

Diageo Australia Limited Letterhead

Mr Bob Charles MP
Chairman
Joint Committee of Public Accounts & Audit
Review of Australia's Quarantine Function
Parliament House
Canberra ACT 2600

Dear Mr Chairman

Public Hearings – Sydney 5 August 2002 Response by Diageo Australia Limited to Questions on Notice

Thank you for the opportunity to appear before the JCPAA in its review of Australia's quarantine function. You may recall that Diageo Australia Limited (Diageo) undertook to follow up on a number of lines of inquiry being made by the Committee further to the evidence given during our appearance.

Our submission was effectively a single-issue submission centered on the administration by the Australian Quarantine Inspection Service (AQIS) of the imported food control legislation, as it applied to the import of spirituous beverages. Diageo was arguing that some recent policy and administrative decisions by AQIS in this area were discriminatory against the larger volume, reputable and compliant importer of spirits.

Our main concern is that AQIS has decided to subject duty free spirits to the same labelling requirements as set out in the food standard codes for alcoholic beverages sold in the domestic retail market. This decision was taken notwithstanding that it is universally recognised throughout the spirits industry that the duty free market is distinctly separate from each of the world's domestic markets, and that duty free product is never commercially imported into any domestic market as such. Duty free distribution is structured along global lines, with a single packaging and labelling standard applying to all products for this distinct market, be the product intended for sale at Sydney Airport, Singapore Airport or London Airport – or as ship stores for consumption by crew and passengers on international voyages.

However, having believed that AQIS was now moving towards a "hard line" approach to labelling compliance, Diageo was then at a loss to explain the release into home consumption by AQIS of imported spirits with non-compliant labels, including spirits still held under Customs control. AQIS requires both an understanding of some commercial realities within our industry, and some consistency in its approach when enforcing food label legislation.

Moreover, there appears to be a double standard at play because level of the 'policing' of the compliance by local manufacturers FSANZ standards differs to the level

applied to imported products by AQIS. The effect could be interpreted as de facto protection for local manufacturers under WTO.

During Diageo's evidence, the Committee was pursuing three main areas of inquiry, for which we now pleased to provide the following information:

Inquiry 1 – why should duty free products be exempt from domestic labelling standards?

The Committee asked why AQIS should not be able to protect Australian citizens by insisting that duty free products carry additional labelling information so that they meet domestic market labelling requirements. This would involve the addition of information as to the number of standard drinks, and a local address for possible consumer contact.

The answer is simply that the duty free spirits market is a distinctly separate market to the domestic spirits market. The International Wine & Spirits Record estimates the size of the world duty free market at just over 16.75 million nine litre case equivalents, with an estimated value of some US\$ 4.5 billion. Duty free thus equates to a sizeable market in its own right and this is how producers of internationally traded spirits view and service such a market, including to the extent that their are international "rules". This has to be the approach, both conceptually (because of globalisation and the prevalence of international travel) and in practice because of the international aspects of the trade.

The concept of duty free goods arises from the extraterritorial nature of international travel. More specifically, it was agreed that travellers should be able to purchase goods, which would normally be liable for customs and/or excise duties, out of the jurisdiction of national governments. While the international conventions governing the duty free trade relate primarily to fiscal matters, all signatories appear to accept the principle that duty free goods are not subject to their domestic regulatory regime. Indeed, national governments almost without exception do not insist on the application of their own domestic labelling requirements, which might include statements, advice or warnings on a variety of issues such as ingredients, allergens, health, environment and GMOs.

This is clearly logical from a legislative/regulatory perspective. However, it also makes sense at a pragmatic level, given that a significant proportion of duty free purchases will be made by the citizens of other countries, where the labelling regime (and even the language used) may be very different. Since the main purpose of labelling is to inform the consumer about the product, it makes no sense to insist on the provision of information, which is likely to be meaningless to a large proportion of potential consumers

Number of Standard Drinks

The first piece of additional information for duty free labels being sought by AQIS is the number of standard drinks. Standard drinks is a concept foreign to many

international consumers of spirits, and in those markets where standard drinks information is offered on labels, each such market has a different measure as to what constitutes a “standard drink”. Once an international measure representing a standard drink is agreed, Diageo would anticipate this information would become part of future global duty free labelling.

Attachment A to this document is a report on standard drinks issued by the International Centre for Alcohol Policy (ICAP) which highlights the current variance in what is considered to be a standard drink. We have attached the report so as to demonstrate to the Committee the irrelevance of standard drinks information, given the range of nationalities of the consumers purchasing spirits in the duty free market.

Importantly, standard drinks information is also aimed primarily at the “single serve” beverage such as beer, or ready to drink pre-mix-spirits, for which there may be confusion as to whether the single can or bottle represents one standard drink. These products are packaged anywhere between 250ml and 440ml, and at strengths between 3.5% a/v and 8% a/v. As a result, the standard drink content can vary from as low as 0.7 drinks to as high as 2.5 drinks. Clearly, such a wide difference has immediate health consequences where consumers still think that a can or a bottle of an alcoholic beverage must necessarily be the same ‘drink’.

Such information is less relevant for full strength spirits in 700ml to 1125ml bottles, which are likely to be consumed by better-informed consumers in the home. Moreover, in most cases the product is not consumed at full strength, but diluted by the consumer into a mixed drink. Therefore, standard drinks in a bottle is a less relevant measure and in this case, information on bottle size and spirit strength expressed as alcohol by volume is more important, and these details are available on existing duty free labels.

We suggest that the various Australian Health authorities use their good officers to engage the world health community to achieve a common standard. Once a world standard is announced we would accommodate it across all products.

Local Importer’s Address

The second piece of information is that of local address details for consumer queries and complaints. Again considered of little value given that in the vast majority of cases the consumer is either a non-resident returning overseas, or is a resident traveling overseas, for which an Australian contact is of little assistance. It is considered far more useful in this situation for consumers to have details of the actual manufacturer, information again that is contained on current duty free labels.

An example - Johnnie Walker Scotch Whisky – Domestic Vs Duty Free

Diageo now provides for the information of the Committee, sample bottles of Johnnie Walker Scotch Whisky – Red Label from stocks that are for domestic sale, and Black Label from duty free sale stocks. The duty free product is clearly marked as such, with distribution agreements further preventing its sale in the domestic retail market.

On comparison between the domestic and duty free products, the Committee should be able to note that there appears little detriment to Australian consumers from the information contained on the Johnnie Walker Black Label, as per the current global standards for duty free products in comparison to the domestically sold product.

Notwithstanding the discussion on duty free labelling, Diageo would argue that duty free Johnnie Walker Black Label product is never “imported” into Australia other than in the case of purchases at an arrivals duty free shop. In these cases, the import is likely to be covered by Section 7 of the *Imported Food Control Act 1992*, and be exempt from the controls as “small private imports of less than 10 litres”.

In all other cases, the Johnnie Walker Red Label duty free products will either be sold to ships providores or airline catering bonds as ship’s stores – again exempt from the provisions of the *Imported Food Control Act* through Section 7, or be exported by departing passengers from licensed duty free shops. Diageo has at Attachment B provided a copy of the relevant legislation that would appear to exempt much of the duty free sales activity from the imported food control laws.

Inquiry 2 – cost to duty free industry to comply with Australian domestic retail labelling standards

To understand the cost to industry, the Committee should first understand the duty free industry itself. As noted above, the major spirits companies service the duty free market on an international basis for a number of reasons:

- In the absence of national labelling requirements, all products destined for the duty free trade is labelled identically. Stock is therefore interchangeable, and can be held at regional distribution hubs for supply to individual countries and/or outlets on a ‘just in time’ basis as required to meet demand. This method of supply is particularly suited to goods such as spirits, which have a relatively long lead time for supply (by sea) to distant markets because air freighting is not economically viable;
- The demand for spirits is known to be price sensitive. This means that in many countries, especially where excise taxation is high, the market is dominated by ‘standard’ brands competing fiercely with one another on price. Companies develop and position particular brands for such markets, so as not to devalue their main internationally traded brands by discounting them to compete on price with lower quality brands;
- By contrast, the duty free trade is dominated by premium brands, not least because they are supplied to the consumer free of duties and taxes and thus represent good value for money, especially as ‘one off’ purchases;
- Because duty free consumers are by definition ‘international’, it makes no sense to service the duty free trade on the same basis as the domestic markets alongside which they operate; and

- Business research and planning is quite different for each sector; indeed, as noted above, the products sold are not the same in spite of some overlap.

The current situation in Australia and New Zealand reflects these dynamics perfectly. Whereas the domestic markets are very price sensitive and are dominated by standard and ‘value for money’ brands, duty free outlets mainly carry an extensive range of deluxe and premium brands targeted closely at the international traveller. These products all bear ‘standard export labels’ and are supplied through the companies’ Asia Pacific duty free distribution hubs.

In light of the above, the AQIS decision to require duty free spirits to comply fully with domestic labelling regulations has serious commercial implications for spirits producers. The current method of supplying the duty free trade from regional distribution hubs will no longer be viable. The present arrangements are built around a global business plan, including an inventory appropriate to the potential customer. Uniformity of labelling is clearly an essential part of the regime, not least because it permits economies of scale for relatively small volumes of high value, premium products in a unique sales environment.

Diageo estimates that the cost of sourcing its duty free supplies for Australia and New Zealand through its domestic business, rather than through its international duty free business, will exceed US\$1.5 million per annum. Moreover, it will not be economically viable to label small batches of high value goods for the duty free trade to meet Australian and New Zealand domestic requirements when there is no domestic market for them. These products will thus have to be removed from the inventory, denying choice to consumers and damaging the brand owners’ profitability.

It is this sort of restrictive trade practice (or non-tariff trade barrier) that the WTO wants to prevent through its “Technical barriers to Trade” (TBT) Agreement. Diageo believes that through this AQID administrative decision, the Australia Government may be in breach of their international obligations under the WTO’s TBT Agreement.

Inquiry 3 – risk of labelling breaches from smaller importers

Having believed AQIS was strengthening its compliance role over the labelling of imported spirits Diageo was able to highlight at least one instance where AQIS had clear information and opportunity to detain, and respond to imported spirits destined for the domestic market and which failed relevant labelling requirements. As outlined in Diageo’s submission, a shipment of “Baileys Irish Cream” for which Diageo holds exclusive distribution rights was stopped by Customs to allow Diageo to inspect for possible trademark infringements.

The product was found to be legitimate Baileys Irish Cream, however, given it was not destined for the Australian market, its label did not have the information required to meet the relevant food code requirements. As such, Diageo referred the product to AQIS through Customs, on the basis it was not properly labelled for the Australian market.

Diageo now provides the Committee with a bottle of Bailey's Irish Cream from the consignment in question. The Committee will note that this bottle was in fact originally destined for the duty free market before being acquired offshore by a "parallel" trader, most likely from a duty free wholesaler, for import to Australia.

Despite all assurances given by AQIS to the contrary, the product proceeded to enter the domestic market with non-compliant labels, namely no information as to standard drinks and no local contact address. The same information being sought by AQIS from Diageo for products it does not intend to put into the domestic market. This type of inconsistent administration leaves the industry confused and disappointed.

As at 29 July 2002, AQIS are still advising that the Baileys Irish Cream in question was adequately labelled before entering the domestic market. At Attachment C is a copy of a facsimile advice from AQIS to Diageo's legal counsel, stating that the consignment was sighted at the importer's premises and deemed to be compliant with labelling legislation. The Committee should note that the Baileys Irish Cream label is clearly marked for "duty free sale only" but significantly missing both "standard drinks" and "local address" information.

However, the Baileys Irish Cream is in fact marked to the same standard as the Johnnie Walker Red Label Duty Free bottle, yet Diageo has been informed this label would be considered non-compliant. Diageo and its peers in the industry, now require from AQIS clarification as to why its duty free labels fail, but product marked to an identical standard imported by a small NSW liquor wholesaler was compliant and released into home consumption without alteration.

Issue 4 – AQIS sampling program

As random surveillance food, AQIS selects one in twenty uses of the various spirits tariff classifications as food it will inspect under the random surveillance sampling regime. The selections are made through the COMPILE import system, being the Customs computer system for the lodgment of customs import declarations.

As a high volume importer of spirits with many import declarations being processed by COMPILE, Diageo will be selected on a regular basis for inspection. The Committee should note that in the past 12 months, Diageo averages 1 in 30 selections for inspection against the use of each of its tariff classifications. Significantly, there has been no product identified by AQIS as "failed foods".

On the other hand, Diageo believes that a lower volume, or a one-off importer of spirits will be unlikely to be selected for an inspection given the randomness of the profile. Diageo would argue however, that the real risk to AQIS is from the lower volume importers of spirits, and yet they would seem to generally fall outside of the testing program.

To support this claim, Diageo has included two further two samples for the Committee to peruse, both acquired in the domestic retail market on 19 September 2002, both imported by small volume importers:

1. “Scharlachberg” brandy 710ml @ 36% a/v – this product bears no English on any labelling, has no reference to an Australian importer, no country of origin, nor number of standard drinks. Significantly, it has been packaged at 36% a/v which is below the prescribed minimum strength for brandy spirit as set out in the Food Standard Codes; &
2. “Sierra Slammer – Tropic” RTD 275ml @ 5% a/v – this product claims to be imported and does identify the importer, however, gives no indication as to the country of origin of the goods.

Cost to industry of AQIS controls

The regular inspection by AQIS of Diageo’s products that are continually found to be properly labelled and safe to consume, is not without commercial costs. These costs are primarily in inconvenience given:

- Product selected must be kept separate from general stock until inspection;
- Bulk spirit selected can not go into production until inspected;
- Packaged spirit can not be sold until inspected;
- AQIS officers have to be booked in advance for an inspection, and so it is often several days before goods are cleared; and
- Twice this year it was urgent consignments that were selected for inspection with urgent inspections also requiring additional paperwork.

There are then financial costs in terms of actual inspection fees (typically A\$ 36 per inspection plus \$36 per on-site inspection if required), and additional fees to have urgent consignments cleared (typically A\$ 14 per 30 minutes of on-site inspection). Notwithstanding, there is a commercial cost of having urgent consignments unavailable for production or sale, and in the provision of resources to arrange and facilitate AQIS inspections.

Diageo would also question the “value for money” of the AQIS approach in terms of its own objectives and for the protection of the community as a whole. It would seem a mis-direction of resources when such resources are continually being diverted to inspect an importer who has been demonstrating full compliance over many years.

AQIS procedures

The Committee was also interested in the actual process performed by AQIS over spirituous products, including the extent of samples drawn.

In terms of imports of bulk spirit selected for inspection, such consignments are set-aside for AQIS who will undertake an examination of the container seals, and the relevant paperwork. Drawing an actual sample from the bulk spirit is rare, and has occurred only once in the past 12 months.

For imports of packaged spirit (i.e. already in bottles), the shipping container is unpacked and the cartons quarantined separately in the bonded warehouse. AQIS will then inspect the labels on both the carton and on the bottles from the cartons selected. Removing the cap to examine bottle contents is again rare, only twice in the past 12 months have AQIS taken samples in this manner.

It appears from the Diageo staff that deal with AQIS at the inspection level that officers attending Diageo's premises are very reasonable about the nature of each inspection. Diageo would again argue that these AQIS resources could be better deployed by a move from random targeting of spirits, towards a more focused selection of consignments more likely to be in breach of labelling requirements.

In conclusion, Diageo again takes this opportunity to thank the Committee for accepting its submission and evidence, and trusts the information supplied to date will be useful for the Committee in its deliberations. It has become clear to Diageo that AQIS could be better educated as to the operations, nuances and risks of our industry, and in doing so begin producing more efficient administrative outcomes for both its objectives and the businesses of those compliant in the industry.

At this point, Diageo continues to be happy to provide any assistance to the Committee, and in this regard it should feel free to contact me in the first instance on the above contact details.

Yours sincerely

Ron Ainsbury
External Affairs Director.

Attachment A

ICAP Paper – What is a Standard Drink

Attachment B

Insert Section 7 Imported Food Control Act

Attachment C

Insert Facsimile correspondence from AQIS re Baileys Irish Cream