

BRITISH AMERICAN TOBACCO ADDITIONAL SUBMISSION SMUGGLING ALLEGATIONS

General Observations

1. British American Tobacco's views on smuggling and the causes of smuggling were presented to the Committee on 16th February, 2000 through the document "Smuggling: Our View" and by oral evidence given by Mr. Martin Broughton, Executive Chairman, and The Rt. Hon. Kenneth Clarke, QC, MP, Non-Executive Deputy Chairman. This was in response to a request from the Committee for further evidence concerning allegations made by an investigative journalist, Duncan Campbell, and a campaigning organisation, Action on Smoking and Health (ASH), inferred from documents selected from the unique document facility at Guildford, England.
2. Smuggling is a global problem for manufacturers of many goods, including computers, oil, electrical goods, cars, watches, wine and spirits, mobile phones, toys, perfumes, even soaps and detergents. Cigarette smuggling, like all smuggling, is a fact of life, well-known to governments and tobacco companies alike. It is caused by high tax differentials between neighbouring areas, weak border controls and import restrictions and bans on goods which are in high consumer demand. As smuggling occurs in all countries, across a vast range of products, and is almost always conducted under conditions of secrecy, it is (and always has been) extremely difficult to control. As the ASH submission correctly states: "the responsibility for tackling smuggling ultimately lies with governments". Manufacturers are not policemen. Neither do they create the economic or social conditions, nor the absence of political will to deal with the problem, which enables smuggling to occur.

International Trade and Distribution

3. There are many sources of supply around the world for the cigarettes which are sold in markets where revenue policies make the market for smuggled product such a lucrative one. Tobacco is plentiful and is grown in many places. The technology to make and package cigarettes is widespread and relatively inexpensive. There is vast manufacturing capacity for the production of both legitimate and counterfeit product. In addition to the major international manufacturers, there are more than 200 independent producers. Located in every corner of the globe, they supply over 50% of the world market. Many make local versions of international brands under licence. There is also significant capacity to produce counterfeit cigarettes in the Far East and globally.
4. The reality is that, in the international market place, cigarettes are a valuable and easily transportable commodity which entrepreneurs are looking to obtain from any available source. To distribute cigarettes efficiently, there are myriad (and highly competitive) primary networks and channels. There is a thriving secondary market – involving numerous brokers around the globe –

that, both opportunistically and systematically, reallocates product from the primary purchasers and networks, including excess inventories and end of shelf-life product. There are local spot markets providing instant pricing mechanisms allowing entrepreneurs to take advantage of price differentials. There are large numbers of local traders, operating on a small but effective basis. Where there are sufficient incentives, demand for contraband cigarettes will overcome any supply side controlling efforts, much as it did during alcohol prohibition in the United States during the 1920's and 1930's and the earlier tobacco prohibition imposed by certain states in the early part of the 20th century.

5. In addition to duty-paid channels for such goods, duty-free channels also exist. These take many forms, from sales directly to licensed duty-free retailers (such as ships chandlers and those which exist at ports and airports), through sales to licensed duty-free wholesalers for onward supply to their customers, to sales into government-sponsored and managed duty-free zones, established to encourage economic activity in selected areas.
6. Along with other manufacturers, British American Tobacco companies manufacture products around the world for both domestic and export markets. In those countries where we do not have domestic manufacturing capacity, we seek to operate either through our own direct distribution networks, staffed by our own employees, or through independent distributors and wholesalers. Where it is necessary for such distributors and wholesalers to be licensed, we only deal with licensed operators and ensure that other necessary checks are made upon their status. However, we are not in a position to control the distribution chain beyond sales to our direct distributors and wholesalers. Documentation completed by our operating companies and/or their appointed agents in connection with the export, import, warehousing or shipping of our product should comply with applicable laws and regulations and is audited regularly, both internally and by customs officials.

Terminology

7. Much of the misunderstanding on which the allegations are based arise from a misunderstanding of the terminology used. There is no settled categorisation of types of sales. References are often made to domestic sales, duty paid sales, duty not paid, duty free sales, general trade, general exports, combined exports and transit sales amongst others. These may often overlap and on occasion may be used as synonyms. The term "general trade" is an industry term which has been in use since at least the mid-1960's. It is used to refer to sales where the ultimate destination for the goods sold cannot be identified at the time of the first sale into the distribution chain. It is a term normally used to refer to wholesale duty free sales, i.e. sales of duty-free products to third party wholesalers and distributors. No distinction in terminology needs to be made. Such products may ultimately end up in either legitimate or unofficial channels. The term would apply to both. The vast majority of general trade cigarettes are packaged as international duty free product with US/European health warnings. Product exported to wholesalers and distributors and on the spot markets is always general trade

product. General trade product, however, is also sold to domestic markets and in duty free retail outlets where there is no local packaging requirement.

8. Once it is appreciated that general trade product is entirely legitimate product to be sold through a number of legitimate routes, it is unremarkable that British American Tobacco companies may have information on the proportion of its exports which may appear in general trade channels. While smuggled goods can come from any of the legitimate markets in which British American Tobacco companies operate, it is believed that a significant proportion of such goods comes from general trade sales.
9. In a similar vein, the word “transit” may be used in a number of contexts with a number of meanings. Transit products are those which are initially shipped to a country other than the country of retail sale. Again, while non-transit goods may, and do, become smuggled goods, the majority of smuggled goods are goods which have been “in transit”. Goods on-sold from one distributor to another, elsewhere in the distribution chain, will have been “in transit”. Again, therefore, there may have been occasions on which the word “transit” has been used as a shorthand for goods which may have become smuggled goods although this is not its only meaning.
10. Goods referred to as “Duty Not Paid” or “DNP” refer to goods entering the distribution chain without duty having been paid. Goods which are duty-free are also referred to as “duty not paid”. The majority of such goods remain thereafter in the duty free channel but, at some point in the chain, such product may end up being smuggled – sometimes, in certain markets, in large quantities. Again, therefore, there may have been occasions on which “DNP” may have been used to refer to smuggled product but such a meaning is, most certainly, not its only meaning.
11. Similarly, the terms “parallel imports” and “parallel exports” usually refer to manufacturers’ own products which appear in a market other than through manufacturers’ own authorised distribution channels in that market.
12. The desire to suggest that basically everything which was not sold, duty paid, through our own established distribution network must be smuggled is best illustrated by ASH’s assertion that the term “VFM” or “Value for Money” is used as a descriptor for illegal tobacco markets. The term “value for money” is a well-recognised descriptor (for example, in the U.S. domestic market) for cigarette products sold generally at the lower price points where applicable excise duties and taxes have already been paid.
13. It is against this misunderstanding (wilful or otherwise) of the terminology of the business that the allegations made against us must be read. It is certainly true that there is no consistency of usage of these terms – neither is there any “secret code”.

Knowledge and Use of Information

14. We accept, and have never sought to deny, that our companies have knowledge of the fact that some of our brands have been, and continue to be,

smuggled. Indeed, we have frequently brought such information to the attention of the authorities ourselves. We take serious issue with any allegation that our operating companies or their officers orchestrated, managed and controlled smuggling. As a major international business, we have obligations to many stakeholders, including governments and their revenue authorities, but also to consumers, customers, suppliers, employees and shareholders. We have an obligation to manage our business properly, to high business standards. Of course, ASH and others question the ethics of the very existence of the tobacco industry. To debate this issue on ethics grounds is to step onto dangerously shifting sands.

15. In order for us to manage our business properly, we need to have good market information. Such information as is available is inherently uncertain, can only be estimated and comes from a variety of sources, e.g. external and internal consumer research, government estimates and estimates of total size of market. This information is, to a great extent, gathered up by us, market by market, from available sources in each country. It is used to understand our business in order to best protect it for the benefit of all our stakeholders, including governments. Our business is brand-driven and our brand equity is of fundamental importance to the continued viability of our enterprise. Smuggled and counterfeit product damage brand equity. The information which we collect is used to understand what is happening to our brands in any given market e.g. how much of our sales are being lost to smuggled or counterfeit products. This information is frequently used for discussions with governments to enable them (as well as ourselves) to better understand the dynamics operating in their market and provides the basis for our active co-operation with them to help to eliminate smuggling. Examples of notable successes in this regard are contained in "Smuggling: Our View".

Other Allegations

16. In addition to the observations set out above, we absolutely and unequivocally deny the allegations that we might have had any involvement in either money laundering or encouraging the growth of the international narcotics trade. Further, broad allegations of price fixing and market sharing, based on quotations taken from selected documents, are not substantiated in any way by evidence concerning the circumstances, whether political, legal or commercial, present in those markets over the periods alleged. Discussions with competitors are not, of themselves, unlawful. In countries suffering severe economic difficulties, such discussions are often initiated by governments.

Conclusion

17. We reiterate that smuggling is neither welcomed nor condoned by British American Tobacco because it is inimical to our long-term business interests. We would gladly be rid of smuggling altogether and we devote considerable effort, with others, to its elimination. It is invidious to single out the tobacco sector, or one tobacco company, as if to suggest that no other industry or company faces equally difficult issues.

18. As indicated to the Committee on 16th February, 2000, well-established and regulated corporate governance mechanisms operate within British American Tobacco and will be utilised appropriately. As the Committee is also aware, however, the people and organisations making allegations against us spent some six months reviewing selected documents in order to present their conclusions. It is axiomatic that selected documents (or portions thereof) do not, and cannot, in themselves, present the full context to any given issue. Journalists and campaigners have the freedom to express their views in broad terms, being largely unaccountable, whereas the targets of such allegations have to proceed with considerable care in formulating their responses since they are, necessarily, more concerned with precision for reputational and legal reasons. In such circumstances, not least for reasons of fairness and natural justice and given the sheer scale, detail and number of years of history covered in the Guildford depository papers, we do not consider it to be appropriate to answer each and every innuendo and sensational allegation raised against us on a document by document basis. To do otherwise would be to encourage a never-ending stream of similar allegations, with all that entails.
19. No evidence has been submitted by anyone which shows that British American Tobacco companies or their employees have been smuggling tobacco products. What has been alleged, in fact, is that knowledge of a widely known phenomenon (i.e. smuggling) and the use of that knowledge for legitimate business purposes equals guilt in some way. This only has to be stated in order for any reasonable and objective observer to see that the allegation is fundamentally misconceived. It also shows the dangerous area which investigative journalists and other campaigners enter into when they put “two and two together to make five”.

British American Tobacco
8th March, 2000