FEDERAL COURT OF AUSTRALIA

PepsiCo, Inc v Commissioner of Taxation [2023] FCA 1490

File numbers:	VID 53 of 2022 VID 55 of 2022 VID 56 of 2022 VID 57 of 2022 VID 74 of 2022 VID 82 of 2022
Judgment of:	**MOSHINSKY J**
Date of judgment:	30 November 2023
Catchwords:	**TAXATION** – royalty withholding tax – where the taxpayers were United States companies – where the taxpayers entered into exclusive bottling agreements (**EBAs**) with an Australian company under which the Australian company would manufacture, bottle, sell and distribute finished beverages in Australia in the taxpayers' branded packaging – where the EBAs contained a licence of the taxpayers' trademarks and other intellectual property to the Australian company – where the EBAs provided for the sale of concentrate by the taxpayers or a nominated seller to the Australian company – where the EBAs provided for the Australian company to pay for the concentrate but did not expressly provide for a royalty to be paid for the licence of the intellectual property – whether the taxpayers were liable to pay royalty withholding tax on a portion of the payments made by the Australian company under the EBAs – held: a portion of the payments was subject to royalty withholding tax **TAXATION** – diverted profits tax – where the taxpayers were United States companies – where the taxpayers entered into exclusive bottling agreements (**EBAs**) with an Australian company under which the Australian company would manufacture, bottle, sell and distribute finished beverages in Australia in the taxpayers' branded packaging – whether, on the assumption that the payments made by the Australian company under the EBAs were not subject to royalty withholding tax, the taxpayers were liable to pay diverted profits tax – whether the taxpayers obtained a "tax benefit" in connection with a scheme – whether it would be concluded that the person or one of the persons who entered into or carried out the scheme did so for a principal purpose of enabling the relevant taxpayer to obtain a tax benefit or both obtain a tax benefit and reduce foreign tax liabilities

Legislation:	*Income Tax Assessment Act 1936* (Cth), ss 6, 19, 128A, 128B, 177A, 177C, 177CB, 177D, 177H, 177J, 177N, 177P *International Tax Agreements Act 1953* (Cth), ss 4, 5, 17A *Income Tax Assessment Act 1997* (Cth), ss 6-5, 995-1 *Judiciary Act 1903* (Cth), s 39B *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth) *Taxation Administration Act 1953* (Cth) *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017* (Cth) *Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed at Sydney on 6 August 1982* (as amended), Art 12
Cases cited:	*ABB Australia Pty Ltd v Federal Commissioner of Taxation* [2007] FCA 1063; 162 FCR 189 *Anglo American Investments Pty Ltd (Trustee) v Commissioner of Taxation* [2022] FCA 971 *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* [1948] HCA 28; 77 CLR 143 *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* [1965] HCA 58; 114 CLR 314 *Brent v Federal Commissioner of Taxation* [1971] HCA 48; 125 CLR 418 *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* [2005] HCA 3; 221 CLR 496 *Commissioner of State Revenue v Lendlease* [2014] HCA 51; 254 CLR 142 *Commissioner of Taxes (SA) v Executor, Trustee and Agency Co of South Australia Ltd* [1938] HCA 69; 63 CLR 108 *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7; 251 CLR 640 *Federal Commissioner of Taxation v Casuarina Pty Ltd* [1971] HCA 78; 127 CLR 62 *Federal Commissioner of Taxation v Guardian AIT Pty Ltd ATF Australian Investment Trust* [2023] FCAFC 3; 115 ATR 316 *Federal Commissioner of Taxation v Macquarie Bank Ltd* [2013] FCAFC 13; 210 FCR 164 *International Business Machines Corporation and Another v Federal Commissioner of Taxation* [2011] FCA 335; 83 ATR 32

	Liquidator of the North Sydney Investment and Tramway Co Ltd v Commissioners of Taxation (1898) 19 LR (NSW) 225 *Minerva Financial Group Pty Ltd v Commissioner of Taxation* [2022] FCA 1092 *Mount Bruce Mining Pty Limited v Wright Prospecting Pty Limited* [2015] HCA 37; 256 CLR 104 *Permanent Trustee Co of New South Wales Ltd v Federal Commissioner of Taxation* [1940] ALR 291 *Perrott v Commissioner of Taxation (NSW)* (1922) 23 SR (NSW) 118 *St George Bank Ltd v Federal Commissioner of Taxation* [2008] FCA 453; 69 ATR 634 *WorkPac Pty Limited v Rossato* [2021] HCA 23; 271 CLR 456
Division:	General Division
Registry:	Victoria
National Practice Area:	Taxation
Number of paragraphs:	467
Date of hearing:	20-24, 27-29 March 2023
Counsel for the Applicant:	Mr EF Wheelahan KC with Ms CM Pierce
Solicitor for the Applicant:	PricewaterhouseCoopers
Counsel for the Respondent:	Ms K Deards SC with Ms T Phillips and Mr D Lewis
Solicitor for the Respondent:	MinterEllison

ORDERS

VID 53 of 2022

BETWEEN:	**PEPSICO, INC** Applicant
AND:	**COMMISSIONER OF TAXATION** Respondent

ORDER MADE BY:	**MOSHINSKY J**
DATE OF ORDER:	**30 NOVEMBER 2023**

THE COURT ORDERS THAT:

1. Within 14 days, the parties provide to the Court any agreed minute of proposed orders to give effect to the Court's reasons for judgment, and in relation to costs.
2. If the parties cannot agree, then within 21 days each party file and serve a minute of proposed orders to give effect to the Court's reasons for judgment, and in relation to costs, together with a short submission.
3. The Court's reasons for judgment be published, in the first instance, on a confidential basis to the parties and to Asahi Beverages Pty Ltd and Asahi Holdings (Australia) Pty Ltd (**Asahi**), to enable them to consider whether to seek confidentiality orders with respect to any part of the judgment. Within two business days, the parties and Asahi provide the Court with any submission on proposed confidentiality orders.
4. Subject to further order, the Court's reasons for judgment otherwise be and remain confidential for a period of seven days.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

ORDERS

VID 55 of 2022

BETWEEN:	**PEPSICO, INC** Applicant
AND:	**COMMISSIONER OF TAXATION** Respondent

ORDER MADE BY:	**MOSHINSKY J**
DATE OF ORDER:	**30 NOVEMBER 2023**

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ORDERS

VID 56 of 2022

BETWEEN:	**STOKELY-VAN CAMP, INC** Applicant
AND:	**COMMISSIONER OF TAXATION** Respondent
ORDER MADE BY:	**MOSHINSKY J**
DATE OF ORDER:	**30 NOVEMBER 2023**

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ORDERS

VID 57 of 2022

BETWEEN:	**STOKELY-VAN CAMP, INC** Applicant
AND:	**COMMISSIONER OF TAXATION** Respondent

ORDER MADE BY:	**MOSHINSKY J**
DATE OF ORDER:	**30 NOVEMBER 2023**

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ORDERS

VID 74 of 2022

BETWEEN:	**PEPSICO, INC** Applicant
AND:	**COMMISSIONER OF TAXATION** Respondent

ORDER MADE BY:	**MOSHINSKY J**
DATE OF ORDER:	**30 NOVEMBER 2023**

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ORDERS

VID 82 of 2022

BETWEEN:	**STOKELY-VAN CAMP, INC** Applicant
AND:	**COMMISSIONER OF TAXATION** Respondent

ORDER MADE BY:	**MOSHINSKY J**
DATE OF ORDER:	**30 NOVEMBER 2023**

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REASONS FOR JUDGMENT

MOSHINSKY J:

Introduction

1 PepsiCo, Inc (**PepsiCo**), a United States company, and Stokely-Van Camp, Inc (**SVC**), also a United States company, have commenced these proceedings to challenge royalty withholding tax notices, and diverted profits tax assessments, issued to them by the Commissioner of Taxation (the **Commissioner**) in respect of the years of income ended 30 June 2018 and 30 June 2019 (the **relevant years**).

2 In brief outline, the background facts are as follows.

3 At all relevant times, the PepsiCo group of companies (the **PepsiCo Group**) operated a global beverage business. PepsiCo was the owner of a world-wide portfolio of trademarks, designs and other rights and assets relating to the Pepsi and Mountain Dew brands, and SVC was the owner of a world-wide portfolio of trademarks, designs and other rights and assets relating to the Gatorade brand.

4 On or about 3 April 2009, each of PepsiCo and SVC entered into an agreement with Schweppes Australia Pty Ltd (**SAPL**), an Australian company that was owned by Asahi Breweries, in relation to the Australian market. The two agreements were:

(a) a Restated and Amended Exclusive Bottling Appointment between PepsiCo, the Concentrate Manufacturing Company of Ireland (**CMCI**) and SAPL (the **PepsiCo EBA**); this agreement relates to carbonated soft drinks (**CSDs**); and

(b) a Restated and Amended Exclusive Bottling Agreement between SVC and SAPL (the **SVC EBA**); this agreement relates to non-carbonated beverages (**NCBs**),

(together, the **EBAs**).

5 Under the EBAs:

(a) PepsiCo or SVC (as the case may be) agreed to sell, or cause a related entity to sell, beverage concentrate (**concentrate**) to SAPL; the concentrate was to be mixed by SAPL with other ingredients in accordance with formulas, specifications and other information provided by the PepsiCo Group to produce finished beverages for retail sale in Australia; and

(b) PepsiCo or SVC (as the case may be) granted SAPL the right to use in Australia trademarks and other intellectual property to enable SAPL to manufacture, bottle, sell and distribute the finished beverages in branded PepsiCo Group packaging.

6 The EBAs provided for SAPL to pay for the concentrate. They did not expressly provide for the payment of a royalty for the right to use the intellectual property.

7 During the relevant years:

(a) Concentrate Manufacturing (Singapore) Pte Ltd (**CMSPL**), a member of the PepsiCo Group incorporated in Singapore, produced concentrate according to a recipe or formula provided by, and with flavour keys supplied by, PepsiCo and SVC;

(b) CMSPL supplied the concentrate to PepsiCo Beverage Singapore Pty Ltd (**PBS**), a member of the PepsiCo Group that was (despite its name) incorporated in Australia;

(c) PBS was nominated as the "Seller" by PepsiCo under the PepsiCo EBA and as the "Seller" by SVC under the SVC EBA;

(d) PBS supplied concentrate to SAPL and invoiced SAPL for the concentrate that had been supplied;

(e) SAPL paid PBS for the concentrate in accordance with those invoices. In total, SAPL made payments of approximately A$[redacted] million to PBS during the relevant years; and

(f) PBS transferred almost all of the money received from SAPL to CMSPL, retaining only a small margin.

8 The Commissioner relies on two alternative contentions in relation to the facts and matters outlined above:

(a) The Commissioner's primary contention is that each of PepsiCo and SVC is liable for royalty withholding tax pursuant to s 128B of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**) and Art 12 of the *Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed at Sydney on 6 August 1982* (as amended) (**US DTA**).

(b) The Commissioner's alternative contention (which only arises if PepsiCo and SVC are not liable for royalty withholding tax) is that the diverted profits tax provisions of Pt IVA of the ITAA 1936 apply.

9 PepsiCo and SVC (the **PepsiCo parties**) have commenced two proceedings under s 39B of the *Judiciary Act 1903* (Cth) (VID 74 of 2022 and VID 82 of 2022) seeking declaratory relief to the effect that they are not liable to pay royalty withholding tax in relation to the relevant years in the amounts determined by the Commissioner, or at all.

10 The PepsiCo parties have also commenced four proceedings pursuant to Pt IVC of the *Taxation Administration Act 1953* (Cth) in relation to diverted profits tax assessments made by the Commissioner in relation to the relevant years. The proceedings are:

(a) VID 53 of 2022 – brought by PepsiCo in relation to the year ended 30 June 2018;

(b) VID 55 of 2022 – brought by PepsiCo in relation to the year ended 30 June 2019;

(c) VID 56 of 2022 – brought by SVC in relation to the year ended 30 June 2018; and

(d) VID 57 of 2022 – brought by SVC in relation to the year ended 30 June 2019.

11 The six proceedings were heard together, and evidence in one proceeding was evidence in the other proceedings.

12 The key issues to be determined in relation to royalty withholding tax are as follows:

(a) whether the payments made by SAPL under the EBAs were, to any extent, *consideration for* the use of, or the right to use, the items set out in paragraphs (4)(a) and (b) of Art 12 of the US DTA and the items set out in paragraphs (a) to (d) of the definition of "royalty" in s 6(1) of the ITAA 1936;

(b) if so, whether the relevant portions of the payments were *income derived* by PepsiCo or SVC (as applicable) for the purposes of s 128B(2B)(a) of the ITAA 1936 and amounts to which they were *beneficially entitled* for the purposes of Art 12 of the US DTA; and

(c) if so, whether the relevant portions of the payments were paid, or taken to have been paid, to PepsiCo or SVC (as applicable) for the purposes of s 128B(2B)(b)(i) as affected by s 128A(2).

13 If it is concluded that portions of the payments made by SAPL under the EBAs constitute "royalties" for the purposes of the royalty withholding tax provisions, the next issue is the *amount* of the royalties (upon which royalty withholding tax is payable). The parties have each filed expert evidence in relation to this issue. In summary, the expert evidence filed by the Commissioner states that the royalties are to be calculated by applying rates of 9.0% or 8.5%

(depending on the brand) to SAPL's net revenue from sales of the relevant products. The expert evidence filed by the PepsiCo parties is to the effect that the royalties are to be calculated by applying a rate of 2.5% to SAPL's net revenue from sales of the relevant products.

14 The Commissioner's contentions in relation to diverted profits tax are predicated on royalty withholding tax not applying. The Commissioner's alleged scheme is, in summary, entry into the relevant EBA on terms whereby no royalty was paid for the use of intellectual property, technical knowledge and/or assistance. There is no real issue about the identification of the scheme. The key issues to be determined in relation to diverted profits tax are:

(a) whether PepsiCo or SVC (as applicable) obtained a *tax benefit* in connection with the scheme for the purposes of s 177J(1)(a) of the ITAA 1936; and

(b) whether it would be concluded, having regard to the matters in s 177J(2) of the ITAA 1936, that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a *principal purpose* of, or for more than one principal purpose that includes a purpose of:

(i) enabling the relevant taxpayer (here, PepsiCo or SVC, as applicable) to obtain a tax benefit, or both obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or

(ii) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the scheme.

15 The Commissioner initially calculated royalty withholding tax and (in the alternative) diverted profits tax on the basis of certain figures for royalties. However, following the filing of expert evidence in this proceeding, the Commissioner amended (downwards) the royalty withholding tax notices and the diverted profits tax assessments to accord with the opinions expressed in the expert evidence he had filed.

16 Under the amended notices of royalty withholding tax (dated 6 March 2023), the liabilities of the two companies for royalty withholding tax for the relevant years (calculated at a rate of 5% of the royalties) are:

(a) for PepsiCo: $[redacted]; and

(b) for SVC: $[redacted].

17 Under the amended diverted profits tax assessments (dated 6 March 2023), the liabilities of the two companies for diverted profits tax for the relevant years (calculated at a rate of 40% of the royalties) are approximately:

	FY 2018	**FY 2019**	**Total:**
PepsiCo	$[redacted] million	$[redacted] million	$[redacted] million
SVC	$[redacted] million	$[redacted] million	$[redacted] million
Total:	$[redacted] million	$[redacted] million	$[redacted] million

As is apparent from the figures set out above, the tax in issue on the Commissioner's alternative case is greater than the tax in issue on his primary case.

18 The following is a summary of my conclusions:

(a) In relation to the royalty withholding tax issue, I have concluded that:

(i) the payments made by SAPL under the EBAs were, to some extent, *consideration for* the use of, or the right to use, the relevant trademarks and other intellectual property;

(ii) the relevant portions of the payments were *income derived* by PepsiCo or SVC (as applicable) for the purposes of s 128B(2B)(a) of the ITAA 1936 and amounts to which they were *beneficially entitled* for the purposes of Art 12 of the US DTA; and

(iii) the relevant portions of the payments are deemed to have been paid by SAPL to PepsiCo or SVC (as applicable) by virtue of s 128A(2) of the ITAA 1936.

It follows from the above that the payments made by SAPL under the EBAs in the relevant years were, to an extent, "royalties" and PepsiCo and SVC are liable to pay royalty withholding tax at the rate of 5% on those royalties.

(b) In relation to the *amount* of the royalties, subject to one matter, I have concluded that the amount of the royalties is 5.88% of SAPL's net revenue from sales of the relevant products during the relevant years. The one matter is that I consider that one licence agreement (contained in the set of comparable transactions) that was treated as non-exclusive (and therefore the subject of an adjustment) should have been treated as exclusive. Accordingly, I consider that that agreement should not have been the subject of an adjustment. I conclude that the figure of 5.88% needs to be revised (downwards) in light of that matter. This would appear to be a mathematical exercise based on material already in evidence.

(c) In light of the above conclusions, it is unnecessary to consider the diverted profits tax issue. However, I consider this issue for the sake of completeness. The Commissioner's diverted profits tax case is predicated on the royalty withholding tax provisions *not* applying. Therefore, in dealing with the diverted profits tax issue, I proceed on the assumption that (contrary to the conclusion I have reached above), the royalty withholding tax provisions *do not apply*. On that assumption, I have concluded that:

(i) each of PepsiCo and SVC obtained a tax benefit in connection with the relevant scheme; and

(ii) having regard to the matters in s 177J(2) of the ITAA 1936, it would be concluded that one of the principal purposes of each of PepsiCo and SVC in entering into or carrying out the relevant scheme was to obtain a tax benefit (namely not being liable to pay Australian royalty withholding tax) and to reduce foreign tax (namely, US tax on their income).

It follows that, had I not concluded that the royalty withholding tax provisions applied, I would have concluded that the diverted profits tax provisions apply.

The hearing and the evidence

19 The PepsiCo parties called the following lay witnesses:

(a) Lillian Dent, General Counsel for the Australia and New Zealand business unit of the PepsiCo Group; Ms Dent has worked in the PepsiCo Group in legal roles for over nine years; on 27 June 2018, she was appointed as a director of PBS; she ceased acting as director on 16 October 2019; she was reappointed as a director on 11 July 2022 and remains a director of PBS;

(b) Andrew Williams, who worked for the PepsiCo Group in marketing and bottling franchise-related roles for over 35 years; in about 2012, he took on the role of establishing the franchise function across PepsiCo International; in 2019, that role was consolidated with the PepsiCo Group’s global beverage marketing role, so he became the President of the PepsiCo Group’s Global Beverage Group and the Franchise Team; in that capacity, he was responsible for setting marketing and bottling franchise-system strategies to be implemented in approximately 115 countries worldwide;

(c) Randall Lovorn, the General Manager of PepsiCo Global Concentrate Solutions (**PGCS**), which is a division of the PepsiCo Group; he has held that role since 2019; he is responsible for all of the functions performed by PGCS related to the manufacture of concentrate, namely manufacturing, planning, logistics, finance, information technology and human resources; and

(d) Myles O'Donnell, the Vice-President of the Coded Materials function and the lead Flavour Trustee within PGCS; he commenced in that role in January 2020; he has worked within PGCS for the last 25 years; Mr O'Donnell was appointed as a Flavour Trustee (described later in these reasons) in 2015; his roles at the PepsiCo Group relate to the manufacture and supply of concentrate, in particular, in recent years, the Coded Keys (described below).

20 Each of these witnesses gave evidence-in-chief by affidavit and was cross-examined.

21 Ms Dent was somewhat tentative in her answers to certain questions and it perhaps appeared that she was not answering some questions directly. In any event, I have no doubt that she gave evidence honestly and was intending to assist the Court, and I generally accept her evidence.

22 Mr Williams answered questions in a clear and straightforward way. It should be noted that he did not have personal knowledge of several matters that are relevant in these proceedings. He was not familiar with the company, Stokely-Van Camp, Inc; he thought (incorrectly) that PepsiCo owned the Gatorade trademark (in fact it is SVC); he was not familiar with the PepsiCo EBA (one of the key documents in the case), and he said that he had not gone through an exclusive bottling agreement in any detail for many years. As discussed later in these reasons, while I accept many parts of Mr Williams's evidence, there are some aspects that I have difficulty in accepting.

23 Mr Lovorn evinced a very good command of the subject-matter. He answered questions in a clear and straightforward way. I generally accept his evidence.

24 The cross-examination of Mr O'Donnell was brief. I generally accept his evidence.

25 The Commissioner did not call any lay witnesses.

26 Each party called one expert witness in relation to the quantification issue; that is, the issue of what proportion of the amounts paid by SAPL constituted a royalty, on the assumption that (contrary to the PepsiCo parties' position) part of those amounts did constitute a royalty. The experts called by the parties were:

(a) the PepsiCo parties called Dawna Wright, a forensic accountant at FTI Consulting based in Melbourne; and

(b) the Commissioner called James Malackowski, an intellectual property consultant at Ocean Tomo, LLC (a part of JS Held) based in Chicago, Illinois, United States of America.

27 The experts prepared reports: Ms Wright prepared an initial report dated 19 September 2022; Mr Malackowski prepared a report dated 22 December 2022; and Ms Wright prepared a reply report dated 3 February 2023.

28 As detailed later in these reasons, the experts updated their calculations following the preparation of their reports, with the updated calculations set out in certain letters.

29 The experts were cross-examined separately (rather than giving evidence concurrently). I discuss and make observations about their evidence later in these reasons.

30 The parties also tendered a number of documents. These were contained in an electronic revised Court Book (**CB**) and an electronic Supplementary Court Book (**SCB**). Following the trial, the parties provided an annotated version of the index to the CB that indicated which documents had gone into evidence.

The pleadings or equivalent documents

31 In relation to the royalty withholding tax proceedings (VID 74 of 2022 and VID 82 of 2022), PepsiCo or SVC (as applicable) have filed an amended originating application and an amended statement of claim, and the Commissioner has filed an amended defence. These documents were filed in March 2023 and reflect the updated figures relied on by the Commissioner in the notices dated 6 March 2023.

32 In relation to the diverted profits tax proceedings, in each proceeding, PepsiCo or SVC (as applicable) has filed a notice of appeal. In each proceeding, the Commissioner has filed an amended appeal statement (albeit the title omits the word "amended") and PepsiCo or SVC has filed an amended appeal statement. The amended appeal statements were filed in March 2023 and reflect the amended diverted profits tax assessments of 6 March 2023. In each proceeding, the Commissioner's amended appeal statement sets out the "scheme" and the counterfactuals (relevant for the "tax benefit" issue). For example, the Commissioner's amended appeal statement in VID 53 of 2022 states:

67. [The] Commissioner contends that PepsiCo entered into a scheme comprising some or all of the following (the **Scheme**):

67.1. effective from 3 April 2009, PepsiCo entered into the [PepsiCo] EBA with SAPL whereby:

(a) SAPL was appointed as the sole and exclusive licensee to bottle, sell and distribute trademarked PepsiCo Group carbonated soft drink beverages. (The beverage brands the subject of the [PepsiCo] EBA, apart from the Seven Up brands, are referred to below as the **Pepsi Beverages**);

(b) SAPL agreed to purchase concentrate for the manufacture of the Pepsi Beverages from PepsiCo or one of its appointed subsidiaries; and

(c) SAPL obtained, under the [PepsiCo] EBA and/or the agreements referred to within it, including the Co-op A&M Agreements:

i. the use of, or rights to use, certain intellectual property owned by PepsiCo in the bottling, sale and distribution of the Pepsi Beverages;

ii. technical, industrial or commercial knowledge or information in relation to the Pepsi Beverages; and/or

iii. assistance ancillary to and furnished as a means of enabling the application or enjoyment of such intellectual property or knowledge or information.

(d) no royalty was paid for the items set out at (c) above.

68. Had the Scheme not been entered into or carried out:

68.1. the [PepsiCo] EBA would or might reasonably be expected to have:

(a) expressed the EBA Payments to be for all of the property provided by (and promises made by) the PepsiCo group entities (rather than for concentrate only); or

(b) expressly provided for the EBA Payments to include a royalty for the provision to SAPL of the rights, knowledge and assistance referred to above at [67.1(c)] (whether or not the amount of the royalty was specified); and

68.2. consequently, a royalty would or might reasonably be expected to have been paid by SAPL to PepsiCo or to another entity on PepsiCo's behalf or as PepsiCo directed (the **Counterfactual**).

33 Contentions in substantially the same form appear in the Commissioner's appeal statements in the other diverted profits tax proceedings.

34 In these reasons, I will refer to the counterfactuals set out in paragraphs (a) and (b) of paragraph 68.1 (read with paragraph 68.2) (and the corresponding paragraphs in the other amended appeal statements) as the **Commissioner's Counterfactuals**.

Factual findings

Overview of the PepsiCo Group business model

35 The PepsiCo Group beverages each have (and had during the relevant years) a "brand owner", namely PepsiCo or CMCI (and later Portfolio Concentrate Solutions UC (**PCS**)) for CSBs, and SVC for NCBs (being mostly sports drinks under the Gatorade brand).

36 The recipe or formula for the manufacture of concentrate for a particular beverage is (and was during the relevant years) highly secret.

37 During the relevant years, the PepsiCo Group had a number of concentrate manufacturing facilities around the world. The concentrate manufacturer either sold the concentrate directly or through a concentrate distributor that derived a small margin on the sales. The local bottler converted the concentrate into finished beverages and was responsible for distributing the beverages in the local market.

38 Under the model, the brand owner (PepsiCo, CMCI (or PCS) or SVC) has (and had during the relevant years) a direct relationship with the bottler. The brand owner controls and protects how the brand is used by the bottler and also has an ability to enforce quality requirements and consistency of how the brand is used.

39 During the relevant years, the concentrate manufacturer bore responsibility for manufacturing the concentrate so as to ensure that each beverage had its distinctive taste, and for getting the concentrate to the bottler. The concentrate manufacturer, or the concentrate distributor, also had responsibility for contributing some of the proceeds it received from the sale of concentrate towards marketing activities and payments to the bottler if it met certain targets.

Exclusive bottling agreements (2000 to 2008)

40 On 6 October 2000, PepsiCo, Seven-Up International (a division of CMCI) and Cadbury Schweppes Pty Ltd (as bottler) entered into an exclusive bottling appointment in relation to Australia.

41 On or about 16 May 2001, SVC entered into an exclusive bottling agreement with Cadbury Schweppes Pty Ltd (as bottler) in relation to Australia.

42 On or about 16 August 2006, SVC and Cadbury Schweppes Pty Ltd entered into a Restated and Amended Exclusive Bottling Agreement.

43 On 24 December 2008, Cadbury Schweppes Pty Ltd, Associated Home Delivery Pty Ltd (as SAPL was then known), PepsiCo, CMCI and SVC entered into a Deed of consent and novation.

44 In 2009, the Cadbury group of companies that controlled the beverage business was acquired by the Asahi group of companies and new exclusive bottling agreements, namely the PepsiCo EBA and the SVC EBA, were entered into. These are described below.

The PepsiCo EBA

45 On 3 April 2009, PepsiCo, CMCI and SAPL entered into the PepsiCo EBA. I note that PBS was not a party to this agreement. The PepsiCo EBA (as amended) was in place during the relevant years.

46 The "Bottler" for the purposes of the agreement was SAPL. The term "Company" was defined as follows:

> When used herein with respect to any matter concerning PEPSI, PEPSI MAX, PEPSI LIGHT, PEPSI LIGHT CAFFEINE FREE or MOUNTAIN DEW, the term 'Company' refers to PepsiCo, when used herein with respect to any matter concerning SEVEN-UP, the term 'Company' refers to CMCI; when used herein generally without regard to any particular trademark or beverage, the term 'Company' means both and each of PepsiCo and CMCI collectively. When used in clauses 24, 26, 29, 32 and 36 hereof, PepsiCo and CMCI shall collectively be regarded as one party;

47 The recitals noted that the Bottler and the Company were parties to an exclusive bottling agreement dated 6 October 2000 in respect of beverages known as and sold under the trademarks "Pepsi", "Pepsi Max", "Pepsi Light", "Pepsi Light Caffeine Free", "Mountain Dew" and "Seven-Up" (referred to as the "EBA"). The recitals also stated that the Bottler and the Company wished to restate and amend the EBA in accordance with this agreement.

48 Clause 2 stated that the EBA was amended and restated by being replaced wholly with this agreement with effect from the Commencement Date (which was 3 April 2009).

49 Clause 3 dealt with the appointment of the bottler as follows:

> **3 Appointment**
>
> (a) Subject to the terms of this Agreement, **PepsiCo hereby appoints Bottler, to bottle, sell and distribute the beverages known as and sold under the trade marks PEPSI, PEPSI MAX, PEPSI LIGHT, PEPSI LIGHT CAFFEINE FREE and MOUNTAIN DEW**; and CMCI hereby appoints Bottler, to bottle, sell and distribute the beverages known as and sold under the trade mark SEVEN-UP, in each case as its sole and exclusive licensee within the Commonwealth of Australia ('**Territory**') and nowhere else.

All the above beverages are hereinafter referred to as the '**Beverages**' and **all the above trade marks are hereinafter referred to as the 'Trade marks'**.

(b) The term of this Agreement shall be from the Commencement Date until 6 October 2020 ('**Original Term**'). This Agreement will be automatically extended for a term of 20 years, unless either Bottler or Company shall give notice in writing to the other party of its intention not to renew this Agreement, said notice to be given at least one year in advance of the expiration of the Original Term.

(c) Bottler accepts this appointment upon the terms herein contained and **will bottle, sell and distribute the Beverages only for ultimate resale to consumers in the Territory** and will not bottle, sell or distribute the Beverages to any person or entity whom bottler knows, or has reason to know, will export the Beverages, whether directly or indirectly, outside the Territory.

(d) Further, Company grants to Bottler a right of first refusal in relation to any other offer of bottling and/or distribution appointment in the Territory which Company or its affiliate wishes to make for any beverage which has not been previously licensed to Bottler. If Bottler declines any such offer or if no written acceptance of the offer is received from Bottler within 30 days of Company's written offer being sent to Bottler, Company reserves such right for itself and for third parties, on terms and conditions no more favourable than those offered to Bottler.

(Emphasis added.)

50 Insofar as the appointment clause, set out above, involved CMCI appointing SAPL in respect of Seven-Up, this can be put to one side for the purposes of the present proceedings, as they do not raise any issues concerning Seven-Up.

51 Clause 4 dealt with supply of concentrate and included:

4 Supply of Concentrate

(a) **Company will sell or cause to be sold by one of its subsidiaries (Company and/or such subsidiary hereinafter both called 'Seller') to Bottler, and Bottler will buy only from Seller, all units of concentrate (hereinafter called 'Units') required for the manufacture of the Beverages by Bottler, at the following prices** for the calendar year 2009.

Beverage	Price per Unit (US$)
PEPSI	[redacted]
PEPSI (FCB)	[redacted]
PEPSI MAX	[redacted]
PEPSI LIGHT	[redacted]
PEPSI LIGHT CAFFEINE FREE	[redacted]
MOUNT DEW	[redacted]
SEVEN-UP	[redacted]

(b) The above prices per Unit shall be adjusted on January 1 of each year during the term of this Agreement based on the official Australia Consumer Price Index (all groups) (‘**CPI**’) as published from time to time by the relevant government majority measured over the 12 month period ended on the immediate preceding June 30 or such other comparable index as the parties will agree if the CPI is suspended or discontinued or its method of calculation is substantially altered.

(c) All Units shall be delivered to Bottler’s plant, with freight, insurance and handling charges to be prepaid by Seller and charged to Bottler. Bottler shall be responsible for paying customs duty and GST. Bottler will at its own cost and expense, and without any cost or expense to Seller, obtain all import licenses and permits in relation to the Units. Company is responsible for ensuring the Units comply with all applicable laws and regulations in the Territory necessary to obtain all import licenses and permits. Title to all Units shipped by Seller to Bottler shall remain in Seller until the Units are paid by Bottler according to the provisions hereof. Payment in full for each order of Units shall be made by Bottler within 7 days of delivery.

(d) Bottler agrees that it shall carry an inventory of Units equal to 45 days’ projected usage, but not less than the previous financial year’s average 45 days’ actual usage.

(Emphasis added.)

The Commissioner draws attention to the fact that the clause provides for sale of concentrate “at” certain prices; it does not state that the payments are made “as consideration for” the concentrate or that the payments are made “only” for the concentrate.

52 Clause 5 dealt with the trademarks:

5 Trade Marks

(a) **Company represents and warrants that it is (and will remain during the term of this Agreement) the registered proprietor in the Territory of the Trade marks and that the use of each of the Trade marks by Bottler according to the provisions of this Agreement will not infringe the rights of any other party**.

(b) The decision of Company on all matters concerning the Trade marks shall be final and conclusive on, and not subject to question by, Bottler. Company will protect and defend the Trade marks at its sole cost and expense, but, subject to the indemnity provided by Company under clause 22 hereof, Company shall not be liable to Bottler for any loss or damage suffered by Bottler by Bottler’s use of the Trade marks or as a result of any litigation or proceeding involving the Trade marks. Bottler will cooperate fully with Company in the defence and protection of the Trade marks and will promptly and fully advise Company of any use in the Territory of any mark infringing the Trade marks. Company agrees to be responsible for any reasonable third-party costs incurred by Bottler in defending and protecting the Trade marks at the request of Company.

(c) Bottler recognises Company’s ownership of the Trade marks and will not take any action which will prejudice or harm the Trade marks, or

Company's ownership thereof, in any way.

(d) Nothing herein contained shall be construed as conferring upon Bottler any right or interest in the Trade marks, or in their registrations or in any designs, copyrights, patents, trade names, signs, emblems, insignia, symbols and slogans, or other marks, used in connection with the Beverages.

(Emphasis added.)

I note that the expression "Trade marks" was earlier defined in clause 3(a).

53 Clause 6 dealt with manufacturing directions. Clause 7 dealt with manufacturing materials. Clause 8 dealt with bottling plants and clause 9 dealt with bottling plant standards.

54 Clause 11 related to selling activities:

11 Selling activities

(a) **Bottler will sell Beverages in the Territory in agreed packages and proprietary packages as Company may from time to time specify.**

(b) Company anticipates that Bottler will sell Beverages in the Territory at prevailing competitive market prices.

(c) Bottler will sell and distribute beverages in accordance with all national, state municipal, local and other governmental laws, decrees, ordinances, rules, orders, regulations and charges.

(d) As may be agreed between the parties from time to time, Bottler will test market and introduce new packages and new package sizes for the Beverages in all or part of the Territory, and provide the bottling, selling and distribution facilities for such purposes.

(e) Bottler will use its reasonable endeavours to maximise the sale of Beverages throughout the Territory. Without in any way limiting bottler's obligations under this clause 11, Bottler must use its reasonable endeavours to fully meet and increase the demand and share of market for Beverages throughout the Territory and secure full distribution up to the maximum sales potential therein through all distribution channels or outlets available to soft drinks, using any and all equipment reasonably necessary to secure such distribution, must fully exploit new packages, new package sizes and new Beverages opportunities; must serve all accounts with frequency adequate to keep them at all times fully supplied with Beverages; must use its own salesmen and trucks (or salesmen and trucks of independent distributors, of whom Bottler shall notify Company), in quantity adequate for all reasons; must cooperate in Company's cooperative advertising and sales promotion programs and campaigns for the Territory.

(Emphasis added.)

55 Clause 12 required SAPL to maintain sufficient inventory. Clause 13 required SAPL to provide samples to the Company on a monthly basis. Clause 14 allowed the Company to conduct

inspections of SAPL's plant or plants. Clause 15 required SAPL to keep records of tests. Clause 16 required SAPL to provide certain information and reports to the Company.

56 Clause 17 dealt with permitted activities of SAPL and provided in part:

> **17 Permitted activities**
>
> (a) **Bottler will sell and distribute Beverages under the Trade marks** and will make only such representations concerning Beverages as shall have been previously authorised in writing by Company.
>
> Neither Bottler nor any affiliated or related entity or one under common ownership or control or one in which Bottler has an interest or participation will, in the Territory, bottle, distribute or sell, directly or indirectly:
>
> (i) any other cola drink or any drink or beverage similar to a cola beverage having the word 'cola' as part of its name, or
>
> (ii) any clear carbonated lemon and/or lime drink which imitates or can reasonably be confused with SEVEN-UP or DIET SEVEN-UP (including get-up, trade mark or logo). For the avoidance of doubt, the following are excluded …
>
> (iii) any carbonated beverage which imitates or can reasonably be confused with MOUNTAIN DEW, and
>
> (b) Bottler will not use in connection with any beverage any trade mark, designation or trade dress which imitates or is likely to be confused with Company's Trade marks, designations or trade dress.
>
> (c) Notwithstanding the foregoing, Company recognises that bottler is involved in co-packaging certain house brand private label supermarket beverages. With the exception of co-packaging of private label cola beverages or beverages similar to a cola beverage, Company agrees that Bottler may continue co-packaging such beverages, provided that the total volume of such co-packed beverages shall not exceed [redacted]% of the total volume of all of the beverages (including Beverages) produced by Bottler in any calendar year. In that regard, Bottler shall provide to Company a certificate signed by a director of Bottler certifying compliance with such volume number.
>
> (d) For the avoidance of doubt, nothing herein shall prohibit Bottler from co-packing any alcoholic pre-mixed beverage with an alcohol content greater than 1%.
>
> (Emphasis added.)

57 Although the agreement did not expressly licence SAPL to use the relevant trademarks and other intellectual property, it is common ground that the agreement contained an implied licence to this effect, having regard to clause 17 and the agreement generally; the agreement could not operate otherwise.

58 Clause 18 dealt with entry into a co-operative advertising and marketing agreement in relation to the beverages in the Territory (defined in clause 3(a) as Australia). Clause 19 related to a performance agreement entered into by Pepsi-Cola International, Cork (**PCIC**), a subsidiary of PepsiCo based in Ireland, and SAPL on the same day as the agreement.

59 Clause 20 dealt with permitted advertising:

> **20 Permitted advertising**
>
> In order to ensure consistency of image Bottler will use only such advertising strategies for Beverages as Company may develop for that market. In that connection, Bottler will use only advertising and promotion materials furnished or caused to be furnished by Company or approved by it in writing which comply with the laws in the Territory and **to the extent any of Company's Trade marks is used, will not advertise the Beverages in or through media or engage in promotions of the Beverages, not approved by Company in writing** (which approval will not be unreasonably withheld or delayed). Company reserves the right to contract with, control and administer national and local media and reserves the right to appoint advertising, sales promotion and public relations and research agencies with respect to Beverages and to be the client of record of these agencies.
>
> (Emphasis added.)

60 Clause 24 dealt with rights of termination and included:

> **24 Rights of termination**
>
> (a) Upon the happening of any one or more of the following events to a party, in addition to all other rights and remedies, the other party shall have the right to cancel and terminate this Agreement by one month's written notice to such party:
>
> (i) The failure of a party to perform or comply with any one or more of the material terms or conditions of this Agreement and such failure (if capable of remedy) is not remedied by such party within 60 days after it has been served with a written notice specifying such failure PROVIDED HOWEVER the right to cancel and terminate and all other rights and remedies under this clause 24(a)(i) will not apply if such failure is not capable of remedy within such 60-day period and such party has demonstrated that it has diligently pursued all necessary steps to cure such failure.

61 Clause 27 dealt with matters arising on termination and stated in part:

> **27 Matters arising on termination**
>
> Should this Agreement be terminated:
>
> (a) Bottler will not after the date of termination use in any manner whatsoever any of the Trade marks, marks, names, symbols, slogans, emblems, insignia or other designs; and …

62 Clause 28 dealt with compliance by distributors and provided:

> **28 Compliance by distributors**
>
> In the event Bottler utilizes distributors, to the extent permissible by law, Bottler will use reasonable endeavours to ensure that distributors comply fully with all of the terms and conditions of this Agreement relative to the sale and distribution of Beverages.

63 Clause 36 provided:

> **36 Confidential information**
>
> Each of the parties has been advised by the other that the information provided by each party to the other hereunder and the provisions hereof (collectively the 'information') which is non-public, confidential and proprietary information and of the possible damage which could result if any of the information is disclosed to a third party. Accordingly both Bottler and Company agree to use the information solely for the purposes contemplated by this Agreement, disclose the information only to its respective directors, officers and employees on a need-to-know basis and keep the information strictly confidential and not disclose any of the information to any third party, without the express prior written approval of the other party.

64 The PepsiCo EBA was varied on a number of occasions.

65 The evidence includes an undated variation agreement that took effect on and from 1 June 2012. The agreement deleted and replaced clause 3(a) with the following:

> Subject to the terms of this Agreement, PepsiCo hereby appoints Bottler, to bottle, sell and distribute the beverages known as, and/or sold under the trade marks PEPSI, PEPSI MAX, PEPSI LIGHT, PEPSI LIGHT CAFFEINE FREE, MOUNTAIN DEW, MOUNTAIN DEW ENERGISED WITH CAFFEINE, DIET PEPSI, DIET PEPSI CAFFEINE FREE, PEPSI NEXT AND PEPSI MAX KICK and CMCI hereby appoints Bottler, to bottle, sell and distribute the beverages known as and sold under the trade mark SEVEN-UP, in each case as its 'sole and exclusive licensee within the Commonwealth of Australia ('Territory') and nowhere else.
>
> All of the above beverages are hereinafter referred to as the 'Beverages' and all of the above trade marks are hereinafter referred to as the 'Trade Marks'.

66 On 16 September 2015, the parties signed a letter agreement varying the PepsiCo EBA by including additional terms relating to the "Say it With Pepsi" campaign and, in particular, the use of certain "Artwork" by the Bottler. The additional terms included the following licence (expressed to be royalty free):

> **2. Licence and IPR**
>
> 2.1 In consideration for the Bottler complying with its obligations under the EBA (including this letter), PepsiCo grants to the Bottler an exclusive, irrevocable, royalty free licence (including a right to sublicense) for the Term to use the Artwork or part of the Artwork (and any Intellectual Property Rights in the

Artwork) in the Territory in the exercise of its rights under the EBA, including this letter (hereinafter, the **Licence**).

2.2 The Bottler acknowledges that all right, title and interest in the Artwork (and any Intellectual Property Rights in the Artwork) remains vested in PepsiCo at all times.

2.3 The Bottler must comply with PepsiCo's reasonable directions relating to the use and application of the Artwork (and any Intellectual Property Rights in the Artwork).

The letter agreement also included warranties, indemnities, general terms and definitions of "Artwork" and "Intellectual Property Rights".

67 On 20 March 2018, the parties signed a letter agreement varying the PepsiCo EBA by including additional terms relating to the bottling, sale and distribution of Pepsi and Pepsi Max branded beverages in a new bottle, known as the AXL Bottle. The letter agreement was broadly similar to that set out above.

68 On 16 May 2018, the parties signed a letter agreement varying the PepsiCo EBA by including additional terms relating to the bottling, sale and distribution of PepsiCo's Pepsi Max Raspberry product. The additional terms were similar to those in the previous two letter agreements.

69 On 23 November 2018, the parties signed a letter agreement varying the PepsiCo EBA by including additional terms relating to the bottling, sale and distribution of PepsiCo's 1893 Pepsi Cola product. The additional terms were similar to those in the letter agreements described above.

Agreements related to the PepsiCo EBA

2009 CSD Performance Agreement

70 On or about 3 April 2009, PCIC and SAPL entered into a performance agreement (the **2009 CSD Performance Agreement**) that deals, broadly, with minimum sales volumes, quality standards, and advertising and marketing. I infer that, at this time, PCIC was the designated seller under the PepsiCo EBA. (In Ms Dent's affidavit, at paragraph 45, she stated that PCIC was the designated seller of concentrate to SAPL as at 2015.) I also infer that the 2009 CSD Performance Agreement remained in place during the relevant years. (The term of the agreement is the same as that of the PepsiCo EBA and there is no indication in Ms Dent's affidavit that the agreement ceased to be in effect or was replaced.) The evidence does not seem to include any agreement by which PCIC was replaced by PBS when it became the

designated seller under the PepsiCo EBA. Ms Dent's affidavit does not refer to any such agreement in the part of her affidavit dealing with this subject-matter (paragraphs 40-41). I will proceed on the basis that PCIC remained a party to this agreement during the relevant years. Nothing turns on whether the PepsiCo Group company that was party to this agreement was PCIC or PBS.

71 The Introduction to the 2009 CSD Performance Agreement stated that the purpose of the agreement was to record the agreement of PCIC and SAPL (referred to as the "Bottler") in relation to certain aspects of the operation of the bottler under the PepsiCo EBA in relation to the beverages sold under the trademarks specified in Sch 1 (defined as "Beverages"). Schedule 1 listed the following trademarks: Pepsi, Pepsi Max, Seven-Up, Mountain Dew, Pepsi Light and Pepsi Light Caffeine Free. The agreement stated that it was the performance agreement referred to in the PepsiCo EBA. It was stated that: definitions and expressions in the PepsiCo EBA applied in this agreement; in the event of any inconsistency, the PepsiCo EBA would prevail; and this agreement, the PepsiCo EBA and the annual Co-operative Advertising and Marketing Agreement (**Co-op A&M Agreement**) contained the entire agreement between the parties with respect to its subject-matter.

72 Clause 3 dealt with minimum annual sales volumes and the setting of sales volume targets. The clause set out agreed total minimum annual sales volumes for the Beverages for each of the calendar years 2009, 2010, 2011 and 2012. It stated that, for each of the subsequent calendar years 2013 to 2020, PCIC and Bottler would discuss in good faith and seek to agree on minimum sales volumes for Beverages for each calendar year, and that these discussions would take place as part of the development of the annual Co-op A&M Agreement.

73 Clause 5 dealt with distribution targets and investments. Clause 6 dealt with quality standards.

74 Clause 7 dealt with marketing and advertising, referring to Above-the-Line (**ATL**) and Below-the-Line (**BTL**) marketing and promotional activities. These expressions were explained in the affidavit of Mr Williams. Mr Williams stated that marketing programs are commonly split into two areas, referred to as "pull" and "push". He explained that: "pull" refers to enticing consumers to go and pull the PepsiCo Group's brands off the shelf; it covers communication and sponsorship; "push" refers to the strategies directed to getting PepsiCo Group beverage brands on the shelves in the right stores and pushing it to the consumers by appropriate pricing and store placement strategies. He stated that the ATL and BTL references in the 2009 CSD Performance Agreement corresponded to the pull and push activities described earlier in his

affidavit; the PepsiCo Group was primarily responsible for ATL activities while the bottler (here, SAPL) was primarily responsible for BTL activities. I accept this evidence.

75 Mr Williams gave evidence in his affidavit (which I accept) that: "ATL" also relates to building brand equity; there are various measures of brand equity, which the PepsiCo Group uses largely to monitor performance against its competitors; for example, taste, frequency of consumption, and whether the brand is top of mind for a consumer; Schedule 3 of the 2009 CSD Performance Agreement describes this as a PepsiCo Group responsibility; brand equity initiatives are typically included in Performance Agreements such as in Schedule 3 because, if too much of a marketing budget is spent on push, this might lead to selling product, but brand equity in the mind of the consumer is not being built; and the PepsiCo Group needs that brand equity to gain pricing power so that higher prices may be charged for its beverages.

76 Clause 7.1 stated that the advertising, marketing and promotional guidelines in Schedule 3 set out the respective roles of PCIC and the Bottler to undertake advertising, marketing and promotional activities.

77 Clause 7.2 stated that, for the calendar years 2009 to 2012, PCIC and SAPL would discuss in good faith, with the intention of entering into, by no later than the end of the second business week in December, a Co-op A&M Agreement to apply for the following calendar year; each Co-op A&M Agreement would outline an annual advertising and marketing expenditure program designed to sustain and grow the volume of Beverages.

78 Clause 7.3 set out a series of principles and terms relating to advertising and marketing. Clause 7.4 provided:

> For each calendar year 2013 to 2020, Bottler and PCIC will negotiate in good faith as part of the annual Co-op A&M an annual advertising and marketing expenditure program designed to sustain and grow the volume of Beverages and for each annual period will provide for and record:
>
> (a) minimum annual sales volumes;
>
> (b) annual sales volume targets;
>
> (c) specific innovation commitments, and
>
> (d) the amount of the PCIC's Fixed Controlled Expenditure, and the allocation of such expenditure as between ATL activities, PCIC BTL, and the amount to be provided for as the Bottler Volume Incentive.
>
> In the event that a Co-op A&M agreement is entered into for a calendar year, the principles and terms set out in clause 7.3 will apply to it.

79 The 2009 CSD Performance Agreement was amended twice, by a letter agreement dated 25 February 2010 and a letter agreement dated March 2011 (effective 1 January 2011).

Co-op A&M Agreements

80 For each calendar year during the period 2009 to 2019, a Co-op A&M Agreement was entered into between a company or companies in the PepsiCo Group and SAPL.

81 For example, PBS and SAPL entered into a Co-op A&M Agreement for the 2017 calendar year (the **2017 CSD Co-op A&M Agreement**). The agreement stated that definitions referred to in the PepsiCo EBA would apply to the agreement, and those definitions would prevail in the event of inconsistency.

82 Clause 2 of the agreement provided that the parties would contribute financially towards the advertising and marketing of the Beverages in the Territory to the extent and in the manner set out in the agreement.

83 Clause 3 dealt with (among other things) the target amount to be spent on advertising and marketing of the Beverages during the year, and the amount to be contributed by each of the Seller and the Bottler. The clause also provided some detail as to how that expenditure was to be allocated, with a breakdown between ATL and BTL activities. Appendix C contained details of the calculations.

84 Clause 7 stated that the agreed allocation of the expenditure to specified advertising and marketing programs was set out in Appendix A. Clause 8 stated that the current proposed allocation of expenditure by the Bottler towards BTL activities was set out in Appendix B. Clause 9 provided in part that the Bottler would not use any art work depicting images of PepsiCo brands in any program that had not been approved by the Seller.

85 Clause 16 provided that the bottler acknowledged that its contribution to the expenditure was for the purposes of improving its sales of Beverages, "not to build the brands of the Beverages".

The SVC EBA

86 On or about 3 April 2009, SVC and SAPL entered into the SVC EBA. I note that PBS was not a party to this agreement. The SVC EBA (as amended) was in place during the relevant years.

87 The recitals stated that: SVC (referred to as the "Company") and SAPL were parties to an exclusive bottling agreement (referred to as the "EBA") dated 16 May 2001 in respect of Gatorade products (which were described in Schedules 1A and 1B); the parties wished to

wholly restate and amend the EBA in accordance with the agreement; the parties intended the agreement to take effect upon the Commencement Date (defined as 3 April 2009); the parties also agreed to enter into the agreement in respect of the Propel products; and, subject to the terms and conditions of the agreement, SVC appointed SAPL to manufacture, package, distribute and sell the Gatorade products and the Propel products "under the respective Trade Marks … as its exclusive licensee of the Intellectual Property within the Territory". Thus, unlike the PepsiCo EBA, the SVC EBA contained an express licence. I note that the present proceedings do not raise any issue concerning the Propel products; that aspect of the agreement can therefore be put to one side.

88 Clause 1.1 included the following definitions (which are relevant to clauses set out below):

> **Company Affiliate** means any company, partnership, joint venture, branch or other corporate entity under the Control of or majority owned by Company.
>
> …
>
> **Information** means data, instructions, plans, specifications, formulae, technology, know-how, technical data, computer software, drawings, process descriptions, reports, developments, results, technical advice and trade secrets, whether in documentary, visual, oral, machine readable or other form and samples, equipment, and other tangible items.
>
> **Intellectual property** means all intellectual property rights in, or in respect of, the Products, Powder Products and SMP including without limitation:
>
> (a) copyright, design rights, Trade Marks, Works, Packaging Specifications, Product Specifications and Artwork;
> (b) any registration, application for or right to apply for registration of, any of those rights owned by or licensed to Company; and
> (c) Company's information,
>
> but excludes all Intellectual property rights owned by [SAPL] or its Related Corporations.
>
> …
>
> **Licence** means the licence of Intellectual Property granted pursuant to **clause 4**.
>
> …
>
> **Packaging** means all packaging, containers, bottles, labels (including for the avoidance of doubt promotional labels), closures and other similar items used in relation to the Products and Powder Products.
>
> …
>
> **Products** means the products to be manufactured by [SAPL] in the Territory in accordance with this Agreement, as described in **schedules 1A**, and **1C** and any other products agreed during the Term.
>
> …

> **Registrations** means the Australian trade mark registrations described in Part 2 of **schedule 3**.
>
> **Related Corporation** has the meaning given to **related body corporate** in the Corporations Act.
>
> …
>
> **Seller** has the meaning given to that term in clause 7.1.
>
> …
>
> **SMP** means in respect of Gatorade Products and PROPEL products their respective proprietary beverage base which is an essential ingredient of the Products but does not include liquid sucrose or citric acid.
>
> …
>
> **Territory** means Australia and includes such other geographical areas that may be agreed to by the parties from time to time to form part of the Territory, such agreement being evidenced in writing and signed by both parties.
>
> **Trade Marks** means the trade marks the subject of the Registrations and the trade marks the subject of the Applications listed in **schedule 3** and all other trade marks as agreed in writing and signed by the parties.

89 Clause 2(a) stated that the EBA was amended and restated by being replaced wholly by this agreement with effect from the Commencement Date.

90 Clause 3(a) dealt with the appointment of SAPL and provided:

> **3 Exclusivity**
>
> (a) Subject to the terms of this Agreement, Company appoints [SAPL] as the exclusive manufacturer, packager, seller and distributor of the Gatorade and PROPEL Products, and the exclusive seller and distributor of the Powder Products, in the Territory.

91 Clause 4.1 contained an express, royalty-free licence of the Intellectual Property:

> **4 Intellectual Property licence**
>
> **4.1 Licence**
>
> **Subject to clause 3**, **Company grants to [SAPL], for the duration of the Term, an exclusive royalty-free licence to use the Intellectual Property within the Territory** in relation to:
>
> (a) the production, manufacture, packaging, distribution and sale of Products (including the production and manufacture of Packaging for the Products);
>
> (b) the distribution and sale of Powder Products; and
>
> (c) the display, marketing, promotion and advertisement of Products and Powder Products,
>
> subject to [SAPL] complying with the terms and conditions of this

> Agreement. For the avoidance of doubt, nothing in this Agreement permits [SAPL] to distribute or sell the Large Sachets.

(Emphasis added.)

Insofar as the above clause referred to Large Sachets, that can be put to one side for present purposes.

92 Clause 5 dealt with manufacturing and quality control.

93 Clause 6 dealt with Intellectual Property and included:

> **6 Intellectual Property**
>
> **6.1 Ownership of Intellectual Property**
>
> [SAPL] for the Term and the Extended Term (if any):
>
> (a) acknowledges that, as between the parties, all rights and interests in the Intellectual Property are and will remain owned absolutely by Company or a Related Corporation of Company and all goodwill accruing in relation to the Intellectual Property after the Commencement Date shall insure to the exclusive benefit of Company; and
>
> (b) will not do anything directly or indirectly, that would or might:
>
> (i) infringe Company's Intellectual Property or the Intellectual Property of a Related Corporation of Company;
>
> (ii) invalidate or put into dispute Company's (or its licensor's) title or the title of a Related Corporation of Company to the Intellectual Property; or
>
> (iii) without limiting **clause 6.1(b)(ii)**, oppose any application for registration of any of the Intellectual Property or support any application to limit, remove, cancel or expunge any of the Intellectual Property.

94 Clause 6.3 contained warranties and an indemnity. These included the Company representing and warranting to SAPL that the Company or a related corporation was the registered proprietor of the Registrations (i.e. the Australian trademark registrations described in Part 2 of schedule 3) and the sole legal and beneficial owner of all common law and other rights attaching to the Intellectual Property. It was also represented and warranted that each of the Registrations was valid and subsisting and, to the Company's knowledge, there was no matter, fact or circumstance that would render any of the Registrations void or voidable.

95 Clause 7 dealt with SMP and Powder Products. As noted above, "SMP" was defined as meaning the proprietary beverage base in respect of Gatorade products and Propel products. Clause 7 provided in part:

7 **SMP and Powder Products**

7.1 **Supply of SMP**

(a) **During the Term, Company agrees to sell or cause to be sold by a Related Corporation of Company or a designated Company Affiliate acting as agent of Company ("Company and/or such subsidiary hereinafter both called "Seller"), and [SAPL] will buy only from Seller, all of [SAPL's] requirements for SMP.** [SAPL] shall use the SMP only for, and in connection with, production of the Products and in strict compliance with the Product Specifications and the terms and conditions of this Agreement and shall not export from the Territory the SMP or any Products containing the SMP.

(b) If the SMP is supplied by a Related Corporation of Company or a Company Affiliate, the terms of this Agreement, to the extent that they are relevant, apply to transactions between [SAPL] and the Related Corporation of Company or Company Affiliate as if they were direct parties to this Agreement.

(c) Company warrants that all SMP supplied to [SAPL] will:

(i) be of good and merchantable quality;

(ii) be fit for their intended purpose;

(iii) be free from any defects; and

(iv) comply with all applicable Laws.

(d) Neither Company nor any Company Affiliate or Supplier of Company shall be required under this Agreement to disclose to [SAPL] or any other person the secret and unique formula comprising the SMP. In the event that a governmental authority requires [SAPL] to provide the SMP ingredients or formula information, Company must provide the required information to [SAPL] solely for the purpose of remitting such information to the relevant governmental authority. [SAPL] must not use such information for any other purpose or make copies of, record in any way or make note in any manner of such information. Company may require [SAPL] or any of its agents or employees to enter into a separate confidentiality agreement covering the provision of the SMP ingredients and/or formula information under this clause. If a disclosure of the SMP formula or any of its ingredients is required by a governmental authority in order to sell the Products in the Territory, Company must provide in a timely manner the SMP ingredients and/or formula information directly to the governmental authority requiring such information.

7.2 **Price of SMP**

(a) **The price of each unit of SMP necessary to produce one single strength litre of the relevant Product sold to [SAPL] (Price) as at the Commencement Date for the Annual Period of 2009 shall be $[redacted]** to be increased at each Review Date during the Term and Extended Term (if any) in accordance with **clause 7.2(c)**.

(b) The price of SMP is CIF Australia port of entry (as defined in the 2000 edition of Incoterms). [SAPL] will reimburse Company for all port charges, customs service fees and delivery costs from the Australian Port to Company's Warehouse. Company shall be responsible for any import duty on the SMP. [SAPL] will bear all costs and expenses incurred in taking delivery of the Products at Company's Warehouse and subsequent transportation to [SAPL's] Facilities.

(c) Effective upon each Review Date, the Price will increase to an amount equal to the Current Price multiplied by [redacted] in instances only where CPI is positive.

…

7.4 Delivery and payment

(a) To assist Company in its production schedule, [SAPL] must:

(i) on or before the Review Date, provide to Company a written estimate of the volume of SMP and Powder Product which [SAPL] will require for the following 12 month period (**Annual Schedule**); and

(ii) on or before the 15th day of each Month, provide Company a written estimate of the volume of SMP and Powder Products which [SAPL] will require for the following 12 week period (**Rolling Schedule**).

(b) The Initial Annual Schedule and Rolling Schedule are annexed to this Agreement as **annexure A**.

(c) Each Annual Schedule and Rolling Schedule must be in substantially the same format as that specified in **annexure A** (or as otherwise agreed between the parties at any time).

(d) A fixed purchase order (**Order**) will be deemed to have been placed by [SAPL] and accepted by Company (for supply in accordance with the Order subject to **clause 7.4(e)**) for any SMP or Powder Products specified in the first 8 weeks of each Rolling Schedule but only after written acknowledgment of such Order is given by Company to [SAPL] which will be provided promptly after receipt of the Order. In the event that more than one Order applies to any specific period, the Order in the Rolling Schedule first received by Company will be deemed to be the Order for that period.

(e) If an Order exceeds a written estimate previously provided under **clause 7.4(a)** for a 12 week period, Company will use its reasonable efforts to meet that Order from [SAPL] but may refuse or reduce it.

(f) **[SAPL] must pay the Price for the SMP and Powder Products supplied by Company, a Related Corporation of Company or a Company Affiliate** within 28 days after the invoice, which shall be issued on the date of delivery of the SMP or Powder Products. Unless the parties agree otherwise, payment shall be made by telegraphic transfer to such bank account in the U.S.A. as may be specified by Company or a Company Affiliate at any time.

(g) Any failure by [SAPL] to make any payment required under this Agreement when due shall be a breach of this Agreement and without limiting Company's other remedies:

(i) Company may at its option require immediate payment to Company, a Related Corporation of Company or a Company Affiliate of all [SAPL's] liabilities and other indebtedness outstanding to Company, a Related Corporation of Company or a Company Affiliate regardless of previously agreed-upon terms of payment;

(ii) [SAPL] shall owe and pay to Company, a Related Corporation of Company or a Company Affiliate as the case may be interest on such overdue payment at the rate of 2% over the prime lending rate of National Australia Bank.

7.5 Passing of Property and Risk

Property and risk in the SMP and Powder Products will pass to [SAPL] on completion of delivery to [SAPL] which shall occur upon [SAPL] or its agent or nominee taking custody of the goods at Company's Warehouse.

(Emphasis added.)

96 Clause 9 dealt with selling and distributing the Products and the Powder Products. Clause 10 dealt with marketing and the allocation of responsibility for aspects of marketing as between the parties. Broadly, the Seller or a Related Corporation of the Seller would be responsible for the Marketing Program (being the program set out in item 1 of schedule 6, being the ATL marketing) and SAPL would be responsible for the BTL marketing.

97 Clause 12 dealt with inspections, samples and reports.

98 Clause 18 dealt with the term of the agreement and termination. The agreement continued until 31 December 2012, but could be extended. It is common ground that the agreement was in place during the relevant years.

99 Clause 18.2(a) provided:

18.2 Termination

Either party may terminate this Agreement immediately by notice to the other party if:

(a) the other party commits a material breach (it being agreed that any non-payment is considered a material breach) of this Agreement (unless the breach is capable of remedy, in which case if the other party fails to remedy the breach within 30 days after being required in writing to do so); or …

100 Clause 18.5 dealt with the effect of termination and included:

18.5 Effect of termination

…

(b) On termination of this Agreement or in the case of any Holding-over Period at the end of the Holding-over Period and subject to any provisions of this Agreement that apply only during such Holding-over Period:

…

(ii) [SAPL's] rights and licences under this Agreement will cease. Without limitation, [SAPL] must not do anything that might lead any person to believe that it is still licensed to use the Trade Marks or is in any way connected with Company;

101 Clause 19 dealt with confidentiality and included:

> **19.3 Permitted use**
>
> Each party may use the information of the other party only for the purpose of performing its obligations under this Agreement.

102 Clause 30 dealt with taxes and duties and included:

> **30 Taxes and duties**
>
> …
>
> (b) Company indemnifies [SAPL] against any Liabilities arising from any withholding tax which may be found to be applicable in respect of the Licence. In the event that withholding tax is imposed, [SAPL] will take such actions as are reasonably required by Company, at Company's cost, to legally challenge such imposition.

103 The SVC EBA was amended by the parties a number of times. The amending agreements are listed in paragraph 33 of Ms Dent's affidavit and are set out at CB tabs 24.12 to 24.19. Some of these involved adding additional products to the agreement. The amendments are not material for the purposes of the issues raised by these proceedings.

Change to the manufacturer of concentrate

104 In 2015, CMSPL was in the process of constructing a new concentrate manufacturing facility in Singapore, which was intended to become the supplier of concentrate to Australia as well as other countries in the region.

Change to the seller under the EBAs

105 As at 2015, the designated seller of concentrate to SAPL under the PepsiCo EBA and the SVC EBA was PCIC.

106 On 25 November 2015, PBS was incorporated.

107 On 8 December 2015, letters were sent by PepsiCo and SVC to SAPL pursuant to the EBAs. The letters are set out below. I note that the Commissioner relies on these letters as constituting a direction to pay for the purposes of the royalty withholding tax provisions.

108 On 8 December 2015, PepsiCo sent a letter to SAPL that stated:

> I refer to the Restated and Amended Exclusive Bottling Appointment between PepsiCo, Inc. ("**PepsiCo**"), The Concentrate Manufacturing Company of Ireland ("**CMCI**") and Schweppes Australia Pty Limited ("**SAPL**"), as amended and restated from time to time (the "**Amended EBA**"). Unless otherwise specified, capitalised terms in this letter have the meaning given to them in the Amended EBA.
>
> PepsiCo notifies you that, from 1 January 2016, the Seller of Units will change to:
>
> PepsiCo Beverage Singapore Pty Ltd
> ABN: 609 497 832
> [address redacted]
>
> Contact:
> [email and telephone number redacted]
>
> From 1 January 2016, all purchase orders should be sent to PepsiCo Beverage Singapore Pty Ltd

109 On 8 December 2015, SVC sent a similar letter to SAPL as follows:

> I refer to the Restated and Exclusive Bottling Appointment between Stokely-Van Camp, Inc. ("**SVC**") and Schweppes Australia Pty Limited ("**SAPL**"), as amended and restated from time to time (the "**Amended EBA**"). Unless otherwise specified, capitalised terms in this letter have the meaning given to them in the Amended EBA.
>
> SVC notifies you that, from 1 January 2016, the Seller of SMP and Powder Products will change to:
>
> PepsiCo Beverage Singapore Pty Ltd
> ABN: 609 497 832
> [address redacted]
>
> Contact:
> [email and telephone number redacted]
>
> From 1 January 2016, all purchase orders should be sent to PepsiCo Beverage Singapore Pty Ltd

110 On 11 January 2016, a letter on PepsiCo letterhead, but signed by PBS, was sent to SAPL as follows:

> I refer to the letter from PepsiCo, Inc. to Schweppes Australia Pty Ltd dated 8 December 2015, notifying you that PepsiCo Beverage Singapore Pty Ltd will be the Seller of Units from 1 January 2016.
>
> The bank account details for PepsiCo Beverage Singapore Pty Ltd are:

Bank:	Citibank
Account name:	Pepsico Beverage Singapore PTY LTD
Account number:	[redacted]
Denomination:	USD
Branch code:	[redacted]

111 On 11 January 2016, a further letter on PepsiCo letterhead, but signed by PBS, was sent to SAPL as follows:

> I refer to the letter from Stokely Van Camp, Inc. to Schweppes Australia Pty Ltd dated 8 December 2015, notifying you that PepsiCo Beverage Singapore Pty Ltd will be the Seller of SMP and Powder Products from 1 January 2016.
>
> The bank account details for PepsiCo Beverage Singapore Pty Ltd are:

Bank:	Citibank
Account name:	Pepsico Beverage Singapore PTY LTD
Account number:	[redacted]
Denomination:	AUD
Branch code:	[redacted]

Concentrate Distribution Agreement

112 On or about 1 January 2018, CMSPL and PBS entered into a Concentrate Distribution Agreement. The recitals to the agreement noted that CMSPL was in the business of producing Concentrate (as defined) used in the Beverages (as defined) within the Territory (as defined) and that PBS was in the business of distributing Concentrate for use in the production of the Beverages within the Territory.

113 Article 1 of the agreement defined "Beverages" as meaning all CSDs and NCBs that were owned or licensed by CMSPL and sold in the Territory. "Concentrate" was defined as the concentrated essence, salts, acidulants, and any other components that were used in making Beverages for sale in the Territory.

114 Article 2 dealt with distribution of Concentrate. Broadly, Section 2.1 provided that PBS would distribute Concentrate to Bottlers and Approved Resellers in the Territory in such annual volumes as PBS and CMSPL agreed.

115 By section 2.4, PBS agreed to perform all necessary activities to fulfil its obligations under Section 2.1 for the benefit of CMSPL.

116 Article 3 dealt with the price at which PBS would purchase Concentrate from CMSPL. In summary, it was provided that PBS would purchase Concentrate from CMSPL at the price equal to PBS's sales price less a distribution discount determined in accordance with Section 3.2. Section 3.2 was headed "Arm's Length Standard" and provided in part:

> The Distribution Price shall meet the arm's length standard under the tax laws of the relevant jurisdictions. Thus, the Distribution Price shall be the amounts that would be provided by a seller to an unrelated purchaser under similar circumstances or conditions, considering all relevant facts.

117 Section 4.5 dealt with the passage of title in the Concentrate from CMSPL to PBS.

118 Article 5 dealt with intellectual property. During cross-examination, Ms Dent gave evidence that this related to the information that the bottler needed to manufacture the beverages; that is, the information needed to turn the concentrate into the beverages.

Supply of concentrate during the relevant years

119 During the relevant years (that is, the years ended 30 June 2018 and 30 June 2019), CMSPL sold concentrate to PBS.

120 During the relevant years, SAPL acquired all units of concentrate under the PepsiCo EBA and the SVC EBA from PBS.

121 The evidence includes copies of sample purchase orders for orders placed by SAPL with PBS for the purchase of CSD concentrate and NCB concentrate during the relevant years (CB tabs 24.45, 24.48).

122 The evidence includes sample invoices issued by PBS for the sale of CSD concentrate and NCB concentrate to SAPL during the relevant years (CB tabs 24.46, 24.49).

123 The evidence includes copies of bank statements detailing the receipt of payments into a bank account in the name of PBS during the relevant years (CB tabs 24.47, 24.50).

124 PBS recorded the income from the sale of concentrate to SAPL in its Australian income tax returns and financial statements for the income years ended 31 December 2017, 31 December 2018 and 31 December 2019.

125 PBS's financial statements for the year ended 31 December 2018 show that it made a profit of $[redacted] for that year. PBS's financial statements for the year ended 31 December 2019 show that its profit for that year was $[redacted]. I note that the Commissioner contends that the margin that PBS earned on the sale of concentrate was 0.05% (and not the figure of 0.5% referred to in his amended appeal statements in the diverted profits tax proceedings).

Additional facts relating to concentrate

Concentrate Solutions Team

126 The PepsiCo Group's Concentrate Solutions Team is responsible for manufacturing, selling and delivering beverage concentrate across the PepsiCo Group's beverage brands to the PepsiCo Group's bottlers worldwide. This involves the operation and management of the

global concentrate manufacturing footprint in which the PepsiCo Group manufactures the concentrate and dispatches it to bottling partners around the world. This in turn requires the Concentrate Solutions Team to oversee the concentrate manufacturing process, monitor ingredient availability, procure the materials to manufacture concentrate and manage the logistics associated with getting concentrate to the bottlers. It also requires oversight of the transactional aspects of providing concentrate to bottlers, including order management and revenue collection from the concentrate sales.

127 The Concentrate Solutions Team supplies the total global demand for beverage concentrate to around 127 markets from eight concentrate manufacturing facilities. Two of those facilities are located in Ireland, one in Singapore, and the others are located in China, Pakistan, India, Uruguay and the United States. In terms of their manufacturing capability, the facilities are broadly the same, but their scale differs depending upon the size of the market they are designed to supply with concentrate. One of the facilities also contains a coded material manufacturing facility which supplies certain locations with specific components.

Concentrate

128 The PepsiCo Group sells beverage concentrate as a kit. The kit contains liquids and powders. Essentially, the Concentrate Solutions Team manufactures the liquid components and blends and unitises the powder components of each concentrate kit.

129 The liquid component of the kit will contain a flavour component (also called characterising flavours, such as cola or citrus) and an acidulent component. Those components are packed and transported in pails.

130 The powder component usually consists of products like caffeine, citric acid or phosphoric acid, which may be blended into a compound and then unitised. Some powders are sorted into separate bags as they cannot interact until the point of finished product manufacture, or they could impact the final product due to oxidate or flavour migration.

131 A single concentrate kit, which generally consists of pails of liquid components and bags of powder components, will make a specified number of servings for one particular product, eg, classic ("blue can") Pepsi. A single eight-hour concentrate batch will provide enough finished concentrate to make millions of servings of finished beverage.

132 Each individual concentrate kit will likely have between 2 and 30-plus different components as part of the kit, but those components could be a combination of many more ingredients.

133 The liquid ingredients of concentrate include the *flavour key* (discussed further below). The flavour key is one individual ingredient of concentrate that is manufactured by the PepsiCo Group's *Coded Materials Team* (also discussed further below). A flavour key is only one part of the flavour profile of a concentrate. It gives beverages their particular flavour or characterising flavour. The other parts of the flavour profile of a concentrate come from other flavours contained in the concentrate.

134 The Coded Materials Team works with the Concentrate Solutions Team to ensure availability of the flavour keys for the manufacture of concentrate, but the concentrate manufacturers are not privy to what goes into the Bill of Materials for the flavour key. Only the *Flavour Trustees* (discussed below) within the Coded Materials Team know that information.

The bottling process

135 Mr Lovorn gave evidence in his affidavit that: the bottling process is one in which the bottler essentially adds carbon dioxide and water to a concentrated mixture and, in some formulas, a sweetener component (sucrose or high fructose corn syrup (**HFCS**)); the bottling process may be compared to baking a cake using store-bought cake mix because it involves taking a product which is homogenous, blended in specific proportions, engineered to produce a particular kind of cake with a familiar taste, to which the home baker usually adds basic ingredients before pouring the mixture into a tin to bake it. During cross-examination, Mr Lovorn gave the following additional evidence about this analogy:

> You are not suggesting, are you, that in drawing that comparison, that the beverage manufacturing process that's undertaken by franchise bottlers is something that anyone can do?---Anybody that had the capital to invest in cold fill manufacturing capacity can make a soda.
>
> But not something that could be done in a domestic kitchen where one might bake a store bought cake mix?---No.
>
> And are you not suggesting by that analogy that the instructions that the bottler are given for bottling PepsiCo Group beverages and manufacturing them, are as simple as the ones that might be found on a packet cake mix bought in a store?---I think in the context of beverage manufacturing yes, because we take all the complexity from the bottler. They manufacture the beverage. We provide the ingredient; we provide the proprietary formulations; we work with the suppliers in qualifying ingredients that buy from our qualified suppliers. So the general manufacturing operation in a cold fill plant is a batch system, a bowl where they mix the ingredients, a filling system where they pour it into a bottle and then they cap it, or put it in a can, and seal it.

136 In subsequent questions, Mr Lovorn was pressed on whether the cake mix analogy was correct. He maintained his position, while acknowledging that the context was the beverage

manufacturing industry. I accept Mr Lovorn's affidavit and oral evidence as set out in the preceding paragraph.

137 Bottlers mostly use what is referred to as a cold fill process to convert the concentrate into finished beverages. Essentially the bottler pours the ingredients and blends from the concentrate kit into a mixer and adds water, and potentially sugar or HFCS, and blends it. That mixture is then put in a bottle with carbon dioxide and enclosed in the approved packaging.

138 The cold fill process is standardised and well known. It is easy to buy the required equipment and a bottler could readily hire a consultant to assist with the mixing of the concentrate with water and carbon dioxide.

139 The complexity and expense involved in the manufacture of concentrate are avoided for the bottler because it receives a simplified concentrate kit; the bottler does not need to know how to fold oils, extract flavours or achieve emulsification. PGCS also manages the complexities of the supply chain for the unique ingredients of concentrate because of the scale of concentrate manufacture globally.

140 Mr Lovorn stated in his affidavit (and I accept) that the bottler is provided with a set of documents containing instructions and specifications to manufacture and bottle each PepsiCo and Gatorade product for sale. During cross-examination, Mr Lovorn was taken to the product specification documents for Pepsi Max Vanilla that were annexed to his affidavit. He said (and I accept) that these documents contained the instructions and specifications to be used by SAPL in manufacturing the Pepsi Max Vanilla product. Mr Lovorn said (and I accept) that the specification was treated within the PepsiCo Group as being confidential and proprietary information; by "proprietary" he said that he meant it is a document to which protection is required to be given within the PepsiCo Group and by bottlers who receive a copy of the document. Mr Lovorn accepted that this was because there is an interest, both for the PepsiCo Group and for the bottling facilities, that the specification not become known to other bottlers that are not in a franchise arrangement with the PepsiCo Group.

141 A bottler has no need to know the recipe for the components of a concentrate kit in order to prepare and distribute a finished beverage, and the bottler would never be told that information, which is kept secret within the PepsiCo Group.

Flavour Trustees

142 The PepsiCo Group has Flavour Trustees, who are the individuals who know the formulations for the flavour keys that give a particular beverage its distinctive taste. Apart from Mr O'Donnell, there are two other Favour Trustees. They are also part of the Coded Materials Team. The flavour keys of which they are the Flavour Trustee are known within the Coded Materials Team as *Coded Keys*.

143 No member of the Coded Materials Team other than the three Flavour Trustees is entitled to know the formulations for the Coded Keys.

Flavour keys

144 A flavour key is a mixture of flavour ingredients or raw materials to produce a concentrated liquid product which gives a beverage its distinctive flavour.

145 The PepsiCo Group requires the Flavour Trustees to treat all flavour keys as trade secrets. This involves adhering strictly to certain practices relating to the coding of raw materials; the quality control procedures relating to the testing of flavour key samples; the segregation of inventory and the manufacturing of flavour keys from other aspects of PepsiCo Group's business, in particular its concentrate manufacturing facilities.

146 Some of the flavour keys for PepsiCo products are managed as "Coded Keys" within the Coded Materials Team. This means that only the three Flavour Trustees know the identity of the ingredients and formulations of the flavour key (the Coded Key) for each of the beverages within those brands. This also means that the raw materials are identified only by codes, so as to maintain the confidentiality and secrecy of the formulation of each flavour key. Another type of flavour key is the "Non-Coded Key". Non-Coded Keys are also managed within the Coded Materials Team as trade secrets but are not treated with the same degree of secrecy as the Coded Keys. In relation to Non-Coded Keys, approximately 25 people (who are known within the Coded Materials team as "Non-Coded Key Holders") have access to information about the ingredients and formulations for those flavour keys. There is a third category of flavour key, which is known as an "Escrowed Key". These are also managed as trade secrets. Escrowed Keys relate to flavours which are developed by a third-party flavour supplier. The intellectual property in the flavour is assigned to PepsiCo, maintained in escrow and licensed back to the supplier to manufacture and supply the flavour key exclusively for PepsiCo.

Coded Materials Team

147 The Coded Materials Team is responsible for: creating and managing the supply of, and ensuring the quality of, Coded and Non-Coded Keys; protecting the secrecy of the flavour keys by managing the flavour key formulations as trade secrets; procuring all raw materials and other ingredients required for the manufacture of the flavour keys; and managing the escrow process for all Escrowed Keys.

148 The Coded Materials Team manages the entire supply chain for flavour keys from end to end; that is, from the sourcing of the raw materials, the procurement of the raw materials, the logistics of the raw materials into the plant, the quality, sampling and testing of the raw materials, the manufacture of the flavour keys themselves, the testing of the keys, the packaging, labelling, documentation and shipping of the flavour keys. Within the context of an overall beverage supply chain involving the supply of beverage concentrate to a bottler, the Coded Materials Team is responsible for a discrete supply chain within the concentrate supply chain.

149 Mr O'Donnell gave evidence in his affidavit that the "original formulations" of the Coded Keys are held in a third-party bank vault, and that the Flavour Trustees regularly re-write codes in order to disguise the formulations. During cross-examination, Mr O'Donnell clarified that the reference in his affidavit to the "original formulations" was to the unencoded forms of the formulas; so, for example, in the bank vault is the unencoded form of the formula for Pepsi as is currently being made and is on the shelf today. I accept this evidence.

150 Mr O'Donnell gave evidence in his affidavit that, as a practice to minimise the risk of loss, none of the Flavour Trustees is permitted to fly in the same aircraft as another Flavour Trustee. During cross-examination, Mr O'Donnell was taken to that paragraph and the following exchange took place:

> Now, given the answer you gave me a moment ago about the unencoded formulations for the currently used keys being stored in the bank vault, if something awful were to happen and you and each of your other two other colleagues who are also flavour trustees all happened to pass away at the same time, it would be the case, wouldn't it, that someone from the PepsiCo Group would be able to access those original formulations of the coded keys in the bank vault?---Yes.
>
> So, again, if something awful like that did happen and all three of you were to pass away at the same time, it's the case, isn't it, that the formula for the coded keys would not be lost because they are in the vault?---That's right, yes.

Incorporation into beverage concentrate

151 Once manufactured, a Coded Key becomes an inventory item noted on the concentrate manufacturer's inventory system, as in the case of a regular raw material. A Bill of Materials for a batch of concentrate will identify a quantity of the Coded Key required to manufacture the batch.

152 There is no need for a concentrate team member to know the formula for a Coded or Non-Coded Key and, in order to protect that formula as a trade secret, the concentrate manufacturer would never be told that information.

Incorporation into finished beverage

153 For the purposes of enabling or assisting a bottler to produce finished beverages from concentrate, the Coded Materials Team is not and would not be required to provide any technical knowledge or assistance to the bottler relating to the properties, behaviour or composition of a flavour key or relating to the use of a flavour key with the other ingredients in the manufacture of the concentrate or the finished beverage.

154 There is no need for a bottler to know the formula for a flavour key and, consistently with the PepsiCo Group's policy and practice of protecting that formula as a trade secret, the bottler would never be told that information because that would be inconsistent with the requirements of formula confidentiality and secrecy of all flavour key formulations within the PepsiCo Group.

Additional facts relating to the franchise model

Early 1900s to 1970s

155 PepsiCo's predecessor, the Pepsi-Cola Company, was established in 1902, not long after Pepsi-Cola was invented.

156 In the early 1900s, the Pepsi-Cola Company adopted a franchise-style model in the United States. Under that model, the company sold Pepsi syrup (equivalent to concentrate) to third-party bottling companies. There were a number of bottling companies appointed to bottle and sell Pepsi-Cola across the United States.

157 The evidence includes a copy of a "License to Bottle Pepsi-Cola" granted by the Pepsi-Cola Company to Charlottesville Pepsi-Cola Bottling Company (the **Bottling Company**) dated 28 December 1908 (the **Charlottesville EBA**). By this agreement, the Pepsi-Cola Company

granted to the Bottling Company "the right to Carbonate Pepsi-Cola in bottles and to Market Bottled Carbonated Pepsi-Cola" in the territory of Charlottesville. The agreement involved the sale of Pepsi-Cola Bottling Syrup by the Pepsi-Cola Company to the Bottling Company for a specified price ($1.25 per gallon). The Pepsi-Cola Company agreed not to sell Pepsi-Cola Bottling Syrup to other bottlers in the territory during the term of the contract. The Pepsi-Cola Company agreed to furnish to the Bottling Company "such advertising matter for distribution and display as is generally furnished to Pepsi-Cola Bottling Plants". The Bottling Company agreed to purchase each year the contract was in force a specified volume of syrup and to bottle the syrup in a specified proportion of syrup to carbonated water "and to pay cash for the syrup upon arrival at destination". The Bottling Company agreed to "mark all crates and bottles with the lettering of the Pepsi-Cola trade mark".

158 Mr Williams gave evidence in his affidavit (which I accept) that, since its inception in the early 1900s, PepsiCo's franchise-style model has been based on the sale to a third-party bottler of concentrate, and on the distribution and sale in local markets of finished beverages produced by a bottler from that concentrate. The model requires joint investment by both PepsiCo and the bottler in the infrastructure and resources required to develop, manufacture, bottle and distribute the beverages and in local marketing to promote beverage sales.

159 In the 1950s, PepsiCo sought to expand the franchise-style model internationally in an attempt to capitalise on changing consumer demands in the post-war era.

160 Until the 1980s, the PepsiCo group marketed one beverage internationally, which was the classic formulation of Pepsi.

The period since the 1980s

161 In around 1986, the PepsiCo Group acquired the "Seven-Up" or "7up" brand of beverages for the purposes of marketing and distributing them internationally. In the following years, the PepsiCo Group's beverage portfolio expanded considerably. It launched Diet Pepsi and later Pepsi Max, and moved into water, juices and Gatorade. There are now over 80 brands in the PepsiCo Group's beverage portfolio.

The FOBO and COBO models

162 In his affidavit, Mr Williams uses the expression "FOBO" (short for "franchise-owned bottling operation") to describe the business model in which the PepsiCo Group sells concentrate that

is then "finished off" by a bottler with local equipment and distribution capabilities. I will use the expression in the same way in these reasons.

163 In his affidavit, Mr Williams uses the expression "COBO" (short for "company-owned bottling operation") to refer to the model in which PepsiCo uses bottling operations that are owned and operated by PepsiCo. I will use that expression in these reasons. In parts of the United States, and in a small number of other countries such as Russia, Poland and Egypt, PepsiCo operates under the COBO model.

164 In about 2009, PepsiCo acquired two of its biggest bottlers in the United States, PPG and Pepsi Americas. That had the effect of bringing about 80% of PepsiCo Group bottling in the United States into the COBO model.

Features of the FOBO model

165 Mr Williams gave evidence in the last sentence of paragraph 17 of his affidavit that, under the FOBO model, the PepsiCo Group "remains responsible for building its global brand so as to increase volumes of beverage sales and gain market share from Coca-Cola". During cross-examination, Mr Williams was taken to that sentence and gave the following evidence (which I accept):

> So is your evidence in that last sentence that it's the global brand of Pepsi that drives the volume of beverage sales and market share?---No, it's a multiple group of things that drive volume and market share.
>
> And can you tell me what the other things are?---We would typically look at everything across what we call push-pull. So everything that involves the brand in a store, so pricing, display, location in the store and trade promotions, so we would regard that as push. And then on pull it would be anything that obviously encourages the consumer to pull the brand off the shelf, so it would be advertising, it would be sponsorship, sampling and so on.
>
> And, generally speaking, pull is the [responsibility] of Pepsi and push is the responsibility of the bottler; is that right - - -?---Yes, we - - -
>
> - - - broadly speaking?---It's not quite as black and white but yes, that would be the case.

166 Mr Williams gave evidence in paragraph 19 of his affidavit (which I accept) that: in implementing the FOBO model worldwide, the PepsiCo Group's essential role is to continue innovating and developing the "brands" under which its products are sold; the model is based on the principle that the PepsiCo Group should focus on activities it is better placed to perform, while third-party bottlers focus on their core business of bottling, selling and distributing finished beverages, as that is their primary business and their field of expertise. In oral

evidence, Mr Williams gave evidence (which I accept) that it is the role of PepsiCo, rather than the bottler, to develop and promote the brands, and that when he used the term "brands" in paragraph 19 of his affidavit he was referring to the trademarks, the get-up, the shape of the bottle, and those sorts of items of intellectual property.

167 Mr Williams gave evidence in his affidavit (which I accept) that: in his experience, the FOBO model drives value for both the bottler and the PepsiCo Group; on the bottler's side, it will earn a higher return on capital from bottling beverages than PepsiCo would because of the bottler's knowledge of the local market and ability to leverage its networks and scale; the local bottler is able to leverage the PepsiCo Group's innovation and marketing capabilities which enhances the bottler's own local capabilities. Mr Williams gave the following evidence (which I accept) during cross-examination:

> … And in 21 of your affidavit, Mr Williams, the last sentence reads that the local bottler is able to leverage the Pepsi Group's innovation and marketing capabilities which enhances the bottler's own local capabilities. Is it also true to say that the bottler gets the benefit of brand recognition in the local market as a result of the arrangement with PepsiCo?---Obviously they get access to the brand - - -
>
> Yes?--- - - - and that brand recognition will drive value, but I don't think you can isolate it like that because there are many factors driving value. So for a new franchise, for example, where the brand is very new, then there's very, very limited value coming through from the brand.
>
> Thank you, Mr Williams. I might just ask you that question again because I'm talking about the benefit to the bottler with this question. So is it also true to say that the bottler gets the benefit of brand recognition in the local market - - -?---Yes.
>
> - - - as a result of the bottling arrangement?---Yes.

168 Mr Williams gave evidence in his affidavit (which I accept) that: on the PepsiCo Group side, the group gains access to the bottler's investment in bottling and distribution equipment and its capabilities, including its distribution network, sales force, leadership, relationships with the trade (such as supermarket executives) and local regulatory authorities; it is beneficial for the PepsiCo Group to do this, as it does not have those local capabilities or assets.

169 Mr Williams gave evidence in his affidavit that the FOBO model remains essentially unchanged since it was created in the early 20th century. While this may be accepted in a general sense, I note that this covers a long period of time and many different countries. Based on the exclusive bottling agreements to which Mr Williams was taken during cross-examination, it does seem that there is considerable scope for variation in the terms of exclusive bottling agreements entered into by the PepsiCo Group.

170 Mr Williams gave evidence in his affidavit that the PepsiCo Group has sought for the past two decades to identify and promote certain practices in carrying out exclusive bottling agreements so that the FOBO model is adopted "simply, consistently and efficiently worldwide". He stated that, in his experience, with so many markets, if you do not reduce the business model to "a very simple model", it is difficult to get both bottlers and PepsiCo Group local franchise managers to implement the model consistently and efficiently. As discussed below, insofar as this relates to the pricing terms, I have some difficulty in accepting that the pricing terms were simple in all cases.

171 Mr Williams gave evidence in his affidavit that, over the last decade, the PepsiCo Group has identified and promoted the fundamental principles of the FOBO model. Between 2012 and 2015, under Mr Williams's direction, the best practices of the bottling system were identified and simplified into a statement of nine "fundamentals". The document is known within the PepsiCo Group as the "9Fs" or "9 Franchise Fundamentals". In formulating the 9Fs, Mr Williams's team spent around three years examining all the markets in which the PepsiCo Group operates looking at how it works with bottlers and identifying the best practices. Eventually, the PepsiCo Group identified these nine principles which allowed it to take anything occurring within a market, whether it be India, China or the United Kingdom, and relate that to one of the nine fundamental principles. A copy of the "9 Franchise Fundamentals" was annexed to Mr Williams's affidavit.

172 During cross-examination, Mr Williams gave evidence (which I accept) that the principles recorded in the document remained constant over the time he was in his franchising role. He gave evidence (which I accept) that the application of the principles would vary across different markets, because it was "a journey of building capability". He accepted that what was expressed in the document was a statement of principles at a fairly high level in terms of business strategies and goals, with the flexibility to be able to implement them differently in different markets according to the needs of those markets.

173 The document included the following statement (at page 11): "The long-term success of our Franchise model comes from building strong brands". Mr Williams gave evidence during cross-examination that he agreed with that proposition, and it was one of the drivers of long-term success. I accept that evidence.

174 Mr Williams accepted during cross-examination that the 9 Franchise Fundamentals document was a series of business goals and strategies for management of the franchise business, rather

than a template for how an exclusive bottling agreement was to be negotiated. Mr Williams accepted during cross-examination that the document did not provide specific guidance as to what could and could not be included in an exclusive bottling agreement.

175 Mr Williams gave evidence during cross-examination (which I accept) that, in his role in franchising, he was not aware of the sale of PepsiCo concentrate ever being offered without a licence of the brand. He said (and I accept) that, in the FOBO model, the concentrate and the brands "always go together". Mr Williams accepted that PepsiCo would never sell its concentrate without also licensing the Pepsi brand under which the finished beverage is to be sold. Mr Williams said (and I accept) that, in his experience, PepsiCo had never licensed the trademark for the Pepsi brand to be used on a carbonated soft drink that was not made from Pepsi concentrate.

Exclusive bottling agreements

176 Mr Williams gave the following evidence in his affidavit relating to the negotiation of exclusive bottling agreements:

(a) Exclusive bottling agreements are usually negotiated locally by PepsiCo Group employees (referred to as "franchise leads") who are based in local markets and are responsible for managing contracts and relationships with bottlers. Therefore, a centralised and consistent approach to the negotiation of exclusive bottling agreements and related agreements is essential and relies on all PepsiCo Group employees understanding which aspects of exclusive bottling agreements are non-negotiable, and what principles guide the negotiable provisions of exclusive bottling agreements and related agreements (eg, monetary investment in annual marketing programs).

(b) Non-negotiable aspects of exclusive bottling agreements are binding on the PepsiCo Group's franchise leads worldwide. These non-negotiable matters are essentially cultural to the PepsiCo Group, having their source in the group's company history and in the historical success of the FOBO model. The PepsiCo Group has insisted on exclusive bottling agreement provisions that ensure that no bottler introduces a cola beverage into its own portfolio to be distributed and sold in competition with Pepsi beverages. This is referred to within the Global Beverage Team as a "non-compete on cola".

(c) The exclusive bottling agreements have a very strict focus on maintaining the quality and consistency of the taste of Pepsi beverages. Therefore, the exclusive bottling agreements stipulate that the bottler must perform its bottling function in strict compliance with PepsiCo's methodologies and specifications and allow PepsiCo to inspect the bottler's operations, conduct quality audits of a bottler's finished product and take water samples to ensure that the bottler's water quality will not degrade the taste or quality of a beverage. PepsiCo also provides ongoing technical assistance and monitoring to train and guide the bottler and ensure that PepsiCo's strict quality standards are maintained and adhered to. These measures are also non-negotiable and failure to meet the quality standards is a breach of the exclusive bottling agreement and may in some cases lead to termination of that contract. By subjecting the bottler to quality assurance measures, the PepsiCo Group protects its brand and the reputation of its products.

(d) As the FOBO model is based on the sale of proprietary beverage syrup, the quality and consistency of which is strictly monitored, controlled and protected, the PepsiCo Group also insists that exclusive bottling agreements provide that beverage concentrate be purchased only from the PepsiCo Group.

(e) The FOBO model is based on the PepsiCo Group's responsibility for supplying concentrate and maintaining and building its brand. The exclusive bottling agreements contain provisions that give the PepsiCo Group strict control over marketing activities undertaken and promotional material produced by the bottler for the purposes of its distribution and sale of beverages. Such terms are also non-negotiable.

177 I accept that the evidence in the above paragraph represents the *general* position regarding terms that are non-negotiable from the PepsiCo Group's point of view. However, the exclusive bottling agreements to which Mr Williams was taken during cross-examination show that there have been a number of instances where an exception has been made to the non-compete on cola. Mr Williams described these as "outliers"; nevertheless, they were exceptions and indicate that there is scope to vary that term. Further, during cross-examination, Mr Williams gave the following additional evidence (which I accept) relating to the negotiation of exclusive bottling agreements:

> … So does that mean that the negotiable and non-negotiable elements that you've described in your affidavit are not exhaustive?---No, but at the end of the day, everything has to be agreed. There are some areas that we will give less leeway on than others.
>
> So as a practical matter, everything is negotiable, is that what you're saying?---No, because there are some things we would walk away from. I think it's very difficult to

> put these relationships into black and white formats like it feels like we're doing. It's a very complex process, awarding an EBA - - -
>
> Yes?--- - - - and you have to come out of the other side in a very sustainable way for both parties. If it only works for one party, it will collapse within two or three years and that doesn't help anybody. So we go through pretty good discussions on every element.
>
> Yes, I see. So there's an element of flexibility there to make the relationship work - - - ?---Mm.

I take Mr Williams's answer to the last question in the above passage to signify agreement with the proposition put to him.

178 Mr Williams gave evidence in his affidavit that the pricing term is a negotiable aspect of the exclusive bottling agreement. He stated:

> 42. **A negotiable provision in the EBA relates to the price for which concentrate is sold by the PepsiCo Group's designated seller**. There are a number of factors which the local franchise executive will bear in mind when negotiating the price for the concentrate.
>
> 43. One such factor is the cost of goods including freight. Another is the amount of money that must be spent on advertising and marketing to protect and grow the brands in the territory.
>
> 44. Another such factor is trade pricing, which means that we try to determine, based on the bottler's channel mix and historical sales, what it could make by selling PepsiCo beverages at a particular price, assuming a bottling net margin of between 2% and 10%. In my experience, larger bottlers which can take advantage of economies of scale and local market conditions can drive a net margin of 4% and upwards. A net margin of 10% is extremely rare. The approach is to look at what it takes to run a sustainable bottling business and then try and model that to determine whether a price will allow the bottler to build a sustainable business that grows PepsiCo beverage market share as opposed to making the bottler so weak that it might lose that market share.
>
> 45. In my experience working for the PepsiCo Group for 35 years, these factors have been consistently adopted in our consideration of concentrate pricing. It is pragmatic and practical because our people (both franchise leads and bottlers) across around 115 markets can understand our pricing. **Negotiating price on this basis is a relatively simple process which is clear for bottlers,** and which encourages them to focus on improving their margins by working collaboratively with the PepsiCo Group on marketing strategies to increase sales volumes.
>
> (Emphasis added.)

179 During cross-examination in relation to paragraph 42 of his affidavit, Mr Williams said that there were two types of pricing structures that the PepsiCo Group uses. One is a flat concentrate price; the other is a net wholesale price (**NWSP**). Mr Williams was taken during cross-examination to an exclusive bottling agreement for Malaysia (CB tab 46) and asked questions

about the NWSP referred to in the agreement. Mr Williams said that it was "a very technical definition" and that, if one really wanted to understand it in detail, "you probably need a finance person to take you through it". He said that the definition will vary from market to market and the definition is an aspect that can be negotiated.

180 In relation to paragraphs 43-45 of his affidavit, Mr Williams was asked during cross-examination if there was any kind of mandatory direction given to the local franchising executives as to what could and could not be taken into account in negotiating price. He gave evidence (which I accept): "No, they will manage that through with the local leadership team". He also gave evidence (which I accept) that it was "whatever works for the local P and L". During cross-examination, Mr Williams said that the list of factors in paragraphs 43 and 44 of his affidavit was a non-exhaustive list. When pressed on what other factors could be relevant, he said "I think we would probably need a finance person to take you through the full detail". He also said that there are "so many different factors".

181 In relation to paragraph 45 of his affidavit, Mr Williams accepted during cross-examination that some of the factors he referred to in paragraphs 43-44 (such as the "cost of goods" figure for concentrate) were matters that PepsiCo would not share with the bottler. He also accepted that the bottler's net margin would not be shared by the bottler with PepsiCo. It was put to him that there is a "certain level of opaqueness to this discussion then because you've [i.e. PepsiCo] got information that they [i.e. the bottler] don't have and they've got information that you don't have". He accepted this.

182 The evidence set out in [179]-[181] above indicates that there is considerable scope to negotiate the way in which the pricing term is expressed and that such terms sometimes have a degree of complexity to them. I am not satisfied that the pricing term is generally expressed in simple terms such as a fixed price for a unit of concentrate.

Performance Agreements

183 While Mr Williams was working in Ireland in the late 1990s, his team introduced Performance Agreements (or Business Development Agreements (**BDAs**)) with the bottler Cantrell & Cochrane in order to regulate how it made the investment necessary to bottle, distribute and sell Pepsi and 7up successfully. Mr Williams considered the introduction of performance targets to be particularly important in that case, for reasons he explained in his affidavit.

184 Mr Williams gave evidence in his affidavit (which I accept) that the structure of the Performance Agreement he negotiated then remains essentially the same as the Performance Agreements used today, in the sense that it sets out: the strategies that the parties jointly agreed to pursue to market PepsiCo Group beverages; the targets the parties jointly agreed in terms of sales and market share growth; and the material (monetary) commitments to deliver those targets.

185 Mr Williams gave evidence in his affidavit (which I accept) that the reason why the Performance Agreement is not a part of the exclusive bottling agreement, but is a separate document, is largely historical. That is, the PepsiCo Group had a series of exclusive bottling agreements already on foot of different durations and therefore it was a way of strengthening the governance surrounding the exclusive bottling agreements, where different exclusive bottling agreements were in place. From the late 1990s, the PepsiCo Group's Franchise Team required that exclusive bottling agreements be supported by a Performance Agreement or BDA, and this was supported by the PepsiCo group's regional Governance Councils.

186 Mr Williams gave evidence in his affidavit (which I accept) that, in simple terms, brand building under the FOBO model involves the development of the brand strategy and then the implementation of that strategy through programs involving sponsorship deals, advertising campaigns and communication strategies; this marketing program is then split into two areas, known as "push" and "pull" (referred to above).

187 Mr Williams gave evidence in his affidavit (which I accept) that, in general terms, the franchise function within the PepsiCo Group develops guidelines on both push and pull; the guidelines seek to describe the best practices from across the various markets and identify those strategies which are best adapted to developed markets, and those which are best adapted to developing and emerging markets.

188 Mr Williams gave evidence in his affidavit (which I accept) that: the PepsiCo Group's Franchise Team tries to simplify, based on those best practices, a model and what they call levers that markets can execute to build the brands; for example, on the pull side, there would be levers such as communication, sponsorship and sampling; on the push side, there might be levers such as pricing, display, availability and store presence.

Co-op A&M Agreements

189 From around 1956, the PepsiCo Group started entering into Co-op A&M Agreements with its bottlers in international markets.

190 More recently, as the PepsiCo Group has been trying to build its brand across many countries, it has become important to create synergy in advertising and marketing. That is because it is inefficient and ineffective to have 115 countries each doing something different in marketing a global brand. This is achieved by making sure there are joint commitments by both the PepsiCo Group and the bottler to shared marketing responsibilities, where local marketing initiatives are influenced by local marketing managers in consultation with bottlers to ensure that the initiatives are locally relevant and are likely to be adaptable by the bottler for the purpose of promoting them to trade outlets.

191 Mr Williams gave evidence in his affidavit (which I accept) that, ideally, the PepsiCo Group's Global Beverage Group comes up with ideas and principles that will steer the brand in the right direction across all these markets, but it gives the markets enough flexibility in the development of the marketing campaign to make sure it is locally relevant. Local marketing managers are expected to be constantly researching consumer trends, the competition and their executional capability, and are expected to be working with the various marketing agencies in that country.

192 Ultimately, the local markets, in consultation with PepsiCo Group's regional team, decide if they are going to run a campaign in the market, and to do so, they must get their bottlers to support that campaign, because the bottler is (generally) funding some portion of the local spending on the brand advertising. In Mr Williams's experience, it is very unlikely that a bottler is going to disagree, because it recognises that advertising and brand building is the PepsiCo Group's field of expertise. However, in practice, in his experience, in the interests of maintaining a collaborative relationship with the bottler, the PepsiCo Group would not run an ad in a market without first consulting the bottler about it.

193 While the exclusive bottling agreement is generally a long-term agreement, the Co-op A&M Agreement is negotiated annually, having regard to market trends, advertising campaigns and considerations subject to change from year to year. It is designed to support the annual operating plan for the market, which is a discrete yearly document.

Contract administration

194 During cross-examination, Ms Dent was asked whether the franchise team in Australia was responsible for administration of exclusive bottling agreements, Performance Agreements and annual Co-op A&M Agreements. She answered, and I accept, that they are involved, but they sometimes seek direction from the franchise group based overseas. She also gave evidence (which I accept) that it was the role of the franchise team (under direction from other members of the franchise team based overseas) to negotiate aspects of the franchising agreement with SAPL if that needs to be negotiated. She said (and I accept) that it was her role to draft agreements that had been negotiated.

Local service agreements

195 In her affidavit, Ms Dent gave evidence (which I accept) that, under the PepsiCo Group business model, there is usually a local service company that provides services to market products in the local market and on-ground support to manage the relationship with the bottler; these services are usually provided to the seller of the concentrate, whether that be the concentrate manufacturer or a concentrate distributor.

196 Between 2010 and 2016, a number of service agreements were entered into by PepsiCo Australia Holdings Pty Ltd (**PAH**), a member of the PepsiCo Group evidently performing the role of a local service company, and PCIC. On or about 1 January 2016, a service agreement was entered into between PAH and PBS.

197 Ms Dent gave evidence in her affidavit (which I accept) that: during the relevant years, PAH's main role was to ensure the smooth running of the beverage franchise business in Australia and New Zealand, including brand maintenance and development; PAH had its own employees, but also drew on employees from other parts of the PepsiCo Group such as, for example, when dealing with regulatory and quality assurance matters; PAH analysed sales performance, maintained contact with the bottlers and looked at opportunities to get the PepsiCo Group brands into quick service restaurants, cinemas and to build brand equity; this included the development of marketing plans with local agencies; PAH also had finance personnel who assisted with interactions with PBS; they monitored the ordering of concentrate, making sure that it arrived on time and that the bottler held adequate stock.

Intellectual property rights and indemnities

198 Ms Dent gave evidence in her affidavit (which I accept) that, because it was ultimately the PepsiCo Group's decision as to what went onto the packaging for PepsiCo Group beverages, and in the marketing materials, the PepsiCo Group commonly dealt with requests from SAPL for licences and indemnities in relation to the use of brand trademarks or other intellectual property belonging to the PepsiCo Group for SAPL's bottling and distribution activities.

199 Ms Dent gave evidence in her affidavit (which I accept) that: she observed that SAPL was quite conservative about depictions on packaging; for example, she recalled on occasions they did not want to over-represent the content of fruit in a beverage; they wanted to remove the fruit from the label or reduce the size of its depiction; the PepsiCo Group would try to reach a point where SAPL felt comfortable; in some cases, SAPL required an indemnity in case anything went wrong. The evidence includes a number of indemnity letters given by PepsiCo or SVC to SAPL.

200 Ms Dent gave evidence in her affidavit, which she confirmed during cross-examination and which I accept, that, in the whole time she has been employed by the PepsiCo Group, she has never been involved in, or been aware of, any discussion with SAPL about payment of a royalty by it for the intellectual property that it uses in the performance of its obligations under the EBAs and related agreements.

Subsequent agreements (2020)

201 The agreements between the PepsiCo Group and SAPL in the years after the relevant years are not directly relevant for present purposes. I note the following evidence for the sake of completeness.

202 Ms Dent gave evidence in her affidavit and orally during evidence-in-chief that it has been and remains the PepsiCo Group's preference not to include the *pricing, payment and shipping terms* in the exclusive bottling agreement, but that, instead, they be recorded in a separate "Concentrate Supply Agreement" or "Concentrate Sale Agreement" between the Seller and the bottler, or that they be recorded in a Performance Agreement between the Seller and the bottler. There appears to be a tension between this evidence and the evidence of Mr Williams relating to the negotiation of exclusive bottling agreements. Mr Williams's evidence at paragraphs 42-45 of his affidavit (see [178] above) proceeds on the basis that the *price* of the concentrate is a provision of the exclusive bottling agreement; he does not refer to a preference to having it

dealt with in another agreement. It does not appear to be necessary to resolve that tension for present purposes.

203 Ms Dent gave evidence in her affidavit that during or after 2016, she attempted to negotiate with SAPL to have the pricing, payment and shipping terms removed from the EBAs and instead have them recorded in a restated Performance Agreement. She stated that, when new exclusive bottling agreements were negotiated in 2019, those terms were removed from the EBAs and a separate concentrate supply agreement (between PBS and SAPL) was entered into. In response to questions as to why these aspects were moved to a separate agreement, Ms Dent said that the reason was so that the payments were in a contract that was with the supplier of the concentrate, so that it would reflect what was happening in practice. It is unnecessary to make a finding as to why the pricing and payment terms were located in a separate agreement.

204 On or about 1 January 2020, an agreement that replaced the PepsiCo EBA was entered into (the **2020 PepsiCo EBA**).

205 On or about 1 January 2020, an agreement that replaced the SVC EBA was entered into (the **2020 SVC EBA**).

206 On or about 1 January 2020, a Concentrate Sale Agreement between PBS (as seller) and SAPL was entered into. This provided for the sale of concentrate under the agreements referred to above.

207 During cross-examination, and in the context of questions about the drafting of the 2020 PepsiCo EBA, Ms Dent referred to a “template EBA”. However, she later qualified this in the following passage:

> … You don’t annex [to] your affidavit the standard template for EBAs?---No, and I used the word “template” kind of loosely. I guess it’s more at the time that we were negotiating the EBA was asking other markets what is the format that everyone is using, what’s the best practice, what includes the latest clauses, for example, on sustainability or anti-bribery.
>
> Yes. So searching for a recent precedent, so to speak, is not a central template that everyone is expected to work off?---Well, I was under the impression that there was, but I don’t know that there actually is. I think it’s more of a [precedent], as you say.

Evidence about the Commissioner’s Counterfactuals

208 In this section, I set out and make some observations about the evidence led by the PepsiCo parties in relation to the Commissioner’s Counterfactuals (see [32] above).

209 In his affidavit, Mr Williams referred to the Commissioner's Counterfactuals and gave the following evidence:

> 66. This suggestion [namely, that set out in the Commissioner's Counterfactuals] is incorrect for the following reasons.
>
> 67. As I have described above, the FOBO model for the sale of concentrate is designed to be simple so that it can be easily and consistently deployed in the 115 countries in which the PepsiCo Group operates. The pricing model which PepsiCo adopts for its concentrate sales is an important part of the simplicity of the FOBO model.
>
> 68. If the pricing of the concentrate were changed to incorporate a payment from the bottler for a licence for trademarks or the like, this would complicate the FOBO model without bringing any obvious commercial benefits either to the bottler or to PepsiCo. In particular, it would add complexity to the setting of the price and to the negotiation process for the EBA and the Co-op A&M, and make it a more difficult process to govern across the 115 countries. I cannot think of a reason why the PepsiCo Group would depart from the existing model in that way.
>
> 69. For the payment to be calculated and agreed upon, the value of whatever was being licensed would need to be worked out based on advice peculiar to each of the markets in which concentrate is sold, and, potentially, for each individual beverage within the bottler's particular portfolio of beverages. In my experience, the value of any one beverage varies between markets, for example, in markets where PepsiCo or SVC is a challenger and markets where it has a leadership position.
>
> 70. This additional aspect of the negotiation on pricing with the bottlers would be a hindrance to the existing governance of the FOBO model by requiring too much negotiation on the various aspects of the pricing. It would likely require the employment by the PepsiCo Group of additional senior staff in local markets to be responsible for the negotiation of bottling contracts, including the Co-op A&M and BDAs, in order protect the PepsiCo Group's relationship with its bottlers. This would require the PepsiCo Group to spend additional amounts on local resources in a way which departs from its traditional model which is light on deployment of both capital and people in local franchise markets. This additional cost would alter the underlying economics of the bottling relationship and, as such, of the FOBO model.
>
> 71. Further, a payment for trademarks or the like would be inconsistent with, and risk undermining, the FOBO model. That is because, if the PepsiCo Group started to charge the bottler for the use of the brand, this would risk the bottler negotiating to reduce its contribution of investment under the Co Op A&M, as the bottler would be undertaking marketing for an asset for which it was already paying a separate amount. In that case, the separate payment would create a risk of a loss of the collaboration between the bottler and the PepsiCo Group which is, in my experience, so important to the effectiveness of the FOBO model.

210 In relation to paragraph 67 of his affidavit, Mr Williams said during cross-examination that the "pricing model" was a reference to the model discussed earlier in his affidavit at paragraphs

43-45. It was put to Mr Williams that it was "overstating it a bit to call it a model". He responded: "Maybe". The following exchange then occurred:

> HIS HONOUR: In paragraph 67 you refer to simplicity as being important and then earlier when I asked you about the net wholesale price method, I think you indicated there's some – when I asked you a question about what the wholesale price is referring to and whether it was the price that a bottler sells at, you said there's quite a lot of detail underpinning that?---Yes.
>
> So does that affect what you say about simplicity of the pricing model, that there might be that complexity?---Yes, there is complexity, but we try and simplify that as much as we can. So the finance people within the market would be trained on these particular mechanisms and they would do the modelling that's required when you're going through a negotiation. Then the NWSP pricing, one example of complexity that we try and simplify is that the customer development agreements that are owned by the bottler will need discussing in terms of are they within that calculation or not. So that would be a point of contention. But apart from that example, we try and keep them as simple as we can, so there are two mechanisms fixed and NWSP. And our local people will work through the two examples and figure out what works best with the bottler. So it's a negotiation but it's not as forced as you might think. And I have seen examples where we have forced the wrong pricing mechanism and the relationship hasn't worked because the bottling P and L doesn't work. We don't grow the business. We don't grow market share and you have to renegotiate the EBA. So we're very careful about where we push and where we back off.

211 In light of that evidence, and the evidence discussed earlier in these reasons at [179]-[181], I have difficulty with the proposition that the FOBO model, insofar as it concerns price, is "simple". It seems that there is considerable scope to negotiate the pricing terms and that such terms can have a degree of complexity to them.

212 In relation to paragraph 70, the following exchange took place during cross-examination:

> When you are talking here in paragraph 70 about this additional aspect of the negotiation of the pricing, is that a reference back to paragraph 69 and 68 about the negotiation of a royalty?---Yes, it is. Yes.
>
> So the problem that you are identifying here in paragraph 70 in the first sentence that it would require too much negotiation, that problem arises if a royalty amount has to be agreed with a bottler. Is that correct?---Yes, and also how do you set the royalty amount.

213 In relation to paragraph 71 of his affidavit, the following exchange took place during cross-examination:

> … Mr Williams, could you go back to your affidavit, please, … and could you turn to paragraph 71, right at the end of your affidavit. So, in this paragraph, Mr Williams, you say that: [paragraph quoted] Is it your evidence that the bottler would negotiate to reduce its below-the-line trade promotion spend under the co-op if they had to pay a royalty under the EBA? Is that what you are saying?---No, they would, in my view – first of all you would be in that model – if I understand it correctly, you would be taking the concentrate pricing down, and then you would be charging them for access

to the brand. That brand gets built and developed in the marketplace through the co-op fund which is jointly funded fifty-fifty. **So, in effect, you would be asking them to pay twice**.

So are you saying that a bottler would think that paying a royalty is the same thing as paying for trade promotion?---I think so, yes.

And what's the - - -?---Not trade promotion - - -

But isn't that - - -?--- - - - brand development because the money to develop the brand is split fifty-fifty between us and the bottler.

Well, I thought we established in the questions that I just asked you about the brand promotion and trade promotion, that Pepsi does the brand promotion and the bottler does the trade promotion?---Yes but that's accountability. That's in terms of who runs – there is a pricing and discount budget, which is the trade promotion. That can be 150. There is then a co-op agreement and the bottler funds the 150. There is then a co-op agreement which is the money to develop the brand. And that is essentially the push part of the brand, and that is split fifty-fifty but there will be elements in the co-op, as you can see from the nine Fs, that are also trade related. But price support doesn't include, doesn't generally get included in that. **So you would be, in effect, asking them to pay twice.**

Isn't a royalty a payment for the use of a brand and the brand promotion, to the extent that the bottler pays anything for that, a payment for advertising the brand? Aren't they different things?---I don't know enough about a royalty model. We've never used one.

I see?---So I'm not sure how it would work, and I'm not sure how you would set the price of that royalty in a particular market.

(Emphasis added.)

214 I have some difficulty with the proposition that by asking bottlers to pay an express royalty for the licence of the relevant trademarks, PepsiCo would be, in effect, asking them to pay twice for the same thing. It seems to me that there is a distinction between paying for the right to use the trademarks and contributing to advertising or marketing, even if it may develop the brand.

215 In cross-examination, Mr Williams was taken to clause 16 of the 2017 CSD Co-op A&M Agreement, which states that the Bottler's contribution to the expenditure is "not to build the brands of the Beverages". He stated that the clause "does look odd". He indicated that he had not seen the agreement before. He stated that, notwithstanding that clause, he thinks "both companies are paying and developing the brand". He said he did not understand "why they put that clause in". In re-examination, Mr Williams gave evidence that, notwithstanding what was said about purpose in clause 16 of that agreement, the expenditure does build the brand of the beverages. In my view, the presence of clause 16 in the 2017 CSD Co-op A&M Agreement does tend to undermine Mr Williams's evidence that asking the bottler to pay an express royalty would be, in effect, asking them to pay twice for the same thing (at least in its application in the Australian context).

216 The following exchange also took place during cross-examination in relation to paragraph 71 of Mr Williams's affidavit:

> … So in circumstances where – I'm talking here about a situation where Pepsi decided to enter into a negotiation of an EBA with a bottler, where the exercise wasn't to identify a separate royalty but simply to change the EBA so that it said that the payment that's being made by the bottler is for the concentrate and for everything else that's passing under the agreement, including the licence of the trademarks?---I can't really comment on hypothetical situations. What I would say is that **any amendments to the EBA will open up discussions across the whole EBA, potentially**.
>
> I see. So any amendments to the EBA open up - - -?---**Potentially open up very wide discussions**.
>
> And so the introduction of a royalty is only one of those scenarios that would open up a renegotiation of the commercial terms of the EBAs. Any change would have that effect; is that your evidence?---Potentially. Potentially.
>
> Potentially, yes. And what about a change that was limited to this: that the payment that's being made under the EBA which remains calculated in exactly the same way as it was before, is expressed to be a payment for concentrate and for everything else under the agreement including the IP?---I think it's too broad. People want to understand exactly what it is they're paying for. I mean, when a bottler typically gets an EBA they're investing so much money, hundreds of millions in infrastructure so they're looking at every line item in a very detailed way. If we suddenly start changing the structure of our concentrate pricing, **that will open up a huge debate**.
>
> I'm describing a scenario, Mr Williams, where the amount of the payment, the dollar value, remains exactly the same. So that hasn't changed?---Yes, but what I'm saying is that – you're painting a very simple picture of a scenario. What I'm saying is that simple scenario will open up much broader discussions.
>
> And why is that?---Because you're changing the structure of the payment. You're changing, in effect, the concentrate price payment.
>
> The scenario that I'm putting to you, Mr Williams, is that the calculation of the payment would remain the same. So if it was fixed per concentrate unit, it would remain that way, or if it was calculated by reference to the net wholesale price as we saw in some of those EBAs previously, it would remain the same. And the only thing that would change would be that there would be a new provision that says that when the payment is made, it's made for not only the concentrate, but also the licence of the intellectual property and everything else that passes under the agreement?---**But then the question would be what is everything else and then they would want to determined what is the value of everything else that's in there, so I don't think you could do what you're saying you would like to do.**
>
> The everything – forget the everything else that's passing under the agreement then. The scenario that I'm putting to you is the payment then is expressed to be made for the licence of the intellectual property and the concentrate and they are things that were already being provided under the EBA. So nothing new is provided under the EBA and the pricing mechanism remains the same. The only thing that changes is that the payment is expressed to be both for the concentrate and also for the licence to the EBA?---But where is the benefit for either PepsiCo or the bottler in this scenario?
>
> I'm not saying that there is a benefit for either the PepsiCo entities or the bottler. What I'm asking you is whether or not the risk that you've identified in paragraph 71 arises

> in the circumstance that I've just described?---**In my view yes, it does**.
>
> And why?---**Because you're adding a complication into something that has been set pretty rigidly over many, many years, and I think you're asking the bottler to make a payment for access to the brand and they will consider that they are already building that brand with us through the co-op arrangement, which they're funding**.
>
> (Emphasis added.)

217 I have some difficulty with the proposition that a change in the pricing term, such that the price was expressed to be paid for both the licence of the intellectual property and the sale of the concentrate, would present the sort of difficulties outlined by Mr Williams in paragraph 71 of his affidavit and in the above passage from his oral evidence. It is a relatively small textual change. To the extent that Mr Williams said that it would be adding a complication into something "that has been set pretty rigidly over many, many years", the evidence shows that there is considerable scope for variation in exclusive bottling agreements, including pricing terms, and that the pricing terms can have some complexity.

Issue (1): royalty withholding tax

Overview

218 The first issue to be determined is whether the payments made by SAPL under the EBAs in the relevant years are, to any extent, "royalties" and subject to royalty withholding tax under s 128B of the ITAA 1936, which is subject to the provisions of the US DTA under the *International Tax Agreements Act 1953* (Cth).

219 This involves consideration of a number of sub-issues, as identified in the parties' submissions. There was some debate at the hearing as to the preferable order in which to consider the various sub-issues. In the PepsiCo parties' outline of opening submissions in relation to royalty withholding tax, they set out the sub-issues as follows:

> 19. It follows that, in order for the [PepsiCo parties] to be liable for royalty withholding tax under s 128B of the ITAA 1936 for the "royalty amounts" specified in the Notices of Royalty Withholding Tax, the following criteria must be satisfied:
>
> (a) the amounts must have been paid or credited as consideration for the items set out in subparagraphs (4)(a) and (b) of Article 12 of the US DTA; and
>
> (b) the amounts must have been income derived by PepsiCo or [SVC] (as applicable) for the purposes of s 128B(2B)(a) and to which they were "beneficially entitled" for the purposes of the US DTA; and
>
> (c) the amounts must have been, or be taken to have been, paid by SAPL

> to PepsiCo or [SVC] (as applicable) for the purposes of s 128B(2B)(b)(i) as affected by s 128A(2).
>
> 20. The [PepsiCo parties] contend that none of these criteria is satisfied.

220 The Commissioner adopted the same order of sub-issues in his outline of opening submissions at paragraph 24.

221 However, in oral opening submissions, senior counsel for the PepsiCo parties approached the sub-issues in a different order. Senior counsel submitted (at T11-12):

> … in order for the [PepsiCo parties] to be liable for royalty withholding tax under section 128B in respect of any part of the payments made by SAPL to PBS, the following criteria must be satisfied. The first is that the amounts must have been income derived by PepsiCo or [SVC] as applicable for the purposes of section 128B(2B)(a) and to which they were beneficially entitled for the purposes of the US double tax agreements.
>
> Secondly, the amounts must have been, or be taken to have been, paid by SAPL to PepsiCo or [SVC] as applicable. And that's for the purposes of section [128B(2B)(b)(i)] as affected by the deeming provision that we saw [in] [section 128A(2)].
>
> And the third is that the amounts must have been paid or credited as consideration for the items set out in subparagraphs 4(a) and (b) of article 12 of the US double tax agreement. They're the three things that each party has addressed in their submissions.

222 Senior counsel for the Commissioner, in her opening oral submissions, also adopted a different order from the written outline of opening submissions. She submitted (at T88):

> … the four issues that we perceive as arising in relation to the imposition of withholding tax in this part of the case is firstly, whether the payments under the EBA are consideration for these items that are of intellectual property and other intangibles that are provided under the EBAs. The second issue is whether the amounts were paid to the applicants. The third is whether the amounts were income derived by the [PepsiCo parties] and because of article 12(2) we need to look at whether the [PepsiCo parties] were beneficially entitled to the income [being the fourth issue].

223 In my view, the appropriate place to start is with the sub-issue whether the payments made by SAPL under the EBAs were, to any extent, *consideration for* the use of, or right to use, the items set out in paragraph (4)(a) and (b) of Art 12 of the US DTA and the items set out in paragraphs (a) to (d) of the definition of "royalty" in s 6 of the ITAA 1936. The definition of "royalties" is the linchpin of Art 12 of the US DTA. Similarly, it is the central concept in s 128B of the ITAA 1936. It therefore makes sense to consider this sub-issue first. I consider it appropriate to consider the sub-issues in the following order:

(a) whether the payments made by SAPL under the EBAs were, to any extent, *consideration for* the use of, or the right to use, the items set out in paragraphs (4)(a) and (b) of Art 12 of the US DTA and the items set out in paragraphs (a) to (d) of the definition of "royalty" in s 6(1) of the ITAA 1936;

(b) if so, whether the relevant portions of the payments were *income derived* by PepsiCo or SVC (as applicable) for the purposes of s 128B(2B)(a) and amounts to which they were *beneficially entitled* for the purposes of Art 12 of the US DTA; and

(c) if so, whether the relevant portions of the payments were paid, or taken to have been paid, to PepsiCo or SVC (as applicable) for the purposes of s 128B(2B)(b)(i) as affected by s 128A(2).

224 I will therefore deal with the sub-issues in that order, after setting out the applicable provisions of the legislation and the US DTA.

Applicable provisions

225 I will set out the relevant provisions of the ITAA 1936 based on the version of the legislation as at 1 July 2017. It does not appear that there were any amendments to the relevant provisions during the relevant years.

226 Section 6(1) of the ITAA 1936 relevantly provided:

> ***royalty*** or ***royalties*** includes any amount paid or credited, **however described** or computed, and whether the payment or credit is periodical or not, **to the extent to which** it is paid or credited, as the case may be, **as consideration for**:
> (a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trade mark, or other like property or right;
> (b) the use of, or the right to use, any industrial, commercial or scientific equipment;
> (c) the supply of scientific, technical, industrial or commercial knowledge or information;
> (d) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as is mentioned in paragraph (a), any such equipment as is mentioned in paragraph (b) or any such knowledge or information as is mentioned in paragraph (c);
> …
>
> (Emphasis added.)

227 Division 11A of Pt III of the ITAA 1936 was headed "Dividends, interest and royalties paid to non-residents and to certain other persons". Section 128A dealt with interpretation and included:

> **128A Interpretation**
>
> …

(1AA) In this Division and in an Act imposing withholding tax:

income includes a royalty and a dividend.

…

(2) For the purposes of this Division, interest or a royalty **shall be deemed to have been paid** by a person to another person although it is not actually paid over to the other person but is reinvested, accumulated, capitalized, carried to any reserve, sinking fund or insurance fund however designated, **or otherwise dealt with on behalf of the other person or as the other person directs**.

(Emphasis added.)

228 Section 128B dealt with liability to withholding tax. Section 128B(1A) provided:

(1A) In this section, a reference to a person to whom this section applies is a reference to the Commonwealth, a State, an authority of the Commonwealth or of a State or a person who is, or persons at least 1 of whom is, a resident.

In the present case, the person to whom this section applies is SAPL.

229 Section 128B(2B) provided:

(2B) Subject to subsection (3), this section also applies to **income that**:

(a) **is derived by a non-resident**:

(i) during the 1993-94 year of income of the non-resident; or

(ii) during a later year of income of the non-resident; and

(b) **consists of a royalty** that:

(i) **is paid to the non-resident** by a person to whom this section applies and is not an outgoing wholly incurred by that person in carrying on business in a foreign country at or through a permanent establishment of that person in that country; or

(ii) is paid to the non-resident by a person who, or by persons each of whom, is not a resident and is, or is in part, an outgoing incurred by that person or those persons in carrying on business in Australia at or through a permanent establishment of that person or those persons in Australia.

In the present case, the non-resident is either PepsiCo or SVC (as applicable).

230 Section 128B(3) provides that the section does not apply in certain circumstances. It is not suggested that any of these circumstances apply here.

231 Section 128B(5A) provided:

(5A) A person who derives income to which this section applies that consists of a royalty is liable to pay income tax upon that income at the rate declared by the Parliament in respect of income to which this subsection applies.

(Emphasis added.)

The rate of tax is affected by the US DTA, discussed below, and is 5%.

232 I will set out the relevant provisions of the *International Tax Agreements Act* based on the version of the legislation as at 1 July 2017. It does not appear that there were any relevant changes during the relevant years.

233 Section 4(2) of the *International Tax Agreements Act* provided that its provisions "have effect notwithstanding anything inconsistent with those provisions in the Assessment Act (other than the provisions covered by subsection (3))". The reference to the "Assessment Act" included the ITAA 1936. Section 4(3) referred to the provisions of Pt IVA of the ITAA 1936. Section 5(1) of the *International Tax Agreements Act* provided that the US DTA had the force of law according to its tenor. The effect of these provisions was that the provisions of the US DTA were incorporated into domestic Australian law and prevailed over s 128B (and associated provisions) to the extent of any inconsistency. Further, s 17A of the *International Tax Agreements Act* provided:

> **17A Withholding tax**
>
> (1) Where a provision of an agreement limits the amount of Australian tax payable in respect of a dividend or a royalty, being a dividend or a royalty in respect of which withholding tax is payable, and the amount of that withholding tax exceeds the limit specified in the agreement, the liability of the taxpayer for the withholding tax shall be reduced by an amount equal to the amount of the excess.
>
> …
>
> (5) Section 128B of the *Income Tax Assessment Act 1936* (which deals with liability for withholding tax) **does not apply to the payment of a royalty** as defined in subsection 6(1) of that Act if:
>
> (a) **the royalty is paid to a person who is a resident of a Contracting State** or territory (other than Australia) for the purposes of an agreement; and
>
> (b) **the agreement does not treat the amount paid as a royalty**.
>
> (Emphasis added.)

234 I will set out the provisions of the US DTA based on the version provided by the parties in the joint bundle of authorities as amended by the protocol dated 27 September 2001 (also included in the joint bundle of authorities). Article 3 of the US DTA provided in part:

> (2) As regards the application of this Convention by one of the Contracting States, any term not defined herein shall, unless the context otherwise requires, have the meaning which it has under the laws of that State relating to the taxes to which this Convention applies.

235 Article 12 of the US DTA, as amended, provided (with the amendments made by the protocol shown in italics):

(1) Royalties from sources in one of the Contracting States, being royalties to which a resident of the other Contracting State is beneficially entitled, may be taxed in that other State.

(2) Such royalties may be taxed in the Contracting State in which they have their source, and according to the law of that State, but the tax so charged shall not exceed *5* percent of the gross amount of the royalties.

(3) Paragraph (2) shall not apply if the person beneficially entitled to the royalties, being a resident of one of the Contracting States, has a permanent establishment in the other Contracting State or performs independent personal services in that other State from a fixed base situated therein, and the property or rights giving rise to the royalties are effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business profits) or Article 14 (Independent personal services), as the case may be, shall apply.

(4) The term "royalties" in this Article means:

(a) payments or credits of any kind to the extent to which they are consideration for the use of or the right to use any:
(i) copyright, patent, design or model, plan, secret formula or process, trademark or other like property or right;
(ii) motion picture films; or
(iii) films or audio or video tapes or disks, or any other means of image or sound reproduction or transmission for use in connection with television, radio or other broadcasting;

(b) payments or credits of any kind to the extent to which they are consideration for:
(i) the supply of scientific, technical, industrial or commercial knowledge or information owned by any person;
(ii) the supply of any assistance of an ancillary and subsidiary nature furnished as a means of enabling the application or enjoyment of knowledge or information referred to in sub-paragraph (b)(i) or of any other property or right to which this Article applies; or
(iii) a total or partial forbearance in respect of the use or supply of any property or right described in this paragraph; or

(c) income derived from the sale, exchange or other disposition of any property or right described in this paragraph to the extent to which the amounts realized on such sale, exchange or other disposition are contingent on the productivity, use or further disposition of such property or right.

(5) Where, owing to a special relationship between the payer and the person beneficially entitled to the royalties or between both of them and some other person, the amount of the royalties paid or credited, having regard to what they are paid or credited for, exceeds the amount which might have been expected to have been agreed upon by the payer and the person so entitled in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the amount of the royalties paid or credited shall remain taxable according to the law of each Contracting State, but subject to the other provisions of this Convention.

(6) (a) Royalties shall be treated as income from sources in a Contracting State when the payer is that State itself or a political subdivision or

> local authority of that State or a person who is a resident of that State for the purposes of its tax. Where, however, the person paying the royalties, whether he is a resident of one of the Contracting States or not, has in one of the Contracting States or outside both Contracting States a permanent establishment or fixed base in connection with which the liability to pay the royalties was incurred, and the royalties are borne by the permanent establishment or fixed base, then the royalties shall be deemed to have their source in the State in which the permanent establishment or fixed base is situated.
>
> (b) Where sub-paragraph (a) does not operate to treat royalties as being from sources in one of the Contracting States, and the royalties relate to use or the right to use in one of the Contracting States of any property or right described in paragraph (4), the royalties shall be treated as income from sources in that State.

In the present case, it is Art 12(2) rather than Art 12(1) that is the potentially applicable provision. This is because it is sought to tax royalties in Australia, being the Contracting State in which they have their source.

236 There is little case law on the interpretation of the royalty withholding tax provisions. The parties cited *International Business Machines Corporation and Another v Federal Commissioner of Taxation* [2011] FCA 335; 83 ATR 32 (***IBM***), a judgment of Bennett J, in which s 128B of the ITAA 1936 and Art 12 of the US DTA were in issue. This provides a useful guide to the application of the provisions.

"Consideration for" issue

237 As noted above, the issue is whether the payments made by SAPL under the EBAs were, to any extent, *consideration for* the use of, or the right to use, the items set out in paragraphs (4)(a) and (b) of Art 12 of the US DTA and the items set out in paragraphs (a) to (d) of the definition of "royalty" in s 6(1) of the ITAA 1936. It is not suggested by either party that there is any difference in the meaning of "consideration for" as between Art 12(4) of the US DTA and the definition of "royalty" in s 6 of the ITAA 1936. Also, it is not suggested that anything turns on the differences in wording between paragraphs (4)(a) and (b) of Art 12 of the US DTA and paragraphs (a) to (d) of the definition of "royalty" in s 6(1) of the ITAA 1936.

238 The PepsiCo parties' submissions on this issue can be summarised as follows:

(a) The question whether the amounts were paid or credited as consideration for the use of, or the right to use, any item identified in Art 12(4)(a) or (b) of the US DTA is to be answered by reference to the terms of the agreements between the parties: cf *IBM* at [16], [41], [51], [54].

(b) Contractual rights and liabilities are to be determined objectively, by reference to the text, context and purpose of the contract. In construing a commercial contract, it is necessary to ask what a reasonable businessperson would have understood its terms to mean: *Mount Bruce Mining Pty Limited v Wright Prospecting Pty Limited* [2015] HCA 37; 256 CLR 104 at [46]-[47].

(c) Under each EBA, SAPL undertook, relevantly, to purchase concentrate from PepsiCo/SVC's nominee, PBS, for specified amounts. The amounts are unambiguously expressed to be solely for the purchase of units of concentrate. No amount is payable by SAPL to PepsiCo/SVC as consideration for the use of, or right to use, intellectual property, technical, industrial or commercial knowledge or information or assistance furnished by members of the PepsiCo Group. This is consistent with the context and purpose of the EBAs, which can objectively be seen to establish a mutually beneficial co-operative arrangement between the parties, with non-monetary consideration passing both ways, and under which both parties will undertake activities directed at increasing goodwill in the PepsiCo Group brands sold in Australia (reflecting a business model which has been in place since the early 1900s).

(d) The consideration which passed from SAPL to PepsiCo/SVC under the EBAs, insofar as it related to the payments, was a promise to purchase concentrate at specified prices. The payments SAPL made to PBS pursuant to the purchase orders and invoices moved the transfer of title in the concentrate from PBS to SAPL: see *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* [1948] HCA 28; 77 CLR 143 (***Archibald Howie***) at 152; *Chief Commissioner of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* [2005] HCA 3; 221 CLR 496 (***Dick Smith***) at [54] and [71]-[72]; *Commissioner of State Revenue v Lendlease* [2014] HCA 51; 254 CLR 142 (***Lendlease***) at [49]. The payments were not, themselves, consideration passing from SAPL to PepsiCo/SVC; the payments are distinct from the promise to purchase the concentrate at the specified prices.

(e) The EBAs are to be contrasted with the contract the subject of *IBM*. In that case, the Australian subsidiary of IBM agreed to pay a fee calculated inter alia as a percentage of its monthly revenue "in consideration for the licences and other rights granted to it hereunder": *IBM* at [28]. IBM unsuccessfully sought to characterise the payments as being for the exercise of general distributorship rights. In rejecting that contention, Bennett J observed, "the Payments are described as being for the acquisition of the stated rights": at [50]. Her Honour said: "clause 6(a) unambiguously indicates that the Payments are for the bundle of rights granted by IBM … This is apparent when the words of clause 6(a) are considered": at [51].

(f) The importance of respecting contractual terms when performing a judicial function involving characterisation was emphasised by the High Court in *WorkPac Pty Limited v Rossato* [2021] HCA 23; 271 CLR 456 at [62] and [97]; see also *Anglo American Investments Pty Ltd (Trustee) v Commissioner of Taxation* [2022] FCA 971 at [309].

239 The PepsiCo parties also made the following submissions in their reply written submissions:

(a) The Commissioner's case is predicated on the *a priori* assumption that because valuable items of intellectual property were licensed to SAPL under the EBAs, SAPL must have paid something for that licence.

(b) The legal terms and commercial aspects of the implementation of the transactions between the PepsiCo, SAPL and PBS described in the reply submissions are those that must be the subject of characterisation in response to the statutory enquiry whether the amounts paid were paid or credited as consideration for any items in Art 12(4) of the US DTA.

(c) It is these same legal and commercial aspects of the transactions in question that the Commissioner impermissibly seeks to recast by overlooking the source of the obligation to pay the amounts (purchase orders and invoices); and by overlooking or denying the fundamental nature of the transactions as sales of goods.

(d) The Commissioner does not allege either that the transactions were a sham, or that PBS received the amounts as agent or trustee for PepsiCo/SVC. On the Commissioner's case, his recasting of the transactions occurs under the banner of characterisation, but in a way which does not accord with the authorities that he cites in the context of the identification of "consideration", such as *St George Bank Ltd v Federal Commissioner of Taxation* [2008] FCA 453; 69 ATR 634 at [62]-[63] per Allsop J (as his Honour then was).

(e) The characterisation of a transaction, including by its examination within a "wider commercial context", is not a warrant to substitute a different transaction, including based on a value judgment about the economic effect of the transaction in issue. But this is the effect of the Commissioner's submissions.

240 The question whether payments are *consideration for* the items set out in paragraphs (4)(a) and (b) of Art 12 and the items set out in paragraphs (a) to (d) of the definition of "royalty" in s 6(1) of the ITAA 1936 involves an exercise of *characterisation*: see *IBM* at [41]. Fundamental to this task are the terms of the relevant agreement (or agreements): *IBM* at [16]. In my view, it is necessary to consider the terms of the agreement in their business and commercial context. This is consistent with general principles of contractual construction that have regard to the commercial purpose or objects to be secured by the contract: *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7; 251 CLR 640 at [35] per French CJ, Hayne, Crennan and Kiefel JJ. This approach furthers the evident purpose of Art 12, which is concerned with identifying the taxing rights of the Contracting States in relation to payments that are, in their business and commercial context, consideration for the use of, or the right to use, the relevant items. Likewise, this approach furthers the evident purpose of the royalty withholding tax provisions of the ITAA 1936, which are concerned with assessing tax on amounts that are, in their business and commercial context, consideration for the use of, or the right to use, the relevant items.

241 It is plain from the wording of Art 12(4) of the US DTA and the definition of "royalty" in s 6(1) of the ITAA 1936 that payments may be consideration for the relevant items *regardless of how the payments are described* by the parties to a transaction. Art 12(4) refers (in both paragraph (a) and paragraph (b)) to payments or credits "of any kind". Section 6(1) refers to any amount paid or credited "however described". These words make clear that the way the payments are described by the parties to a transaction is not determinative of whether they are consideration for the relevant items. Thus, payments may be consideration for the use of, or the right to use, (for example) trademarks, even if the payments are not called a "royalty".

242 It is also plain from the wording of Art 12(4) and the definition of "royalty" in s 6(1) that an *apportionment* exercise is envisaged. Art 12(4) uses the words "to the extent to which" in both paragraph (a) and paragraph (b). Section 6(1) also uses the words "to the extent to which". Thus, a single payment may be consideration for more than one thing. In such a case, the payment is to be apportioned.

243 The word "consideration" in Art 12(4) and in the definition of "royalty" in s 6(1) is not used in its contractual sense but in the broader sense in which it is used in conveyancing. This is consistent with the approach taken by the High Court in relation to the word "consideration"

in State stamp duty legislation. In *Dick Smith*, Gummow, Kirby and Hayne JJ at [71] quoted with approval the following passage from the judgment of Dixon J in *Archibald Howie* at 152:

> the word "consideration" should receive the wider meaning or operation that belongs to it in conveyancing rather than the more precise meaning of the law of simple contracts.

That is, as Dixon J went on to say (at 152), "the consideration is rather the money or value passing which moves the conveyance or transfer". Gummow, Kirby and Hayne JJ then stated at [72]:

> To adapt what was said by Lord Wilberforce of other stamp duty legislation:
>
> > "In the first place, the phrase 'consideration for the transfer or conveyance' seems to me to refer clearly and naturally to that which passed to the transferor company 'for' the transferred properties."
>
> The criterion in the Act of consideration "for" the transaction, being the Agreement for the sale and transfer of the Shares to the Purchaser, upon whom s 13 imposes the liability to pay the duty, looks to what was received by the Vendors so as to move the transfers to the Purchaser as stipulated in the Agreement.
>
> (Footnote omitted.)

This approach was followed in *Lendlease* at [49] by French CJ, Hayne, Kiefel, Bell and Keane JJ.

244 In the present case, while the payments made by SAPL were, on their face, payments for the purchase of concentrate, this is not determinative of their characterisation for the purposes of Art 12(4) and s 6(1). The payments were made pursuant to the EBAs. In order to characterise the payments, it is necessary to consider the terms of the EBAs in their business and commercial context.

245 In my view, it is apparent from the terms of the EBAs (considered in their business and commercial context) that the payments were, to some extent, *consideration for* the use of, or the right to use, the relevant trademarks and other intellectual property. The following features and terms of the EBAs are significant:

(a) The parties to the EBAs were PepsiCo and SVC – the owners of the relevant trademarks and other intellectual property. The seller of the concentrate (during the relevant years, PBS) was not a party to the EBAs.

(b) Each of the EBAs contained a licence by PepsiCo or SVC (as applicable) of the relevant trademarks and other intellectual property to SAPL. In the case of the PepsiCo EBA, the licence was implied (see [57] above). In the case of the SVC EBA, the licence was express (see [91] above).

(c) In each case, the licence of the trademarks and other intellectual property was fundamental to the agreement: see, eg, clauses 3(a), 5(a), 11(a) and 17(a) of the PepsiCo EBA and clauses 4.1, 6.1, and 6.3 of the SVC EBA. Without a licence of the trademarks and other intellectual property, SAPL would not be able to package and sell the beverages under the Pepsi, Mountain Dew and Gatorade brands (as applicable). It may be inferred that SAPL would not have agreed to make the payments without the licence of the trademarks and other intellectual property.

(d) The payments to be made by SAPL were linked with the licence of the trademarks and other intellectual property, in the sense that a failure by SAPL to perform its payment obligations could result in a termination of the agreement and therefore the licence. In the case of the PepsiCo EBA, this was the effect of clauses 24 and 27 (see [60] and [61] above). In the case of the SVC EBA, this was the effect of clauses 18.2 and 18.5 (see [99] and [100] above).

246 In light of these matters, I am satisfied that the payments made by SAPL were, to an extent, *consideration for* the use of, or right to use, the relevant trademarks and other intellectual property.

247 As noted above, Mr Williams gave evidence during cross-examination (which I have accepted) that, in his role in franchising, he was not aware of the sale of PepsiCo concentrate ever being offered without a licence of the brand. He said (and I have accepted) that, in the FOBO model, the concentrate and the brands "always go together". This evidence is consistent with the payments being, in part, for the use of, or the right to use, the trademarks and other intellectual property.

248 I note also that the Pepsi brand is one of the strongest and most valuable brands in the global beverage industry. The Mountain Dew and Gatorade brands are also strong and valuable brands in that industry. These matters are established by the evidence of Mr Malackowski. In these circumstances, it would be very surprising if PepsiCo and SVC were prepared to licence the relevant trademarks for nothing. This tends to support the proposition, which is apparent in any event from the terms of the EBAs, that the payments were in part consideration for the use of, or the right to use, the trademarks and other intellectual property.

249 Although clause 4 of the SVC EBA describes the licence as "royalty-free", I do not consider this to assist in resolving the question of characterisation. As discussed above, both Art 12(4) and s 6(1) make clear that the way payments are described by the parties to a transaction is not determinative. Likewise, the way the licence is described is not determinative of the characterisation question.

250 The approach adopted above does not involve any recasting of the transaction or the substitution of a different transaction (as submitted by the PepsiCo parties in response to the Commissioner's submissions). It involves a consideration of the terms and features of the EBAs as entered into by the parties.

251 Further, the above approach does not rely on an *a priori* assumption that because valuable items of intellectual property were licensed by PepsiCo/SVC under the EBAs, SAPL must have paid something for that licence. Rather, it is based on an analysis of the terms of the EBAs in their business and commercial context.

252 I therefore conclude that the payments made by SAPL under the EBAs were, to an extent, *consideration for* the use of, or the right to use, the items set out in paragraphs (4)(a) and (b) of Art 12 of the US DTA and the items set out in the definition of "royalty" in s 6(1) of the ITAA 1936.

"Income derived" and "beneficially entitled" issue

253 If the answer to the previous issue is Yes (which it is), the next issue is whether the relevant portions of the payments were *income derived* by PepsiCo or SVC (as applicable) for the purposes of s 128B(2B)(a) and amounts to which they were *beneficially entitled* for the purposes of Art 12 of the US DTA.

254 The PepsiCo parties' submissions can be summarised as follows:

(a) The phrase "income derived", as it appears in s 128B of the ITAA 1936, bears its ordinary meaning. Where used in relation to ordinary income, the word "derived" is affected by the definition in s 995-1(1) and s 6-5(4) of the *Income Tax Assessment Act 1997* (Cth), which is based on the former s 19 of the ITAA 1936. The ordinary meaning of "income derived" was described by Gibbs J in *Brent v Federal Commissioner of Taxation* [1971] HCA 48; 125 CLR 418 (***Brent***) at 427-428.

(b) In *Commissioner of Taxes (SA) v Executor, Trustee and Agency Co of South Australia Ltd* [1938] HCA 69; 63 CLR 108 (***Carden's Case***), Dixon J (with whom Rich and McTiernan JJ agreed) said at 155:

> Speaking generally, in the assessment of income the object is to discover what gains have during the period of account come home to the taxpayer in a realized or immediately realizable form.

(c) In *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* [1965] HCA 58; 114 CLR 314, Barwick CJ, Kitto and Taylor JJ at 318 said that Dixon J's reference in *Carden's Case* to monies having "come home" to the taxpayer was a reference not simply to beneficial receipt but to the reaching of a situation in which monies received might properly be counted as gains completely made, so that there was neither legal nor business unsoundness in regarding them, without qualification, as income derived.

(d) A conclusion that amounts paid by SAPL to PBS for the purchase of concentrate were income derived by PepsiCo or SVC (as applicable) is not open as a matter of fact or law. In the absence of any agency or trust relationship (and none is pleaded), it would require a denial of PBS's separate corporate personality (as to which, see *Federal Commissioner of Taxation v Casuarina Pty Ltd* [1971] HCA 78; 127 CLR 62 at 77 per Windeyer J) or an impermissible recasting of the transactions which took place. Moreover, no commercial practice or principle of accountancy would require amounts paid by SAPL to PBS for the purchase of concentrate to be brought to account as income for PepsiCo or SVC (as applicable).

(e) Consistently with the way in which it has been returned and reported by PBS, income from amounts paid by SAPL to PBS at no stage and in no form "came home" to PepsiCo or SVC (as applicable).

255 In my view, PepsiCo and SVC, as the parties to the EBAs, were entitled to receive the payments made by SAPL under the EBAs. This follows as a matter of contract from the fact that PepsiCo and SVC were the parties to the EBAs and SAPL's payment obligations under the EBAs were owed to them. This remained the case even though PepsiCo and SVC nominated PBS as the seller of the concentrate. PBS was not, and did not become, a party to the EBAs.

256 PepsiCo and SVC nominated PBS to be the seller of the concentrate under the EBAs for the relevant years. This constituted a direction to SAPL to pay PBS rather than PepsiCo or SVC (as applicable). In these circumstances, the relevant portions of those payments (being the portions that were consideration for the use of, or the right to use, the relevant items) "came

home" to PepsiCo/SVC (in the sense described by Dixon J in *Carden's Case* and in the other authorities cited by the PepsiCo parties) by being applied as they directed. The relevant portions were therefore *income derived* by PepsiCo/SVC.

257 I do not accept the submission that this denies the separate corporate personality of PBS. I accept that PepsiCo or SVC (as applicable) and PBS were separate legal persons. The point is that, in circumstances where PepsiCo/SVC were entitled to receive the payments, and directed that they be paid to PBS, which then occurred, the relevant portions "came home" to PepsiCo/SVC.

258 Further, in the circumstances, PepsiCo and SVC were *beneficially entitled* to the relevant portions of the payments within the meaning of Art 12 of the US DTA. For the reasons given above, they were entitled to receive the payments under the EBAs and directed SAPL to pay PBS. In these circumstances, PepsiCo and SVC were beneficially entitled to the relevant portions of the payments.

259 In summary, I consider that the relevant portions of the payments were *income derived* by PepsiCo or SVC (as applicable) for the purposes of s 128B(2B)(a) and amounts to which they were *beneficially entitled* for the purposes of Art 12 of the US DTA.

"Paid to" issue

260 If the answers to the previous two issues are Yes (which they are), the next issue is whether the relevant portions of the payments were paid, or taken to have been paid, to PepsiCo or SVC (as applicable) for the purposes of s 128B(2B)(b)(i) as affected by s 128A(2).

261 Section 128A(2) has been set out above but is reproduced here for ease of reference (with the relevant persons inserted):

> (2) For the purposes of this Division, interest or a royalty **shall be deemed to have been paid** by a person [here, SAPL] to another person [here, PepsiCo or SVC, as applicable] although it is not actually paid over to the other person but is reinvested, accumulated, capitalized, carried to any reserve, sinking fund or insurance fund however designated, **or otherwise dealt with on behalf of the other person or as the other person directs**.

(Emphasis added.)

262 The PepsiCo parties' submissions can be summarised as follows:

(a) The reference to "otherwise dealt with on behalf of the other person or as the other person directs" (in s 128A(2)) should be construed as qualifying the list of acts which precedes it as having been done on behalf of or at the direction of the putative payee. The section thus presupposes an underlying entitlement of the putative payee to the royalty, such that the subsequent dealing can be said to be done on their behalf or at their direction. This is supported by the presence of the expression "actually paid". The section is concerned with a form of payment whereby funds are not actually received by the putative payee but a monetary obligation to that person nonetheless exists which is discharged by other means: *ABB Australia Pty Ltd v Federal Commissioner of Taxation* [2007] FCA 1063; 162 FCR 189 at [166]; see also *Liquidator of the North Sydney Investment and Tramway Co Ltd v Commissioners of Taxation* (1898) 19 LR (NSW) 225 at 229; *Perrott v Commissioner of Taxation (NSW)* (1922) 23 SR (NSW) 118 at 124; *Permanent Trustee Co of New South Wales Ltd v Federal Commissioner of Taxation* [1940] ALR 291 at 293; *Brent* at 430-431.

(b) The section is not apt to deem the payments made by SAPL to PBS to be payments made to PepsiCo or SVC (as applicable). Neither PepsiCo nor SVC had an entitlement to the payments that were paid to PBS as the price for concentrate. PBS received the payments beneficially and returned and reported the associated income.

(c) On no view of the evidence did PepsiCo or SVC (as applicable) have the benefit of, any control over or any entitlement to the amounts paid by SAPL to PBS, as neither of them owned or sold concentrate to SAPL. Accordingly, the deeming in s 128A(2) can have no application. It follows that the conditions in s 128(2B)(b)(i) are not satisfied.

263 I do not accept these submissions.

264 It has been concluded, in relation to the "consideration for" issue, that the payments made by SAPL under the EBAs were, to an extent, consideration for the use of, or the right to use, the items set out in paragraphs (4)(a) and (b) of Art 12 and the items set out in paragraphs (a) to (d) of the definition of "royalty" in s 6(1). I have also concluded that PepsiCo and SVC (as applicable), as the parties to the EBAs, were entitled to receive the payments made by SAPL under the EBAs. PepsiCo and SVC nominated PBS as the seller of the concentrate under the EBAs, and thereby directed SAPL to pay PBS. In these circumstances, the relevant portions (as described at [256] above) were "dealt with on behalf of [PepsiCo/SVC]" or dealt with "as [PepsiCo/SVC] directs".

265 Accordingly, I consider that the relevant portions of the payments are deemed to have been paid by SAPL to PepsiCo or SVC (as applicable) by virtue of s 128A(2).

Conclusion

266 It follows from the above that the payments made by SAPL under the EBAs in the relevant years were, to an extent, "royalties" and PepsiCo and SVC are liable to pay royalty withholding tax at the rate of 5% on those royalties.

Issue (2): the amount of any royalty

Overview

267 The next issue to consider is the amount of the royalty (or royalties) for the purposes of s 128B of the ITAA 1936 and Art 12 of the US DTA.

268 As noted above, the PepsiCo parties called Ms Wright, and the Commissioner called Mr Malackowski. Broadly, the experts were instructed to assume that the payments made by SAPL under the EBAs were to some extent for the intellectual property owned by PepsiCo/SVC and used by SAPL, and instructed to determine the amount paid for the use of the intellectual property.

269 The respective positions of the experts can be summarised as follows:

(a) Ms Wright considered four alternative methods in her first report. Ultimately, Ms Wright's preferred method was her third method. Under this method, Ms Wright concluded that, assuming that the payments made by SAPL under the EBAs were to some extent for the intellectual property owned by PepsiCo/SVC and used by SAPL, the extent of the payments related to the intellectual property would be in the range 2.0% to 3.0% of SAPL's net revenue from sales of the relevant products. She adopted 2.5% as a midpoint. On the basis of a royalty rate of 2.5% of SAPL's net revenue from sales of the relevant products, the royalty payments would be approximately $[redacted] million for FY18 and $[redacted] million for FY19.

(b) Mr Malackowski adopted two methods (with the first method having two parts to it). Mr Malackowski averaged the results of his two methods to produce a royalty rate for each brand (being a rate to be applied to SAPL's net revenue from sales of the relevant products). Mr Malackowski concluded that, assuming that the SAPL payments were to some extent for the intellectual property owned by PepsiCo/SVC and used by SAPL, the royalty rates would be: for Pepsi – 9.0%; for Gatorade – 8.5%; and for Mountain Dew – 8.5%. On the basis of these royalty rates (applied to SAPL's net revenue from sales of the relevant products), the royalty payments would be approximately $[redacted] million for FY18 and $[redacted] million for FY19.

270 I use the expression "net revenue" to refer to gross sales, less discounts, returns and allowances; it is not a profit measure. This is the description provided by Mr Malackowski during oral evidence. Further, in this section of my reasons (relating to issue (2)) I will use the expression "Relevant Items" in the same way as it is used in the instructions to Mr Malackowski (see below). I approach the quantification exercise on the basis that it involves the quantification of a royalty for a licence of the Relevant Items by PepsiCo/SVC to SAPL.

271 Ms Wright's qualifications and experience are set out in section 1.3 of Appendix B to her first report. She has considerable experience as a forensic accountant, but only limited experience in valuing intellectual property rights or assessing the royalty rate for a licence of intellectual property. During cross-examination, Ms Wright was asked if she had any specific experience in licensing in the soft drink beverage industry. She answered: "Only insofar as I've come across [it] in other matters relating to similar industries". She added that this was in the course of valuation, forensic accounting and auditing. Ms Wright said during cross-examination that she did not have any experience in consulting with IP owners or licensees in the context of negotiating IP licences.

272 Mr Malackowski's background and qualifications are summarised in section 1 of his report and a detailed curriculum vitae is attached as Appendix A to his report. Mr Malackowski has extensive experience in valuing intellectual property rights, including assessing reasonable royalty rates. He has considerably more experience in this area than Ms Wright.

273 Both experts gave evidence in a way that was evidently intended to assist the Court. On some occasions, Ms Wright did not appear to answer questions directly. Mr Malackowski expressed himself in a clear and confident manner.

Ms Wright's evidence

274 As noted above, Ms Wright prepared a first report and a reply report. In addition, she prepared a letter dated 2 March 2023 (CB tab 278). That letter related to a typographical error that emerged in Tab 125A of the briefing materials to Mr Malackowski. Those materials had been relied on by Ms Wright in her reply report. The typographical error required some adjustments to be made to the calculations in the reply report. The adjustments are not material.

275 Ms Wright was instructed to provide her opinion in response to the following question:

Assuming the Payments made by the Bottler [SAPL] to the Seller pursuant to each of the EBAs were payments or credits being to an extent consideration for:

(a) the use of or the right to use any:

(i) copyright, patent, design or model, plan, secret formula or process, trademark or other like property or right;

(ii) industrial, commercial or scientific equipment, other than equipment let under a hire purchase agreement;

(b) the supply of scientific, technical, industrial or commercial knowledge or information owned by any person;

(c) the supply of any assistance of an ancillary and subsidiary nature furnished as a means of enabling the application or enjoyment of knowledge or information referred to in sub-paragraph (b) or of any other property or right to which sub-paragraphs (a) and (b) apply; or

(d) a total or partial forbearance in respect of the use or supply of any property or right described in sub-paragraphs (a) to (c),

please provide your opinion as to how one would work out the extent to which the payments were paid or credited in consideration for the use of, right to use, or supply of any of those items and the amount paid or credited for those items.

276 In her first report, Ms Wright refers to the items listed in paragraphs (a) to (d) of her instructions as "Intellectual Property" or "IP". I will adopt those expressions when discussing the evidence in Ms Wright's first report. It appears that these expressions cover the same property and rights as the expression "Relevant Items" in the instructions to Mr Malackowski (see below).

277 In providing her opinion, Ms Wright was instructed to assume that:

(a) the terms of the EBAs do not provide SAPL with access to any secret formula, process or trade secret that is used in the manufacture of the concentrate; and

(b) in particular, SAPL is not provided the secret formula for the flavour for each carbonated soft drink or the "secret and unique formula" for the beverage base for each non-carbonated beverage.

278 Importantly, as set out in the introductory words of Ms Wright's instructions, she was asked to assume that the payments made by the Bottler (SAPL) to the Seller pursuant to each of the EBAs were payments or credits that were *to an extent* consideration for the items listed in paragraphs (a) to (d) of her instructions.

279 In response to the question "how one would work out" the extent to which the payments were paid or credited as consideration for the use of the Intellectual Property, Ms Wright considered four alternative methods in her first report. The four methods were:

(a) Analysis of the Bottler's business activities and responsibilities per the EBAs (**Wright Method 1**);

(b) Allocation of payments to each of the various assets/services provided (**Wright Method 2**);

(c) Relief from royalty method (**Wright Method 3**); and

(d) 25% rule of thumb (**Wright Method 4**).

280 It should be noted that, at the time Ms Wright prepared her first report, she did not have SAPL's financial statements or figures for SAPL's net revenue from sales of the relevant products. In preparing her reply report, Ms Wright had access to 25 additional bottling agreements (**Additional Bottling Agreements**). She also had access to the material at Tab 125A of the briefing materials to Mr Malackowski; these provided SAPL's net revenue figures from sales of Pepsi, Mountain Dew and Gatorade during the relevant years. In addition, Ms Wright had access to certain additional licensing agreements that had been utilised by Mr Malackowski in his report. In her reply report, Ms Wright updated certain calculations based on the additional material and information.

Wright Method 1

281 In relation to Method 1, Ms Wright summarised this method at [4.1.2] of her first report as follows:

> 4.1.2. … Method 1 is based on an analysis of the Bottler's business activities, responsibilities and restrictions per the EBAs in order to identify and assess:
>
> (a) the extent to which the Payments [i.e. the payments made by SAPL to PBS under the EBAs during the relevant years] as described in the EBA relate to physical assets (such as Concentrate) or Intellectual Property or other benefits;
>
> (b) the assets provided to, and used by SAPL to deliver the service, in particular the extent to which SAPL uses physical assets (such as the Concentrate) or Intellectual Property; and
>
> (c) the ability of SAPL to exploit PepsiCo/SVC's Intellectual Property for SAPL's own benefit.

282 Ms Wright explained the information she needed to use this method at [4.2.1]:

> 4.2.1. I require the following information to use this method:
>
> (a) the quantum of the Payments;
>
> (b) the EBAs, that I have received; and
>
> (c) a description of the nature of the Bottler's operating activities, that I

have received.

283 Ms Wright's reasoning in relation to this method included:

4.3.1. I have been provided with the quantum of the Payments, and the EBAs to which they relate. The nature of my assessment under this method is to apportion the Payments to components that relate to physical/tangible assets, the Intellectual Property items, or other benefits, based on the terms of the EBAs. Accordingly, I have set out a detailed review of the Bottler's business activities and responsibilities under the EBAs at Section 3.4. Based on my review, as set out at paragraph 3.4.33:

(a) the tangible assets acquired and used by SAPL pursuant to the EBAs are Units of Concentrate and certain packaging materials;

(b) the manufacturing undertaken by SAPL is limited to adding carbon dioxide and water to the Concentrate mixture and in some cases a sweetener;

(c) SAPL's activities generally relate to blending, bottling, packaging, selling and distribution pursuant to the Seller's specifications;

(d) the intangible assets used by SAPL are limited to manufacturing instructions and specifications (such as for heating and blending), the use of Trademarks with permission for the purpose of distributing the Seller's products, and certain training and assistance in relation to the specifications and EBA activities;

(e) SAPL does not have the right to use the Trademarks for any other purpose; and

(f) SAPL has limited opportunity to exploit the EBA-related Intellectual Property for its own benefit other than as a packager and distributor of the product.

…

4.3.3. Specifically in relation to the extent to which the Payments relate to Trademarks and Intellectual Property, **the EBAs include the following statements**:

(a) nothing in the Pepsi EBA shall be construed as conferring upon the Bottler any right or interest in the trademarks, or in their registrations or in any designs, copyrights, patents, trade names, signs, emblems, insignia, symbols and slogans, or other marks, used in connection with the Beverages; and

(b) SVC grants to the Bottler, for the duration of the term of the Gatorade EBA, an exclusive royalty-free licence to use the Intellectual Property in Australia.

4.3.4. Based on the above and on my experience, I also infer the following:

(a) SAPL has manufacturing assets, has a distribution network and offers a bottling and packaging service to a number of soft drinks, juice and water manufacturers for other products;

(b) SAPL's activities under the EBAs are performed using standard plant and equipment and distribution activities (because the activities are also performed for other parties);

(c) SAPL's activities are subjected to PepsiCo and SVC quality standards and audits, and it appears that PepsiCo maintains control over its products;

(d) **the most significant value in the product (i.e., the most valuable component) is the recipe to manufacture the Concentrate**, as evidenced by the tight restrictions and secrecy of the formula imposed by PepsiCo and SVC, and the recipe is not provided to or used by SAPL; and

(e) there is no PepsiCo proprietary information involved in the bottling process or distribution, other than specifications for heating and blending.

4.3.5. Additionally, based on publicly available information:

(a) the activities SAPL undertakes for PepsiCo are similar to activities it would undertake for other drink manufacturers. Additionally, SAPL undertakes similar activities for its own products;

(b) selling concentrate **alone** to a bottler is common practice in the industry. In an independent expert's report regarding Coca-Cola Amatil Ltd (Amatil) prepared by Deloitte Corporate Finance Pty Ltd, Amatil states that Amatil was required to purchase beverage concentrate from designated suppliers for a price aligned with agreed growth and return objectives, with The Coca-Cola Company playing an active role in marketing;

(c) the EBAs are consistent with Coca-Cola's comprehensive beverage agreements, where the bottler is granted:

> … an exclusive, royalty-free license to use the Trademarks, solely in connection with the marketing, promotion, distribution, and sale …

(d) the EBAs are also consistent with examples of Coca-Cola's bottler's agreements, where the use of Intellectual Property is deemed:

> … a mere temporary permission, uncoupled with any right or interest, and without payment of any fee or royalty charge …

(Footnotes omitted; emphasis added.)

284 In relation to [4.3.3] of her first report, it was put to Ms Wright during cross-examination that taking these aspects of the contract into account was inconsistent with the assumption she was instructed to make that a portion of the payments made by SAPL related to IP. She accepted that the clauses described in [4.3.3] were inconsistent with the assumption she was asked to make. Ms Wright confirmed that she did take these clauses into account.

285 In relation to [4.3.4(d)] of her first report, Ms Wright explained during cross-examination that she inferred from the restrictions and secrecy that were imposed over the recipe that the

concentrate was the most valuable component. The following exchange took place in cross-examination in relation to [4.3.4(d)]:

> Well, I'm really talking about the conclusion you have come to in 4.3.4(d), sorry, Ms Wright. Your analysis in this paragraph is focused on what the most significant value in the finished beverage is, as I understand it; is that right?---Well, the purpose of this paragraph is to assess what SAPL has and doesn't have because that's my – that's the question I'm asked. I'm not asked about the value of the brand to Pepsi or where that fits. I'm asked about the benefit obtained by SAPL.
>
> You've said here that what you're doing is looking at the relative value of components in the finished beverage; is that right? The most significant value in the product, ie, the most valuable component is the recipe?---Yes, that's my inference, yes.
>
> And isn't another component of the product the trademark that's applied to the can or the bottle as it's sold in the Australian market?---Yes.
>
> And how did you come to the view that the recipe is more valuable than the use of the trademark?---By – I've inferred it from the restrictions placed on it by Pepsi.
>
> And that's the only thing that you take into account in comparing the value of – the value contribution of the recipe as opposed to the value contribution of the trademark?---In this method I'm trying to identify what benefit SAPL has and I'm saying it has a limited benefit to use the trademark and it doesn't have access to the recipe.
>
> Yes. The question that I'm trying to ask you is whether or not you took any steps to compare the value of the use of the Pepsi trademark on the finished beverage to the value of the recipe in producing the taste in the finished beverage. Did you undertake that exercise?---No.

286 In relation to [4.3.5.(b)] of her first report, Ms Wright accepted during cross-examination that all of the transactions she referenced also included a licence (express or implied) of trademarks. It was put to Ms Wright that it would be more accurate to say that the common practice in the industry is to enter into an arrangement that involves the sale of concentrate and a licence of trademarks, but to make the payment for the concentrate alone. She responded: "Yes, perhaps [I] shouldn't have put alone in that spot in the sentence".

287 Ms Wright's opinion in relation to her Method 1 was:

> 4.4.1. For the reasons discussed above, it is my opinion that:
>
> (a) SAPL's activities generally relate to blending, bottling, packaging, selling and distribution pursuant to the Seller's specifications, therefore the intangible assets provided by the Seller and used by SAPL are limited to manufacturing instructions and specifications (such as for heating and blending), the use of Trademarks with permission for the purpose of distributing the Seller's products, and certain training and assistance in relation to the specifications and EBA activities;
>
> (b) **the Payments do not relate to the use of the Intellectual Property that is of any material value to SAPL as a result of the significant**

restrictions by PepsiCo/SVC on the operations;

(c) there is limited opportunity for the Bottler to exploit the Intellectual Property for its own benefit in an entrepreneurial sense because:

(i) the Intellectual Property is tightly controlled;

(ii) the user of the brand (Bottler) does not own the brand;

(iii) the Bottler (SAPL) is performing routine/standard activities;

(d) the terms of the EBAs do not provide SAPL with access to, and therefore no portion of the Payments relate to, any secret formulae, processes or trade secrets;

(e) the Payments from SAPL are therefore mostly for the physical asset, being Units of Concentrate, from which SAPL is responsible for bottling, selling and distributing the Beverages; and

(f) **the portion or extent of the Payments that would be for the Intellectual Property items would be de minimis**.

4.4.2. Because I am instructed to assume that the Payments, were to an extent, related to Intellectual Property, and I am instructed to provide my opinion of 'the amount paid' for the Intellectual Property items, I have also considered other methods.

(Emphasis added.)

288 Ms Wright was taken to [4.4.1(b)] of her first report during cross-examination. The following exchange took place:

> So, Ms Wright, the view that you're expressing here is that the intellectual property which includes the Pepsi trademark is of no material value to the bottler that distributes the Pepsi products in Australia as a result of the restrictions that are placed on the use of that trademark by PepsiCo and SVC?---Yes, it has limited use – very limited use for that intellectual property.

289 Ms Wright confirmed that the restrictions she was talking about in [4.4.1(b)] were those set out in paragraphs (d), (e) and (f) of [4.3.1]. She said that these were the main restrictions. Ms Wright was asked: "in what other way might SAPL have had the opportunity to exploit the EBA-related IP as licensee? What would be another way that a licensee would ordinarily exploit IP other than to use it as a packager and distributor of the finished beverage?" She responded: "It might be able to use it to create its own product, for example".

290 It was put to Ms Wright during cross-examination that, despite the restrictions on the use of trademarks in the EBA, there is material value in SAPL being able to sell finished beverages as Pepsi as opposed to, for example, a supermarket cola brand. Ms Wright responded that, in order to answer that, she would need to analyse the profit that SAPL makes from each of those brands relative to each other, and she did not have the detail to do that.

291 During cross-examination, Ms Wright was taken to an IBISWorld report called "Soft Drink Manufacturing in Australia" dated February 2022 (CB tab 219). Ms Wright was taken to various passages referring to the significance of branding or "brand equity". At page 25, the report stated: "Brand equity has been the leading point of differentiation for the industry's top players and this has driven substantial advertising expenditure in the industry." It was put to Ms Wright that this indicated that the brand is playing a major role in driving the sale of products. Ms Wright responded that it "indicates that it [the brand] would impact the revenue and volumes". She said that while *prices* may be higher, it did not tell her about the *profitability* of one brand over another to SAPL.

292 In relation to [4.4.1(f)] of her first report, Ms Wright said during cross-examination that, if it were not for the instruction that a portion of the payments made by SAPL related to IP, she probably would have said that the payment for the IP was nil.

293 In her reply report at [3.2.7], Ms Wright stated that she had undertaken a detailed analysis of the Additional Bottling Agreements. She stated at [3.2.8] of her reply report that, based on the Additional Bottling Agreements, her view that the portion or extent of the payments that would be for the Intellectual Property items would be de minimis, remained unchanged.

294 It was put to Ms Wright during cross-examination that there was an inconsistency between: (a) the assumption that she was instructed to make (that a portion of the payments made by SAPL under the EBAs related to IP); and (b) the publicly-available agreements she had referred to in her first report (at [4.3.5]) and the Additional Bottling Agreements she had referred to in her reply report (at [3.2.7]), which did not provide for a royalty to be paid. Ms Wright said that she had resolved the inconsistency by adopting or considering a different method, namely, Wright Method 3. She also said that the de minimis answer in her Method 1 was relevant for the purposes of the sensitivity analysis conducted as part of Method 3. She said the reason she adopted zero as the bottom end of the sensitivity analysis was because of the outcome of Method 1.

295 Ms Wright accepted during cross-examination that the ultimate conclusion she came to in her first report and her reply report was a royalty in the range 2.0% to 3.0% and she adopted 2.5% as a midpoint. It seems, therefore, that it is Ms Wright's analysis under Wright Method 3 that provides her opinion in relation to the question she was instructed to address.

296 Further and in any event, I place little weight on Wright Method 1. In my view, as exposed in the cross-examination summarised above, there were significant difficulties with this method. In particular, it had regard to contractual terms that were inconsistent with the instructed assumption that a portion of the payments made by SAPL under the EBAs was for the Intellectual Property. Further, it had regard to publicly-available agreements and the Additional Bottling Agreements that did not provide for payment of a royalty and were therefore inconsistent with the instructed assumption.

Wright Method 2

297 Ms Wright explained this method as follows in her first report:

> 5.1.2. In order to allocate the value of the Payments across each of the components to which the Payments may relate, I would be required to analyse the business as a whole and identify the relative contribution of each component to the generation of revenue and profit of the business.

298 Ms Wright outlined the material she would need to undertake this analysis and the steps involved. She concluded at [5.3.4] that she did not have sufficient information to use this method to calculate the amount paid or credited for the Intellectual Property items, as it required detailed information from SAPL and SAPL management. This method can therefore be put to one side for present purposes.

Wright Method 3

299 Ms Wright explained this method as follows in her first report:

> 6.1.2. … Method 3 is a market method based on the 'Relief from royalty', based on benchmarking the assumed payment for Intellectual Property to comparable market rates. This is a method commonly referred to in the International Valuation Standards.
>
> 6.1.3. In my experience, the relief from royalty method is a common method to value Intellectual Property such as brands, trademarks, trade names, patents, technology and know-how. I use this method as guidance in researching market comparable royalty rates to determine a reasonable range of royalty rates that could be applicable to SAPL. This method starts from the assumption that a component of the Payments does represent a royalty payment.
>
> 6.1.4. Under this method, third party royalty or license agreements are analysed as obtained from public sources. Generally, the net revenue generated by the Intellectual Property is multiplied by the selected benchmark royalty rate. The selected licencing agreements should therefore reflect similar risks and characteristics to the subject Intellectual Property. Accordingly, depending on the terms of the selected comparable licensing agreements, the observed royalty rates may need to be adjusted to make them comparable to the subject Intellectual Property as necessary.

300 Essentially, Wright Method 3 involves a search for comparable agreements in order to find a benchmark for a royalty. In order to look for benchmarks, Ms Wright searched a database called Royalty Range. This was the database that her firm in Australia had a licence to. Ms Wright accepted during cross-examination that there are other databases that include licence agreements that could be relevant. She said she did not search them as she did not have access to them.

301 Ms Wright outlined the steps involved as follows in her first report:

> 6.2.1. Below are the steps I would perform under this method:
>
> (a) **Step 1**: Search Royalty Range database, an intellectual property royalty rate database for comparable licensing and royalty agreements in the food and beverage industry. The database consists of royalty rate reports that contain manually gathered and analysed data. The Royalty Range database is funded by the European Union's Structural Funds and has been featured in publications by the Organisation for Economic Co-operation and Development, World Bank Group, International Monetary Fund and United Nations;
>
> (b) **Step 2**: Identify agreements where the licensee produces, manufactures, distributes and sells food and beverage products;
>
> (c) **Step 3**: Of the identified agreements, analyse the fees paid (license/royalties) to the licensor for the use of intellectual property and conclude on a typical range of royalty rates (calculated as a percentage of earnings, assuming the earnings to be on the same basis as for SAPL) charged for the intellectual property associated with the production, manufacturing, distribution and sale of food and beverage products; and
>
> (d) **Step 4**: Calculate a royalty payment as a royalty rate (generally expressed as a percentage) multiplied by a level of earnings (revenue, profit).
>
> (Footnotes omitted.)

302 Ms Wright explained at [6.3.1]-[6.3.4] the information that she did, and did not, have access to (at that stage).

303 Ms Wright's detailed reasoning in relation to this method in her first report included:

> 6.4.1. Assuming the Payments were, to an extent, for Intellectual Property owned by PepsiCo/SVC and used by SAPL, and in the absence of the SAPL financial statements, I have prepared an estimate of a royalty payment based on the information I have been provided and been able to obtain from my market research.
>
> 6.4.2. My calculations are based on
>
> (a) a range of royalty rates I have identified in my market research (refer to Range of royalty rates section below and **Annexure D**); and

(b) my estimate of revenue using publicly available comparable company information (refer to the Estimate of revenue using publicly available comparable company information section below and **Annexure E**).

Range of royalty rates

6.4.3. Assuming the Payments were, to an extent, for Intellectual Property owned by PepsiCo/SVC and used by SAPL, I have undertaken research to identify relationships that reflect similar characteristics to those that I have identified in Section 3.4. This includes identifying arrangements representing the manufacturing and distribution of the finished products and does not encompass sharing any proprietary information (such as trade secrets) with the licensee. Accordingly, I have only considered agreements where no proprietary manufacturing related intangible assets are licensed to the licensee. In my view, this is consistent with the EBAs as PepsiCo/SVC does not transfer any Intellectual Property related to the Concentrate to SAPL. In selecting these agreements, I have:

(a) searched the Royalty Range database for agreements with entities involved in the food and beverage industry where the licensee distributes or sells food and beverage products;

(b) excluded agreements where the licensor does not own food or beverage brands;

(c) excluded agreements where manufacturing related intangible assets such as recipes, formulae or similar know-how were transferred to the licensee;

(d) selected royalty agreements that calculate the royalty rate as a percentage of net sales; and

(e) narrowed the search to a list of eight agreements as my final set of comparable royalty agreements.

6.4.4. Set out at **Annexure D** is my review of royalty agreements and the royalty rates I have considered based on market data. The intangible assets licensed to the licensee as part of these agreements includes the license to manufacture and distribute, as well as marketing related intangible assets such as trademarks, trade names and brands.

6.4.5. Based on my research in relation to the royalty agreements:

(a) net sales appear to be the most common base for expressing a royalty rate percentage;

(b) the royalty rates range from 1.0% to 7.0% of net sales;

(c) **the median for the low and high royalty rates are 2.0% and 3.0% of net sales, respectively**; and

(d) the average for the low and high royalty rates are 2.3% and 3.5% of net sales, respectively.

6.4.6. However, as discussed at paragraph 4.3.4, there are a number of bottling and distribution arrangements that are royalty free, which appears to be common practice in the industry. As such, I have not identified such agreements in the Royalty Range data base as the licensee does not pay a licensor for the use of intangible assets. Additionally, my analysis for method 1 (refer to Section 4) indicates that the portion or extent of the Payments that would be for the Intellectual Property items would be de-minimis. **Accordingly, I consider the lower end of the royalty rate range to be 0%.**

(Footnote omitted; emphasis added.)

304 In her first report, after a filtering process, Ms Wright considered *eight licence agreements* under her Method 3. Those agreements were set out in Annexure D to her first report.

305 The next section dealt with the estimate of SAPL's net revenue. This part of the first report has been overtaken by Ms Wright's reply report, which is based on SAPL's actual net revenue from sales of the relevant products.

306 In her first report, Ms Wright stated at [6.4.11]

6.4.11. Assuming that the Payments were, to an extent, for Intellectual Property owned by PepsiCo/SVC and used by SAPL, **I have estimated a royalty payment based on:**

(a) **a 2.5% royalty rate, based on the median for the low and high royalty rates of 2.0% and 3.0% of net sales**; and

(b) my estimate of revenue calculated from publicly available comparable company information as described in paragraphs 6.4.7 and 6.4.10.

6.4.12. Assuming that the Payments were, to an extent, for Intellectual Property owned by PepsiCo/SVC and used by SAPL, and assuming a 2.5% royalty of revenue, the extent of the Payments that relate to Intellectual Property is approximately $[redacted] million in FY18, and approximately $[redacted] million in FY19 …

(Emphasis added.)

I note that the dollar figures appearing in the above extract were updated in Ms Wright's reply report (discussed below).

307 Ms Wright then conducted a sensitivity analysis to examine the impact of varying the assumed royalty rate between 0% and 5%.

308 Ms Wright's conclusions in relation to her Method 3 as set out in her first report were:

6.5.1. For the reasons discussed above, assuming that the Payments were, to an extent, for Intellectual Property owned by PepsiCo/SVC and used by SAPL, and based on the information I was provided and market research I have obtained in the absence SAPL financial statements, it is my opinion that the extent of the Payments related to the Intellectual Property would be in the range of 0.0% to 5.0%, with a mid-point of 2.5% (consistent with the median for the low and high royalty rates are 2.0% and 3.0% of net sales I have identified from market research), being approximately $[redacted] million in FY18, and approximately $[redacted] million in FY19, or 8.3% of the Payments.

6.5.2. My opinion is based on the information I was provided and market research I have obtained in the absence of the SAPL financial statements. If I am provided with SAPL financial statements, then my opinion may change.

(Footnote omitted.)

Again, I note that the dollar figures appearing in the above extract were updated in the reply report (see below).

309 For the purposes of her reply report, Ms Wright excluded four of the licence agreements she had considered for her first report and included five licence agreements that were drawn from Mr Malackowski's set of agreements. This produced a set of *nine licence agreements*. These were identified at [5.2.7] and Table 11 of her reply report. Ms Wright then stated in her reply report:

5.2.8. **As set out above, the median for the low and high royalty rates is 2.0% and 3.0%, respectively. The average of these is 2.5% and is the same as the royalty used in the Wright Report** [i.e. her first report].

5.2.9. Of the nine licensing agreements, the four beverage related licensing agreements have a median low rate of 2.5% and a median high rate of 4.0%. In my view, this subset cannot be used as it comprises only four agreements. All of these licensing agreements are less comparable to the EBAs compared to the royalty-free bottling agreements identified in the Wright Report and the Additional Bottling Agreements.

5.2.10. To supplement these four agreements, I have also considered an additional five licensing agreements that relate to snack foods as opposed to beverages. All of these licensing agreements were also selected by Mr Malackowski, and they have a median low rate of 2.0% and a median high rate of 3.0%. Mr Malackowski has considered additional snack food related licensing agreements; however, I have excluded them from my analysis for reasons including inappropriate sources and brands related to basic ingredients, as detailed at Annexure E.

5.2.11. In the Wright Report, I performed a sensitivity analysis from 0% (based on the royalty-free licences) to 5% for the reasons set out at 6.4 of the Wright Report. Based on the new information provided to me and analysis undertaken, my opinion as to the range of royalties for the sensitivity calculations remains unchanged. The median royalty rate for the subset of four beverage agreements, the subset of five snack food licensing agreements and the collective set of nine agreements all fall within the 0.0% to 5.0% royalty rate range I adopted for sensitivity analysis in the Wright Report. That is, the median royalty rates range between 2% to 4%, within the 0.0% to 5.0%.

(Emphasis added.)

310 In her reply report, Ms Wright provided the following updated royalty payment under her Method 3:

5.2.12. Assuming that an extent of the Payments was for Relevant Items owned by PepsiCo/SVC and used by SAPL, I have estimated a royalty payment based on:

(a) a 2.5% royalty rate, based on the median for the low and high royalty rates of 2.0% and 3.0% of net sales; and

(b) the sales information provided at Tab 125A of the Malackowski Report.

5.2.13. Assuming that an extent of the Payments was for the Relevant Items owned by PepsiCo/SVC and used by SAPL, and assuming a 2.5% royalty of revenue, the extent of the Payments that relate to Intellectual Property is approximately $[redacted] million in FY18, and approximately $[redacted] million in FY19 as summarised in the table below.

[Table redacted]

311 After setting out the above, Ms Wright referred to her revised sensitivity analysis. This was set out at [5.2.14]-[5.2.17] and Table 13.

312 Ms Wright's ultimate opinion in her reply report in relation to her Method 3 was:

5.2.18 For the reasons discussed above, assuming that an extent of the Payments was for Intellectual Property owned by PepsiCo/SVC and used by SAPL, **it is my opinion that the extent of the Payments related to the Intellectual Property would be 2.5% (consistent with the median for the low and high royalty rates of 2.0% and 3.0% of net sales I have identified from market research), being approximately $**[redacted] **million in FY18, and approximately $**[redacted] **million in FY19.**

(Footnote omitted; emphasis added.)

313 Two agreements that Ms Wright *included* in her revised set of comparable agreements were *excluded* by Mr Malackowski for the purposes of his Method 1 – Part 1 (which is substantially the same as Wright Method 3). These agreements were identified in Ms Wright's reply report at Annexure E, section 1.3, and were: (a) MD Enterprises Inc/Bravo! Food International Corp; and (b) Del Monte Corporation/Coffee Holding Co. Mr Malackowski excluded these agreements because he considered that the brand that was the subject of the licence was considerably weaker than the Pepsi brand. In relation to the first agreement, Ms Wright's view was that the licensed product (flavoured milk – Moon Pie snack) was comparable to the products produced by SAPL and PepsiCo/SVC because it was beverage-related; she considered it more comparable than many of the other licence agreements selected by Mr Malackowski. During cross-examination, Ms Wright accepted that the agreement concerned a trademark for Moon Pie. She said she understood this to be a kind of snack food available in the United States, and that the agreement concerned the use of the Moon Pie trademark on a flavoured milk product. During cross-examination, Ms Wright said that she had been unable to verify what Mr Malackowski had said about the differences in brand strength. She expressed the view

that brand strength "will be taken into account in the volumes and pricing" as referred to earlier during cross-examination. In relation to the comparability of the agreement relating to Moon Pie, Ms Wright said during cross-examination that all the trademarks are different; none of them are perfectly comparable. She accepted that she would prefer it to be more comparable, but maintained her position that it was appropriate to include the agreement.

314 In relation to the second agreement that Ms Wright included but Mr Malackowski excluded (namely Del Monte Corporation/Coffee Holding Co), Mr Malackowski rejected that agreement on the basis of brand strength, and Ms Wright expressed the view in her reply report (Annexure E, section 1.3) that the licensed product and brand relate to coffee, which is (in her view) comparable to the beverage-related brands and products under the EBAs. During cross-examination, Ms Wright said the agreement was not as comparable as she would prefer, but she had included beverages to expand the set. She said she had not undertaken any analysis of the strength of the brand that was the subject of the licence.

315 In Ms Wright's reply report at Annexure E, section 1.4, she discussed agreements that were *included* by Mr Malackowski (in his set of comparable agreements for the purposes of his Method 1 – Part 1) that Ms Wright had *excluded*. One of the agreements Ms Wright excluded was the MasterFoods USA/Bravo! Foods International Corp agreement. Ms Wright's explanation for excluding this agreement included: "These developments and associated recipes are owned by the licensor. Hence, the licensor's intellectual property is shared with and further developed by the licensee. As the formula for the concentrate is not shared with SAPL, this agreement should be excluded." During cross-examination, Ms Wright was taken to the agreement and it was put to her that, in fact, the licensee was coming up with the recipe and providing it to the brand owner, which then owned the intellectual property. Ms Wright maintained that it was a different relationship than the relationship with SAPL.

316 Another agreement that Mr Malackowski included and Ms Wright excluded was Celestial Seasonings, Inc/The Perrier Group of America, Inc. The reason Ms Wright excluded this was because she was unable to locate the licensing agreement. She was taken to a document (CB tab 241) that was said to be the agreement. Ms Wright said that the agreement had not been drawn to her attention.

317 Two of the agreements that were included by Mr Malackowski and excluded by Ms Wright involved Land O'Lakes Inc as licensor. In relation to the first of these agreements, Ms Wright stated that the licensor's brand related to butter and manufactured products such as sour cream

and instant formula. In relation to the other agreement, she stated that it was similar to the first agreement. Ms Wright stated that these agreements were not comparable to the EBAs. During cross-examination, Ms Wright said that it was a different relationship to that involving SAPL. She said that both the product and the function of the licensee were different.

318 Another agreement that was included by Mr Malackowski and excluded by Ms Wright was Chiquita Brands, Inc/Delicious Cookie Company, Inc. Ms Wright stated in her reply report (in Annexure E, section 1.4.) that the licensor was a producer and distributor of bananas and other produce, and the agreement was not comparable and should be excluded. During cross-examination, Ms Wright said that her understanding was that the Chiquita trademark was being applied to banana and chocolate chip cookies. She said that the relevant difference was that the licensee "has its own recipe, its own IP, its own value added to that and the relative value of the banana to the cookie is different than the relative value of the concentrate to … what SAPL is doing, which is blending it with water, bottling and distributing".

319 Another agreement that was included by Mr Malackowski and excluded by Ms Wright was The Mrs Fields' Brand, Inc/Nonni's Food Company, Inc. Ms Wright stated in her reply report (in Annexure E, section 1.4.) that the licensing agreement should be excluded because it relates to a licensor that is a franchisor, and its franchisees sell snack foods through retail stores. She also stated that the brand was associated with a restaurant chain rather than any specific beverage or snack food products. During cross-examination, Ms Wright maintained that in her opinion it was a different relationship and not comparable.

320 In her reply report, Ms Wright was critical of Mr Malackowski's approach (in the context of his Method 1 – Part 1) in relation to certain non-exclusive licence agreements. As discussed below, Mr Malackowski made an adjustment for exclusivity that involved doubling the royalty rate. Ms Wright considered this arbitrary. Ms Wright also expressed the view that the non-exclusive character was already taken into account. During cross-examination she said that the only way it would be justified to make this kind of adjustment would be "if you knew all else was equal". She also said that "the comparison of them isn't precise enough to adjust any of them for any one feature over another".

321 Another criticism made by Ms Wright in her reply report was Mr Malackowski's inclusion of settlement agreements as comparables. During cross-examination, Ms Wright was taken to one of the comparables she included in her revised set, namely the Sara Lee Global Finance, LLC/Championlyte, Inc agreement, effective 1 April 2003 (CB tab 213). She was also taken

to a settlement agreement between the same parties dated 1 April 2003 (SCB tab 358). Ms Wright said that if the licence agreement was the result of the settlement agreement, then she should have excluded it.

322 I will give further consideration to Wright Method 3 in the section of these reasons headed "Determination of royalty rate".

Wright Method 4

323 In her first report, Ms Wright provided the following explanation of this method:

> 7.1.2 … Method 4 is the "Rule of thumb" of 25% of profit, or EBIT. Under this method, an implied royalty rate is estimated with reference to SAPL's profitability, providing an indication of the benchmark proportional allocation of profit between licensor and licensee.
>
> 7.1.3. The rule of thumb suggests that the licensee would not pay a royalty of more than 25% of its expected profits for the sale of the product that incorporates a charge for the use of the intellectual property. The rule of thumb is a reasonableness assessment, commonly used as a crosscheck in valuing intangible assets, to other methods such as the relief from royalties method.
>
> (Footnote omitted.)

324 Ms Wright explained the steps as follows:

> 7.2.1. Below are the steps I would perform under this method:
>
> (a) **Step 1**: Review SAPL's financial statements to identify the profit from the sale of PepsiCo's and SVC's products.
>
> (b) **Step 2**: Calculate EBIT (earnings before interest and tax). As the benchmark applies to earnings before the deduction of a royalty payment, the EBIT should represent earnings 'before' any royalty expense.
>
> (c) **Step 3**: Calculate 25% of EBIT as the general royalty benchmark, adjusted as required to take into account the specific characteristics of each case.

325 Ms Wright stated at [7.3.1] of her first report that she would require the financial statements of SAPL, including details on Pepsi and Gatorade segments, to identify EBIT or revenue for each segment. She stated at [7.3.2]-[7.3.3] that: she had not been provided with the financial statements of SAPL to identify EBIT or revenue and therefore had conducted her own research as a substitute for a typical EBIT and revenue in the industry; and, based on the SAPL payments and information she had obtained from her market research, she had calculated a royalty payment based on estimated EBIT based on the assumptions detailed at Section 6.4 of her first report.

326 In her first report, Ms Wright's provided the following estimate of a royalty payment based on her Method 4:

> 7.4.15 Assuming the Payments are, to an extent, for Intellectual Property owned by PepsiCo/SVC and used by SAPL, I have estimated a royalty payment as 25% of Grossed-Up EBIT, calculated as:
>
> (a) the estimate of revenue (assumed to be on the same basis as SAPL) as set out in my response to method 3; *multiplied by*
>
> (b) a Grossed-Up EBIT margin of 12.8% (refer to paragraph 7.4.14 above).
>
> 7.4.16. Assuming the Payments are, to an extent, for Intellectual Property owned by PepsiCo/SVC and used by SAPL, set out below is my estimate of a maximum royalty payment assuming a 12.8% EBIT margin: …
>
> 7.4.17. Based on the table above, my calculations adopting a Grossed-Up EBIT margin of 12.8% results in a royalty payment of 10.7% of the total Payments under the EBAs.
>
> 7.4.18. I consider the result of the above calculation to be the 'maximum' royalty payment because it is a general benchmark that needs to be adjusted to take into account the following characteristics of this specific case:
>
> (a) based on my analysis under Method 1, compared with a 'general royalty benchmark', the portion or extent of the Payments that would be for the Intellectual Property items would be de-minimis;
>
> (b) based on my analysis under Method 3, there are a number of bottling and distribution arrangements that are royalty free, and I therefore consider 'nil' to be the lower end of the range; and
>
> (c) the profit margin that I have adopted is based on Asahi Holdings, which may have a higher profit margin than that related only to the bottling and distribution activities.

327 During cross-examination, Ms Wright said that Wright Method 4 was capable of independently calculating a royalty, but it was less precise and not her preferred method. She said it was a cross-check and not as accurate as the other methods. Ms Wright was asked which was her preferred method. She said, if she had all the information, it would be her Method 2; in the absence of that it would be her Method 3. In light of this evidence, I do not propose to rely on Wright Method 4 in determining a royalty rate.

Other evidence

328 In her reply report, Ms Wright made the following criticisms of the profit split method adopted by Mr Malackowski (under his Method 2, discussed below):

> 3.5.4. In my opinion, Mr Malackowski's calculation is inappropriate for the following reasons:

(a) The brand to EV portion relates to a full ownership situation; hence it is more meaningful for valuing ownership in intangible assets. It is not appropriate for the present SAPL situation, where SAPL does not have full ownership of the brand;

(b) The brand to EV ratio calculated by [Markables] will likely include intangible assets other than licensing agreements. Therefore the ratio may not be appropriate to the Relevant Items;

(c) The profit split, as used by Mr Malackowski, is between brand and non-brand assets (i.e., non-brand assets comprise net assets including working capital, fixed assets, other intangible assets);

(d) Mr Malackowski uses Asahi Holdings' EBIT margin and applies it to SAPL. The brand to EV ratio is based on the third quartile, which does not include Asahi Holdings and SAPL. Additionally, Mr Malackowski's calculations assumes that Asahi Holdings' EBIT includes payment of a royalty in proportion to its brand value which would not be appropriate to the extent that it benefits from value of brands that it owns. And where it doesn't pay any royalty.

(e) The brand to EV ratio is comparing the value of the brand owned by the brand owner to the value of the owner (i.e., the business value). In this case, the brand owner is PepsiCo and SVC and not SAPL.

329 During cross-examination, Ms Wright was taken to the International Valuation Standards (**IVS**), effective 31 January 2022 (SCB tab 357) being a document referred to in her first report. At page 75, the IVS discussed the relief from royalty method. In outlining the key steps in applying this method, the IVS stated:

> (b) develop a royalty rate for the subject intangible asset. Two methods can be used to derive a hypothetical royalty rate. The first is based on market royalty rates for comparable or similar transactions. A prerequisite for this method is the existence of comparable intangible assets that are licensed at arm's length on a regular basis. The second method is based on a split of profits that would hypothetically be paid in an arm's length transaction by a willing licensee to a willing licensor for the rights to use the subject intangible asset,

Ms Wright accepted that the second method, the profit split method, is an acceptable way to apply the relief from royalty method. She also accepted that (as indicated in the IVS at page 76) it may be acceptable to apply both methods in reaching a royalty rate.

330 During cross-examination, Ms Wright expressed the view that Mr Malackowski's approach (that is, his Method 2, discussed below) did not represent the profit split method, in that the method is concerned with the relationship between two different entities, whereas his approach looked at only one side of the equation (the owner). She also said that the dollar value that Mr Malackowski was starting from is a price paid for a company; he was not doing any kind of bottom-up assessment of any specific intellectual property.

Mr Malackowski's evidence

331 As noted above, Mr Malackowski prepared a single report. In addition, the evidence includes three letters that he prepared; two dated 2 March 2023 (CB tabs 275 and 276) and one dated 21 March 2023 (Exhibit R3; SCB tab 365). In the first letter dated 2 March 2023, Mr Malackowski, having reviewed Ms Wright's reply report, accepted that two licence agreements that he had included in his set of comparable agreements (for his Method 1 – Part 1) were related-party agreements. He accepted that they should be excluded and provided revised calculations on that basis. In the second letter dated 2 March 2023, Mr Malackowski referred to the typographical error in Tab 125A of his briefing materials and provided updated calculations based on the corrected figure. The changes are not material. In the letter dated 21 March 2023, Mr Malackowski provided some clarifications and minor corrections to his report.

332 Mr Malackowski was instructed to answer the following three questions:

> **Question 1:**
>
> Assuming the Payments made by SAPL to PBS pursuant to each of the [PepsiCo] EBA and [SVC] EBA respectively were payments or credits being to an extent consideration for the Relevant Items (defined below), please provide your opinion as to how one would work out the extent to which the Payments were paid or credited in consideration for the use of, right to use, or supply of those items, and the amount paid or credited for those items.
>
> **Question 2:**
>
> Assuming the Payments were made by SAPL to PBS pursuant to each of the [PepsiCo] EBA and [SVC] EBA respectively were not payments or credits that were to any extent consideration for the Relevant Items (defined below), please provide your opinion as to what, if any, royalty might reasonably be expected to have been paid for the use of, right to use, or supply of the Relevant Items, on the following predicate:
>
> (a) the total amount of the Payments made by SAPL remained the same;
>
> (b) the parties to the [PepsiCo] EBA and [SVC] EBA agreed that the Payments would be consideration for all of the Property provided to, and promises made to SAPL (including the concentrate, and the use of, right to use, or supply of the Relevant Items); and
>
> (c) the [PepsiCo] EBA and [SVC] EBA expressly provided for the Payments to include a royalty for the use of, right to use, or supply of the Relevant Items.
>
> **Question 3:**
>
> Do you agree with the reasoning and conclusions recorded in the Wright Report? Please explain why/why not.

333 Mr Malackowski was provided with the following definition of the "Relevant Items" for the purposes of the above questions:

For the purposes of Questions 1 and 2, the "**Relevant Items**" are the following, or the use of or right to use the following on an exclusive basis in Australia:

(a) The "Beverage Documents" referred to in the affidavit of Randall Scott Lovorn affirmed 5 September 2022 at [39] (see, eg, [PepsiCo] EBA clause 6; [SVC] EBA clauses 4.1, 5.1, 5.2, 5.5).

(b) Bottling instructions, including beverage quality manuals and product specifications (see, eg, [PepsiCo] EBA clause 6; [SVC] EBA clauses 4.1, 5.1, 5.2 and 5.5).

(c) The shape and configuration of containers including bottles and cans, and specifications thereof (see, eg [PepsiCo] EBA clauses 7 and 11(a); [SVC] EBA clauses 4.1, 5.1, 5.2, 5.5).

(d) Each of the following elements of packaging (see, eg [PepsiCo] EBA clauses 5, 7, 11(a), 17(a) and 17(b); [SVC] EBA clauses 4.1, 5.1, 5.2, 5.3 and 5.5):

(i) The names "Pepsi", "Mountain Dew", "Gatorade", "G-Active", "Propel" and the names of each of the beverage brands listed in the tables in the Statement of Facts at [6] except "7UP Lemonade" (each, a Brand Name).

(ii) The use of each Brand Name in a stylised font.

(iii) The logo appertaining to each Brand Name.

(iv) Each Brand Name in combination with the logo appertaining to it.

(v) The get-up or trade dress of the products (including bottles and cans) and other packaging corresponding to or associated with each of the Brand Names, being the appearance of some or all of the above elements in combination on the products or other packaging.

(e) Each of the following elements used by SAPL in distribution and advertising, marketing or promotion of beverages produced by SAPL pursuant to the EBAs (see, eg [PepsiCo] EBA clauses 7, 11, 18 and 20; [SVC] EBA clauses 4.1, 5.3, 9 and 10)

(i) Each Brand Name.

(ii) The use of each Brand Name in a stylised font.

(iii) The logo appertaining to each Brand Name.

(iv) Each Brand Name in combination with the logo appertaining to it.

(v) Any artistic or other original copyright work, cinematograph film or sound recording that PepsiCo or SVC or their respective agents permit SAPL to use.

(vi) The shape and configuration of vending machines, dispensers, displays and other containers (eg promotional cups).

(vii) The get-up or trade dress corresponding to or associated with the Brand Names, being the appearance of some or all of the above elements in combination on vending machines, dispensers, displays and other aspects of distribution and advertising, marketing or promotion.

(f) The training manuals and documents and training assistance provided to SAPL's distribution team (see, eg [PepsiCo] EBA clauses 6, 8 and 9; [SVC] EBA clauses 4.1, 5.1, 5.2, 5.5 and 5.6).

(Footnote omitted.)

334 I note that there is no real issue between the experts as to the above definition of Relevant Items. Ms Wright adopted that definition in her reply report.

335 Mr Malackowski was instructed to assume that, under each of the EBAs, SAPL was not provided with access to any secret formulas, processes or trade secrets that may be used in the manufacture of the concentrate supplied to SAPL.

336 Mr Malackowski dealt with general and background topics in sections 6, 7, 8, 9 and 10 of his report. Mr Malackowski's detailed reasoning in relation to Questions 1 and 2 was set out in section 11 of his report.

337 He provided the following explanation of the relief from royalty methodology in section 11.1:

> The Relief from Royalty methodology is based on the following premise: a property's value can be measured by what the owner of the property would pay in royalties if it did not own the property and had to license it from a third party. Alternatively, this approach may also quantify the amount of income the owner would generate by licensing the intellectual property to others.
>
> This method requires the determination of projected royalty payments, which are derived by applying a royalty rate to an appropriate royalty base. Often the rate is a percentage applied to **net revenues** derived from products or services embodying the intellectual property. The royalty base is determined by projecting the expected revenues to be generated throughout the useful life of the intellectual property in question or throughout the relevant period being analyzed. It is worth clarifying that the determination of an appropriate royalty rate, and its application to the revenues of the licensed products to calculate royalty income, are only the first two steps of a Relief from Royalty analysis. The final step, calculating the present value of the IP assets by discounting the stream of royalty income payments to present day using an appropriate discount rate, was not necessary in this case and not performed by either Wright or myself.
>
> An appropriate royalty rate may be determined by examining actual transactions that have been negotiated between willing buyers (or licensees) and willing sellers (or licensors). Royalty rates are also often based on the amount of profits, cost savings, or other income associated with the asset being valued.
>
> A reasonable royalty with respect to IP is generally determined using the construct of a willing buyer and a willing seller. The transaction is evaluated in the context of the specific facts and circumstances faced at that time by the IP owner and the prospective licensee and considers the nature, strength, and other relevant qualities of the licensed IP.

338 In section 11.3.1, Mr Malackowski considered one internal agreement. For reasons he explained, Mr Malackowski did not rely on the royalty rate in that agreement. This method can therefore be put to one side.

339 It is convenient to refer to the balance of Mr Malackowski's analysis in the following way (consistently with the labels used by the parties during the course of the hearing):

(a) Malackowski Method 1 – Part 1;

(b) Malackowski Method 1 – Part 2; and

(c) Malackowski Method 2.

340 It should be noted that these methods are *cumulative*, in the sense that Mr Malackowski used the results of all of these methods in calculating a royalty rate.

Malackowski Method 1 – Part 1

341 In section 11.3.2, Mr Malackowski considered third-party agreements (in other words, licence agreements between third parties) (**Malackowski Method 1 – Part 1**). Mr Malackowski explained this method as follows:

> In addition to license agreements directly involving the PepsiCo entities, I considered third-party license agreements. In my search for comparable license agreements, I reviewed and analyzed royalty and license transaction data from ktMINE®, RoyaltySource®, and RoyaltyStat®. The ktMINE® and RoyaltyStat® databases are subscription-based databases that provide access to over 10,000 intellectual property documents. RoyaltySource® tracks intellectual property news and licenses related to technology (patent, know-how, trade secret, and business method), software, trademarks, trade names, brands or logos, copyrights and rights of publicity.
>
> (Footnotes omitted.)

342 In summary, this method involved searching for and considering comparable licence agreements to derive a royalty rate. As Mr Malackowski accepted during cross-examination, this method is substantially the same as Wright Method 3.

343 Mr Malackowski described the search queries he used and that those queries collectively resulted in over 1,000 results. He therefore filtered these down to the most relevant (explaining in his report the basis upon which he did so). He stated that that filtration process resulted in an initial agreement set of approximately 30 agreements. Mr Malackowski stated that he then reviewed these licence agreements in finer detail. He excluded agreements where management commentary indicated that the licensed brand's strength, sales or awareness were not comparable to the Relevant Items.

344 Mr Malackowski stated that the remaining licence agreements were reviewed in finer detail and the considered agreements were consolidated into a list of comparable agreements. These were selected on the basis of brand strength, agreement structure, and licensed intellectual property assets, among other considerations. Mr Malackowski stated that, ultimately, he relied upon a set of *18 comparable licence agreements* in his royalty rate determination (under his Method 1 – Part 1). Mr Malackowski stated that four of those licence agreements were *non-exclusive* (compared with the EBAs, which are exclusive licence agreements). Mr Malackowski therefore made an adjustment to the royalty rates under those four agreements. The adjustment was to double the royalty rate under those four agreements.

345 Mr Malackowski summarised the outcome of his Method 1 – Part 1 in Figure 17 of his report:

Figure 17
Royalty Rate Summary of Comparable Licenses

Royalty Rate Summary of Comparable Licenses			
	Adj. Low	Adj. High	Average
Min	1.0%	2.0%	1.5%
Average	4.0%	5.3%	4.7%
Median	3.0%	4.6%	3.8%
Quartile 3	5.0%	6.3%	5.6%
Max	10.0%	14.0%	12.0%

(Footnote omitted.)

346 During cross-examination in relation to his Method 1 – Part 1, Mr Malackowski was challenged on the exclusivity adjustment he had made with regard to four licence agreements that he considered to be non-exclusive. He maintained his opinion that this was appropriate, based on his experience.

347 During cross-examination, Mr Malackowski was taken to several of the licence agreements that he had characterised as non-exclusive (and therefore doubled the royalty rate). One of these was the Entenmann's Products, Inc/Coffee Holding Company, Inc licence agreement (CB tab 211), being the second licence agreement identified in Exhibit 5.1 to Mr Malackowski's report. Mr Malackowski accepted that, insofar as there is a licence to use the trademarks in the channels of distribution in relation to the products, it is exclusive (T434). On the basis of this answer, I consider that this agreement should have been classified as exclusive rather than non-exclusive for the purposes of Malackowski Method 1 – Part 1.

348 During cross-examination in relation to Method 1 – Part 1, it was put to Mr Malackowski that he should have *excluded* the agreements that he characterised as non-exclusive (rather than making an adjustment to the royalty rate) on the basis that they were fundamentally different

from the EBAs. He maintained his position that it was appropriate to include them, with adjustment.

349 During cross-examination in relation to his Method 1 – Part 1, Mr Malackowski was asked questions about his adoption of Quartile 3. Mr Malackowski responded that the dataset was comparable, but within that dataset there was a range and the valuation standards require the valuer to determine whether within that range is the best measure for the asset being valued. It was put to Mr Malackowski that by choosing Quartile 3 he had double-counted for brand strength because he was already dealing with a set of transactions involving comparable brands. Mr Malackowski did not accept this.

350 During cross-examination in relation to his Method 1 – Part 1, Mr Malackowski was taken to some transactions that he included in his set of transactions but Ms Wright (in her reply report) considered should be excluded. Mr Malackowski maintained his position that they were appropriately included.

351 I will give further consideration to Malackowski Method 1 – Part 1 in the section of these reasons headed "Determination of royalty rate".

Malackowski Method 1 – Part 2

352 In section 11.3.3 of his report, Mr Malackowski considered implied royalty rates from comparable transactions (**Malackowski Method 1 – Part 2**). Mr Malackowski explained this method as follows:

> In addition to my analysis of comparable license agreements, I also considered the implied royalty rates from public company comparable transactions. For this analysis, I relied on data from Markables. The Markables database collects public company transaction data and provides estimated implied royalty rates from enterprise-level transactions where value is allocated to trademarks. These implied rates are calculated using publicly-available financial data from transactions and the publicly disclosed purchase price allocation ("**PPA**") data reported by the company, along with independent assumptions by Markables about discount rates, tax rates, and revenue growth rates utilized in the PPA calculations. Based on my understanding of Markables' methodology in calculating implied royalty rates, I understand that the extent to which Markables exercises subjective judgment in arriving at its royalty rate conclusions is limited. Thus, I relied upon the royalty rates calculated by Markables without any modification.

353 Mr Malackowski clarified during cross-examination that his Method 1 – Part 2 relies on analyses carried out by Markables. In contrast, his Method 2 is based on publicly available data that is reported by Markables; it is not based on analyses carried out by Markables.

354 Mr Malackowski provided the following further description of the steps he undertook:

> In my search, I sought to identify transactions that included the right to use Tradenames/Trademarks in industries and segments similar to the Company (i.e., CSD, NCB, and other consumer packaged goods). Within the Markables database, I used product classification codes to filter Markables' agreements for those transactions most applicable to the Relevant Items. I relied upon the product classification code 231 for "Nonalcoholic Beverages," as it was determined to include the majority of the products covered by the Relevant Items.
>
> My search identified over 100 transactions. I reviewed the Markables produced descriptions of the acquired companies which provided product descriptions, company descriptions, and related industry commentary for each company to develop an understanding of its customer base, product offerings, and price positioning. Specifically, I excluded agreements that: …
>
> (Footnotes omitted.)

355 Mr Malackowski stated in his report that this refinement process resulted in a set of 32 comparable transactions. He stated that four comparable transactions reported royalty rates of above 25% of revenue. He excluded these four transactions from the royalty rates considered. This resulted in *28 comparable transactions* for the purposes of his Method 1 – Part 2. It is convenient to note here that Exhibit 6.0 to Mr Malackowski's report is a table with information from Markables about the 32 transactions referred to in this part of his report. The four transactions that were excluded from Malackowski Method 1 – Part 2 are the transactions that have "NM" (apparently standing for "not meaningful" – see note (1) at the end of Exhibit 6.0) in the columns headed "Low Range" and "High Range".

356 Mr Malackowski summarised the outcome of his Method 1 – Part 2 in Figure 18 of his report:

Figure 18
Summary of Comparable Markables Transactions

	Low	High	Average	Brand/EV
Min	0.2%	0.3%	0.2%	6.5%
Average	5.3%	7.5%	6.4%	40.4%
Median	3.7%	5.4%	4.5%	38.6%
Quartile 3	8.3%	11.9%	10.1%	50.7%
Max	16.7%	24.4%	20.5%	81.5%

> (Footnote omitted.)

I note that the information in the above table under the heading "Brand/EV" (Brand to Enterprise Value ratio) is relevant to Malackowski Method 2 (discussed below).

357 In relation to Malackowski Method 1 – Part 2, Mr Malackowski was taken during cross-examination to Exhibit 6.0 to his report. It was put to Mr Malackowski that none of the transactions from the Markables database that he had identified were comparable to the licences

of the Relevant Items by PepsiCo and SVC under the EBAs. He rejected that. He was asked whether he agreed that they were, in fact, *sales of enterprises* and not licences of trademarks. He accepted that the transactions were sales of enterprises. He noted that this included the sale of trademarks. Mr Malackowski accepted the following description of his Method 1 – Part 2: what he identified was not a comparable licence, but an estimate of an implied royalty rate for a hypothetical licence based on publicly available purchase price allocation data for business acquisitions.

358 During cross-examination in relation to Malackowski Method 1 – Part 2, Mr Malackowski accepted that some of what he had identified as comparable transactions may involve companies that have never licensed their intellectual property. Mr Malackowski said that this was "very much true because of the quality of those brands" and that his "intention was to include companies that have a brand of such quality that it's not likely that it was actually licensed". The following exchange took place:

> So, in that sense, the so-called implied royalty rate, you would agree, is a fiction?---Well, perhaps you can define your word "fiction". The implied royalty rate is the type of analysis that experts use and that I use when negotiating royalties outside of litigation. It's very common within our field. We would never describe it as a fiction.
>
> Hypothetical?---Hypothetical is a word we use in many contexts. I don't dispute that word. You asked me a moment ago.
>
> It doesn't purport to be a royalty rate recorded in any actual agreement?---**It is not represented to be a royalty rate that was embodied in an actual two-party agreement**. That's not the purpose of the analysis.
>
> (Emphasis added.)

359 During cross-examination in relation to Malackowski Method 1 – Part 2, Mr Malackowski was taken to one of the printouts from the Markables database forming part of his comparable transaction set. He was taken to the note regarding implied royalty rates, which states:

> Implied royalty rates must not be confounded with reported or effective royalty rates. Implied royalty rates are rates concluded by the appraiser to be appropriate to arrive at the reported trademark value under certain likely assumptions. Such assumptions include revenue growth rates, discount rates, and tax rates. MARKABLES calculates implied royalty rates in a cautious and in an optimistic scenario, by applying different assumptions of discount rates and growth rates to future revenues. These two scenarios represent the first and third quartile range of assumptive valuation parameters typically observed in PPAs and trademark valuations. For a detailed explanation of implied royalty rates, please go to the glossary page on www.markables.net. The link to the glossary is on the top right in any of your project folders.

The following exchange then took place:

> So, Mr Malackowski, not only is this a hypothetical rate, I think you've acknowledged in your report that it is also an estimate based on the subjective judgment and assumptions made by people working for Markables?---**So the implied analysis is a calculation by Markables.** I don't know your meaning of "subjective". It's the type of analysis that experts do frequently. The Markables data is well understood and relied upon when I or others calculate relief from royalty, so there is a disclaimer here in a footnote but I don't think that makes it subjective to the point of not reliable.
>
> Well, Mr Malackowski, you state in your report that it's subjective, don't you?---I don't dispute the term. In fact, I probably cite this very footnote. But I don't believe that it's therefore not reliable. It's the exact type of evidence that I rely and others rely upon in doing this work.
>
> (Emphasis added.)

360 Mr Malackowski accepted during cross-examination in relation to Malackowski Method 1 – Part 2 that the Markables data was said to be based on purchase price allocation data in the public domain. He said that he had not examined the underlying purchase price allocation data in all cases. He said that he assumed that Markables had correctly reported the data and he thought that was a fair assessment.

361 During cross-examination, Mr Malackowski was taken to an extract from the Markables website with the heading "Legal" on the first page of the printout (SCB tab 323). The document stated on page 4:

> Our Content is based on publicly available data from the financial reporting of public companies, from corporate press releases, from websites and from other information in the public domain, which we deem reliable sources. TCAG may make modifications and/or changes in this Site or in the Content at any time and for any reason. Our Content is updated on a regular basis. TCAG endeavors to provide the most accurate, up-to-date, reliable and complete Information through this Site. However, it is expressly stated that any Information through this Site is provided on an "as is" and "as available" basis. No guarantees or assurances can be made to the accuracy or completeness of any information provided or our Content.

362 It was put to Mr Malackowski during cross-examination that, if he were to be taken to any one of the comparable transactions upon which he relied (for his Method 1 – Part 2), he could not say whether the information was sourced from company accounts, a press release or a commentator's website. He said the information was based on the best available data and the type of data that experts routinely use. He said that, without going to the Form 10K during the year of the transaction, he could not say. He indicated that he had gone to the Form 10K in some cases, but not others. The following exchange took place:

> So, Mr Malackowski, where Markables deem something to be a reliable source, you are unable to tell his Honour, in your professional opinion, whether you agree with

> that?---I disagree. Your Honour, in my professional opinion, experts doing this type of relief from royalty analysis routinely rely upon, and accept as reliable, Markables data as well as data from the royalty databases we discussed. Is it possible that there is an error or discrepancy? Of course. If there was, it would attempt to be corrected. You would think that correction from an agreement would update over time. I know of no errors in what I've used.

363 During cross-examination, and in relation to his Method 1 – Part 2, Mr Malackowski was taken to an extract from the Markables website headed "Glossary trademarks – explanations and definitions" (SCB tab 322) (**Markables Glossary**) and the definition of "royalty rate implied" on page 6. The first paragraph reads:

> Please note that the implied royalty rate is not an effective royalty rate. The implied royalty rate is a rate which the appraiser likely applied under the royalty relief method. MARKABLES calculates the implied royalty rate by retrogressively applying the royalty relief method on revenues to arrive at the trademark value. This retrogressive calculation requires the assumption of certain valuation parameters, such as revenue growth, discount rate, and taxation which the appraiser of the trademark might have used in his original valuation.

364 Mr Malackowski accepted that Markables was here assuming that the appraiser (the person who did the original purchase price allocation) applied a royalty relief method to work out the reported value of the trademark. Mr Malackowski accepted that Markables tries to work backwards from the reported trademark value using revenues to re-engineer a royalty rate which it says the appraiser likely used. He accepted that, in undertaking that exercise, Markables has to make a number of assumptions.

365 Mr Malackowski accepted that the first step in that exercise was to work out current revenues. Mr Malackowski was taken to the definition of "revenues" in the Markables Glossary. This included a statement that revenue figures can be reported as audited, non-audited pro-forma, or non-audited from press releases or analyst estimates. Mr Malackowski accepted that he did not know the particular source relied upon by Markables to work out the revenues in any given case. He said he relied on Markables as an accurate source.

366 Mr Malackowski was taken to the definition of "scenario" in the Markables Glossary. The definition (or description) was:

> For the majority of trademark values, the underlying assumptions regarding growth and discount rates are not reported. Therefore, MARKABLES estimates these estimates by applying the scenario method. When calculating implied royalty rates, MARKABLES applies two scenarios, cautious and optimistic (see there). These scenarios relate to the risk of future cash flows as perceived by the appraiser. The two scenarios capture the 25% to 75% range of likely assumptions on a risk scale. The frequency distribution of appraisers' assumptions on that scale is derived from nearly 2,000 cases where the underlying assumptions are reported.

367 Mr Malackowski accepted that, under the method described in that extract, Markables is generally making assumptions about what the appraiser's perception was of the risk of future cashflows. Mr Malackowski accepted that, in the subsequent definitions of "scenario, cautious" and "scenario, optimistic", the scenarios themselves involve assumptions about combinations of revenue growth and discount rates that might have been applied by an appraiser. He said that he relied on Markables "as a regarded third party expert firm" for these purposes. He said that he relied upon the conclusion of Markables and the analysis they prepared "as an expert firm within our industry".

368 Mr Malackowski was taken during cross-examination to the second paragraph in section 11.1 of his report (see [337] above), which referred to a final step of calculating the present value of the IP assets by discounting the stream of royalty income payments to present day using an appropriate discount rate. In the context of the Markables implied royalty rates, Mr Malackowski accepted that the final step was determined by the purchase price allocator, and this was the first item that Markables started with; Markable then reverse-engineered from that number back to a royalty rate.

369 The following exchange occurred during cross-examination in relation to Malackowski Method 1 – Part 2:

> Mr Malackowski, do you consider yourself a professional valuer?---Yes, sir.
>
> Are you able to confirm to his Honour whether, in your professional opinion, you agree with the judgments and assumptions made by Markables in arriving at the so-called implied royalties?---Your Honour, yes, in the sense that I recognise them, as do my peers, as do peer reviewed journals, as the best available evidence and the type of evidence that is relied upon to determine royalty rates in and outside of litigation.

370 Mr Malackowski was taken during cross-examination to the IVS at page 33 (dealing with valuation approaches and methods). The following exchange occurred:

> Mr Malackowski, I suggest you have not evaluated the various assumptions made by Markables because you don't know what they are?---Well, I would disagree with you. I think that Markables makes clear the range of assumptions that they use. Their selection within that relatively narrow range is something that I can test as an expert through the alternative approaches. And it is the type of analysis that is accepted in our industry.

371 Mr Malackowski accepted that, insofar as the estimated implied royalties have been calculated by Markables on the basis of purchase price allocation data relating to sales of companies, the purchase price allocation is an exercise carried out by one party to the transaction, namely the purchaser. He added that it was informed by the totality of the transaction. Mr Malackowski

accepted that it was generally done for their own accounting purposes. He added that it was generally done by their external accountant, reviewed by management and then auditors.

372 During cross-examination in relation to Malackowski Method 1 – Part 2 , it was put to Mr Malackowski that there was a significant difference in the royalty range produced by his Method 1 – Part 1 (1.0% to 14.0%) compared to his Method 1 – Part 2 (0.2% to 24.4%). The following exchange occurred:

> Now, Mr Malackowski, shouldn't this have raised alarm bells for you?---No. In fact, your Honour, it confirms that the reason the Markables dataset is so important here is because we are dealing with one of the most valuable brands in the world, and those are brands that are not typically licensed and available in the RoyaltySource type agreement. So the difference was noted of course but no alarm bells were expected.

373 In my view, there are significant difficulties with accepting Malackowski Method 1 – Part 2 for the purposes of determining a royalty rate in these proceedings. This method does not rely on analysis conducted by Mr Malackowski himself, but rather on analysis conducted by a third party (Markables). The steps taken by Markables involve making a number of assumptions that are not detailed in the material before the Court and cannot be tested. Further, the exercise conducted by Markables to derive an implied royalty rate takes as its starting point the purchase price allocations prepared by an appraiser (such as an external accountant of the purchaser). These figures were prepared for other purposes and were based on a number of assumptions that are not before the Court and cannot be tested. Thus, the Markables implied royalty rates are the product of *two* levels of analysis, each of which involves the making of assumptions that are not before the Court. I accept that the Markables database is commonly used by commercial parties as the basis or reference point for negotiating royalty rates. However, that is a different exercise to the one that needs to be conducted by the Court in this case. For the reasons indicated, I do not consider that implied royalty rates calculated by Markables provide an appropriate basis to determine a royalty rate for present purposes.

Outcome of Malackowski Method 1

374 In section 11.5 of Mr Malackowski's report, he stated how he arrived at a royalty rate under Method 1 (both parts):

> My first method for determining an appropriate royalty rate consists of an analysis of the comparable observed and implied royalty rates described in Sections 11.3.2 and 11.3.3 [i.e. Method 1 – Part 1 and Method 1 – Part 2]. **In consideration of the strength of the Relevant Items in comparison to the brands included in the identified transactions, I relied upon the average of the third (upper) quartiles of these agreement sets in my determination of an appropriate royalty rate for the Pepsi,**

> **Mountain Dew, and Gatorade brands**. Based on my calculations, the average of the third quartiles results in an indicated royalty rate for the brands of approximately 7.9%.
>
> (Emphasis added.)

375 As detailed in Exhibits 4.2, 4.3 and 4.4 to Mr Malackowski's report, for the Pepsi, Mountain Dew and Gatorade brands, Mr Malackowski adopted the following figures:

(a) the average for Quartile 3 under Method 1 – Part 1 (5.6% – see Figure 17, quoted above); and

(b) the average for Quartile 3 under Method 1 – Part 2 (10.1% – see Figure 18, quoted above).

He then averaged those two figures to produce a royalty rate of 7.9% for the Pepsi, Mountain Dew and Gatorade brands under Method 1.

376 I note for completeness that Mr Malackowski did not adopt Quartile 3 for the Propel brand, but that brand is not relevant for present purposes.

Malackowski Method 2

377 In section 11.3.5 of his report, Mr Malackowski considered royalty rates from merger and acquisition transactions and value allocations (**Malackowski Method 2**). Mr Malackowski explained this method in his report as follows:

> In addition to my review of comparable license agreement[s] and implied royalty rates from public company transactions, I also considered the profit splits implied by the value allocated to brand assets in each of the transactions identified by Markables. Markables estimates the percentage of enterprise profit allocated to the brand assets of the acquired business based on purchase price allocation data. The allocation of profits, or the "profit split," provides a proxy for the share of profits that would be negotiated between the owner of an intellectual property asset (the licensor) and a licensee. The profit split is a consideration when assessing the reasonableness of a selected royalty rate. The Brand/EV ratio calculated by Markables provides insight into the range of enterprise profit that is allocable to the brand assets in each comparable transaction. Markables describes the profit split as follows:
>
>> Purchase price allocations provide meaningful data to perform profit split analyses…Values reported in a purchase price allocation represent the present value of future profits they are expected to generate. The ratio of a specific intangible to enterprise value is the profit split which this intangible is expected to contribute to total profits.
>
> (Footnote omitted.)

378 During cross-examination, Mr Malackowski provided the following clarification of his Method 2:

… Mr Malackowski, I will turn now to the method 2, the profit split methodology. This methodology is also based on data from Markables?---Yes and no. I think there's some confusion Ms Wright has about my use of this and I want to be clear. Method 2 is a dataset that is 100 per cent based on purchase price allocation [from] publicly available information. Markables happens to be an aggregator of that but it is not their data: they simply aggregate that information.

379 In other words, as noted above, Malackowski Method 2 relies on publicly-available data that is reported by Markables; it does not rely on analyses conducted by Markables.

380 In his report, Mr Malackowski provided the following further description of the steps he took:

I created a series of summary statistics for the Brand/EV ratio **using the same transaction set utilized in Section 11.3.3**. In reviewing these transactions, it is important to recognize that the majority of the transactions included in the Markables data were companies with brands that possess less brand strength, scale, and recognition than the Relevant Items for PepsiCo.

(Emphasis added.)

381 Mr Malackowski provided the following summary of the outcome of his Method 2 in Figure 20 of his report:

Figure 20
Summary of Brand Apportionment (Profit Splits) in Comparable Markables Transactions

	Brand/EV
Min	6.5%
Average	40.4%
Median	38.6%
Quartile 3	50.7%
Max	81.5%

(Footnote omitted.)

382 In section 11.3.5.2 of his report, Mr Malackowski stated that he was not provided with SAPL's Earnings Before Interest and Tax (**EBIT**) margin in connection with sales under the EBAs. He noted that, as a proxy, Ms Wright had calculated (under her Method 4) an average EBIT margin for Asahi Holdings from FY18 to FY20 of 9.6%. Mr Malackowski stated that he considered this reasonable and adopted the same profitability assumption in his analysis for his Method 2.

383 In section 11.5.2, Mr Malackowski provided the following further description of the steps he took under his Method 2:

As described in Section 11.3.3, the acquiror of a business is required to allocate the acquisition purchase price of the enterprise to the acquired assets. This allocation includes an allocation of the enterprise value to the brand assets; and the amount of enterprise value allocated to the brand represents the portion of total enterprise profitability, or the implied profit split, attributable to those assets. Based on the provided data, I used Markables to identify comparable transactions and their respective Brand/EV ratios (i.e., profit splits) to determine an implied royalty rate from the estimated profitability of the bottler.

> I began with an analysis of the profitability of the bottler. As described in Section 11.3.5.2, **I relied upon Asahi Holdings' calculated historical EBIT of 9.6% to estimate the profitability of SAPL**. I've been instructed to assume the EBA Payments includes an implied royalty for the use of the brands, thus the EBIT of 9.6% is a profitability figure net of payments for the use of the Relevant Items. That is, it includes the implied cost of royalty payments for the use of the brand assets. **Because the reported EBIT number is net of brand royalty payments, I added back the assumed royalty payments to EBIT to arrive at a "Grossed-Up EBIT" for the purposes of this analysis**.
>
> In considering the brand strength of the Relevant Items as compared to the strength of comparable transactions, **I have relied upon the third quartile of the Markables transaction set in my determination of a Grossed-Up EBIT and implied royalty for the Pepsi, Gatorade, and Mountain Dew brands. The third quartile Brand/EV ratio is 50.7%**, which implies the reported EBIT of 9.6% represents only 49.3% of enterprise profit before implied royalty payments for the brands. **Grossing up the EBIT results in a pre-royalty implied EBIT of 19.5%. Applying the upper quartile Brand/EV ratio results in an implied profit split royalty of 9.9% for the Gatorade, Pepsi, and Mountain Dew brands.**
>
> (Footnotes omitted; emphasis added.)

384 In summary, in relation to the Pepsi, Mountain Dew and Gatorade brands, Mr Malackowski adopted the figure for Quartile 3 (a Brand/EV ratio of 50.7%) for the purposes of calculating a royalty rate under his Method 2. This produced a royalty rate of 9.9% for the Pepsi, Mountain Dew and Gatorade brands under his Method 2.

385 During cross-examination, Mr Malackowski gave the following evidence about the steps involved in his Method 2:

> So you have taken the values assigned to trademarks for purchase price allocation purposes as reported by Markables?---As aggregated by Markables, yes.
>
> Well, Mr Malackowski, you keep saying "aggregated" but you took the numbers from the Markables database, didn't you?---Correct, but without any adjustment from them, the third party publicly available data.
>
> You didn't go to the third party publicly available data. You used the numbers from Markables. So when I say "reported by Markables", I mean numbers published by Markables. That's what you took?---True.
>
> Thank you. You took the values assigned to trademarks for purchase price allocation purposes and divided that by the overall enterprise value of those companies?---True.
>
> As reported by Markables?---Correct.
>
> And you have called that the Brand to EV ratio?---Correct.
>
> And you have treated that ratio as an indicator of the proportion of profits derived by the acquired company that are attributable to its trademarks?---Correct.
>
> And you have worked out the trademark to enterprise value ratios for each of the 32 companies that you used for your implied royalty analysis?---Yes. The data comes

> again right from the Markables. But, yes, I have it for all of them.
>
> Sorry, could you repeat that?---I said the data comes from the Markables reports for all the companies.
>
> Yes. And you have taken the third quartile of that dataset which was a ratio of 50.7 per cent?---Correct.
>
> So Brand to EV ratio of 50.7?---Correct.
>
> And you have applied that to the EBIT of Asahi Holdings?---As determined by Ms Wright, correct.
>
> Yes. There's a proxy for SAPL?---Generally, yes.
>
> Because you were unable to work out the EBIT of SAPL?---Because the EBIT of SAPL was not provided to my knowledge.

386 Mr Malackowski confirmed during cross-examination that the way he did that was to apply the ratio of 50.7% to the EBIT of Asahi Holdings (as proxy for SAPL). This involved taking Asahi Holdings' EBIT of 9.6% and grossing this up to 19.5%, on the hypothesis that the 19.5% would represent profitability before such payment. He said that he then took 50.7% of that amount, being 9.9%.

387 Mr Malackowski accepted during cross-examination that, to the extent that his Method 2 relies on the value assigned to trademarks, it again relies on the assumptions made by the appraiser preparing the purchase price allocations. Mr Malackowski said that the purchase price allocations are generally based on the relief from royalty method. He said that this in turn was almost invariably based on actual licence agreements.

388 During cross-examination in relation to his Method 2, Mr Malackowski was asked questions as to why he chose to adopt Quartile 3. He accepted that this was based on his assessment of the strength of the brands under consideration. He said he believes there is a correlation between a strong brand and a higher Brand to EV ratio. It was put to him that he had not set out any empirical or quantitative analysis to establish such a relationship in his report. He accepted that he had not quantified such a relationship, but he believed his report did document that the higher quality brand would generate elements of value such as revenue, profitability and price premium.

389 During cross-examination in relation to his Method 2, Mr Malackowski was taken to Exhibit 6.0 to his report. As noted above, this exhibit provides information from Markables about 32 transactions. By reference to a number of examples, it was put to him that there was no significant correlation between brand strength and Brand to EV ratio. He did not accept this.

Mr Malackowski did accept that matters internal to the company, such as the nature of its business and its assets, play a role in the Brand to EV ratio.

390 Mr Malackowski said during cross-examination that he thought his adoption of Quartile 3 for Method 2 was "conservative" as the "relevant items here in the brand are amongst the most valuable in the world".

391 It was put to Mr Malackowski during cross-examination that, for the purposes of his Method 2, he had *not* excluded the four transactions that he had excluded for his Method 1 – Part 2 (see [355] above). The context for this question was that, in Exhibit 6.0 to Mr Malackowski's report, while the four transactions that were excluded for the purposes of Malackowski Method 1 – Part 2 have the letters "NM" in the columns headed "Low Range" and "High Range", they *do have a value* in the column headed "Brand/EV" (the column relevant to Malackowski Method 2). Mr Malackowski said his understanding was that the four transactions *were* excluded for the purposes of his Method 2. He referred to page 68 of his report, where he described the data used for the EV analysis (i.e. Method 2). He noted that in the first full paragraph on that page (set out at [380] above) he stated that he used the same transaction dataset as for section 11.3.3 (i.e. Method 1 – Part 2). The matter was not taken further during cross-examination. However, during closing submissions, senior counsel for the PepsiCo parties handed up an "aide memoire" that contained: (a) a copy of Exhibit 6.0 to Mr Malackowski's report without any changes; (b) a version of Exhibit 6.0 in which, for the four transactions, the letters "NM" (rather than a value) appeared in the column headed "Brand/EV". In the revised version of Exhibit 6.0, the outcomes were different. It was submitted that this demonstrated that Mr Malackowski *had used* the data from all 32 transactions in his calculations under his Method 2. Senior counsel for the Commissioner accepted this during closing submissions (T602). In light of this, I find that, for the purposes of his calculations under Method 2, Mr Malackowski *did use* data in relation to all *32 transactions* identified in Exhibit 6.0 (including the four transactions that he excluded under his Method 1 – Part 2).

392 During cross-examination in relation to Malackowski Method 2, and specifically Figure 20 (showing a Brand/EV range from 6.5% to 81.5%), it was put to Mr Malackowski that the range was so large as to render it meaningless as a way of calculating a hypothetical royalty rate for the EBAs. Mr Malackowski said he certainly disagreed. He said the range was reflective of

the impact that a brand can have on the business, and so it is appropriate to consider the totality of the dataset.

393 During cross-examination, in response to questions about the grossing up from 9.6% to 19.5%, Mr Malackowski said that the starting point that he adopted from Ms Wright was that the 9.6% represents a fair proxy for SAPL for the brands at issue. He said that everything else relating to Asahi Holdings could then be separated (that is, put to one side). It was put to him that he had taken a figure of 9.6% based on Asahi Holdings, which includes profits on brands where it was not paying a royalty, and grossed that figure up in its entirety, and this was a source of upward bias. Mr Malackowski did not accept this. He said he tested it by looking at a number of other bottling companies and this confirmed the reasonableness of the 9.6% figure.

394 In my view, there are significant difficulties in accepting Malackowski Method 2 as a basis for calculating a royalty rate for the purposes of these proceedings. The starting point for the analysis is the purchase price allocations prepared by appraisers (such as external accountants for purchasers of enterprises). Those figures were prepared for other purposes and were based on a number of assumptions that are not before the Court and cannot be tested. In these circumstances, I am not satisfied that the figures provide a sound basis for the calculation of a royalty rate for present purposes. I therefore do not rely on Malackowski Method 2 for the purposes of determining a royalty rate.

Outcome of Malackowski Methods 1 and 2

395 Section 11.6 of Mr Malackowski's report contains his overall royalty rate conclusions, based on his Methods 1 and 2. In summary, Mr Malackowski averaged the outcome under Method 1 and the outcome under Method 2 to produce an overall outcome. He explained this in his report as follows:

> I relied on an average of the two methodologies described above to calculate a fair and reasonable royalty rate for each of the Relevant Items. I consider the average, which weighs each of the two methods equally, to be appropriate given the fact that each method offers a slightly different, yet complementary perspective. For example:
>
> - Method 1 includes consideration of the range of market royalty rates from the comparable license agreements as well as the range of implied royalty rates calculated by Markables (a third-party) which are derived from the enterprise transactions. The enterprise transactions also represent a second data source from which to analyze the contribution of IP to a business.
> - Method 2 incorporates the profit split method which explicitly factors in the expected profitability of the Bottler. This is important, as licensee profitability is a consideration in the determination of a royalty rate.

The benefit of approaching the quantitative royalty rate analysis through two different, yet related and complementary methods is that one is able to triangulate in on the most appropriate rate. The methods also serve as an important reasonableness check of each other, and the overall analysis. Arriving at similar rates using different methodologies ultimately provides greater comfort and support for the final figures. My findings are summarized in Figure 21 below.

Figure 21
Net Sales Royalty Rate Summary by Brand

Brand	Royalty Rate
Pepsi	9.0%
Gatorade	8.5%
Mountain Dew	8.5%
Propel	5.0%

Based on my knowledge and understanding of the Relevant Items and the respective industries in which they operate, I believe these royalty rates to be reasonable.

(Footnotes omitted.)

396 The reason why the figure for Pepsi (9.0%) is different from the figures for Gatorade and Mountain Dew (both 8.5%) is provided in the notes in Exhibits 4.2, 4.3 and 4.4 to Mr Malackowski's report. For all three brands, the conclusion under Method 1 and the conclusion under Method 2 were the same (7.9% and 9.9% respectively). The average was the same for all three brands: 8.87%. In the case of Pepsi, Mr Malackowski considered it appropriate, given the high brand strength and sales, to round this figure up to 9.0%. However, in the cases of Gatorade and Mountain Dew, he considered it appropriate to round the figure down to 8.5% to account for the lower brand strength and sales relative to the Pepsi brand.

397 Section 12 of Mr Malackowski's report contained his calculation of the royalty amounts based on the royalty rates he had calculated. That section included:

Based on the calculated royalty rates and provided net sales for the Relevant Items, my calculations for total consideration are summarized in Figure 24 below.

[Figure redacted]

Total consideration is calculated to be $[redacted] AUD. This payment represents approximately 30% of Payments made by the SAPL to the concentrate manufacturer, as calculated by reference to the Payment figures detailed in Section 10.3. Based on my understanding of the Relevant Items and their roles within their related industries, I find this allocation to be reasonable.

(Footnote omitted.)

398 As noted above, in the first letter dated 2 March 2023 (CB tab 275), Mr Malackowski, having reviewed Ms Wright's reply report, accepted that two licence agreements that he had included

in his set of comparable agreements (for his Method 1 – Part 1) were related-party agreements. He accepted that they should be excluded and provided revised calculations on that basis. The effect is to change the average for Quartile 3 from 5.63% (rounded to 5.6% in Figure 17, set out above) to 5.88%.

Determination of royalty rate

399 For the reasons given above, I put to one side Wright Methods 1, 2 and 4. I also put to one side Malackowski Method 1 – Part 2 and Malackowski Method 2. This leaves Wright Method 3 and Malackowski Method 1 – Part 1. As noted above, these methods are substantially the same. Both involve an assessment of an appropriate royalty rate based on identifying and considering comparable licence agreements.

400 Broadly, I prefer the analysis of Mr Malackowski under his Method 1 – Part 1 to that of Ms Wright under her Method 3. Mr Malackowski has considerably more experience in relation to the valuation of intellectual property rights. I consider his evidence to be persuasive as to why he did, or did not, include certain licence agreements in his set of comparable agreements. Mr Malackowski maintained his position in this regard during cross-examination and provided cogent reasons for the approach he took in deciding which transactions to include or not include.

401 Insofar as Mr Malackowski adopted the average of Quartile 3, I accept that this is reasonable given the strength of the relevant brands, a point emphasised by Mr Malackowski in his written and oral evidence. I do not accept that this involves double-counting. The set of comparable transactions contains within it a range. It is appropriate, given the strength of the Pepsi, Mountain Dew and Gatorade brands, to adopt the average of Quartile 3.

402 Insofar as Mr Malackowski made an exclusivity adjustment for four licence agreements, subject to one exception I consider this to be appropriate, for the reasons given by Mr Malackowski. The one exception is the Entenmann's Products, Inc/Coffee Holding Company, Inc licence agreement. For the reasons given at [347] above, I consider that this agreement should have been classified as exclusive rather than non-exclusive for the purposes of Malackowski Method 1 – Part 1. Accordingly, I consider that the agreement should not have been the subject of an adjustment.

403 In Mr Malackowski's report, his conclusion under his Method 1 – Part 1 was that the royalty rate for the Pepsi, Mountain Dew and Gatorade brands was 5.6% (being the average for

Quartile 3 in Figure 17, set out above). In other words, on the assumption that a portion of the payments made by SAPL under the EBAs was for the Relevant Items, he concluded that the extent of the payments related to the Relevant Items would be 5.6% of SAPL's net revenue from sales of the relevant products. In the first letter dated 2 March 2023 (CB tab 275), the figure of 5.6% was revised to 5.88%.

404 It follows from the above, that, subject to the matter discussed at [402] above, I accept the figure of 5.88% provided by Mr Malackowski under his Method 1 – Part 1. This figure needs to be revised (downwards) in light of the matter discussed at [402] above. I assume that it will be possible for the parties to agree on a revised figure. It would appear to be a mathematical exercise based on material already in evidence.

Issue (3): diverted profits tax

Overview

405 In light of the conclusion reached above in relation to the royalty withholding tax issue, it is unnecessary to consider the diverted profits tax issue. However, I consider it appropriate to consider this issue for the sake of completeness.

406 The Commissioner's diverted profits tax case is predicated on the royalty withholding tax provisions *not* applying. Therefore, in this section of my reasons, I will proceed on the assumption that (contrary to the conclusion I have reached above), the royalty withholding tax provisions *do not apply*. This could be because any one or more of the sub-issues discussed under issue (1) above were decided differently.

407 The Commissioner's alleged "scheme" in relation to PepsiCo is set out in paragraph 67 of his amended appeal statement in VID 53 of 2022 (see [32] above). A comparable scheme is alleged in relation to SVC in the relevant amended appeal statements. In summary, in each case, the alleged scheme is entry into the relevant EBA on terms whereby no royalty was paid for the use of intellectual property. There is no real issue between the parties about the identification of the scheme.

408 The key issues to be determined in relation to diverted profits tax are:

(a) whether PepsiCo or SVC (as applicable) obtained a *tax benefit* in connection with the scheme for the purposes of s 177J(1)(a) of the ITAA 1936; and

(b) whether it would be concluded, having regard to the matters in s 177J(2) of the ITAA 1936, that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a *principal purpose* of, or for *more than one principal purpose that includes a purpose* of:

(i) enabling the relevant taxpayer (here, PepsiCo or SVC, as applicable) to obtain a tax benefit, or both obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or

(ii) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the scheme.

409 The Commissioner alleges that each of the other elements of the diverted profits tax provisions (set out in s 177J(1)(c) to (g)) is satisfied in the present case, and the PepsiCo parties do not put in issue any of those elements for the purposes of these proceedings. They can, therefore, be put to one side.

410 I will first set out the applicable provisions, and then address the two key issues.

Applicable provisions

411 The principal diverted profits tax provisions are ss 177H-177R, which are located in Pt IVA of the ITAA 1936. These provisions utilise some of the pre-existing provisions of Pt IVA, in particular ss 177C, 177CB and 177D.

412 The diverted profits tax provisions were introduced by the *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017* (Cth). They apply in relation to DPT tax benefits (see below) for an income year that starts on or after 1 July 2017 (whether or not the DPT tax benefit arises in connection with a scheme that was entered into, or was commenced to be carried out, before 1 July 2017): *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017*, Sch 1, item 52.

413 The background to and context of the diverted profits tax provisions are explained in chapter 1 of the Revised Explanatory Memorandum (Senate) for the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017 (Cth) (the **2017 Explanatory Memorandum**).

414 I note that the US DTA does not have a role to play in relation to the diverted profits tax part of the case, as Pt IVA is 'carved out' of s 4(2) of the *International Tax Agreements Act*.

415 I will set out the relevant provisions of the ITAA 1936 based on the version of the legislation in force on 1 July 2017. It does not appear there were any relevant amendments during the relevant years.

416 Section 177A (dealing with interpretation) relevantly provided:

> (1) In this Part, unless the contrary intention appears:
>
> …
>
> ***DPT base amount*** has the meaning given by subsection 177P(2).
>
> ***DPT provisions*** means sections 177H, 177J, 177K, 177L, 177M, 177N, 177P, 177Q and 177R.
>
> ***DPT tax benefit*** has the meaning given by subsection 177J(1).
>
> …
>
> ***scheme*** means:
>
> (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
> (b) any scheme, plan, proposal, action, course of action or course of conduct.

417 Section 177C dealt with *tax benefits* and relevantly provided:

> (1) Subject to this section, a reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:
> …
> (bc) the taxpayer not being liable to pay withholding tax on an amount where the taxpayer either **would have, or might reasonably be expected to have**, been liable to pay withholding tax on the amount if the scheme had not been entered into or carried out;
> …
> and, for the purposes of this Part, the amount of the tax benefit shall be taken to be:
> …
> (g) in a case to which paragraph (bc) applies—the amount referred to in that paragraph.
>
> (Emphasis added.)

The effect of s 177C(1)(g) is that, if there is a tax benefit in circumstances where a taxpayer is not liable to pay royalty withholding tax on an amount, the amount of the tax benefit is the entire royalty amount.

418 Section 177CB (which dealt with the bases for identifying tax benefits) provided in part:

(1) This section applies to deciding, under section 177C, whether any of the following (***tax effects***) would have occurred, or might reasonably be expected to have occurred, if a scheme had not been entered into or carried out:

…

(e) the taxpayer being liable to pay withholding tax on an amount.

(2) A decision that a tax effect **would have occurred** if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme).

(3) A decision that a tax effect **might reasonably be expected to have occurred** if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.

(4) In determining for the purposes of subsection (3) whether a postulate is such a reasonable alternative:

(a) have particular regard to:

(i) the substance of the scheme; and

(ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act); but

(b) disregard any result in relation to the operation of this Act that would be achieved by the postulate for any person (whether or not a party to the scheme).

(5) Subsection (4) applies in relation to the scheme as if references in that subsection to the operation of this Act included references to the operation of any foreign law relating to taxation:

(a) if this Part applies to the scheme because of section 177DA or 177J; or

(b) for the purposes of determining whether this Part applies to the scheme because of section 177DA or 177J.

(Emphasis added.)

419 Section 177CB was introduced by the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth). The background to and context of the changes made by that Act are discussed in *Minerva Financial Group Pty Ltd v Commissioner of Taxation* [2022] FCA 1092 at [254]-[261]. See also chapter 1 of the Explanatory Memorandum (House of Representatives) for the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 (Cth) (the **2013 Explanatory Memorandum**).

420 Although s 177CB uses the expression "postulate", in these reasons I will adopt the expression "counterfactual" for the same concept.

421 Section 177D(1) is not relevant for present purposes. It is necessary to set out s 177D(2), as this is referred to in the diverted profits tax provisions. Section 177D(2) provided:

(2) For the purpose of subsection (1), have regard to the following matters:

(a) the manner in which the scheme was entered into or carried out;
(b) the form and substance of the scheme;
(c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
(d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
(e) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
(f) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
(g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;
(h) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f).

Note: Section 960-255 of the *Income Tax Assessment Act 1997* may be relevant to determining family relationships for the purposes of paragraphs (f) and (h).

422 Section 177H provided:

177H Diverted profits tax—objects

(1) The primary objects of the DPT provisions are:

(a) to ensure that the Australian tax payable by significant global entities properly reflects the **economic substance of the activities** that those entities carry on in Australia; and

(b) to prevent those entities from reducing the amount of Australian tax they pay by diverting profits offshore through **contrived arrangements** between related parties.

(2) In addition, the DPT provisions (in combination with Division 145 in Schedule 1 to the *Taxation Administration Act 1953*) have the object of encouraging significant global entities to provide sufficient information to the Commissioner to allow for the timely resolution of disputes about Australian tax.

(Emphasis added.)

423 Section 177J relevantly provided:

177J Diverted profits tax—application

Scheme for a purpose including obtaining a tax benefit etc.

(1) This Part also applies to a scheme, in relation to a tax benefit (the ***DPT tax benefit***) if:
(a) a taxpayer (a ***relevant taxpayer***) has obtained, or would but for section 177F obtain, the DPT tax benefit in connection with the scheme, in a year of income; and
(b) it would be concluded (having regard to the matters in subsection (2))

that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:

(i) enabling the relevant taxpayer to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or

(ii) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the scheme;

whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers; and

…

Have regard to certain matters

(2) For the purposes of paragraph (1)(b), have regard to the following matters:

(a) the matters in subsection 177D(2);

(b) without limiting subsection 177D(2), the extent to which non-tax financial benefits that are quantifiable have resulted, will result, or may reasonably be expected to result, from the scheme;

(c) the result, in relation to the operation of any foreign law relating to taxation, that (but for this Part) would be achieved by the scheme;

(d) the amount of the tax benefit mentioned in paragraph (1)(b).

424 Sections 177N and 177P provided:

177N Diverted profits tax—consequences

If this Part applies to a scheme because of section 177J:

(a) section 177P applies to the relevant taxpayer mentioned in section 177J; and

(b) the Commissioner cannot make a determination under subsection 177F(1) or (2A) in relation to the scheme merely because of section 177J.

177P Diverted profits tax—liability

(1) The relevant taxpayer is liable to pay tax at the rate declared by the Parliament on:

(a) if this Part applies to a scheme in respect of the relevant taxpayer for the year of income mentioned in paragraph 177J(1)(a), in relation to one DPT tax benefit—the DPT base amount for that DPT tax benefit; or

(b) if this Part applies to a scheme in respect of the relevant taxpayer for the year of income mentioned in paragraph 177J(1)(a), in relation to more than one DPT tax benefit—the sum of the DPT base amounts for those DPT tax benefits.

Note: The tax is imposed by the *Diverted Profits Tax Act 2017* and the rate of the tax is set out in that Act.

(2) The ***DPT base amount*** for a DPT tax benefit is:

(a) **if the DPT tax benefit is a tax benefit mentioned in paragraph 177C(1)**(a), (b), (ba) or **(bc)—the amount of the DPT tax benefit**; or

> (b) otherwise—the amount of the DPT tax benefit divided by the standard corporate tax rate.
>
> (3) The tax is due and payable at the end of 21 days after the Commissioner gives the relevant taxpayer notice of the assessment of the amount of the tax for the year of income mentioned in paragraph 177J(1)(a).
>
> Note: For assessments of the amount of the tax see Divisions 145 and 155 in Schedule 1 to the *Taxation Administration Act 1953*.
>
> (Emphasis added.)

425 The effect of ss 177N and 177P, read together with s 177C(1)(bc) and (g), is that, if the diverted profits tax provisions apply to a tax benefit consisting of a taxpayer not being liable to pay royalty withholding tax on an amount, diverted profits tax (at a rate of 40%) is payable on the amount of the royalty.

Tax benefit issue

426 The issue to be considered is whether PepsiCo or SVC (as applicable) obtained a *tax benefit* in connection with the relevant scheme for the purposes of s 177J(1)(a) of the ITAA 1936. This turns on whether PepsiCo or SVC (as applicable) obtained a *tax benefit* as relevantly defined in s 177C(1)(bc).

427 Section 177C(1)(bc) has been set out above. For ease of reference, it is reproduced here (with the relevant parties indicated):

> (1) Subject to this section, a reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:
>
> …
>
> (bc) the taxpayer [here, PepsiCo or SVC, as applicable] not being liable to pay withholding tax on an amount where the taxpayer either **would have**, or **might reasonably be expected to have**, been liable to pay withholding tax on the amount if the scheme had not been entered into or carried out;
>
> (Emphasis added.)

428 Section 177C(1)(bc) calls for a counterfactual analysis. Section 177C is the subject of elaboration in s 177CB.

429 As already noted, the Commissioner relies on two schemes: one in relation to PepsiCo; and one in relation to SVC. In summary, in each case, the alleged scheme is entry into the relevant EBA on terms whereby no royalty was paid for the use of intellectual property.

430 In relation to each scheme, the Commissioner relies on two counterfactuals, which are alternatives. In summary, the Commissioner contends that, had the relevant scheme not been entered into or carried out:

(a) the relevant EBA would or might reasonably be expected to have expressed the payments to be made by SAPL to be for *all* of the property provided by (and promises made by) the PepsiCo Group entities (rather than for concentrate only); or

(b) the relevant EBA would or might reasonably be expected to have expressly provided for the payments to be made by SAPL *to include a royalty* for the use of, or the right to use, the relevant trademarks and other intellectual property (whether or not the amount of the royalty was specified).

431 The Commissioner alleges that, consequently, a royalty would or might reasonably be expected to have been paid by SAPL to PepsiCo or SVC (as applicable) or to another entity on PepsiCo/SVC's behalf or as PepsiCo/SVC directed.

432 To the extent that the Commissioner's Counterfactuals are expressed in terms of "would … have", as distinct from "might reasonably be expected to have", this appears to be inconsistent with s 177CB(2). That subsection provides that a "decision that a tax effect *would have occurred* if the scheme had not been entered into or carried out *must be based on a postulate that comprises only the events or circumstances that actually happened or existed* (other than those that form part of the scheme)" (emphasis added). Section 177CB(2) was designed to make clear that the "would have" limb of s 177C has a distinct and separate operation from the "might reasonably be expected to have" limb. The "would have" limb involves what may be referred to as an "annihilation approach". In other words, a relevant tax advantage is exposed by applying the taxation law to the facts remaining once the statutory counterfactual has done its work in deleting the scheme: see the 2013 Explanatory Memorandum, [1.37], [1.44], [1.71], [1.77]-[1.84]. Given that the Commissioner's Counterfactuals involve events or circumstances that did not actually happen, they are appropriately considered under the "might reasonably be expected to have" limb rather than the "would have" limb. I therefore put to one side the aspects of the Commissioner's Counterfactuals that are expressed in terms of "would … have".

433 The PepsiCo parties contend, in summary, that the Court should find that the Commissioner's Counterfactuals are not reasonable alternatives for the purposes of s 177CB(3) of the ITAA 1936, with the consequence that there is no tax benefit for the purposes of s 177C(1)(bc). The PepsiCo parties submit that the Commissioner's Counterfactuals represent a departure from the

substance of the schemes (see s 177CB(4)(a)(i)) and do not achieve the same commercial results or consequences as the schemes (see s 177CB(4)(a)(ii)).

434 In my view, in relation to each scheme, had the scheme not been entered into or carried out, it might reasonably be expected that the relevant EBA would have provided for the payments to be made by SAPL to be for *all* of the property provided by (and promises made by) the PepsiCo Group entities (rather than for concentrate only). Consequently, PepsiCo or SVC (as applicable) might reasonably be expected to have been liable to pay royalty withholding tax on a portion of the payments. In other words, I accept the first counterfactual proposed by the Commissioner.

435 I consider this counterfactual to be a reasonable alternative, as required by s 177CB(3) and having particular regard to the matters referred to in s 177CB(4)(a). My reasons are as follows.

436 First, I am required to have particular regard to the substance of the scheme (s 177CB(4)(a)(i)). The 2013 Explanatory Memorandum at [1.103]-[1.106] indicates that this was intended to require consideration of the scheme's commercial and economic substance as distinct from its legal form or shape. It is suggested that, "[i]n order for a postulate to constitute a reasonable alternative to the entering into and carrying out of the scheme, the substance of the postulate should correspond to the substance of the scheme". In order to apply this provision to the facts of the present case, it is necessary to compare the substance of the counterfactual with the substance of *the EBAs*. Adopting this approach, the substance of the counterfactual is the same as the substance of the EBAs. The amount of the payments to be made by SAPL is the same under the EBAs and the counterfactual. Under both the EBAs and the counterfactual, the payments to be made by SAPL are, in substance, for both the concentrate and the licence of the intellectual property.

437 Secondly, I am required to have particular regard to any result or consequence for the taxpayer that is or would be achieved by the scheme (apart from tax effects) (s 177CB(4)(a)(ii)). The 2013 Explanatory Memorandum at [1.107]-[1.112] indicates that this was intended to require a consideration of any financial or other consequences for the taxpayer that would be accomplished or achieved as an end result of the scheme having been entered into or carried out. It is suggested that "[i]t would be expected that a postulate that is a reasonable alternative to the entering into and carrying out of a scheme would achieve for the taxpayer non-tax results and consequences that are comparable to those achieved by the scheme itself". In order to apply this provision to the facts of the present case, it is necessary to compare the results or

consequences for PepsiCo/SVC of the counterfactual with the results or consequences of *the EBAs*. Adopting this approach, the financial and other consequences for PepsiCo/SVC of the counterfactual are comparable to those of the EBAs. Again, the amount of the payments to be made by SAPL is the same under the EBAs and the counterfactual. The only difference is that, rather than the payments being expressed to be only for concentrate, the payments are expressed to be for all of the property and promises.

438 Insofar as the PepsiCo parties submitted in their outline of opening submissions that the Commissioner's Counterfactuals would introduce complexity into pricing under the FOBO model, which is designed to be "simple", the evidence shows that there is considerable scope to negotiate the pricing terms and that such terms can have a degree of complexity to them. Further and in any event, the Commissioner's first counterfactual does not involve any change in the amount of the payments; it is therefore difficult to see why it would increase complexity in relation to pricing.

439 Insofar as Mr Williams expressed the view that a change such as that envisaged in the Commissioner's first counterfactual would "[p]otentially open up very wide discussions", as noted above, I have difficulty in accepting this proposition. The Commissioner's first counterfactual involves a relatively small textual change; it is difficult to see why this would open very wide discussions. To the extent that Mr Williams said that such a change would be adding a complication into something "that has been set pretty rigidly over many, many years", the evidence shows that there is considerable scope for variation in exclusive bottling agreements, including pricing terms, and that the pricing terms can have some complexity.

440 Further, the licence of the trademarks and other intellectual property was a fundamental feature of each of the EBAs: see, eg, clauses 3(a), 5(a), 11(a) and 17(a) of the PepsiCo EBA and clauses 4.1, 6.1, and 6.3 of the SVC EBA. As noted earlier in these reasons, without a licence of the trademarks and other intellectual property, SAPL would not be able to package and sell the beverages under the Pepsi, Mountain Dew and Gatorade brands (as applicable). In these circumstances, a counterfactual in which the payments to be made by SAPL are expressed to be for *all* of the property and promises (including the licence of the trademarks and other intellectual property) is a reasonable alternative to the EBAs.

441 For these reasons, I accept the Commissioner's first counterfactual. It is therefore unnecessary to consider the Commissioner's second counterfactual.

442 It is also unnecessary to consider a further counterfactual proposed by the PepsiCo parties, namely that they might reasonably be expected to have entered into exclusive bottling agreements in the form negotiated with SAPL in 2020. Those agreements do not contain pricing terms for the sale and purchase of concentrate, which are instead incorporated into a separate concentrate sale agreement between PBS and SAPL. The difficulty with this counterfactual is that it replicates a key feature of the scheme: the provision of a licence of intellectual property on a royalty-free basis. It therefore does not provide a relevant counterfactual for present purposes.

443 I therefore conclude that each of PepsiCo and SVC obtained a *tax benefit* in connection with the relevant scheme.

Principal purpose issue

444 This next issue is whether it would be concluded, having regard to the matters in s 177J(2) of the ITAA 1936, that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a *principal purpose* of, or for *more than one principal purpose that includes a purpose* of:

(a) enabling the relevant taxpayer (here, PepsiCo or SVC, as applicable) to obtain a tax benefit, or both obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or

(b) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the scheme.

445 In relation to the expression "principal purpose", the 2017 Explanatory Memorandum at [1.46] indicates that this expression was intended to be a lower threshold than the "sole or dominant purpose" threshold that applies under s 177D(1). The 2017 Explanatory Memorandum stated:

> 1.46 **The 'principal purpose or more than one principal purpose' threshold is lower than the 'sole or dominant purpose threshold',** which is used in subsection 177D(1) of the ITAA 1936. Consistent with the multinational anti-avoidance law, the relevant principal purpose need not be the sole or dominant purpose of a person or persons who entered into or carried out the scheme, **but must be one of the main purposes**, having regard to all the facts and circumstances.
>
> 1.47 This recognises that a scheme or part of a scheme may be entered into or carried out for a number of purposes, some or all of which are principal purposes. The scheme will be caught under section 177J of the ITAA 1936 as long as one of those principal purposes satisfies the tax benefit requirements

of the principal purpose test.

(Emphasis added.)

446 The text of s 177J(1)(b) refers to "more than one principal purpose that includes a purpose of …". This envisages that there can be more than one principal purpose.

447 In light of the text, context and purpose of the provision, I consider that the expression "principal purpose" refers to a purpose that is a prominent, leading or main purpose. As already noted, there can be more than one such purpose.

448 The text of s 177J(1)(b) indicates that the enquiry relates to objective (rather than subjective) purpose. This is indicated by the use of the words "it would be concluded", being the same words as used in s 177D(1). In that context, it is accepted that the enquiry relates to objective purpose. See also the 2017 Explanatory Memorandum at [1.151].

449 The Commissioner contends that it would be concluded, having regard to the matters in s 177J(2), that each of PepsiCo and SVC entered into or carried out the relevant scheme for a principal purpose of, or for more than one principal purpose that included a purpose of, enabling it to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of its liabilities to tax under a foreign law, in connection with the scheme.

450 The PepsiCo parties contend that it would not be concluded, having regard to the matters in s 177J(2), that a person who entered into or carried out the schemes identified by the Commissioner, or any part of those schemes, did so for a principal purpose of, or for more than one principal purpose that included a purpose of, enabling the person to obtain a tax benefit (in the form of not being liable to pay royalty withholding tax), or both to obtain such a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the relevant scheme.

451 In answering the enquiry about purpose, it is necessary to have regard to the matters in s 177J(2). I will now consider each of the matters in s 177D(2) (referred to in s 177J(2)(a)). I will then consider the matters referred to in s 177J(2)(b)-(d).

452 Section 177D(2)(a) refers to "the manner in which the scheme was entered into or carried out". There is no detailed evidence about the negotiation of the EBAs in 2009. The PepsiCo parties emphasise that the EBAs reflected the FOBO model, which had been in place since the early 1900s, and the standard pricing structure under that model, which had also been in place since the early 1900s (as evidenced by the Charlottesville EBA). The PepsiCo parties submit that

these matters point strongly against PepsiCo/SVC having a principal purpose as described in s 177J(1)(b). I accept that these matters point, to some extent, against the presence of a principal purpose as described in s 177J(1)(b). However, in my opinion, they do not take matters very far. There is no detailed and comprehensive evidence as to why, as at 2009, the PepsiCo Group generally adopted that pricing structure in its exclusive bottling agreements (or, for that matter, why some others in the beverage industry also adopted that structure). It would not be safe to assume that tax considerations did not have a role to play. Insofar as Mr Williams gave evidence that the pricing model was adopted because it was "simple", I have difficulties with that evidence. The sample exclusive bottling agreements in evidence show that there was considerable complexity in the pricing terms in some agreements. I therefore consider that this matter supports the PepsiCo parties' position on purpose, but only slightly.

453 Section 177D(2)(b) refers to "the form and substance of the scheme". If there are material differences between the form and the substance, this may support the presence of the requisite purpose: see (in the context of s 177D(1)) *Federal Commissioner of Taxation v Macquarie Bank Ltd* [2013] FCAFC 13; 210 FCR 164 (***Macquarie***) at [263]. In the present case, in my view, there is a disconnect between the form and substance of the EBAs. In *form*, the payments to be made by SAPL were for the concentrate alone and not for the licence of the trademarks and other intellectual property. However, in *substance*, the payments to be made by SAPL were for both the concentrate and the licence of the trademarks and other intellectual property. The trademarks licensed under the EBAs were highly valuable; the brands were among the most valuable brands in the global beverage industry. In this context, I infer that, as a matter of substance, the payments to be made by SAPL were not merely for the concentrate but were also for the right to use the trademarks and other intellectual property. There is, therefore, a disconnect between the form and the substance of the scheme. This matter strongly supports the Commissioner's position that the requisite purpose did exist.

454 Section 177D(2)(c) refers to "the time at which the scheme was entered into and the length of the period during which the scheme was carried out". The occasion for the entry into the EBAs (which were restatements of earlier exclusive bottling agreements) was the acquisition of SAPL by the Asahi Group. The EBAs operate for a long period of time, which appears to be standard under the FOBO model. I consider this factor to be neutral.

455 Section 177D(2)(d) refers to "the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme". As the Commissioner submits, the result in relation

to the operation of the ITAA 1936 that, but for Part IVA, would be achieved by each scheme, is that PepsiCo/SVC would not be liable to pay royalty withholding tax on an amount that, but for the scheme, might reasonably be expected to have been a royalty. In a number of cases (eg, *Macquarie* at [272]-[275]; *Federal Commissioner of Taxation v Guardian AIT Pty Ltd ATF Australian Investment Trust* [2023] FCAFC 3; 115 ATR 316 (***Guardian***) at [205]-[208]), it has been held that the fact that more tax might be payable if Pt IVA applied (without more) does not attract the inference of dominant purpose. I consider this matter, of itself, to be neutral.

456 I note that, in the PepsiCo parties' submissions, they submit that, under the schemes, the amounts SAPL paid to PBS to purchase concentrate were included in PBS's assessable income in Australia; and that, after claiming deductions for the purchase of the concentrate, PBS paid tax in Australia on the margin it earned. While this is correct, it needs to be understood in context. The deductions claimed by PBS for purchase of concentrate from CMSPL represented almost the entirety of the amounts PBS received from SAPL, therefore PBS paid only a small amount of tax. I note also that CMSPL is incorporated in Singapore, a low tax jurisdiction. It is likely that it paid little tax on the payments it received for concentrate from PBS. (The Commissioner's outline of opening submissions stated that the applicable tax rate for CMSPL in Singapore was 0% and the PepsiCo parties did not respond to that in their reply submissions.)

457 Section 177D(2)(e) refers to "any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme". In considering this factor, it is important to have regard not only to the scheme but also to the counterfactual: *Guardian* at [210]-[211]. Under each scheme, PepsiCo or SVC (as applicable) do not receive any royalty income under the EBAs. Under the counterfactual, they do receive such income (upon which they would be liable to pay Australian royalty withholding tax). As discussed below, the amount of such royalty withholding tax is not large in the context of the total payments under the EBAs. Nevertheless, this matter tends to support the Commissioner's position as to requisite purpose.

458 Section 177D(2)(f) refers to "any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme". As with the previous factor, it is important to have regard not just to the scheme but also to the counterfactual. It does not appear that there was any change in the financial position of SAPL as a result of the scheme; under the counterfactual, it would pay the

same amounts as under the EBAs. In relation to PBS, it is unclear whether there was any change in its financial position as a result of the scheme. I consider this matter to be neutral.

459 Section 177D(2)(g) refers to "any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out". There do not appear to be any additional matters to be considered here.

460 Section 177D(2)(h) refers to "the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f)". SAPL is independent of the PepsiCo Group. PBS is a member of the PepsiCo Group.

461 Section 177J(2)(b) refers to "the extent to which non-tax financial benefits that are quantifiable have resulted, will result, or may reasonably be expected to result, from the scheme". In relation to this matter, the 2017 Explanatory Memorandum states:

> 1.52 The significance of quantifiable non-tax financial benefits which have, may or will result, or may reasonably be expected to result, from the scheme, relates to the amount of those benefits relative to the tax benefit. If the scheme produces significant quantifiable non-tax financial benefits, this could be a strong indicator that the purpose of the scheme was not to produce the tax benefit. This factor is weighed alongside the other factors in subsection 177J(2) in determining if the overall facts and circumstances of the scheme point to an objective purpose of enabling a taxpayer to obtain a tax benefit.
>
> 1.53 Non-tax financial benefits are quantifiable commercial benefits arising from a scheme — for example, a computable and identifiable amount of economic value generated from the scheme. Tax outcomes are not included in this quantification. The quantification of non-tax financial benefits is based on the value of those benefits at the time of entering into the scheme.

462 It is important to have regard not just to the scheme but also to the counterfactual. In relation to each scheme, comparing the scheme with the Commissioner's first counterfactual, it does not appear that any non-tax financial benefits that are quantifiable resulted from the scheme. If and to the extent that the PepsiCo parties rely on Mr Williams's evidence in relation to the Commissioner's counterfactuals, I refer to the discussion of that evidence at [208]-[217] above. I consider this matter to be neutral.

463 Section 177J(2)(c) refers to "the result, in relation to the operation of any foreign law relating to taxation, that (but for this Part) would be achieved by the scheme". This too requires a comparison between the scheme and the counterfactual. In his outline of opening submissions, at paragraphs 102-114, the Commissioner made submissions about the foreign law effects of the schemes. In oral closing submissions, senior counsel for the PepsiCo parties accepted that prior to 30 June 2018 (this should perhaps be 31 December 2017, in light of the following

matters), any royalty that would have been paid to PepsiCo/SVC in the United States would have been subject to tax at 35%. I assume that this would have been offset by any Australian withholding tax (payable at the rate of 5%). Further, he said that the PepsiCo parties were prepared to proceed on the basis that, from 1 January 2018, the difference in the effective US tax rate under the scheme compared with the Commissioner's Counterfactuals was 10.5% versus 13.125%; so the difference was under 3%. It appears, therefore, that the schemes would achieve a reduction in US tax for Pepsico and SVC. At least in the period prior to 31 December 2017, the reduction would appear to be substantial. This matter supports the Commissioner's position as to requisite purpose.

464 Section 177J(2)(d) refers to "the amount of the tax benefit mentioned in paragraph (1)(b)". As noted above, by virtue of s 177C(1)(g), the amount of the tax benefit is taken to be the amount of the royalty (rather than the amount of royalty withholding tax). However, for the purposes of the enquiry as to purpose in this case, the relevant aspect would seem to be the amount of royalty withholding tax that PepsiCo/SVC might reasonably be expected to have been liable to pay if the scheme had not been entered into or carried out. In the section of these reasons dealing with issue (2) I have concluded that the royalty rate is 5.88% of SAPL's net revenue from sales of the relevant products (subject to revision in respect of one matter). Adopting that figure as an approximate figure for present purposes, and applying it to the SAPL net revenue figures in Exhibit 1.0 to Mr Malackowski's report, the total royalty amount for both PepsiCo and SVC for the relevant years is approximately $[redacted] million. The royalty withholding tax payable on that amount (at a rate of 5%) is approximately $[redacted] million. This is not a large amount in the context of the total payments under the EBAs. Nevertheless, this matter supports the Commissioner's position.

465 Having regard to the matters discussed above, I consider that it would be concluded that one of the principal purposes of each of PepsiCo and SVC in entering into or carrying out the relevant scheme was to obtain a tax benefit (namely not being liable to pay Australian royalty withholding tax) and to reduce foreign tax (namely, US tax on their income). I consider that the terms of the EBAs are contrived, in that payments that are ostensibly for concentrate alone are in substance for both concentrate and the licence of valuable intellectual property.

Conclusion – diverted profits tax

466 It follows that, had I not concluded that the royalty withholding tax provisions applied, I would have concluded that the diverted profits tax provisions apply. There is an issue between the

parties as to the amounts of the DPT tax benefits. This turns on the determination of the amount of any royalty, a topic that I have dealt with under issue (2) of these reasons. The determination in that section of these reasons applies equally to the diverted profits tax issue.

Conclusion

467 My conclusions have been summarised in [18] above. At this stage, I will make orders to the effect that: within 14 days, the parties provide to the Court any agreed minute of proposed orders to give effect to the Court's reasons for judgment, and in relation to costs; and, if the parties cannot agree, then within 21 days each party file and serve a minute of proposed orders to give effect to the Court's reasons for judgment, and in relation to costs, together with a short submission.

I certify that the preceding four hundred and sixty-seven (467) numbered paragraphs are a true copy of the Reasons for Judgment of the Honourable Justice Moshinsky.

Associate:

Dated: 30 November 2023