quantity of illicit tobacco purchased in Australia (tonnes) | ⑦ | ③ × ⑥ = ⑦ |
| Quantity of illicit tobacco purchased in Australia in 2013 (tonnes) | ⑧ | Average of H1 2013 and H2 2013 quantity of unbranded tobacco |

Note: (a) Please see appendix A2.2 for details of the estimation of the smoking population

The results of the H2 2013 consumption model indicate an increase in unbranded volume but a moderate decline in illicit manufactured cigarette volume

A1.1 Consumption model (continued)

Figure A1.1 Consumption model results, 2013⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾^(a)

| | Unbranded | | | Counterfeit | | | Contraband | | | Total illicit tobacco | | |
|--|-------------|-------------|----------------|-------------|-------------|----------------|-------------|-------------|----------------|-----------------------|-------------|----------------|
| | LTM H1 2013 | LTM H2 2013 | Full Year 2013 | LTM H1 2013 | LTM H2 2013 | Full Year 2013 | LTM H1 2013 | LTM H2 2013 | Full Year 2013 | LTM H1 2013 | LTM H2 2013 | Full Year 2013 |
| ① Quantity of illicit tobacco purchased per occasion (g) | 196 | 221 | | 142 | 94 | | 136 | 117 | | | | |
| ② Frequency of illicit tobacco purchased per annum | 10 | 12 | | 9 | 7 | | 9 | 8 | | | | |
| ③ Quantity of illicit Tobacco purchased per annum (g) $\text{①} \times \text{②}$ | 1,960 | 2,652 | | 1,278 | 658 | | 1,224 | 936 | | | | |
| ④ Total adult smoking population ('000) | 2,609 | 2,615 | | 2,609 | 2,615 | | 2,609 | 2,615 | | | | |
| ⑤ Illicit tobacco users as % of Australian tobacco users | 17.5% | 16.9% | | 4.3% | 4.1% | | 6.9% | 7.3% | | | | |
| ⑥ Number of illicit tobacco users, Australia ('000) $\text{④} \times \text{⑤}$ | 457 | 442 | | 112 | 108 | | 180 | 191 | | | | |
| ⑦ Quantity of illicit tobacco purchased in Australia (tonnes) $\text{③} \times \text{⑥}$ | 895 | 1,173 | 1,034 | 143 | 71 | 107 | 220 | 179 | 200 | 1,258 | 1,423 | 1,341 |

The full year 2013 consumption model results indicate that total consumption of illicit tobacco is approximately 1.3 million kilograms. This estimate is based on the average of the H1 2013 and H2 2013 consumer survey results.

The consumption model indicates that illicit manufactured cigarette volumes declined moderately between H1 2013 and H2 2013, whilst unbranded volumes has increased from 0.9 million kilograms in LTM H1 2013 to 1.2 million kilograms in LTM H2 2013. This annualised increase of 71.6% in unbranded consumption between LTM H1 2013 and LTM H2 2013 appears to be high and does not accurately reflect the market trend.

Additionally, we believe that consumers are likely to give a more accurate estimate of their recent purchase behaviour rather than that of the last twelve months. Therefore, using an average of the H1 and H2 consumption model results would provide a more accurate number for 2013.

For the purpose of this report, the 2013 estimate of unbranded consumption volume is based on the average of the H1 2013 and H2 2013 consumer surveys. The net result of this approach is a reduction of unbranded tobacco consumption.

Note: (a) The number for 2013 is the average of the H1 2013 and the H2 2013 consumer survey results

Sources: (1) Deloitte, *Illicit Trade of Tobacco in Australia*, 2012
 (2) Roy Morgan Research, *Consumer survey, H1 2013 and H2 2013*
 (3) Euromonitor, *Tobacco consumption in Australia*, 2013
 (4) KPMG analysis

The Q4 2013 empty pack survey found that 9.7% of manufactured cigarettes consumed originated outside Australia, consistent with the Q2 2013 results

A1.2 Empty pack survey analysis

Five empty pack surveys have been carried out in Australia in the last five years.

AC Nielsen carried out surveys solely for PML in Q4 2009 and Q4 2010. The 2009 survey consisted of 9,343 collected packs and the 2010 survey 6,000 packs and these surveys are believed to be broadly comparable to the 2012 and 2013 empty pack surveys.

AC Nielsen also carried out the 2012 Q2 survey which was commissioned by all three industry parties; BATA, PML and ITA. The 2012 survey was conducted in May, June and July and consisted of 12,000 packs collected across 16 cities.

In 2013, the empty pack survey provider changed from AC Nielsen to MSIntelligence (MSI). MSI were selected after a tender process. MSIntelligence were commissioned to replicate the survey using an identical methodology to AC Nielsen.

Two surveys have been conducted for 2013 and have been again produced for all three industry parties. The Q2 survey was conducted in May and June whilst the Q4 survey was conducted in October and November. Both the surveys were carried out in the same 16 cities as 2012 and again consisted of 12,000 collected packs.

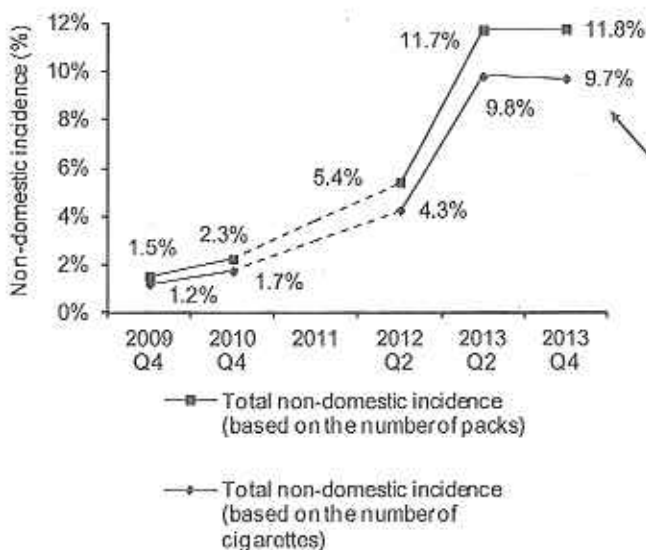
Empty pack survey results can be calculated on either a cigarettes basis or a packs basis. This is possible as the size of each pack collected is recorded during the survey. As there is considerable variation in pack sizes, utilising a measurement based on the number of cigarettes provides a more accurate representation of consumption patterns.

The empty pack survey analysis takes the proportion of cigarettes which are not Australian (health warnings missing or not in English, brands not sold in Australia, packs with identifying marks from other markets such as tax stamps) and classes these cigarettes as "non-domestic". The proportion of non-domestic cigarettes recorded by the empty pack survey is called the non-domestic incidence. The non-domestic incidence of the EPS is shown above.

The total non-domestic incidence in Australia in the Q4 2013 survey was 9.7% (on the basis of number of cigarettes) and 11.8% (on the basis of number of packs). These results are consistent with the non-domestic incidence recorded in the Q2 2013 survey. Overall the 2013 non-domestic incidence is the highest level of non-domestic incidence recorded in an empty pack survey and indicates an increase in illicit manufactured cigarettes.

Whilst a proportion of non-domestic cigarettes will be legally brought into Australia by both inbound (foreign nationals travelling to Australia) and outbound travellers (Australians returning from abroad), this legal proportion is relatively small, with the majority of non-domestic cigarettes being illicit. A calculation of the legal volume of non-domestic cigarettes is shown in appendix A2.4. Nonetheless, this increase occurred at a time after the inbound traveller allowance was reduced in September 2012.

Total non-domestic incidence, Q4 2009 – Q4 2013^{(1)(2)(a)(b)}



The total non-domestic incidence in Australia for the year 2013 was 9.8% (on the basis of number of cigarettes) and 11.7% (on the basis of number of packs). This has been calculated using a blended empty pack survey approach i.e. using a combination of Q2 2013 and Q4 2013 results.

Notes: (a) No survey was conducted in 2011, trend line is for information only

(b) Non-domestic incidence based on the number of packs is higher than the non-domestic incidence based on the number of cigarettes due to the average Australian pack of cigarettes being larger than an international pack, i.e. the most commonly sold pack size in Australia is 25 cigarettes compared to the standard 20 cigarettes packs available internationally

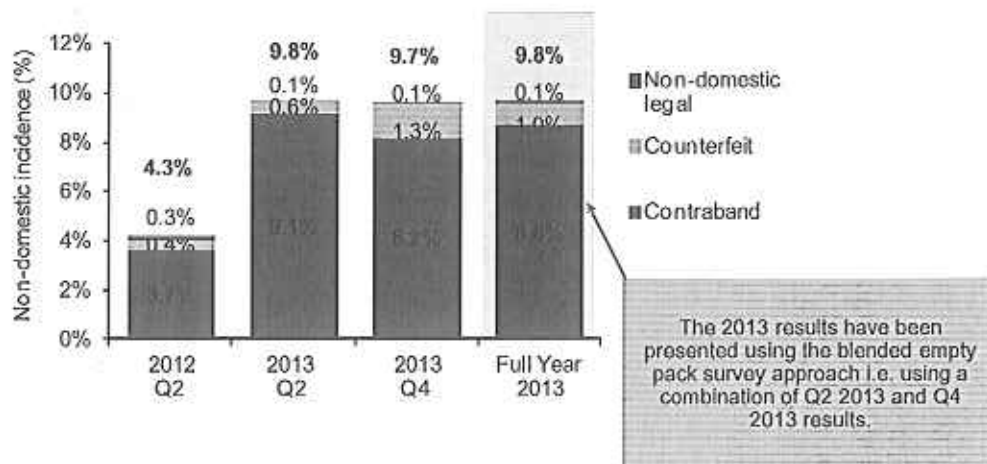
Sources: (1) MSIntelligence Research, *Empty pack survey, Q2 2013 and Q4 2013*

(2) AC Nielsen, *Empty pack survey, 2009, 2010, 2012*

Whilst contraband products continue to be the primary driver of increased illicit consumption, counterfeit products witnessed a large increase in the Q4 2013 empty pack survey results

A1.2.1 Empty pack survey analysis (continued)

Break down of non-domestic incidence, Q2 2012 – Q4 2013⁽¹⁾⁽²⁾⁽³⁾



As discussed on the previous page, not all non-domestic tobacco is illicit tobacco. Non-domestic incidence can be broken down into three separate categories:

- 1. Non-domestic legal** – These are cigarettes legally brought into Australia as part of travelers' inbound allowance.^(a)
- 2. Counterfeit** – The packs collected in the empty pack survey are examined by the participating companies. They are able to identify packs which are counterfeit versions of their products.
- 3. Contraband** – The remainder, and majority, of non-domestic manufactured cigarettes are legitimate products (i.e. non-counterfeit) that have entered Australia illegally.

Non-domestic legal volumes constitute only a very small proportion of the total non-domestic incidence. They accounted for 0.1% of the total non-domestic incidence in both Q2 2013 and the Q4 2013. The decline from 2012 is in part explained by the reduction in Australia's inbound traveler allowance from 250g to 50g/ 50 sticks per person per trip in September 2012.^(a)

The majority of non-domestic cigarettes are therefore illicit, with the illicit proportion of manufactured cigarettes consumed in Australia showing a marked increase since 2012.

The empty pack survey findings for both quarters of 2013 indicate that contraband product, with a share of more than 85% in the total illicit consumption, is the predominant driver of the increase in illicit manufactured cigarette volumes seen between 2012 and 2013.

However, the contraband share of the total non-domestic incidence declined slightly in the Q4 2013 empty pack survey when compared to the previous quarter. This decline is attributed to a concurrent increase in counterfeit volumes.

The empty pack survey findings showed that 1.3% of all packs collected in Q4 2013 were counterfeit products, compared to the 0.6% level recorded in the Q2 2013 survey.

Note: (a) Please refer to appendix A2.4 for detailed for detail on the calculation of non-domestic legal volumes
 Sources: (1) MStelligence Research, *Empty pack survey*, Q2 2013 and Q4 2013
 (2) AC Nielsen, *Empty pack survey*, 2012
 (3) KPMG analysis

The results of the empty pack survey analysis indicate an illicit volume of 1.4 million kilograms for manufactured cigarettes

A1.2.2 Empty pack survey analysis (continued)

We have used the non-domestic incidence obtained from the empty pack surveys as the basis of estimates for the volumes of counterfeit and contraband consumption in Australia.

The 9.8% non-domestic incidence is combined with estimates for legal domestic sales volumes from Figure A1.2.2

Euromonitor to create a volume estimate for illicit manufactured cigarettes. This can then be broken down into volume estimates for non-domestic legal, counterfeit and contraband.

| Australian empty pack survey non-domestic consumption and illicit estimate ^{(1)(2)(3)(4)(a)(b)(c)} | | | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---------|------------------|--------|--------|--------|--------|--------|
| Legal sales of manufactured cigarettes (tonnes) | ① 10 | | 15,881 | 14,598 | 13,908 | 13,468 | 13,321 |
| Empty pack survey non-domestic incidence | ② 49 | | 1.2% | 1.7% | - | 4.3% | 9.8% |
| Total consumption of manufactured cigarettes (tonnes) | ③ | = ① / (100% - ②) | 16,071 | 14,857 | - | 14,068 | 14,762 |
| Non-domestic consumption (tonnes) | ④ | = ③ - ① | 191 | 258 | - | 600 | 1,441 |
| Non-domestic (legal) volume estimate (tonnes) | ⑤ 62,64 | | 34.6 | 33.7 | - | 35.6 | 22.0 |
| Illicit consumption (tonnes) | ⑥ | = ④ - ⑤ | 156.4 | 224.3 | - | 564 | 1,419 |
| Empty pack survey counterfeit incidence | ⑦ 50 | | - | - | - | 0.4% | 1.0% |
| Counterfeit consumption (tonnes) | ⑧ | = ④ * (⑦ / ②) | - | - | - | 50 | 143 |
| Contraband consumption (tonnes) | ⑨ | = ⑥ - ⑧ | - | - | - | 515 | 1,276 |

Figure A1.2.2 shows the calculation used to estimate the total volume of illicit manufactured cigarettes consumed in Australia. The percentage of non-domestic cigarettes is added to legal domestic consumption in order to calculate total consumption in step 3. Total illicit consumption is calculated by removing the non-domestic legal volume estimate in step 6.

The EPS also records the counterfeit incidence as a percentage in step 7. This counterfeit incidence is taken as a percentage of total non-domestic consumption and multiplied by the non-domestic consumption estimate in step 8, with the remainder contraband in step 9.

The results of the empty pack survey analysis show a large increase in non-domestic volumes in 2013. As non-domestic legal volumes declined, this translated into much higher volumes of illicit counterfeit and contraband manufactured cigarettes.

Whilst volumes attributable to counterfeit manufactured cigarettes rose, the true volume increase was driven by contraband product, which accounts for 90% of the total illicit consumption indicated by the empty pack survey analysis.

Notes: (a) We have uplifted the Euromonitor manufactured cigarettes volumes by 2% in each year, as we believe that the overall quantum of estimate is too low
(b) Counterfeit incidence is not available for 2009, 2010 and 2011
(c) The non-domestic legal estimate for 2013 is based on both the volumes brought by tourists arriving in Australia and by short term resident departures. Please refer to appendix A2.4 for further details

Sources: (1) MSI Intelligence Research, *Empty pack survey, Q2 2013 and Q4 2013*
(2) AC Nielsen, *Empty pack survey, 2009, 2010, 2012*
(3) Euromonitor, *Legal domestic sales*, accessed January 2014
(4) KPMG analysis

The illicit tobacco volumes generated by the consumption model fall within the range provided by the rolling papers analysis

A1.3 Rolling papers analysis

Figure A1.3.1 Rolling papers calculation for unbranded tobacco

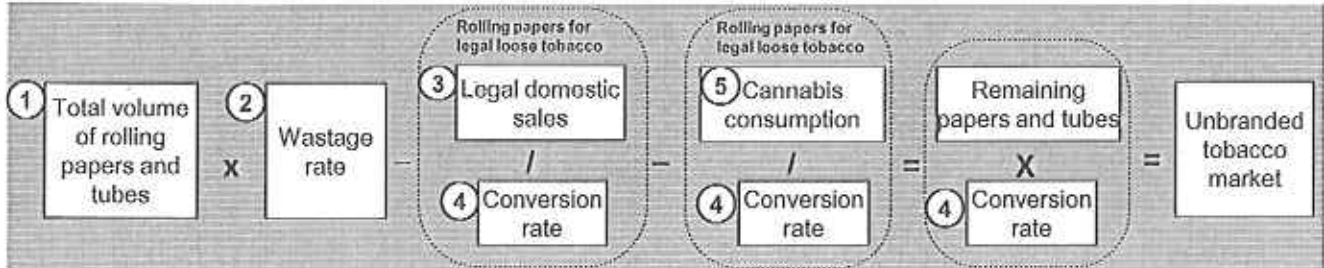
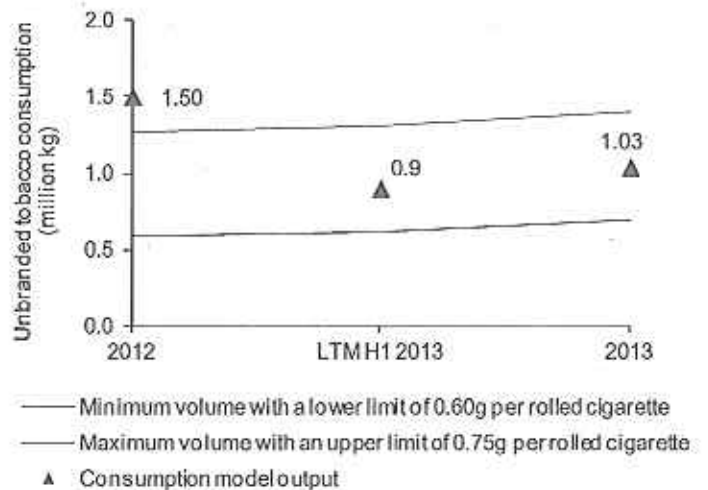


Figure A1.3.1 highlights our approach to the rolling papers analysis used to calculate the total volume of unbranded tobacco. For other clients we have applied this approach to markets with sizeable loose tobacco consumption and has proven to help validate the size of the unbranded market. Each step of the calculation involves the following assumptions and data-points:

- 1 Total volume of rolling papers and tubes – the volume used comes from retail sales data provided by Aztec and cannot be published due to contractual obligations with the data provider.
- 2 Wastage rate – The wastage rate is the percentage of rolling papers used and excludes any discarded or spoil papers. This data has been sourced through consumer research undertaken by the industry and is commercially sensitive and cannot be published.
- 3 Legal domestic sales of loose tobacco – We use the same volumes calculated for 2013, which equated to 1,893 tonnes.
- 4 Conversion rate – The amount of grams of tobacco used in a rolled cigarette. Consumer surveys and estimations by the industry have produced a range of values. As a sensitivity, we use an upper and lower limit of 0.75 and 0.6 respectively. We believe that a lower limit of 0.6g is reflective of the Australian market – this limit may be lower or higher than other markets.
- 5 Cannabis consumption – Rolling papers are also used in the consumption of cannabis. The conversion rate for use of papers and tubes is assumed to be the same as the conversion rate for cigarettes. Total cannabis consumption is estimated on the basis of the Australian Department of Health and Aging survey at a total volume of 22,500kg.⁽²⁾

Volume of illicit unbranded tobacco generated by the rolling papers analysis, 2012- 2013



The chart above illustrates a sensitized range for the rolling papers analysis. The sensitivity is based around the value for the conversion rate which is the most uncertain variable in the analysis. By flexing this value between a high value of 0.75g per rolled cigarette and a low value of 0.6g per rolled cigarette, we can determine a range of potential market sizes. We believe that this approach is appropriate to validate the unbranded tobacco market and we intend to keep tracking it similarly in subsequent reports.

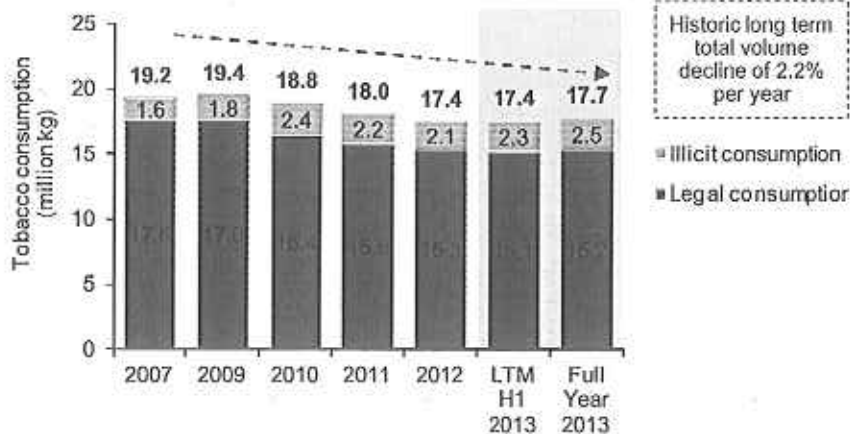
The volume of illicit unbranded tobacco generated by the consumption model output is within the range of the rolling papers analysis in both the H1 2013 and 2013. As highlighted earlier, KPMG has used a prudent estimate of unbranded consumption in 2013. The consumer survey results for H2 2013 indicated a large increase in consumption of unbranded tobacco which does not appear to accurately reflect the market trend. We have utilised the average of the H1 and H2 results to derive a more accurate estimate for 2013.

Sources: (1) Size of rolling papers market obtained from the industry
 (2) National Drug and Alcohol Centre NSW, Cannabis in Australia, June 2007

Our estimate of total tobacco consumption for 2013 is consistent with the historic decline in tobacco consumption

A1.4 Consumption gap analysis

Trend in total consumption of tobacco in Australia, 2007 – 2013^{(1)(2)(a)(b)(c)}



| CAGR (%) | 2007-LTM H1 2013 | 2009-LTM H1 2013 | 2007-13 | 2009-13 |
|--------------------------|------------------|------------------|--------------|--------------|
| Illicit consumption | n/a | 8.2% | n/a | 8.6% |
| Legal consumption | -2.7% | -4.2% | -2.4% | -3.5% |
| Total consumption | -1.7% | -2.9% | -1.3% | -2.2% |

Under the KPMG methodology, the overall level of tobacco consumption was equal to 17.7 million kilograms in 2013.

Although the full year 2013 estimate of total consumption is higher than the 2012 estimate, it shows a continuation of the long term historical trend of declining tobacco consumption since 2007 when the first study was conducted.

The 2013 estimate indicates a confirmation of a small increase in consumption initially highlighted in the H1 2013 report.

Overall, as our 2013 estimate fits with the trend of continuing decline in total tobacco consumption, we believe the consumption gap analysis supports our estimate.

Notes: (a) H1 2013 represents consumption for the twelve months to end June 2013

(b) Counterfeit and contraband estimations are unavailable for 2007

(c) Legal consumption includes both legal domestic sales volumes and non-domestic legal volumes

Sources: (1) KPMG analysis of previous reports on illicit trade in Australia, run by Deloitte between 2009 and 2012

(2) Deloitte, *Illicit Trade of Tobacco in Australia*, 2012, 2011, 2012

Appendix 2: Technical appendices

A2.1 Source of legal domestic sales estimates

A2.2 Estimation of smoking population

A2.3 Recent regulatory changes

A2.4 Travel trends and non-domestic legal
calculation

A2.5 Consumer surveys

A2.6 Scope of work

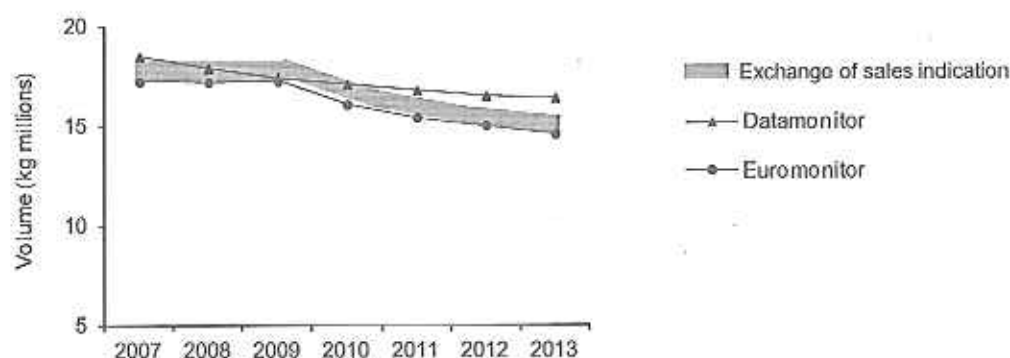
A2.7 Roy Morgan Research questionnaire

A2.8 Bibliography

Over the past few years Euromonitor has tracked the market most accurately in Australia. As a result we have adopted this as our measure for legal domestic sales

A2.1 Source of legal domestic sales estimates

Estimates of legal domestic sales manufactured cigarette volumes, 2007 – 2013^{(1)(2)(3)(a)}



| CAGR (%) | 2007-09 | 2009-13 | 2007-13 |
|---------------|---------|---------|---------|
| → Datamonitor | -2.9% | -1.5% | -2.0% |
| → Euromonitor | -0.0% | -4.1% | -2.8% |

In order to accurately reflect the size and trend of the illicit tobacco volumes, it is necessary to obtain a robust estimate of legal domestic sales. Understating legal domestic sales has the effect of incorrectly inflating the estimate of the illicit proportion of the market.

We have examined several publicly available estimates of Australian legal domestic sales and have compared it to sales data supplied by the industry. Whilst we cannot publish sales data from industry players due to the commercial sensitivity of this information, we show an indicative range on the chart above. We have analysed this industry sales data and how it relates to publicly available estimates of the illicit market in Australia.

As indicated in the H1 2013 report, compared with industry sales data, Euromonitor data most accurately captures both the nominal volumes and the trend in the market across the 2007-2012 period as a whole. As a result, we have adjusted the historic illicit volumes estimations based on using Euromonitor volume estimates.

We have sought to avoid possible over estimation of the illicit proportion of the market that would be caused by having an estimation of legal domestic sales lower than industry supplied volumes. As a result, we have uplifted the Euromonitor volume estimate for manufactured cigarettes by 2% in each year between 2007 and 2013. Loose tobacco volumes do not require adjustment.

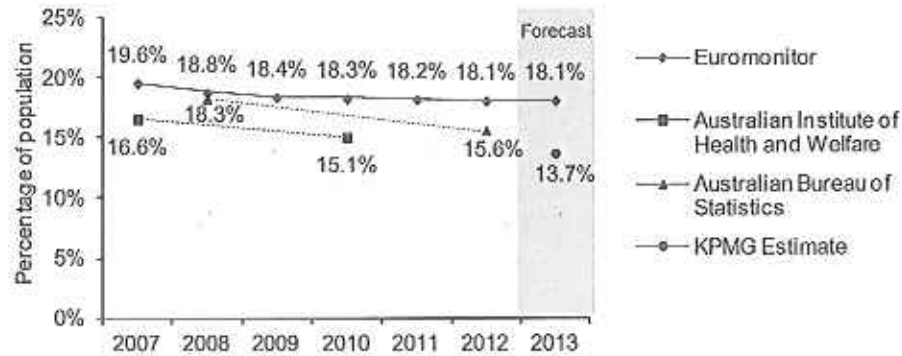
Note: (a) To preserve confidentiality of commercially sensitive data, Exchange of Sales data has been grossed up to factor in the market coverage of the data and then rounded to the nearest thousand

Sources: (1) Datamonitor
(2) Euromonitor, Legal domestic sales, accessed January 2014
(3) Industry sales data

Several estimations of Australian smoking prevalence are publicly available, but yearly data is not available from the Australian government

A2.2 Estimation of smoking population

Smokers as a percentage of population, 2007 – 2013 ^{(1)(2)(3)(a)(b)(c)}



| CAGR (%) | 2007-10 | 2008-12 | 2007-13 |
|--|---------|---------|---------|
| * Euromonitor | -2.3% | -0.9% | -1.3% |
| * Australian Institute of Health and Welfare | -3.1% | - | - |
| * Australian Bureau of Statistics | - | -3.9% | - |

Official Australian Government estimates of smoking incidence are available from both the Australian Institute of Health and Welfare (AIHW) and the Australian Bureau of Statistics (ABS). Euromonitor also provide estimates of smoking incidence.

Each of the surveys reflects specific age groups. The AIHW and ABS estimates reflect prevalence for 14 year olds and above, whilst Euromonitor figures estimate prevalence among those aged over 18. This in part explains the higher Euromonitor estimate.

Timing of estimates also varies. The National Drug Strategy Household Survey is conducted by the AIHW every three years and includes questions on smoking prevalence. The last two surveys were conducted in 2007 and 2010; the 2013 survey is underway and results are expected to be released in 2014.

ABS figures are taken from Australian Health Surveys carried out in 2008 and 2012, whilst Euromonitor compiles its estimates annually.

All smoking prevalence surveys encounter issues with respondents under reporting. The AIHW survey highlights the possibility of under-reporting as some respondents did not answer smoking related questions. Potential under-reporting was identified in the ABS report, primarily due to social pressures, especially where other household members / parents were present at the interviews for respondents.

Where KPMG require prevalence data for our modelling process, we have used the AIHW results to ensure that our estimate for the number of Australian smokers is not overstated. Overstating the number of smokers would lead to an incorrectly inflated estimate of the size of the illicit trade.

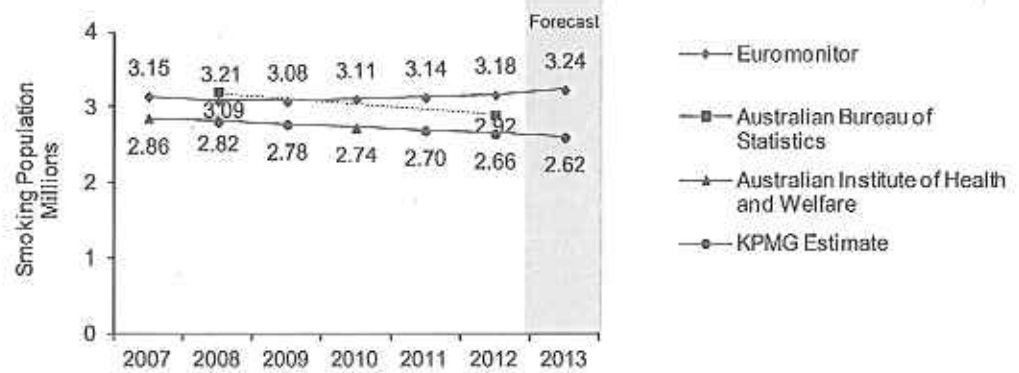
We have estimated the smoking population for 2013 based on AIHW results for 2007 and 2010.

Notes: (a) Euromonitor, percentage of population that are smokers refers to daily smokers > 18 years
 (b) Australian Institute of Health and Welfare and ABS percentage of population that are smokers refers to daily smokers >14 years
 (c) Euromonitor figures for 2013 are based on full year estimates
 Sources: (1) Euromonitor, Smoking prevalence, updated January 2014
 (2) Australian Institute of Health and Welfare, National Drug Strategy Household Survey, 2007, 2010
 (3) Australia Bureau of Statistics

As with prevalence, KPMG believes it is prudent to use the lowest estimates of smoking population to calculate illicit consumption

A2.2 Estimation of smoking population (cont.)

Total number of smokers, 2007 – 2013 ^{(1)(2)(3)(a)(b)(c)}



| CAGR (%) | 2007-10 | 2008-12 | 2007-13 |
|--|---------|---------|---------|
| → Euromonitor | -0.4% | 0.7% | 0.5% |
| → Australian Institute of Health and Welfare | -1.4% | - | - |
| → Australian Bureau of Statistics | - | -2.4% | - |
| → KPMG Estimate | -1.4% | -1.5% | -1.5% |

The number of adult daily smokers in Australia is used to extrapolate the consumer survey results up to an illicit estimate for the entire population.

To avoid overstatement of results, KPMG considers it prudent to use the lowest estimate for smoking population to extrapolate illicit consumption due to the effect it has on the modelling process – i.e. as a higher smoking population equates to a higher illicit estimate.

As there is no recent AIHW estimate, KPMG has had to extrapolate forward the rate of decline in smoker numbers to create an estimate for 2013. Extrapolating the rate of decline forwards is more likely to give us an accurate estimate of the smoking population in comparison to taking the published 2010 AIHW estimate.

Notes: (a) Euromonitor considers adult population as >18 years, while ABS and the Australian Institute of Health and Welfare considers adult population >14 years
 (b) Figures for Australian Bureau of Statistics are taken for 2008 & 2012 from Australian Health Survey; for the Australian Institute of Health and Welfare they are taken from the National Drug Strategy Household Survey, 2007 and 2010
 (c) Figures for 2013 are based on full year estimates
 Sources: (1) Euromonitor, Smoking prevalence, accessed January 2014
 (2) Australian Institute of Health and Welfare, National Drug Strategy Household Survey, 2007, 2010
 (3) Australia Bureau of Statistics

The Commonwealth government has implemented the Plain Packaging Act and other tobacco controls in 2012

A2.3 Recent regulatory changes

Table A2.3.1: Recent regulatory changes 2012/13⁽¹⁾⁽²⁾

| Jurisdiction | Legislation title | Regulation type | Effective date | Brief description |
|--------------|--|--------------------------------|---|--|
| Australia | Tobacco Advertising Prohibition Amendment Act 1992 | Internet advertising | 6 September 2012 | <ul style="list-style-type: none"> ■ It is made a criminal offence to publish tobacco advertising on the internet or other electronic media. ■ Internet point-of-sale tobacco advertisements need to be presented in plain text-only format with graphic health warnings and warnings about age restriction on tobacco sales. ■ Online tobacco retailers will have to display health warnings and comply with restrictions on advertisement wording under the same legislation that other forms of advertising are covered. |
| | Tobacco Plain Packaging Act 2011; <i>Trade Marks Amendment (Tobacco Plain Packaging) Act 2011</i> | Plain packaging of tobacco | 1 December 2012 | <ul style="list-style-type: none"> ■ Law on plain packaging for all tobacco products sold enacted and fully implemented. |
| | Customs Amendment (Smuggled Tobacco) Bill 2012 <i>Amendment of Customs Act 1901</i> | Illicit tobacco | November 2012 | <ul style="list-style-type: none"> ■ Smuggling tobacco or possessing illicit tobacco will attract tougher penalties including potential imprisonment. |
| | Competition and Consumer (Tobacco) Information Standard 2011 | Health warnings | 1 December 2012 | <ul style="list-style-type: none"> ■ Tobacco products required to display the updated and expanded graphic health warnings covering 75% of the front of face. |
| | Customs Act 1901, Customs Tariff Act 1995 | Duty free tobacco restrictions | 1 September 2012 | <ul style="list-style-type: none"> ■ Inbound traveller allowance for tobacco products is reduced from 250g per person to 50g/ 50 sticks per person. |
| | Excise Tariff Amendment (Tobacco) Bill 2014 and Customs Tariff Amendment (Tobacco) Bill 2014 | Excise | 1 December 2013 for excise increases 1 March 2014 AWOTE change will be effective | <ul style="list-style-type: none"> ■ In August 2013 the Australian government announced excise duty increases in tobacco products of an additional 12.5% annually for the next four years in addition to the switch to AWOTE. The first of these increases was implemented on 1 December 2013. These four tax increases will increase the excise on a pack of cigarettes in Australia by 60% above the rate of AWOTE inflation until September 2016. |

Sources: (1) Australian Government Department of Health

(2) Department of Health, Victoria, www.health.vic.gov.au/tobaccoreforms

Local states have been introducing additional regulations to further restrict tobacco consumption and meet local market requirements

A2.3 Recent regulatory changes (continued)

Table A2.3.2 Recent regulatory changes 2012/13 – state specific^{(1)(2)(3)(a)}

| Jurisdiction | Legislation title | Regulation type | Effective date | Brief description |
|-----------------|--|--|-----------------|---|
| New South Wales | Public Health Act 2008; Public Health Regulation 2009 | Retail Display Ban | 1 July 2013 | Exemption for specialist tobacconists under the ban on the display of tobacco products at point-of-sale ends |
| Victoria | Tobacco Act 1987 | Smoke free Local Areas | 1 December 2012 | A ban on smoking at all of Victoria's patrolled beaches in the area between the red-and-yellow lifesaving flags and within a 50 metre radius of a red-and-yellow flag. |
| | Tobacco Amendment (Shopper Loyalty Schemes) Bill 2012 | Removal of tobacco from shopper loyalty programs | 1 March 2013 | Tobacco products are prohibited from earning points under shopper loyalty initiatives. |
| | Tobacco Amendment Act 2013 | Smoke free Local Areas, Cessation of new certification for specialist tobacconists | 1 October 2014 | Introduction of smoke-free children's playgrounds and related recreational areas. Applications for specialist tobacconist certification received on or after 1 April 2014 will not be considered. Price boards will come under closer scrutiny and there are provisions to repeal certain packaging and labelling requirements made redundant by plain packaging. The Bill received Royal assent on 6 November 2013 |
| South Australia | Tobacco Products Regulation Act 1997. Tobacco Products Regulations 2004. Tobacco Products Variation Regulations 2012 (Capsule cigarette) | Retail Display Ban | 1 January 2012 | A ban on the display of tobacco products at point-of-sale with an exemption for specialist tobacconists. Display of 'capsule' cigarettes banned, extending previous ban on fruit & confectionery flavoured cigarettes. |

Note: (a) There has been no new legislation specifically for the Australian Capital Territory

Sources: (1) Australian Government Department of Health

(2) Department of Health, Victoria, www.health.vic.gov.au/tobaccoforms

(3) The Tobacco Amendment Act 2013

Local states have been introducing additional regulations to further restrict tobacco consumption and meet local market requirements

A2.3 Recent regulatory changes (continued)

Table A2.3.2 Recent regulatory changes 2012/13 – state specific^{(1)(2)(3)(a)}

| Jurisdiction | Legislation title | Regulation type | Effective date | Brief description |
|------------------------|---------------------------------------|--|------------------|---|
| Tasmania | Public Health Act 1997 | Retail Display Ban | 1 March 2012 | Specialist tobacconists included in retail display ban, removing earlier exemption. |
| | | Removal of tobacco from shopper loyalty programs | 1 March 2012 | Tobacco products are prohibited from earning points under shopper loyalty initiatives. |
| | | Licensing of tobacco retailers | 1 March 2012 | <ul style="list-style-type: none"> ■ Licences must be obtained prior to selling products from additional venues. ■ Licences are not transferable to new business owners. ■ Licences will not be displayed in premises. |
| | | Vending machine restrictions | 1 March 2012 | Tobacco vending machines now restricted to one machine per site within specified locations. |
| Queensland | Health Legislation Amendment Act 2012 | Tobacco type restriction | 25 November 2012 | Ban on the sale of fruit & confectionery flavoured cigarettes. |
| The Northern Territory | Smokefree legislation | Ban on smoking in prisons | 1 July 2013 | Total ban on tobacco in prisons. |

Note: (a) There has been no new legislation specifically for the Australian Capital Territory

Sources: (1) Australian Government Department of Health

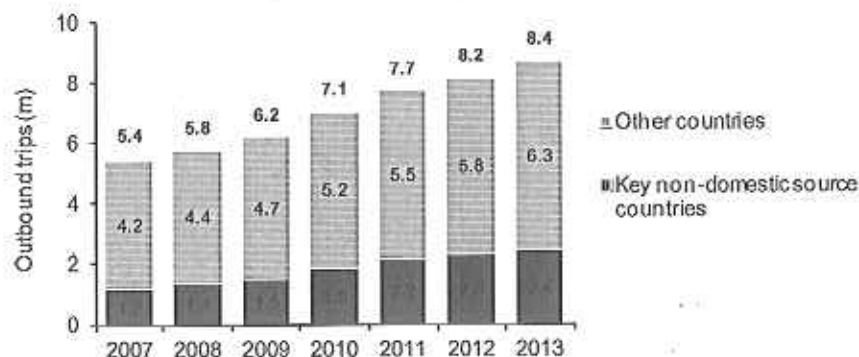
(2) Department of Health, Victoria, www.health.vic.gov.au/tobaccoreforms

(3) All IW Media Release, 22 October 2013

Visits to countries indicated by the empty pack survey as contributors to non-domestic packs found in Australia have grown strongly. This could imply a growth in legal non-domestic consumption

A2.4.1 Travel trends and non-domestic legal calculation based on departures of Australians

Overseas travel of Australian residents, 2007 – 2013^{(1)(a)}



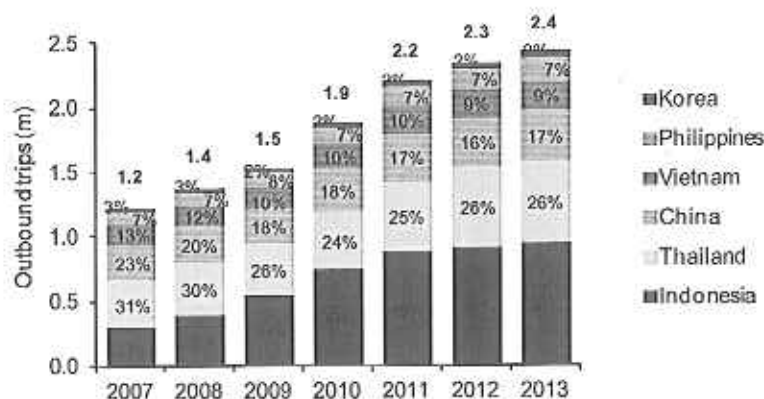
| CAGR (%) | 2007-09 | 2009-11 | 2011-13 | 2007-13 |
|-------------------------|---------|---------|---------|---------|
| Key ND source countries | 11.9% | 20.1% | 5.1% | 12.2% |
| Total overseas trips | 7.0% | 11.5% | 6.1% | 8.2% |

Travel trend data can be used in the calculation of non-domestic legal volumes, i.e. tobacco products that are brought into the country legally by consumers, such as during an overseas trip.

Trips made to key non-domestic source countries of manufactured cigarettes increased at a faster rate than overall visits, 12.2% compared to 8.2% between 2007 to 2013.

Later in the report this data is used to estimate legal non-domestic sales which, it will be shown, is immaterial in size.

Overseas travel of Australian residents to key non-domestic source countries, 2007 – 2013^{(1)(a)}



Visits to key non-domestic source countries reached a total of 2.44 million in 2013 accounting for approximately 30% of all trips made overseas by Australian residents.

However, reductions in inbound traveller allowances will likely have tempered the growth of legal non-domestic consumption. We examine this in more detail overleaf.

Note: (a) Key non-domestic source countries have been selected from the empty pack survey carried out in 2013, the countries highlighted in the graph above accounted for over 75% of the non-domestic cigarette packs found in Australia and excludes packs that come from unspecified countries

Source: (1) Australian Bureau of Statistics, *Short-term movement, Resident Departures - Selected Destinations: Travel, 2013*

Non-domestic legal ND(L) estimates account for a small proportion of total consumption and have a limited effect on the aggregate results

A2.4.1 Travel trends and non-domestic legal calculation (continued)

| Example non-domestic legal calculation | | | | | | | | | | | |
|--|-----------------|---|-----------|---|----------------------|---|------------------------|---|-----------------|---|----------------|
| Year | Overseas visits | x | ND uplift | x | % population smokers | x | Propensity to purchase | x | Amount per trip | = | Total (tonnes) |
| 2013 | 2.4m | | 10% | | 13.7% | | 59% | | 50g | | 10.8 |

| KPMG non-domestic legal calculation ^{(1)(2)(3)(a)(b)(c)} | | | | | | | |
|---|---------------------------------|--------|--------|--------|--------|--------|--------|
| | Source | 2007 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Overseas trips to non-domestic source countries in the year (m) | Australian Bureau of statistics | 1.22 | 1.53 | 1.53 | 2.2 | 2.35 | 2.44 |
| Non-domestic source uplift | Empty pack survey | 10% | 10% | 10% | 10% | 10% | 10% |
| % of population that are smokers | AIHW (and extrapolated) | 16.1% | 15.5% | 15.1% | 14.7% | 14.2% | 13.7% |
| % of smokers that buy tobacco | RMR consumer survey | 53% | 53% | 53% | 53% | 53% | 59% |
| Number of smokers purchasing overseas (m) | | 0.11 | 0.14 | 0.14 | 0.19 | 0.20 | 0.22 |
| Amount purchased | Inbound traveller allowance | 250 | 250 | 250 | 250 | 183 | 50 |
| Total (kg) | | 28,628 | 34,565 | 33,673 | 47,136 | 35,602 | 10,835 |
| Non-domestic legal as % of total consumption | | 0.1% | 0.2% | 0.2% | 0.3% | 0.2% | 0.1% |

Estimates of non-domestic legal show that total volumes account for a small proportion of total consumption.

The change to inbound traveller allowances made in September 2012 has a considerable impact on the amount of tobacco consumers can bring back into the country legally, reducing the estimate of legal non-domestic volumes further in 2013.

A consumer survey undertaken in February 2013 was the first time respondents were asked about overseas travel and tobacco purchase. The percentage of smokers who bought tobacco whilst overseas was 53%, however, this may have changed during the period from 2007-2012. The H2 2013 survey suggested that 59% of smokers bought cigarettes overseas, potentially indicating how the difference in price impacts purchasing decisions.

- Notes: (a) Respondents were asked "Q51. Have you travelled outside of Australia in the last 6 months?"
 (b) Respondents were then asked "Q52. Did you buy any manufactured cigarettes or any other tobacco products to bring back to Australia on any of your trips to other countries in the past 6 months?"
 (c) The inbound traveller allowance for 2012 has been calculated using the 250g limit for 8 months and the 50g limit for 4 months to reflect the change in inbound traveller allowances made in September 2012
- Sources: (1) Roy Morgan Research, Consumer survey, H1 2013 and H2 2013
 (2) Australian Institute of Health and Welfare, *National Drug Strategy Household Survey, 2007, 2010*
 (3) Australian Bureau of Statistics, *Short-term movement, Resident Departures - Selected Destinations: Trend, 2013*

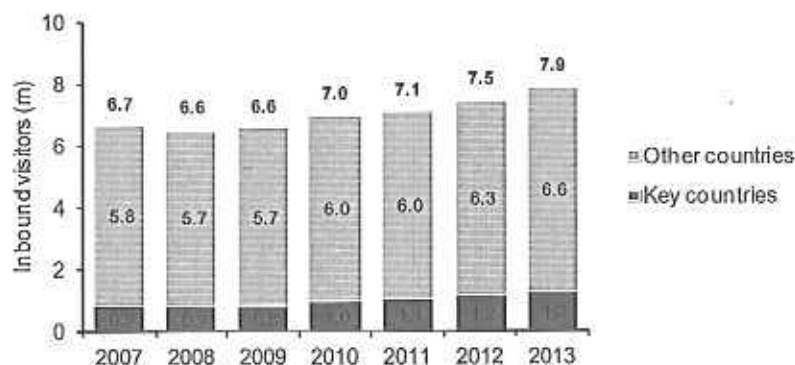
Visitors from countries indicated by the empty pack survey also serve as contributors to non-domestic packs found in Australia

A2.4.2 Travel trends and non-domestic legal calculation based on arrivals of visitors (short-term visitors and permanent settlers)

A common comment on the H1 2013 report was that domestic legal inflows calculation only considers the amount of product brought in by Australian residents returning from short-term visits overseas and does not reflect any cigarettes brought to Australia by overseas visitors.

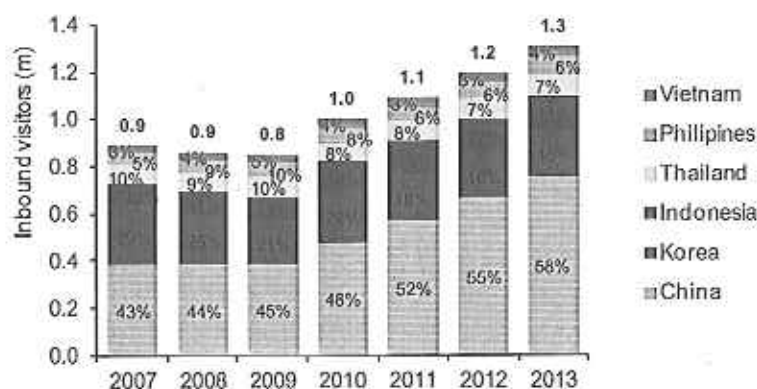
At the time we understood the immateriality of the impact, but feel it is worth highlighting. Thus, we provide an approach of estimating non-domestic legal inflows that considers both the amount of product brought in by Australian residents returning from overseas visits as well as cigarettes brought by overseas visitors (short-term visitors and settlers).

Overseas visitors (short term visitors and settlers) arrivals to Australia, 2007 – 2013^{(1)(2)(a)}



| CAGR (%) | 2007-09 | 2009-11 | 2011-13 | 2007-13 |
|-------------------------|---------|---------|---------|---------|
| Key ND source countries | -2.3% | 13.4% | 9.5% | 6.6% |
| Total overseas trips | -0.4% | 2.5% | 4.6% | 2.2% |

Overseas visitors arrivals from key non-domestic source countries, 2007 – 2013^{(1)(2)(a)}



Overseas visitors arrivals from key non-domestic countries include both short term arrivals and permanent settlers.

Visitors from the key non-domestic source countries have increased since 2007. Visitors from China have increased by 12% between 2007 and 2013.

Later in the report this data together with the overseas travel of Australian residents data are used to estimate legal non-domestic sales which, it will be shown, the impact of the change in domestic legal inflows calculation is immaterial in size.

Note: (a) Key non-domestic source countries have been selected from the empty pack survey carried out in 2013, the countries highlighted in the graph above accounted for over 75% of the non-domestic cigarette packs found in Australia. Packs that come from unspecified countries are excluded.

Sources: (1) Australian Bureau of Statistics, *Short-term Movement, Visitor Arrivals - Selected Countries of Residence: Trend, 2013*

(2) Australian Bureau of Statistics, *Permanent Movement, Settlers - Country of Birth, Major Groups and Selected Source Countries: Original, 2013*

Non-domestic legal estimates calculated on the basis of inbound visitor arrivals indicate that non-domestic legal remains a small proportion of total consumption

A2.4.2 Inbound travel trends and non-domestic legal calculation (continued)

Example non-domestic legal calculation based on overseas visitor arrivals data

| | | | | | | | | |
|---|---|-----------------------|---|----------------------|---|---|---|------------|
| Inbound visitor arrivals ^(a) | x | % population above 18 | x | % population smokers | x | Amount per trip (max. allowance of 50g) | = | Total (Kg) |
|---|---|-----------------------|---|----------------------|---|---|---|------------|

Estimated number of visitors who bring in tobacco to Australia

Example of KPMG non-domestic legal calculation based on overseas visitor arrivals to Australia⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾

| 2013 | Inbound visitor arrivals (m) ^(a) | % population above 18 ^(b) | % population smokers | Number of visitors bringing tobacco (m) ^(c) | Amount purchased (kg) |
|-------------|---|--------------------------------------|----------------------|--|-----------------------|
| Source | Australian Bureau of statistics | Euromonitor | Euromonitor | | |
| China | 0.78 | 70% | 25% | 0.132 | 6,596 |
| Korea | 0.19 | 69% | 20% | 0.026 | 1,318 |
| Indonesia | 0.15 | 63% | 36% | 0.034 | 1,685 |
| Thailand | 0.09 | 67% | 23% | 0.014 | 678 |
| Philippines | 0.07 | 56% | 28% | 0.011 | 561 |
| Vietnam | 0.05 | 66% | 22% | 0.007 | 338 |
| Total (kg) | 1.30 | | | 0.224 | 11,176 |

Total amount purchased by overseas visitors to Australia

Estimation of non-domestic legal volumes shows that total volumes account for a small proportion of total consumption.

This proportion remains insignificant even if arrivals data is included in the non-domestic legal calculation. This has been shown in detail on the next page.

- Notes: (a) Inbound visitor arrivals to include arrivals of short term overseas visitors and permanent settlers
 (b) Population within the age group 18-64 years
 (c) KPMG has used a prudent approach and assumed that 100% of visitors arriving in Australia purchase the maximum inbound traveller allowance
- Sources: (1) Australian Bureau of Statistics, *Short-term Movement, Visitor Arrivals - Selected Countries of Residence: Trend, 2013*
 (2) Australian Bureau of Statistics, *Permanent Movement, Settlers - Country of Birth, Major Groups and Selected Source Countries: Original, 2013*
 (3) Euromonitor, Population: National Estimates, accessed January 2014
 (4) Euromonitor, Smoking Prevalence Among Total Adult Population, accessed January 2014

The change in the calculation of non-domestic legal ND(L) estimates has a limited impact on the aggregate results

A2.4.2 Inbound travel trends and non-domestic legal calculation (continued)

Comparison of non-domestic legal estimate,
2012 – 2013⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾⁽⁶⁾⁽⁷⁾

| | 2012 ^(a) | | LTM H1 2013 ^(b) | | 2013 ^(b) | |
|--|---------------------|--------------|----------------------------|--------------|---------------------|--------------|
| | H1 2013 Approach | New approach | H1 2013 Approach | New approach | H1 2013 Approach | New approach |
| Legal domestic sales | 15,296.8 | 15,296.8 | 15,113.8 | 15,113.8 | 15,214.2 | 15,214.2 |
| Non-domestic legal | 35.6 | 73.0 | 10.7 | 21.5 | 10.8 | 22.0 |
| Unbranded loose | 1,495.2 | 1,495.2 | 895.5 | 895.5 | 1,034.3 | 1,034.3 |
| Contraband | 505.5 | 505.5 | 1,347.9 | 1,347.9 | 1,276.2 | 1,276.2 |
| Counterfeit | 48.9 | 48.9 | 84.9 | 84.9 | 142.8 | 142.8 |
| Total | 17,382.0 | 17,419.4 | 17,452.8 | 17,463.6 | 17,678.3 | 17,689.4 |
| Non-domestic legal as % of total consumption | 0.20% | 0.42% | 0.06% | 0.12% | 0.06% | 0.12% |
| Total illicit as % of total consumption | 11.8% | 11.8% | 13.3% | 13.3% | 13.9% | 13.9% |

Under the H1 2013 approach, the non-domestic legal volumes have been computed based on only the short-term departures data i.e. tobacco brought back into Australia by locals travelling overseas.

The new approach estimates the non-domestic legal volumes by combining the volume of tobacco brought into Australia by Australian residents travelling overseas (i.e. short-term resident departures) and by visitors coming to Australia (i.e. short-term arrivals as well as permanent settlers).

There is a marginal difference in the proportion of non-domestic legal as a percentage of total consumption but non-domestic legal volumes remain small.

In this report we have used the new approach to derive the 2013 results. However, we have not updated or restated non-domestic estimates from previous years as the overall non-domestic legal volumes remain immaterial.

Notes: (a) The amount per trip in 2012 is based on the inbound traveller allowance for 2012. This has been calculated using the 250g limit for 8 months and the 50g limit for 4 months to reflect the change in inbound traveller allowance made in September 2012

(b) The amount per trip in 2013 is based on the new maximum inbound traveller allowance of 50g per person per trip

Sources: (1) Euromonitor, Legal domestic sales, accessed January 2014

(2) MSI Intelligence Research, Empty pack survey, Q2 2013 and Q4 2013

(3) Roy Morgan Research, Consumer survey, H1 2013 and H2 2013

(4) Australian Bureau of Statistics, Short-term Movement, Visitor Arrivals - Selected Countries of Residence: Trend, 2013

(5) Australian Bureau of Statistics, Short-term movement, Resident Departures - Selected Destinations: Trend, 2013

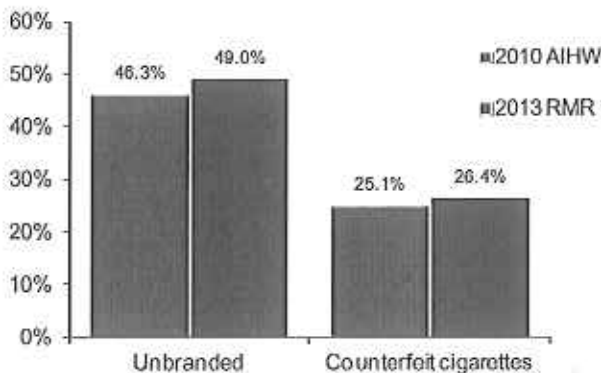
(6) Australian Bureau of Statistics, Permanent Movement, Settlers - Country of Birth, Major Groups and Selected Source Countries: Original, 2013

(7) KPMG Analysis

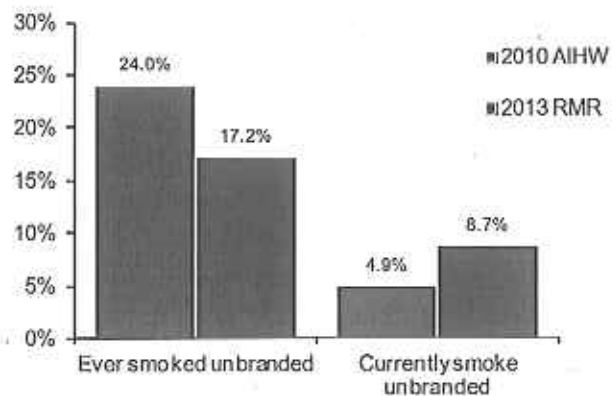
The outputs of the Roy Morgan Research survey are broadly consistent with the AIHW survey on major indicators

A2.5 Consumer surveys

Comparison of illicit tobacco awareness levels in consumer surveys^{(1)(2)(a)}



Comparison of unbranded illicit tobacco prevalence in consumer surveys^{(1)(2)(a)}



Comparison of RMR and AIHW consumer surveys⁽¹⁾⁽²⁾

| | RMR | AIHW (conducted by RMR) |
|-----------------------------------|--|---|
| Survey focus | ■ Size of the illicit tobacco market | ■ Knowledge of and attitudes towards drugs, drug consumption histories and related behaviours |
| Frequency | ■ At least annually from 2009 | ■ Every three years |
| Sample size | ■ 2010: 949 ■ 2011: 931 ■ 2012: 1,405 ■ 2013: 4,223 (H1: 2,107 + H2: 2,116) | ■ > 26,000 people aged 12 years or older participated in the survey |
| Age groups | ■ Smokers aged 18 + | ■ Smokers aged 14+ |
| Methodology | ■ Web based surveys | ■ Self-completion drop and collect methodology |
| Types of tobacco addressed | ■ Unbranded, counterfeit cigarettes, contraband cigarettes | ■ Unbranded, counterfeit cigarettes |

The Australian Institute of Health and Welfare's (AIHW) National Drug Strategy Household Survey is the only other major consumer survey in Australia that provides an overview on the prevalence of the use of illicit tobacco. There are a number of differences between the Roy Morgan Research and AIHW survey including the frequency of surveys carried out, size of the sample and the key purpose of each. The RMR survey is used to estimate the size of the illicit market whereas the AIHW survey is focused more on attitudes and behaviours. A key metric used from the RMR survey for sizing the illicit market is the quantity of illicit tobacco purchased per occasion, data that is not captured in the AIHW survey.

Despite differences in the survey objectives and methodologies, headline awareness and prevalence indicators of unbranded illicit tobacco are similar in the AIHW and RMR surveys. Awareness of unbranded tobacco was close to 50% in both studies, while awareness of counterfeit cigarettes was close to 30%. Both surveys highlight the difference in responses when asking consumers about having 'ever smoked' compared to 'currently smoking'. Respondents in both cases appear to be more willing to admit to illicit behaviour when its not considered a 'current' activity. The 2010 AIHW survey asks consumers about Chop Chop (unbranded loose tobacco sold in bags) only whereas the 2007 survey asked about both Chop Chop and unbranded cigarettes.

Note: (a) Roy Morgan Research results for 2013 are based on CAWI responses only

Sources: (1) Roy Morgan Research, Consumer survey, H1 2013 and H2 2013

(2) Australian Institute of Health and Welfare, *The 2010 National Drug Strategy Household Survey, 2011*

The description of the services set out below comprises the agreed scope of our work

A2.6 Scope of work

Scope

We will analyse and report on:

- The total level of legal domestic sales of tobacco products and consumption in the market.
- The estimated proportion of the Australian tobacco market accounted for by the illicit trade, across both manufactured products and the unbranded, encompassing contraband, counterfeit and unbranded products (including 'chop chop').
- An overview of the nature of the illicit trade in the country, including the sources of illicit product.
- Findings on the characteristics and consumption patterns of illicit tobacco users, and how these have changed from the results of surveys previously undertaken, based on the consumer research outputs.
- Data on how taxation has evolved over time and report on tobacco regulation in the Australian market.

Methodology

In order to size the illicit tobacco market, we will use two principal approaches:

Consumer research approach: utilising the half yearly and full year 2013 Roy Morgan Research reports, as used in the previously published Deloitte 'Illicit trade of tobacco in Australia: Report for 2011/ 2012'; namely:

- Analyse consumer responses to establish the proportion of illicit tobacco consumed (including assisting with the design of the sampling methodology and the questionnaire for the 2013 surveys in order to help ensure that the consumer research is as robust as possible).
- Extrapolate the proportion of illicit tobacco consumed on a national level.
- Express the findings as a proportion of total tobacco consumption.

Empty pack survey approach: utilising empty pack survey data; namely

- Analyse the data output from the empty pack surveys to establish the proportion of market accounted for by non-domestic manufactured cigarettes.
- Extrapolate the non-domestic and counterfeit incidence estimates identified in the empty pack survey against the level of legal domestic sales in Australia.
- Express findings on the estimates of both non-domestic consumption of manufactured cigarettes and consumption of counterfeit product as a proportion of consumption.

The overall results from the two approaches will then be compared and combined in order to build up our overall estimate of the size and composition of the illicit market as a proportion of total tobacco consumption.

Appendix – Technical appendices

Questions asked by the consumer survey

A2.7 Roy Morgan Research questionnaire

Do you, or does any member of your immediate family work in any of the following companies/industry sectors?

What is your post code?

What is your gender?

Are you currently employed?

Which of the following occupational categories best suits you? (Options provided)

What is your approximate annual personal income?

What is your current age?

Which products do you currently consume? (Options provided)

What type of tobacco product do you smoke or use, even if only occasionally?

How often do you normally smoke manufactured cigarettes?

How often do you normally smoke roll your own cigarettes?

How many manufactured cigarettes do you normally smoke each day (on average)?

How many roll your own cigarettes do you normally smoke each day (on average)?

What is your regular brand of manufactured cigarettes, that is, the one you smoke more than any other brand now-a-days?

What other brands of manufactured cigarettes do you currently smoke?

What is your regular brand of roll your own cigarettes, that is, the one you smoke more than any other brand now-a-days?

What other brands of roll your own cigarettes do you currently smoke?

Are you aware that unbranded tobacco can be purchased? Unbranded tobacco is also known as 'chop chop.' It is loose tobacco or cigarettes in cartons or packs that are sold without a brand name. This does not include branded tobacco products that are now sold in plain packaging that are green/brown in colour with graphic health warnings and information messages.

Since you turned 18 have you ever purchased unbranded tobacco?

Throughout the survey, we're just focusing on products you buy for your own use. Do you purchase unbranded tobacco for your own use currently?

Have you purchased unbranded tobacco in the last 12 months? (we are talking about purchases for your use)

In the past 12 months, how often did you purchase unbranded tobacco?

Well, can you give me an estimate of how often you purchased unbranded tobacco in the past 12 months?

Since you turned 18, how long had you been buying unbranded tobacco?

Well, can you give an estimate of how long you had been buying unbranded tobacco since you turned 18?

When you last purchased unbranded tobacco, from which outlet or outlets did you buy it?

When you last purchased unbranded tobacco, how many grams of unbranded tobacco did you purchase?

When you last purchased unbranded tobacco, what format or formats was the unbranded tobacco in?

When you last purchased loose unbranded tobacco, how many grams did you buy? (In grams)

When you last purchased loose unbranded tobacco, how much did it cost in total?

How long ago was your most recent purchase of loose unbranded tobacco?

Well, can you give me an estimate of when your most recent purchase of loose unbranded tobacco was?

When you last purchased cartons of unbranded tobacco, how many did you buy?

When you last purchased cartons of unbranded tobacco, how much did it cost in total?

How long ago was your most recent purchase of unbranded tobacco in cartons?

Well, can you give me an estimate of when your most recent purchase of unbranded tobacco in cartons was?

When you last purchased packs of unbranded tobacco, how many did you buy?

When you last purchased packs of unbranded tobacco, how much did it cost in total?

How long ago was your most recent purchase of unbranded tobacco in packs?

Well, can you provide an estimate of when your most recent purchase of unbranded tobacco in packs was?

When you were smoking unbranded tobacco, how much of it would you say that you smoked per day?

Well, can you provide an estimate of how much unbranded tobacco you were smoking per day?

How did you usually consume unbranded tobacco?

Appendix – Technical appendices

Questions asked by the consumer survey

A2.7 Roy Morgan Research questionnaire

How many suppliers did you ever purchase unbranded tobacco from, since you turned 18?

When you stopped buying unbranded tobacco did you not smoke or did you purchase duty paid tobacco products?

Why did you smoke unbranded tobacco?

Do you know the country of origin of the unbranded tobacco that you purchased?

Where does it usually come from?

Please select the reasons why you stopped purchasing unbranded tobacco? (Options provided)

How often do you purchase unbranded tobacco?

Well, can you provide an estimate of how often you purchase unbranded tobacco?

Since you turned 18, how long have you been buying unbranded tobacco?

Well, can you provide an estimate of how long you have been buying unbranded tobacco?

From which outlets do you usually buy your unbranded tobacco?

How many grams of unbranded tobacco do you purchase for the average purchase?

What format or formats do you usually purchase unbranded tobacco in?

What is the minimum price that you have paid for loose unbranded tobacco in bags?

What is the average price that you have paid for loose unbranded tobacco in bags?

What is the maximum price that you have paid for loose unbranded tobacco in bags?

What is the minimum price that you have paid for unbranded cigarettes in cartons?

What is the average price that you have paid for unbranded cigarettes in cartons?

What is the maximum price that you have paid for unbranded cigarettes in cartons?

What is the minimum price that you have paid for unbranded cigarettes in packs?

What is the average price that you have paid for unbranded cigarettes in packs?

What is the maximum price that you have paid for unbranded cigarettes in packs?

How much would you say that you smoke per day of unbranded tobacco?

per day of unbranded tobacco?

The most recent time you purchased unbranded tobacco what format or formats was it?

How much loose unbranded tobacco did you buy? (In grams)

How much did it cost in total?

How long ago was your most recent purchase of loose unbranded tobacco?

Well, can you provide an estimate of when your most recent purchase of loose unbranded tobacco was?

How many cartons of unbranded cigarettes did you buy?

How much did it cost in total?

How long ago was your most recent purchase of unbranded tobacco in cartons?

Well, can you provide an estimate of when your most recent purchase of unbranded tobacco in cartons was?

How many packs of unbranded cigarettes did you buy?

How much did it cost in total?

How long ago was your most recent purchase of unbranded tobacco in packs?

Well, can you provide an estimate of when your most recent purchase of unbranded tobacco in packs was?

How do you usually consume unbranded tobacco?

How many suppliers have you ever purchased unbranded tobacco from, since you turned 18?

Do you find unbranded tobacco easier or harder to obtain than a year ago or has there been no change?

If you cannot get unbranded tobacco do you not smoke or do you purchase duty paid tobacco products?

Why do you smoke unbranded tobacco?

Do you know the country of origin of the unbranded tobacco that you purchase?

Where does it usually come from?

Contraband cigarettes are legitimate brands of cigarettes purchased in shops without duty paid.

Are you aware that contraband cigarettes can be purchased?

How did you become aware of the availability of contraband cigarettes?

Since you turned 18, have you ever purchased contraband cigarettes?

Appendix – Technical appendices

Questions asked by the consumer survey

A2.7 Roy Morgan Research questionnaire

Do you purchase contraband cigarettes for your own use currently?

Have you purchased contraband cigarettes in the last 12 months?

If you think you might have purchased contraband cigarettes, which brand(s) was it? Any others?

What would you do if contraband product were not available where you usually purchase it from? (Options provided)

How would you rate the overall quality of the contraband product(s) you purchase compared to the non-contraband version(s)?

Counterfeit cigarettes are packs of cigarettes labelled with a brand name that are not really that particular brand. They have been smuggled into the country without duty paid.

Are you aware that counterfeit cigarettes can be purchased?

How did you become aware of the availability of counterfeit cigarettes?

Since you turned 18 have you ever purchased counterfeit cigarettes?

Do you purchase counterfeit cigarettes for your own use currently?

Have you purchased counterfeit cigarettes in the last 12 months?

If you think you might have purchased counterfeit cigarettes, which brand(s) was it? Any others?

What made you believe the cigarettes were counterfeit?

What would you do if counterfeit product were not available where you usually purchase it from?

How would you rate the overall quality of the counterfeit product(s) you purchase compared to the non-counterfeit version(s)?

You have indicated that you have bought counterfeit product. What does the availability of the brand(s) in counterfeit form make you feel? (Options provided)

You indicated that you would feel more negative towards the brand knowing that it is available in counterfeit, can you please explain why you feel this way.

What would you do if counterfeit product were not available where you usually purchase it from? (Options provided)

How would you rate the overall quality of the counterfeit product you purchase compared to the real legitimate brand?

The most recent time you purchased counterfeit cigarettes, did you buy them by weight, by packs, or by cartons?

When you bought the counterfeit cigarettes by weight, how much did you buy?

How much did it cost in total?

How long ago was your most recent purchase of counterfeit cigarettes by pack?

When you bought the counterfeit cigarettes/carton, how much did you buy?

How much did it cost in total?

How long ago was your most recent purchase of counterfeit cigarettes by carton?

Do you find counterfeit cigarettes easier or harder to obtain than a year ago or has there been no change?

Why do (or did) you smoke counterfeit cigarettes?

The most recent time you purchased contraband cigarettes, did you buy them by weight, by packs, or by cartons?

When you bought the contraband cigarettes by weight, how much did you buy?

How much did it cost in total?

How long ago was your most recent purchase of contraband cigarettes by weight?

When you bought the contraband cigarettes by pack, how much did you buy?

How much did it cost in total?

How long ago was your most recent purchase of contraband cigarettes by pack?

When you bought the contraband cigarettes by carton, how much did you buy?

How much did it cost in total?

How long ago was your most recent purchase of contraband cigarettes by carton?

Do you find contraband cigarettes easier or harder to obtain than a year ago or has there been no change?

Why do (or did) you smoke contraband cigarettes?

It is sometimes possible to purchase cigarettes for less than the normal retail price. The price of these 'cheap cigarettes' is several dollars or more below the normal retail price, (for example, a price of AUD10 or less for a pack of 25, or AUD8 or less for a pack of 20).

Appendix – Technical appendices

Questions asked by the consumer survey

A2.7 Roy Morgan Research questionnaire

Before today, were you aware of packs of cheap cigarettes that can be purchased for less than the normal retail price?

Since you turned 18 have you ever purchased cheap cigarettes for your own use?

Do you purchase cheap cigarettes for your own use currently?

Have you purchased cheap cigarettes for your own use in the last 12 months?

How did you become aware of the availability of cheap cigarettes?

If you think you might have purchased cheap cigarettes, what brand(s) were they?

What would you do if cheap cigarettes were not available where you usually purchase them from?

What did you do if cheap cigarettes were not available where you usually purchased them from?

How would you rate the overall quality of the cheap cigarettes that you have purchase(d) compared to the full price product(s)?

The most recent time you purchased cheap cigarettes, did you buy them by packs, or by cartons, or both?

When you bought the cheap cigarettes by pack, how many packs did you buy?

How much did it cost in total?

How long ago was your most recent purchase of cheap cigarettes by pack?

When you bought the cheap cigarettes by carton, how many cartons did you buy?

How much did it cost in total?

How long ago was your most recent purchase of cheap cigarettes by carton?

From what outlets do/did you usually buy cheap cigarettes?

Do you find cheap cigarettes easier or harder to obtain than a year ago or has there been no change?

Why do (or did) you smoke cheap cigarettes?

Why did you stop smoking cheap cigarettes?

You have indicated that you have purchased either contraband or counterfeit cigarettes in the past. Sometimes people refer to contraband or counterfeit cigarettes as 'cheap' cigarettes. These people may or may not know that the 'cheap' cigarettes are contraband or counterfeit.

Whilst you are familiar with the terms contraband and/or counterfeit, do you also know contraband or counterfeit cigarettes as 'cheap' cigarettes?

Do you purchase rolling papers, tubes, or both for the purpose of smoking loose tobacco?

When you purchase rolling papers for smoking loose tobacco, what is the once pack size of rolling papers you usually purchase?

What percentage of that pack of rolling papers do you use before the pack is damaged, lost or discarded? (Options provided)

When you purchase tubes for smoking loose tobacco, what is the one pack size of tubes you usually purchase?

What percentage of that pack of tubes do you use before the pack is damaged, lost or discarded? (Options provided)

Have you travelled outside of Australia in the last 6 months?

Did you bring back any manufactured cigarettes or any other tobacco products to bring back to Australia on any of your trips to other countries in the past 6 months?

How many trips in the last 6 months did you make where you purchased manufactured cigarettes or any other tobacco products to bring back to Australia?

For each type of product listed below, indicate how much you brought back into Australia on average per trip? (Options provided)

In which countries did you buy manufactured cigarettes/any other tobacco products?

Did you buy duty free manufactured cigarettes or any tobacco products at the airport or port on your return to Australia after any of your trips to other countries in the last 6 months?

How many trips did you make in the last 6 months where you purchased duty free manufactured cigarettes or any other tobacco products on your return to Australia?

For each type of product, indicate how much you purchased in duty free on average per trip.

Appendix – Technical appendices

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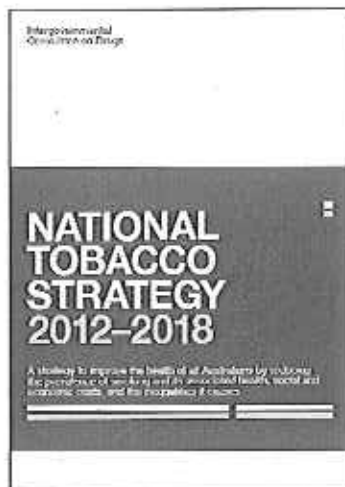
Denormalisation, smoking rates and the way ahead for tobacco product regulation

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Why look at smoking rates?

The primary stated goal of most tobacco control policy is to reduce smoking prevalence. For example, the Australian Federal Authorities have set a performance benchmark to reduce smoking rates to 10% by 2018 in their tobacco control strategy for 2012 to 2018¹.



This is set out as follows:

"Australia has been successful in reducing smoking prevalence over many years. Yet smoking rates in our community are still too high..."

"...the Council of Australian Governments committed to the following performance benchmark: 'By 2018, reduce the national smoking rate to 10 per cent of the population...'"

"Progress against this performance benchmark will be measured by reference to the adult daily smoking rate. This performance benchmark forms the basis for the targets adopted in this strategy."

¹ Australian National Tobacco Strategy 2012-2018

[http://www.nationaldrugstrategy.gov.au/internet/drugstrategy/publishing.nsf/Content/D4E3727950BDBAE4CA257AE70003730C/\\$File/National%20Tobacco%20Strategy%202012-2018.pdf](http://www.nationaldrugstrategy.gov.au/internet/drugstrategy/publishing.nsf/Content/D4E3727950BDBAE4CA257AE70003730C/$File/National%20Tobacco%20Strategy%202012-2018.pdf)

Smoking rates have also been set as the benchmark for the review of the European Tobacco Products Directive (TPD). Across Europe 28% of EU citizens still smoke, and the explicit objective of the European Commission is to reduce this by 2% through the revised TPD.

James Reilly, the Irish Minister for Health, addressed the European Parliament on 25 February 2013 at the beginning of their evaluation of the Commission's proposal for the TPD. In his keynote address he said:

"...overall prevalence rates for Ireland are more or less similar to the EU average with 29% of Irish adults being current smokers. This is simply not acceptable."

In a briefing note from the Library of the European Parliament, a review of the effectiveness of tobacco control policy concluded that:

"It is difficult to quantify the effectiveness of anti-smoking measures...however, smoking rates among young people in the EU appear to be fairly constant, indicating that the main target group is not being effectively reached by current policies"²

What are smoking rates?

The smoking rate (also referred to as 'prevalence' or 'incidence') is a measure of the percentage of smokers in the population. This metric is derived from population surveys in which a sample of people are asked different questions about their lifestyle. Data is normally available for regular (daily) and occasional smokers. Data is usually segmented by age, gender and socio-economic status.

This segmentation can reveal cultural and historical differences between different national groups. For example in some Eastern cultures there may be a huge difference between male and female smoking rates – with rates for female smokers typically much lower.

In some cultures a cross section of the whole population smokes, whereas in others it is more strongly associated with lower socio-economic status.

It is also important to bear in mind that no differentiation is made between smokers of domestic, cross-border or illicit products.

In this review the focus will be throughout on REGULAR ADULT smokers. Sources of data referenced will be either European Research Consultants (ERC) Reports³ or national statistics unless otherwise stated.

Trends In Smoking Prevalence

There has been a decline in smoking rates in most countries since the risks associated with smoking were first made known in the 1960s and 70s. However, rates of decline particularly in mature

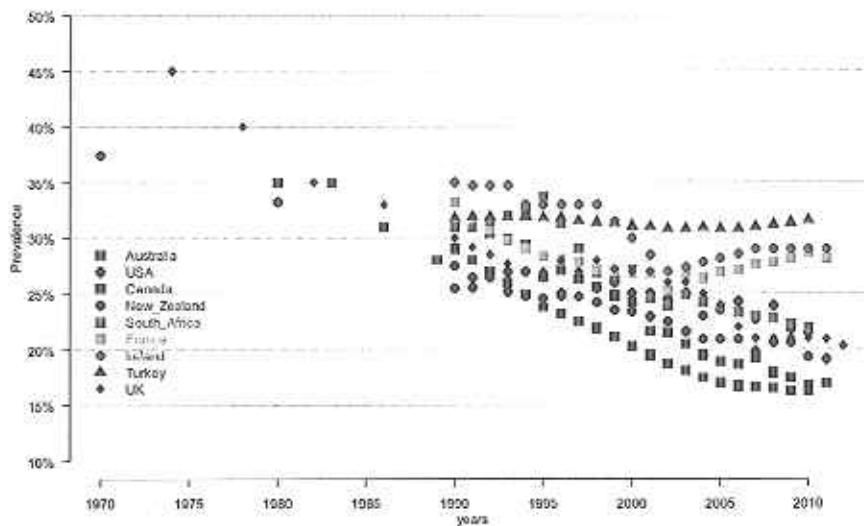
² Reducing smoking rates in the EU; EP Library Briefing, 30 September 2011

³ <http://www.erc-world.com/cigarette-smoking-prevalence>

markets are now levelling off. This is typified by data from Australia and the US. Against this backdrop it is hard to see how Australia's National Tobacco Strategy target of 10% by 2018 would be achieved. (See Figure 1)

Although smoking rates have been steadily declining in most countries there are exceptions. For example, smoking rates in Turkey have remained largely unchanged over the last 20 years. And despite falls in in the 1990s, smoking rates in France and Ireland have risen slightly in recent years.

Figure 1: Smoking rates in different regions



Whilst smoking rate reduction remains the key objective for many jurisdictions, there are other criteria that have been used to compare and evaluate success of tobacco control policy

Denormalisation

In recent years there has been a shift in regulatory policy towards co-ordinated global population level interventions designed to change attitudes to tobacco use and to alter its social context. This social engineering approach to tobacco control is referred to as 'denormalisation' and has been championed by the World Health Organisation through specific provisions in the Framework Convention on Tobacco Control (FCTC), made explicit through a combination of (non-binding) guidelines.

Denormalisation aims to work on both supply of and demand for tobacco products – seeking to reduce the production and availability of tobacco products, curtailing opportunities to smoke at work and the home, and attacking brand value and attractiveness through product standardisation. Those who don't smoke become less tolerant of those who do, and even those who continue to choose to smoke can become more receptive to regulation. Tobacco manufacturers are treated with suspicion and are excluded from discussion, even where their expertise could inform regulation.

A 2012 review claimed that *"The majority of studies suggest that tobacco industry denormalisation is effective in reducing smoking prevalence and initiation and increasing intentions to quit."*⁴ This claim will be investigated by focussing on the relationship between tobacco control initiatives and smoking prevalence, particularly in those countries such as Australia, Ireland, Canada and the UK that have espoused these principles.

Tobacco Control Scale

The Tobacco Control Scale (TCS), presented by Luk Joossens and Martin Raw on behalf of the Association of European Cancer Leagues, attempts to rank tobacco control activity in 31 European countries (latest in 2010) and presents them in the form of a table⁵. Countries were judged against a number of measures which, according to the authors, are described by the World Bank as those that should be prioritised as part of a comprehensive tobacco control programme. These are:

- price increases through higher taxes on cigarettes and other tobacco products;
- bans/restrictions on smoking in public and work places;
- better consumer information, including public information campaigns, media coverage, and publicising research findings;
- comprehensive bans on the advertising and promotion of all tobacco products, logos and brand names;
- large, direct health warning labels on cigarette boxes and other tobacco products;
- treatment to help dependent smokers stop, including increased access to medications

Figure 2: Tobacco Control Scale



⁴ Tobacco industry denormalisation as a tobacco control intervention: a review; Ruth E Malone, Quinn Grundy and Lisa A Bero, *Tob Control* 2012 21: 162-170

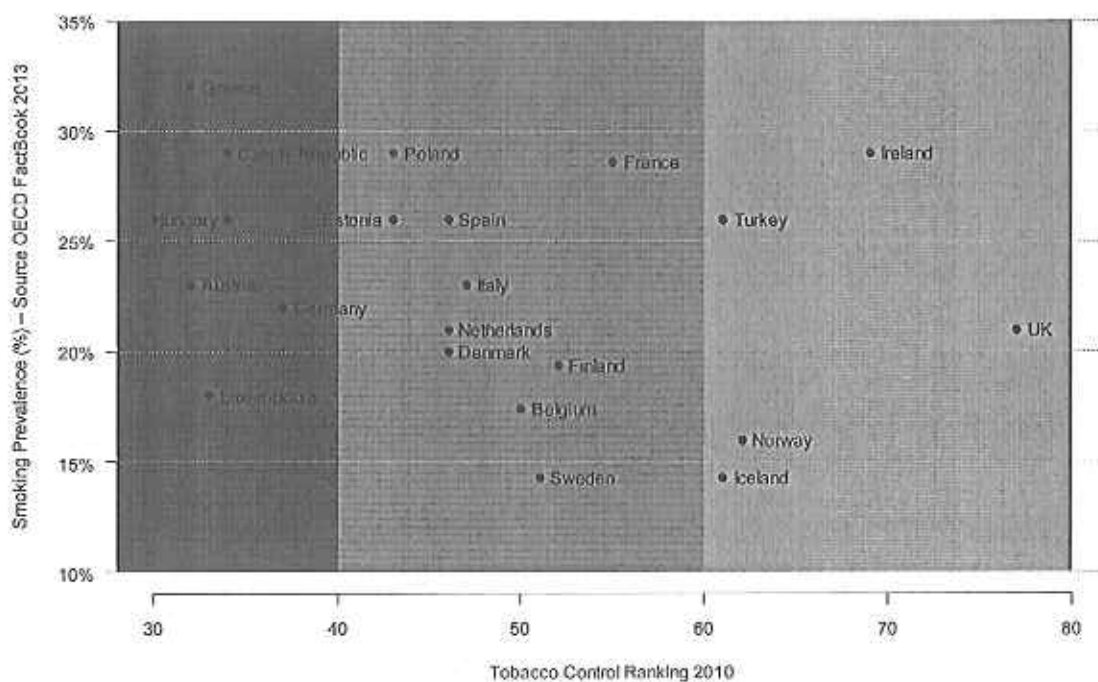
⁵ The Tobacco Control Scale 2010 in Europe, Luk Joossens & Martin Raw, Association of European Cancer leagues, 2011.

Joossens and Raw claimed that higher TCS scores were '...strongly associated with lower smoking prevalence'. This is simply not the case. Figure 3 shows a plot of smoking rates against each country's Tobacco Control Score. Visually there is no relationship between the figures. Although a trend-line can be calculated which estimates the association as:

$$\text{Smoking Rate(\%)} = 28.029 - (0.1064 \times \text{TCS})$$

the correlation is extremely weak, with an estimation for R^2 of only 0.0668.

Figure 3. Tobacco Control Score vs Smoking Prevalence

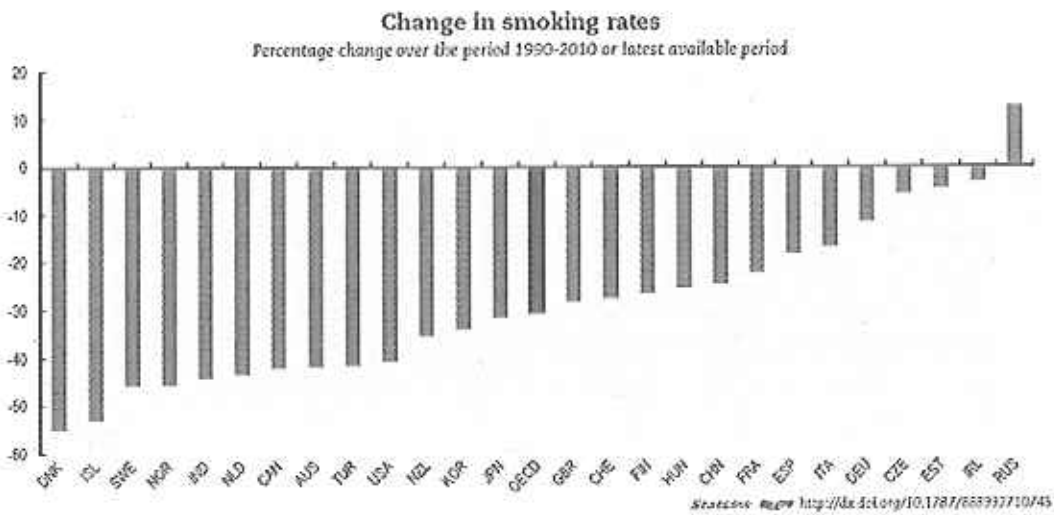


The data on smoking rates shown in Figures 3, 4 and 5 were taken from the OECD Factbook which was published earlier this year⁶.

One of the presentations made by OECD is a comparison of smoking rates between 1990 and 2010, shown here in Figure 4. An advantage of this comparison is that cultural differences between some countries (especially in relation to female smoking) are eliminated. This shows that in the EU, Scandinavian countries including Denmark, Sweden and Norway had the largest fall in smoking rates over the period. The UK is just behind the OECD average. In its own terms, Ireland had one of the poorest records over the last 20 years.

⁶ OECD Factbook 2013, Economic, Environmental and Social Statistics; <http://www.oecd-ilibrary.org/sites/factbook-2013-en/12/02/01/index.html?contentType=&itemId=/content/chapter/factbook-2013-98-en&containerItemId=/content/serial/18147364&accessItemIds=&mimeType=text/html>

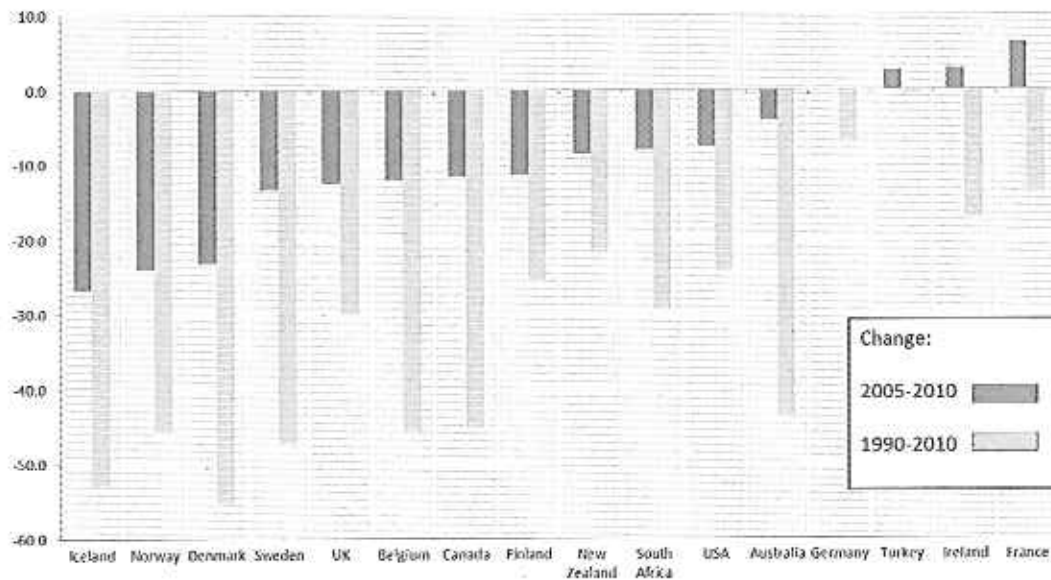
Figure 4. Change in smoking rates 1990 to 2010



Source OECD Factsbook 2013

To evaluate the impact of denormalisation on smoking rates it's relevant to focus on the changes which have occurred since FCTC ratification in 2005. This is shown in Figure 5, side-by-side with the OECD data from 1990-2010.

Figure 5. Change in smoking rates - percentage change over the period 2005 - 2010



Although rates of decline have slowed in recent years, the Scandinavian countries have continued to see continuing falls in smoking rates, and this is worth further investigation.

However for many other developed countries FCTC ratification appears to have had little or no impact on smoking rates. When compared to the period from 1990-2010, whilst Canada appears to have maintained some momentum, Australia has seen little change in its smoking prevalence since

2005. Smoking rates in France and Turkey have actually increased since 2005, despite both countries embracing policies of tobacco denormalisation.

Ireland has also seen a rise in smoking rates despite introducing being the first country in Europe to introduce a comprehensive smoking ban in 2004, a display ban in 2009 and still having amongst the most expensive cigarettes in Europe.

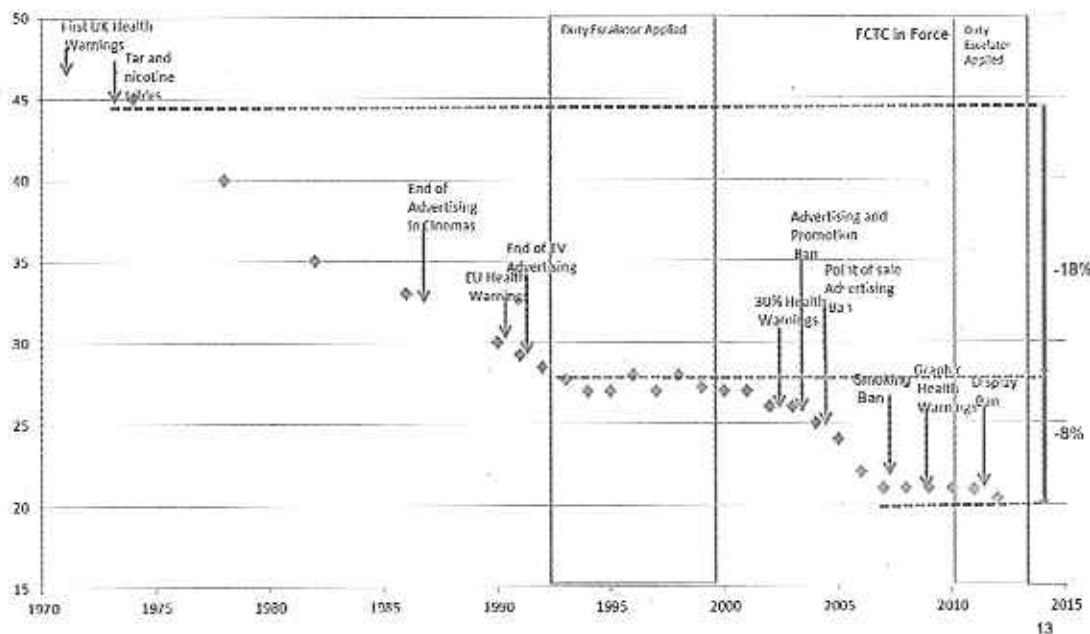
The UK stands out in this group together with the Nordic countries, with on-going declines in smoking rates over the last five years, and this is worth further investigation. Figure 6 is a plot of UK smoking rates since the 1970s, overlaid with a timeline of tobacco regulation and taxation. It shows a similar pattern to the US and Australia; rapid decline in the 1970s and 1980s followed by a levelling off after 1990. I.e.:

1972 to 1992 = -18%

1992 to 2012 = -8%

According to Joossens and Raw, higher taxes on cigarettes and other tobacco products coupled with bans/restrictions on smoking in public and work places are generally believed to have most impact on smoking rates. Yet neither strategy appears to have had any impact on UK smoking rates. Nor has the ratification of the FCTC in 2005

Figure 6. UK – Impact of Regulation on Smoking Rates

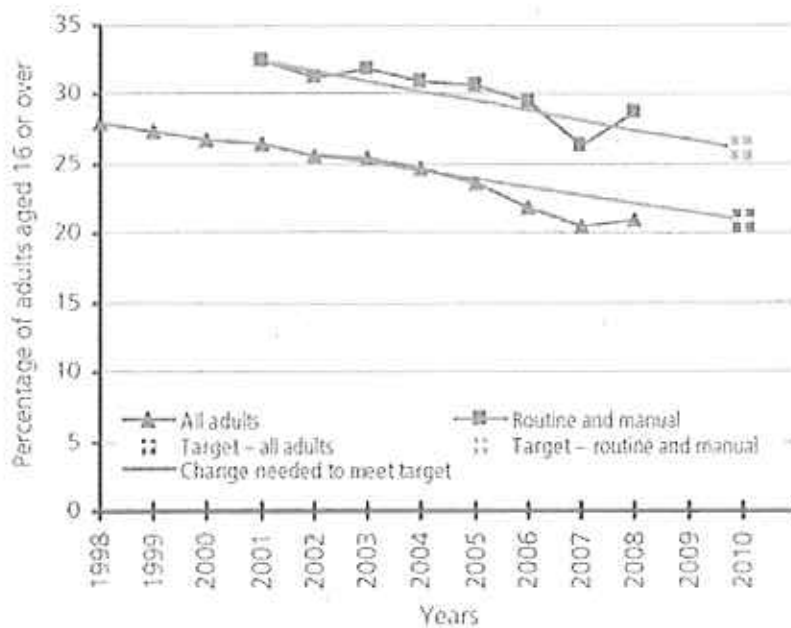


UK – Impact of the Smoking Ban

In England and Wales, smoking was banned in all indoor public places, including workplaces, restaurants and pubs, from July 2007. In 2010 the UK Government published a ten year tobacco control plan entitled 'A SmokeFree Future'.⁷ It later published a review of the smoking ban from Professor Linda Bauld alongside the 2011 version of the Tobacco Control Plan.⁸

The UK DoH's own data suggests that rather than having no impact on smoking rates; the smoking ban may in fact have had the opposite effect. Figure 7 is a reproduction of a graph which was shown on Page 15 of the Tobacco Control Plan. It indicates that for 2008, the year after the smoking ban was first introduced, smoking rates rose both for manual workers and in the general population.

Figure 7: Smoking Rates In England from 1998 to 2008



Source: 'A Smokefree Future' UK Department of Health, February 2010

This completely contradicts the analysis made in UK DoH's official report of the smoking ban impact in March 2011:

"...this type of legislation has the potential to change social norms around smoking and results in changes in smoking behaviour..." [evidenced by] "...a general pattern of reduced tobacco consumption"

This is something that we challenged in more detail in our own critique – "The Bauld Truth?"⁹

⁷ 'A Smokefree Future' UK Department of Health, February 2010

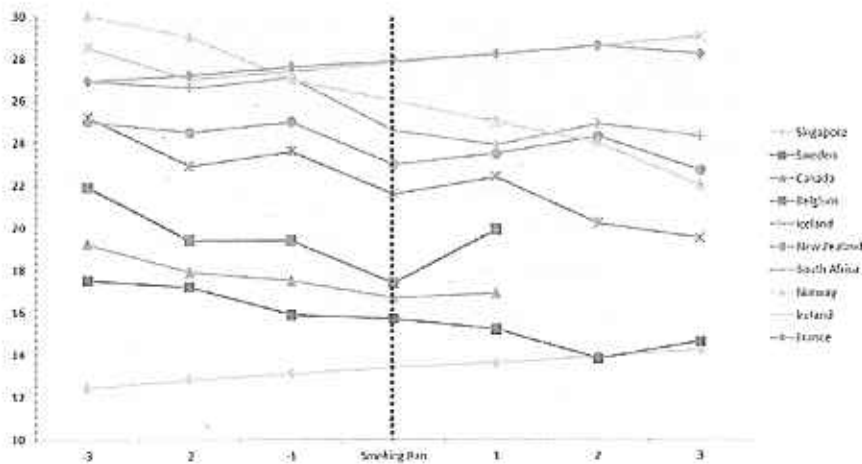
⁸ The Impact of Smokefree Legislation in England: Evidence Review, Professor Linda Bauld, March 2011

⁹ 'The Bauld Truth' The Impact of Smokefree Legislation in England: A critique of the evidence review using publicly available information http://www.imperial-tobacco.co.uk/files/the_bauld_truth_June11.pdf

Is the data from the UK representative, or is it an anomaly? The evidence suggests that it may not be an isolated case.

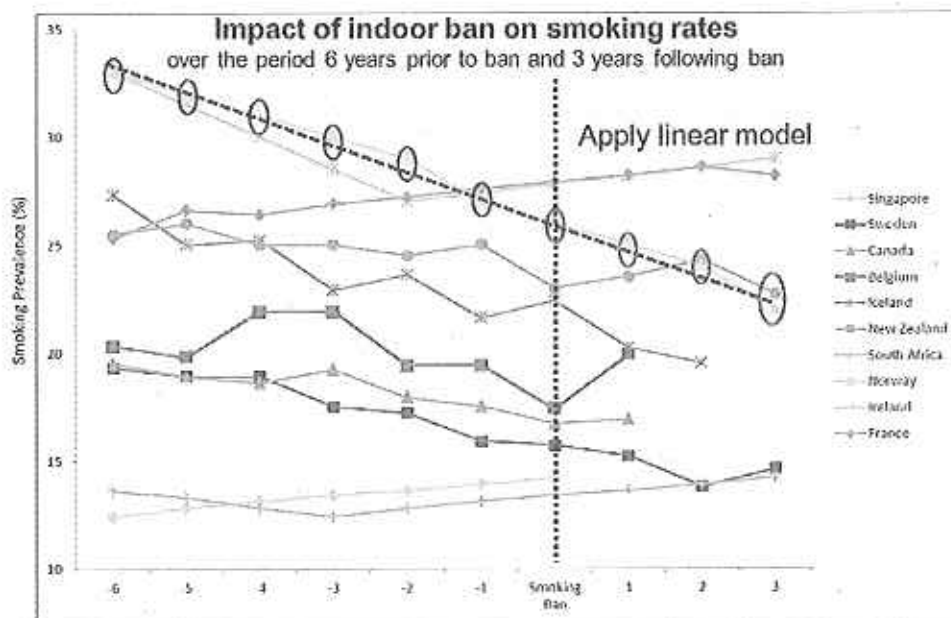
Figure 8 is a comparison of smoking incidence for the three years prior and three years after comprehensive indoor smoking bans were imposed in 10 countries. In six of these, smoking incidence rose the year after the smoking ban was introduced.

**Figure 8: Impact of indoor ban on smoking rates:
Over the period 3 years prior to and following ban:**



This is interesting, but not conclusive. Figure 9 takes this a stage further: For each country we have modelled the trend based on a linear model, using the six years prior to the implementation of the smoking ban (see example for Norway) and use this trend to make a prediction for the three years following the smoking bans' implementation, and compare with what actually happened.

Figure 9 Effect of smoking ban on 6 year trend



If there were to be a significant effect from the ban the model should identify this as a gap between the predicted and the observed prevalence after the smoking ban for each country.

Figure 10 illustrates the small residuals (lower than 10%) obtained before the smoking bans for all the countries, which suggests that the quality of the model was acceptable in each case.

Figure 10: Residuals from linear model prior to smoking ban

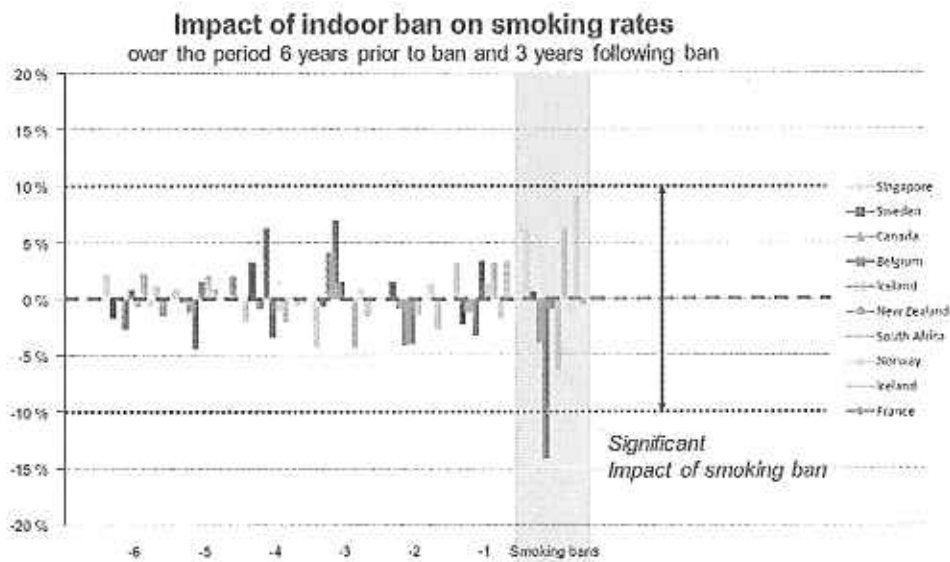
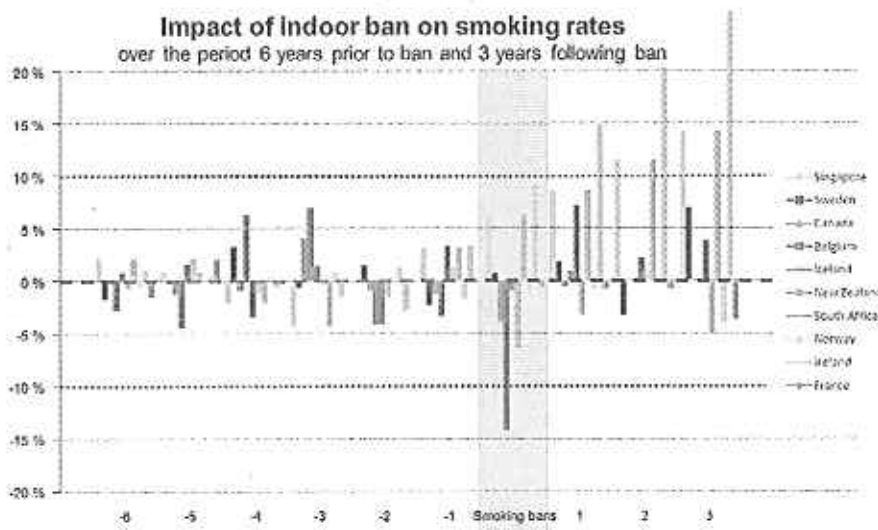


Figure 11 compares the residuals prior to and after the smoking ban. Any impact from the smoking ban on the prevalence will produce a difference (in percentage) between the predicted prevalence and the observed prevalence. For the three years after the ban a difference of at least +10% would be significant

Figure 11: Residuals from linear model prior to and after the smoking ban

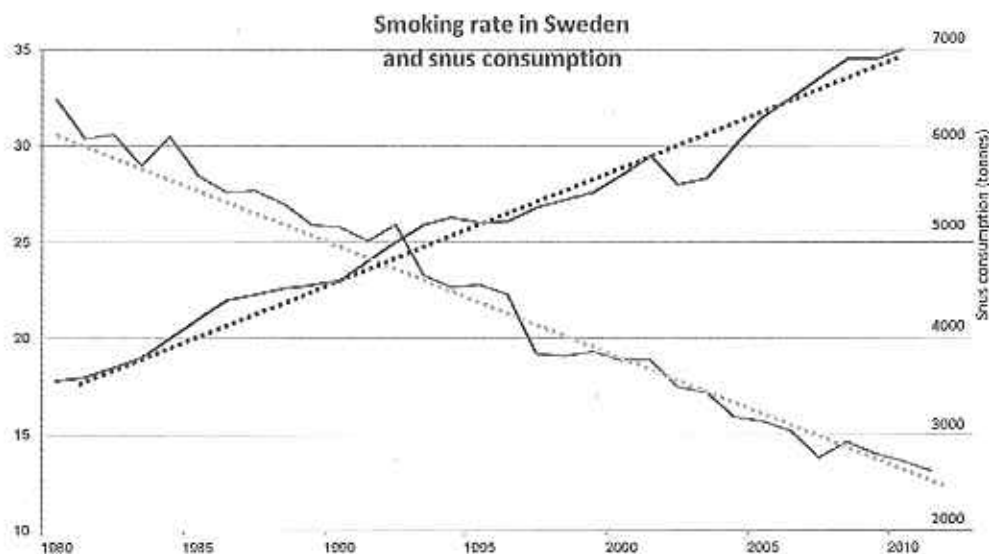


The variations obtained after the smoking bans were introduced strongly suggest that the smoking ban did not reduce smoking prevalence in any of these 10 countries. Furthermore, for some of these countries, it appears that there may be a significant increase in smoking rates associated with the smoking ban.

Case Study - Sweden

In Sweden the decline in smoking rates does not appear to match the pattern found elsewhere (e.g. in USA, Australia or the UK). This is illustrated in figure 12, together with data for snus consumption, since 1980. Here has been no levelling off – just a steady decline to the point where Sweden now has the lowest smoking prevalence in Europe - which suggests that there may be a different dynamic at work.

Figure 12: Case Study – Sweden



Sources: Swedish Central Bureau of Statistics
Snus Consumption - Swedish Match

The decline in smoking in Sweden over the last 30 years appears to be matched by an increase in the consumption of snus. We can explore whether snus consumption is a factor in the on-going decline of smoking in Sweden further by considering male and female smoking and snus rates separately. Snus prevalence since 1980 has been substantially higher for Swedish men than for women, although use of snus in women may also have increased slightly since about 2003.

Figure 13 shows the smoking and snus rates for men and women in Sweden firstly in absolute terms, and secondly, relative to the position in 1980. The rate of decline in smoking in men is faster than in women in Sweden, and this is mirrored by the relative prevalence of snus. There is also a suggestion in these data that the very recent take-up of snus amongst Swedish women may be associated with a faster decline in female smoking rates over the same period. Although not proof positive, it is strongly indicative of the impact of snus on smoking rates in Sweden.

Figure 13a: Smoking rates and snus prevalence in Swedish men and women

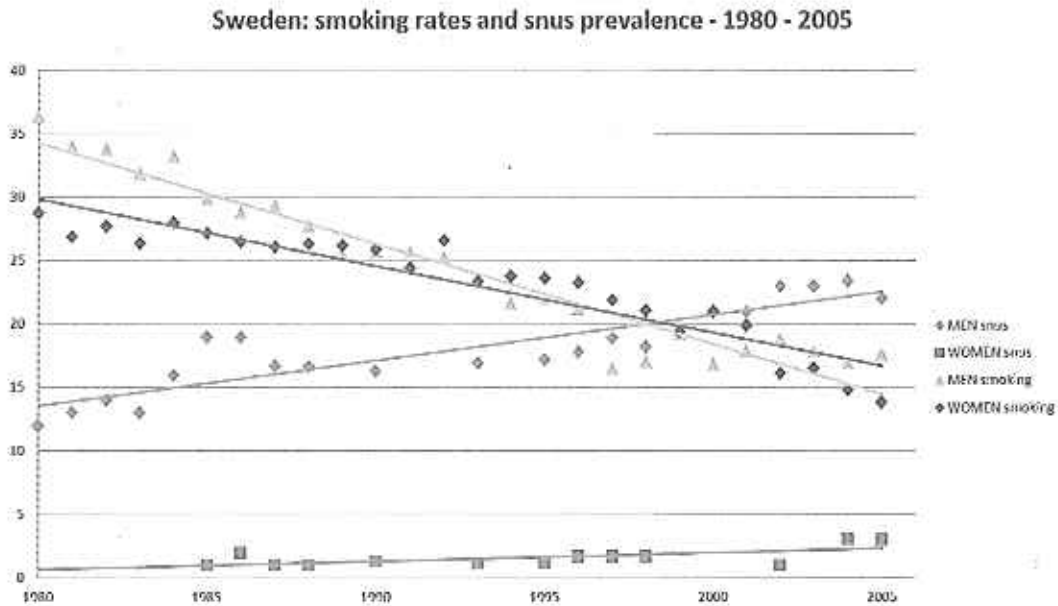
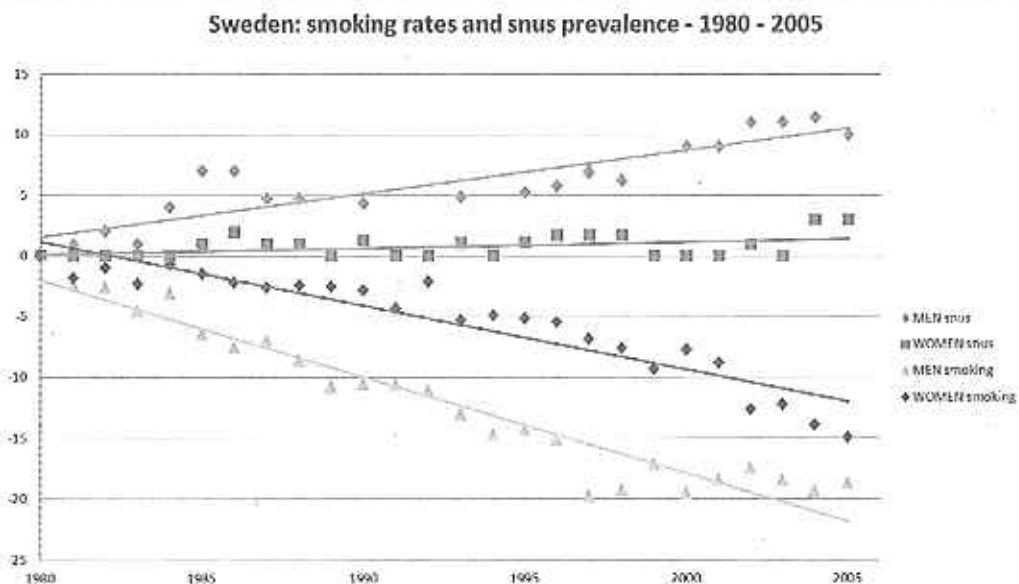


Figure 13b: Smoking rates and snus prevalence in Swedish men and women: 1980 = zero

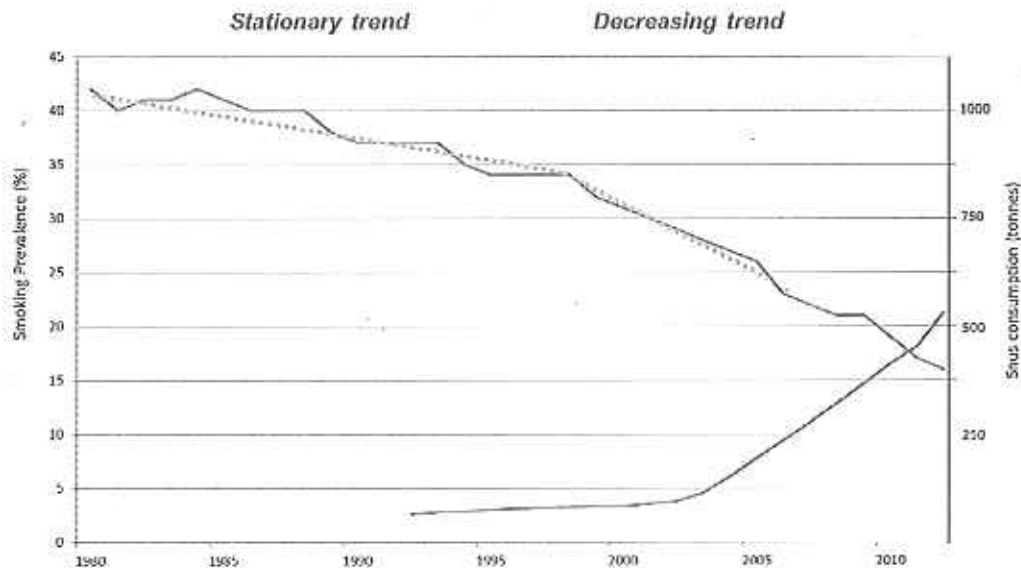


Case Study – Norway

Norway makes an interesting study, as unlike in Sweden the growth in snus consumption has only been significant for the last 10-15 years; i.e. since about 1998/9. This may provide further evidence of the potential for snus consumption to have an impact on smoking rates.

Smoking prevalence and snus consumption in Norway is illustrated in Figure 14. What is clear is that until 1998/9 smoking rates in were amongst the highest in Europe with a fairly flat downward trend, however after 2000, the rate of decline sped up – to the point that smoking rates in Norway are now amongst the lowest in Europe.

Figure 14: Smoking prevalence and snus consumption in Norway since 1980



Source: Statistics Norway

In order to identify the factors that may explain the decline in prevalence in Norway after 2005, an Auto Regressive Movin Average was applied on the observations collected before 2005. This is illustrated in Figure 15.

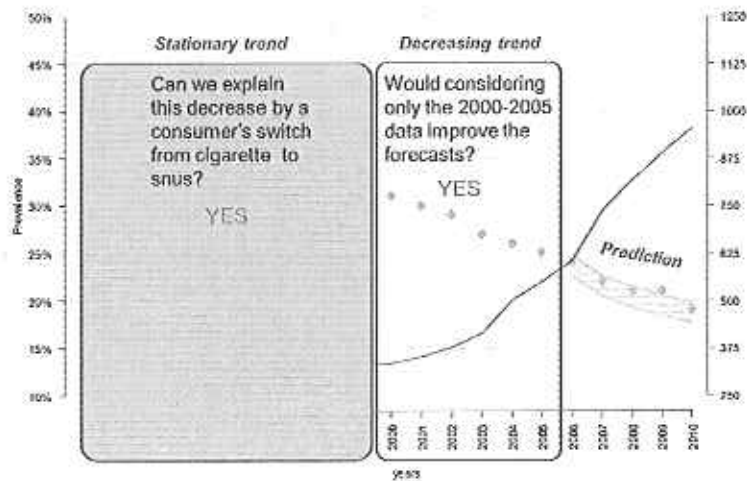
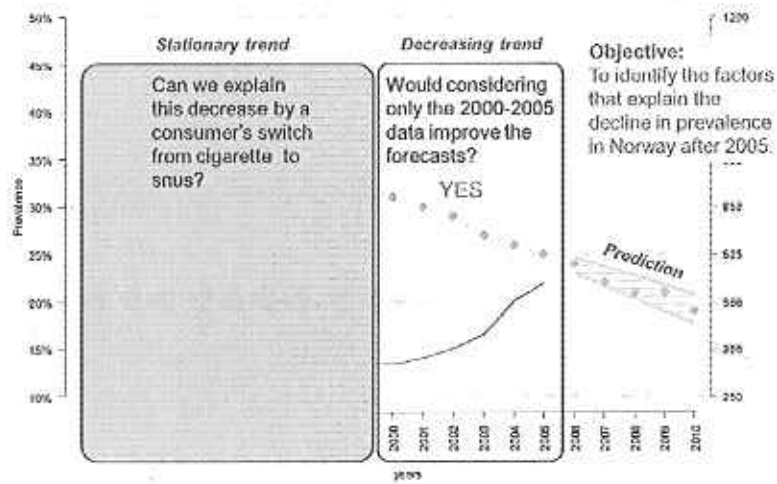
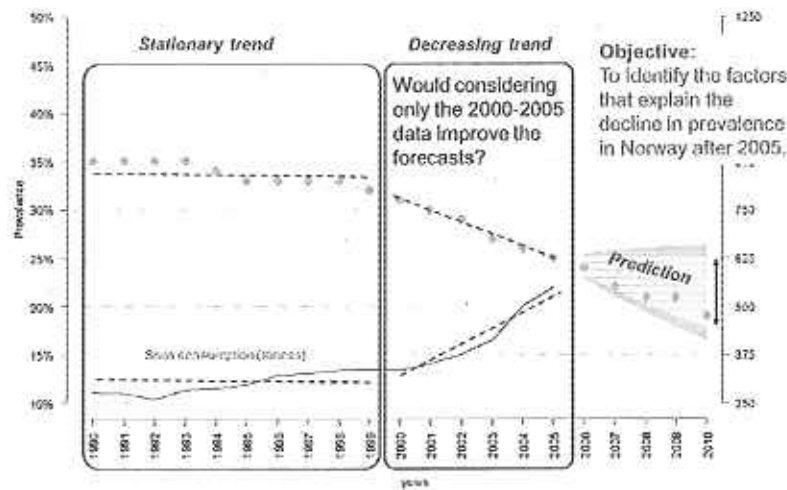
If we use trend analysis for the entire period 1990-2005 to predict what will happen after 2005, without taking into account the snus consumption and the change in trend around 2000, the precision in prediction (confidence interval) is quite weak. This is illustrated in the first diagram.

The trend in smoking prevalence changed around the year 2000. To decrease the confidence interval, the calibration base was first reduced to the range 2000-2005. This is shown in the second diagram. In this case the prediction range appeared to be greatly improved.

The final question is whether this decrease can be explained entirely from consumers switching from cigarettes to snus. For that we made a prediction of the range for 2005-2010 taking only the snus consumption data into consideration, and this is shown in the final diagram.

The predictions and the precision of predictions were still good which strongly suggests that the rate of decrease in cigarette prevalence after 2000 is a consequence of the switch from cigarettes to snus.

Figure 15: Norway: Using 1990-2005 prevalence data to predict smoking rate after 2005



CONCLUSIONS

In conclusion, the smoking rate is used as the key success criterion for tobacco control policy/regulation, and many countries explicitly quantify this objective in terms of a target value and timescale.

Globally, there were rapid declines in smoking rates in the 70s and 80s which probably reflected the growing awareness and acceptance of government health messages on smoking. However smoking rates have been levelling off in most jurisdictions since about 2000 and especially since 2005 when the Framework Convention on Tobacco Control was ratified.

We have explored the relationship between tobacco control initiatives (e.g. as quantified by the tobacco control score) and smoking rates and found there to be no correlation between them. Neither is there evidence that smoking rates have been greatly impacted by tobacco regulation nor the policy of denormalisation pursued after ratification of the WHO FCTC in 2005. In these terms, denormalisation is not working as an effective tobacco control policy.

Smoking rates are still falling consistently in markets where a viable choice/alternative to smoking is presented to consumers. Furthermore, we suggest that the Norwegian experience with smokeless tobacco could be a predictor of what the impact of e-cigarettes on smoking rates could be in the US and Western Europe in 10 to 15 years' time, provided that the growth of this sector is not impeded by poorly conceived regulation.



The Evidence is Plain

The ineffectiveness of standardised packaging for public health

A response to the Chantler Review on standardised packaging of tobacco products

10 January 2014

<http://www.imperial-tobacco.com>

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1. Introduction - Company background

Imperial Tobacco Group PLC ("ITG") is a FTSE top 25 company, the world's fourth largest international - and second largest European - tobacco company. ITG manufactures and sells a range of cigarettes and other tobacco products. ITG has sales in over 160 countries worldwide and is the world leader in the premium cigar, fine-cut (roll-your-own) tobacco and rolling papers sectors.

Imperial Tobacco UK ("ITUK", and, together with ITG, "Imperial Tobacco") is the Bristol-based trading operation of ITG which distributes Imperial Tobacco's products to the UK market. ITUK is market leader, holding approximately 45 per cent market share. ITUK's leading UK cigarette brands include Lambert & Butler, JPS, Richmond, Embassy and Regal. ITUK also distributes tobacco products on behalf of Philip Morris Ltd.

Imperial Tobacco has its headquarters in Bristol with manufacturing and distribution facilities in Nottingham. Imperial Tobacco directly employs over 1,600 people in the UK and last year collected around £5.8 billion for the Exchequer in duties and other taxes. Imperial Tobacco has around 26,000 shareholders with 53 per cent of issued shares held in the UK. Over 34,000 individuals are members of the company pension fund, and it is estimated that the tobacco industry indirectly supports the livelihoods of over 66,000 people elsewhere in the economy via the supply chain, production and packaging, retailers within the UK¹.

Tobacco is a legal product, enjoyed by around 10 million adults in the UK. This equates to around 20 per cent of the adult population and is not an insignificant minority. These adults make an informed choice to smoke; they smoke for many and varied reasons and despite the continual stream of unreasonable and disproportionate tobacco control regulations imposed upon them and propaganda to the contrary many do not wish to give up.

Our commercial focus is solely on gaining the custom of the 55% of adult smokers – over 5 million adults - who currently do not choose our products. We do not market our products to anyone under the age of 18 or to non-smokers. We adhere to all legislation, and where none exists, our International Marketing Standards which are published at: http://www.imperial-tobacco.com/files/environment/marketing_standard_2009.pdf. We support retailer programmes designed to discourage tobacco sales to children such as our support for the 'No ID, No Sale' retailer awareness campaign and the CitizenCard proof-of-age scheme.

¹ [Cogent factsheet, published Q2 2012](#)

2. Executive summary

Imperial Tobacco welcomes the opportunity to respond to the *Chantler Review on standardised packaging of tobacco products* (the "Review").

Imperial Tobacco supports sound, evidence-based, reasonable and practicable regulation of tobacco products.

We have noted carefully the closely defined remit for this review, and have tailored our response accordingly. However, we are concerned that such a narrow consideration of the available evidence of a very complex issue will disregard crucial elements of the evidence base that should be considered as a whole when reaching any conclusions.

Sir Cyril's Method Statement states:

"I am concerned with evidence directed to the specific question of whether the introduction of standardized packaging is likely to lead to a decrease in the consumption of tobacco, including in particular a decrease in the risk of children becoming addicted. I start from the uncontroversial premise that any such decrease will have a positive effect on public health."

Following the Department of Health's Consultation on Standardised Packaging² ("DH" and "Consultation"), the closure of which led to a rigorous and comprehensive assessment of all submissions, the Government chose not to proceed with the proposed policy due to a lack of solid, credible evidence that standardised packaging would work. The various studies produced by the tobacco control community since then have not changed that situation; standardised packaging will not achieve the Government's stated objectives and will very likely lead to serious unintended consequences to the detriment of public health.

For any review to be credible, methodologies and conflicts of interests of existing standardised packaging studies should be scrutinised very carefully, especially those around perceptions of packaging. Most of the existing 'evidence' is by no means independent research, but instead appears to have been manufactured with a specific result in mind, i.e. to produce material that would support the introduction of standardised packaging. It should also be noted, that a lot of the material has been 'peer reviewed' by like-minded individuals from within the public health

² Department of Health consultation on standardised packaging of tobacco products, 16 April 2012

community who share a common public health goal. This further undermines the transparency and credibility of these studies.

The very narrow focus of the Review is surprising and unhelpful. Sir Cyril's Method Statement makes it plain that: "*I am concerned only with any public health benefits of introducing standardised packaging...*". It is unclear why the Government has adopted this approach in light of the fact that standardised packaging is, from any perspective, a complex and significant issue with important repercussions for society as a whole. As a consequence, and as we explain below, the impact of standardised packaging cannot properly or adequately be considered from such a narrow standpoint.

2.1 No contribution to improving public health

There is no credible evidence whatsoever that standardised packaging will contribute to improving public health or will affect smoking behaviour at all. By depressing prices and effectively promoting the non-UK duty-paid tobacco trade ("illicit") (with tobacco prices being lower in many other countries and illicit tobacco sold at lower prices than UK duty-paid products), there is a real risk of consumption increasing. The consultation ignored the established research as to the reasons why people smoke and continue smoking, specifically those under 18, which do not include packaging and branding.

There is no evidence that demonstrates that standardised packaging would achieve any or all of the Government's stated policy objectives). The DH Systematic Review³ ("**Systematic Review**") and Impact Assessment ("IA") have not shown that smoking behaviour and consumption would change as a result of the introduction of standardised packaging; still less do they provide a sufficient evidence base to justify such a draconian policy. Crucially for the terms of reference for this Review, no new robust evidence has been provided to date. The Systematic Review update⁴ (17 studies) produced in September 2013 contained the same flaws as the previous Review e.g. self-reported intent versus real world impact and the statement that they do not show standardised packaging to be an effective intervention. We note from Sir Cyril's Method Statement that he envisages: "...commissioning further expert evidence to assist in the qualitative analysis of what I consider to be key evidence". We respectfully request that all interested parties to this Review are afforded an opportunity to

³ Department for Health Systematic Review April 2012 [Plain tobacco packaging : A systematic review](#)

⁴ <http://www.stir.ac.uk/media/schools/management/documents/Plain%20Packaging%20Studies%20Update.pdf>

review and comment upon any 'new' evidence that may be submitted – either in support of or against standardised packaging – or any expert advice obtained by Sir Cyril before his final report is published. This would be consistent with the principles of a fair and open consultation process.

Following the introduction of standardised packaging in Australia, smoking prevalence has not been affected. The latest national statistics from Australia covering smoking prevalence only cover the period up to the end of 2012 and there has been no data or anecdotal evidence on youth smoking rates in Australia after 2011. We are not aware of any national statistics from Australia that are due to be published in the next few months, which Sir Cyril could review, covering the period since standardised packaging was mandated. We consider this to be an essential requirement for a proper assessment of the policy's impact.

We believe any introduction of standardised packaging would be ineffective for public health for the reasons set out in detail below.

3. The existing regulatory context and the impact on public health

The proposal to introduce standardised packaging makes no sense in the existing regulatory context. The Government has introduced a number of far reaching tobacco control measures, the last of which - the display of tobacco products in retail outlets - will not fully come into force until 2015. The common denominator in all of these regulatory measures is that they do not address the reasons why people start or continue to smoke. The consultation and IA were no different and ignored all of the well-established research on the main reasons for smoking initiation by young people and the factors that influence quitters, and completely failed to provide any analysis of how standardised packaging would address those reasons.

The Government must acknowledge and take into account developments in other jurisdictions that are important and relevant to UK policy and this must be considered as part of the Review.

3.1 The European context

At the end of a long and robust deliberation process, the institutions of the European Union have come to the conclusion in the revised Tobacco Product Directive ("EUTPD") of 16 December 2013, that graphic health warnings covering 65% of the front and back of pack surface are appropriate to introduce in the 28 Member States. The UK and Ireland are currently alone among the EU Member States in consulting on standardised packaging. Would it not be

appropriate for the UK Government and the Review process to await evidence regarding the effectiveness of this measure before considering the introduction of standardised packaging? It is therefore, important that the review not only considers if standardised packaging is likely to lead to a decrease in the consumption, but also if it would have the effect of achieving any decrease beyond what the EUTPD may achieve when it comes into effect.

3.2 Assess current legislation before proposing additional legislation

The Government stated in the Impact Assessment accompanying the consultation that standardised packaging must be based on benefits *"over and above existing tobacco control measures"*.

It is incumbent on the Government to undertake a comprehensive and considered analysis of the effect of the existing regulatory framework, including a rigorous assessment of the impact of *"the existing tobacco control measures"* and their effect before it considers standardised packaging. However, the existing tobacco control measures have not been properly evaluated - either during the consultation and IA, or since - for their effectiveness or for delivering the outcomes or benefits that were originally expected or promised. In the UK, we are only half way through the implementation of a ban on the display of tobacco products. We believe the impact of this measure should be properly evaluated and assessed before considering the next regulatory measure.

It is therefore impossible for the Government to assess whether any further tobacco control measure would have an appreciable effect on improving public health over and above existing measures.

It is our strongly held view that the Government needs to develop a rational and appropriate framework within which legitimate consumer demand for tobacco and nicotine products is met and real public health goals achieved, rather than continuing to pursue an irrational approach that appeases a small minority of vested interests but achieves no public health benefit.

3.3 Inappropriate Regulation

Over the last decade, a range of tobacco control measures have been implemented with the stated objective of reducing youth smoking uptake. The measures rarely stand up to scrutiny and are not evidence based. This irrational approach to regulation has led to many unintended consequences, including a rise in the number of underage and adult smokers being exposed to

illicit products. In many ways, it is a sad irony that overregulation has led to an increasingly unregulated market through increases in illicit tobacco sales.

In markets where bans on smoking in public places ("SiPPs") have been implemented, while we have generally seen an initial dip in duty paid volumes, overall volume trends have not been affected as adult smokers adapt to the new social environment. Whilst this has had little impact on prevalence, it has had a profound impact on local economic and social trends as consumers stay at home and pub closures have been accelerated.

In the context of setting out its Tobacco Control Plan for England, the DH published a report by Professor Linda Bauld, whom it commissioned to provide an academic review of the 'smokefree' (smoking ban) legislation that was implemented in England in 2007. As highlighted by Imperial Tobacco in June 2011⁵ the review conducted by Linda Bauld - who had a clear conflict of interest - is not methodologically sound and is deliberately selective, and is easily refuted using freely available information. It fell well short of the Regulatory Policy Committee's principles by which the robustness and quality of the analysis and evidence used to inform policy decisions must be judged. We suggested at the time that the Government should find an appropriate and recognised third-party to objectively analyse and review the impact of the 2007 smoking ban, devoid of the conflicts of interest that are all too apparent in the review paper. At the very least, the Government should have conducted an objective evaluation of Linda Bauld's review.

The disproportionate and ill-considered blanket implementation of the SiPPs ban was further highlighted in December 2013 through the media coverage discrediting the links between Environmental Tobacco Smoke ("ETS") and lung cancer. As reported in the Journal of the National Cancer Institute on 6 December 2013⁶:

"The large prospective cohort study of more than 76,000 women...found no link between [lung cancer] and secondhand smoke."

The study was presented by Ange Wang, a Stanford University medical student, at the June 2013 meeting of the American Society of Clinical Oncology in Chicago. It was also reported in many UK national mainstream media outlets including the Telegraph, The Mail and The

⁵ The Bauld truth - The Impact of Smokefree Legislation in England: A critique of the evidence review using publicly available information http://www.imperial-tobacco.com/files/the_bauld_truth_june11.pdf

⁶ Journal of National Cancer Institute, 6th September 2013

Independent. The articles generated a considerable number of readers' comments – largely in favour of relaxing the smoking restrictions in bars and restaurants or generally against Government interference. The experience of SiPPs, where inadequate evidence has been shown to have led to policy intervention which in turn has led to unnecessary damaging effects on legitimate businesses, demonstrates the need for clear and compelling evidence of the efficacy of standardised packaging before considering its introduction.

3.4 Government's role in public health

In January 2014, Ipsos MORI, the Social Research Institute, released the latest edition of its *Understanding Society* report⁷. In this issue, they look at the way Britons live now and how attitudes, values and behaviours compare with those in other countries. Interestingly, a poll of 19 major countries (including the UK) found that the majority of the population everywhere (with the exception of Russia) think Governments at best have a limited role in trying to "encourage healthy lifestyles". Only 30% of Britons thought it was the responsibility of Government to influence people's behaviour to encourage healthy lifestyles. The researchers also noted:

"Whether or not we support government involvement, we clearly believe responsibility for maintaining a healthy lifestyle remains in the hands of individuals, at least to a large extent. Only five per cent of the British public strongly believe it is the job of the NHS to keep people healthy – this compares to a far greater proportion (39%) who strongly believe it is the individual's responsibility to keep themselves healthy."

Unintended consequences are not exclusive to the tobacco category. Changes in regulation meant that food producers were forced into rapid changes in the ingredients of the foods that they produce. The change meant that "desinewed meat" ("DSM"), a fine mince rubbed under pressure from carcasses, could no longer be called meat on packaging. DSM produced in the UK was the main ingredient in most value-range burgers, sausages, pies and kebabs and the change meant that thousands of tonnes of meat had to be sourced from elsewhere and at low cost. There have been claims from some quarters that poor, rushed implementation meant producers switched to horsemeat as one of the few readily available alternatives.

It is therefore essential to consider the unintended consequences of irrational and disproportionate regulation; and in doing so, avoid effectively coercing members of society into purchasing from illicit, and unregulated, channels.

⁷ Ipsos MORI: *Understanding Society - Great Britain: The way we live now. January 2014*

4. No credible evidence or research

4.1 Imperial Tobacco does not believe there is any credible or reliable evidence that standardised tobacco packaging will achieve the Government's stated objectives of reducing smoking prevalence among young people or assisting smokers who have, or are trying to, quit.

The research which is relied upon is speculative and inconclusive and fails to provide the "*robust and compelling case*" that is required by the Government's Better Regulation Agenda.⁸

Instead the consultation and IA relied upon "*subjective judgments*" from anonymous "*experts*" about their views on the likely impact of standardised packaging. These judgements were not made available as part of the consultation and cannot form the basis for an evidential justification of standardised packaging. It is valid to question the independent nature and objectivity of such research and its methodology and underlying raw data. Proponents of standardised packaging ignore the substantial body of research which runs contrary to their pre-determined objectives.

The consultation failed to provide any explanation of how standardised packaging would address the real issues behind smoking initiation and activity by young people and attempted quitters.

4.2 Standardised Packaging of tobacco – A Systematic Review

The authors of the Systematic Review - despite being well-known tobacco control advocates and in many cases reviewing their own work - do not show that standardised packaging would meet the Government's stated objectives. The Systematic Review provided no evidential basis for standardised packaging.

The Review Report relied on by Government is the product of selective and questionable research methods and does not present the clear and compelling evidence base that would be required to justify the introduction of standardised packaging. In summary, the Systematic Review:

- is not independent. Its authors have well-established links with, and receive funding from, organisations that actively pursue a tobacco control agenda and/or have been

⁸ [BIS general principles of better regulation](#)

well known advocates of standardised packaging for many years. Indeed, 20 of the 37 studies included in the Systematic Review include work by the authors (and their colleagues);

- failed to demonstrate a causal link between tobacco packaging and smoking behaviour (including initiation, prevalence and consumption);
- does not demonstrate, therefore, that standardised packaging is necessary to achieve the Government's public health objectives by affecting smoking behaviour; and,
- does not comply with the Government's own guidelines and standards. The conclusion reached stated only "*there was consistency in study findings regarding the potential impacts of plain packaging*. That, manifestly, does not provide the standard of "*robust and compelling*" evidence that standardised packaging will have any impact on smoking behaviour that is required by the Government's Better Regulation Agenda.

Contrary to how it has been presented, the UK Public Health Research Consortium ("PHRC") 'systematic review' commissioned by the DH does not provide supporting evidence that standardised packaging would be an effective intervention. It concluded:

"...**caution is required in interpreting these findings**, as expressed smoking-related intentions are not always predictive of future smoking behaviour⁹ and perceptions of the impact of a future policy measure on the behaviour of others are of course subjective. However, there is **some evidence** from the studies in this review **that standardised packaging may affect** smoking-related attitudes and beliefs, and smoking behaviour, particularly for young people and/or non-smokers and lighter smokers."¹⁰ [our emphasis]

Attempts to present the PHRC review as evidence supporting standardised packaging would be unjustifiable. The same would be true of the subsequent subjective views solicited by the DH from an unknown group of selected academics, which itself concluded that "*there remains considerable uncertainty about the likely impact of plain packaging of tobacco products.*"¹¹ More recent reports by advocates of standardised packaging suffer from the same limitations.

Many of them seek to show that survey participants (including children) prefer branded packs to non-branded packs. That is not in itself surprising, but it does not show that non-branded packs would lead to actual changes in behaviour when people are deciding whether or not to

⁹ Ajzen & Madden 1986, Sheeran 2002

¹⁰ http://phrc.lshtm.ac.uk/papers/PHRC_006_Final_Report.pdf

¹¹ <http://www.blomedcentral.com/1471-2458/13/18>

smoke, particularly in a mandated standardised packaging environment where such comparisons – at least between legal products – could not occur.

In Imperial Tobacco's view, in addition to not being evidence-based it is difficult to envisage how the introduction of such a draconian measure could be:

- reasonable, having regard to a full consideration of the costs of standardised packaging, including its effects on illicit trade;
- proportionate, having regard to whether there are less costly ways of realising the identified policy objectives. The Government does not address this issue at all, and has historically ignored alternative ways of limiting the access of young smokers to tobacco (see *Alternative Solutions*); and,
- effective, in terms of achieving the stated objectives of reducing tobacco consumption, particularly by the young and poor socio-economic groups. It is quite clear that the evidence for any public health benefits can at best be described as very limited, with there being no consideration of whether these benefits will be appreciable in the context of all the other anti-tobacco measures which have recently been introduced (see *Appendix A - Current tobacco control measures*).

4.3 Is packaging a reason why people start smoking?

All the evidence suggests not. Only 1% of UK smokers cite packaging as one of the various factors in their decision to start smoking.¹² Research regularly shows the most important factors involved in smoking initiation include:

- rebelliousness;
- risk taking;
- family structure, parental example;
- relationships, peer pressure;
- socioeconomic status;
- school connection; and,
- educational success.

¹² http://ec.europa.eu/health/tobacco/docs/eurobaro_attitudes_towards_tobacco_2012_en.pdf

4.4 Why do people smoke?

The many different benefits of smoking, including habitual behaviour, all contribute to why an individual chooses to smoke. The reasons for smoking may differ between smokers, and a smoker may smoke for different reasons throughout the day.

The benefits that smokers report include: aid to socialising, pleasure, sensory stimulation, mood regulation, and cognitive enhancement. The strong habitual behaviour aspect of smoking is supported by scientific evidence and it develops as a consequence of the benefits of smoking. While such behaviour becomes repetitive, and to a degree automatic, it is still controllable. These observations are supported by scientific studies. An expert health panel report to Health Canada concluded:

- young people do not decide to smoke on the basis of tobacco packages;
- packages do not lead to smoking; and,
- changing the package will not *"have any major effect on the decision(s) to smoke or not to smoke"*.¹³

The evidence and research suggest the introduction of standardised packaging would not have a material impact on addressing smoking, particularly underage smoking, therefore providing no discernible health benefit.

4.5 Why young people smoke [please refer to Section 3.3 of our Consultation response – Appendix C]

4.6 The impact of 'Denormalisation' policies on smoking rates

The smoking rate (also referred to as 'prevalence' or 'incidence') is a measure of the percentage of smokers in the population. This metric is derived from population surveys in which a sample of people are asked different questions about their lifestyle. Data is normally available for regular (daily) and occasional smokers. Data is usually segmented by age, gender and socio-economic status.

¹³ Goldberg ME, Liefeld J, Kindra K, Madill-Marshall J, Lefebvre J, Martohardjono N and Vredenburg H. *When Packages Can't Speak: Possible Impacts of Plain and Generic Packaging of Tobacco Products: Expert Panel Report to Health Canada*, Ottawa, 1995.

The primary stated goal of most tobacco control policies is to reduce smoking prevalence. For example, the Australian Federal Authority has set a performance benchmark to reduce smoking rates to 10% by 2018 in their tobacco control strategy for 2012 to 2018¹⁴. Reducing the smoking rate by an average of 2% across Europe was also set as the benchmark for the review of the EUTPD. Globally, there were rapid declines in smoking rates in the 70s and 80s which probably reflected the growing awareness and acceptance of government health messages on smoking. However smoking rates have been levelling off in most jurisdictions since about 2000 and especially since 2005 when the World Health Organisation's Framework Convention on Tobacco Control ("FCTC") was ratified. However, against this global trend there are exceptions. For example smoking rates in Turkey have remained largely unchanged over the last 20 years. And despite falls in the 1990s, smoking rates in France and Ireland have risen slightly in recent years.

Since the ratification of the FCTC in 2005 there has been a shift in regulatory policy towards co-ordinated global population level interventions designed to change attitudes to tobacco use and to alter its social context. This social engineering approach to tobacco control is referred to as 'denormalisation'.

Denormalisation aims to work on both supply of and demand for tobacco products – seeking to reduce the production and availability of tobacco products, curtailing opportunities to smoke at work and the home, and attacking brand value and attractiveness through product standardisation. The denormalisation objective is for those who don't smoke to become less tolerant of those who do, and even those who continue to choose to smoke to become more receptive to regulation. Tobacco manufacturers are treated with suspicion and are excluded from discussion, even where their expertise could inform regulation. A 2012 review claimed that:

*"The majority of studies suggest that tobacco industry denormalisation is effective in reducing smoking prevalence and initiation and increasing intentions to quit."*¹⁵

This claim is refuted by the evidence. For example, the Organisation for Economic Co-operation and Development ("OECD") published a Factbook on Economic, Environmental and Social Statistics in early 2013. They compared the change in smoking rates in a number of

¹⁴ Australian National Tobacco Strategy 2012-2018
[http://www.nationaldrugstrategy.gov.au/internet/drugstrategy/publishing.nsf/Content/D4E3727950BDBAE4CA257AE70003730C/\\$File/National%20Tobacco%20Strategy%202012-2018.pdf](http://www.nationaldrugstrategy.gov.au/internet/drugstrategy/publishing.nsf/Content/D4E3727950BDBAE4CA257AE70003730C/$File/National%20Tobacco%20Strategy%202012-2018.pdf)

¹⁵ Tobacco industry denormalisation as a tobacco control intervention: a review; Ruth E Malone, Quinn Grundy and Lisa A Bero, *Tob Control* 2012 21; 162-170

countries between 1990 and 2010. Their analysis shows that in the EU, Scandinavian countries including Denmark, Sweden and Norway saw the largest fall in smoking rates over the period. In contrast, Great Britain was just behind the OECD average and Ireland had one of the poorest records of all, a decline of just 3% over 20 years.

To evaluate the impact of denormalisation on smoking rates, it is most relevant to focus on the changes which have occurred since FCTC ratification in 2005. Although rates of decline have slowed in many countries since about 2000, the Scandinavian countries continued to see continuing falls in smoking rates over the same period. However for many other developed countries, FCTC ratification appears to have had little or no impact on smoking rates. When compared to the period from 1990-2010, whilst Canada appears to have maintained some momentum, Australia has seen little change in its smoking prevalence since 2005. Smoking rates in France and Turkey have actually increased since 2005, despite both countries embracing policies of tobacco denormalisation. Most significantly of all, Ireland has also seen a rise in smoking rates since 2005 despite being the first country in Europe to introduce a comprehensive smoking ban in 2004, a display ban in 2009 and having amongst the most expensive cigarettes in Europe.

In England and Wales, smoking was banned in all indoor public places from July 2007. In 2010 the UK Government published a ten year tobacco control plan entitled 'A SmokeFree Future'.¹⁶ The data presented in this plan suggests that rather than having no impact on smoking rates; the smoking ban may in fact have had the opposite effect. It indicates that for 2008, the year after the smoking ban was first introduced, smoking rates rose both for manual workers and in the general population. This completely contradicts the analysis made in DH's official report of the smoking ban impact in March 2011¹⁷:

"...this type of legislation has the potential to change social norms around smoking and results in changes in smoking behaviour..." [evidenced by] "...a general pattern of reduced tobacco consumption..."

Further evidence of the lack of any correlation between denormalisation, tobacco control initiatives and smoking rates is presented in our review 'Denormalisation, smoking rates and the way ahead for tobacco product regulation' in Appendix E. Overall, there is no evidence that smoking rates have been greatly impacted by tobacco regulation nor the policy of

¹⁶ 'A Smokefree Future' UK Department of Health, February 2010

¹⁷ The Impact of Smokefree Legislation In England: Evidence Review, Professor Linda Bauld, March 2011

denormalisation pursued after ratification of the FCTC in 2005. In these terms, denormalisation is not working as an effective tobacco control policy.

Smoking rates are still falling consistently in markets where a viable choice/alternative to smoking is presented to consumers. Furthermore, we suggest that the Norwegian experience with smokeless tobacco could be a predictor of what the impact of e-cigarettes on smoking rates could be in the US and Western Europe in 10 to 15 years' time, provided that the growth of this sector is not impeded by poorly conceived regulation.

5. Australian experience has proven that standardised packaging has had no effect

The Government in Australia introduced standardised packaging and the laws came into effect on 1 October 2012 for cigarettes and 1 December 2012 for other tobacco products.

5.1 What does the evidence from Australia show so far?

The facts from Australia, the only country to have introduced standardised packaging, so far show the following effects.

5.2 Smoking prevalence has not been affected

The KPMG report 1H2012 found that overall consumption has remained stable. The latest national statistics from Australia covering smoking prevalence are only as recent as up to the end of 2012 and there has been no data or anecdotal evidence on youth smoking rates in Australia after 2011. We are not aware of any national statistics from Australia that are due to be published in the next few months, which Sir Cyril could review, covering the period since standardised packaging was mandated. We consider this to be an essential requirement for a proper assessment of the policy's impact.

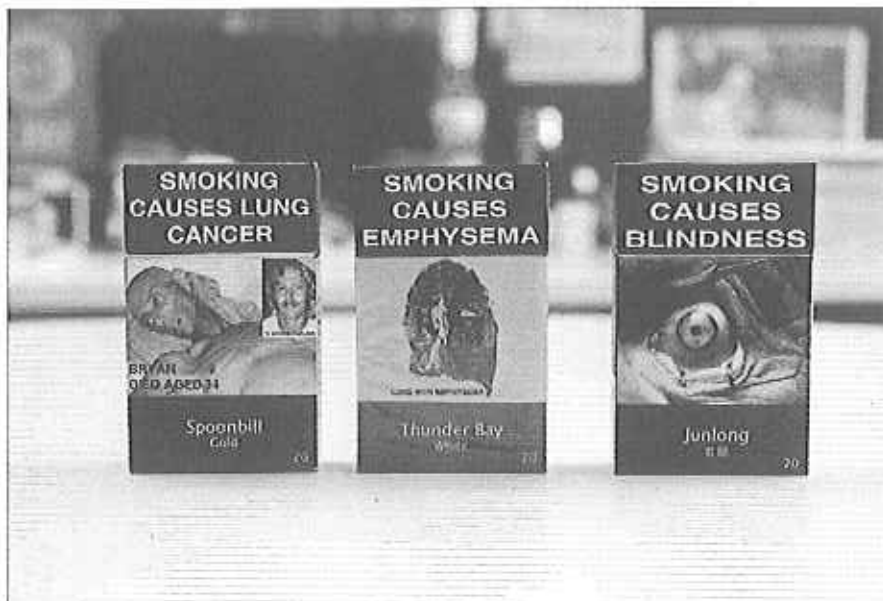
5.3 Increase in the illegal market

The illegal market has increased significantly from 11.8% to 13.3% (a 13% increase) in the twelve months prior to June 2013. The images illustrate the first examples of an illicit standardised pack sold in Australia.

The brand Spoonbill is not officially registered anywhere in the world. Intelligence suggests that it was manufactured in Asia and smuggled



into Australia. It demonstrates that with standardised packaging regulations in force, it is not even necessary for counterfeiters to use an existing brand. Criminals can simply use a fictitious name, comply with packaging regulations to avoid obvious detection and sell cheaply. It would be impossible for a consumer to tell whether this is a genuine product or not. The images below illustrate 'Spoonbill' again, and 'Thunder Bay', the first examples of an illicit standardised pack sold in Australia; plus 'Jun Long' which is the first example of a counterfeit version of a brand 'Jin Ling' which is in itself an "illicit white" (Low cost cigarettes legally produced by small independent tobacco companies but sold illegally outside their intended market(s)).product.



5.4 The increase in the illicit trade has been detailed in the KPMG Report

At the end of October 2013, KPMG released a report [see Appendix D] which aimed to estimate the size of the illicit tobacco market in Australia in the first six months since the introduction of standardised packaging in December 2012. The report was by KPMG on behalf of PMI, BAT Australia and Imperial Tobacco Australia and is based on an empty pack survey, web-based consumer interviews to gauge the prevalence of loose tobacco and rolling paper data.

The report finds that illicit tobacco in Australia as a proportion of total consumption has increased from 11.8% in 2012 to 13.3% in 1H2013. It also indicates a structural shift away from unbranded tobacco (chop chop) towards manufactured cigarettes. Illicit whites have emerged

as a major form of illicit trade. Manchester is currently the largest illicit whites brand in Australia; if it were sold legally in the country it would have a 1.3% market share. If all of this illegal tobacco had been consumed in the legitimate market, it would have represented an excise amount of approximately AUD1.0bn at current excise rates.

While the legal tobacco market has contracted slightly, overall consumption remained stable at 17.4%. Figures provided since the implementation of standardised packaging have shown a reduction in legal consumption, however, overall consumption has remained stable, demonstrating that the illicit trade has grown considerably and will grow even further after the 12.5% tax increase in December 2013. Early indications from the 3Q2013 illicit trade report suggest that illicit sales rose further to 15.5% (from 13.3%).

5.5 Lack of robust evidence that standardised packaging has worked

Contrary to what tobacco control lobbyists have been saying and how some media outlets have portrayed it, a study by the Centre for Behavioural Research in Cancer in Australia (funded by the anti-tobacco lobbying organisation Quit Victoria) does not support a case for standardised packaging. In fact an analysis of the study on the UK NHS Choices¹⁸ website concludes that:

"...the study could not assess whether a change in packaging achieves the desired outcomes – of an increase in quit rates...While people smoking the plain pack cigarettes were significantly more likely to have thought about quitting and place higher priority on quitting, their intention to quit smoking remained unchanged." [our emphasis]

The effectiveness of the policy in Australia can only be properly judged on actual changes in consumption by both adults and under-age smokers, after factoring out other possible significant influences on consumption like tax increases and the reduction in travel allowances.

5.6 Australian Government to review standardised packaging

The Australian Government is planning to conduct a review on the standardised packaging implementation in December 2014 and we would expect other Governments to wait until this review has been conducted before making any decisions. The Australian review would present a more appropriate time for a comprehensive review to be conducted in the UK. Indeed, this

¹⁸ <http://www.nhs.uk/news/2013/07/July/Pages/Does-plain-packaging-help-smokers-quit.aspx>

appeared to be accepted by the Government when it announced, following the extensive consultation that concluded in August 2012, that it would wait until the impact of standardised packaging in Australia could be properly analysed before making a policy decision. It is wholly unclear why the Government has departed from its previous stated position.

As a result of its policy on the standardised packaging of tobacco products, legal actions have been brought against Australia before the World Trade Organisation ("WTO") Dispute Settlement Body by Ukraine, Honduras, Cuba, the Dominican Republic and Indonesia. A major tobacco company has also separately brought international arbitration proceedings against the Australian Government claiming billions in damages.

The numbers support our previously expressed concerns that standardised packaging is a gift to organised crime, whereas there are still no facts to show it is an effective intervention to reduce smoking prevalence amongst young people or adults. The jury is still out in Australia.

6. Standardised packaging will increase the trade in illicit tobacco

Standardised packaging would increase the supply of, or demand for, illicit tobacco or non-duty-paid tobacco in the United Kingdom. The increase in illicit trade would have a direct influence on public health for the following reasons:

6.1 Product Differentiation - Standardised packaging would, by its very nature, reduce the differentiation between brands and packs. The commoditisation of any category leads to an increased focus on price. The cheapest available price will be found in the illicit market.

6.2 Easier to counterfeit - Standardised packaging would provide a stimulus for the illicit trade of tobacco products - which already costs the Exchequer billions of pounds each year - by creating a "*Counterfeiters' Charter*", aiding and accelerating the spread of counterfeit tobacco products and the trade in illicit tobacco by making it simpler to copy legitimate packaging and also by creating an unfulfilled supply vacuum for branded products. Furthermore, the criminals have no qualms about selling their products to children; a clear public health issue.

6.3 Increased access for children - The illicit tobacco market undermines Government and industry efforts by making it easier for children and adults to access illegal tobacco products. Peddlers of illicit product, unlike the vast majority of UK tobacco retailers, do not care or

question how old a buyer is; they are happy to sell packs and even single cigarettes to minors¹⁹.

The opportunity that standardised packaging would bring to criminals would increase the availability of illicit products, which in turn would expose tobacco to more children under the age of 18 who cannot legally purchase the product. This may be a gateway to further criminal activity, including drugs, and have the effect of increasing smoking prevalence of youth smoking and not reducing it. In this regard, it should be noted that there is clear survey evidence²⁰ that:

- 50% of the tobacco bought by 14 to 15 year olds is illegal;
- 1 in 4 young smokers are regularly offered illegal tobacco, which is far more often than adults²¹;
- 1 in 7 young smokers have gone to a private address (or a "fag house"²²) to buy illegal cigarettes;
- Buyers of cheap illicit smoke more, and admit it keeps them smoking²³; and,
- A third of all smokers aged 14 -17 buy illicit and on average accounts for almost half of total consumption²⁴.

If the Government wants to protect children from tobacco, as we do, it should not drive them into the arms of criminals who have no qualms about who they sell to.

6.4 Unregulated product is dangerous - Illicit and counterfeit products usually undermine and circumvent legislation on ingredients, smoke emissions and reduced fire risk cigarettes and may not carry mandated English language health warnings.

7. International legal implications

Standardised packaging is in breach of UK and EU law and is being challenged with a view to infringing on the obligations undergone by the Member States of the World Trade Organization. The Australian Plain Packaging Act is subject to an ongoing dispute in the WTO on grounds of

¹⁹ <http://www.bbc.co.uk/news/uk-england-devon-25671824>

²⁰ IIMRC Measuring Tax Gaps 2011

²¹ NEMS 2011 <http://tobaccofreeutures.org/news/illegal-tobacco-dealers-are-making-it-easy-for-kids-to-smoke-in-the-north-west/>

²² NEMS 2011, *ibid*

²³ <http://ash.org.uk/localtoolkit/docs/clr-briefings/Illicit.pdf>

²⁴ <http://www.ashscotland.org.uk/media/3480/Andrea%20Crossfield%20TS%20Sept%202010.pdf>

eroding the protection of intellectual property rights, imposing severe restrictions on the use of validly registered trademarks, and erecting an unnecessary obstacle to trade.

8. Alternative solutions

We may wish that as part of the Review process the possibility of alternatives to standardised packaging are considered. It is incumbent on the Government to assess the best and least restrictive way of achieving its policy objectives and any assessment of standardised packaging must be made in that context. **We would propose the following alternative approaches:**

8.1 Enforcing existing legislation and providing additional resources

We do not want children to smoke and we support effective measures to ensure tobacco products do not get into the hands of children. Existing legislation should be supported with greater enforcement of current laws via the relevant enforcement agencies. The Government should provide additional resources to support enforcement agencies and retailers in their efforts to tackle under-age smoking. Imperial Tobacco supports appropriate penalties for retailers who knowingly break the law by selling tobacco to children or illicit tobacco. In addition, we would like to ensure increased enforcement, in the form of penalties and prosecutions, to tackle the illicit trade.

8.2 Strengthening current legislation

We do not market our products to anyone under the age of 18 or to non-smokers. We adhere to all legislation, and where none exists, our International Marketing Standards²⁵. We support retailer programmes designed to discourage tobacco sales to children such as our support for the 'No ID, No Sale' retailer awareness campaign (<http://www.noidnosale.com/>) and the CitizenCard proof-of-age scheme (<http://www.citizencard.com/>) which has helped prevent under-age sales. The government should give greater support to proof-of-age schemes, which have contributed to a decrease in youth smoking prevalence (11-15 year-old regular smokers in England) from 13% in 1996 to the **lowest ever figure of 4%**²⁶ in 2011, and to 3% (average 13 years old – lowest figure since 1982) in Scotland.²⁷

8.3 Proxy purchasing

²⁵ http://www.imperial-tobacco.com/files/environment/marketing_standard_2009.pdf

²⁶ <http://www.hscic.gov.uk/catalogue/PUB11454/smok-eng-2013-rep.pdf>

²⁷ http://www.drugmisuse.isdscotland.org/publications/local/SALSUS_2010.pdf

We would support reasonable action to combat proxy purchasing e.g. adults who purchase tobacco on behalf of children, as implemented in Scotland in April 2011. We therefore support the recent Opposition proposal for legislation which makes proxy purchasing an offence across the UK, following Scotland's lead, which would also bring tobacco in line with alcohol.

8.4 Education programmes – German model

Germany, which permits the advertising and display of tobacco products and has no plans for standardised packaging, has significantly fewer young people taking up smoking than in the UK, which has some of the most draconian anti-smoking laws in the world. Germany has a tobacco control strategy with education embedded at its core, and it delivers proven results.

As part of the Review process, the DH should engage with their German counterparts - who have a significantly lower youth smoking rate than the UK - to explore how they have successfully reduced youth smoking rates, and consider how such proven measures could be implemented successfully in the UK.

9. Conclusion

Imperial Tobacco believes that public policy interventions in the tobacco sector should be both designed and shown to address the well-established reasons why people smoke.

In summary, increasing education and retailer programmes to prevent children being able to purchase tobacco products, together with preventing access via the illicit trade and strengthened enforcement against both retailers and those attempting to purchase tobacco for others, are the most effective methods of preventing children purchasing or accessing tobacco and therefore achieving the public health objectives.

Imperial Tobacco also believes that an evidence led policy requires the UK Government not to consider the introduction of standardised packaging until its effects in Australia have been properly studied. Those studies need to be based on population wide, independent, robust national statistics and the Australian Government has committed to such a review in December 2014.

We do not believe that legislation should be pursued until what is a highly controversial policy - with potentially very significant unintended consequences - actually in and of itself is proven to reduce consumption amongst under-age smokers.

Appendix A - Current tobacco control measures

The existing UK regulatory context includes:

- the ban on advertising (2002);
- one of the most punitive tobacco tax regimes in the world;
- the ban on smoking in public places (2006 - Scotland, 2007 - England, Wales and Northern Ireland);
- the use of pictorial health warnings (2007);
- Age of Sale of Tobacco Products increased from 16 – 18 years (2007 - UK)
- the ban on tobacco vending machines (2011 - UK, 2013 - Scotland);
- Tobacco Retailers' Register implemented and a ban on proxy purchasing (Scotland - 2011) and, most recently,
- the ban on the display of tobacco at the point of sale - despite the Coalition parties having opposed it in Opposition on the grounds of a lack of evidence, which hasn't changed (2012 - smaller shops, and 2015 - larger premises in England and Wales, 2013 - smaller shops, and 2015 - larger premises in Scotland).²⁸

Appendix B - Education on tobacco in Germany

According to Eurobarometer 2012, 28% of UK smokers have started under the age of 15 compared to an EU average of 17%. The German rate is also 17%. In Germany smoking among under aged people between the age of 12 and 17 has seen a significant decline from 27.5 % in 2001 to 11.7 % in 2012.²⁹ Even among elder people smoking is in decline.

Germany permits advertising and display of tobacco products and has fewer young people taking up smoking than Ireland which has some of the most draconian anti-smoking laws in the world. Germany has a tobacco control strategy with education embedded at its core and it seems to be working. The German tobacco control approach identifies three different target groups:

- Education for the entire population
- Education for valuable groups, for example children or pregnant women
- Education and support for current consumers

²⁸ <http://www.telegraph.co.uk/news/politics/3183980/Tories-to-oppose-tobacco-restrictions.html>;

²⁹ http://www.24dash.com/news/Central_Government/2008-12-09-Tobacco-display-ban-nanny-state-going-too-far-Lamb

²⁹ Bundeszentrale für gesundheitliche Aufklärung, 2012

Every measure has to take into consideration:

- possible reasons for up taking
- familial environment
- gender related specifics
- age related specifics

Examples of measures that are in place in relation to tobacco

1. "Class2000" - Strong and healthy in elementary school": "Class2000" is the largest national education program to promote health, addiction and violence prevention in elementary school. Since 1991, it has already reached more than 930,000 children. The educational program is financed by donations in the form of sponsorships for individual classes (200 euros per class and school year). The most important partners are the Lions Clubs in Germany. (www.klasse2000.de)
2. "ClearSight"- Join-In Circuit on tobacco and alcohol: Education on risks associated with smoking, focused on school aged children from 12 to18. In 2012, 52 events were held. 16,089 people attended: 13,826 students and, among others, 822 educational escorts and teachers and 165 media representatives. The project is hosted by the Federal Centre for Health Education (BZgA).(www.klarsicht.bzga.de)
3. "Be Smart – Don't Start": Non-smoking competition for school classes to motivate young people to remain smoke-free. Classes of students at the age between 12 and 15 agree in the competition that they'll be smoke-free for the contest period of half a year. Since its start in the school year 1997/98 130,000 school classes with more than three million students have participated in the competition. It is hosted, among others, by the Federal Centre for Health Education (BZgA), the German Cancer Aid and the German Heart Foundation. (www.besmart.info)
4. "Smoke-Free" campaigns of the Federal Centre for Health Education (BZgA)
 - The youth campaign's goal is to continuously increase the number of non-smokers. In addition, young people shall be encouraged to stop smoking. Central Element of the campaign is the Internet platform www.rauch-frei.info. It offers access to information material, interactive elements as online-trainings and is a free source for media that can be used by teachers in schools. The website recorded more than 62,000 Visits in 2012.
 - The adult campaign aims to promote non-smoking in the adult population. This provides information about the health risks of smoking. To promote quitting the campaign also offers various free media, including the booklet "Yes, I'll be smoke free". The "smoke-free starter pack" contains this brochure, a "calendar for the first 100 days after quitting"

and a "Relax Ball". In addition to print media, the Internet platform www.rauchfrei-info.de is a central element of the adult campaign. The Internet platform was accessed about 270,000 times in 2012 by a total of about 175,000 visitors.

5. Youth Movie Days "Nicotine and Alcohol - everyday life drugs in focus": 16 Events every year in various Cinemas across Germany. In 2012 Youth Movie Days reached more than 140,000 participants, of which approximately 9,000 were teachers. The Movie Days are hosted by the Federal Centre for Health Education (BZgA) in cooperation with the Association of Private Health Insurances.
6. Internet based education for specific risks during pregnancy: Education and support platform "IRIS" (www.iris-plattform.de). Participants are supported on the platform for twelve weeks, the treatment is anonymous. In addition, it provides weekly e-mail contact with a so-called e-coach. The platform is hosted by the University of Tübingen and receives financial support from the Ministry for Health.
7. Round table "Youth Protection - Improving law enforcement": The Website www.jugendschutzaktiv.de additionally provides videos, flyers etc. for various groups, for example parents, teachers and retailer. The project is hosted by the Federal Ministry for Family Affairs, Senior Citizens, Women and Youth in cooperation with the associations of retail, restaurant and gas station industry.
8. "Smoke free PLUS" - health centers for counseling and smoking cessation: The German network Smoke-Free Hospitals & Health facilities (DNRfK) continues the pilot project funded from Ministry of Health and develops it further. This is supported by many different opportunities to non-smoking and smoking cessation. (www.rauchfrei-plus.de)

The "Report on Drug use and addiction 2013" published by the German Ministry for Health contains more than 100 best practice examples regarding education on tobacco and other substances. Those measures are offered by national authorities as well as non-governmental organizations.

Please see additional documents supplied:

Appendix C - Imperial submission to DH standardised packaging consultation - August 2012

Appendix D - Australian Study on Illicit Trade (KPMG) - October 2013

Appendix E - 'The impact of 'Denormalisation' policies on Smoking Rates' - September 2013

Appendix F - 'The Bauld Truth: The Impact of Smokefree Legislation in England: A critique of the evidence review using publicly available information' - June 2011