

Inter-Office Correspondence

Date: 3 March 2010

Subject: Brand Integrity Global Operations – February 2010 Update

To date this year, the Container Tracking Program run by the Brand Integrity (BI) *Global Intelligence Team* in cooperation with Imperial Tobacco has identified 28 containers known or suspected to be carrying counterfeit or diverted JTI and other international cigarettes. Fourteen of these containers were or are bound for recipients in the European Union and were passed to OLAF and other regional enforcement agencies for intercept. Of the remaining containers eight were identified in Asia, four were or are bound for buyers in South America, while the remaining two were or are heading to Africa.

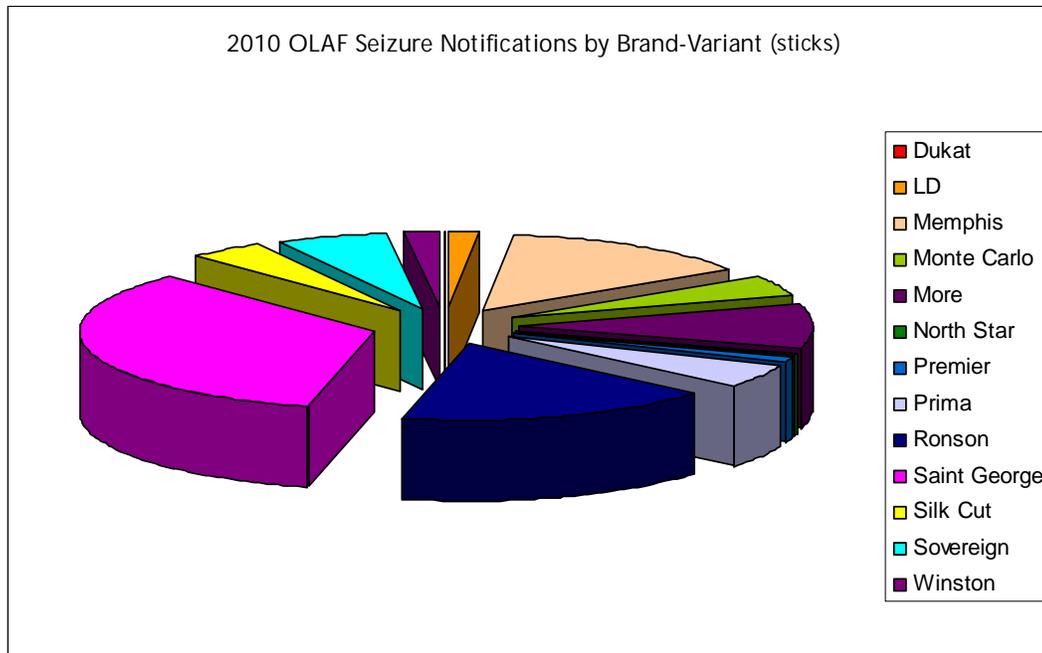
- Three of the containers heading to Europe have been seized in Spain, Lithuania, and Germany – one carrying a mix of counterfeits, including Benson & Hedges, and two others carrying counterfeit PMI brands – while another two remain part of controlled delivery operations being coordinated by OLAF. The rest continue to be tracked pending intercept. In addition to the container intercepted based on a BI tip off, Spanish Customs also intercepted two additional containers from China carrying a total of over 1,100 cases of counterfeit Benson & Hedges with Irish Health Warnings, as well as over 900 cases of an Imperial Tobacco brand. Preliminary assessments indicate that these containers may have been identified based on information previously supplied by BI to the authorities.



Benson & Hedges seized in Barcelona on 9 February

- Philippine Customs seized a container in Manila this month carrying PMI brands while Royal Malaysia Customs seized three containers carrying smuggled cheap whites. Other containers heading to Malaysia, Singapore, and Australia will be stopped and checked in coming weeks.
- In Africa and the Americas, one shipment each has been stopped for inspection in Kenya and Panama, respectively, while two more have been stopped in Chile. Another shipment is now bound for Chile from Panama and its details have been passed to Chilean Customs agents.

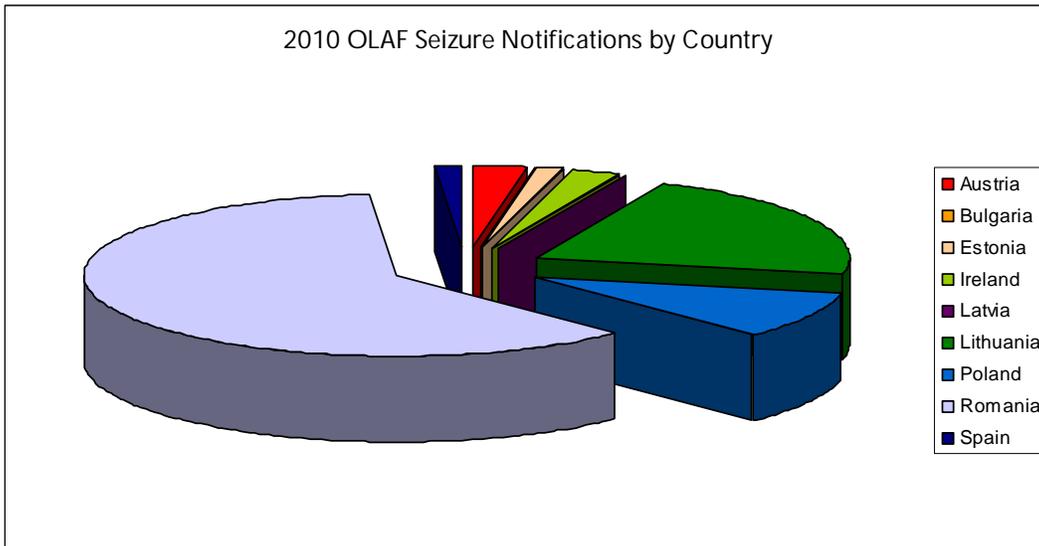
In the past month, the BI *Diversion and Special Investigations Team*, working with Corporate Affairs, Compliance, and Quality Assurance, inspected 10 consignments of smuggled JTI brands that had been seized in the European Union and were subject of OLAF Notifications. The past month saw an additional 12 OLAF Notifications – bringing the total this year to 74, although two of the largest, seizures of eight million and three million sticks in Ireland and Romania, respectively, are almost certainly entirely counterfeit Palace. Of the diverted product, Saint George, Ronson, and Memphis are the main brands seized.



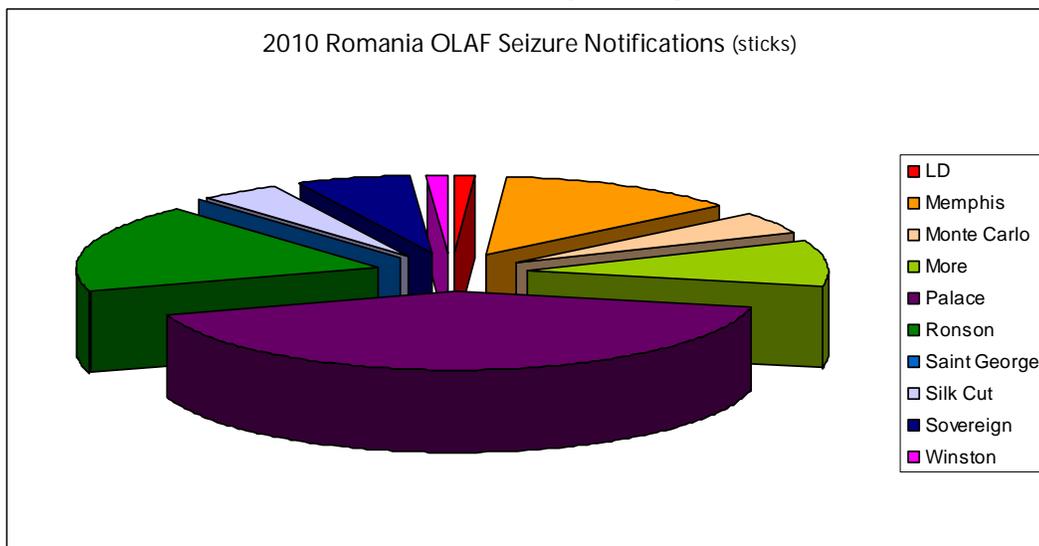
2010 OLAF Notification Seizures by Brand¹

- Of the 45 Notifications submitted by the authorities in Romania this year, we have confirmed that the cigarettes covered by 26 of these have been destroyed, which since these occurred prior to our inspection, effectively cancels the Notifications. The authorities have confirmed that two seizures can be inspected, while we are waiting to receive approvals to inspect a further 17. Ronson and More dominate the seizures of diverted cigarettes.
- Lithuania continues to report the largest number of individual seizures – 16 to date this year – and most are for Saint George smuggled from the CIS. Nine 2009 Notifications remain outstanding, although the cigarettes related to two of these may have already been destroyed.
- Hungary has issued three Notifications but state that a MOU is required with Hungarian Customs before any inspections can be allowed.

¹ Palace seizures - 113,975,800 sticks, year-to-date - are not included since they are all assessed to be counterfeit.



2010 Seizures by Country



2010 Seizures by Brand in Romania

Europe

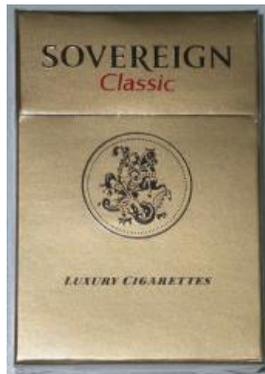
Developments in Europe revolve around the continuing flow of counterfeit, diverted, and smuggled cheap-white cigarettes into the European Union and mainly bound for the UK market.

- In Bosnia, BI investigators continue to develop information on a factory in Siroki Brijeg believed to be producing counterfeit Memphis and possibly other international brands. We are developing plans to pass information on this factory to a reliable enforcement agency.
- In Austria, on 7 February Austrian Customs intercepted a truck carrying 700 cases of the cheap white brand Raquel heading for the United Kingdom. The vehicle had a cover load of

cornflakes allegedly for delivery to a recipient in Belgium, which has emerged as a staging area for shipments of counterfeits and smuggled cigarettes bound for the United Kingdom.

- In Poland, Customs officers in the eastern Podlaskie Region, near the border with Belarus, intercepted some 1,300 master cases of Jin Ling in the past month in a series of operations.

In Malta, meanwhile, the authorities destroyed 649 master cases of Sovereign on 16-17 February. The authorities seized the Sovereign in November 2008 on route from Turkey to Panama. The destruction was witnessed by JTI local legal representatives.



Seized Sovereign Classic - Valletta November 2008

In Romania, members of the European BI team met in Bucharest with local JTI Management and Law Enforcement officers from Customs and the Border Police to get an update on the current situation in respect to illicit trade, as local market research indicates a significant rise in illicit sales in recent months. The information collected from all parties is now being evaluated and a plan is being developed to identify the sources of this illicit supply of JTI product. The local research indicates that Winston, Monte Carlo and More are the most smuggled JTI brands found in Romania which are being smuggled in from Moldova and Ukraine or sourced from Duty Free Shops on the Serbian Border and sold illegally in street markets in Romania.

Americas and Emerging Markets Watch

After an initiative launched by BI last year to prompt authorities to seize and destroy old diverted JTI product on health grounds, the Customs and Health Departments in Panama used this same approach to seize, pending destruction, a container carrying over 1,000 cases of M1 Classic cheap white brand that the Container Tracking Program had identified leaving Jebel Ali in the United Arab Emirates. The consignor is a Cypriot based trader who has traded in counterfeit JT Group brands in the past, while the consignee reportedly has links to Mexican drug cartels.



M1 Classic Seized in Panama

CIS

The CIS BI Team has been continuing investigations into known or suspected counterfeits found in Kyrgyzstan.

- BI investigators are working with the Customs Service to identify the provenance of Mild Seven Light without required tax stamps found in Bishkek. A forensic assessment of a sample is pending.



Mild Seven Found in Kyrgyzstan

- Using information collected by the Global Intelligence Team, the authorities in Osh, Kyrgyzstan are now seeking to identify additional persons who may have been involved in smuggling China-made counterfeit Sovereign Blue into the country (see January Monthly Report).

In the Ukraine, a Working Group of Corporate Affairs representatives from main tobacco manufacturers in the country has submitted to the Customs Service a draft Memorandum of Understanding. Previously, the Service had refused to sign agreements with individual companies. It is hoped a joint accord will allow for deeper cooperation in tackling illicit trade.

Middle East, North Africa, and Turkey

As part of several parallel investigations run in partnership with the Intelligence, Diversion and Special Investigations, and Europe Teams, the BI MENAT Team has identified what appears to be an important channel to divert JTI brands from authorized sales channels. The reporting shows that most of the cigarettes – as much as one or more 40-foot containers worth each month – are being moved to Iran and Iraq via the Port of Mersin in Turkey and the Habur Border Crossing with Iraq. During one operation related to the investigation, Turkish Customs stopped and inspected a shipment of 400 cases of Winston and 40 cases of Camel at the Habur Crossing.



Opened boxes 'diverted' cigarettes at Turkish – Iraq border



Habur Border Crossing

The MENAT Team continues to make headway building ties to regional enforcement agencies.

- In Egypt, a joint BI and Imperial Tobacco delegation met the Director General and eight senior officers of the Customs Authority in Cairo and discussed the on-going problems of smuggling via Port Said and Alexandria. It was agreed that JTI and Imperial would organize in the Third Quarter a Regional “Operational” Conference, to be held in Egypt under the auspices of the Egyptian Customs Authority. The aim of the conference will be to discuss the smuggling activities in the Eastern Mediterranean Sea – two attendees from Customs Authorities of Lebanon, Syria, Turkey, North and South Cyprus will be invited.



Meeting with Egyptian Customs

- A team of Jordan Customs Officers and four staff members from the Aqaba Special Economic Zone Authority were trained in Trier this month in counterfeit recognition techniques.



Jordan officials in Trier

Asia-Pacific

Based on intelligence provided by investigators employed under the joint JTI-Imperial China Printer Program, enforcement authorities raided a printer in Raoping County, Guangdong Province on 28 February seizing a large amount of international and local-brand packaging as well as a Chinese-made gravure printer. This is the second month in a row that the program has resulted in a seizure of gravure machinery and packaging.



Gravure Printer Seized During the Raoping Raid

- The investigators reportedly also seized sufficient counterfeit Mild Seven Original packaging with Russian markings to produce some 570 master cases of finished cigarettes. Of concern, the packaging was off-set printed, which suggests it was not produced at the printer that was raided. It is not clear how or why this packaging was found at this facility or if there has been an attempt to falsify raid records in order to garner an additional payment from the sponsoring companies.



Offset Mild Seven Original Packaging Reportedly Seized at Gravure Printer in Raoping

In Taiwan, BI Investigators operating under the Destination Market Enforcement Program continue to work in close coordination with the authorities to disrupt the smuggling of JTI brands and key cheap white brands.

- In the past month, retail inspections in Taipei, Kaohsiung, and elsewhere resulted in the seizure of more than seven master cases of a mix of smuggled Mild Seven, Caster, Peace, and Mi-Ne that originated from sources in Japan and Duty Free. The small amounts found suggest these are the result of retail “spillage” vice large-scale smuggling.



Contraband Seven Stars and Peace Seized in Taipei on 5 February



Contraband Peace, Mild Seven, Mi-Ne, Caster, and Seven Stars in Kaohsiung 1 February

In contrast, large-scale smuggling of cheap whites and other international brand continues with the authorities seizing over 1,000 master cases in a series of operations. In one case, the Coast Guard recovered on 1 February over 500 cases of the brand Halo [哈囉] on the sea coast and from two vans intercepted in Yilan. On 28 January, a Coast Guard team seized another sizable consignment of smuggled cheap white brands from the “fishing boat” CT3-4973 Hong Long 32 [宏隆 32 號] and a nearby warehouse at a small port in Tai Dong County.



Smuggled Cheap-White Halo Seized on 1 February



Cigarettes Seized from CT3-4973 and Nearby Warehouse

Based on a tip off from a source, BI investigators identified and then monitored the operations of a factory near Manila in the Philippines producing counterfeit Salem Menthol. A sample was obtained and proceedings had begun to obtain a search warrant for the factory when the counterfeiters were tipped off to the pending raid and moved the materials from the factory. BI investigators continue to monitor the activities of the group involved, which also runs a factory making counterfeit China National Tobacco cigarettes, and we will work with law enforcement to disrupt the activities of the counterfeiters when the opportunity arises.

- A forensic assessment of the Salem obtained from the factory indicates it is a high-quality machine-packed version bearing the old Malaysia Health Warning on left panel. The pack has a 4 digit code "XIYE" printed on the poly-wrap and pack code "10328" embossed on the bottom panel. The blend was mentholated which covered all the bad tobacco taste during smoking. Tipping paper was printed with "Salem" logo, has two lines of mechanical perforation, while the packaging glows under UV light.



Exterior of Factory Producing Counterfeit Salem



Sample of Counterfeit Salem

Based on information from BI investigators, Royal Malaysia Customs (FMC) seized three containers carrying close to 2,400 master cases of smuggled cheap-white brands League, Texas 5, and Tex shipped from Cambodia, Thailand, and Vietnam, respectively.



Container of Smuggled League Intercepted in Malaysia

- In a related development, the RMC raided a factory on 28 January in Selangor, Malaysia that was found to be illegally producing Half Time 5 and League brand cigarettes.



Cigarette Making Equipment Located in the Selangor Cigarette Factory



Half Time 5 Recovered at the Selangor Factory