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October 15, 2003

Via Hand Delivery

Mr. William Foster  
Chief, Regulations & Procedures Division  
Attn: Notice Number 4  
Alcohol & Tobacco Tax & Trade Bureau  
1310 G Street, N.W.  
Washington, D.C. 20005

Re: Notice Number 4. Flavored Malt Beverages and Related Proposals  
Dear Mr. Foster:

Diageo plc, Diageo North America, Inc. and the DIAGEG-Guinness U.S.A., Inc.

(collectively "Diageo") hereby submit comments on Alcohol & Tobacco Tax & Trade Bureau  
("TTB")1 Notice 4, Flavored Malt Beverages and Related Proposals ("Notice 4" or "Notice"), 68

Fed. Reg. 14291 (Mar. 24, 2003). As a member of the Flavored Malt Beverage Coalition  
("FMBC" or "Coalition"), Diageo agrees with the Coalition's comments on Notice 4 and adopts  
them as its own. We write separately to reinforce and further illuminate points made by FMIBC,  
and to address issues not addressed by the Coalition.

Our comments begin with a brief summary of our position- a position of great  
importance to our company because a Diageo product, Smimoff Ice, is the best-selling flavored  
malt beverage ("FMB") in the United States. A background section follows, explaining Diageo's  
particular history with the FMB category. Our comments follow, divided into Parts addressing

TTB is also referred to as the "Agency" throughout this document.

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Notice 4's: (I) Proposed Formulation Standards for Beer and Malt Beverage Products; (II) Proposed Labeling and Advertising Regulations; and (III) Proposed Formula Regulations.

SUMMARY

Diageo supports a national standard for FMBs that would require that a majority (more than 50%) of a finished product's alcohol content derive from fermentation of the product's base in order to qualify as a "beer" or a "malt beverage." Diageo does not believe, however, that sound policy justifies limiting the alcohol contribution from non-beverage flavors<sup>2</sup> or other sources to just 0.5% of the alcohol by volume ("ABV") in the finished product. Notice 4 does not produce any evidence of confusion to back up its claim that existing FMB labels mislead consumers, and the Notice fails to explain why either of its stated rationales (alleged consumer confusion and state concerns) favor a 0.5% standard over the more reasonable majority standard. In light of Diageo's good faith reliance on longstanding federal policy and the substantial disruption to Diageo's business that any change in policy will require, we believe fairness dictates that TTB adopt the rule that causes the least disruption to business and consumer expectations.

Diageo supports codification of the labeling and advertising policies announced in ATF Ruling 2002-2. Diageo believes, however, that the language employed by Notice 4 requires clarification to avoid future confusion over TTB's intent. Most significantly, the language borrowed from old wine regulations that prohibits certain statements employing distilled spirit standards of identity is overbroad and would not survive a legal challenge under contemporary First Amendment standards. In addition, the final rule should more clearly articulate TTB's

<sup>2</sup> These comments use the term "non-beverage flavors" to refer to flavors deemed "unfit for beverage purposes" and containing alcohol. See 26 U.S.C. § 5131.

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intent to continue approving labels and advertising employing distilled spirit brand names, in keeping with longstanding practice acknowledged by Ruling 2002-2. Diageo also supports alcohol content labeling for malt beverages, but believes Notice 4 arbitrarily singles out products containing alcohol from other sources for its proposed alcohol content labeling requirement.

Finally, Diageo believes Notice 4's laudable goal of modifying and codifying TTB's practices towards the submission of pre-import analyses and statements of process ("SOPs" - renamed formulas under Notice 4's proposed regulations) requires further simplification and clarification to accomplish that goal. Diageo believes the regulations proposed in Notice 4 will continue to leave brewers and importers guessing about when they must file a formula, and what criteria TTB will apply in evaluating those submissions. We accordingly submit that TTB must commence further rulemaking that proposes standards TTB will apply in reviewing brewers' formulas.

#### BACKGROUND

The comments of FMBC will provide TTB with a historical overview of the entire FMIB category. Diageo writes separately to explain the particular circumstances surrounding its entry into the FMB market. Those circumstances may help explain why Diageo feels particularly aggrieved by the change in FMB formulation policy proposed in Notice 4.

Diageo was formed in 1997 by the merger of Guinness plc and Grand Metropolitan plc. Neither company nor their respective predecessors participated in the early FMB market of the 1960s and early 1970s (Champale, Malt Duck, etc.) or the "cooler" boom and the subsequent evolution of second-generation FMBs (Bartles & James, Seagram coolers, etc.) in the 1980s. As explained below, Diageo did not invest in the FMB category until the actions of TTB's

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predecessor agency demonstrated to Diageo management that federal policy firmly favored the policies Notice 4 now proposes to overturn.

In 1994, several new FMBs caught the attention of Grand Metropolitan subsidiary and Diageo North America predecessor Heublein, Inc. The FMBs in question were coolers that bore the names of well-known cocktails, most notably "margarita." Heublein, the importer of America's leading tequila brand, feared that these malt beverages would mislead consumers into believing that they contained tequila – the alcohol source of the traditional margarita. Heublein accordingly sought to stop the primary marketers of these "cocktail coolers," E. & J. Gallo Winery and Joseph E. Seagram & Sons, Inc., from selling FMBs bearing the name "margarita" and other well-known distilled spirit cocktails.<sup>3</sup> Heublein's efforts included federal court litigation<sup>4</sup> and a petition to TTB's predecessor, the Bureau of Alcohol, Tobacco & Firearms ("ATF" or "agency"), seeking new regulations that would prohibit the use of cocktail names in malt beverage labeling and advertising. ATE responded by publishing an Advanced Notice of Proposed Rulemaking seeking comments on whether it should prohibit or restrict the use of cocktail names on FMBs. See 61 Fed. Reg. 57597 (Nov. 7, 1996). Although the rulemaking addressed labeling and advertising, it concerned the same subject that Notice 4 cites as its prime justification for acting – consumer perception of FMBs. See 68 Fed. Reg. at 14296, 14296-97.

<sup>3</sup> Publicly-available documents filed in the suit did reveal that non-beverage flavors used to make the coolers did, in fact, contain tequila.

<sup>4</sup> Heublein, Inc. v. Joseph E. Seagram & Sons, Inc., S.D.N.Y. No. 94 CV 8152 (LBS) (AJP); Heublein, Inc. v. E. & J. Gallo Winery, S.N.D.Y. No. 94 CV 8155 (LBS) (AJP). The parties to those matters ended their litigation after a confidential settlement. The terms of that settlement are not public.

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In late 1997, after receiving over 5,000 comments on the subject, ATF rejected Heublein's petition, concluding that cocktail coolers neither misled consumers nor threatened federal excise tax revenues. On the question of consumer confusion, the agency stated:

Evidence introduced indicates that flavored malt beverages are viewed by consumers as coolers or low alcohol refreshers, and not as a distilled spirits product. Evidence introduced also indicates that the presence of distilled spirits or any similarity of these products to a distilled spirits drink is not a criteria in their selection by consumers.

Letter to William L. Webber, from Arthur J. Libertucci, dated Nov. 17, 1997, at 2 (copy attached). ATF further determined that the sale of FMBs presented no threat to federal excise tax revenues. Id.

After the cocktail cooler petition, Diageo came to recognize that it could utilize the premium image and substantial goodwill associated with its brands to sell innovative new ready-to-drink products. The first fruit of this realization was Smirnoff Ice, introduced in the United Kingdom in 1998. Smirnoff Ice found substantial commercial success in Europe, and Diageo accordingly began to consider introducing it in the United States. An FMB formulation proved instantly attractive in light of the substantial discrimination against both wine and spirits products contained in federal law and the laws of many states.

Diageo prepared an FMB-formulated Smirnoff Ice for the U.S. test market in the spring of 2000. At that time we were contacted by another industry member and informed that an ATF official was suggesting that the agency would revive the rulemaking project abandoned after Ruling 96-1. See Ruling 96-1 (Feb. 26, 1996). Diageo accordingly met with ATF officials in the summer of 2000 to learn more about ATF's plans and to express its support for existing federal policy. During the meeting, Diageo revealed to ATF its intention to enter the FMB market in the near future in reliance on existing policy. ATF officials were told that Diageo would reconsider

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plans to enter the FMB market if the agency planned to place new limits on the use of flavors in FMBs containing not more than 6% ABV. After the meeting, ATF officials stated that the agency did not plan to change existing policy towards FMB formulation.

In reliance on assurances that ATF would not change existing federal policy, Diageo introduced Smimoff Ice in December 2000. The product proved an instant success, selling more than 10.3 million cases in 2001 and 28.2 million cases in 2002. <sup>5</sup> We anticipate that Smimoff Ice and Smimoff Ice Triple Black will continue to succeed in the marketplace in 2003 and beyond. Diageo also anticipates developing and introducing other FMBs in the future.

Smimoff Ice and other Diageo FMBs have generated jobs throughout the United States. Two different Diageo facilities are involved in the production of FMBs, and co-packing has occurred at five non-Diageo facilities in the past three years. We estimate that approximately 200 Diageo positions depend directly on the production of FMBs. FMBs also employ almost

200 Diageo sales people, and approximately 60 other Diageo employees. In addition, Diageo FMBs generate work for numerous suppliers and their employees. During the last fiscal year alone, Diageo spent over \$77.8 million on glassware, closures, cartons, labels, and other packaging materials for its FMB products.

#### COMMENTS

##### I. Proposed Formulation Standards for Beer and Malt Beverage Products

##### A. Diageo Favors a Majority Standard and Opposes the Proposed 0.5% Standard

Diageo believes that logic, policy consistency and basic fairness support a national standard requiring that a majority (more than 50%) of the alcohol in an FMB derive from the

<sup>5</sup> The 2002 case figure includes a small amount of Captain Morgan Gold.

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product's fermented beer/malt beverage base. Diageo opposes Notice 4's proposed 0.5% ABV limit on the use of non-beverage flavors as unnecessarily restrictive and unsupported by the law or facts. Moreover, a 0.5% standard would unfairly provide a competitive advantage to those companies that: (a) would profit from unfair and overly burdensome restrictions on the FMB category; or (b) allegedly already possess the capability to produce FMBs under TTB's proposed standard. We highlight our reasoning below and reiterate that the comments of FIVIBC explain our position in greater detail.

Notice 4 cites just two bases for its proposed limitation on the use of non-beverage flavors to just 0.5% ABV in a finished product – alleged consumer confusion and the concerns of state regulators. See 68 Fed. Reg. at 14294, 14295, 14296, 14297. These justifications do not withstand closer scrutiny. Notice 4's unsubstantiated allegation of consumer confusion fails to meet TTB's heavy burden of showing that current FMIB labeling misleads consumers about the source of alcohol in those products. See, e.g., *Ibanez v. Florida Dep 't of Bus. & Prof'l Regulation*, 512 U.S. 136, 141-42 (1994); *Pearson v. Shalala*, 164 F.3d 650, 659 (D.C. Cir. 1999). In our experience, consumers simply do not care about the source of alcohol in an FMB, and we have received no consumer complaints that using the term "malt beverage" on the label of our popular FMBs mislead any of them into buying the products. Notice 4 also fails to explain why a 0.5% standard is needed to avoid consumer confusion as to the alcohol source in a malt beverage when other, less stringent standards apply to the alcohol source in wines and distilled spirits. See, e.g., 26 U.S.C. § 5373 (allowing the fortification of wine with distilled spirits); 27 C.F.R. § 5.11 (allowing a distilled spirit to derive up to 50% of its alcohol from Un-distilled wine).

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Notice 4 also fails to explain how the concerns of state regulators support a 0.5% standard instead of a majority rule. TTB believes that federal law would support a majority standard, see 68 Fed. Reg. at 14296, and most state statutes contain definitions similar to the federal definitions of "malt beverage" or "beer." Compare 26 U.S.C. § 5052(a) and 27 U.S.C. § 211(a)(8) with Fla. Stat. Ann. § 563.01 and Mass. Gen. Laws ch. 138, § 1. TTB accordingly must recognize that state regulators, like TTB, possess substantial discretion when interpreting their definition of beer and/or malt beverage. That discretion allows states to adopt a majority standard as well as a 0.5% standard and, indeed, state regulators endorsed a majority by volume standard in the spring of last year.

B. The Law Does Not Authorize the Limits on Flavors Proposed in Notice 4

Although Diageo can accept a majority standard, a review of the law demonstrates that TTB lacks a statutory basis for issuing Notice 4. The relevant provisions of the Internal Revenue Code ("IRC"), 26 U.S.C. §§ 5001-5691, show that Congress did not give TTB the authority to limit the use of non-beverage flavors in a product taxed as "beer." The definition of that term, 26 U.S.C. § 5052(a), gives brewers flexibility in their choice of ingredients. The statute is entirely silent on the use of non-beverage flavors, and the repeal of old Internal Revenue restrictions on producing a beverage from non-beverage articles like flavors demonstrates that the current IRC's silence on the subject represents a deliberate choice by Congress not to restrict flavor use in the manner TTB now proposes. Compare I.R.C. § 2837 (1951) with I.R.C. §§ 5195-96, 5216, 5217 (1954).

Nor does TTB possess the authority to reclassify beers containing alcohol from non-beverage flavors as distilled spirits. The IRC taxes products as distilled spirits only if the added

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distilled spirits were not taxpaid and drawback flavors are, by definition, taxpaid. See 26 U.S.C. §§ 5001(a)(2) (defining "products containing distilled spirits"), 5131(a) (non-beverage drawback provision applies to distilled spirits "on which the tax has been determined").

Similarly, Diageo's willingness to support the majority standard does not alter our belief that the Federal Alcohol Administration Act ("FAA Act" or the "Act"), 27 U.S.C. §§ 201-211, does not place limits on the use of flavors in a malt beverage. The definition of a "malt beverage" explicitly authorizes the use of "wholesome food products" in a malt beverage, see *id.* at § 211(a)(8), a term that Notice 4 concedes encompasses non-beverage flavors, see 68 Fed. Reg. at 14296 ("We and our predecessors have considered flavoring containing distilled spirits to be wholesome food products and have allowed their use in producing malt beverages"). And like the current IRC, today's FAA Act replaced a statute that explicitly restricted the use of non-beverage flavors to make a beverage, indicating that the silence of the Act represents a deliberate choice by Congress and not mere oversight. Compare 27 U.S.C. § 13(e) (repealed) with *id.* at §§

201-211. In short, neither the IRC nor FAA Act gives TTB the power to restrict the use of non-beverage flavors as proposed in Notice 4. Congress intended to rely on the nature of non-beverage flavors themselves to put a practical limit on the amount of alcohol such flavors could contribute to either a beer or a malt beverage.

#### C. Timing of Any Proposed Change

Diageo believes the substantial changes required to reformulate, then mass-produce multi-million case brands like Smimoff Ice and Smimoff Triple Black necessitate an eighteen-month transition period to adequately prepare for the proposed change. Reformulating existing brands presents a particular challenge, as developers must not only create a great-tasting product,

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but one that does not compromise consumers taste and aroma experience. Moreover, the huge number of cases affected by any change requires a transition that does not disrupt Diageo's business infrastructure or those of its co-packers, distributors and other business partners.

The first task compelled by Notice 4 is the development of new product formulations that will meet TTB's final regulations (whether a majority or 0.5% standard) ~ consumers' expectations. In our experience, this task takes at least nine months. Thereafter, the product must undergo rigorous product testing, including sensory matching and shelf-life trials. After internal evaluation, actual consumer research is required to measure the level of consumer acceptance of the reformulated product.

Following the development steps outlined above, Diageo must transfer its reformulated FMB design to one ready for full-scale production. We estimate the lead time for the substantial capital investments necessary to prepare for production at eighteen months, including time to design, purchase and install necessary production equipment. Preparing for scale production also requires the completion of numerous legal tasks: Diageo must establish new ingredient contracts and renegotiate and/or amend existing co-packing agreements. In the case of production facilities owned by co-packers, the increased volumes associated with producing substantial quantities of malt base will likely require new handling and transportation contracts as well. Similarly, gearing up for production requires numerous business changes. Quality standards, for example, must be amended to reflect changed production methods, and personnel at multiple sites and across multiple products will require new training.

The need for a seamless and robust process combined with the uncertainty inherent in an undertaking like the reformulation of several multi-million case brands necessarily requires some

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"slack" in a timeline. This slack will allow Diageo to tackle unforeseen hurdles that may arise in almost any process along the way - from consumer testing, contract negotiations, production scale up or elsewhere.

Diageo already is preparing for an eventual new FMB rule. We have conducted product formulation work, internal testing and engaged in significant capital design work. But we can not prudently mobilize full production resources and staff until after a final rule clarifies whether the new national FMB rule will be a majority or a 0.5% standard. As a result, Diageo requests an eighteen-month transition period before the effective date of any final rule. Further, to avoid any confusion, final regulations should clearly explain that the new rule applies only to removals from internal revenue or customs bond after the effective date, and will not require the recall of FMB products already in the market.

## II. Proposed Labeling and Advertising Regulations

### A. Codification of Ruling 2002-2 - Proposed Sections 7.29(a)(7) and 7.54(a)(8)

Diageo agrees with TTB that its malt beverage labeling and advertising regulations should be updated to incorporate current policy articulated in Ruling 2002-2. See 68 Fed. Reg. at 14298; Ruling 2002-2, Industry Circular 2002-4 (Apr. 8, 2002). That policy permits the use of distilled spirit brand names and cocktail names as malt beverage brand or fanciful names. See Ruling 2002-2. The policy also prohibits placing distilled spirit standards of identity (e.g., rum, vodka) in a malt beverage statement of composition, and presumes that such standards of identity are misleading when used elsewhere in the advertising and labeling of a malt beverage. *Id.* As articulated in the comments of FMBC, however, Diageo believes the language Notice 4 proposes to codify Ruling 2002-2 is overbroad and would result in the suppression of numerous truthful,

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non-misleading labeling and advertising statements. See 68 Fed. Reg. at 14301 (proposed Section 7.29(a)(7)(i) – labeling), 14302 (proposed Section 7.54(a)(8)(i) – advertising). As proposed, Notice 4 would prohibit numerous unobjectionable statements about a malt beverage, such as:

- "Tastes like a cream liqueur";
- "With the same color as a tequila sunrise";
- "Serve from a brandy snifter";
- "Aged in used whisky barrels"; and
- "Smokier than single-barrel scotch."

The First Amendment does not allow the government to suppress such truthful, non-misleading statements. See, e.g., 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484 (1996); Rubin v. Coors Brewing Co., 514 U.S. 476 (1995). Thus, although Diageo supports TTB's existing policy, we believe the regulation codifying that policy should be carefully drafted to avoid the inadvertent suppression of constitutionally-protected speech. Narrow drafting will ensure continuity of TTB's existing policy by removing the possibility that a court will strike down any final regulation as unconstitutional. Diageo accordingly urges TTB to replace proposed Sections 7.29(a)(7)(i) and 7.54(a)(8)(i) with the following:

Any statement, design, device, or representation that tends to create the impression that a malt beverage is a distilled spirit, or that falsely suggests that a malt beverage contains distilled spirits.

Finally, Diageo urges TTB to provide companies that have invested millions in reliance

on existing labeling and advertising policies with an assurance that it intends no change from existing policy. Regardless of the language selected, any rule governing the use of distilled spirit

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brand names, fanciful names and standards of identity must necessarily remain general in order to deal with unanticipated circumstances. Nevertheless, that generality should not allow some future government official to reverse longstanding policy and rule that a regulation like proposed Section 7.54(a)(8) prohibits advertising that TTB now permits. Diageo accordingly requests that the preamble of the final rule confirm that any final labeling or advertising regulation will not result in a change of existing labeling or advertising policy.

B. Mandatory Alcohol Content Labeling – Proposed Section 7.22(a)(5)

Diageo also supports mandatory alcohol content labeling and has placed an alcohol content statement on the labels of all its FMBs since the introduction of Smimoff Ice in late 2000. But Diageo believes TTB should make alcohol content labeling mandatory for all malt beverages, and believes Notice 4 arbitrarily and unfairly singles out FMBs for alcohol content labeling without any basis for doing so.

Notice 4 provides no evidence for requiring mandatory alcohol content labeling only on the labels of malt beverages that contain alcohol from non-beverage flavors and other sources. Instead, the Notice relies on speculation that FMB consumers may believe that spirits-branded FMBs contain the same high alcohol content as distilled spirits, and that other FMBs may contain no alcohol due to their unconventional appearance. See 68 Fed. Reg. at 14296-97. Not only does TTB have no basis for this proposition, but the proposed rule bears no relationship to its cited justification: Notice 4 proposes to require alcohol content labeling on all products containing alcohol from other sources, regardless of whether they bear a distilled spirit brand name or do not look like conventional beer products. Thus, a malt beverage bearing a distilled spirit brand name but without flavors (e.g., Jack Daniel's Pilsner) would not require an alcohol

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content statement, while a malt beverage containing flavors but looking exactly like a conventional beer (e.g., Pete's Strawberry Blonde Ale) would require an alcohol content statement. The law demands a better fit between the asserted problem and the regulation proposed to address it.

### III. Proposed Formula Regulations

#### A. Introduction

Diageo agrees with Notice 4 that the current standards for SOP submissions are vague and often generate confusion among manufacturers and importers alike. See 68 Fed. Reg. at 14298. We commend TTB for proposing much-needed guidance in this area, and offer the

following comments to improve both the efficiency and utility of the proposed formula process.

#### B. Consistent Treatment of Domestic and Imported Products - Proposed Sections 25.55-.58

Notice 4 would apply different formula filing rules on imported malt beverages than those applied to domestic beer. For example, the regulations require domestic brewers to file detailed formulas for products that meet the criteria in proposed Section 25.55. See 68 Fed. Reg. at 14302. In contrast, proposed Section 7.31 states that TTB may require importers to submit malt beverage formulas but provides no further guidance on what information should be submitted or when. See *id.* This critical discrepancy in the proposed formula submission rules will perpetuate importers' confusion on which foreign malt beverage products require a formula submission, and may result in the disparate treatment of domestic versus foreign products.

In order to clarify the standards applicable to importers and to assure the equal treatment of all beers and malt beverages, Diageo believes that the same formula filing requirements should apply to domestic and imported products. TTB already applies the same formula filing

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standards to domestic and imported distilled spirits. Under Parts 5 and 27, TTB conditions the release of imported distilled spirits products from Customs custody upon the submission of a TTB-approved certificate of label approval ("COLA"). See 27 C.F.R. §§ 5.51, 27.58. Before TTB will review an importer's COLA application for certain distilled spirits products, however, the Agency evaluates the product's composition based on a pre-import letter submission or a laboratory analysis of a product sample. See Industry Circular 2002-2 (July 24, 2002). Importers must submit the same formula information to TTB under the pre-COLA evaluation process as domestic producers provide under the formula requirements in Part 5. Compare 27 C.F.R. §§ 5.25-.28 with Industry Circular 2002-2. Based on the distilled spirits model, Diageo encourages TTB to include the proposed formula requirements in Part 7, which applies to all malt beverages sold or shipped in interstate commerce, rather than Part 25, which applies only to domestic breweries.

Placing the new formula regulations in Part 7 fully comports with TTB's authority under the FAA Act. The formulation of a domestic or imported malt beverage relates directly to TTB's ability to enforce the FAA Act's labeling and advertising requirements because a product's composition determines how it may be labeled and advertised. TTB's authority under 27 U.S.C.

§ 205(e) and (f) to regulate alcohol beverage labeling and advertising accordingly authorizes TTB to require formula submissions by importers and domestic producers alike. As Part 7 contains the labeling and advertising standards for malt beverages sold or shipped in interstate and foreign commerce, including the proposed formula provisions in Part 7 would provide for the equitable and consistent treatment of domestic and imported products.

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In addition, all domestic beer should be subject to the same formula filing requirements as domestic and imported malt beverages, regardless of whether the beer enters the stream of interstate commerce. TTB can impose this requirement on domestic brewers by including a regulation in Part 25 that cross references the formula requirements in Part 7, subject to an exception for research and development purposes like the one contained in proposed Section

25.55(c)(2).

C. What Processes and Ingredients Trigger a Formula Requirement -  
Proposed Section 25.55(a)

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Notice 4 proposes to modify and codify longstanding federal policy 6 requiring the

submission and approval of an SOP (renamed a formula by Notice 4) for certain beer products. See 68 Fed. Reg. at 14302. Current regulations require an SOP where a brewer plans to "produce and market [beer] under a name other than 'beer,' 'ale,' 'porter,' 'stout,' 'lager,' or 'malt liquor.'" 27 C.F.R. § 25.67(a). Notice 4 proposes to significantly change the trigger for filing an SOP/formula from one focused on the brewer's marketing plans to a more complex analysis examining ingredients, processes and final product. More specifically, proposed Section 25.55(a) would require a formula for any beer:

- (1) treated by "any special processing, filtration or other methods of manufacture;"
- (2) containing taxpaid wine, a non-beverage flavor, or other ingredient containing alcohol;
- (3) containing "coloring or natural or artificial flavors;"
- (4) containing "fruits, herbs, spices, or honey;" or
- (5) that is "Sake, flavored sake, or sparkling sake  
6 27 C.F.R. § 25.67; Industry Circular 57-17 (July 2,1957).

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68 Fed. Reg. at 14302. Diageo welcomes a clarification of SOP/formula rules for beer, but believes that proposed Section 25.55(a) contains significant ambiguities that will frustrate TTBT's goal of creating a clear, workable and transparent formula submission requirement.

First, proposed Section 25.55(a) will leave brewers guessing about when they need to file a formula. For example, Section 25.55(a)(1) mentions filtration as a "special process," but the Notice 4 preamble also mentions filtration as a process that does not require the submission of a formula. See 68 Fed. Reg. at 14299. Similarly, current informal TTB policy requires a brewer to submit an SOP for a beer containing maple syrup, yet Section 25.55(a) fails to mention maple syrup as an ingredient requiring formula approval while explicitly requiring a formula for products containing a similar ingredient, honey. See *id.* at 14302 (proposed Section 25.55(a)(4)). That these and many other ambiguities abound is not surprising in light of the almost limitless number of processes and ingredients brewers can apply or add to beer.

Proposed Section 25.55(a) also will require many unnecessary formula submissions that will drain TTB resources and impose needless costs and delays on the industry. The formula process allows TTB to monitor the use of certain processes and ingredients in order to ensure that their use does not alter a product's tax classification or impact product labeling. 68 Fed. Reg. at 14298. A case-by-case examination of such processes and ingredients accordingly makes sense where TTB has not yet formulated a policy towards a given process or ingredient, or where the process or ingredient is so new that TTB must specifically evaluate any usage to determine health, tax and labeling implications. But once the use of a process or ingredient becomes commonplace, requiring rote submission of a formula serves no useful purpose and squanders both government and industry resources. To take one example, the use of "cold

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filtration" in lieu of pasteurization would have qualified as a "special treatment" when first introduced by brewers several decades ago. Today, however, many brewers employ cold filtration and, as noted in Notice 4, the process has become a "traditional" brewing process. See *id.* at 14299.

Furthermore, where published federal policy has clearly established the tax and labeling implications of a particular process or ingredient, the need for a formula vanishes. For example, Notice 4 proposes to adopt a precise limit on the quantity of alcohol that a beer can derive from sources other than the fermented beer base. Upon the adoption of such a rule, TTB will no longer have any reason to require a formula for products merely because they contain alcohol from a source other than the fermented beer base. TTB can develop its policy towards other processes and ingredients through rulings clarifying, for example, that the use of a particular commonly-used spice in beer (e.g., coriander, nutmeg) is permitted up to the limits found in the regulations of the Food & Drug Administration, provided that the brewer also identifies the use of spices in the beer's class/type designation.

Therefore, a final rule should incorporate a mechanism that gives TTB flexibility in determining what constitutes a "special process" in order to avoid needless filings. That mechanism also should give the industry a precise and transparent rule on what processes require the submission of a formula. Similarly, the formula rule should facilitate flexibility, efficiency and transparency by allowing TTB to waive the submission of a formula when the use of a particular process or ingredient has become so commonplace that it no longer requires case-by-case monitoring. Indeed, although proposed Section 25.55(a)(4) would require a formula for any

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beer containing spices, it implicitly excludes the most common spice used in beer - hops - from this requirement.

In order to accomplish the twin goals of efficiency and transparency while allowing TTB to ensure the proper taxation and labeling of beer products, Diageo urges that any final rule substantially re-write the formula submission rules proposed in Section 25.55(a). We suggest the following text:

(a) For what fermented products must a formula be filed? You must file a formula with TTB if you intend to produce:

(1) Any fermented beer products that will be treated by any processing that the Director has not recognized as an established brewing practice. The Director shall from time to time publish rulings in the Federal Register that list practices deemed to constitute established brewing practices, in addition to the following established practices:

- (i) pasteurization;
- (ii) filtration for clarification prior to bottling;
- (iii) filtration in lieu of pasteurization;
- (iv) centrifuging for clarification;
- (v) lagering; and
- (vi) carbonation.

(2) Any fermented beer products that will contain any ingredient that the Director has not recognized as a recognized brewing ingredient, or that will contain any ingredient in excess of any limits established by the Director for the use of a recognized brewing ingredient. The Director shall from time to time publish in the Federal Register rulings that list recognized brewing ingredients and any limitations on their use, in addition to the following recognized brewing ingredients:

- (i) malted barley or its extracts and byproducts;
- (ii) cereal grains or their extracts, syrups and byproducts;
- (iii) hops and hop extracts;



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(iv) potable drinking water; and

(v) brewer's yeast.

(3) Sake, flavored sake, or sparkling sake.

Diageo believes the text above will allow TTB to ensure the proper taxation and labeling of fermented products with far more clarity and flexibility than the text proposed by Notice 4. By regularizing in the regulations a process of recognizing processes and ingredients, TTB would provide the industry with far more guidance and certainty than either its current SOP policies or proposed Section 25.55(a).

#### D. Criteria for Evaluating Formulas

The formula rules in proposed Sections 25.53 through 25.58 aim in part to give TTB the ability to "determine the proper tax classification for fermented products." 68 Fed. Reg. at 14299. Thus, the formula process necessarily assumes that the use of certain ingredients and processes will render a product something other than a beer – either wine or distilled spirit. Yet Notice 4 provides the industry with no guidance on how TTB will evaluate a formula to determine whether the product is beer, wine or distilled spirit.

Notice 4 would codify existing federal policy permitting the use of many commodities, including "honey, fruit, fruit juice [and] fruit concentrate." 68 Fed. Reg. at 14302 (proposed Section 25.15(a)). The regulation does not mention, however, the unofficial policy of TTB to require that half the fermentable material in a beer derive from malted barley and/or other grains. Codification (or modification) of this and similar policies is necessary to provide guidance to the industry as to the limits TTB will apply in determining when a product qualifies as beer, and when the use of honey, fruit or other materials will require classification as a wine. As noted in the comments of FMBC, the absence of any regulatory guidance on this important question

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leaves brewers guessing about potentially important rules and invites inconsistent and arbitrary decision making by the TTB officials charged with reviewing formulas.

Similarly, although Notice 4's preamble notes that TTB will review formulas using a "special process [] to determine whether a particular process may be distillation and thus not eligible to be conducted on brewery premises," 68 Fed. Reg. at 14299, it provides no guidance on how TTB will make this determination. Once again, the proposed rule's lack of transparency will impose uncertainty on the industry and may lead to arbitrary decisions by TTB.

For the forgoing reasons, Diageo believes TTB must promulgate regulations that articulate clear standards as to how the Agency will evaluate formulas to determine what products qualify as beer, what products qualify as wine, and what products qualify as distilled spirits. Brewers today have little or no guidance on what, if any, standards apply, and any rulemaking accordingly should give the public an opportunity to comment on proposed regulations before any standards are finalized. The industry requires certainty and transparency when developing products and should not be forced to guess about applicable standards.

#### E. Other Alcohol Source Specificity - Proposed Section 25.57

Regulations proposed in Notice 4 specify the limits on other alcohol sources for products classified as "beer" and "malt beverages." See 68 Fed. Reg. at 14301 (proposed Section 7.11), 14302 (proposed Section 5.12). Regardless of the formulation standard adopted by the final rule, Diageo sees no further need to require that formulas include detailed information about other alcohol sources as proposed in Section 25.57.

Notice 4 intends to codify the information requirements contained in Rulings 94-3, 96-1, and 2002-2. See 68 Fed. Reg. at 14299. But the data called for by those rulings aimed to gather

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information in the absence of the clear formulation requirements that will arise from Notice 4. By limiting the permissible amount of alcohol derived from sources other than fermentation at the brewery, Notice 4 eliminates the need for detailed information about other alcohol sources.

TTB does not need alcohol content and source information called for by Section 25.57 in order to enforce its proposed beer and malt beverage standards. If it did, TTB would also need, for example, detailed information about the hops in a malt beverage in order to determine the product's compliance with the unofficial requirement that a malt beverage contain 7.5 pounds of hops, or the equivalent in extracts, per hundred barrels of product. See The Beverage Alcohol Manual (BAM), Basic Mandatory Labeling Information for Malt Beverages (Vol. 3), ATF Pub. 5130.3 (7-2001) at 4-2. As the proposed information collection unnecessarily complicates the proposed formula filing process, Diageo requests that TTB eliminate this rule. TTB can satisfy any concerns regarding other alcohol sources in a beer or malt beverage by requiring the producer or importer to include an appropriate certification statement in its formula filing.

F. Permitted Ranges in Formulas – Proposed Section 25.57(a)(1)

TTB seeks comments on what would constitute a "reasonable range" for identifying the quantity of ingredients listed in a formula. See 68 Fed. Reg. at 14299. Today, producers put large ranges in their SOP submissions for a variety of important reasons. A large range helps protect brewers' confidential trade secrets by ensuring that the disclosure of an SOP will not allow a competitor to easily duplicate the product. Ranges give brewers flexibility by allowing adjustments, where necessary, without the need to seek and obtain a new SOP. Ranges also help in the product development process by allowing brewers to seek TTB approval before they

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finalize an exact product formulation, thereby avoiding delays that SOP processing time would otherwise impose.

Diageo recommends that TTB define a "reasonable range" as follows: First, the range for "major ingredients," those that represent more than 3% of a product's total weight or volume, should vary by no more than 30% from the actual amount used in production. For example, if a manufacturer plans to use approximately 100 barrels of water in a product, the formula could list a reasonable range of 70 to 130 barrels. Second, for "minor ingredients," those that represent 3% or less of a product's total volume or weight, a reasonable range could vary by up to 200% from the actual quantity used in a product.

In addition, the final rule should codify current TTB policy permitting the listing of optional ingredients in a submission as long as those optional ingredients do not impact the product's labeling or classification as a beer/malt beverage. Listing optional ingredients allows manufacturers to replace out-of-stock flavors and other ingredients as necessary without the need to obtain a new formula each time such production adjustments are needed.

#### G. Formula Confidentiality

Highly sensitive trade secret information contained in an SOP or formula could be used to replicate a product's composition and method of production. Confidentiality concerns are heightened by TTB's proposal to narrow the ranges permitted for identifying the quantity of each ingredient used, as large ranges help protect exact formulations from disclosure. To codify the confidentiality standards that apply to SOP/formula information, Diageo urges TTB to add a new regulation specifying that all beer and malt beverage formulas submitted to the Agency are confidential and protected from public disclosure in accordance with the trade secrets exemption

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of the Freedom of Information Act, 5 U.S.C. § 552(b), and the confidentiality provisions for tax return information, 26 U.S.C. § 6103.

HI. Other Proposed Formula Provisions

1. Simplifying Formula Filing Processes

Diageo commends TTB for proposing several changes that will simplify key aspects of the formula filing process.

a. Formula Submissions – Proposed Section 25.56(b)

We agree that submitting formulas directly with the Advertising, Labeling and Formulation Division ("ALFD") of TTB in Washington, D.C. is superior to the current system. See 68 Fed. Reg. at 14302 (proposed Section 25.56(b)).

b. Superceding Existing Formulas – Proposed Section 25.58(d)  
Diageo supports Notice 4's proposal to allow the superceding of existing formulas. See

id. at 14303 (proposed Section 25.58(d)). Such a rule will provide valuable guidance on the recurring question of when and how to file a superceding product formula under TTB's current unwritten policies.

c. Government Formula Form

Diageo encourages TTB to create a standardized government form for formula filings as a means to facilitate both the filing of formula information by manufacturers and to increase the efficiency of TTB's review process. See id. at 14299.

2. Research and Product Development Exception –  
Proposed Section 25.55(c)(2)

Diageo urges TTB to adopt the proposed research and product development ("R&D") exception to the formula filing requirements. See 68 Fed. Reg. at 14302 (proposed Section

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25.55(c) (2)). The ability to pursue R&D activities on a number of product concepts and to adjust those research endeavors quickly is essential to market competitiveness and effective cost management. TTB's proposed R&D exception will facilitate product innovation without compromising the purpose and integrity of TTB's regulatory scheme.

3. Formula Revocation – Proposed Section 25.55(d)

Notice 4 references TTB's ability to cancel or revoke a beer or malt beverage formula under proposed Section 25.55(d), but it does not describe the process by which such an action would occur. See 68 Fed. Reg. at 14302. An attempt to revoke or cancel formulas without providing the formula holder with an opportunity to respond and other procedural safeguards would raise serious due process issues. See generally *Cabo Distribution Co., Inc. v. Brady*, 821 F. Supp. 582, 597-98 (N.D. Cal. 1992). Should TTB retain the formula revocation reference in its final rulemaking, the U.S. Constitution requires, at a minimum, that such revocations receive the procedural safeguards built into the administrative process for COLA revocations contained in Part 13 of the regulations.

4. Company Code – Proposed Section 25.57(a)(2)

TTB should delete the reference to "TTB company code" from the list of mandatory formula information. See 68 Fed. Reg. at 14303 (proposed Section 25.57(a) (2)). ALFD is discontinuing the assigning of vendor codes under its new electronic label filing system.  
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CONCLUSION

Diageo appreciates the opportunity to comment on Notice 4 and looks forward to working with TTB in establishing sound, workable regulatory standards for the beer and malt beverage product category.

Sincerely,

David Eickholt  
President  
Diageo-Guinness USA

Enclosure  
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