

Chair's Text for INB-3

Control of the Supply Chain (Licensing and customer identification and verification/due diligence)

1. This briefing reviews Article 5 of the current Chair's text for an Illicit Trade Protocol, relating to licensing of tobacco industry participants, and Article 6, relating to what is currently described as customer identification and verification.

Licensing

2. Article 5 of the current Chair's text would require an entity in a Party to the protocol to be licensed, if it wishes to engage in any of the following activities:
 - manufacturing of tobacco products or primary processing of tobacco
 - manufacturing the equipment used in the manufacture of tobacco products
 - the commercial import, export, wholesaling, brokering, warehousing or distribution of tobacco, tobacco products or manufacturing equipment
 - transporting commercial quantities of tobacco, tobacco products or manufacturing equipment of tobacco products; and
 - Parties would also *"endeavour to license, to the extent considered appropriate"* tobacco growers and retailers of tobacco.
3. Article 5 would require Parties to set up or designate an appropriate authority to administer the required licence system (including issuing, renewal, suspension and removal of licences) and sets out a detailed list of the information that would have to be provided in a licence application.
4. Various forms of licensing are already in operation in Australia, Brazil, Canada, Iran, in twenty-two states in the WHO European Region and in other jurisdictions.
5. FCA strongly supports the principle that key participants in the tobacco supply chain should be licensed. Licensing is potentially a powerful weapon in combating illicit trade, since withdrawal or suspension of a license would prevent a business from involvement in the tobacco trade in the Party concerned. It provides a vital means of enforcement for other obligations on the tobacco trade specified in the Chair's text, including due diligence, tracking and tracing and record keeping. It would also assist governments in collecting information on participants in the tobacco trade and in monitoring their behaviour.
6. A major apparent weakness of the current Chair's Text in relation to licensing is that it does not explicitly provide for the suspension or revocation of the licences of entities breaking the law. This should be included in the text, which should also provide that licensing authorities do not grant licences to applicants that are unfit to carry out the activities covered by the application.



7. The reporting requirement in Article 5.3b(vi) should also be strengthened to go beyond notifying the licensing authority of any offences committed or charges filed by government agencies. This should include other relevant information such as infringement notices or penalties issued, or civil proceedings filed by government agencies, and proceedings brought by others, for example actions for trademark or copyright infringement (important in combating counterfeiting and other forms of illicit manufacture).
8. FCA would propose a revised list of entities covered by licensing requirements: specifically any legal or natural person conducting the following activities:
 - manufacturing, commercial import, commercial export, warehousing¹, brokering or wholesaling of tobacco products
 - manufacturing, *commercial import, commercial export, brokering, wholesaling or retailing* of manufacturing equipment used in the manufacture of tobacco products; *and*
 - commercial import, commercial export warehousing, primary processing, wholesaling, or brokering of tobacco, excluding wholesaling or primary processing by the legal or natural person responsible for growing the tobacco.
9. Detailed proposed FCA amendments to Article 5 are listed in the side by side commentary to the Chair's text attached to this brief.

Customer identification and verification (due diligence)

10. Article 6 would require Parties to ensure that entities involved in
 - selling "*commercial quantities*" of tobacco,
 - the manufacture, sale, distribution, storage, shipment, import or export of tobacco products (excluding the final retailer and persons importing tobacco products for personal consumption), and
 - the manufacture, sale, distribution, storage, shipment, import or export of equipment used in the manufacture of tobacco products,conduct due diligence in relation to their commercial customers ("*first purchasers*"), and also require them to ensure that their customers in turn conduct due diligence in relation to any entity with whom they engage in relevant commercial transactions.
11. Article 6 also proposes that private businesses presented with "*sufficient evidence*" by a government agency that a commercial customer has engaged in illicit trade contrary to the provisions of the protocol should be required to terminate business relations. Such customers would then be designated as "*blocked customers*" for at least five years and prevented from engaging in commercial transactions with any entities in Parties to the protocol involved in the tobacco industry. All Parties would be required to designate an authority to maintain a list of blocked customers, and would be required to recognise blocks imposed in other Parties.

¹ "Warehouse" is defined by FCA in this context as to store in a controlled location before applicable taxes and duties are paid.

12. There is extensive evidence of tobacco manufacturers being at best reckless or negligent in their previous commercial dealings, and thus assisting the diversion of tobacco products into the illicit trade. One notorious example from many is the case of Gallaher (now part of Japan Tobacco International) and their involvement with the Cyprus-based businessman Ptolomeous Tlais (see for example www.timesonline.co.uk/tol/news/uk/article745509.ece and the excellent reporting on the case by the International Consortium of Investigative Journalists www.publicintegrity.org/investigations/tobacco/articles) Between 2000 and 2005, Gallaher shipped billions of cigarettes to Mr Tlais, many of which later returned as smuggled goods to the UK and other jurisdictions. After action by UK Customs and Excise, the relationship with Tlais was ended by Gallaher in 2005, by which time Gallaher cigarettes accounted for more than three quarters of all UK seizures of tobacco products. Although Tlais subsequently lost his UK court action against Gallaher for breach of contract, the judge in the case specifically criticised the company for failing to conduct any due diligence.
13. FCA therefore strongly supports the principle that businesses involved in the tobacco industry should be required to conduct due diligence on their commercial customers. It is absolutely unacceptable that tobacco manufacturers and other key players should be able to sell their products to dubious third parties and then disclaim all responsibility for what happens next.
14. However, the current form of Article 6 appears to require considerable revision. It places obligations on private businesses to take actions that are properly the responsibility of government agencies. For example, the language of the Chair's text could be read as requiring companies rather than governments to place blocks on customers.
15. FCA would therefore suggest the following key principles should be explicitly included in the Chair's text:
 - Due diligence by manufacturers and other regulated entities, including the requirement to ensure that commercial partners have all necessary licenses
 - Getting information on the purpose of transactions, for example for which market products are destined
 - Reporting suspicious activity
 - Each Party would be required to have a system for ordering their licensees not to trade with any specific entity (based domestically or in any other Party) that the designated government agency regards as unfit to trade, including on the basis of evidence that they have engaged in illicit trade. FCA considers that this is the most appropriate means of introducing the blocking system proposed in the Chair's text
 - Parties would be obliged to share with other Parties the names of entities with which they have ordered entities not to trade, together with the reasons for doing so, but this would not mean *automatic* action by other Parties: they would be required to give the decisions of other Parties due weight and consideration.
16. FCA would also strongly urge the removal of the loophole in Article 6.5 about "*taking into account...any unnecessary burden on small and medium-sized businesses and on Parties' administrations*". Any burden implied by Article 6

would be substantially lessened since the process of blocking would be the responsibility of governments, and since their would be access to information collected by governments in the process of administering the licence system. Nothing in the obligations summarised in paragraph 14 above should be considered beyond the resources of a small or medium business involved in the tobacco industry. There is therefore no need to raise the possibility of exemptions for small and medium businesses, which would risk rendering this vital part of the protocol much less effective.

17. FCA would favour a requirement that Parties should ensure that all natural and legal persons engaged in the tobacco trade supply tobacco, tobacco products or manufacturing equipment only in amounts commensurate with reasonably anticipated consumption or use in the intended market of use or retail sale, and that they therefore refuse to supply such items in amounts that exceed such consumption or use.
18. Detailed proposed FCA amendments to Article 6 are listed in the side by side commentary to the Chair's text attached to this brief.