

PHILIPPINES – TAXES ON DISTILLED SPIRITS

(DS403)

**REPLIES OF THE UNITED STATES OF AMERICA
TO THE PANEL'S QUESTIONS**

FEBRUARY 24, 2011

64. (European Union and United States) Please indicate whether you are asking the panel to make findings concerning the treatment in the Philippines market of: (i) All distilled spirits and liqueurs covered by HS heading 2208; (ii) All distilled spirits; or, (iii) Six specific types of distilled spirits (i.e., gin, brandy, rum, vodka, whisky and tequila or tequila-flavoured spirits).

1. The United States is requesting the Panel to make findings covering all distilled spirits, as defined by the Philippine measures.¹ This includes the full scope of HS 2208 and would not be limited to the six types of spirits listed in part (iii) of the Panel's question.

2. The United States has made two distinct claims in support of these findings, under the first and second sentences, respectively, of Article III:2 of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994"). In some cases, the United States has requested the Panel to find that a domestic product is "like" an imported spirit; for all spirits, the United States has additionally requested that the Panel find that all imported spirits are directly competitive or substitutable with all Philippine spirits. As the United States stated at paragraph 24 of its Second Written Submission:

The United States is specifically requesting findings covering all distilled spirits under both the first and second sentences of Article III:2 of the GATT 1994, but in different ways. With respect to the first sentence, the United States asks the Panel to review the evidence of Philippine domestic brands and their imported counterparts to confirm that Philippine "brandy" is like imported "brandy," Philippine "gin" is like imported "gin," etc.² With respect to the second sentence of Article III:2, the United States further requests that the Panel find that all imported distilled spirits are directly competitive or substitutable with all Philippine distilled spirits.

71. (European Union, United States and the Philippines) In light of the evidence on the record, the Panel understands that the same outlets in the Philippines where imported spirits (including those made from raw materials other than cane sugar) are sold either for consumption on the premises (restaurants, bars, pubs, clubs, discotheques, hotels, etc.) or off the premises (stores or supermarkets) also offer domestic spirits, while the opposite is not always the case; that is, many establishments (especially, small retail stores) that offer domestic spirits, do not carry imported spirits. Is the Panel's understanding correct?

3. The United States agrees that the evidence on the record reflects that there are some outlets in the Philippines (both for consumption on premises and off premises) that sell both imported and domestic brands of spirits, and there are some outlets that sell mainly or only domestic spirits. In particular, evidence on the record, including pictures of store displays in

¹ Exhibit US-2, page 3.

² U.S. First Written Submission, para. 90.

Exhibit US-30 and menus at Exhibit US-31 bear this out. Such evidence shows that where imported products are sold in the Philippines, they are sold in the same channels of distribution as local products.

73. (European Union and United States) In its rebuttal, the Philippines submitted Exhibit PH-77, which is a further revised version of the Price Survey dated September 2010. The Philippines has requested that the Price Survey contained in exhibit PH-19 (original) and exhibit PH-19 (amended) be deemed superseded by the new exhibit PH-77. The Philippines has stated that exhibit PH-77 was presented after the discovery of additional errors in the Price Survey. The Philippines has categorized changes introduced by exhibit PH-77 as follows: (i) Changes to correct "wholesale" technical errors; (ii) Changes to correct errors in computing and/or inputting average price observations; and, (iii) Changes to supply the correct excise tax rate. Please comment on the Philippines' submission of exhibit PH-77 and the request that exhibits PH-19 (original) and PH-19 (amended) be disregarded by the Panel.

4. The Philippines twice has corrected PH-19, one of its key exhibits for arguments depending on evidence of prices of brands of distilled spirits in the Philippines. Even after these corrections, price information for some brands is still missing in several columns.³ These changes present doubts about the reliability of the exhibit, regardless of the corrections offered by the Philippines.

5. At the same time, whether or not the Panel uses any information from Exhibit PH-19 (corrected to PH-77), the Philippine arguments do not withstand scrutiny. The Philippines asks the Panel to use price information, including that in PH-19, to confirm its theory of market segmentation. In fact, there are several sources of information on prices before the Panel other than Exhibit PH-19, none of which support the Philippine view.⁴

6. While the various sources on pricing suggest that imports are relatively more expensive than domestic products, they also show that domestic and imported products are each available at a variety of price points. Moreover, the data indicating that there are fewer imported products at the relatively lower-priced part of the market, where the highest volumes of sales occur, likely reflects the fact that there are high taxes on such imported products.⁵ As such, the absence of lower-priced imported products at present does not support the conclusion that imports would not compete with domestic products in the absence of the challenged measures.

³ E.g., Carlos Brandy, only listed under Supermarket Retail Chain, and Ginebra Especial, only listed under Supermarket B.

⁴ These sources include Exhibit US-41, Exhibit PH-49, Exhibit US-15, and the annexes to the Philippines' own regulations. The Panel may draw general information regarding pricing – and regarding the reliability of corrected Exhibit PH-77 – from these sources.

⁵ See, U.S. Opening Statement at the Second Panel Meeting, paras. 33-40.

7. In *Chile – Alcohol*, the Appellate Body expressed reservations regarding the use of market information where the information reflects the impact of the challenged measures. It stated:

The comparatively small volume of imports consumed on the Chilean market may, in part, be due to past protection.⁶ We consider that it would defeat the objective of Article III:2, second sentence, of the GATT 1994 if a Member of the WTO were able to avoid a finding that a measure is applied “so as to afford protection” for reasons that could, in part, result from its past protection of domestic production.⁷

8. The United States believes this dispute presents such a situation. The absence of imported products should only be considered in the context of the longstanding Philippine tax measures, which have altered the ability of imported products to compete in the Philippine market. This means that the Philippine measures themselves make it more difficult to rely upon current sales information from the Philippine market in assessing whether imported products are able to compete. For these reasons, regardless of whether the Panel draws upon PH-19 in its findings, its conclusions should be the same.

77. (European Union, United States and the Philippines) With respect to domestically-produced gin, brandy and rum, can the Philippines indicate what is the approximate weight of the cost of the raw materials used in the production of the base spirit as a proportion of the final net retail price of distilled spirits in the Philippines market. With respect to their own production of gin, brandy and rum, can the European Union and the United States indicate the approximate weight of the cost of the raw materials used in the production of the base spirit as a proportion of the final net retail price of distilled spirits in their own markets.

9. The cost of the raw materials used in the production of distilled spirits, and the proportion of the final retail price attributable to those costs, varies widely across product categories and price points.

10. Distillers make different decisions about raw material, processing of the materials, and other factors in the production process depending on the product they want to make and in accordance with the regulations of the exporting country and the importing country. As explained in response to Question 1 of the Panel to the parties, all distilled spirits essentially are produced by converting sugars in a raw material (*e.g.*, sugar cane molasses, grapes) into alcohol, but there are many variations and these affect the percentage of the final price attributable to the raw materials.

⁶ Footnote omitted

⁷ *Chile – Alcohol (AB)*, para. 68.

11. In response to the Panel’s question, the United States requested information from the U.S. industry association regarding this issue. It noted costs related to several aspects of production and sales. For example, aging is particularly expensive. Some products such as whiskies and brandies are aged for several years in new oak barrels, which are expensive to produce, whereas others are not aged at all. Adding flavorings, such as apple flavor to vodka⁸ or coconut to rum, is another possible step in the process and a source of expense. Differences in production processes, such as use of pot still versus continuous distillation, as well as warehouse costs, product loss (evaporation), and inventory carrying costs, can also affect the overall price to raw material cost ratio.

12. In addition to the differences in raw materials and production methods, the retail price is also impacted by other costs, such as product packaging, transportation, marketing and promotional costs.

13. Thus, generally speaking, raw materials account for a small portion of the final retail price. The specifics vary considerably from brand to brand (and even from store to store). The price ultimately is affected more by the product the producer wants to put on the shelf than the original raw materials.

78. (European Union, United States and the Philippines) Does the text of the HS Explanatory Notes (HSEN) to heading 2208 provide guidance for determining whether the following specific types of spirits are associated with certain raw materials: gin, vodka and tequila? If it does, please point out to the relevant language in the HSEN.

14. As noted in the U.S. response to Question 42 from the Panel:

The Explanatory Notes are the official interpretation of the Harmonized System at the International Level (World Customs Organization). They are not dispositive or legally binding, but may provide commentary on the scope of each heading of the HTSUS and U.S. Customs and Border Protection routinely consults relevant Explanatory Notes.⁹ They are consulted, along with other information available, to classify goods imported into the United States.¹⁰

15. In addition, the U.S. would like to note the limits of relying on the Explanatory Notes for interpretation of the claims in this dispute. The claims are under the GATT 1994, and the HS2007 Explanatory Notes are not an “application” of that treaty – nor did they exist when WTO Members agreed to the GATT 1994 commitments. Accordingly, while customs authorities’

⁸ See, e.g., Exhibit EU-100.

⁹ T.D. 89-80, 54 Fed. Reg. 35127, 35128 (Aug. 23, 1989).

¹⁰ U.S. Responses to Panel Questions, Dec. 8, 2010, para. 32.

practices in application of the HS and its Explanatory Notes provide some information regarding treatment of the products at issue, it is of very limited weight in interpretation of GATT 1994 commitments.

16. With that caveat, with respect to EN 22.08, in addition to a general description of the goods of that heading, the Explanatory Note provides a list of eighteen different types of spirits to serve as examples of those covered under the heading. Several of these provide guidance regarding the materials used as a factor in tariff classification of the particular spirit.

17. The specific spirits in the Panel’s question, gin, vodka, and tequila, do not have tariff classifications that require a particular raw material. EN 22.08(C)(5) indicates that heading 22.08 covers “[v]odka obtained by distilling fermented mash of agricultural origin (e.g., cereals, potatoes) and sometimes further treated with activated charcoal or carbon”. EN 22.08(C)(4) states that gin contains “...the aromatic principles of juniper berries” as the particular characteristic for gin, and does not refer to a particular raw material. EN 22.08 does not describe tequila, and tequila is not specifically provided for under the Harmonized System. In the United States, it would be classified under subheading 2208.90 as an “other” spirit.

79. (European Union, United States and the Philippines) The HS Explanatory Notes (HSEN) to heading 2208 refer to "Spirits obtained exclusively by distilling fermented products of the sugar cane..." Please explain the meaning of the word "exclusively" in this reference and whether it affects the scope of the product description under subheading 2208.40.

EN 22.08(C)(3) states that the heading 22.08 covers “spirits obtained exclusively by distilling fermented products of the sugar cane (sugar-cane juice, sugar-cane syrup, sugar-cane molasses), e.g., rum, tafia, cachaca”.

18. As the Panel’s question suggests, products made with only sugar cane generally are classified under subheading 2208.40, which provides for “Rum and other spirits obtained by distilling fermented sugar-cane products”. The word “exclusively” in the above-quoted language of EN 22.08 clarifies that the spirits concerned can be obtained from no other material than sugar cane.¹¹

80. (European Union, United States and the Philippines) The HS Explanatory Notes (HSEN) to heading 2208 refers to "Spirits obtained exclusively by distilling fermented products of the sugar cane..." and separately also to "Vodka obtained by distilling fermented mash of agricultural origin... and sometimes further treated with activated charcoal or carbon." If sugar cane is a product of agricultural origin, please explain if vodka obtained by distilling a fermented mash of sugar cane and further treated with

¹¹ In one U.S. administrative ruling, a rum was classified in 2208.40 notwithstanding some added flavor enhancers not made from sugar cane. The additional ingredients were less than 3.5% of the product by volume. See, Exhibit US-49.

activated charcoal or carbon would fall under the second group of spirits instead of the first.

19. Vodka produced from sugar cane could be classified under subheading 2208.60, providing for “vodka,” if it had been subject to a sufficient number of distillations to remove all of the secondary constituents and organoleptic characteristics present in the original sugar cane material. As indicated in EN 22.08, charcoal filtration is not required to remove such secondary constituents, but would help accomplish this result.

81. *(European Union and United States) In reference to the survey submitted as exhibits EU-41 and US-41, please explain whether Vino Kulafu, identified in Table 2, is a distilled spirit, noting that in exhibits EU-15 and US-15 it is listed as a wine.*

20. Yes, Vino Kulafu is a distilled spirit. Notwithstanding that “Vino” might imply wine (which may be part of the reason that some sources list it as a “wine”), it is a type of “Chinese wine” that, according to the producer’s website, is made with a special distillation process.¹² The term “Chinese wine” is an inexact translation into English and may refer to fermented beverages (huáng jiǔ) or to distilled beverages (bái jiǔ); “Vino Kulafu” is one of the latter. Moreover, it is classified as a distilled spirit in the scope of the Philippine measures, with applicable tax at the low rate under Section 141(a) of the internal revenue code.¹³

83. *(European Union and United States) In reference to the Table 2 in the survey submitted as exhibits EU-41 and US-41, please identify the source and date of collection of the basic data used by the authors of the study (Euromonitor International) to estimate the shares of the top 14 brands in the Philippines market in the year 2009. Please indicate whether each of these 14 brands corresponds to a single product or to more than one. (For example, in the case of Ginebra San Miguel, listed as the top brand, does the 35.3 per cent share correspond to all gin products in the company's portfolio?)*

21. In order to respond to the Panel’s question, Euromonitor International (Euromonitor) provided to the United States the additional information described below.

22. The source of the information is the Euromonitor database, which has been developed over the last 15 years and is updated on an annual basis. It includes information from many different sources particular to the Philippines market and at different points in time. The sources Euromonitor uses for the Philippines market are listed at Exhibit US-53, and are further described in the response to question 85.

¹² Exhibit US-50.

¹³ See, Section 2.A, number 26 in Exhibit US-8, Revenue Regulations 12-2004. Note this section refers to brands produced from nipa, coconut, etc. under “141(b)” of the Internal Revenue Code; this appears to be a typographical error and the reference should be to “141(a).”

23. The top selling brands in the Philippine market in 2009 are shown in the table attached as Exhibit US-52 prepared by Euromonitor. This table is an updated version of the information in Table 2 of Exhibit US-41. Where there are differences in the specific percentages, the differences reflect changes resulting from ongoing updates to the latest version of the Euromonitor database. Euromonitor reviews the full historical period in each subsequent update, as information on previous years becomes more readily available over time.

24. Each row is at the highest level of detail maintained by Euromonitor in its database. Some rows show “umbrella brands” that reflect more than one sub-brand. Annually, Euromonitor analysts work to develop brand shares at the lowest level possible, given available secondary information and primary interview responses. In the corresponding chart, Euromonitor has highlighted which umbrella brands represent one major sub-brand and which represent an aggregation of multiple sub-brands.

25. For example, Ginebra San Miguel, which accounted for 34.3% of the total market was made up of a number of Ginebra San Miguel SKUs,¹⁴ including: a) Ginebra San Miguel, b) Ginebra San Miguel Lite, c) Ginebra San Miguel Premium, and d) Ginebra San Miguel Blue Gin. In other cases, where a sub-brand is particularly significant for sales, it is listed separately by subbrand (*e.g.*, Tanduay Rhum ESQ and Tanduay Rhum ESQ), although the table does not break out different available sizes by brand.

84. (European Union and United States) In reference to the survey submitted as exhibits EU-41 and US-41, please clarify whether Barcelona brandy from London Birmingham Distillers Ltd, identified in Table 2, is an imported product.

26. Barcelona brandy is a Philippine product.¹⁵ Tanduay licenses the name through London Birmingham, as indicated in securities filings.¹⁶

27. In response to the Panel’s questions, the United States requested further information from industry regarding the information in this table, particularly the “import” and “local” classifications in this table. Industry confirmed with Euromonitor that Barcelona should be classified as “local.” In addition, Napoleon brandy should be classified as “local.”¹⁷ These

¹⁴ An SKU is a “stock keeping unit” such as 750 ounce bottle of Ginebra San Miguel gin.

¹⁵ See, Exhibit US-55, Tanduay Product Information.

¹⁶ Exhibit US-54, page 8.

¹⁷ Several producers, including importers, have “Napoleon” brandies or cognacs. The high volume selling product is the Philippine local product, listed in the “local” section A of Revenue Regulations 12-2004 as “Napoleon VSOP” and “Napoleon 5 years.” Exhibit US-8. See also, p. 2 of PH-77.

products are made by local Philippine producers, and receive the low tax rate under Section 141(a) as a result of the use of local types of raw materials in the production.

28. Having discovered the errors in Table 2, the United States requested further information on whether these misclassifications affected the survey results. Euromonitor confirmed that the misclassification was limited to Table 2 of the market background only, which was provided as additional information and not part of the consumer survey itself. Euromonitor also confirmed that these products were not misclassified in the survey when consumers were asked about their views. Consumers were asked for views on “imports” and “local” products as a group, with some examples provided for each. Napoleon was provided as an example of a “local” product, and Barcelona was not provided as an example.

85. (United States) In reference to exhibit US-40, please identify the "official statistics", as well as the "trade associations", "trade press", "company research", "store checks", and "trade interviews" indicated as source of Table 26 in page 13, including the dates of each source.

29. Exhibit US-40 is a standard country report by Euromonitor, similar to reports it produces for the more than 80 countries that it covers. Exhibits US-56 provides information on the research methodology applied to all Euromonitor reports, and Exhibit US-53 provides information on the information used for the Philippine market in particular.

30. According to information received from Euromonitor, Exhibit US-40, the Philippines sector briefing for 2009, is based on the source information listed in Exhibit US-53. The list in Exhibit US-53 reflects 2011 sources, but the same list is applicable to the 2009 data. There were no major changes in the research that yielded the updated brand shares, besides a refinement of historical information to more clearly represent the latest available information

31. Exhibit US-53 lists seven official sources, seven trade associations, eight trade press documents (including several specific to the Philippines), more than 80 companies, and several other sources. Among the company sources, there are retailers both in and outside Manila. These sources correspond to the official statistics, trade associations, trade press, company research, store checks and trade interviews noted for Table 26 of Exhibit 40, as referenced in the Panel’s question. Trade interviews refers to interviews across the supply chain, with importers, exporters, manufacturers, distributors, wholesalers, retailers, associations and other significant stakeholders.

32. Regarding the timing of the collection of the information supporting Table 26, the Euromonitor database is updated on an annual basis to reflect the full historical information in each subsequent update. Euromonitor conducts spot store visits, primary interviews and a full review of all secondary research on an annual basis, using a 12 week timeframe. The sources list for Table 26 provided represent those players from which information was gathered in the form of secondary research or a primary interview. Through these updates, Euromonitor is able to maintain a current, accurate set of industry information.

88. *European Union, United States and the Philippines) Parties have identified Ginebra San Miguel as the gin most often sold in the Philippines. (See exhibit EU-15. See also, United States' response to Panel question No. 23, para. 13; Philippines' response to Panel question No. 35.) Can the Philippines identify with which of gin products included in the prices lists provided in exhibit PH-19 does Ginebra San Miguel corresponds. Can the European Union and the United States identify which of the gins made by Ginebra San Miguel do they regard as the gin most often sold in the Philippines.*

33. The firm Ginebra San Miguel manufacturers many different products, and the gins are the highest volume sellers in the Philippines. Ginebra San Miguel gins account for 34% of the market for distilled spirits in the Philippines (2009 data).¹⁸

34. The basic “Ginebra San Miguel” is the leading seller in the Philippines, according to the company’s information, providing 40% of the company’s total revenues.¹⁹ “Ginebra San Miguel” gin accounts for more than 95% percent of all gin sales in the Philippines.²⁰ (See response to question 83 above.)

90. *(European Union, United States and the Philippines) Referring to Tanduay Centennial Dark Rhum, the Philippines has expressed that this "product is a 'limited edition' rum produced exclusively to commemorate the Philippine Centennial celebration of independence: its cost reflects the elaborate packaging of a tinder box, and a scroll, and an additional 300 ml of liquor when compared to [other products and is further] not available off-the-shelf, but must be ordered directly from the manufacturer." Can the European Union and the United States comment on this statement and whether in their view Tanduay Centennial Dark Rhum is available in the Philippines market. Can the Philippines explain whether Tanduay Centennial Dark Rhum is available in the Philippines market.*

35. The premium product Tanduay Centennial Dark Rum, while limited edition and not widely sold, is available in the Philippine market as it was produced and sold to customers in the Philippines. As the company’s own promotion materials state, it commemorates the Philippine centennial,²¹ so it would be surprising if it were intended for any other market. Further, Exhibit EU-73 shows it for sale in the Philippines.

¹⁸ Exhibit US-52.

¹⁹ Exhibit US-60, Exhibit US-58, p. 4.

²⁰ Exhibit US-51.

²¹ Exhibit EU-93.

36. This product – like other examples on the record such as Gran Matador Reserva – shows that Philippine producers manufacture a range of products at different price points, including more costly “premium” products for occasional purchases. The presence of this product thus supports the conclusion that imported and local products are best considered as part of a single market rather than segmented into two parts by price or income.

91. (European Union, United States and the Philippines) Can the parties explain whether Napoleon VSOP brandy, Amoroso brandy, Paradise Mango rum and Gilbey's 1857 vodka are available in the Philippines market, including in outlets in the metropolitan area of Manila.

37. The four brands listed in the Panel’s question – Napoleon VSOP, Amoroso brandy, Paradise Mango Rum, and Gilbey’s 1857 vodka – are all available in the Philippine market. They are listed in the IWSR 2009,²² as well as in the Philippines’ own Exhibit 77. As Manila is the largest metropolitan area in the Philippines,²³ it is reasonable to conclude that the widest range of products – including these four – are available in that city and its surrounds.

38. Other market evidence confirms that these products are available. “Napoleon Brandy” and “Paradise Mango Rum” also appear on some pictures of store shelves,²⁴ and Philippine companies advertise Gilbey’s 1857 vodka (and it appears in PH-77).²⁵ Further information regarding Paradise Mango Rum, including the statement that it is “readily available in selected SEAIR flights, upscale hotels and resorts, and in major supermarkets and retail outlets nationwide [in the Philippines]” is contained in Exhibit US-57. Amoroso brandy is available in the Philippines, as confirmed by an article about its introduction to the market.²⁶

²² Exhibit US-15.

²³ Over 1.6 million people per 2007 census information:
<http://www.census.gov.ph/data/pressrelease/2010/pr1041tx.html>.

²⁴ EU-66 and EU-67.

²⁵ Exhibit EU-71.

²⁶ Exhibit US-59. *See also*, PH-77.

List of Exhibits

Number	Exhibit
US-49	Myers Rum CBP Ruling
US-50	Vino Kulafu Information
US-51	Brand Shares by Category from Euromonitor Database
US-52	Updated Table on Brand Shares – Euromonitor
US-53	Alcoholic Drinks Sources 2011: Philippines
US-54	Tanduay SEC Filings
US-55	Tanduay Brand Information
US-56	Euromonitor International Research Methodology
US-57	Paradise Mango Rum Information
US-58	GSM SEC Filings
US-59	Amoroso Information
US-60	GSM Website Information