

## Inter-Office Correspondence

Date: 1 February 2010

Subject: Brand Integrity Global Operations – January 2010 Update

Since December 2009, based on information developed by the Intelligence and Disruption Team, Brand Integrity (BI) passed to OLAF and Customs Services and other enforcement agencies in Europe, Africa, and the Americas tip offs on 20 containers known or suspected to be carrying counterfeit or smuggled cigarettes.

- To date, enforcement authorities have seized seven of the containers and raided an associated warehouse, recovering 2,300 master cases of counterfeit international brands – including small amounts of counterfeit B&H and Winston – and cheap-white brand Jin Ling in Lithuania and the Netherlands and over 2,400 master cases of smuggled cheap whites in Chile and South Africa. The authorities in the Netherlands also seized a container with counterfeit perfume.
- Three containers – two of which are believed to be carrying counterfeit B&H bound for the United Kingdom and Ireland markets – via Poland, Spain, and the Baltic States from China, and one heading to the United States from North Korea are the subject of ongoing controlled deliveries.

### Diversions Inspections and Investigations

In the past month, BI, working with Corporate Affairs, Compliance, and Quality Assurance, inspected 13 consignments of smuggled JTI brands that had been seized in the European Union and were subject of OLAF Notifications. Over 70 additional OLAF Notification seizures covering some 120 million sticks of mainly counterfeit Palace recovered in Ireland based on a BI tip off, but also including Saint George, More, Ronson, and Winston in Romania, Lithuania, Poland, Austria, and elsewhere remain to be inspected. Seizures totaling some 2.4 million sticks of More, Monte Carlo, Winston, and North Star in Romania and Poland initially appear to meet the threshold for OLAF penalty payments, which could total over €170,000.

- Of the total that remain to be inspected, a sizable number in Romania appear to relate to seizures of fGallaher brands that predate the EC-JT Agreement, while inspections of five in Poland and three in Hungary are pending approvals from local authorities, possibly in contravention of the Agreement. The authorities in Lithuania and Latvia also withdrew authority for our teams to inspect seized consignments. All cases in which the authorities refuse our requests for timely inspections are being addressed with OLAF.

An assessment conducted by the BI Russia Team indicates that smugglers moving diverted JTI cigarettes from Russia into the Baltic States are now mainly using a routes from Russia's Pskov Region to Latvia, via Saint Petersburg into Estonia, and from Smolensk in Russia to Minsk and Mogilev in Belorussia and then into the eastern part of Lithuania. Previously the preferred routes were via the

Kaliningrad enclave and directly from Russia into Latvia and Estonia. For large consignments, the smuggling gangs continue to mainly conceal shipments inside consignments of sawn timber or charcoal loads of carried by rail.



Smuggling More Cigarettes Concealed in Shipment of Sawn Timber

Meanwhile, in the Philippines, BI continues to work with the market to monitor and disrupt the efforts of a known smuggler to purchase and consolidate consignments of Winston for shipment to Europe. The market has been cutting deliveries to buyers known or suspected to have been approached by the smuggler. BI disrupted the efforts of this same smuggler in September 2009 to ship several consignments of Philippines Winston and Camel to a trader in the European Union, which if intercepted by authorities could have resulted in penalties to the company of some €3 million (see October 2009 Monthly Report).

- BI Diversion investigators, working with the Intelligence and Disruption and BI MENAT Teams, also are monitoring the activities of several traders in the Middle East who have been discussing the sale of over 2,000 master cases what appear to be genuine Camel and Winston – as well as some 3,000 cases of PMI and BAT brands – which reportedly are currently at an unknown location in Egypt.



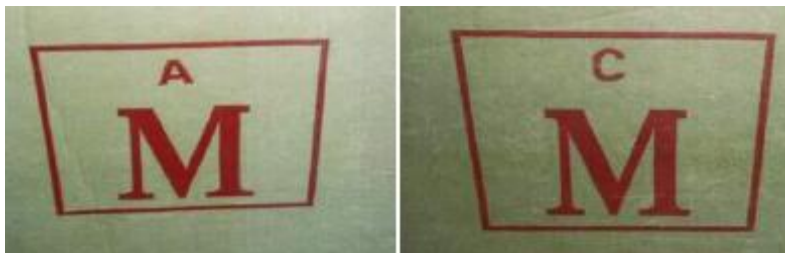
Pictures of Suspected Diverted JTI Brands Currently On Offer by Traders in the Middle East

- Investigators working for the BI MENAT Team also monitored the shipment of what is believed to be a consignment of diverted JTI cigarettes from Mersin in Turkey into northern Iraq, possibly bound for Iran, in the past month. We will focus efforts in the near term of identifying suspect shipments on this route.

## Forensic Investigations

An inspection this month of over 700 master cases counterfeit Winston and Camel seized by China Customs last year found the cigarettes were packed into correctly marked JTI master cases, sealed with JTI case tape, and then into outer cases with codes to indicate the brands inside. Customs also recovered similarly marked and packed Marlboro.

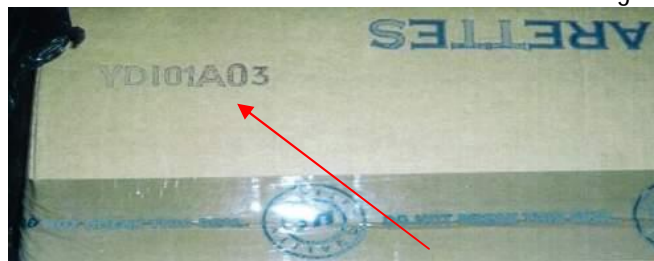
- Counterfeiters rarely spend the time and resources to print correctly marked master cases and tape since loads smuggled into destination markets typically are rapidly broken down to the carton and pack level for distribution and sale.
- The use of JTI master cases – which also bore markings and stamped codes to indicate a particular JTI factory of production – invariably suggest the cigarettes are intended to be co-mingled at an up-stream distribution level that handles large amounts of multiple-case consignments.
- The use of coded outer cases to identify the brands inside, moreover, points to a high degree of organization within the smuggling syndicate and also suggests the group has been shipping – or intended to ship – large amounts of the cigarettes, which again suggests the involvement of a buyer capable of absorbing large master-case consignments of counterfeits.



Coded Outer Cases for Counterfeit Winston and Camel Respectively



Winston and Camel Master Cases with Correct JTI Markings and Tape



The Camel Filter Box Case Code

In a possibly related development, a single master case of counterfeit Winston, again packed inside a correctly marked JTI master case, was recovered from a container carrying mainly counterfeit PMI brands from China in the Netherlands in January based on a BI tip off to OLAF. It is believed that this master case was intended as a sample for a buyer and, pending a full forensic examination, appears to be the same variant as that which was seized by China Customs in September 2009.



The Winston King Size Clean Label Counterfeit Inside JTI Master Case Seized in the Netherlands

## Europe

The Destination Market Enforcement Program (DMEP) in the United Kingdom and Ireland will reach full operation by the end of March as coverage extends to Northern Ireland, the final uncovered area in these two markets.

- On 1 January Irish Revenue and Customs seized 800 cases of Palace in a container that arrived in Dublin from the Jebel Ali Free Zone in the United Arab Emirates. Last year we tracked the movement of several containers of counterfeit Palace from a factory in the Philippines to a warehouse in Jebel Ali before losing the shipments. We have received samples of the seized Palace and will determine if they match same acquired from the Philippine factory (see previous Monthly Reports and related article below).

Under the Austria DMEP, our investigators have confirmed that retailers of smuggled cigarettes that had been shut down by the authorities late last year have resumed their operations, albeit it on a smaller scale. Austria Customs are aware of the situation and are preparing to seize additional smuggled cigarettes from this group.

- Following the disruption of a major smuggling group based on BI intelligence last year (see xxx Monthly Report), the key members of the gang have now been sentenced to up to one year in jail and collectively face fines totaling over €2 million.
- Austrian authorities on 9 January seized 19 cases of Memphis from a car bearing diplomatic plates returning from Serbia that was stopped near St. Poelten. This same vehicle – which has been modified with hidden compartments to carry the cigarettes – has been noted making several similar trips carrying cigarettes to Austria from the Balkans in the past. BI investigators continue to work with Austrian authorities based in Serbia to interrupt the flow of cigarettes.

In Romania, the local market and officials report a significant upsurge in the presence of contraband cigarettes in the country since the beginning of the year. The reports indicate that a major but unknown portion of the smuggled cigarettes are entering the country from the Ukraine and Moldova. BI plans to conduct a series of snap shot surveys in the country to confirm the make up and provenance of the smuggled cigarettes in Romania and, in cooperation with BI units in the CIS, work to disrupt the flows.

## CIS

In mid-January, a long-running police and Customs Service investigation in Kyrgyzstan, supported by information provided by the CIS BI and Intelligence and Disruption Teams, resulted in the arrests of several persons and the disruption of a syndicate smuggling and selling counterfeit Sovereign Blue cigarettes produced in Fujian Province, China. The counterfeits were first noted on the local market in May 2009. Following a series of raids of warehouses and the seizure of over 100 cases of the cigarettes in December last year, BI passed to the authorities the full background details of the Chinese persons involved in the smuggling and the production of the cigarettes in China.



Counterfeit Sovereign Blue Seized in Vehicle and at Warehouse

On 25 January, the local JTI sales force alerted BI to the presence in and around Yakutsk, Sakha Republic, Russia, of wines bearing the JTI Glamour trade mark. After confirming the location of the production facility and the entity that ordered the wine, BI passed details to the Intellectual Property Team in Geneva for follow up.



Wines Bearing the JTI Glamour Trademark Found in Yakutsk

The seizure by Latvia Customs of a truck carrying 1,250 cases of cheap-white brand Jin Ling entering from Russia in late December highlighted a previously unknown smuggling ruse. The driver correctly declared the cigarettes to Russia Customs at the border. Upon entering the neutral zone between the Russia and Latvia Customs checkpoints, however, the driver exchanged license plates with an empty



truck from Latvia. The truck loaded with cigarettes, now bearing the Latvian license plates, then attempted to enter Latvia. Russia Customs noted that they have seen this scheme used on two occasions in the past year

### Middle East, North Africa, and Turkey

In the past month, investigators working for the BI MENAT and Intelligence and Disruption Teams obtained information to show that a well-known syndicate, which has been producing counterfeit JTI and other international brands at a "protected" factory in northern Iraq for several years, was preparing to produce cigarettes bearing a famous consumer luxury brand's trade mark at another factory in the United Arab Emirates. BI shared details of the planned production – as well as registrations of their trade marks in different countries – with the luxury-brand company's brand protection unit. The company intends to take legal action against the syndicate, using the BI intelligence, which we anticipate will help disrupt the group's overall counterfeiting and smuggling operations.

- Meanwhile, the BI MENAT Team is working with their counterparts at Imperial Tobacco on a new effort to track movements of counterfeits from the northern Iraq factory in anticipation of seizing these as/when possible.



Carton Artwork for Counterfeit Cigarettes Bearing Famous Luggage Brand Name

The BI MENAT Team has been working to develop a program to identify and track the movement of counterfeit or smuggled JTI brands moving across the eastern Mediterranean into small ports in southern Europe. In a related development in mid January, Greek Customs arrested 11 Russian crew members on board of a vessel which had departed from Alexandria, Egypt and was found to be carrying close to 8,000 cases of cheap-white brands Camelford, Camelot, and Business Royal as well as counterfeit Cooper. The investigation is ongoing but may be linked to a smaller seizure in December 2009 at a storage place in Greece where an as yet unknown amount of Camel was seized with smuggled BF and Cooper.



Camel and Other Brands Seized in Greece in Mid December

### Asia-Pacific

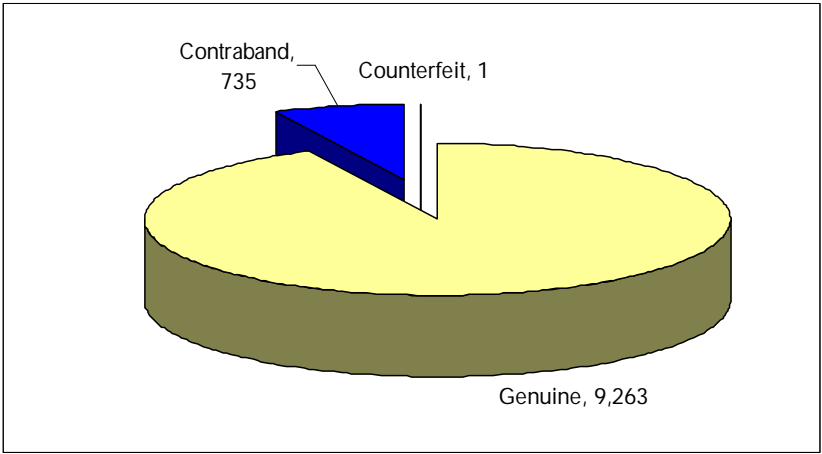
In order to assess the relative presence and distribution of counterfeit and smuggled Mild Seven, Mi-Ne, and LD in Taiwan, the BI Asia-Pacific and Forensic Investigations Teams jointly designed and sponsored a nation-wide pack-retrieval survey in Taiwan over the past three months.<sup>1</sup> Most surprisingly, out of 10,000 packs recovered, the survey teams found only one pack of counterfeit China-made Mild Seven Original Blue. No other counterfeits were found. A total of 93 percent of the packs retrieved were genuine local product, while the remaining seven percent were diverted from other markets.

- Of the 735 packs of diverted product found out of the 10,000 total, 80 percent came from Taiwan Duty Free channels, 12 percent from Japan Duty Free, and the remaining 6.5 percent equally from China and Asia Duty Free. Interestingly, the incidence of diverted product was significantly higher in Taipei City versus southern and central Taiwan, with the exception of Yunlin County. In the past, southern Taiwan had seen a significantly larger presence of contraband and had been the principal entry point for smuggled goods.
- The almost total lack of counterfeits found on the market is somewhat surprising. Although we have seen a very sizable shift within the smuggling community from the trade in counterfeits to smuggled cheap-whites in the past three years, the evidence of continuing production of counterfeit Mild Seven in China, North Korea, and elsewhere regionally is not consistent with the findings of the survey.<sup>2</sup> We cannot rule out the possibility that the methodology used by the survey team to find and retrieve pack samples was flawed and simply missed areas in which counterfeits are traded.

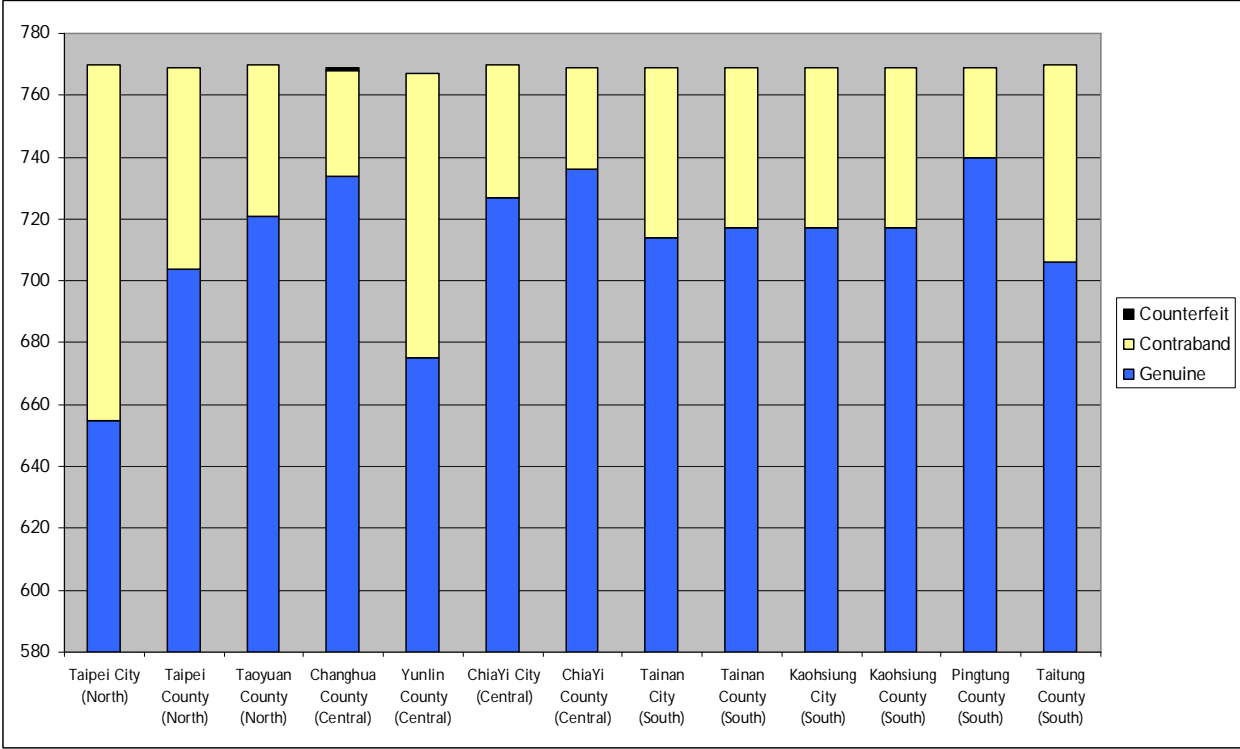
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<sup>1</sup> The survey was limited to these three JTI brands and did not address the overall presence of counterfeits and other smuggled product bearing other trade marks, including cheap white brands. The survey was intended to help focus BI efforts to protect the Taiwan market and specifically the Mild Seven brand.

<sup>2</sup> The Intelligence and Disruption Team is monitoring the activities of four separate syndicates that are currently producing or preparing to produce counterfeit Mild Seven in China or North Korea for the Taiwan market, while the Asia-Pacific Team's China Enforcement Program continues to successfully raid printers making counterfeit Mild Seven packaging, although much of this appears to be bound for the local China market, vice Taiwan.

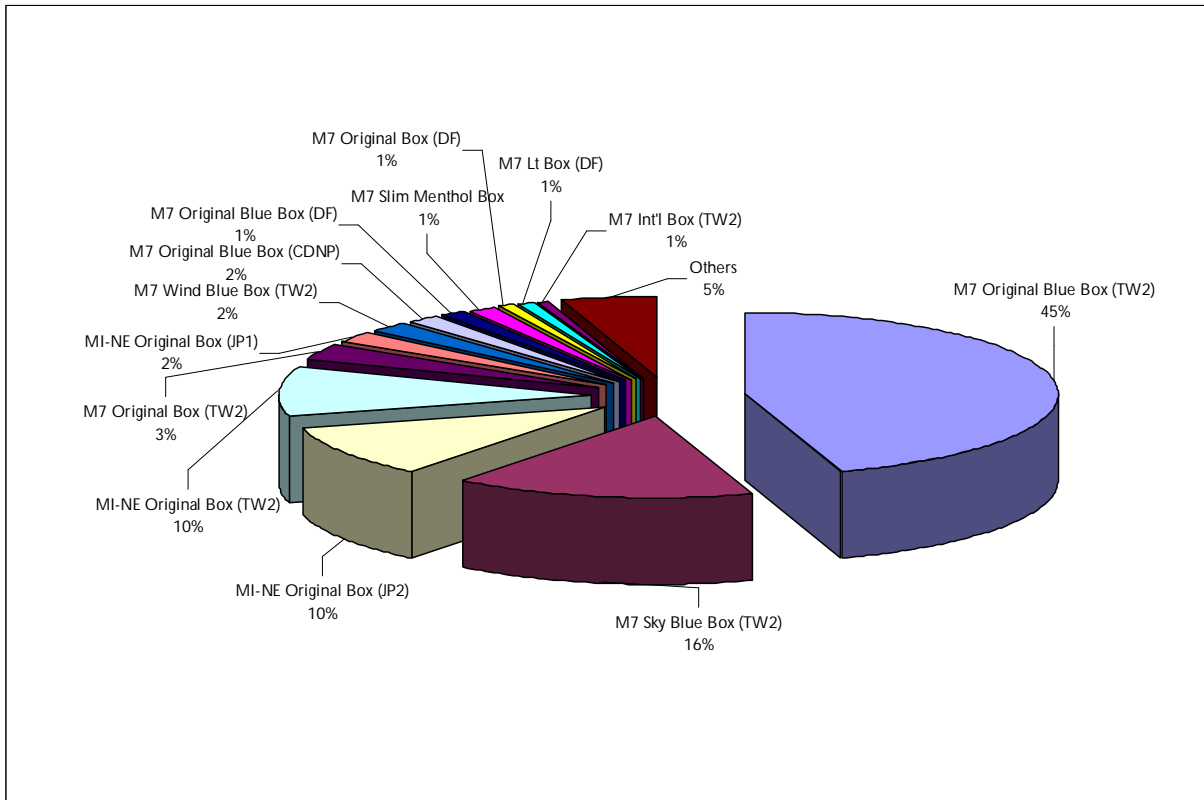


Breakdown of Genuine Local JTI Brands versus Contraband and Counterfeit



Survey Results from Thirteen Taiwan Counties Nationwide





Breakdown of Diverted JTI Brands Found in Taiwan<sup>3</sup>

The joint JTI-Imperial China Enforcement Program continues to make progress and this month generated intelligence to allow the local authorities to successfully raid a printer in Raoping County producing packaging for counterfeit Mild Seven. During the raid, the authorities recovered sufficient packaging to produce just under 1,000 master cases of counterfeit Mild Seven Original Blue with US Health Warnings. They also seized a Beiren 04 off-set color printer as well as cutting and type-setting machine, and large amounts of other materials.

- A forensic examination on the packaging confirmed that it matched 28 cases of counterfeit Mild Seven Original box seized in late December from a van in nearby Shantou.



Mild Seven Original Packaging Seized During the 13 January Raid in Raoping City

<sup>3</sup> "TW2" and "JP2" refer to Taiwan and Japan Duty Free cigarettes, respectively; while "JP1" is Japan Domestic.



Mild Seven Original Printing Plate Seized in Raoping City



Mild Seven Original Counterfeit Seized in Shantou in December

Based on information from an Intelligence and Disruption Team source monitoring the movement of counterfeit cigarettes from North Korea, South Korea and Philippine authorities inspected two container shipments of cigarettes outbound from Nampo that were found to be carrying full loads of cheap white brand Hasedat with Taiwan market markings. Monitoring of the shipments showed them entering the Philippines and then moving to small ports on the northeast coast used by syndicates that smuggle cigarettes into Taiwan. The production of Hasedat in North Korea appears to be a new development and could indicate the country's entry into the burgeoning regional market for smuggled cheap white brands.



North Korean Hasedat Bound to be Smuggled into Taiwan

A forensic analysis of a pack of counterfeit Palace King Size Box recovered by investigators in the Philippines shows it is different from the counterfeits seized last year in Ireland from the same factory (see the December 2009 Monthly Report). The tax stamp of this version is printed vice glued on the back panel of pack; the pack code font size measures 5mm vice 3mm; the expiration date is printed

on the bottom of the pack by an inkjet printer vice on the overwrap; and, the tipping paper has micro laser perforations vice the either electrostatic perforations or no perforations found on earlier versions of the Palace.

- Reporting from BI investigators in the Philippines and elsewhere indicates that the Philippine factory has up to two different customers for the counterfeit Palace in addition to the group linked to last year’s Ireland seizure. As recently as earlier this month another container of counterfeit Palace – which had been produced last year but had been hidden in a local warehouse for the past few months – may have left the country (see related article above regarding a seizure of Palace earlier this month in Ireland which may have originated in this factory).



Palace King Size Box in the Philippines Containing Different Markings and Stamps