

TOBACCO INDUSTRY SMUGGLING
Submission to the House of Commons
Health Select Committee
Action on Smoking and Health 16th February 2000

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1 Summary

1. Over the last six months ASH has been undertaking research in parallel with others, including the International Consortium of investigative Journalists, on the documents in BAT's litigation archive in Guildford England. Our work has been independent, but we have co-ordinated publication.
2. Correspondence between BAT executives shows the company was heavily involved in orchestrating, managing and controlling cigarette smuggling in Asia and Latin America in the early 1990s.
3. BAT exercised control on illegal distribution channels through intermediaries, notably Romar in Aruba and SUTL [Singapura United Tobacco Ltd] in Singapore. The form of control was:
 - Adopting an approach to business planning and sales target setting which treats the various routes for smuggling as near-normal distribution channels which are under the same sort of control as legitimate channels;
 - Deliberately establishing business relations with intermediaries that directly or indirectly supply smugglers and directing these companies so as to gain share in the illegal markets;
 - Controlling the price and availability of products through these channels and so influencing end-market conditions;
 - Building warehouses and stationing marketing personnel close to borders with poor customs controls;
 - Using a small legal or duty-free market to justify advertising campaigns which have the real purpose of stimulating demand for cigarettes on sale in the illegal market (these are known as 'umbrella operations');
 - Organising complicated movements of cigarettes through several jurisdictions or multiple levels within an elaborate distribution chain – leading to difficulties in tracing the products;
 - Identifying and/or developing transit routes where official controls are weak or corrupt.

- Colluding with other international tobacco companies over pricing and smuggling strategy;
- BAT executives knew the nature of their business and sought to conceal it.
- BAT was not the only international tobacco company involved.

Quotes from documents illustrating each of the points above form the bulk of the body of this submission.

4. The personnel involved are very senior – the memos feature current BAT board members including the Managing Director (Ulrich Herter), Finance Director (Keith Dunt) and Marketing Director (Paul Adams). No documents have been found to date, which refer to the current Chairman or Deputy Chairman.
5. The assertion by BAT that it only acts legally is false. While there is little evidence of BAT smuggling tobacco itself, there is compelling evidence to suggest that BAT is a significant part of a conspiracy which causes smuggling to happen. At least one BAT executive has been convicted for smuggling-related offences in Hong Kong and other legal actions are possible. While conspiracy action in the UK is unlikely for technical reasons, conspiracy-equivalent actions in the jurisdictions where the smuggling has taken place are plausible. US-based racketeering actions (RICO) have been launched against the tobacco industry for its involvement in Canadian smuggling and RICO actions against BAT and Philip Morris are reportedly under consideration by the Colombian Governors.
6. The prevalence of tobacco smuggling in Colombia and the Golden triangle points to a wider picture which almost certainly involves the laundering of illegal 'narco-dollars' – proceeds of cocaine and heroin trafficking. There is no suggestion in the documents that BAT staff are directly involved in this process, but it is very likely that contraband distribution in these areas is carried out by established organised crime networks, and for these organisations tobacco smuggling would provide effective money laundering with advantages to all parties. By failing to take responsibility for the markets that its product enters, BAT is facilitating the spread of illegal drugs as well as that of tobacco.
7. Recently smuggling has reached serious proportions in the UK and Europe, and from what we know, it appears that similar patterns of distribution management are being used to those documented from Latin America and Asia. This is particularly true of tobacco company relationships with intermediary groups in specific distribution nodes who supply smugglers. For a time, Andorra was used by British manufacturers, Gallaher and Imperial Tobacco in a manner similar to BAT's operations in Aruba detailed below. As a result of this distribution network, UK tobacco exports to Andorra rose from 13 million cigarettes in 1993 to 1,520 million in 1997 – vastly more than the Andorran population of 63,000 could conceivably consume.
8. ASH believes the issues raised by these revelations are a matter for a DTI investigation. The Secretary of State for Trade and Industry has powers to mount an investigation into corporate conduct in these circumstances under s.432 of the 1985 Companies Act. An HM Customs & Excise investigation is unlikely because we have already established that the relevant conspiracy offence did not come into force until 1999 and all the evidence we have pre-dates this.
9. It is also important that BAT's own business practices are subject to internal checks and balances and that the company is properly supervised by its non-executive directors, led by the Deputy Chairman, Rt. Hon Kenneth Clarke QC MP. Mr. Clarke should now launch an internal inquiry to report to the AGM on 27th April 2000. BAT should also make a clear statement to shareholders regarding its exposure to smuggling related-legal action.
10. Smuggling is not a victimless crime. Current projections suggest one billion people will die of tobacco-related disease in the 21st Century – 10 times as many as the 20th Century and overwhelmingly in developing countries. Taxation is one measure to counter this dreadful toll, and smuggling undermines it by lowering prices and reducing the political feasibility of a high tobacco tax policy. To this extent, tobacco companies benefit from the impact of smuggling in their markets – and health suffers.
11. The responsibility for tackling smuggling ultimately lies with governments. A new WHO convention, the Framework Convention on Tobacco Control has a proposed protocol on smuggling. This could form the basis of a global response to tobacco smuggling by creating a secure distribution system, introducing anti-fraud markings, tracking and tracing the movement of tobacco products and holding each person responsible for ensuring that they sell only to legitimate businesses.

2 Setting the scene

British-American Tobacco (BAT) is in a pitched battle with U.S.-based Philip Morris for the growing global

tobacco market. Both are enormously wealthy companies with global operations. In virtually every market in the world, these companies are fighting for market share and market growth. Smuggled cigarettes are the key weapon in a ferocious price war in crucially contested markets. [Analysis of trade figures](#)^[1] suggests around one third of all internationally traded cigarettes are smuggled – about 355 billion cigarettes in 1996 – overwhelmingly the international brands of the multinational tobacco companies, such as 555 State Express (BAT), Marlboro (Philip Morris) and Camel (RJ Reynolds). This fraction and the absolute amount of smuggled cigarettes have been steadily rising through the 1990s. Although our evidence mostly relates to the period 1988 to 1994, the problem continues.

3 Smuggling and the tobacco business

Most countries apply taxes to tobacco products to raise government revenue and, increasingly, to create a disincentive to smoking – an approach now advocated by the World Bank^[2]. When cigarettes are smuggled the taxes are evaded and the black market price is lower. The manufacturers and wholesalers are still paid for these sales, but the finance ministries and legitimate retailers lose out. The lower prices increase demand and improve the competitive position of the brand and stimulate overall market demand – with knock-on health impacts due to increased smoking. In countries where many brands are sold illegally without duty not paid, brands that are sold legally (duty-paid) face stiff price disadvantages. This creates a powerful market pressure on manufacturers to ensure their products are well represented in illegal sales channels, or to go even further and ensure that illegal distribution channels are available for their product.

4 How cigarette smuggling happens

Cigarettes legitimately move through the 'in-transit' regime without bearing tax until they reach the final end market – at which point tax is payable. Most smuggling involves the cigarettes moving out of the untaxed distribution chain and entering the final end-market illegally – often through a third country. This can happen by legal export followed by illegal re-import or cigarettes in transit may be diverted from the legal to the illegal distribution chain. Smuggling is not generally driven by differences in tobacco taxes between countries, but by the avoidance of taxation by diversion from the wholesale distribution chain – where duty has not been paid.

5 Health implications – why smuggling is not a victimless crime

If current smoking trends persist, there will be about one billion deaths from tobacco during the 21st century compared with 100 million during the whole of the 20th century. Around three quarters in developing countries. China alone (with 20% of the world's population) already suffers almost a million deaths a year from tobacco, a figure that is likely to at least double by 2025.^[3] Tobacco-related illness is the single largest avoidable public health problem and still on the increase.

As the international tobacco companies direct their marketing firepower towards developing countries, a range of public health measures including increased taxation, can attenuate the burden of disease and death. The health case for increasing tobacco taxes is clear and well expressed in a 1999 report by the World Bank^[4]:

“Evidence from countries of all income levels shows that price increases on cigarettes are highly effective in reducing demand. Higher taxes induce some smokers to quit and prevent other individuals from starting. They also reduce the number of ex-smokers who return to cigarettes and reduce consumption among continuing smokers. On average, a price rise of 10 percent on a pack would be expected to reduce demand for cigarettes by about 4 percent in high income countries and by about 8 percent in low- and middle-income countries, where lower incomes tend to make people more responsive to price changes. Children and adolescents are more responsive to price rises than older adults, so this intervention would have a significant impact on them.”

Smuggling undermines this tax policy in two ways: by supplying cigarettes at a lower price and by creating political pressure (promoted by the tobacco companies) for reductions of tax policy. These market-wide effects are another reason why the companies benefit from smuggling – in addition to their competitive edge. The result is increased smoking, and hence increased illness, especially in developing countries, among the poor, and among children and adolescents.

6 BAT's response

BAT [responded](#) on 31st January 2000^[5] by dismissing the allegations as selective and refusing further

comment:

We do not intend to answer questions or address allegations apparently based on highly selective and out-of-context documents...

The documents are certainly a selection from the total of 8 million pages held in Guildford, and these are a sub-set of the whole of BAT's documents which includes documents post-1994, documents not released to the State of Minnesota, documents for which legal privilege is claimed, and lost and shredded documents. Even a *single* document which indicates control over smuggling requires explanation and justification.

The decision not to comment was reversed on 4th February when BAT's Deputy Chairman, the Rt. Hon Kenneth Clarke QC MP, made a [statement](#) to *The Guardian*^[6] and acknowledged:

Where any government is unwilling to act or their efforts are unsuccessful, we act, completely within the law, on the basis that our brands will be available alongside those of our competitors in the smuggled as well as the legitimate market.

The thrust of this submission is that the 'acts' that Mr. Clarke refers to amount to control of smuggling through intermediaries, and go well beyond acceptable corporate behaviour, at times have broken the law, and, at best, operate in a legal 'twilight'. The following two sections outline the different ways in which BAT exercised control by quoting from memos discovered in the Guildford depository.

7 Terminology

BAT does not generally refer to "smuggling" or to the product as "contraband" in its internal correspondence. The company tends to use its own marketing terminology to refer to smuggled products. Though the meaning of such terms is not immediately apparent, the context in which the terms are used in the documents clarifies the meaning. The crucial terms which are used to describe smuggled product are:

- DNP ('duty not paid' in contrast to 'duty paid' and 'duty free')
- Transit (a reference to the usual source of smuggled cigarettes)
- GT (General Trade)
- There are also various other descriptions which often refer to illegal tobacco markets: 'border trade', 'parallel exports', 'free markets' and occasionally VFM [value for money]. In each case the context of the text in the document has led us to conclude that the activities described refer to smuggling despite the anodyne language.

Documents demonstrating the meaning of the terms of [DNP](#)^[7] – [Transit](#)^[8] – [GT](#)^[9] are stored on the ASH web site, but for the sake of brevity these have not been reproduced here.

8 How BAT control smuggling – the modus operandi and evidence

One reading of the relationship between tobacco companies is that smuggling goes on entirely outside the control and intent of the tobacco companies – they simply acknowledge smuggling as a reality and act accordingly. This has been the basis of BAT's defence. However, the documents suggest BAT's conduct goes way beyond this and that it exerts control over smuggling channels through intermediaries. The following ten sections give examples from the documents that illustrate the true nature of BAT's involvement. There are further documents that support each point available on the ASH web site.

8.1 Documents showing that BAT adopted an approach to business planning which treated various smuggling routes as near-normal distribution channels - subject to the same encouragement, exploitation and control as legitimate channels:

One of the most powerful memos shows BAT simply deciding to increase its Argentinean market share through smuggling.

[Memo](#): 18/5/93^[10]

Keith Dunt to Ulrich Herter, Barry Bramley [Chairman BAT Co], Pilbeam, Castro

“SUBJECT: DNP BRAZIL – ARGENTINA

I am advised by Souza Cruz that the BAT Industries Chairman has endorsed the approach that the Brazilian Operating Group increase its share of the Argentinean market via DNP.”

[The Chairman of BAT Industries at the time was Sir Patrick Sheehy, who was knighted in 1991]

This fax shows that BAT actively encouraged specific players into illegal markets, it also shows that Keith Dunt appeared to be aware of the sensitive nature of the markets described.

FAX: Keith Dunt [BAT Latin American Director] to A.M.Castro [Souza Cruz] 25/01/93^[11]

“As you know I spent last week in Argentina – with Nobleza Piccardo.

In view of the close liaison needed between us in the Southern Cone I am forwarding you, (by hard copy only) a copy of the trip notes. I would ask that these are not shared nor copied. It is absolutely important that we leverage your Company’s muscle into the Argentinian (sic) situation, (plus in fact that of B&W) in terms of the DNP [Duty Not Paid] business.” (original emphasis)

This letter shows that Keith Dunt of BAT actively encouraged those in other organisations to disregard the ‘ethical’ judgements surrounding breaking the law:

LETTER: Keith Dunt to Grant [Nobleza Piccardo] 24/6/92^[12]

“Thanks for your notes of 15th June on the DNP market...

1 DNP Market/Other Matters

We will be consulting here on the ethical side of whether we should encourage or ignore the DNP segment. You know my view is that it is part of your market and to have it exploited by others is just not acceptable...” (original emphasis)

This marketing plan shows that BAT actively sought to expand their share of illegal markets as an intrinsic part of their company strategy:

1995 BAT Interim Marketing Plan for State Express 555 in Vietnam^[13]

“Trade Marketing and Distribution:

We must vigorously pursue strategies designed to *achieve and sustain* measurable competitive advantage. Accordingly, total in market volume, irrespective of source, channel presence, marketing, market intelligence and share of the international segment should be the primary measures of achievement.” (original emphasis)

Similarly this Five Year Plan shows BAT’s intention to actively manage illegal business:

BATCo Global Five-year Plan 1994-1998^[14]

“1.1.1 Market trends:

1.1.1.4 (iii) Continued pressures on domestic market performance and profitability rising from border business and in some markets, from excise/ tax evasion.

In 1993, it is estimated that nearly 6% of the total world cigarette sales of 5.4 trillion were DNP sales. Eastern Europe and the Asia-Pacific region (c85blln each) accounted for the majority of this volume. Though Western Europe (c50blln) was also significant. In relation to total market sales, DNP volumes are largest in Eastern Europe (c13%) and Africa/ M. East (c12%), but are also significant in Latin America (c9%) and Western Europe (c7%). *A key issue for BAT is to ensure that the Group’s system-wide objectives and performance are given the necessary priority through the active and effective management of such business.*” (emphasis added)

8.2 Documents showing BAT controlling the price and availability of products through illegal channels;

The printed document illustrates the extent to which BAT controlled this illegal market – they had the power to stop exporting into specific channels. The marginalia shows that they were aware of the risks of continuing their illegal trade, but continued regardless:

“[RESPONSE TO J REMBISZEWSKI VISIT \[02/09/92\]](#)^[15]

1.1 STOP DNP EXPORTS

Agreed to continue. [K Dunt Marginalia: Agreed with Ulrich/Barry (despite risk) in July]”

This strategy paper shows BAT actively looking for ‘alternative’ routes to penetrate Chinese markets, as official exports to China are limited by a quota. It also shows the extent to which it can control pricing in end markets and through specific smuggling routes:

[Media Strategy Paper: China \(555\)](#)^[16]

...

4 To establish regular contact with other major industry members to consult on the duty paid business in China (CNTC), in areas of pricing, smoking and health issues, credit/consignment stocks.

5 To investigate alternative export routes/customers that will improve penetration of UK brands in northern and central provinces.

6 To continually monitor the Sino-Russian Border Trade business during Q3/Q4 1991, to further test effectiveness of this route, and dependant on results to reappraise the route and pricing in Jan 1992.

This briefing paper shows that BAT takes pains to understand and to some extent control the pricing of illegal products in these markets, and that they are aware of the possibility that the GT [General Trade – illegal market] may be stopped by an enforced Government clampdown.

[Information sent on 21.10.93 by Paul McPhail, BAT Singapore, to Patrick O’Keeffe, BAT Millbank, re. McPhail’s recent Vietnam visit:](#)^[17]

“B: Key Issues

Pricing

Ex factory price should be such that retail price falls at parity with GT (not fully controllable). GT price structure is:

(In US\$ per case)

BATUKE to SUTL: \$245

SUTL to Importer (Cambodia): \$290

Importer to Wholesaler (Cambodia): \$348

Wholesaler to Trader (Cambodia border): \$350

Therefore GT exiting Cambodia at US \$350 (Laos route also appears to exit at US \$350)”

“We must accept the continued presence of GT (unless a complete Government clampdown takes place). Both versions will have a role to play in the further building of the brand and the ‘system’ profitability... We have the high ground [in negotiations with Vinataba] given the excellent quality of distribution, presence, and value of the GT product.”

These briefing notes further demonstrate the degree of control exerted over pricing in illegal markets.

[Visit Notes – China 2/3/92-6/3/92: A.A.Chown](#)^[18]

“Lucky Strike is far too low in its price positioning in the free market and is considered by the Group manager for B&W brands as not having the critical mass in the market yet to be able to take a significant price repositioning upwards. However, the conundrum is that should Lucky Strike grow at its low price positioning it will provide fertile feeding ground for Marlboro as smokers aspire to the “face” value of premium priced US international brands once they are affluent enough to uptrade.

A price strategy for Lucky Strike needs to be developed. Some work has to be done to quantify the risks of a relative increase in price to Marlboro (over time) on forecast sales and, therefore, contributions.”

This whole document describes plans for the Belmont Brand, demonstrating BAT’s control over both the DP [Duty Paid] and GT [General Trade/illegal] markets: determining when and how Brands are launched in illegal markets, as well as the ability to remove specific brands from particular markets at will.

[Document dated February 1995, entitled Belmont Name Change: Project Maiden^{\[19\]}](#)

“2. Options

- Maintain current Belmont in GT channel only
- Maintain current Belmont in GT channel and launch new brand in DP
- Launch new brand in GT and DP channel

1. Key Issues

- Risk of name change vs. maintaining current Belmont in GT channel...

2. Risk analysis

2.1 *Name Change (DP/ GT)*

Pros:

- clean brand ownership for BATCo
- avoids reliance on GT channel...

Cons:

- ...profit impact vs. maintaining Belmont in GT channel only

2.2 *Launch new brand in DP and maintain Belmont in GT*

Pros:

- Maintains brand heritage via GT channel
- Logical that GT product continues to be Belmont
- Minimises risk given importance of GT business

Cons:

- ...cannot support Belmont in GT via advertising

2.3 *Maintain Belmont in GT only*

Pros:

- Avoids risk of consumer rejection
- Protects current position (to an extent) at lower risk than 4.1 above

Cons:

- ...GT channel closes...

10. Implementation plan

Assumptions:

...Belmont only sold in GT until cancellation action outcome known

10.1 Plan summary

- ...Risk of going sooner greater than risk of GT only sales for 4 months
- new brand launched in DP/ GT simultaneously

10.2 Key Actions

C. Pre cancellation announcement:

- manage stock levels in GT channel
- initiate project Scorpio (Bogota distribution)...

D. Cancellation announcement:

- ...Launch new brand in DP/ GT channels...”
-

8.3 Documents showing BAT exploiting relatively weak border controls; specifically the encouragement of storage warehouses and strong marketing close to strategic borders to stimulate illegal cross-border sales:

A brief quote illustrating the BAT attitude to illegal sales over the Paraguay/Argentine border.

[Paraguay Trip Notes 12-14 July 1994^{\[20\]}](#)

“2.21: Excellent work has been done in the border town, which is the main supply point of DNP product for the Argentinean market.”

These notes were circulated to some of the most senior BAT executives, showing high levels of BAT support for and awareness of groups supplying product to various strategic borders and comprehensive knowledge of an illegal market.

[Paraguay Market Visit 24-25 January 1994^{\[21\]}](#)

Notes dated 8.2.94, distributed to:

KS Dunt
J Rembiszewski
C Figueiredo
IG Hacking
C Rodriguez

“12. Border Trade

12.1 Sabah recruiting ex BAT personnel to dedicate himself to developing and managing the Derby border trade.

...15. Systems

15.3 Thought should be given to provide accounting and system backup from either Chiletabacos/ Nobleza for the Peruvian Paraguayan/ Bolivian operations with Bigott supporting the Colombian and Ecuadorian office.

16. Border Trade – Market Visit

16.1 Derby 84mm. Out of stock – heavy demand for the product, 100mm Derby in stock. Need to get the split 100mm/ 84mm right.

16.2 Need to get buffer stock available a.s.a.p.

16.3 Le Bouqueron’s version of Ritz selling through well. Trade know it as the counterfeit version.

16.4 Souza Cruz’s Ritz has been out of stock for two weeks, trade view for this was that it was more profitable to sell product into Brazil and not Argentina. Is this true or has product been shorted by Souza Cruz?”

These meeting minutes show BAT’s main South East Asia distributors SUTL [Singapura United Tobacco Ltd] arranging for border warehousing to be established near a ‘free trade zone’ in Myanmar.

[Minutes of meeting with SUTL on Friday 1 March 1991^{\[22\]}](#)

1) Burma transshipment

...In conjunction with the Yunnan Regional Government...Moosa (a town on the Burma China border) was to become a ‘trading city’...Final ratification is due on 9th March...the indication is that Moosa is to become a ‘free trade zone’. JH [Janet Ho of SUTL] intends to visit Moosa...and if positive, arrange for warehouse facilities...It is anticipated that the assessment value of cigarettes will fall on 9th March, returning Burma to a duty paid market.”

8.4 Documents showing BAT’s use of ‘Umbrella Operations’ a term denoting the use of limited legal or duty free sales to justify advertising campaigns which have the real purpose of stimulating demand for illegal cigarettes.

These trip notes show that BAT are capable of tracking the movement of their tobacco products, despite their claims to the contrary to Customs and Excise. The notes also explain in detail the concept of Umbrella Operations and the possible risks associated with this sort of covert action.

[Internal document from Andrew O’Regan to ADG Pereira dated 7.12.93^{\[23\]}](#)

Trip Notes – India 29 Nov to 2 Dec 93

“There was no evidence yet of any of the three separate shipments made to the Gulf and destined for this market.

...Issues, Recommendations and Action

Official Imports: Achieving official importation of the brands should be a high priority because it will help legitimise our ATL activities and also enable some promotional work to be done directly with our target consumers. Our SEFK target group tend to socialise at 4 & 5 star hotels. The “Available in Duty Free” cover for extensive media coverage needs to be very carefully used, as it can easily become antagonistic and will draw attention to the source of market supply, which we would rather did not come under scrutiny. Legitimate imports through various hotel groups is defensible and provides another source of “cover” for our brand building plans, and a promotional platform.”

A further document explaining ‘Umbrella Operations’, and BAT’s long term aim to use cheap illegal channels to build demand for its brands in new markets.

[NOTE: Dunt \(BAT\) to Bramley \(BAT\) 6/9/92^{\[24\]}](#)

“RECOMMENDATIONS

6.1.3 It is recommended that BAT operate under “umbrella” operations. A small volume of Duty Paid exports would permit advertising and merchandising support in order to establish the brands for the medium/long term with the market being supplied initially primarily through the DNP channel.”

8.5 Documents showing the complicated movements of cigarettes through several jurisdictions or multiple levels within an elaborate distribution chain – making illegal product tracing virtually impossible;

This marketing plan discusses the complexity of BAT’s Vietnamese market distribution, as well as the problems associated with marketing an illegal product.

[1995 Interim Marketing Plan for State Express 555 in Vietnam^{\[25\]}](#)

“The ‘Vinataba Saigon’ Wholesale Channel:

...Product is then sold on through a series of sub-distributors and it is at this level that ‘imported product’ enters the wholesale chain...It is not unusual for stock to pass through three or more ‘wholesale layers’ before ending up in retail.”

“Retail Channels:

...Product visibility however, outside the central commercial district where it is displayed openly is not good due to the requirement in those areas to conceal illegal product.

...Immediate challenges are therefore distribution of legal product, universe identification and classification, and presence marketing domination of target outlets

...1995 Trade Marketing Objectives and Strategies:

...Presence marketing within convenience and key sub distributors (the assumption being that distribution within these channels is not a problem).”

A report detailing various efforts by tobacco companies to make distribution within a market more complicated and thereby to facilitate the evasion of taxes.

[Report: Philippines – A Draft Overview and Recommendation, 1994^{\[26\]}](#)

“2.3 Taxes:

...As cigarette taxes are levied at the first level of sale (i.e. to distributor), Fortune has established a number of dummy marketing companies, selling at below manufacturing cost, to avoid considerable taxes.

“...2.5 Distribution:

The Philippines distribution structure is a multilayered system, which passes through up to 7 levels prior to the consumer purchasing the product.

The chain starts with the manufacturer who sells to the marketing/ distribution companies often lower than cost to minimise excise taxes...”

8.6 Documents showing BAT encouraging or developing new smuggling routes, particularly in areas where official controls were weak or corrupt.

These meeting notes show that official exports to China were routed through BAT China, BATCo subsidiary in the state, while illegal sales are handled by SUTL. The document specifically notes BAT's encouragement for the development of new overland smuggling routes.

MEETING NOTES: SUTL and BATCo 24/2/93^[27]

“CHINA;

SUTL are encouraged to expand overland routes through Indochina. Enquiries for duty paid should be referred to BAT China.

...P.N. Adams agreed that SUTL should be able to pursue any enquiries from the USSR provided that goods were shipped through Eastern Siberia and not through Europe or the Baltic ports.”

This Company Plan explains in detail the various methods of tobacco reaching a national market, and the financial and legal implications of each method.

FAR EAST SOUTH COMPANY PLAN. 1992 – MYANMAR^[28]

“Product reaches the market by one of three methods:-

- i) Duty Paid – duty rates vary according to point of entry
Yangon is the most expensive legitimate import for all stocks. Rates are constantly under review with a uniform rate being sought in order to eliminate transit.
- ii) Partial Duty Paid – Product arrives at ports less rigidly “policed”
Duty is, therefore, paid on some of the amount imported. This will vary according to the compliance of the customs personnel – the usual point of entry being Moulmein.
- iii) Transit - Product arrives at various points on a creek to the north of Moulmein and at Kawthaung near Thailand. Shipment is met and transported to Yangon.

The retail trade is supplied through the major wholesale markets in each of the cities – Mengala in Yangon; Xeygyo in Mandalay, etc.

Product moves up-country with an appropriate cost for the transport, etc, being reflected in retail pricing. This varies from between 2.5% - 5% of case price from point of entry to destination, i.e. US\$8.00 to US\$15.00.

...

Border trade fluctuates, dependent on such factors such as the weather (ie monsoon) and insurgent rebel activities.

Established buyers positioned at each of the main border trade points in Bangladesh, China and Thailand maintain regular orders with Myanmar importers.

...

PRICING MODEL

...

- 2) Negotiations between the government and traders over the last year have failed to resolve the issue of duty levels. However, as at July 1991, the port of Moulmein has been closed to importers and traders have been ordered to route all shipments through Kawthaung where duty will be enforced in full.

This is the firmest indication yet that the authorities ‘blind eye’ with regard to transited goods is beginning to open. In return, they promise a review to the duty levels by the end of July that should go some way in eliminating the necessity to transit.”

A further quote from the same document gives details of illegal tobacco distribution in the Vietnamese market, and of BAT's intimate knowledge of the trade.

FAR EAST SOUTH COMPANY PLAN. 1992 – VIETNAM^[29]

“DISTRIBUTION CHANNELS

Following the ban in October 1990, imported cigarettes like JET, 555, HERO and RUBY QUEEN are sold into Vietnam through Cambodia wholesale market. The main route into Vietnam is by the river.

Due to continued activity by the authorities, wholesalers in Vietnam do not hold large buffer stocks.

On the retail level, 555 and JET are readily available in HCM city. However, the routes north are still hazardous.

...

SWOT [Strengths, Weaknesses, Opportunities, Threats] analysis

STRENGTH

- 1 555 with its high level of awareness and demand has prompted wholesalers and retailers to stock the brand despite the ban and the risk.
- 2 SUTL with its strong network of customers in Cambodia have been able to capitalise on the demand of the Vietnamese customer despite the ban.
- 3 Increased market knowledge through market visit.”

8.7 Documents showing collusion with other companies over pricing and distribution

This document refers briefly to an arrangement between Philip Morris, RJ Reynolds and BAT to introduce their brands into the Thai market at a set price. This constitutes cartel behaviour and is, as such, illegal under Thai law.

[General Comments/ Action Points Arising out of Market Visits 13-30 November, 1990](#)^[30]

“4. Thailand

...PM/ RJR/ RPE are advocating market entry at 40 Baht in order to demonstrate that the legal business will be minimal, GT will continue and therefore revenue lost. The belief is that the Thais will then reduce the Duty.”

This document demonstrates an extraordinary example of cartel behaviour, referring to ‘share agreements’ under which companies would divide market share to an agreed formula and so reduce the marketing cost of competing. The document also refers to an ‘industry agreement’ which needed ratification from the BATCo Board –indicating most senior awareness. The document mentions negotiations between Philip Morris and BAT over pricing levels in both legal and illegal channels – once again showing the level of control the companies exert over their illegal distribution networks.

[FILE NOTE: marked “Secret” 05/08/92](#)^[31]

“MEETING WITH PHILIP MORRIS REPRESENTATIVES

At Pennyhill Park, Bagshot

In attendance:

Peter Scheer President Latin America Region [PMI]

Rafael Arguelles Vice President Latin America Region [PMI]

Fred Hauser Vice President Central America, Puerto Rico, and Dominican Republic [PMI]

K S Dunt)

D J Etchells) BATCo

T M Wilson)

...

REGIONAL FOR C.A. [Central America]

- 1) PMI obviously anxious for increased profitability from C.A. and would like some agreement containing expensive market support practices such as bonusing, exclusivity and level of advertising support in certain territories should be considered so as to improve industry profitability of both companies.
- 2) They wanted an indication from BATCo of the possibility of a share agreement in all four Countries where we compete and suggested we exchange concepts by the end of September 1992, for discussion at a meeting in October...

...

ANDEAN PACK
VENEZUELA

2) Price Increases

BATCo stated concern over the significant growth of the market segment emerging in DNP and cautioned that this would, if allowed to spread, destabilise the industry throughout the region.

PMI agreed with this stance.

BATCo suggested an aggressive price increase to be negotiated at a local level for DNP to be implemented if possible by the end of August.

...

Following action on DNP PMI suggested we should pursue a DP price increase. PMI wanted linkage between the DNP increase. This was not supported by us.

...

MERCOSUR
ARGENTINA

PMI rejected any joint move for domestic price increases or widening the market gaps.

They also rejected any share agreement in Argentina unless this was linked with the Brazilian market. KSD [Keith Dunt] confirmed that this was outside his remit but he would refer back to Souza Cruz and the BATCo board.”

8.8 Evidence which suggests that BAT knew the nature of this business and sought to hide their involvement in it:

This document shows that BAT employees were aware of the legal implications of their activities, but took steps to avoid detection.

**Secret BATCo Singapore document entitled “Proposed re-definition of Market Responsibilities.”
December 1988** ^[32]

“Transit: the nature of this business brings paradoxical requirements of an arm’s length approach and close supervision. Where BAT has legitimate interests in the end markets it must be able to disassociate itself from direct involvement in parallel imports. Nevertheless, indiscriminate sourcing can and does lead to potentially embarrassing problems.

This conflict can be resolved by maintaining close control over the accredited export agent in the home market, backed up market intelligence garnered from end market visits...Market observation in Vietnam has been useful in responding to SUTL’s requests for revised branding and pricing for that market.”

Similarly this document shows the complex contractual arrangements surrounding BAT’s distribution deals with intermediaries through which it was operating its illegal distribution channels.

MEETING MINUTES: SUTL and BATCo 24/3/93 ^[33]

“c) For Myanmar, Laos and Cambodia, BAT wants to formalise its duty paid contractual arrangements with the end-market distribution companies, ie, UIL, SUTL (Laos) and ANCO International. Alex Stuart stated that SUTL would prefer, if these contracts were formalised with SUTL and not the end-market companies. Fred Combe replied that BAT would only be prepared to formalise agreements with bona-fide duty paid distribution companies such as the end-market companies, due to General Trade sensitivities. SUTL believes this will only complicate matters.”

8.9 Documents showing clearly that BAT was not the only company involved in smuggled markets

This document shows the role of Japan Tobacco International in establishing illegal tobacco supply networks in a specific market.

Review of Asia-Pacific Cigarette Market by BATCo Marketing Intelligence Department January 1995
[\[34\]](#)

“Taiwan:

...The imported segment has increased each year and penetration reached 32.6% in 1993. This figure includes legal imports which accounted for 6.7 bns in 1993...plus GT imports estimated at 7.6 bns (17.4% SOM). The gap between legal and GT imports narrowed in 1993 as JTI (which has used the GT route to circumvent an embargo on imports ex-Japan) began importing legally from UK and Switzerland.
 ...the fastest growth in the Imported segment has come from JTI which is now the leading company and increased its share to 40.2% in 1993. It is estimated that 86% of JTI volume in 1993 was GT.”

(JTI = Japan Tobacco International)

A table demonstrating the various market shares for both Philip Morris and BAT in the legal and illegal Taiwanese markets.

BATCo Asia-Pacific Review May 1993[\[35\]](#)

Table entitled Coverage of Outlets Achieved
 Includes entry for Taiwan as follows:

		BAT	PM
Taiwan	Legal	86%	83 % (est.)
	Total	60%	

(PM = Philip Morris)

This document gives further evidence of Philip Morris's involvement in specific smuggling routes.

FAX: WATERFIELD to COOPER (BAT LEGAL TEAM) 10/4/92[\[36\]](#)

“ I enclose a sample of Bigott's version of Belmont which is sold in Venezuela, Aruba and Colombia. In Colombia the product is transitted in from the Aruba free trade zone.

Also attached is PMI's version of Belmont made in Ecuador. This product is not available in the Arubian Market but is transitted into Colombia from the Arubian free trade zone. Once the product has been transitted into Colombia, a proportion of it flows across the border into Venezuela.”

This document refers to apparently illegal 'transhipments' made by Brown and Williamson, Philip Morris, RJ Reynolds and Souza Cruz into the Argentinean market in 1991.

INTERNAL BAT FILE NOTE:[\[37\]](#)

"PROJECT PARAGUAY

The estimate on imports last year was around 3.9 billion cigarettes which 46.4% of this volume was consumed domestically.

The remaining volume is then transhipped to Argentina due to the price advantage provided by Paraguayan market.

This is demonstrated by the large number of transhipments made by BWIT, PMI, RJR and Souza Cruz brands to Argentina in 1991.

...

Souza Cruz exploit the medium/low price segment under GT operation. Souza Cruz brands (Hilton, Minister and Carlton) are sold only along the border of Brazil and Argentina.

...

BRAND STRATEGIES

...

(i.i.i.) To introduce all brands on a duty paid basis.

This document once again refers to the uneasy relationship between BATCo and Philip Morris in Brazil.

[Secret paper from Keith Dunt to Barry Bramley, dated 15.10.93](#), entitled “RBU Latin America and Caribbean – A Better Approach”^[38]

“Souza-Cruz has greatest synergy with Paraguay/ Uruguay. Key to this now is the DNP flows (8-10% of Brazil and 12% of Argentina markets) which are growing and represent a major threat to our Brazilian share and profits and also give exploitation/ de-stabilisation opportunities to PMI which they are using unashamedly...”

“Recommendation:

2) Andean Pact should be managed as domestic markets...Venezuelan-sourced products have a real consumer perceived preference in this market. The GM would access his VFM brand ex-Souza Cruz via UK invoicing base on the agreed brand portfolio range.”

9 Further evidence

The documentary evidence shown above is not the result of “cherry picking” – these are only a few of hundreds of quotes unearthed through ASH’s research, with potentially thousands more still in the Guildford depository. For a fuller set of quotes and printable (PDF) copies of the original documents please see the ASH website at www.ash.org.uk/smuggling/ to find the following lists:

- [Documents discussing ‘DNP’](#)
- [Documents discussing ‘Transit’](#)
- [Documents discussing ‘general trade’](#)
- [Documents which taken together suggest BAT exercise control over smuggling](#)
- [Documents describing how smuggling works](#)
- [The full ASH document set including those listed above](#)

10 The legality of BAT’s actions

Deputy Chairman of BAT, Rt. Hon Kenneth Clarke QC MP, has argued in [The Guardian](#):

Where any government is unwilling to act or their efforts are unsuccessful, we act, completely within the law, on the basis that our brands will be available alongside those of our competitors in the smuggled as well as the legitimate market.

The claim that these ‘acts’ are always within the law is both audacious and false. It depends on the nature of the actions taken and the extent to which they may be construed as aiding or controlling the smuggling itself. Mr. Clarke’s assertion is certainly false if only because at least one senior BAT employee has been convicted of smuggling-related bribery. In the light of this evidence, potential smuggling-related legal actions include individual actions against employees where they have broken the law as well as conspiracy and racketeering offences. These are organised-crime offences in which those exercising control are held responsible for actions of others that commit the substantive illegal acts. These are offences aimed at the convicting the ‘Mr. Bigs’ – the organisers who do not actually smuggle contraband by driving the trucks or offering bribes, but act so as to ensure that others do. Even if BAT employees did not generally do the smuggle tobacco themselves, it does not mean that they cannot have been party to a conspiracy to cause smuggling to happen.

10.1 Legal action against BAT employees

BAT’s Export Director for Hong Kong, [Jerry Lui](#), was convicted in June 1998 for accepting HK\$33 million (£2.6 million) in bribes between June 1988 and December 1993 in connection with a cigarette smuggling syndicate. He received a jail sentence of three years and eight months. Despite prolonged technical wrangling over his case, Hong Kong’s highest court reaffirmed the conviction on 14th December 1999.

10.2 Conspiracy action in England

Because BAT is based in Britain, and much of the control and strategy for smuggling in Asia and Latin America was co-ordinated from Britain, we wished to examine the prospects for a conspiracy action under English law. Legal advice for ASH shows that the relevant offence in English law did not come into force until 4th September 1999. It was only the Criminal Justice (Terrorism and Conspiracy) Act (1998) that

created the offence of conspiring to break the law in jurisdictions outside the European Union. The common law prior to the 1998 Act would not support a conspiracy action in the English courts. There is thus no possibility of action in the English courts.

10.3 Conspiracy action where the smuggling took place

Proving a criminal conspiracy in one jurisdiction when the substantive illegal act happened in another will always be difficult. However, there is no reason why conspiracy actions should not be taken against BAT or its executives in the jurisdictions in which the substantive smuggling acts have occurred. This is why we believe Mr. Clarke's claim is 'bold'. To make it with confidence Mr. Clarke would require an implausible familiarity with the documents and with conspiracy legislation in the jurisdictions in which the smuggling occurs. If he is merely acting on the advice of others within BAT, then he is not taking the independent view that should be expected of a senior non-executive director. Health experts in Hong Kong have called on the Government: "to consider whether indictable offences had been committed for which BAT executives should be extradited to answer in Hong Kong."

10.4 Racketeer Influenced and Corrupt Organisations (RICO) actions in the United States

United States RICO laws enable losses through fraud and other organised crime to be recovered from the perpetrators. The damages awarded can be up to three times the losses. Damages could be very substantial and not easily recovered by co-ordinated price increases and passing the cost on to the consumer without loss of competitive edge. In other words the shareholders rather than consumers are likely to pay.

This US legislation is already being used against one tobacco company for its smuggling actions in other jurisdictions. In December 1999, the Canadian government has commenced RICO action against RJ Reynolds in Northern District of New York. A Grand Jury investigation in the North East District of South Carolina is currently investigating tobacco smuggling and this may also lead to smuggling-related legal action. ASH has forwarded a dossier to the Grand Jury. The proceedings of the Grand Jury are confidential.

There are also reports that the Colombian Governors and Mayor of Bogota are about to bring action in the US courts. According to the report of the Washington DC-based Center for Public Integrity:^[39]

A majority of Colombia's state governors and the mayor of Bogota have retained U.S. lawyers to prepare lawsuits in the United States against British American Tobacco and Philip Morris, said Jose Manuel Arias Carrizosa, executive director of the Federation of Colombian Governors. He added that the 21 governors and the mayor of Bogota were seeking "an indemnification for damages caused through contraband of cigarettes into the country." He would not say exactly how much would be demanded of the two companies.

"We think there are two markets, one legitimate that pays its duties and taxes, and the other much bigger, illegal," Arias said in an interview. "That cannot be happening without the knowledge of the producing companies." A lawyer hired by the Colombians, who spoke only on condition that neither he nor his firm be identified, said the governors had "a viable cause of action" under civil provisions of the Racketeer Influenced and Corrupt Organizations Act, or RICO.

10.5 Response of BAT

ASH wrote to the Chairman of BAT on 31st January requesting that he make a statement to all shareholders regarding the company's exposure to smuggling-related legal actions. In his reply of 4th February, Mr Broughton refused, arguing the (specious) point that he was unable to answer our request individually. We believe that BAT should present a candid assessment of its exposure to smuggling-related legal action, and we have written again requesting the Company makes a statement. We believe that the documents revealed show the level of control and involvement to be sufficient to warrant a clear statement from BAT.

11 What should be done?

We believe there should be three major actions taken in response to the revelation of these documents:

11.1 DTI investigation

The Department of Trade and Industry should undertake a fact-finding investigation. Under the Companies Act 1985 s.432, the Secretary of State for Trade and Industry may "appoint inspectors to investigate the affairs of a company. He can do this if he suspects fraud or misconduct or if the company's shareholders have not been given the information which they might reasonably expect".^[40] ASH has written to the

Secretary of State for Trade and Industry, Mr. Byers ^[41], requesting a fact-finding investigation which should assess:

- the conduct of members of BAT's main board, notably the Finance Director, Keith Dunt, Managing Director, Ulrich Herter, and marketing Director Paul Adams, and whether these individuals are fit to be at the helm of a major British company.
- whether BAT's business practices were and are acceptable – a question of corporate conduct.
- whether there is adequate supervision of the executive management – a question of corporate governance.

As [The Guardian leader of 4th February](#) ^[42] put it:

The Commons Health Select Committee, examining tobacco-related diseases, was right this week to demand Mr Clarke's presence for cross-examination. . He has a lot of explaining to do. But it should not stop there. Trade and industry officials, who laboured so long over whether Mohamed Al-Fayed was a fit person to run Harrods, should be given a new and bigger task: the review of the BAT documents to determine if its senior officials are fit people to preside over a company which runs its company so dangerously.

We know of no other route by which the conduct of BAT could be independently investigated in the UK.

11.2 BAT internal inquiry

[ASH has written to Mr. Clarke](#) (31st January) pointing out that in his capacity as the most senior non-executive director the Deputy Chairman of BAT, he has a responsibility to supervise the executive board of BAT, and to ensure that the company operates with acceptable conduct and adequate governance. Mr. Clarke cannot possibly have made an adequate assessment of this matter in the four days between the revelations on 31st January and his response giving BAT the 'all-clear' which was published on 3rd February. For this reason we believe Mr. Clarke should undertake a full inquiry and present at least an interim report to the BAT Annual General Meeting on 27th April 2000.

As part of this we believe that BAT should make a statement to shareholders regarding its exposure to smuggling related legal action – even if it is to assert that, in BAT's view, there is no exposure.

11.3 Co-ordinated international action on tobacco smuggling

While it is important that rogue corporations are investigated, held accountable, punished as appropriate and as far as possible reformed, the ultimate responsibility for tackling smuggling lies with governments. The World Health Organisation is currently advancing an intergovernmental treaty, the [Framework Convention on Tobacco Control](#) which would create a global response to many of the problems caused by tobacco. Within this Convention is a [proposal](#) to develop a Protocol on smuggling ^[43]. Co-ordinated measures agreed under such a protocol could include:

- Deterrence through increased probability of conviction and increased punishment
- Overt tax stamps which would indicate the tax status of tobacco products.
- Covert anti-fraud markings to allow tracking and tracing of tobacco products through the distribution chain.
- Record-keeping and monitoring of the movements of tobacco products.
- Creation of a 'custody-chain' for the distribution of duty-suspended products prior to reaching final retail market. A licensing system could be used to implement this.
- Creation of a 'duty of care' in which a seller within the distribution chain is held accountable for the actions of subsequent buyers.

In its statement of 31st January, BAT stated that:

British American Tobacco group companies work with governments and customs and excise authorities around the world proposing solutions to the issue [cigarette smuggling], and supporting initiatives to help eradicate the problem. ^[44]

We hope this means that BAT will lend its weight, expertise, and its ability to co-ordinate smuggling strategy with other international tobacco companies to support the development of an effective smuggling protocol

within the WHO Framework Convention.

12 Is the smuggling problem really due to inappropriate taxation?

In its 31st January statement^[45], BAT asserts that:

Smuggling arises from tax differentials in different countries, and national trade barriers. A policy of raising tobacco taxes to excessive levels, often driven by anti-tobacco activists, can only exacerbate this situation.

Smuggling is caused by smugglers. Of course, there would be no smuggling if there were no taxes and no cross border price differences. Likewise there would be no income tax evasion or VAT fraud if these taxes did not exist. The problem is criminal, not fiscal.

It is important to recognise that smuggling is *not*, as claimed by BAT, driven primarily by cross-border differences between duty-paid prices, but by the difference between duty-paid (DP) and duty-not-paid (DNP) prices. Most smuggled cigarettes have never had duty paid in any jurisdiction – they are diverted in transit in the wholesale market. Given that even modest levels of duty generate an adequate incentive to smuggle, the level of smuggling depends more on the ease with which smuggling can occur. This explains why European countries like Spain and Italy have high levels of smuggling, despite having some of the lowest cigarette prices in Europe.

Cross-border 'bootlegging' is an unwelcome problem, but wholesale transit fraud dominates the market for smuggled cigarettes. ASH believes that it would be wrong to reverse the well-founded fiscal and health policy of tobacco tax increases and concurs with the World Bank which states in the summary of its 1999 report^[46] that:

Smuggling is a serious problem, but the report concludes that, even where it occurs at high rates, tax increases bring greater revenues and reduce consumption. Therefore, rather than foregoing tax increases, the appropriate response to smuggling is to crack down on criminal activity.

13 References

Documentary references are in the form [BAT file number / BAT box number / Bates number / ASH web address for a printable (Adobe PDF) version of the document].

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