

# Legal analysis of the agreements between the European Union, Member States, and multinational tobacco companies

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## Executive Summary

There are four major publicly available legally binding agreements in effect between the European Union (EU), its Member States (MS), and multinational tobacco companies. The first such agreement was the Philip Morris International Anti-Contraband and Anti-Counterfeit Agreement and General Release (*PMI Agreement*), signed while litigation between the parties was pending in July 2004 as a 'resolution of all past disputes relating to contraband cigarettes' and a 'forward-looking' arrangement for 'strong coordinated action' in combating illicit trade in cigarettes.

The *PMI Agreement* was strongly supported by the European Parliament, and expected to 'serve as a model for other manufacturers'. Negotiations for similar agreements with Japan Tobacco (JT) and British American Tobacco (BAT) appear to have been underway by at least June 2005. The Japan Tobacco International Cooperation Agreement (*JTI Agreement*) was signed in December 2007, settling pending civil disputes between the parties and initiating a legally binding system of cooperation to combat illicit trade. Most recently, the British American Tobacco Cooperation Agreement (*BAT Agreement*) and Imperial Tobacco Cooperation Agreement (*ITL Agreement*), signed in July and September 2010, do not settle legal disputes between the parties, but establish extensive legally binding systems of anti-illicit trade cooperation. It appears likely that related confidential agreements are in effect at least between the EU, MS and JT, BAT and ITL, and that additional public agreements with other large tobacco manufacturers may be under negotiation.

It should be noted that the EU and MS are not the only Parties to the WHO Framework Convention on Tobacco Control (FCTC) to have entered into agreements with the tobacco industry in relation to illicit trade in tobacco products. Canada and Colombia have also entered into legally binding agreements with tobacco companies, and many states have signed memoranda of understanding (MOUs), which are not legally binding and are sometimes confidential.

## Legal obligations of the parties

The parties to the *PMI*, *JTI*, *BAT* and *ITL Agreements* undertake the following obligations:

- the companies undertake similar obligations with respect to their manufacturing, sales, distribution, storage and shipment practices – restrictions on supply and forms of payment for cigarettes, requirements for 'suspicious transaction' reporting and other internal compliance procedures, and due diligence and other procedures applicable to business relationships involving sale, distribution, storage, or shipment of more than 25,000,000 cigarettes per year;

- the companies undertake obligations with respect to marking and ‘tracking and tracing’ of their products – these obligations vary according to form of packaging and intended market of retail sale, and, for JT and BAT, are limited to what is ‘commercially reasonable’;
- the companies undertake similar obligations with respect to maintaining records relating to their regulated business relationships and ‘tracking and tracing’;
- the companies undertake obligations, varying between the agreements, with respect to the provision of information to authorities, and the EU and MS agree to maintain the confidentiality of certain information;
- the companies agree to cooperate with authorities in the event of significant seizures of products bearing their trademarks (by inspecting the cigarettes, determining whether they are counterfeit or ‘genuine’, and providing information to OLAF), and to make payments to the EU and MS (ordinarily in the amount of unpaid taxes, with additional payments in certain circumstances) if the seized cigarettes are not counterfeit (subject to exceptions, qualifications, and termination rights which vary between the agreements);
- the companies agree to make additional payments to the EU and MS (up to USD 1.25 billion for PMI, USD 400 million for JT companies, USD 300 million for ITL, and USD 200 million for BAT companies – subject to rights of reduction and termination which vary between the agreements), and the EU and MS agree to discuss with JT and BAT companies and ITL the possible uses of their payments;
- the companies agree to conduct training programmes for their employees, and the companies and the EU and MS agree to meet at least annually to assess the functioning of the agreements – BAT and the EU and MS will also cooperate in other respects, including additional meetings, information sharing, and training conducted by BAT for EU and MS personnel;
- the EU and MS agree to release PMI and JT companies from particular legal claims (the *BAT* and *ITL Agreements* do not contain releases from liability, however ITL may reduce its payments under its agreement if the EU and MS bring particular claims against it; there may also be provisions relating to liability in related confidential agreements);
- the EU and MS agree that PMI, BAT companies and ITL may request more favorable treatment if the EU enters into an agreement (or amends an agreement) with another cigarette manufacturer relating to the same subject matter on more favorable terms; and
- the parties undertake obligations in respect of compliance and dispute settlement – the companies will provide annual compliance reports, and disputes that cannot be resolved informally will be referred to confidential arbitration proceedings.

#### The agreements and the WHO Framework Convention on Tobacco Control

The EU and all but one MS are subject under the WHO Framework Convention on Tobacco Control (FCTC) to legally binding international obligations with respect to tobacco control. Certain aspects of the agreements with multinational tobacco companies raise issues with respect to the obligations of the EU and MS under article 5.3 of the FCTC, as well as related obligations under article 12 and article 13.

#### *Transparency and accountability*

Article 5.3 requires parties, in setting and implementing their ‘public health policies with respect to tobacco control’, to ‘act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law’. Under article 15, parties recognize that ‘the elimination of all forms of illicit trade in tobacco products’ is an ‘essential component’ of tobacco control and undertake obligations towards this end. Building on the provisions of article 15, parties are in the process of negotiating a protocol to the FCTC which mirrors key aspects of the EU agreements. While the measures provided for in the agreements have a range of objectives, including protection of tax revenue and law and order, they are also clearly ‘public health policies with respect to tobacco control’. To the extent that the negotiation, execution and implementation of the agreements involve setting and implementing public health policies with respect to tobacco control, they should meet the requirements of article 5.3.

The guidelines for implementation of article 5.3 recognize that fulfillment of the obligation to protect tobacco control policies from tobacco industry interests requires parties to be accountable and transparent in their dealings with the industry – they should interact ‘only when and to the extent strictly necessary to enable them to effectively regulate the tobacco industry and tobacco products’, and should ensure that any necessary interactions are conducted transparently. Further, article 12 requires parties to promote public access to a wide range of information on the industry, and to promote awareness and participation of organizations not affiliated with the industry in developing and implementing tobacco control programmes and strategies.

The extensive negotiations which led to the execution of the agreements may not all have been strictly necessary to enable the EU and MS to effectively regulate the companies and their products. Some of the outcomes of the negotiations might have been achieved through direct regulation; others may not have been ‘strictly necessary’ for effective efforts to combat illicit trade. To the extent that the interactions were necessary to achieve the desired regulatory outcomes, recognizing that EU political processes can make direct regulation a slow process, there are questions as to the extent to which they were conducted transparently. There were very limited opportunities for participation by relevant organizations not affiliated with the industry or for provision of information to the public. The possibility that there are additional confidential agreements with the companies, and confidential documents and correspondence provided at execution that impact directly on the companies’ right to terminate or reduce their payments under the agreements, is also a matter of concern.

Interactions provided for under the agreements (such as meetings between the EU, MS and the tobacco companies, and training programmes or workshops involving both tobacco company employees and government officials), to the extent that they involve setting and implementing relevant policies, should also meet the standard necessary to comply with article 5.3 – that is, they should be strictly necessary for effective regulation and should be conducted transparently. The arrangements for BAT to meet with and conduct training programmes for EU and MS officials are of particular concern in this respect, as are the dispute settlement provisions of all four agreements, which require confidentiality and therefore could prevent access to important information about failures in implementation.

*Partnerships and corporate social responsibility*

The guidelines for implementation of article 5.3 state that parties should not accept, support or endorse ‘partnerships’ with the tobacco industry in any initiative linked to setting or implementing public health policies, and that any necessary interactions with the industry should be carried out ‘in such a way as to avoid the creation of any perception of a real or potential partnership or cooperation’ (and, if the industry creates such a perception, parties should act to correct it). The ‘cooperative approach’ of the agreements is a concern in relation to this aspect of effective implementation of article 5.3. While some interaction with the industry is necessary to effectively combat illicit trade (for example, in relation to identification of counterfeit cigarettes), not all of the matters regulated under the agreements strictly require cooperation with tobacco companies. The agreements are not drafted, and have not been portrayed to the public, in such a way as to avoid the creation of perceptions of cooperation or partnership. The EU has promoted the agreements as establishing arrangements whereby tobacco companies and European law enforcement agencies ‘combine their resources and enhance their coordination’, and the EU and MS have allowed the companies to promote the agreements as establishing partnerships between the industry and the EU and MS.

Both the guidelines for implementation of article 5.3 and the guidelines for implementation of article 13 (which requires parties to implement a comprehensive ban on tobacco advertising, promotion and sponsorship, unless prevented from doing so by their constitutions or constitutional principles) also recommend regulation of ‘socially responsible’ practices of the tobacco industry – recognizing that parties should not support or participate in tobacco company ‘corporate social responsibility’ efforts, should make all branches of government and the public aware of their true purpose, and should prohibit public dissemination of information about such activities (except where strictly necessary). The use of the agreements as a form of ‘corporate social responsibility’ is a matter of particular concern in relation to the *BAT* and *ITL Agreements*, which the Commission has publicly stated were ‘initiated by’ the companies, and which do not settle formal legal disputes between the parties. The additional payments under these agreements can be understood as a form of tobacco sponsorship within the meaning of articles 1 and 13 of the FCTC – a contribution ‘with the aim, effect or likely effect of promoting a tobacco product or tobacco use either directly or indirectly’. The publicisation of information about the agreements as ‘socially responsible’ business practices, such as occurs on the *BAT* and *JTI* websites, should also be prohibited.

#### *Possible conflicts of interest*

The guidelines for implementation of article 5.3 recognize that payments by the tobacco industry to government institutions ‘can create conflicts of interest’ which may threaten tobacco control policies. The payments to the EU and MS under the agreements are mandated by legally binding and enforceable agreements, and therefore not subject to the guidelines’ express recommendation against acceptance of contributions from the tobacco industry. However, without further information about the circumstances in which the payments under the *JTI*, *BAT* and *ITL Agreements* may be terminated by the companies, it is not possible to determine whether the payment arrangements give rise to possible conflicts of interest.

Unlike PMI, JT and BAT companies and ITL have the ongoing right to terminate the provisions of their agreements requiring them to make payments if there are significant failures of their ‘reasonable expectations’ as to their benefits under the agreements. Because these expectations are to be assessed by reference to documents, correspondence and agreements which are not publicly available, the breadth of the circumstances in which the EU and MS might risk termination by the companies cannot be determined. It is possible that the aim of continuing to receive annual payments from JT and BAT companies and ITL might influence the decisions of EU and MS officials with respect to relevant policies while the agreements are in force. This risk is greater with respect to the *BAT Agreement*, under which the largest payment of EUR 23,000,000 is scheduled in 2029, significantly increasing the importance of keeping the agreement in force. The risk of influence is increased by JT companies, BAT and ITL’s rights under the agreements to discuss the possible uses of their payments with the EU and MS.

#### The agreements and the draft FCTC protocol to eliminate illicit trade in tobacco products (draft FCTC ITP)

The adoption of an FCTC protocol to eliminate illicit trade in tobacco products has been a political priority for the EU. EU negotiators have worked to secure the inclusion of a number of elements of the *PMI, JTI, BAT and ITL Agreements* in the draft protocol to be considered by COP-4. Should an FCTC ITP be agreed, it may contain the provisions on which consensus was reached by the INB or similar provisions. Relevant ‘consensus’ provisions include that dealing with tracking and tracing (draft article 7), and those relating to information sharing and cooperation in training and capacity building (draft articles 20, 21, 22, 23 and 28).

Draft article 7 would require the EU and MS, if they became parties to an FCTC ITP, to extend their requirements for product marking and ‘tracking and tracing’ beyond those required by the agreements – all manufacturers would be required to mark all tobacco product packaging, and the markings would be linked to additional information. Some changes may be required in practices of interaction established pursuant to the agreements, to ensure that authorities, in participating in the protocol’s global tracking and tracing regime, interact with the industry ‘only to the extent strictly necessary’ in the implementation of article 7. With respect to the proposed requirements relating to information sharing and cooperation in training and capacity building, the agreements give rise to a number of possible concerns – certain information provided to other parties to a protocol may be determined by the industry, the extent to which relevant information can be shared may be limited, information provided by other parties to the EU and MS may be shared with the industry, and EU and MS participation in international capacity building and training efforts may be influenced by the interactions provided for under the agreements. It should be noted, however, that such concerns are not limited to the EU and MS, and would also arise in relation to other potential parties to an FCTC ITP.

#### The agreements and international customs, trade and criminal cooperation agreements

The definitions used in the *PMI, JTI, BAT and ITL Agreements* – including, in particular, ‘counterfeit’ and ‘contraband’ – are generally consistent with the terminology used in existing agreements and arrangements relating to customs and trade. The definition of ‘cigarette’ includes a number of tobacco products classified separately under the World Customs Organization (WCO) Harmonized System, but

this does not appear to impact other agreements and arrangements relating to classification of tobacco products. The provisions of the agreements dealing with provision and protection of information may have some limited impacts, similar to those noted above in relation to the draft FCTC ITP, on EU and MS implementation of existing commitments relating to information sharing with other countries – including, for example, under mutual administrative assistance and criminal justice cooperation treaties.

## Introduction

There are four major publicly available legally binding agreements in effect between the European Union (EU), its Member States (MS), and multinational tobacco companies: the 2004 Philip Morris International Anti-Contraband and Anti-Counterfeit Agreement and General Release (*PMI Agreement*);<sup>1</sup> the 2007 Japan Tobacco International Cooperation Agreement (*JTI Agreement*);<sup>2</sup> and the 2010 British American Tobacco Cooperation Agreement (*BAT Agreement*)<sup>3</sup> and Imperial Tobacco Cooperation Agreement (*ITL Agreement*).<sup>4</sup>

This analysis, based on the four agreements, their annexes and exhibits, and supporting documentation including press releases, statements and materials prepared by the parties and observers, outlines: 1)

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<sup>1</sup> The *PMI Agreement*, executed on 9 July 2004, binds Philip Morris International Inc, Philip Morris Products Inc, Philip Morris Duty Free Inc, Philip Morris World Trade SARL, the European Community (EC), and all 27 MS (the 10 initial MS signatories were subsequently joined by the remaining 17; the last to sign was the United Kingdom (UK), in April 2009). When the Treaty of Lisbon came into effect in December 2009, the EU acquired the legal personality of the EC and took over its obligations. The *PMI Agreement* will remain in force until 9 July 2016 (unless terminated in the exceptional circumstances set out in art 11), and is expected to be extended in duration (the parties agree to meet no later than 9 July 2014 and attempt in good faith to reach another agreement covering the same subject matter: art 11.02). The full text of the agreement is available online at [http://ec.europa.eu/anti\\_fraud/budget/cig\\_smug/2004\\_en.html](http://ec.europa.eu/anti_fraud/budget/cig_smug/2004_en.html).

<sup>2</sup> The *JTI Agreement*, together with the Mutual Cessation Agreement and Agreement regarding Gallaher, all executed on 14 December 2007, bind JT International SA, JT International Holding BV, the EC, and all 27 MS (26 MS signed the agreements on the execution date; the UK signed the agreements in April 2009). The EU took over the legal obligations of the EC in December 2009. The *JTI Agreement* will expire on 14 December 2022 (unless the parties mutually agree otherwise, or unless it is terminated earlier in accordance with art 12). The full text of the agreement is available online at [http://ec.europa.eu/anti\\_fraud/budget/cig\\_smug/2007\\_en.html](http://ec.europa.eu/anti_fraud/budget/cig_smug/2007_en.html).

<sup>3</sup> The *BAT Agreement*, executed on 15 July 2010, binds British-American Tobacco (Holdings) Ltd, the EU, and 24 MS. On the execution date, a press release of the European Commission (the Commission) stated that some MS 'indicated certain procedural problems in the run up to the signature of the Agreement, which prevented them from signing before today', but that all MS were expected to sign 'very soon' ('Contraband and counterfeit cigarettes: frequently asked questions' (MEMO/10/334, Brussels, 15 July 2010, online at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/334&format=HTML&aged=0&language=EN&guiLanguage=en>)). The three MS which had not yet signed the agreement were Poland, Spain and Sweden (see 'BAT and EC sign agreement to combat illicit trade', *Tobacco Journal International*, 16 July 2010, online at <http://www.tobaccojournal.com/index.php?id=50109>). The *BAT Agreement* will remain in force until 15 July 2030 (unless terminated earlier in accordance with art 12), and is expected to be extended in duration (the parties agree to meet no later than 15 July 2028 and attempt an extension: art 12.6). The full text of the agreement is available online at [http://ec.europa.eu/anti\\_fraud/budget/2010/BAT-Main-Agreement.pdf](http://ec.europa.eu/anti_fraud/budget/2010/BAT-Main-Agreement.pdf).

<sup>4</sup> The *ITL Agreement*, executed on 27 September 2010, binds Imperial Tobacco Ltd, the EU, and certain MS. It is not clear which MS have signed the agreement: the MS signature pages are not attached to the publicly available copy of the agreement, and a press release of the Commission on the execution date stated that some MS 'are still conducting their review of the Agreement consistent with their internal procedures', but that it was confident that all MS would sign 'very soon' ('Contraband and counterfeit cigarettes: frequently asked questions' (MEMO/10/448, Brussels, 27 September 2010, online at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/448&format=HTML&aged=0&language=EN&guiLanguage=en>)). The *ITL Agreement* will remain in force until 27 September 2030 (unless terminated earlier in accordance with art 11), and is expected to be extended in duration (the parties agree to meet no later than 27 September 2028 and attempt in good faith to reach another agreement covering the same subject matter: art 11.2). The full text of the agreement is available online at [http://ec.europa.eu/anti\\_fraud/budget/2010/Main-Agreement-sept2010.pdf](http://ec.europa.eu/anti_fraud/budget/2010/Main-Agreement-sept2010.pdf).

the background and context to the negotiation of the agreements; 2) the legal obligations of the parties; 3) the extent to which the agreements may be considered compatible with the obligations of the EU and MS under the WHO Framework Convention on Tobacco Control (FCTC); 4) the relationship between the agreements and the draft FCTC protocol to eliminate illicit trade in tobacco products (draft FCTC ITP); and 5) the relationship between the agreements and relevant international agreements relating to customs, trade, and criminal justice cooperation.

## 1. Background and context

In 2000, the European Commission (the Commission), on behalf of the European Community (EC), launched a civil action in the United States against Philip Morris (PM), Japan Tobacco (JT), and RJ Reynolds alleging torts and violations of the RICO Act<sup>5</sup> arising from the companies' 'involvement in organized crime in pursuit of a massive, ongoing smuggling scheme' (the US litigation).<sup>6</sup> Joined by ten MS,<sup>7</sup> the EC sought significant damages and equitable and injunctive relief, asserting that it had 'lost, and continues to lose, billions of dollars, including the deprivation of customs duties, fees, taxes, money, and property by reason of the Defendants' schemes to smuggle vast shipments of contraband cigarettes and other tobacco products into the European Community'.

Procedural rules – most importantly, the common law revenue rule – held back key aspects of the EC claim.<sup>8</sup> While a series of appeals and related actions were in process,<sup>9</sup> PMI, the ten MS involved in the litigation, and the EC (led by the Commission's Anti-Fraud Office (OLAF)) negotiated the *PMI Agreement*, described as a 'resolution of all past disputes relating to contraband cigarettes' and a 'forward-looking' arrangement for 'strong coordinated action' in the battle against smuggling and counterfeiting.<sup>10</sup>

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<sup>5</sup> *Racketeer Influenced and Corrupt Organizations Act 1970*, Title IX of the Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922, codified at 18 U.S.C. §§ 1961-68.

<sup>6</sup> See statement of claim, available online at <http://projects.publicintegrity.org/docs/Tobacco/EUSuit.pdf>. The proceedings included multiple complaints filed in 2000, 2001, and 2002. See European Commission, 'Background: Legal action by the European Commission against cigarette smuggling' (online at [http://ec.europa.eu/anti\\_fraud/budget/background.pdf](http://ec.europa.eu/anti_fraud/budget/background.pdf)).

<sup>7</sup> Belgium, Finland, France, Germany, Greece, Italy, Luxembourg, the Netherlands, Portugal and Spain.

<sup>8</sup> The revenue rule generally allows courts to decline to enforce foreign tax judgments or foreign revenue laws. On its application to the EC claim, see Brenda Mallinak, 'The revenue rule: a common law doctrine for the twenty-first century' 16 *Duke Journal of Comparative and International Law* (2006) 79, 102-103.

<sup>9</sup> The related actions included challenges brought by PM, JT and RJ Reynolds in the Court of Justice of the European Communities, seeking annulment of the Commission's decision to bring the action: see *Philip Morris International, Inc and Others v Commission of the European Communities* (Judgment of the Court (Grand Chamber), 12 September 2006), available online at <http://curia.europa.eu/jurisp/cgi-bin/gettext.pl?where=&lang=en&num=79939087C19030131&doc=T&ouvert=T&seance=ARRET>; *Philip Morris International, Inc and Others v Commission of the European Communities* (Judgment of the Court of First Instance, 15 January 2003), available online at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62000A0377:EN:HTML>.

<sup>10</sup> European Commission, 'European Commission and Philip Morris International sign 12-year Agreement to combat contraband and counterfeit cigarettes' (press release IP/04/882, Brussels, 9 July 2004, online at [http://ec.europa.eu/anti\\_fraud/budget/pr\\_en.pdf](http://ec.europa.eu/anti_fraud/budget/pr_en.pdf)); Statement by Commissioner Michaele Schreyer (Brussels, 9 July 2004, online at [http://ec.europa.eu/anti\\_fraud/budget/discours\\_en.pdf](http://ec.europa.eu/anti_fraud/budget/discours_en.pdf)).

Concluded in 2004, the *PMI Agreement* recognized that smuggling of PM cigarettes had been ‘greatly reduced’ in the preceding years, and that there was a ‘growing threat’ of illegal importation of counterfeit cigarettes.<sup>11</sup> It emphasized the mutual interests of the MS, EC and PMI in: eliminating illegal importation, distribution and sale of cigarettes and related illegal activity; ensuring the collection of applicable taxes and duties; protecting lawful competition in the sale of cigarettes; protecting the trademark rights of ‘legitimate’ cigarette manufacturers; and preventing consumers from being misled about the source and quality of cigarettes. As the first legally binding cooperation agreement, it was expected to ‘serve as a model for other manufacturers who are willing to work with [the EU] to combat illegal trade in their products’.<sup>12</sup>

Negotiations with JT and BAT for similar agreements appear to have been underway by at least June 2005.<sup>13</sup> By June 2006, nearly all MS had signed the *PMI Agreement*, and a European Parliament resolution dealing with the use of monetary payments under the agreement called on OLAF and the Commission to ‘do everything within their power to conclude similar agreements with other international cigarette manufacturers’.<sup>14</sup> A further resolution in 2007 – expressing worry, in particular, about ‘the increased amount of counterfeit cigarettes found on the European market’ – expressed regret ‘that, until now, no other cigarette manufacturer has concluded a similar agreement’.<sup>15</sup> The Parliament supported the Commission ‘in its recent calls on Japan Tobacco and Reynolds American to sign similar agreements in return for the EU dropping legal proceedings against them’, and called on it ‘to continue negotiations with all major players in the market in order to conclude agreements whereby the Philip Morris agreement, except the main payment, is the minimal standard’.

Like the *PMI Agreement*, the 2007 *JTI Agreement* settled all legal disputes between JT companies, the EC and MS relating to or connected with the US litigation, and initiated a legally binding system of cooperation between the parties in the fight against illicit trade in cigarettes. In contrast, neither the *BAT Agreement* nor the *Imperial Agreement* signed in 2010 settled any existing legal claim; both established extensive systems of cooperation between the manufacturer and the relevant EU and MS authorities. The Commission reports that ‘[v]ery positive results from the first two agreements have been seen over the past few years, in terms of a reduction in the level of smuggled cigarettes from these brands’, and that it ‘expects the same kind of success will be seen from the BAT and ITL agreements in

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<sup>11</sup> *PMI Agreement*, Recitals.

<sup>12</sup> Statement by Commissioner Schreyer; see also press release IP/04/882.

<sup>13</sup> In European Parliament debates on 8 June 2005, Member Bart Staes noted that he was ‘expecting a progress report, possibly behind closed doors, about the negotiations with British American Tobacco and Japan Tobacco’: European Parliament, Debates (8 June 2005, Strasbourg). Note that a press release of the Commission on the signing of the *BAT Agreement* stated only that negotiations had ‘lasted for over two years’ (MEMO/10/334). A press release on the signing of the *ITL Agreement* also stated that negotiations for that agreement ‘lasted for over two years’ (MEMO/10/448).

<sup>14</sup> *Protection of the financial interests of the Communities and the fight against fraud – 2004 annual report*, Resolution of the European Parliament, 15 June 2006 (A6-0185/2006) [57].

<sup>15</sup> *Implications of the agreement between the Community, Member States and Philip Morris on intensifying the fight against fraud and cigarette smuggling and progress made in implementing the recommendations of Parliament's Committee of Inquiry into the Community Transit System*, Resolution of the European Parliament, 11 October 2007 (A6-0337/2007) [30]-[34].

time as the results become visible'.<sup>16</sup> The four agreements may be followed by public agreements with other large tobacco manufacturers.<sup>17</sup> It also appears likely that additional confidential agreements are already in effect, and that more such agreements may be under negotiation.<sup>18</sup>

It should be noted that the EU and MS are not the only Parties to the FCTC to have entered into agreements with the tobacco industry in relation to illicit trade in tobacco products. Canada and Colombia have also entered into legally binding agreements with tobacco companies, and many states have signed memoranda of understanding (MOUs), which are not legally binding and are sometimes confidential.

## 2. Legal obligations of the parties

Under each of the four agreements, the tobacco company concerned undertakes obligations with respect to:<sup>19</sup> its manufacturing, sales, distribution, storage and shipment practices; marking and 'tracking and tracing' of its products; record-keeping; provision of information to authorities; cooperating with authorities in the event of significant seizures of products bearing its trademarks; and

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<sup>16</sup> MEMO/10/448.

<sup>17</sup> In relation to Reynolds American, the third manufacturer involved in the US litigation, it may be noted that a press release of the Commission on the UK's signing of the *PMI Agreement* and *JTI Agreement* in April 2009 stated that the lawsuit against RJ Reynolds and its affiliated entities 'is currently pending', and that the EU-wide membership of the existing agreements 'is a strong signal to other companies that such legally binding agreements are an essential tool to strengthen our action in this area': 'All EU Member States now signatories to the agreements to combat illicit trade in tobacco products' (press release IP/09/610, Brussels, 21 April 2009, online at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/610>).

<sup>18</sup> There appear to have been one or more confidential agreements made in connection with the *JTI Agreement*, the *BAT Agreement* and the *ITL Agreement*. The provision of the *JTI Agreement* dealing with materials that may be relied upon in addition to the agreement (including for the purposes of ascertaining whether there has been a sustained and substantially complete failure of JT companies' 'reasonable expectations' of their benefits under the agreement, giving rise to a right to terminate) allows for reliance on 'provisions of any other agreement with, another Party or their counsel provided and/or executed at or immediately prior to the Execution Date'. The *BAT Agreement* is described on the website of the Commission as the 'Final non-confidential BAT main agreement' (see [http://ec.europa.eu/anti\\_fraud/budget/2010/BAT-Main-Agreement.pdf](http://ec.europa.eu/anti_fraud/budget/2010/BAT-Main-Agreement.pdf)), indicating that there may be an additional agreement or agreements that are not publicly available. The provision of the *ITL Agreement* dealing with ITL's right to terminate in case of a sustained and substantially complete failure of its 'reasonable expectations' of its benefits under the agreement provides that these expectations are to be assessed by reference to the terms of the agreement 'and related agreements ... executed at or immediately prior to the Execution Date'.

<sup>19</sup> Note that, where new manufacturing facilities are acquired after execution of their agreements, **JT** and **BAT companies** are allowed a 12 month phase-in period to implement any of the requirements of the agreements in those facilities, and **ITL** is allowed a 12 month phase-in period to implement the 'compliance protocols' and 'tracking and tracing protocols' in those facilities (*JTI Agreement*, art 3; *BAT Agreement*, art 26; *ITL Agreement*, art 2.3). Where **JT** and **BAT companies** acquire other companies, they must meet with the EU to discuss the extent to which the provisions of their agreements 'might reasonably be applied' to those companies; where **ITL** acquires other companies it must make commercially reasonable efforts to apply the 'compliance protocols' and 'tracking and tracing protocols' to those companies within 12 months. For JT companies, phase-in periods also applied in respect of Gallaher, which should have been in full compliance with the *JTI Agreement* by April 2009 (Agreement regarding Gallaher).

making specified payments to the EU and MS. The companies, EU and MS also commit to cooperating in particular respects and to conducting certain forms of training; and the EU and MS agree to release PMI and JT companies from particular claims they may have against the companies, and to provide equal treatment to PMI and BAT companies and ITL. The parties to each agreement also undertake obligations in respect of compliance and dispute settlement.

a) Manufacturing, sales, distribution, storage and shipment practices

The three agreements contain very similar obligations with respect to the manufacturing, sales, distribution, storage and shipment practices of the tobacco company concerned, designed to combat smuggling and money laundering.

These obligations of **PMI**,<sup>20</sup> **JT companies**,<sup>21</sup> **BAT companies**<sup>22</sup> and **ITL**<sup>23</sup> include: ‘know your customer’ or due diligence procedures under which business relationships involving the sale, distribution, storage, or shipment of more than 25,000,000 cigarettes per year are regulated;<sup>24</sup> restrictions on the forms of payment the companies may receive for cigarettes;<sup>25</sup> a requirement to supply cigarettes only in amounts commensurate with legitimate demand in the intended market;<sup>26</sup> and requirements for ‘suspicious transaction’ reporting and other internal compliance procedures.<sup>27</sup> The companies also agree to comply with relevant internal policies.<sup>28</sup>

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<sup>20</sup> PMI means PMI Inc and its controlled subsidiaries, including without limitation PM Products Inc, PM Duty Free Inc and PM World Trade SARL.

<sup>21</sup> JT companies are JTI, JTH, and existing subsidiaries of JTH involved in manufacture, sale, distribution and/or storage of JT cigarettes.

<sup>22</sup> BAT companies are BAT plc and its direct and indirect subsidiaries involved in manufacture, sale, distribution warehousing, shipping or transportation of BAT cigarettes within, through, or into markets or countries covered by the *BAT Agreement* (the MS and the countries included in the confidential list in Appendix C).

<sup>23</sup> ITL means ITL and all its affiliates existing as at 27 September 2010 and involved in manufacture, sale, distribution, shipment and/or storage of ITL cigarettes.

<sup>24</sup> *PMI Agreement*, art 2.01 and Appendix B (‘EC Compliance Protocols’), protocols 2, 3 and 4; *JTI Agreement*, arts 5.2-5.14 and Annex 3; *BAT Agreement*, art 4.5 and Appendix A; *ITL Agreement*, Schedule 1 (‘EU Compliance Protocols’). Note that for **PMI** and **BAT companies** these obligations apply only in respect of cigarettes sold within, through, or into the countries covered by their agreements; for **ITL** the obligations apply six months after execution in respect of cigarettes sold within, through, or into the countries covered by its agreement, and 12 months after execution on a worldwide basis; **JT companies** undertake to apply know your customer programmes on a worldwide basis. **PMI**, **JT companies** and **ITL** are required to conduct due diligence at least annually for each purchaser/contractor covered by the obligations; **BAT** is required to do this only every three years.

<sup>25</sup> *PMI Agreement*, art 2.01 and Appendix B, protocol 5; *JTI Agreement*, arts 5.16-5.20; *BAT Agreement*, art 4, Appendix A, [26]; *ITL Agreement*, Schedule 1, protocol 5.

<sup>26</sup> *PMI Agreement*, art 2.01 and Appendix B, protocol 2.02 (commensurate with ‘retail demand’); *JTI Agreement*, art 5.1 (commensurate with ‘legitimate consumption’); *BAT Agreement*, art 4.5 and Appendix A, [11] (commensurate with ‘legitimate demand’, comprising ‘local consumption and legitimate cross-border trade’); *ITL Agreement*, Schedule 1, protocol 2.3 (commensurate with ‘retail demand’ – ‘both for legitimate local consumption and to satisfy the legitimate demand of the travelling consumer’).

<sup>27</sup> *PMI Agreement*, art 2.01 and Appendix B, protocol 13; *JTI Agreement*, arts 4.6-4.9; *BAT Agreement*, art 4.5 and Appendix A, [21]; *ITL Agreement*, Schedule 1, protocols 12-14. Note that while **PMI**, **JT companies** and **ITL** agree to require their employees to report suspected violations, **BAT companies** agree only to ‘make commercially reasonable efforts’ to do so. Other internal compliance procedures included in the agreements deal with

b) Product marking and ‘tracking and tracing’

Under each agreement, the tobacco company concerned undertakes certain obligations with respect to product marking and ‘tracking and tracing’, designed to combat smuggling. The primary difference between the agreements in respect of these obligations is that while **JT** and **BAT companies** are required to make ‘commercially reasonable’<sup>29</sup> efforts to achieve particular results,<sup>30</sup> **PMI** and **ITL** are generally directly obliged to achieve them.<sup>31</sup> The extent of the obligations also varies according to form of packaging, and some of the obligations vary according to the intended market of retail sale.

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appointment of dedicated compliance officers, distribution and publicisation of compliance standards and procedures, and penalization of violations. These are less detailed in the *BAT Agreement* than in the *PMI, JTI* and *ITL Agreements*.

<sup>28</sup> **PMI** agrees to comply with its internal policy on compliance with fiscal, trade and anti-money laundering laws, annexed to the *PMI Agreement*, while **BAT companies** agree to adhere to periodically updated standards of business conduct available on the BAT website, **JT companies** agree to retain and enforce programmes ‘substantially in the form of ... and providing, in aggregate, a degree of compliance and ethical standards not materially less than’, their internal policies, and **ITL** agrees to continue to undertake ‘as a matter of company policy’ the policies in the Code of Conduct available on the Imperial website (*PMI Agreement*, art 2.01 (Appendix A); *JTI Agreement*, art 3.5; *BAT Agreement*, art 4; *ITL Agreement*, art 2.1).

<sup>29</sup> It should be noted that the term ‘commercially reasonable’ is not defined in the *PMI* or *JTI Agreements*; in the *BAT Agreement* “‘commercially reasonable”, as used in describing an act required herein, requires the obligated Party to make reasonable business efforts in good faith, to accomplish the relevant activity including incurring expenditure, assigning staff and/or allocating resources as appropriate to comply with the relevant activity’. In the *ITL Agreement*, particular factors to be taken into account in a formal dispute as to whether ITL has complied with an obligation to make ‘commercially reasonable efforts’ to achieve an undertaking are set out in the dispute settlement provisions in art 12.

<sup>30</sup> *JTI Agreement*, art 6. Note that JT companies’ ‘tracking and tracing’ obligations vary according to the market for which cigarettes are manufactured, and that some obligations are to be implemented within particular time periods. Note also that none of the ‘tracking and tracing’ obligations in the *JTI Agreement* apply to tobacco products in ‘non-Cigarette form’, including ‘roll-your-own’ tobacco, or to cigarettes in ‘promotional packaging’ (provided the total volume of promotionally packaged cigarettes does not exceed 175,000,000 per year in a particular market, and 750,000,000 per year in all markets – though note that increases in these volume thresholds may be allowed on ‘reasonable request’ by JT companies).

*BAT Agreement*, art 2.1, Appendix B. BAT’s ‘tracking and tracing’ obligations apply to products made in or for sale within, through or into any MS or other country covered by the agreement, except markets with a single ‘first purchaser’ or (where agreed with OLAF) where the BAT company for the market operates ‘a direct store sales distribution system’. The schedule for implementation of the markings is to be ‘as agreed between the Parties’. Note that BAT’s termination rights for ‘monetary obligations’, described in section e) below, include ‘future expenditure for the implementation of the product identification requirements set out in Appendix B’.

<sup>31</sup> *PMI Agreement*, art 5.01, Appendix D. PMI agrees ‘to adopt, implement, maintain and be bound by the commercially reasonable practices and procedures with respect to the tracking and tracing of shipments of Philip Morris Cigarettes’ as set forth in Appendix D. Note that PMI’s obligations vary according to the market for which cigarettes are manufactured, as set out in Appendix D and the attached exhibits, and that some obligations allow a phase-in period where new manufacturing facilities are acquired. Note also that none of the ‘tracking and tracing’ obligations apply to products in ‘promotional packaging’ (provided the total volume of cigarettes using that packaging in a particular market does not exceed 300,000,000 per year).

*ITL Agreement*, art 7. ITL agrees ‘to adopt, implement, maintain and be bound by’ the ‘tracking and tracing protocols’ attached as Schedule 2, in accordance with an agreed confidential timetable for implementation. Note that cigarettes manufactured for certain markets are exempted from the ‘tracking and tracing’ obligations, that some manufacturing facilities are exempted, and that none of the obligations apply to cigarettes in ‘promotional

## *Master cases*

A master case is a large case containing approximately 10,000 cigarettes. **PMI** is required to mark master cases with unique machine-scannable and human-readable barcode labels; scan the labels in order to record the date, facility, machine and production shift of manufacture; and make ‘commercially reasonable efforts’ to maintain ‘first purchaser databases’ linked to this recorded information and containing the first purchaser name, order number, shipment date, destination, consignee, point of departure, and intended market of retail sale. **ITL** is required to mark master cases with unique machine-scannable and human-readable barcode labels; scan the labels in order to record the date, facility, machine and production shift of manufacture and to link the information in a database with the first purchaser name, invoice and order number, shipment date, destination, consignee, point of departure, intended market of retail sale, and product description; and make ‘commercially reasonable efforts to maintain a ‘first purchaser database’ containing this information. **JT** and **BAT companies** are required to make ‘commercially reasonable efforts’ to: mark master cases with machine and human readable markings allowing for identification of the date, factory, machine and production shift of manufacture, first purchaser name, invoice or order number, shipment date, destination, consignee, point of departure, and intended market of retail sale; and, where such unique codes are applied, create and maintain a tracking and tracing database through scanning the markings to capture and record the information and link it to the master cases. The companies must provide access to their databases to relevant EU and MS authorities.<sup>32</sup> Efforts to further develop databases to include sales by first or subsequent purchasers are also required.<sup>33</sup>

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packaging’ (provided the total volume of promotionally packaged cigarettes does not exceed 150,000,000 per year in a particular market – though note that ‘reasonable increases’ in this volume threshold may be allowed on ‘reasoned request’ by ITL, and that additional obligations apply if the total volume of promotionally packaged ITL products in the countries covered by the agreement in any year exceeds 1,000,000,000 cigarettes).

<sup>32</sup> **PMI** agrees to provide ‘automated query-only access’ to allow duly designated authorized EU and MS representatives to determine the information in the first purchaser databases from ‘complete barcode level information’ from a barcode label obtained as part of a single seizure of three or more master cases of PM cigarettes (and, where technical difficulties prevent it from providing automated access, to comply with requests for this information by other means). The information obtained may be shared only with ‘duly authorized law enforcement authorities who are actually engaged in inquiries related to the seizures which led to the specific query, who have an actual need to know such information, and who shall use such information only in connection with the relevant ongoing inquiries’ – except where the EU or MS are legally required to disclose the information (in which case they must notify PMI prior to disclosure, to the extent permitted, and make a good faith attempt to provide an opportunity for PMI to seek a protective order or other remedy), or in other circumstances with the written consent of PMI, which must not be unreasonably withheld. Each of the MS and the EU may have up to 25 designated representatives from up to five specific agencies, services or departments, and PMI must not unreasonably refuse requests for access for additional representatives from a particular agency, service or department where required for operational reasons. **JT companies** agree to make commercially reasonable efforts to provide OLAF and MS with ‘remote automated access’ to their tracking and tracing database, and with access to code reading technologies to enable scanning. **BAT companies** agree to make commercially reasonable efforts to grant OLAF and participating MS ‘electronic access’ to their database ‘in a reasonable format’. **ITL** agrees to provide duly designated authorized representatives of the EU and participating MS, within three months of implementation of its first purchaser database in a market, first purchaser and other relevant information ‘via automated response to requests resulting from Seizures by the authorities of Contraband Imperial Tobacco

### *Cartons and packs*

A carton contains approximately 200 cigarettes (or ten packs), while a pack is the small packaging unit containing approximately 20 cigarettes. **PMI** and **ITL** must mark – and **BAT companies** must make ‘commercially reasonable efforts’ to mark – cartons and packs to allow for determination of the date, facility, machine and production shift of manufacture; all three companies must make ‘commercially reasonable efforts’ to ensure that cartons and packs bear markings enabling identification of the intended market/s of retail sale.<sup>34</sup> For both **BAT companies** and **JT companies**, the efforts required in relation to markings, scanning and recording of information for master cases, described above, are also required in respect of cartons. In addition, **JT companies** must make these efforts in respect of packs, where and when needed and agreed, and **BAT companies** must make commercially reasonable efforts to develop a system to mark packs so as to allow for determination of the individual master case or carton in which they were shipped or packed, linked to its tracking and tracing database.<sup>35</sup> **ITL** must apply unique identifiers to cartons, link cartons in its ‘first purchaser database’ to the master case in which they are packaged, and implement pack coding technologies in markets meeting particular conditions when such technologies have been identified as ‘commercially feasible’ as part of its ongoing research and development program. **PMI** must implement carton and/or pack coding technologies in markets meeting particular requirements when such technologies are identified as ‘commercially feasible’ as part of its ongoing research and development program.

#### c) Record-keeping

Each of the agreements requires the company concerned to maintain relevant records. **PMI, JT companies** and **ITL** must maintain records relating to regulated business relationships (including commercial documents, identification documents and payment records), and records kept in and

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Cigarettes’. **ITL** also agrees to make commercially reasonable efforts to provide **OLAF** and the participating **MS**, upon request, with access to code reading technologies to enable scanning.

<sup>33</sup> Where agreed with **OLAF**, ordered by an arbitrator or requested by a first or subsequent purchaser, **PMI** must make available a ‘second layer tracking kit’ and training to allow a purchaser of **PM** cigarettes to maintain databases similar to its ‘first purchaser databases’. **PMI** agrees to require participants in ‘second or subsequent layer tracing’ to provide it with the information collected, and, to the extent that it receives such information, to maintain it and provide access to it in the same manner as for the ‘first purchaser database’. **JT companies** and **ITL** must make commercially reasonable efforts to develop and expand the scope of the database technology to cover sales by first, second and subsequent purchasers and give **OLAF** and **MS** access to any such database, and to deploy tracking and tracing technology where voluntarily requested by a first, second or subsequent purchaser. **BAT companies** must make commercially reasonable efforts to develop an ‘additional customer tracking program’ and provide **OLAF** and **MS** with electronic access in a reasonable format to the information in any additional databases created, to provide assistance to those customers wishing to participate in a tracking programme consistent with **BAT**’s marking and scanning programme, and to require that a customer deploy additional customer tracking as soon as practicable following a written reasoned request from **OLAF**.

<sup>34</sup> Note that the *BAT Agreement* provides that these markings may include the health warning, language, brand, name or variant, as advised by **BAT** to **OLAF**. **BAT** must advise **OLAF** of any changes in these markings no later than 30 days after any product bearing such new markings leaves the company’s possession.

<sup>35</sup> Once the implementation of such a pack marking system is reasonable and industrially feasible, commercially reasonable efforts are required to include in it all the information used in the master case and carton system, and to implement it according to a reasonable timetable to be agreed between **OLAF** and **BAT**.

relating to ‘tracking and tracing’ databases, for at least five years.<sup>36</sup> **BAT companies** must maintain records of material documents relating to regulated business relationships and records to show details of volumes, brands, and shipments of cigarettes to major contractors, and keep ‘all material documents and records created or maintained in accordance with this Agreement’ for five years.<sup>37</sup>

d) Provision of information

Each of the agreements requires the company concerned to provide certain information to OLAF, the EU and MS upon request (or, for **BAT**, ‘reasonable request’).<sup>38</sup> Additionally, **PMI** is required to automatically notify customs authorities of shipment of duty-suspended cigarettes or cigarettes for export, and **JT companies** are required to ‘pro-actively disclose’ to OLAF and or the MS ‘all material information’ coming into their possession after the execution of the agreement relating to potentially counterfeit or contraband cigarettes, including information relating to their competitors. The **EU** and **MS** must maintain the confidentiality of certain information, unless required by law to disclose it.<sup>39</sup>

e) Seizure procedures

Under each of the agreements, the tobacco company concerned agrees to cooperate with law enforcement authorities in the event of a seizure of a significant quantity of cigarettes bearing its trademarks, and to make payments to the EU and concerned MS if the seized cigarettes are not counterfeit.

Each of the companies, when notified by OLAF of a seizure of 50,000 or more cigarettes bearing its trademarks, can inspect the seized cigarettes and must determine whether or not they are counterfeit cigarettes and provide OLAF with particular information about them.<sup>40</sup> If the company determines that

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<sup>36</sup> *PMI Agreement*, Appendix B, protocol 2, and Appendix D, protocol 3; *JTI Agreement*, arts 5.8, 6.13; *ITL Agreement*, Schedule 1, protocol 2.5, Schedule 2, protocol 3.3.

<sup>37</sup> *BAT Agreement*, Appendix A, [10], Appendix B, [13].

<sup>38</sup> *PMI Agreement*, art 2.01 and Appendix B, protocols 3, 6, 8; *JTI Agreement*, arts 9.1, 9.6, 9.7, 10.1; *BAT Agreement*, art 4, Appendix A, [10, 22, 27]; *ITL Agreement*, Schedule 1, protocols 6, 8. The information required varies between the agreements, and in some cases is required to be provided within particular time periods. It includes information about regulated business relationships and transactions, sales volumes and projections, information about products, including products under the regime of transit or duty suspension, and information about ‘tracking and tracing’ programmes.

<sup>39</sup> Under the *BAT Agreement*, the EU and MS must not release any ‘commercially sensitive’ or ‘business secret’ information to third parties without BAT’s prior written consent (art 10); under the *JTI Agreement*, the EU and MS must not release any ‘commercially sensitive’ or ‘business secret’ information to any private company without JTI’s prior consent (art 16); and under the *PMI* and *ITL Agreements*, the EU and MS must not use or transmit any information provided to them pursuant to the agreements for any purpose other than combating cigarette smuggling, counterfeiting and related money laundering without the companies’ prior written consent (*PMI Agreement*, art 13.13; *ITL Agreement*, art 13.12).

<sup>40</sup> *PMI Agreement*, art 4.01; *JTI Agreement*, arts 7.2-7.9; *BAT Agreement*, art 3; *ITL Agreement*, arts 5, 6. The company must be permitted to inspect the seized cigarettes within 30 days of receiving the notification from OLAF. Within 30 days of its inspection (or 60 days of the notification), the company must make the determination and provide a written response to OLAF. If it determines that the cigarettes are ‘genuine’, it must provide detailed information about their manufacture and sale. If it determines that the cigarettes are counterfeit (considering agreed upon factors for determination), it must provide documentation and examination results. The agreements

the cigarettes are 'genuine', it must make a payment to the EC and seizing participating MS.<sup>41</sup> The requirement to make 'seizure payments' is subject to a number of exceptions and qualifications, which vary slightly between the agreements – including, for JT and BAT companies and ITL, an exception for seizures made acting on information provided by the companies.<sup>42</sup> It should be noted that JT companies, BAT and ITL have the right to terminate provisions requiring them to make payments if the EU or a MS is in material breach of their agreement, or if there are sustained and material or 'substantially complete' failures of the reasonable expectations of the company of the benefits to it under the agreement.<sup>43</sup>

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provide for procedures under which OLAF may dispute a determination and the dispute may be resolved by an independent examination of the cigarettes.

<sup>41</sup> Ordinarily, the payment must be *equal to 100% of the taxes and duties* that would have been paid on equivalent legal product, less any amount of taxes and duties already paid on the cigarettes to the EU or any MS. However, if the cigarettes, added to the number of contraband cigarettes of the tobacco company concerned already seized in the EU in the same year, result in a total number that exceeds a particular threshold (90,000,000 cigarettes for **PMI, JT companies** and **ITL**; 150,000,000 for **BAT companies**), the payment must include an additional amount *equal to 400% of the taxes and duties*. The *PMI, BAT* and *ITL Agreements* provide that these payments are to compensate the EU and seizing participating MS for their lost taxes and duties and other costs, and may serve as a source of additional funding for anti-contraband initiatives (and, for PMI and BAT, anti-counterfeit initiatives) (*PMI Agreement*, art 3.02; *BAT Agreement*, art 3.6; *ITL Agreement*, arts 6, 1). Note that under the *JTI Agreement*, additional 400% payments are due only on the cigarettes exceeding the 90,000,000 total, and under the *BAT* and *ITL Agreements*, the threshold for additional 400% payments includes only those contraband cigarettes on which the ordinary 100% payment would be due (not cigarettes falling within any of the exceptions listed below).

<sup>42</sup> Under the *JTI* and *ITL Agreements*, payment is not required where the seizure was made 'acting on specific information provided by' the companies; under the *BAT Agreement*, where 'information provided by or on behalf of, or at the request of, a BAT Company was a substantial and specific factor that led to the seizure'. The exceptions under all four agreements include situations where: the 'notice of seizure' has not been delivered reasonably or the company has not been permitted to inspect the seized cigarettes in accordance with the requirements; the cigarettes were manufactured before the execution date of the agreement; the cigarettes were stolen by a third party; the cigarettes were seized outside the EU and were not destined for the EU; the cigarettes were sold, distributed, stored, and shipped in accordance with all applicable fiscal and legal requirements of the EU and a MS; the cigarettes have been previously seized, sold or resold by a MS; or the cigarettes were sold at retail (note that the *BAT Agreement* requires the parties to agree to 'a definition or mathematical formula, based on available seizure data', to determine whether or not cigarettes are deemed to have been 'sold at retail'). The *BAT Agreement* also includes exceptions for seized cigarettes bearing valid MS tax stamps, and for seized BAT cigarettes repackaged into non-BAT packaging or non-BAT cigarettes packed into BAT packaging without BAT companies' knowledge or consent.

Each of the agreements provides for amendment of the seizure payment procedures. Also note that under the *PMI Agreement*, special procedures apply to MS that join the EU after the execution of the agreement, and **PMI** has the right to reduce its payments to offset any losses resulting from claims brought against it in violation of art 9 (Release and dismissal of claims) (art 10). **JT companies** and **ITL** have the right to reduce their payments to offset any losses resulting from claims or disputes of a monetary nature brought against them by the EU or MS in connection with any alleged misconduct relating to manufacture, sale, shipment or storage of the companies' cigarettes before the execution of their agreements (*JTI Agreement*, art 13; *ITL Agreement*, art 10); **JT companies** also have this right where there is a knowing and willful breach of the confidentiality provisions, by the amount of any demonstrable and material loss or damage resulting from claims for damages for unauthorized use or disclosure of passwords, security features or information in the tracking and tracing databases (*JTI Agreement*, art 6.15).

<sup>43</sup> *JTI Agreement*, art 12; *BAT Agreement*, art 12; *ITL Agreement*, art 11. The companies' 'reasonable expectations' are to be assessed by reference to the terms of the agreement and all other related documents and

After a seizure of 50,000 or more of its cigarettes, the company concerned also has obligations in respect of the provision of additional information to OLAF upon request.<sup>44</sup> In addition, **JT companies** agree to give full free technical support to OLAF and/or MS in identifying counterfeit or contraband cigarettes connected with any JT company activities, and to provide access to the services of their laboratories for this purpose, and the **MS** agree to seek to respond favourably to any request from JT companies for return of their seized cigarettes.<sup>45</sup>

f) Additional payments

Under each agreement, the tobacco company concerned agrees to make payments to the EU and MS, additional to any payments made in accordance with the seizure procedures described above.<sup>46</sup> **PMI's**

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correspondence (and, under the *JTI* and *ITL Agreements*, 'related agreements') between the parties and/or their counsel provided and/or executed on or immediately prior to the date of execution (see also *BAT Agreement*, art 17.1; *JTI Agreement*, art 24; *ITL Agreement*, art 13.8). Note that BAT may have its monetary payment obligations 'reduced' or terminated. Note also that this ground for termination under the *JTI* and *ITL Agreements* is expressly limited to circumstances in which the failure of expectations is 'due to the behaviour of [the EU or MS]'.

The agreements will not be terminated if the breach or failure of reasonable expectations has been substantially remedied through subsequent action of the parties, or could be addressed adequately through an order of the arbitrators and the party in default complies with the order (or, under the *JTI* and *ITL Agreements*, through a reasonable amendment to the agreement to which all parties can agree). If the cause of termination is clearly confined in its application to particular MS, the termination will be limited to that or those MS and will include termination of the 'non-pecuniary benefits' of the relevant agreement in relation to that or those MS. Note that the *BAT Agreement* provides that termination or reduction of BAT's monetary obligations will not affect any of its other obligations under the agreement.

**PMI** has the right to terminate its agreement only in very limited circumstances (art 11): if MS with a 10% or more share of the EU's PM cigarette market bring a claim or demand against PMI that would, if successful, enable it to exercise its right to offset payments due under the agreement, and there is a final judicial, legislative, executive or administrative action that invalidates or renders unenforceable a material provision of art 9 (release and dismissal of claims) or art 10 (right of setoff). If such termination occurs, certain rights and obligations, including those relating to the 'compliance protocols' and the 'tracking and tracing protocols', remain in effect.

<sup>44</sup> *PMI Agreement*, art 2.01, Appendix B, protocol 6; *JTI Agreement*, art 9.8; *BAT Agreement*, art 3.2(b); *ITL Agreement*, Schedule 1, protocol 6. **PMI** and **JT companies** must make commercially reasonable efforts to promptly fulfill any request from OLAF for information regarding other cigarettes shipped to the first purchaser associated with the seized cigarettes. **BAT** must promptly advise OLAF, upon request, of previous shipments to the first purchaser in the 3 months prior to the date of shipment of the seized cigarettes, any current orders, the volumes forecast and sold for the 12 months prior to the seizure, and the volumes forecast for the seized brands for that market and that purchaser for the following 12 months. **ITL** must, in the case of *any* seizure of contraband IT cigarettes, make commercially reasonable efforts to promptly provide to OLAF, upon request, information about cigarettes shipped to the first purchaser in the 3 months prior to and 3 months subsequent to the date of shipment of the seized cigarettes.

<sup>45</sup> *JTI Agreement*, arts 7.4, 7.9.

<sup>46</sup> Note that the termination provisions of the *JTI*, *BAT* and *ITL Agreements*, described above in section e), also apply to these payments. Note also that **PMI**, **JT companies** and **ITL** have the right to reduce their payments to offset losses resulting from particular claims brought against them (and, for PMI and JT companies, from knowing

payments, which ‘may serve as a source of additional funding for anti-contraband and anti-counterfeit initiatives’, are to be made on a sliding scale, with the largest payments in the first year of the agreement, and may total up to USD 1,250,000,000 in the 12 years in which the agreement is expected to be in force.<sup>47</sup> Resolutions of the European Parliament in the years following execution of the *PMI Agreement* expressed significant concern regarding the use of these payments, noting that ‘the Community received only 9.7 % thereof and the rest went un-earmarked straight to the Ministers of Finance of the [MS]’, and considering that this distribution ‘goes against the spirit and intention of the agreement, which was negotiated on the basis that the USD 1,25 billion concerned had to be used in the fight against fraud’.<sup>48</sup> The Parliament called upon the MS and the Commission to use PMI’s payments ‘to finance measures to prevent and combat cigarette smuggling, including counterfeiting’,<sup>49</sup> and ‘to make it clear, before other agreements are signed, to all parties that future payments will be used for the fight against fraud’ (considering ‘the unwise distribution of the payments’ to be ‘a major deterrent against other manufactures concluding similar agreements or settlements’).<sup>50</sup>

The payments under the *JTI*, *BAT* and *ITL Agreements* are considerably lower than those under the *PMI Agreement*, and the **EU** and **MS** agree to discuss the possible use of the payments with the three companies.<sup>51</sup> **JT companies’** payments, which may be used ‘in the pursuit of eliminating’ contraband and counterfeit cigarettes, are to be made in the amount of USD 50,000,000 twice in the first year of the agreement and once in the second, third and fourth years, and USD 15,000,000 in each of the following ten years, totaling USD 400,000,000.<sup>52</sup> **ITL’s** payments, which may be used ‘to support the EU and the participating MS in their fight to eliminate illicit trade in cigarettes’, are to be made in the amount of GBP 7,730,842.97 in each of the first ten years of the agreement, and GBP 10,823,180.16 in each of the following ten years, totaling USD 300,000,000.<sup>53</sup> **BAT companies’** payments, which may be used ‘in the pursuit of eliminating the illicit trade in Cigarettes’, are to be made in the amount of EUR 3,000,000 in the first year of the agreement, EUR 6,000,000 in each of the following 18 years, and EUR 23,000,000 in the final year, totaling USD 200,000,000.<sup>54</sup>

g) Cooperation and training

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and willful breach of the confidentiality provisions relating to the tracking and tracing databases) (*PMI Agreement*, art 10, and Appendix D, protocol 3; *JTI Agreement*, arts 13, 6.15; *ITL Agreement*, art 10).

<sup>47</sup> *PMI Agreement*, art 3.02, Appendix C. PMI was required to make an initial payment of USD 250,000,000; subsequent annual payments are calculated according to a percentage of a ‘base payment’ multiplied by an index attached to PMI’s market share. See estimate in press release IP/04/882. Note that in 2008, OLAF estimated that the payments would total approximately USD 1,000,000,000. It noted that, during the period between the signing of the agreement and the end of 2007, the payments totaled almost USD 575,000,000: *Report of the European Anti-Fraud Office: Eighth Activity Report for the period 1 January 2007 to 31 December 2007* (2008), 70.

<sup>48</sup> Resolution of the European Parliament, 11 October 2007 (A6-0337/2007) [32].

<sup>49</sup> Resolution of the European Parliament, 15 June 2006 (A6-0185/2006) [55].

<sup>50</sup> Resolution of the European Parliament, 11 October 2007 (A6-0337/2007) [33].

<sup>51</sup> *JTI Agreement*, art 8.3; *BAT Agreement*, art 6.5; *ITL Agreement*, art 4.

<sup>52</sup> *JTI Agreement*, art 8.

<sup>53</sup> *ITL Agreement*, art 4, Schedule 3.

<sup>54</sup> *BAT Agreement*, art 6, Appendix F.

Each of the four agreements contains commitments relating to cooperation between the companies and the EU and MS, and to training of company employees (and, for **BAT**, training of EU and MS law enforcement and other relevant officials). These provisions are more extensive in the *BAT Agreement* than in the *PMI, JTI* and *ITL Agreements*.

The *PMI, JTI* and *ITL Agreements* provide for **PMI, JT companies** and **ITL** to meet at least annually with representatives of the Commission to ‘confer and assess the functioning of the Agreement’,<sup>55</sup> and to meet annually with representatives of the **MS** and **EU**.<sup>56</sup> **BAT** and the participating MS and OLAF agree to meet at least annually, ‘with a view to doing so on a regular basis’, to discuss, assess and review the efforts being made to combat illicit trade and the performance of the *BAT Agreement*.<sup>57</sup> Additionally, **BAT** and OLAF will discuss ‘proposals and measures that can be taken to combat illicit trade’ (and conduct a regular review of this at least annually, with **BAT** allowed to make proposals to OLAF at any time), and discuss and monitor the availability of technology to provide ‘secure methods for distinguishing genuine Cigarettes from Counterfeits’ (which **BAT** companies will adopt where reasonable and where the technology would materially assist in reducing counterfeit).<sup>58</sup> **BAT** companies will also cooperate with OLAF and participating MS in any investigation or enforcement action regarding **BAT** cigarettes,<sup>59</sup> and **BAT** companies and the EU and participating MS agree to share information with one another on the nature and sources of illicit trade into and within the participating MS.<sup>60</sup>

All four companies are required to conduct training programmes regarding manufacture, sale, distribution and storage of cigarettes for their relevant employees.<sup>61</sup> A representative of OLAF must participate in **PMI** and **JT companies’** training at least once a year, and OLAF and MS representatives may participate in **BAT companies’** training at least once a year or otherwise as agreed with **BAT**. **BAT** companies will also provide OLAF and MS with ‘appropriate training and information at least once a year on how to distinguish genuine **BAT** Cigarettes from Counterfeits’, and conduct training programmes and workshops for ‘appropriate’ EU and MS personnel ‘to enhance cooperation and understanding on the issues of illicit trade in order to promote and support better controls and action to prevent illicit trade and discourage those responsible’ (with OLAF allowed to ‘suggest to **BAT** where such programmes might be carried out and the content for such programmes’).<sup>62</sup> OLAF must make all reasonable efforts to train

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<sup>55</sup> *PMI Agreement*, art 6.01; *JTI Agreement*, art 9.3; *ITL Agreement*, art 8.

<sup>56</sup> *PMI Agreement*, Appendix D, protocols 2, 3 and 5; *JTI Agreement*, art 9.4; *ITL Agreement*, Schedule 2, protocol 2.4. Note that **PMI** and **ITL’s** annual meetings with the MS and EU are specifically for the purpose of determining what, if any, additions, improvements or changes shall be made to the marking, tracking and tracing requirements under their agreements, taking into account the reports provided on their ongoing programmes of research and development.

<sup>57</sup> *BAT Agreement*, art 7.1. Topics to be discussed at the annual meeting include advances in package marking technology, as well as ‘the functioning of this Agreement, and what further action could be taken and improvements made, and whether any changes should be made’ to the agreement.

<sup>58</sup> *BAT Agreement*, arts 6.1, 7.2.

<sup>59</sup> *BAT Agreement*, art 4, Appendix A.

<sup>60</sup> *BAT Agreement*, art 6.3.

<sup>61</sup> *PMI Agreement*, art 2.01, Appendix B, protocol 11; *JTI Agreement*, art 4.5; *BAT Agreement*, arts 5.1, 5.3; *ITL Agreement*, Schedule 1, protocol 11. Note that **PMI** must notify the curriculum for its training programmes to OLAF, and **JTI** and **ITL** must notify their curricula to OLAF and the participating MS.

<sup>62</sup> *BAT Agreement*, arts 5.1, 5.2, 5.4.

and inform those with access to the PMI and JTI tracking and tracing databases about the importance of secrecy and confidentiality.<sup>63</sup>

#### h) Release of claims

The *PMI* and *JTI Agreements* contain releases from liability. The **EU** and **MS** agree to fully and unconditionally release and discharge PMI (Altria Group) (and all of its current and former affiliates, subsidiaries, successors, employees, directors, officers and servants) and JT companies (and their successors, agents and assigns) from any and all civil claims for conduct prior to the execution date of the relevant agreement arising out of or relating to allegations that were or could have been raised in relation to the matters in the US litigation.<sup>64</sup> The EU, MS, **PMI** and **JT companies** agree to obtain dismissal with prejudice and without costs of all relevant pending actions.<sup>65</sup>

The *ITL Agreement* does not contain a release from liability, but provides a strong pecuniary disincentive to the EU and participating MS bringing claims against ITL by allowing it to reduce its payments under the agreement to offset losses resulting from claims or disputes of a monetary nature brought against it by the EU or participating MS in connection with 'any alleged misconduct relating to manufacture, sale, shipment or storage of ITL cigarettes before the Execution Date'.<sup>66</sup> The *BAT Agreement* does not contain any release from liability. However, it should be noted that this does not mean that steps have not been taken to initiate litigation against BAT,<sup>67</sup> and that there may be provisions relating to liability in a related confidential agreement or agreements.<sup>68</sup>

#### i) Equal treatment

The *PMI*, *BAT* and *ITL Agreements* each contain an 'equal treatment' clause providing that if, during the term of the relevant agreement, the EU enters into an agreement (or amends an existing or future agreement) with another cigarette manufacturer relating to the same subject matter on more favorable

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<sup>63</sup> *PMI Agreement*, art 2.01, Appendix D, protocol 3; *JTI Agreement*, art 6.15.

<sup>64</sup> *PMI Agreement*, art 9.01; JTI Mutual Cessation Agreement, arts 3.1-3.2. Note that **JT companies** also agree to fully and unconditionally release and discharge the EU and MS (and their public officials, officials, employees, staff and successors) from any and all civil claims for conduct prior to the execution date arising out of or relating to allegations that were or could have been raised in relation to the matters in the ECJ proceedings.

<sup>65</sup> *PMI Agreement*, art 9.02; JTI Mutual Cessation Agreement, arts 3.4-3.5.

<sup>66</sup> *ITL Agreement*, art 10.

<sup>67</sup> It may be noted that BAT has been publicly implicated in large-scale smuggling schemes and has been subject to litigation for smuggling and related activities in other jurisdictions: see generally 'BAT Expose', *The Guardian* (2001), online at <http://www.guardian.co.uk/bat>; International Consortium of Investigative Journalists and Center for Public Integrity, *Tobacco companies linked to criminal organizations in lucrative cigarette smuggling* (2001), online at <http://projects.publicintegrity.org/Content.aspx?context=article&id=351>.

<sup>68</sup> It may be noted that a UK government press release reported on M2 Presswire on the execution of the *BAT Agreement* stated: 'BAT will also be required to make supplemental payments to Member States if their product is found smuggled in significant volumes. In return, the manufacturers are released from any civil claims arising out of past conduct relating to illicit trade' ('UK Government: Government and industry take a significant step in the fight against tobacco smuggling', 15 July 2010, online at [http://www.tradingmarkets.com/news/press-release/bti\\_uk-government-government-and-industry-take-a-significant-step-in-the-fight-against-tobacco-smugglin-1043458.html](http://www.tradingmarkets.com/news/press-release/bti_uk-government-government-and-industry-take-a-significant-step-in-the-fight-against-tobacco-smugglin-1043458.html)). It is unclear whether this statement was included in error, or refers to a separate agreement not included in the publicly available *BAT Agreement*.

terms, PMI, BAT or ITL may request treatment at least as relatively favorable as the overall terms provided to the other manufacturer, and the **EU** and **MS** will act in good faith to consider the request and grant it if it is consistent with the intent of the agreement.<sup>69</sup> The *JTI Agreement* does not contain an equal treatment clause.<sup>70</sup>

j) Compliance reporting and dispute settlement

Each of the agreements requires the company concerned to report on compliance with its commitments, and provides for procedures to be followed in the event of non-compliance. **PMI** provides an annual report to the EU and MS describing its fulfillment of the requirements of the compliance protocols and tracking and tracing protocols;<sup>71</sup> **JT companies** and **ITL** provide annual reports describing their fulfillment of all requirements of their agreements;<sup>72</sup> and **BAT** agrees to provide an annual 'written confirmation that BAT companies have complied with the Policies and Procedures required' in relation to the manufacture, sale, distribution, and/or storage of BAT cigarettes (or, if there has been non-compliance, information about the non-compliance and measures taken to address it).<sup>73</sup>

OLAF may notify PMI, JT companies or ITL within 60 days of receipt of an annual report if it has reasonably concluded that the company is failing to perform its obligations, and may notify BAT if it believes that the information provided in the annual report is not materially correct or complete or that the measures taken to address any identified non-compliance are insufficient. OLAF may notify any of the three companies at any time if it reasonably believes that there is a significant compliance failure that could likely result in a significant increase in the volume of a company's contraband cigarettes. Following any such notification, the company must provide a written response (and, under the *PMI, JTI* and *ITL Agreements*, meet the Commission and attempt to resolve any dispute in good faith). If such a dispute with PMI, JT companies or ITL is not resolved within 60 days of the notification, the Commission may bring the dispute before an arbitrator, who may issue a binding compliance order or an order allowing OLAF to conduct an audit to determine what compliance orders may be required. Under the *BAT Agreement*, if the issue has not been resolved within 60 days any party may refer the matter to dispute settlement, and the arbitrator may order that BAT companies make certain categories of records or information available for inspection by OLAF.

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<sup>69</sup> *PMI Agreement*, art 13.14; *BAT Agreement*, art 25; *ITL Agreement*, art 13.13. In considering whether the overall terms are more favorable, due consideration is to be given to 'relevant differences in volume of Cigarettes or other appropriate factors'.

<sup>70</sup> Note, however, that the *JTI Agreement* provides that OLAF's existing practices relating to records and information about seizures, and provision of information upon request to enable companies (with similar agreements in place) to take effective action against contraband and counterfeit cigarettes, are 'equally applicable' to JT companies (arts 7.1, 9.2), and that JT companies are entitled to meet OLAF at its annual Task Group meeting, to the same extent as any other company with a similar agreement in place with the EU or some or all MS (art 9.5).

<sup>71</sup> *PMI Agreement*, arts 2.02, 5.02.

<sup>72</sup> *JTI Agreement*, art 11; *ITL Agreement*, arts 2.2, 7.2.

<sup>73</sup> *BAT Agreement*, art 8.

The parties to each agreement also agree on methods and procedures for settlement of any disputes arising out of the agreements.<sup>74</sup> If no negotiated resolution can be reached, disputes may be referred to arbitration. Any such arbitral proceedings are confidential – the parties must not disclose the nature or scope of the proceedings or any information obtained in or arising out of the proceedings, and no amicus curiae briefs (containing information from third parties such as non-governmental organizations) may be filed.

### 3. The agreements and the FCTC

The EU and all but one MS are subject under the FCTC to legally binding international obligations with respect to tobacco control.<sup>75</sup> Certain aspects of the agreements with multinational tobacco companies raise issues with respect to article 5.3 (protection of public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry), as well as related obligations under article 12 (education, communication, training and public awareness) and article 13 (tobacco advertising, promotion and sponsorship). It should be noted that the EU and MS have been subject to these obligations only since entry into force of the FCTC for them. For the EU, the obligations have applied since 30 June 2005 – thus, for example, the negotiations for the *PMI Agreement* were not covered by the FCTC; actions taken by the EU pursuant to the agreement since June 2005 are covered.

#### a) Transparency and accountability

Article 5.3 requires parties, in setting and implementing their ‘public health policies with respect to tobacco control’, to ‘act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law’. Under article 15, parties recognize that ‘the elimination of all forms of illicit trade in tobacco products’ is an ‘essential component’ of tobacco control and undertake obligations towards this end. Building on the provisions of article 15, parties are in the process of negotiating a protocol to the FCTC which mirrors key aspects of the EU agreements. While the measures provided for in the agreements have a range of objectives, including protection of tax revenue and law and order, they are also clearly ‘public health policies with respect to tobacco control’. To the extent that the negotiation, execution and implementation of the agreements involve setting and implementing public health policies with respect to tobacco control, they should meet the requirements of article 5.3.

The Conference of the Parties to the FCTC (COP) has adopted guidelines to assist parties in meeting their legal obligations under article 5.3, which emphasize the need to apply protective measures in all government bodies that ‘contribute to, or could contribute to, the formulation, implementation, administration or enforcement’ of relevant policies.<sup>76</sup> The guidelines recognize that fulfillment of article

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<sup>74</sup> *PMI Agreement*, art 12; *JTI Agreement*, art 14; *BAT Agreement*, art 11; *ITL Agreement*, art 12.

<sup>75</sup> The EC formally confirmed the FCTC in 2005; the EU took over the legal obligations of the EC in 2009. All MS except the Czech Republic (which has signed, but not ratified) are also parties to the FCTC.

<sup>76</sup> *Guidelines for implementation of Article 5.3 of the WHO Framework Convention on Tobacco Control*, decision FCTC/COP3(7) (22 November 2008), available online at <http://www.who.int/fctc/guidelines/en/>.

5.3 requires parties to be accountable and transparent in their dealings with the tobacco industry – they should interact with the industry ‘only when and to the extent strictly necessary to enable them to effectively regulate the tobacco industry and tobacco products’, and should ensure that any necessary interactions are conducted transparently (wherever possible, in public). Further, article 12 of the FCTC requires parties to promote public access to a wide range of information on the tobacco industry, and to promote awareness and participation of organizations not affiliated with the industry in developing and implementing tobacco control programmes and strategies.

The extensive negotiations which led to the execution of the agreements with multinational tobacco companies may not all have been strictly necessary to enable the EU and MS to effectively regulate the companies and their products. Some of the outcomes of the negotiations might have been achieved through direct regulation; others may not have been ‘strictly necessary’ for effective efforts to combat illicit trade. To the extent that the interactions were necessary to achieve the desired regulatory outcomes, recognizing that EU political processes can make direct regulation a slow process, there are questions as to the extent to which they were conducted transparently. There were very limited opportunities for participation by relevant organizations not affiliated with the tobacco industry or for provision of information about the negotiations to the public. The possibility that there are additional confidential agreements with the tobacco companies, and confidential documents and correspondence provided at execution that impact directly on the companies’ right to terminate or reduce their payments under the agreements, is also a matter of concern.

Interactions provided for under the agreements (such as meetings between the EU, MS and the tobacco companies, and training programmes or workshops involving both tobacco company employees and government officials), to the extent that they involve setting and implementing public health policies with respect to tobacco control, should also meet the standard necessary to comply with article 5.3 – that is, they should be strictly necessary for effective regulation and should be conducted transparently. The arrangements under the *BAT Agreement* for BAT to meet with and conduct training programmes for EU and MS officials are of particular concern in this respect. The dispute settlement provisions of all four agreements, which require confidentiality and therefore could prevent the public and organizations not affiliated with the industry from accessing important information about failures in implementation of the agreements, are also of concern.

b) Partnerships and corporate social responsibility

The guidelines for implementation of article 5.3 state that parties should not accept, support or endorse ‘partnerships’ with the tobacco industry in any initiative linked to setting or implementing public health policies, and that any necessary interactions with the industry should be carried out ‘in such a way as to avoid the creation of any perception of a real or potential partnership or cooperation’ (and, if the industry creates such a perception, parties should act to correct it).<sup>77</sup>

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<sup>77</sup> Though the recommendation that parties ‘reject partnerships and non-binding or non-enforceable agreements with the tobacco industry’ may be read to distinguish legally binding agreements as acceptable arrangements,

The 'cooperative approach' of the agreements is a concern in relation to this aspect of effective implementation of article 5.3. While some interaction with the industry is necessary to effectively combat illicit trade (for example, in relation to identification of counterfeit cigarettes), not all of the matters regulated under the agreements strictly require cooperation with tobacco companies. The agreements are not drafted, and have not been portrayed to the public, in such a way as to avoid the creation of perceptions of cooperation or partnership. The EU has promoted the agreements as establishing arrangements whereby tobacco companies and European law enforcement agencies 'combine their resources and enhance their coordination'.<sup>78</sup> The EU and MS have also allowed the companies to promote this view – PMI, for example, describes its agreement as 'a long-range and comprehensive framework for national governments, the European Commission, and PMI to fight the illicit trade in cigarettes together',<sup>79</sup> while the CEO of JTI describes its agreement as establishing 'a solid forward-looking partnership' with the EC and MS,<sup>80</sup> and an IT press release states that its agreement 'underlines our commitment to partner with authorities worldwide in the fight against tobacco smuggling and counterfeiting'.<sup>81</sup>

Both the guidelines for implementation of article 5.3 and the guidelines for implementation of article 13 (which requires parties to implement a comprehensive ban on tobacco advertising, promotion and sponsorship, unless prevented from doing so by their constitutions or constitutional principles)<sup>82</sup> recommend regulation of 'socially responsible' practices of the tobacco industry – recognizing that parties should not support or participate in tobacco company 'corporate social responsibility' efforts, should make all branches of government and the public aware of their true purpose, and should prohibit public dissemination of information about such activities (except where strictly necessary). The guidelines for implementation of article 13 recognise that promotion 'of tobacco companies themselves ... is a form of promotion of tobacco products or tobacco use'.

The use of the agreements as a form of 'corporate social responsibility' is a matter of particular concern in relation to the *BAT* and *ITL Agreements*, which the Commission has publicly stated were 'initiated by'

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legally binding agreements or the process of their negotiation may nonetheless give rise to unacceptable 'partnerships' or perceptions of 'partnership or cooperation'.

<sup>78</sup> See, eg, European Commission, 'European Commission and JT International (Japan Tobacco) sign 15-year Agreement to combat contraband and counterfeit cigarettes' (press release IP/07/1927, Brussels, 14 December 2007, online at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1927&format=HTML&aged=1&language=EN&guiLanguage=en>).

<sup>79</sup> PMI, 'E.C. Agreement', online at [http://www.pmi.com/eng/tobacco\\_regulation/illicit\\_trade/pages/ec\\_agreement.aspx](http://www.pmi.com/eng/tobacco_regulation/illicit_trade/pages/ec_agreement.aspx).

<sup>80</sup> JTI, 'JT International and the European Commission sign a 15-year Agreement to combat contraband and counterfeit cigarettes' (press release, Geneva, 14 December 2007, online at [http://www.gallaher-group.com/press\\_home/press\\_releases/fab8c47e00ac4e19a24a184f9e17eb28/EC-PR\\_English.pdf](http://www.gallaher-group.com/press_home/press_releases/fab8c47e00ac4e19a24a184f9e17eb28/EC-PR_English.pdf)).

<sup>81</sup> IT, 'Imperial Tobacco and European Union sign co-operation agreement to jointly combat illicit trade in tobacco' (press release, Bristol, 27 September 2010, online at <http://www.imperial-tobacco.com/index.asp?page=78&newsid=1198>).

<sup>82</sup> *Guidelines for implementation of Article 13 (Tobacco advertising, promotion and sponsorship)*, decision FCTC/COP3(12) (22 November 2008), available online at <http://www.who.int/fctc/guidelines/en/>.

the companies, and which do not settle formal legal disputes between the parties.<sup>83</sup> BAT's website describes 'tackling illicit trade' as a key priority, requiring cooperation between 'legitimate tobacco companies', governments and international organizations, and notes that it is 'helping to fund the fight' in the EU 'with contributions of \$200m (EUR134m)'.<sup>84</sup> Media coverage of the *BAT Agreement* has focused on BAT's contributions 'to help the EU fight the trade in counterfeit and contraband cigarettes' – one news article, for example, was entitled: 'BAT to give 200 million dollars to help stub out cigarette smuggling'.<sup>85</sup> Similarly, ITL emphasizes that it is making payments to 'fund anti-illicit trade initiatives',<sup>86</sup> and media coverage reports that the company 'initiated this co-operation agreement because [it] sees this as an area of investment for Imperial', emphasizing a trend in which 'tobacco companies are contributing funds to the fight against cigarette smuggling'.<sup>87</sup>

In this context, the additional payments under the *BAT* and *ITL Agreements* can be understood as a form of tobacco sponsorship within the meaning of articles 1 and 13 of the FCTC – a contribution 'with the aim, effect or likely effect of promoting a tobacco product or tobacco use either directly or indirectly'. The use of the *JTI Agreement* as a form of corporate social responsibility is also of some concern – JTI publicizes information about the agreement on the 'corporate responsibility' pages of its website, expressing its commitment to 'further establishing mutually beneficial cooperation arrangements with governments across the world'.<sup>88</sup>

### c) Possible conflicts of interest

The guidelines for implementation of article 5.3 recognize that payments by the tobacco industry to government institutions 'can create conflicts of interest' which may threaten tobacco control policies. The payments to the EU and MS under the agreements are mandated by legally binding and enforceable

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<sup>83</sup> European Commission, 'European Commission and British American Tobacco sign agreement to combat illicit trade in tobacco' (press release IP/10/951, Brussels, 15 July 2010, online at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/951&format=HTML&aged=0&language=EN&guiLanguage=en>); 'European Commission and Imperial Tobacco sign agreement to combat illicit trade in tobacco' (press release IP/10/1179, Brussels, 27 September 2010, online at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1179&format=HTML&aged=0&language=EN&guiLanguage=en>). Note that EU taxation commissioner Algirdas Semeta has publicly stated that these payment 'are not penalties, not another way for manufacturers to buy their way out of any responsibility': see Matej Hruska, 'EU teams up with Imperial Tobacco to fight cigarette smuggling', *EU Observer* (Brussels, 27 September 2010), online at <http://euobserver.com/9/30902>.

<sup>84</sup> BAT, 'How we tackle illicit trade', online at [http://www.bat.com/group/sites/uk\\_3mnfen.nsf/vwPagesWebLive/DO6TNLZ2?opendocument&SKN=1](http://www.bat.com/group/sites/uk_3mnfen.nsf/vwPagesWebLive/DO6TNLZ2?opendocument&SKN=1).

<sup>85</sup> 'BAT to give 200 million dollars to help stub out cigarette smuggling' (15 July 2010), online at <http://pda.trend.az/en/1721433.html>; <http://www.earthtimes.org/articles/news/335026,help-stub-cigarette-smuggling.html>. See also 'BAT and EC sign agreement to combat illicit trade', *Tobacco Journal International* (16 July 2010), online at <http://www.tobaccojournal.com/index.php?id=50109>.

<sup>86</sup> IT, 'Imperial Tobacco and European Union sign co-operation agreement to jointly combat illicit trade in tobacco' (press release, Bristol, 27 September 2010).

<sup>87</sup> Matej Hruska, 'EU teams up with Imperial Tobacco to fight cigarette smuggling', *EU Observer* (Brussels, 27 September 2010), online at <http://euobserver.com/9/30902>.

<sup>88</sup> JTI, 'Corporate responsibility: compliance and business conduct', online at [http://www.jti.com/cr\\_home/cr\\_compliance](http://www.jti.com/cr_home/cr_compliance).

agreements, and therefore not subject to the guidelines' express recommendation against acceptance of contributions from the tobacco industry. However, without further information about the circumstances in which the payments under the *JTI*, *BAT* and *ITL Agreements* may be terminated by the companies, it is not possible to determine whether the payment arrangements give rise to possible conflicts of interest.

Unlike PMI, JT and BAT companies and ITL have the ongoing right to terminate the provisions of their agreements requiring them to make payments if there are significant failures of their 'reasonable expectations' as to their benefits under the agreements. Because these expectations are to be assessed by reference to documents, correspondence and agreements which are not publicly available, the breadth of the circumstances in which the EU and MS might risk termination by the companies cannot be determined. It is possible that the aim of continuing to receive annual payments from JT and BAT companies and ITL might influence the decisions of EU and MS officials with respect to relevant policies while the agreements are in force. This risk is greater with respect to the *BAT Agreement*, under which the largest payment of EUR 23,000,000 is scheduled in 2029, significantly increasing the importance of keeping the agreement in force. Also unlike PMI, JT and BAT companies and ITL have the right to discuss the possible uses of their payments with the EU and MS, which may increase the risk that the payments will influence EU and MS priorities in relation to illicit trade in tobacco products – for example by directing greater attention towards the protection of JT, BAT and IT trademarks.

#### **4. The agreements and the draft FCTC ITP**

The EC was active in the negotiations which led to the inclusion of article 15 (illicit trade in tobacco products) in the FCTC, and has made the adoption of an FCTC protocol to eliminate illicit trade a political priority. Both the expert group which prepared the protocol template and the Intergovernmental Negotiating Body (INB) which negotiated the draft protocol were chaired by senior officials of the Commission, and a session of the INB was partially funded by a large extrabudgetary contribution from the Commission. EU negotiators have worked, strongly supported by the European Parliament, to 'anchor the principles of the Philip Morris agreement in the protocol', while committing other tobacco companies to these principles through the signing of additional agreements.<sup>89</sup> This was recently reaffirmed by the Commission in its statement that the obligations set out in the *ITL Agreement* 'will underpin the efforts of the EU to promote a strong Protocol'.<sup>90</sup>

The draft protocol to be considered by the upcoming COP-4 reflects a number of elements of the *PMI*, *JTI*, *BAT* and *ITL Agreements*, in particular: draft article 1 (Use of terms) proposes a number of definitions based on those used in the agreements; draft article 5 (licence, equivalent approval or control system) proposes that licence applicants be required to provide the same information as is required in the companies' regulated business relationships, and draft article 6 (customer identification and verification) proposes similar due diligence requirements; draft article 7 (tracking and tracing) proposes similar

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<sup>89</sup> Resolution of the European Parliament, 11 October 2007 (A6-0337/2007) [42].

<sup>90</sup> Press release IP/10/1179.

marking, tracking and tracing systems; draft article 8 (record-keeping) proposes similar requirements for record-keeping and provision of information; draft article 9 (security and [other] preventive measures) proposes restrictions on supply and methods of payment, and requirements for suspicious transaction reporting; and draft article 17 (seizure payments) proposes a limited obligation with respect to recovering lost taxes and duties from manufacturers.<sup>91</sup> Some of these provisions were not discussed at INB-4; others were discussed but no consensus was reached. Consensus was reached on the draft provision on tracking and tracing.

Should an FCTC ITP be agreed, it may contain the provisions on which consensus was reached by the INB or similar provisions.<sup>92</sup> Draft article 7 would require the EU and MS, if they became parties to such a protocol, to extend their requirements for product marking, tracking and tracing beyond those required by the *PMI*, *JTI*, *BAT* and *ITL Agreements*.<sup>93</sup> They would be obliged to require all manufacturers, including PMI, JTI, BAT and ITL, to apply unique identification markings to ‘all unit packets, packages and any outside packaging’ of cigarettes within 5 years of entry into force, and other tobacco products within 10 years.<sup>94</sup> At the time of production, shipment or import of any product covered by the marking requirements, the following information would need to be recorded, and made accessible by means of a link with the markings: in addition to information included in the tracking and tracing databases under the agreements (date, factory, machine and production shift of manufacture, first purchaser name, invoice or order number, shipment date, destination, consignee, point of departure, and intended market of retail sale), product description,<sup>95</sup> location of manufacture, first purchaser invoice and payment records, identity of any known subsequent purchaser, and any warehousing and shipping.<sup>96</sup> The information would be made electronically accessible to a ‘global information sharing focal point’.

Each party to the protocol would be obliged to establish a ‘tracking and tracing system, controlled by the Party’,<sup>97</sup> to require the further development and expansion of the system, and to cooperate in sharing and developing best practices (including facilitating development, transfer and acquisition of technology, and supporting training and capacity-building programmes). The parties would be required

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<sup>91</sup> *Draft protocol to eliminate illicit trade in tobacco products*, document FCTC/COP/4/5 (14 May 2010), available online at [http://apps.who.int/gb/fctc/PDF/cop4/FCTC\\_COP4\\_5-en.pdf](http://apps.who.int/gb/fctc/PDF/cop4/FCTC_COP4_5-en.pdf).

<sup>92</sup> It should be noted that ‘[t]he attributed consensus should be read in light of the holistic approach that the Intergovernmental Negotiating Body agreed to take on the draft protocol: “Nothing is agreed until everything is agreed”’ (Report of the Chairperson of the Intergovernmental Negotiating Body on a Protocol on Illicit Trade in Tobacco Products to the fourth session of the Conference of the Parties’, document FCTC/COP/4/4 (14 May 2010), [28]).

<sup>93</sup> It should be noted that nothing in the agreements prevent this: each of the three agreements provides that all obligations under the agreement are subject to EU law and the applicable national laws of MS, as enacted or amended at any time (*PMI Agreement*, art 13.06; *JTI Agreement*, art 20.2; *BAT Agreement*, art 22.2; *ITL Agreement*, art 13.6).

<sup>94</sup> It should be noted that no consensus has been reached on the definitions of ‘cigarette’ and ‘tobacco products’.

<sup>95</sup> Note that the *ITL Agreement* already requires the inclusion of this information in ITL’s first purchaser database.

<sup>96</sup> Certain information would be required to ‘form part of’ the markings: the date, location and facility of manufacture, product description, and (where available at the time of marking) the intended market of retail sale.

<sup>97</sup> It should be noted that this does not mean that control of the tracking and tracing databases established under the *PMI*, *JTI* and *BAT Agreements* would need to be transferred to the EU and MS – these databases may form part of a broader ‘system’ under the control of the EU and MS.

to ensure that, in participating in the global tracking and tracing ‘regime’ established under the protocol, their ‘designated competent national authorities [...] interact with the tobacco industry only to the extent strictly necessary in the implementation of the provisions of [article 7]’. This may require some changes in practices established pursuant to the agreements – for example, if meetings relating to tracking and tracing are held more frequently than is strictly necessary, fewer meetings with the companies.

Other relevant draft provisions on which consensus of the INB is recorded are those relating to information sharing and cooperation in training and capacity building – draft articles 20 (general information sharing), 21 (enforcement information sharing), 22 (information sharing: confidentiality and protection of information), 23 (assistance and cooperation: training, technical assistance, and cooperation in scientific, technical and technological matters), and 28 (law enforcement cooperation). These provisions would require parties to the protocol to exchange (and, where appropriate, report in their FCTC reports) detailed information about seizures, exchange other information about investigations and prosecutions, and cooperate in building capacity to collect and exchange information and in training, technical assistance and scientific, technical and technological matters.<sup>98</sup>

The proposed requirements give rise to four possible concerns in relation to the *PMI*, *JTI*, *BAT* and *ITL Agreements*. First, certain information provided by the EU and MS pursuant to requirements of a protocol (such as information about seizures of tobacco products) may be determined or influenced by the tobacco companies. Second, the extent to which relevant information could be shared might be limited – for example, if information provided by BAT pursuant to its agreement is considered ‘commercially sensitive’, BAT’s written consent to release of the information is required.<sup>99</sup> Third, information provided by other parties to the EU and MS may be provided to the companies – in particular, the requirement that the EU and participating MS share information with BAT about the nature and sources of illicit trade into and within participating MS may increase the likelihood that BAT will receive information shared by other parties.<sup>100</sup> Finally, EU and MS participation in capacity building and training efforts under a protocol may be influenced by their increased interactions with the companies, particularly under the meeting and training provisions of the *BAT Agreement*. However, concerns relating to the exchange of information and cooperation with the tobacco industry are not limited to the EU and MS, and also apply to other potential parties to an FCTC ITP.

## **5. The agreements and international customs, trade and criminal cooperation agreements**

The definitions used in the *PMI*, *JTI*, *BAT* and *ITL Agreements* are generally consistent with the terminology used in existing agreements and arrangements relating to customs and trade. ‘Counterfeit’

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<sup>98</sup> Draft FCTC ITP, articles 20.1, 21(e) (seizure information may include quantity, value, product details, counterfeit and ‘genuine’ brands, taxes evaded, entities involved and modi operandi used); articles 21, 28; articles 20.2, 23.

<sup>99</sup> Note, however, that the obligation to maintain confidentiality or seek consent is subject to applicable EU and MS law, and that BAT is required not to unreasonably withhold its consent (*BAT Agreement*, arts 10, 22).

<sup>100</sup> Note, however, that the exchanging party may specify that the information may not be passed on (draft FCTC ITP, article 21), or the information may be deemed confidential (draft FCTC ITP, article 22).

trademark goods are generally understood as ‘any goods, including packaging, bearing without authorization a trademark which is identical to the trademark validly registered in respect of such goods, or which cannot be distinguished in its essential aspects from such a trademark, and which thereby infringes the rights of the owner of the trademark in question under the law of the country of importation’.<sup>101</sup> Under the *PMI, JTI, BAT* and *ITL Agreements*, ‘counterfeit cigarettes’ means cigarettes bearing a trademark of a manufacturer that are manufactured by a third party without the consent of the manufacturer (not including cigarettes using tobacco produced or sold by the manufacturer, or cigarettes bearing the manufacturer’s trademark and packaged in its genuine packaging).<sup>102</sup>

Under the *PMI, JTI* and *ITL Agreements*, all cigarettes imported into, distributed or sold in a MS, or en route to a MS for sale in the MS, in violation of applicable tax, duty, or other fiscal laws of the MS or EU are considered ‘contraband’. However, the definitions provide that for the purposes of the agreements – which distinguish between illicitly traded cigarettes of the manufacturer (for which the manufacturer bears certain responsibilities) and other illicitly traded cigarettes – the term ‘contraband cigarettes’ excludes counterfeit cigarettes. Though the *BAT Agreement* does not contain a definition of ‘contraband’, it uses the term ‘contraband’ to similar effect.

The definition of ‘cigarette’ under the agreements includes a number of tobacco products that appear to be classified separately under the World Customs Organization (WCO) Harmonized System: under the *PMI, JTI* and *BAT Agreements*, ‘any product that contains tobacco and is intended to be burned or heated under ordinary conditions’, including any ‘roll-your-own’ tobacco ‘which, because of its appearance, type, packaging or labelling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes’; under the *ITL Agreement*, ‘any product that is taxed as a cigarette or as fine-cut tobacco’, including any ‘fine-cut’ tobacco ‘which, because of its appearance, type, packaging or labelling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes’.<sup>103</sup> These definitions create one term covering tobacco products commonly smuggled in the EU and MS for the purposes of application of the agreements, but do not appear to impact on EU and MS obligations under other agreements and arrangements relating to classification of tobacco products.

The provisions of the *PMI, JTI, BAT* and *ITL Agreements* dealing with provision and protection of information may have some limited impacts on the EU and MS’ implementation of existing

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<sup>101</sup> WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), art 51, footnote 14. Any sign or combination of signs capable of distinguishing the goods or services of one undertaking from those of other undertakings can constitute a trademark (art 15.1), and the owner of a registered trademark shall have the exclusive right to prevent all third parties not having the owner’s consent from using in the course of trade identical or similar signs for goods or services which are identical or similar to those in respect of which the trademark is registered where such use would result in a likelihood of confusion (art 16.1).

<sup>102</sup> Under the *BAT Agreement*, counterfeit cigarettes also include ‘authentic Cigarettes which have been repackaged into unauthorised packaging without the knowledge or consent of the manufacturer or unauthorised Cigarettes which were packed into authentic packaging without the knowledge or consent of the manufacturer’.

<sup>103</sup> The definition appears to cover the following three Harmonized System codes: 2402.10 (Cigars, cheroots and cigarillos, containing tobacco); 2402.20 (Cigarettes containing tobacco); and 2403.10 (Smoking tobacco, whether or not containing tobacco substitutes in any proportion).

commitments relating to information sharing with other countries – including under mutual administrative assistance agreements and, to the extent that the agreements relate to serious criminal forms of cigarette smuggling, counterfeiting and related criminal activity, criminal justice cooperation agreements.<sup>104</sup> As noted above, the agreements may impact on the nature and availability of relevant information, the use of information provided by other countries to the EU or MS, and assistance provided by the EU and MS to other countries in planning and implementing relevant training programmes.<sup>105</sup>

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<sup>104</sup> These include, for example, the United Nations Convention against Transnational Organized Crime (UNTOC), the United Nations Convention against Corruption (UNCAC), the International Convention on Mutual Administrative Assistance for the Prevention, Investigation and Repression of Customs Offences (Nairobi Convention), and a range of bilateral agreements. Note that the EU and all MS except Greece are currently parties to UNTOC; the EU and all MS except the Czech Republic, Germany and Ireland are currently parties to UNCAC; and 11 MS are currently parties to the Nairobi Convention and at least one of its operative annexes (Cyprus, the Czech Republic, Finland, France, Ireland, Italy, Latvia, Lithuania, Slovakia, Sweden and the UK).

<sup>105</sup> Including, for example, under art 29 of UNTOC, assistance in training relating to: methods used in the prevention, detection and control of offences; routes and techniques used; monitoring of the movement of contraband; detection and monitoring of the movements of proceeds of crime, and methods used in combating money-laundering; collection of evidence; control techniques in free trade zones and free ports; and law enforcement equipment and techniques.