

# Brand Integrity Group Investigations Report

24 September 2009

## Assessment of Saint George Diversions from Russia in 2009<sup>1</sup>

### Key Findings

Reporting from Brand Integrity (BI) investigators and data from Customs monitoring of shipments into the Kaliningrad Region of Russia and seizures throughout Russia and Europe indicate that smugglers may be diverting between 2,600 and almost 2,900 cases of Saint George from Russia to markets mainly in the Baltic States each month or as much as 34,500 cases annually. This equates to around two percent of total sales of Saint George in Russia, based on current market figures, and makes up over 40 percent of the total volume of Value Brands sold by JTI in the Baltic States.<sup>2</sup> BI's window into the activities of the smugglers is limited and the outflow estimate is based largely on an assumption that most of the Saint George moved into Kaliningrad is ultimately smuggled into other markets. Nonetheless, given the likelihood other still-unknown diversion channels exist, the cited figures for Saint George now being diverted should be considered a low-end estimate. Further research is required to develop a more accurate number and/or to further validate the current figures.

Based on the current estimate, seizures as reported to BI by Customs Services and/or via OLAF Notifications make up just over 10 percent of the total being smuggled. If all Saint George now known or suspected of being diverted from Russia were seized in the European Union, the Company could be exposed to EU penalties of some Euro 28-to-31 million annually.<sup>3</sup>

BI investigations reveal that several wholesalers and sub-distributors working for or with JTI's current distributor in Russia appear to be colluding with smugglers in collecting and consolidating loads of Saint George, which are then moved to the Baltic States via mainly the Kaliningrad Region of Russia. Many shipments purportedly move via Belarus and/or Lithuania. In Kaliningrad, additional firms associated with JTI's authorized distributor reportedly are linked to efforts to re-pack and re-document loads bound for the Baltic States.

BI's information on the distribution and sales of Saint George in the Baltic States is extremely limited. The amount of product currently being smuggled into the market, however, appears

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<sup>1</sup> This assessment is based on the best data available to Brand Integrity at the time of publication. Much of this information comes from third-party investigators, both official and informal law enforcement sources, and from Customs shipment and seizure reporting. Often it is single-source reporting and cannot be fully substantiated by wholly independent parallel reporting channels. Nonetheless, we believe the preponderance of the reporting – which collectively comes from a broad cross-section of sources – supports the overall conclusions of this paper. It must be noted that the available reporting only provides a brief “snap-shot” into the diversions of Saint George from Russia, is based largely on an assumption that all or the overwhelming preponderance of Saint George diversion take place only via Kaliningrad, and as such may substantially underestimate the total outflows.

<sup>2</sup> Market data indicates that JTI Value Brand sales in the Baltic States were 52,570 cases between January and July 2009, which equates to a monthly average of 6,571 cases. Diversions into the market of 2,606 to 2,881 per month would make up between 40 and 44 percent of the total.

<sup>3</sup> According to the EU-JTI Agreement, penalties of Euro650-900 per cases would apply for seizures in the Baltic States. In addition, any seizure volumes above 9,000 master cases will result in penalties per case five times this amount. The estimate in the text is based on 900x31,272-to-34,572, which results in Euro28-31 million in penalties.

to be too large to be easily absorbed via informal distribution channels, which suggests one or more official cigarette distribution networks likely are involved in selling the diverted cigarettes.

### Background and Investigation Results

A review of reporting Lithuania and Russia Customs, as well as BI investigators, indicates that between 31,272 and 34,572 master cases, or 313 to 346 million sticks of genuine Saint George will likely be diverted from Russia to the Kaliningrad Region of Russia and then onward to the Baltic States and possibly elsewhere in Europe. This equates to a monthly average of 2,606 to 2,881 cases.<sup>4</sup>

- To date in 2009, Customs Services have seized 3,300 cases or 330 million sticks or some 11 percent of the May to mid-September total (see attachment "Global Seizures Saint George 2009 YTD 19 Sep 09").
- The monthly average of 2,606 to 2,881 cases is around two percent of the total monthly sales of Saint George in Russia.<sup>5</sup>
- If all the Saint George is sold into the Baltic States and targets the Value Sector, the monthly average equates to around 40 percent of JTI Value Brand sales, according to the latest market sales data.

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<sup>4</sup> BI investigators to date succeeded in gaining access to the data covering smuggling of Saint George by what we suspect is the principal syndicate involved in the trade for only the period May until mid September 2009. Due to a lack of data covering other periods, we have used these numbers to extrapolate an annual estimate. The lower number represents only those cigarettes reportedly smuggled by the group based on information from our investigators, while the higher number also includes Saint George seized. We believe this range is likely a more accurate estimate of Saint George diversions given the fact we do not know if – but suspect it likely that - other groups are also smuggling Saint George.

<sup>5</sup> As of the beginning of September 2009, according to the Weekly Brief Ending Week 36, sales of Saint George stood at 10.0135 billion sticks or just over one million cases, which is a monthly average of 125,163 cases. Of this amount, 2,606 to 2,881 per month equates to a "loss" of around two percent.

Saint George Shipments to Kaliningrad Region by Firms Linked  
to the Kuznetsov Crime Group January – 14 September 2009 (master cases)<sup>6</sup>

Company	Feb	March	April	May	June	July	Aug	Sept	Total
Regiontabak	1191	717							1908
Kameya		1338	946						2284
Advent				3881	4465	4050	6167	1800	20363
Pobeda		500		822					1322
Modultorg			700				340		1040
Baltopt					166	290			456
Balt Tabak					250	820	670		1740
	1191	2555	1646	4703	4881	5160	7177	1800	29,113

Shipments to Kaliningrad – 2009 Extrapolation (master cases)

Total to Date (Week 36)		29,113
Weekly Average	29,113/36	809
Anticipated Full Year Total (52 weeks)	809x52	42,068
Monthly Average	42,068/12	3,506

Kaliningrad – Amount Available to Divert (master cases)

Monthly Average		3,506
Kaliningrad Monthly Consumption		900 <sup>7</sup>
Monthly Amount Available to Divert	3,506-900	2,606
Annual Amount Available to Divert	2,606x12	31,272

Reported Seizures of Saint George – 2009 Year-to-Date and Extrapolation (master cases)<sup>8</sup>

Seizures Year-to-Date (Week 36)		3,300
Weekly Average	3,300/36	92
Anticipated Full Year Total (52 weeks)	92x52	4,784
Monthly Average	4,784/12	399

Total 2009 and Monthly Available to Divert and Anticipated Seizures

Total Annual (Available to Divert + Seizures)	31,272+3,300	34,572
Weekly Average	34,572/52	665
Monthly Average	34,572/12	2,881

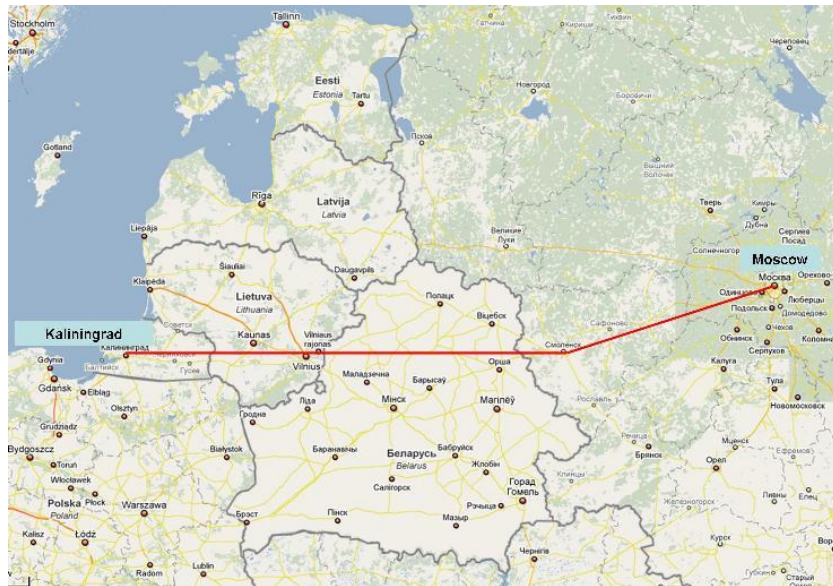
<sup>6</sup> The data on the companies and their shipments to Kaliningrad comes from Lithuania Customs and is then double-checked with data from Russia Customs. In accordance with the Russian State Regulation on Border Crossing and Customs Control, all goods bound for Kaliningrad must move via the "Kaliningrad Transit" route, which crosses Lithuania. All data received from Lithuania Customs includes both entry into the country and then the exit into Kaliningrad. We also then receive confirmation from Russia Customs as the cigarettes enter Kaliningrad. Thus we are confident no sizable "spillage" occurs during the transit phase. See attached "Lithuania Customs Data on Saint George Transfers to Kaliningrad September 2009.xls" for the latest data available.

<sup>7</sup> Sales data comes from the market and averages between 600 and 900 cases of Saint George sold in Kaliningrad per month. We took the higher figure as a basis for this assessment.

<sup>8</sup> The seizure data comes from the AIT Database. See attached "Global Seizures Saint George 2009 YTD 19 Sep 09.xls" for the latest data.

Potential Diversion Range for Saint George in 2009  
(Available to Divert – to – Available to Divert + Seizures)

	ATD	ATD + Seizures
Annual Range	31,272	34,572
Monthly Average	2,606	2,881



The “Kaliningrad Transit Route”

The reporting indicates that the bulk of the Saint George cigarettes are acquired in, and then shipped from, Russia via a series of front and temporary companies owned or controlled by a group of individuals who Russian law enforcement agencies confirm are associated with the Kuznetsov Criminal Group (see Appendix A for a list of known or suspected Kuznetsov members who have been identified by our investigators and Russian law enforcement as principal players in the trade and the attached Linkchart detailing relationships between group members).<sup>9</sup> In Moscow, where loads of Saint George are often consolidated before onward movement to Kaliningrad of the Baltics, the main figures reportedly are former employees of JTI distributor Megapolis, while those active outside Moscow in collecting consignments of Saint George are mainly former distributors or sub-dealers of Megapolis.

- Between May and August 2009, the firm LLC Advent dominated the trade, moving some 20,363 cases of Saint George from Russia to mainly Kaliningrad, while the companies LLC Pobeda, LLC Baltopt, and LLC Balt Tabak shipped 1,322, 456, and 1,740 cases respectively. The firm LLC Kamenya reportedly dominated the trade earlier in the year, but investigators report the syndicate ceased using this company after it became well known to authorities as a smuggling vehicle.

<sup>9</sup> The Kuznetsov Crime Group is a Kaliningrad-based syndicate well known to the authorities. The following press articles provide further details on the group: <http://kaliningrad.allnw.ru/news/77247> and <http://www.gusev-online.ru/novosti/proishestvia/756-arestovan-kriminalnyji-avtoritet-kuzja.html>.

- Dmitriy VIRKO, working closely with a Yuriy RYABCHIKOV, both purported members of the Kuznetsov Crime Group, owns all or significant portions of both LLC Advent and LLC Kamenya.
- Other companies identified during this period and earlier in the year consolidating shipments included LLC Diksika, LLC Sena-K, LLC Tabak Invest in the Moscow Region; Everest Company in Stavropol; and Agrofarm Company and LLC Kvinta in Volgograd.

Most shipments move from the Moscow area to the Kaliningrad Region by truck or rail, often via Smolensk, Belorussia, or Lithuania, before onward movement into the Baltics or other destination markets. Reporting from BI investigators indicates that the firm LLC BaltLesBizness, which is owned by Ryabchikov, provides warehousing facilities and workers for the movement of the cigarettes and likely is the principal local organizer of the trade in the Kaliningrad Region.

- BaltLesBizness is an "official retailer" for JTI Russia exclusive distributor Megapolis Company.
- These or possibly other smugglers also move shipments to the Baltic States via the Pskov and Sebezhh Regions of Russia.



Russian Customs Border-Crossings in Pskov and Kaliningrad Regions Used to Smuggle Saint George

### Liaison, Enforcement, and Disruption Efforts

Efforts to intercept and seize shipments are complicated by the fact the movement of cigarettes from throughout Russia to the Kaliningrad Region is not illegal. Once in Kaliningrad – in which the Kuznetsov Group reportedly has high-level connections and protection – again the legal interdiction of shipments leaving the territory is often problematic and typically garners little or no support from local enforcement authorities.

BI's efforts to date have been focused on identifying the parties involved in the trade and then working with both national-level – federal – authorities in Russia and with individual Customs Units to disrupt the flow of Saint George (see Appendix B for a list of law enforcement units BI has engaged on the issue).

## APPENDIX A – Known or Suspected Member of Kuznetsov Crime Group Smuggling Saint George<sup>10</sup>

Dmitriy VIRKO is a main figure in smuggling Saint George from mainland Russia to Kaliningrad and then into the European Union. Within the Kuznetsov Group, he reportedly is responsible for sales and organizing shipments to customers. Between 2003 and 2006, Virko was General Director of LLC Krasnaya Strela, Kaliningrad, a “tobacco products sales” company. From October 2006 until December 2008, he was a Sales Director at LLC KS Baltika (KS – Krasnaya Strela), which was also listed as a “tobacco sales” company. During 2008, the company shipped to Kaliningrad a total of some 6,876 cases of Saint George. After LLC KS Baltika ceased operations – purportedly after being caught smuggling – Virko formed LLC Kameya in January 2009. During January-April 2009, LLC Kameya was noted shipping 2,284 master cases of Saint George to Kaliningrad, before it ceased operations. Since April 2009, Virko has been using LLC Advent to ship Saint George to Kaliningrad; moving 19,152 cases of Saint George to date.

Yuriy RYABCHIKOV, who appears to be provide shipping services and warehouses for the Kuznetsvo Group, is co-founder of LLC Leskova Plus, LLC Alma, and LLC SMP, all of which have no listed legal address but reportedly are involved in “tobacco sales and distribution.” He also runs tobacco sales firms LLC Elikom R.C. and LLC BaltLesBiznes, which are based in Kaliningrad. Many of the co-founders of these companies have criminal records for tobacco smuggling, tax evasion, and related crimes, including association with organized crime groups “Pak,” “Baikov,” and “Musiychenko,” most of which ceased operations in the mid-1990s after the murders of their leaders.

Sergey TARASEVICH is responsible for consolidating loads of Saint George in and near Moscow on behalf of the syndicate and in response to order placed by Virko. Tarasevich also obtains shipping documents and “handles any problems” with the Police or Customs. Tarasevich was first noted in July 2008 when he acted as a representative of KS Baltika in an effort to release a shipment of Saint George detained at the Baltiysk Seaport in Kaliningrad. Tarasevich also reportedly paid off Customs Officials in Smolensk in December 2008 to release a truck carrying diverted Saint George. Between 2008 and May 2009, Tarasevich has been linked to 44 separate shipments of Saint George.

Leonid SIZOV orders cigarettes and organizes shipments from throughout Russia – notably Volgograd, Rostov, and Yekaterinburg – to Moscow for consolidation based on order submitted by Virko. During 1999-2005, Sizov was co-founder of the group of companies “Tabachnye Traditsii,” which company registry documents indicates traded in tobacco products. In 2007 and until the present, Sizov has been noted serving as Logistics Director of the “Premier Drinks Company,” based in Moscow.

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<sup>10</sup> All the information in this section comes from Russian law enforcement, company registry checks, and the result of investigations conducted by our service providers.

## APPENDIX B - Cooperation with the Law Enforcement Agencies

Anti-contraband Unit of Federal Customs Service, Moscow (meetings in February and March 2008)

Central Customs, Moscow (meeting in May 2008, official letters in May 2008 and May 2009)

Central Operative Customs, Moscow (meetings in June 2008, May 2009, letters in June and July 2008)

Central Excise Customs (meeting in July 2009)

Zelenograd Customs (meeting in August 2009, letter in August 2009)

Smolensk Customs (meetings in September 2008 and August 2009, letter in August and December 2008)

North-West Operative Customs, Saint Petersburg, and its subordinates:

Kaliningrad Customs (meetings in January and March 2008)

Kaliningrad Operative Customs (meetings in January, March, June 2008, January 2009, letters in June, July 2008)

Pskov Customs (meetings in October 2008 and April 2009, letters in August, October, November 2008, January, March 2009)

Sebezh Customs (meetings in October 2008, April and July 2009, letters in October and November 2008, March 2009)

Velikie Lyki Customs (meeting and letter in November 2008)

Kingisepp Customs (letter in March 2009)

Baltiysk Customs (meeting in October 2008)

West Unit of Russian Transportation Police (meetings in March 2008 and January 2009, letter in June 2009)

Kaliningrad Regional Unit of Russian Federal Security Service (meeting in July 2008, letters in April and May 2009)

Kaliningrad Regional Unit of Russian Service of Customer' Rights Protection (letters in May 2009)

Liaisons in Police units:

Economic Crime Unit of Russian Ministry of Interior (meeting in April 2009)

Moscow Economic Crime Department (meetings in May-June 2009)

Moscow Region Economic Crime Department (meeting in April 2009)

Kaliningrad Region Economic Crime Department (meetings in January and June 2008, January 2009, letters in July 2008, May 2009)

Smolensk Region Economic Crime Department (letter in December 2008)