What is the problem under consideration? Why is government intervention necessary?
The Scotch Whisky market is characterised by high value, high quality products with strong branding which are susceptible to imitation and counterfeiting. Many spirit drinks made in Europe benefit from national legislation which defines the product and its characteristics, including those which result from using materials and methods distinctive to the region of production. The EU Spirit Drinks Regulation [which is to be] adopted in December 2007 provides for EU recognition of geographical indications which will then benefit from the provisions of the World Trade Organisation’s Trade Related Intellectual Property Rights (TRIPS) Agreement, allowing the relevant products to protect their reputation through action against imitation and fraud in overseas markets. The adoption of the EC Regulation provides an opportunity to revise and enhance the UK rules on the definition of Scotch Whisky. There are a number of distinctive products and methods of production which have not previously been defined in legislation, and providing a statutory basis for these will benefit domestic consumers and, through EU recognition and TRIPS, provide protection for Scotch whisky in overseas markets, thereby supporting an important UK export. These benefits cannot be secured other than by national legislation because the relevant provisions are not contained in the new EC regulation.

What are the policy objectives and the intended effects?
The policy objective is to secure the benefits of a tighter definition of different types of Scotch whisky to improve consumer information and reduce the opportunity for imitation and fraud in both the UK and overseas markets. Robust domestic legislation is particularly important because the rules governing the production and sale of prestigious products (such as Scotch Whisky) in their home market are crucial to their effective protection in overseas markets from such things as counterfeiting and ‘passing-off’. This relates to the Defra Strategic Objective of a “thriving farming and food sector”.

What policy options have been considered? Please justify any preferred option.
1. Do nothing – i.e. maintain the status quo. This would allow the existing rules on Scotch whisky to form the basis of a geographical indication recognised at EU level but would not secure the benefits of more detailed definitions.
2. Introduce more detailed legislation to define Scotch whisky. This is the preferred option because it would provide stronger legal protection against imitation and fraud in both domestic and overseas markets.
Examples to support Option 2 are given in the evidence base summary.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? Defra will review the impact of the legislation three years after the new Regulations come into force, consulting local authorities, consumers and the industry itself. The consultation invites respondents to comment on the issues which will need to be addressed to demonstrate that the regulations have produced the desired effect.

Ministerial Sign-off For SELECT STAGE Impact Assessments:
I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:
......................................................................................................................................................Date:
### Summary: Analysis & Evidence

<table>
<thead>
<tr>
<th>Policy Option: 2</th>
<th>Description: UK legislation on enhancing the protection of Scotch Whisky</th>
</tr>
</thead>
</table>

#### ANNUAL COSTS

| Description and scale of key monetised costs by ‘main affected groups’ | Costs to the industry (producers, bottlers, warehouse keepers, wholesalers, retailers, exporters and ancillary businesses in the supply chain) will mainly be one-off, arising as a result of labelling changes. Exporters of Single Malt Scotch Whisky in bulk for bottling abroad may incur additional annual costs for having to bottle in Scotland before export, but this will be offset by the higher premium commanded by such goods. Compulsory labelling costs are not likely to be incurred until year 2. |
| One-off (excluding one-off) | £ 1 million Yrs 2 |
| Average Annual Cost | £ Nil |

**Total Cost (PV)** £ 1m

Other key non-monetised costs by ‘main affected groups’ There are unlikely to be any non-monetised costs.

#### ANNUAL BENEFITS

| Description and scale of key monetised benefits by ‘main affected groups’ | Producers and consumers of Scotch Whisky. The key benefit will be the enhanced protection arising from the measures to counteract the sale of counterfeit products, estimated at around 75 million bottles per annum. Combined with the dynamic benefits of strengthening the legal definitions, the benefits could be worth in the order of £100m, but in the absence of hard evidence this is a speculative figure |
| One-off (excluding one-off) | £ 100m (very rough) |
| Average Annual Benefit | £ Nil |

**Total Benefit (PV)** £ 500m- £1bn

Other key non-monetised benefits by ‘main affected groups’ Enhancing the reputation of Scotch Whisky in the UK and abroad, protection from unfair competition and protection of consumers from misleading practices and from counterfeit products.

#### Key Assumptions/Sensitivities/Risks

The evidence provided by the Scotch Whisky Association shows that the measures will result in minimal costs to the industry and will provide greater protection to consumers. But there is substantial uncertainty around the extent of benefits to producers and what constitutes a net benefit to the UK.

### Price Base Year 2007 Time Period One Years **Net Benefit Range (NPV) £ 500m-1bn**

<table>
<thead>
<tr>
<th>NET BENEFIT (NPV Best estimate)</th>
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</thead>
<tbody>
<tr>
<td>UK</td>
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</table>

<table>
<thead>
<tr>
<th>On what date will the policy be implemented?</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 2008</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Which organisation(s) will enforce the policy?</th>
</tr>
</thead>
<tbody>
<tr>
<td>To be confirmed</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>What is the total annual cost of enforcement for these organisations?</th>
</tr>
</thead>
<tbody>
<tr>
<td>£ to be confirmed</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Does enforcement comply with Hampton principles?</th>
</tr>
</thead>
<tbody>
<tr>
<td>To be confirmed</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Will implementation go beyond minimum EU requirements?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes – see evidence</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>What is the value of the proposed offsetting measure per year?</th>
</tr>
</thead>
<tbody>
<tr>
<td>£ N/A</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>What is the value of changes in greenhouse gas emissions?</th>
</tr>
</thead>
<tbody>
<tr>
<td>To be confirmed</td>
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</table>

<table>
<thead>
<tr>
<th>Will the proposal have a significant impact on competition?</th>
</tr>
</thead>
<tbody>
<tr>
<td>To be confirmed</td>
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</table>

<table>
<thead>
<tr>
<th>Annual cost (£-£) per organisation (excluding one-off)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Are any of these organisations exempt?</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
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</table>

### Impact on Admin Burdens Baseline (2005 Prices)

<table>
<thead>
<tr>
<th>Increase of</th>
<th>Decrease</th>
<th>Net Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>£ to be</td>
<td>£ N/A</td>
<td>£ to be confirmed</td>
</tr>
</tbody>
</table>

### Key:

Annual costs and benefits: (Net)
Rationale for Government intervention

One of the key principles of better regulation is that Government should only intervene where market forces either fail to operate efficiently ("market failure") or cause significant adverse social or ethical effects. Market failure can provide a rationale for government intervention to correct or strengthen market mechanisms cost-effectively with potential gains in economic welfare.

One theoretical cause of market failure relevant to the sale of Scotch Whisky on domestic and export markets is asymmetric information between producers and consumers. If consumers cannot differentiate between (the characteristics of) high and low quality products, high quality producers will be unable to obtain a higher price for their products, and lower quality products will tend to proliferate. This problem is often corrected through the use of branding as a signal of quality and reputation. However this may not be possible where the quality is not specific to an individual producer, and where competitors can appropriate the branding. High quality products will struggle to compete, even though consumers, if fully informed, would have been willing to pay for them.

This forms the legal and economic basis for geographical indications ("GI") which increase product information, and prevent imitation and misuse. However, in the case of Scotch Whisky, current GI recognition is insufficient to provide the safeguards against counterfeiting and fraud that the industry is calling for. The industry has demonstrated that it is necessary for government to introduce the proposals set out in this Impact Assessment since the industry’s own conventions cannot be enforced because they have no legal base. As a consequence, the different descriptors provided for the various categories of Scotch Whisky at present are confusing because they are applied inconsistently by the industry. This does not help the reputation of the industry and can lead to a loss of confidence in its ability to regulate itself and in future investment. Furthermore, consumers are left confused about the products that they buy because of this inconsistent labelling approach by the industry.

The ability of producers to export Scotch Whisky, including high-quality Single Malt Whiskies which command a high retail value, in wooden casks which can lead to a deterioration in the product at various stages of its maturation and bottling process, or at worst adulteration, does not do anything to maintain the high reputation of a brand worth over £2.5 billion in exports to over 170 countries around the world.

Like most successful products, Scotch Whisky has many imitators. Where those imitators seek to trade unfairly on the reputation of Scotch Whisky. It is essential that the industry is protected against such imitators. If that is not achieved, the industry risks losing market share to imitation products. The industry currently spends over £1.5 million per year taking action around the world to protect Scotch Whisky.

For each bottle of counterfeit “Scotch Whisky" sold, there is potentially a corresponding lost sale of genuine Scotch Whisky. The extent of lost sales will be determined by the proportion of consumers that bought the offending product in the belief it was a genuine Scotch Whisky. It is assumed that where the counterfeit product is specifically described as Scotch Whisky, the majority of consumers will have been deceived. Counterfeit Scotch Whiskies tend to be sold in most markets for the same price as genuine Scotch Whisky and through similar retail outlets. However, in a limited number of markets, products passed off as Scotch Whisky are frequently sold at much lower prices than genuine Scotch Whisky, and it cannot be assumed that the consumer would have been deceived and would necessarily have bought a genuine product.
Scotch Whisky has over 30% of the UK market share of the spirit drinks sector. It is sold in over 170 countries around the world.

Exports of Scotch Whisky were worth £2.5bn in 2006. Its export performance (and that of the UK spirits sector as a whole) is why the UK is the centre of operations for two of the world’s largest spirits producers - **Diageo** (owner of **Johnnie Walker Red Label** whisky, and **Bell’s** whisky) and **Pernod Ricard** (**Ballantine's** whisky and **Chivas Regal**).

Broadly, producers in the UK industry fall into two main groups namely (1) distillers of Scotch Whisky, the majority of who are also brand owners engaged in the wholesale trade, and (2) non-distillers engaged in the wholesale trade, producing brands from Scotch Whisky distilled by companies in group 1. Whilst there are in the region of 90 producers in these two groups, the industry is highly concentrated, with the top 6 companies accounting for 85% of distilling capacity and world wide case sales. **Diageo** is the industry leader, with a world market share of approximately 34% and 29 distilleries. **Pernod Ricard** is the second largest with a world market share amounting to approximately 23% and 15 distilleries. According to research for the Scotch Whisky Association, over 7,000 people are employed in the industry and over £90 million worth of Scottish cereals are used.

The growth in exports of Scotch Whisky in 2006 was particularly marked for both Malt and Blended Scotch Whisky. Single Malt Scotch Whisky is the ‘crème de la crème’ of Scotch Whiskies and is one of the whiskies which the industry in particular wishes to enhance by the measures set out below.

One of the particular problems that Scotch Whisky faces is that caused by its reputation as a quality product and the fact that it is mainly exported. Imitation and counterfeiting are particular problems for Scotch Whisky which the proposals outlined in this IA address.

Many foreign courts do not understand the legal protection afforded to Scotch Whisky, mainly because the industry, when challenged abroad, is not able to produce a piece of legislation which specifically provides for the kind of protection they seek.

EU and UK legislation currently protects Scotch Whisky as a geographical indication, based on the Scotch Whisky Act 1988 and the Scotch Whisky Order 1990. However, both these pieces of legislation pre-date the 1994 World Trade Organisation’s Agreement on Trade Related Aspects of International Property Rights (“TRIPS”) which defined GIs and provided for their international protection. The Act and Order are based on a definition dating back to 1969 and neither is formulated to take full advantage of the protection now afforded by TRIPS. In particular, neither the Act nor the Order goes as far as the industry, following consultation by the SWA, wishes to go because neither currently provides for the enhanced protection that the Scotch Whisky Association is asking for as detailed below.

For these reasons, the UK government supports the industry in seeking enhanced protection which, because this will be set out in a specific piece of legislation called The Scotch Whisky Regulations, will in the considerable experience of the industry, bring sufficient clarity and recognition to the legal protection afforded to Scotch Whisky, to enable it to fight against counterfeiting and adulteration in foreign courts more effectively than at present.

**Government Intervention**

**Option 1 – the status quo**

Whilst this would allow the existing rules on Scotch whisky to form the basis of a geographical indication recognised at EU level, it would not provide any of the extra protective measures that the industry have shown to be necessary to protect their valuable
brand. The current Scotch Whisky definition is open to misinterpretation, allowing further maturation of Scotch Whisky abroad through its export in wooden casks where it could, after the minimum three-year maturation period required for Scotch Whisky, be further matured, thus changing its essential character, making it no longer a Scotch Whisky. This goes against the whole principle of ensuring Scotch Whisky is a wholly Scottish product, produced and matured entirely in Scotland. The current rules also cannot prevent adulteration abroad, particularly of the premium Single Malt Scotch Whisky, because there are currently no restrictions on the export of such Scotch Whisky in bulk.

**Option 2 – the new categories and protection**

The seven measures set out below were chosen by the SWA after lengthy consultation of the industry, in order to address specific issues explained above. The specific measures and their intended effect are:

i) **Definition of maturation** – this will ensure that Scotch Whisky is wholly matured in Scotland. At present, the Scotch Whisky Order requires that maturation take place in Scotland, “the period of maturation being not less than 3 years”. This is open to the misinterpretation that once the initial 3-year period is over, there is nothing to stop a producer from exporting the Scotch Whisky in bulk where it could continue to mature. Such maturation would alter the whole character of the whisky and mean that it was no longer wholly produced in Scotland, thereby undermining the GI.

ii) **Prohibition on bulk exports in wooden casks** – again this is about maintaining the reputation, quality and therefore high value of the brand. Currently, Scotch Whisky can be exported in bulk in wooden casks, but this means that there is lack of control over its quality because Scotch continues to mature whilst in wooden casks. Ensuring that such bulk exports are only allowed in future to take place if the Scotch Whisky is in an inert container (such as a steel drum or plastic container) will mean that no further maturation outside Scotland can take place.

iii) **Requirement for Single Malt Scotch Whisky to be bottled in Scotland** – again this is about maintaining the quality and high value of premium Scotch Whisky. Once bottled, Scotch Whisky, (indeed all spirits) unlike wine, stops maturing. Such an export prohibition as this will ensure that Single Malts (premium Scotch whiskies) maintain their quality and that this quality can be ensured by the expert bottlers in Scotland. No guarantees can be afforded that bottlers outside Scotland have the expertise required. Examples of the type of common ways in which the character of Scotch Whisky can be badly affected before or during bottling are:

- Contamination of the bottling line
- Deliberate addition of flavourings, or sugar
- Adulteration with other spirit
- Inappropriate filtration
- Dilution below the minimum legal strength for Scotch Whisky, and
- Use of inappropriate water.

There is a precedent for such a trade restriction, as set out in the ECJ Case (338/95) which concerned Quality wines produced in a specified region - Designations of origin – and the obligation to bottle in the region of production. The ECJ found in favour of Rioja wine producers who wanted to protect the quality of Rioja by ensuring it was bottled in the region where it was produced and not exported in bulk. This is exactly the same reason for this proposed measure.
iv) **Scotch Whisky definitions and labelling** – there are currently no legally binding definitions for different categories of Scotch Whisky. The only legally defined and protected term is Scotch Whisky itself. (Note: the Finance Act 1969 [as amended] contains a definition of “Blended Scotch Whisky” which is still extant, albeit it has been provisionally repealed. However, that definition is in any case consistent with the definitions currently proposed). The industry has therefore relied on its own conventions and practices, but these have no force in law and are not readily enforceable abroad. Moreover, notwithstanding those conventions, the use of various descriptions has blurred the distinction between the various categories of Scotch Whisky, making them confusing to the average consumer. For this reason, the industry thinks that it is worth using the opportunity provided by the introduction of new EC legislation, to provide for clarity in Scotch Whisky category definitions in UK law. This will ensure that terms currently used in different ways by the industry, finally have agreed meanings that consumers and enforcement authorities, both in the UK and abroad can understand and be confident have legal force.

v) **Protection of Regional names** – the purpose of this is to protect traditional locality and regional names which the SWA has demonstrated to Defra, have been exploited by unscrupulous traders. Examples include “Highland Chief” (on an Indian product), “Lowlands” (on a Spanish product), “Speysids” (sic) (on a Spanish product), and “Islay Cream” (on an Italian product). This occurs because the following terms:

- Highland
- Lowland
- Speyside
- Campbeltown, and
- Islay

do not have any legal protection under EU or UK law, but are recognised by consumers as being associated with Scotch Whisky. They are therefore used to provide spurious authenticity to spirits products which have nothing to do with the location in question or the Scotch Whisky characteristics of that location. The definition of these terms would also stop anyone in future using them to describe a Scotch Whisky finish (e.g. Islay Cask Finish) when the Scotch Whisky in question has not been distilled and matured on Islay. The proposed protection of the names would only apply to Scotch Whisky and Whisky-based drinks. Other producers would therefore continue to be able to use these terms to describe their own products, e.g. the producer of lowland lamb. Trade marks currently using these terms as part of the trade mark e.g. Highland Queen, would be exempt from the prohibition on their use, including those who are using the trade mark as a description for a whisky, provided that this did not result in consumer deception.

vi) **Prohibition on the use of the term ‘Pure Malt’** – this has been proposed because of the use of the word ‘pure’, which for consumers means something special or superior. All categories of Scotch Whisky must conform to the basic definition and could be described as “pure” Scotch Whisky. However, the expression “Pure Malt” has more often been used as a pseudo category in its own right. This has caused two types of consumer confusion; on the one hand an expectation that “Pure Malt” must be superior to “Single Malt”, and on the other hand a belief that a “Pure Malt” is a Single Malt. In fact, the expression is currently most often used as the sales description for Blended Malt Scotch Whisky.

vii) **Controls on the use of Distillery and Distillers’ names** – to protect consumers this proposal will prohibit misleading references to distilleries or distillers on Scotch Whisky labels. In the case of a Single Malt or Single Grain Scotch Whisky, the use of a distillery name will be forbidden anywhere on labelling or packaging unless the whisky has been distilled in the named distillery. In the case of other Scotch Whiskies (i.e. blends), it will be
forbidden to use a distillery name as the brand name, but such a name may appear in a
description of the drink provided that whisky from that distillery is present in the blend, and
it is clear from the presentation that the brand also contains other whiskies. Where the
names of certain closed distilleries have been used on other whiskies for many years
without causing confusion, those names will qualify for an exemption provided that, in the
case of Single Whiskies, the actual distillery is also identified. To ensure that these
proposals are not undermined, the use of names which resemble a distillery name will be
forbidden on the labelling and packaging of Single Malt and Single Grain Scotch Whisky,
and labelling, packaging or advertising which suggests that any Scotch whisky has been
distilled at a distillery other than the true distillery will also be forbidden. The regulation will
also forbid labelling, packaging and advertising which suggests that a Single Malt or Single
Grain Scotch Whisky has been distilled by any person other than the actual distiller, owner
or operator of the distillery where the brand was distilled. Blended Scotch Whiskies will not
be affected by the latter provision as the name of the producer, who may or may not be a
distiller, identifies the blender rather than the distiller or the place of distillation.

viii The year of distillation and age – Older whiskies command a significant premium.
Consumers can be misled as to the age of a Scotch Whisky if only the date of distillation is
given. For example, a statement “Distilled 2000” is likely to suggest to a purchaser buying
the product in 2007, that the brand has been matured for 7 years, whereas it may be a 4
year old whisky bottled in 2004. The proposal will require the date of bottling, or the actual
age, to be stated in addition to the distillation date. It is customary to state the age of a
whisky by the use of a prominent single figure in years. However, there is currently nothing
to stop the age being stated in the form of a prominent single figure representing the
months of maturation. To prevent the use of spurious age claims on Scotch Whisky, the
age will have to be shown in years.

Costs and benefits

- **Sectors and groups affected** – the sectors and groups affected by these
proposals are the following.

**Option 1 and 2**

- **Distillers** (of Scotch Whisky) – there are 30 companies engaged in the
distillation of Scotch Whisky, comprising 10 large enterprises, 6 of which account
for 85% of capacity. The remaining 20 distillers are Small or Medium-Size
Enterprises (SMEs)
- **Wholesalers** - Almost all distillers are also wholesalers. In addition, there
are in the UK approximately 60 companies who do not distil Scotch Whisky, but
are brand owners engaged in the wholesale trade. These comprise 2 large
enterprises and 58 SMEs
- **Bottlers** – approximately 25 enterprises in the above two categories also
bottle Scotch Whisky. (11 out of 12 of the large enterprises, and 14 SMEs). In
addition one SME functions as a contract bottler alone
- **Warehouse keepers** (nearly 700 member companies of UK Warehouse
Association, operate around 100 million sq ft of warehouse and distribution
centre space from some 2000 locations across the UK).
- **Retailers** (over 700 in the food and drink sector)
- **Consumers**, and
- **Ancillary businesses** in the supply chain. No data on individual
businesses.

The most recent information available relates to a study for the SWA by DTZ Pieda
Consulting in 2000 showing purchases from ancillary businesses in the supply chain as
follows:
<table>
<thead>
<tr>
<th>Sector</th>
<th>UK expenditure in 2000 (£million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cereals</td>
<td>118.59</td>
</tr>
<tr>
<td>Packaging</td>
<td>255.31</td>
</tr>
<tr>
<td>Bottles</td>
<td>149.40</td>
</tr>
<tr>
<td>Plant &amp; Machinery</td>
<td>59.84</td>
</tr>
<tr>
<td>Energy</td>
<td>40.43</td>
</tr>
<tr>
<td>Transport &amp; Distribution</td>
<td>82.53</td>
</tr>
<tr>
<td>Other services</td>
<td>312.76</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>£1,018.87m</strong></td>
</tr>
</tbody>
</table>

- **Benefits**

**Option 1** – Status quo, existing protection for Scotch Whisky *per se*.

**Option 2** – Overall, greater protection for producers and consumers, and a reduction in costs to the industry taking action to protect Scotch Whisky. These are specifically explained below.

**National Benefits**

At present, the description “Scotch whisky” is geographical. No whisky may be described as “Scotch whisky” which has not been wholly distilled and matured in Scotland. There is no need to emphasise the probable consequences for the Scotch Whisky industry, and therefore the UK economy, if as a result of misuse, the description “Scotch Whisky” became generic like “Cheddar Cheese” and could be applied to a type of whisky which could be produced anywhere. Whilst the UK has robust laws both in Statute and at Common Law, to prevent deceptive marketing, that is of no avail if the description “Scotch Whisky” is allowed to be misused abroad, and becomes generic there as a result of misuse. It is in the vital interests of the UK economy that this should not happen. Whilst the industry itself takes vigorous action abroad to protect consumers from deception, it is hampered by the fact that practice within the trade is often the result of convention, and cannot be shown to be enshrined in UK law. By enshrining these matters in UK law, the industry will be much better placed to protect Scotch Whisky worldwide, and maintain a situation in which consumers can and do rely on the geographical significance of the description “Scotch Whisky”. The importance of this to the UK economy is beyond price.

The overall benefit to the UK of being able to demonstrate tight control of every aspect of Scotch Whisky production, cannot be over-emphasized. For example, if there are aspects of the production of Scotch Whisky which cannot be verified, protection at EU level would be lost.

**Producer benefits**

In 2006 the industry exported over 1 billion bottles of whisky with a sales value of £2.5 billion, giving an average of £2.50 per bottle. The average value of domestic retail sales will be greater (because of the additional value added in the transport and retailing stages of the chain).

The SWA estimate that legal cases have highlighted some 150m bottles worldwide were sold over a two-year period that could be considered counterfeit. At average values, this

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1 According to HMRC figures, Scotch Whisky released for UK consumption in 2006 amounted to 28,259,200 LPA, equivalent to 101 million bottles. Mintel estimate UK 2005 sales at around £2.7 bn.
gives a very broad figure of £200m p.a. worth of sales. This would not be the cost to the industry, for two reasons:

(i) many of these still represent sales by the producer, for example where genuine Scotch Whisky is used as an ingredient, or is adulterated. On the other hand, there could be other misleading sales of Scotch Whisky that have not been picked up. But in any case, the introduction of regulations to enforce existing definitions would not necessarily eliminate counterfeit sales. Very crudely assuming that counterfeit sales would halve, we might speculate that legitimate Scotch Whisky sales might increase by up to £100m p.a.

(ii) sales are not the same as lost profit. According to the Grocer 150 index, the operating profit of the big whisky producers Diageo and the Edrington Group was over 20% in 2005, but other producers are known to have smaller margins. Applying a profit margin of 20% across all lost sales would yield additional benefits of around £20m (following on from the bullet above), but again this is speculative. A plausible range might be £10-30m.

By enabling the industry to uphold intellectual property definitions of Scotch whisky, the proposed regulations would substantially reduce the risk to the whole Scotch Whisky brand of being undermined both in established markets and in emerging markets. Industry focuses on future demand because Scotch Whisky needs to be matured for at least 3 years. Some focus on long periods, e.g. Chivas Regal is sold at 12, 18 and 25 years etc. Experience shows that loss of reputation, through exposition of illegal or consumer unfriendly practices can inflict grave damage on brands, sales and product investment. Again, estimating benefits is very speculative, but even if a loss of 2% of the world spirit drinks market was avoided, this would be worth £50m p.a. Avoiding a loss of 10% would be worth £250m p.a. These figures are only indicative, and they would relate to future benefits. They also show that potentially the dynamic benefits of action (or the risks of inaction) are likely to be particularly significant.

Of course, these “additional” sales figures are likely to be at the expense of other sales. However, a large proportion of such displaced sales could not be considered legitimate or would be lost to overseas suppliers and/or bottlers.

In the light of these crude calculations, as a working assumption, the benefits of the regulations to the industry could be as follows:

Fewer counterfeit sales (around £10-30m p.a.) + dynamic sales effects (£50-£250m p.a.) = a total of £60 - £280m.

These estimates are inevitably crude and speculative, but they offer a starting point for assessing the possible benefits of action and the underlying assumptions. We would therefore welcome additional evidence from consultees in relation to:

- Realistic estimates of the reduction in counterfeit sales worldwide
- The extent to which gains for the whisky industry might be offset by lost legitimate sales by other UK drinks producers.
- Plausible assumptions about the relationship over time between misrepresentation, reputation and sales.
- Which of the proposed seven areas of regulation are likely to yield the highest benefits?

Consumer benefits

Although most Scotch is exported, the UK consumer market is itself significant, with a retail value of £2.7bn in 2006 according to Mintel. Retail prices vary between brands and outlets. Malt whisky trades at a substantial premium (e.g. see retailers’ price checkers for whisky products).
It is not just Scotch Whisky producers who lose out from other producers or wholesalers making illegitimate use of the Scotch Whisky definition. Consumers would become confused about the nature of Scotch Whisky and this could eventually erode differentiation within the market. Consumer choice would suffer, average product quality could be diminished and consumer appreciation of the regional and cultural heritage of Scotch Whisky would become eroded. Quantifying such benefits of prevention in any meaningful way makes little sense, but the size of the market and the differentiation within the market suggest that consumers greatly value the quality of Scotch Whisky (and are prepared to pay for it), and that any counterfeiting would represent a material harm to consumers.

(i) Definition of Maturation

It is not possible to quantify the financial benefits of this measure for the industry. However, the Scotch Whisky Association (SWA) have evidence that this measure will benefit producers and wholesalers by preserving the geographical distinctiveness of Scotch Whisky and therefore support the market for the ageing of Scotch Whisky in Scotland. Maturation is part of the production process of Whisky. If Scotch Whisky is allowed to be taken abroad for maturation, it would have two effects: Firstly, it would mean that Scotch Whisky need not be wholly produced in Scotland. It has been alleged that this is indeed the effect of the current legislation. Whilst the industry has legal advice to the contrary, it is vitally important that the matter is put beyond any doubt, so that the UK retains tight control on the production of Scotch Whisky, and its international protection as a product wholly produced in Scotland is not put in doubt. Secondly, it would cause confusion for consumers who would no longer be able to rely on the geographical significance of the term “Scotch Whisky”. The geographical origin of whisky is of importance to consumers, but the exact provenance of a whisky produced partly in one country and partly in another would be in doubt. The SWA believes that this measure is of high importance, and the benefit of removing any doubts in this area is very high. In economic terms, investment in maturation in Scotland is significant. For example, in February 2007 Diageo announced an investment of £20 million in packaging and warehousing, and in July 2007 Bacardi announced that it was building a new maturation warehouse in South Lanarkshire. As at 31 Dec 2006, stocks of maturing Scotch whisky stood at over 2.9 billion litres of pure alcohol (LPA) [A litre of pure alcohol is equivalent to 3.57 bottles].

(ii) Prohibition on Bulk Exports in Wooden Casks

Scotch whisky continues to mature for the entire period it is in cask. This measure is a logical consequence of the preceding measure and will preserve the geographical distinctiveness of Scotch Whisky and maintain the market for stocks of Scotch Whisky ageing in Scotland, thereby benefitting wholesalers. The measure will also benefit consumers by avoiding confusion between genuine Scotch Whisky and whisky only partly matured in Scotland. This provision will apply to all Scotch Whisky producers who export. See above for the levels of maturation in Scotland, and recent investments in this area.

(iii) Requirement for Single Malt Scotch Whisky to be bottled in Scotland

The proposal will prevent the significant adulteration / contamination problems experienced by other categories of Scotch Whisky shipped in bulk being extended to Single Malt Scotch Whisky, the industry’s premium product. The proposal also has reputational benefits for Single Malt Scotch Whisky with “Bottled in Scotland” product commanding a premium. The current economic benefit to bottlers is relatively small, but is likely to increase significantly as the category expands. The benefit for small bottlers is likely to be more pronounced, due to the fact that specialist bottlings of Single Malt Scotch Whisky may be a significant part of their business. However, it is not possible to quantify the financial value of these benefits. The long term benefit, if the sector grows, is likely to be much more significant.
(Exports of bottled Scotch Malt Whisky increased by 24% in 2006). The regulation may also benefit ancillary businesses in the supply chain because the quantity of dry goods required in the UK will increase

(iv) Scotch Whisky Definitions / Labelling

The new regulations will also provide greater clarity and consistency of labelling for consumers. In the past, the use of varied descriptions has blurred the distinction between the categories of Scotch Whisky. These will now be compulsorily identified, making it easier to market each category in its own right.

The provisions against misleading labelling will make it easier for the industry to challenge deceptive labelling by whisky producers suggesting that a product is Scotch Whisky when it is not. As an indication of the scale of malpractice, in a recent two year period the SWA estimated that in 50 per cent of legal cases where it was possible to recover sales data, over 100 million bottles of misleadingly labelled product had been sold worldwide. In the remaining cases, information on volumes sold was not available. It is assumed that the true scale of the problem is significantly greater than the legal challenges indicate, and may increase if not addressed.

Ancillary businesses in the supply chain that are engaged in the production of dry goods could benefit marginally if label design changes are made earlier than would otherwise have been the case.

(v) Protection of Regional Names

The measure protects the traditional regional names for Scotch Whisky as Geographical Indications and will enable these names to be protected more easily, and therefore more cheaply, abroad. The value in terms of increased protection and reputational benefit is difficult to quantify but potentially significant in the medium to long term. The proposal will also provide consistency and clarity for consumers.

(vi) Prohibition on the Use of the Description “Pure Malt”

There is evidence of consumer confusion between “Single Malt” and “Pure Malt” and the Scotch Whisky Association believes that some brands of “Pure Malt” have been able to take advantage of this confusion in their marketing. The proposal will therefore provide clarity and consistency for the consumer. The financial value of this benefit cannot be readily quantified.

(vii) Controls on the Use of Distiller’s Names and Trade Marks on Single Scotch Whiskies

This measure will prevent a producer portraying itself as the distiller of Single Scotch Whisky when this is not the case, or using a trade mark which suggests distillation at a place other than the true distillery. Certain existing brands may be exempted from the provisions relating to distillery names subject to identifying, in the case of Single Malt and Single Grain Scotch Whiskies, the actual distillery where the whisky was distilled. This will provide extra information for the consumer in those cases where the identity of the Single Malt Scotch Whisky sold under the name of a closed distillery changes on a regular basis. The proposal will therefore, provide consistency and clarity for consumers.

The proposal also ensures that the integrity of indications of origin used on Scotch whisky is preserved.

- Costs
Option 1 – No new costs.

It is difficult to assess levels of deception where the indications of Scottish origin are indirect. For example, instances of words that suggest a strong association with Scotland and suggest that the product is Scotch Whisky have been identified by the industry.

Malpractice increases the risk of lost sales of genuine Scotch Whisky in the future. If a consumer purchases a ‘fake’ Scotch Whisky and has a negative experience of it, it is possible that they may decide not to drink Scotch Whisky again, and may not change their minds unless they recognise that they were deceived or are subsequently given a genuine Scotch Whisky to drink. This could mean a loss of sales for the Scotch Whisky industry lasting over many years. Furthermore, a consumer having such an experience may share their negativity of the fake product with others which in turn may influence their purchasing decisions in the future. For these reasons, every sale of a fake Scotch Whisky, which will inevitably be of lower quality than genuine Scotch Whisky, is likely to result in much larger loss of future sales.

Furthermore, they may no longer believe they can rely on the description “Scotch Whisky” (or for example “Single Malt Scotch Whisky”) on the label to indicate the source and high quality of the product.

The most significant damage which would be caused through the sale of counterfeit products is that the description “Scotch Whisky”, as a result of extensive misuse, no longer signifies to consumers that the product is a whisky from Scotland. If this were to occur, the investment in quality and advertising by the industry over more than a century would be wasted, with consequent damage to the UK economy. While consumers both in the UK and abroad might still know that Scotch Whisky was a product to be sought after, they might end up inadvertently purchasing “Scotch Whisky” that is not Scotch Whisky.

Option 2

This Option involves the introduction of more detailed legislation to define Scotch whisky. This is the preferred option because it would provide stronger legal protection against imitation and fraud in both domestic and overseas markets.

(i) Definition of Maturation

It is proposed that the definition of Scotch Whisky within the new Regulations will require it to be wholly matured under Customs control in Scotland. The measure will reinforce the existing prohibition on the maturation of Scotch Whisky outside of Scotland set out in the Scotch Whisky Act 1988 and the Scotch Whisky Order 1990, which has been misinterpreted by some as allowing further maturation in oak casks outside of Scotland after a minimum maturation period in Scotland of three years. As maturation of Scotch Whisky outside of Scotland is currently illegal under the Scotch Whisky Act 1988 and the Scotch Whisky Order 1990, there are no eligible costs to UK businesses associated with strengthening the definition as proposed.

(ii) Prohibition on Bulk Exports in Wooden Casks

To ensure compliance with the requirement that Scotch Whisky be wholly matured in Scotland, it is proposed that the new regulations will also prohibit the export of Scotch Whisky in oak casks. Exports of Scotch Whisky - excluding Single Malt Scotch Whisky - in steel or plastic containers for the purposes of bottling overseas, will, however, be allowed under the new regulations. There is a potential cost to wholesalers from the loss of bulk sales to customers seeking exports in wooden casks. However, in terms of
current practice it is considered to be rare for Scotch Whisky to be exported in this form due to the leakage of wooden casks and the resulting costs of this mode of transit. Potential lost sales are therefore believed to be negligible, and alternative inert containers are available for bulk shipping of Scotch Whisky. Furthermore, as maturation of Scotch Whisky outside of Scotland is currently illegal under the Scotch Whisky Act 1988 and the Scotch Whisky Order 1990, and export in casks results in such maturation, the costs of this measure to UK businesses are not regarded as eligible.

(iii) Requirement for Single Malt Scotch Whisky to be bottled in Scotland

In the case of Single Malt Scotch Whisky, it is proposed that regulations should stipulate that it should not only be matured but also bottled in Scotland. These stricter regulations are aimed at protecting the reputation of Single Malt Scotch Whisky, the premium Scotch Whisky on the market, and preventing adulteration or contamination during the bottling process. It is important that regulations protect the quality and reputation of the industry’s premium product by requiring that it is both matured and bottled in Scotland.

No significant impact is expected as all brands of Single Malt Scotch Whisky sold by or on behalf of distillery owners (proprietary brands) are already bottled in Scotland. Currently, Single Malt Scotch Whisky is exported in bulk for bottling abroad as Single Malt Scotch Whisky by a very small number of producers.

The vast majority of Malt Scotch Whisky is exported in bottle. In 2006, for example, exports of Malt Scotch whisky in bottle amounted to 21.37 million LPA, i.e. 7% of total Scotch Whisky exports, and were valued at £409,550,000, equivalent to £19 per litre. By contrast, bulk exports of Scotch Malt Whisky amounted to 7.2 million LPA, i.e. 2.4% of total Scotch Whisky exports, valued at £22,500,000, equivalent to £3.125 per litre. Statistics do not allow a breakdown between Single Malt Scotch Whisky and Blended Malt Scotch Whisky, but the majority of bottled Malt Scotch Whisky is likely to be Single Malt Scotch Whisky, and commands a premium price. The vast majority of Malt Scotch Whisky exported in bulk is sold for blending / admixture with foreign whiskies, and Blended Malt Scotch Whisky can be supplied to meet this requirement. The amount of Single Malt Scotch Whisky exported in bulk for bottling abroad as Single Malt Scotch Whisky is estimated to be in the region of 1% of the amount of Single Malt exported in bottle i.e. 0.2 million LPA.. At a cost of £3.125 per bulk litre, the trade affected by this measure is therefore estimated to be worth approximately £625,000. However, the industry believes that this measure will result in that trade being replaced by Single Malt Scotch Whisky in bottle.

(iv) Scotch Whisky Definitions / Labelling

It is estimated that around 90 per cent of Scotch Whisky brand owners (i.e. 98 per cent of Scotch Whisky companies) will be required to make changes to their labels to comply with the proposals.

The industry has indicated that these measures are expected to have a negligible impact on large producers. Whilst design costs for large companies can amount to £20,000 per brand, design changes are undertaken on a frequent basis, both to incorporate changes in compulsory requirements and to maintain a fresh brand image. Labelling print runs for large brands may take place as often as every 4-6 weeks. As a result, changes to labels can be undertaken as part of frequent design changes. Stocks of the cartons or tubes sometimes used to package individual bottles, by contrast, may last a couple of years, and the same may apply to advertising, both in film and print. The latter can, however, often be digitally amended to reflect a new presentation, thus reducing costs.

Small producers are expected to incur some costs as a result of this measure. Originating label changes for each brand are estimated to be between £1,000 and £2,000. Except
where there is a change in other compulsory information required by Government, labels may only be updated at intervals of around ten years and stocks of cartons may last several years. It is estimated that there are approximately 480 brand produced by SMEs (including different expressions of the same brand), so total costs could range from between £500,000 to £1 million.

The proposed two year derogation period from the date the legislation is enacted would assist in minimising costs to all businesses engaged in the production and sale of Scotch Whisky. The transition period would allow companies to use existing labels until the end of that period, with stocks in the hands of retailers being sold off until exhausted. The industry therefore believes the cost of the required changes can be absorbed as part of its normal business.

(v) Protection of Regional Names

The aim of this proposal is to protect the following regional or locality names which have traditionally been used to describe Scotch Whiskies:

- Highland
- Lowland
- Speyside
- Campbeltown
- Islay

The industry has indicated that this provision is expected to result in no significant costs for the industry. There are a number of established brands which have used a regional name as part of the brand name of a Blended Scotch Whisky without confusion. Where these are established trademarks, they will be exempted from the restriction limiting the use of regional names to Scotch Whiskies from the regions in question. If the value of the brand is so low that it does not justify trademark protection, the cost of complying with the legislation is unlikely to be significant, and the brand can be replaced with another brand name. Brand names which the proprietor does not wish to incur the cost of protecting, are common in the trade, and are often regarded as “disposable”.

Recognition of the regional names as Geographical Indications will give these names international protection, thereby increasing the scope for legal action in the future. This could result in potential costs for the SWA which may have to prevent the names in question being adopted by producers abroad. However, current cases where the SWA is taking legal action to prevent the misuse of the traditional regional names on products produced abroad are relatively small in number and the misuse of the name is generally part of a package other of misleading elements, all of which would be challenged in any event. Any increase in costs is therefore likely to be very small, and is likely to be offset by savings arising from the fact that it is generally cheaper to defend a protected Geographical Indication than it is to defend an unprotected name.

(vi) Prohibition on the Use of the Description “Pure Malt”

The proposed measure will provide clarity for the consumer, and remove the pseudo category of “Pure Malt” from use which has reportedly caused confusion.

The costs of label changes are as identified under the definitions/labelling measure.

(vii) Controls on the Use of Distillers’ Names and Trade Marks on Single Malt Scotch Whiskies
It is proposed to introduce controls on the use of distillery names.

In the case of a Single Malt or Single Grain Scotch Whisky, it is proposed that a distillery name may not appear anywhere on the labelling or packaging unless the whisky has been distilled in the named distillery. In the case of other Scotch Whiskies, it is proposed that a distillery name may not appear as the brand name on labelling or packaging, but may appear in a description of the drink provided that whisky from that distillery is present in the blend, and it is clear from the presentation that the brand also contains other whiskies. Both these provisions may require some brand owners to change their labels.

However, where certain defunct distillery names have been used on whiskies for many years without causing confusion, those names will qualify for an exemption provided that, in the case of Single Malt Whiskies, the actual distillery is also identified. Label changes will also be required under these circumstances.

To ensure that these proposals are not undermined, it is also proposed that the use of names which resemble a distillery name should be forbidden on the labelling and packaging of Single Malt and Single Grain Scotch Whisky, and that labelling, packaging or advertising which suggests that any Scotch whisky has been distilled at a distillery other than the true distillery will be forbidden. Both provisions may require some brand owners to change their labels.

It is also proposed to introduce controls on the use of distiller’s names on Single Malt and Single Grain Scotch Whisky.

The regulation would forbid labelling, packaging and advertising which suggests that a Single Malt or Single Grain Scotch Whisky has been distilled by any person other than the actual distiller, owner or operator of the distillery where the brand was distilled. This provision may require some brand owners to change their labels. Blended Scotch whiskies will not be affected by this provision as the name of the producer, who may or may not be a distiller, identifies the blender rather than the distiller or the place of distillation.

Details of the costs of label changes are given in the definitions/labelling section. The main affected groups likely to incur costs are the same as those identified under the definitions/labelling provision. In addition, retailers of some “own label” Single Malt Scotch Whiskies may face costs where they are required to identify the distillery at which the Single Malt Scotch Whisky was distilled. This could arise either because the brand name currently used is that of a defunct distillery and an exemption is granted on the condition that the true distillery is identified, or because the name of the distillery is added voluntarily to some brands where it is considered that the brand name or packaging may give rise to a risk that consumers may be misled as to the place of distillation. Where the supplier of these brands, and therefore the identity of the Single Malt Scotch Whisky in question, changes on a regular basis, there will be an additional compliance cost. This cannot be quantified as it will depend on whether or not an exemption is sought, and that may in turn depend on the frequency with which a retailer changes supplier. Any additional cost could, moreover, be avoided by the adoption of an alternative name for the “own label” product, which would only involve a “one off” label change.

Specific Impact Tests

Competition Assessment

- Q. 1 Directly limit the number or range of suppliers?
The proposals will have no impact on the number or range of suppliers. The proposals are aimed at ensuring that every stage of the production of Scotch Whisky can be verified before it is placed on the market (an EU requirement), and that terminology on labels is clear and does not mislead consumers. By protecting and enhancing the reputation of Scotch Whisky, the proposals will ensure that Scotch Whisky is better able to compete worldwide, thereby encouraging new entrants to take part in the industry.

- **Q. 2** Indirectly limit the number or range of suppliers?
  - See answer to above.
- **Q. 3** Limit the ability of suppliers to compete?
  - It is in the nature of a protected Geographical Indication that all suppliers must obey the rules applicable to a particular GI. That is currently the position with the existing UK legislation, and it is illegal for any enterprise to seek a competitive advantage by not observing the rules. The introduction of new rules governing areas previously covered by custom and practice will ensure a more level playing field for all enterprises and help to encourage new entrants. On the other hand it is possible that new regulations may create unnecessary new barriers to legitimate market entry and innovation, and we need to be assured that this would not be the case.
- **Q. 4** Reduce suppliers’ incentives to compete vigorously?
  - See answer to above.

Given the uncertainty at this stage over the totality of effects on market competition, we intend to consider further these questions, particularly 3 and 4.

We would welcome the views of consultees on these questions.

**Small Firms Impact Test**

There are 30 companies engaged in the distillation of Scotch Whisky, comprising 10 large enterprises, 6 of which account for 85% of capacity. The remaining 20 distillers are SMEs. Almost all distillers are also wholesalers. In addition there are in the UK approximately 60 companies who do not distil Scotch Whisky, but are brand owners engaged in the wholesale trade. These comprise 2 large enterprises and 58 SMEs. Approximately 25 enterprises in the foregoing two categories also bottle Scotch Whisky. (11 out of 12 of the large enterprises, and 14 SMEs). In addition one SME functions as a contract bottler alone. The impact of these proposals will fall most heavily on the six large enterprises which account for 85% of worldwide case sales and have, proportionately, the most brands. These proposals will not disproportionately affect SMEs.

**Legal Aid**

[These proposals will create new sanctions through fixed penalty notices. [To be expanded]. Does legal aid apply to civil actions?]

**Carbon Impact Assessment and other environmental issues**

It is not possible at this stage to estimate what impact, if any these proposals may have on a fuller range of environmental indicators, such as green house gas emissions or water quality. However, Scotch Whisky distillers are closely tied to the environment, their products being uniquely influenced by the supply of natural raw materials and a range of factors including water, location, and climate.

Protecting the environment and promoting sustainability are therefore top priorities, underpinning Scotch Whisky’s reputation for quality around the world. Distillers work closely with communities to support the local environment, for example, by using
excess distillery heat to provide low cost energy to local homes. Scotch Whisky also underpins a sustainable local economy in many rural areas of Scotland, where other opportunities may be limited.

Distillers are investing in innovative technology to minimise environmental impacts and resource use. Energy-saving measures range from small steps such as upgrading a boiler unit, to major capital expenditure on heat recovery systems. 'Lightweight' glass technology has been widely adopted, using less raw material and requiring less energy to make and transport. Distillers are meeting exacting targets for the cutting of carbon dioxide releases. Under its Climate Change Agreement, at the end of the first milestone period, the UK spirits industry had cut its use of energy per litre by nearly 3%, and exceeded agreed targets for the cutting of carbon dioxide releases. By 2004, the industry had met its agreed second milestone period target even more successfully.

Water is fundamental to Scotch Whisky, and the industry has the utmost respect for this vital resource. A total of 90% of water used is for cooling purposes and is then returned to its source without any deterioration in quality. Water quality is constantly monitored to ensure there is no harm to the natural environment. Distillers are regularly developing best practice in managing water resources and work closely with the Scottish Environment Protection Agency.

The industry ensures that nothing is left over when whisky is made. The residues left after fermentation and distillation are re-used where possible. For example, draff (the cereal residue from malt and grain distilleries) is recycled as highly nutritious, much prized animal feed used by local farmers.

The increased energy consumption attributable to the very small amount of Single Malt Scotch Whisky displaced from abroad to the UK for bottling will be infinitesimal compared to the overall energy consumption of the industry.

Health Impact Assessment

These proposals will not directly impact on health and wellbeing and will not result in health inequalities.

Race/Disability/Gender/Age

These proposals do not impose any restriction or contain any requirements which a person of a particular racial background, disability, gender, age, or sexual orientation would find more difficult to meet. Conditions apply equally to all individuals and businesses involved in the activities covered by the proposals.

Human Rights

These proposals are consistent with the Human Rights Act 1998.

Rural Proofing

These proposals will not have any different effect in rural areas. Rural employment would not be affected in an adverse way. In fact, the industry has a long history of ensuring that its association with the rural economy is maintained.

Unintended consequences

None are anticipated at this stage.
5. ENFORCEMENT AND SANCTIONS

Option 1: Do nothing

Existing powers and regulatory controls would be used. To date the industry has been able to rely on the protection afforded to “Scotch Whisky” at EU level (Regulation 1576/89) both in the UK and elsewhere in the EU. Regulation 1576/89 will shortly be replaced by a new EU Spirit Drinks Regulation. If we do nothing, i.e. if we do not make the Scotch Whisky Regulations, there will be no direct consequence in terms of the loss of the protection for Scotch Whisky after the seven-year period within which a technical file for a geographical indication should be submitted to the EU Commission. If nothing is done (except to put in place underpinning enforcement provisions for all spirit drinks, including Scotch Whisky, as we are required to do and would do) and we then submit a technical file to the Commission under the arrangements set out in the new EC Regulation based on the existing legislative requirements for Scotch Whisky, then Scotch Whisky would have permanent protection as a registered product under the new EC Regulation. Therefore, if the UK was not to make the Scotch Whisky Regulations, but simply do what we would be required to do, i.e. provide for UK enforcement for the EC spirit drinks regulation as a whole (including the provisions in it which cover Scotch Whisky, but which do not include those extra national rules set out in the proposed Scotch Whisky Regulations), then Scotch Whisky per se would continue to be protected.

Option 2: New enhanced legislation as the basis for protection in the UK and abroad.

The overall aim of the proposals is to bring greater clarity to the definition, description, presentation and labelling and protection of Scotch Whisky. Whilst the level of malpractice in the UK is low, there have been examples of misleading labelling which the regulatory authorities have found difficult to tackle because of the absence of clear rules. Whilst the industry is not aware of any products currently on the market which fall into that category, it is likely that there may be a small increase in the number of infringements reported to the UK authorities in the future. The proposals may, by their very nature, have the indirect result that the industry will take more frequent enforcement action against producers abroad. This cost will be met by the industry.

Sanctions

The draft Regulations provide for civil remedies for non-compliance with the Regulations and extend civil remedies provided for in the Scotch Whisky Act 1988 and the Scotch Whisky Order 1990 to the full range of requirements in these Regulations. The only areas where criminal sanctions are provided are in relation to the failure to take measures to take corrective action specified in the improvement notice and obstruction by those in contravention of the rules. The cost of this is difficult to estimate as it is uncertain what is the level of non-compliance in the UK.

Monitoring

Regular contact with the enforcement authorities and the relevant trade associations as at present to ensure that proportionate monitoring, given the predicted high compliance, is carried out.
## Specific Impact Tests: Checklist

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<thead>
<tr>
<th>Type of testing undertaken</th>
<th>Results in Evidence Base?</th>
<th>Results annexed?</th>
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<td>Competition Assessment</td>
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<td>Small Firms Impact Test</td>
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Structure of the Scotch Whisky Industry

Background

Scotch Whisky is one of the UK’s most important export industries. In 2006, it was exported to 176 countries. It is Scotland’s second largest manufacturing export industry after office machinery\(^2\) (excluding oil and gas), and accounts for around 13% of Scotland’s exports.\(^3\)

In accordance with National Accounting principles, total Scottish exports do not include any exports of oil and gas extracted from the UK continental shelf. This is consistent with the approach taken in all Scottish economic statistics in that, following European System of Accounts (ESA 95) conventions, the National Accounts determine that these cannot be allocated to any one region of the UK\(^4\).

According to the Scotch Whisky Association around 90% of all Scotch Whisky produced is exported\(^5\). In 2006 exports of Scotch Whisky were worth a record £2.5 billion; and accounted for 72% of the total value of UK exports of alcoholic drinks. The value of Scotch whisky exports increased by 4.5% in 2006; while export volume (in tonnes) increased by almost 9%.

Export destinations by value £m, 2006

The USA was the largest export market (£416 million in 2006) and accounted for 16% of exports. Sales to EU countries (£880 million in 2006) accounted for 35% of Scotch whisky sold overseas. Sales to Estonia grew by 67% in value in 2006, exports to Venezuela grew by 45%, while exports to Brazil, Poland, and Ukraine grew in value by 44%, 42%, and 30% respectively\(^6\).

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\(^4\) Scotland’s Global Connections Survey 2005 (Notes 7) - http://www.scotland.gov.uk/Publications/2006/12/19161113/1
By contrast, consumption of whisky in the UK has exhibited long-term decline, in favour of wine and white spirits. In 2006, ‘Home-produced whisky’ released for UK consumption was 283 thousand hectolitres, 22% down on 1996. In 2006, ‘Home-produced whisky’ represented 25% of the volume of spirits released for UK consumption, down from 39% in 1996.\(^7\)

Whisky production last peaked at 4.8 million hectolitres in 1997. In 2006 its production was 3.99 million hectolitres, up from 3.76 million hectolitres in 2005. Whisky production accounts for 89% of spirit production in the UK.\(^8\)

According to market research company, Mintel, retail sales of whisky in the UK were worth almost £2.7 billion in 2005.\(^9\) Of this total, blended whisky accounted for 67% of sales, malt whisky for 14%, deluxe whisky for 1%, and imports for 18%.

The industry accounts for around 4% of all Scottish manufacturing jobs and the industry spends £1 billion a year buying goods and services from local suppliers.\(^10\) Scottish Enterprise and the Scotch Whisky Association claim that one million tourists each year visit around 40 distilleries in Scotland which are open to the public.\(^11\)

The companies which are the leading producers of Scotch Whisky are Diageo (the world’s largest spirits producer), Pernod Ricard (the world’s second largest spirits producer, which operates in Scotland through its Chivas Brothers subsidiary), William Grant & Sons, and The Edrington Group.

The leading brand of blended whisky sold in the UK in 2005 was Bell’s, produced by Diageo Plc, with 13%, by volume, of the UK market.\(^12\) Diageo operates 27 malt distilleries and 2 grain distilleries across Scotland. In second place was The Famous Grouse, produced by The Edrington Group, with almost 13% of the market. The Jack Daniel’s brand, owned by Brown-Forman of the US, was in third place with 7%, followed by the Teacher’s brand, owned by Pernod Ricard of France in fourth place with just under 4%.

In February 2007, Diageo announced that was to invest £100m in building Scotland’s first major malt distillery in more than 20 years (creating an estimated 200 jobs during the investment process over the next few years) as it expands its whisky operations following a huge surge in demand from emerging markets such as Russia, China, India, Mexico, and Brazil. Subject to planning consent, Diageo will build a malt whisky distillery in Roseisle, near the Moray Firth, where it already has a large maltings facility. It hopes to start production in 2009, with the first whisky becoming available in 2012.\(^13\)

Brian Higgs, Diageo’s malt distilling director has stated that the proposed Roseisle complex is expected to be Scotland’s most environmentally advanced malt distillery.\(^14\)

Diageo’s announcement was followed by Bacardi revealing in July 2007 that it would invest more than £120m in Scotland to increase production of its Dewar’s Scotch Whisky brand.\(^15\)

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\(^9\) Mintel report: Whiskies (August 2006)
\(^10\) The Economic Impact of the Production of Scotch Whisky, Gin & Vodka in Scotland (Pages 7 and 8) - http://www.scotch-whisky.org.uk/swa/files/Eclmpact%20Report.pdf
\(^11\) The Scotch Whisky Association further states that distilleries represent a quarter of all Scotland’s five-star tourist attractions, with sales at Scotch Whisky tourist attractions worth over £17 million a year to the Scottish economy Scotch Whisky Association press release - http://www.scotch-whisky.org.uk/swa/files/Distilleryguide07.pdf
\(^13\) The Scotsman - http://thescotsman.scotsman.com/index.cfm?id=1083282007
The majority of Scotland’s 96 Scotch whisky distilleries currently produce around 1.8 million litres of spirit annually, with the smallest distillery, **Edradour**, producing around 90,000 litres of malt whisky each year. **Cameronbridge** (owned by Diageo) is the largest grain whisky distillery in the UK and is capable of producing around 70 million litres of grain whisky annually, while **Tomatin** (Japanese owned), is the largest malt whisky distillery, and can produce up to 12 million litres of malt whisky annually.

In November 2007, it was reported that the high demand for Scotch Whisky among India’s increasingly affluent middle class, and the Indian government’s withdrawal of additional customs duty on imported wines and spirits in July 2007, had led to a 45% increase in the export of Scotch whisky to India in 2007\(^\text{16}\).