

**RESPONSE OF BRITISH AMERICAN TOBACCO COMPANY (HONG KONG) LIMITED TO THE
GOVERNMENT'S PROPOSAL TO INCREASE THE SIZE OF THE GRAPHIC HEALTH
WARNINGS FOR PACKETS AND RETAIL CONTAINERS OF CIGARETTES TO 85%**

23 JUNE 2015

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3.	The expert report of Professor Viscusi, Distinguished Professor of Law, Economics and Management, Vanderbilt University Law School, Nashville, Tennessee, United States, (" The Viscusi Report ").
4.	The expert report of Professor Philip Zerrillo, Ph.D., a Full Professor in the Marketing department at Singapore Management University (" The Zerrillo Report ").
5.	The expert report of John Hector, a former investigator for the U.K. Her Majesty's Revenue and Customs and Fiscal Crime Liaison Officer at the UK Embassy in Beijing, (" The Hector Report ").

1. INTRODUCTION

- 1.1 This submission by British American Tobacco Company (Hong Kong) Limited ("**BAT (HK)**") (the "**Response**") responds to the Hong Kong Government's proposal to amend the area of the graphic health warnings and messages for packets and retail containers of cigarettes under the Smoking (Public Health) (Notices) Order (Cap 371B) (the "**Order**"), by requiring that the area of the graphic health warning shall be of a size that covers at least 85% of two largest surfaces of the packet or of the retail container (the "**Proposal**"). The Proposal would substantially and impermissibly expand the size of graphic health warnings for packets and retail containers of cigarettes from the current size of at least 50% to at least 85% which is beyond what is necessary or permissible.
- 1.2 BAT (HK) is a member of the British American Tobacco group of companies and is responsible for the importation, distribution and sale of tobacco products in the Hong Kong. BAT (HK) has an approximate 24% share of the Hong Kong market. BAT (HK) currently supplies 11 brands in Hong Kong, including VICEROY, PALL MALL, KENT, CAPRI, CASTAN, DUNHILL, HILTON, WINFIELD, and LUCKY STRIKE. There are also currently plans to continue the investment into new brands.
- 1.3 As explained in detail in this Response, BAT (HK) is strongly opposed to the Proposal to increase graphic health warnings on tobacco packaging in Hong Kong to at least 85%.

2. EXECUTIVE SUMMARY

2.1 BAT (HK) opposes to the Proposal to increase the size of graphic health warnings to 85% on a number of grounds, including:

2.1.1 **The Proposal is unlawful.** The Proposal would deprive BAT (HK) of its property rights and the right to use its trademarks as protected under Articles 6 and 105 of the Basic Law in Hong Kong. The Proposal is therefore contrary to existing laws and thus there is no legal or valid basis upon which the Government can make these regulations.

The Proposal would represent a fundamental shift in Hong Kong's attitude towards intellectual property and property rights generally. Adopting the Proposal would diminish the reputation of Hong Kong as an international trading centre which supports and protects intellectual property and investment. Its implications would also extend beyond the tobacco industry. Industries that sell other consumer products that are perceived to pose health risks would consider that in time they will also become targets for similar labelling policies.

According to the Economic Freedom Index 2015, Hong Kong is ranked no.1 in the world. Rule of law and the degree by which the law protects private property is one of the criteria. The strong rule of law that exists in the territory is a principal reason why Hong Kong is attractive to investors and thus all efforts should be made to uphold and fortify that reputation. If the Government's actions damage the right to property or it does not protect property to the greatest possible extent envisaged by the law, as would be the case if the Proposal is adopted, then Hong Kong's status as an international centre for investment will be diminished, contrary to the Government's obligation under Article 109 of the Basic Law to: "*provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre.*"

2.1.2 **The Proposal is also manifestly disproportionate.** The interference resulting from the Proposal goes to the very essence of the fundamental rights of property and so the requisite thresholds for justification and proportionality are at their highest. The burden imposed by the 85% graphic health warning requirement would manifestly outweigh any illusory benefit. The Proposal is not necessary. There is already universal awareness of the risks of smoking. Evidence also demonstrates that further increasing the size of the graphic health warnings would not be more effective in increasing awareness (which is already effectively universal) or reducing smoking. In addition, the proposed size of 85% graphic health warnings is entirely arbitrary and has no evidential basis at all.

The Proposal is also likely to have serious adverse consequences which undermine the public health objective, including:

- exacerbating a serious illicit trade problem in Hong Kong;
- stimulating price competition leading to down trading to cheaper products, which may in turn lead to an increase in consumption;
- distorting competition and raising barriers to entry; and
- stifling innovation.

The Proposal must also be considered against the background of the existing comprehensive ban on tobacco advertising and promotion in Hong Kong. Packs, and the trademarks used on them, are to all practical purposes the only means by which manufacturers can identify and differentiate their products from those of their competitors. It is clear that a measure, which cannot be shown to be effective, and that would virtually extinguish this last means of communication for a lawfully available product, while resulting in adverse consequences in respect of pricing, the illicit market and public health, cannot be justified or proportionate.

2.1.3 **The Proposal would place the Hong Kong Government in breach of its international obligations.** The Proposal would violate Hong Kong's international obligations under World Trade Organization ("**WTO**") Agreements such as the Agreement on Trade-Related Aspects of Intellectual Property Rights ("**TRIPS Agreement**") and the Agreement on Technical Barriers to Trade ("**TBT Agreement**"), or which are vital for the fair treatment of Hong Kong's exports. Further, certain companies within the BAT Group hold significant investments in Hong Kong that are protected under Investment Treaties. The Proposal would breach these treaties, damaging Hong Kong's international reputation and putting the Government at risk of legal awards requiring it to repeal the legislation and/or pay substantial sums in compensation.

2.1.4 **The Proposal is not required nor authorised by the World Health Organisation ("WHO") Framework Convention on Tobacco Control ("FCTC").** The current graphic health warnings that already occupy 50% of the front and back of tobacco product packages are already over and above the FCTC requirement. Accordingly, the Proposal is not necessary to meet the requirements of FCTC.

2.1.5 **The Government has not undertaken any regulatory impact analysis ("RIA").** The failure to undertake any impact analysis of the Proposal goes against the recommendation made in the Regulatory Impact Analysis undertaken in 2001 in respect of proposed amendments to the then existing smoking

legislation, that: “any future requirements for pictorial and graphic contents take into account the likely financial and economic costs of implementation and that these be weighed against the likely health and economic benefits likely to arise.”¹

The Legislative Council paper on Progress of Tobacco Control Measures No. CB(2)1456/14-15(07) (the "**Legislative Council Paper**") doesn't address these issues at all. The lack of a proper evidence-based regulatory impact analysis means that Legislative Council cannot properly scrutinise the Proposal under the negative vetting procedure to ensure that it is justified.

¹ Regulatory Impact Assessment, *Proposed amendments to the existing smoking legislation*, Environmental Resources Management Limited, LC Paper No. CB(2)1/02-03(04), Dec 2001, page 107
<http://www.legco.gov.hk/yr02-03/english/panels/hs/papers/hs1025cb2-1-4e.pdf>

3. THE PROPOSAL WOULD EVISCERATE THE ESSENTIAL ROLE OF TRADEMARKS

- 3.1 Trademarks are used by manufacturers as an essential tool to distinguish their goods from similar products. The function of trademarks is to indicate the source of the product and to identify the product by distinguishing it from its competitors. Trademarks are essential for product differentiation and thus for competition in the market. They are an important tool to permit market penetration and trademarks facilitate local and international trade. Trademarks can only perform these functions if they can be effectively used as they were registered.
- 3.2 Trademarks are often the most valuable asset that a manufacturer possesses and are at the centre of the global economy, as recognized by a recent report of the World Intellectual Property Organization, World Intellectual Property Report 2013: Brands – Reputation and Image in the Global Marketplace.² According to this report, the "public good" of trademarks exists in their functional use as a communication tool. The report notes that "the trademark system provides the legal framework underpinning [consumer] confidence", and "trademarks play an important role in preventing market failure". It concludes that "society is bound to be worse off" without the "market-enabling role of trademarks" as, without protected trademarks, consumers can no longer gain access to the product reputation mechanism to guide their purchases and producers have a reduced incentive to invest in product differentiation, thus undermining product quality and diversity. This would gravely damage the interests of consumers in general.
- 3.3 It is clear that the Government accepts the value and sanctity of trademarks as a key type of intellectual property. The website of the Government's Intellectual Property Department, states:

"Protection of intellectual property rights protects creativity...

Hong Kong, China is a creative place. Our...graphical design and production skills are known world-wide and...Hong Kong, China is an international trading centre, we need to provide the necessary intellectual property rights protection to our investors to assure them of a free and fair environment in which to do business. Thus it is in our very interest to protect intellectual property rights...

*The Government...attaches great weight to the contribution that the creation of intellectual property makes to the economy. We have been involved in an on-going effort to ensure that Hong Kong, China people and overseas investors in Hong Kong, China can be assured of intellectual property protection as good as and even better than in any other economy in the world."*³

² Available at http://www.wipo.int/edocs/pubdocs/en/intproperty/944/wipo_pub_944_2013.pdf.

³ Available at http://www.ipd.gov.hk/eng/intellectual_property/ip_hk.htm

- 3.4 The right of manufacturers to use their trademarks and the requirement to allow sufficient space on packaging for trademarks, was confirmed in a 2014 decision of the Court of Appeal of Sri Lanka, in which the court held that 80% graphic health warnings on cigarette packages would not allow sufficient space to display trademarks and directed that the size of the graphic health warnings should only occupy a space of 50% to 60% of the pack. The Court stated:

"Having considered the size of the packs and other relevant facts, I am of the view that 20% of the space is not reasonably sufficient to present and exhibit a trademark. 20% of the space is not exclusively left for the trademark. It may carry other information as well. In such a space, the presentation of the trademark necessarily becomes comparatively very small. The owner of a trademark cannot reach the consumers with his mark which is hidden in the health warning. The consumers will also not be able to see and identify the trademark properly and consequently the source of the respective goods. They have to make extra efforts to see or identify the trademark, when they buy the goods. Such a situation will unreasonably interfere with the statutory right of the owner of the trademark to use it frustrating the whole purpose of a trademark and of the trademark law"; and

"This court observes that a balance need [sic] to be maintained, having considered the case of either party. Health of each and every citizen of our country and all those living in Sri Lanka permanently or in a temporary capacity is paramount and need to be protected. On the other hand a legally established business/industry cannot be denied its legitimate rights, flowing from the laws of our country. If 80% of the space is covered by health warnings the remaining space would not be sufficient to display the manufacturers' trade mark." A copy of the decision of the Court of Appeal of Sri Lanka is submitted with this Response (see Appendix 1).⁴

- 3.5 BAT (HK) submits that the factual observations made by the Court in Sri Lanka would equally apply in respect of the Proposal and a Court in Hong Kong would apply the same reasoning and reach the same result, namely that 85% graphic health warnings would provide insufficient space for display of trademarks on tobacco product packaging.
- 3.6 BAT (HK) also submits the Expert Report of Professor Philip Zerrillo, Ph.D. Professor Zerrillo is a Full Professor in the Marketing department at Singapore Management University and Dean of Post Graduate Professional Programmes. He is also the Executive Chairman of the Board for the Masters in Marketing (MIM) programme at Thammasat University in Thailand. Professor Zerrillo has taught graduate level courses in marketing channels and marketing strategy for 17 years in this programme. He also teaches a

⁴ BAT (HK) notes that the subsequent decision of the Sri Lankan Government to introduce 80% graphic health warnings and circumvent the decision of the Court of Appeal is contrary to the rule of law, and would clearly not be countenanced in Hong Kong.

doctoral level seminar at Thammasat University. Professor Zerrillo's report (the "**Zerrillo Report**") is submitted with this Response (see Appendix 4).

3.7 In his Report, Professor Zerrillo describes the importance of trademarks and the brands that they represent, and how they affect consumers, manufacturers, competition in the marketplace, and international trade. He also opines upon the ramifications to trademarks and brands that will result from the requirement to increase the size of the graphic health warnings on cigarette packages in Hong Kong to cover not less than 85% of the package surface, and the resulting impact on consumers, manufacturers and the marketplace.

3.8 A summary of Professor Zerrillo's opinions are, as explained in his Report⁵:

3.8.1 Trademarks (such as words, logos, images, designs or combination of these elements) and packaging are vital to brands.

3.8.2 Trademarks perform valuable functions for both consumers and the firms that own them. A trademark identifies the brand and differentiates the product performing important navigation and reassurance functions for consumers. It signals the source or origin of the product and, as such, aids the consumer's navigation among competing products. Trademarks also symbolize a product's quality and features, and guarantee that the goods or services measure up to expectation. The existence of trademarks, and the brands they represent, is particularly important for effective market competition, as they enable firms to uniquely identify and differentiate their products other than on the basis of price alone. For manufacturers, the protection of the intellectual property rights afforded to trademark owners means that the firm can invest in the trademark and the associated brand with confidence. In addition to the firm's ability to obtain the benefits of its valuable asset sustained over time, it provides an incentive for the firm to create greater value for all stakeholders including consumers.

3.8.3 Increasing the size of GHWs to cover 85% of the cigarette packages will make it impossible for manufacturers to use some trademarks as registered (including logos and labels) and for them to use other trademarked elements effectively. Trademarks will not be able to adequately serve their essential functions of differentiating products and uniquely identifying their origin and quality.

3.8.4 In Hong Kong, the extensive ban on advertising and sponsorship of cigarettes means that the limited space available on cigarette packs for trademarks is the only tool manufacturers have to identify and differentiate their products from other competitive offerings. A further reduction in this already limited space will minimize or even eliminate any meaningful use of trademarks and, in doing so,

⁵ Zerrillo Report at para 12.

destroy their value. As a result, decades of investment in brands and their related trademarks, along with their inherent goodwill, will be lost.

3.8.5 Brands including trademarks play an important role in the cigarette market, and their erosion or elimination changes the nature of the market. In general, markets without brands become price-driven commodity markets.

3.8.6 Commodity markets produce lower prices that encourage more consumption. Commodity markets also make the market inhospitable to firms trying to enter the market and for existing brands, particularly small brands, to compete for a greater market share. Commoditization of the cigarette market in Hong Kong and a shift to pure price driven competition could also lead to an increase in illicit trade because without the added value of brands, legitimate products will be less clearly differentiated from illicit products.

3.9 Professor Zerrillo includes in his Report images below of current cigarette packs of BAT (HK)'s brands sold in Hong Kong with the proposed health warning covering 85% of the packages on the right. As noted by Professor Zerrillo these images clearly illustrate that the graphic health warnings covering 85% of the packages would destroy the "visual equity" of BAT (HK)'s relevant trademarks.⁶

⁶ Zerrillo Report at para 46.

<p>香港特區政府忠告市民</p>  <p>吸煙引致肺癌</p> <p>焦油：5 毫克 尼古丁：0.4 毫克</p> <p>PALL MALL FAMOUS AMERICAN BLEND</p>  <p>CHILLED</p>	<p>戒煙熱線：1833 183</p>  <p>吸煙帶來痛苦 生不如死</p>  <p>CHILLED</p>
<p>香港特區政府忠告市民</p>  <p>吸煙禍及家人</p> <p>焦油：8 毫克 尼古丁：0.7 毫克</p> 	<p>戒煙熱線：1833 183</p>  <p>吸煙帶來痛苦 生不如死</p> 
<p>香港特區政府忠告市民</p>  <p>吸煙可加速皮膚老化</p> <p>焦油：13 毫克 尼古丁：1.0 毫克</p> <p>RICH TOBACCOS - FILTER KINGS</p>  <p>AMERICAN BLEND</p>	<p>戒煙熱線：1833 183</p>  <p>吸煙帶來痛苦 生不如死</p>  <p>AMERICAN BLEND</p>

4. **THE PROPOSAL IS UNLAWFUL**

(A) THE PROPOSAL WOULD VIOLATE FUNDAMENTAL RIGHTS PROTECTED UNDER HONG KONG LAW

4.1 The Proposal to increase the area of the graphic health warnings on tobacco packaging in Hong Kong to cover at least 85% of two largest surfaces of the packet and of the retail container, is a violation of BAT (HK)'s fundamental property rights which are protected under the Basic Law of Hong Kong. Indeed, by eviscerating the essential role of trademarks as highlighted in preceding section 3, the Proposal would deny all meaningful use or all economically viable use of the trademarks. It would thereby deprive BAT (HK) of its extremely valuable intellectual property rights; namely, its trademark rights together with the goodwill arising in their brands. The Basic Law expressly protects property rights under the following provisions:

Article 6

The Hong Kong Special Administrative Region shall protect the right of private ownership of property in accordance with law.

Article 105

The Hong Kong Special Administrative Region shall, in accordance with law, protect the right of individuals and legal persons to the acquisition, use, disposal and inheritance of property and their right to compensation for lawful deprivation of their property.

Such compensation shall correspond to the real value of the property concerned at the time and shall be freely convertible and paid without undue delay.

The ownership of enterprises and the investments from outside the Region shall be protected by law.

4.2 The concept of protected property rights under Hong Kong law includes tangible rights as well as intangible rights. This was specifically determined by the Hong Kong court in *Michael Reid Scott v The Government of HKSAR* (HCAL 188/2002) in which the court found that that property (for the purposes of Article 105) is a very wide concept and requires a "wide and purposive interpretation". In light of this judgment, it is clear that intangible rights including intellectual property, business goodwill and reputation rights are protected under Article 105 of the Basic Law. Section 10(1) of the Trade Mark Ordinance (Cap. 559) also provides that a "*registered trade mark is a property right obtained by the registration of the trade mark under this Ordinance*" and section 27(1) provides that a "*registered trademark is personal property*". By virtue of paragraph 3 of Article 105 of the Basic Law, the protection of trademark rights and other intellectual property rights extends

to those owned and invested in by legal persons including foreign companies such as the BAT group.

- 4.3 The concept of "use" of a trademark involves use on or in relation to goods to distinguish them from competitors' goods. The Proposal would make it impossible to use a number of trademarks consisting of logos and other devices placed at certain positions on the pack (including, but not limited to, position marks and entire pack marks). The right to use these trademarks would be eliminated. In addition, the proposed 85% graphic health warnings would have such a severe impact on the use of other trademarks that they would effectively deprive owners of the 'use' right. As explained in section 3 the Proposal would eviscerate the essential role of trademarks.
- 4.4 In *Fine Tower Associates Ltd v Town Planning Board* [2008] 1 HKLRD 553, the Court of Appeal in Hong Kong considered Article 105 of the Basic Law and held that action adversely affecting use of property, despite falling short of formal expropriation, may in certain circumstances properly be described as deprivation. The Court held that "*deprivation*" in this context contemplates the removal or denial of all meaningful use, or all economically viable use, of the property.
- 4.5 The following special features of the tobacco products further exacerbate the manufacturers' vulnerability to deprivation of their property rights:
 - 4.5.1 The advertising of tobacco products has already been banned in Hong Kong, such that one of the last remaining channels of communication between the manufacturer and the consumer is through the packaging of the product for retail sale;
 - 4.5.2 The physical size of the packaging of tobacco products is small and the use of the packaging is already severely limited by the existing warnings that occupy 50% of the front and back surfaces of tobacco packaging;
 - 4.5.3 The likely manner of purchase of cigarette products at their points of sale where a whole host of different brands are grouped and displayed together (which is unique to cigarette sale), making it imperative for a packet to be readily recognisable not only by its brand name but by the display of the trade dress in a reasonably sufficient space on the packaging.
- 4.6 Although there may still be room left for applying some word and device trademarks, the space left for displaying the trademarks being a maximum of 15% of the two largest surfaces of the packet and retail container, is patently insufficient to effectively differentiate the product from the competition. This leaves the trademark without its function as an identification of the commercial origin and the quality of the underlying product. In order to serve as a source-identifier, a sign must be easily identifiable and widely visible on the pack space. Where only 15% of the packet is left for the display of trademarks and the

package is dominated by oversized graphic health warnings, this requirement cannot be fulfilled and the essential role of trademarks is eviscerated. The decision of the Court of Appeal of Sri Lanka, discussed in section 3 above, demonstrates that when graphic health warnings become too large, as would be the case with 85% graphic health warnings, trademarks can no longer serve their essential functions and the right to use is infringed.

4.7 The Proposal would therefore remove or deny all meaningful use or all economically viable use of the trademarks and thereby constitutes a deprivation of the property of the trademark owners.

4.8 As explained by Professor Zerrillo:

*"With GHWs covering 85% of the package it would be impossible to effectively include all the desired information on the package. Increasing the size of the GHWs to 85% will prevent consumers' from being able to perceive the brand on cigarette packages. Without distinctive packaging to make the trademark elements stand out, a brand becomes undifferentiated from competing brands. Trademarks will not be able to effectively differentiate, and identify the origin and quality of products, which are essential functions of trademarks. **The consequence of this is that the trademarks and their related brands are practically destroyed and the goodwill inherent in the trademarks and their related brands will be lost, along with the decades of significant investment it took to generate such goodwill.**"⁷ (emphasis added)*

4.9 In addition to trademark rights, the goodwill associated with the packaging of BAT's products and used in connection with their sale, including the main panels of the packaging of the product which make up its trade dress, would be adversely affected. Generally, the longer a trade dress has been in use, the more valuable it will be as a tool to help visually distinguish the product from those manufactured or marketed by competitors. This is all the more important given that the effect of the Proposal will be to allow a maximum of only 15% of cigarette packaging to bear the relevant trademark, logo and reflect the trade dress.

4.10 The practical sterilization of the manufacturers' property, by reason of the requirement to print warnings covering over 85% of the surfaces of the packaging amounts to a deprivation of intellectual property rights and the associated goodwill that manufacturers have cultivated over years of investment, of which these rights are protected under the Basic Law. Given the commercial value of BAT (HK)'s trademarks and valuable goodwill built over the years in their brand portfolios, the loss caused by the Proposal would clearly be very substantial.

⁷ Zerrillo Report at para 48.

- 4.11 Accordingly, the Proposal is inconsistent with the Basic Law and thus the Government is precluded under the law from implementing this proposed change.
- (B) THE PROPOSAL EXCEEDS THE SCOPE OF THE POWER AND AUTHORITY UNDER SECTION 18(2) OF THE SMOKING (PUBLIC HEALTH) ORDINANCE (CAP 371)
- 4.12 The power to prescribe health warnings is vested with the Secretary for Food and Health (the "Secretary") pursuant to section 18(2) of the Smoking (Public Health) Ordinance (Cap 371). The power conferred upon the Secretary under section 18(2) is restricted to the "form (including specifications)" of the health warning and does not confer a power to violate rights protected under the Basic Law which is higher law.
- 4.13 As explained above, the Proposal would deprive BAT (HK) of its property rights and the right to use its trademarks as protected under the Basic Law in Hong Kong. This deprives BAT (HK) of the very substance of the protections provided under the Basic Law, including Article 105. The Proposal is therefore beyond the scope of power and authority of the Secretary under section 18(2).

5. **THE PROPOSAL IS DISPROPORTIONATE AND THEREFORE CANNOT BE JUSTIFIED AS A PUBLIC HEALTH MEASURE**

5.1 The principles of proportionality require administrative acts to meet a three-pronged test, as set out in the Hong Kong Court of Appeal decision in *Mok Charles v Tam Wai Ho*⁸, namely:

5.1.1 The restrictions or limitation must pursue a legitimate aim;

5.1.2 The restrictions or limitations must also be rationally connected to that legitimate aim; and

5.1.3 The restrictions or limitations must also be no more than is necessary to accomplish that legitimate aim.

5.2 The Government has the burden of showing that the Proposal meets the above requirements. As discussed below, the Government has not prepared an RIA in relation to the Proposal. Absent this analysis, it cannot be demonstrated that the above requirements have been met.

5.3 The Proposal must also be considered in context, namely that the current graphic health warnings already occupy 50% of the front and back sides of cigarette packs. The Government has not adduced any evidence to show either (a) that the current size of graphic health warnings are inadequate or insufficient to achieve their intended purpose, namely to inform the public of the health risks involved by smoking, or (b) that the further increase in the size of the graphic health warnings from 50% to 85% will more effectively achieve that purpose than the current size of 50%.

(A) **THERE IS NO LEGITIMATE PURPOSE THAT REQUIRES THE PROPOSAL**

5.4 The first essential step in an impact analysis is to identify and establish the problem that the measure is intended to solve. The Government must be able to identify a specific and addressable problem before it can show why the proposed increase in warnings size from 50% to 85% is required and how it will address the problem identified.

5.5 There is no problem that requires further increasing the size of graphic health warnings from 50% to 85% because:

5.5.1 Public awareness in Hong Kong about the risks of smoking cigarettes is effectively universal. BAT (HK) has commissioned an expert report from Professor Viscusi, the University Distinguished Professor of Law, Economics, and Management at Vanderbilt University (the "**Viscusi Report**") (see Appendix 3). As explained in the Viscusi Report the public, including youth in Hong Kong are well informed about the risks of smoking. Statistics reflect the widespread

⁸ (2010) 13 HKCFAR 762.

exposure of the public to anti-smoking messages, and indicate universal awareness of the potential health consequences of smoking. The youth are often taught about the dangers of smoking in schools, and are targeted in media campaigns that warn of possible health risks. Warnings on cigarette packets have reinforced the media coverage of smoking risks. The high level of awareness includes the youth, as demonstrated by the independent 2009 Global Youth Tobacco Survey (GYTS) data for Hong Kong which found that 95.4% of respondents answered 'Definitely Yes' (89.8%) or 'Probably Yes' (5.6%) to the question 'Do you think cigarette smoking is harmful to your health?'⁹ Professor Viscusi states:

"Given that the public are aware of the risks of smoking, there is no beneficial informational role for increased warnings. In the absence of any effect of additional warnings on risk beliefs, one would not expect that warnings that reiterate what consumers already know would alter smoking behavior. It is well documented that reminder warnings do not alter consumer or worker behavior. Independent studies have also demonstrated that further attempts to modify consumer behavior are misguided if they are premised on the notion that people lack adequate information about smoking."¹⁰

- 5.5.2 Branded packaging also does not neutralise consumers' existing awareness of the risks of smoking or prevent consumers from seeing and assimilating the health warnings. Accordingly the removal of trademarks from packaging is not required to increase the effectiveness of health warnings.
- 5.5.3 The existing cigarette packages in Hong Kong, which already carry large graphic health warnings that cover 50% of the two largest surfaces of packages, do not mislead consumers about the harmful effects of smoking as demonstrated by the universal awareness of the risks of smoking as highlighted above.
- 5.5.4 Furthermore, existing laws are sufficient to meet any demonstrable concerns regarding deceptive packaging. The existing protections against false or misleading trade descriptions on goods including tobacco products under sections 6 and 7 of the Trade Descriptions Ordinance (Cap.362), in addition to the extensive restrictions on sale, advertising and on misleading descriptors of tobacco products under the Smoking (Public Health) Ordinance (Cap.371), are sufficient to address any allegedly misleading elements of packaging, while also respecting the choices and rights of adults who choose to use tobacco products

⁹ Viscusi Report at paras 27-29.

¹⁰ Viscusi Report at para 30.

and allowing tobacco manufacturers, as a part of a legal industry, to communicate with consumers about product information.

- 5.5.5 It is also clear from numerous studies that factors other than a deficit of information or branded packaging are the real drivers of smoking initiation. According to leading public health authorities, a wide variety of psychosocial risks factors are related to the initiation of tobacco use among adolescents. They include low socioeconomic status, tobacco accessibility, sibling use, peer use, normative expectations, academic achievement, social support, problem behaviours, expected utility, self-esteem and self-image, personality factors, and psychological well-being¹¹. In a 2008 paper, James Heckman, a Nobel Prize-winning economist who specializes in research regarding why young people behave as they do, reviewed a vast amount of literature on the causes of youth smoking and concluded that:

*"The available evidence in the developing literature on adolescent risky behavior, including smoking, supports a multi causal model for youth smoking, as many factors have been empirically linked to youth smoking in this literature. These factors include price, parental influences, risk preferences, peer influences, and access."*¹²

- 5.6 Given the absence of any problem requiring the increase in graphic health warnings, the Proposal is plainly disproportionate as it cannot be necessary or serve any legitimate objective
- (B) FURTHER INCREASING THE SIZE OF GRAPHIC HEALTH WARNINGS FROM 50% TO 85% IS INADEQUATE AS A PUBLIC HEALTH MEASURE.

Increasing the size of graphic health warnings to 85% would not reduce smoking.

- 5.7 A proper evidence-based analysis demonstrates that graphic health warnings do not reduce smoking prevalence. The Government has not cited any existing studies or commissioned any studies to support its assertion that increasing the size of graphic health warnings from the current 50% to 85% will meet these aims.

¹¹ See, e.g., US Department of Health and Human Services. "Preventing tobacco use among young people: A report of the Surgeon General" (1994) (summarizing approximately 160 studies on the subject of the psychosocial risk factors associated with underage tobacco use). See also US Department of Health and Human Services, "Preventing tobacco use among youth and young adults: A report of the Surgeon General" (2012), at Ch. 4 (reinforcing findings of 1994 Surgeon General's report with added emphasis on individual cognitive processes).

¹² James Heckman, "An Assessment of Causal Inference in Smoking Initiation Research and a Framework for Future Research," *Economic Inquiry*, (2008).

- 5.8 The Viscusi report contains a detailed review of the empirical evidence regarding the effect of graphic cigarette warnings on smoking behaviour. A summary of Professor Viscusi's conclusions is ¹³:
- 5.8.1 Analysis of smoking trends in Canada, the U.K., and Australia fails to indicate any beneficial effect of graphic warnings when assessed either on a within country basis or in comparison to trends in the U.S. Empirical evidence also indicates that the introduction of 50% graphic warnings in Hong Kong in October, 2007 has similarly had no impact on reducing smoking prevalence. The downward smoking prevalence trend is similar to the U.S., which does not have graphic health warnings but only a small text warning. Neither increasing the warning size nor the use of graphic health warnings has been effective in reducing smoking prevalence rates.
- 5.8.2 Evidence demonstrates that the risks of smoking have been well publicized over the last several decades and that the youth are well informed about the risks of smoking. Given that consumers are aware of the risks of smoking, there is no beneficial role for increased warnings. However, if there are concerns regarding the current warnings being worn out and lower levels of awareness of specific illnesses, these can be met by changing the current warning content. Increasing the size or format of the warnings is not needed and will not have any improved benefit in terms of reducing smoking rates.
- 5.8.3 The U.S. Food and Drug Administration (the "FDA") undertook a substantial statistical analysis to estimate the effect of the Canadian graphic warnings on smoking prevalence rates. In its preferred analysis that accounted for U.S. smoking trends and cigarette tax levels, the FDA found that the effect of graphic warnings on prevalence rates was less than one-tenth of 1 percentage point. In all of its statistical analyses all effects of graphic warnings on smoking prevalence were statistically equivalent to a zero effect.
- 5.8.4 The FDA also funded a large scale experimental survey that compared the efficacy of a wide variety of graphic warnings relative to text warnings that did not include the graphic information. There was no evidence of efficacy of graphic warnings in influencing smoking decisions of adults or younger age groups for any of the nine smoking risks that were studied.
- 5.8.5 Nevertheless, the FDA proceeded with a proposed graphic warnings regulation. However, the U.S. courts overturned this regulation in 2012 in *R.J. Reynolds Tobacco Co. v. Food and Drug Admin.* because, in the view of the Court: "FDA

¹³ Viscusi Report at paras 3.1-3.8.

has not provided a shred of evidence—much less the ‘substantial evidence’ required by the APA [Administrative Procedures Act]—showing that the graphic warnings will ‘directly advance’ its interest in reducing the number of Americans who smoke.”

- 5.8.6 The preponderance of other studies of graphic warnings is not informative as these studies typically ask people if the warnings provided information to them, or would alter their behaviour, rather than assessing how warnings actually affect their risk beliefs and influence their smoking behaviour. While there have been many claims of efficacy of graphic cigarette warnings, there is a profound gap between these claims and any concrete evidence that graphic warnings are more effective than text warnings in altering risk beliefs or smoking behaviour.
- 5.8.7 There is no sound basis in experimental data, survey data, or data on smoking behaviour to conclude that larger graphic warnings are more effective in increasing risk awareness or reducing smoking behaviour. It therefore cannot be expected that increasing the size of existing graphic warnings from 50% to 85% would have any impact on smoking behaviours.
- 5.9 As noted above, the Government has not undertaken any assessment to establish if further increasing the size of graphic health warnings from 50% to 85% would in some shape or form address an information deficit that has not been demonstrated to exist. This renders the Proposal totally arbitrary and irrational. Further, it must be considered that even if the Government had undertaken a proper evidence-based analysis it would have reached a similar outcome to the FDA, namely that increasing the size of the existing warnings would not be effective in reducing smoking prevalence. The FDA analysis is the *state of the art* when it comes to assessing the impact of graphic health warnings, which nevertheless failed to find any impact of graphic health warnings on smoking behaviours. This is particularly telling in the present case where graphic health warnings in Hong Kong already cover 50% of the pack. In these circumstances further increasing the graphic health warnings to 85%, when there is no information deficit to be addressed and no evidence that (i) consumers do not understand the current warnings covering 50% of the pack and that (ii) the increased warnings would reduce smoking prevalence, is clearly arbitrary and an improper use of power.

Further increasing the size of graphic health warnings from 50% to 85% would distort competition and drive down prices which may lead to an increase in consumption contrary to the public health objective.

- 5.10 In view of the prohibition of all forms of advertising and existing restrictions on tobacco packaging, the principal, if not sole remaining competitive levers available to tobacco manufacturers are product differentiation and price.

- 5.11 As explained by Professor Zerrillo, increasing the size of graphic health warnings to 85% would effectively prevent manufacturers from being able to differentiate their products and will make the packages all look largely the same. To the limited extent that trademarks can be squeezed onto the remaining space on the pack, they will be unable to effectively perform their function of identifying and differentiating products, signalling the source or origin of the product and indicating a product's quality and characteristics¹⁴.
- 5.12 Without the ability to differentiate or offer the quality and value attributes created by trademarks and the brands they represent, tobacco products will become increasingly standardised and manufacturers would only be able to compete on price. As such, price competition, which is already extremely vigorous in the tobacco market, will become even more intense leading to further price reductions.
- 5.13 Professor Zerrillo opines that:

"The elimination or minimization of cigarette brands will also impact the market structure and market dynamics. First, competition will shift from brand competition to price competition. In the short term, a lack of competitive dimensions could lead to market rigidity, with little switching by consumers among brands. This market rigidity will further discourage innovation and investment and will hasten competition on price alone. It will also give an advantage to domestic brands that are likely to be able to compete more effectively on price.

The impact of the loss of brand differentiation in the Hong Kong tobacco market will differ among firms depending upon the extent to which they have already established their market position and depending upon the nature of their business model. Firms for which the business model depends upon the use of diversity so as to appeal to the niche tastes and firms that are currently seeking to enhance their market position by winning market share from the leading firms stand to suffer more than firms relying on one dominant brand – indeed, the latter may gain in the short run (in terms of market share) because they will still benefit from being known as a market leader and will be subject to less competitive pressure from other firms. Nonetheless, even as their market share increases, margins on these brands will decrease and eventually be eroded more or less completely, as the market evolves to pure price competition.

As cigarettes become commodity products resulting in competition on price alone, price conscious smokers will likely navigate toward low value, non-premium brands. The focus on commodity pricing likely will result in lower prices

¹⁴ Zerrillo Report at para 12(c).

*to consumers, a result which could also lead to increased purchases and consumption."*¹⁵

- 5.14 The impact of reduced prices is likely to increase in consumption, especially among price-sensitive consumers, as tobacco products become more affordable. This would undermine the public health objective of reducing smoking prevalence.
- 5.15 By implementing measures that distort competition, the Proposal would also betray a policy of Hong Kong to facilitate fair competition, as inferred from the Competition Ordinance (Cap. 619) ("An Ordinance to prohibit conduct that prevents, restricts or distorts competition in Hong Kong") and Articles 109¹⁶, 115¹⁷ and 119¹⁸ of the Basic Law. We refer again to Hong Kong's long-standing reputation for economic freedom and a supportive business friendly environment which will be damaged by measures such as the Proposal that undermine competition and business investment.
- 5.16 Professor Zerrillo also explains that:

"One of the benefits of brands to market structure is that they can make it possible for new competitors to enter the marketplace and differentiate themselves from their competitors. In an unbranded commodity market, new entrants to the marketplace have a very difficult time encouraging consumers to try their product except on the basis of price. Given that they cannot effectively differentiate their products through communication about the brand, the only way to encourage trial is to compete on price. However, in a market like cigarettes where incumbents have significant scale advantages, competing on price is not likely to be an attractive option for new entrants. In contrast, in a market with brands, it is possible for a new brand to establish itself in consumers' minds as something different from existing brands and, therefore, as something worthy of switching to. One of the keys to ensuring that a market functions efficiently is ensuring that incumbents feel a continuous threat that new entrants may enter the market and therefore continue to try to improve the quality of their products and brand

¹⁵ Zerrillo report at paras 54-56.

¹⁶ Article 109 provides: "The Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre."

¹⁷ Article 115 provides: "The Hong Kong Special Administrative Region shall pursue the policy of free trade and safeguard the free movement of goods, intangible assets and capital."

¹⁸ Article 119 provides: "The Government of the Hong Kong Special Administrative Region shall formulate appropriate policies to promote and co-ordinate the development of various trades such as manufacturing, commerce, tourism, real estate, transport, public utilities, services, agriculture and fisheries, and pay regard to the protection of the environment."

*reputation. In essence it ensures a "best behavior" practice on the part of market participants."*¹⁹

Further increasing the size of graphic health warnings from 50% to 85% would further incentivise the illicit trade

5.17 The illicit trade in tobacco is a major concern to society in undermining public health attempts to reduce smoking prevalence and the financing of organised crime.

5.18 A 2013 International Tax and Investment Center and Oxford Economics report on the illicit tobacco trade in 14 selected Asian markets estimated that 33.6% of tobacco consumption in Hong Kong is illicit.²⁰ Of the 14 Asian countries surveyed, Hong Kong had the third largest percentage of illicit consumption in the region. It was estimated that illicit trade in tobacco would cost the Hong Kong government HK\$3.2 billion in lost tax revenues in the fiscal year 2013/2014.

5.19 This growing illicit market is becoming increasingly problematic for Hong Kong. Cross border criminal syndicates are often behind illicit cigarette trade, and the illicit trade is a source of violent crime, economic losses, and counterfeit smuggling. It also poses a threat to Hong Kong's international reputation as a leading international city.

5.20 Further increasing the size of graphic health warnings to 85% would exacerbate the already significant illicit trade in tobacco products in the following ways:

5.20.1 Removing the incentive to pay premiums for products that no longer look or feel premium would drive prices down across all cigarette market segments, conferring a competitive advantage to those able to supply the lowest cost product – i.e. the illicit trader. As a Morgan Stanley research note on tobacco and illicit trade points out:

*"...to the extent that brand equity is degraded over time, it could result in lower tobacco prices than would otherwise have been the case (presumably resulting in higher tobacco consumption), and a potential substantial increase in illicit volumes."*²¹

5.20.2 The market in illicit fully branded products would grow in response to demand from those consumers who would rather continue using the fully branded product they are used to. This is likely to be sourced either through illegal supply from other countries or by suppliers of counterfeit branded products.

¹⁹ Zerrillo Report at para 39.

²⁰ Asia-14: Illicit Tobacco Indicator 2013, at p. 63, available at <http://www.oxfordeconomics.com/asia14>

²¹ Tobacco – Legitimate Manufacturers or Illicit Trade? A Stark Choice", Morgan Stanley Research, July 2, 2012.

5.21 As part of this Response, BAT also submits the expert report of Mr John Hector, a recently retired former UK Her Majesty's Revenue and Customs officer nearly 45 years' experience, including acting as the Fiscal Crime Liaison Officer at the UK Embassy in Beijing from 2006 to 2011 where his role was to combat the flow of illicit trade in tobacco product to the UK and Europe in conjunction with Chinese Law Enforcement agencies. Mr Hector sets out his observations on the illicit trade of tobacco products in Hong Kong and the likely impact of increasing the size of graphic health warnings to 85% on the illicit trade, based on his many years of experience in tackling the illicit tobacco market. Mr Hector's report (the "**Hector Report**") is submitted with this Response (see Appendix 5).

5.22 Mr Hector explains that:

*"The impact of further regulation on the illicit trade must be carefully considered given the existence in Hong Kong of a well-established and accessible illicit market. Consumers can easily find and purchase illicit products if they want to. Given the high price of legal cigarettes in Hong Kong compared to neighbouring countries there is already a greater incentive for illicit trade in Hong Kong. This situation will only be made worse by the introduction of further measures that incentivise the illicit market, such as making legal products less recognisable or increasing the product range that the illicit market can provide consumers. Cigarette smugglers can readily provide whatever type of packaging that smokers of any age want."*²²

5.23 Mr Hector concludes:

*"In my view, increasing the size of graphic health warnings from 50% to 85% will only make the significant illicit problem in Hong Kong worse by incentivising consumers' willingness to purchase the cheapest products available rather than pay the increasingly higher price for legal products which no longer look and feel like premium products. It will provide the illicit tobacco trader with an additional advantage in that they can provide packaging without large graphic health warnings if that is what consumers want."*²³

5.24 Not only would this increase in illicit trade severely undermine the public health objectives – i.e., the proliferation of cheap illicit products would stimulate demand for tobacco products rather than reduce it – but, it would also have a significant impact on government revenues and society in general through increased criminal activity, and would further undermine public health by:

5.24.1 increasing youth access to tobacco products; and

²² Hector Report at para 16.

²³ Hector Report at para 17.

5.24.2 exposing consumers to unregulated products with no controls on hygiene standards and ingredients, or compliance with other product regulation including ceilings on tar, carbon monoxide and nicotine levels.

(C) FURTHER INCREASING THE SIZE OF GRAPHIC HEALTH WARNINGS FROM 50% TO 85% WOULD NOT BE PROPORTIONATE

5.25 The interference resulting from the Proposal goes to the very essence of the fundamental rights of property and so the requisite thresholds for justification and proportionality are at their highest. As explained above, the Proposal would deprive BAT (HK) of its extremely valuable intellectual property rights; namely, its trademark rights together with the goodwill arising in their brands. Given the commercial value of BAT (HK)'s trademarks and valuable goodwill built over the years in their brand portfolios, the loss caused by the Proposal would clearly be very substantial.

5.26 The burden imposed by the 85% graphic health warning requirement would manifestly outweigh any possible illusory benefit. The Proposal is also disproportionate for the following further reasons.

85% graphic health warnings go beyond what is necessary to effectively warn consumers.

5.27 Large graphic health warnings that effectively rebrand cigarette packs, such as the 85% graphic health warnings proposed, are also unnecessary for the purpose of effectively conveying warnings to consumers. There is no evidence that consumers are unable to comprehend the current warnings which already occupy 50% of the front and back of the pack.

5.28 Furthermore, concerns that the current 50% warnings are worn out, which would have to be substantiated by evidence that has not been presented, and that there are lower levels of awareness of specific illnesses—evidence of which the Government has not identified -- can be met by changing the current warning content and do not require increasing the size of the warnings. Accordingly, 85% graphic health warnings would go beyond what is necessary to effectively warn consumers.

There are a number of more effective and less intrusive measures

5.29 Existing laws that prevent false or misleading trade descriptions of goods are sufficient to meet any demonstrable concerns regarding packaging while also respecting the choices and rights of adults who choose to use tobacco products and allowing manufactures, as a part of a legal industry, to communicate product information to consumers. Enforcement of these laws should be undertaken, if required, before introducing more unnecessary regulation.

5.30 Further, the existing 50% graphic health warnings are sufficient for the purpose of informing consumers about the hazards of tobacco use. Such warnings comply with the

obligations under the FCTC, while minimising the violation of the rights of manufacturers and obligations under other international agreements.

5.31 There are also a number of alternative regulations that are more effectively targeted to reducing youth smoking. For example:

5.31.1 Reducing youth access, by for example:

- (A) Rigorous enforcement of existing laws forbidding retailers to sell to minors and/or the implementation of additional age verification measures;
- (B) Creating an offence of proxy purchase. Such a measure would directly target minors' access to cigarettes and would close off a significant avenue through which minors obtain cigarettes; and
- (C) Creating an offence of youth purchase. As in the case of a proxy purchasing offence, criminalising purchases by minors is a targeted measure. The risk of criminal prosecution may also act as a deterrent for minors. Similar measures have been adopted in relation to the purchase of alcohol, and evidence suggests that such measures are effective in reducing sales.

5.31.2 Implementing more targeted youth education programmes aimed at preventing young people from taking up smoking. A significant body of research, including research by the Nobel prize-winning economist James Heckman, establishes that early childhood interventions that affect personality traits and cognitive skills supportive of health can be effective policy tools in preventing unhealthy behaviour, such as smoking;²⁴

5.31.3 Implementing a consistent tax policy that discourages youth uptake of smoking while disincentivising adult consumers from purchasing illicit products;

5.31.4 Increasing measures to prevent the trade of illicit tobacco. In light of the rampant illicit trade situation in the Hong Kong market, we strongly urge the Government to focus its efforts on making Hong Kong a place without illicit cigarettes as a far more effective means of reducing the criminality and other harms associated with illicit trade while also increasing tax revenue.

5.31.5 Using targeted warnings to address any perceived information deficits. To the extent that the Government is concerned about any specific information deficits relating to the health risks of smoking (despite the well-established nature of the public's awareness of these risks), it can remedy these concerns through

²⁴ Heckman J. "Skill formation and the economics of investing in disadvantaged children" *Science*, 312(5782), 1900-1902 (2006); Feeny T. "The case for investing in early childhood. A snapshot of research by Professor James Heckman (University of Chicago, USA) and Dr. Richard Tremblay (University of Montreal, Canada)", (April 2006).

focussed warning messages that would provide the appropriate, purportedly “unknown” information to targeted populations.

6. THE PROPOSAL WOULD VIOLATE HONG KONG'S INTERNATIONAL OBLIGATIONS.

World Trade Organization Agreements

- 6.1 The increase in size of graphic health warnings to 85% of pack surfaces is entirely inconsistent with Hong Kong's obligations under several WTO Agreements, namely: (i) the TRIPS Agreement (and the related Paris Convention for the Protection of Industrial Property ("**Paris Convention**")), and (ii) the TBT Agreement. It is unquestionably in Hong Kong's interests to comply, and ensure compliance by other States, with these WTO Agreements. They are vital for the fair treatment of Hong Kong's exports.
- 6.2 The proposed 85% graphic health warnings would undermine intellectual property rights by adversely affecting the use of trademarks on the packaging of tobacco products and the enforcement of trademark rights. As a result of their impact on internationally protected trademark rights, the graphic health warnings must be analysed under the provisions of the TRIPS Agreement. In particular, the 85% graphic health warnings would impose special requirements that encumber the use of trademarks, including preventing the use of certain validly registered trademarks, thus violating Articles 15, 16, and 20 of the TRIPS Agreement and several trademark-related provisions of the Paris Convention, such as Articles 6*quinquies* and 10*bis*.
- 6.3 Article 20 of the TRIPS Agreement provides that use of trademarks 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*".
- 6.4 The proposed increase to 85% graphic health warnings would constitute a "special requirement" because it would be mandatory; and the requirement is specifically limited to certain tobacco products and the position and size of the graphic health warnings on the tobacco packaging is specifically regulated (thus constituting "special" requirements).
- 6.5 The 85% graphic health warnings would encumber the use of trademarks by requiring their use in a manner that is detrimental to the capability of the trademarks to distinguish products. The 85% graphic health warnings would prevent the use of trademarks registered for the entire pack and impair trademarks' identification and distinguishing functions. The Proposal also prescribes the use of trademarks in a special form as those limited trademarks which could still be used have to be adapted to fit the limited remaining space on the pack.
- 6.6 Article 20 of the TRIPS Agreement confirms that a measure that requires use in a special form or use in a manner that is detrimental to the capability of the trademarks to distinguish products is *ipso facto* an "*unjustifiable*" encumbrance. This means that the Proposal cannot

be justified under TRIPS. However, even if the measure could be justified, the absence of any contribution to the reduction of smoking rates, let alone a material reduction, and the availability of less trademark-restrictive alternative measures that are equally or more effective, confirms that the encumbrances resulting from the 85% graphic health warnings are not "necessary" and thus certainly not "justifiable" under Article 20 of the TRIPS Agreement.

6.7 The proposed 85% graphic health warnings would also violate the basic principles that protect the function of trademarks and the minimum guaranteed rights that are reflected in Articles 15 and 16 of the TRIPS Agreement:

6.7.1 Article 15.1 provides that "*[a]ny sign, or any combination of signs, capable of distinguishing the goods or services of one undertaking from those of other undertakings, shall be capable of constituting a trademark*". The ordinary meaning of a "trademark" is a sign used to distinguish products. Article 15.1 thus requires Members to allow "any distinctive sign" to be capable of constituting a "trademark" irrespective of the form or category of the sign. Where graphic health warnings are of such a size that they make the use of a specific sign (e.g., logo or combination marks) impossible (as would be the result from increasing the size of graphic health warnings to 85%), these signs would no longer be capable of constituting a trademark as properly defined under the TRIPS agreement.

6.7.2 Article 15.4 provides that "*[t]he nature of the goods or service to which a trademark is to be applied shall in no case form an obstacle to registration of the trademark*". Article 15.4 confirms therefore that the nature of the product cannot be an obstacle to registration. It also confirms that trademarks are intellectual property rights that must be examined and protected independently of the product or service to which they are applied.

6.7.3 Article 16.1 of the TRIPS Agreement provides an exclusive right to the owner of a trademark to prevent others from using identical or similar signs on identical or similar goods, when such use is likely to cause confusion. Article 16.3 provides additional protection to owners of well-known marks from unauthorized use of similar signs even on dissimilar goods, if such use indicates a connection and is likely to cause damage to the interests of the trademark owner. A mark obtains and maintains this well-known status as a result of frequent and widespread use in the relevant market. The more intensive use of the mark, the stronger the mark becomes and the greater scope of protection it enjoys because of an increased likelihood of confusion between marks. Increasing the size of graphic health warnings to 85% would prevent or impair trademarks from being used on

the product packaging, thereby undermining the ability of registered trademark owners to maintain the distinctiveness and associations between the trademark and the product that are required to exercise these rights effectively and to establish "confusion" in any infringement proceeding. A well-known mark that can no longer be properly used will lose its special status and extended scope of protection under Article 16.3. Increasing the size of graphic health warnings to 85% would therefore violate the obligation to guarantee a minimum level of protection for registered trademarks and well-known marks under Articles 16.1 and 16.3 of the TRIPS Agreement.

- 6.8 Furthermore, increasing the size of graphic health warnings to 85% would not only violate the provisions of the TRIPS Agreement discussed above but also violate Articles 10*bis* and 6*quinquies* of the Paris Convention because they mandate confusion that causes unfair competition and fail to ensure protection of the trademark "as is" registered and protected in other countries that are parties to the Paris Convention. As opposed to protecting against unfair competition and prohibiting acts that create confusion, 85% graphic health warnings would allow for the kind of confusion and unfair competition that a WTO Member is under an obligation to prevent. Such confusion and unfair competition are, in effect, mandated because the 85% graphic health warnings would make all cigarette packs look almost identical and will suggest that all products are essentially the same in terms of their characteristics. Accordingly, by requiring the confusion that it was obligated to prevent under Article 10*bis*, increasing the size of graphic health warnings to 85% would violate Hong Kong's obligation under Article 10*bis* of the Paris Convention.
- 6.9 Furthermore, increasing the size of graphic health warnings to 85% would be inconsistent with Article 2.2 of the TBT Agreement as it would create an unnecessary obstacle to trade because it would:
- 6.9.1 significantly limit market entry for imported tobacco products;
 - 6.9.2 reduce product differentiation and lower the value of imported products; and
 - 6.9.3 strongly disincentives exports to Hong Kong because of the required adaptation costs and the potential risk of penalties for non-compliance.
- 6.10 The trade restrictive nature of the proposed increase in the size of graphic health warnings to 85% cannot be justified. First, as discussed below, there is no evidence to suggest that increasing the size of graphic health warnings would make a material contribution to the achievement of their legitimate public health objective (given the evidence that graphic health warnings do not actually reduce smoking prevalence). In light of this, there is no need to consider if less trade restrictive alternative measures are available. However, as explained above, there are a number of alternative measures which would be more effective than increasing the size of graphic health warnings to 85%.

Bilateral Investment Treaties

- 6.11 Increasing the size of graphic health warnings to 85% could also expose Hong Kong to claims from foreign investors under Bilateral Investment Treaties (BITs). Invariably, intellectual property is specifically included in the definition of investments protected by such treaties and increasing the size of graphic health warnings to 85% would inevitably breach several of the usual protections afforded by BITs including those prohibiting expropriation of investments (including goodwill and intellectual property) without the payment of compensation, as well as those requiring fair and equitable treatment.
- 6.12 The 'fair and equitable' standard requires the Hong Kong Government to act towards foreign investors consistently and to respect their legitimate expectations. Every legal business has a legitimate expectation of its continuity without unlawful or arbitrary impairment or obstruction, and that it will be able to use its registered trademarks and other intellectual property which it has used for decades in accordance with Hong Kong legislation.
- 6.13 The Government must also act proportionately and not discriminate unjustifiably. Tobacco is a legal product and the tobacco industry is a legitimate industry. The Proposal would frustrate the legitimate expectation of BAT Group companies that they will be able to continue to use long-established trademarks.
- 6.14 Given the commercial value of BAT (HK)'s trademarks and valuable goodwill, the Hong Kong Government would be exposed to a substantial damages award.

7. **THE PROPOSAL IS NEITHER REQUIRED NOR AUTHORISED BY THE WHO FRAMEWORK CONVENTION ON TOBACCO CONTROL**

7.1 The Legislative Council Paper relies on WHO Guidelines to the FCTC as the basis for the Proposal. However, the FCTC neither requires nor authorises the increase in the size of graphic health warnings to 85%. Hong Kong's existing graphic health warnings of not less than 50% are already over and above the FCTC requirements. Paragraph 15 of the Legislative Council Paper is incorrect.

7.2 Article 11 of the FCTC requires that a Party shall "*adopt and implement, in accordance with its national law, effective measures to ensure that*" tobacco product packaging carries health warnings in the form of text warnings covering "*no less than 30% of the principal display areas*" of packages. The FCTC only suggests that such warnings "should" (not "shall") cover 50% or more of the principal display areas and "may" (not "shall") be in the form of or include pictures or pictograms.

7.3 Furthermore, the WHO Guidelines to Article 11 of the FCTC which call for parties to consider warnings that cover no less than 50% and to use pictures, do not impose any binding obligations. The WHO Guidelines to the FCTC are only "*intended to assist Parties in meeting their obligations*" under the FCTC and do not create legally binding obligations.

7.4 Accordingly, in order to comply with its binding legal obligations under the FCTC, a Party must issue a notification or law, consistent with national law, so as to adopt and implement "effective" textual warning labels on tobacco packaging covering not less than 30% of the principal display area. Hong Kong's existing graphic health warnings of not less than 50% are already over and above the FCTC requirements. Accordingly, there is nothing in the FCTC that requires increasing the size of graphic health warnings to 85%

7.5 Importantly, the FCTC does not authorise Parties to implement or issue measures that breach national law-making criteria or procedures, which is the case with the graphic health warnings of not less than 85% required under the Proposal. Article 11 of the FCTC expressly states that the implementation of measures shall be: "*in accordance with [a Party's] national laws*". Article 5(2) of the FCTC, which sets out the general obligations of parties, similarly acknowledges that the implementation of tobacco control measures must be in "*accordance with [Parties'] capabilities*". As explained in section 4 of the Response, the Proposal is inconsistent with the Basic Law and beyond the scope of the power and authority under Section 18(2) of the Smoking (Public Health) Ordinance (Cap 371), and therefore is contrary to the FCTC.

7.6 Article 2.1 of the FCTC also confirms Parties' obligations to comply with international laws in respect of the implementation of any measures that exceed a party's obligations under the FCTC. It provides that: "*nothing in these instruments shall prevent a Party from imposing stricter requirements that are consistent with their provisions and are in*

accordance with international law" (emphasis added). Thus, the graphic health warnings of not less than 85% required under the Proposal, which go far beyond the requirement in the FCTC to impose a textual warnings covering 30%, must be "in accordance with international law." However, as explained above, the 85% graphic health warnings required under the Proposal violate Hong Kong's international obligations under the TRIPS Agreement, the Paris Convention, and the TBT Agreement.

- 7.7 The Legislative Council Paper incorrectly relies on the FCTC to justify the increase in graphic health warnings from 50% to 85% when in fact the FCTC only obliges Hong Kong to maintain 30% textual warnings and the existing graphic health warnings of not less than 50% are already over and above the FCTC requirement. Accordingly, the Proposal is not necessary to meet the requirements of FCTC.
- 7.8 The Proposal also directly contravenes the WHO Guidelines in proposing to retain the requirement to print tar and nicotine yields on tobacco product packaging. The WHO Guidelines state that: "*Parties should prohibit the display of figures for emission yields (such as tar, nicotine and carbon monoxide) on packaging and labelling.*"²⁵

²⁵ *Who Framework Convention on Tobacco Control* Guidelines for implementation, 2013 edition, page 63
http://apps.who.int/iris/bitstream/10665/80510/1/9789241505185_eng.pdf?ua=1

8. A PROPER IMPACT ASSESSMENT IS REQUIRED BEFORE PROCEEDING WITH THE PROPOSAL

- 8.1 An RIA that undertakes a thorough analysis of the Proposal, including whether it is necessary and whether there are less burdensome means of achieving the regulatory objective, ought to be undertaken to enable the Legislative Council to properly scrutinise the Proposal under the negative vetting procedure. As noted above, the failure to undertake any impact analysis of the Proposal goes against the recommendation made in the Regulatory Impact Analysis undertaken in 2001 in respect of proposed amendments to the Existing Smoking Legislation. The 2001 RIA recommended introducing an enabling provision to allow for health warnings to contain pictorial and graphic content, but stated: "*any future requirements for pictorial and graphic contents take into account the likely financial and economic costs of implementation and that these be weighed against the likely health and economic benefits likely to arise.*"²⁶ The Legislative Council Paper doesn't address these issues at all.
- 8.2 An RIA is also the cornerstone of internationally accepted principles of Better Regulation, such as those defined by the Organization for Economic Co-operation and Development and the Asia-Pacific Economic Cooperation of which Hong Kong is a member. The APEC paper *Supporting the TBT Agreement with Good Regulatory Practices*²⁷ states: "*it is impossible to regulate well if the consequences of government action are not understood in advance. Understanding consequences of various options for action more clearly is the main purpose of RIA*".
- 8.3 The failure to undertake a proper evidence based RIA violates these principles and also means that the measure cannot be shown to comply with the obligations under WTO TBT Agreement or the TRIPS Agreement which mandate that requirements do not constitute an "unnecessary obstacle to trade" or a violation of internationally protected intellectual property rights.²⁸

²⁶ Regulatory Impact Assessment, *Proposed amendments to the existing smoking legislation*, Environmental Resources Management Limited, LC Paper No. CB(2)1/02-03(04), Dec 2001, page 107 <http://www.legco.gov.hk/yr02-03/english/panels/hs/papers/hs1025cb2-1-4e.pdf>

²⁷ *Supporting the TBT Agreement with Good Regulatory Practices*, APEC, March 2012 http://publications.apec.org/publication-detail.php?pub_id=1266

²⁸ WTO Members that failed to undertake such impact assessments have been heavily criticized for failing to conduct the necessary impact assessment, including an examination of less trade-restrictive alternatives. For example, the EU questioned Brazil over whether it had properly conducted an impact assessment of its regulation to ban certain ingredients in tobacco products (G/TBT/M/54 (20 September 2011), p. 54).

- 8.4 The first step in the analysis must be clearly to identify the inadequacies in the existing state of affairs which need to be rectified.²⁹ A problem must be identified which specifically requires larger graphic health warnings as opposed to other tobacco control measures. It is manifestly irrational to proceed with larger graphic health warnings when it is not necessary to address a legitimate objective.
- 8.5 The Legislative Council Paper does not identify a problem with the existing 50% graphic health warnings or provide any evidence to demonstrate that increasing the size of graphic health warnings from the current size of 50% to 85% is necessary. As outlined in section 5 of this Response, increasing the size of graphic health warnings from the current size of 50% to 85% is neither necessary, including because there is already universal awareness of the risks of smoking, nor adequate as a public health measure. The proposed size of 85% graphic health warnings in the Legislative Council Paper is entirely arbitrary and has no evidential basis at all.
- 8.6 The Legislative Council Paper also fails to consider whether the Proposal is lawful. As explained in section 4 above, the Proposal is inconsistent with, inter alia, Articles 6 and 105 of the Basic Law. The Proposal is therefore illegal.
- 8.7 BAT (HK) also submits the expert report of Mr Stephen Gibson (SLG Economics Limited), formerly Chief Economist and Director of Economic Policy at Postcomm in the United Kingdom, who specialises in competition and regulatory economics (the "**Gibson Report**"). The Gibson Report is submitted with this Response (see Appendix 2). The Gibson Report assesses the proposals for larger graphic health warnings contained in the Legislative Council Paper and considers whether they are in line with better regulatory principles, and to what extent they are necessary, appropriate or proportionate. As explained by Mr Gibson, the Legislative Council Paper does not include the necessary evidence or analysis to support the implementation of the proposed policy; it does not provide proportionate evidence-based policy recommendations. It has not shown that the proposed increase in GHWs from 50% to 85% is necessary, appropriate or proportionate. Mr Gibson notes that the Legislative Council Paper:

²⁹ This is reflected in the APEC Guidelines for the preparation, adoption and review of technical regulations, which state: "*The first step in the development process should be to clearly identify the problem that needs to be addressed*" and "*accurate problem definition reduces the risk of choosing inappropriate options for government action or ignoring more effective solutions, and reduces the likelihood of over regulation.*" *Guidelines for the Preparation, Adoption and Review of Technical Regulations*, APEC, available at http://www.google.co.uk/url?url=http://www.ism.gov.my/documents/10180/86670/Guidelines%2Btechnical%2BRegulations.doc/8bce9281-59f4-4403-bc7d-5c9dbf35997f&rct=j&frm=1&q=&esrc=s&sa=U&ved=0CB4QFjABahUKEwio3e63slfGAhXkKNsKHaTcAvA&usq=AFQjCNHe0Mkpx2A5xUFXEkebDhKg4cu_Yg

- Fails to include a public consultation;
- Fails to include a Regulatory Impact Assessment;
- Fails to follow the recommendations of the 2001 Tobacco Regulation RIA;
- Fails to follow the principles of better regulation;
- Fails to recognise that the current tobacco controls are already more than is required under the WHO Framework Convention on Tobacco Control;
- Fails to analyse the baseline or identify any problems with the current 50% GHWs that might need further regulation;
- Fails to properly specify the objectives of the proposals;
- Fails to provide any evidence for the proposals;
- Sets out proposals that are arbitrary and gold-plated;
- Sets out proposals that directly contravene the FCTC Guidelines;
- Fails to consider alternative policies or identify the policy with the greatest net benefits;
- Fails to estimate the costs of the proposals; and
- Fails to estimate the benefits of the proposals.

8.8 Taking the factors outlined above into account, Mr Gibson concludes that: "**it would be manifestly inappropriate to rely on the [Legislative Council] Paper to proceed with larger graphic health warnings.**"³⁰

8.9 Accordingly, a proper impact assessment should be carried out before proceeding further with the Proposal.

³⁰ Gibson Report at p14, emphasis in original.

9. CONCLUSION

For the reasons set out above, BAT (HK) believes that the Proposal should be rejected. In summary, those reasons include:

- 9.1 The enactment of effective and evidence-based regulation which meets public health objectives and respects Hong Kong's legal framework and international obligations is central to its reputation as the top international trade and investment hub.
- 9.2 However, the Proposal completely disregards the current levels of awareness of the risks of smoking in Hong Kong, which renders it totally unjustified. The Proposal is proceeding without any analysis or evidence demonstrating that: (a) that the current size of graphic health warnings are inadequate or insufficient to achieve their intended purpose, namely to inform the public of the health risks involved by smoking; or (b) that the further increase in the size of the graphic health warnings from 50% to 85% will more effectively achieve that purpose than the current size of 50%.
- 9.3 The Proposal is unlawful. The Proposal would deny all meaningful use or all economically viable use of trademarks and thereby deprive BAT (HK) of its extremely valuable intellectual property rights; namely, its trademark rights together with the goodwill arising in their brands, as protected under the Basic Law in Hong Kong.
- 9.4 The Proposal is also manifestly disproportionate. The Proposal is fundamentally flawed in that it is not necessary and would not achieve its stated objectives. The Government has failed to undertake any analysis or provide any evidence demonstrating that further increasing the size of the health warnings from 50% to 85% is necessary and appropriate to materially contribute to the protection of health, and proportionate. Evidence also demonstrates that increasing the size of the warnings would not be more effective in increasing awareness (which is already effectively universal) or reducing smoking. The Proposal would also distort competition, drive down prices leading to increased consumption, and incentivise illicit trade which would undermine the public health objective. The Proposal would cause substantial losses to BAT (HK) and other manufacturers, and there are a number of more effective alternatives.
- 9.5 In addition, the Proposal is neither required nor authorised by the FCTC and it would violate Hong Kong's international obligations under the TRIPS Agreement, Paris Convention, TBT Agreement and Bilateral Investment Treaties.
- 9.6 The Government has not undertaken a regulatory impact assessment in order to properly consider the impacts, costs and benefits of the Proposal. It must be considered that if the Government had undertaken a proper evidence-based analysis it would have reached a

similar outcome to the U.S. FDA, namely that increasing the size of the existing warnings would not be effective in reducing smoking prevalence.

IN THE COURT OF APPEAL OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

Ceylon Tobacco Company PLC
No. 178, Srimath Ramanathan
Mawatha, Colombo 15.

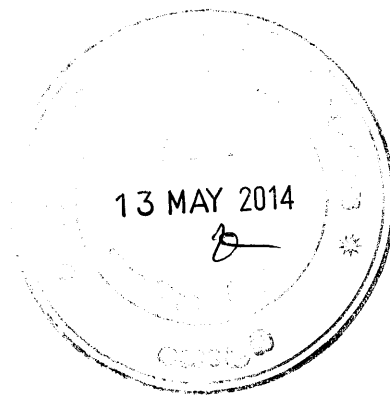
PETITIONER

Vs.

C.A 336/2012 (Writ)

1. Hon. Maithripala Sirisena
Minister of Health
Ministry of Health.
"Suwasiripaya",
Colombo 10.
2. Dr. Nihal Jayathilaka
Secretary,
Ministry of Health.
"Suwasiripaya",
Colombo 10.
3. National Authority on Tobacco and
Alcohol
"Suwasiripaya",
Colombo 10.

RESPONDENTS



BEFORE: Anil Gooneratne J. &
Malinie Gunaratne J.

COUNSEL: Faiz Musthapha P.C., with Ali Shabry P.C. and C.Wijesinghe,
Faizer Marker, M. Bandara M. Careem, R. Cooray
and Mohamed Imthiyas instructed by Sudath Perera
Associates for the Petitioner

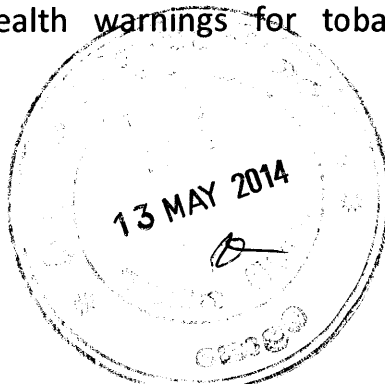
~~Janak de Silva D.S.G., with Suranga Wimalasena S.C.
for the Respondents~~

ARGUED ON: 03.02.2014 & 07.02.2014

DECIDED ON: 12.05.2014

GOONERANTNE J.

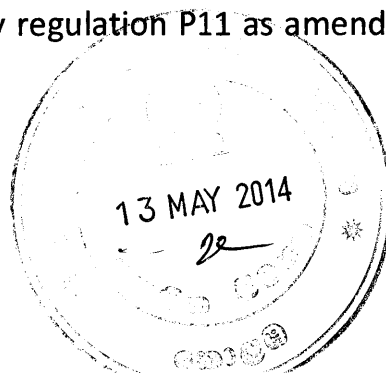
The Petitioner in this Writ Application is the Ceylon Tobacco Company PLC. A Writ of Certiorari is sought to quash the tobacco products (labeling and packaging) Regulation No. 1 of 2012, published in Gazette Notification marked P11 of 8.8.2012. A mandate in the nature of Writ of prohibition is also sought against the three Respondents, proceeding to make regulation prescribing health warnings for tobacco products containing



pictorials, graphics, images or any other non-textual content under Section 30 read with Section 34 of the National Authority on Tobacco and Alcohol Act No. 27 of 2006. Petitioner in terms of sub para (d) of the prayer to the petition has sought an interim order staying the operation of the above regulation referred to in Gazette marked P11. The learned President's Counsel for the Petitioner on 20.2.2013 supported this application for the issuance of interim relief. However the then Hon. President of this court by his order dated 22.2.2013 refused to grant and issue an interim order as prayed for in the prayer to the petition.

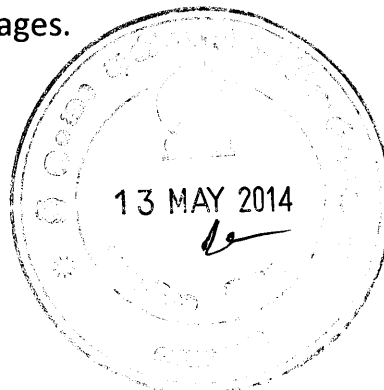
Petitioner Company sought Special Leave to Appeal from the order of the Court of Appeal dated 22.2.2013. However on a perusal of the record, I find that the state, at an early stage of the above leave to appeal application gave an undertaking to the Supreme Court that the impugned regulation will not be operationalised, and as such undertaking had been extended from time to time, and on 1.4.2013 Supreme Court ordered the status quo to be maintained. Such an order pronounced by the Supreme Court to maintain the status quo also had been extended periodically.

The Petitioner in this application is challenging the vires of regulation P11 as amended. More particularly regulation P11 as amended are ultra vires



of the powers of the Minister, of the National Authority on tobacco and Alcohol Act No. 27 of 2006 (hereinafter called NATA Act) and that Section 34(1) does not provide for pictorial health warnings. The Respondents with objections have filed Gazette Notification marked R3 and R15. Perusal of R3 and R15 it appears that regulation (P11) shall come into operation on 1st March 2013 and regulation No. 1 of 2012 (P11) is further amended according to R15 and regulation Nos. 5, 6 & 7 amended and a new regulation 11, added to regulation (P11). As such the Petitioner Company submits that the impugned regulations seek to:

- (i) Introduce mandatory pictorial health warnings to be displayed on packets of cigarettes covering 80% of the total area of a pack.
- (ii) Impose a descriptor ban (use of descriptions 'light' 'low' and 'mild').
- (iii) Print date of production on every cigarette stick.
- (iv) Print of information on the relevant constituents and emissions of tobacco products, including formaldehyde and other toxic contents if any
- (v) Print health warnings and other information in a font size of not less than 10 and in all 3 languages.



The learned President's Counsel for Petitioner raised numerous points and objections to favour the case of the Petitioner. The main argument advanced by the learned President's Counsel for the Petitioner and referred to inter alia, the following matters to demonstrate that the impugned subordinate legislation should be rejected since it is:

-
- (a) Unreasonable and disproportionate to the main statute.
 - (b) Impossibility of compliance (time factor) and the insertion of multiple labels and the failure to prescribe dimensions of health warnings. The submission of impossibility of compliance was an argument advanced when supporting for interim relief. Petitioner did not hesitate to put forward this submissions also when the substantive matter was argued.
 - (c) To require the printing of constituents and emissions. Regulations is ambiguous resulting in varying interpretations
-
- (d) A requirement to print the date of production and date of expiry on cigarette sticks. It is practically impossible to comply. Further Section 34(1) requires only a single label.
 - (e) To prescribe pictorial health warnings to cover 80% of the front and back surface areas, has by subsidiary legislation illegally subverted the statutory right of Petitioner to effectively use its intellectual property rights, recognized under the Intellectual Property Act.
 - (f) Petitioner not heard before publication of impugned regulations. Breach of natural justice.

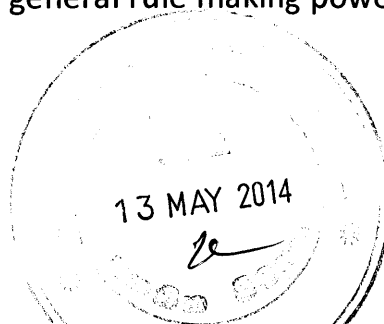


(g) Exclusion of the Beedi, cigars and white illicit whites from the application of the impugned regulations.

It is the position of the Petitioner that (a) to (F) above would make Regulation Nos. 5, 6, 7 and 8 and the added Regulation No. 11, ultra vires the provision of the NATA Act.

Learned President's Counsel was also critical of the Respondents stance of reading Section 34 of the NATA Act (an Act itself is to give effect to who Framework Convention on Tobacco Control (FCTC)) in harmony with FCTC obligations. FCTC does not require 80% pictorial warnings (Article 11 of FCTC) FCTC require only 50% or more. Further FCTC do not use pictorial, do not impose a binding obligation to use pictures.

Another argument advanced, was that the NATA Act does not empower the Minister to make regulation generally for carrying out the intention/purpose/principles in enacting the NATA Act. The Minister is only empowered to make regulations required to be prescribed or in which regulations are authorized or required by the Act. Minister cannot make regulations generally of any matter for carrying out the intention/purpose/principles in enacting the NATA Act. Attention of this court was drawn to several other statutes where a Minister is generally permitted, a general rule making power on all matters by the



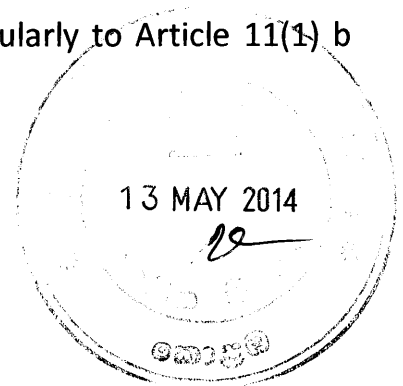
use of legislative language e.g. Condominium Property Act, Employees Provident Fund Act, Employees Trust Fund Act, Inland Revenue Act, etc. Petitioner argues that the Minister does not have the power to grant a blanket rule making power.

President's counsel for Petitioner submitted that regulation Nos. 2 & 3 are not authorized by Section 34 of the NATA Act. As such the regulation is ultra vires. The Consumer Authority Act No. 9 of 2003, already regulates on conduct that is misleading or deceptive. He referred to Section 30 of the Act No. 9 of 2003. As such Minister has no power to make regulations 2 & 3. It was also submitted that under Section 34 the required label shall contain a statement of the tar and nicotine content of the product and a health warning. The printing of information relating to other constituent and emissions is not required or prescribed. As such requirement of printing information relating to constituent and emissions in regulation 6 is ultra vires. the phrase 'including its nicotine and tar cannot be read as only tar and nicotine in background of having 5,600 identified chemicals in cigarette smoke. Section 34 already contains provisions on same. As such there is no need for delegated regulations. NATA Act does not require the date of manufacture and or the expiry date to be printed thereon and regulation 7 is also ultra vires . Further printing in a font size of 10 in all 3 languages clearly renders the regulations practically impossible to perform.



The learned Deputy Solicitor General on behalf of the Respondents submitted in his oral submissions, at the very outset to the evidence of harmful effects of tobacco smoking and invited court to, document R8, (pg. v) mainly to the material contained in the foreword. He also referred to the preamble of the WHO Framework Convention on Tobacco Control more particularly to 3rd para which state about the serious concern about increase in the worldwide consumption and production of cigarettes. Article 8 (pg. 8 of R8) refer to scientific evidence has unequivocally established that tobacco smoke cause death, decease and disability. He also invited us to R6, the S.C. Determination 13-22/05 on National authority on Tobacco & alcohol Bill especially Clause 34 which have the objective of enhancing health and the quality of life. The objectives cannot be reconciled with the harmful effects of tobacco and alcohol products and the objectives of the bill are not inconsistent with the Constitution. Learned Deputy Solicitor General referred to document R11 (pg. 5) to emphasis on the death rate as a consequence of smoking cigarettes. (inclusive of passive smoking) R12 on regional situation of tobacco control in the South East Asia Region and the figures of deaths and decease.

Learned Deputy Solicitor General in his address to court referred to packaging and labeling of tobacco products, more particularly to Article 11(1) b



11(1) (iv) of R8 to emphasis on international standards that Sri Lanka, is bound to adopt and follow in its national legislation, since our country was a signatory to the Who Framework Convention on Tobacco Control. Reference was also made to R4 cigarette package health warnings (pg. 7) i.e effectiveness of warnings, increase with larger size, and use of pictures. R10 (para 14) refer to use of pictorials. Para 15 of R10 gives details of evidence when compared with text only health warnings and messages those with pictures.

- Are more likely to be noticed;
- Are rated more effective by tobacco users;
- Are more likely to remain salient over time;
- Better communicate the health risks of tobacco use;
- Provoke more thought about the health risks of tobacco use and about cessation
- Increase motivation and intention to quit; and
- Are associated with more attempts to quit.

By a gradual process the learned Deputy Solicitor General drew the attention of this court to the preamble of the National Authority on Tobacco and Alcohol Act No. 27 of 2006. It was the position of the Respondents that the above act of Parliament envisage a variety of matters to protect public health. He drew the attention of this court to letter R9 by the Chairman of the National Authority on Tobacco and Alcohol to the Minister of Health. We have noted the contents of

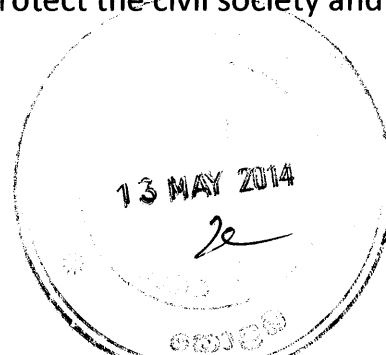


R9, along with Section 15 (J) of the Act. section 15(J) reads thus (clearly explains adherence to International Treaties).

To recommend adherence to such International Treaties and Conventions dealing with Tobacco and Alcohol as the Government may ratify and accede to;

It was the contention of the learned Deputy Solicitor General that reading Section 30 and 34 of the above Act, should not be construed in the absence of International Treaties and Conventions which had been ratified and signed by Sri Lanka. Section 30 is the enabling section to frame regulations and Section 34 impose a prohibition on sale of tobacco products without health warnings etc. We were also invited on behalf of the Respondents to consider a purposive construction and referred to several rules of interpretation/constructions relevant to the National Authority on Tobacco and Alcohol Act No. 27 of 2006, especially as regards Section 30 and 34 of the Act.

The Petitioner Company is one of the oldest business establishments engaged in the manufacture, export and distribution of cigarettes in our country. There is no total prohibition placed on the tobacco industry, but it is and has to be subject to certain restrictions and controls imposed by statute. It is so all over the world. The Respondents in this application as well as the Government of the day and any successive governments are duty bound to protect the civil society and its



citizens from all possible health hazards, caused due to cigarette smoking, and tobacco products. Scientific evidence prove and establish that smoking of cigarettes and use of tobacco cause death, illness and disability. Even the Petitioner does not dispute this aspect which cause all bad health effects to the people and its consumers.

The subject matter of this Writ Application cannot be considered in isolation of data and material gathered from other jurisdictions. Though the challenge before court is more or less focused on subordinate legislation, all necessary and relevant background facts need to be ascertained not only from within our country, but from also a global point of view since pictorial warnings on cigarette packs are accepted displayed and adopted all over the world, both in developed and developing countries as well as in 3rd world countries. The prime necessity all over the world being to protect all from health hazard, death, decease and disabilities. As such I do consider it essential to examine initially whatever available research, studies around the world and the attitudes of the authorities concerned with reference to case law in favour and against tobacco packaging warning messages and pictorial/graphic warnings, before giving my mind to the vires of the regulations (P11) framed under NATA Act.



I would include the following in this judgment, an excerpt of a report from the University of Waterloo, Canada : (though it is somewhat prolex)

*Health warnings on tobacco packages:
Summary of evidence and legal challenges*

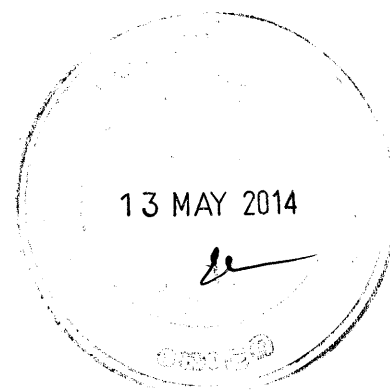
Prepared by:

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January 2008*

www.global.tobaccofreekinds.org
Website visited on 2nd May 2014

To date, more than 17 countries have passed legislation requiring large pictorial health warnings on cigarette package: Dozens of other jurisdictions are currently preparing similar legislation in response to the international labeling regulations under Article 11 of the World Health Organization Framework Convention on Tobacco Control. The evidence on effective packaging and labeling practices has grown rapidly over the past decade to keep pace with these regulatory developments. A consistent pattern of findings has emerged from this body of research:

- Package health warnings are among the most prominent and cost-effective health communications available
- Health warnings have high awareness and visibility among non-smokers and youth.
- Obscure text warnings have little impact



- Large, pictorial warnings can increase health knowledge, motivation to quit, and cessation behavior.
- Pictorial warnings are especially important for reaching low-literacy smokers and children
- Messages that depict health risks in a vivid and emotionally arousing manner are most effective.
- “Graphic” information should be accompanied by supportive cessation information.
- There are no adverse effects in response to pictorial warnings.
- Large pictorial warnings are credible and have high levels of public support.

This report also includes a review of legal challenges to health warning regulations in Canada and the European Union. In both jurisdictions, national courts have ruled against tobacco manufacturers and have upheld comprehensive labeling regulations including requirements for large pictorial health warnings on packages.

Background: Tobacco Packaging

Packaging is an important component in the overall marketing strategy of consumer goods. Packaging helps to establish brand identity in competitive markets and serves as an effective form of promotion both at the point of purchase and while the product is being used. Packaging is particularly important for consumer products such as cigarettes, which have a high degree of social visibility. Unlike many other consumer products, Cigarette packages are displayed each time the product is used and are often left in public view between uses. Cigarette packages also serve as an important link to other forms of tobacco advertising. Package designs help to reinforce brand imagery that is communicated through other media, and play a central role in point of purchase marketing, which now accounts for a majority of the industry’s promotional spending in Canada and the US.



Health warnings: Evidence

This section provides a review of the scientific literature and research on health warning labels. The section begins with a review of general evidence on health communications, followed by evidence specifically related to tobacco warning labels on packages.

2.1 The use of pictorial information in health communications

A wide variety of research has clearly demonstrated the effectiveness of using pictures and imagery in health communications.

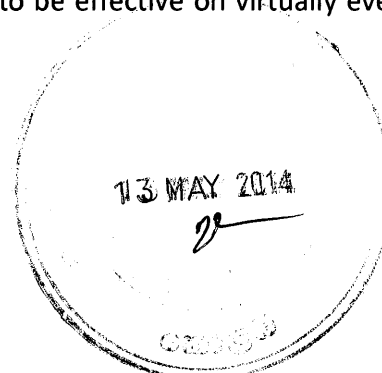
- Warnings with pictures are significantly more likely to draw attention and result in greater information processing.
- Pictures improve memory for the accompanying text and encourage individuals to imagine health consequences.
- Health warnings with pictures are also more likely to be accessed when an individual is making relevant judgments and decisions.

Experimental Research

Experimental research on cigarette warnings has also found that picture-based warnings are more likely to be rated as effective versus text-only warnings both as a deterrent for new smokers and a means to increase cessation among current smokers.

Populations-surveys and impact evaluation

A series of population-based surveys have compared the effectiveness between text and pictorial warnings. To date, surveys have been conducted in Brazil, Thailand, Singapore, Uruguay, Mexico, Canada, New Zealand, Australia, the United Kingdom and the United States. These findings are consistent with both the experimental and government commissioned research: graphic warnings are more likely to be effective on virtually every



outcome that has been evaluated. The following provides a brief summary of the evidence key area.

Pictorial warnings are more likely to be noticed and read than text-only warnings including by non-smokers

- Health warnings on cigarette packages are among the most prominent sources of health information: more smokers report getting information about the risks of smoking from packages than any other source except television.
- Findings from Thailand and elsewhere, indicate that considerable proportions of non-smokers also report awareness and knowledge of package health warnings.
- Picture help to minimize the “wear-out’ of health warnings over time.

Picture warnings increase awareness and recall of the health effects from tobacco use

- The impact of warnings on health knowledge depends upon the prominence of warnings: obscure text warnings have little effect, large pictures warnings have the greatest effect.
- Pictorial warnings increase how often smokers think about the health effects.

Health warnings promote cessation behavior

- Significant proportions of adult and youth smokers report that large comprehensive warnings have reduced their consumption levels increased their motivation to quit and increase the likelihood of remaining abstinent following a quit attempt.

Prominent health warnings increase in the use of cessation services.



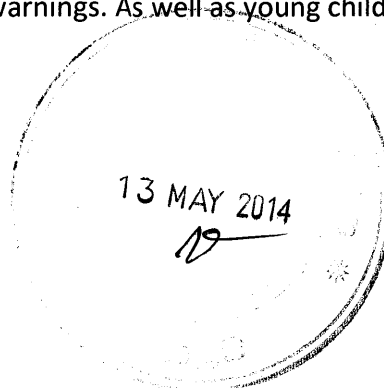
Research conducted in Brazil, the UK, the Netherlands, and Australia has examined changes in the usage of national telephone “helplines” after contract information was in package health warnings. Each of these studies reports significant increases in call volumes. For example calls to the tollfree smoking cessation helpline in the Netherlands increased more than 3.5 times after the number was printed on the back of one of 14 package warnings. Therefore while it is not possible to precisely quantify the impact of health warnings on smoking prevalence or behavior, all of the evidence conducted to date suggests that health warnings can promote cessation behavior and that larger pictorial warnings are most effective in doing so.

Picture warnings appear to be especially effective among youth

- More than 90% of Canadian youth agree that picture warnings on Canadian packages have provided them with important information about the health effects of smoking cigarette, are accurate, and make smoking seem less attractive. Other national surveys of Canadian youth suggest similar levels of support and self reported impact.
- A recent study with Australian school children found that students were more likely to read , attend to think about, and talk about health warnings after the pictorial warnings were implemented in 2006. Experimental and established smokers were more likely to think about quitting and to forgo a cigarette, while intention to smoke was lower among those students who had talked about the warning labels and had forgone cigarettes.

Pictorial health warnings are essential in countries with low literacy and multiple languages

- Text-only health warnings have little or no effect among those who cannot read. This includes illiterate individuals, individuals who may be literate but only in a language other than that used for text warnings. As well as young children.

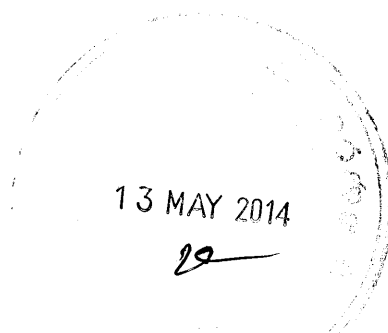


- Text-only health warnings, therefore, can increase health disparities across socio-economic groups
- The most effective way to reach low-literacy smokers is to include pictures,, which can be universally understood,, including by young children.
- Preliminary evidence suggests that countries with pictorial warnings demonstrate fewer disparities in health knowledge across educational levels.

Prominent health warnings have the potential to undermine brand appeal and the impact of package displays at retail outlets

- A Quebec Supreme Court Judge in Canada remarked upon this phenomenon in a ruling regarding the industry's challenge to pictorial warnings in Canada:
"Warnings are effective and undermine tobacco companies' efforts to use cigarette packages as badges associated with a life style.

In the United States in the year 2009 the congress passed the Family Smoking and Tobacco Control Act (Tobacco Control Act) 21 USCA. In that Act among many powers delegated to the Food and Drug Administration (FDA), the congress mandated the FDA to adopt a Rule requiring new graphic warnings on cigarette packages and advertisements. In June 2011 the FDA Rule required that coloured graphic warnings cover fifty percent (50%) of the front and back of each cigarette package sold in the U.S. This regulation is consistent with required warning label on cigarette packages in a number of other countries including



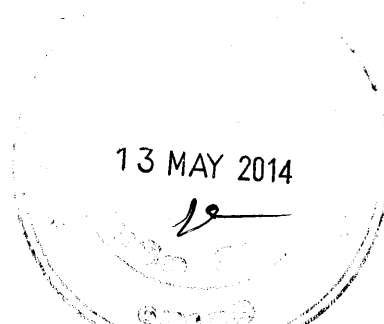
Canada, Australia, Brazil and Thailand. In consequence of publishing these regulations by the FDA, tobacco companies filed the following cases where courts expressed different views

On August 31, 2009, five tobacco manufacturers and one retailer filed suit in U.S District Court for the Western District of Kentucky to challenge several provisions of the Tobacco Control Act. This case, Discount Tobacco City & Lottery v. Food and Drug Administration (Discount Tobacco) upheld the graphic warning requirements. This decision was upheld on appeal to the U.S. Court of Appeals for the Sixth Circuit. On August 16, 2011, five tobacco manufacturers filed suit in the U.S. District Court for the District of Columbia to challenge the FDA's final regulation governing graphic warning labels for cigarettes. In this case, R.J. Reynolds Tobacco Co. v. Food and Drug Administration (R.J. Reynolds), the court found that the graphic warning rule unconstitutionally limited the tobacco companies' right to freedom of speech. On appeal, the U.S. Court of Appeals for the D.C. Circuit upheld the district court's finding that the graphic warning requirement was unconstitutional. The federal government has decided not to appeal this decision to the U.S. Supreme Court.

Overview of the above two cases

Discount Tobacco

In Discount Tobacco, the Sixth Circuit upheld the provisions of the Tobacco Control Act that authorized and directed the FDA to issue a rule requiring large, graphic warnings to be placed on cigarette packages and advertisements. The Act requires color pictorial images showing the health effects of smoking to appear on the top half of all cigarette packs, and twenty percent (20%) of the upper portion of cigarette advertisements, along with new textual warnings. The companies argued that these provisions were overly restrictive and infringed upon their free speech rights under the First Amendment.

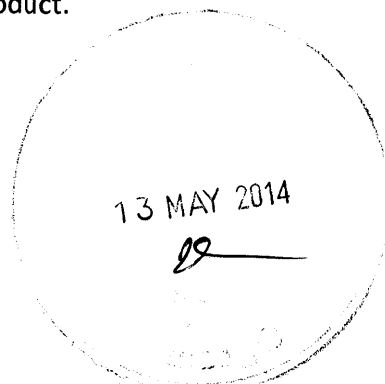


In January 2010, Judge Joseph H. McKinley, Jr. of the U.S. District Court for the Western District of Kentucky upheld the graphic warning label requirements, along with other key provisions of the Tobacco Control Act. Judge McKinley found that the “content and format” of the warning labels were justified in light of evidence that consumers do not pay attention to current warnings, and ruled that the warnings were not too burdensome because the companies retain half of the space on the cigarette packs and eighty percent (80%) of cigarette advertisements for their own speech. The tobacco companies appealed this ruling to the U.S. Court of Appeals for the Sixth Circuit. In March 2012, a three-judge panel upheld Judge McKinley’s ruling on the graphic warning label requirements. The appeals court ruled that the graphic warnings do not “impose any restrictions on the (tobacco companies’) dissemination of speech, nor do they touch upon plaintiff’s core speech.” The court also held that the textual warnings mandated by the Tobacco Control Act were “reasonably tailored to overcoming the informational deficit regarding tobacco.

R.J Reynolds

In contrast, the U.S. Court of Appeals for the D.C. Circuit found in R.J. Reynolds that the graphic warning rule created by the FDA pursuant to the Tobacco Control Act did violate the tobacco companies’ First Amendment rights.

In June 2011, the FDA issued its final rule mandating graphic warning labels on cigarette packages and advertisements. Nine graphic warning images were selected by the FDA, and the tobacco companies were required to display these warnings on a rotating basis. Among these images were a man smoking through a hole in his throat, and a cadaver with chest staples. Two months after the rule was issued, five major tobacco companies filed suit, challenging the FDA’s graphic warning label rule arguing that it forced them to convey the government’s message about smoking and advocate against their own product.



In February 2012, U.S District Judge Richard J. Leon held that the FDA's graphic warning label rule violated the tobacco companies' First Amendment rights. The court took issue with the size of the mandated warning labels and concluded that the government has other means of discouraging smoking at its disposal. The FDA appealed this decision to the U.S. Court of Appeals for the D.C. Circuit. In a split ruling, the appeals court found that the rule violated the First Amendment. Two members of the panel ruled that the warning labels exceeded the proper scope of government authority to "force the manufacturer of a product to go beyond making purely factual and accurate commercial disclosures and undermine its own economic interest." The majority also ruled that the FDA failed to prove that the labels would "directly cause" a decrease in smoking rates in the United States.

(The above material obtained – Tobacco Control Legal Consortium 875 Summit Avenue, Saint Paul, MN 55105.3076 www.publichealthlawcenter.org 651.290.7506 Website visited on 2nd May 2014)

Apart from the above material included in this judgment which demonstrate contrary decisions of the US courts, the research undertaken by those authorities and the initiatives taken by very many countries to protect health of all persons by taking a step to include pictorial, health warnings/graphics in cigarette packets, I am unable to gather from the material made available, whether in our local scene the National Authority on Tobacco and Alcohol, on its own took the trouble to conduct research programmes prior to enacting Act No. 27 of 2006? As a passing comment I would also like to observe, as to whether the authorities concerned in the same way as "Tobacco" thought it fit to apply the same standards for 'Alcohol' and endeavored to prescribe



regulations for 'Alcohol' also since both tobacco and alcohol are injurious to health and the resulting consequences are very much the same?

The relevant sections of the statute in question are Sections 30 & 34.

Section 30 reads Thus:

(1) The Minister may make regulations in respect of any matter required by this Act to be prescribed or in respect of which regulations are authorized or required by this Act to be made.

(2) without prejudice to the generality of the powers conferred by subsection (1), the Minister may make regulations –

- (a) identifying the tobacco products that are harmful or injurious to human health;
- (b) specifying the types or categories of tobacco products which do not generate smoke.

(3) Every regulation made by the Minister shall be published in the Gazette, and shall come into operation on the date of such publication or on such later date as may be specified in such regulation.

(4) Every regulation made by the Minister shall after thirty days of its publication in the Gazette, be brought before Parliament for approval. Any regulation which is not so approved shall be deemed to be rescinded as from the date of such disapproval but without prejudice to anything previously done thereunder.

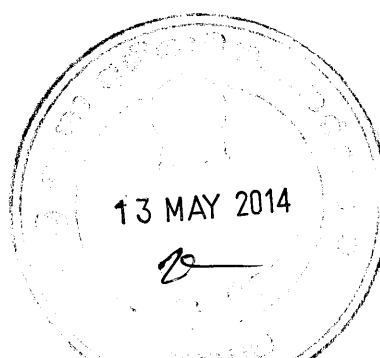
(5) Notification of the date on which any regulation made by the Minister is deemed to be rescinded shall be published in the Gazette



Section 34 reads thus:

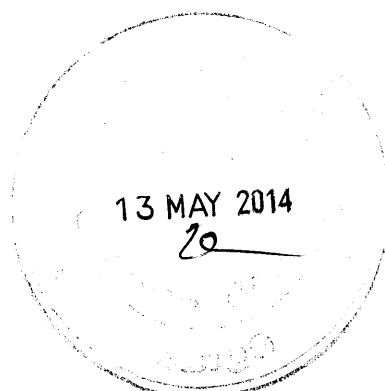
- (1) A manufacturer of a tobacco product shall cause to be displayed, conspicuously and in easily legible print, on every packet containing tobacco products manufactured by such manufacturer, a label of such dimensions as may be prescribed containing a statement of the tar and nicotine content in each tobacco product in such packet and such health warnings as may be prescribed. Different dimensions may be prescribed in respect of packets of different sizes.
- (2) A person shall not sell or offer for sale, a packet containing tobacco products unless there is displayed on such packet, a label of the prescribed dimensions containing a statement of the tar and nicotine content in each tobacco product in such packet and the prescribed health warning.
- (3) Any person who contravenes the provisions of subsection (1) or subsection (2) shall be guilty of an offence under this Act, and shall on conviction after summary trial before a Magistrate be liable to a fine not exceeding two thousand rupees or to imprisonment for a period not exceeding one year or to both such fine and imprisonment.

I observe that the Minister could in terms of the enabling Section 30, of the NATA Act make regulations on matters required by the Act to be prescribed. That would be the 1st limb that surface from Section 30(1). If one looks at Section 34(1) and 34(2) the matters and material that need to be prescribed could be understood and identified. Then the other limb of Section 30(1), contemplate of making regulations by the Minister, where the Act authorize or require to be done under the Act. Even Section 33(1) connects the



word 'prescribed'. Then subsection (2) of Section 30 seems to bestore on the Minister something more and an additional power from what is given in Section 30(1). As such I do agree with the learned Deputy Solicitor General that if by a narrow interpretation pictorial health warnings are ousted or ruled out, by resorting to Section 30(2) (a) the Minister may make regulations identifying the tobacco products that are harmful or injurious and thereby inclusion of pictorial health warnings could be permitted by regulations. Further I observe that Sections 30(1) and 30(2) are somewhat inter connected by the use of the words "without prejudice to the generality of the powers conferred by sub Section (1)". As such I could safely conclude based on the above interpretation that the regulation in question (P11 as amended by R3 & R15) could be presented by the Minister, subject to views expressed by this court. In the instant case, the regulations have been presented by the Minister in terms of Section 30 read with Section 34 of the NATA Act.

The basic and general rule of interpretation is that it must be construed in the ordinary and natural meaning of the word and sentence. However this rule is subject to well accepted exceptions. Having this in mind, when I peruse Section 34 of the above Act in its entirety it appears to me that the



choice is between two interpretations. Section 34(1) envisage a prohibition on sale of tobacco products without health warnings and the tar and nicotine content. There is no specific reference to 'pictorial' health warnings in Section 34 of the Act. Petitioner puts more emphasis on the words 'easily legible print. Learned President's Counsel also relies on the Sinhala version and Section 44 of the Act. It was strongly argued that it is nothing but written letters or words and the health warning could be described accordingly in letters or words. On a plain reading of the Section it appears to be so. However I cannot in the instant case give a narrow meaning and it is the duty of court to give an interpretation in keeping with the intention of the legislature.

A 'health warning' in the context of the statute and applicable to the subject matter of the Writ Application before us, cannot be given a narrow restricted meaning. The term health warning cannot be narrowly interpreted since a warning in today's context and society could be expressed by words, texts, pictures or even by use of symbols. The use of symbols in health communication could attract attention of the consumers. E.g. uses of skull and crossbones as the universal symbol for toxic substances. As such a health warning could attract a variety of meanings inclusive of pictorial health



warnings. It would never have been the intention of Parliament to exclude pictorial health warning since such a pictorial warning need to reach all category of persons. i.e the poor, rich, middle class, literate and illiterate, disabled and as well as children. Petitioner attempts to interpret the above terms differently by referring to various documentation and material, but I am compelled to reject and dismiss such views, since the intention of Parliament gathered from all the material placed before court by the Respondents and the Hansard favour the view that health warning referred to in Section 34 could be very comfortably extended to pictorial health warnings.

In the Sinhala version of Section 34 of the words clearly readable. (පහසුවෙන් කියවිය හැකි අකුරින්) would also have to be construed and applied to both the health warnings and statement of nicotine and tar contents. I do agree by perusing extracts from the Malalasekera English-Sinhala Dictionary (5th Ed 2007) produced as A11 & A12 and the Gunasena Maha Sinhala Shabdakoshaya (2008) produced as A13 the word 'letter' to include certain forms of pictures. Even the Sinhala version should be read in the context of words which state නිකොටින් හා තාර ප්‍රමාණය දැක්වෙන හා සෞඛ්‍යයට හානිකර බවට අනතුරු ඇඟවීමක් ඇතුළත් කියම කරනු ලැබිය හැකි ආකාරයෙන් වූ හා It is understood as a health warning in the prescribed manner. As such



the same interpretation stated above need to be adopted and applied since the primary purpose of statutes is to purpose justice and avoid absurd unacceptable interpretations. Statutory language is not read in isolation, but in its context. This court has been invited to peruse the following extract from Bindra Interpretation of Statutes – 10th Ed pg. 275-6

“It is a well known principle of interpretation of statutes that a construction should not be put upon a statutory provision which would lead to manifest absurdity or futility, palpable injustice, or absurd inconvenience or anomaly. To avoid absurdity or incongruity grammatical and ordinary sense of the words can, in certain circumstances, be avoided. There is no obligation on a court of law to construe a clause as would lead to a clear absurdity which would not possibly be regarded as contemplated by the legislating authority or agency. Since the basic and underlying purpose of all legislation, at least in theory, is to promote justice, it would seem that the effect of the statute should be of primary concern. If this is so, the effect of a suggested construction is an important consideration and one which the court should never neglect. As a result, the court should strive avoid a construction which would tend to make the statute unjust, oppressive, unreasonable, absurd, mischievous or contrary to public interest. One should avoid construction which would result in absurdity and give a harmonious construction so as to avoid making one provision of the Act conflict with the other.”

At this point in this judgment I would prefer to refer to some rules of interpretation of Statutes which fortify my views and which enabled me to express the above observations.



Construction ut res magis valeat quam pereat

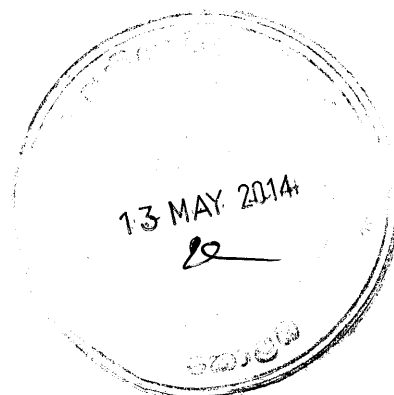
“If the choice is between two interpretations, the narrower of which would fail to achieve the manifest purpose of the legislation, we should avoid a construction which would reduce the legislation to futility and should rather accept the bolder construction based on the view that Parliament would legislate only for the purpose of bringing about an effective result”, “Where alternative constructions are equally open, that alternative is to be chosen which will be consistent with the smooth working of the system which the statute purports to be regulating; and that alternative is to be rejected which will introduce uncertainty, friction or confusion into the working of the system.”

Maxwell on The Interpretation of Statutes 12th Ed. Pg. 45

CONSTRUCTION MOST AGREEABLE TO JUSTICE AND REASON

At pg. 199.....

In determining either the general object of the legislature, or the meaning of its language in any particular passage, it is obvious that the intention which appears to be most in accord with convenience, reason, justice and legal principles should, in all cases of doubtful significance, be presumed to be the true one. “An intention to produce an unreasonable result is not to be imputed to a statute if there is some other construction available.” Where to apply words literally would “defeat the obvious intention of the legislation and produce a wholly unreasonable result” we must “do some violence to the words” and so achieve that obvious intention and produce a rational construction. The question of inconvenience or unreasonableness must be looked at in the light of the state of affairs at the date of the passing of the statute, not in the light of subsequent events.



MODE OF ASCERTAINING MEANING IF OBSCURE

Pgs. 94/95..

CRAIES ON STATUTE LAW

If (as is often the case) the meaning of an enactment, whether from the phraseology used or otherwise, is obscure, or if the enactment is, as Brett L.J. said in *The R. L. Alston*, “unfortunately expressed in such language that it leaves it quite as much open, with regard to its form of expression, to the one interpretation as to the other,” the question arise, “What is to be done? We must try and get at the meaning of what was intended by considering the consequences of either construction.” And if it appears that one of these constructions will do injustice, and the other will avoid that injustice, “it is the bounden duty of the court to adopt the second, and not to adopt the first, of those constructions.” However “difficult, not to say impossible,” it may be to put a perfectly logical construction upon a statute, a court of justice “is bound to construe, it, and, as far as it can, to make it available for carrying out the objects of the legislature, and for doing justice between parties.”

Bindra, Interpretation of Statutes, 10th Ed., pg. 277

“When there is doubt or a patent absurdity and the grammatical construction fails to give effect to the plain intention of the Act, as gathered from the preamble, then the courts are competent to and should rewrite the section in such a way so as to give effect to the Act”.

As observed above adherence to such International Treaties and conventions is provided in terms of Section 15(J) of the NATA Act. Having perused R8 (WHO Framework Convention on Tobacco Control – referred to as FCTC) refer to inclusion of pictures or pictograms, in Article 11. It considers the harmful effect of tobacco and promote health warnings to be included in packaging and labeling. Space to be occupied within a ratio of 50% or more but not less than 30%.



13 MAY 2014
[Signature]

According to rule of construction of statutes, legislature is presumed not to enact rules contravening international law or common law of realm.

The Judges may not pronounce an Act ultra vires as contravening international law, but may recoil, in case of ambiguity, from a construction which would involve a breach of the ascertained and accepted rules of international law. (Bindra Interpretation of Statutes. 10th Ed. Pg. 204.

Our Supreme Court in decided cases emphasized the need to interpret domestic law in harmony with Sri Lanka's international commitments even in cases where no specific domestic law had been enacted to give effect to its international obligations.

In Weerawansa Vs. A.G 2000 (1) SLR 387 at 409

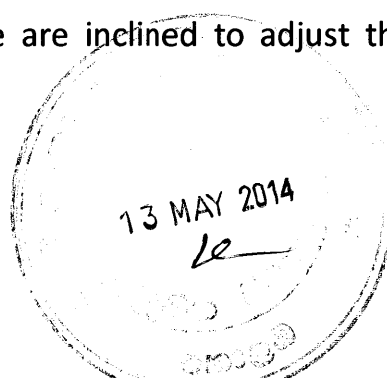
“Should this court have regard to the provisions of the Covenant? I think it must. Article 27(15) requires the State to “endeavor to foster respect for international law and treaty obligations in dealings among nations”. That implies that the State must likewise respect international law and treaty obligations in its dealings with its own citizens, particularly when their liberty is involved. The State must afford them the benefit of the safeguards which international law recognizes.

In the background it would be wrong to attribute to Parliament an intention to disregard those safeguards. The PTA cannot be interpreted as dispensing, by implication or inference, with the safeguard of prompt production before a judicial officer under and in terms of Article 13(2) “.

13 MAY 2000
B

Having read FCTC (R8) and the guidelines for implementing of Article 11 (R10) of the FCTC there cannot be any prohibition to convey the message by pictorial health warnings. As such apart from the matters stated in this judgment as regards inclusion and interpreting health warning to cater to pictorial health warning more support is lent, to do so from documents R8 and R10. Our courts recognize international commitments and articles 27(15) of the Constitution, endeavor to foster respect for international law and treaty obligation. As such I reject the argument that Section 34(1) of the NATA Act provide only for textual warnings. Health warnings in the context of said section and the NATA act need to be interpreted in a meaningful and purposive way and not so narrowly as the Petitioner argues. It may be essential to do some violence to the words to achieve the intention of the legislature. It is so because the message need to reach all category of persons in our country inclusive of children as observed above. Words of a section of a statute should be interpreted harmoniously to avoid conflict, friction, absurdity and inconvenience.

On behalf of the Petitioner Company, we also had the benefit to hear the submissions of Mr. Ali Sabry, President's Counsel, on the aspect of Petitioner's Intellectual Property Rights. We find some substance in those submissions of learned President's Counsel. As such we are inclined to adjust the 20% space



allocated to the Petitioner Company in a more reasonable and a meaningful way for the following reasons.

In view of Sections 121(1) and 121(2), of the Intellectual Property Act the rights of the registered owner of a trademark take both positive and negative forms in the sense that section 121(1) allows the registered owner to use the trademark, assign or transmit the mark and conclude licence agreements in respect of the trademark and 121(2) allows the registered owner to preclude third parties from using the trademark or a sign misleadingly similar to the trademark. (S.N. Silve J. in *Leelananda v. Earnest de Silve* (1990 (2) Sri LR 237-240-241).

These rights are subject to the limitations recognized under section 122 of the IP Act. These limitations restrict the right of the registered owner to preclude third parties from using the mark in certain specified circumstances. They do not restrict the positive rights of the registered owner – the right to use the trademark etc.

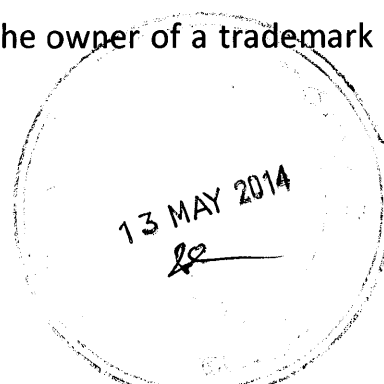
Even section 35(1)(a) of NATA Act recognizes the right of the registered owner to use the trademark. Section 35(1) of NATA Act prohibits the advertisements involving tobacco but section 35(1)(a) expressly permits the use of trademarks in respect of tobacco.



These statutory provisions clearly indicate that the registered owner of a trademark has the right to use the trademark. A trademark is used in trade and commerce. The use is intended to achieve the owner's reasonable business objectives – to reach the consumers and promote the commercialization of the concerned goods.

Consequently, the petitioners should have a reasonable opportunity to exercise the rights attached to their registered trademarks such as the use of the trademarks to reach the consumers and promote the commercialization of their goods. It is noted that the law does not prohibit the sale of tobacco. The petitioners can sell etc. tobacco subject to the lawful restrictions. They have the right to sell tobacco using their trademarks.

Where 80% of the pack is covered with the health warning, the practical issue that arises is whether the remaining 20% is reasonably sufficient to present and exhibit the mark or in other words to use the mark. Having considered the size of the packs and other relevant facts, I am of the view that 20% of the space is not reasonably sufficient to present and exhibit a trademark 20% of the space is not exclusively left for the trademark. It may carry other information as well. In such a space, the presentation of the trademark necessarily becomes comparatively very small. The owner of a trademark cannot



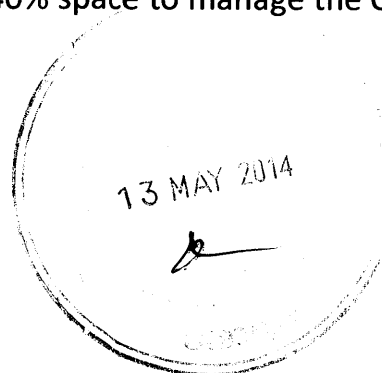
reach the consumers with his mark which is hidden in the health warning. The consumers will also not be able to see and identify the trademark properly and consequently the source of the respective goods. They have to make extra efforts to see or identify the trademark, when they buy the goods. Such a situation will unreasonably interfere with the statutory right of the owner of the trademark to use it frustrating the whole purpose of a trademark and of the trademark law.

Moreover, the Trademark Law, while protecting the rights of the owners of the registered trademarks, attempts to safeguard the interests of the consumers as well. In a market where there are several brands or trademarks in respect of same or similar goods the protected trademarks enable the consumers to make their choice. The consumers can identify the goods and the source of the goods that they actually want to buy through trademarks and brands without being misled to purchase the goods of wrong sources and wrong quality. Where only 20% of the space is available for the presentation of the trademark and other information, the consumers will not be able to see the trademark properly and make their choice properly and effectively. The packs of each manufacturer may look the same where 80% of the space is covered with the health warning. When the trademarks are not obviously and clearly presented, the unscrupulous traders



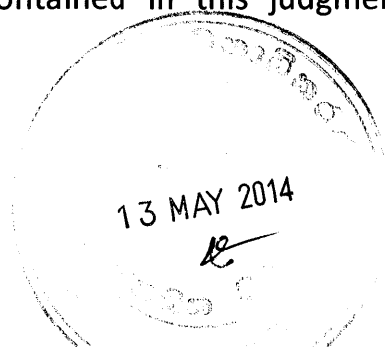
may even misuse such situation to mislead the consumers by selling products from wrong sources rather than selling what actually the consumer wants to buy.

This court observes that a balance need to be maintained, having considered the case of either party. Health of each and every citizen of our country and all those living in Sri Lanka permanently or in a temporary capacity is paramount and need to be protected. On the other hand a legally established business/industry cannot be denied its legitimate rights, flowing from the laws of our country. If 80% of the space is covered by health warnings the remaining space would not be sufficient to display the manufacturers trade mark. At the oral hearing of this application, the learned Deputy Solicitor General very correctly conveyed to this court that the authorities concerned would be agreeable and willing to allocate 75% of the space for health warnings. However at that point of time of the hearing the learned President's Counsel for the Petitioner Company was not prepared to act on the above ratio of 75%, as he may have thought that to accept the suggestion of learned Deputy Solicitor General would not be in the best interest of his client. However it is the view of this court that warnings/pictorial health warning should cover a space between 50% to 60%. Thus giving the Petitioner Company at least 40% space to manage the Companies



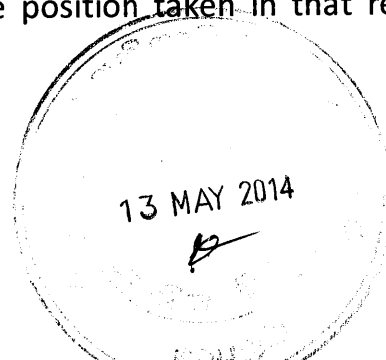
Trade Mark rights, within that space. The authorities concerned are directed to suitably amend the regulation to allocate a ratio anything between 50% to 60% for health/pictorial warnings.

We have also noted the contents of motion dated 14th March 2014, filed by the registered Attorney-at-Law for the Respondents. The said motion indicates that regulations marked P11, R3 & R15 had been placed before Parliament and same had been approved by Parliament on 19.2.2014. Section 30(4) of the NATA Act requires the regulations to be placed before Parliament after 30 days of its publication in the Gazette for approval. Regulations not so approved deemed to be rescinded. As such after a lapse of the 30 day period, as stated in section 30(4) the regulation, need to be placed before Parliament. I cannot see a prohibition as regards the provisions conferred in Section 30(4) to place the regulations before Parliament at any time after 30 days of publication in the Gazette. Now that regulation P11, R3 & R15 are approved by Parliament as subordinate legislation it remains valid for all purposes which has a quasi – Parliamentary validity subject to the views expressed by this court, as regards regulation No. 5 of P11 as amended by regulation R15. The space to be occupied for pictorial health warnings should only occupy a space in the ratio anything between 50% to 60% for the reasons contained in this judgment. The 1st



Respondent is directed to suitably amend the above regulation in keeping with the direction given by this court. The above requirement in the circumstances of this case would not offend the principle of proportionality. The attempt to introduce pictorial health warnings is only to minimize the harmful health consequences of smoking cigarettes. There is no total prohibition or ban on the Tobacco Industry or to engage in its business by the Petitioner Company. The regulations only attempt to impose a valid restriction or exercise some control for the benefit of safeguarding health of our people and as such the principles of proportionality cannot be offended.

In all the facts and circumstances of this Writ Application, we are of the view as stated in this Judgment and subject to the view expressed by this court as regards regulation No. 5 of P11 as amended by regulation R15, challenge to the regulation in question by the Petitioner on the several grounds urged by the Petitioner is a futile attempt. The regulation in question is not ultra vires the statute. However having regard to the Petitioner's rights flowing from Intellectual Property Act as regards the rights of the registered owner of a trade mark the positive rights of the registered owner, the right to use the trade mark, and the recognition given in terms of Section 35(1) (a) of the NATA Act, this court is mindful of same and as such accepts the position taken in that regard by the

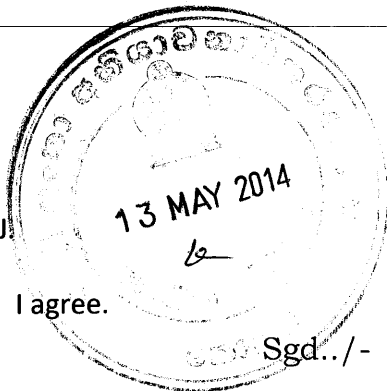


Petitioner. On that account we direct the 1st Respondent to adjust the particular regulation referred to above, accordingly.

The remedy sought by the Petitioner Company are the prerogative Writs of Certiorari and Prohibition which are discretionary remedies of court. The granting of a Writ is a matter for the discretion of court, and court is bound to take into consideration the consequences which by the issue of the writs sought will entail. A Petitioner seeking a prerogative writ is not entitled to relief as a matter of course, as a matter of right or as a matter of routine. In the circumstances, subject to the views expressed by this court application of the Petitioner is refused and dismissed without costs.

Application dismissed.

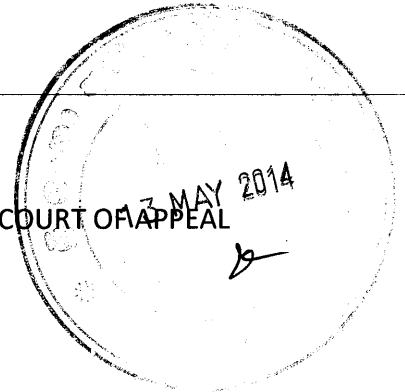
W.M.M. Malinie Gunaratne J



I agree.

Sgd../-

Sgd../
JUDGE OF THE COURT OF APPEAL



JUDGE OF THE COURT OF APPEAL

I do hereby certify that the foregoing is a true copy of the Judgment dated 12.05.2014 filed of record in C.A. No. 336/2012.(Writ).

Typed by: *[Signature]*

Comp'd with : *[Signature]*.....

[Signature]

Chief Clerk of the Court of Appeal

Chief Clerk of the Court of Appeal

$$\frac{352925}{22}$$

2014/05/12

SLG ECONOMICS LTD

ECONOMICS, REGULATION, COMPETITION

**Review of Proposals for Larger Graphic
Health Warnings in Hong Kong**

SLG Economics Ltd

June 2015

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Review of Proposals for Larger Graphic Health Warnings in Hong Kong

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Review of Proposals for Larger Graphic Health Warnings in Hong Kong

1 Introduction

The Legislative Council Secretariat has put forward a briefing paper¹ ('**LC Briefing Paper**') and updated background brief,² relating to the progress of tobacco control measures for the meeting of the Panel of Health Services on 18 May 2015. It proposed to strengthen tobacco control measures by amongst other things³:

- Increasing the area covered by graphic health warnings from 50% to at least 85% of the two largest surfaces of the packet;
- Increasing the number of health warnings from six to twelve;
- Changing the health warning message to: "*Tobacco kills up to half of its users, Quitline 1833 183*" (or the Cantonese equivalent); and
- The indication of tar and nicotine yields to be printed in a conspicuous place on a side of the packet adjacent to its flip-top lid.

This report assesses the proposals for larger graphic health warnings ('**GHW**'s) contained in the LC Briefing Paper and considers whether they are in line with better regulatory principles, and to what extent they are necessary, appropriate or proportionate. It has been commissioned by British American Tobacco Company (Hong Kong) Limited.

2 Executive Summary

The LC Briefing Paper:

- Fails to include a public consultation;
- Fails to include a Regulatory Impact Assessment ('**RIA**');
- Fails to follow the recommendations of the 2001 Tobacco Regulation RIA;
- Fails to follow the principles of better regulation
- Fails to recognise that the current tobacco controls are already more than is required under the WHO Framework Convention on Tobacco Control ('**FCTC**')

¹ LC Paper No. CB(2)1456/14-15(07) http://www.legco.gov.hk/yr15-16/english/panels/hs/papers/hs_a.htm

² LC Paper No. CB(2)1456/14-15(08) http://www.legco.gov.hk/yr15-16/english/panels/hs/papers/hs_a.htm

³ There are also proposals to designate bus interchange facilities as non-smoking areas and to regulate electronic cigarettes, but these are not the subject of this report.

- Fails to analyse the baseline or identify any problems with the current 50% GHWs that might need further regulation;
- Fails to properly specify the objectives of the proposals;
- Fails to provide any evidence for the proposals;
- Sets out proposals that are arbitrary and gold-plated;
- Sets out proposals that directly contravene the FCTC Guidelines;
- Fails to consider alternative policies or identify the policy with the greatest net benefits;
- Fails to estimate the costs of the proposals; and
- Fails to estimate the benefits of the proposals.

Overall the failures of process and lack of evidence mean that the proposals cannot be shown to be necessary, appropriate or proportionate. The LC Briefing Paper does not identify any problem with the existing 50% GHWs, establish why the proposed increase in size from 50% to 85% is necessary, or what benefits it would provide over and above existing regulation or alternative measures. Taking all the concerns raised in this report together, it would be manifestly inappropriate to rely on the LC Briefing Paper to proceed with larger graphic health warnings.

3 SLG Economics

SLG Economics is an economics consultancy set up in 2011 by Stephen Gibson providing specialist micro-economic policy advice to regulated companies, regulators and government. Mr Gibson has over 25 years' experience of leading major economic and strategy projects across a broad range of industries from both sides of the regulatory fence.

Mr Gibson has been Chief Economist at Postcomm – the independent regulator of postal services in the UK, Principal Economist at Ofcom – the communications sector regulator and Head of Economics at Network Rail – the UK rail infrastructure owner, as well as a number of other senior economics positions.

Mr Gibson has been a lecturer at City University, London on their MSc in Competition and Regulation and is a lecturer at Birkbeck University on their undergraduate and postgraduate Industrial Economics courses. He has lectured widely on economic regulation at national and international industry conferences and seminars and is regularly interviewed on BBC TV and Radio, ITV and Sky News about economic issues. He was the external supervisor for a PhD in rail regulation at Cambridge University. He has an MA in Economics and Management Studies from Sidney Sussex College, Cambridge University and postgraduate

qualifications in: Computer Science from Cambridge University; Accounting and Finance from the ACCA; and Corporate Finance from London Business School. He has published papers on regulatory and competition economics issues in peer reviewed books and journals.

4 The Process for developing proposals for increasing graphic health warnings from 50% to 85%

The LC Briefing Paper fails to follow proper process in developing proposals for larger GHWs. It fails to:

- Conduct a public consultation;
- Undertake a RIA;
- Follow the recommendation of the 2001 Tobacco Regulation RIA; and
- Follow the principles for better regulation.

4.1 Failure to conduct a public consultation

Consultations are an important part of policy development. They allow the policy maker to gather the views and preferences of stakeholders (including members of the public), understand the possible unintended consequences of a policy and obtain a better perspective on implementation. Consultation increases the level of transparency and engagement with interested parties and improves the quality of policy making by bringing to bear expertise and alternative perspectives, and identifying practical problems.

The Secretary for Health and Welfare issued proposals in 2001 for a series of tobacco control measures⁴ (the '**2001 Tobacco Control proposals**'). The development of these proposals included a formal consultation⁵ inviting views and comments on the proposed legislative arrangements. The consultation responses identified and highlighted problems with the affordability of the proposals for hawkers and small businesses. As a result, the final legislation contained an exemption to the restriction on the display of tobacco advertising for hawkers and small businesses with a turnover less than HK\$500,000.

Hong Kong is a member of the Asia-Pacific Economic Cooperation (APEC). The APEC-OECD checklist on regulatory reform⁶ is clear on the importance of consultation, recommending:

⁴ Including proposals to: expand the statutory no smoking areas, restrict the size of price boards and price markers, prohibit the sale of tobacco products with other merchandise, restrict tobacco sponsorship and allow health warnings to contain graphic content.

⁵ Smoking (Public Health) Ordinance Cap.371 Consultation Document, http://www.fhb.gov.hk/en/press_and_publications/consultation/Smoke2.HTM

⁶ APEC-OECD Integrated Checklist on Regulatory Reform, *a policy instrument for regulatory quality, competition policy and market openness*, 2005 <http://www.oecd.org/regreform/34989455.pdf>

- “Public consultation should not be limited to insiders, such as already established businesses, but should be open to all interested parties”⁷; and
- “Consultation with stakeholders is considered to be fundamentally important for a well-managed regulatory system”⁸.

The APEC *Guidelines for the preparation, adoption and review of technical regulations*⁹ (which are defined as mandatory government regulations put in place to achieve health, safety, consumer information and environmental objectives) require that the administration:

- “ensure that adequate consultation takes place”.

Similarly, the APEC paper *Supporting the TBT Agreement with Good Regulatory Practices*¹⁰ states:

- “The importance of public consultation is widely recognised”; and
- “Consultation should not be a discretionary part of regulating society”.

It is therefore a failure of process that (unlike the 2001 tobacco control proposals) the current proposals have not been subject to a proper public consultation process. As well as not following better regulation principles, the lack of public consultation means that the proposals do not take account of stakeholder feedback and fail to consider the practical consequences of the proposals.

4.2 Failure to undertake a Regulatory Impact Assessment

The 2001 Tobacco Regulation proposals were also supported by a detailed (214 page) RIA¹¹ of the proposed amendments. RIAs are a structured process for collecting and using evidence to better solve policy problems. They are an important part of policy development that enables the government to understand the costs, benefits and risks of its proposed actions and policy alternatives and to thereby choose the solution that best achieves the policy goals at lowest cost. The APEC paper *Supporting the TBT Agreement with Good*

⁷ Ibid, page 17

⁸ Ibid, page 17

⁹ *Guidelines for the Preparation, Adoption and Review of Technical Regulations*, APEC http://www.google.co.uk/url?url=http://www.jsm.gov.my/documents/10180/86670/Guidelines%2Btechnical%2Bregulations.doc/8bce9281-59f4-4403-bc7d-5c9dbf35997f&rct=j&frm=1&q=&esrc=s&sa=U&ved=0CB4QFjABahUKEwio3e63sIfGAhXkKNsKHATcAvA&usg=AFQjCNHe0Mkpx2A5xUFXEkebDhKg4cu_Yg

¹⁰ *Supporting the TBT Agreement with Good Regulatory Practices*, APEC, March 2012

http://publications.apec.org/publication-detail.php?pub_id=1266

¹¹ Regulatory Impact Assessment, *Proposed amendments to the existing smoking legislation*, Environmental Resources Management Limited, LC Paper No. CB(2)1/02-03(04), Dec 2001 <http://www.legco.gov.hk/yr02-03/english/panels/hs/papers/hs1025cb2-1-4e.pdf>

*Regulatory Practices*¹² states: “it is impossible to regulate well if the consequences of government action are not understood in advance. Understanding consequences of various options for action more clearly is the main purpose of RIA”. The APEC Good Practice Guide on Regulatory Reform¹³ comments: “as parliaments realise the importance of RIA, they can provide invaluable support for its use.”

It is therefore a further failure of process that (unlike the 2001 Tobacco Control proposals) the current proposals have not been subject to a proper (or indeed any) RIA process (see also Section 7 below on the proportionality of the proposals).

4.3 Failure to follow the recommendation of the 2001 Tobacco Control RIA

The 2001 Tobacco Control RIA concluded that: “it is recommended that the proposed amendment be enacted, but that any future requirements for pictorial and graphic contents take into account the likely financial and economic costs of implementation and that these be weighed against the likely health and economic benefits likely to arise”¹⁴. The lack of an RIA or any assessment of the costs and benefits of the current proposals totally disregards this recommendation.

4.4 Failure to follow the principles of better regulation

The APEC *Good Practice Guide on Regulatory Reform*¹⁵ sets out a set of seven principles of better regulation that have been widely accepted as good practice and are intended to be applicable to any economy and any policy issue. It is remarkable that the LC Briefing Paper fails to comply properly with any of the principles. The APEC principles for better regulation are:

- *Clearly define the problem* – The LC Briefing Paper fails to identify any problems with the current 50% GHWs that might need to be rectified by new regulations (see Section 5.2) or specify the objectives of the proposals (see Section 5.3).
- *Justify government action* – The LC Briefing Paper fails to provide explicit evidence that government action is justified (see Section 6.1).
- *Consider a range of policy options* – The LC Briefing Paper fails to consider alternative policy options (see Section 7.1).

¹² *Supporting the TBT Agreement with Good Regulatory Practices*, APEC, March 2012

http://publications.apec.org/publication-detail.php?pub_id=1266

¹³ *Good Practice Guide on Regulatory Reform*, APEC, August 2008 http://publications.apec.org/publication-detail.php?pub_id=1061

¹⁴ Regulatory Impact Assessment, *Proposed amendments to the existing smoking legislation*, Environmental Resources Management Limited, LC Paper No. CB(2)1/02-03(04), Dec 2001, page 107
<http://www.legco.gov.hk/yr02-03/english/panels/hs/papers/hs1025cb2-1-4e.pdf>

¹⁵ *Good Practice Guide on Regulatory Reform*, August 2008, APEC, July 2010, paragraph 8
http://publications.apec.org/publication-detail.php?pub_id=1061

- *Weigh the benefits and the costs of the regulation* – The LC Briefing Paper fails to estimate the costs and benefits of the proposed regulations (see Sections 7.2 and 7.3) or weigh them together (see Section 7.1).
- *Consult with interested parties* - The LC Briefing Paper fails to consult with stakeholders (see Section 4.1).
- *Consider enforcement and incentives for compliance* - The LC Briefing Paper fails to assess the incentives and institutions through which the regulation will take effect and design implementation strategies that make best use of them.
- *Review mechanisms to ensure the continuing effectiveness of the regulation* - The LC Briefing Paper fails to consider review mechanisms (such as a post-implementation review) to check whether the regulations are working effectively and remain relevant.

5 Establishing whether increasing the graphic health warnings from 50% to 85% is necessary

The LC Briefing paper fails to show that increasing the size of the GHWs from 50% to 85% is necessary, in fact:

- The current 50% GHWs are more than is required under the FCTC;
- There is no analysis of the baseline to support further regulations; and
- The LC Briefing Paper fails to properly set out the objectives of the proposals. It is therefore impossible to assess what the proposals are intended to achieve and whether they will meet those objectives.

5.1 The current tobacco control regulations are more than is required under the Framework Convention on Tobacco Control

The LC Briefing Paper justifies the proposed increase in GHWs solely on the basis of recommendations in the WHO Guidelines. These state that: "*the size of the health warnings and messages should cover more than 50% of the principal display areas and aim to cover as much of the principal display areas as possible.*"¹⁶ However, the WHO Guidelines¹⁷ quote Article 11.1(b)(iv) of the FCTC which provides that that health warnings and messages on tobacco product packaging and labelling: "*should be 50% or more, but no less than 30%, of the principal display areas*" and "*may be in the form of or include pictures or pictograms.*" Therefore the FCTC only requires Parties to implement 30% text warnings, and the current

¹⁶ LC Briefing Paper, paragraph 15

¹⁷ *Who Framework Convention on Tobacco Control* Guidelines for implementation, 2013 edition, http://apps.who.int/iris/bitstream/10665/80510/1/9789241505185_eng.pdf?ua=1

regulations in Hong Kong that require 50% GHWs are already more than is required under the FCTC. This is not recognised in the LC Briefing Paper and means that larger GHWs are not necessary to meet the requirements of Article 11 of the FCTC.

5.2 Failure to assess the problem against a baseline

In order to properly make a case for further tobacco control regulation, the LC Briefing Paper should assess the efficacy of the current tobacco control regulations to provide a baseline and identify any problems that might need to be rectified by new regulations. There is no analysis of the baseline or the need for further regulations. The LC Briefing Paper doesn't identify any problem with the existing 50% GHWs or establish why an increase in size from 50% to 85% is necessary or what benefits it might bring. As the *APEC Guidelines for the preparation, adoption and review of technical regulations*¹⁸ state: “The first step in the development process should be to clearly identify the problem that needs to be addressed” and “accurate problem definition reduces the risk of choosing inappropriate options for government action or ignoring more effective solutions, and reduces the likelihood of over regulation.”

5.3 Failure to properly specify the objectives of the proposals

The LC Briefing Paper does not set out the objectives of the proposals – it simply proposes them to “strengthen our tobacco control efforts”. This is in contrast to the 2001 tobacco control proposals which set out two clear objectives to: “reduce the exposure and impacts of second hand smoke, and to reduce the uptake of smoking and hence overall smoking rates”¹⁹.

Without a clearly framed objective(s), it is impossible to assess what the proposals are intended to achieve, whether the proposals are likely to deliver the objective(s), whether there are alternative less costly or more effective ways of delivering the objective(s) and to debate whether the objective(s) is a sensible goal for public policy. The *APEC Guidelines for the preparation, adoption and review of technical regulations*²⁰ are clear that “it is essential to clearly specify policy goals. These goals or objectives should focus on outcomes, rather than means to achieve them, so that all possible alternatives can be considered”. Similarly

¹⁸ *Guidelines for the Preparation, Adoption and Review of Technical Regulations*, APEC
http://www.google.co.uk/url?url=http://www.jsm.gov.my/documents/10180/86670/Guidelines%2Btechnical%2Bregulations.doc/8bce9281-59f4-4403-bc7d-5c9dbf35997f&rct=j&frm=1&q=&esrc=s&sa=U&ved=0CB4QFjABahUKEwio3e63sIfGAhXkKNsKHaTcAvA&usg=AFQjCNHe0Mkpx2A5xUFXEkebDhKg4cu_Yg

¹⁹ Regulatory Impact Assessment, Proposed amendments to the existing smoking legislation, Environmental Resources Management Limited, LC Paper No. CB(2)1/02-03(04), Dec 2001, page 15
<http://www.legco.gov.hk/yr02-03/english/panels/hs/papers/hs1025cb2-1-4e.pdf>

²⁰ *Guidelines for the Preparation, Adoption and Review of Technical Regulations*, APEC
http://www.google.co.uk/url?url=http://www.jsm.gov.my/documents/10180/86670/Guidelines%2Btechnical%2Bregulations.doc/8bce9281-59f4-4403-bc7d-5c9dbf35997f&rct=j&frm=1&q=&esrc=s&sa=U&ved=0CB4QFjABahUKEwio3e63sIfGAhXkKNsKHaTcAvA&usg=AFQjCNHe0Mkpx2A5xUFXEkebDhKg4cu_Yg

the Hong Kong Department of Justice in their publication *How Legislation is made in Hong Kong*²¹ state that Instructions for Bills and subsidiary legislation should include a general statement setting out “*the principal objectives to be achieved by the legislation*”²² and the *APEC Good Practice Guide on Regulatory Reform*²³ states: “*A regulatory reform policy should have clear objectives*”

6 Establishing whether the evidence for increasing graphic health warnings from 50% to 85% is adequate

The LC Briefing Paper (and the WHO Guidelines on which it is based) does not demonstrate adequate evidence to support increasing the size of GHWs to 85%. It does not provide any evidence of an information deficit that requires larger warnings and fails to identify a problem with the existing 50% GHWs:

- It is solely based on a reference to the WHO Guidelines and does not set out any supporting evidence ;
- The choice of 85% is arbitrary and results in gold-plated regulations ; and
- The proposals directly contravene WHO Guidelines relating to printing tar and nicotine yields on packets.

6.1 Lack of evidence for proposals

The proposal for increasing the size of the GHWs from 50% to 85% is based solely on the non-binding recommendation in the WHO Guidelines that the size of the health warnings and messages should cover more than 50% of the principal display areas and aim to cover as much of the principal display areas as possible. However, there is no indication of the source or quality of the evidence on which this recommendation is based. Without the evidence being properly set out, it is inappropriate to place any weight on recommendations stemming from it. Again, it must be remembered that the current regulations in Hong Kong that require 50% GHWs are already more than is required under the FCTC and meet the recommendation under the WHO Guidelines (see Section 5.1).

I have also reviewed the expert report of Professor W. K. Viscusi²⁴ which provides evidence which directly contradicts the assumption that increasing the size of graphic health warnings will have any impact on smoking behaviours. This evidence includes: statistical analysis by the U.S. Food and Drug Administration of Canadian data which found no evidence of a

²¹ *How Legislation is made in Hong Kong, A Drafter’s View of the Process*, Law Drafting Division, Department of Justice, June 2012, <http://www.legislation.gov.hk/blis/eng/pdf/2012/drafting2e.PDF>

²² Ibid, Appendix to Chapter V, paragraph 8(c)

²³ *Good Practice Guide on Regulatory Reform, August 2008*, APEC, July 2010, paragraph 4
http://publications.apec.org/publication-detail.php?pub_id=1061

²⁴ *Expert Report on Proposals to Increase the Size of Graphic Cigarette Warnings in Hong Kong*, W. Kip Viscusi, June 2015

beneficial effect of graphic warnings on smoking behaviour; evidence that the introduction of 50% GHWs in Hong Kong in 2007 had no impact on reducing smoking prevalence; and evidence that GHWs in Canada, Australia and the UK had no effect on the trend in smoking prevalence rates in those countries. Professor Viscusi concludes that: *“There is no sound basis in experimental data, survey data, or data on smoking behavior to conclude that larger graphic warnings are more effective in increasing risk awareness or reducing smoking behavior. It therefore cannot be expected that increasing the size of existing graphic warnings from 50% to 85% would have any impact on smoking behaviors”*. The LC Briefing Paper fails to consider any evidence or undertake any analysis of the type referred to in Professor Viscusi's report.

6.2 Arbitrary and gold-plated regulations

The WHO Guidelines are silent as to the basis on which graphic health warnings of any percentage above 50% are to be chosen. They do not provide any recommendations for 85% GHWs. The choice of 85% in the LC Briefing Paper is purely arbitrary and has no evidential basis at all. It effectively gold-plates the regulations – going well beyond the 30% text warnings required under the FCTC or indeed even the non-binding recommendation of 50% GHWs in the WHO Guidelines.

6.3 Proposals directly contravene WHO Guidelines relating to tar and nicotine yields

The WHO Guidelines clearly state that: *“Parties should prohibit the display of figures for emission yields (such as tar, nicotine and carbon monoxide) on packaging and labelling”*²⁵, because they are concerned that *“marketing of cigarettes with stated tar and nicotine yields has resulted in the mistaken belief that those cigarettes are less harmful”*. However the LC Briefing Paper proposes that: *“tar and nicotine yields be printed on a side adjacent to a typical flip-top lid of a cigarette packet ... presented in a conspicuous place of such side of the packet”*²⁶ - in direct contravention of the Guidelines.

It is remarkable, given that the only justification put forward in the LC Briefing Paper for the proposals is to seek to follow WHO Guidelines, that they then directly contravene those Guidelines.

7 The proportionality of 85% graphic health warnings

The LC Briefing Paper does not demonstrate that increasing the size of GHWs from 50% to 85% would be a proportionate policy measure i.e. whether the benefits significantly outweigh the costs. In fact the LC Briefing Paper does not provide any quantified or even qualitative evidence on the impact of the incremental increase in the size of GHWs from

²⁵ *Who Framework Convention on Tobacco Control* Guidelines for implementation, 2013 edition, page 63 http://apps.who.int/iris/bitstream/10665/80510/1/9789241505185_eng.pdf?ua=1

²⁶ LC Paper No. CB(2)1456/14-15(07), paragraph 17(d) http://www.legco.gov.hk/yr15-16/english/panels/hs/papers/hs_a.htm

50% to 85% and fails to consider any of the costs or benefits that might arise as a result of the measure or possible alternative measures. The LC Briefing Paper fails to:

- Consider alternative policies or identify the policy with the greatest net benefit to society;
- Consider the costs of the proposals and in particular the impact on trademarks; and
- Estimate the benefits of the proposal.

7.1 Failure to consider alternative policies and identify the policy with the greatest net benefit

The LC Briefing Paper fails to consider any policy alternatives. The Hong Kong Department of Justice in their publication *How Legislation is made in Hong Kong*²⁷ states that the responsible Government agency is required to provide a clear statement of purpose for a proposed measure, demonstrating that “*legislation is necessary, in the public interest and that other options ... cannot achieve the objective*”²⁸

The APEC *Guidelines for the preparation, adoption and review of technical regulations*²⁹ similarly state that: “*In order to ensure that any government intervention brings the greatest possible net benefits, it is important to ensure that all the feasible options are identified and assessed. In addition to the imposition of technical regulations, there are a number of policy instruments available which should be considered.*”

Without an estimate of the costs and benefits of the proposed measure, it is impossible to judge whether the proposal is proportionate, whether the benefits outweigh the costs and risks involved, and whether it provides the maximum net benefit compared to alternative policy options. The APEC *Guidelines for the preparation, adoption and review of technical regulations*³⁰ state: “*Each option should then be considered carefully in terms of costs and benefits. The option chosen should be the option which either provides the maximum net benefit or the least net cost to society. It is important to include the status quo in the set of options being considered, to ensure that no option is chosen which would in fact be worse for the economy than the status quo.*”

²⁷ *How Legislation is made in Hong Kong, A Drafter’s View of the Process*, Law Drafting Division, Department of Justice, June 2012, <http://www.legislation.gov.hk/blis/eng/pdf/2012/drafting2e.PDF>

²⁸ Ibid, Appendix 3, paragraph 451 (a)

²⁹ *Guidelines for the Preparation, Adoption and Review of Technical Regulations*, APEC http://www.google.co.uk/url?url=http://www.jsm.gov.my/documents/10180/86670/Guidelines%2Btechnical%2Bregulations.doc/8bce9281-59f4-4403-bc7d-5c9dbf35997f&rct=j&frm=1&q=&esrc=s&sa=U&ved=0CB4QFjABahUKEwio3e63sIfGAhXkKNsKHaTcAvA&usg=A FQjCNHe0Mkpx2A5xUFXEkebDhKg4cu_Yg

³⁰ *Guidelines for the Preparation, Adoption and Review of Technical Regulations*, APEC http://www.google.co.uk/url?url=http://www.jsm.gov.my/documents/10180/86670/Guidelines%2Btechnical%2Bregulations.doc/8bce9281-59f4-4403-bc7d-5c9dbf35997f&rct=j&frm=1&q=&esrc=s&sa=U&ved=0CB4QFjABahUKEwio3e63sIfGAhXkKNsKHaTcAvA&usg=A FQjCNHe0Mkpx2A5xUFXEkebDhKg4cu_Yg

This evidence on costs, benefits and risks of a range of policy options should have been provided through the RIA process (see Section 4.2) which would have allowed comparison of the proposal with the 'Do Nothing' option of maintaining existing GHWs and alternative options – for example using different warning messages.

7.2 Failure to estimate the costs of the proposals

The LC Briefing Paper does not even mention the potential costs of the measure. In contrast, the previous 2001 Tobacco Control RIA showed that the costs of tobacco control measures could be substantial – for example the costs of the previous amendments to restrict tobacco advertising and promotion were estimated at HK\$555m. There are a wide range of costs that should be addressed, but are not considered at all in the LC Briefing Paper, including:

- One-off costs and running costs of changing health warnings;
- Loss of manufacturing industry profits - particularly through the impact on trademarks;
- The impact on the packaging industry;
- The cost of introducing the regulations;
- The impact on employment; and
- The impact on tax revenues and illicit trade.

7.2.1 The impact on trademarks

I have reviewed the expert report of Professor Zerrillo³¹ which describes the importance of trademarks and the brands that they represent, how they affect consumers, manufacturers and competition in the marketplace, and the ramifications to trademarks and brands that will result from the requirement to increase the size of the GHWs to 85%. Professor Zerrillo explains that:

- Increasing the size of GHWs to cover 85% of the cigarette packages will make it impossible for manufacturers to use some trademarks as registered (including logos and labels) and for them to use other trademarked elements effectively. Trademarks will not be able to adequately serve their essential functions of differentiating products and uniquely identifying their origin and quality.
- In Hong Kong, the extensive ban on advertising and sponsorship of cigarettes means that the limited space available on cigarette packs for trademarks is the only tool manufacturers have to identify and differentiate their products from other competitive offerings. A further reduction in this already limited space will minimize

³¹ Expert Report of Professor Philip Zerrillo, June 2015

or even eliminate any meaningful use of trademarks and, in doing so, destroy their value. As a result, decades of investment in brands and their related trademarks, along with their inherent goodwill, will be lost.

- Brands including trademarks play an important role in the cigarette market, and their erosion or elimination changes the nature of the market. In general, markets without brands become price-driven commodity markets.
- Commodity markets produce lower prices that encourage more consumption. Commodity markets also make the market inhospitable to firms trying to enter the market and for existing brands, particularly small brands, to compete for a greater market share. Commoditization of the cigarette market in Hong Kong and a shift to pure price driven competition could also lead to an increase in illicit trade because without the added value of brands, legitimate products will be less clearly differentiated from illicit products.

Professor Zerrillo concludes: *“In sum, it is my opinion that increasing the size of GHWs to 85% will preclude any effective or meaningful use of trademarks, thereby preventing them from performing their essential brand functions. Further, it is my opinion that the elimination of trademarks as a platform for brand communication has a number of important negative repercussions for consumers, manufacturers, and the market in general, including some unintended consequences that are at cross-purposes with the stated health goals of the initiatives.”*³²

These impacts are not considered at all in the LC Briefing Paper. This is not only a failure of process, but as noted in Section 4.3 above, also goes against the recommendation made in the 2001 Tobacco Control RIA that: *“any future requirements for pictorial and graphic contents take into account the likely financial and economic costs of implementation and that these be weighed against the likely health and economic benefits likely to arise.”*³³

7.3 Failure to estimate the benefits of the proposals

The LC Briefing Paper does not estimate the extent of the benefits of its proposals in order to establish that some form of government intervention is warranted. The APEC *Guidelines for the preparation, adoption and review of technical regulations*³⁴ are clear that *“once the nature of the problem is established, the magnitude of the problem must be assessed”*,

³² Expert Report of Professor Philip Zerrillo, June 2015, Paragraph 56.

³³ Regulatory Impact Assessment, *Proposed amendments to the existing smoking legislation*, Environmental Resources Management Limited, LC Paper No. CB(2)1/02-03(04), Dec 2001, page 107
<http://www.legco.gov.hk/yr02-03/english/panels/hs/papers/hs1025cb2-1-4e.pdf>

³⁴ *Guidelines for the Preparation, Adoption and Review of Technical Regulations*, APEC
http://www.google.co.uk/url?url=http://www.jsm.gov.my/documents/10180/86670/Guidelines%2Btechnical%2Bregulations.doc/8bce9281-59f4-4403-bc7d-5c9dbf35997f&rct=j&frm=1&q=&esrc=s&sa=U&ved=0CB4QFjABahUKEwio3e63sIfGAhXkKNsKHaTcAvA&usg=A FQjCNHe0Mkpx2A5xUFXEkebDhKg4cu_Yg

because “*the mere existence of a problem does not mean that Government intervention is warranted*”. It warns about the danger of over regulation: “*Over regulation occurs where the extent and/or nature of regulation is greater than what is needed to address a problem. This results in additional costs to the economy, for example through increased production costs, reduced competition, reduced innovation, or reduced customer choice.*”

8 Conclusion

The analysis in this report shows that the LC Briefing Paper does not include the necessary evidence or analysis to support the implementation of the proposed policy and does not provide proportionate evidence-based policy recommendations. It has not shown that the proposed increase in GHWs from 50% to 85% is necessary, appropriate or proportionate.

The LC Briefing Paper does not identify any problem with the existing 50% GHWs, establish why the incremental increase in size from 50% to 85% is necessary or what benefits it would provide over and above existing regulation or alternative measures. It fails to consider any evidence on the costs or benefits that might arise from the measure.

Taking all the concerns raised in this report together, it would be manifestly inappropriate to rely on the LC Briefing Paper to proceed with larger graphic health warnings.

SLG Economics Ltd

June 2015

Expert Report on Proposals to Increase the Size of Graphic Cigarette Warnings in Hong Kong

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Vanderbilt University

June 17, 2015

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Expert Report on Proposals to Increase the Size of Graphic Cigarette Warnings in Hong Kong

by Prof. W. Kip Viscusi

INTRODUCTION

1. My name is Professor W. Kip Viscusi. I am the University Distinguished Professor of Law, Economics and Management, Vanderbilt University, Nashville, Tennessee, United States. Further details of my qualifications and experience are outlined below.
2. I have been asked by British American Tobacco Company (Hong Kong) Limited to provide a report on the proposals that increase the size of existing graphic health warnings on cigarette packages in Hong Kong from 50% to 85% of the front and back surface area of cigarette packages. Specifically, I have been asked to provide a review of the empirical evidence and public health claims regarding the effect of graphic cigarette warnings on smoking behavior.
3. The principal sections of my report summarize my professional background, assess the effect of cigarette graphic warnings policies on trends in smoking prevalence in Hong Kong and other countries that have instituted such warnings, review the studies by the U.S. Food and Drug Administration of the effect of graphic warnings on smoking prevalence and on reported attitudes toward smoking, and consider the findings in the literature on surveys of the effect of graphic warnings on beliefs and intentions. The principal findings based on my assessment of the literature and available empirical evidence are summarized below.

- 3.1. The most meaningful test of the efficacy of graphic warnings for cigarettes is whether the graphic warnings policies that have been implemented have altered the temporal trend in smoking prevalence rates. Analysis of smoking trends in Canada, the U.K., and Australia fails to indicate any beneficial effect of graphic warnings when assessed either on a within country basis or in comparison to trends in the U.S. Empirical evidence also indicates that the introduction of 50% graphic warnings in Hong Kong in October, 2007 has similarly had no impact on reducing smoking prevalence. The downward smoking prevalence trend is similar to the U.S., which does not have graphic health warnings but only a small text warning. Neither increasing the warning size nor the use of graphic health warnings has been effective in reducing smoking prevalence rates.
- 3.2. Evidence demonstrates that the risks of smoking have been well publicized over the last several decades and that youth are well informed about the risks of smoking. Given that consumers are aware of the risks of smoking, there is no beneficial role for increased warnings. However, if there are concerns regarding the current warnings being worn out and lower levels of awareness of specific illnesses, these can be met by changing the current warning content. Increasing the size or format of the warnings is not needed and will not have any improved benefit in terms of reducing smoking rates.
- 3.3. The U.S. Food and Drug Administration (the "**FDA**") undertook a substantial statistical analysis to estimate the effect of the Canadian graphic warnings on smoking prevalence rates. In its preferred analysis that accounted for U.S. smoking trends and cigarette tax levels, the FDA found that the effect of graphic warnings on prevalence rates was less than one-tenth of 1 percentage point. In all of its statistical analyses all effects of graphic warnings on smoking prevalence were statistically equivalent to a zero effect.

- 3.4. The FDA also funded a large scale experimental survey that compared the efficacy of a wide variety of graphic warnings relative to text warnings that did not include the graphic information. There was no evidence of efficacy of graphic warnings in influencing smoking decisions of adults or younger age groups for any of the nine smoking risks that were studied.
- 3.5. To summarize, both the FDA's statistical analysis of the effect of graphic warnings in Canada and its large scale survey of the reported reactions to different graphic warnings discussed above found no evidence of a beneficial effect of graphic warnings on smoking behavior. These studies provide no evidence to support a claim that increasing the size of existing graphic warnings from 50% to 85% would have a beneficial effect on smoking behaviors.
- 3.6. Nevertheless, the FDA proceeded with a proposed graphic warnings regulation. However, the U.S. courts overturned this regulation in 2012 in *R.J. Reynolds Tobacco Co. v. Food and Drug Admin.* because, in the view of the Court: "FDA has not provided a shred of evidence—much less the 'substantial evidence' required by the APA [Administrative Procedures Act]—showing that the graphic warnings will 'directly advance' its interest in reducing the number of Americans who smoke."
- 3.7. The preponderance of other studies of graphic warnings is not informative as these studies typically ask people if the warnings provided information to them, or would alter their behavior, rather than assessing how warnings actually affect their risk beliefs and influence their smoking behavior. While there have been many claims of efficacy of graphic cigarette warnings, there is a profound gap between these claims and any

concrete evidence that graphic warnings are more effective than text warnings in altering risk beliefs or smoking behavior.

- 3.8. There is no sound basis in experimental data, survey data, or data on smoking behavior to conclude that larger graphic warnings are more effective in increasing risk awareness or reducing smoking behavior. It therefore cannot be expected that increasing the size of existing graphic warnings from 50% to 85% would have any impact on smoking behaviors.

EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE

4. I am the University Distinguished Professor of Law, Economics, and Management at Vanderbilt University, where I hold tenured appointments in the Vanderbilt University Law School, the Department of Economics, and the Owen Graduate School of Management. I have previously held tenured full professor positions at Harvard University, Duke University, and Northwestern University. I hold a Bachelor's degree in Economics, a Master's Degree in Public Policy, a Master's degree in Economics, and a Ph.D. degree in Economics, all from Harvard University. I graduated *summa cum laude*, Phi Beta Kappa, and won awards at Harvard University for the best undergraduate thesis and the best doctoral dissertation in economics.
5. My research focuses on societal and individual responses to risk and uncertainty, with particular emphasis on risks to health and safety. I have published over 340 articles and 20 books dealing primarily with health and safety risks. Most of these articles and books have been peer reviewed. I have been ranked among the top 25 economists in the world based on citations and have been ranked as the leading contributor to the health economics literature by *Health Economics* and the leading contributor to the risk and

insurance literature by *Journal of Risk and Insurance*. My research has won numerous article of the year and book of the year awards from organizations such as the Royal Economic Society and the American Risk and Insurance Association. I am the founding Editor of the *Journal of Risk and Uncertainty*, which is the leading international journal in its field and which I continue to edit.

6. My research currently focuses on how consumers make decisions involving products such as cigarettes and drinking water that may pose precisely understood risks and less well understood hazards. Much of my research has analyzed hazard warnings and how they affect consumer behavior. I have worked extensively with the U.S. Environmental Protection Agency (“EPA”), on a continuous basis from 1983 to 2012, serving in several different roles. Much of my work for the EPA has focused on the development of guidelines for the Agency for hazard warnings for dangerous pesticides and chemicals. These studies involved an experimental structure in which consumers reviewed different warnings, assessed the implied risks, and indicated the precautions that they would take in using the product. This work has appeared in numerous articles, and much of it is summarized in two books with Wesley Magat: *Learning about Risk: Consumer and Worker Responses to Hazard Information* (Cambridge: Harvard University Press, 1987), and *Informational Approaches to Regulation* (Cambridge: MIT Press, 1992). I have also written many articles and two peer reviewed books devoted to consumer decisions pertaining to smoking, *Smoking: Making the Risky Decision* (Oxford University Press, 1992) and *Smoke-Filled Rooms: A Postmortem on the Tobacco Deal* (University of Chicago Press, 2002).

7. In addition to my extensive work for the EPA, I have consulted for several other governmental entities on a variety of issues. I have also taught courses about risk, uncertainty, risk analysis, and hazard warnings to hundreds of FDA officials, congressional staff, and federal and state judges. I served as the Associate Reporter on The American Law Institute Study on Enterprise Responsibility for Personal Injury and co-wrote the chapter on Product Defects and Warnings. I have testified before Congress on nine occasions as an expert in economics and risk analysis. This testimony addressed such topics as, for example, alcoholic beverage warnings. Apart from my academic and governmental work, I have consulted on matters such as risk perception, hazard warnings design, and safety devices for large companies, including Bic, Dupont, Becton Dickinson, Bristol-Meyers Squibb, R. J. Reynolds, Anheuser-Busch, Black & Decker, and Medline Industries. My discussion below draws on my professional expertise and knowledge of the literature on risk and warnings.

EMPIRICAL EVIDENCE ON GRAPHIC WARNINGS AND SMOKING PREVALENCE

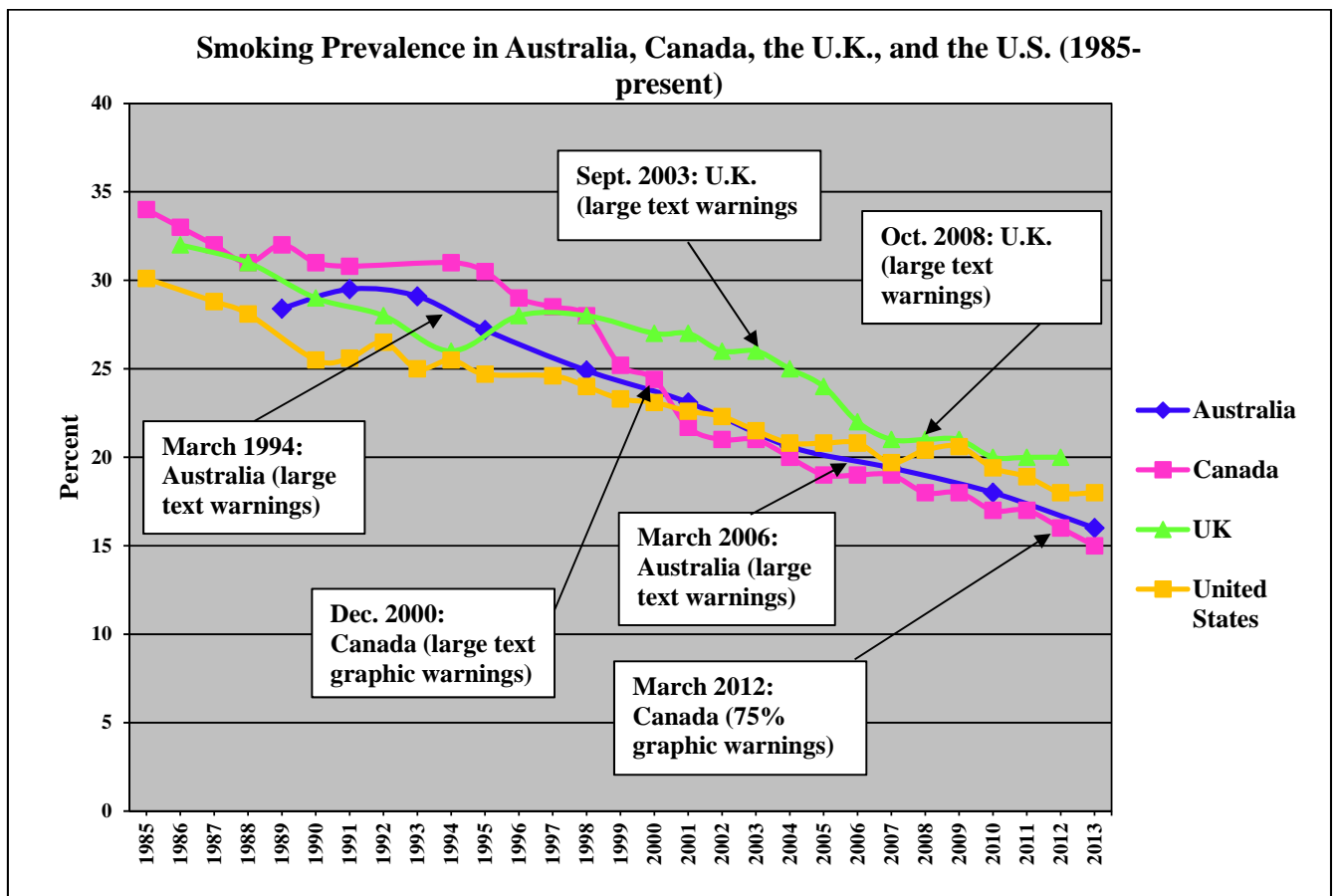
8. The most meaningful test of whether graphic warnings will have an effect on smoking behavior is to analyze the effect of these warnings on smoking prevalence in countries that have implemented these warnings. Before considering smoking prevalence trends in Hong Kong, I first present a graphical analysis of the performance of graphic warnings policies in Australia, Canada, and the United Kingdom. All three countries currently require that text and graphic warnings occupy a large proportion of the cigarette packaging, as described more fully below. Claims that graphic warnings have fostered quitting and other smoking related behaviors in Canada, Australia, and other

countries that have implemented these warnings, are unsupported by the data and can be rejected based on the statistics that I present and studies of the Canadian experience by the U.S. FDA.

9. Advocates of graphic warnings routinely cite studies in these countries that have shown that smokers claimed that the warnings would make them more likely to quit, and nonsmokers responded that they would be less likely to initiate smoking. However, despite the favorable evidence on stated smoking intentions and subjective assessments of the efficacy of graphic warnings, in fact these warnings have not influenced the pre-existing downward trend in smoking prevalence.
10. In Canada, cigarette packs have had on-product warnings since 1972. Large text only warnings, occupying 33% of the front and back of cigarette packets, were required from 1994 to 2000 and beginning from December 2000 to March 2012, cigarette packages were required to carry a warning on 50% of the front and 50% of the back of the packaging (one in English and the other in French). Beginning March 21, 2012, the required graphic warnings in Canada were increased to 75% on both the front and back of the cigarette package.
11. The United Kingdom previously employed large text warnings on cigarettes from September 2003 to October 2008. The warning on the front (30%) was one of the “general warnings” and the warning on the back of the pack (40%) was one of the “additional warnings.” From October 2008, cigarettes in England were required to include graphic warnings on 40% of the rear of the pack and a text warning on 30% of the front of the pack.

12. Australia has employed similar warnings on cigarette packs since 1994. From March 1994 to March 2006, the Australian warnings were required to include large text (25% of the front of the pack, and 33% of the rear of the pack). Australia implemented large size graphic warnings beginning in March 2006. These graphic warnings were required to cover 30% of the front of the package and 90% of the back, so that overall 60% of the front and back panels of a pack was appropriated for warnings. The size of the graphic warning on the front of the pack was increased to 75% on Dec. 1, 2012.
13. Despite the presence of these large text warnings and/or large text and graphic warnings on cigarette packaging in Canada, the U.K., and Australia, there is no evidence that the presence of these warnings produced a reduction in smoking among adults or youth in those countries based on analysis of smoking prevalence in each country. Smoking prevalence has declined over time and will continue to decline for a variety of reasons unrelated to cigarette warnings such as higher product taxes. Thus, simply noting that the smoking rate has declined is not a valid test of the efficacy of warnings. The appropriate test for an effect of the new warnings is whether graphic warnings have produced an acceleration of the pre-existing downward trend in smoking prevalence.
14. Inspection of the smoking prevalence trends provides a test of whether there has been a shift in prevalence trends for any particular country, and also a test of whether there has been a shift relative to the prevalence rates in the U.S., where there are no graphic warnings in place. Figure 1 below demonstrates that there has been no such shift in prevalence rates after the introduction of graphic warnings either based on the within country trends or comparison to the U.S.

Figure 1. Smoking Prevalence in Australia, Canada, the U.K., and the U.S. by Year

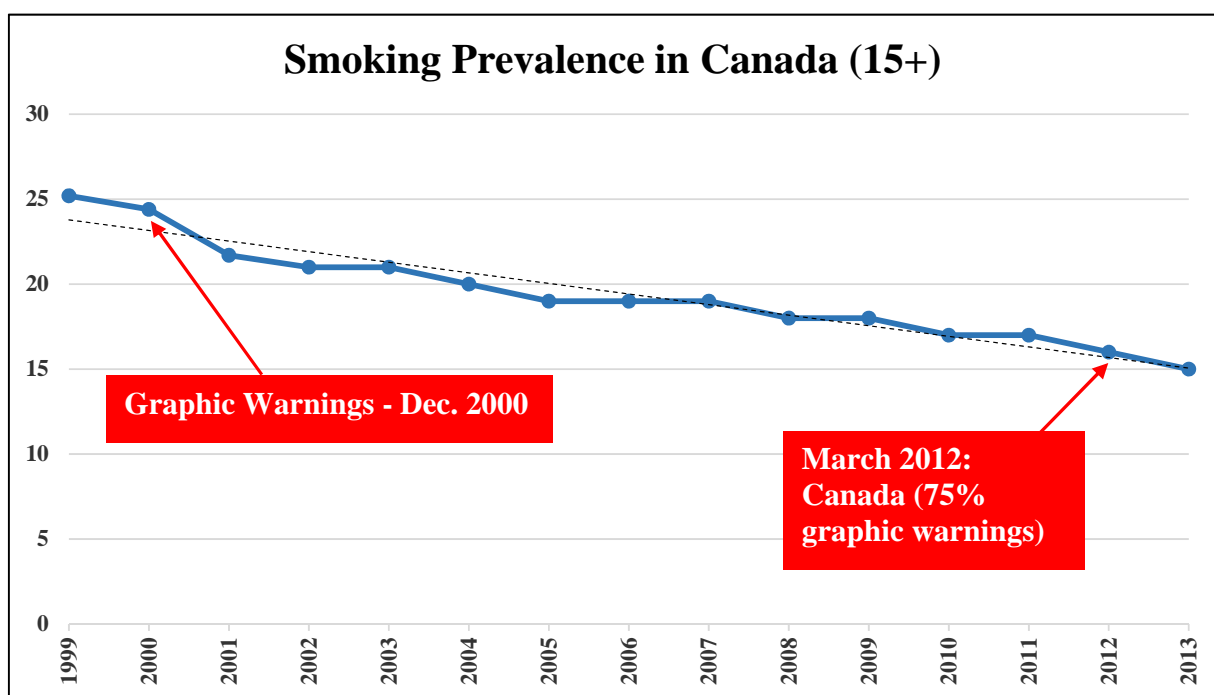


The smoking prevalence data for these countries were obtained from government sources. As indicated on the chart, these data include youth and adults.

15. In the case of Canada, which uses both large text, placed on the front and back of the pack, and graphic imagery regarding health effects of smoking, there is no apparent impact at all of the 50% graphic warnings or the increased size of these warnings to 75% on the pre-existing trend in smoking prevalence.
16. Figure 2 shows the smoking prevalence rates in Canada using a more consistent statistical series based on the 1999-2012 Canadian Tobacco Use Monitoring Survey (CTUMS) data and the Canadian Tobacco, Alcohol, and Drugs Survey, 2013 data. It

also indicates no evidence of an acceleration in the pre-existing smoking prevalence trend after the advent of the 50% graphic warning or the increased size of these warnings to 75%. The dashed trend line is based on a linear regression of the smoking prevalence rate against a time trend and a constant term.

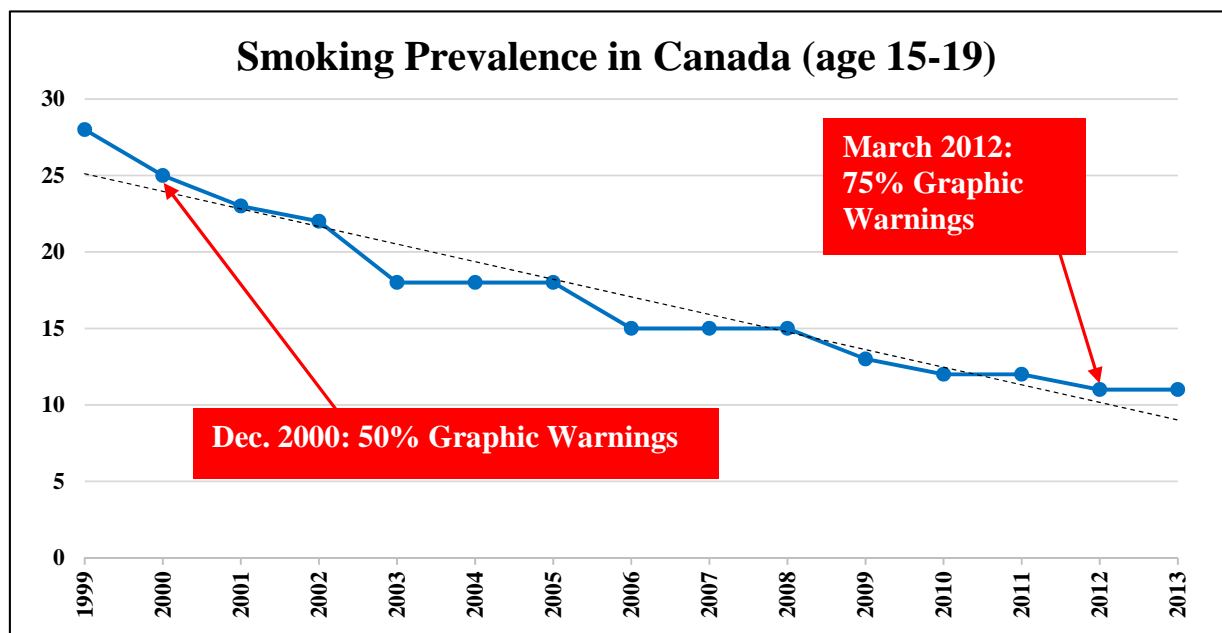
Figure 2. Smoking Prevalence in Canada (Ages 15+) by Year



17. The drop in smoking prevalence rates from 26% in 1999 to 16% in 2012 and 15% in 2013 reflects a steady downward trend. There is no apparent effect on smoking prevalence rates in Canada of either the 50% graphic health warnings or larger 75% graphic health warnings—despite having 14 years of data on smoking prevalence following the introduction of graphic health warnings.

18. A similar pattern is observed in Figure 3 for smoking prevalence rates since 1999 for the group that has exhibited a greater decline in smoking rates, those aged 15 to 19. Their smoking rate was 27.7% in 1999, which declined fairly steadily to 10.9% in 2012 and then to 10.7% in 2013. The 2013 smoking prevalence rate for those aged 15-19 reflects a continuation of past trends and is not even significantly different than the smoking prevalence rate before the advent of 75% graphic warnings. Figure 3 and the dashed trend line indicate this long run pattern.

Figure 3. Smoking Prevalence in Canada (Ages 15-19) by Year



19. The lack of any impact of these warnings in Canada—despite having 13 years of data on smoking prevalence following their introduction—vividly demonstrates simply assuming, on the basis of “common sense” or otherwise, that such warnings will reduce smoking, is unjustified based on real world experience.

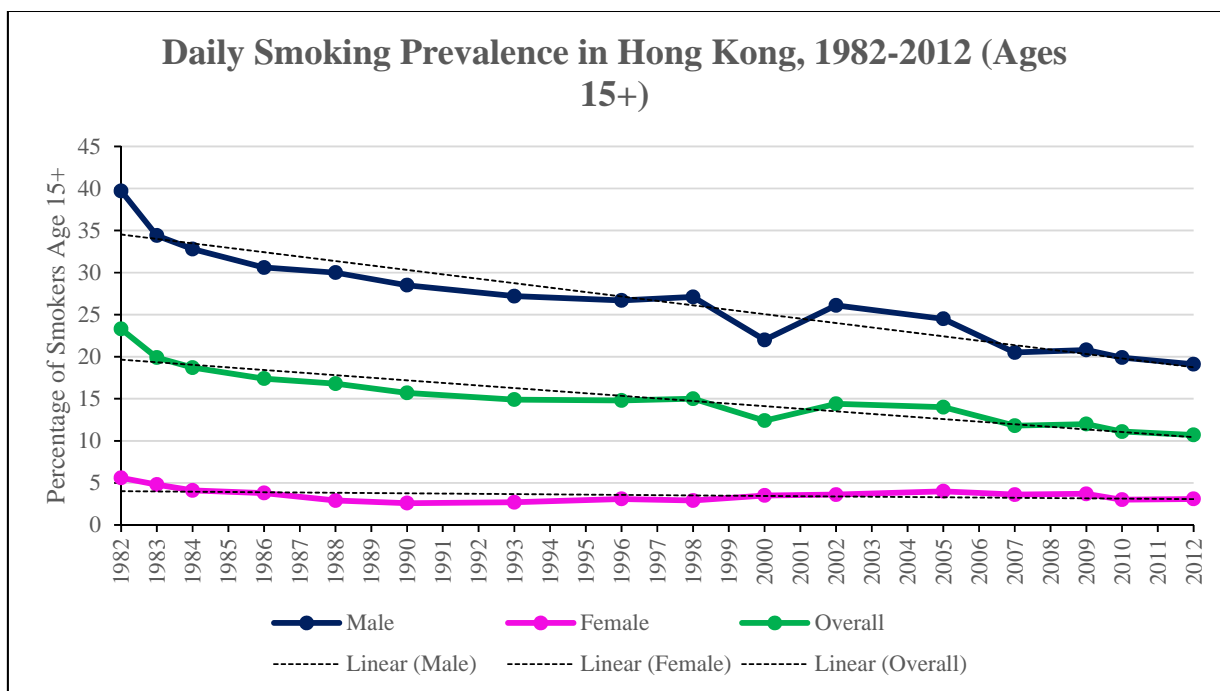
20. The data from the U.K. and Australia shown in Figure 1 are consistent and again reflect that when large warnings were adopted there was no acceleration of the pre-existing downward trend in smoking prevalence. In fact, the U.K. data demonstrates a flattening out of the decline in smoking prevalence in the first year after the large text warnings were introduced in 2003 and again when graphic warnings were introduced in 2008. This pattern is telling, as one would expect based on the novelty of the modified warnings that the best evidence of impact would be in the short term immediately following their adoption. Thus, data from the three countries discussed above all reflect real world applications of graphic warnings, but there is no evidence that such warnings had any effect on smoking prevalence.
21. An earlier study by Gospodinov and Irvine (2004) used micro data from the Statistics Canada data set to assess warnings that they characterized as “gruesome” with large font vivid text messages plus images. Consistent with my analysis of the chart above, the authors concluded that the new warnings had no effect on smoking prevalence.
22. Likewise the Public Health Research Consortium (2010) for the U.K. Department of Health concluded that health warnings did not alter behavior even though they have been effective generally in reaching the public. Data for this study were based on a subsample for respondents to the Health Survey for England 2007/2008. Despite the visibility of the graphic warnings and evidence that the public had received the warnings, there was no fundamental change in risk beliefs or behavior after the advent of graphic warnings. More specifically, the report concluded: “The range and depth of knowledge about the health risks of smoking did not change after the pictures were introduced.” The overall impact of the graphic warnings was limited. “There were very

few smoking-related behavior changes observed after the pictures were introduced.”

The warnings had a “negligible” impact on young people.

23. The introduction of 50% graphic warnings requirement in Hong Kong on October 27, 2007 similarly had no impact on reducing smoking prevalence. Figure 4 indicates trends in daily smoking prevalence for ages 15+ for males, females, and overall. In each case, the daily smoking prevalence rates follow the dashed linear trend line in a steady manner. There is no evidence of a break in the trend in 2008. For example, the overall daily smoking prevalence rate was 11.8 in 2007 and 12.0 in 2009.

Figure 4. Daily Smoking Prevalence in Hong Kong (Ages 15+) by Year



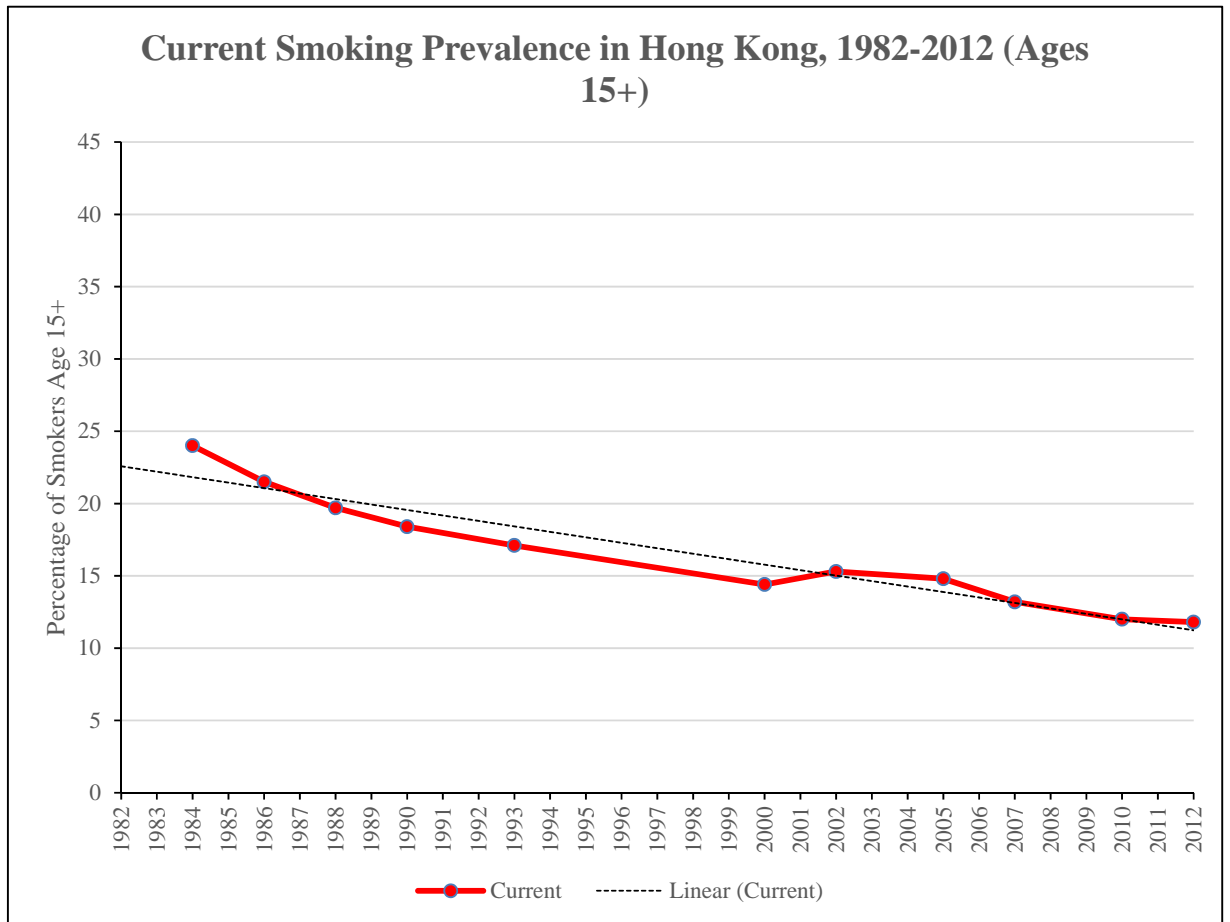
24. The lack of any effect that is apparent visually is also borne out in a formal statistical analysis. A regression of the smoking prevalence rate on a constant term, a time trend variable, and an indicator variable for the 2008-2012 post-graphic health warnings

period fails to show any statistically significant drop in daily smoking prevalence rates starting in 2008. Indeed, while the effect is not statistically significant, the results indicate a positive rather than a negative effect on daily smoking prevalence rates.

These results continue to hold if the statistical analysis also accounts for changes in the level of cigarette duties. For all three daily smoking measures shown in Figure 4, there is no evidence that graphic health warnings have reduced smoking prevalence rates.

25. Figure 5 presents information on current smoking prevalence rates in Hong Kong, which is a more inclusive category than daily smoking prevalence. Current smoking prevalence rates include daily smoking and occasional smoking. The data series used to construct the current rates are drawn from different data eras. The patterns shown in Figure 5 indicate a steady downward trend throughout the 1982-2012 period, with no evident shift starting in 2008. Focusing on the consistent data series starting in 2000 also indicates a steady trend with no evident shift, as current smoking prevalence rates are 13.2% in 2007 and 12.0% in 2010, a difference that is consistent with the general downward trend. Formal statistical analysis using regression models indicates no statistically significant shift in smoking prevalence rates after accounting for the general trend. This absence of any impact also holds true after including the level of excise duties in the statistical analysis.

Figure 5. Current Smoking Prevalence in Hong Kong (Ages 15+) by Year



WHY GRAPHIC HEALTH WARNINGS DO NOT ALTER SMOKING PREVALENCE RATES

26. It is generally recognized that one of the most remarkable public health achievements of the last half century has been the communication of the risks of smoking to the public and the success of various cigarette warnings efforts in reducing smoking rates. In 1964, the US Surgeon General issued a report concluding that cigarette smoking was causally related to lung cancer in men. The report attracted widespread international attention, and was followed in subsequent years by numerous additional reports including reports by the US Surgeon General and the Royal College of Physicians in the United Kingdom

that considered the relationship between cigarette smoking and a myriad of specific illnesses and diseases, such as lung cancer, cardiovascular disease, and chronic obstructive lung disease. Similar information has been publicized in a variety of ways over the last several decades, including in schools and the news media, and by public health organizations.

27. The public, including youth are well informed about the risks of smoking. Statistics reflect the widespread exposure of the public to anti-smoking messages, and indicate universal awareness of the potential health consequences of smoking. Youth are often taught about the dangers of smoking in schools, and are targeted in media campaigns that warn of possible health risks.
28. Warnings on cigarette packets have reinforced the media coverage of smoking risks. Much of the effect of these warnings stemmed not from the wording or size of the warnings but from the fact that cigarettes were one of the first mass marketed consumer product to have safety warnings pertaining to inherent risks associated with the product. Once a warning has achieved noticeability, increasing the warning size or prominence does not have an influence on risk beliefs or smoking behaviors. Eventually there is diminishing marginal effectiveness of making any warning more prominent.
29. Awareness of the risks of smoking in Hong Kong is effectively universal. Mackay et al. (1986) notes that "[b]y the end of 1983, 95% of the population were not only aware of the government's publicity but also believed that smoking was harmful." Lam et al. (2002) also state "[t]he respondents' knowledge about the health risks associated with active and passive smoking and levels of experience of discomfort and symptoms from exposure to passive smoking was high. Ninety seven per cent agreed that smoking is

hazardous to health." The 2009 Global Youth Tobacco Survey (GYTS) data also establishes an overwhelming level of youth awareness that smoking is harmful, with 95.4 % of respondents answering 'Definitely Yes' (89.8% %) or 'Probably Yes' (5.6%) to the question 'Do you think cigarette smoking is harmful to your health?'

30. Given that the public are aware of the risks of smoking, there is no beneficial informational role for increased warnings. In the absence of any effect of additional warnings on risk beliefs, one would not expect that warnings that reiterate what consumers already know would alter smoking behavior. It is well documented that reminder warnings do not alter consumer or worker behavior. Independent studies have also demonstrated that further attempts to modify consumer behavior are misguided if they are premised on the notion that people lack adequate information about smoking. The Surgeon General addressed this topic at some length in her 1994 report entitled "Preventing Tobacco Use Among Young People, A Report of the Surgeon General" ("1994 SGR"). There, the Surgeon General explained her conclusion as follows: "In the 1960s and early 1970s, strategies to prevent the onset of cigarette smoking were often based on the premise that adolescents who engaged in smoking behavior had failed to comprehend the Surgeon General's warnings on the hazards of smoking. The assumption was that these young people had a deficit of information that could be addressed by presenting them with health messages in a manner that caught their attention and provided them with sufficient justification not to smoke." However, "[c]omprehensive reviews published at that time concluded that smoking-prevention programs based on the information deficit approach were not effective." Consequently, a wave of prevention programs developed in the late 1970s and throughout the 1980s

that fundamentally redefined the concept of adolescent smoking prevention. These smoking prevention programs “focus[ed] particularly on social influences, norms, and skills training.” According to the Surgeon General, “[o]nly the social influence approaches have been scientifically demonstrated (through replicated research studies) to reduce or delay adolescent smoking.” The 2012 Surgeon General report updates these assessments and reiterates this position.

31. Studies also demonstrate that applying different warning formats (e.g., use of warning colors, safety symbols, signal words, etc.) to information does not increase behavioral compliance. Bolder warnings do not convey unknown information and telling people something that they already know in **bold** letters or **LARGE TYPE FACE** or with graphics does not change that. There is no empirical evidence that “shouting” works in increasing behavioral compliance in this context.
32. A substantial literature also demonstrates that factors other than a lack of awareness of the risks of smoking are the main determinants of smoking initiation. The causes of youth smoking have been the subject of two reports by the U.S. Surgeon General as well as dozens of studies throughout the world. As the review below indicates, the key contributing factors to smoking initiation by youths are influences involving one’s parents, siblings, friends, peers, access to cigarettes, personal characteristics, and cost.
33. The U.S. Surgeon General (1994) report listed factors driving initiation such as low socioeconomic status, peer and sibling use and approval of tobacco, lack of parental support, low levels of academic achievement, and low self-image. The more recent U.S. Surgeon General (2012) report reiterated these themes and added emphasis on the high accessibility and availability of tobacco products, such as obtaining tobacco products

from parents, siblings, or peers. More generally, parental support, social norms, use by friends, and religion are among the other causal factors cited.

STUDIES BY THE U.S. FOOD AND DRUG ADMINISTRATION

34. To test for the likely effect of graphic warnings, the U.S. FDA undertook two types of studies assessing the effect of graphic warnings. The first line of inquiry consisted of statistical analyses of the effect of graphic warnings on smoking prevalence rates in Canada. The other approach used was a large scale experimental study of the effect of different types of graphic warnings. Neither type of study indicated that there would be an effect of graphic warnings on smoking behavior. These studies provide no evidence to support a claim that merely increasing the size of existing graphic warnings from 50% to 85% would have a beneficial effect on smoking behaviors.
35. The first set of studies analyzed smoking prevalence trends as illustrated above and tested statistically whether the Canadian graphic warnings reduced smoking prevalence rates. The FDA undertook two such statistical studies, a 2010 study that ignored changes in cigarette tax rates and a 2011 study that incorporated recognition of the effect of cigarette taxes on smoking prevalence. Neither of these studies succeeded in demonstrating any effect of graphic warnings in Canada.
36. The 2010 study by the FDA used the U.S. smoking prevalence trends as a reference point for what trends in Canada would have been in the absence of graphic warnings. The FDA found in its preferred analysis that graphic warnings reduced smoking prevalence rates by 0.212 percentage points from 2001-2008 as compared to 1999-2000. If the trends in the U.S. are ignored, then the graphic warning level effect could be 1.648 percentage points, but the FDA did not consider this to be a valid statistical test and, as

in the case of the lower estimate, one could not reject the statistical hypothesis that there was zero effect of the graphic warnings. The FDA concluded that the “effectiveness estimates are in general not statistically distinguishable from zero.”

37. Although the 2010 study took into account smoking trends, it ignored changes in the price of cigarettes, which may have been related to other changes in cigarette policies. Thus, even these studies indicating a zero effect of graphic warnings may have overstated the efficacy of graphic warnings. In 2011 the FDA updated its analysis to account for cigarette tax changes, finding an estimated effect of graphic warnings of 0.574 percentage points in a comparison of 2001-2009 to 1994-2000 if the analysis ignores the U.S. smoking trends. However, if both taxes and the U.S. experience are included as controls, which the FDA indicates is the FDA’s “preferred estimation method,” then the estimated effect of graphic warnings is 0.088 percentage points. The FDA is correct in preferring a statistical approach that accounts for cigarette tax changes and accounts for U.S. smoking trends so as to control for what Canadian trends would have been without the graphic warnings. After making these adjustments, the FDA estimates that the effect is less than one-tenth of a percentage point. Not surprisingly, the FDA concluded that their “effectiveness estimates are in general not distinguishable from zero; we therefore cannot reject, in a statistical sense, the possibility that the rule [requiring graphic warnings] will not change the U.S. smoking rate.”
38. As a second level of analysis the FDA commissioned a survey to measure consumer attitudes, beliefs, perceptions, and intended behaviors related to cigarette smoking in response to graphic warning labels (the “**FDA Study**”). The FDA Study included approximately 18,000 participants and is the largest survey of stated consumer responses

to cigarette graphic health warnings ever conducted. This study tested the relative efficacy of 50% graphic warnings relative to a control of a text warning statement only. The control group viewed a pack of cigarettes with just a text warning statement presented on the side of the packet in accordance with the current standard warning on cigarette packets in the US. The treatment groups (exposed to warning images) viewed a hypothetical pack of cigarettes that included the graphic warning label. The FDA Study failed to find a consistent pattern of significant effects on risk beliefs for a wide variety of possible graphic health warnings. Notably, the authors concede that “[t]he graphic cigarette warning labels did not elicit strong responses in terms of intentions related to cessation or initiation.”

39. The study design is less informative than examination of smoking prevalence trends for a number of reasons. The study presented respondents with computer images of different graphic warnings and compared their smoking attitudes and stated smoking intention responses to those elicited without the use of graphic warnings. This design does not in fact measure actual behavior (e.g., quitting smoking) following exposure to these messages. Rather, it employs a proxy measure—stated intention to quit—that is known to be unreliable and inaccurate and that undoubtedly overestimates actual behavior. Many smokers who indicate an intention to quit make no effort to do so. This may be attributable to social-desirability bias associated with questions pertaining to this and similar subjects. Consequently, quit intentions such as this tend to significantly overestimate the number of smokers who actually intend to quit as a result of the proposed warning. There was no effort to account for this bias other than to acknowledge it.

40. The researchers did not take advantage of the opportunity to see if people actually changed their behavior after seeing the graphic warnings. Interestingly, even though respondents were re-contacted a week after as part of the study, those who indicated previously that they intended to quit were not asked if they had in fact taken any steps to do so.
41. Putting aside these methodological limitations, it is clear from the data that these warning labels were ineffective at increasing smokers' stated intentions to quit. The study considered nine different cigarette warnings for which the study examined an average of four different graphics approaches for each warning. The consistent result was that irrespective of the warning or the graphic illustration accompanying it there was no evident effect on quit intentions or other smoking-related behaviors for any of the sample groups.
42. Finally, this study also sought to assess the impact of the proposed graphic warning labels on discouraging smoking initiation among youth respondents. Even accepting the research design at face value, the FDA Report concluded that the data do not support the conclusion that exposure to the graphic warning labels will discourage smoking initiation. (*"For youth, we used a measure of how likely [they] felt they were to be smoking 1 year from now as a measure of the impact of viewing the warning images on potential initiation. We did not find much evidence for an impact of the warning labels on this outcome."*). This study failed to find any demonstrable impact of graphic warnings over and above text warnings, on intentions related to smoking initiation or cessation. Given these outcomes, it cannot be expected that merely increasing the size

of existing graphic warnings from 50% to 85% would have any impact on smoking behaviors.

43. Notwithstanding that its own analysis and study did not find any support for the effectiveness of proposed graphic warnings, the U.S. FDA proceeded to introduce the warnings. However, the U.S. courts overturned this regulation in 2012, finding that the proposed graphic warnings were unconstitutional. The U.S. Court of Appeals for the D.C. Circuit concluded, as I did in my discussion above, that there is a consistent lack of evidence in support of the efficacy of graphic warnings based on the results of either FDA's major survey of different graphic warnings approaches or its statistical analysis of the Canadian graphic warnings experience. The Court stated:

"FDA has not provided a shred of evidence—much less the “substantial evidence” required by the APA [Administrative Procedures Act]—showing that the graphic warnings will “directly advance” its interest in reducing the number of Americans who smoke. FDA makes much of the “international consensus” surrounding the effectiveness of large graphic warnings, but offers no evidence showing that such warnings have *directly caused* a material decrease in smoking rates in any of the countries that now require them. While studies of Canadian and Australian youth smokers showed that the warnings on cigarette packs caused a substantial number of survey participants to think—or think more—about quitting smoking, Proposed Rule at 69,532, and FDA might be correct that intentions are a “necessary precursor” to behavior change, Final Rule at 36,642, it is mere speculation to suggest that respondents who report increased thoughts about quitting smoking will actually follow through on their intentions. And at no point did these studies attempt to evaluate whether the increased *thoughts* about smoking cessation led participants to actually quit. Another Australian study reported increased quit *attempts* by survey participants after that country enacted large graphic warnings, but found “no association with short-term quit success.” Proposed Rule at 69,532. Some Canadian and Australian studies indicated that large graphic warnings *might* induce individual smokers to reduce consumption, or to help persons who have already quit smoking remain abstinent. *See id.* But again, the study did not purport to show that the implementation of large graphic warnings has *actually* led to a reduction in smoking rates.

FDA's reliance on this questionable social science is unsurprising when we consider the raw data regarding smoking rates in countries that have enacted graphic warnings. FDA claims that Canadian national survey data suggest that

graphic warnings may reduce smoking rates. But the strength of the evidence is underwhelming, making FDA's claim somewhat misleading. In the year prior to the introduction of graphic warnings, the Canadian national survey showed that 24 percent of Canadians aged 15 or older smoked cigarettes. In 2001, the year the warnings were introduced, the national smoking rate dropped to 22 percent, and it further dropped to 21 percent in 2002. *Id.* at 69,532. But the raw numbers don't tell the whole tale. FDA concedes it cannot directly attribute *any* decrease in the Canadian smoking rate to the graphic warnings because the Canadian government implemented other smoking control initiatives, including an increase in the cigarette tax and new restrictions on public smoking, during the same period. *Id.* Although FDA maintains the data "are suggestive" that large graphic warnings "may" reduce smoking consumption, *id.*, it cannot satisfy its First Amendment burden with "mere speculation and conjecture." *Rubin*, 514 U.S. at 487, 115 S.Ct. 1585.

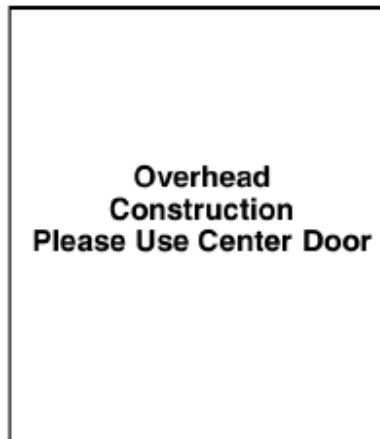
FDA's Regulatory Impact Analysis ("RIA") essentially concedes the agency lacks any evidence showing that the graphic warnings are likely to reduce smoking rates...In light of the number of foreign jurisdictions that have enacted large graphic warning labels, the dearth of data reflecting decreased smoking rates in these countries is somewhat surprising, and strongly implies that such warnings are *not* very effective at promoting cessation and discouraging initiation."

FINDINGS IN THE PUBLIC HEALTH LITERATURE

44. There have been numerous articles that have attempted to assess the effect of graphic warnings on smoking behavior and which have asserted, without sound empirical support, that graphic plus text warnings are significantly more effective than text only warnings in influencing consumer behavior.
45. The 2012 report by the U.S. Surgeon General provides an overview of the studies of what the report terms "pictorial health warnings" related to cigarettes. There are two principal questions with respect to assessing the efficacy of such warnings. First, do graphic warnings communicate the risks more effectively than text only warnings and alter risk beliefs? Doing so is presumably a prerequisite to altering behavior. Second,

do graphic warnings lead to changes in smoking related behavior by fostering smoking cessation and decreasing smoking initiation?

46. The types of evidence in the literature that is reviewed by the U.S. Surgeon General do not address either of these questions in a meaningful way. With respect to risk beliefs, the U.S. Surgeon General relies on studies where respondents in focus groups and other survey contexts report that they thought that graphic warnings were more likely to be noticed, thought about and more likely to be recalled, and communicated the risks better. But none of these subjective responses indicates that graphic warnings actually altered risk beliefs with respect to cigarettes more than do warnings without pictorial information. Moreover, informal focus group and survey evidence of this type is subject to serious “demand effects,” whereby the respondent gives the answer that he or she believes the survey administrator or the focus group leader wants to hear. Asking respondents if they thought graphic warnings would affect their beliefs is not a substitute for determining whether graphic warnings actually alter beliefs.
47. Further, studies demonstrate that survey respondents' predictions of the impact of warnings are unreliable and that people dramatically overstate the likelihood of compliance with warnings. For example, Frantz et al. (2005) examined the extent to which predicted responses to different warnings signs and labels correspond with actual responses. Participants were shown a pair of warnings for: (1) car sun visor labels for lap belts, (2) file cabinet tipping labels, (3) construction hazard signs, and (4) laboratory warning signs. For example the construction hazard signs shown to participants were:



Non-ANSI



ANSI-1



ANSI-2

And the two laboratory warning signs shown to participants were:



Less ANSI



More ANSI

48. These signs had the same general message wording but were formatted very differently (with a text only sign that that was less consistent with ANSI (the American National Standards Institute) and ANSI-style signs with bolder larger text, color and symbols). Participants were asked to predict how many people, out of 100, would (a) notice the signs and (b) comply with the warnings. The results showed that most participants thought the ANSI-style signs would elicit significantly greater compliance than the 'Non ANSI' or 'Less ANSI' signs. However, results showed no difference between the signs regarding compliance rates. The authors concluded that: *"[t]he present study generally replicated the findings of Laughery et al. (2002) for participants' predictions of the extent to which people would notice and/or comply with warnings. Participants in the present study consistently and incorrectly reported that people would be more likely to notice and more willing to comply with warnings that had greater conformance to ANSI as opposed to less. The present study shows that these ratings have little or no utility in predicting people's actual behavior in response to the warnings."*
49. The second and more fundamental issue pertaining to graphic warnings studies is whether they demonstrate that there will be concrete, demonstrable effects on smoking behavior. The studies reviewed by the U.S. Surgeon General do not consider any behavioral changes. Rather the studies report that respondents indicate that after being shown graphic warnings they "thought about quitting and forgoing cigarettes," stated that they had "increased motivation to quit smoking," or that an "intention to smoke was lower among those students who had talked about the warning labels and had forgone cigarettes." Unlike the FDA study, most of these studies do not compare the efficacy of graphic warnings to similar warnings without the pictorial information so that the

experiments are not designed to provide a proper test of the graphic warnings component. In addition, stated quit intentions in surveys and stated intentions to not start smoking are quite different matters than actual behavior, and none of the studies document any behavioral consequences of graphic warnings.

50. Other studies that deal with the effect of graphic warnings on smoking risk beliefs and behaviors have similar limitations to those reviewed by the U.S. Surgeon General. With respect to smoking risk beliefs, such studies rely on smokers' perceptions of the effectiveness of graphic warnings without documenting any change in risk beliefs induced by warnings or indicating the effect of graphic warnings relative to comparable text only warnings. Studies pertaining to smoking behavior adduce evidence consisting of subjective inferences and self-reports, which are no substitute for empirical evidence of whether graphic warnings have actually been effective in changing smoking behaviors. Some studies have offered evidence that calls to smoking toll-free helplines increased after contact information was included in the warnings as evidence of efficacy in altering cessation, but no studies have provided a link between these calls and cessation behavior.
51. A tobacco-related study that documents the role of informational saturation with respect to the size of cigarette warnings is the study by Bansal-Travers et al. (2011). Respondents addressed the question of which cigarette they would buy if they were trying to reduce the risk to their health. The percentage choosing cigarette packages with different warning labels was 34 percent for warnings comprising 30 percent of the label, 11 percent for warnings comprising 50 percent, and 53 percent for the warning comprising 100 percent of the label. This U-shaped pattern of concern for averting risk

and its relation to the percentage of warning on the pack implies that there is no consistent relationship at all between the amount of warning information and choices based on health risk. And once again, the study's focus avoids the more fundamental issue of whether increasing the warning label's percentage significantly affects whether the warning is read, understood, and leads people to have more accurate risk beliefs. And if there are such effects, will they be observed for regular smokers rather than in a one-time experiment?

52. A rationale often made for new warnings policies is that warnings policies are subject to a "wear-out effect." That is, over time, people read the warnings less frequently. In terms of the theory of hazard warnings that type of behavior is exactly what one expects, but it does not indicate a failure of the warnings policy. Once a person has read and acquired the information, it is not necessary to reread the information repeatedly in order to understand the information. Failing to reread the warning does not imply that the person does not know the information included in the warning. Moreover, if the objective is to only deal with such a "wear-out effect," that can be accomplished by a change in the warning message. Increasing the size of the warning from 50% to 85% is not needed and will not have any improved benefit in terms of reducing smoking rates.
53. It is also often claimed that that consumers do not have an adequate perception of specific health risks. However, such concerns can be met by changing the current warning content and do not require increasing the size of the warnings.

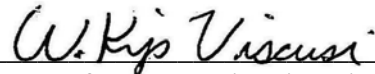
CONCLUSION

54. The available evidence on the efficacy of graphic warnings is substantial and provides a consistent basis for assessing the impact of graphic warnings. Overall, there is a

profound gap between the claims of efficacy of graphic warnings and evidence of actual impacts. Studies in the literature in support of graphic warnings have relied on subjective reports of assessments of the warnings, claims of likely effects on behavior, and study designs that generally fail to compare the graphic warnings to a text only counterpart. Moreover, even if the reported effects are taken at face value there is no way to translate this evidence into a predicted effect of graphic warnings.

55. The best evidence on the effect of graphic warnings should rely on actual policy impacts rather than hypothetical or experimental effects. Because graphic warnings policies have been in place in many countries, undertaking such an assessment is feasible. Examination of the effect of graphic warnings in Canada, Australia, and the U.K. indicates that there has been no effect on the trend in smoking prevalence rates. Additionally, a statistical analysis of the Canadian data by the U.S. FDA found that any effects of graphic warnings cannot be distinguished statistically from a zero effect. The introduction of graphic warnings in Hong Kong in 2007 has similarly had no impact on reducing smoking prevalence. The continued downward trend in smoking prevalence rates in Hong Kong is similar to that in the U.S., which has no graphic health warnings and only smaller text warnings. Graphic health warnings and larger warnings do not enhance the efficacy of warnings in influencing smoking prevalence rates.
56. However, if there are concerns regarding the current warnings being worn out and lower levels of awareness of specific illnesses, these can be met by changing the current warning content. Increasing the size of the warnings is not needed and will not have any improved benefit in terms of reducing smoking rates.

57. The U.S. courts concluded that there is not “a shred of evidence” indicating that larger graphic cigarette warnings will be effective in reducing smoking prevalence. There is no sound basis in experimental data, survey data, or data on smoking behavior to conclude that larger graphic warnings are more effective in increasing risk awareness or reducing smoking behavior. It cannot be expected that merely increasing the size of existing graphic warnings from 50% to 85% would have any impact on smoking behaviors.



Professor W. Kip Viscusi

Expert Report of Professor Philip Zerrillo, Ph.D.

Hong Kong

June 18, 2015

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Expert Report of Philip Zerrillo, Ph.D.

I. Introduction

A. Qualifications

1. My name is Philip Zerrillo. I am a Full Professor in the Marketing department at Singapore Management University. In addition, I have several other responsibilities at the university. I am the Dean of Post Graduate Professional Programmes, in which I develop, administer and govern graduate degree programmes in the areas of Business, Economics, Law, Accounting, Social Sciences and Information Systems. Additionally, I am the Executive Director of the Center for Practice Management, the Academic Director of the PhD in General Management, and the Executive Director and founder of the university's case writing initiative. I am also the Vice Dean of the Lee Kong Chiang School of Business.
2. I am also Executive Chairman of the Board for the Masters in Marketing (MIM) programme at Thammasat University in Thailand. I have taught graduate level courses in marketing channels and marketing strategy for 17 years in this programme. I also teach a doctoral level seminar on teaching effectiveness at Thammasat University, and am a member of the board of directors for the School of Accountancy and Commerce.
3. I am the Dr. Bienvenido Tontocco, Distinguished Chaired Professor in Retailing, at Jose Rizal University (Philippines).
4. Previously, I was a Visiting Professor at the J.L. Kellogg Graduate School of Management of Northwestern University, where I taught courses on marketing management, distribution channel management and marketing strategy. Before that, I served as the Associate Dean and Director of Executive Education at the McCombs School of Business and the Graduate Dean and Director of Graduate Studies at the college. In addition, I have taught at numerous other universities, internationally in Asia, Europe, the Middle East and the United States.
5. My field of expertise is marketing and in particular managerial marketing as it is applied in the field. I have taught graduate school courses in many management and marketing subjects, including branding and brand management. In these courses I have covered topics such as brand value, creation of new brands, brand competition, pricing, and strategy.
6. I hold a Ph.D. in Marketing from Northwestern University's J.L. Kellogg Graduate School of Management, and an undergraduate degree from The University of Texas (BBA). After my undergraduate studies I spent seven years in the finance industry, before entering the Ph.D. program. This background has given me practical insights into the financial performance of the marketing and branding functions of firms. True to this

background, much of my post graduate professional work has focused on market actions and their impact on the financial performance of firms.

7. I am a member of the Board of Directors of Sharps Compliance (NASDAQ: SMED) and have been since 1998. In my role as a board member I am currently chairman of the audit and governance committees.
8. I have consulted with numerous firms in areas such as hi-tech, oil and gas, consumer electronics, internet, metal fabrication, health and fitness, tobacco, alcohol and consumer packaged goods. I have conducted, supervised, evaluated or reviewed a great number of marketing research studies in my various roles as thesis supervisor, Ph.D. advisor, ad hoc reviewer for The Journal of Marketing and The Journal of Marketing Research and as a consultant to industries.
9. Further information about my academic and professional qualifications is provided by my curriculum vitae in Appendix A.

B. Scope of Assignment

10. I have been asked by British American Tobacco Company (Hong Kong) Limited ("**BAT (HK)**") to submit this report describing the importance of trademarks and the brands that they represent, and how they affect consumers, manufacturers, competition in the marketplace, and international trade. I have been asked in particular to opine upon the ramifications to trademarks and brands that will result from the proposed regulation to increase the size of the graphic health warnings (hereinafter "GHWs") on cigarette packages in Hong Kong to cover 85% of the package surface area, and the resulting impact on consumers, manufacturers and the marketplace. In particular, I have been asked to examine these issues in the context of Hong Kong where brand communication is highly restricted, including an extensive ban on tobacco advertising and sponsorship, and GHWs already occupy 50% of the cigarette package surface area.
11. To write this report, I have relied upon my own expertise in marketing and branding (described above). I also have reviewed and considered a wide range of authoritative writings on marketing and branding by experts in the field. Appendix B lists the materials that I considered in the course of my investigation. This report contains my findings and opinions as of the submittal date.

C. Summary of Opinions

12. It is my expert opinion that:
 - a) Trademarks (such as words, logos, images, designs or combination of these elements) and packaging are vital to brands.

- b) Trademarks perform valuable functions for both consumers and the firms that own them. A trademark identifies the brand and differentiates the product performing important navigation and reassurance functions for consumers. It signals the source or origin of the product and, as such, aids the consumer's navigation among competing products. Trademarks also symbolize a product's quality and features, and guarantee that the goods or services measure up to expectation. The existence of trademarks, and the brands they represent, is particularly important for effective market competition, as they enable firms to uniquely identify and differentiate their products other than on the basis of price alone. For manufacturers, the protection of the intellectual property rights afforded to trademark owners means that the firm can invest in the trademark and the associated brand with confidence. In addition to the firm's ability to obtain the benefits of its valuable asset sustained over time, it provides an incentive for the firm to create greater value for all stakeholders including consumers.
- c) Increasing the size of GHWs to cover 85% of the cigarette packages will make it impossible for manufacturers to use some trademarks as registered (including logos and labels) and for them to use other trademarked elements effectively. Trademarks will not be able to adequately serve their essential functions of differentiating products and uniquely identifying their origin and quality.
- d) In Hong Kong, the extensive ban on advertising and sponsorship of cigarettes means that the limited space available on cigarette packs for trademarks is the only tool manufacturers have to identify and differentiate their products from other competitive offerings. A further reduction in this already limited space will minimize or even eliminate any meaningful use of trademarks and, in doing so, destroy their value. As a result, decades of investment in brands and their related trademarks, along with their inherent goodwill, will be lost.
- e) Brands including trademarks play an important role in the cigarette market, and their erosion or elimination changes the nature of the market. In general, markets without brands become price-driven commodity markets.
- f) Commodity markets produce lower prices that encourage more consumption. Commodity markets also make the market inhospitable to firms trying to enter the market and for existing brands, particularly small brands, to compete for a greater market share. Commoditization of the cigarette market in Hong Kong and a shift to pure price driven competition could also lead to an increase in illicit trade because without the added value of brands, legitimate products will be less clearly differentiated from illicit products.
- g) Ultimately, in a commoditized cigarette market in which consumers are price sensitive and the ability to identify the products of a firm is severely limited, the incentives to invest in better quality or better service will be reduced.

- h) Moreover, firms that do not have a well-known brand would be incentivized to compete only on price and reduce the quality of their goods, ultimately affecting the consumer. The relationship between consumers and their brands is a very important means to incentivize manufacturers to honor that relationship and not behave in a purely transactional manner.

II. The Context of Packaging Regulation in Hong Kong

13. I have been given to understand that almost all forms of tobacco advertising are banned in Hong Kong under the Smoking (Public Health) Ordinance (Cap. 371) (the "**Ordinance**"). This ban covers a broad range of advertising channels including print, radio, television, the Internet, and promotional activities such as free samples or gifts. Additionally, it is my understanding that under the Smoking (Public Health) (Notices) Order (Cap. 371B) (the "**Order**"), all cigarette packages and retail containers must bear a health warning and tar and nicotine yields. This warning is required to cover at least 50% of the two largest surfaces.
14. In light of these prohibitions and the restrictions under the Ordinance and the Order, it is clear that the law in Hong Kong already severely restricts the ability of manufacturers to use their trademarks in order to differentiate their brands and communicate with consumers. In fact, one of the only forms of communication available to manufacturers under the present law, though limited, is the display of their trademarks on the tobacco package itself.

III. British American Tobacco Trademarks

15. I am advised that BAT (HK) is the proprietor or licensee in Hong Kong of the trademarks associated with the CAPRI, CASTAN, DUNHILL, HILTON, WINFIELD, VICEROY, PALL MALL, KENT, SHUANGXI, STATE EXPRESS 555 and LUCKY STRIKE cigarette brands as visible on the cigarette package or cartons of cigarettes sold in Hong Kong. These trademarks include words, stylized labels, and full pack marks, including words, signatures, crests, logos colors and designs. I have been advised that the following are examples of some label and full pack trademarks for BAT (HK) products sold in Hong Kong.

Figure 1: Label and Full Pack Registered Trademarks of BAT (HK) Products Sold in Hong Kong



IV. Introduction to Brands and Trademarks

A. The Function of Trademarks and Brands

16. Trademarks are a type of intellectual property. A trademark is a legally protected “sign,” such as a name, word, phrase, graphic, logo, image, design or combination of these elements, that acts to exclusively identify to consumers the source of the product and differentiate it from the competition.¹ It may consist of words, designs, letters, numerals or the shape of goods or their packaging.² The owner of the trademark has the exclusive right to affix the trademark to units of the product and to use the trademark in its communications. As such, trademarks are essential components of brands because they are the outward representation of the brand to consumers.³
17. In fact, some definitions of “brand” are almost indistinguishable from the definition of “trademark.” For example, the American Marketing Association defines a brand as a “name, term, sign, symbol, or design, or a combination of them, intended to identify the goods and services of one seller or group of sellers and to differentiate them from those of competition.”⁴ Trademarks are really not exactly the same thing, but rather

¹ Helmers, Christian and Mark Rogers (2010), “Trademarks and performance in UK firms,” in da Silva Lopes, Theresa and Paul Duguid (editors), *Trademarks, Brands and Competitiveness*, Routledge, page 56.

² Fogg, Janet (1998), “Brands as intellectual property,” in Hart, Susannah and John Murphy, *Brands: The New Wealth Creators*. New York: New York University Press, page 72.

³ Aaker, D. A., (1991), *Managing Brand Equity*, New York, NY: The Free Press, page 21.

⁴ http://www.marketingpower.com/_layouts/dictionary.aspx?dLetter=B

trademarks are a crucial component of brands.⁵ Many brands are based on a combination of several trademarked elements⁶ that identify and differentiate one owner's product(s) from a similar offering by competitors.⁷

18. Therefore, brands and the trademarks associated with them play important roles in the marketplace. They help consumers navigate through the available choices in a product category and can provide a measure of reassurance about product quality, contents, origin and relative price. In sum, trademarks, as signals of the brand, have three important functions that combine to provide the consumer with a level of assurance:
 - “To distinguish the goods or services of one business from those of another
 - To indicate the source or origin of the goods or services
 - To serve as an indication of consistent quality....”⁸
19. Because visual identity is so important to brands, trademarks and other forms of intellectual property, such as patents and unique package design, are among a company's most valuable assets.⁹ Accordingly, the protection of trademarks and other intellectual property is vital to maintaining the value of the brand¹⁰ and protecting investment and business goodwill.
20. A strong visual identity can act as a type of shorthand expression of the brand and its features. Strong visual identity is apparent in the trademarked logos presented in Figure 2. These trademarked images combine the company's name (or, in some cases, initials which have come to stand in for the name) with a distinctive colored logo that are recognized globally.
21. Moreover in the case of fast moving consumer goods such as cigarettes, the package and trademark serve as the only point of purchase assurance to the customer that the product inside is reputable, and that the producer of that product is identifiable and potentially honorable.

⁵ Aaker, D. A., (1991), *Managing Brand Equity*, New York, NY: The Free Press, page 21.

⁶ Lindemann, Jan. (2010), *The Economy of Brands*, Palgrave MacMillan: 2010, page 7.

⁷ Murphy, J.M. (1990), *Brand Strategy*, Cambridge: Director Books, page 2.

⁸ Fogg, Janet (1998), “Brands as intellectual property,” in Hart, Susannah and John Murphy, *Brands: The New Wealth Creators*. New York: New York University Press, page 72.

⁹ H.M. Meyers and M.J. Lubliner, *The Marketer's Guide to Successful Package Design*, Chicago: American Marketing Association/NTC Business Books, 1998, p. 191.

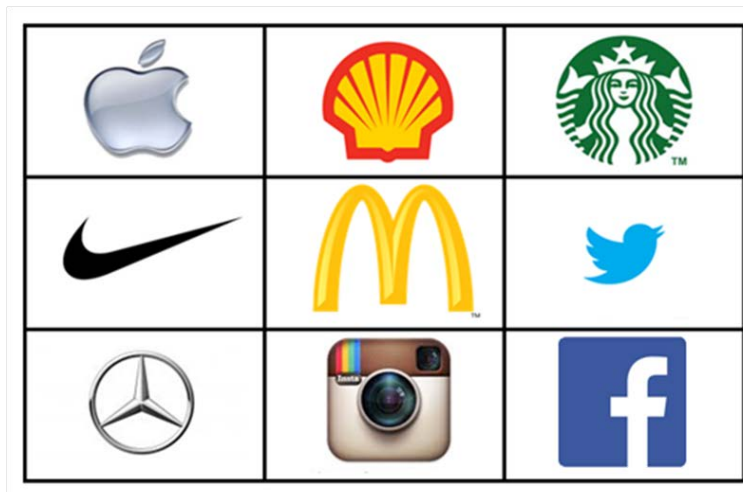
¹⁰ Fogg, Janet (1998), “Brands as intellectual property,” in Hart, Susannah and John Murphy, *Brands: The New Wealth Creators*. New York: New York University Press, page 81.

Figure 2: Logos Combine the Company Name with a Distinctive Graphic to Represent the Brand



22. In some cases, the logos are so widely recognized that the brand name is not even necessary. For example, both Twitter and Starbucks have recently dropped the brand name from their iconic logos. Figure 3 shows examples of global brands whose trademarked pictures are so ubiquitous that they communicate the brand’s identity without words.

Figure 3: Graphic Logos Can Evoke the Brand in the Customer’s Mind without the Use of Words



23. Other brands use trademarked “wordmarks” (also known as “logotype”) to give their brands strong visual identity across media. Figure 4 presents some highly-recognizable wordmarks.

Figure 4: Wordmarks or Logotype Designs are Stylized Versions of Brand or Company Names at a Glance



24. Figure 5 below shows some examples of Hong Kong brands that are recognized widely, even outside of Hong Kong.

Figure 5: Iconic Hong Kong Trademarks that are Widely Recognized



B. Effective Packages are Critical to Brand Awareness and Differentiation

25. Well-designed packaging with distinctive trademarked features plays an important role in brand identification and differentiation particularly in a market such as in Hong Kong where packaging is the last means of communication. The design of a product package is critical to the creation and maintenance of brand awareness and differentiation. An important characteristic of effective packaging design is that it is “holistic.” In other words, when it comes to effective packaging the overall effect of the package comes not

from any individual element but rather from the combination of all elements working together as a holistic design. This means that the combination trademarks that are used to create the packaging, including words, colors, images, and typefaces, cannot be easily divided without diminishing the overall effect and power of the trademark and brand. The whole is greater than the sum of the parts, and particularly greater than any one part (such as the written name only). Indeed as discussed above, some brands only use trademarked logos with no wordmarks and in other cases the trademark comprises both words and graphics, which are integrated and essential to identifying and distinguishing the brand.

26. Effective packaging also requires consistency over time. Because consumers spend just a few seconds looking at a package,¹¹ a key to effective package design and immediate consumer recognition is the maintenance of “consistency” that “identifies the product unequivocally and provides reassurance to the consumer faced with bewildering choice.”¹² Consistency in package design is also important because it takes “long and repeated exposure to develop ‘visual equity.’”¹³
27. Figure 6 shows some examples of iconic packages for brands with a strong visual identity.

¹¹ Young, Scott and Vincenzo Ciummo (2009), “Package Viewing Patterns: Insights and Implications for Global Design,” *Package Design Magazine*, July 2009, pages 26-30. Accessed at http://www.prsresearch.com/fileUploads/Package_Viewing_Patterns.pdf

¹² Murphy, John M. *Brand Strategy*. Prentice Hall: 1990, page 89.

¹³ Murphy, John M. *Brand Strategy*. Prentice Hall: 1990, page 84.

Figure 6: The Visual Identity of these Iconic Packages is Widely Recognized



28. Figure 7 shows examples of Hong Kong products with iconic packaging.

Figure 7: Hong Kong Products with Iconic Packaging



V. Brands and their Trademarked Symbols Serve Important Functions in the Market

A. Benefits to Consumers

29. Particularly in a market such as in Hong Kong, in which packaging is the last means of communication, the trademarked symbols and packaging associated with brands perform essential navigation and reassurance functions for consumers. In many categories, there is a dizzying number of product choices, and the buying process can be time-consuming and even stressful. Brands, as identified by the associated trademarked elements, can help customers navigate through the huge quantity of information available. Specifically, it is the brand's trademarked elements that identify and differentiate the product and, as such, aid the consumer's navigation among competing products. Brands help consumers organize and remember a large quantity of information. They can simplify a complicated purchase decision by reducing the need to evaluate the offerings in an entire product category across multiple dimensions.
30. The presence of a strong brand can also reduce the risk involved in making a purchase decision because the consumer has confidence in the quality of the product because of its popularity and/or longevity in the market. For example, a customer interested in buying tires might be bombarded with product choices (both branded and unbranded). Instead of doing time-consuming research on the characteristics of each offering, the buyer might

just simply choose Michelin tires, confident either through past experience or reputation that he or she would be satisfied with the purchase.

31. In particular, the trademarked symbols of the brand provide reassurance that the brand's customers are getting the quality product they expect. Consumers often choose to purchase a branded rather than a non-branded product, as they believe that someone stands behind these products. The use of one's name reduces the anonymity of the supplier and hence subjects them to the evaluation and scrutiny of the consumer. As consumers repeatedly purchase and consume the product, they determine if the brand meets or fails to meet their expectations on an ongoing basis. The prominent use of trademarks identifies the owner of the brand and implicitly guarantees an assurance of quality from the brand owner to the purchaser. When consumers pay a premium price for a branded product, they are paying for an implicit guarantee of superior quality.¹⁴ Branded batteries such as Energizer provide a good example of a branded product providing both perceived and actual high quality over many of their unbranded counterparts.

B. Benefits to the Firm

32. For manufacturers, the protection of the intellectual property rights afforded to trademark owners means that the firm can invest with confidence in the trademark and the associated brand and obtain the benefits of its value and associated business goodwill sustained over time. In many cases, the brand's trademarked name (together with its associated trademarked logo or other brand markers) is the only means of communication that a competitor cannot copy. For example, one marketing reference explains it this way: "An orange ... is an orange ... is an orange. Unless, of course, that orange happens to be Sunkist, a name that 80% of consumers know and trust."¹⁵
33. A strong brand can also make it easier for a firm to enter new geographic markets. In today's world of global media and travel, it is quite likely that a foreign brand entering a new market would find that some consumers in the new market would be familiar with its brand before it even entered. Some of these consumers would likely have even tried the product while traveling or living abroad and be in a position to share their knowledge of the brand through word-of-mouth.

¹⁴ Png, I. P. L., & Reitman, D. (1995). "Why are some products branded and others not?" *Journal of Law and Economics*, 38(1), 207-224.

¹⁵ Davis, Scott M., *Brand Asset Management: Driving Profitable Growth Through Your Brands*. John Wiley & Sons, Inc.: 2002, page 203, quoting Russell Hanlin, CEO, Sunkist Growers.

C. Importance of Brands to the Efficient Functioning of the Market

34. In addition to bringing many benefits to the manufacturer and consumer, brands are important because they contribute to the efficient functioning of the market in a number of important ways.
35. **Competition:** In a sense, the brand encapsulates all of the non-price dimensions of competition. Therefore, differentiation through branding offers manufacturers an alternative to price competition. Competing on price alone is not good for the functioning of the market in the long run because price competition naturally drives out all but the lowest cost producers and leads to excessive concentration in the industry. This effect is particularly important in industries with high economies of scale, like cigarette production. In categories such as cigarettes, where the products themselves can be seen as broadly similar, trademarks and other brand elements are key sources of differentiation.
36. **Competitive Advantage in a Mature Market:** In order to understand the role of brands in markets, it is important first to examine the nature of demand in mature markets. Economists speak of two types of demand: primary demand and secondary demand. Primary demand refers to the total demand that exists in the market. The total demand for soft drinks is an example of primary demand. Secondary demand refers to the demand for a specific brand within the market; for example, the demand for Diet Coke. In mature markets, primary demand is relatively stable, and firms' efforts to increase sales are centered on efforts to increase secondary demand by stealing market share away from their competitors. In fact, "for many businesses active in mature markets, brand support and marketing can be the biggest single item of overhead cost."¹⁶
37. The tobacco market is an example of such a mature market, where consumers are well aware of the product features and benefits. In this type of market, firms' efforts are focused on stealing market share from one another not on increasing overall market demand.
38. Brands that consumers can identify by their trademarked components, are a particularly important element of the competition for secondary demand in industries like tobacco where the products are similar. Without branding in such markets, "Customers readily purchase entirely on the basis of comparative pricing ... [which] leads to cut-throat competition for consumers," as described above.¹⁷ In developing his concept of generic strategies, Professor Michael Porter has pointed out that there really are only two possible

¹⁶ Blackett, Tom, "What is a brand?" in Rita Clifton (editor) *Brands and Branding*, 2nd edition. London: The Economist in association with Profile Books, 2009, page 24.

¹⁷ Pope, Joe; David Cullwick and Jo Kennelly (1998), "Commodity Branding" in Hart, Susannah and Murphy, John, editors, *Brands: The New Wealth Creators*, MacMillan Business: 1988, page 161.

sources of sustained competitive advantage, cost advantage or differentiation.¹⁸ “You win either by being cheaper or by being different, that is, being perceived by the customer as being better or more relevant.”¹⁹ Therefore, firms that are unable to differentiate their product are left with no alternative but to compete on cost.

39. **New Entrants and International Competition:** One of the benefits of brands to market structure is that they can make it possible for new competitors to enter the marketplace and differentiate themselves from their competitors. In an unbranded commodity market, new entrants to the marketplace have a very difficult time encouraging consumers to try their product except on the basis of price. Given that they cannot effectively differentiate their products through communication about the brand, the only way to encourage trial is to compete on price. However, in a market like cigarettes where incumbents have significant scale advantages, competing on price is not likely to be an attractive option for new entrants. In contrast, in a market with brands, it is possible for a new brand to establish itself in consumers’ minds as something different from existing brands and, therefore, as something worthy of switching to. One of the keys to ensuring that a market functions efficiently is ensuring that incumbents feel a continuous threat that new entrants may enter the market and therefore continue to try to improve the quality of their products and brand reputation. In essence it ensures a “best behavior” practice on the part of market participants.
40. A further impact of the reduced power of brands is a reduction in international trade and competition in the market. For a foreign international competitor to succeed in the market, it is essential that the competitor is able to maintain some price premium over local competition in order to compensate for the added costs of doing business internationally.²⁰ It is all but impossible for a foreign competitor to maintain these margins as an incumbent, or to establish them as a new entrant, if the international foreign competitor is not able to build and maintain a strong brand.
41. **Quality, Innovation and Niche Products:** In the cigarette market, in which product configuration, method of consumption and visual characteristics are similar to one another, brands are also important because they serve as one of the few areas of competition available. The long term value generated by a firm’s efforts to deliver quality products is captured in the value of its brands. In a market where brands cannot be utilized for product differentiation, the long term value of investments in quality and innovation is greatly diminished.

¹⁸ Porter, Michael E. *Competitive Advantage*, The Free Press: 1995, page 11.

¹⁹ Lindemann, Jan. *The Economy of Brands*, Palgrave MacMillan: 2010, page 12.

²⁰ These added costs faced by foreign firms are a well-established principle of international business. They are often referred to as “the liability of foreignness.” See, for example, Srilata Zaheer, “Overcoming the Liability of Foreignness,” *Academy of Management Journal*, 1995, Vol. 38, No. 2. 341-363.

42. Reducing the value of brands in the market also has the effect of making it difficult for niche players to survive. Normally, niche players are able to survive in markets by building brands that appeal to a small segment of consumers. Without the benefit of the brand, these niche players would disappear as part of the process of industry consolidation and monopolization described above.
43. Moreover, in markets with limited differentiation and limited incentive for investment, business models that differentiate on better quality or better service are discouraged.

VI. Impact of Increased Sized Graphic Health Warnings

44. The requirement to display 50% graphic health warning on Hong Kong cigarette packages already severely limits the use of trademarks and prevents firms from designing cigarette packages holistically. However, by increasing the size of the warning to 85%, trademarks will not be able to adequately serve their essential functions.
45. Enlarging the GHWs on cigarette packages to 85% of the packages will also result in a reduction in the “visual equity” of the brands involved through a loss of consistency in the affected packages. As discussed below, reducing further and thus eliminating the impact of the trademarks on cigarette packaging will have negative implications for consumers, firms and the market in general.
46. Figure 9 below shows cigarette packs of brands sold in Hong Kong with the proposed health warning covering 85% of the packages on the right. The images clearly illustrate that the effect of GHWs covering 85% of the packages would destroy the "visual equity" of the brands involved.

Figure 9: The Proposed Health Warnings Destroy the “Visual Equity” of the Related Brands



47. Increasing the size of GHWs to cover 85% of the cigarette packages will make it impossible for manufacturers to use some of their trademarks as registered (including logos and labels) and for them to use other trademarked elements effectively.
48. With GHWs covering 85% of the package it would be impossible to effectively include all the desired information on the package. Increasing the size of the GHWs to 85% will prevent consumers' from being able to perceive the brand on cigarette packages. Without distinctive packaging to make the trademark elements stand out, a brand becomes undifferentiated from competing brands. Trademarks will not be able to effectively differentiate, and identify the origin and quality of products, which are essential functions of trademarks. The consequence of this is that the trademarks and their related brands are practically destroyed and the goodwill inherent in the trademarks and their related brands will be lost, along with the decades of significant investment it took to generate such goodwill.
49. In the case of similar products, where trademarked symbols and packaging are key sources of differentiation, the function of these brand elements as a navigational tool to consumers is critical. With less than 15% of the packaging space available for trademarks, customer confusion is a significant concern. Increased opportunity for customer confusion reduces the value of brands for the manufacturers and consumers and reduces consumer welfare.
50. Additionally, the consumer's confidence in evaluating the authenticity of the brand is diminished by the lack of trademarked packaging. That is, the package is in essence a guarantee of what is inside. The holistic representation of the package serves as a large, multi-faceted signal to the consumer of the maker and the probability that the maker is authentic. Further reducing the available space for trademarks, reduces the ability of consumers to judge with confidence whether the product within the package was actually produced by the manufacturer. Thus, in the absence of holistic and complete packaging, the opportunity for counterfeiters and other fraudulent actors to take advantage of the consumer is increased.
51. Finally, a market with differentiated products through strong brands provides more choice for the consumer, which is a vehicle towards increased consumer power in the market, driving efficiency and other improvements.
52. Manufacturers will also receive less benefit from an impaired trademark and brand. The most obvious detriment will be in the reduced ability of firms to maintain their premium brands on the basis that they will look the same as lower quality brands and will not look and feel like premium quality products. Furthermore, any measure which diminishes brand equity will reduce the ability of new tobacco firms to introduce their brands into new geographic markets and compete with the existing brands.
53. This is especially so when the markets being entered place severe restrictions on the ability of firms to utilize their trademarks and realize the value in their brands. Thus, increasing the size of GHWs on Hong Kong cigarette packages to 85% will decrease both

the ability of foreign firms to enter the Hong Kong market and the ability of Hong Kong firms to expand abroad. Foreign firms will not be able to communicate to Hong Kong consumers about their brands, and Hong Kong firms will not have strong domestic brands to use as a base to launch their efforts in new markets. The effect of these two factors will be to reduce both the likelihood of new entrants and the basis for non-price competition in the market.²¹

54. The elimination or minimization of cigarette brands will also impact the market structure and market dynamics. First, competition will shift from brand competition to price competition. In the short term, a lack of competitive dimensions could lead to market rigidity, with little switching by consumers among brands. This market rigidity will further discourage innovation and investment and will hasten competition on price alone. It will also give an advantage to domestic brands that are likely to be able to compete more effectively on price.
55. The impact of the loss of brand differentiation in the Hong Kong tobacco market will differ among firms depending upon the extent to which they have already established their market position and depending upon the nature of their business model. Firms for which the business model depends upon the use of diversity so as to appeal to the niche tastes and firms that are currently seeking to enhance their market position by winning market share from the leading firms stand to suffer more than firms relying on one dominant brand – indeed, the latter may gain in the short run (in terms of market share) because they will still benefit from being known as a market leader and will be subject to less competitive pressure from other firms. Nonetheless, even as their market share increases, margins on these brands will decrease and eventually be eroded more or less completely, as the market evolves to pure price competition.
56. As cigarettes become commodity products resulting in competition on price alone, price conscious smokers will likely navigate toward low value, non-premium brands. The focus on commodity pricing likely will result in lower prices to consumers, a result which could also lead to increased purchases and consumption.
57. Commoditization of the market and a shift to pure price driven competition could also lead to an increase in illicit trade, since without the added value of brands, legitimate products will be less clearly differentiated from cheaper illicit products both in terms of appearance and perceived quality and value.
58. In sum, it is my opinion that increasing the size of GHWs to 85% will preclude any effective or meaningful use of trademarks, thereby preventing them from performing their essential brand functions. Further, it is my opinion that the elimination of trademarks as a platform for brand communication has a number of important negative

²¹ See, for example, Srilata Zaheer, “Overcoming the Liability of Foreignness,” *Academy of Management Journal*, 1995, Vol. 38, No. 2. 341-363.

repercussions for consumers, manufacturers, and the market in general, including some unintended consequences that are at cross-purposes with the stated health goals of the initiatives.

Dated: June 18, 2015

A handwritten signature in black ink, appearing to read "Philip Zerrillo", written over a horizontal line.

Philip Zerrillo, Ph.D.

Appendix A: CV of Philip Zerrillo

PHILIP C. ZERRILLO PH.D.

EDUCATION

Ph.D. Northwestern University, J.L. Kellogg Graduate School of Management (Marketing)

B.B.A. The University of Texas (Austin) Marketing

HONORS

2013

The Dr. Benvenuto Tantocco Distinguished Chair in Retailing, Jose Rizal University (Philippines)

2007

Journal of Business to Business Marketing (Best paper Award)

1993

Institute for the Study of Business Markets NCR AT&T Doctoral Award Competition "Most Outstanding Doctoral Dissertation Submission", Grand Prize Award

1990-1992

Northwestern University, J.L. Kellogg Graduate School of Management, "Steel Resource Foundation" Doctoral Fellowship

1989-1993

Northwestern University, J.L. Kellogg Graduate School of Management, Doctoral Fellowship

1982

The University of Texas, "The Most Outstanding Scholar Award"

ACADEMIC EXPERIENCE

2010- Present

Full Professor (Practice) Singapore Management University.
-Dean Post Graduate Professional Programmes (Law, Business, Information Sciences, Economics, Social Sciences, Accounting)
-Executive Director Case Writing Initiative
-Executive Director Center for Management Practice
- Academic Head Ph.D. in Business (General Management)

2010- Present

Executive Chairman of the Board -Thammasat University MIM (Thailand)

2008-2010

Visiting Professor – Northwestern University, Kellogg Graduate School of Management

2005-Present

Lecturer- Goizueta School of Business, Research fellow Zyman Institute for Brand Science (ZIBS), Emory University

1999-2004	Associate Dean and Executive Director, Executive Education, University of Texas at Austin
2000-2002	Graduate Business Dean, The University of Texas at Austin
1997-2001	Director of Dallas Based Executive MBA Program (Focusing on Technology)
1993-1998	Assistant Professor- The University of Texas Graduate School of Business (Marketing Core, Channels and Distribution Policy, Pricing, Marketing Strategy Global Studies)
1997-1998	Visiting Professor-Northwestern University, J.L. Kellogg Graduate School of Management (Channels and Distribution Policy, International Distribution)
1991-1993	Lecturer- Northwestern University, J.L. Kellogg Graduate School of Management (Distribution Channels)

YEARLY VISITING POSITIONS

2010-Present	Washington University St. Louis (Shanghai Campus)
1997-Present	Visiting Professor-Thammasat University, Bangkok, Thailand
1997-Present	Visiting Lecturer-Hebrew University, Jerusalem, Israel
2009-Present	Lecturer Owen School of Management- Vanderbilt University
2008-Present	Smith School of Business- University of Maryland (Shanghai)
2002-2006	Visiting Professor IMADEC University, Vienna, Austria
2004-2006	Visiting Professor Helsinki School of Economics- Singapore
2000-2003	Visiting Professor Aoyama Gakuin University, Tokyo, Japan
2002-2003	Sun Yat Sen University, Guangzhou, China

RECENT INDUSTRY EXPERIENCE

2007- Present	Monitor Consulting
2005	Principal, Business Asia 101- focusing on business event planning and networking

1996-2001 CEO, Farig Consulting,- Key Corporate Clients 3M, PPG, Motorola, Accenture, E-Partners solutions, Input /Output KUHF Radio, On-air investment and business show host Rauscher Pierce Refsnes, Registered representative

BOARDS AND ADVISORY BOARDS

2010- Present Thammasat University- Executive Chairman of the Board MIM programme

1998-Present Sharps Compliance, Lead Director, Audit Committee Chairman Member (NASDAQ), Medical waste disposal

2002-2005 Tholos International, European based video conferencing company

1999-2001 GKS Services, (Founder- acquired by Applied Materials), Data mining applications for semiconductor fabrication applications

1996-2000 Garden.Com (NASDAQ), Internet based distribution of garden products

1997-2000 Exterprise Incorporated, (acquired by Commerce One) Business-to-business exchange software

TEACHING HONORS AND ACTIVITIES

2011 Outstanding Professor Address- SMU MBA commencement

2008 Northwestern University, Faculty Honor Roll

2008 Chosen to Deliver "Goizueta MBA Final lecture" Student recognition of the outstanding professor asked to deliver their farewell lecture"

2005-2007 Emory University. "Special Faculty Recognition for Outstanding MBA Teaching"

2000-2005 University of Texas Teaching Honor Roll - During every teaching semester

2001-2005 Doctoral Teaching Seminar for Doctoral Candidates, Thammasat University

2002 MBA Class of 1997 Alumni Award "The Professor with the Greatest Impact"

2002 MBA Class of 2002, "Outstanding Contributor to Student Life"

1994-1998 The University of Texas, Finalist, "The Joseph Beasley Award for Teaching Excellence"

1997-1999 Member of "Northwestern University, J.L. Kellogg Graduate School of Management Teaching Honor Roll" for teaching excellence

- 1993-1996 The University of Texas, Graduate Business Council, "Outstanding Marketing Core Instructor"
- 1995 Guest Lecturer, University of Texas, Graduate School of Business course on "Teaching Effectiveness"
- 1992-1993 Member of "Northwestern University, J.L. Kellogg Graduate School of Management Teaching Honor Roll" for teaching excellence and outstanding representation of the student honor code

RECENTLY PUBLISHED RESEARCH

- James C Anderson, Philip Zerrillo and Lihua Wang, "Inter Organizational Properties and Inter-organizational Perceptual Agreement: A Model and Empirical Test in Marketing Channel Relations" December 2007, (Winner of Best Paper Award)
- Frenzen, Jonathan, Paul Hirsch and Philip C. Zerrillo, "Consumption Preferences and Changing Lifestyles," Neil Smelzer and Richard Swedberg (eds.), *The Handbook of Economic Sociology*, Russell Sage, Princeton NJ. (1994)
- Iacobucci, Dawn and Philip C. Zerrillo, "Multiple Levels of Relational Phenomenon," Dawn Iacobucci (ed.) *Relationships in Marketing*, Russell Sage, Princeton NJ. (1996)
- Iacobucci, Dawn and Philip C. Zerrillo, "The Relationship Life Cycle: I) A Network-Dyad-Network Dynamic Conceptualization, and II) The Application of Some Classic Psychological Theories to its Management," Jagdish Sheth and Charles Frame (eds.) *Review of Marketing*, JAI Press, Greenwich, (Forthcoming, 1996)
- Peterson Robert, Karen Smith and Philip Zerrillo, "Trademark Dilution and the Practice of Marketing" *Journal of the Academy of Marketing Science*, Vol 27, No. 2 pp 255-268 (1999)
- Shervani, Tasadduq and Philip Zerrillo, "The Albatross on New Product Innovations," *Business Horizons*, Vol 40 No.1, (Jan 1997) pp.57-62 (Also republished *Engineering Management Review* Winter 1997, Vol 4 Pg 26-32) Also Republished JPIM On-line Hot Topic, review Dec 2000) (Also republished Euskotek, *Revist de la Red ParquesTecnologicos* Numero 6 Ano1999,)
- Zerrillo, Philip C., Jon M. Flemming and Angela McKee, "Vertical Territory and Customer Resale Restrictions a New Rule of Reason Approach," *Iowa Law Review: Journal of Corporation Law*, (May 1997)
- Zerrillo, Philip and Dawn Iacobucci, "Trade Promotions a Call For a More Rational Approach," *Business Horizons*, Vol 38 No.4, (July-August) (1995) pp. 69-76
- Zerrillo, Philip and Angela McKee, "Vertical Restraints and Consumer Welfare, Clear Distinctions for Restraints: Via a Modified Rule of Reason Approach" *Contemporary Knowledge of Relationship Marketing*, Emory University Center for Relationship Marketing June 1996,

Zerrillo, Philip and Ravi Raina, "A Vertical View of Marketing Networks: A New Entrants Approach" Dawn Iacobucci (ed.) Relationships in Marketing, Russell Sage, Princeton NJ. (1996)

Philip C Zerrillo and Greg M. Thomas, "Developing Brands in Emerging Markets, a Framework for Growth," Journal of Place Branding Fall 2007.

PUBLISHED CASES

2011 Memaska Steel (Singapore Management University case Series, European Case Clearing House)

2011 With Kevin Sproule, Hammerlick Brewing (Singapore Management University case Series, European Case Clearing House)

2012 With Havovi Joshi and S.N. Venkat Tata Salt- What to do When a a Challenger Brand Grows Up? Case A

2012 With Havovi Joshi and Sn Venkat Tata Salt Case B. (Singapore Management University case Series, European Case Clearing House)

2012 Minh Long Porcelain (Singapore Management University case Series, European Case Clearing House)

2013 Minh Long Porcelain Case B. (Singapore Management University case Series, European Case Clearing House)

2013 Tata Starbuck, Brewing a Perfect Blend (Singapore Management University case series. European Case Clearing House)

EXPERT TESTIMONY

Latin America Courier, and Pegaso Express V. Airborne Express Inc., Airborne Express Inc., Airborne Freight Corporation, George Trevino DHL Holdings (USA) Inc, DHL Danzas Air and Ocean North America, DHL Worldwide Express Inc., and DHL International De Mexico S.A. Friedman V. 24hr Fitness

JK Enterprises LLC., DBA Jeremy Franklin Suzuki, Et.al, v. American vs. American Suzuki Motor Corporation, et.al.

Stripes LLC, vs. Carlson Worldwide Inc., TGI Friday's, Inc, and TGI Friday's, of Minnesota Inc.

EXECUTIVE EDUCATION/CONSULTING

Developed and delivered executive training for consulting firms, (Accenture, Monitor Consulting, Deloitte consulting) universities (Thammasat (Thailand), Northwestern University Kellogg Graduate School of Management, University of Maryland, The

University of Texas, Help Institute of Malaysia, Songang (Korea), Tech de Monterrey (Mexico)), and private clients including Genentech, Cargill, Imperial Tobacco (UK), 3M, LG, CP Food (Thailand), Baxter, Scott& White Hospitals, Texas Instruments, Freescale, Motorola, General Electric etc.

Recent consulting engagements: Motorola, Input/Output, 3M, 24Hr Fitness, Foley Lardner, Batesville Casket, LG Electronics, Imperial Tobacco, Suffolk Group, Orrick Hamilton, Countrywide Financial, CP Food.

CONTACT INFORMATION

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Singapore Management University
Dean
Executive Director
Full Professor

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September 2012

Appendix B: Documents Considered

Books

- Aaker, David A. *Managing Brand Equity*. New York, NY: The Free Press, 1991.
- Davis, Scott M. *Brand Asset Management: Driving Profitable Growth Through Your Brands*. John Wiley & Sons, 2002.
- Hart, Susannah and John Murphy, *Brands: The New Wealth Creators*. New York: New York University Press, 1998.
- Lindemann, Jan. *The Economy of Brands*. Palgrave MacMillan, 2010.
- Meyers, H.M. and M.J. Lubliner. *The Marketer's Guide to Successful Package Design*. Chicago: American Marketing Association/NTC Business Books, 1998.
- Murphy, John. M. *Brand Strategy*. Prentice Hall, 1990.
- Porter, Michael E. *Competitive Advantage*. New York, NY: The Free Press, 1985

Articles and Reports

- Blackett, Tom. "What is a brand?" in *Brands and Branding*, 2nd edition, edited by Rita Clifton. London: The Economist in association with Profile Books, 2009.
- Helmers, Christian and Mark Rogers (2010), "Trademarks and performance in UK firms," in da Silva Lopes, Theresa and Paul Duguid (editors), *Trademarks, Brands and Competitiveness*, Routledge, page 56.
- Fogg, Janet (1998), "Brands as intellectual property," in Hart, Susannah and John Murphy, *Brands: The New Wealth Creators*. New York: New York University Press, page 72.
- Png, I. P. L., & Reitman, D. (1995). "Why are some products branded and others not?" *Journal of Law and Economics*, 38(1), 207-224.
- Pope, Joe; David Cullwick and Jo Kennelly (1998), "Commodity Branding" in Hart, Susannah and Murphy, John, editors, *Brands: The New Wealth Creators*, MacMillan Business: 1988, page 161.
- Young, Scott and Vincenzo Ciummo (2009), "Package Viewing Patterns: Insights and Implications for Global Design," *Package Design Magazine*, July 2009, pages 26-30. Accessed at http://www.prsresearch.com/fileUploads/Package_Viewing_Patterns.pdf

Zaheer, Srilata. "Overcoming the Liability of Foreignness." *Academy of Management Journal* 38 (1995).

Online Resources

American Marketing Association Dictionary. Available at:
<https://www.ama.org/resources/Pages/Dictionary.aspx?dLetter=B&dLetter=B>.

Statement of John Hector on the likely impact on illicit trade of increasing the size of graphic health warnings on tobacco product packages in Hong Kong to 85%.

19 JUNE 2015

Statement of John Hector on the likely impact on illicit trade of increasing the size of graphic health warnings on tobacco product packages in Hong Kong to 85%.

1. My name is John Hector. I retired from the U.K. Her Majesty's Revenue and Customs ("HMRC") in July 2011 following 45 years in the Department. I joined Her Majesty's Customs and Excise (later renamed HMRC) in 1965, and worked as an investigator from 1977 until my retirement. I developed specialist expertise in Asia, holding posts in Thailand from 1998 to 2003 and Beijing from 2006 to 2011.
2. During my time in Beijing, I held the role of Fiscal Crime Liaison Officer at the UK Embassy. My role was to combat the flow of illicit trade in tobacco products to the UK and Europe in conjunction with the Chinese law enforcement agencies. I worked closely with the Police and Customs authorities in both China and Hong Kong. My work focused on the gathering and exchange of intelligence to identify and intercept illicit trade. Hong Kong was a major point of interest because of its location on the Pearl River which was used as a route to smuggle cigarettes from China. I was also responsible for liaising with law enforcement bodies to combat the illicit trade of tobacco products in the neighbouring countries of Vietnam, Thailand, South Korea and Japan.
3. Since leaving HMRC I have worked as a consultant to various industries in relation to cross border smuggling, mainly in the Far East. I am still in regular contact with colleagues in China and Hong Kong Customs, and recently visited Hong Kong and China while working on behalf of the Mauritius Government. I am well aware of illicit trafficking in Hong Kong.
4. I have been requested by British American Tobacco Company (Hong Kong) Limited to provide my observations on the illicit trade of tobacco products in Hong Kong and the likely impact on illicit trade of increasing the size of graphic health warnings on tobacco product packages in Hong Kong from 50% to 85% of their surface area, based on my many years of experience in tackling the illicit tobacco market.

Nature of Illicit Market in Hong Kong

5. While I do not think it is possible to definitively state the size of the illicit market given its very nature, the 2013 International Tax and Investment Center and Oxford Economics in a report on the illicit tobacco trade in 14 selected Asian markets (the "ITIC Report"), estimated that 33.6% of tobacco consumption in Hong Kong is illicit.¹ Of the 14 Asian countries surveyed, Hong Kong had the third largest percentage of illicit consumption in the region. It was estimated that illicit trade in tobacco would cost the Hong Kong government HK\$3.2 billion in lost tax revenues in the fiscal year 2013/2014.
6. During my time with HMRC in Beijing, we tended to work on an estimate of about 18% to 20% of total tobacco consumption in Hong Kong being illicit. However, I would not be surprised if illicit consumption has increased, particularly given further increases in the cost of cigarettes in Hong Kong. However, on any view, it is clear the sale and consumption of illicit tobacco in Hong Kong is significant, and poses a large problem for public health and law enforcement.
7. The illicit market in Hong Kong is primarily comprised of contraband cigarettes, and to a lesser extent, counterfeit cigarettes. Contraband cigarettes are cigarettes taxed in one country, where taxes are lower and smuggled into another country to be illegally re-sold. Counterfeit cigarettes are fake copies of well-known branded cigarettes smuggled into a country for sale without payment of tax.

¹ Asia-14: Illicit Tobacco Indicator 2013, at p. 63, available at <http://www.oxfordeconomics.com/asia14>

8. Hong Kong is particularly vulnerable to the illicit trade in contraband cigarettes because of the high price of cigarettes in Hong Kong compared to neighbouring countries. For example a pack of cigarettes costs US\$ 0.80 or US\$ 1.1 in Vietnam and China respectively, compared with US\$ 6.4 in Hong Kong.² The largest share of contraband tobacco which is smuggled into Hong Kong comes from mainland China in breach of personal duty free allowances. Contraband products also come from Vietnam, Macau and Indonesia.³ Many of the contraband brands are devoid of graphic health warnings. The price and familiarity of contraband brands make them attractive to consumers of illicit tobacco once smuggled into Hong Kong.
9. Counterfeit cigarettes are also present in the illicit Hong Kong marketplace. Again Hong Kong is particularly vulnerable to the illicit trade in counterfeit given its border with mainland China (where a large percentage of the world's counterfeit tobacco products are manufactured) and Hong Kong's position as a regional port. Chinese counterfeiters are mainly based in the provinces of Guangdong and Fujian, and their products are smuggled out of China to Hong Kong and the world.
10. The international illicit trade in tobacco is perpetrated in Hong Kong through organized crime and smuggling syndicates. These groups smuggle illicit products out of China, often via barges on the Pearl River network. Smugglers will then load containers carrying illicit products onto ocean-going ships while within Hong Kong's waters. Fleets of transport vehicles also move quantities of illicit products either mixed in with a cover load or concealed within the frame of the vehicle over the China/Hong Kong border or through Hong Kong's ports. Much of this illicit product is destined for overseas markets, including Australia and Europe.
11. The illicit trade of products intended to be re-sold in Hong Kong is primarily conducted by smuggling syndicates and individuals who import duty free cigarettes in excess of permitted limits. Those entering Hong Kong are permitted to bring with them only 19 cigarettes or less without incurring duties. Many may bring small quantities of additional cigarettes with them, which they then sell to local merchants, shop owners and casual vendors. While the illegal importer receives a higher price than they themselves paid in purchasing the product outside Hong Kong, the seller will then recoup that cost and more once the pack is sold to the end customer in the Hong Kong marketplace. Given the vast number of people arriving at Hong Kong's border daily, including the hundreds of thousands that commute to work from homes in mainland China, it is very difficult to detect and combat illegal import conducted en masse in small quantities.
12. Illicit products can be easily purchased by consumers in Hong Kong. In my experience, illicit non-duty paid cigarettes are widely available for purchase in shops of all manner which exist everywhere, as well from street peddlers. It has also been reported that illicit cigarettes are available for purchase through telephone schemes run by smuggling syndicates, whereby orders for illicit products are placed by customers and delivered clandestinely, and that criminal syndicates sell illicit tobacco in schools and on public housing estates.⁴ Smuggled cigarettes may also be mixed with duty paid products and inserted into the legitimate supply chain.⁵

² Ibid at p. 60

³ Ibid at p. 16

⁴ <http://www.stopit.hk/wp-content/uploads/2015/02/HKUAIT-Budget-Consultation-2015-EN-FINAL.pdf>

⁵ Ibid

13. Illicit trade is tackled in Hong Kong by the Customs and Excise Department ("C&ED"). The C&ED is tasked with preventing and detecting smuggling activities under the Import and Export Ordinance. As set out on its website, the C&ED has taken significant steps to combat illicit trade in tobacco, such as conducting raids on storage, transport and distribution networks, and conducting undercover operations to target peddling. It has also increased random checks on individuals at border crossings to enforce duty free limits. However, the scale of the task faced by C&ED is vast. C&ED report that in 2013 on average 281,000 people crossed the land border between mainland China and Hong Kong each day (many of whom commute to jobs in Hong Kong). A total of 12.3 million passengers also arrived in Hong Kong from the Mainland and Macau by sea and by helicopters. In addition, the throughput of air passengers in Hong Kong was 59.9 million and the throughput of air cargoes was about 4.13 million tonnes. Hong Kong is also one of the busiest container ports in the world. It handled 22.4 million TEUs (20-foot equivalent units) in 2013 and in 2013, 29, 915 ocean-going vessels and 157, 625 river-trade vessels arrived in Hong Kong.⁶ The illicit trade in tobacco continues to present significant enforcement problems and remains well in excess of Hong Kong's neighbours.

14. Euromonitor International in its 2015 report 'Tobacco in Hong Kong, China' states:

*"Cigarette smuggling across borders remained active and serious in Hong Kong, although the authorities had already made a great deal of effort to prevent this. The large price difference between taxed and untaxed cigarettes made the illicit tobacco trade in Hong Kong highly profitable yet a low risk activity for criminal syndicates. The total volume seized by the Hong Kong Customs and Excise Department rose significantly in 2013. As more restrictive measures are anticipated for the future, further tax increments might fuel the illicit tobacco trade."*⁷

15. A survey conducted by research agency IPSOS in December 2014, also reported that 90% of respondents agreed that Hong Kong had a problem with black market cigarettes, with 70% agreeing that it was easy for children under 18 to access illegal tobacco products and 81% believing that it is easy for adults to access illegal tobacco products.⁸

Impact of increased graphic health warnings on illicit trade

16. The impact of further regulation on the illicit trade must be carefully considered given the existence in Hong Kong of a well-established and accessible illicit market. Consumers can easily find and purchase illicit products if they want to. Given the high price of legal cigarettes in Hong Kong compared to neighbouring countries there is already a greater incentive for illicit trade in Hong Kong. This situation will only be made worse by the introduction of further measures that incentivise the illicit market, such as making legal products less recognisable or increasing the product range that the illicit market can provide consumers. Cigarette smugglers can readily provide whatever type of packaging that smokers of any age want.

17. In my view, increasing the size of graphic health warnings from 50% to 85% will only make the significant illicit problem in Hong Kong worse by incentivising consumers' willingness to purchase the cheapest products available rather than pay the increasingly higher price for legal products which no longer look and feel like premium products. It will provide the illicit

⁶ <http://www.gov.hk/en/about/abouthk/factsheets/docs/customs.pdf>

⁷ <http://www.euromonitor.com/tobacco-in-hong-kong-china/report>

⁸ Available at http://www.stopit.hk/wp-content/uploads/2015/02/Hong_Kong_IT_Survey_2015_EN-FINAL.pdf

tobacco trader with an additional advantage in that they can provide packaging without large graphic health warnings if that is what consumers want.

18. As outlined above, the illicit trade in Hong Kong is well established. Consumers can easily find and purchase illicit product if they want to.
19. In addition to the public health and criminal impacts of the illicit trade, the impact of increased illicit trade will also deprive the Government of Hong Kong of duties and taxes associated with the licit, legitimate trade of tobacco.



John Hector

19 June 2015