

NOTE OF MEETING – BRITISH AMERICAN TOBACCO (BAT) AND DEPARTMENT OF HEALTH (DH)

Impact Assessment on Standardised Packaging of Tobacco

Wellington House
Friday 25 January 2013

Attendees

For BAT:

- [REDACTED] ((Acting) Head of Corporate & Regulatory Affairs)
- [REDACTED] (Head of Regulatory Policy)

For DH:

- [REDACTED] (DH economist)
- [REDACTED] (DH economist)
- [REDACTED] (DH Tobacco Programme official)
- [REDACTED] (DH Legal Services)

Introduction

DH noted that the meeting was being held with a view to informing the Impact Assessment (IA) so that it could be as accurate and comprehensive as possible: part of the purpose of the IA is to assess the impact on business. It was stressed that going through the hundreds of thousands of consultation responses was a time consuming process, that the government remained open-minded about standardised packaging of tobacco and that no advice had been submitted to Ministers to enable them to make a decision. In due course, the policy team would brief Ministers but it is Ministers who make the decision. The IA would need to be submitted to the Regulatory Policy Committee and Ministers for consideration, but there was no timetable for this.

BAT appreciated the opportunity to have a face to face meeting; while DH takes its obligations under article 5.3 of the Framework Convention on Tobacco Control (FCTC) seriously, it was noted that contact with tobacco companies is not precluded under the terms of the FCTC. In the interests of maximising transparency, a note of the meeting would be agreed with BAT and would stand as the official record of the meeting. The note would sit on file and could be provided under Freedom of Information (FOI) if requested.

In relation to the confidentiality of any information BAT might provide to DH, [REDACTED] letter (22 Jan 2013) set out the basic principles. DH would seek to treat as confidential any information BAT regard as confidential and could see no reason why it should be disclosed. Respecting confidentiality would be in the interests of DH as well as BAT. However, given that DH would be working within the constraints of Freedom of Information legislation, BAT would need to seek their own legal advice. BAT felt that this provided limited reassurance but had come to the meeting in a spirit of openness. Where there was doubt whether information could be shared, BAT would refer back to its legal team before doing so.

For the purposes of the IA, it was noted that the aim was to obtain the aggregate impact of standardised packaging on UK business rather than the impact on an individual company. When questioned as to whether the IA for standardised packaging was a DH IA or a government IA, DH noted that IAs are a government assessment and intended to be a comprehensive analysis.

The packaging process

BAT provided an overview of how the packaging process works. The pack originates with the artwork and decisions made about the complexity of the packaging, with a cheaper product having cheaper packaging. The printing company then produces the gravure cylinders which capture the image of the pack. This process is wholly outsourced as is the prior stage of consumer research among smokers to specialist agencies. Market research is generally undertaken for specific reasons such as responding to competitors.

Once the cylinders have been produced and board procured, the blanks are printed. Printing is carried out by factories which can produce the required high quality, which could be in the UK. Other companies supply foils and other elements of the packaging and BAT's factory puts all the components together. While BAT has a leaf plant in Corby to produce the various mixtures of tobaccos used in the end product, no finished product is produced in the UK.

BAT has a relatively limited portfolio of products in the UK, with a market share of 8%. The biggest selling brands are Pall Mall and Royals. Other brands are Rothmans, Lucky Strike, Vogue and Cutters Choice (roll your own). Across the stock keeping units (SKUs) in the UK market, there are 12 package shapes. Packaging changes do not follow a regular cycle but occur as needed depending on the opportunities in the market and what competitors are doing.

Implications for business

BAT explained that the implications for business of changes in pack design depend on the nature of the pack redesign, that is, whether the changes constitute a complete overhaul or are relatively minor. Revision of the opening mechanism would require new investment in machinery by BAT. Where suppliers incur costs, these are passed on to the tobacco company. Complexity in pack design generates costs, but higher costs are accepted as the competitive environment demands a degree of differentiation and innovation. If standardised packaging might enable economies of scale to be exploited, it also reduces the opportunities for brand differentiation, which BAT considered would be problematic from a competition point of view. BAT went on to explain that, while factories supply more than one market, it is possible that some machinery would need to be scrapped if standardised packaging were introduced. Printers may relocate to low cost countries. BAT said it could not speak on behalf of the printing sector and therefore suggested that DH also spoke with the printing industry to appreciate the full scale of the business impact. For the purposes of the IA, DH noted that the costs to business as they relate to retail sales of tobacco in the UK benefitting UK based shareholders are of concern. BAT couldn't tell how many of their shareholders are UK based, but expressed concern that only UK based shareholders would be taken into account.

Illicit trade

BAT remarked that in its view the IA did not address with sufficient details the impact of standardised packaging on illicit trade, to which DH replied that it was unable to put a number on the link between standardised packaging and illicit trade. BAT explained their view that, in the past, the level of the

illicit trade has depended on tobacco prices and enforcement activities. Introduction of the duty escalator encouraged illicit activity whereas the opposite occurred on dropping the escalator. The escalator re-appeared in 2011. BAT believed that in 2011 there was also a reduction in enforcement budgets. In BAT's view, standardised packaging would increase the illicit trade but the size of the effect is hard to predict. However, the impact of a 1 percentage point increase in the tax gap, being around £130mn, and the cost of enforcement/compliance activities are generally known from public HMRC data sources. BAT believe that standardised packs will lower barriers to entry for counterfeiters as, instead of producing a limited number of high cost printing cylinders to focus on the leading brands, counterfeiters would be able to copy any pack on the market. The BAT Empty Pack Survey, which BAT said was endorsed by OLAF, shows a tax gap of 26% in quarter four 2012.

DH asked if BAT could supply an estimate showing a clear link between standardised packaging and illicit trade without any distorting factors. BAT felt that the impact of standardised packaging would be difficult to isolate given that the display ban was still being implemented in the same way as DH acknowledged the difficulty of evaluating the impact of standardised packaging on smoking rates in isolation from other tobacco control measures. While tobacco companies have measures in place to counter the illicit trade, BAT has not estimated a value for the potential impact of standardised packaging on the illicit trade.

Market Segments and downtrading

DH asked about different segments in the market, packaging shapes and pricing dynamics including downtrading. BAT said that it expected sharper price competition as a result of standardised packaging, but queried whether the IA had indeed tried to use downtrading as a model to calculate the impact of standardised packaging on brand value. It said that brand value is a function of much more than downtrading, but also includes things like IP rights and patents. BAT thought that the impact on brand value would therefore be far more substantial than the DH was attempting to determine using the original calculation method. DH acknowledged that there were various ways of calculating brand value.

Impact on small shops

DH said that it wanted to calculate the profit impact for small shops pre and post standardised packaging but that it only had turnover data. BAT said it could not provide data that was not its own and that it recommended that DH speak to the retail associations.

Given the UK's perceived leadership role in best practice regulation, which it advocates at least within the Commonwealth countries, BAT asked whether the DH or Ministers, in making decisions on this, will consider that other Governments might copy UK legislation. The DH replied that this will not be part of the consideration as it is up to governments to make and implement their own regulations and laws.