UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10756 / February 19, 2020

SECURITIES EXCHANGE ACT OF 1934
Release No. 88234 / February 19, 2020

ADMINISTRATIVE PROCEEDING
File No. 3-19701

In the Matter of **DIAGEO plc,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against DIAGEO plc ("Diageo" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

Summary

1. In its fiscal years 2014 and 2015, Diageo failed to make required disclosures of known trends and uncertainties, thereby rendering its required periodic filings materially misleading to investors with respect to its financial results. During those periods, employees at Diageo's largest and most profitable subsidiary—Diageo North America, Inc. ("DNA")—pressured distributors to buy products in excess of demand to meet performance targets in a flagging market. As a result, distributors in North America held substantial unneeded inventory, which was a known trend or uncertainty: the continued selling over demand was unsustainable because it was likely that distributors would purchase less product in future periods. Diageo's periodic filings did not disclose these known trends and uncertainties to investors.

2. The DNA employees' "overshipping" of certain products to counteract the impact of declining market conditions and to meet performance targets allowed Diageo to report higher growth in certain of its key performance indicators. These indicators included organic net sales growth and organic operating profit growth, financial metrics closely followed by investors and analysts. DNA's overshipping was also a factor in causing Diageo or DNA to meet or surpass analysts' expectations for these two metrics.

3. By early fiscal 2015, certain distributors' inventory positions became unsustainable and they began pushing back on orders. In response, DNA designed and implemented, and Diageo approved, a plan to reduce inventory levels. Under newly agreed-to contractual terms with certain distributors, DNA planned to correct the elevated inventories over a period of years, principally through a reduction in shipments to distributors, a process known as "destocking."

4. Diageo did not disclose the known trends and uncertainties created by DNA's overshipping and elevated distributor inventory levels because it did not have sufficient procedures in place to consider whether DNA's overshipping or distributor inventory builds were trends or uncertainties that needed to be disclosed. As a result, Diageo failed to disclose significant known trends and uncertainties in its 2014 and 2015 Forms 20-F. In particular, Diageo did not disclose DNA's overshipments versus demand and the resulting distributor inventory levels; the positive impact those trends had on organic net sales and organic profit growth, and the negative impact they were reasonably likely to have on future sales; and the fact that they caused Diageo's and DNA's reported financial information to not be indicative of future operating results or financial condition. These omissions also rendered misleading certain statements the company made concerning its and DNA's financial performance.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

5. As a result, Diageo's conduct violated Section 17(a)(2) and 17(a)(3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder.

Respondent

6. DIAGEO plc is incorporated in England and Wales and is headquartered in London, England. Its shares trade on the London Stock Exchange, and its American Depositary Shares are registered with the Commission pursuant to Section 12(b) of the Exchange Act and trade on the New York Stock Exchange under the symbol DEO. As a foreign private issuer, Diageo files annual reports with the Commission on Forms 20-F. Diageo's fiscal year begins on July 1 and ends the following June 30th.

Other Relevant Entities

7. Diageo North America, Inc. is incorporated in Connecticut and has its principal place of business in New York, New York. Diageo plc conducts its U.S. operations through Diageo North America. DNA's financial results are included as a separate business segment in Diageo's Forms 20-F.

Facts

1. Background

8. During its fiscal years 2014 and 2015, DNA sold spirits, wine and beer in the U.S., contributing about 40% of Diageo's annual operating profit and a third of its net sales. In most states, DNA sold its products to third-party distributors, which in turn sold to retailers such as liquor stores, bars and restaurants.

9. DNA regularly received reports of U.S. distributor depletions (distributors' sales to retailers) and shipments (DNA's sales to the distributors) of Diageo products. From this information, DNA tracked distributor inventory levels for its base products, which were measured in Days Sales Inventory ("DSI"). DSI is a forward looking metric that Diageo calculated by using estimated future depletions to estimate how long it would take to deplete existing inventory. DNA did not include newly introduced products (called "innovation" products) in calculating DSI for the first year after launch because, despite having made pre-launch projections, DNA felt it could not always accurately forecast depletion rates for these new products.

10. Distributor DSI levels for base products were reported to Diageo's Filings Assurance Committee ("FAC") in London twice a year, in connection with the preparation of Diageo's half-year and year-end financial regulatory filings. Distributor ending inventory levels of innovation products were also reported to Diageo's FAC in London twice a year.

11. Two of Diageo's key performance indicators, organic net sales growth and organic operating profit growth, were closely followed by analysts and investors as measures of the demand for Diageo's products and the health of its business.

12. At the beginning of the relevant period, DNA's FAC submissions demonstrated that DSI levels at distributors for spirits were high relative to the pre-2008 financial crisis era.

13. To meet its financial goals, Diageo issued sales and profit targets to DNA, which in turn negotiated yearly "annual operating plans" with the distributors to achieve those targets. DNA's plans set "depletion goals" for the distributors based on Diageo's targets, and the distributor agreements required that the distributors purchase an amount of shipments equal to those goals.

14. To meet DNA's financial targets, DNA sales and finance department employees shipped certain Diageo spirit brands, principally newly launched "innovation" products, to distributors in excess of what distributors needed to fulfill market demand and in the face of declining overall demand for spirits.

2. <u>DNA employees engaged in overshipping to meet DNA's targets.</u>

15. In fiscal 2014 and 2015, DNA's business began to slow due to various market factors. This caused the distributors' depletions to fall. When depletions failed to meet DNA's targeted levels, certain DNA employees pressured distributors to purchase additional products to make up the gap to its performance targets. Certain DNA financial personnel closely tracked the gap between actual and forecasted revenue and profits. This trend of overshipping continued throughout fiscal 2014 and in the first half of fiscal 2015.

16. Certain DNA sales and finance employees knew that they were shipping unneeded inventory to the distributors and that the practice was enabling DNA to come closer to its targets. For example, in fiscal 2014, after being told by a distributor that the distributor had unnecessary inventory and was not planning to put in orders, a DNA sales executive wrote to the distributor: "I know I say this every time the shipments discussion comes around….but this is a critical one for me. If you need me to get the big guns involved let me know."

17. DNA employees increasingly relied on new innovation products to meet DNA's sales and profit targets through overshipping. Various internal DNA documents reflected overshipping. For instance, in fiscal 2014, a DNA employee remarked: "They [the distributor] are suggesting they are long on Innov Inventory and are bringing some data. We will handle. Plan is always ships=depletes on base [brands] but we clearly have been pushing Innov for all its worth on ships."

18. DNA's practice of overshipping relative to demand also involved the use of extraordinary sales practices. For example, under its contracts with distributors, DNA had the right to terminate the relationship if distributors failed to meet certain depletion targets. When distributors told DNA that they would not meet their targets, DNA agreed to waive its termination clauses if distributors would purchase additional unneeded innovation products. Other examples included DNA waiving penalty payments distributors were contractually required to pay to DNA for failing to meet targets if the distributors agreed to purchase unneeded innovation products.

3. <u>DNA developed and Diageo approved a plan to reduce distributor inventory levels.</u>

19. By early fiscal 2015, inventory levels at some distributors were so high that they were resisting additional purchases. For these distributors, the purchase of unneeded inventory from DNA had become unsustainable. In response, DNA prepared and Diageo approved a plan to reduce inventory levels at certain DNA distributors. This would be achieved principally through a reductions in sales, a process known as "destocking." The plan, to take effect beginning in fiscal 2016, would reduce distributor inventory over a period of years in an amount that would have been material if it occurred in a single reporting period.

20. DNA, as part of a series of proposals to alter its relationship with distributors, negotiated new contracts with its main distributors, to take effect in fiscal 2016, which provided for a reduction in inventory levels and which required the distributors to make additional payments to DNA. One effect of those additional payments was to mitigate the lost revenue arising out of the inventory reduction provisions.

4. <u>Diageo failed to disclose in its fiscal 2014 and 2015 Forms 20-F the trends and uncertainties resulting from DNA's overshipping, rendering its periodic filings misleading to investors with respect to its financial results.</u>

21. Diageo's Filings Assurance Committee ("FAC") was responsible for ensuring the accuracy of the company's financial disclosures. The FAC reports in fiscal 2014 and fiscal 2015, which were also reviewed by management, reflected that DNA's distributors were significantly increasing their inventories, resulting in significant additional net sales and operating profit. The FAC reviewed DNA's FAC reports in fiscal 2014 and fiscal 2015, including information about the inventory builds at distributors, but did not consider the issue of whether DNA's overshipping and the resulting inventory builds were material trends or uncertainties that were required to be disclosed. Diageo did not have adequate procedures to require such a consideration, or to specifically address how to review and evaluate a build in inventory, and particularly for innovation products. As a result, the FAC approved the company's Forms 20-F for fiscal 2014 and 2015 without making such evaluation or consideration. Diageo's internal disclosure process failed to ensure that it adequately considered its disclosure obligations surrounding DNA's trend of overshipping and the resulting inventory build at the U.S. distributors and subsequent inventory reductions.

22. Diageo's failure to identify and disclose material trends and uncertainties had the consequence of rendering certain statements in Diageo's periodic filings misleading in light of the circumstances in which they were made. On August 12, 2014, and August 11, 2015, Diageo filed its fiscal 2014 and 2015 Forms 20-F with the Commission. The Forms 20-F contained required statements about DNA's financial performance, including statements of organic net sales growth and organic operating profit growth, that were rendered materially misleading by the failure to include material trends and uncertainties concerning Diageo's revenues and profit.

23. For example, Diageo's 2014 Form 20-F, in discussing DNA's results, said: "North America … again delivered top line growth, driven by 5% growth in Spirits and Wines…. Our strength in innovation has continued." This statement was rendered misleading by the fact that a significant portion of DNA's top line growth was from overshipping, primarily of new innovation products. Diageo's 2015 Form 20-F, in discussing DNA's results, said: "In North America, US Spirits has delivered improved depletion performance…. Shipments were broadly in line with depletions and therefore net sales were down 2% year on year as last year shipments were higher than depletions mainly driven by innovation launches." This statement was rendered misleading by the fact that, in fiscal 2015, shipments exceeded depletions in the first half of the year, and DNA's overshipping required a need for a reduction of distributor inventory in the second half of the year of roughly the same amount, which is why shipments were "broadly in line with depletions" for the year. Further, the description of 2014 was misleading, as shipments were higher than depletions in fiscal 2014 in significant part due to overshipping by DNA employees.

24. In addition, the Forms 20-F contained information on Diageo and DNA's organic net sales growth and organic operating profit growth that were rendered misleading by the failure to disclose DNA's overshipping. These omissions made it appear as if Diageo and DNA achieved reported growth through organic net sales when, in fact, the results were achieved principally through overshipping unneeded product.

25. Specifically, Diageo's fiscal 2014's Form 20-F reported DNA's organic net sales growth as 3% and organic operating profit growth as 8%. The omission of the overshipping rendered this information materially misleading as, without the overshipping, organic net sales growth and operating profit growth would have been materially lower. Similarly, Diageo's reported organic net sales growth of 0.4% and operating profit growth of 3% were rendered materially misleading, as the growth without overshipping would have been materially lower. These omissions were also material because DNA's overshipping was a factor in causing Diageo and DNA to meet or surpass analyst expectations for organic net sales growth and operating profit growth.

26. Diageo's fiscal 2015's Form 20-F reported DNA's organic net sales growth as -1% and organic operating profit growth as -2%. The omission of the overshipping rendered this information materially misleading as, without the overshipping, organic net sales growth and operating profit growth would have been materially lower. Similarly, Diageo's reported organic net sales growth of 0% and operating profit growth of 1% were rendered materially misleading, as the growth without overshipping would have been lower. DNA's reported negative organic net sales growth and operating profit growth for fiscal 2015 missed analyst consensus estimates. DNA's overshipping was, however, a factor in causing Diageo's reported organic net sales growth and operating profit growth to be in line with consensus.

27. Form 20-F requires an issuer to disclose "the most significant trends in … sales … since the latest fiscal year," as well as to "discuss, for at least the current financial year, any known trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on the company's net sales or revenues, income from continuing operations, profitability … or that would cause reported financial information not necessarily to be indicative of future operating results or financial condition."

28. Diageo failed to disclose the trends of shipping in excess of demand and the resulting inventory builds; the positive impact those trends had on sales and profits, and the negative impact they reasonably could be expected to have on future growth; and the fact that they caused Diageo and DNA's reported financial information to not necessarily be indicative of future operating results or financial condition. The failure to disclose this additional information left investors with the misleading impression that Diageo and DNA were able to achieve growth in certain key performance indicators through normal customer demand for Diageo's products. Without this information, investors had a diminished ability to evaluate the company's financial results in context and compare results across periods, and to evaluate Diageo's and DNA's future sales and profits and judge the company's likely future performance.

29. During the relevant period, Diageo issued securities pursuant to employee benefit plans and also issued securities to employees through the exercise of stock options.

Violations

30. As a result of the conduct described above, Diageo violated Section 17(a)(2) and (3) of the Securities Act, which prohibit any person from directly or indirectly obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser, in the offer or sales of securities. In addition, Diageo violated Section 13(a) of the Exchange Act and Rule 13a-1 thereunder, which require reporting companies to file with the Commission complete and accurate annual reports. Diageo also violated Rule 12b-20 of the Exchange Act, which requires an issuer to include in a statement or report filed with the Commission any information necessary to make the required statements in the filing not materially misleading.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 8A of the Securities Act and 21C of the Exchange Act, it is hereby ORDERED that:

A. Diageo shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) and (3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 13a-1 and 12b-20 thereunder.

B. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $5,000,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Diageo as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Melissa Hodgman, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor

Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary