

EL275

Appendix 9 of BAT's Response to the Consultation: The Faber Report

**The Role of Trademarks and the Brands They Represent
Report of Ronald J. Faber, Ph.D.**

Background and Qualifications

1. I am a Professor Emeritus of Mass Communication in the School of Journalism and Mass Communication at the University of Minnesota. I received my Ph.D. in Mass Communication from the University of Wisconsin in 1979. I began my teaching career in the Advertising Department at the University of Texas and moved to the University of Minnesota in 1987. Throughout my career, I have taught and conducted research in advertising, marketing, mass communications and consumer behavior. The courses I have taught include Psychology of Advertising, Advertising Management and Advertising Campaigns at the undergraduate level and Advertising Theory, Mass Communication Theory, Advertising Research and seminars in various advertising and strategic communication topics at the graduate level.
2. I am an active member of the American Academy of Advertising (AAA). I received the AAA's Ivan L. Preston Outstanding Contribution to Research Award and I was elected a Fellow of the American Academy of Advertising in 2007 for my contributions to the field of advertising. My research has been published in the leading scientific journals in marketing, advertising, and consumer behavior.
3. I actively review research manuscripts for several journals. I am a former Editor of the *Journal of Advertising*, and I currently serve on the Editorial Review Boards of several journals, including the *International Journal of Advertising*, the *Journal of Interactive Advertising*, the *Journal of Current Issues and Research in Advertising*, and the *Journal of Consumer Policy*. I am also a member of the Senior Advisory Board for the *Journal of Advertising*, a former member of the Policy Board of the *Journal of Consumer Research*, and currently serve on the James Webb Young Advisory Board for the Advertising Department of the University of Illinois.
4. Along with reviewing academic research, I have also served as a judge for professional advertising campaigns. For several years, I was a final round judge for the Effie Awards (the major awards for advertising effectiveness in the United States (U.S.)) and was a member of the Board for the Advertising and Marketing Effectiveness Award.
5. The professional and academic experience set out above frequently involves considerations of how trademarks and branding are used in conjunction with broader marketing campaigns.

Scope and Summary of Opinions

6. I have been asked to review the United Kingdom (U.K.) Department of Health (June 2014) Impact Assessment on the Standardised Packaging of Tobacco Products and the report of Sir Cyril Chantler on standardized packaging of tobacco products, and to comment on the impact that standardized packaging would likely have on trademarks and the brands that they represent. I have considered this in the context of the existing situation in the U.K. where branding is already extremely limited. I understand that warnings have appeared on cigarette packs in the U.K. since 1971 and pictorial warnings are now required on

all tobacco products. Tobacco advertising on TV or radio has been banned since the 1990s and the Tobacco Advertising and Promotion Act of 2002 prohibited all forms of tobacco advertising including that in print media, on billboards, by direct mail or through sponsorship. The display of tobacco products is prohibited in large shops and this will extend to all shops by early April 2015. Tobacco sales through vending machines is prohibited and it is an offence for any retailer to sell tobacco products to anyone below the age of 18. As a result, standardized packaging would take place in an environment where brand communication is already extremely limited and where the tobacco market in the U.K. is a mature and declining one. I understand that the standardized packaging proposed in the U.K. would prevent the use of any color, brand or trade dress and instead only allow the brand name to be used when set in a standard font.

7. Based on my expertise in advertising, marketing, mass communication and consumer behavior, I conclude that:
 - Trademarks are a key element in branding a product and perform valuable functions for both consumers and the brand manufacturers. They serve to help consumers identify brands and distinguish between competing brands. They aid consumers in selecting preferred brands over other alternatives. From a manufacturer's perspective, trademarks are a key element in developing and maintaining brand equity and "goodwill". This allows a company to enhance market share, achieve and maintain brand loyalty and command a premium price for its products.
 - In the current regulatory environment in the U.K., packaging is among the last remaining branding elements that can be used to differentiate between competing brands. Standardized packaging would prohibit the use of all trademark elements on tobacco products and packages. This will limit adult consumers' ability to distinguish and identify preferred brands and adversely impact the ability of tobacco companies to successfully sell their brands, but will not serve to reduce primary demand. This change in trademarked packaging will also adversely affect the goodwill and brand equity a company has cultivated over years of investment.
 - This reduction of goodwill and brand equity can affect the prices brands can charge and lead to lower prices. Pushing brands to compete on lower prices may lead consumers to shift towards cheaper, lower quality tobacco products. Thus, the primary impact standardized packaging is likely to have is to harm the ability of brands to compete in the marketplace.

Role of Trademarks and Brands

8. Trademarks are a critical way in which brands identify themselves and distinguish themselves from other brands. According to the U.K. Trade Marks Act 1994 (the Act), a trade mark is defined as: "any sign capable of being represented graphically which is capable of distinguishing goods or services of one undertaking from those of other undertakings". The Act also states that registration of a trade mark confers a property right on the proprietor of the

registered trade mark and that the proprietor has the rights and remedies provided by the Act.¹

9. Examples of marks used to distinguish pottery and other goods dates back at least as far as 1300 B.C.² Brand marks were used to differentiate the work of a particular artisan or group. These marks provided a quick and easy way for consumers to determine the quality of workmanship, and the attributes and characteristics (e.g. – specific types of clay, dye or finishing process used) associated with a specific mark.
10. Today, a trademark can include a brand name as well as highly recognizable elements of a brand such as a symbol, logo, design or distinctive coloring or lettering.³ Trademarks are a key element in branding a product and perform several valuable functions for consumers:
 - Trademarks help to make identification of a brand easy for consumers and serve to distinguish different brands of goods and services;
 - Trademarks signal the source or origin of the product and symbolize a brand's quality or characteristics. By clearly identifying the brand, the trademark also serves to guarantee that the branded product will measure up to expectations;
 - Trademarks help consumers to process and store information about a brand; and
 - Trademarks are essential in forming and maintaining brand loyalty among consumers.
11. For consumers, trademarks and the brands they represent serve as a shorthand device to store information and simplify product decisions. Logos, distinctive colors or fonts can all serve to make a brand easily and quickly identifiable to consumers.
12. For firms, trademarks are essential to allow manufacturers to compete. They provide a means of distinguishing one brand from others, thus allowing a firm to benefit from investments in the brand. Trademarks and the brands they represent are extremely valuable legal properties that can be bought and sold and can provide sustained future revenues.⁴

Trademarks and Brands Assist Consumers to Make Informed Choices

13. It is important to recognize that the basic goal of most branding efforts is to help differentiate one brand from other competitive brands. One of the most central and important distinctions made in marketing and promotions is between primary demand and secondary or selective demand. Primary demand involves trying to create or increase sales for an entire category of products. Selective demand

¹ Trade Marks Act 1994 online at: www.ipo.gov.uk accessed July 11, 2014.

² Kevin Laue Keller, *Strategic Brand Management* (3rd ed. 2008).

³ Philip Kotler & Gary Armstrong, *Principles of Marketing* (4th ed. 1989).

⁴ Keller (2008).

involves promotion for a specific brand or company within the broader product category. Typically, primary demand is a goal only in the early development and introductory stage of a new product category. At this stage, many people do not know about the product and consumers need to be informed about what it is and why it may be desirable. Much of the goal of generating primary demand is to educate people about the product, what it does, how it works, and why they might want it.

14. Once a product is well-known, the focus of brand communication is on how one brand differs from the competition and why the consumer would want this particular brand rather than other brands. It no longer serves to influence primary demand. Indeed, this lack of impact on primary demand has been found to be true for advertising, which can communicate a far more extensive brand message than can be done with just a package or trademark. For example, after reviewing advertising and sales data for 10 major product categories of frequently purchased package goods in Britain, Jones concluded, "significant and often increasing expenditures on advertising have been unable to generate category growth, or even to arrest decline."⁵ Similar findings have been reported looking over a wide range of mature products in the U.S.⁶ Cigarettes are an example of a mature product category and indeed, in many countries the tobacco market has moved through the maturity stage and is into decline at this time. Therefore, it is not surprising that a meta-analysis of studies that specifically examined cigarette advertising and total cigarette sales in the U.K., similarly concluded that advertising does not affect total sales.⁷
15. In a mature market like tobacco, trademarks and the brands that they represent are important to consumers because they help people who want a specific product to make informed decisions about which brand to buy i.e. selective demand. Once people have tried a brand, they may determine that they like it and buying it in the future will ensure that they are making a satisfactory product choice. Trademarked elements of a brand such as symbols, logos, designs or distinctive coloring or lettering can help people to identify and remember the brand. Consumers learn that a good identified by a specific trademarked symbol, design characteristic or brand can be relied upon to come from a particular source and have a given standard of quality and reliability.
16. Some consumers may also use high awareness or visibility of a trademarked product as an indication that this brand is high quality because if many other people are using it, it must be good quality.⁸ Here, the visibility of brands through

⁵ John Paul Jones, "Macroeconomic Effects: The Influence of Advertising on Overall Sales Levels," in John Paul Jones (ed.) *How Advertising Works* (1998) p. 328.

⁶ Mark S. Albion & Paul W. Ferris, *The Advertising Controversy: Evidence on the Economic Effects of Advertising* (1981).

⁷ Martyn Duffy, "Econometric Studies of Advertising, Advertising Restrictions and Cigarette Demand: A Survey," *International Journal of Advertising*, (1996).

⁸ Wayne D. Hoyer & Steven P. Brown, "Effects of Brand Awareness on Choice for a Common, Repeat-Purchase Product," *Journal of Consumer Research*, (Sept., 1990).

their trademarks can help people to identify brands that are perceived of as high quality.

17. Moreover, brands not only assist consumers directly but also indirectly as they serve to encourage companies to maintain or improve the quality of their brands.⁹ Central planners in the Soviet Union, for example, found that requiring manufacturers of consumer goods to imprint production marks on goods helped to prevent deteriorating quality.¹⁰
18. Trademarks and the brands they represent "signals to the customer the source of the product, and protects both the customer and the producer from competitors who would attempt to provide products that appear to be identical."¹¹ This can be very important because physical similarities between brands can lead consumers to misattribute the origin or source of a brand or lead consumers to rate brand attributes and quality similarly.¹² For this reason, there is a lot of concern by trademark and brand owners about the brand confusion that can be caused by look alike or counterfeit brands.

Trademarks Protect the Goodwill and Equity of a Brand

19. A distinctive trademark protects the goodwill and equity of a brand. Aaker defines brand equity as "a set of brand assets and liabilities linked to a brand, its name and symbol that add to or subtract from the value provided by a product or service to a firm and/or to that firm's customers."¹³ In other words, it is the non-objective elements associated with a good or service from a particular company that makes it more or less preferred as a brand choice. Brand equity can be seen as the difference in consumer responses to a given brand as compared to their responses to a version of the exact same good or service that was unnamed or given a fictitious name.¹⁴ If the brand name or symbol is changed, brand equity can be affected.¹⁵
20. Brands with high equity and goodwill can command premium prices over less popular or generic equivalent brands.¹⁶ Aaker reported that American Motors showed people a model of a car without any brand name and asked them to indicate what they would pay for it.¹⁷ The same question was then asked for a model with their brand name on it. People were willing to pay \$3000 more for

⁹ George Miacoulis & Nancy D'Amato, "Consumer Confusion & Trademark Infringement," *Journal of Marketing* (April, 1978).

¹⁰ Ricky Wilke & Judith Lynne Zaichkowsky, "Brand Imitation and Its Effects on Innovation, Competition and Brand Equity," *Business Horizons* (Nov.-Dec. 1999).

¹¹ David A. Aaker, *Managing Brand Equity* (1991) at 7.

¹² Loken et al. (1986).

¹³ Aaker (1991) at 15.

¹⁴ Kusum L. Ailawadi, Donald R. Lehmann & Scott A. Neslin, "Revenue Premium as an Outcome Measure of Brand Equity," *Journal of Marketing* (Oct. 2003); Keller (2008).

¹⁵ Aaker (1991).

¹⁶ Ailawadi et al. (2003); Keller & Lehmann (2006).

¹⁷ Aaker (1991).

the one with the brand name. This ability to charge a premium price further enhances a firm's profitability and shareholder value.

21. For many companies, brands are their most valuable and sustainable asset.¹⁸ For example, a Forbes magazine article indicated that PepsiCo had a total market value of approximately \$86.8 billion. However, only \$6.5 billion of that was from tangible assets. The majority of the value (approximately \$56.1 billion) instead came from the intangible asset of the value of their trademarked brands.¹⁹

Trademarks and the Brands they Represent Contribute to the Efficient Functioning of the Market

22. Trademarks and the brands they represent are also important because they contribute to the efficient functioning of the market. They help companies compete based on product distinctions, rather than price. Brands that are unable to differentiate their products are left with little alternative but to compete on the basis of price. Lower prices further reduce or eliminate incentives to ensure high quality products.
23. Trademarks and brands also benefit the market structure by assisting new entrants into the marketplace by allowing them to differentiate themselves from their competitors. Without a way to effectively differentiate a new brand, about the only way to encourage trial is to compete on price. Standardized packaging may, therefore, have the effect of making it difficult for manufacturers to introduce niche products and innovations, especially in light of the advertising and display bans that are already in place in relation to tobacco products in the UK.

Importance of Package Design

24. A brand's packaging is extremely important in forming brand identity in the mind of the consumer. The package elements include the trademarks, colours, text and graphic elements. Taken together these elements constitute the "trade dress" of the package (i.e., the overall look and feel of the package).
25. Stella Artois and Beck's are imported beers that sell well in the U.K. Seeing each of them helps trigger recognition of the brand, as well as its origins and perceptions of its quality.

¹⁸ Oliver Hupp & Ken Powaga, "Using Consumer Attitudes to Value Brands: Evaluation of the Financial Value of Brands," *Journal of Advertising Research* (September 2004).

¹⁹ Cecily Fluke & Kurt Badenhausen, "Power Brands - Beyond the Balance Sheet," *Forbes* (April 19, 2004) (online at <http://www.forbes.com/forbes/2004/0419/059.html> - accessed Oct. 7, 2013).



26. Note that the two brands have a number of package elements in common. Both have labels featuring the color red and use an oval shaped design. The brand names appear in capital letters across the center of the labels. Each label appears on a green bottle. Yet we can very quickly distinguish these brands. This points out the fact that the identity of a brand and the trade dress of a package typically involve the overall look and arrangement of the package elements in a holistic manner and not just specific individual elements.²⁰ Changes in the holistic package can affect brand recognition and weaken brand equity.²¹
27. The value of image consistency to a brand can be seen in the care brands take not to change their packaging, logos or colors too drastically at any point in time. Instead, they choose to make small gradual changes so consumers will not be upset or confused. They hope to keep the change below what is known as the "just noticeable difference" level (JND). Brands like Michelin tires, Pepsi, BMW, Shell gasoline and Campbells soup have all made several modifications to their trade characters, logos, fonts and packages over the years to remain contemporary (see Pepsi example below). However, each time the goal is to make the change small and gradual so as not to confuse consumers or risk losing their historical brand equity.

²⁰ Ulrich R. Orth & Keven Malkewitz, "Holistic Package Design and Consumer Brand Impressions," *Journal of Marketing* (May 2008).

²¹ Herbert M. Meyers & Murray J. Lubliner, *The Marketer's Guide to Successful Package Design* (1998).



28. Tropicana Orange Juice learned the hard way just how strong an attachment people have to packaging and logos.²² Tropicana changed their old package featuring a graphic of an orange with a straw through it for a newer, more contemporary look. The result was a huge public outcry. Tropicana eventually had to bow to public demand and brought back its old packaging. More recently, Gap tried to change its logo. However, outpourings of anger on social media led them to go back to their old logo. People feel passionately about trademarks and the brands they represent. The trade dress of the packaging can make up an important part of brand equity and provide a strong competitive advantage.
29. The U.K. government appears to recognize the importance of packaging to a brand. In a section on look-a-like brands on its Intellectual Property Office website, it states:

"Look-a-like items are items that look like a well known brand. The product may have very similar packaging; same size, same type and shape of container and very similar graphics and or a similar brand name as that of a brand leader and therefore may benefit from another product's reputation.

The role played by packaging in communicating brands values is receiving considerable attention in the context of brand look-a-likes. The increasing number of retail products which take on the visual appearance of the brand leaders is causing great concern for the manufacturers of branded products.

The government supports investment in distinctive branding for products and recognises the value that such brands have in helping consumers to quickly identify quality products and make informed choices in a busy market. We, therefore, support reasonable measures which prevent parties taking unfair advantage of the investment made

²² Stuart Elliott, "Tropicana Discovers Some Buyers Are Passionate about Packaging," *New York Times*, B-6, Feb. 23, 2009, online at <http://www.nytimes.com/2009/02/23/business/media/23adcol.html?pagewanted=all>.

in developing distinctive branding with a reputation amongst the public."²³

30. Brands try to minimize changes to their packaging and trademarks in order to avoid creating consumer confusion and harming brand equity. Standardized packaging will harm the ability of brand owners to use their trademarks to effectively perform their functions of distinguishing between products and identifying the commercial origin and the quality of the underlying product.
31. Consumers expect high equity brands to be different from other brands, even if these differences are perceptual rather than substantive. Standardized packaging will eliminate the visual differences between brands and make the packages all look the same. When brand packages look similar, consumers think of the brands as being similar and this can diminish brand equity.²⁴ As a result, brand value will drop and this would lead to a brand's ability to command a premium price disappearing.²⁵
32. There would be little opportunity for new brands, brand extensions or brand innovations to be noticed by smokers. Brand awareness is a necessary, but not sufficient condition for building brand equity and achieving success for a new brand or an existing brand with a new innovation. Brand awareness generally requires frequent exposure to the brand name along with an indication of what type of product it is. For this reason, attempts to achieve brand awareness generally utilize advertising. Other promotional activities such as point-of-purchase displays and sponsorship can also help to enhance brand awareness. However, all of these standard approaches to developing brand awareness are already prohibited for tobacco brands in the U.K. Thus, the ability for a new brand to enter the market is already extremely limited.
33. Manufacturers of existing brands can use trademarks and packaging to help communicate features of new products or innovations to customers. They may use mostly the same packaging colors and symbols as their existing brands to show that the new innovation is from the same company. For example, when Colgate introduces Colgate Whitening or Colgate Cavity Protection, it uses a similar package with many of the same design elements, but with a distinct section (see examples below). Generally these manufacturers also use large advertising budgets along with package design or trademarks to make consumers aware of the new innovation. Without the benefit of recognized trademark and packaging elements, as well as the prohibition of the use of advertising and other promotional strategies, manufacturers cannot effectively communicate these niche products and innovations to consumers while, at the same time, making it clear that the brand extension is part of the brand family and has the basic attributes and quality associated with the specific brand.

²³ Intellectual Property Office, "Look-a-like packaging" online at <http://www.ipo.gov.uk/t-policy-lookalike.htm> (accessed July 15, 2014)

²⁴ Foxman et al. (1992); Miaoulis & D'Amato (1978).

²⁵ Rajesh Iyer & James A. Muncy, "The Role of Brand Parity in Developing Loyal Customers," *Journal of Advertising Research* (June 2005).



34. Similarly, it would be unlikely that any new brands would enter the tobacco market unless they were to do so by undercutting prices. Novel packaging helps new brands to be noticed by consumers. Standardized packaging, along with all of the other restrictions on tobacco sales and promotion in the U.K. will make it extremely difficult, if not impossible, for a new brand to enter the market.
35. Ultimately, all cigarette brands, even the leading brands, would likely be damaged if distinctive packaging elements and trademarks are no longer allowed. As a result, all brands may begin to be perceived as equivalent to each other. If brands are seen this way, they will no longer be able to demand a premium price. Without the value proposition provided by brands, smokers will likely navigate towards low value tobacco products. The focus on pricing will also likely result in lower prices, a result which could also lead to increased purchases and consumption since price has been found to be an extremely important factor in smoking consumption.²⁶
36. Standardized packaging is also likely to benefit the counterfeit and illicit trade, since it would be cheaper and easier for counterfeiters to copy the new standardized packages and more difficult for consumers and retailers to identify legitimate products.

Conclusion

37. Trademarks, brand marks, distinctive brand colors and other elements of trade dress play a fundamental role for both consumers and brand manufacturers. They help consumers distinguish between brands and more easily recognize the source of a product. These visual elements can help consumers more easily store brand information in their memory and avoid confusion. As a result, consumers are better able to select their preferred brands in future brand choice situations.
38. Trademarks and brand symbols are also important components of brand equity for the company.²⁷ This is important for the manufacturers since brand equity can promote and maintain brand loyalty, allow the company to command a premium price and protect it from price discounting by competitors. This is a major reason why brands are careful to make small gradual changes in brand colors, symbols or packaging rather than risking consumer confusion or displeasure by making more abrupt changes.


²⁶ WHO Technical Manual on Tobacco Tax Administration (2011).

²⁷ Aaker (1991).

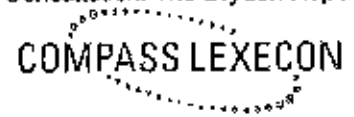
39. Standardized packaging would prohibit the use of all trademarks, except word marks that could only be used in a standardized size, color and font. As a result, it will be harder for consumers to identify and find brands that they prefer. It will lead to consumer confusion since all packs will look very similar. This will result in making it more difficult for newer brands to enter the marketplace and for smaller brands to compete against established leading brands.
40. Over time, brand equity will diminish for all brands and the perception of all brands as being generic equivalents will grow. As a result, the only avenue available for brands to differentiate and compete will be on the basis of lowest price. Pushing brands to compete on lower prices could also lead to increased consumption since price has been found to be an extremely important factor in smoking consumption.



Ronald J. Faber



(date)



The effects of standardised packaging on competition

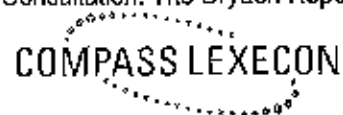
Neil Dryden

7 August 2014

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Glossary of terms

BAT	British American Tobacco UK Limited.
Consumer surplus	The difference between consumers' willingness to pay for products and what they actually pay for them.
Cross-border trade	Import, for personal use, of cigarettes or other products by consumers who buy cheaply abroad, usually in jurisdictions characterised by lower tax rates.
Economic welfare	The sum of consumer surplus and producer surplus.
FMC	Factory made cigarette, a cigarette, produced by a tobacco manufacturer, capable of being smoked as such.
Illicit trade	Any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase of tobacco products.
Producer surplus	Profits of manufacturers.
Standardised packaging	Restrictions on a cigarette packet's colour; restrictions on permitted text and features on a cigarette packet; requirements for the cigarette packets to be flat and smooth and without ridges, embossing or other irregularities of shape or texture; restrictions on inserts and wrappers; and, restrictions on the appearance of cigarettes.
TPD2	Directive 2014/40/EU of the European Parliament and the Council, the Revised Tobacco Product Directive.

Section 1

Introduction

- 1.1 I am Nell Dryden, an Executive Vice President of Compass Lexecon, an economic consulting firm. Compass Lexecon is part of FTI Consulting Inc., a global business advisory firm. My experience and expertise is as a micro-economist, specialised in the economics of competition policy, regulation, public policy and market analysis. I have included my CV at Annex A.

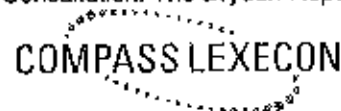
Background

- 1.2 In 2012, the UK government issued a consultation into the effects of the plain packaging of cigarettes and other tobacco products.¹
- 1.3 In November 2013, the Department of Health requested Sir Cyril Chantler to provide advice "taking into account existing and any fresh evidence, as to whether or not the introduction of standardised packaging is likely to have an effect on public health (and what that effect might be), in particular in relation to the health of children".²
- 1.4 Chantler stated that he "would consider *evidence* on whether standardised packaging is likely to lead to a decrease in tobacco consumption, including in particular the risk of children becoming addicted". He said that we would start "from the uncontroversial premise that any such decrease will have a positive impact on public health".³
- 1.5 Chantler's results were published in 2014.

¹ "Consultation on standardised packaging of tobacco products" (2012).

² See Chantler (2014), page 3.

³ See Chantler (2014), page 3, emphasis in original.



1.6 In 2014, a government consultation proposed the implementation of standardised packaging.⁴ An accompanying Impact Assessment set out an analysis of three alternative policy options: (i) implementing the changes of TPD2⁵ without standardised packaging, (ii) the implementation of standardised packaging on top of TPD2 (the government's preferred option),⁶ and (iii) delaying the implementation of standardised packaging to observe better the effects of similar legislation in Australia.⁷

Instructions

- 1.7 I have been asked to prepare this report by Herbert Smith Freehills LLP, on behalf of British American Tobacco UK Limited ("BAT").
- 1.8 I have been asked to set out my views on any distortive effects that the proposed standardised packaging regulations will have on competition in the supply of cigarettes within the United Kingdom.
- 1.9 I have also been asked to provide my opinions specifically on the following economic matters:
- The implications for consumer welfare resulting from the implementation of standardised packaging;
 - The implications for the prices of cigarettes of standardised packaging;
 - The implications for the quantity of cigarettes consumed of standardised packaging; and
 - The effects of an offsetting duty increase as a potential measure to counteract anticipated price decreases following the implementation of standardised packaging.
- 1.10 I have also been asked to comment on the Department of Health's Impact Assessment and Chantler's report, insofar as they address the issues outlined above.

⁴ "Consultation on the Introduction of regulations for standardised packaging of tobacco products", 2014.

⁵ Directive 2014/40/EU of the European Parliament and the Council, the Revised Tobacco Product Directive ("TPD2").

⁶ As well as other forthcoming regulation such as the small business retail display ban.

⁷ See Impact Assessment, p. 1.

My analysis of TPD2

- 1.11 I have previously written an expert report for BAT regarding the impact of TPD2 on competition.⁸ In that report, I showed that TPD2 will directly distort competition by restricting dimensions along which firms compete in the market. In particular TPD2 will reduce horizontal differentiation, product variety, and quality differentiation.
- 1.12 Using standard microeconomic models of competition, I showed that different aspects of TPD2 will either distort competition by reducing consumer welfare, or increase consumption contrary to the health objectives of TPD2.
- 1.13 I also set out that TPD2 will make price competition more intense with two main effects on manufacturers. First, it will reduce their incentives to invest in product innovation and quality. Second, it will make scale economies more important increasing the risk of exit for smaller, relatively inefficient players. Finally, I explained why TPD2 will increase the incentive to engage in illicit trade.
- 1.14 In this report, I explain how standardised packaging would result in a further direct restriction of a dimension of competition (i.e. differentiation) and would also lead to an accentuation of many of the effects associated with TPD2 and the upcoming small business retail display ban in relation to consumer surplus, price and quantity. Since standardised packaging comes on top of TPD2 and the retail display ban, the effects are if anything more serious as the costs to distorting competition are likely to be higher as the residual amount of competition left becomes less.⁹ This report repeats my analysis of TPD2 where it is relevant to analysing the effects of standardised packaging.

Declarations

- 1.15 I was assisted in preparing this report by Peter Caradonna, an Analyst at Compass Lexecon working under my supervision. However, the opinions contained in this report are mine alone.
- 1.16 Throughout this report I use the word "market". This is not intended to imply a well-defined market in competition policy terms.
- 1.17 I have set out the sources upon which I have relied in Annex B.

⁸ "The effects of the European Union Revised Tobacco Products Directive on competition" (2014), provided to the Secretary of State for Health in connection with BAT's challenge of the legality of TPD2.

⁹ See paragraph 4.8.

Structure of the report

1.18 The next section sets out a summary of my conclusions.

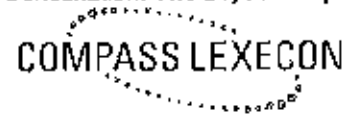
1.19 The remainder of the report is then structure in four parts as follows.

- **Part 1 - Summary of Chantler/Impact Assessment.** First, I summarise the report of Sir Cyril Chantler, as well as the Department of Health's Impact Assessment where they relate to the issues I have been asked to examine (Section 3).
- **Part 2 - Theoretical analysis.** Second, I set out a theoretical framework of analysis and apply it to understand the implications of standardised packaging for competition and for the specific issues I have been asked to examine (Section 4 to Section 8).
- **Part 3 - Empirical analysis.** Third, I discuss the empirical simulation work of Dr. Jorge Padilla on the effects of standardised packaging in both the United Kingdom and Australia and then use the results of that work to model the scale of the countervailing duty increase required to offset the price effects resulting from the implementation of standardised packaging (Section 9 and Section 10).
- **Part 4 - Comments on Chantler/Impact Assessment.** Finally, I provide my comments on Chantler's report as well as the Department of Health's Impact Assessment in the light of the analysis above (Section 11).

Section 2

Summary of conclusions

- 2.1 I consider that standardised packaging will directly distort competition by restricting dimensions along which firms compete in the market.
- 2.2 Before any tax increases to offset anticipated price reductions, standardised packaging will either distort competition by reducing consumer welfare, or increase consumption contrary to the health objectives of standardised packaging. I conclude that the tax increase required to neutralise the likely price reduction is large, will unambiguously reduce consumer welfare and will increase incentives for illicit trade. I conclude that Sir Cyril Chantler's review and the impact assessment contain an incomplete, and in some cases erroneous and simplistic, analysis of these issues.
- 2.3 In particular as set out in this report:
- the UK tobacco market is already highly regulated and the distortive effects of further regulation on competition are likely to be more serious than absent existing regulation;
 - standardised packaging will directly distort competition by severely restricting the scope for horizontal and vertical product differentiation;
 - standardised packaging will result in more homogenised products, intensifying price competition. This will result in lower prices and an increase in consumption;
 - consumer welfare may also fall if the loss of variety from brands outweighs the benefits of lower prices;
 - standardised packaging will incentivise legitimate cross-border trade and illicit trade;
 - to the extent that the government increases tax to 'neutralise' any price reduction, this will unambiguously reduce consumer welfare, as consumers either turn to legitimate cross-border trade or illicit trade or pay the same for an inferior product (each of these options offering lower utility);



- the scale of the tax increase required to neutralise the price reduction is potentially large, increasing the tax incidence on cigarettes from 77% to a figure in the range 82-91%;
- the Chanler Report and the Impact Assessment contain at best a cursory analysis of the issues above. Inter alia they have not considered adequately the implications of the regulation for consumer surplus, the possible magnitude of price reductions, or the size or implications of any tax increase required to neutralise such price reductions.

Section 3

Summary of Sir Cyril Chantler's report and Impact Assessment

- 3.1 In this section I summarise the work undertaken by Sir Cyril Chantler in his review of the likely effects of standardised packaging, and the Department of Health's Impact Assessment.

Chantler's report

- 3.2 In November 2013, the Department of Health requested Chantler to provide advice "taking into account existing and any fresh evidence, as to whether or not the introduction of standardised packaging is likely to have an effect on public health (and what that effect might be), in particular in relation to the health of children".¹⁰
- 3.3 Chantler stated that he "would consider evidence on whether standardised packaging is likely to lead to a decrease in tobacco consumption, including in particular the risk of children becoming addicted". He said that we would start "from the uncontroversial premise that any such decrease will have a positive impact on public health".¹¹ His primary focus was therefore on the effect of the regulation on quantity consumed.

Price and quantity effects

- 3.4 Chantler presented mixed conclusions on the implications of standardised packaging for prices.¹²

¹⁰ See Chantler (2014), page 3.

¹¹ See Chantler (2014) page 3, emphasis in original.

¹² See Chantler (2014), Annex C.

- 3.5 In relation to the demand side, he indicated that standardised packaging may cause prices (at least prices paid) to fall:

"Overall, if standardised packaging was working, a degree of down-trading would be expected to occur, especially in the long-term. This reflects that tobacco in standardised packaging becomes less desirable than it was in branded packaging and therefore the amount consumers are willing to pay decreases".¹³

- 3.6 He stated that evidence in relation to the supply side was mixed. Chantler referred to Dr. Padilla's report for PMI, stating this argued that prices would fall because of competition based "solely on price". He said this was contradicted by a report for JTI, indicating that standardised packaging would lead to a reduction in competition and an increase in barriers to entry.¹⁴
- 3.7 In relation to Australia, Chantler concluded that "there is no evidence to date of a commoditisation of the market leading to immediate and widespread price reductions". Further "It is too soon to make definitive conclusions, but the fact that leading brands are increasing prices above tax suggests that predictions of widespread price reductions are exaggerated, at least in the short-run".¹⁵
- 3.8 Chantler stated that a reduction in prices as a result of standardised packaging would not induce an increase in consumption as cigarettes have become less desirable.¹⁶
- 3.9 In the light of at least the possibility of price reductions, Chantler noted that, should prices actually fall as a result of the implementation of standardised packaging, such price reductions could be mitigated through an offsetting tax increase.¹⁷

Consumer welfare

- 3.10 Consumer surplus is not mentioned in Chantler's review, nor is any consideration made of variety effects or other utility-enhancing effects of branding upon consumers.

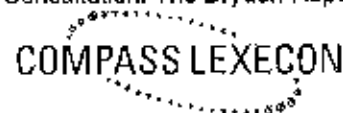
¹³ See Chantler (2014), p. 45.

¹⁴ See Chantler (2014), p. 45-46.

¹⁵ See Chantler (2014), p. 46.

¹⁶ See Chantler (2014), p. 45.

¹⁷ See Chantler (2014), p. 46.



Competition distortions

- 3.11 In relation to other competition distortions, Chantler also observed that in Australia there has been evidence of decreased entry by new brands.¹⁸
- 3.12 Moreover, Chantler also noted that the rapid introduction of a number of new products just before the implementation of standardised packaging in Australia is likely evidence that it will be considerably harder for firms to communicate innovations in the future.¹⁹

Impact Assessment

- 3.13 The Impact Assessment attempted to quantify the impact of standardised packaging on consumers, suppliers, and the government.

Price and quantity effects

- 3.14 The Impact Assessment acknowledged the possibility that prices may decrease in response to the implementation of standardised packaging.²⁰
- 3.15 However, it conducted no additional analysis on this topic relative to Chantler's report. It similarly stated that the ability to increase taxes to offset any price effects is grounds effectively to dismiss any further discussion of price impact.²¹

Consumer surplus

- 3.16 The Impact Assessment does acknowledge that consumer surplus is normally an important consideration for any regulation. However, rather than address consumer welfare in a conventional economic fashion, the Impact Assessment argues that the change is ambiguous, and thus it is justified in assuming the net change to be zero in the absence of other evidence.²²

¹⁸ See Chantler (2014), p. 46.

¹⁹ See Chantler (2014), p. 46.

²⁰ Impact Assessment para. 68 considers the possibility of consumers substituting away from 'premium,' high-price brands. Paragraph 114 explicitly lists 'Drop in price' under potential costs to the exchequer.

²¹ See Impact Assessment, para. 114.

²² See Impact Assessment, para. 263.

- 3.17 The rationale for the assumption that consumer surplus can effectively be excluded in this context is the presumption that brands are not only utility-enhancing for their consumers, but are also envy-inducing for non-consumers. As such, the Impact Assessment states, "branding might therefore be seen as a zero-sum game".²³
- 3.18 In conclusion, while acknowledging that consumer welfare is normally an important criterion in regulatory matters, the Impact Assessment discounts it in its analysis of the effects of the implementation of standardised packaging.

Competition distortions

- 3.19 The Impact Assessment also considered that standardised packaging would have implications for innovation. It argued that:

"[Standardised packaging] is also expected to increase price competition, which may result in process innovation as companies improve the efficiency of the production process. Standardised packaging may result in product innovation as tobacco companies invent new ways of differentiating their products".²⁴

Conclusion

- 3.20 The above summarises the work of Sir Cyril Chantler and the Department of Health's Impact Assessment in reviewing the likely effects of standardised packaging. I provide my comments in Section 11.

²³ See Impact Assessment, para. 263.

²⁴ See Impact Assessment, para. 203.

Section 4

Economic approach

- 4.1 In this and the following three sections of the report, I set out a theoretical framework of analysis and apply it to understand the implications of standardised packaging for competition and for the specific issues I have been asked to examine.
- 4.2 This section begins by setting out the economic approach that I have adopted.

Baseline for comparison

- 4.3 To analyse the effect of some event or intervention in a market it is necessary to compare a 'factual' scenario (with the event or the intervention) with a 'counterfactual' scenario (in the absence of the event or the intervention). In the present case, the factual scenario refers to the future state of the UK tobacco market *with the implementation of standardised packaging* and the counterfactual scenario refers to the future state of the UK tobacco market *absent the implementation of standardised packaging*. I have assumed that TPD2 and the small business retail display ban will be introduced in either case.²⁵
- 4.4 My approach is therefore to identify the *incremental* effects of standardised packaging relative to the existing regulations, assuming that TPD2 and the small business retail display ban will be introduced.
- 4.5 The market for cigarettes in the UK is already characterised by a high degree of regulation: *inter alia*, a partially implemented retail display ban, advertising and promotion bans, a general warning that covers at least 30% of the most visible surface of the packet, and additional warnings and graphics covering at least 40% of the other most visible surface of the packet.²⁶

²⁵ The baseline "no action" policy regime described in the Impact Assessment links UK regulation to TPD2, implying further future regulation imposing homogeneity on the packaging of cigarettes irrespective of the implementation of standardised packaging. See Impact Assessment, p. 1.

²⁶ See "The effects of the European Union Revised Tobacco Products directive on competition" (2014), para. 4.8-4.10.

- 4.6 Additional UK restrictions include bans on advertising, event sponsorship, vending machine sales and retail display. The retail display ban was introduced into large retailers in England in April 2012 and will become effective for small retailers in April 2015. Similar display bans exist or are being introduced in Wales, Scotland and Northern Ireland. Broadly, these display bans require the tobacco products to be stored in specified storage units that prevent customers seeing the products except in limited circumstances, with additional requirements for displaying the prices of products.
- 4.7 Moreover, TPD2 and the small business display ban stand to be implemented in both the factual and counterfactual scenarios, imposing further restrictions on the available branding of cigarettes in the UK.
- 4.8 Therefore, any distortions arising from standardised packaging are likely to be more significant because they are on the top of already existing competition distortions.²⁷
- 4.9 The cigarette market in Europe is characterised by a significant level of illicit trade before the introduction of standardised packaging.²⁸ Moreover, Judith Kelly of the HMRC's Tobacco Strategy and Policy Team indicated to Chantier that "the EU rates the UK as the number 1 destination for illicit tobacco so the threat to the UK remains high".²⁹

Economic methodology

- 4.10 I have analysed the effects of the intervention using standard tools of microeconomic analysis (see Section 5 to Section 8). I have used two standard theoretical models from the industrial organisation literature in microeconomics to identify the various effects on key variables of interest.

²⁷ See for example Bellamy & Child (2014) "European Union Law of Competition", Oxford University Press (seventh edition), paragraph 2.133 (in the context of agreements under Article 101 of the Treaty on the Functioning of the European Union): "Where there is limited scope for competition in the relevant market, any additional restriction or distortion arising from the agreement will be regarded as having a significant impact".

²⁸ According to a report commissioned by the European Commission, illicit trade in FMC stands at 6.25% of total trade in the EU. See Matrix Insight (2013) "Economic analysis of the EU market of tobacco, nicotine and related products", p.30.

²⁹ See Chantier "Notes of UK-based Meetings" (2014), p. 36. (<http://www.kcl.ac.uk/health/packaging-docs.aspx>)

Identifying competition distortions

- 4.11 I have been asked to provide my opinion on any distortive effects that certain regulations required under the proposed standardised packaging legislation will have on competition within the United Kingdom. It is therefore necessary to consider what a distortion of competition amounts to. I have adopted two approaches.

Distortion of competition through restriction of parameters along which competition takes place.

- 4.12 First, a distortion of competition can be considered to be any situation where competition along a certain dimension (e.g. price, quantity or differentiation) is restricted.
- 4.13 The concept of competition envisages rivalry between competitors along parameters of competition, such as price, output, product quality, product variety or innovation.³⁰ At a high level, competition can be said to be distorted if a relevant parameter of competition is distorted in some way. This could include:
- Reducing the ability for companies to compete with one another by restricting a relevant parameter of competition, such as product variety; and/or
 - Favouring a subset of companies over another subset of companies. I understand that the provisions of standardised packaging apply equally to all manufacturers. However, there may be *de facto* favouring of some companies over others, for example by restricting a relevant parameter of competition (such as innovation) that some (but not others) have invested in.

³⁰ See European Commission 2011/C 11/01, "Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements" (henceforth "Horizontal Guidelines"), paragraph 27: "For an agreement to have restrictive effects on competition within the meaning of Article 101(1) it must have, or be likely to have, an appreciable adverse impact on at least one of the parameters of competition on the market, such as price, output, product quality, product variety or innovation".

Restriction of competition through reduction of economic welfare or consumer surplus

- 4.14 Second, the field of competition policy provides a further and useful reference point for what may be considered a distortion on competition, in particular an intervention that reduces total welfare, or which reduces the consumer welfare component of total welfare.³¹
- 4.15 Professor Massimo Motta, presently Chief Competition Economist of the European Commission, has argued that "*economic welfare [or total welfare] is the objective that competition authorities and courts should pursue*".³²
- 4.16 Accordingly, Professor Motta has defined competition policy as "*the set of policies and laws which ensure that competition in the marketplace is not restricted in such a way as to reduce economic welfare*".³³
- 4.17 It follows that an intervention that affected the choice of products available and altered competition between firms in a market, and which reduced the sum of consumer surplus and firms' profits (producer surplus), would be contrary to the objectives of competition policy and thus, in the terms of competition policy, a distortion of competition.
- 4.18 While most economists prefer a total welfare standard (like Professor Motta), competition policy in practice is based in many jurisdictions on a consumer welfare standard.
- 4.19 This is true for instance for the European Commission, whose Horizontal Guidelines state:

*"Intellectual property laws and competition laws share the same objectives of promoting innovation and enhancing consumer welfare."*³⁴

³¹ Total welfare comprises consumer surplus plus producer surplus. Consumer surplus is the difference between how much consumers value products at (i.e. their willingness to pay) and what they actually pay for them. Thus if a consumer values a packet of cigarettes at €10 but pays €8 to obtain it, €2 of consumer surplus is generated. Producer surplus (or profit) is the difference between how much consumers pay for the product and what it costs to supply an additional unit including taxes that have to be paid. Thus if a consumer pays €8 (as above) and the cost of manufacture and taxes is €7, the gross profit is €1.

³² See Motta, M. (2004) "*Competition Policy Theory and Practice*", Cambridge University Press, p. 30, emphasis in original.

³³ See Motta, M. (2004) "*Competition Policy Theory and Practice*", Cambridge University Press, p. 30.

³⁴ See European Commission's Horizontal Guidelines, para. 269.



4.20 Also, the former European Commissioner for competition policy, Neelle Kroes, has stated:

"Consumer welfare is now well established as the standard the Commission applies when assessing mergers and infringements of the Treaty rules on cartels and monopolies. Our aim is simple: to protect competition in the market as a means of enhancing consumer welfare and ensuring an efficient allocation of resources."³⁵

4.21 Professor Motta's view, with which I agree, is that choice between a consumer welfare standard or a total welfare standard will often lead to the same conclusions. In particular, once it is recognised that a reduction in firm's profits will reduce firms' dynamic incentives to invest and innovate, lower profits are also seen to have a negative effect on consumer surplus in the long-run.³⁶ Thus a long-run assessment of the impact of a regulation or intervention on consumer surplus should also have regard to firms' profits.

4.22 It is also necessary to consider whether any identified distortions can be considered to be appreciable. In this regard, I note that distortions of competition are likely to be more significant where parameters of competition have already been restricted or reduced.³⁷ I discuss the status quo, including the current restrictions that manufacturers face in seeking to differentiate their products, in paragraphs 4.3 to 4.9.

Summary of approach to identifying competition distortions

4.23 In this report I therefore approach the question of whether certain regulations of standardised packaging have any distortive effects on competition as follows. I first consider whether the regulations I am addressing affect any relevant parameters of competition, which could in itself be characterised as a distortion of competition. I then use economic tools to consider the effects the regulations have on consumer welfare, as a means of identifying distortions of competition.

Health aspects

4.24 My analysis assumes (conventionally) that consumer surplus is given as the difference between a smoker's valuation of cigarettes (given by their willingness to pay) and what they actually pay. I have assumed for the purposes of this report that smokers are fully aware of the risks associated with smoking, and that they fully factor them in their smoking decisions and in their willingness to pay for cigarettes.

³⁵ See SPEECH/05/512 of 15 September 2005.

³⁶ See Motta, M. (2004) "Competition Policy Theory and Practice", Cambridge University Press, p. 21.

³⁷ See footnote 27.

- 4.25 Second, my analysis of the effects of the regulation does not take into account the direct effects, if any, of health warnings on consumption levels. Within this regard, I understand that a report by Dr. Viscusi states that standardised packaging will not increase the efficacy of health warnings.³⁸
- 4.26 I believe it is appropriate not to take account of health aspects in the context of this report since it allows for isolating any competition distortions from the impact on public health of consumption of cigarettes or of the impact of health warnings on consumption, which may then be analysed separately by those with expertise in those areas.
- 4.27 I consider the approach outlined in the previous paragraph (in particular, isolating the welfare effects of distortions in tobacco markets using a conventional economic welfare analysis) is consistent with the approach taken by competition authorities that have analysed competition in tobacco markets. For example, the recent analysis undertaken by the Jersey Competition Regulatory Authority on the supply of cigarettes in Jersey was prompted by concerns that the pre-tax prices of tobacco products were significantly higher in Jersey than in the United Kingdom.³⁹ In addition, in a recent case concerning vertical restraints between tobacco manufacturers and supermarkets in the UK, the OFT was concerned that the agreement had the objective of raising prices.⁴⁰

Summary of approach

- 4.28 In summary, I proceed by analysing the incremental effect of standardised packaging recognising that the market is already highly regulated (and will become more so as a result of TPD2 and the small business retail display ban) and that the competitive significance of any further distortion of competition may be correspondingly greater.

³⁸ See Viscusi, W. K. (2014) "An assessment of the likely effect of plain packaging on warnings efficacy: A response to the United Kingdom Impact Assessment on standardised packaging of tobacco products".

³⁹ See Channel Islands Competition and Regulatory Authorities (CICRA) 14/20 (2014) "Review of the supply of tobacco products in Jersey".

⁴⁰ See Decision of the Office of Fair Trading, Case CE/2598-03: Tobacco, 15 April 2010.

Section 5

Standardised packaging and its economic nature

- 5.1 In this section, I set out my views of the economic nature of standardised packaging, which provides a starting point for assessing its effects.

The regulations and their economic characterisation

- 5.2 Standardised packaging will make some or all products in the market more similar to each other. I refer to this reduction in product differentiation as "increased homogeneity" (or "homogenisation").
- 5.3 In particular, increased homogeneity arises from restrictions on a cigarette packet's colour; restrictions on permitted text and features on a cigarette packet; requirements for the cigarette packets to be flat and smooth and without ridges, embossing or other irregularities of shape or texture; restrictions on inserts and wrappers; and, restrictions on the appearance of cigarettes.⁴¹
- 5.4 In each case I assume that the number of products available on the market does not change,⁴² but the regulations make them more similar (by suppressing branding or by suppressing communication of differentiating factors).
- 5.5 In what follows, I illustrate the nature of increased homogeneity within a product differentiation framework.

The product differentiation framework

- 5.6 Economists distinguish between horizontal and vertical product differentiation.

⁴¹ References to "standardised packaging" in this report relate to all of these requirements.

⁴² This is not a restrictive assumption. All results on the economic outcomes of this regulation hold for the limiting case when all heterogeneity in a given dimension is removed from the market, rendering certain groups of brands indistinguishable. This outcome is then analogous to the redundant brands having been removed from the market.

- **Horizontal product differentiation** means that consumers have different tastes (preferences) over different goods. For the same price, some consumers prefer good *A* (e.g. Lucky Strike), while other consumers prefer good *B* (e.g. Camel).
- **Vertical product differentiation** means that consumers have the same tastes over quality: for instance, consumers may agree that product *A* is better than product *B*, and if these two products had the same price all consumers would buy *A* and nobody would buy *B*. However, if product *A* is more expensive, only a subset of consumers is willing to pay for the 'quality premium'.

- 5.7 In this section, I focus on horizontal product differentiation. However, I use an analytical framework that allows for the analysis of both horizontal and vertical product differentiation, which I also use later to analyse vertical product differentiation. This framework was first developed by the economist Kelvin Lancaster in his 1966 paper "A New Approach to Consumer Theory".⁴³
- 5.8 Lancaster observed that consumers value the characteristics embedded in the products, rather than the products themselves. For instance a meal embeds at least two characteristics: nutritional values and taste. Two meals, such as a steak and sushi, differ because they deliver different amounts/values of these characteristics. Further, a meal in a restaurant differs from the (otherwise) same meal at home, as they differ among other things in the nature of social interaction.
- 5.9 In such a framework, products are simply collections of characteristics and are unique only insofar as they provide a unique combination of characteristics. This framework provides a convenient basis for the analysis of the impact of the proposed regulation.
- 5.10 To provide an intuitive formalisation of Lancaster's framework, I consider the UK market for cigarette with n product varieties (Marlboro red, Lucky Strike, ...), where each product is typified by m possible characteristics (taste and brand etc.).⁴⁴
- 5.11 In what follows I first characterise products and product differentiation, and then discuss consumers' preferences.

⁴³ See Lancaster, K. J. (1966) "A new approach to consumer theory", *The Journal of Political Economy*, Vol. 74, No. 2.

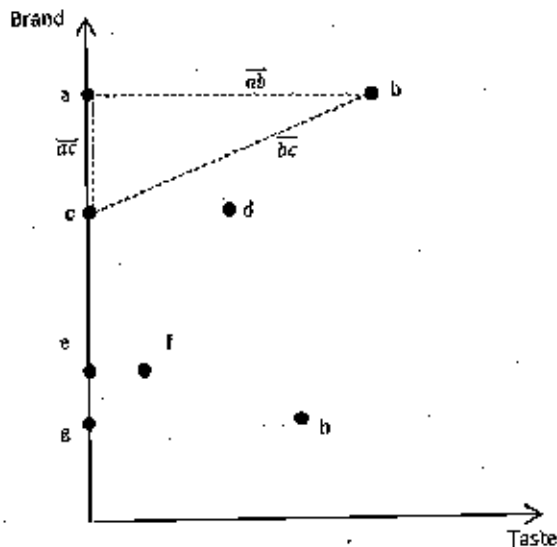
⁴⁴ Mathematically this may be representable as a collection of n points in an m -dimensional space.

Products and product differentiation

- 5.12 To make the exposition simpler, I assume that cigarette products only differ with respect to two characteristics: brand and taste (e.g. stronger versus weaker). This can be thought of as the subset of products that only differ along these two dimensions, and are otherwise equivalent (i.e. they have the same nicotine content, same additives, same pack size, etc.).
- 5.13 This simplified world is represented in Figure 1, where cigarette varieties are represented as points in this two-dimensional space.
- On the horizontal axis, cigarettes are ordered according to their taste: cigarettes to the left have a weaker tobacco taste than cigarettes to the right.
 - On the vertical axis, cigarettes are ordered by branding: two adjacent brands are perceived as more similar than two brands that lie far from each other. For instance, products that lie higher in the product space can be thought of as more strongly branded products, while products that lie lower are less branded products.⁴⁵ While branding is a complex concept, for expositional purposes I assume that each brand is valued by smokers in a different way. I also assume that smokers have heterogeneous preferences, meaning that different smokers may prefer different brands (horizontal differentiation). For clarity, I am not addressing here the quality difference between premium and non-premium brands. That issue relates to vertical (as opposed to horizontal) differentiation and I will address it in Section 7.
- 5.14 In Figure 1, product *a*, *c*, *e*, and *g* represent weak tasting products, while product *b*, *d*, *f*, and *h* have a stronger taste. Also, all brands supply both a strong tasting and a weaker tasting variant. For instance, products *a* and *b* share the same brand and thus lie at the same height in the graph.

⁴⁵ Points in the horizontal axis, not shown in the figure, would represent unbranded products.

Figure 1: Product varieties in a two-characteristic world

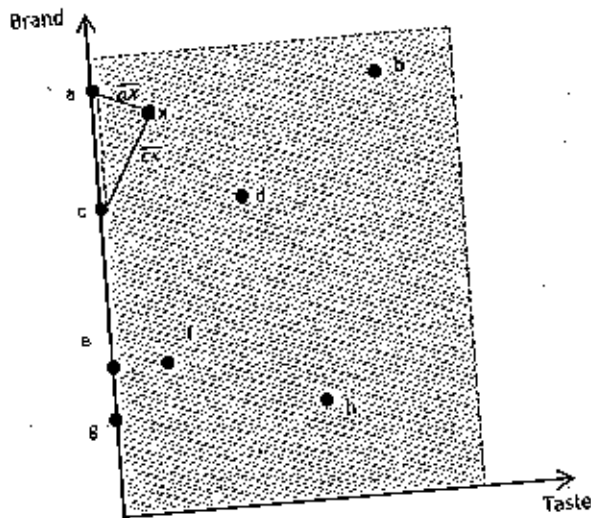


- 5.15 Drawing on the spatial differentiation literature, it is easy to supplement this formulation with a notion of distance: intuitively, the further two products in this space lie from one another, the more differentiated they are.
- 5.16 In the example above, products *a* and *c* are more similar to each other than they are to product *b*. Graphically, this translates to their distance \overline{ac} being smaller than the distance between *a* and *b* (\overline{ab}) and also smaller than the distance between *b* and *c* (\overline{bc}).

Consumers' preferences

- 5.17 All else equal, each consumer buys the product that is more similar to his 'ideal' product, meaning the product that provides his/her ideal combination of characteristics. Each consumer can then be positioned in the product space according to his ideal product. For instance, if the consumer's ideal product is *a*, the consumer would be represented as a point coinciding with the product *a*.
- 5.18 Different smokers have different preferences over cigarette varieties, and as a result the market for cigarettes is characterised by a strong market-wide 'preference for variety'.
- 5.19 This preference for variety is represented in Figure 2 where I assume that consumers are distributed evenly over the whole product space, as represented by the green rectangle. The product space represents the set of all possible combinations of characteristics, i.e. the space of all potential products.

Figure 2: Consumers' ideal products



- 5.20 If products *a* and *c* had the same price, a consumer located at *x* (i.e. with preferences for brand and taste given by point *x*) would buy product *a* since it is closer to his ideal product than product *c* is. This is reflected in the distance between *a* and *x* (\overline{ax}) being smaller than the distance between *c* and *x* (\overline{cx}).
- 5.21 This simple geometric framework proves useful for analysing the impact of the proposed legislation. In what follows, I discuss the effects of increased homogeneity.

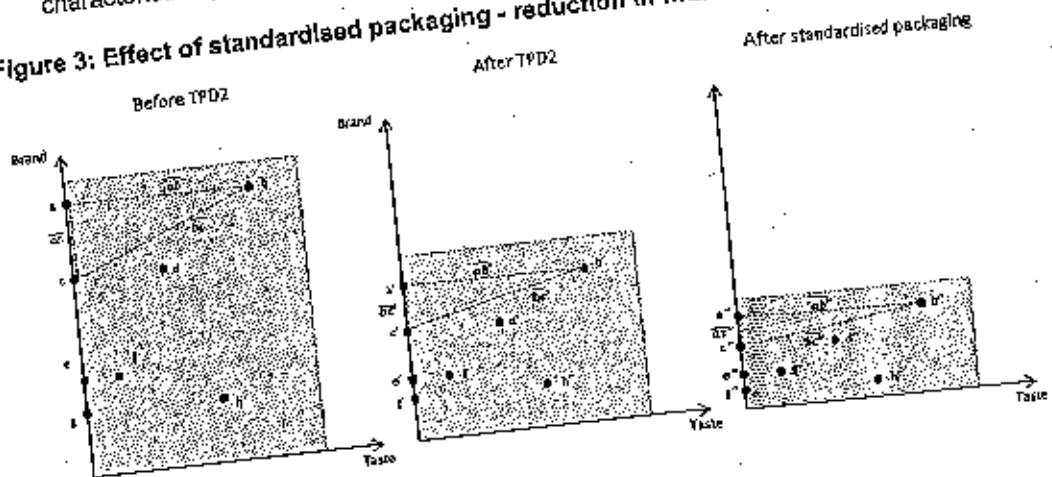
Increased homogeneity

- 5.22 As discussed in paragraph 5.3 above, standardised packaging introduces various regulations that will have the impact of increasing homogeneity.
- 5.23 The sum effect of these regulations is to severely restrict the degree of differentiation of cigarette products in the eyes of the smokers.
- 5.24 For expositional simplicity, in what follows I focus on the severely reduced scope for branding. However, any regulation that results in increased homogeneity would have similar effects that differ in degree depending on the level of homogeneity imposed by the regulation.

5.25 In the Lancaster framework, the inability of manufacturers to communicate to consumers the distinguishing characteristics of their products – e.g. by branding or by displaying factual information on the packet – results in a contraction of the product space. This may happen through a reduction in the ability of manufacturers to differentiate their products along one dimension (e.g. lower scope for branding), as illustrated in Figure 3.

- The left hand side figure represents the market before the implementation of TPD2 or standardised packaging. The blue rectangle represents the feasible product space, i.e. where manufacturers can position their products in terms of branding and taste. If a manufacturer increases the branding of its product, it effectively moves the product upwards; if it increases how strongly its product tastes, it moves the product to the right. I assume for simplicity that the product space is bounded, e.g. there is a limit to feasible brand strength.
- The middle and right hand side figure respectively represent the market once further regulations contained in TPD2⁴⁶ and standardised packaging reduce the scope for brand differentiation. The feasible product space is compressed and manufacturers need to reposition their product in the market.⁴⁷ For instance, product *a* is repositioned at *a'*. Note that *a'* is effectively a different product than *a* because it embeds different characteristics (in this case less branding).⁴⁸

Figure 3: Effect of standardised packaging - reduction in maximum differentiation



⁴⁶ As well as the small business retail display ban scheduled to go into effect in 2015.

⁴⁷ I note that while the axis denoting the strength of the tobacco taste of cigarette brands will not be compressed by TPD2, other product variety dimensions such as flavour will additionally be collapsed.

⁴⁸ It is important to emphasise that in this section I do not address the issue of vertical differentiation among premium and non-premium brands, but rather the issue of horizontal differentiation between different brands within one category. I will address vertical differentiation in Section 7.

- 5.26 The effect of severely restricting the scope for branding is twofold:
- First, some smokers are no longer able to consume a product as close to their ideal as before. For instance, smokers who like more information about the characteristics of their products as conveyed by branding are worse off because the scope for delivering product information through branding is reduced.
 - Second, differentiation among products is reduced. For instance, product a and product c become more similar, as captured by the fact that their distance is reduced (i.e. $\overline{a^*c^*} < \overline{ac}$).
- 5.27 The first effect impacts smokers directly. The second effect affects smokers indirectly through its impact on the competitive interaction among companies. This effect is indirect because it affects consumers via a change in prices.
- 5.28 The purpose of Section 6 is to analyse the nature of these effects in more detail and to use a standard model of competition from the industrial organisation literature to make predictions about the impact of increased homogeneity on prices, quantities, consumer surplus and producer surplus.

Conclusions

- 5.29 I have discussed an analytical framework that allows me to analyse the economic effects of the regulatory effects of standardised packaging.
- 5.30 The economic nature of the standardised packaging regulation is to increase homogeneity. The effects of increased homogeneity are as follows:
- The number of product characteristics along which products differentiate (m) does not change. However, the scope for differentiation along one or more dimensions is reduced.
 - Products become more similar.
- 5.31 I will analyse the static effect of increased homogeneity, both horizontal and vertical, in Section 6 and Section 7. I analyse the dynamic effects of the regulation in Section 8.

Section 6

Static effects of increasing horizontal homogeneity

- 6.1 In the previous section I discussed the effects of the proposed standardised packaging regulation, in particular the effect of increasing the homogeneity of cigarettes.
- 6.2 I have also shown, using an analytical framework developed by the economist Kelvin Lancaster, that increased homogeneity will produce a two-fold effect on consumers:
- **A direct effect**, which is the result of manufacturers supplying less differentiated products. For instance, total standardisation of cigarette packaging reduces the scope for branding. As a result, smokers who have a taste for more information about the characteristics of their products as conveyed through the brands are worse off.
 - **An indirect effect**, which arises from the impact of product repositioning on the pricing incentives of the manufacturers.
- 6.3 In this section I propose a framework that allows me to analyse the two effects in isolation. Using this framework, I discuss the results of the Salop (1979) model,⁴⁹ which is a standard economic model of product differentiation.
- 6.4 I conduct the analysis in two steps. First, I analyse the effect of the standardised packaging regulation before any offsetting tax increase (i.e. a tax increase to restore prices to their pre-regulation level). Second, I analyse the effect of standardised packaging after an offsetting tax increase (i.e. with prices restored to their pre-regulation level). Since I understand Chantler and the Impact Assessment envisage such a tax increase, I view the first step as an intermediate stage of the analysis and the second step as a prediction of the likely outcome of the regulation.

⁴⁹ See Salop, S. C. (1979) "Monopolistic competition with outside goods", *The Bell Journal of Economics*, Vol. 10, No.1.

- 6.5 At the first step, I show that reduced horizontal product differentiation produces more intense price competition which boosts consumption, contrary to the health objectives of the standardised packaging initiative outlined in the Department of Health's Impact Assessment.⁵⁰ The effect on consumer surplus is ambiguous, and producer surplus is reduced, with consequential negative impacts on investment in innovation and quality. Moreover, these effects are incremental over the effects of existing regulations, and therefore more significant than they would be in the absence of these existing regulations.
- 6.6 At the second step, I show that any offsetting tax increase would unambiguously reduce consumer welfare, as consumers either turn to legitimate cross-border trade or illicit trade or pay the same as the pre-regulation level for an inferior product (each of these options offering lower utility than consumers would obtain absent the regulation).

The 'variety effect' and 'price effect' of increased homogeneity

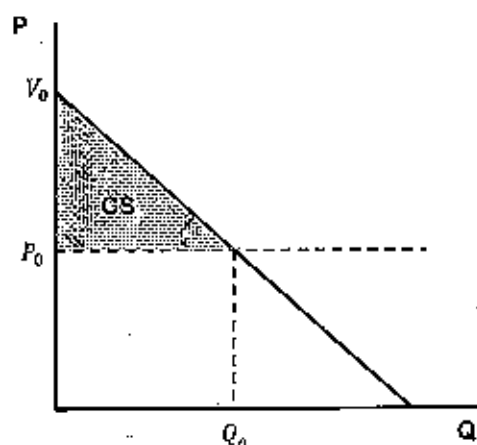
- 6.7 When analysing the effects of increased homogeneity on market outcome I will distinguish between the direct (or 'variety') effect and the indirect (or 'price') effect. In order to analyse the two effects in isolation, I use the concept of consumer surplus. In what follows,
- I first discuss the concept of consumer surplus.
 - I then analyse the variety effect.
 - I finally analyse the price effect.

The concept of consumer surplus

- 6.8 The concept of consumer surplus is illustrated in Figure 4 below.

⁵⁰ See Impact Assessment, p. 1.

Figure 4: Illustration of consumer surplus



- 6.9 The diagonal blue line illustrates a market demand curve for a determined product (e.g. a strongly branded product). The demand curve is defined as the consumers' valuation of (or willingness to pay for) the product. This curve slopes downwards. There is a certain price – V_0 – above which nobody wants to buy the product. That price is the maximum valuation for the product and lies at the intersection between the demand curve and the vertical axis. At prices slightly below V_0 , a few customers (those who value the product very highly) are willing to buy the product, and a few sales are made. As price falls, subsequently more customers (with lower valuations) purchase the product and more sales are made.
- 6.10 The red line indicates the price that would be charged in equilibrium (P_0). The intersection with the demand curve shows the quantity sold at this price (Q_0).
- 6.11 Many of the customers that buy the product at P_0 would actually be willing to pay a higher price. This is implied by the fact that, to the left of quantity Q_0 , the demand curve lies above the line indicating the P_0 price. A customer that values the product more highly than the price that he pays for it enjoys a surplus. The aggregate consumer surplus of the customers that purchase the product at price P_0 is given by the area of the shaded triangle *CS* between the demand curve and the P_0 price level.

- 6.12 The consumer welfare effect (i.e. the impact on consumer surplus) of homogenisation can be measured with a theoretical construct known as Compensating Variation ("CV").⁶¹ The intuition for the CV is the following: if homogenisation reduces consumer welfare, consumers would prefer not to have it, unless they are compensated with a sufficient amount of money (e.g. €100 per consumer). The minimum compensation that consumers are willing to accept to allow homogenisation therefore represents their welfare loss from homogenisation. The CV represents the negative of that minimum compensation (e.g. -100€ per consumer) and can therefore be expressed as follows:

$$CV = (E(P_0, V_0, CS_0) - E(P_1, V_1, CS_0))$$

- 6.13 This expression represents the difference between two levels of expenditure: (i) consumers' total level of expenditure before homogenisation (the first term on the right hand side) and (ii) the level of expenditure consumers would need to have after homogenisation in order to achieve the same level of consumer surplus they enjoyed before the regulation (the second term on the right-hand side).
- 6.14 The first term on the right-hand side of the expression above (i.e. $E(P_0, V_0, CS_0)$) represents the actual pre-regulation⁶² expenditure (E) of consumers. In this term, P_0 represents the pre-regulation prices of all products; V_0 represents the pre-regulation consumers' valuation of all products; and CS_0 represents the pre-regulation consumer surplus.
- 6.15 The second term on the right-hand side (i.e. $E(P_1, V_1, CS_0)$) represents the amount consumers would have to spend after the regulation has changed prices (P_1) and the consumers' valuation of the products (V_1). In order to obtain the same level of consumer surplus they enjoyed before the regulation (CS_0).
- 6.16 If the second term is larger than the first term, this implies that consumers need to spend more money after the regulation than they spend before the regulation in order to achieve the same level of consumer surplus. The difference in expenditure levels is therefore the monetary compensation that would allow consumers to keep their welfare unchanged following the regulation. In other words, the difference in the expenditure levels represents the change in consumer welfare produced by the regulation.

⁶¹ See Mas-Colell, A., Whinston, M., and Green, J. (1995) "Microeconomic Theory", Oxford University Press, New York, p.82.

⁶² In this section I refer to "regulation" as increased homogenisation.

- 6.17 The CV can be decomposed into two parts that can be analysed separately: a variety effect ('VE') and a price effect ('PE').⁵³ The decomposition of the CV into a VE and a PE is a theoretical artefact that allows me to illustrate the various forces that produce the final effect of the regulation on the market outcome. Neither of VE and PE should thus be used in isolation to assess the impact of standardised packaging. It is only their combined effect that is observed in the market.

The variety effect

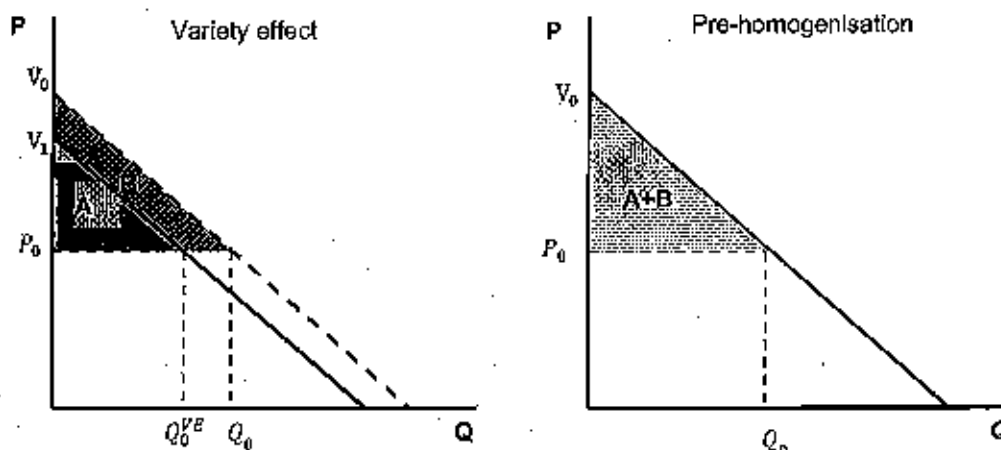
- 6.18 For a regulation that increases product homogeneity, the VE represents the direct change in consumer welfare due to the reduced product differentiation, and abstracts from any effects homogeneity may have on prices. The VE can be expressed formally as:

$$VE = (E(P_0, V_0, CS_0) - E(P_0, V_1, CS_0))$$

- 6.19 The VE is the difference between two levels of expenditure: (i) the actual pre-regulation expenditure; and (ii) the amount consumers would need to spend after the regulation to obtain the pre-homogenisation consumer surplus if prices did not change.

- 6.20 Figure 5 illustrates the VE on consumer welfare.

Figure 5: Variety effect of increased homogeneity



- 6.21 The right hand side diagram illustrates the demand and the consumer surplus pre-regulation. The left hand side diagram illustrates the change in demand that arises as a result of homogenisation. In this figure, homogenisation directly reduces the valuation of consumers for the product. This is represented as an inward shift of the demand curve.

⁵³ Formally, $CV = VE + PE$.

6.22 Ignoring any price effect, the VE:

- Reduces consumption from Q_0 to Q_0^{VE} . This is only a partial effect of increased homogeneity. As discussed below, increased homogeneity also increases consumption through a price reduction (PE). As I show later using the Salop model, the sum effect of increased homogeneity is an increase in consumption.
- Reduces consumer welfare by the area B.

The price effect

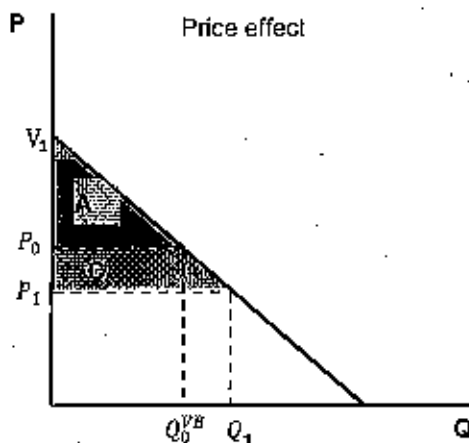
6.23 By changing the competitive interaction among manufacturers, increased homogeneity also affects prices. The PE represents the change in consumer welfare due to the price reaction of manufacturers to increased homogeneity. The PE can be expressed formally as:

$$PE = (E(P_0, V_1, CS_0) - E(P_1, V_1, CS_0))$$

6.24 The PE is the difference between (i) the amount consumers would need to spend after the regulation to obtain the pre-homogenisation consumer surplus if prices did not change, and (ii) the amount consumers would need to spend after the regulation to obtain the pre-homogenisation consumer surplus (considering that prices will change).

6.25 The PE on consumer welfare is shown in Figure 6, where I assume that prices reduce from P_0 to P_1 following the regulation.

Figure 6: Price effect of increased homogeneity



6.26 Most economic models of product differentiation predict that increased homogeneity reduces prices. This can be explained as follows.

- 6.27 A manufacturer takes into account two factors for its pricing decision: the marginal benefit and the marginal cost of increasing the price of its product.
- The marginal benefit is approximately the increase in revenues from the customers that keep buying its product.
 - The marginal cost is the lost profits on customers that decide to switch to other products.
- 6.28 If products become more homogeneous more customers would switch away after a price increase, which implies that the marginal cost of increasing prices is higher. Therefore homogenisation produces lower prices.
- 6.29 In Figure 6 above, the PE:
- Increases consumption from Q_0^{YB} to Q_1 ; and
 - Increases consumer welfare by the area C .
- 6.30 The overall effect of increasing homogeneity on consumer surplus (combining the VE and the PE) is thus $C - B$.
- 6.31 This reflects the fact that consumers are made worse off from the reduction in variety (keeping prices unchanged), but are made better off by the reduction in prices due to more intense competition between homogeneous products.
- 6.32 In what follows, I analyse the relative size of these effects using a standard economic model of competition with product differentiation. This model allows me to isolate the VE and the PE and also to come to conclusions about the overall effects of increased homogeneity on prices, quantities, consumer surplus and producer surplus (profits).

Salop model

- 6.33 Hotelling (1929)⁵⁴ developed a model of duopoly with horizontal product differentiation, where the degree of differentiation between the products is captured by the distance between these two products in the product space. The similarity with the Lancaster framework I presented in the previous section is stark. The only difference is that, in Hotelling, products are only differentiated along one characteristic.

⁵⁴ See Hotelling, H. (1929) "Stability in Competition," *Economic Journal*, Vol. 39.

- 6.34 Salop (1979) is a generalisation of the Hotelling model and allows for the analysis of industries characterised by more than two competitors. In what follows I analyse the effect of increased homogeneity using the Salop model, which allows for more flexibility. The Salop model analyses a market with n manufacturers, each owning one brand, and each selling one variety of this brand. For the analysis of homogenisation, however, it suffices to use a simpler duopoly model, i.e. the Salop model with $n = 2$. This is because the qualitative effects of increasing homogeneity do not depend on the number of companies competing in the market as long as there are at least two.
- 6.35 In the Salop model, consumers' preferences are characterised as follows. Each consumer has an 'ideal' product. Everything else equal – consumers prefer to consume the product that is closest to his 'ideal' product.
- 6.36 In the traditional Salop model, each consumer has a unit inelastic demand. This means that he only consumes one unit of the product he decides to buy. In this set-up therefore total demand is constant (i.e. it does not depend on prices) and competition determines how the demand is split among suppliers.⁶⁵
- 6.37 As the effect of homogenisation on total demand is relevant for the assessment of the economic effects of standardised packaging, I have modified the Salop model to include endogenous quantity choice so that I can use the model to examine the implications for quantity consumed.
- 6.38 In this model, each consumer incurs a cost of buying a good that is far from his 'ideal' product. This is modelled as a transportation cost: the farther the purchased good is from the 'ideal' good, the larger the cost. This cost can thus be interpreted as a 'disutility' of consuming a good for which the consumer has low valuation.
- 6.39 Consumers take two decisions:
- First, they decide which product to buy, based on their preferences and on prices.
 - Second, they decide how much of that product to buy, based on its price.
- 6.40 Increased homogeneity is analysed in this model by imposing a maximum distance among the products. When products lie closer in the product space, they are more similar in the eyes of consumers (i.e. consumers incur a similar transportation cost to buy one or the other product).
- 6.41 I have summarised the effects of homogenisation in this model below, before any offsetting tax increase is introduced. The more detailed analysis is presented in Annex C.

⁶⁵ I note that this aspect of the model has been relaxed in my analysis of the effects of standardised packaging. The model employed allows consumers to decide both which brand to consume, and how much. For more discussion see Annex C.

Variety effect

- 6.42 When price effects are ignored, increasing homogeneity reduces consumer surplus. The intuition is as follows.
- 6.43 Increasing homogeneity implies that products are re-allocated in the product space. A reallocation of the products implies that:
- Some consumers are better off. These are consumers whose 'ideal' product lies closer to the re-allocated products than it lies to products before the re-allocation.
 - Some consumers are worse off. These are consumers whose 'ideal' product lies further from the re-allocated products than it lies to products before the re-allocation.
- 6.44 The total disutility of consumers who are worse off is larger than the total utility of consumers who are better off. Intuitively this is because the market appetite for variety is less satisfied when products are more homogeneous.
- 6.45 While the VE reduces consumer surplus, it does not have any effect on total consumption, as the decision of how much to consume is predicated only on the price level which, by construction, is not considered when analysing the VE.
- 6.46 By the nature of tobacco products, this is realistic: reducing horizontal product differentiation has a direct negative effect on consumer welfare for the reason explained above, but is not expected to change their smoking behaviour. However, a price increase (decrease) may induce smokers to scale down (scale up) consumption as a result of budget constraints.

Price effect

- 6.47 This model predicts that prices decrease as homogeneity increases. This is a standard result of economic theory. At the extreme, when all ability to differentiate is removed and products become identical, the firms compete down to marginal costs.⁵⁶
- 6.48 The reduction in prices produces an increase in consumption, leading to a gain in consumer welfare.

⁵⁶ Identical products can only differentiate themselves via their prices. As a result, whichever product undercuts the other in price, even if only marginally, captures the entire available market. Thus firms compete down to their minimum price, the marginal cost of producing the good.

Overall effect on prices, quantities, consumer surplus and profits

- 6.49 Finally, I can use the Salop model to analyse the overall effect (combining the VE and PE) of homogenisation on prices, quantities, consumer surplus and producer surplus (profits), before any offsetting tax increase is introduced.
- 6.50 **Prices.** As discussed above, since standardised packaging reduces companies' ability to differentiate their products, price competition intensifies leading to a price reduction.
- 6.51 **Quantities.** In the modified Salop model, consumption increases following the decrease in prices.
- 6.52 **Consumer surplus.** Homogenisation produces two opposite effects on consumer surplus.
- The VE reduces consumer surplus due to an increase in the expected distance between consumers' ideal products and the products supplied in the market.
 - The PE increases consumer surplus by boosting consumption.

Overall, the change in consumer surplus in response to an increase in homogeneity is ambiguous. As differentiation decreases, consumers incur a 'disutility' of consuming less differentiated goods for which they have low valuation. This disutility is modelled as a transportation cost that each consumer incurs when the purchased good is far from the 'ideal' good. On the other hand, the price decrease that arises from more intense competition boosts consumption increasing consumer surplus but undermining the stated health objective. If the transportation cost is high (meaning that consumers have strong preferences for the product they consume before the regulation), the variety effect dominates and surplus falls. If it is low, the price effect dominates.

- 6.53 **Profits.** Profits decrease. This is the consequence of more intense price competition. The decrease in profits following homogenisation is intuitive: If companies were able to increase profits by lowering prices they would have done it even in the absence of homogenisation.

- 6.54 **Offsetting tax changes.** The preceding analysis assumes no regulatory response to the predicted decrease in price. To the extent that tax duties increase (for a more detailed discussion, see my analysis in Section 10) this would unambiguously reduce consumer welfare. This is because consumers have two options. First, they could turn to legitimate cross-border trade or illicit trade. However, this must offer lower consumer surplus, otherwise they would already have chosen this option pre-regulation.⁵⁷ Second, they could pay the same for an inferior product (i.e. pay the pre-regulation price for the homogenised product). Furthermore, with an offsetting tax increase the incentives for illicit trade and cross-border trade will be unambiguously higher (since legitimate trade in the UK will offer a homogenised product for the same price and is therefore unambiguously inferior to what was available before). Finally, firms' profits will remain lower due to the increased intensity of price competition and would be further suppressed by legitimate cross-border shopping and illicit trade.

Conclusions

- 6.55 In this section I have shown that homogenisation makes consumers worse off by reducing the variety of products but better off due to the lower prices that result from the fiercer competition that arises when products are more similar to each other.
- 6.56 I have used a model of competition to analyse the overall effects of homogenisation (i.e. analysing the VE and PE together). I find that before any offsetting tax increases consumption increases, contrary to the health objectives of the standardised packaging initiative, that firm profits decrease, and that consumer surplus can increase or decrease, implying a potential distortion of competition in the market, as defined in paragraphs 4.11-4.22.
- 6.57 Moreover, since these effects are incremental over the effects of existing regulations, including the yet-to-be implemented TPD2 and the small retail store display ban, they are more significant than they would be in the absence of these existing regulations.
- 6.58 Any offsetting tax increase would unambiguously reduce consumer welfare, as consumers either turn to legitimate cross-border trade or illicit trade or pay the same as the pre-regulation level for an inferior product (each of these options offering lower utility than consumers would obtain absent the regulation).

⁵⁷ This result comes from the economic concept of revealed preference: if a consumer chooses option A over option B when both options are available, we can infer that option A offers higher consumer surplus.

Section 7

Static effects of increasing vertical homogeneity

- 7.1 In Section 5 I have defined products as a collection of characteristics, and explained that consumers care about the characteristics embedded in the products rather than the products themselves.
- 7.2 I have then shown that consumers have different preferences over these characteristics, so that, for instance, some consumers prefer more strongly tasting cigarettes than others. I have explained that different preferences give rise to horizontal product differentiation. I have then analysed the effects of homogenisation, i.e. a reduction in horizontal product differentiation in Section 6.
- 7.3 In this section, I analyse the effects of standardised packaging on vertical product differentiation. Vertical product differentiation means that all consumers have the same preferences along a certain characteristic, which is usually associated with quality. For instance, everybody prefers faster microprocessors to slower microprocessors, or safer cars to less safe cars.
- 7.4 In the case of cigarettes, smokers see premium brands as more valuable than non-premium brands. As a result, if two varieties had the same characteristics (e.g. in terms of taste, nicotine content, etc.) and the same price, but one is premium brand and the other is non-premium brand, all smokers would buy the premium brand.
- 7.5 As discussed in Section 5, standardised packaging severely restricts the scope for branding. Reduced branding affects smokers' perception of the quality difference between premium and other brands. In particular, I expect that manufacturers' ability to differentiate premium from other brands decreases. Thus, standardised packaging directly reduces the scope for manufacturers to compete in the quality dimension. Moreover, these effects should be understood as incremental over the effects of existing regulations.

7.6 In what follows,

- I first discuss the analytical framework I use to discuss the effects of reducing vertical differentiation. This framework is essentially an extension of the framework I used in Section 5 and Section 6 to analyse horizontal differentiation.
- I then use this framework to decompose the total effect in a 'quality effect' and a 'price effect'.
- I finally discuss these two effects, using an economic model of vertical differentiation.

7.7 As in my analysis of reduced horizontal product differentiation, I conduct the analysis of reduced vertical product differentiation in two steps. First, I analyse the effect of the standardised packaging regulation before any offsetting tax increase (i.e. a tax increase to restore prices to their pre-regulation level). Second, I analyse the effect of standardised packaging after an offsetting tax increase (i.e. with prices restored to their pre-regulation level). Since I understand Chantler and the Impact Assessment envisage such a tax increase, I view the first step as an intermediate stage of the analysis and the second step as a prediction of the likely outcome of the regulation.

7.8 At the first step, I show that reduced vertical product differentiation produces more intense price competition which boosts consumption, contrary to the health objectives stated in the Department of Health's Impact Assessment.⁵⁶ The effect on consumer surplus is ambiguous, and producer surplus is reduced with consequential negative impacts on investment in innovation and quality. Moreover, these effects are incremental over the effects of existing regulations, and therefore more significant than they would be in the absence of these existing regulations.

7.9 At the second step, I show that any offsetting tax increase would unambiguously reduce consumer welfare, as consumers either turn to legitimate cross-border trade or illicit trade or pay the same as the pre-regulation level for an inferior product (each of these options offering lower utility than consumers would obtain absent the regulation). Firms' profits will remain lower due to the increased intensity of price competition and would be further suppressed by legitimate cross-border shopping and illicit trade.

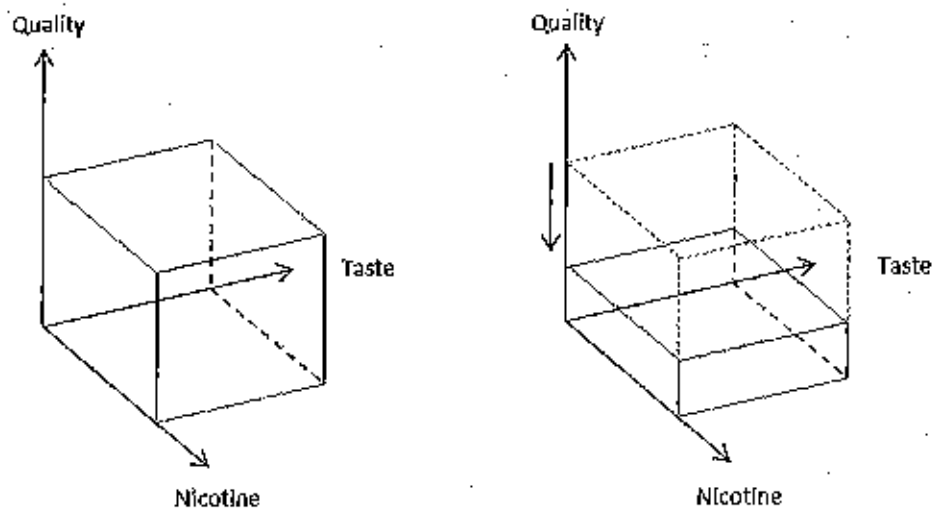
Analytical framework

7.10 In order to analyse the impact of standardised packing on vertical differentiation, I use the same analytical framework that I have used in Section 5 and Section 6. In particular, I extend that framework to allow for products to be differentiated along a quality characteristic. This is shown in Figure 7.

⁵⁶ See Impact Assessment, p. 1.

- 7.11 The left hand side diagram illustrates the market before the implementation of standardised packaging. Products are differentiated along three characteristics, and the product space is represented as a box. The base of the product space represents horizontal differentiation: cigarettes are differentiated due to different levels of nicotine content and to different taste strengths, and people have different preferences over these two characteristics.
- 7.12 However, in Figure 7, cigarettes are also differentiated by a quality characteristic (the vertical axis). Quality increases as we go from 'non-premium' to 'premium' brands. All consumers value quality, and therefore the consumers' 'ideal' products sit in the top rectangle of the product space: for any given level of taste and nicotine content, smokers prefer premium to other lower quality brands.

Figure 7: Change in the degree of vertical product differentiation



- 7.13 The effect of standardised packaging is to reduce the smokers' awareness of the product quality. I refer to this effect as "increased vertical homogeneity" (or "vertical homogenisation"). This is represented on the right hand side diagram by a compression of the product space towards lower perceived quality.

7.14 Vertical homogenisation has three effects:

- **Short-term quality effect.** This is the direct effect on consumer surplus that arises from a reduction in smokers' valuation of premium brands.
- **Price effect.** The reduction in vertical differentiation affects the competitive interaction among businesses and thus their pricing incentives. In particular, since the ability to compete in quality is reduced, higher-quality brands would be priced more aggressively.
- **Long-term quality effect.** The above effects may reduce the profitability for companies of investing in higher-quality brands. As a result, companies may be discouraged from investing in quality.

7.15 The first two effects are the equivalent of the 'variety effect' and the 'price effect' in the horizontal differentiation framework. I address both these effects in this section.

7.16 The third effect is a dynamic effect. I only address it partially in this section.⁵⁹

7.17 I analyse the short-term quality effect (henceforth 'quality effect') and the price effect in the next subsection.

The 'quality effect' and 'price effect' of increased vertical homogeneity

7.18 In order to measure the effect of increased vertical homogeneity on consumer surplus I again use the concept of Compensating Variation ('CV'). This represents the negative of the minimum compensation that consumers would be willing to accept to allow vertical homogenisation or, in other words, represents the change in consumer welfare produced by vertical homogenisation. The CV can be expressed as follows:

$$CV = (E(P_0, k_0, CS_0) - E(P_1, k_1, CS_0))$$

7.19 This expression represents the difference between two levels of expenditure: (i) consumers' total level of expenditure before vertical homogenisation (the first term on the right hand side) and (ii) the level of expenditure consumers would need to have after vertical homogenisation in order to achieve the pre-regulation⁶⁰ level of consumer surplus (the second term on the right hand side).

⁵⁹ In particular, I analyse the effect of reducing vertical homogenisation on the profitability of higher-quality products. I then use this result to fully analyse the 'long-term quality effect' in Section 8.

⁶⁰ In this section I refer to "regulation" as increased vertical homogenisation.

- 7.20 The first term on the right-hand side of the expression above (i.e. $E(P_0, k_0, CS_0)$) represents the pre-regulation actual expenditure (E) of consumers. In this term, P_0 represents the pre-regulation prices of all products; k_0 represents the pre-regulation 'quality premium', i.e. the extra value that consumers attach to the high-quality product; and CS_0 represents the pre-regulation consumer surplus.
- 7.21 The second term on the right-hand side (i.e. $E(P_1, k_1, CS_0)$) represents the amount consumers would have to spend after the regulation has changed prices (P_1) and the quality premium (k_1). In order to obtain the same level of consumer surplus they enjoyed before the regulation (CS_0), I assume that the regulation reduces the quality premium (i.e., $k_1 < k_0$).
- 7.22 If the second term is larger than the first term, this implies that consumers spend less money before the regulation than they will need to spend after the regulation to achieve the same level of consumer surplus as they receive before the regulation. The difference in expenditure levels is therefore the monetary compensation that would allow consumers to keep their welfare unchanged following the regulation. In other words, the difference in the expenditure levels represents the change in consumer welfare produced by the regulation.
- 7.23 I again decompose the CV into two parts: a quality effect ('QE') and a price effect ('PE').⁶¹

The quality effect

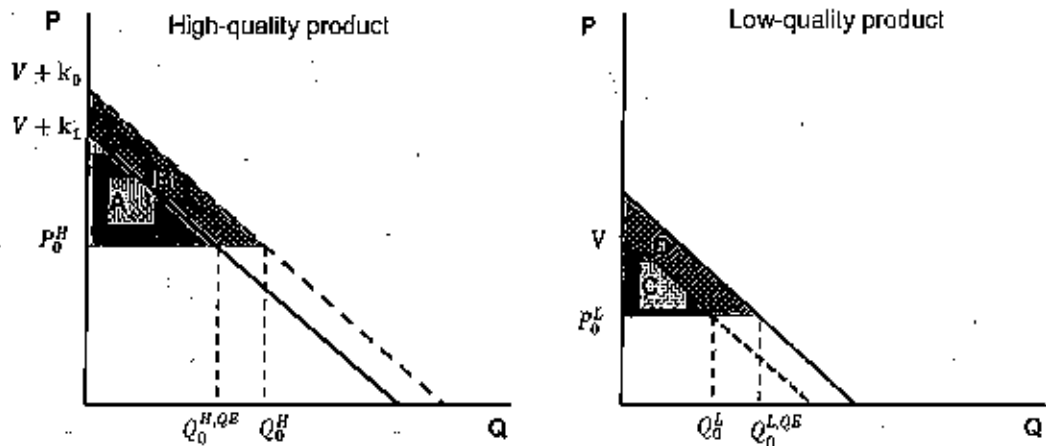
- 7.24 For a regulation that increases vertical homogeneity, the QE represents the direct change in consumer welfare due to the reduced perceived value of the high-quality product. The QE abstracts from any effects the regulation may have on prices, and can thus be expressed formally as:

$$QE = (E(P_0, k_0, CS_0) - E(P_0, k_1, CS_0))$$

- 7.25 The QE is the difference between two levels of expenditure: (i) consumers' total level of expenditure before vertical homogenisation; and (ii) the amount consumers would have to spend after the regulation in order to obtain the pre-regulation consumer surplus if prices do not change.
- 7.26 Figure 8 illustrates the VE on welfare.

⁶¹ Formally, $CV = QE + PE$.

Figure 8: Quality effect of increased vertical homogeneity



- 7.27 The left hand side diagram illustrates the market for the high-quality product. Initially, the consumer surplus is represented by the sum of the areas A and B. Vertical homogenisation directly reduces the valuation of consumers for the high-quality product, thus decreasing the demand for this product over lower quality products. This is represented as an inward shift of the demand curve. Post-regulation, the consumer surplus is reduced to the area A.
- 7.28 The right hand side diagram illustrates the market for the low-quality good. The initial consumer surplus is C. After vertical homogenisation, some consumers may be willing to substitute the high-quality with the low-quality product. If this happens, the demand for the low-quality good increases, and the consumer surplus increases to C + D.
- 7.29 Ignoring any price effect, the QE reduces consumer surplus by B - D.

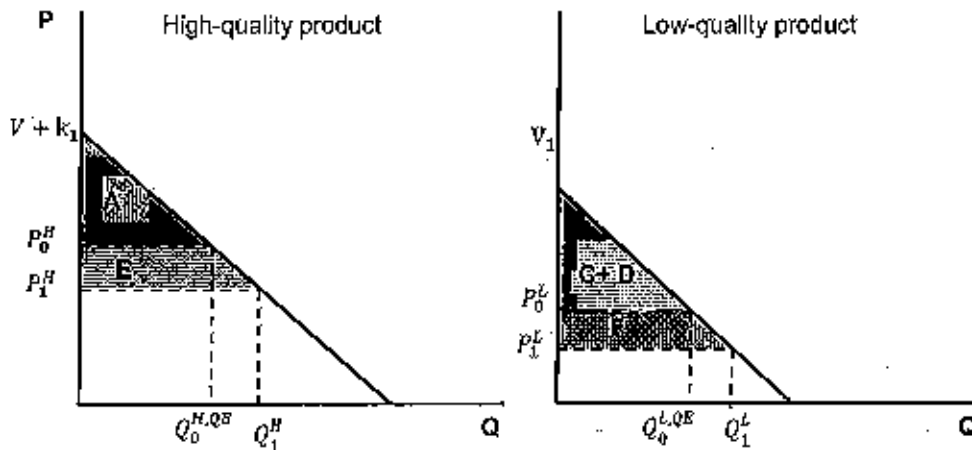
The price effect

- 7.30 By restricting competition in the quality dimension and causing vertical homogenisation, standardised packaging also changes the competitive interaction between manufacturers in the remaining dimension of competition (price). The PE represents the change in consumer welfare due to the price reaction of manufacturers to increased vertical homogeneity. The PE can be expressed formally as:

$$PE = (E(P_0, k_1, CS_0) - E(P_1, k_1, CS_0))$$

- 7.31 The PE is the difference between (i) the amount consumers would need to spend after the regulation to obtain the pre-regulation level of consumer surplus if prices did not change; and (ii) the amount consumers would need to spend after the regulation in order to obtain the pre-regulation consumer surplus (considering that prices change).
- 7.32 The PE on welfare is shown in Figure 9.

Figure 9: Price effect of increased vertical homogeneity



- 7.33 The left hand side diagram illustrates the market for the high-quality product. The price of the high-quality product decreases following the decrease in consumers' valuation of this product. This drop in price increases consumer welfare by the area E .
- 7.34 The right hand side diagram illustrates the market for the low-quality product. The post-regulation price for this product may also decrease because, as a consequence of vertical differentiation being suppressed by standardised packaging, price competition becomes more intense.
- 7.35 The PE thus increases consumer surplus by $E + F$.
- 7.36 The overall effect of increasing vertical homogeneity on consumer surplus (combining the QE and the PE) is thus $D + E + F - B$.
- 7.37 In what follows, I analyse the QE and the PE using an economic model of vertical integration developed by Motta (1993).⁶²

⁶² See Motta, M. (1993), "Endogenous Quality Choice: Price vs. Quantity Competition", *Journal of Industrial Economics*, Vol. 41.

Motta model of vertical differentiation

- 7.38 The model has been developed with the purpose of analysing the degree of vertical differentiation that markets provide under different market structures. For clarity, the model has not been used by Prof. Motta to analyse the welfare effects of an exogenous change in vertical differentiation. However, I find this model useful for the purpose of this report, because – contrary to most models of vertical differentiation – it allows for an analysis of the impact of quality on consumption.
- 7.39 In this model, two companies compete in the market. One of them sells a high quality product, and the other sells a low-quality product. Consumers have different willingness to pay for quality, for instance because they have different levels of income.
- 7.40 All consumers value the high-quality product more than the low-quality product. If the two products had the same price, all consumers would only buy the high-quality product. In equilibrium, the high quality product is more expensive than the low-quality product, and both are consumed.
- 7.41 Consumers may also decide not to buy any product in the legal market. This happens for consumers who have a low valuation of the products, if the price of the low-quality products is too high with respect to its quality. I note, however, that while these consumers may leave the legal market, this exit should not be construed as a cessation of consumption because they may still purchase in the illicit market.
- 7.42 I have summarised the effects of increasing vertical homogeneity (i.e. reducing the quality of the high-quality product), before any offsetting tax increase is introduced, below. The more detailed analysis of the model is presented in Annex D.

Quality effect

- 7.43 When price effects are ignored, increasing vertical homogeneity decreases consumer surplus. The intuition is as follows.
- 7.44 Increasing homogeneity lowers consumers' valuation of the high-quality good. This reduces the utility of consumers who, before the regulation, were consuming the high-quality good.
- Consumers who keep buying the high-quality good are worse off because their valuation of this product is lower.
 - Consumers who switch to the low-quality good are worse off by revealed preferences: they preferred the high-quality to the low-quality good before the regulation, but they switch to the low-quality good after the regulation.
- 7.45 The QE does not have any impact on the utility of consumers who, before the regulation, were consuming the low-quality good.

7.46 Overall, thus, the QE reduces consumer surplus and makes some customers switch from the high-quality to the low-quality product. Below I discuss how prices decrease as a result of intensified competition between the high- and the low-quality good, boosting consumption.

Price effect

7.47 As noted above, by restricting competition in the quality dimension and causing vertical homogenisation, standardised packaging also changes the competitive interaction between manufacturers in the remaining dimension of competition (price).

7.48 A reduction of the quality premium:

- Reduces the price of the high-quality product. This is a direct consequence of the fact that this product is less valuable.
- Reduces the price of the low-quality product. This is because price competition intensifies after the high-quality product partially loses its quality edge.

7.49 A reduction in the price of the low-quality product increases consumption by attracting new customers to the market.⁶³

7.50 The PE thus increases consumer welfare, since it decreases the price of both products and it increases total consumption.

Overall effect on prices, quantities, consumer surplus and profits

7.51 The overall effect (i.e. the combination of the QE and the PE) of increasing vertical homogeneity on prices, quantities, consumer surplus and producer surplus (profits), before any offsetting tax increase is introduced, is as follows.

7.52 **Prices.** As discussed above the prices of both the high-quality and the low-quality product decrease. This is because the high-quality product becomes more similar to the low-quality products, which intensifies competition.

7.53 **Quantities.** The overall consumption increases. This is the result of the fact that prices decrease.

7.54 **Consumer surplus.** Consumer welfare decreases via the negative QE (i.e. the loss of quality) and increases via the positive PE (i.e. the reduction in prices which increases consumption). The overall effect is ambiguous.

7.55 **Profits.** Profits of both companies decrease due to price competition being more intense as a result of standardised packaging suppressing vertical differentiation.

⁶³ While not captured by the model, I would expect that lower prices also increase consumption of existing consumers.

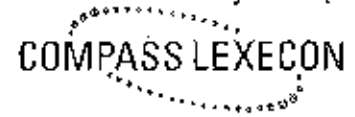
- 7.56 As discussed more in depth in Section 8, if standardised packaging reduces the profitability of offering high-quality products, businesses may also reduce their investments in quality.
- 7.57 **Offsetting tax changes.** The preceding analysis assumes no regulatory response to the predicted decrease in price. To the extent that tax duties increase (for a more detailed discussion, see my analysis in Section 10) this would unambiguously reduce consumer welfare. This is because consumers have two options. First, they could turn to legitimate cross-border trade or illicit trade. However, this must offer lower consumer surplus, otherwise they would already have chosen this option pre-regulation.⁶⁴ Second, they could pay the same for an inferior product (i.e. pay the pre-regulation price for the homogenised product). Furthermore, with an offsetting tax increase the incentives for illicit trade and cross-border trade will be unambiguously higher (since legitimate trade in the UK will offer a homogenised product for the same price and is therefore unambiguously inferior to what was available before). Firms' profits will remain lower due to the increased intensity of price competition and would be further suppressed by legitimate cross-border shopping and illicit trade.

Conclusions

- 7.58 In this section I have shown that increasing vertical homogeneity increases total consumption, contrary to the stated health objectives of standardised packaging as articulated by the Department of Health's Impact Assessment.⁶⁵
- 7.59 I have used a model of competition to analyse the overall effects of vertical homogenisation (i.e. analysing the QE and PE together). I find that, before any offsetting tax increases, consumption increases, contrary to the health objectives of the standardised packaging initiative, that firm profits decrease, and that consumer surplus can increase or decrease, implying a potential distortion of competition in the market, as defined in paragraphs 4.11-4.22
- 7.60 Moreover, since these effects are incremental over the effects of existing regulations, including the yet-to-be implemented TPD2 and small retail store display ban, they are more significant than they would be in the absence of these existing regulations.

⁶⁴ As noted previously, this result comes from the economic concept of revealed preference: if a consumer chooses option A over option B when both options are available, we can infer that option A offers higher consumer surplus.

⁶⁵ See Impact Assessment, p. 1.



7.61 Finally, any offsetting tax increase would unambiguously reduce consumer welfare, as consumers either turn to legitimate cross-border trade or illicit trade or pay the same as the pre-regulation level for an inferior product (each of these options offering lower utility than consumers would obtain absent the regulation).

Section 8

Dynamic effects

- 8.1 In this section I discuss the impact of standardised packaging on various other market outcomes, in particular the level of innovation, barriers to entry and illicit trade. I have labelled these effects "dynamic" as they are not captured by the static models of competition analysed in the previous sections.

Innovation

- 8.2 Innovation can take the form of product innovation (producing new varieties) or process innovation (reducing costs of production).
- 8.3 The level of innovation taking place within an industry will depend on the ability and incentives of firms to invest in innovation.

Ability to invest

- 8.4 There is a well-established literature in corporate finance that examines the relationship between cash flows and investment levels.
- 8.5 According to this literature, if capital markets are imperfect so that creditors have limited information on the quality of borrowers and their repayment capacity, internal finance constitutes the cheapest financing means, as the lack of perfect information regarding the financial capacity of borrowers makes financing investments through credit more expensive than using internal capital flows. Therefore, cash flows constitute the primary source of financing.
- 8.6 The empirical literature shows ample evidence of a positive and significant impact of cash flows on investment. Holding investment opportunities constant, firms with more cash flows invest more.
- 8.7 In previous sections, I showed that the considered regulation can be expected to cause profits to fall.⁶⁶ Therefore, I would expect cash flows to be lower and innovation, both product and process innovation, to be lower as a result.

⁶⁶ See paragraph 6.56 and paragraph 7.59.

Incentives to invest

- 8.8 Plainly, standardised packaging will severely restrict the incentives to invest in all aspects of products that it regulates, such as branding and aspects of packaging. It will also reduce the incentives to innovate in branding due to the diminished role of brand.
- 8.9 This is because it becomes nearly impossible for firms to communicate to consumers the existence of a novel innovation due to the strict regulation of standardised packaging.⁶⁷
- 8.10 Standardised packaging could, however, increase the incentives to invest in process innovation. This is because of my finding that price competition will be fiercer as a result of increased horizontal product homogeneity caused by standardised packaging.⁶⁸ Process innovations that enable a firm to reduce its marginal costs would therefore be more rewarding and the incentives to invest in process R&D correspondingly greater.⁶⁹ However, such process R&D by reducing marginal costs would reduce prices further and increase quantities consumed. This would be contrary to the stated health objective of standardised packaging as articulated by the Department of Health's Impact Assessment.⁷⁰

Conclusion

- 8.11 The regulations within standardised packaging have various implications for innovation over and above, and thus potentially more significant than, TPD2. Product innovation would be lower because (i) firms would have a lower ability to invest due to having reduced cash flows from which to fund R&D and (ii) firms would have a reduced incentive to invest as product innovations would be impossible to commercialise where the new products/product features are contrary to the standardised packaging regulation. This lower investment would reduce consumer welfare.

⁶⁷ Chantler noted that there is evidence that many product innovations were introduced just before the launch of plain packaging in Australia, suggesting that firms recognised the necessity of branding, and were seeking to establish their differentiation while they were still able (Chantler (2014), page 46).

⁶⁸ See paragraphs 6.27 to 6.28 for an explanation, and paragraph 6.56 for the result.

⁶⁹ This is because a reduction in differentiation increases the market share a firm can gain from a marginal reduction in price, and thus increases profitability of such innovations. To see this, consider a case where firms previously share the market by compelling prices down to marginal costs. If a process innovation allows one firm to reduce marginal costs, this firm captures the entire market.

⁷⁰ See Impact Assessment, p. 1.

- 8.12 Firms would also have a lower ability to engage in process innovation as they would have a lower ability to invest due to having reduced cash flows from which to fund R&D. Set against that, firms would have increased incentives to engage in process R&D due to intensified price competition. If the incentive effect dominates the ability effect, process innovation could increase. However, this would lead to a reduction in costs and in turn to a reduction in prices and thus to an increase in consumption, contrary to the health objectives of standardised packaging.

Entry and exit

- 8.13 In principle, the imposition of standardised packaging regulation could have an impact on entry.
- 8.14 However, given that the cigarette market in the United Kingdom has been shrinking over at least the last decade, while the issue of entry is a complex question, I consider entry to be relatively unimportant for the overall dynamics of this market.⁷¹ In any case, I consider the implications for entry are complicated and it would be hard to come to clear conclusions. Inter alia, entry may be harder due to it being more difficult (or impossible) for entrants to communicate their new product to consumers.
- 8.15 Therefore, I do not discuss the effects of standardised packaging on entry and instead focus on the more relevant effects of standardised packaging on market exit.
- 8.16 As discussed in Section 6 and Section 7, increased homogeneity is likely to severely restrict brand and quality competition and to intensify price competition, producing a commoditisation of tobacco products. Scale economies would thus become more important, increasing the risk of exit for smaller, relatively inefficient players.

Illicit trade and legitimate cross-border trade

- 8.17 As I noted in discussing the status quo, the UK cigarette market has a high level of illicit trade.⁷²
- 8.18 I would expect the level of illicit trade to depend on the ability and the incentives of those engaged in illicit trade to conduct such trade. The regulations I have been asked to consider only affect the incentives for illicit trade.

⁷¹ See <http://www.the-tma.org.uk/tma-publications-research/facts-figures/uk-cigarette-consumption>.

⁷² See Footnote 29.

Incentives to trade illicitly

- 8.19 The incentive to engage in illicit trade will directly increase as a result of standardised packaging. By suppressing the role of brand, standardised packaging will increase the rewards available to brands with illicit branding since they will capture more of the demand from smokers who have a preference for highly branded packs. Moreover, as a result of suppressing the role of brand, standardised packaging will also make cheap whites a closer substitute to legal cigarettes. This will increase the total rewards available to illicit trade in unbranded cigarettes.
- 8.20 On the other hand, as noted above, I have found that the increased horizontal homogeneity arising from standardised packaging will have the effect of reducing prices. Directionally, this would reduce the incentives on illicit traders because the profit margins available would be less. However, since illicit traders do not pay tax, the effect on the margin they can capture is likely to be small and I would expect the other effects above, which affect the size of the demand they can capture, to dominate.
- 8.21 Moreover, if taxes are increased to offset any reduction in prices that would otherwise occur any possible reduction in incentives as a result of lower prices will not materialise.

Cross-border trade

- 8.22 As explained in the previous sections of this report, given the restrictions to branding that standardised packaging presents, the nature of competition within the UK will change and become focused on price. This can be expected to have an impact on patterns of trade both within the UK and between the UK and Member States. Whilst branded packaging will no longer be available for sale legitimately in the UK, it will be available legitimately in EU Member States that have not adopted standardised packaging measures. This will lead to irregular patterns of sales and distortion of how competition would otherwise take place for the sale of cigarettes: the level of reduced ability to differentiate in the UK – with the resulting increase in price-based competition – will not necessarily be replicated in other Member States.
- 8.23 I also note that standardised packaging would increase the incentives of consumers to engage in legitimate cross-border trade to the extent that they valued the packaging itself. UK consumers may bring an unlimited amount of cigarettes back into the UK from other EU Member States, provided they transport the cigarettes themselves, the cigarettes are for personal use or a gift, and the duty and tax has been paid on the cigarettes in the Member State where they were acquired.⁷³

⁷³ <http://www.hmrc.gov.uk/customs/arriving/arrivingeu.htm>

8.24 A significant number of consumers seeking branded packets of cigarettes could therefore potentially result in a significant increase in cross-border shopping. In this regard I note that 90,478 coaches, 2,206,278 road haulage vehicles, 2,471,193 passenger cars and 12,753,343 passengers passed through the port of Dover in 2013.⁷⁴ Given this significant number of people already passing through Dover alone, the potential exists for a large number of consumers to increase their cross-border shopping levels, resulting in further distortion of current levels of trade in cigarettes between the UK and other Member States

Conclusions

8.25 The regulations within standardised packaging increase incentives to engage in illicit trade and legitimate cross-border trade and therefore, all else equal, I would expect these forms of trade to increase.

⁷⁴

<http://www.doverport.co.uk/about/performance/>

Section 9

Dr. Padilla's simulation papers

- 9.1 The next two sections of my report present empirical evidence on the potential magnitude of price reductions resulting from standardised packaging and the implied magnitude of tax increases to offset this.
- 9.2 In this section I summarise the empirical simulation results of Dr. Jorge Padilla's⁷⁶ two 2010 studies of the likely effects of standardised packaging on prices in the UK and Australian cigarette markets.⁷⁶

Summary

- 9.3 Padilla observes that plain packaging would remove a crucial method by which cigarette suppliers are able to distinguish their brands from those of their competitors. Moreover, given the existing level of regulation of branding for cigarettes, he notes packaging is the most important currently permissible method of differentiation.⁷⁷
- 9.4 He finds that in the absence of the ability to differentiate brands via packaging existing suppliers would be forced to compete to a greater extent on prices, resulting in a price reduction of between 4.4% and 14.1% in the UK,⁷⁸ and 4.8% to 14.8% in Australia.⁷⁹
- 9.5 Moreover, such a price reduction would have the effect of increasing sales and consumption of cigarettes. Padilla estimates the increase in quantity consumed to be between 2.2% and 10.6% in the UK,⁸⁰ and 2.6% to 11.1% in Australia.⁸¹

⁷⁵ Dr. Jorge Padilla is a colleague of mine at Compass Lexecon, and the head of Compass Lexecon Europe.

⁷⁶ Padilla (2010a), "The impact of plain packaging of cigarettes in UK: a simulation exercise," and Padilla (2010b) "The impact of plain packaging of cigarettes in Australia: a simulation exercise." In what follows I consider the 'no entry' case in Padilla's analysis.

⁷⁷ See Padilla (2010a), p. 1.

⁷⁸ See Padilla (2010a), p. 15, Table 3.

⁷⁹ See Padilla (2010b), p. 15, Table 3.

⁸⁰ See Padilla (2010a), p. 16, Table 4.

Theoretical framework

- 9.6 Padilla's theoretical framework is entirely consistent with the one described in the theoretical part of my report.
- 9.7 Padilla establishes that economic theory distinguishes two primary categories of products: homogeneous goods, where, in the eyes of a consumer, one variety of the good is completely substitutable with any other, and heterogeneous or differentiated goods, where consumers do not view the products of any one supplier as identical with the products of any other.⁸²
- 9.8 This differentiation, Padilla writes, permits firms to charge a premium. This is because a consumer is less likely to switch between products in the face of a price increase, as different brands are viewed as not interchangeable. This phenomenon has been extensively documented in the economics literature.⁸³
- 9.9 The paper then notes that the plain packaging initiative serves to reduce this differentiation in brands, eroding the ability of suppliers to charge premiums for their respective products. This results in a reduction in prices.⁸⁴

Empirical approach

- 9.10 Padilla's simulation exercise utilises a calibrated model of economic behaviour to generate the predictions of the impact of the plain packaging intervention on the market for cigarettes. Such a model necessarily relies on certain data and assumptions to create predictions. I outline and discuss these assumptions below.

Structure of substitutability

- 9.11 Cigarette brands are perceived as highly differentiated by end consumers. Thus, from the perspective of these consumers, brands may be placed into groups, in this case corresponding to well-recognised vertical brand categories.⁸⁵

⁸¹ See Padilla (2010b), p. 15, Table 4.

⁸² See Padilla (2010a), p. 2.

⁸³ For seminal work on this topic see: Hotelling (1929) "Stability in Competition," and Salop (1979). "Monopolistic Competition with Outside Goods."

⁸⁴ See Padilla (2010a), p.2.

⁸⁵ See Padilla (2010a), p. 8.

- 9.12 It is assumed that consumers can differentiate between products in different categories. This is no different than assuming that cigarette smokers are perceptive of differences between premium and low quality brands.^{86,87}

Bertrand competition

- 9.13 The second assumption is that firms compete in prices using standard models of oligopolistic competition. In Padilla's model, firms set the prices of their brands to maximise profits, taking into account the expected non-collusive strategies of their rivals. An equilibrium occurs in such a model when no one firm has a profitable price deviation available to it.⁸⁸

Elasticity

- 9.14 A further assumption is made regarding how consumers react to changes in price. This effect is referred to as the consumers' own-price elasticity of demand, and the degree of substitutability between brands is termed the cross-price elasticity of demand.

- 9.15 Padilla's simulations are run for two possible sets of own-price elasticities, a lower bound of -0.5, and an upper bound of -1.0. These values, Dr. Padilla notes, are in line with existing empirical work on estimating this parameter.⁸⁹

- 9.16 The simulation is also similarly conducted for 'high' and 'low' values of cross-price elasticities governing substitutability between brands.

Nested logit specification

- 9.17 Lastly, Padilla's simulation uses an econometric model known as a nested logit model.⁹⁰ In such a model, products are placed into specific groupings, nests, in this case corresponding to vertical categories of cigarettes in the market (premium, low-quality, etc.). For a given consumer, the utilities of consuming goods in the same nest are correlated. Thus in response to price changes, consumers are more likely to substitute first within their nest of choice, before considering products elsewhere.

⁸⁶ See *Impact Assessment*, paragraph 263, as well as Scheffels (2008).

⁸⁷ I note that this is an assumption that is well supported in the literature. For example, see Scheffels (2008).

⁸⁸ See Padilla (2010a) p. 9.

⁸⁹ For example, see Cogen and Viscusi (2003) "Principles for cigarette taxation in Africa"

⁹⁰ See Padilla (2010a) Appendix 2.

- 9.18 As Padilla notes, this is a commonly employed statistical model in the empirical economic literature.⁹¹

Results

- 9.19 Padilla's results yield a range of values, corresponding to differing combinations of parameter assumptions. These have been reproduced in Table 1 below.⁹²
- 9.20 When the price-elasticity of demand for consumers is considered to be large and there is only an average increase in within-nest substitutability resulting from the legislation, Padilla's simulation estimates the lower bound of the magnitude of the expected price change: a range of -4.4% to -6.9%.
- 9.21 When the price-elasticity of demand is large, the increase in within-nest substitution is large, the expected price change is maximal, in the range of -7.2% to -14.1%.

Table 1: Estimated price impact of plain packaging

Market elasticity of demand	Increase of within-nest substitutability	Change in weighted average price (%)		
		Min	Mean	Max
-0.5	Average	-7.0%	-6.2%	-4.7%
-1.0	Large	-13.8%	-11.8%	-7.4%
-0.5	Average	-6.9%	-6.0%	-4.4%
-1.0	Large	-14.1%	-11.8%	-7.2%

Source: Padilla (2010a) "The Impact of Plain Packaging of Cigarettes in UK: A Simulation Exercise," Table 3.

- 9.22 Table 2 below gives the corresponding predicted changes in quantity consumed for given parameter combinations.⁹³ If the price-elasticity of demand is low and there is only an average increase in intra-nest substitutability, Padilla predicts a minimum increase in consumption in the range of 2.2% to 3.1%.
- 9.23 If the price-elasticity of demand is high, however, and there is a large change from plain packaging to Intra-nest substitutability, then consumption could increase by up to 7.4% to 10.6%.

⁹¹ See Padilla (2010a), p. 9, footnote 27.

⁹² For original see Padilla (2010a), p. 15.

⁹³ For original see Padilla (2010a), p. 18.

Table 2: Estimated quantity impact of plain packaging

Market elasticity of demand	Increase of within-nest substitutability	Change in weighted average price (%)		
		Min.	Mean	Max.
-0.5	Average	2.2%	2.6%	3.1%
-1.0	Large	3.6%	4.3%	5.1%
-0.5	Average	4.5%	5.3%	6.2%
-1.0	Large	7.4%	9.0%	10.6%

Source: Padilla (2010a) "The Impact of Plain Packaging of Cigarettes in UK: A Simulation Exercise," Table 4.

Observations of the Padilla model

- 9.24 I note that Padilla's simulation work is consistent with the predictions of my theoretical work outlined in Section 6 and Section 7.
- 9.25 Within the framework of Padilla's model, nests are arranged by vertical categories of cigarettes, from premium to super-low quality. In this context, intra-nest substitution in response to the implementation of plain packaging exactly analogous to the vertical effects analysed in Section 7.
- 9.26 Correspondingly, Padilla's paper supports the conclusion of a price decrease and consumption increase following the implementation of plain packaging.
- 9.27 Moreover, Padilla's inter-nest substitution is equivalent to the horizontal effects considered in Section 6.
- 9.28 These two notions are intimately related by the parameter σ , governing the correlation of valuations across products within the same nest in Padilla's model. When $\sigma = 1$ there is perfect correlation in preferences between products in the same grouping, rendering them perfectly substitutable. In this case the effects of plain packaging are vertical, and Padilla's model considers a related problem to what is presented in Section 7.
- 9.29 When $\sigma = 0$ there is no correlation of preferences within categories, and, as such, consumers are just as likely to substitute within-nest as cross-nest in response to a price increase. In this case, the effects of plain packaging are exclusively horizontal, and Padilla's model studies a similar problem to that discussed in Section 6.
- 9.30 For values $0 < \sigma < 1$, then, Padilla's model combines the analysis presented in the prior sections.

- 9.31 I observe that Padilla's results are fully consistent with the theoretical work presented in Section 6 and Section 7. As outlined above, Padilla's model is a combination of the vertical and horizontal models previously discussed. Both of these theoretical models predict decreasing prices and increasing consumption. Padilla's work, then, gives a rigorous empirical estimate as to the magnitude of these effects in the UK market.⁹⁴

Conclusion

- 9.32 Padilla finds that in the absence of the ability to differentiate brands via packaging existing suppliers would be forced to compete to a greater extent on prices, resulting in a price reduction of between 4.4% and 14.1% in the UK⁹⁵, and 4.0% to 14.8% in Australia.⁹⁶
- 9.33 Moreover, such a price reduction would have the effect of increasing sales and consumption of cigarettes. Padilla estimates the increase in quantity consumed to be between 2.2% and 10.6% in the UK,⁹⁷ and 2.6% to 11.1% in Australia.⁹⁸

⁹⁴ Chantler and the Impact Assessment cited a paper providing a critique of Padilla's estimates (Reed (2011) "Analysis and review of J. Padilla, "The Impact of plain packaging of cigarettes in the UK: a simulation exercise," cited in the Impact Assessment, at para. 245). I note that (i) Reed did not advance any alternative estimation of the effect of standardised packaging and (ii) neither Chantler nor the IA addressed any of Reed's points. More generally, Reed's views do not present a coherent alternative view, e.g. he argues that higher prices may be associated with higher demand. If this was the case, however, the approach of taxing tobacco products more heavily would be misconceived.

⁹⁵ See Padilla (2010a), p. 15, Table 3.

⁹⁶ See Padilla (2010b), p. 15, Table 3.

⁹⁷ See Padilla (2010a), p. 16, Table 4.

⁹⁸ See Padilla (2010b), p. 15, Table 4.

Section 10

Taxation

- 10.1 As set out in the previous section, Padilla projects that the implementation of plain packaging would result in an anticipated price decrease in the cigarette market of between 4.4% and 14.1% in the UK.⁹⁹
- 10.2 Both Chantler's report, as well as the Department of Health's Impact Assessment indicate that it would be possible to offset price reductions through a commensurate countervailing tax increase.
- 10.3 To offset the expected price effect of the plain packaging initiative indicated above, a tax increase on the sale of cigarettes sufficient to increase price between 4.6% and 16.4% would be necessary.¹⁰⁰
- 10.4 In this section, I consider the scale of tax increase required to bring about such an increase in price and its implications for tax incidence of cigarettes in the UK.

Historical summary

- 10.5 In the United Kingdom, cigarette taxes take two forms, an ad valorem percentage levied on the price of a pack, as well as a flat tax per thousand cigarettes.
- 10.6 Since at least 2005, the tax based upon the percentage of the retail price has remained constant in every year barring 2008 and 2011, whereas the flat tax per thousand cigarettes has increased every year. In 2011, the percentage tax dropped from 24% of retail price to 16.5%, but the flat tax increased from £119.03 per thousand cigarettes to £154.95.¹⁰¹

⁹⁹ To calculate the necessary magnitude of the price raise to undo the price effect of plain packaging, I make the following note: for a price of £100, a 4.4% decrease yields a decreased price of £95.6. This requires an increase of 4.6% to once again be £100. Similarly, a 14.1% decrease yields a decreased price of £85.9, which in turn requires a 16.4% increase to return the price to £100.

¹⁰⁰ See footnote 97.

¹⁰¹ See <https://www.uktradeinfo.com/Statistics/Tax%20and%20Duty%20Bulletins/Tobacco0614.xls>

- 10.7 Table 3 below gives the recommended retail price for a carton of cigarettes in pounds sterling for the Most Popular Price Category (MPPC), as reported by the UK Tobacco Manufacturers' Association, as well as degree to which that price is made up by tax ('tax incidence').

Table 3: Cigarette prices and tax (2004-present) (nominal terms)

Date	Recommended Retail Price (RRP) (£ per 20)	Of which tax (£ per 20)	Tax Incidence (%)	Annual change in RRP (%)	Annual change in tax (%)
2004	4.65	3.65	78%	--	--
2005	4.82	3.77	78%	3.7%	3.3%
2006	5.05	3.91	77%	4.8%	3.7%
2007	5.33	4.07	76%	5.5%	4.1%
2008	5.44	4.18	77%	2.1%	2.7%
2009	5.67	4.34	77%	4.2%	3.8%
2010	6.13	4.67	77%	8.1%	7.6%
2011	6.63	5.08	77%	8.2%	8.8%
2012	7.09	5.45	77%	6.9%	7.3%
2013	7.72	5.91	77%	8.9%	8.4%
Present	7.98	6.17	77%	3.4%	4.4%
Min.	-	-	76%	2.1%	2.7%
Mean	-	-	77%	5.6%	5.4%
Max.	-	-	78%	8.9%	8.8%

Note: Variation in Recommended Retail Price due to both tax and manufacturing cost fluctuations.
Source: UK Tobacco Manufacturers' Association¹⁰²

- 10.8 The average annual tax increase on cigarettes has been approximately 5.4% in nominal terms. The average annual increase in price has been approximately 5.6% in nominal terms.

¹⁰²

<http://www.the-tma.org.uk/tma-publications-research/facts-figures/uk-cigarette-prices/>

Necessary magnitude of offsetting tax in perspective

- 10.9 Table 4 below shows the countervailing price increase and necessary change in tax to neutralise the price reductions identified by Padilla.

Table 4: Change in incidence resulting from tax increase

	Price decrease	Countervailing price increase	Necessary change in tax	Resulting incidence
Min.	-4.4%	4.6%	5.7%	81.7%
Mid.	-9.25%	10.2%	12.0%	86.6%
Max.	-14.1%	16.4%	18.2%	91.4%

Notes: Calculations using 'Present' values from Table 3.¹⁰³
Source: Compass Lexecon calculations

- 10.10 As Table 4 shows, such an offsetting tax increase would have the result of pushing the tax incidence to between 81.7% and 91.4% from its current level of around 77%. This will increase the incentives for illicit trade.

Conclusions

- 10.11 I have shown that the countervailing tax to offset the anticipated price reduction would increase the tax incidence on cigarettes to between 81.7% and 91.4% which would have strong implications for illicit trade, which neither Chantler nor the Impact Assessment adequately address.
- 10.12 Lastly, the competitive effects of such a tax are distortionary. Any offsetting tax increase would unambiguously reduce consumer welfare, as consumers either turn to legitimate cross-border trade or illicit trade or pay the same as the pre-regulation level for an inferior product (each of these options offering lower utility than consumers would obtain absent the regulation).
- 10.13 As such I conclude that such an offsetting tax, in the face of the anticipated price decrease resulting from the implementation of standardised packaging, would be strictly detrimental from a consumer surplus standpoint, and would constitute a further distortion of the market for cigarettes beyond that imposed by standardised packaging alone.

¹⁰³

In the above calculations I use the 'Present' RPP and tax of the MPPC of cigarettes as my baseline, varying only according to the range of possible price changes given by Padilla (2010a). To calculate incidence I solve for the fraction of the baseline price the baseline tax plus offsetting tax increase constitutes:

$$\text{Resulting Incidence} = \frac{\text{Baseline Tax} + (\text{Baseline Price}) \cdot (1 - \text{Price Decrease \%}) + (\text{Offsetting Duty Increase \%})}{\text{Baseline Price}}$$

Section 11

Critique of Chantler's report and the Impact Assessment

- 11.1 In this section, I revisit the economic arguments of Chantler and the Department of Health's Impact Assessment in light of the analysis set out above.

Direct competition distortions

- 11.2 Neither Chantler nor the Impact Assessment comprehensively identifies the direct distortive effects of standardised packaging.

Consumer surplus

- 11.3 Chantler's review does not consider the effects of standardised packaging on consumer welfare; the Department of Health's Impact Assessment does consider consumer welfare, however, dismisses it completely on grounds that envy effects may neutralise the impact of a loss of consumer surplus from branding.
- 11.4 This assumption is implausible as it implies that the aggregate social value of brands in the economy is nil.
- 11.5 It hardly needs saying that this assumption is inconsistent with the generally recognised value of brands in free markets. It is also inconsistent with the theoretical framework presented in this report and the empirical evidence also presented on the role of brands in contributing to consumer surplus in the form of variety effects.

Prices and quantities

- 11.6 Chantler's report does not contain any meaningful analysis of the effect of the regulation on prices. His suggestion that Padilla's simulation exercise showing lower prices is inconsistent with evidence from JTI on barriers to entry is incorrect. This evidence is consistent because prices will still be lower in a homogenised market with higher barriers to entry than in a differentiated product market.

- 11.7 Chantler relies on Australia to suggest that price effects are not clear, but acknowledges that the Australian evidence has serious limitations and in any case would only relate to the short run.

Offsetting taxes

- 11.8 Both Chantler's report and the Impact Assessment treat the institution of a tax to counteract the anticipated price decrease as a matter of fact but do not consider the increase in tax required or the implications of any such increase.
- 11.9 As seen from Table 4, we estimate that the tax incidence would have to increase from a historic range of 76% to 78% to 81.7% to 91.4%.

Dynamic distortions

- 11.10 The Impact Assessment claimed that the loss of product innovation would be compensated for by other forms of product innovation. It failed to recognise the very limited scope for this and that, with reduced returns to product innovation, incentives to innovate and invest in products would be less. It also failed to recognise that the ability to invest in product innovation would be reduced by reduced cash flows.
- 11.11 The Impact Assessment correctly indicated that incentives to engage in process innovation would increase. It failed to recognise that this would lead to a further reduction in prices (and thus a further need for compensating tax increases). It also failed to recognise that the ability to invest in process innovation would be reduced by reduced cash flows.

Annex A

Curriculum vitae

- A.1 Neil Dryden is an Executive Vice President in Compass Lexecon's European competition policy practice, based in the firm's London office. He has worked as a professional economist for over 15 years and during that time he has advised on numerous mergers, agreement cases, dominance cases, damages and market investigations.
- A.2 Neil's significant cases since 2010 include acting as an expert in the pay TV and tobacco cases (both at the Competition Appeal Tribunal), and advising in outdoor advertising (OFT), Sports Direct/JJB (Competition Commission and Competition Appeal Tribunal), Asda/Netto (OFT) and Level 3/Global Crossing (OFT).
- A.3 In addition to numerous cases in the European Union, Neil has advised on cases in India and South Africa. Neil also has extensive experience in regulatory economics, including a series of projects for the UK postal regulator. Neil has prepared submissions in the context of a number of UK government inquiries including the Barker review of land use planning.
- A.4 Neil has analysed cases in sectors including advertising, banking and financial services, chemicals, energy, FMCG, grocery retailing, healthcare, manufacturing, media and broadcasting, mining, petroleum, pharmaceuticals, postal services, publishing, scientific instruments, sports, technology, telecommunications, tobacco, transport, and water.
- A.5 Neil was educated at Oxford University where he obtained a B.A. in Philosophy, Politics and Economics (first class) and an M.Phil. in Economics, and held a college lectureship for two years. At King's College, London, he obtained a postgraduate diploma in EC competition law (with distinction). Neil co-authored "What makes firms perform well?" published in the European Economic Review.
- A.6 Prior to joining Compass Lexecon, Neil worked as a Director at LECG and prior to that as an Associate Director in NERA's European competition policy practice for seven years. Neil spent the first six years of his career in Arthur Andersen's economic and financial consulting practice, where he was a Senior Manager.
- A.7 My full CV can be found at <http://www.compasslexecon.com/professionals/bio?id=209>.

Annex B

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Annex C

Salop model

- C.1 The spatial competition models of Hotelling and Salop provide a clear geometric interpretation of the role of product variety and differentiation in price setting behaviour by firms. In both these models, there exists a simple geometric figure, be it a line or circle, with a fixed volume of customers representing the constant market demand, distributed uniformly along its length. The most intuitive interpretation for this demand is that consumers live along a road (line), or around a lake (circle).
- C.2 Firms differentiate their products by placing them at points along this figure. Customers then make a choice as to which product to purchase based solely on minimizing their costs, where both the transport costs to traverse 'to' the product, and the product's price itself are considered.
- C.3 The model can be interpreted as follows: products are differentiated along one characteristic, and each consumer has an ideal product in terms of that characteristic. The closer (i.e. the more similar) the product(s) supplied in the market to the consumer's ideal product, the higher the consumer surplus, everything else equal.
- C.4 In such a world, product differentiation is given a strong visual interpretation: the closer two products lie along the curve, the less of a price discount it would take to induce consumer substitution away from one to the other. Effectively, distance in the Salop-Hotelling world captures the degree of substitutability between two products.
- C.5 The original spatial competition model is due to Hotelling (1929), where consumers are distributed uniformly along a line. In this model, two stores compete for customers by choosing their location and the price of their products. Customers face increasing transportation costs, inducing them to buy from the cheapest store, if stores have the same prices.
- C.6 The Hotelling model becomes however analytically non-tractable for the analysis of an oligopoly.¹⁰⁴ This is because the line along which consumers are distributed has two end points, which creates an asymmetry between (i) the two stores located at the extremes and

¹⁰⁴ See for instance Brenner, S. (2005) "Hotelling games with three, four, and more players", *Journal of Regional Science*, Vol. 45, No. 4.

(ii) the rest of the stores that are located internally: each of the former only competes with one store (the one next to it), while each of the latter competes with two stores (the one to its left and the one to its right). Apart from making the solution analytically intractable, this asymmetry also implies that the two types of stores have different market power and different profits, something that would be difficult to justify in a model of the tobacco industry.

C.7 These issues are resolved in Salop (1979) model, where consumers are distributed along a circle. In this model, each company first chooses where to locate on the circle, and then chooses the prices of its product. It has been shown¹⁰⁵ that in this model, and under the assumption of symmetric cost structures, firms

- Locate themselves equidistantly along the circle's perimeter, thus maximising product differentiation; and
- Set prices symmetrically.

The extended Salop model

C.8 The standard Salop model, however, is uninteresting in this context because it assumes that each consumer only consumes one unit of the product variety he chooses to acquire. In this sense the model is of limited applicability to the case at hand because consumers only choose what cigarette variety to buy (e.g. Lucky Strike regular or Camel regular) but do not decide how much to smoke. I have, therefore, modified the model to include an endogenous consumption choice made by consumers.

C.9 For expositional simplicity, I analyse the duopoly case where each company supplies one product. I will then also analyse the case with $n > 2$ products.

Consumers

C.10 Each consumer on the circle of perimeter 1, maximises utility:

$$U(q_i) = \log(q_i) - p_i q_i - t(x' - t)^2$$

¹⁰⁵

See D'Aspremont et al (1979), Economides (1989)

Utility depends on:

- The volume of consumption (q_t), where the sub-index t indicates the product variety.¹⁰⁶
- The expenditure ($p_t q_t$), where p_t represents the price of product variety t .
- The 'disutility' of consuming a product variety that is different from the consumer's ideal variety ($t(x - i)^2$). This is a function of the distance between the consumer's ideal product (x) and the location of the product he consumes (i). The parameter $t > 0$ is a scale parameter, meaning that it determines the magnitude of the transportation cost for any given distance.

- C.11 Each consumer first chooses which product to buy, and then chooses how much to consume.

Product choice

- C.12 When choosing which product to buy, each consumer compares the utility he obtains by consuming each of the two products. He then buys the product that provides him with higher utility. For instance, a consumer located at x chooses to buy product i if $U(q_i) > U(q_j)$:

$$\log(q_i) - p_i q_i - t(x - i)^2 > \log(q_j) - p_j q_j - t(j - x)^2$$

Consumption choice

- C.13 Consumers choose consumption (q) to maximise utility. In the example above, consumer x solves:

$$\max_{q_i} U(q_i) = \log(q_i) - p_i q_i - t(x - i)^2$$

- C.14 The solution to this problem is $q_i = \frac{1}{p_i}$, which implies that consumption is lower when prices are higher.

Firms

- C.15 Firms take two decisions: they first choose where to locate their products (i.e. they choose product differentiation) and then choose the price of their products. I solve the problem by backward induction, i.e. I solve the pricing problem first and the location problem last.

Choice of price

- C.16 In order to choose the price that maximises its profits, each company must first compute the demand for its product. As shown below, this demand depends on the location of the two

¹⁰⁶ As is common in both mathematical and economic literature, log is taken to be the natural log unless otherwise specified.

companies and on the price of the two products.

- C.17 For the moment I work under assumption that the two companies are located at an unspecified distance $\lambda \in [0, 1/2]$ from each other. In other words I do not make any specific assumption about their location in the circle.
- C.18 Total demand for each firm is composed of the sum of demands in two intervals: one of length λ , and one of length $1 - \lambda$. In the interval of length λ , a consumer located at x is indifferent between the two products if the utility he obtains from the consumption of one product is the same as the utility he obtains from the consumption of the other product:

$$\log(q_i) - p_i q_i - t x^2 = \log(q_j) - p_j q_j - t(\lambda - x)^2$$

where $x \in (0, \lambda)$, $j \neq i = 1, 2$, and I have normalised for simplicity the location of product i at point 0.¹⁰⁷

- C.19 In the interval of length $1 - \lambda$, an agent at location y is indifferent between the two products if:

$$\log(q_i) - p_i q_i - t y^2 = \log(q_j) - p_j q_j - t(1 - \lambda - y)^2$$

and $y \in (0, 1 - \lambda)$.

- C.20 These yield demands¹⁰⁸ x and y for each firm on each respective interval:

$$x_i = \frac{\log(q_i) - \log(q_j) + (p_j q_j - p_i q_i) + t \lambda^2}{2 \lambda t}$$

$$y_i = \frac{\log(q_i) - \log(q_j) + (p_j q_j - p_i q_i) + t(1 - \lambda)^2}{2(1 - \lambda)t}$$

and for each i , total demand $D_i = (x_i + y_i)q_i$. Therefore, each firm seeks to maximise profits:

$$\max_{p_i} \pi_i = (p_i - c)D_i$$

where c is the marginal cost of production, which I assume is equal for the two companies.

- C.21 Differentiating with respect to p_i and imposing symmetry $p_i = p_j$, I obtain that each company serves half of the market: $x_i + y_i = \frac{1}{2}$. The optimal price is:

$$p_i^* = p_j^* = p^* = (1 + t\lambda(1 - \lambda))c$$

¹⁰⁷ This is without loss of generality, because only the distance between products matters, while their exact location is irrelevant.

¹⁰⁸ Technically x and y are the distance of the indifferent consumers from each good. However, since there is a uniform density of consumers along the circle, these are the proportions of the total market demand each firm faces.

Choice of location

- C.22 Each company chooses the location (i.e. the product differentiation) that maximises its profits. In equilibrium, profits are given by:

$$\pi_i^* = (p_i^* - c) \frac{q_i^*}{2} = p_i^* q_i^* - c q_i^* = \frac{1}{2} \left(1 - \frac{1}{(1 + t\lambda(1 - \lambda))} \right)$$

- C.23 Therefore profits are continuously increasing in the product differentiation parameter λ , for $\lambda \in [0, 1/2]$. It follows that the two companies choose maximum differentiation i.e. $\lambda = 1/2$.
- C.24 Using this set-up, I analyse the effects of standardised packaging on the market equilibrium.

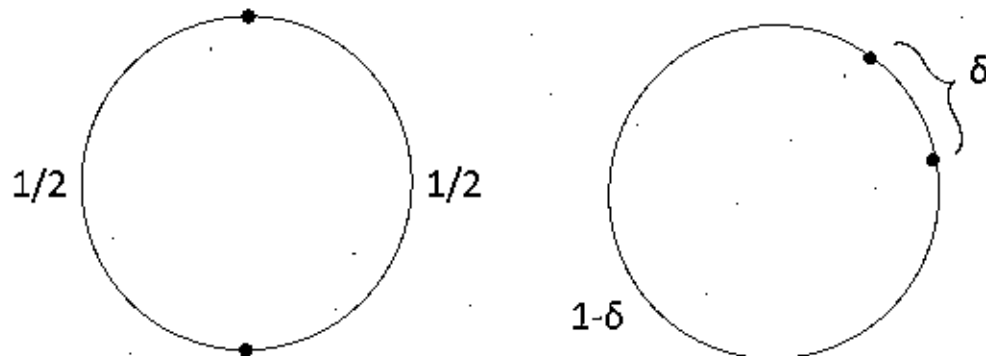
Increased homogeneity

- C.25 The most reasonable representation of an exogenous decrease in product differentiation (i.e. distance) in the Salop model is to impose a maximum distance, δ , between products along the perimeter of the circle.

Variety effect

- C.26 Before the imposition of a maximum differentiation, companies locate opposite to each other along the circle, as discussed above. The distance between two companies is thus $\frac{1}{2}$. After the regulation, companies locate at a distance δ from each other. This is because, as shown above, companies choose to locate at the maximum available differentiation. However, I do not impose the exact location of the two companies on the circle. This is shown in Figure 10 below where the left-hand side diagram represents the pre-regulation market, and the right-hand side diagram represents the post-regulation market. The two points on the circle represent the locations of the two companies:

Figure 10: Increased homogeneity in the Salop model



- C.27 The regulation has a direct variety effect on consumer welfare: total transport costs go up; the expected utility of the average consumer is:

$$\mathbb{E}(U) = \mathbb{E}(\log(q) - tx^2 - pq) = \log(q) - t\mathbb{E}(x^2) - pq$$

where the second equality comes from the linearity of the expectations operator and x is the distance to the product of choice.

- C.28 The expected value of the transportation cost tx^2 , is $1/48$ in the unregulated case:

$$t\mathbb{E}(x^2) = 4t \int_0^{1/4} x^2 dx = \frac{t}{48}$$

- C.29 However, constraining the maximal distance firms may locate in space, the expected value of the transportation cost becomes:

$$t\mathbb{E}(x^2) = 2t \int_0^{\delta/2} x^2 dx + 2t \int_{\delta/2}^{1-\delta} x^2 dx = \frac{t}{12} (\delta^3 + (1-\delta)^3)$$

- C.30 Thus, for any $\delta < 1/2$,¹⁰⁹ the expected transportation cost strictly increases if the distance δ among the two firms decreases. Increasing homogeneity thus has the direct effect of strictly reducing consumer surplus.

Price effect

- C.31 Since, as shown above, consumption decreases when prices go up, increased homogeneity also leads to more consumption. Thus the price effect increases consumer surplus through a boost in consumption.

¹⁰⁹

I restrict attention to $\delta < 1/2$, because if $\delta \geq 1/2$ the regulation does not affect the market equilibrium.

Overall effect on prices, quantities, consumer surplus and profits*Prices*

- C.32 As seen above, in the Salop model with endogenous quantity selection, prices are increasing in δ , thus, the implementation of standardised packaging, leading to a reduction in δ , will lead to a fall in equilibrium prices in the model.

Quantities

- C.33 Since, in the original Salop model, total consumption is exogenously fixed, I have extended the model to include endogenous consumption. As seen above, consumption increases as prices decrease. As a result, according to this model, the regulations of standardised packaging that decrease product differentiation will lead to an increase in cigarette consumption.

Consumer surplus

- C.34 As shown above, the expected transport cost for a given consumer is $\frac{t}{12}(\delta^3 + (1 - \delta)^3)$. This allows us to express the total consumer welfare as:

$$E(U) = \log(c + ct\delta(1 - \delta)) - \frac{c - ct\delta(1 - \delta)}{c - ct\delta(1 - \delta)} - t \left(\frac{\delta^3 + (1 - \delta)^3}{12} \right)$$

where the second term on the right-hand side represents consumer's expenditure, i.e. price times quantity. Since $q = 1/p$, this term equals 1.

- C.35 In order to analyse the effect of increased homogeneity on consumer welfare, I take the derivative of $E(U)$ with respect to δ . The sign of this derivative depends upon the relative magnitudes of the parameters of the model. There are two offsetting effects following increased homogeneity: expected transport costs rise, producing a negative variety effect and prices decrease, producing a positive price effect. If per unit transport costs are high, meaning that smokers have strong preferences for their favourite brand/variety, the negative variety effects of reducing differentiation dominate and consumer surplus decreases. If per unit transport costs are low, then the price effect dominates and consumer surplus rises.

Profits

- C.36 As shown above, equilibrium profits are defined as $\pi_c^* = 1 - \frac{1}{(1+t\delta(1-\delta))c}$. Therefore profits are increasing in δ , meaning that increasing homogeneity (lower δ) reduces profits. This result is intuitive, because price competition becomes more intense as a result of increased homogeneity.

Conclusions

- C.37 I have used an extended version of the Salop model that takes into account the consumption

choice of consumers. In this model, increased homogeneity (i.e. less product differentiation) induces a drop in prices, a rise in consumption, an ambiguous change in consumer surplus, and a decrease in profits.

Annex D

Motta model of vertical differentiation

- D.1 In this Annex I use a model of vertical differentiation developed by Professor Massimo Motta.¹¹⁰ As explained in the report, while Professor Motta does not use this model to capture the effect of an exogenous reduction in vertical differentiation, his model features certain characteristics that make it suitable for such analysis.

The model

- D.2 In this model, a single product is supplied in two versions: a high-quality and a low-quality version. Each quality is supplied by a different manufacturer, implying that manufacturers compete both in quality and in price.¹¹¹

Consumers

- D.3 Consumers differ in their valuation of the product. Formally this is reflected by ordering consumers from the lowest to the highest valuation along an interval $[\underline{\theta}, \bar{\theta}]$.
- D.4 The utility of consumer $\theta \in [\underline{\theta}, \bar{\theta}]$ when he consumes quality $i \in \{L, H\}$ is:

$$U(\theta, i) = \theta k_i - p_i$$

where i indicates the low (L) or high (H) quality consumed, k_i and p_i represent the quality and price of quality i , respectively. Since the quality of the high-quality product is higher than the quality of the low-quality product, i.e. $k_H > k_L$, if these two products had the same price nobody would buy the low-quality product.

¹¹⁰ See Motta, M. (1993), "Endogenous Quality Choice: Price vs. Quantity Competition", *Journal of Industrial Economics*, Vol. 41.

¹¹¹ Professor Motta considers two games, one in which producers compete in price and one in which they compete in quantities. Without further note I will be referring exclusively to the price competition model as this is in line with how competition takes place in the tobacco industry.

- D.5 Consumers take the price and quality of each product as given, and decide:
- Whether to consume at all. Consumer θ only consumes if consumption produces a positive utility, i.e. if $U(\theta, i) > 0$ for some $i \in \{L, H\}$.
 - Which variety to consume. In particular he compares the utility he obtains by consuming each variety, and chooses the variety that produces the higher consumer surplus. Formally, he chooses variety i if $U(\theta, i) > U(\theta, j)$ with $j \neq i$, and $i, j \in \{L, H\}$.
- D.6 Each consumer then only consumes one unit of the product he chooses to buy (if any).

Firms

- D.7 I take qualities as initially fixed, and only consider price competition. I then analyse the effect of an exogenous decrease in the quality of the high-quality good.
- D.8 In order to compute the optimal price for its product variety, each manufacturer first needs to compute the demand for its product.
- D.9 Similarly to the model of horizontal competition discussed in Annex C, this is done by first finding the consumer who is indifferent between the high quality and low quality product. This consumer is denoted θ^* :

$$\theta^* = \frac{p_H - p_L}{k_H - k_L}$$

Consumers who value the product more than θ^* (i.e. for $\theta > \theta^*$) buy the high-quality product.

- D.10 Also, in this model, there is a 'minimal consumer type' who is just indifferent between purchasing the low-quality good and not buying at all, denoted θ_{min} :

$$\theta_{min} = \frac{p_L}{k_L}$$

- D.11 Consumers who value the product less than θ_{min} (i.e. for $\theta < \theta_{min}$) would obtain a negative consumer surplus from buying the product. They are thus better off not buying any product.
- D.12 The demand for the high-quality product is thus $\bar{\theta} - \theta^*$, while the demand for the low-quality product is $\theta^* - \theta_{min}$, and a proportion $\theta_{min} - \underline{\theta}$ of the consumers does not buy any product. It can be assumed, without loss of generality that $\underline{\theta} = 0$ and $\bar{\theta} = 1$.
- D.13 Solving for profit maximization, the optimal pricing rules for the producer of the high quality good and the low quality good are given by:

$$p_H = \frac{k_H(2k_H - 2k_L)}{4k_H - k_L}$$

$$p_L = \frac{(k_H - k_L)k_L}{4k_H - k_L}$$

D.14 This implies quantities demanded to the high and low type producing firms of:

$$q_H = \frac{2k_H}{4k_H - k_L}$$

$$q_L = \frac{k_H}{(4k_H - k_L)}$$

$$q_{Total} = \frac{3k_H}{(4k_H - k_L)}$$

Quality effect

- D.15 The effect of regulation in such a market is to reduce k_H , effectively reducing the degree of vertical differentiation. This is analogous to the compression of product space in the horizontal differentiation model.
- D.16 As k_H decreases, some consumers switch from the high-quality to the low-quality good (i.e. θ^* moves to the right). This means that these consumers are rendered strictly worse off. Furthermore, consumers who previously consumed the high quality good and still do are worse off because they now receive less utility from the reduced quality of the high-quality product.
- D.17 Consumers who always consumed the low quality product are untouched.
- D.18 Thus the net result of the quality effect is to reduce welfare for all original high-quality type consumers, and to reduce overall welfare.

Price effect

- D.19 As k_H is reduced, the high-quality manufacturer reduces the price of its product. In essence, since quality competition is reduced, price competition is enhanced. This is similar to the increased homogeneity in the horizontal differentiation model.
- D.20 As a result of the more intense price competition, the manufacturer of the low-quality good also reduces the price of its product. This strictly increases consumer surplus, and lowers θ_{min} , increasing aggregate consumption.
- D.21 The price decrease and the associated increase in consumption have a positive effect on consumer welfare, where consumer welfare is measured by:

$$CS = \int_{\theta_{min}}^{\theta^*} k_L \theta - p_L d\theta + \int_{\theta^*}^{\bar{\theta}} k_H \theta - p_H d\theta$$

Overall effect on prices, quantities, consumer surplus and profits*Prices*

- D.22 As seen above, as the quality of the high-quality good decreases, prices are forced down as firms, less able to differentiate themselves in physical characteristics, intensify price competition.

Quantities

- D.23 Consumers in the Motta model are simplistic and each consumes a fixed unit quantity of whatever good they decide upon. However, a decrease in quality in the market lowers all prices, which induces an expansion of the market (agents who previously found it unprofitable to consume the low quality good may now find consumption palatable at the lower price).
- D.24 Consumption thus increases.

Consumer surplus

- D.25 Reducing k_H reduces consumer surplus via the QE and increases it via the PE. The total effect on consumer surplus is ambiguous.

Profits

- D.26 A decrease in the quality of the high-quality good reduces both the profits of the high-quality good and total market profits:

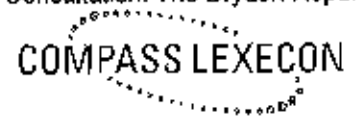
$$\frac{d\pi_{Total}}{dk_H} = 16k_H^3 - 12k_H^2k_L + 10k_Hk_L^2 + k_L^3 > 0$$

$$\frac{d\pi_H}{dk_H} = \frac{4k_H(4k_H^2 - 3k_Hk_L + 2k_L^2)}{(4k_H - k_L)^3} > 0$$

- D.27 Profits decrease because price competition intensifies.

Conclusions

- D.28 The Motta model allows for the analysis of the change in market equilibrium following a decrease in vertical differentiation due to a reduction in the quality of the higher-quality product:
- D.29 First, lower average quality produces a direct loss of consumer surplus.
- D.30 Second, since quality differentiation is weaker, price competition intensifies, making both the high-quality and the low-quality good cheaper.
- D.31 Lower prices imply an increase in consumption. The overall effect on consumer welfare is



ambiguous.

D.32 Finally more intense price competition reduces profits.

Annex E

Empirical literature on new product introductions

Hausman (1996)¹¹²

- E.1 This study examines the impact of the introduction of Apple-Cinnamon Cheerios, a new breakfast cereal produced by General Mills. Hausman uses sales data from seven major US cities to estimate the demand system for breakfast cereals, and uses the resulting demand system to estimate the consumer surplus using the framework shown above.
- E.2 Hausman notes that the introduction of Apple-Cinnamon Cheerios induces an increase in price from General Mills' other related (Cheerios) brands, ranging from 0.3-3.0% brand to brand.
- E.3 After adjusting for the fact that General Mills owns several other cereal brands which will be priced higher after the introduction of the Apple-Cinnamon Cheerios,¹¹³ Hausman estimates that the net gain in consumer surplus from the new product is around \$27,000 per city per week. This equates to total annual gain in consumer surplus of \$66.8 million, or around 27 cents per person.
- E.4 He lastly observes that the price effect of the introduction of a new good is diminishing in the welfare-increasing effects of the introduction in industries characterised by imperfect competition, and thus all differentiated product industries. This is because the introduction of a new product in such a market may permit multiproduct firms to raise the prices of their other brands. He notes, however, that new brand introduction should almost always be considered economically positive, given its "significant welfare increasing effects".¹¹⁴

¹¹² See Hausman, J. (1996) "Valuation of new goods under perfect and imperfect competition" in Timothy Bresnahan and Robert Gorgon (eds.) *The Economics of New Goods*, University of Chicago Press.

¹¹³ This is because some of the diversion from any increase in prices for the existing products will now be to the new Cheerio product.

¹¹⁴ See Hausman (1996) "Valuation of new goods under perfect and imperfect competition" in Timothy Bresnahan and Robert Gorgon (eds.) *The Economics of New Goods*, University of Chicago Press, p. 235

Hausman, Pakes and Rosston (1997) ¹¹⁵

- E.5 The authors apply the same framework shown above to introduction of voice messaging services offered on fixed lines in the US and the introduction of mobile telephony in the US. The authors note that examining telecoms services in this way has different implications to, for example, the similar study on breakfast cereals, since the introduction of these services is heavily dependent on regulatory policy.
- E.6 The estimate of the consumer surplus arising from voice messaging services is based on data on demand and prices for the period 1991-1994. The authors estimate that, depending on the functional form of the demand curve assumed, the consumer surplus gain from the introduction of voice messaging services in the US is within the range \$480 million and \$2.1 billion per year, with the most likely estimates around \$1.2 billion.
- E.7 A similar analysis for mobile telephony based on price and subscriber data from the period 1989-1993 estimates the net gain in consumer welfare of \$49.8 billion per year. A lower bound figure for consumer surplus, based on conservative functional forms, is a net gain of \$24.2 billion per year.

Hausman and Leonard (2002) ¹¹⁶

- E.8 The authors of this paper carry out an estimation of the net welfare gain to consumers from the introduction of *Kleenex Bath Tissue*, a new tissue product manufactured by Kimberly-Clark. The analysis is based on scanner data from 30 US cities during the period January 1992-September 1995.
- E.9 The authors estimate that, in total over all 30 cities, the introduction of the new product resulted in net consumer surplus gain from the variety effect of \$33.4 million. Summing both variety effect and indirect price effect implies a total net consumer surplus gain of \$69.2 million.
- E.10 The consumer surplus gain from the new product varied significantly between different cities. The city with the smallest relative impact saw consumer surplus gain of around \$200,000, 1.2% of the total expenditure on tissues in that city. The city with the largest impact had a consumer surplus gain of \$3.4 million, 17.9% of the total expenditure on tissues.
- E.11 Their analysis indicated a price effect of -0.7% to -3.6% across different competitors in the market, inducing a total consumer surplus gain of approximately \$35.8 million, and a total variety effect of approximately \$33.4 million.

¹¹⁵ See Hausman, J., Pakes, A. and Rosston, G. (1997) "Valuing the effect of regulation on new services in telecommunications", *Brookings Papers on Economic Activity: Microeconomics*.

¹¹⁶ See Hausman, J. and Leonard G. (2002) "The competitive effects of a new product introduction: a case study", *Journal of Industrial Economics* 50, Vol.3.

Petrin (2002)¹¹⁷

- E.12 Petrin examines the introduction of the minivan by Chrysler into the domestic automobile market.
- E.13 Petrin shows that prices vary considerably from firm to firm with decreases ranging from -0.9% to -1.5% for GM and Ford products, and increases in Chrysler's own prices, as well as those of Volkswagen and AMC ranging from 1.08% to 3.10%.
- E.14 Total compensating variation from the introduction was approximately \$2.9B over the first five years from 1984 to 1989.

Brynjolfsson, Smith, and Hu (2003)¹¹⁸

- E.15 The authors study the variety effects of modern online book retailing. They note that shelf space constraints in conventional book stores are a strict limit on the volume of product, and thus variety available to offer, but this is effectively limitless in online retailing.
- E.16 They estimate that online book stores have increased consumer welfare strictly through variety effects by approximately \$731 million to \$1.03 billion in the year 2000 alone (with standard errors of \$46.7 and \$65.8 million respectively).
- E.17 They calculate the corresponding price effect to have increased consumer surplus by between \$100.5 million and \$103.3 million.
- E.18 They conclude:

"While lower prices due to increased market efficiency in internet book markets provide significant benefits to consumers, we find that the increased online availability of previously hard-to-find products represents a positive impact on consumer welfare that is seven to ten times larger."

Goolsbee and Petrin (2004)¹¹⁹

- E.19 Goolsbee and Petrin (2004) examined the impact of the entry of satellite TV in the US on consumer welfare.

¹¹⁷ See Petrin, A. (2002) "Quantifying the Benefits of New Products: The Case of the Minivan" *Journal of Political Economy* Vol. 110 No. 4.

¹¹⁸ See Brynjolfsson, E., Smith, M., and Hu Y. (2003) "Consumer surplus in the digital economy: estimating the value of increased product variety at online bookstores", *Management Science* Vol. 4, No. 11.

¹¹⁹ See Goolsbee, A. and Petrin, A. (2004) "The consumer gains from direct broadcast satellites and the competition with cable TV", *Econometrica* Vol. 72 No. 2.

- E.20 Direct broadcast satellite ("DBS") TV was introduced into the US pay TV market at the end of 1994. By 2001, it had gained 16.1 million subscribers compared to 69.0 million subscribers on cable TV (market share of 18.9%), the only other pay TV technology available in the US.
- E.21 The authors attempt to estimate the impact of the introduction of DBS TV on consumer welfare based on the market conditions in 2001. The authors summarise their approach as follows:

"Our base level of welfare is that achieved by households in 2001 with DBS available as an alternative. We ask how much income would have to change for a household to achieve that same utility level in 2001 with DBS not available (i.e. the compensating variation)."¹²⁰

- E.22 The impact of the entry of DBS TV on consumer welfare is positive both for consumers who switch to satellite TV and consumers who continue to subscribe to cable TV:

"Welfare increases for satellite consumers for two reasons. First, at the observed 2001 prices and characteristics, DBS consumers' willingness to pay for satellite exceeds the price. Second, [...] without DBS, almost all of these satellite consumers would subscribe to cable at both a higher price and a lower quality than that observed in 2001. Similarly for cable customers, surplus increases because they pay both lower prices and get higher quality cable than they would have without DBS entry."

- E.23 The data for the analysis is taken from a consumer survey conducted by Forrester Research, a market research company. The sample includes around 30,000 households in 317 cable franchise areas. This has been supplemented with data on the cable TV offerings that these households would have access to, taken from a dataset of cable TV product characteristics taken from an industry publication. Both sources are based on 2001 data.
- E.24 The authors find that if cable prices and characteristics are held constant, the consumer welfare gain from the availability of satellite TV for the satellite TV subscribers themselves is \$127 per subscriber per year.
- E.25 These are not the only benefits accruing to the satellite TV subscribers. Accounting for the negative impact of the availability of satellite TV on cable TV prices increases the consumer welfare gain for satellite TV subscribers to \$175 per subscriber per year.
- E.26 Finally, accounting for the impact of satellite TV on cable TV prices and product quality increases the consumer benefits for satellite subscribers to \$190 per subscriber per year.
- E.27 For cable TV subscribers, the impact of satellite TV on cable TV prices increases consumer surplus by \$4 per subscriber per month, while the positive impact on product quality

¹²⁰ See *ibid.* p.375.

Increases consumer surplus by \$1 per subscriber per month.

- E.28 The aggregate price effect calculated leads to a net increase in consumer surplus of about \$3.3 billion for consumers that stay with cable; furthermore, the entrance of satellite TV induces quality improvements in cable worth approximately another \$800-900 million, for an aggregate welfare gain of approximately \$4 billion per year for cable consumers.

Hausman and Leibtag (2007)¹²¹

- E.29 The authors of this paper calculate estimates of the impact of the entry of Wal-Mart into local areas. The authors note that the indirect price effects resulting from the entry of Wal-Mart into local markets is well-documented, with other local retailers dropping prices significantly in response to Wal-Mart's entry.
- E.30 The analysis is based on food sales data from 34 local markets in the US.
- E.31 The authors find that on average, the variety effect arising from the entry of Wal-Mart amounts to 20.2% of the average household expenditure on food, with a range of 9.6% to 32.7% observed in the sample of local areas. The indirect price effect amounts to 4.8% of household expenditure on food on average, with a range of 1.3% to 7.3%.
- E.32 Added together, this implies that entry of Wal-Mart into an area results in consumer welfare gain amounting to around 25% of total food expenditure.

¹²¹

See Hausman, J. and Leibtag, E. (2007) "Consumer benefits from increased competition in shopping outlets: measuring the effect of Wal-Mart", *Journal of Applied Econometrics* 22.

**Statement of Stuart Crookshank OBE on the
Likely Impact of Standardised Packaging on the
Illicit Tobacco Trade in The United Kingdom.**

30 July 2014

1. I retired from HM Revenue and Customs ("HMRC") on 30 April 2012 after nearly 40 years of service. I joined HM Customs and Excise ("HMCE") (later renamed HMRC) in August 1972 as an Officer working on the new tax then about to be introduced – VAT. I became a Customs Investigator in 1974 dealing with smuggling cases, including tobacco and serious betting fraud. Between then and 1999 I was employed in Investigation and rose to the rank of Assistant Collector (Fraud), at one time managing over 250 staff including Investigators, Intelligence Officers and front-line anti-smuggling Officers. These staff were based at Waterloo International, Tilbury docks and London City Airport. The seizure of illicit tobacco and the investigation and intelligence-gathering associated with tobacco offences was one of my key areas of responsibility. In 1999 I was seconded into HQ and became Deputy Head of Operational Anti-Smuggling where my role was to co-ordinate the national implementation of the new anti-smuggling tobacco strategy, targeted primarily at cross-border shopping.
2. I also devised and implemented some strategies of my own. These included the creation of a national 120-strong anti-tobacco smuggling 'Strike Force' targeting ports, airports and inland 'hotspots'. Between 2001 and 2003 I managed these anti-tobacco smuggling teams and became Head of Gatwick Customs. During this time I sat on a number of tobacco strategy Boards and devised and implemented strategies for dealing with tobacco smugglers bringing in cigarettes through the airport.
3. Between 2004 and 2006 I was made Head of Operations for all the London airports (including Heathrow, Gatwick, Stansted, Luton and City Airport). I also kept my responsibilities for tobacco delivery and sat on a number of strategy groups. In 2005 I was awarded an OBE for my services to HMCE (the last to be awarded for that Department). In 2006 I was appointed Head of Intelligence for the Department's (now HMRC) Informant Handling Intelligence and Case Development Teams, where again one of my key priorities was tobacco. In 2009 I was approached to head up the new HMRC Inland Detection Team – this consisted of 342 staff committed to the tackling of inland tobacco and alcohol smuggling throughout the UK. I was the Assistant Director responsible for devising and implementing the strategies for tackling tobacco smuggling inland, which included coordinating media activity for our customer hotline and targeting and managing inland detection officers on blitz exercises throughout the UK mainland.
4. In my last six months in the Department I was seconded into ECSM (Excise, Customs, Stamps and Money) Directorate which, amongst other things, holds the tobacco policy for HMRC. One of the initiatives that I introduced was, where appropriate, the revocation of alcohol licences for international shops found with illicit cigarettes. I also attended a number of 'tobacco' conferences, representing HMRC and making presentations, and liaised closely with senior police and Department of Trading Standards ("DTS") colleagues. In addition I also represented HMRC on national and local media on all matters concerning inland tobacco and alcohol smuggling.

5. I have read the Department of Health 2012 'Consultation on standardised packaging of tobacco products' ("2012 Consultation") and the associated Impact Assessment ("2012 IA") and the Department of Health June 2014 'Consultation on the introduction of regulations for standardised packaging of tobacco products' ("2014 Consultation") and the associated Impact Assessment ("2014 IA"). I have also read the Report of the Independent Review undertaken by Sir Cyril Chantler on 'Standardised packaging of tobacco' dated April 2014 ("Chantler Report"), including the notes of Sir Chantler's meetings with Andrew Leggett, Deputy Director, and Judith Kelly, Tobacco Strategy and Policy Team, HMRC on 20 January 2014 and 7 March 2014.
6. I have been engaged by British American Tobacco UK Limited for my opinions on the subjects I address in this statement. Set out below are my observations on the illicit trade of tobacco products in the UK and the likely impact of standardised packaging on the illicit trade, based on my many years of experience in tackling the illicit tobacco market in the UK.
7. At the outset, it is important to detail what I understand to be the illicit UK tobacco market. This falls into three categories:
 - a. Illicit cross-border shopping: legal branded cigarettes purchased overseas and brought back into the UK which are not for personal consumption or above personal allowances;
 - b. Counterfeits: copies of branded well-known legal cigarettes, manufactured cheaply in the Far East and smuggled normally by containers into the UK; and
 - c. Cheap whites: branded local (eastern European) manufactured cigarettes smuggled into the UK from Europe.
8. A summary of my main conclusions are:
 - a. I believe that the actual scale of the illicit market in the UK is substantially higher than the figures provided by HMRC which are cited in the Department of Health Impact Assessments and the Chantler Report. Today's illicit market has changed. It is now predominantly made up of 'cheap whites' and counterfeits, of which there is currently no reliable measure. Judith Kelly, Tobacco Strategy and Policy Team, HMRC stated at her meeting with Sir Cyril Chantler on 20 January 2014: "*[r]ecent trends also showed that the risk from illicit white cigarettes was overtaking counterfeit, partly because these were cheaper, of an acceptable quality to consumers, and could be made to order*".
 - b. The illicit trade of tobacco is a major concern to society in terms of lost revenue, undermining public health attempts to reduce smoking prevalence and financing organised crime. The recent UK Home Affairs Committee Report on Tobacco Smuggling notes: "[t]obacco

smuggling is associated with organised crime, including the smuggling of controlled drugs, weapons and human beings."

- c. There is a well-established infrastructure, supply lines and market for illicit cigarettes in the UK. It is neither difficult nor high risk for consumers to obtain illicit cigarettes. Illicit cigarettes, in particular cheap whites and, to a lesser extent, counterfeits, are now being increasingly sold through international shops which are found in growing numbers throughout the towns and cities of the UK. Judith Kelly, Tobacco Strategy and Policy Team, HMRC stated at her meeting with Sir Cyril Chantler on 7 March 2014 that: *"the EU rates the UK as the number 1 destination for illicit tobacco."*
- d. If standardised packaging were to be introduced in the UK, based on my experience I believe that counterfeiters would be able to copy this standardised packaging with ease and at a reduced cost. However, they may well not bother replicating standardised packaging but instead continue to replicate branded packaging. There is already a market for branded counterfeit cigarettes and, if anything, this market will only increase on the introduction of standardised packaging.
- e. International shops provide an easy, accessible and reliable source of illicit cheap whites. In my view standardised packaging will only make this situation worse. The cheap white producers will quickly fill any demand for cheap branded cigarettes. In my opinion, standardised packaging will create a further opportunity for cheap white operators to sell into the market.
- f. An assumption that the illicit market in the UK is being effectively combatted is in my view over optimistic and reflects a lack of understanding of the illicit market in the UK. It cannot be expected that the illicit market particularly cheap white cigarettes will be contained by enforcement unless the Government commits significant additional resources and makes widespread changes to the current enforcement regime to contain any growth in the illicit market in the future.
- g. In my opinion based on nearly forty years of experience, standardised packaging runs the very real risk of incentivising the illicit market and driving currently compliant tax-paying smokers down the non-compliant illicit route. If there is a stigma attached to smoking standardised packaged cigarettes or consumers are no longer prepared to pay the price of legal cigarettes, it will not be difficult for consumers to switch to branded cheap white or counterfeit cigarettes which have the added attraction in these austere times of cost savings as well.
- h. HMRC asserts that the introduction of standardised packaging will not create any new risks. This is correct in the sense that standardised packaging will not create any new methods for smuggling tobacco products or impact on current detection methods. However, the point

is that standardised packaging will further incentivise the existing very lucrative, particularly cheap whites, illicit market which HMRC acknowledges it cannot currently accurately assess.

- i. The 2014 IA recognises that there is a risk that standardised packaging could increase the demand for and supply of illicit tobacco. In these circumstances, the proposal in the 2014 IA to simply monitor the impact of standardised packaging on the illicit market ignores the issue and risks creating a much worse situation that will undermine public health and support organised crime in the current environment where there is a well-established illicit market and already established supply lines. Given this and the current lack of priority, resourcing and an effective approach to deterring and disrupting the illicit market, I cannot see how the Government can justify taking the unquantifiable and unknown risk of potentially increasing criminality and reducing revenues collected by the Treasury by introducing standardised packaging.

A. The Size of the Illicit Market

9. I am not at all sure it is possible to ascertain the true extent of the current illicit market especially cheap whites. However, in my view the figure of 9 per cent cited in the 2014 IA and the Chantler Report for the illicit cigarette market, which are based on the midpoint of HMRC estimates, are incomplete and the figures should be substantially higher. Today's illicit market has changed. It is now predominantly made up of cheap whites and, to a lesser extent, counterfeits, of which there is currently no reliable measure. As noted above, Judith Kelly, Tobacco Strategy and Policy Team, HMRC stated at her meeting with Sir Cyril Chantler on 20 January 2014: "*[r]ecent trends also showed that the risk from illicit white cigarettes was overtaking counterfeit, partly because these were cheaper, of an acceptable quality to consumers, and could be made to order*".
10. The entire supply chain for cheap whites and counterfeit cigarettes is illicit from the moment the cigarettes leave the factory to the minute they are sold 'under the retail counter'. This consequently means that HMRC cannot produce reliable figures for the level of tobacco smuggling in the UK as it has no way of measuring this predominant section of the illicit market.
11. Given my experience during 2009-2012 of the change in the illicit market and the amount of seizures of cheap whites and counterfeit cigarettes, I believe that the actual scale of the illicit market is most likely substantially higher than the figures provided by HMRC which are cited in the 2014 IA and the Chantler Report. I note that the National Audit Office Report on 'Progress in tackling tobacco smuggling' dated 6 June 2013 ("**NAO Report**"), which is not referred to in the Chantler Report or the 2014 IA, recognises the uncertainty around the HMRC estimates and reports a range of estimates, including industry figures and figures provided by KPMG which suggest an increase in non-UK duty paid consumption to 21 per cent and 19.2 per cent respectively in 2012. Judith Kelly, Tobacco Strategy and Policy Team, HMRC also stated

at her meeting with Sir Cyril Chantler on 7 March 2014 that: *"the EU rates the UK as the number 1 destination for illicit tobacco so the threat to the UK remains high"*.

B. The Impact of Illicit Trade

12. The illicit trade of tobacco is a major concern to society not only in terms of loss revenue but also in undermining public health attempts to reduce smoking prevalence and financing organised crime. HMRC has noted that: *"[i]llicit tobacco makes smoking more affordable. Unregulated distribution networks associated with smuggling make tobacco more accessible to children and young people and perpetuate health inequalities across socio-economic groups"* and: *"[t]obacco fraud remains one of the main pillars of organised criminal activity in the UK"* (HMRC, *Tackling Tobacco Smuggling—building on our successes, A renewed strategy for HM Revenue and Customs and the UK Border Agency* (2011), at pp 2 & 8). The Home Affairs Committee First Report of Session 2014-15 on Tobacco Smuggling dated June 2014 (*"Home Affairs Committee Report"*) notes (at paragraph 6): *"[t]obacco smuggling is associated with organised crime, including the smuggling of controlled drugs, weapons and human beings"*. Counterfeit cigarettes also raise quality concerns with some counterfeit cigarettes having been shown to contain increased levels of tar, nicotine and arsenic.

C. The Nature of the Illicit Market

13. It is important to understand that the illicit cigarette market in the UK is no longer as covert and secretive as it used to be. Cheap whites and, to a lesser extent, counterfeits are readily available and accessible through international shops, which are now prolific throughout the UK mainland.
14. The Chantler Report states that: *"[t]ypically illicit cigarettes are bought from friends, family and colleagues or through known illicit routes, such as destination shops like "fag houses" or approaches in pubs or clubs. Only about 20% of illicit is purchased from local shops, and at prices that make clear that it is not tax-paid legal product."* I do not know where the figure of 20 per cent for purchases in local shops is derived from but this is not consistent with what I saw when I was the Head of HMRC's Inland Detection teams in 2009-2012 where the highest risk for supplying illicit tobacco were international retail shops situated in many high streets.
15. While historically the majority of illicit products were sold in pubs or clubs at the workplace or on street corners, this is no longer the case. Instead, illicit cigarettes, in particular cheap whites and counterfeits, are now being sold largely through international shops which are found in increasingly large numbers throughout the towns and cities of the UK. A reason for this shift is that pubs and clubs are licensed, and therefore controlled, and the penalties on pubs and clubs for being caught selling illicit tobacco are significant, including loss of their alcohol licence which would shut them down. These international shops not only provide a ready source of cheap cigarettes but they are often

unregulated and in effect uncontrolled, open all hours and very 'user' friendly. It is neither difficult nor high risk for consumers to obtain illicit cigarettes.

(i) *Counterfeit Cigarettes*

16. In 2001/2002 counterfeit cigarettes were beginning to make in-roads into the UK cigarette market. These products, manufactured in the Far East, were smuggled in huge quantities into the UK (6 million at a time in containers through Felixstowe) and sold through organised crime networks onto the streets of the UK. The best example of this was Holloway Road in London where Eastern Europeans and asylum seekers of various nationalities would sell counterfeit cigarettes a pack at a time quite openly outside supermarkets on street corners. Seeing as they are entirely illicit, from manufacture to final sale, it is inevitably very difficult to ascertain the true extent of the illicit counterfeit market in the UK. It is also very difficult to obtain quality intelligence about the true extent of the counterfeit (and illicit white) market because of the culture of 'secrecy and family' of the smuggling groups involved in this business. This was very evident during my time as Head of Intelligence when quality intelligence on counterfeit cigarette smuggling was hard to come by. Technology initially proved very valuable and scanners introduced into major container ports and airports produced impressive seizures of counterfeit cigarettes. Such technology and deployment of overseas liaison officers has had some impact on countering large scale importation of counterfeit cigarettes. However, the nature of cigarette smuggling has changed with cheap whites in particular being smuggled from Europe little and often, which is much harder to detect. As outlined by Jim Hara Director General, Business Tax, HMRC at paragraph 11 of the Home Affairs Committee Report: *"There has been a move away from use of the postal channel and the use of large consignments through containers, as consignments are fragmented into smaller values"*. Mr Hara also stated in his oral evidence before the Home Affairs Committee that it is *"increasingly difficult"* to make seizures because smugglers are *"bringing them [illicit cigarettes] over the border in smaller values"*.

17. If standardised packaging were to be introduced in the UK, based on my experience counterfeiters will be able to copy this standardised packaging with ease and at a reduced cost. Rather than having to copy numerous different packages to mirror genuine brands as is currently the case, counterfeiters will merely have to produce one standard package and then change the brand name for different consignments.

18. However, counterfeiters may well not bother replicating standardised packaging but instead continue to replicate branded packaging. There is already a market for branded counterfeit cigarettes; if anything, this market will only increase on the introduction of standardised packaging as people who previously bought genuine cigarettes and prefer branded packages to standardised packages could be pushed to the illicit market which is already accessible. Therefore people wanting to buy branded packs as normal will buy counterfeit branded packs. On the other hand, if the counterfeiters do

replicate standardised packaging this will only add to the profits of the counterfeit cigarette producers by reducing their costs.

19. The Chantler Report states (at page 35) that hardly any counterfeit standardised packages have been found in Australia, where standardised packaging has already been introduced. Whether this is the case or not, the UK is a different market to Australia. Australia does not have the availability of counterfeit cigarettes (and cheap whites) from the EU in the same way as the UK does. Counterfeit cigarettes would need to be flown into Australia or brought in by ship whereas in 2013, in Dover alone, there was an average of approximately 6770 tourist cars, 248 coaches and 6046 trucks passing through the port every day. The total number of passengers for the year was 12,753,343.¹ In addition, the fact that the UK (and particularly London) has an extremely multicultural society means that there already is a thriving market here for counterfeits and cheap whites as brands of choice, as outlined below.

(ii) Cheap Whites

20. In 2009-2012, as the Head of HMRC's Inland Detection Department, I noticed a shift in the illicit market, highlighted by the actual seizures that were being made. There was a major increase in cheap white cigarettes. The Home Affairs Committee Report notes that in: "2012-13 most large seizures were of illicit whites". These cigarettes use better quality tobacco, unlike the cheap tobacco used in counterfeiters' sweat shops. In addition they come with packaging that is very similar to some legal brands in the UK; for example a cheap white pack of 'Raquel' looks like a legal 'Marlboro Lights' pack, a cheap white pack of 'Jin Ling' looks similar to a legal 'Camel' pack and there are several other such instances. These cheap whites sell for half the price of UK tax-paid cigarettes and not only do they offer a cheaper product but for many smokers they are becoming a brand of choice. HMRC have noted that along with counterfeits, illicit whites "represent the most significant threat to legitimate trade and tobacco revenues in the UK from large scale organised criminality" (HMRC, *Tackling Tobacco Smuggling—building on our successes, A renewed strategy for HM Revenue and Customs and the UK Border Agency* (2011), at p7). Indeed some counterfeiters are actually counterfeiting cheap whites as the cheap white market is so prevalent.
21. The supply chains for cheap whites were also proving different to those for both cross border shopping and, to a lesser extent, counterfeits. As noted above, the vast majority of cheap whites were not sold in pubs or clubs, at the workplace or on street corners. Instead, cheap whites were being sold largely through international shops which can now be found in large numbers throughout the towns and cities of the UK. International shops can be described, in the main, as those shops selling Eastern European products to supply that particular market in the local area.

¹ <http://www.doverport.co.uk/?page=AnnualTrafficStatistics>

22. In 2009-2012 we would from time to time receive information that these international shops were selling smuggled goods. This resulted in the relevant shop being placed under observation and sometimes being subjected to a raid to seize the goods. I specifically remember conducting raids on international shops in Boston in Lincolnshire, Portsmouth in Hampshire, and Chatham during this period. The hit rate for finding illicit cigarettes in international shops during raids in 2009-2012 was nearly 100 per cent. In one town visited by HMRC Inland Detection Officers, all six international shops were found to have illicit cheap whites for sale covertly at £3-£3.50 per pack of 20 compared to £6-£7 or more for a pack of legal cigarettes. These shops rarely hold large stocks of illicit cigarettes but nearly all those visited during the raids conducted in 2009-2012 held some, often enough for 3-4 days' sales. Packs of these cigarettes were usually stored under the counter and at the back of the shop. In one particular raid we found that the shop had a false shelf under the counter. The proprietors I spoke to all came up with the same answer when asked who supplied the illicit cigarettes: an Eastern European in a transit van on a regular basis.
23. While observing these shops I saw school children coming into the shops and buying single cigarettes. Children cannot generally afford packs of cigarettes so they buy single cigarettes. This also has the added advantage that they will not be caught with a pack of cigarettes at school. Standardised packaging will have no impact on this scenario, which is something that isn't considered in the Chantler Report or the 2014 IA.
24. These international shops provide an easy, accessible and reliable source of illicit (mainly cheap white) cigarettes. The infrastructure and supply lines for smuggling these products are well established and these cigarettes are for many already a brand of choice. In my view standardised packaging will only make this situation worse. The cheap white producers will quickly supply any increasing demand, be that a standardised packaged cigarette or the current cheap white packaged cigarette. If consumers are put off by standardised packaging, cheap whites offer an alternative cheaper branded pack. In my opinion, standardised packaging will create a further opportunity for cheap white operators to sell into the market.

(iii) Smuggled Hand Rolled Tobacco (HRT)

25. The market penetration of smuggled HRT has remained at around 45 to 50 per cent over the last 10 years, with counterfeit HRT (in branded packaging) maintaining its predominance because of the price. The illegal supply chains for illicit HRT have remained fairly static with the largely ethnic smuggling organisations unchanged and the customer base contained within lower social economic classes. Interestingly, as far as I am aware, international shops have not provided many HRT seizures. Again, in my view, standardised packaging will only push HRT smokers who are put off by standardised packaging into the illicit counterfeit market.

D. Enforcement

26. The Chantler Report states (at page 36):

"Many high tax jurisdictions, including the UK, have already demonstrated that an effective enforcement regime and appropriate sanctions can keep illicit to low levels. Illicit tobacco is not a normal market -- more people would buy illicit cigarettes today if they could, but they cannot because supply is limited by effective enforcement".

27. This assumption that the illicit market is being effectively combatted is in my view over optimistic.

28. The NAO Report examining HMRC's progress in tackling tobacco smuggling makes it clear that HMRC does not have an effective integrated approach to deterring and disrupting the illicit market within the UK. The NAO Report also concludes that HMRC did not meet its targets in 2012-13 and lacks a timely and comprehensive assessment of the impact of its strategy on the scale and nature of tobacco smuggling. Similarly, the recent Home Affairs Committee Report also concluded that the Government was not doing enough to combat the illicit tobacco trade, concluding that:

"We are worried that not enough is being done by the Government and its appropriate agencies to combat the problem of tobacco smuggling at source"

and:

"over the last three years the numbers of prosecutions and convictions for organised crime cases involving tobacco have fallen. We do not believe that these numbers are decreasing due to the reduction in this type of crime and are deeply concerned that these figures may indicate a reduction in enforcement action."

29. Effective enforcement of the illicit tobacco market is extremely difficult. It requires a committed and co-ordinated approach between HMRC, Border Force and the DTS. Currently, with reduced budgets and competing priorities there is not, I suggest, an effective enforcement approach for tackling inland illicit tobacco.

30. The NAO Report states (at paragraph 16) that HMRC's *"approach to deterring and disrupting the distribution of illicit tobacco within the UK is not yet effectively integrated"*, i.e. HMRC needs to develop its approach on tobacco inland. I am in full agreement with this statement. During my time as Head of Inland Detection I had 342 full-time inland investigators concentrating on illicit tobacco but this team has now been disbanded and the investigators shifted into multi-functional teams with competing priorities, such as income tax. Investigators are expensive as they work seven days a week and need special training so they are allocated to the prevailing priority areas.

31. With cuts to the HMRC budget there is also no media support for intelligence gathering. During my time as Head of Inland Detection most intelligence-based seizures originated from media-based campaigns which promoted the Customs Hotline. Success usually resulted from the police, the DTS, the Department of Health and HMRC all working together; the Customs Hotline was often the key to this success. Now the HMRC budget has been cut there is no media support – the Customs Hotline is still there but people are not actively encouraged to use it. This is also picked up on in paragraphs 30-31 of the Home Affairs Committee Report which suggests that free media should be used to broaden the knowledge and awareness of enforcement actions and penalties.
32. The separation of the policy side and border enforcement side in 2007 has also resulted in the responsibility for enforcing policy on illicit cigarettes falling on a department that does not set the border policy. While HMRC is responsible for setting policy on illicit tobacco and accountable for revenue collection, it is in fact Border Force that enforces these policies. This is not effective, Border Force's priority is currently immigration and with limited resources its front line officers are not solely focused on illicit tobacco. The Home Affairs Committee Report notes at p3: *"John Vine CBE OPM, the Independent Chief Inspector of Borders and Immigration scrutinised Border Force freight operations between March and July 2013. He concluded that there had been a breakdown in communication between Border Force and HMRC at an operational level."* This is again picked up in paragraph 22 of the Home Affairs Committee Report which states that:

"HMRC and Border Force must continue to strengthen the lines of communication between the two organisations, to ensure that relevant and up-to-date information is passed between teams. In particular, it is vital that referrals be made to HMRC in all cases of seizures where it appears that there might be scope for sanctions to be imposed. HMRC and Border Force should create a platform where effective examples of joint working with local police forces and partner agencies such as Trading Standards across the UK can be accessed for training and in order to share good practice. Without sharing information, raising prosecution and arrest rates for tobacco smuggling will be more difficult, if not impossible."

33. As noted above, many of the international shops selling illicit tobacco are unregulated unless they sell alcohol. If the shop does sell alcohol then it is regulated by the DTS. The DTS is appointed and funded by local councils and it has also been subjected to substantial budget cuts.² When I was working at HMRC I was told by DTS Officers that alcohol and tobacco were not a priority; the priorities were instead counterfeit toys, food and hygiene, i.e. scams on the public. As illicit cigarettes are not in the public eye in the same

² See e.g. "40% cut in trading standards will devastate vulnerable consumers", 07 April 2014, <http://www.tradingstandards.gov.uk/extra/news-item.cfm/newsid/1464>

way as faulty goods, for example, the approach is often taken that they are less of a problem.

34. Jim Harra, the Director General, Business Tax, HMRC stated in his evidence before the Home Affairs Committee, in response to a question regarding whether plain packaging is going to be more difficult:

"First of all, there is a real dearth of data that enable you to predict what the impact of standardised packaging will be on smuggling. Only one major country has introduced it—Australia. We are collaborating very closely with them to learn the lessons, even though there may not be direct parallels with the UK. Our assessment is that it is not going to create any new risks for us but it could well change the profile of the illicit market, and we would have to respond to any changes in that market in that way, but we do not think any new risk is created."

35. I agree that the introduction of standardised packaging will not create new risks in terms of how tobacco products are smuggled or detection methods. However, this misses the point. The point is that there is a very high current risk which I believe will be exacerbated by the introduction of standardised packaging requirements, making a bad situation worse. The infrastructure, supply lines and market for counterfeit and cheap whites is already in place so the introduction of standardised packaging will not create a new market but risks incentivising that existing illicit market. As Mr Hara noted, standardised packaging could well change the profile of the illicit market and there is a dearth of data to enable a prediction of what the impact of standardised packaging will be on this highly organised profitable but illegal trade.

36. Judith Kelly, Tobacco Strategy and Policy Team, HMRC stated in her meeting with Sir Cyril Chantler on 7 March 2014 that: *"HMRC does not have any data to quantify the particular risk from counterfeit product and is unable to assess the impact of Standardised Packaging on the degree of counterfeiting."* Mrs Kelly and Andrew Leggett, Deputy Director, HMRC also concluded that: *"standardised packaging probably does enhance and diversify the existing risks the UK faces but it is very difficult to quantify any changes in risk because there is such a lack of good data. HMRC have effective enforcement responses available to counter these risks."* I agree with the first part of this statement, but I do not agree that HMRC has effective enforcement responses available to counter these risks. Firstly, as acknowledged, HMRC does not even know what the actual risk really is. Further, as noted above, both the NAO Report and the Home Affairs Committee Report concluded that HMRC does not currently have an effective approach to deterring and disrupting the illicit market successfully within the UK.

E. The 2014 IA

37. The 2014 IA recognises the risk that standardised packaging will increase the illicit market, stating that: *"There is a risk that the intervention may*

unintentionally encourage smokers who want branded tobacco to seek it from places where it is still available ... standardised packaging could increase the demand for and supply of illicit tobacco". The 2014 IA also concludes that *"there is likely to be an increase in the UK duty unpaid segment but we have no means of quantification."* However, the 2014 IA provides no proposal for dealing with this increased risk. Instead the 2014 IA proposes to monitor the impact on the illicit market on the basis that *"[m]itigating action could however be taken if the intervention causes an increase in the illicit tobacco market."* It is also stated that: *"[t]o mitigate any increase in illicit trade would require additional resources devoted to reducing the demand, and intercepting the supply of illicit tobacco products which would increase costs and the additional funding required cannot be guaranteed or assumed."* This is not a proposal to address the issue at all, but essentially amounts to ignoring the issue and hoping for the best. There is no proposed measure to mitigate the risk.

38. In only proposing to monitor the impact of standardised packaging on the illicit market, the Department of Health is wrongly disregarding the very real consequences that the introduction of standardised packaging could have, particularly when it is acknowledged that additional resources and funding cannot be assumed or guaranteed. Without an effective inland enforcement regime in place this will incentivise the illicit market and risks providing further support to the recognised criminality associated with the illicit market.
39. Judith Kelly, Tobacco Strategy and Policy Team, HMRC also stated in her meeting with Sir Cyril Chantler on 7 March 2014 that *"there was a risk that once an individual began to purchase illicit product they would consume more due to relatively low cost"*, i.e. once a smoker moves to the illicit market they are unlikely to return to genuine brands. Accordingly, the Government cannot assume that they will be able to subsequently undo the effect that standardised packing has on the illicit market. Indeed there is not even any commitment from the Government to provide any additional resources to tackle this threat.

F. Conclusion

40. In my opinion based on nearly forty years of experience, standardised packaging runs the very real risk of incentivising the illicit market and driving currently compliant tax-paying smokers down the non-compliant illicit route. As set out above, international shops provide an easy, accessible and reliable source of illicit (mainly cheap white) cigarettes. Both legal and illicit cigarettes are currently available from the same source on the High Street. If there is a stigma attached to smoking standardised packaged cigarettes or consumers are no longer prepared to pay the price of legal cigarettes, it will not be difficult for consumers to switch to cheap white or counterfeit brands which have the added attraction in these austere times of cost savings as well. There is no evidence to suggest that smokers are at all put off by smoking a non-UK duty paid branded cigarette, as the increase in seizures of cigarettes manufactured for an overseas market (e.g., L&M cigarettes, a brand that is popular in Poland) tends to indicate.

41. Furthermore standardised packaging will almost certainly be welcomed by the HRT and cigarette counterfeiters and the cheap white manufacturers as either they will be able to copy this standardised packaging with ease and at a reduced cost or they will continue to produce branded products which appeal to those smokers put off by standardised packaging.
42. It goes without saying, of course, that any move nudging smokers into the illicit market either through cost, branding or increased availability will have potentially significant positive implications for organised crime but negative ones for the Treasury with few obvious health advantages to compensate.
43. Law enforcement is already challenged and it cannot be expected without significant additional resources to contain any potential growth in the illicit market in the future. The Government cannot rely on enforcement reducing the risk that introducing standardised packaging will have on the illicit market if it does not at the same time provide more resources for enforcement, more frontline officers, more customs officers inland to control the international shops and supply chains together with a tobacco licensing regime, more DTS officers, a publicity campaign to provide intelligence to tackle the problem and robust sanctions procedures including prosecutions. Given the current lack of priority, resourcing and an effective approach to deterring and disrupting the illicit market within the UK, I cannot see how the Government can justify taking the unquantifiable risk of increasing criminality and reducing revenues collected by the Treasury and thereby not meeting Sir Cyril Chantler's proposed response to the increased risk to the illicit market which is to have an effective enforcement regime and appropriate sanctions.



EL276



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):

National Foreign Trade Council

Name of person providing submission (required):

[Redacted]

Job Title (required):

President

Contact address of organisation (required):

1625 K Street, NW
Suite 200
Washington, DC 20006 USA

Contact email address (required):

[Redacted]

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:

The NFTC receives funding from its member companies in the form of standardized annual membership dues. Fewer than two percent of our members are involved in even the most indirect way with the cultivation, export, manufacture, distribution or sale of tobacco products.

- 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?

No

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?

See Attached Letter

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?

See Attached Letter

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?

See Attached Letter

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

NATIONAL FOREIGN TRADE COUNCIL, INC.

1625 K STREET, NW, WASHINGTON, DC 20006-1604

TEL: (202) 887-0278



FAX: (202) 452-8160

August 7, 2014

Department of Health
Standardised Packaging Tobacco Consultation
PO Box 1126
Canterbury
CT1 9NB
tobaccopackaging@dh.gsi.gov.uk

On behalf of the National Foreign Trade Council (NFTC) the following comments are submitted in response to the UK Department of Health Consultation on the Introduction of Regulations for Standardised Packaging of Tobacco.

The NFTC, founded in 1914, is a trade association that represents some 250 global companies on matters of international trade and tax policies, export finance and international human resource issues. Our members come from all sectors of business and industry; fewer than two percent of them are involved in even the most indirect way with the cultivation, export, manufacture, distribution or sale of tobacco products.

Why is the NFTC making this submission? Simply put, the NFTC regards efforts to mandate plain or standardized packaging of tobacco or other products to be a serious infringement on intellectual property rights, and a violation of widely accepted rules of international trade. Specifically, it is our view that plain packaging requirements, regardless of the product or products to which they apply, are inconsistent with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), the WTO Agreement on Technical Barriers to Trade (TBT Agreement) and the Paris Convention for the Protection of Industrial Property (Paris Conventions).

Trademarks and brands play a central role in the global economy. Among other benefits, they provide consumers with important information about the quality and characteristics of products in the market place and help to prevent consumer confusion and deception. Building a brand's reputation is critical to the success of companies that compete in the marketplace. To do so also is a very costly and long-term process. In fact, a trademark or brand often is a company's most valuable asset. This is not mere hyperbole. Witness the well-known case of Ford Motor Company that, in 2006, was required by its creditors to secure a \$23.5 billion loan with all of its marketable assets, specifically including the company's iconic blue oval trademark.

Six years later, in May 2012, following dramatic improvement in the company's finances and an upgrade for its commercial paper, creditors no longer needed Ford's trademark as collateral to secure its debt. The blue oval was "returned" to Ford unencumbered. Highlighting just how important that trademark is, Ford Chairman Bill Ford said at the time:

"When we pledged the Ford Blue Oval as part of the loan package, we were not just pledging an asset. We pledged our heritage." . . . "Getting the Ford Blue Oval back feels amazing, and it is one of the best days that I can remember."

Companies with established and respected brands create millions of jobs around the world, are major drivers of capital investment and important contributors to the global economy. For governments, regardless of intentions, to destroy a product's identity and a company's accumulated value would set a short-sighted and ultimately self-damaging precedent with far-reaching trade and investment consequences.

The NFTC understands the health concerns associated with smoking and supports well-designed measures that mitigate those health risks. We also support measures to prevent consumer deception. Our concern is that the proposed standardized/plain packaging initiative will sacrifice important trademark protection and violate several international trade agreements without achieving the stated public health objectives of plain packaging proposals.

Banning the use of distinguishing trademarks on tobacco products through such regulations would deprive consumers of critical product information. Mandated use of standardized packaging and typeface would further facilitate the manufacture and distribution of counterfeit and contraband tobacco products and deprive governments of an important source of tax revenue.¹ In 2009, sales of counterfeit cigarette products were estimated to cost governments \$40.5 billion in lost revenue.²

If standardized/plain packaging would make illicit tobacco trade easier and reduce tax revenues from legal sales, it arguably likewise would not achieve the stated objectives of such a measure, namely to delay the age of initiation of tobacco use, reduce tobacco consumption and improve the effectiveness of anti-smoking warnings.³ A survey of studies conducted by Dr. Jorge Padilla and Dr. Nadine Watson⁴ suggests that the expected increase in counterfeit products coupled with the inability of companies to differentiate their products based upon quality, taste, filtration, etc. would likely result in lower average prices for tobacco products, thus making cigarettes cheaper and more available to a younger demographic and encouraging initiation of smoking at an earlier age.

Additional and more recent study has confirmed these findings. A 2013 KPMG⁵ study found that since the implementation of laws requiring tobacco products sold in Australia be packaged in a plain and standardized manner, illegal tobacco consumption in that country rose from 11.8% of total consumption to 13.9% of total consumption by the end of 2013, an increase of almost 20%. The report also found that the consumption of illegal branded cigarettes in Australia grew 151% in the first year alone of mandatory plain packaging.

The NFTC does not regard the protection of intellectual property to be at odds with the advancement of public health. But we are convinced that the elimination of intellectual property rights via plain/standardized packaging requirements:

- perversely, would not accomplish the stated health objectives;
- would seem to violate international trade agreements; and
- would send a troubling signal to those concerned with the creeping erosion of IP globally.

1 http://transcrime.eu.univ.it/ce/bo/publication/AP/Transcrime-Plain_packaging_and_illicit_trade_in_the_UK-ES.pdf

2 L. Jousens et al. *Eliminating the Global Illicit Cigarette Trade Would Increase Tax Revenue and Save Lives*, Paris: International Union Against Tuberculosis and Lung Disease (2009).

3 *Berenberg Bank study* - <http://www.smoke-free.ca/plain-packaging/Documents/2011/Philip%20Morris%20-%20Annex%2012%20-%20Bloomquist,%20Berenberg%20Bank%20-%20The%20Plain%20Risk%20to%20Global%20Tobacco%20-%2021%20March%202011.pdf>

4 Dr. Jorge Padilla and Dr. Nadine Watson, LECG Consulting, "A Critical Review of the Literature on Generic Packaging for Cigarettes" (November 18, 2008).

5 http://www.pmi.com/eng/tobacco_regulation/illicit_trade/Documents/Illicit_Tobacco_in_Australia_2013_full_year_report.pdf
Advancing Global Commerce for A Century
www.nftc.org

Another major concern is that the destruction of the industry's ability to differentiate its brands would benefit the illicit tobacco industry, which often is run by organized crime and which always can sell its counterfeit products at a fraction of the cost of legal tobacco. According to the 2011 *Europol Organized Crime Threat Assessment*:

*"Preferred destinations [for cigarette smuggling] within the EU are countries with comparatively high taxes on tobacco, such as the Scandinavian countries, Germany, Spain, the UK (emphases added) and Ireland. Destination countries may also serve as transit points to larger markets in other Member States, as is the case of Ireland, where the land border with Northern Ireland is susceptible to smuggling into the UK."*⁶

Finally, though the present consultation is confined to plain/standardized packaging of tobacco products, the NFTC views this issue as far broader than tobacco. There already have been suggestions in some countries about extending plain/standardized packaging rules to alcohol. For instance the Indonesian Trade Ministry has announced that it is considering new regulations requiring brand owners to use plain packaging for liquor with alcohol content of 20% and above⁷. It takes little imagination to think that additional products easily could be added to the list.

It is the hope of the NFTC that the UK Government will exercise great caution when considering the imposition of standardized/plain packaging requirements for any industry. We would encourage restraint and careful reflection and strongly recommend that Government not adopt any policies that would diminish intellectual property rights protection.

As representatives of international companies, we advocate for rules-based trade that sustains economic growth, employment and innovation. It is our conclusion that standardized/plain packaging requirements would violate existing international trade agreements, benefit manufacturers of counterfeit tobacco products and reduce tax revenues while still not achieving the public health goals favored by those who advocate them.


President

⁶ <http://www.europol.europa.eu/sites/default/files/publications/octa.2011.1.pdf>

⁷ <http://www.packwebasia.com/compliance/legislation/3251-Indonesia-ponders-new-law-for-liquor-packaging>



U.S. CHAMBER OF COMMERCE

1615 H Street, NW
Washington, DC 20062-2000
www.uschamber.com

August 7, 2014

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region. Our members place great importance on the protection of IP rights, which are essential to the ability of businesses to thrive in the global economy. Which is why the proposed introduction of 'plain packaging' laws in the United Kingdom concerns us.

Please find attached several documents which will elaborate on our concerns and policy position. Attached are: (1) the U.S. Chamber of Commerce's position on plain packaging, (2) our official submission to the Department of Health of the United Kingdom in response to the "Consultation on the introduction of regulations for standardized packaging of tobacco products," and (3) our letter explaining in detail the Chamber's stance on the destruction of trademarks.

Thank you for the opportunity to provide comments.



U.S. CHAMBER OF COMMERCE

1615 H Street, NW
Washington, DC 20062-2000
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August 7, 2014

The Hon. Jeremy Hunt
Secretary
Department of Health of the United Kingdom
Standardised Packaging Tobacco Consultation
PO Box 1126
Canterbury
CT1 9NB
United Kingdom

RE: Consultation on the introduction of regulations for standardized packaging of tobacco products

Dear Secretary Hunt:

On behalf of the U.S. Chamber of Commerce (the U.S. Chamber), we wish to provide this submission opposing the introduction of the above-referenced regulations for standardized packaging in the United Kingdom. This submission reiterates the concerns we raised in our April 2014 letter to the Prime Minister and in our July 2012 submission during an earlier consultation period.

At the outset, we categorically state that the U.S. Chamber is a strong supporter of measures to protect public health and recognizes the importance of reducing smoking rates in those efforts. However, we believe that implementing standardized 'plain packaging' does not support these public health goals and is a departure from the U.K. government's international trade and intellectual property (IP) commitments. These proposed regulations set a dangerous precedent at the expense of the protection of IP rights for a number of industries, not just tobacco. Indeed, internationally there are similar proposals for plain packaging on additional products based on alcohol, fat, and/or sugar content. This is precisely the situation we believe should be avoided given its adverse consequences on global IP protections and the potential disruption to trade flows.

Department of Health

Page Two

August 7, 2014

The U.S. Chamber is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region. Our members place great importance on the protection of IP rights, which are essential to the ability of businesses to thrive in the global economy. Implementing plain packaging in the United Kingdom would effectively deprive brand owners of the right to use their trademarks in commerce, thereby significantly undermining the fundamental value of trademark protections.

Plain Packaging Renders Trademarks Worthless without Advancing Public Health Objectives and Risks Unintended Consequences

The protection of trademarks is a priority for the U.S. Chamber. Trademarks safeguard the reputation of companies and their products and prevent consumer confusion and deception. For many of our members, the brand itself – the reputation of which is built over years of providing quality goods and services – is their most valuable asset. The U.S. Chamber's significant efforts through the International Division, the Global Intellectual Property Center (GIPC) and the Coalition Against Counterfeiting and Piracy (CACP) illustrate our serious commitment to protecting these valuable assets.

There is no compelling evidence that plain packaging of tobacco products will actually advance the U.K. government's intended objectives. On the contrary, according to a recently released study, the level of illicit trade in Australia has risen nearly 20% since that country mandated plain packaging in late 2012¹. According to the study, "The key driver of this growth has been a large increase in the consumption of illicit manufactured cigarettes, primarily in the form of contraband."

The availability of counterfeit tobacco products, including so-called "illicit whites," appears to have increased in Australia. 'Illicit white cigarettes' are those that may have been manufactured legally in one market but enter another market illegally. The KPMG study noted, "Manchester is currently the largest illicit white brand in Australia; if it were sold legally in Australia it would have a 1.3% market share." Furthermore, according to the data in this study, this was the first time since 2009 that tobacco consumption, including of counterfeits, in Australia did not decline year on year, casting doubt on claims by proponents of this policy that it would trigger a decline in smoking rates when enforced.

¹ See KPMG LLP, "Illicit tobacco in Australia," April 2014

Note too that a recent Australian Institute of Health and Welfare (AIHW) 2013 National Drug Strategy Household Survey showed a drop in smoking rates for people over the age of 14, from 15.1% in 2010 to 12.8% in 2013. As mentioned above, these figures do not correspond with recent studies or industry sales data. Even more importantly, where the media cites the AIHW study as evidence of the success of plain packaging, the Australian Government is reluctant to make such claims itself. In June 2014 Geoff Neideck of the AIHW said, “[I]t would be a stretch to say this data shows that [plain packaging] was a key factor” in cutting the smoking rate.

Further, we believe that the lack of distinguishing trade dress and labeling may ultimately result in an increased risk of consumer deception and confusion; may paradoxically result in unintended harm to public health through increased illicit trade; and would deny the property rights of companies and their workers who have invested in building their brand’s reputation.

Plain Packaging Is Inconsistent with the United Kingdom’s International Obligations

Plain packaging requirements would likely be considered inconsistent with the U.K. government’s international obligations, including those highlighted below under the World Trade Organization’s (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), the Paris Convention of Industrial Property (Paris Convention), and the WTO Agreement on Technical Barriers to Trade (TBT).

- **Article 20 of the TRIPS Agreement** states that: “[t]he 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.” A standardized packaging requirement which allows manufacturers only to “print brand and product names” would eliminate the use of most trademarks, which are a critical means for consumers to distinguish among products. By eliminating trademarks on the package, standardized packaging amounts to an encumbrance by special requirement that is inconsistent with TRIPS Article 20.
- **Article 16 of the TRIPS Agreement** confers exclusive rights to owners of registered trademarks and provides a guaranteed minimum level of protection of the distinctiveness and reputation of the mark. The scope of

protection guaranteed under Article 16 of the TRIPS Agreement is determined by the use made of the mark and the resulting strength of the mark. For example, Article 16.3 of the TRIPS Agreement protects well known marks from dilution and allows the owner of a well-known mark to prevent the use of similar marks even on dissimilar product when that use would risk damaging the mark owner's interests and if it would suggest an association with the well-known mark. A plain packaging measure that prevents the use of all trademarks and requires the use of the brand name in a standardized form and font reduces the level of protection below that minimum level. A well-known mark that can no longer be used will soon lose its special status and its extended scope of protection. Similarly, certain trademarks like colors that are distinctive only as a result of prolonged use in relation to a particular product will become non-distinctive and will no longer be protected as trademarks. A plain packaging measure therefore violates the minimum enforcement rights guaranteed by Article 16 of the TRIPS Agreement.

- **Standardized packaging exceeds the “limited exceptions” described under Article 17 of the TRIPS Agreement.** TRIPS Article 17 allows WTO Members to provide for limited exceptions to trademark rights, “provided that such exceptions take account of the legitimate interests of the owner of the trademark and of third parties.” Such exceptions do not apply in this case for several reasons. For example, the prohibition on use of the cigarette trademarks (apart from the name in plain type) is not “limited” but is instead a near-complete abrogation of the trademark. In addition, the proposed regulations does not “take account of the legitimate interests” of trademark owners to differentiate their products, nor does it take into account the rights of third parties, especially consumers, to identify with confidence the product they are purchasing.
- **Article 10bis of the Paris Convention** prohibits “all acts of such a nature as to create confusion by any means whatever with the establishment, the goods, or the industrial or commercial activities, of a competitor.” A standardized packaging rule would remove all distinctive elements of tobacco packaging with the exception of the word mark in standardized type face. As a result, anti-competitive behavior is effectively required and there is a very substantial risk that there will be confusion in the retail setting as to the brand of tobacco product consumers are purchasing.

- **Article 2.2 of the TBT Agreement** requires that “technical regulations shall not be more trade-restrictive than necessary to fulfill a legitimate objective, taking account of the risks non-fulfillment would create.” While protection of public health is clearly a legitimate objective, the U.S. Chamber is concerned that standardized packaging requirements, particularly in the absence of credible science-based evidence that these requirements would address public health concerns, might actually have the opposite effect. There are other measures that could be employed to achieve the stated objectives, with less trade-restrictive results.

This bill sends a negative message to the United Kingdom's trading partners and undermines its reputation for the rule of law. It also exposes the business community to potential trade disruptions.

Conclusion

While the U.S. Chamber supports improving public health, we are deeply concerned about the credibility of this approach and its possible unintended consequences. These include the dangers of increased smoking rates due to competition through pricing in the legal market and an influx of illicit and counterfeit tobacco products as described above. In the absence of trademarks, brands will be competing solely on price – which would likely drop as a result of plain packaging.

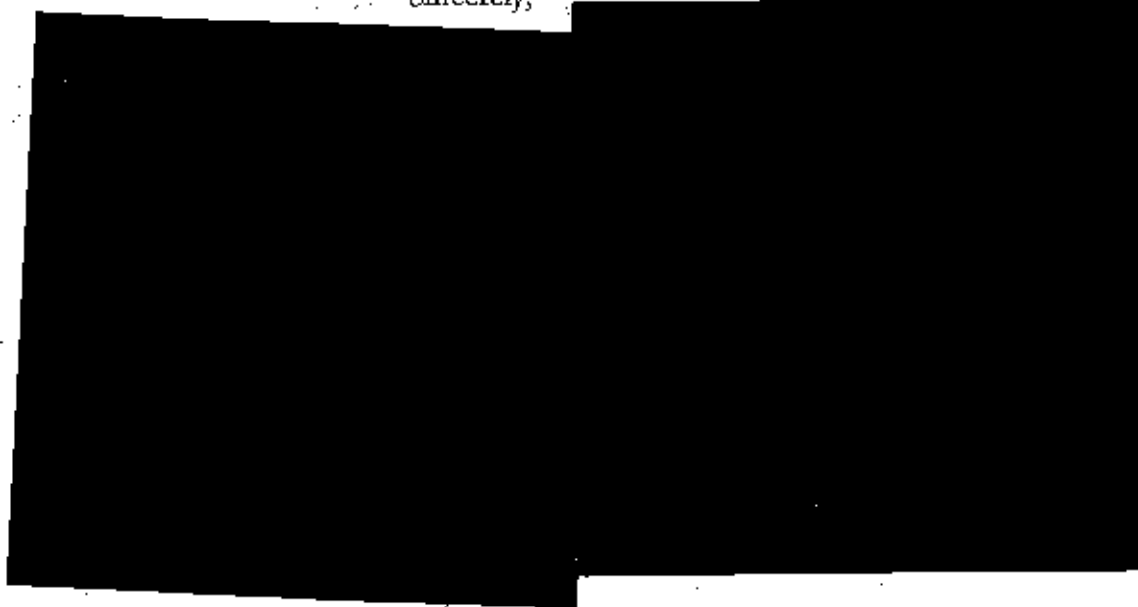
Further, we are concerned that standardized packaging potentially violates numerous international commitments and has the potential to undermine trademark and other intellectual property rights, creating an additional problem of consumer confusion. As you are likely aware, Australia's law continues to face challenges under international law, both through WTO proceedings and investment arbitration.

The impact on the economy of the United Kingdom could also be significant if it is viewed as failing to safeguard IP rights through the improper destruction of registered marks.

For these reasons, we ask the Government of the United Kingdom to affirm the importance of adhering to international trade and investment obligations and acknowledge the prudence of awaiting the outcome of the various legal challenges leveled against existing plain packaging legislation, while considering other proposals which would be more effective in achieving public policy goals.

Department of Health
Page Six
August 7, 2014

Sincerely,



U.S. Chamber of Commerce Position on "Plain Packaging"

The U.S. Chamber of Commerce strongly supports measures to protect public health and recognizes the importance of reducing smoking rates. However, we believe that standardized packaging — also known as "plain packaging" — undermines lawful protection of intellectual property, does not advance public health goals, violates international agreements, and sets a dangerous precedent for other industries.

Protection of trademarks is a priority for the U.S. Chamber. A company's reputation is built over years of providing high-quality, fairly priced and reliable products and services. Its brand is its most valuable asset. Trademarks protect the reputation of companies and their products and prevent consumer confusion and deception. Plain packaging undermines the value of trademark protections by depriving brand owners of the ability to use their mark in commerce, resulting in a loss of investment and jobs.

The Chamber is also concerned that standardized packaging requirements do not advance public health goals and may have unintended consequences. Several studies have shown that, where plain packaging laws have been implemented, there is a risk of increased consumption of illicit and possibly counterfeit products. Counterfeit tobacco products create additional health and safety concerns, including the possible consumption of unregulated products containing dangerous contaminants. Moreover, purveyors of illicit and counterfeit products often are linked to criminal organizations, which, in addition to their illegal undertakings, do not generate tax revenue.

Plain packaging legislation also violates the international agreements that protect the intellectual property of all industries. This includes obligations countries have accepted as parties to the World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), the Paris Convention of Industrial Property (Paris Convention), and the WTO Agreement on Technical Barriers to Trade (TBT).

Finally, state-sponsored attacks on trademarks could invite retaliation, threatening the well-being of virtually any industry. Indeed, similar measures have been considered for processed foods, wine & spirits, and sugary beverages.

In summary, plain packaging requirements do not advance public health goals, may unintentionally foster illicit trade, violate international agreements, and set a dangerous precedent for other industries. The U.S. Chamber urges that plain packaging requirements be rejected and that measures intended to safeguard public health be designed in a way that does not undermine the effective protection of intellectual property rights.



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):

[Redacted]

Job Title (required):

Contact address of organisation (required):

[Redacted]

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:

The U.S. Chamber is the world's largest business federation representing the interests of more than three million businesses and organizations of every size, sector and region.

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?

At the outset, we categorically state that the U.S. Chamber is a strong supporter of measures to protect public health and recognizes the importance of reducing smoking rates in those efforts. However, we believe that there is a lack of sufficient evidence that implementing standardized 'plain' packaging would support these public health goals. For example, we understand that the first review of the public health impacts of Australia's 'plain packaging' laws will be released in late 2014 and the evidence thus far does not show a negative impact on smoking rates which would suggest that this policy should receive continued support.

Regarding the Chantler Review, we understand that the scope of the review was rather narrow and did not cover important impacts on the economy, intellectual property rights, or the trade in counterfeit goods, which may have provided a more complete picture. This limit of depth is acknowledged in the Chantler Review in the Letter to the Secretary of State for Health (paragraph 18) which notes, "I have not seen evidence that allows me to quantify the size of the likely impact of standardised packaging...." Accordingly, it would seem difficult to justify regulatory action on this basis.

We agree that there is a lack of evidence to show the impact of plain packaging and would also note that the only evidence we have from a country which is experimenting with plain packaging comes from Australia. We understand that in a recent study conducted by the firm KPMG in that country, where plain packaging has been implemented since December 1, 2012, the level of illicit cigarette consumption has reached record levels, growing from 11.8% to 13.9% of total consumption at the end of 2013. This is an increase of nearly 20% since the introduction of plain packaging. According to the study, "The key driver of this growth has been a large increase in the consumption of illicit manufactured cigarettes, primarily in the form of contraband."

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?

Recent figures in Australia have shown cigarette sales have increased by 59 million cigarettes in the first year since plain packaging was introduced, reversing the long-term decline of legal sales volumes in the country since before 2009 (see: The Telegraph, 24/03/14).

Regarding the uptake in illicit trade in tobacco products, we understand that the Australian Customs and Border Protection Service's (ACBPS) Annual Report states that tobacco detections nearly doubled (from 45 to 76) between 2011-12 and 2012-13, the total number of cigarettes confiscated reached 200 million cigarettes in 2012-13 versus just 82 million in 2010-11, and, most notably, the duty evaded rose to \$151 million (from \$125 million).

In addition to the uptake in illicit consumption we make reference to above, it may also be worth noting that the KPMG study found the prevalence of counterfeit tobacco products appears to have increased. 'Illicit whites' have emerged as a major form of contraband this year. Illicit white cigarettes are those that may have been manufactured legally in one market but enter another market illegally. "Manchester" is currently the largest illicit white brand in Australia; if it were sold legally in Australia it would have a 1.3% market share."

According to the data in this study, this was the first time since 2009 that tobacco consumption in Australia did not decline year on year, suggesting some doubts about the claims by proponents of this policy that it would trigger a decline in smoking rates when enforced.

Further, we believe that the lack of distinguishing trade dress and labelling may ultimately result in an increased risk of consumer deception and confusion; may paradoxically result in unintended harm to public health through increased illicit trade; and would deny the property rights of companies and their workers who have invested in building their brand's reputation.

We would note, as above, that studies conducted in Australia have not shown a decrease in tobacco consumption, but rather an increase in the consumption of illicit tobacco products. Additionally, despite media claims of plain packaging success referencing the recent Australian Institute of Health and Welfare's (AIHW) 2013 National Drug Strategy Household Survey which showed a drop from 15.1% of people older than 14 smoking in 2010 to 12.8% in 2013 (a number which doesn't correspond with industry sales data), the Australian Government is reluctant to make such claims itself. In June 2014 Geoff Neideck of the AIHW said, "[I]t would be a stretch to say this data shows that [plain packaging] was a key factor" in cutting the smoking rate."

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?

Plain packaging requirements would likely be inconsistent with the Government of United Kingdom's international obligations, including those highlighted below under

the World Trade Organization's (WTO) Agreement on Trade – Related Aspects of Intellectual Property Rights (TRIPS Agreement), the Paris Convention of Industrial Property (Paris Convention), and the WTO Agreement on Technical Barriers to Trade (TBT). Among the provisions:

- Article 20 of the TRIPS Agreement states: “[t]he 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.” A standardized packaging requirement which allows manufacturers only to “print brand and product names” would eliminate the use of most trademarks, which are a critical means for consumers to distinguish among products. Consequently, by eliminating the trademark on the package, standardized packaging places encumbrances by special requirements that are inconsistent with TRIPS Article 20.

- Article 16 of the TRIPS Agreement confers exclusive rights to owners of registered trademarks and provides a guaranteed minimum level of protection of the distinctiveness and reputation of the mark. The scope of protection guaranteed under Article 16 of the TRIPS Agreement is determined by the use made of the mark and the resulting strength of the mark. For example, Article 16.3 of the TRIPS Agreement protects well known marks from dilution and allows the owner of a well-known mark to prevent the use of similar marks even on dissimilar product when that use would risk damaging the mark owner's interests and if it would suggest an association with the well-known mark. A plain packaging measure that prevents the use of all trademarks and requires the use of the brand name in a standardized form and font reduces the level of protection below that minimum level. A well-known mark that can no longer be used will soon lose its special status and its extended scope of protection. Similarly, certain trademarks like colors that are distinctive only as a result of prolonged use in relation to a particular product will become non-distinctive and will no longer be protected as trademarks. A plain packaging measure therefore violates the minimum enforcement rights guaranteed by Article 16 of the TRIPS Agreement.

- Standardized packaging exceeds the “limited exceptions” described under Article 17 of the TRIPS Agreement. TRIPS Article 17 allows WTO Members to provide for limited exceptions to trademark rights “provided that such exceptions take account of the legitimate interests of the owner of the trademark and of third parties.” Such exceptions do not apply in this case for several reasons. For example, the prohibition on use of the cigarette trademarks (apart from the name in plain type) is not “limited” but is instead a near-complete abrogation of the trademarks. In addition, the proposed Bill does not “take account of the legitimate interests” of trademark owners to differentiate their products, nor does it take account of the rights of third parties, especially consumers, in being able to identify with confidence the product they are purchasing.

- Article 10bis of the Paris Convention prohibits "all acts of such a nature as to create confusion by any means whatever with the establishment, the goods, or the industrial or commercial activities, of a competitor." A standardized packaging rule would remove all distinctive elements of tobacco packaging with the exception of the word mark in standardized type face. As a result, anti-competitive behavior is effectively required and there is a very substantial risk that there will be confusion in the retail setting as to the brand of tobacco product consumers are purchasing.

- Article 2.2 of the TBT Agreement requires that "technical regulations shall not be more trade-restrictive than necessary to fulfill a legitimate objective, taking account of the risks non-fulfillment would create." While protection of public health is clearly a legitimate objective, the U.S. Chamber is concerned that standardized packaging requirements, particularly in the absence of credible science-based evidence that these requirements would address public health concerns, might actually have the opposite effect. There are other measures that could be employed to achieve the stated objectives, with less trade-restrictive results.

This bill sends a negative message to the United Kingdom's trading partners and undermines its reputation as a reliable destination for international investment. It also exposes the government to potential trade disruptions. For these reasons, we ask the Government of the United Kingdom to affirm the importance of adhering to international trade and investment obligations and acknowledge the prudence of awaiting the outcome of the various legal challenges leveled against existing plain packaging legislation, while considering other proposals which would be more effective in achieving public policy goals.

On a final note, should plain packaging laws be found to be a taking of property, the financial implications would be significant. The compensation due to trademark owners for the deprivation of their brands has been estimated most recently by BNP Paribas at up to £11 billion. As BNP Paribas analysis stated, "...at both the WTO and especially the EU level, the Tobacco Industry seems to have a robust case against plain packaging which would allow it to claim compensation." The Sun, Ministers face £11bn bill if they bring in plain cigarette packs, 8 July 2014, <http://www.thesun.co.uk/sol/homepage/news/politics/5738866/ministers-face-11bn-bill-over-plain-cig-packs.html>

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?

Yes, a number of experts have publicly questioned the effectiveness and impact of plain packaging laws. This includes Dr. Neil McKeganey, of the Drugs Misuse Research Centre in Glasgow, one of Scotland's leading experts in tackling addiction

who has warned that there is insufficient evidence for the UK and Scottish governments to press ahead with the introduction of plain packaging for tobacco. In his paper, published in the same week as Sir Cyril Chantler's review, he states "The argument for requiring tobacco products to be sold in plain or standardised form may well be a case where the collective support for a policy has developed well beyond the available evidence."

Additionally, empirical evidence, such as reports from the University of Zurich that show there is no evidence plain packaging impacts youth smoking, was unfortunately not included within Sir Cyril Chantler's review.

We also encourage the government to examine evidence of down trading where customers are switching from more expensive to cheaper brands, with a rise in the market share of cheaper cigarettes from 32% to 37%. The Australasian Association of Convenience Stores chief executive Jeff Rogut said: "Talking to members, one of the most common refrains they get from people coming into stores is, 'What are your cheapest smokes?'" and that with the move to lower priced products, "people are coming back more often" (see The Australian, 06/06/14).

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)

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

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

- o **Emailing your response to:**

TobaccoPackaging@dh.gsi.gov.uk

- o **Posting your response to**

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

TRADEMARK ELIMINATION VIA PLAIN PACKAGING

We are writing to express our concerns regarding government-mandated trademark elimination via "plain packaging" measures.

Effective protection of intellectual property rights is an essential element of a thriving economy, generating jobs and growth by fostering competition and spurring innovation. Trademark protection is essential in identifying and distinguishing products in the marketplace. The protection of such property is a fundamental tenet of law whose vital importance is enshrined in domestic laws the world over as well as in several international agreements, including the World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights and the Paris Convention on Industrial Property.

We recognize that governments have the authority to regulate when necessary to protect the public interest. Such measures should be consistent with fundamental tenets of law and international legal obligations. They should be proportionate, evidence-based and effective in achieving a specific purpose. They should be adopted after sober deliberation and careful consideration of the potential for unintended consequences. Plain packaging rules that mandate trademark elimination do not meet these standards. In fact, such measures currently are the subject of a WTO dispute settlement proceeding.

There are ways to regulate effectively in the public interest. Mandating destruction of intellectual property is not among them, and we urge governments to forego it.

American Chamber of Commerce in Bulgaria
American Chamber of Commerce in Indonesia
American Chamber of Commerce in Italy
American Chamber of Commerce in Jordan
American Chamber of Commerce in Kazakhstan
American Chamber of Commerce in Kosovo
American Chamber of Commerce in Macedonia
American Chamber of Commerce in Montenegro
American Chamber of Commerce in the Netherlands
American Chamber of Commerce in Russia
American Chamber of Commerce in Senegal
AmCham Serbia
American Chamber of Commerce in the Slovak Republic
American Chamber of Commerce in Spain

American Farm Bureau Federation
American-Hellenic Chamber of Commerce
BritishAmerican Business
British-American Business Council
Cámara Nacional de Comercio y Servicios del Uruguay
The Canadian Chamber of Commerce
Canadian Manufacturers & Exporters
Chamber of Commerce and Industry of Serbia
Chamber of Industries in Ecuador
Council of the Americas
economiesuisse
Emergency Committee for American Trade
Estonian Patent Attorneys Association
European Chamber of Commerce in Korea
Federation of Attica and Piraeus Industries
Federation of Israeli Chambers of Commerce
Federation of Korean Industries
Greek Association of Branded Products Manufacturers
ICC BASCAP
ICC Lithuania
ICC United Kingdom
Lithuanian Business Federation
Lithuanian Confederation of Industrialists
National Association of Manufacturers
National Association of Small and Medium Retailers of Romania
National Foreign Trade Council
Polish Chamber of Trade
Trade-related IPR Protection Association in Korea
Trans-Atlantic Business Council
Turkish Patent and Trademark Attorneys' Association
US-ASEAN Business Council
U.S. Chamber of Commerce
United States Council for International Business

EL278



Department
of Health



Llywodraeth Cymru
Welsh Government



The Scottish
Government
Riaghaltas na h-Alba



Department of
Health, Social Services
and Public Safety
www.dhsspseni.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):

[Redacted]

Job Title (required):

Contact address of organisation (required):

Contact email address (required):

[Redacted]

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:

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?

Having considered the Chantler Review and the report by Professor David Hammond supporting the views of Sir Cyril Chantler we in Wolverhampton consider that the case for standardised packaging has been well made. We consider that all attempts to reduce further the number of our young people who take up smoking are justified.

In Wolverhampton we have one of the highest rates of smoking in pregnancy and we struggle to achieve real and meaningful reductions in these rates. What we do know is that many of these women report that they started to smoke at approximately age 13 and at school. We carry out a bi-annual 'Health Related Behaviour Survey' (a confidential health and well being survey of young people aged 6 - 16) which includes several questions around attitudes and behaviours towards smoking. Whilst as a general rule we have observed a steady decline in young people who report having tried smoking, there is a clear 'jump' in numbers of pupils who state that they currently smoke or have done in the past as they get older. For example, when asked to select from a statement to describe their smoking behaviours, 96% of Primary pupils selected 'I have never smoked a cigarette', compared to 80% of Secondary school pupils.

The estimated number of smokers in Wolverhampton is approximately 43,000 and young smokers are the only replacement smokers for the Tobacco Industry. We would support the response from Jane Ellison MP to the Chantler Review and agree that introducing regulations for standardised packaging should proceed as swiftly as possible. We are concerned about potential delays and efforts to stall the legislation by the tobacco industry based on concerns that standardised packaging could increase counterfeiting of cigarettes and the illicit tobacco trade. We would share the views and the confidence of the Association of Chief Trading Standards Officers (ACTSO) in the ability of the Tobacco Industry to implement suitable security features as are currently present on branded packaging. The EU Tobacco Products Directive due to be implemented in 2016 will require additional safeguards, to include; unique identifiers, coded numbering and covert anti-counterfeit marks. The Tobacco Industries are also collaborating on a sophisticated shared Digital Coding and tracking system to support enforcement and reduce the illicit trade so are giving out mixed messages about their concerns.

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?

Evidence from the introduction of Standardised packaging in Australia as part of a comprehensive strategy estimates that if were to do a similar campaign in the UK, on a per capita basis the cost would be the equivalent of £33.7 million. In wolverhampton alone it is estimated that smoking in our population costs approximately £70.8 million pounds. This is from early death, cost to the NHS, loss of productivity from smoking breaks and sickness absence.

The emerging evidence from Australia since the 2012 consultation does highlight a reduction in total consumption of tobacco and cigarettes and a fall in excise and customs duty since they introduced standardised packaging. In addition some of the concerns identified by the tobacco industry related to the introduction of standardised packaging have not occurred in Australia e.g. loss of custom for convenience stores due to increased waiting times, transaction times have declined and not increased.

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?

We would support the views of Action on Smoking in Health (ASH) in that the legislation should also apply to specialist tobacco products e.g. cigars as despite the low usage by young people it does not set a good example and could be interpreted as an endorsement of these products. In addition we would also support the prohibition of brand names that mislead people into thinking some products are less harmful e.g. 'natural', 'organic', slim etc.

Please note that the timescales for implementing the regulations is now very tight with some of the processes taking up to 6 months and we would urge that nothing should further delay Parliament getting the opportunity to vote on the regulations.

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 Impact assessment does not fully take on board any additional costs that may be incurred by the enforcement agencies and this does need to be considered in light of current financial constraints facing Local Authorities. Standardised packaging is backed by the Smokefree Action Coalition (with a membership of over 250 organisations including the Royal Colleges). It is popular with the Public and has been endorsed by the passing in both the House of Lords

and House of Commons of section 94 of the Children and Families Act. The majority of the opposition is from the tobacco industry as it looks to its only growth market - young people.

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:

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



722 12TH ST NW, SUITE 400 WASHINGTON, DC 20005 -202.785.0266 - WWW.PROPERTYRIGHTSALLIANCE.ORG

To:
Department of Health
Standardised Packaging Tobacco Consultation
PO Box 1126, Canterbury, CT1 9NB
E-mail: tobaccopackaging@dh.gsi.gov.uk

RE: Submission about the draft regulations on "The Standardised Packaging of Tobacco Products Regulations"

Introduction

On behalf of the **Property Rights Alliance (PRA)**, we respectfully submit our views in response to the invitation from the Department of Health about draft policies on "The Standardised Packaging of Tobacco Products Regulations 1" (hereafter referred to as the "SPTPR"). We thank the Department of Health for the invitation to make such a submission regarding the SPTPR and discuss the implications of the proposal. The SPTPR seeks to amend product information standards to remove brands trademarks, and logos from tobacco packaging.

The Property Rights Alliance

The PRA is an advocacy organization, based in Washington, DC dedicated to the protection of physical and intellectual property rights throughout the world. The PRA produces the annual **International Property Rights Index**, a comparative study that measures the significance of both physical and intellectual property rights and their protection for economic well-being. In order to incorporate and grasp the important aspects related to property rights protection, the Index focuses on three areas: Legal and Political Environment (LP), Physical Property Rights

¹Appendix B: http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/323922/Consultation.pdf

(PPR), and Intellectual Property Rights (IPR). The 2013 study analyzes data for 131 countries around the globe, representing ninety-eight percent of world GDP and ninety-three percent of world population. The 2013 index incorporates data of Property Rights protection from various sources, often directly obtained from expert surveys within the evaluated countries.²

The Importance of the Intellectual Property Rights

The right to own and enjoy property is a fundamental part of the rights of people and even referred to as an extension of human rights. As such, the protection of property rights, both physical and intellectual, is critical to economic development, and is the most important guarantee of freedom. Creating and maintaining an environment where both forms of property are protected and legally enforceable contributes to economic growth and stability.

Intellectual property rights can boost trade and foreign direct investment not only in the U.S. and in the European Union (EU) but also in the developing world as well. As highlighted in the 2013 edition of the International Property Rights Index (IPRI), people in countries that protect their physical and intellectual property enjoy a GDP per capita up to eight times greater than those without legal protection.³ Weakening of IP rights not only is detrimental to the economy, but also puts the public's health and safety at risk.

The protection of property rights, both physical as well as intellectual, is critical to the economic development of any economy. Creating and maintaining an environment, where both forms of property are protected, contributes to the economic growth and stability of modern economies. We note that the economies of United Kingdom (UK), as well as the European Union, revolve significantly around businesses related to intellectual property, whether it is pharmaceuticals, movies, music, books, software or inventions and industrial designs. As such, the continued protection of intellectual property rights is critical for the economy to continue to flourish.

The protection of trademarks is a vital part of the protection of intellectual property rights and the present consultation proposes prohibiting the use of tobacco trademarks. For all manufacturers, packaging is a critical way brand information is provided to consumers. Tobacco companies have significant intellectual property rights through their trademarks, and this is demonstrated by the degree of brand loyalty in the market today. Plain packaging legislation would significantly erode the value of this property.

² Dr. Francesco di Lorenzo "2013 International Property Rights Index," Property Rights Alliance, September 2013. Can be accessed: www.internationalpropertyrightsindex.org.

³ Dr. Francesco di Lorenzo "2013 International Property Rights Index," Property Rights Alliance, September 2013. Can be accessed: www.internationalpropertyrightsindex.org.



722 12TH ST NW, SUITE 400 WASHINGTON, DC 20005 -202.785.0266- WWW.PROPERTYPRIIGHTSALLIANCE.ORG

By denying a manufacturer the right to use their trademark to identify their product, the SPTPR strikes at the very core principles of corporate identity and consumer information the EU is based upon. As such, it not only violates the legal rights of companies affected, but sets a very dangerous precedent for the future of any government unwilling to respect intellectual property rights.

The assault on the centuries-old protection of trademarks would represent a grave threat to the future of property rights, individual freedom, and the freedom of speech and should be rejected by the UK Government without reservation.

Observations about the Sir Cyril Chantler Independent Review⁴

Following the publication of the Chantler report, on 3 April 2014, the governing body of the UK publicly announced that it was going to move ahead with a standardised packaging plan following a brief public consultation.⁵

The UK Government stated recently that it aims to introduce these regulations before the next general election.⁶ Jane Ellison, Public Health Minister said: *"We are minded to introduce regulations to provide for standardised packaging of tobacco products in line with Cyril Chantler's recommendations. It is vital that any decision is properly and fully informed. The consultation includes a set of draft regulations so it is clear how such a policy would work in practice. I urge anybody with any new evidence relating to the wider implications of introducing standardised packaging, to contribute so their voice can be heard. All aspects of the policy will be considered before a final decision is made."*

On 13 March 2014 an updated version of the Children and Families Act⁷ was drafted and implemented into law. The changes to this piece of legislation give the Secretary of State for Health the power to impose limitations onto the packaging of tobacco products. These limitations are, of course, up to the discretion of the

⁴ Standardised packaging of tobacco, Report of the independent review undertaken by Sir Cyril Chantler April 2014. <http://www.kcl.ac.uk/health/10035-TSO-2901053-Chantler-Review-ACCESSIBLE.PDF>

⁵ Jane Ellison, Oral Statement to Parliament, 3 April 2014 <https://www.gov.uk/government/speeches/chantler-report-on-standardised-packaging-of-tobacco-products>

⁶ Earl Howe, Statement to the House of Lords, 3 April 2014 <http://www.publications.parliament.uk/pa/ld2014/ldhansrd/text/140403-0003.htm>

⁷ <http://www.legislation.gov.uk/ukpga/2014/6/contents/enacted>

Secretary; that discretion being whether they deem the packaging is contributing at any time negatively or positively to the health peoples under the age of 18.⁸

Standardised packaging has to be legally implemented as legislation. It's current state is in the form of an Affirmative Instrument, which will need to be passed in order for the enabling legislation to be brought into force, within the litigational boundaries of the Children and Families Act.

According to PRA, the Chantler's report -which analyzes the potential impact of standardised packaging on public health- is both statistically and idealistically flawed. The scope of the Chantler review is narrow in that it merely focuses on the potential health impacts while ignoring the broader, more economically driven impacts of the policy. The effects of standardised packaging on businesses and efficiency of supply chain management should be a completely separate review piece unto itself.

In reviewing the potential health impacts of the policy, Sir Cyril concedes that the evidence to date is inconclusive, noting that he finds it 'intuitively plausible' that plain packaging would have a positive impact on health. This is an insufficiently robust standard of proof upon which to base a policy with significant legal and economic implications.

The Chantler Report disregards evidence that reveals an increase in the illicit trade in Australia since the introduction of plain packaging (discussed in further detail below). This is a significant concern shared by many businesses in the tobacco supply chain and evidence produced by independent third parties with well-established credibility such as KPMG⁹ should be given appropriate consideration on this topic.

Observations about the Impact Assessment (IA) and opinions by Regulatory Policy Committee (RCP)

The Department of Health, in the IA on the standardised tobacco packaging, supports "Option 2" which states it will: *"Go beyond the European Tobacco Products Directive in 2016 and requires standardised tobacco packaging of cigarettes and hand rolling tobacco (HRT)."*¹⁰

PRA agrees with and supports the opinions stated by the RCP with regards to Option 2 *"[...] By going beyond minimum EU requirements, the Department is gold-plating the measure."*¹¹

⁸ Children and Families Act 2014 <http://www.legislation.gov.uk/ukpga/2014/6/section/94/enacted#section-94-6>

⁹ http://www.pmi.com/eng/media_center/Documents/KPMG%20Report%20on%20Illicit%20Trade%20Australia.pdf

¹⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/323518/impact_assessment.pdf

¹¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/336590/2014-05-29-RPC12-DH-1229_2_-_Standardised_packaging_of_tobacco.pdf



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1. Legal and Intellectual Property Violations

The SPTPR will violate international obligations and protocol

If enacted, the SPTPR would violate several international agreements to which the UK is a part of. For example, it will affect the Trade-Related Aspects of Intellectual Property Rights (TRIPS) that is administered by the World Trade Organization. In particular the:

- **Article 15 (4)**¹² of TRIPS that states: *"The nature of the goods or services to which a trademark is to be applied shall in no case form an obstacle to registration of the trademark."*
- **Article 20**¹³ of TRIPS that states: *"The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as use with another trademark, 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. This will not preclude a requirement prescribing the use of the trademark identifying the undertaking producing the goods or services along with, but without linking it to, the trademark distinguishing the specific goods or services in question of that undertaking."*

The SPTPR will affect the **Paris Convention**, an international convention dealing with the protection of industrial property (patents, industrial designs and trademarks). In particular the:

- **Article 6**¹⁴ that states: *"every trademark duly registered in the country of origin shall be accepted for filing and protected as in the other countries of the Union."*
- **Article 6 (quinquies)**¹⁵ that states: *"trademarks covered by this Article may be neither denied registration nor invalidated except in the following cases:*
 - *(f) when they are of such a nature as to infringe rights acquired by third parties in the country where protection is claimed;*

¹² http://www.wto.org/english/whop/c/trips_e/tr-ann3_e.htm#1

¹³ http://www.wto.org/english/whop/c/trips_e/tr-ann3_e.htm#1

¹⁴ http://www.wipo.int/treaties/en/ip/paris/tradocs_wo020.html#P147_20484

¹⁵ http://www.wipo.int/treaties/en/ip/paris/tradocs_wo020.html#P147_20484

- (ii) when they are devoid of any distinctive character, or consist exclusively of signs or indications which may serve, in trade, to designate the kind, quality, quantity, intended purpose, value, place of origin, of the goods, or the time of production, or have become customary in the current language or in the bona fide and established practices of the trade of the country where protection is claimed;
 - (iii) when they are contrary to morality or public order and, in particular, of such a nature as to deceive the public. It is understood that a mark may not be considered contrary to public order for the sole reason that it does not conform to a provision of the legislation on marks, except if such provision itself relates to public order."
- **Article 7¹⁶**, that has identical requirements of the Article 15 (4) of TRIPS, states "The nature of the goods to which a trademark is to be applied shall in no case form an obstacle to the registration of the mark."

The SPTPR will affect the agreement on Technical Barriers to Trade (TBT) that deals with the procedure of testing and certifying conformity to technical regulations. All WTO members, of which the UK is one, are required to uphold the principles of the TBT Agreement. In particular the:

- **Article 2.2¹⁷** states: "Members shall 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, taking account of the risks non-fulfilment would create. Such legitimate objectives are, inter alia: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, inter alia: available scientific and technical information, related processing technology or intended end-uses of products.

2. The failure of the Plain Packaging policy

The Australian case

For the first time since the implementation of Plain Packaging in Australia there is hard data to disprove misleading anecdotes and predictions about its true impact and effectiveness. Contrary to what advocates of Plain Packaging would lead one to believe, the data demonstrates that since the introduction of this policy the black

¹⁶ http://www.wipo.int/treaties/cj/lp/paris/trtdoctr_wa020.html#P147_20484

¹⁷ http://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm



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market has grown while consumption and smoking rates of tobacco overall have not declined.

Increase in Illicit Trade In Australia

- The illegal consumption of tobacco has reached record levels, growing from 11.8% to 13.3% from June 2012 to June 2013.¹⁸
- The key driver of this growth has been a large increase in the consumption of illegally branded cigarettes, primarily in the form of contraband. Consumption of counterfeit cigarettes has also increased.
- The 154% increase in black market, branded cigarettes has come at the same time volumes of illicit unbranded tobacco, known as “chop chop” in Australia, have declined by 40%.
- If these black market purchases had been made in the legal market, the government would have collected AUD1.0 billion in additional excise tax revenue.

Smoking rates in Australia

Research conducted by London Economics found that *“over the timeframe of the analysis, the data does not demonstrate that there has been a change in smoking prevalence following the introduction of plain packaging despite an increase in the noticeability of the new health warnings.”*¹⁹

Experts from the Universities of Saarland and Zurich conducted a statistical analysis of smoking prevalency among Australians aged 14+, in order to assess whether the introduction of plain packaging and larger graphic health warnings have any impact on the desire to smoke²⁰. The study found that regardless of the packaging techniques used, no evidence was found that supported the positive benefits brought out by plain packaging. According to this analysis, plain packaging had at most, failing to have a continual effect beyond December 2012.

Industry figures have shown cigarette sales increased by 59 million cigarettes in the first year plain packaging was introduced, reversing the long-term decline of legal

¹⁸ http://www.pml.com/eng/media_center/Documents/KPMG%20Report%20on%20Illicit%20Trade%20Australia.pdf

¹⁹ <http://london-economics.co.uk/wp-content/uploads/2013/11/London-Economics-Report-Australian-Prevalence-Final-Report-25-11-2013.pdf>

²⁰ Ashok Kaul and Michael Wolf (2014), Working paper series / Department of Economics No. 165, The (Possible) Effect of Plain Packaging on Smoking Prevalence in Australia: A Trend Analysis, <http://www.econ.uzh.ch/static/workingpapers.php?id=844>

sales volumes in the country since before 2009.²¹ Consequently, plain packaging can have the complete opposite effect in terms of desired outcome.

In conclusion, Professor Sinclair Davidson of RMIT University in Victoria, Australia has stated: *"I have no doubt that the consumption of cigarettes has risen since plain packaging was introduced; we just can't be sure whether it is by existing smokers or new smokers."*²²

Retailer problems in Australia

A study conducted by Roy Morgan²³ and commissioned by Philip Morris in Australia found that:

- Since plain packaging was introduced 43% of small retailers surveyed in Australia perceive a moderate or major threat to their business from illegal tobacco, up from 36% in December 2012. One-third report customers have asked if they can purchase illegal cigarettes from their store.
- 78% of small retailers experienced increases in the time it takes to complete tobacco purchases for adult customers.
- 62% faced increased frustration from adult tobacco customers and 65% have seen an increase in the frequency of staff supplying the wrong products primarily due to difficulty in recognizing and distinguishing between brands.
- Two-thirds of small retailers have been forced to spend additional time training staff as a result of the changeover while 44% have faced additional costs from training staff members.

3. Plain Packaging Consequences on the Illicit trade In the United Kingdom

A recent investigation by *The Sun*²⁴ demonstrated the severity of the measure's effect on the economy. In their investigation, journalists met with distributors of counterfeit cigarettes in Indonesia who admitted that plain packaging will help them import counterfeit cigarettes, reduce costs, and increase profits. According to one counterfeiter, his factory is already producing 100 million cigarettes per month, 10 million of which are smuggled into the UK via shipping containers. He claimed that plain packaging will make his costs significantly lower and reduce the likelihood of his fake cigarettes being identified.

²¹ The Telegraph, 'Australia tobacco sales increase despite plain packaging', *The Telegraph*, 24/03/14.

²² Quoted in Sloan, J., 'Claims plain packaging works go up in smoke', *The Australian*, 16/06/14.

²³ <http://www.aacs.org.au/new-research-validates-retailers-fears-of-illicit-trade-and-other-negative-impacts-of-plain-packaging>

²⁴ http://www.thesun.co.uk/sol/homepage/news/5669365/Sun-investigates-fake-cigarette-foreign-crime-gangs.html?CMP=SOC-Sun-Twitter-11_20_2013-191-0-0



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4. The image of United Kingdom at risk and the economic impact

According to Forbes Magazine, the UK has been ranked n.12 in the "Best Country in World for Business" in December 2013²⁵. This prestigious recognition is due to important free-market industrial and pro-business policies adopted by the UK Government in the last 20 years, with the protection of intellectual property being the main backbone and driver of the UK economy. In fact, according to the 2013 International Property Rights Index, the United Kingdom²⁶ ranks 2 out of 131 on the protection of the intellectual property rights while internationally UK is 12, above Germany and the United States respectively 14 and 17. Efforts to enact plain packaging laws in the UK would compromise the trademark rights of American companies. This would impact jobs in the United States and the economies of both countries.

While it is difficult to quantify the economic impact on the United States and the UK, it should be noted that even a small drop in the legal cigarette market could impact the US tobacco farmer.

- o According to NC State University, even a 2% drop in the EU cigarette market (Due to the UK's policies) would mean that US farm income would decline by over \$8 million USD.
- o The states of North Carolina, Kentucky and Virginia would bear the largest share of this impact since the majority of U.S. tobacco production, processing and shipping occurs in and from these states.

Poorly crafted policies like plain packaging that destroy the IP of US companies call into question whether or not the UK can meet the high regulatory and scientific standards of that are required with today's global economy.

Plain packaging would cause damage to the UK's international reputation as a supporter and promoter of legitimate business and a defender of commercial rights, particularly in relation to intellectual property.

²⁵ <https://www.forbes.com/places/united-kingdom/>

²⁶ <https://www.propertyrightsalliance.org/userfiles/2011%20International%20Property%20Rights%20Index%20PBA.pdf>

Plain Packaging sets a precedent for restrictions on other industries, damaging the UK's competitive position. Already, plain packaging has been proposed for alcoholic beverages. If the SPTPR is enacted, the UK could compromise its historical and world-renowned images pro-market and pro-business country with a serious negative impact not only on the job market but also on the foreign investments. According to the Centre for Economic and Business Research, plain packaging would threaten the productivity of the independent retail sector²⁷. In particular they estimate that as a result of plain packaging:

- 6,400 convenience stores could close
- Up to of the 182,300 retail jobs in the UK could be lost
- Small retailers' overall earnings could be cut by up to £300 million p.a. – the equivalent of 19% of sector earnings.²⁸

5. International Legal response on Plain Packaging

Australia WTO Dispute

The first legal reaction from the international community came from Ukraine, Honduras, the Dominican Republic, Cuba and most recently Indonesia (on 21st September 2013). These countries have each initiated World Trade Organization (WTO) proceedings against Australia seeking to rectify plain packaging's violations of key WTO agreements, including the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and Agreement on Technical Barriers to Trade (TBT).

The European Union, as part of major revisions to the Tobacco Products Directive has rejected plain packaging at every EU institution multiple times.²⁹

6. Conclusion

As PRA we strongly recommend that the UK Government rethink the SPTPR because of its strong violation of the international treaties on intellectual property rights and its very negative impact on the UK job market. Nanny state policies, like plain packaging, will seriously damage the UK's reputation as one of the freest nations in the world, especially in terms of economic freedom (UK #14), according to the *2014 Index of Economic Freedom*³⁰. The SPTPR by the UK's Department of Health will contribute not only to deterioration of the UK's international reputation of being

²⁷ Centre for Economic and Business Research, March 2013 A scenario-based quantification of the economic impact of plain packaging for tobacco products in the UK, <http://www.cebr.com/reports/impact-of-plain-packaging/>

²⁸ Retail Times, High streets will be hit hard by plain packaging for tobacco products, study finds, <http://www.retailtimes.co.uk/high-streets-will-be-hit-hard-by-plain-packaging-for-tobacco-products-study-finds/>

²⁹ <http://www.reuters.com/article/2013/07/10/eu-tobacco-idU5L6N0RQ32W20130710>

³⁰ <http://www.heritage.org/index/country/ukinitedkingdom>



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both a supporter and promoter of legitimate business and trademarks rights, but also could seriously affect the current Transatlantic Trade and Investment Partnership negotiations. This is a direct attack on free-market principles and an open violation of to the main international trade conventions, as mentioned above, such as the Agreement on Trade-Related Aspects of Intellectual Property Rights and the Agreement on Technical Barriers to Trade.



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INTRODUCTION

1. Redd Solicitors LLP ("Redd") is a specialist law firm practising predominantly in the field of intellectual property. Matters relating to trade marks, copyright, designs and patent are at the heart of Redd's practice. Redd's clients include a large number of brand owners, many with worldwide reputations and substantial trade mark portfolios, in a wide range of industries including luxury goods, food and drink, pharmaceuticals, tobacco, entertainment, IT, communications and fast moving consumer goods.
2. The solicitors at Redd are members of, and actively participate in, many of the key intellectual property organisations in the UK and internationally. All of the partners are recognised in legal directories as experts in the field. We are therefore well-placed to comment on any policy initiative that will affect intellectual property rights.
3. We believe that the UK Government's proposal to introduce standardised packaging for tobacco products raises some important points of principle in relation to intellectual property, particularly trade marks, which go beyond the interests of the tobacco industry. Redd submitted a response to the consultation on standardised packaging of tobacco products published on 16 April 2012 (the "2012 Consultation") which raised several of these points of principle (the "2012 Response"). We do not repeat those points here, other than in passing in order to give context to our submission.
4. We believe that the consultation on the introduction of regulations for standardised packaging of tobacco products published on 26 June 2014 (the "Consultation"), and in particular the draft regulations (the "Regulations") which form part of the consultation, raise new issues in relation to intellectual property which we consider merit a further response. This response will focus on consultation questions 2 and 3, concerning the wider aspects of standardised packaging and the draft regulations.
5. We disclose that Phillip Morris is a current client of the firm and that it is through our work for them that we have become particularly interested in the issues surrounding standardised (or plain) packaging. However, Philip Morris has not had any involvement in the content of this response. We believe that the issues raised by the proposals are of sufficient general trade mark importance that it is appropriate to submit an independent response reflecting our own views as intellectual property law practitioners.

Consultation 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?

COMPATIBILITY WITH THE UK'S EXISTING LEGISLATIVE OBLIGATIONS

6. We consider that the proposed introduction of standardised packaging threatens to put the UK in breach of numerous of its European and wider international obligations, as set out below:

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Revised TPD

7. During the course of the negotiation of the Revised TPD, an amendment which would have mandated standardised packaging was proposed but rejected in its entirety by the Committee on the Environment, Public Health and Food Safety.¹ The reasons for the rejection of standardised packaging are unclear. However, Article 24(2) of the final text of the Revised TPD expressly permits Member States to introduce further measures to standardise the packaging of tobacco products, subject to the measures being: (i) justified on public health grounds; (ii) proportionate and not a disguised means of restricting the free movement of goods; and (iii) notified to the European Commission, together with the grounds for maintaining or introducing them. The measures must be justified on public health grounds "taking into account the high level of protection of human health achieved through [the Revised TPD]".
8. The Consultation acknowledges the existence of the Revised TPD and lists many of the requirements it imposes, but does not address the requirements set out in Article 24(2) which specifically addresses standardised packaging. In particular, it does not include a draft of the public health grounds for introducing them nor does it explain why the measures are necessary over and above the provisions of the Revised TPD.

Council Regulation (EC) 207/2009 on the Community Trade Mark ("CTMR")

9. The CTMR has direct applicability in the UK. A principle of the CTMR is that Community trade marks have 'unitary character' throughout the European Union. Article 1(2) of the CTMR expressly prohibits Member States derogating from the principle of the unitary character of a Community trade mark unless otherwise provided for in the CTMR. The introduction of standardised packaging would be an example of exactly such a derogation by imposing a prohibition on use which is not provided for in the CTMR, contrary to the overall objectives of the CTMR. If the UK introduces standardised packaging without resolving this conflict with the CTMR, any such measures may, in theory, be subject to an action for non-compliance by the European Commission pursuant to Article 258 of the Treaty on the Functioning of the European Union. This issue has been addressed by Anna Carboni (a partner of this firm) in an article published in the 'ITMA Review' (June 2014 edition) entitled: "Making it plain", the text of which is set out in the Schedule to this submission.

Charter of Fundamental Rights of the European Union (the "Charter") and European Convention for the Protection of Human Rights (the "ECHR")

10. We addressed the incompatibility of standardised packaging with the provisions of the Charter and the ECHR in our 2012 Response.

Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)

11. We addressed the incompatibility of standardised packaging with the provisions of TRIPS in our 2012 Response.

¹ Debate of the European Parliament, 8 October 2013. Available at: <http://www.europarl.europa.eu/slides/getDoc.do?type=CRE&reference=20131008&secondRef=ITEM-005&language=EN&ring=A7-2013-0276> [Accessed on 6 August 2014].

CONSULTATION DESIGN

12. We consider that the Consultation has not been held in a manner that is commensurate with the topic under consultation or which complies with the Government's own Consultation Principles published on 17 July 2012 (the "Principles").
13. The Principles set out guidance that Government departments should adopt when engaging with stakeholders. In particular, the Principles state that²:
- a) timeframes for consultation should be proportionate and realistic and, where the consultation spans all or part of a holiday period (which is stated to include August), policy makers should consider what if any impact there may be and take appropriate mitigating action;
 - b) consultations may last between two weeks and twelve weeks, depending upon factors such as complexity, the diversity of the interested parties and whether there has been prior consultation. However, they also state that for a "new and contentious policy, 12 weeks or more may still be appropriate";
 - c) policy makers should ensure that the consultation captures the full range of stakeholders affected; and
 - d) one reason to conduct a consultation is to "understand possible unintended consequences of a policy".

Length and Timing of the Consultation

14. We consider that the time period provided for the Consultation was not proportionate or realistic, due to the complexity of analysing a draft Statutory Instrument, the fact that it spanned a holiday period, the contentious nature of the subject matter (as demonstrated by the number of responses received to the 2012 Consultation) and the fact that secondary legislation under a public health act is being used to amend primary trade mark legislation, which policy makers may have reasonably assumed would give rise to concerns about unintended consequences.
15. Indeed, the Consultation states, at paragraph 5.16, that the Regulations will not be implemented until May 2016 in order to coincide with the deadline for the transposition of the Revised TPD. In the light of this deadline and in light of the Principles, it is difficult to understand how it can have been considered appropriate for the consultation to be only six weeks in length and held over the summer holiday period.

UK Intellectual Property Office ("UKIPO")

16. Where it is proposed that legislation be enacted which affects intellectual property, it is generally the UKIPO which runs the consultation process. Examples of topics of previous consultations run by the UKIPO include: draft regulations for the UK orphan works scheme, proposed revisions to the EU copyright framework and draft regulations to regulate collecting societies. We consider it to be surprising that the UKIPO does not appear to have participated in

² Cabinet Office, 17 July 2012, "Consultation Principles: Guidance". Accessible at: <https://www.gov.uk/government/publications/consultation-principles-guidance> [Accessed on 7 August 2014]

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the consultation process, especially in the light of the severity of the restrictions being imposed on the ability of trade mark owners to use their trade marks and the requirement of the Principles that policy makers should ensure that all relevant stakeholders are consulted. Indeed, the UKIPO would normally consult directly with a list of interested companies/ firms/Individuals among their stakeholders, users and interested parties. Even if the UKIPO has been involved in some way in this exercise, because the Consultation is not a UKIPO-led one, these stakeholders have not been consulted on this occasion.

Children and Families Act 2014 (the "CFA")

17. The power to make the Regulations can be found in section 94 of Part 5 of the CFA, entitled "Welfare of Children". On the same day that the Chantler Review was announced the Parliamentary Under-Secretary of State for Health, Jane Ellison MP, announced that the Government would take the opportunity to insert enabling powers for standardised packaging into the CFA.³
18. UK trade mark law has largely been harmonised with the rest of Europe and we consider that it is not appropriate for the Trade Marks Act 1994, which is a piece of primary legislation enacted to give effect to the terms of a European directive, to be modified by secondary health legislation. This is particularly so given that the introduction of standardised packaging will undermine the principle that the protection offered by UK trade marks and Community trade marks is, through the process of harmonisation and the direct effect of the CTMR, meant to be broadly equivalent save for in relation to the geographical scope of the monopoly granted.

Chantler Review

19. We note that the decision to hold the Consultation was announced by Jane Ellison MP upon the publication of the Report of the Chantler Review. At that time, Jane Ellison MP stated that she was "minded to proceed with introducing regulations to provide for standardised packaging"⁴ but stated that draft regulations would be published, and a short consultation held prior to a final decision being taken. Given that the terms of reference of the Chantler Review did not allow consideration of the other potential impacts of the Regulations, it is especially surprising that the Government chose to hold such a short consultation.

Consultation 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?

KEY CONCERNS

20. We set out below some comments of the "Miscellaneous provisions" in Part 5 of the Regulations, which we consider give rise to the following concerns:

³ Department of Health, 28 November 2013, "Press Release – Independent Review of Standardised Packaging for Tobacco". Accessible at: <https://www.gov.uk/government/news/independent-review-of-standardised-packaging-for-tobacco> [Accessed on 7 August 2014].

⁴ Jane Ellison MP, 3 April 2014, "Oral Statement to Parliament – Chantler Report on standardised packaging of tobacco products". Accessible at: <https://www.gov.uk/government/speeches/chantler-report-on-standardised-packaging-of-tobacco-products> [Accessed on: 6 August 2014].

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a) *Compatibility and interaction with the Trade Marks Act 1994 (the "TMA").*

The Regulations do not formally amend the TMA. Instead, they purport to add a 'gloss' to certain provisions where a conflict or possible inconsistency has been identified. Unless the Government's intention is to amend the TMA at a later stage, our concern is that the current approach addresses the inconsistencies between the TMA and the standardised packaging proposal in a superficial manner, without engaging with their substance.

b) *Lack of involvement of the UKIPO:*

As discussed at paragraph 16 above, given the impact of the Regulations on the rights of trade mark owners and the obvious implications in terms of UKIPO procedures and practice, we would have expected the UKIPO to be involved directly throughout the whole process, including in relation to the drafting of the Regulations.

c) *The Evidential Burden under the 'But For' Fiction:*

Whilst the Regulations endeavour to obviate the inconsistencies between the TMA and the standardised packaging proposal, the wording adopted does not introduce express exceptions or carve-outs. For example, instead of recognising that certain requirements are deemed to have been satisfied automatically in the case of applications for the registrations of trade marks for tobacco products, the Regulations require applicants to produce evidence of what their intentions or conduct would have been, had the Regulations not been in force. We do not believe this is an appropriate solution for the following reasons:

- (i) It imposes a virtually impossible evidential burden on applicants, as they are expected to produce probative evidence of what their conduct would have been in circumstances where, at all material times, those applicants knew that they would not be able to use the trade marks being applied for (we refer you, for example, to our comments in relation to Regulation 14(1) below).
- (ii) The logic behind it is somewhat circular. For example, with regard to the requirement to use or have *bona fide* intention to use a trade mark applied for (section 32(3) TMA), it is clear that applicants for trade marks for tobacco products will not be able to show such *bona fide* intention. However, instead of recognising this fact and creating an exception or recognising that such intention is deemed to exist, Regulation 14(1) states that "is to be taken" to have such intention "if the applicant would have" had it "but for the operation of these Regulations". If the burden is on the applicants to show what their intention would have been, then Regulation 14(1) does not achieve removal of the 'intention to use' requirement. Instead, it gives applicants the opportunity to attempt to satisfy it by producing evidence of what they would have done in circumstances which the Government, the UKIPO and the applicants all know could never happen. It is difficult to see what preparatory acts for use could be undertaken or expected to be undertaken to satisfy this requirement when the applicant knows he will not be able to use the mark applied for.

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d) *Reputation and goodwill:*

The standardised packaging proposal will affect rights holders' ability to preserve (for existing trade marks) and generate (for new trade marks) reputation and goodwill in those trade marks. The Regulations fail to address this point altogether.

COMMENTS ON THE SPECIFIC WORDING OF THE REGULATIONS

Regulation 14(1): intention to use

21. Regulation 14(1) appears to be primarily designed to obviate the requirement in section 32(3) of the TMA, whereby applicants for trade marks must declare that they use or that they have a *bona fide* intention to use the trade mark applied for. A declaration to this effect is included in Form TM3 which applicants must sign in order to apply for a trade mark. Professional representatives sometimes sign this declaration on behalf of their clients and they will have particular difficulty in doing so under the proposed regime.
22. Considering the procedural implications of this requirement, we would have expected the UKIPO to be heavily involved in (1) devising the appropriate solution to reconcile section 32(3) of the TMA with the standardised packaging proposal and (2) the drafting of Regulation 14(1).
23. Rather than impose the evidential burden created by the 'but for' fiction postulated under Regulation 14(1), which effectively requires applicants to make a declaration they know is a fiction, it would perhaps be more appropriate for section 32(3) of the TMA to be amended so as not to apply to applications for trade marks in relation to tobacco products.

Regulation 14(2): bad faith

24. Regulation 14(2) is structured in a similar way to Regulation 14(1), in that it introduces a similar legal fiction, albeit phrased slightly differently, whereby an applicant for a trade mark should not be taken as having made the application in bad faith if he would not have been so taken "were these Regulations not in force". It is unfortunate that the phrasing of Regulations 14(1) and 14(2) is not expressed in the same way, if they are intended to have the same legal effect.
25. The same concerns set out above in relation to Regulation 14(1) regarding the lack of involvement of the UKIPO and the evidential burden on applicants apply equally to Regulation 14(2).

Regulation 15: Oppositions based on trade marks for tobacco products

26. The purpose of Regulation 15 is to remove the requirements for use of a trade mark which is registered in respect of goods and services which cover tobacco products, where the trade mark proprietor wishes to rely on that mark for the purposes of an opposition. Regulations 15(1) and 15(2)(b) both contain the 'but for' fiction described above in respect of Regulation 14(1), accordingly, we repeat our comments relating to the lack of involvement of the UKIPO and the impossible evidential burden imposed on applicants.
27. Further, Regulation 15 does not address all of the possible impacts which the Regulations could have on a trade mark proprietor's ability to rely on its marks for the purposes of an opposition. In particular, Regulation 15 does not address the impact of the restrictions on use imposed by

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the Regulations on a trade mark proprietor's ability to rely on section 5(3) TMA. This section gives protection to trade marks which have a reputation, on the basis that such marks should enjoy a wider scope of protection than marks without such a reputation. In order to succeed on this ground, it is necessary to show that the relevant trade mark enjoys a reputation and that the trade mark which the proprietor wishes to oppose would take unfair advantage of, or be detrimental to the distinctive character or reputation of its earlier mark. As the Regulations severely restrict the ways in which word marks may be used and prohibit altogether the use of figurative and 'get-up' marks, once the Regulations are enacted the reputation of existing trade marks will gradually dissipate and it will become progressively more difficult to show that the opposed mark is taking unfair advantage of the earlier rights. With regard to future trade mark applications in respect of new brands, rights holders will never be in a position to generate or acquire reputation in those marks due to the standardised packaging proposal.

28. For similar reasons, registered proprietors of trade marks which cover tobacco products may find it increasingly difficult to rely upon section 5(4) TMA to oppose applications, as the proprietor's goodwill attaching to the mark will dissipate, over time, to zero in the case of figurative 'get-up' marks and will decrease significantly, in respect of word marks.

Regulation 16: non-use

29. Regulations 16(1)(a) and 16(2)(a) both contain the 'but for' fiction described above in respect of Regulation 14(1). Accordingly, we repeat our comments relating to the lack of involvement of the UKIPO and the impossible evidential burden imposed on applicants.
30. Regulation 16(1) deems that where a provision of the Regulation causes any non-use of a trade mark, that provision shall be deemed to be a proper reason for non-use pursuant to section 46(1) TMA. The way in which this Regulation is drafted gives rise to uncertainty, both for trade mark proprietors of marks which cover tobacco products and those who may wish to challenge such marks. In particular, any provision of the Regulations will only become a 'proper reason' for non-use once it causes the non-use complained of. Presumably, it will be for the UKIPO or a UK Court to make a finding of the cause of the non-use, so registered proprietors will not know whether they can rely on this defence unless and until a challenge is launched. This risk is exacerbated by the incorporation of the 'but for' fiction, the potential dangers of which are identified above.
31. The purpose of Regulation 16(3) is to consider any non-use of a trade mark caused by the Regulations to be a proper reason for non-use, where the trade mark proprietor wishes to rely on that mark for the purposes of an invalidity action. It is unclear why Regulations 16(3) and 15(2)(b) are drafted differently when both of them effectively address the same issue, albeit in relation to invalidity actions and oppositions respectively. This is particularly so, given that sections 47(2B) and 6A(2)(b) TMA which they are respectively designed to address are drafted in the same way as each other.

Please direct any questions in relation to this response to Anna Carboni (tel: 020 7776 4760; email: anna@redd.eu).

Redd Solicitors LLP
7 August 2014

SCHEDULE

The text of the article by Anna Carboni published in the 'ITMA Review' (June 2014 edition) entitled: "Making It plain" is set out below.

Introduction

The UK government has been considering the introduction of plain packaging for tobacco products for a number of years. Following a consultation in 2012 the current government decided against its introduction, but it appears to be back on the agenda. This article considers whether the introduction of plain packaging, be it for cigarettes or sweets, alcohol or fast food, would be compatible with the unitary character of the Community trade mark ("CTM").

Recent Developments in the UK and EU

Children and Families Act 2014: On 13 March 2014, the Children and Families Act (the "Act") received royal assent. Part 5 of the Act, entitled "Welfare of Children", contains a provision which enables the Secretary of State for Health to make regulations "if [he] considers that [they] may contribute at any time to reducing the risk of harm to, or promoting, the health or welfare of people under the age of 18". The Act envisages regulations being made in relation to both the retail packaging of tobacco products and the products themselves (under sub-sections 94(6) to (8)), which may impose prohibitions, requirements or limitations relating to "the use of branding, trademarks or logos" and "any other features ... which could be used to distinguish between different brands of tobacco products". Such restrictions are of course the antithesis of the primary purpose of trade marks, which is to indicate the economic source of the products.

Tobacco Products Directive: On 14 March 2014, the European Council adopted the revised EU Tobacco Products Directive ("TPD") following its approval by the European Parliament on 26 February 2014. The TPD is expected to enter into force in May, following which member states will have two years to transpose it into national law. The TPD does not mandate the adoption of plain packaging, but Article 24 expressly permits member states to introduce further measures to standardise the packaging of tobacco products, subject to the measures being: (i) justified on public health grounds; (ii) proportionate and not a disguised means of restricting the free movement of goods; and (iii) notified to the European Commission.

Chantler Review: On 3 April 2014, Sir Cyril Chantler published the results of his independent review into the public health impact of plain packaging, commissioned by the Department of Health ("Chantler Review"). He has concluded that "there is enough evidence to say that standardised packaging is very likely to contribute to a modest but important reduction in smoking", and the Public Health Minister has said that she is "minded to proceed".

Unitary Nature of the CTM

Article 1(2) of Council Regulation 207/2009 on the Community trade mark ("CTMR") states: "a Community trade mark shall have a unitary character. It shall have equal effect throughout the Community: It shall not be registered, transferred or surrendered or be the subject of a decision revoking the rights of the proprietor or declaring it invalid, nor shall its use be prohibited, save in respect of the whole Community..." This principle is also set out in Recital (3) to the CTMR and reinforced by Article 7(2) which provides that where absolute grounds for refusal of a CTM apply in only part of the Community the application must be refused, and Article 16(1) which provides that a CTM is an object of property which shall only be dealt with for the whole of the Community.

As stated by the CJEU in Case C-149/11 *Leno Merken v Hagelkruis Beheer*, a key objective of the CTMR is to enable the proprietor of a CTM "to distinguish his goods and services by identical means throughout the entire Community, regardless of frontiers". (The current Proposal for a Regulation

amending the CTMR retains this objective and the unitary character provisions.)

The unitary principle has been tested in the case law in four key areas:

- (1) **Genuine Use:** In Case C-149/11 *Leno Merken v Hagelkruis Beheer*, a question arose as to whether genuine use in one member state was sufficient to demonstrate genuine use in the Community under Article 15(1) CTMR. Although the CJEU did not rule out the possibility that use in one member state could be enough, it held that the starting point for assessing use should be that territorial borders of member states are irrelevant. The Court considered that, if particular significance were afforded to the boundaries of member states, the unitary nature of the CTM would be diminished.
- (2) **Acquired Distinctiveness:** In Case T-91/99 *Ford Motor Company v OHIM*, it was held that Articles 7(2) and (3) CTMR must be read in the light of the principle of unitary character. This means that, if a sign is inherently non-distinctive in any substantial part of the Community, acquired distinctiveness must be demonstrated in that part before it can be registered as a CTM.
- (3) **Reputation:** In Case C-301/07 *PAGO v Tirolmilch*, it was held that a CTM must have a reputation in a substantial part of the territory of the Community in order to benefit from Article 9(1)(c) protection. In the circumstances of that case, the territory of Austria was considered sufficient to meet the test. In the earlier case of *Whirlpool v Kenwood* [2008] EWHC 1930 (Ch), it was held that reputation in a single member state was sufficient for the purposes of Article 9(1)(c), on the more general basis that a CTM should not receive less protection than a national trade mark with a reputation in the same territory (in that case, the UK).
- (4) **Injunctions:** In Case C-235/09 *DHL Express France v Chronopost*, the CJEU held that the unitary character of the CTM necessitates that any injunction to restrain infringement should as a matter of principle extend to the entire area of the Community. The Court acknowledged that it might be appropriate to restrict the scope of an injunction in certain circumstances, such as where the essential function of the CTM is not affected in parts of the Community, but the burden appears to be on the defendants to demonstrate this: in *Interflora v Marks and Spencer* [2013] EWHC 1484 (Ch), Mr Justice Arnold ruled that a pan-EU injunction should be granted in the absence of evidence from the defendants to show that the grounds of infringement did not exist outside the UK.

These examples all reflect the principle of unitary character and show how the EU is to be regarded as a single unit for the purposes of the acquisition, maintenance and enforcement of CTMs.

Impact of Plain Packaging

Article 1(2) CTMR expressly prohibits member states derogating from the principle of unitary character of the CTM "unless otherwise provided for in this Regulation". The introduction of plain packaging by the UK government would be an example of exactly such a derogation by imposing a prohibition on use which is not provided for in the CTMR and which would be contrary to the overall objectives of the CTMR discussed above.

If the UK were to introduce plain packaging without resolving the conflict with the CTMR, any such measures may in theory be subject to an action for non-compliance by the European Commission pursuant to Article 258 of the Treaty on the Functioning of the European Union. The Commission may undertake such action of its own volition or as a result of a complaint from an aggrieved party. Such action might seem incompatible with the Commission's involvement in the TPD, which permits standardised tobacco packaging to be introduced at a national level, but there are other concerns about the consequences of national plain packaging which should also be considered.

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Intention to use and non-use

Section 32(3) of the Trade Marks Act 1994 ("TMA") is a home-grown (i.e. non-harmonised) provision that requires applicants for UK trade marks to make a declaration that they intend to use the mark. It is hard to see how a tobacco company could make that declaration for any elements of branding apart from the mere name of the company or product, thus taking away the choice that most brand owners have between using the national and the Community systems for protection.

As far as CTMs are concerned, there have been a couple of cases in which it has been argued that, if use of a CTM is prohibited in part of the Community, then registration of the mark should be denied or cancelled on the basis that it was made in bad faith or was contrary to public policy and accepted principles of public morality. These approaches reflect the unitary nature of the CTM but they have not yet been successful (Case R-255/2006-1 *Johnson Pump v Johnson Pump* and Case T-140/02 *Sportwetten v OHIM*). It is nevertheless possible that CTMs affected by the restrictions on packaging could be challenged on this basis.

Existing UK trade marks would, under section 46(1) TMA, become vulnerable to revocation for non-use after a period of five years unless there are proper reasons for such non-use. The Australian government negated the non-use problem for tobacco marks by designating plain packaging as a proper reason for non-use, but the tobacco company is required to rebut any action for revocation for non-use by demonstrating that but for the restriction they would have used the mark. Although an equivalent provision could be introduced into the TMA, it is likely to become increasingly difficult to rebut a revocation action as time goes by and the tobacco products market changes (e.g. through the introduction of lower risk products such as e-cigarettes). In summary, it would no longer be possible to obtain new national UK registrations and it would become increasingly difficult to maintain existing ones.

Where tobacco companies have mainly UK rights, they may consider that the best way to maintain their protection would be to file CTMs (for which no declaration as to use is required) and claim seniority from their existing UK trade marks. The tobacco companies would, of course, have to use their CTMs outside the UK in order to maintain their registrations.

Equivalence principle

CTMs co-exist with national trade marks (which have themselves been harmonised); proprietors are able to choose the degree of protection most suitable for their business interests (*Leno Marken v Hagelkruls Beheer*, at para 40).

As stated above, the protection offered by CTMs and UK national trade marks is, through the process of harmonisation, meant to be broadly equivalent save in relation to the geographical extent of the monopoly granted. As can be seen from the foregoing, if plain packaging were to be introduced, it would still be possible to obtain and maintain a CTM registration, albeit subject to attack as being contrary to UK law, whereas it would no longer be possible to obtain or maintain a UK national mark.

Erosion effect

The introduction of plain packaging legislation in the UK has recently been enabled at both the European and domestic level. However, both sets of enabling legislation focus on the potential health benefits of plain packaging without apparent consideration for any unintended consequences for European trade mark law in particular. The erosion of the unitary character of the CTM is potentially damaging to the development of European trade mark law, in a way that is not restricted to tobacco trade marks. It also cuts across the harmonisation agenda and, more broadly, the free movement of goods within the EU.

EL282



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)

[Redacted name] _____

Address of respondent (required):

Gateshead, South Tyneside and Sunderland Stop Smoking Service, Bedewell,
Monkton Hall, Hebburn, NE32 5NN

Contact email address (required)

[Redacted email address] _____

Now go to question 1

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:

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?

I welcome the findings of the Chantler Review, particularly the impact that standardised tobacco packaging could have on uptake of smoking among young people. Living and working as a health professional in the North East, I see the effects of this on a daily basis. Smoking is the leading cause of health inequalities. The richest smokers die earlier than the poorest non-smokers as found in Gruer et al (2009) who concluded that the scope for reducing health inequalities related to social position is limited unless many smokers in lower social positions stop smoking. Although our stop smoking services work hard to target smokers from the most deprived sections of society, the cultural veins of smoking run deep amongst this group, who find it harder to stop, or to sustain a quit. Absolutely the best thing to do, in my opinion, is never start smoking in the first place.

We need to make 'not starting' an easier option for young people, in the North East and across England. Around 9,000 young people in the North East start to smoke every year and we need to do all we can to ensure that this number reduces to negligible levels. Repeated surveys of North East smokers have found the average age of trying cigarettes and starting to smoke to be 15. We also know that most smokers regret ever starting. I believe we have a duty to protect young people, to reduce the appeal of glamorised cigarette packaging, and to not put the needs and wants of individual businesses over the health needs of our population.

I particularly welcome Chantler's dismissal of tobacco industry scaremongering about the alleged impact of standardised packaging on the illicit tobacco trade. Chantler is not convinced by the tobacco industry's argument that standardised packaging would increase the illicit market, especially in counterfeit cigarettes. Recent figures from Australia have also indicated that the illicit market has not increased since the introduction of the measure and that tobacco use is at an all-time low.

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?

Support for standardised packaging is at an all-time high with 69% of people in the North East in favour and only 9% opposing. Nationally, public support is equally high, and perhaps surprisingly more smokers support standard packs (32%) than oppose (30%) with the remainder ambivalent or undecided. My experience of talking to smokers on this issue suggests most smokers are very keen for their children not to start.

Further measures to regulate tobacco are popular with the public – only 12% of people in the North East think the government is doing too much to tackle smoking. There is still a worrying lack of awareness about the impact that smoking has on health. Research gathered during the development of the 'Don't be the 1' campaign suggests that 90% of North East smokers underestimate the risk that smoking kills one in two of all long term smokers. When informed of the true risk 65% admitted they find the true risk worrying and 43% said it is "very worrying."

Yes, I certainly believe that illegal tobacco is a problem. However, it is a TAX problem rather than a public health problem. There is no such thing as a safe cigarette, and action needs to be taken against those responsible for manufacture and importing of illegal and counterfeit tobacco. We need to keep in mind here that it is the tobacco that kills, and on that subject, I believe that fears that standardised packaging will increase the amount of illicit tobacco available are overblown and disproportionate. Illicit tobacco is less of a problem than it has been in recent years. HMRC published its tax gap estimates in October 2013 which showed that the size of the illicit cigarette market had remained the same as its last published estimate of 9%, and the illicit hand-rolling tobacco market had shrunk to 36% .

Even Big Tobacco don't believe the illicit tobacco market has increased. A report commissioned jointly by the four transnational tobacco companies (British American Tobacco, Imperial, JTI and Philip Morris International) provides estimates on the scale and development of the illicit cigarette market in Europe and reports that consumption of counterfeit and contraband declined in the UK by 6.2% despite other industry data suggesting an increase.

Comprehensive regional illicit tobacco programmes change the social norms around illicit tobacco, reducing the size of the illicit tobacco market, reducing the proportion of smokers buying illicit tobacco and increasing the public's likelihood to report intelligence. For example, in the North East between 2009 and 2013, following partnership development, three bursts of social marketing activity and enhanced intelligence and enforcement models:

- o the proportion of smokers buying illicit tobacco had dropped from 24% to 17%
- o the size of the illicit tobacco market had shrunk from 15% to 9%
- o the proportion of smokers who buy illicit tobacco believing that 'everybody does it' shrunk from 45% to 28%
- o the proportion of adults who are uncomfortable with the illicit tobacco trade rose from 57% to 70% .

A major Trading Standards survey in the North West of England has shown that fewer young children are accessing illicit tobacco products. Between 2011 and 2013 there were reductions in:

- o the proportion of young people who have bought cigarettes from sellers such as neighbours, car boots and ice-cream vans from 42% to 27%

- o the proportion of young people who have bought fake cigarettes, down from 28% to 22%
- o the proportion of young smokers who have ever bought single cigarettes, from 67% to 49% .

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?

- I welcome the comprehensive draft regulations particularly in terms of:
 - o The stipulated colour of tobacco packets
 - o The minimum number of cigarettes or minimum weight of hand rolling tobacco that a packet can contain
 - o The reassurance that these regulations will not affect other labelling requirements for tobacco products such as health warnings and fiscal marks
 - o The scope of the regulations across the UK
 - o The clarity of the regulations in relation to their impact on trade mark protection
 - o The scope to include the changes required for Directive 2014/40/EU.
- However there are a number of issues with the draft regulations that I would like to see addressed:
 - o The draft regulations apply only to cigarettes and hand-rolling tobacco. I believe that the regulations should also apply to specialist tobacco products including cigars, cigarillos and 'blunts'. The rationale for this exclusion is low rates of use, particularly by young people, and the provision is made that that the regulations could be extended if young people become increasingly attracted to these types of tobacco. My view is that this opportunity should not be missed to highlight to young people the dangers of these products before consumption increases and that the regulations should be extended now to include specialist tobacco products rather than when these products have become a problem so that there is a level playing field.
 - o The draft regulations do not propose requirements relating to the size or length of cigarettes. Evidence in the North East shows that young women in

particular are attracted to slim cigarettes therefore regulations should be included to stipulate a minimum size of cigarette. This would also prevent any opportunity for slim cigarettes to be repositioned as cigarillos thereby becoming exempt from regulations given their specialist tobacco products status (unless this exemption is removed as recommended).

o I would urge consideration of risks around the industry using the sticks themselves as the final marketing device, and the regulations need to prohibit the sticks being decorated with brands, colours, patterns, images and logos.

o The draft regulations do not propose requirements relating to the size of cigarette or tobacco packets. Instead, the only stipulation in terms of size is 'cuboid' and this is open to interpretation. This is a real concern and a potential weakness in the regulations. Dimensions should be provided to ensure consistency and to prevent the tobacco manufacturers from determining the size themselves and using it as a means of product differentiation. In Australia, the dimensions stipulated are as follows and we recommend the UK government follows this model:

Physical features of cigarette packs

The dimensions of a cigarette pack, when the flip-top lid is closed, must not be:

- (a) height — less than 85 mm or more than 125 mm; and
- (b) width — less than 55 mm or more than 82 mm; and
- (c) depth — less than 20 mm or more than 42 mm.

o The draft regulations allow two forms of opening – flip top lid or shoulder box hinged lid. Tobacco manufacturers often use the means of opening their packets as a marketing tool, e.g. sideways sliding packs, therefore the regulations should stipulate that only one type of opening should be used in order to prevent distinctions between brands. In Australia, only a flip top lid opening is permitted and we recommend the UK government follows this model.

o In the draft regulations there is a proposal at 10.3.(e), which prohibits packing that 'resembles a food or cosmetic container.' This could lead to confusion and is a very broad term, for example some cosmetic products are contained in cuboid outer wrappers e.g. perfumes. Specifying the pack size as above would remove the need for this clause.

o The requirements prevent packaging from producing a noise or scent but do not prohibit any smell arising from a permitted additive. Tobacco manufacturers will be innovating packaging now to ensure they can work around these regulations therefore we feel that any scent other than that which normally arises from tobacco products should be prohibited. This is particularly relevant for menthol cigarettes which, under the directive 2014/40/EU, have an exemption until 2020. The development of capsule cigarettes shows that the tobacco industry is still innovating in this area.

- o The requirements only apply to retail packaging of tobacco products to retail packaging of tobacco products and not packaging that is used only within the tobacco trade, for example for stock management in a warehouse or wholesale premises. It would be preferable for the requirements to apply to all tobacco packaging to avoid any potential confusion over definitions of warehouses.
- o To aid enforcement of the regulations, it would assist if images of the packages, currently in Appendix C of the consultation document, were placed in the body of the regulations. A similar approach is used in other legislation that has specific labelling or presentation requirements, for example the regulations on pack health warnings.
- o Local authority Trading Standards officers will be tasked with enforcing this legislation. Trading Standards departments are playing an increasing role in public health and in tobacco control in particular. I feel therefore that it is important that the UK government invests in this vital service and provides it with the leadership and powers it needs to sustain this vital function.

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?

- I welcome the overall recommendations of the consultation-stage impact assessment particularly its statement that the implementation of standardised tobacco packaging is worth pursuing now and that the cost of delaying a decision is too great in public health terms.
- I welcome the decision to review the policy after five years which will allow time for early impacts to become clear although it needs to be borne in mind that long term impacts such as reduced youth uptake, reductions in smoking prevalence and improvements in public health will take many years to manifest.
- I support any effective measures to maintain the costliness of tobacco in particular adjusting rates on tobacco duty, given that price is the single most effective policy lever for reducing smoking prevalence available to governments. Peto (2013) has recommended an approach to taxation that would have a significant impact on consumption: tripling inflation-adjusted specific excise taxes on tobacco which would approximately double the average price of cigarettes (and more than double prices of cheaper brands) which would reduce consumption by about a third and actually increase tobacco revenues by about a third. I fully expect the tobacco industry to respond to standardised packaging by dropping prices to make smoking more affordable.

- The impact assessment considers the potential costs that may arise through increases in the demand for and the supply of illicit tobacco. However, can I draw the consultation team's attention to:

- o the findings of Chantler who is not convinced that standardised packaging would increase the illicit market and found no evidence that standardised packaging is easier to counterfeit.

- o evidence from Australia which has shown there to be no increase in the illicit tobacco trade since the measure was introduced while tobacco consumption has fallen

- o the conclusion of the Home Affairs Committee inquiry into tobacco smuggling which recommended that any risks in this area could be mitigated by increasing enforcement action

- o Peto's view that use of specific excise taxes on tobacco (rather than ad valorem taxes), stronger tax administration, and practicable controls on organised smuggling can limit the problem. Even with some smuggling, large tax increases can substantially reduce consumption and increase revenue especially if supported by better tax enforcement

- o the impact that health-related social marketing can have on reducing smoking at population level and, in turn, reducing the illegal tobacco market, as seen in the North East, North West and South West where the illicit tobacco market share has reduced significantly

- The impact assessment also considers the costs for retailers and states that, anecdotally, the profit margins on the sale of tobacco may be relatively low. John McClurey, elected member for Gateshead Council and independent retailer in Newcastle, maintains that:

"most traders rely less and less on tobacco profits since the gross profit is so small. I make as much profit from a pack of chewing gum as a £6 pack of cigarettes. What my customers save by quitting or never starting to smoke, they can spend on other things. That means more money into the local economy." For me this is key: the dependence on tobacco products of many individuals in the North East damages the local economy, burdens our NHS services and prevents people from experiencing a full quality of life.

- The benefits of introducing standardised packaging identified in the impact assessment far outweigh the costs, many of which can be quantified at the North East level:

- o Overall, the main smoking related diseases are conservatively estimated to cost the NHS across the North East £110.4 million per year

o The cost of smoking-related hospital admissions in the North East alone is calculated to be nearly £65.8 million per year

o An additional £32.1 million is lost to the regional economy each year through increased levels of absence from work from smokers compared to their non-smoking counterparts, which accounts for over 361,000 additional lost days of productivity per year across the North East.

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 1128
CANTERBURY
CT1 9NB



ADPH - West Midlands Network

Consultation on the Introduction of Regulations for Standardised Packaging of Tobacco Products

Response from Association of Directors of Public Health - West Midlands Network

The Association of Directors of Public Health - West Midlands Network has been established to improve and protect the population of the West Midlands by enabling Directors of Public Health to collaborate and respond more effectively to important public health issues. This response to the consultation on the introduction of regulations for standardised packaging represents the collective view of the Directors of Public Health in the West Midlands.

It is estimated that 852,000 of people smoke across the West Midlands; this represents approximately 19% of the adult population similar to the England average. Smoking contributes hugely to ill health and poor quality of life in our region and also costs the economy around £1.4 billion each year. This includes output lost from early death, loss of productivity from smoking breaks at work and early death due to passive smoking, NHS care, sick days, domestic fires and cost of cleaning smoking littering. Smokers in the West Midlands spend around £1.5 billion each year on tobacco products contributing roughly £1.1 billion in duty to the Exchequer; this means that there is an annual funding shortfall of £258.3million in this area¹.

Despite smoking rates being similar to the national average, the combined health and financial costs to the region remain very significant. Therefore, introducing regulations for the standardised packaging of tobacco products will be an important part of Public Health policy in reducing the uptake of smoking by future generations and ongoing burden of disease caused by smoking.

As Directors of Public Health we welcome the opportunity to respond to this consultation and urge the Government to lay Regulations on standardised packaging, under Section 94 of the Children and Families Act, before Parliament as soon as possible. We believe that this policy, combined with other tobacco control policies, will make a positive contribution to prevent the next generation of young people taking up smoking.

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

1. Sir Cyril Chantler stated in his covering letter to the Secretary of State: *"it is in my view highly likely that standardised packaging would serve to reduce the rate of children taking up smoking"* and *"the body of evidence shows that standardised packaging, in conjunction with the current tobacco control regime, is very likely to lead to a modest but important reduction over time in the uptake and prevalence and thus have a positive impact on public health."*

¹ Data and cost calculated from Action on Smoking and Health Toolkit available at <http://www.ash.org.uk/localtoolkit/docs/Reckoner.xls>

2. A report by Professor David Hammond for the Irish Department of Health² backs up Sir Cyril Chantler's view. He concluded that, "Overall, the existing evidence on plain (standardised) packaging supports four primary conclusions:
 - 1) Plain packaging will reduce smoking initiation among youth and young adults.
 - 2) Plain packaging will promote smoking cessation among established smokers.
 - 3) Plain packaging will support former smokers to remain abstinent.
 - 4) Plain packaging will help to de-normalise tobacco use."
3. We welcome the response of Jané Ellison MP, Minister for Public Health, to the Chantler Review. She said that the report found standardised packaging was "very likely to have a positive impact" on public health. She went on to say: "In the light of the report and the responses to the previous consultation in 2012, I am minded to proceed with introducing regulations to provide for standardised packaging" and that she wished to "proceed as swiftly as possible". She also reported that the Government's Chief Medical Officer, Dame Sally Davies, had written to her supporting the conclusions of the Chantler Review and the introduction of standardised packaging.³
4. We therefore consider that the case for standardised packaging has been made, and that the Government should lay Regulations on standardised packaging, under Section 94 of the Children and Families Act, before Parliament as soon as possible. Given that notification to the European Union of the intended Regulations will take six months, there is now only a short time available to do this before the 2015 General Election.

Consultation 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?

Standardised packaging needs to be part of a comprehensive strategy

5. Tobacco control policies must be pursued in parallel if they are to have their best possible effect in reducing prevalence rates. The optimum date for implementation of standard packaging would be May 2016 at the same time as implementation of the EU Tobacco Products Directive, which includes updated larger health warnings and graphic warnings on the front of the packs.
6. The DH Tobacco Control Plan for England runs until the end of 2015 and needs to be renewed and refreshed for the period 2016-2020, the period when standardised packaging will be implemented. It is important in updating its tobacco strategy that the Government gives careful thought to how to maximise the public health benefits of the implementation of standardised packaging, by, for example:
 - Increasing funding for sustained mass media campaigns in advance of standardised packaging coming into effect;
 - making stop smoking services mandatory and ensuring delivery to a high quality standard;
 - supporting enforcement through adequate funding of trading standards departments, regional partnerships against illicit trade, and work on illicit trade by HMRC and the UK Border Force;

² Hammond, D. Standardized Packaging of Tobacco Products. Evidence Review. Prepared on behalf of the Irish Department of Health. March 2014.

³ Hansard, H.C column 1018 et seq. (3rd April 2014):

- introducing tax rises on tobacco products over and above the existing escalator, particularly to counteract any possible negative effects from brand-shifting or price cutting

Illicit Tobacco Trade: General

7. A principal tobacco industry argument against standardised packaging has been that it will inevitably lead to an increase in the illicit tobacco trade. There is no good reason to accept this argument, since there is no plausible mechanism of action, and indeed evidence published since the 2012 consultation suggests that it is false.
8. There is no plausible mechanism of action because all the key security features on existing packs of cigarettes would also be present on standardised packs, and additional markings will be required under the EU Tobacco Products Directive. These include unique identifiers, coded numbering and covert anti-counterfeit marks. Jane Ellison, Parliamentary Under-Secretary of State for Health, said in a November 2013 Parliamentary debate that: *"I am grateful to those hon. Members who have made the point that if we were to adopt standardised packaging, it would not mean plain packaging. Approaches such as anti-smuggling devices could be built into standardised packaging, if we choose to go down that route."*⁴
9. Number codes will develop further into an international standard system because of the requirements of Article 15 of the revised EU Tobacco Products Directive and Article 8 of the Illicit Trade Protocol, a subsidiary treaty under the WHO Framework Convention on Tobacco Control, to which the UK is a Party.
10. Article 15 of the Tobacco Products Directive states that: *"Member States shall ensure that all unit packets of tobacco products are marked with a unique identifier. In order to ensure the integrity of the unique identifier, it shall be irremovably printed or affixed, indelible and not hidden or interrupted in any form, including through tax stamps or price marks, or by the opening of the unit packet."*⁵
11. Article 8.3 of the Illicit Trade Protocol states that: *"With a view to enabling effective tracking and tracing, each Party shall require that unique, secure and non-removable identification markings (hereafter called unique identification markings), such as codes or stamps, are affixed to or form part of all unit packets and packages and any outside packaging of cigarettes within a period of five years and other tobacco products within a period of ten years of entry into force of this Protocol for that Party."*⁶
12. Andrew Leggett, Deputy Director for Tobacco and Alcohol Strategy at HM Revenue and Customs has said about standardised packaging that *"we're very doubtful that it would have a material effect [on counterfeiting and the illicit trade in tobacco]"*.⁷ This conclusion was supported by the House of Commons Home Affairs Select Committee, in its report on the illicit tobacco trade published in June 2014. The Committee reported that: *"We believe that the decision on standardised packaging should be driven by health reasons and the imperative need to reduce the numbers of young people who start smoking. We note the statement of Sir*

⁴ Hansard: backbench business debate. H.C Column 477. (7 November 2013)

⁵ Revised EU Tobacco Products Directive: Article 15

⁶ Text of the Illicit Trade Protocol: Article 8.3

⁷ Oral evidence to the House of Lords European Union Sub Committee (Home Affairs) on 24th July 2013.

Cyril Chantler to the effect that he was not convinced that standardised packaging would bring about an increase in the illicit market; even if this were the case, we believe that the proper response would be a more vigorous effort on enforcement rather than any lessening in the Government's drive towards introducing standardised packaging."⁸

Illicit Tobacco Trade: Australia

13. The tobacco industry has repeatedly claimed that the level of illicit trade in Australia has increased since, and as a result of, the introduction of standardised packaging. For example, BAT told investors in March 2014 that total illicit activity in Australia had risen by more than 30 per cent since the introduction of standardised packaging.⁹
14. These claims were examined during the Chantler Review and shown to be unsupported, a fact that was effectively admitted during Review meetings with representatives of the tobacco industry in Australia.¹⁰ The Australian Government and customs officials have also rejected tobacco industry claims that illicit trade in Australia has risen since the introduction of standardised packaging.¹¹ In March 2014 the *Sydney Morning Herald* reported that there had been only one seizure of counterfeit plain packs since December 2012.¹²

Tobacco Consumption in Australia

15. The tobacco industry has also claimed that tobacco consumption in Australia has risen since the introduction of standardised packaging. Again, independent evidence does not support this proposition.
16. The tobacco industry in Australia has reported an increase in tobacco sales from 21.015bn sticks in 2012 to 21.074bn in 2013,¹³ and the industry and its front groups in the UK have claimed that this showed standardised packaging was not working. Although the industry reported a small (0.28%) increase in sales year on year, they did not report the increase in the Australian population between 2012 and 2013. Adjusted for population, tobacco sales per person by their measure of consumption would in fact have fallen, from 920.4 per person in 2012 to 906.9 in 2013.¹⁴
17. The Australian Government's Department of Health has released figures showing that total consumption of tobacco and cigarettes in Australia in the first quarter of 2014 was the lowest ever recorded, as measured by estimated expenditure on tobacco products:
 - \$5.135 billion in September 1959;

⁸ Home Affairs Select Committee First Report on Tobacco Smuggling: paragraph 44

⁹ Greenblat, E. Plain packaging making 'no impact' on Australian smokers, say tobacco chiefs: *The Australian* 4th March 2014

¹⁰ Chantler Review, *Notes-of-Australia-based-meetings*: see for example exchange with Mark Connell of BAT Australia, page 38.

¹¹ See p.48 of the Explanatory Memorandum to the Australian Excise Tariff Amendment (Tobacco) Bill 2014 and p.6 of Sir Cyril Chantler's report.

¹² Corderoy, A *Tobacco industry claims on impact of plain packaging go up in smoke*, *Sydney Morning Herald*, 12 March 2014.

¹³ Kerr, C. *Labor's plain packaging fails as cigarette sales rise*: *The Australian*, 6 June 2014

¹⁴ *Is Smoking Increasing in Australia?*: *Guardian Datablog*, 6 June 2014

- \$3.508 billion in December 2012 (when standardised packaging was introduced); and
- \$3.405 billion in March 2014.

18. This is supported by figures from the Australian Treasury showing that tobacco clearances (including excise and customs duty) fell by 3.4% in 2013 relative to 2012 when tobacco plain packaging was introduced. Clearances are an indicator of tobacco volumes in the Australian market.¹⁵

Other Evidence from Australia

19. Young JM et al, University of New South Wales and Cancer Institute New South Wales, reported in January 2014 that the introduction of standardised packaging in Australia in 2012 was associated with a sharp rise in the number of calls to the Quitline New South Wales service.¹⁶ Statistical modelling to screen out the impact of other factors on the number of calls (such as health advertising campaigns, changes in price, etc.) suggested that the number of calls to Quitline NSW rose by 75% from the week before standardised packs were first introduced in the Australian market to four weeks later and a significant increase in calls was sustained over time.
20. Wakefield M et al, Cancer Council Victoria, Annenberg School for Communication Pennsylvania and South Australian Health and Medical Research Institute University of Adelaide, reported in 2013 that smokers in Australia were less willing to display their packs in public and smoke in outdoor areas since plain packaging was introduced. Researchers counted patrons, smokers and tobacco packs at cafes, restaurants and bars with outdoor seating for several months both before and after the introduction of standardised packaging. They found that pack display on tables declined by 15% after plain packaging, which was mostly due to a 23% decline in the percentage of patrons who were observed smoking. The study also found that the declines in pack display and patrons observed smoking were stronger in venues where children were present.¹⁷
21. Tobacco retailers in the UK have suggested that the introduction of standardised packaging means that it will take longer to serve customers and so convenience stores will lose custom. As the Impact Assessment concludes there is no evidence at all that this is the case from the experience in Australia, indeed transaction times have tended to decline post implementation not increase. Most recently, research published at the end of May, which may not been taken into account in the IA, reported that the claim that plain packaging would negatively impact small tobacco retailers by making it harder to locate and retrieve cigarette packs, thereby increasing transaction times, has not eventuated in Australia.¹⁸

¹⁵ Tobacco facts and figures: Australian Department of Health. 19 June 2014

¹⁶ Young JM et al. Association between tobacco plain packaging and Quitline calls: a population-based, interrupted time-series analysis

¹⁷ Zacher, M et al. Personal tobacco pack display before and after the introduction of plain packaging with larger pictorial health warnings in Australia: an observational study of outdoor café strips *Addiction*, 2014; 109: 653-663 - doi: 10.1111/add.12466

¹⁸ Wakefield M, Bayly M, Scolio M. Product retrieval time in small tobacco retail outlets before and after the Australian plain packaging policy: real-world study *Tobacco Control* 2013 - doi:10.1136/tobaccocontrol-2013-050987.

Consultation 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?

22. The Association of Directors of Public Health- West Midlands Network welcomes the draft regulations. However, if the government decides to proceed with the legal controls on packaging, beyond the draft regulations, published as part of this consultation, we would be expect to be consulted on any of the specific guidance or additional materials to be provided to support both businesses and enforcers in enforcing the regulations.
23. Furthermore, we believe that the regulations should also apply to specialist tobacco products including cigars and cigarillos. While we note the explanation for their exclusion is their low rate of use by young people, we consider that it sets an unhelpful example if any smoked tobacco products are excluded from the regulations, since this might be interpreted as endorsement of the idea that they are in some way less harmful to health.
24. Additionally, in the Australian regulations, the dimensions of the cigarettes and packs are stipulated, and we suggest that this may be useful in preventing any attempt to circumvent the intent of the regulations by introducing an element of branding. In particular we would like to see the UK prohibit the sale of 'slim' cigarettes. We also recommend that the UK prohibit the use of misleading brand variant names such as 'slim', 'natural', 'organic', 'without additives', 'without flavours' as well as 'smooth', 'gold' and 'silver'.¹⁹

Consultation 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?

25. We note that the impact assessment does not include any recognition of the additional costs of enforcement of these regulations. Whilst appreciating that this is small compared to revenue and healthcare cost considerations, it is however an important issue. Given the resource constraints at a local level, any new enforcement requirements would need to be properly recognised and resourced.

Impact on Retailers

26. Tobacco sales are undergoing long-term decline. At its peak in the 1950s adult male smoking prevalence was 80%.²⁰ Female smoking prevalence continued to rise and reached a peak of 45% in the mid-1960s.²⁰ Since then smoking prevalence amongst both men and women has declined significantly and is now under 20% and government policy is designed to sustain and increase this trend. More recent data from HMRC tobacco clearances shows the impact this has had on sales volume with the number of million cigarette sticks cleared for UK sales falling from 94,080 million in 1992/3 to 54,737 million in 2002/3 to 37,932 million in 2012/13, a decline of 30% in the last ten years. (See table below from the HMRC Tobacco Factsheet November 2013). Small retailers have had to adjust to this decline and will continue to have to do so, it is important to note that any impact of standardised packaging will be marginal compared to the overall secular trend.

¹⁹ Hammond D, Dockrell M, Arnott D et al. Cigarette pack design and perceptions of risk among UK adults and youth. *European Journal of Public Health* 2009; 19:631-7.

²⁰ Wald, N. & Nicolaides-Bouman, A. *UK Smoking Statistics* (2d ed.). OUP, 1991.

27. HMRC clearance data also shows the importance of the government's anti-smuggling strategy in supporting retailers. The impact is clearest with respect to hand rolled tobacco. At its peak the illicit market share of hand rolled tobacco was estimated to be over 60%, most recent estimates by HMRC suggest that it has fallen to 36%. This is matched by a growth in the amount of taxed HRT released for consumption which rose 2.8 million kilograms in 2002/3 to 6.2 million kilograms in 2012/13.
28. The Impact Assessment page 28 p.112 states 'anecdotally the profit margins on the sale of tobacco may be relatively low.' This is corroborated by information provided to ASH by a retailer in Gateshead, John McClurey, a member of the ASH advisory council. According to John McClurey profit margins on cigarettes average around 4.5% compared to profits on other products on sale in his shop which average around 22%. This means that while tobacco currently amounts to around 50% of his sales turnover it is a much smaller proportion of his profits. In fact he estimates that currently tobacco sales only amount to about 20% of his profits with 80% of his profits coming from sale of non-tobacco products. To illustrate the point John McClurey has told us that if a customer buys a packet of chewing gum he makes around 17 pence in profit compared to 14 pence on a price-marked packet of 10 John Player Special. Plus a price-marked pack of 10 JPS cigarettes costs £3.50, while a packet of chewing gum only costs 50 pence, so the customer buying chewing gum as opposed to cigarettes has £3 left over available to spend on other items.
29. For a shop where tobacco only accounts for 20% of turnover, which is the average estimated in the ACS report referenced in the IA, the proportion of profits would be even smaller at around 5% for tobacco compared to 95% for non-tobacco products.
30. Comprehensive data on prices and profit margins is available from wholesalers such as Bookers who can be contacted via their website <https://www.booker.co.uk/help/contactus.aspx>. Data on the proportion of tobacco sales accounted for by different types of outlet is available from AC Nielsen who can also provide data on the trends in sales of tobacco between different types of retailers over time. We recommend that the DH get in touch with Bookers and AC Nielsen for more information.

Conclusions

31. Standardised packaging is backed by the Smokefree Action Coalition, which is an alliance supported over 250 organisations including medical Royal Colleges and other medical organisations, health and children's charities such as the British Heart Foundation and Cancer Research UK, the Chartered Institute of Environmental Health, the Trading Standards Institute and others.²¹ The consensus of medical professionals, public health and other relevant experts is that it would make an important positive contribution to reducing the harm caused by tobacco consumption.
32. Standardised packaging is also popular with the public. A poll on the issue by YouGov, conducted for ASH in March 2014, found that overall 64% of adults in Great Britain were in favour of standardised packaging with only 11% opposed. There was majority support across age groups, genders and social classes.²² It is clear that most people believe that this policy, combined with other tobacco control initiatives, is an important way to prevent the next generation of young people from starting to smoke.

²¹ [Smokefree Action Coalition](#)

²² The poll total sample size was 12,269 adults. Fieldwork was undertaken by YouGov between 5th and 14th March 2014. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+). Respondents were shown what a standard pack could look like, including larger health warnings as in Australia.

33. Section 94 of the Children and Families Act 2014 was passed overwhelmingly in both the House of Lords (nem con) and House of Commons (24 MPs voted against), following a strong cross-Party campaign in support of the policy. It therefore demonstrably has majority support in Parliament.
34. Opposition to standardised packaging has been driven and financed by the tobacco industry, which requires young people to start smoking in large numbers every year, as its previous consumers quit or die prematurely from smoking-related disease.²³
35. Following the six week consultation on the draft regulations, the Government will then have to notify the European Union of the draft Regulations, under the Technical Standards and Regulations Directive 98/34/EC. This process can take up to six months.²⁴ Therefore, time is now short if Parliament is to get the opportunity to vote on the Regulations before the General Election. If this opportunity were now to be missed, it would be widely understood as a public health disaster and as suggesting that the tobacco industry still has excessive influence at the heart of Government.

For further information or response, please contact administrator@lfphwm.org.uk

²³ The pro-smoking group FOREST, which receives virtually all its funding from the tobacco industry, have hired the marketing agency Kreate to collect "digital signatures" for the "Hands off Our Packs" petition to the Prime Minister. Kreate describes itself as "an experiential agency that specialises in the delivery and staffing of face-to-face experiences". Agencies have also been commissioned directly by BAT to run a six week, "anti-plain packs roadshow", aiming to sign up 100,000 people to oppose plain packs. The company is reported to have allocated £500,000 to the activity. Over 100 people a day will be working on this campaign. ASH recommends that consultation responses generated in this way should be regarded by the Government as constituting a single response on behalf of the tobacco industry.

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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):

[Redacted]

Job Title (required):

Leader of Newcastle City Council and Chair of the Making Smoking History in the North East Partnership

Contact address of organisation (required):

c/o Fresh, Bede House, Belmont Business Park, Durham, DH1 1TW

Contact email address (required):

c/o info@freshne.com

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:

Regional tobacco control partnership in the North East of England

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:

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

Consultation questions

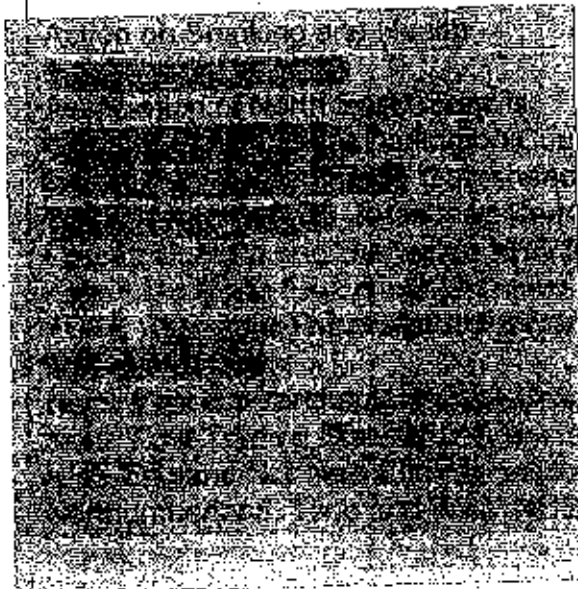
1. Do you have any observations about the report of the Chantler Review that you wish to bring to our attention?

1. The Making Smoking History in the North East Partnership exists to work collectively towards the long term aim to 'make smoking history for the North East' where tobacco smoking ultimately becomes a thing of the past. Its mission is to maintain and nurture an ongoing broad partnership of organisations and individuals committed to promoting and implementing comprehensive tobacco control measures which reduce smoking prevalence and health inequalities and help to improve health and wellbeing across communities of the North East. The strategic aim of the partnership is to reduce tobacco related harm and ultimately to reduce tobacco smoking to a suggested level of below 5% by 2025 and through shifting the social norms of tobacco use to make it less accessible, affordable and attractive and to centre action around:

- Motivating and supporting smokers to stop
- Reducing uptake of smoking
- Protecting individuals and communities from tobacco related harm

The Partnership acknowledges that whilst the North East has made significant progress in recent years to reduce adult smoking prevalence from 29% in 2005 to 22% in 2012, that smoking remains the key contributor to premature death and disease causing over 5000 deaths annually. There is a need for further progress and to maintain the short, medium and long term commitment and focus on tobacco control.

2. The Partnership supported the implementation of standardised packaging during the 2012 consultation along with 128 other organisations in the region including all 12 local authorities. All members of the Partnership endorse this response as listed:



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Foundation Trust
tobacco control programme
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Public Health England North East Centre
Smoke Free North East Network
Trades Union Congress North East.

3. We welcome the findings of the Charter Review, particularly the impact that standardised tobacco packaging could have on uptake of smoking among young people

4. Smoking is the leading cause of health inequalities. The richest smokers die earlier than the poorest non-smokers as found in Gruer (1) who concluded that the scope for reducing health inequalities related to social position is limited unless many smokers in lower social positions stop smoking.

5. Tobacco use is the leading cause of premature death and preventable disease. In the North East, 5,500 deaths every year occur as a result of tobacco use.

6. Around 9,000 young people in the North East start to smoke every year and we need to do all we can to ensure that this number reduces to negligible levels. Repeated surveys of North East smokers have found the average age of trying cigarettes and starting to smoke to be 15.

7. We particularly welcome Chantler's dismissal of tobacco industry scaremongering about the alleged impact of standardised packaging on the illicit tobacco trade. Chantler is not convinced by the tobacco industry's argument that standardised packaging would increase the illicit market, especially in counterfeit cigarettes. Recent figures from Australia have also indicated that the illicit market has not increased since the introduction of the measure and that tobacco use is at an all-time low (2).

8. We consider that the case for standardised packaging has been made and that regulations should be laid before Parliament in advance of the 2015 General Election.

(1) <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2645845/>

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

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?

9. A considerable amount of new information on the potential effectiveness of standardised packaging since has emerged since the previous consultation in 2012.

10. Support for standardised packaging is at an all-time high with 69% of people in the North East in favour (3) and only 9% opposing. Nationally, public support is equally high, and perhaps surprisingly more smokers support standard packs (32%) than oppose (30%) with the remainder ambivalent or undecided. Our experience of talking to smokers on this issue suggests most smokers are very keen for their children not to start.

11. Further measures to regulate tobacco are popular with the public – only 12% of people in the North East think the government is doing too much to tackle smoking (4).

12. There is still a worrying lack of awareness about the impact that smoking has on health. Research gathered during the development of the 'Don't be the 1' campaign suggests that 90% of North East smokers underestimate the risk that smoking kills one in two of all long term smokers. When informed of the true risk (5) 65% admitted they find the true risk worrying and 43% said it is "very worrying."

13. 82% of smokers in the North East wish they had never started and 68% say they would like to be able to quit.

14. Fresh submitted the results of focus groups of smokers and non-smokers aged 18-24 during the original consultation, during which examples of Australian standardised packs were rated as likely to be most harmful and less attractive than branded packs, with many young people feeling their greatest potential lay in dissuading young experimenters, occasional smokers and non-smokers (the stated aim of the policy rather than existing adult smokers). Discussions with young people since then has revealed further the potential impact standardised packs could have, including this film featuring two young female smokers from Gateshead, Tyne and Wear comparing examples of Australian standardised packs with current branded cigarettes. Quotes from the young smokers included:

"It tells you... like more what it can actually do to you. They've [branded packs] just got like... little pictures on the back that you can't see when you're buying them."

"It'll probably make us want to quit smoking... like I'd probably try more than what I ever have." (6)

15. In Australia, research has shown that social norms in smoking behaviour are already beginning to change as a result of the implementation of standardised packaging. There has been a sharp rise in the number of calls to the Quitline New South Wales service (7) and that smokers are less willing to display their packs in public or to smoke in outdoor public places particularly where children are present (8).

16. Figures released by the Australian government in July have shown adult smoking rates have fallen significantly between 2010 and 2013 (9). In 2010 daily

smoking prevalence amongst those aged 14 or older stood at 15.1% and has now fallen to 12.8%. The latest survey was conducted before the Australian Government's tobacco tax increases in December 2013, ruling out price as the primary reason for the dramatic fall in smoking during this 12-month period. Standardised packaging is the only major policy change over this time period and is therefore the most likely reason for the significant fall in smoking prevalence.

Tobacco industry opposition to standardised packaging - misusing data on illicit tobacco

17. The tobacco companies are spending considerable efforts in opposing any moves towards the introduction of standardised tobacco packaging. In the North East, JTI entered into a partnership arrangement with the Evening Chronicle newspaper (part of the Trinity Mirror media group) which featured three weeks' worth of JTI-funded advertising on illegal tobacco and published a series of articles generated by the company. Fresh was able to counter the misinformation provided by JTI and clearly outline that the illicit market is on a sustained long-term decline, that there is no evidence that standardised packaging would lead to an increase in the illicit trade and that all tobacco – legal or illegal – will kill one in two of its long term users.

18. The tobacco industry repeatedly claims that consumption of illicit tobacco will be increased by policies such as higher tax to reduce smoking and restricting tobacco promotion to reduce youth uptake, even though official figures show the illegal tobacco market has in fact decreased in the UK as a result of the introduction of such measures over a number of years. In November 2013 the chair of the Public Accounts Committee accused tobacco multinationals of deliberately oversupplying European markets, with the tobacco smuggled back into the UK. Committee Chair Margaret Hodge said:

"The supply of some brands of hand-rolling tobacco to some countries in 2011 exceeded legitimate demand by 240 per cent. HMRC must be more assertive with these manufactures. So far it has not fined a single one of them."

19. The tobacco industry also claims that standardised tobacco packaging will be cheaper to counterfeit. In fact, the production costs of illicit cigarettes, including packaging, are very low, at around 20 US cents a pack (10). Counterfeiters are able to produce quality and apparently genuine packaging at low prices in a short time, therefore outside packaging is a very poor indicator of whether a pack of cigarettes is licit and illicit. Furthermore, if standardised packaging was introduced, enforcers would easily be able to identify counterfeit and smuggled branded packs and illicit white packs.

20. All security features on current packs will also be present on standardised packaging and additional international tracking and tracing mechanisms to tackle the illicit tobacco trade are required through Article 15 of the revised EU Tobacco Products Directive and Article 8 of the WHO FCTC Illicit Trade Protocol.

21. A briefing from the Tackling Illicit Tobacco for Better Health Partnership on the tobacco industry and their tactics in using illegal tobacco arguments to oppose tobacco control measures can be found here: <http://www.illegal-tobacco.co.uk/wp-content/uploads/2014/03/Illegal-Tobacco-The-facts-about-the-Tobacco-Industry-V3-28-05-14.pdf>

22. HMRC estimates that in 2000 around 20% of cigarettes and 60% of hand-rolling tobacco (HRT) smoked in the UK were smuggled, costing over £3 billion a year in lost tax revenue (11). HMRC data suggests that by 2012/13 (the latest year for which this information is available) the illicit market in cigarettes had fallen to around 9% of the UK market, and in HRT to around 36% of the market with an associated revenue loss of £2 billion (midpoint) down from £3 billion in 2000 (12).

23. A report commissioned jointly by the four transnational tobacco companies (British American Tobacco, Imperial, JTI and Philip Morris International) (13) provides estimates on the scale and development of the illicit cigarette market in Europe and reports that consumption of counterfeit and contraband declined in the UK by 6.2% despite other industry data suggesting an increase.

24. The experience from England shows that comprehensive regional illicit tobacco programmes change the social norms around illicit tobacco, reducing the size of the illicit tobacco market, reducing the proportion of smokers buying illicit tobacco and increasing the public's likelihood to report intelligence. For example, in the North East between 2009 and 2013, following partnership development, three bursts of social marketing activity and enhanced intelligence and enforcement models:

- the proportion of smokers buying illicit tobacco had dropped from 24% to 17%
- the size of the illicit tobacco market had shrunk from 15% to 9%
- the proportion of smokers who buy illicit tobacco believing that 'everybody does it' shrunk from 45% to 28%
- the proportion of adults who are uncomfortable with the illicit tobacco trade rose from 57% to 70% (14).

25. A major Trading Standards survey in the North West of England has shown that fewer young children are accessing illicit tobacco products. Between 2011 and 2013 there were reductions in:

- the proportion of young people who have bought cigarettes from sellers such as neighbours, car boots and ice-cream vans from 42% to 27%
- the proportion of young people who have bought fake cigarettes, down from 28% to 22%
- the proportion of young smokers who have ever bought single cigarettes, from 67% to 49% (15).

Tobacco industry opposition to standardised packaging – misinformation from Australia

26. Further examples of misinformation include the release of misleading figures on tobacco consumption in Australia where standardised packs have been introduced. In November 2013, a study by the consultancy firm London Economics, funded by Philip Morris, reported that since the measure was introduced, there had been no significant change in smoking prevalence (16). However, the study used an online survey panel which was not representative of the general population and had a higher than average smoking prevalence, and the sample size used was not sufficient to determine statistically significant changes (17).

27. More recently, statistics from Australia were released in June 2014 claiming that cigarette sales had increased in Australia since the introduction of standardised packaging. A number of these articles appeared in one key newspaper in Australia that had opposed standardised packs, which then picked up coverage in national newspapers in England. However, figures from the Australian Bureau of Statistics (ABS) show that in March 2014 tobacco consumption in the country was the lowest ever recorded. Analysis in Australia suggests these statistics had been completely misreported in an attempt to discourage other Ministers in the UK from proceeding with standardised packaging (18). The recent figures released by the ABS show that total consumption of tobacco and cigarettes is currently the lowest ever recorded, dropping from \$3.508bn in December 2012 (when standard packs were introduced) to \$3.405 billion in March 2014 (19). After population growth is taken into account tobacco sales per person have continued to decrease from 920.4 cigarettes in 2012 to 906.9 in 2013 (20). The Commonwealth Treasury has further advised that tobacco clearances (including excise and customs duty) fell by 3.4% in 2013 relative to 2012 when standardised packaging was introduced.

28. Tobacco retailers in the UK, often backed by tobacco-funded organisations, have suggested that the introduction of standardised packaging means that it will take longer to serve customers and that convenience stores will lose custom. However, research in Australia (21) has shown that "retailers quickly gained experience with the new legislation... The long retrieval times predicted by tobacco industry-funded retailer groups and the consequent costs they predicted would fall upon small retailers from plain packaging are unlikely to eventuate."

(3) YouGov Survey. Total sample size was 12,269. Fieldwork was undertaken between 5th and 14th March 2014. All surveys were carried out online. The figures have been weighted and are representative of all GB Adults (aged 18+).

(4) *ibid.*

(5) The Doctors Study" (Doll R, Peto R, Wheatley K, Gray R, Sutherland I. Mortality in relation to smoking: 40 years observations on male British doctors. *British Medical Journal* 1994; 309:901-911).

(6) <http://www.youtube.com/watch?v=R1AEH4Pemlw>

(7) <https://www.mja.com.au/journal/2014/200/1/association-between-tobacco-plain-packaging-and-quitline-calls-population-based>

(8) <http://onlinelibrary.wiley.com/doi/10.1111/add.12466/abstract>

- (9) <http://www.aihw.gov.au/alcohol-and-other-drugs/ndshs/>
- (10) http://www.cancerresearchuk.org/prod_consump/groups/cr_common/@nre/@pol/documents/generalcontent/smuggling_fullreport.pdf
- (11) http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_MiscellaneousReports&propertyType=document&columns=1&id=HMCE_PROD1_031246
- (12) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/249543/131009_Publication_of_Tobacco_Tax_Gap_estimates_2012-13.pdf
- (13) http://www.pmi.com/eng/media_center/media_kit/Documents/SUN%20Report%202013.pdf
- (14) http://www.illegal-tobacco.co.uk/wp-content/uploads/2014/03/NE_Illicit_Tobacco_Report_key_findings.pdf
- (15) http://tobaccofreefutures.org/wp-content/uploads/2013/08/8353_TSNW-Young-Persons-Alcohol-Tobacco-Report_130605_V3.pdf
- (16) <http://londoneconomics.co.uk/wp-content/uploads/2013/11/London-Economics-Report-Australian-Prevalence-Final-Report-25-11-2013.pdf>
- (17) http://www.cancervic.org.au/downloads/tobacco_control/2013/Critique_by_Cancer_Council_Victoria_on_report_by_PMI_26.11.13.pdf
- (18) <http://www.abc.net.au/mediawatch/transcripts/s4026465.htm>
- (19) <http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco-kff>
- (20) <http://www.theguardian.com/society/datablog/2014/jun/06/is-smoking-increasing-in-australia>
- (21) <http://tobaccocontrol.bmj.com/content/early/2013/05/25/tobaccocontrol-2013-050987.abstract>

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?

29. We broadly welcome the comprehensive draft regulations particularly in terms of the stipulated colour of tobacco packets; the minimum number of cigarettes or minimum weight of hand rolling tobacco that a packet can contain; the reassurance that these regulations will not affect other labelling requirements for tobacco products such as health warnings and fiscal marks; the scope of the regulations across the UK; the clarity of the regulations in relation to their impact on trade mark protection; the scope to include the changes required for Directive 2014/40/EU.

30. However there are some issues with the draft regulations that we would like to see addressed.

31. The draft regulations apply only to cigarettes and hand-rolling tobacco. We believe that the regulations should also apply to specialist tobacco products including cigars, cigarillos and 'blunts'. The rationale for this exclusion is low rates of use, particularly by young people, and the provision is made that that the regulations could be extended if young people become increasingly attracted to these types of tobacco. Our view is that this opportunity should not be missed to highlight to young people the dangers of these products before consumption increases and that the regulations should be extended now to include specialist tobacco products rather than when these products have become a problem so that there is a level playing field.

32. The draft regulations do not propose requirements relating to the size or length of cigarettes. Evidence in the North East shows that young women in particular are attracted to slim cigarettes therefore regulations should be included to stipulate a minimum size of cigarette. This would also prevent any opportunity for slim cigarettes to be repositioned as cigarillos thereby becoming exempt from regulations given their specialist tobacco products status (unless this exemption is removed as recommended).

33. The draft regulations do not propose requirements relating to the size of cigarette or tobacco packets. Instead, the only stipulation in terms of size is 'cuboid' and this is open to interpretation. This is a real concern and a potential weakness in the regulations. Dimensions should be provided to ensure consistency and to prevent the tobacco manufacturers from determining the size themselves and using it as a means of product differentiation. In Australia, the minimum dimensions for a 20 pack of cigarettes are stipulated as follows and we recommend the UK government follows this model:

Physical features of cigarette packs

The dimensions of a cigarette pack, when the flip-top lid is closed, must not be:

- (a) height — less than 85 mm or more than 125 mm; and
- (b) width — less than 55 mm or more than 82 mm; and
- (c) depth — less than 20 mm or more than 42 mm.

34. Once standardised packaging is introduced, brand names, variant names and brand descriptors will all become important tools for the tobacco industry to differentiate their brands from others. Recital (27) of the EU Tobacco Products Directive covers this issue listing words that are misleading e.g. 'low-tar' and 'light.' However, the list included at Recital (27) is not comprehensive and we urge the government to include additional words where there is evidence that they are misleading to consumers by creating the false impression that they are less harmful to health e.g. 'smooth,' colour names such as 'gold' or 'silver' and numbers. The

burden should be on the tobacco industry to prove that any brand names, variants or descriptors are not misleading before they can be put on sale in the UK.

35. The requirements prevent packaging from producing a noise or scent but do not prohibit any smell arising from a permitted additive. Tobacco manufacturers will be innovating packaging now to ensure they can work around these regulations therefore we feel that any scent other than that which normally arises from tobacco products should be prohibited. This is particularly relevant for menthol cigarettes which, under the directive 2014/40/EU, have an exemption until 2020. The development of capsule cigarettes shows that the tobacco industry is still innovating in this area.

36. The requirements only apply to retail packaging of tobacco products and not packaging that is used only within the tobacco trade, for example for stock management in a warehouse or wholesale premises. It would be preferable for the requirements to apply to all tobacco packaging to avoid any potential confusion over definitions of warehouses.

37. To aid enforcement of the regulations, it would assist if images of the packages, currently in Appendix C of the consultation document, were placed in the body of the regulations. A similar approach is used in other legislation that has specific labelling or presentation requirements, for example the regulations on pack health warnings.

38. Local authority Trading Standards officers will be tasked with enforcing this legislation. Trading Standards departments are playing an increasing role in public health and in tobacco control in particular. We feel therefore that it is important that the UK government invests in this vital service and provides it with the leadership and powers it needs to sustain this vital function.

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?

39. We welcome the overall recommendations of the consultation-stage impact assessment particularly its statement that the implementation of standardised tobacco packaging is worth pursuing now and that the cost of delaying a decision is too great in public health terms.

40. We welcome the decision to review the policy after five years which will allow time for early impacts to become clear although it needs to be borne in mind that long term impacts such as reduced youth uptake, reductions in smoking prevalence and improvements in public health will take many years to manifest.

41. We understand the difficulty of apportioning value to certain outcomes from interventions but there are some statements within the impact assessment that are particularly difficult to accept including:

"an additional benefit [of implementing standardised packaging] is the possible enhancement of price competition between tobacco companies and the potential for accelerated product innovation to exploit other avenues for product differentiation."

"consumer surplus [identified as a cost] represents the loss of the ability of those who continue to smoke to gain the intangible benefit associated with smoking a particular brand that only the packaging of that brand, as it is currently available, can produce."

The reality is that all cigarettes, regardless of brand or price, will kill one in two of its long-term users. Making products more affordable or more attractive cannot be judged to be a benefit.

42. We support any effective measures to maintain the costliness of tobacco in particular adjusting rates on tobacco duty above those currently required by the duty escalator, given that price is the single most effective policy lever for reducing smoking prevalence available to governments. Peto (22) has recommended an approach to taxation that would have a significant impact on consumption: tripling inflation-adjusted specific excise taxes on tobacco which would approximately double the average price of cigarettes (and more than double prices of cheaper brands) which would reduce consumption by about a third and actually increase tobacco revenues by about a third. We can fully expect the tobacco industry to respond to standardised packaging by dropping prices to make smoking more affordable.

43. The impact assessment considers the potential costs that may arise through increases in the demand for and the supply of illicit tobacco. However, we draw the consultation team's attention to:

- the findings of Chantler who is not convinced that standardised packaging would increase the illicit market and found no evidence that standardised packaging is easier to counterfeit.

- evidence from Australia which has shown there to be no increase in the illicit tobacco trade since the measure was introduced while tobacco consumption has fallen

- the conclusion of the Home Affairs Committee inquiry into tobacco smuggling which recommended that any risks in this area could be mitigated by increasing enforcement action

- Peto's view (23) that use of specific excise taxes on tobacco (rather than ad valorem taxes), stronger tax administration, and practicable controls on organised smuggling can limit the problem. Even with some smuggling, large tax increases can substantially reduce consumption and increase revenue especially if supported by better tax enforcement

- the impact that health-related social marketing can have on reducing smoking at population level and, in turn, reducing the illegal tobacco market, as seen in the North East, North West and South West where the illicit tobacco market share has reduced significantly

44. The impact assessment also considers the costs for retailers and states that, anecdotally, the profit margins on the sale of tobacco may be relatively low. John McClurey, elected member for Gateshead Council and independent retailer in Newcastle, maintains that:

"most traders rely less and less on tobacco profits since the gross profit is so small. I make as much profit from a pack of chewing gum as a £6 pack of cigarettes. What my customers save by quitting or never starting to smoke, they can spend on other things. That means more money into the local economy."

45. Standardised packaging was introduced in Australia on conjunction with larger health warnings and sustained mass media campaign, the per capita equivalent of which at then exchange rates would be £33.7 million a year in the UK. Australia is also committed to annual increases in tobacco taxation of 12.5 per cent over inflation each year for four years from December 2013.

46. Tobacco control policies should be comprehensive and complementary if they are to achieve maximum possible impact therefore consideration by the government must be given to the following areas if the public health benefits of standardised packaging are to be realised:

- Funding a sustained mass media campaign to support the implementation of standardised packaging
- Ensuring that stop smoking services are funded adequately
- Supporting and investing in efforts to reduce the supply of and demand for illicit tobacco through partnerships between health and enforcement based on the model of the Tackling Illicit Tobacco for Better Health Partnership (24)
- Considering tax rises on tobacco products over and above the existing escalator, particularly to counteract any possible negative effects from brand-shifting or price-cutting
- Considering further levies on the tobacco industry based on local sales data and designed to fund broad tobacco control and health costs caused by tobacco consumption.

47. The benefits of introducing standardised packaging identified in the impact assessment far outweigh the costs, many of which can be quantified at the North East level:

- Overall, the main smoking related diseases are conservatively estimated to cost the NHS across the North East £110.4 million per year
- The cost of smoking-related hospital admissions in the North East alone is calculated to be nearly £65.8 million per year
- An additional £32.1 million is lost to the regional economy each year through increased levels of absence from work from smokers compared to their non-smoking counterparts, which accounts for over 361,000 additional lost days of productivity per year across the North East.

(22) <http://www.nejm.org/doi/full/10.1056/NEJMra1308383>

(23) <http://www.nejm.org/doi/full/10.1056/NEJMra1308383>

(24) www.illegal-tobacco.co.uk

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
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