
Eye on the Industry

Spring 2016 Edition

**Smoking and Health Action Foundation/
Non-Smokers' Rights Association**

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Introduction

This is NSRA/SHAF's last full length tobacco industry backgrounder document; later this spring the first in a series of tobacco industry bulletins will be published. This document, aimed at policy makers and public health intermediaries, provides an overview of the tobacco industry in Canada and its multi-national parent companies, issues facing the industry in the form of legislation and regulation, and strategies employed by Big Tobacco to address them, such as litigation and appeals. Of particular note is plain and standardized packaging, which was explicitly included in Prime Minister Trudeau's 2015 mandate letter to the federal Minister of Health. As well, a recent ban on manufacturer payments to retailers and a new minimum size for graphic health warnings on cigarette and little cigar packages in Quebec have set a new bar in Canada for provincial legislation.

Main Tobacco Companies in Canada



Imperial Tobacco Canada Limited - www.imperialtobaccocanada.com

- Largest tobacco company: 49% market share in 2015
- President and CEO: Jorge Araya since December 2014
- Head office: Montreal
- Manufacturing plant: Monterrey, Mexico
- Fully owned by British American Tobacco (BAT) since 2000
- BAT's global profits increased 0.2% in 2015 to approximately \$8.68 billion CAD
- Most popular brands in Canada: du Maurier, Player's, Peter Jackson and Matinée



Rothmans, Benson & Hedges Inc.

Rothmans, Benson & Hedges - www.pmi.com

- Second largest tobacco company: 37.3% market share in 2015
- Managing Director: Mindaugas Trumpaitis since 2013
- Head office: Toronto
- Manufacturing plants: Quebec City and Brampton
- Fully owned by Philip Morris International (PMI) since 2008
- PMI's global net earnings decreased 8% in 2015 to approximately \$9.13 billion CAD
- Most popular brands in Canada are Canadian Classics, Next, Number 7 and Belmont



JTI-Macdonald - www.jti.com

- Third largest tobacco company: 13.1% market share in 2015
- Regional President, Americas: Marchant Kuys since 2016
- Head office: Mississauga
- Manufacturing plant: Montreal
- Fully owned by Japan Tobacco International (JTI) since 1999
- JTI's global profits decreased 5.2% in 2015 to approximately \$7.32 billion CAD
- Most popular Canadian brands are Export A and Macdonald



Grand River Enterprises (no website)

- Canada’s largest native tobacco manufacturer
- CEO: Jerry Montour
- Head office: Six Nations of the Grand River Reserve near Brantford
- Wholly native owned - financial information not publicly available
- Canadian brands: Sago, Putters, DK's and Golden Leaf



Casa Cubana Spike Marks Inc. (www.casacubana.ca)

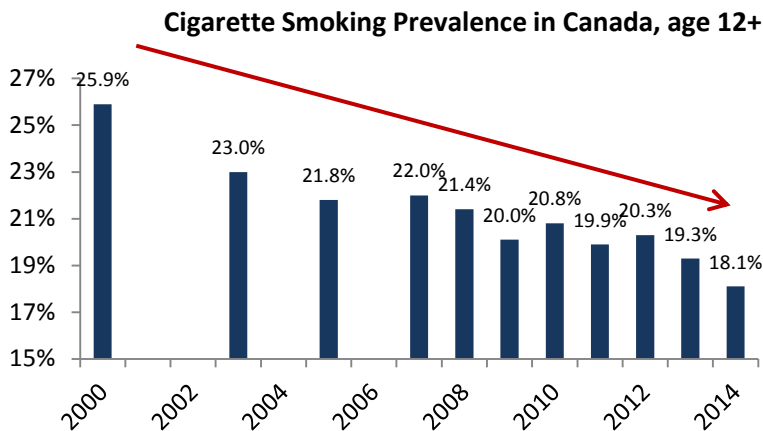
- Privately owned and operated: distributor of pipe tobacco, cigars and cigarillos
- Head office: Montreal
- Established in 1998



National Smokeless Tobacco Company Ltd. (www.nstco.ca)

- Largest distributor of smokeless tobacco products in Canada
- Marginal share of the Canadian tobacco market
- Head office: Montreal
- Popular brands: Skoal and Copenhagen

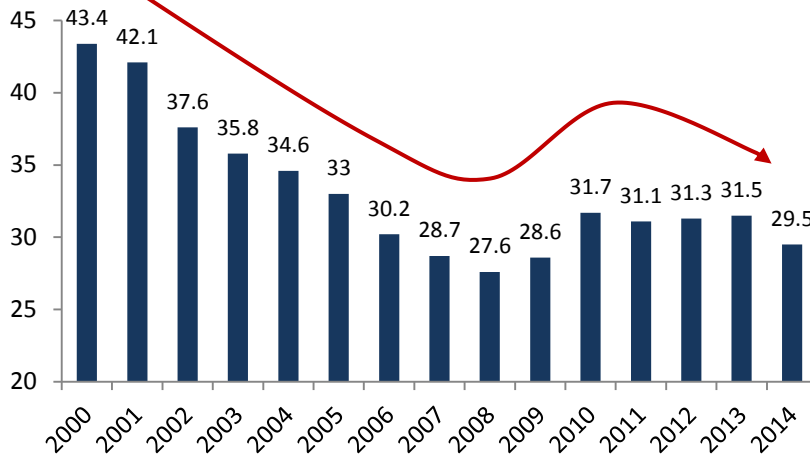
Key Canadian Tobacco Market Indicators



Source: Canadian Community Health Survey

Among the population as a whole, smoking prevalence in Canada has never been lower.

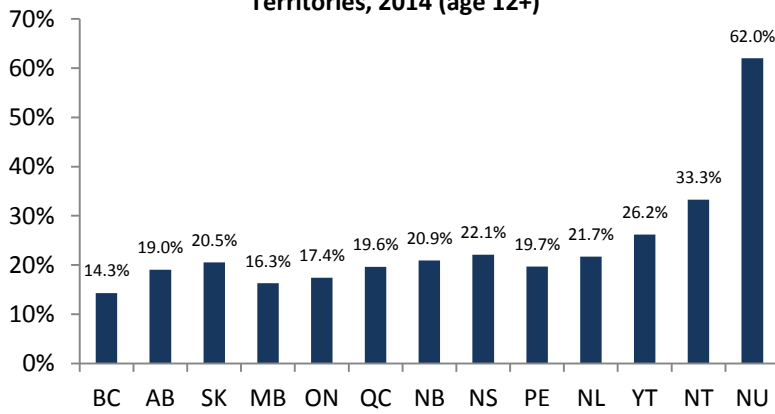
Cigarette Sales in Canada (in billions)



Source: Health Canada

The increase in legal sales after 2008 is related to better contraband control measures and increased enforcement activities.

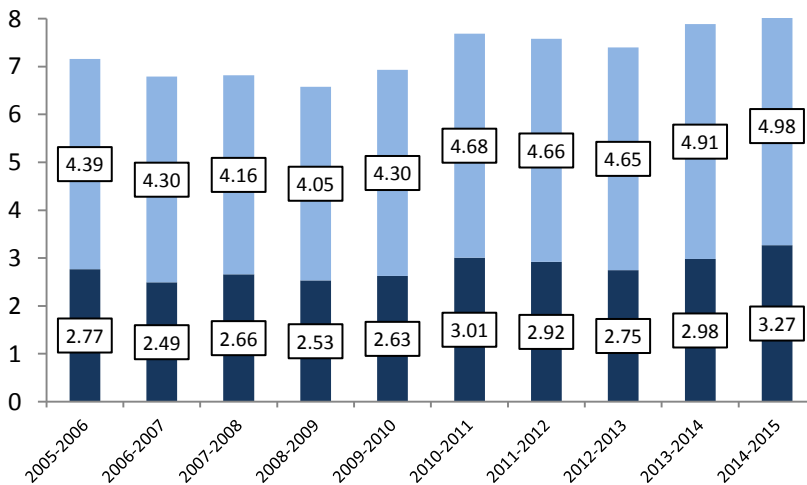
Cigarette Smoking Prevalence in Provinces and Territories, 2014 (age 12+)



Source: Canadian Community Health Survey

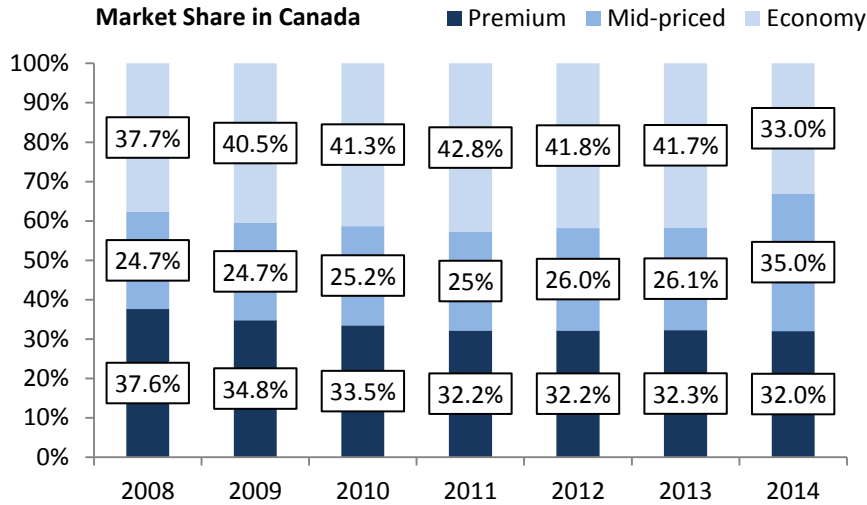
The province with the lowest smoking prevalence is still British Columbia, followed by Manitoba and Ontario.

Tax Revenues in Billions (No GST and PST or HST) ■ Federal ■ Prov & Terr



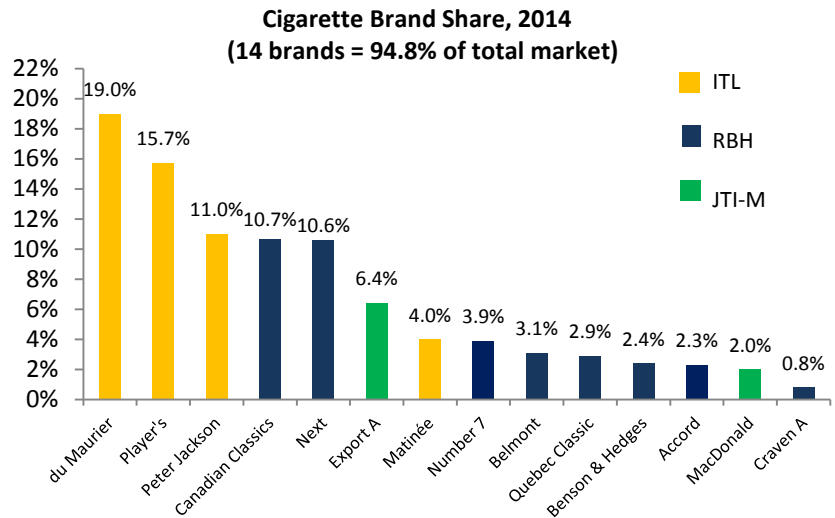
Source: Government Budgets and Public Accounts

Government tax revenues have been increasing in response to tighter controls on contraband and in some cases tax hikes.



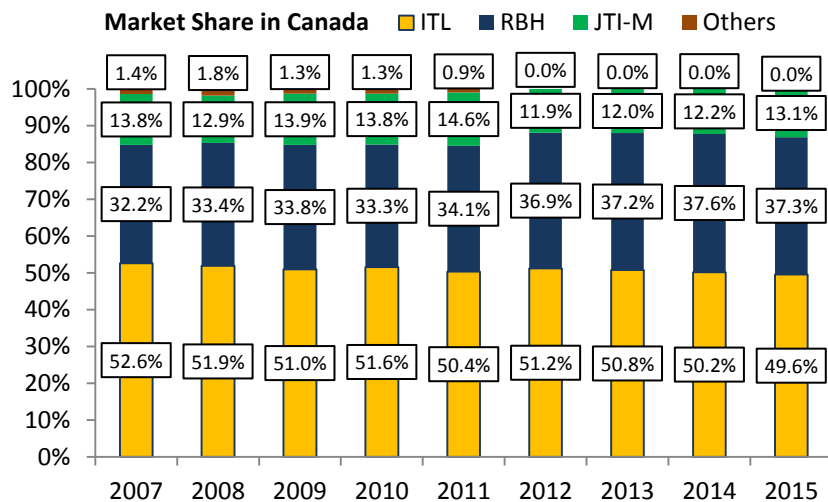
Source: Euromonitor International

Sales of premium brands have been decreasing in favour of more affordable mid-priced and economy brands.



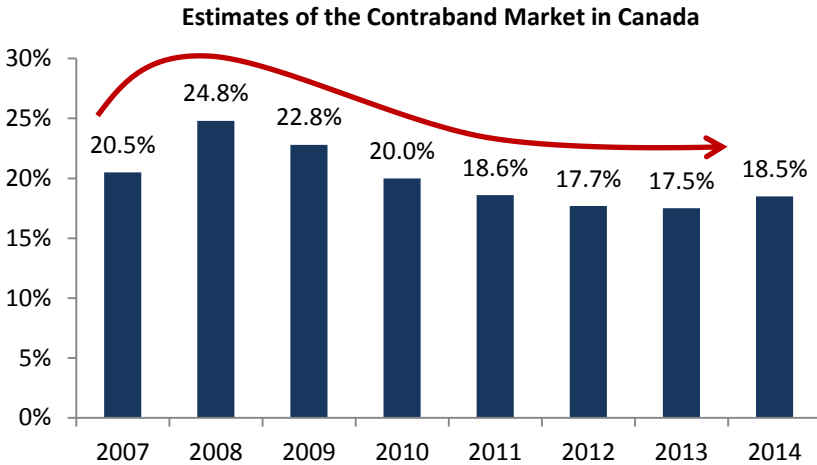
Source: Euromonitor International

Canada's top 3 cigarette brands—du Maurier, Player's and Peter Jackson—are all owned by Imperial Tobacco Canada; together they represent 45.7% of the market.



Source: Citi Group and company financial reports

RBH's 5 percentage point increase in market share over the last 8 years reflects its aggressive move into the discount market.



Source: Euromonitor International

To divert attention from other issues, the National Coalition Against Contraband Tobacco, an industry front group, often portrays the contraband market as much larger than it actually is.

Issues Facing the Industry in Canada

Canada is one of the most regulated tobacco markets in the world, with legislation and regulations at all levels of government in place to control the manufacture, sale and use of tobacco. Referred to by the tobacco industry as a “dark market” owing to numerous restrictions on tobacco advertising and promotion, Canada could become darker still with the introduction of plain and standardized packaging. The measures outlined below provide information regarding how governments continue to raise the bar on tobacco control in Canada, and what they mean for the industry.

Plain & standardized packaging

Much happened on the plain packaging front during the past year, both in Canada and abroad. The French government hosted a “First ministerial meeting on plain tobacco packaging” in Paris in July 2015, bringing together about a dozen health ministers from around the world interested in implementing plain tobacco packaging. Later in the year, plain packaging legislation was approved in France, after a long and contentious campaign. Legislation was also passed in the UK, and a number of other countries around the world indicated their intention to implement the reform.

A major development in 2015 is that a World Trade Organization dispute settlement panel heard oral arguments on the trade dispute against Australia’s plain packaging law brought by five countries—Ukraine (withdrew in 2015), Indonesia, Cuba, Honduras, and Dominican Republic. Demonstrating the global significance of the issue is the fact that 36 Third Parties (other countries) are participating in the proceedings, more than any previous WTO case. A decision is expected this year, at the earliest.

Pack-based promotion stronger than ever

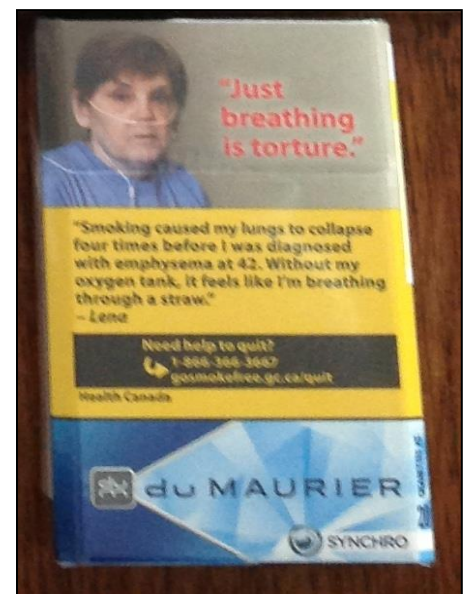
Canadian tobacco companies have been active in introducing novel package designs to promote their products, underscoring the need for plain and standardized packaging. As the industry’s primary marketing vehicle, tobacco packaging—and especially cigarette packaging—is being exploited to

highlight product innovations.

Rothmans, Benson & Hedges was the first company to introduce cigarettes with menthol capsules in Canada, although they have been available for several years in foreign markets. The products are being sold in provinces that have not yet implemented a ban on menthol flavouring. When the filter is squeezed at the designated spot, the capsule is crushed, which releases a burst of menthol flavour. Menthol reduces the harshness of the tobacco smoke, making it easier for youth to experiment with smoking and become addicted.



In the fall of 2015, RBH launched four new brand variants with menthol capsules in English Canada—Canadian Classics Crush, Next Snap, Belmont Hybrid, and Benson & Hedges Unison—and three in Quebec—Next Klik, Belmont Hybrid and Benson & Hedges Unison. Since then Imperial Tobacco has followed suit, introducing du Maurier Synchro and John Player Charge.



Several Canadian brands have been highlighting other filter innovations in addition to menthol capsules. The entire du Maurier brand family (which now includes at least ten variants—Signature, Distinct, Distinct Silver, Mellow, Menthol, Synchro, Master Blend, Fresh Blend, Fine Cut—that are each available in packs of 20 and 25 in king size and regular cigarettes) is transitioning to the “duPLUS” charcoal filter technology. The filter has a hole visible at the end of the cigarette and features a “firm feel, clean tip, unique design.” Although this filter was first used on select products in 2013, ITC has been making much fanfare of introducing it on other du Maurier variants.

Similar to Imperial Tobacco Canada’s very expensive package-based promotion of the new filter design for its du Maurier brand, RBH launched the new filter technology on its Belmont brand with a costly package overwrap. Belmont’s new “firm [charcoal] filter” professes to offer a “consistent performance” and “smooth taste.”

As the packs below illustrate, ITC has gone to considerable expense to highlight the filter technology, selling certain packs in a box within a box and offering some in a limited edition metal box set containing a cigarette pack and a metal case.



Canada moves forward

During the federal election in the fall of 2015, both the Liberal and NDP Parties promised to implement plain packaging if they were elected. In the mandate letter to Health Minister Jane Philpott, Prime Minister Trudeau gave explicit instructions that the implementation of plain packaging is to be a priority during the new government’s first term:

“In particular, I will expect you to work with your colleagues and through established legislative, regulatory, and Cabinet processes to deliver on your top priorities ... Introduce plain packaging requirements for tobacco products, similar to those in Australia and the United Kingdom.”

While the phrase “similar to those in Australian and the United Kingdom” is open to interpretation, both of these countries mandated elements of standardized packaging in their reforms, as well as restrictions on the design of the cigarette itself. This bodes well for Canada’s reforms going beyond merely banning branding elements such as colours and logos from the packs.

In March 2016, the government took the first big step forward in what will likely be a long road to implementation when Health Canada issued a public tender for a cost-benefit analysis of plain packaging of tobacco products. The analysis is to include an estimate of the cost of standardized product packaging, including “standardized plain appearance, dimensions and shape,” as well as the cost of a standardized cigarette size, clearly indicating that the government is open to a broad-based reform.

Of the Big Three Canadian tobacco companies, Imperial Tobacco has been the only one to voice its opposition to the promised packaging reforms, attacking the measure on several different grounds:

- Plain packaging is an ineffective, “feel good” measure. There is no evidence that plain packs have a positive impact on health by reducing smoking rates. The government should focus instead on education.
- No one starts smoking because of the packaging—three-quarters of the pack is already covered by a health warning and stores can’t display tobacco products: “I don’t think anybody walks into a convenience store today and says ‘you know what, this brand looks cool, I will start smoking it’” (Eric Gagnon, Head of Corporate Affairs). Rather, youth start smoking because of peer pressure and the environment in which they grow up.

Although Imperial’s spokesperson told CBC on March 15 that Imperial would wait until the details of the packaging reforms are known before deciding whether to sue the government, just two weeks earlier, on March 1st, Imperial launched a lawsuit against Quebec’s *Act to bolster tobacco control* (Bill 44), in part because of the packaging reforms that mandate a minimum warning size.

Flavour bans

Flavoured tobacco is favoured by young people—flavourings encourage experimentation, reduce the harshness of tobacco and help to discourage cessation. Much progress was made on this issue in 2015. Federally, flavour restrictions on little cigars were tightened to include products weighing 6 grams or less, closing a 6 year old loophole. However, menthol, rum, whisky, wine and port flavours were exempted. In May 2015 Nova Scotia set a global precedent by becoming the first jurisdiction to ban flavoured tobacco including menthol (some exemptions exist). Alberta followed suit, as did New Brunswick (no exemptions), Quebec (ban comes into force August 2016) and Ontario, but with a sunset exemption for menthol until January 1, 2017. Manitoba also has new legislation (exempts menthol) but it has not yet come into force, and Prince Edward Island is developing regulations.

Implications to the industry of banning flavours, including menthol, are enormous. Significantly, half of all Canadian students in grades 9-12 who reported using a tobacco product in the last 30 days used flavoured tobacco products.¹ Flavour bans reduce the attraction of tobacco for young people, which in turn reduces experimentation, subsequent addiction and tobacco industry profits.

¹ Manske SR, Rynard VL, Minaker LM. 2014 (September). *Flavoured Tobacco Use among Canadian Youth: Evidence from Canada’s 2012/2013 Youth Smoking Survey*. Waterloo: Propel Centre for Population Health Impact, 1-18. cstads.ca/reports.

Quebec bans payments to retailers

As previously mentioned, Canada is considered a “dark market” because of the tight restrictions on tobacco advertising and promotion. Tobacco manufacturers have therefore increasingly relied on retailers to communicate with customers and help boost sales, recognizing them as an essential component of their marketing strategies. Early programs saw retailers receiving payments from tobacco manufacturers for prime shelf space, despite point of sale display bans. Recent testimony given by convenience store stakeholders at a Quebec parliamentary committee on the revision of *The Tobacco Act* included details of loyalty programs in which retailers are pressured to sign performance-based contracts. Bonuses and perks such as vacations are available to retailers who meet sales volume targets, and rebates are offered if a brand is sold below a maximum retail price. To meet sales targets and avoid losing their contracts and associated perks, retailers sometimes sell tobacco at deeply discounted prices, sometimes even at a loss.²

Recognizing the pressure put on retailers by tobacco manufacturers to sell more cigarettes, Quebec took the rare step of banning any type of tobacco industry payment or benefit to retailers. This is an important first in Canada, and an encouraging step towards much-needed retail reform of tobacco products. In addition, banning tobacco industry payments and benefits to retailers will become even more important if plain and standardized packaging is implemented, as manufacturers will no doubt further increase their reliance on retailers to communicate with customers about their products.

Minimum warning size in Quebec

Health Canada requires graphic health warning messages covering 75% of the front and back of cigarette and little cigar packages. However, the tobacco industry has gone to great lengths with packaging innovations to minimize both the size and impact of graphic health warnings. For example, purse packs and 8-sided packages with bevelled edges reduce the size of the text and graphics of warnings, diminishing their effectiveness. Quebec’s new legislation, the *Tobacco Control Act*, addresses this issue by requiring that health warnings have an even surface with a minimum surface area of 4,648 mm². This measurement is based on the traditional package design known as “slide and shell.” Requiring a minimum warning size that is equivalent to 75% of the front and back surface areas by de facto requires a minimum package size. As such, by November 2016 purse packs and other designs which undermine health warnings will no longer be permitted in Quebec.

This is a significant development. While the federal government works on legislating plain and standardized packaging, provinces can take action towards this end by emulating Quebec’s lead. Implications to the industry of requiring a minimum warning size are significant; in Canada’s dark market the package itself is essentially the last remaining form of tobacco advertising.

² Porter, I. *Tobacco: Convenience stores under pressure*. Le Devoir. 26 October 2015. Translated by the Quebec Coalition for Tobacco Control.
www.cqct.qc.ca/Documents_docs/DOCU_2015/ART_15_10_26_Depanneurs_sous_pression_LEDevoir_ENG.pdf.

Litigation

All provinces and two territories have passed health care cost recovery legislation and all provinces have filed statements of claim.³ These lawsuits allege that domestic tobacco manufacturers and their parent companies engaged in an elaborate conspiracy to create doubt in the public mind about the dangers of smoking; failed to warn consumers of the dangers of smoking despite their own knowledge that cigarettes were dangerous; marketed 'light' cigarettes to reassure smokers when they knew these cigarettes were just as hazardous as 'regular' ones; and targeted children in their advertising and marketing. The statements of claim for Ontario, Quebec and Alberta alone total \$120 billion.

The benefits of suing big tobacco for conspiracy and fraud go beyond recovering tobacco-related health care costs borne by the provinces. Large pay-outs also have the potential to:

- Increase the cost of tobacco products (price increases are a tobacco control best practice);
- Draw public attention to industry practices and the dangers of smoking, which could in turn stimulate more quit attempts;
- Motivate industry change towards being more honest and ethical;
- Through discovery, make public confidential internal industry documents (extremely useful for further tobacco control measures); and
- Seriously undermine the financial stability of tobacco companies, if the awards/settlements are large enough.⁴

Legal appeals, used often by Big Tobacco to delay and disrupt the progress of lawsuits, are a favoured tactic. Canada's big three tobacco companies have gone to great lengths not only to challenge the constitutionality of health care cost recovery enabling legislation, but also to exclude their parent companies from the legal proceedings. None of these challenges has been successful to date, although their efforts continue.

There are also several existing class action lawsuits that have been filed in Canada by victims against the tobacco industry. However, only one has reached the trial phase to date, and in 2015 a verdict was handed down. The case combined two class action lawsuits representing ill and addicted Quebec victims against the three main Canadian tobacco manufacturers: *Cécilia Létourneau v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI-Macdonald Corp.* and *Conseil québécois sur le tabac et la santé and Jean-Yves Blais v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI-Macdonald Corp.*^{5,6} The victims were smokers who started smoking in the 50s, 60s and 70s at a time when the risks

³ Smoking and Health Action Foundation / Non-Smokers' Rights Association. *Tobacco-Related Litigation in Canada*. March 2016. [www.nusra-adnf.ca/cms/file/files/Tobacco-related Litigation in Canada 2016.pdf](http://www.nusra-adnf.ca/cms/file/files/Tobacco-related%20Litigation%20in%20Canada%202016.pdf).

⁴ Tobacco Control Resource Centre, Inc. *Types and Uses of Tobacco Litigation*. PowerPoint Presentation. Slides 27-33. <http://tc.bmjournals.com/content/vol11/issue3/images/data/DC1/TCRC.zip>. Accessed March 2016.

⁵ Trudel & Johnston. « *Requête introductive d'instance d'un recours collectif*. » 30 Septembre 2005. http://www.trudeljohnston.com/en/recours_collectifs/nos_recours/responsabilite_fabricant/tabac/docs/procedure/Requete%20introductive%20d%20instance.pdf. Accessed March 2015.

⁶ Lauzon, Bélanger, Lespérance. « *Requête introductive d'instance d'un recours collectif amendée*. » 31 mars 2006. http://lblavocats.ca/fr/recours/victimes-tabac/dossiers-actifs/documents/Requete_introductive_amendee_06_03_31_000.pdf. Accessed March 2015.

of smoking were not known to the public, cigarette warnings were non-existent or insufficient and tobacco ads were everywhere. However, the risks had been known to the tobacco industry since the 1950s. The victims were seeking over \$20 billion in damages from the companies.

The trial finally ended in December 2014 after 253 days of hearings during which 76 experts and witnesses took the stand and more than 8,000 documents were filed as evidence. On June 1, 2015 Judge Brian Riordan of the Quebec Superior Court released his judgment, ordering the companies to pay more than \$15 billion in moral and punitive damages to almost 100,000 Quebec smokers and ex-smokers who developed emphysema, lung cancer or throat cancer.



Justice Brian Riordan

"Over the nearly fifty years of the Class Period, and in the seventeen years since, the companies earned billions of dollars at the expense of the lungs, the throats and the general well-being of their customers. If the companies are allowed to walk away unscathed now, what would be the message to other industries that today or tomorrow find themselves in a similar moral conflict?"

The manufacturers were found guilty of committing four separate faults, including under the general duty not to cause injury to another person, under the duty of a manufacturer to inform its customers of the risks and dangers of its products, under the *Quebec Charter of Human Rights and Freedoms* and under the *Quebec Consumer Protection Act*.

"These companies colluded among themselves in order to impede the public from learning of health-related information about smoking, a collusion that continued for many decades thereafter," wrote Justice Riordan in his historic ruling.

The court ordered an initial aggregate deposit of \$1 billion divided among the defendants in accordance with their share of liability. The Defendants were required to deposit these sums within sixty days of the date of the judgment. Not surprisingly, the tobacco manufacturers appealed the decision, and in July 2015 the provisional execution was overturned because, among other reasons, *"it will be hard to recover payments from those who have received them if the companies win on appeal."* In October, following a motion from the plaintiffs, the Quebec Court of Appeal ordered Imperial Tobacco Canada and Rothmans, Benson & Hedges to provide security in the amount of \$984 million (six installments from December 2015 to March 2017). A day-to-day account of the trial is available on the blog *Eye on the Trials* (<http://tobaccotrial.blogspot.ca>).

In its annual report to the US Securities and Exchange Commission for the year 2015, Philip Morris International, the parent company of Rothmans, Benson & Hedges, continues to express concerns over ongoing litigation in several countries:

*“Damages claimed in some tobacco related litigation are significant and, in certain cases in Brazil, **Canada** and Nigeria, range into the billions of U.S. dollars.... The FCTC encourages litigation against tobacco product manufacturers. It is possible that our consolidated results of operations, cash flows or financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation [emphasis added].”⁷*



There is no doubt that this case will be appealed right up to the Supreme Court of Canada and that it will have important repercussions for other litigation across the country, including the health care cost recovery claims filed by the provinces. It has been estimated that tens, possibly hundreds, of billions of dollars are at stake. If the tobacco companies are found guilty and are forced by the courts to pay out significant damages, the potential exists to bankrupt the companies. Such a scenario would completely change the tobacco market landscape in Canada and could provide a unique opportunity for public health authorities to look at novel approaches to regulate the tobacco market.

Tobacco taxes

Price increases through higher taxation, which reduce the affordability of tobacco, are a globally-recognized tobacco control best practice. Tobacco taxation deters smoking uptake, reduces tobacco consumption, increases smoking cessation and increases government revenue. It is estimated that a 10% price increase in cigarettes can result in a 4% reduction in adult consumption in developed countries, and even more among youth who are price sensitive. In its annual presentation to shareholders for 2015, PMI outlined the company’s business risks, and significant increases in cigarette-related taxes were at the top of the list.

Tobacco tax increases were included in the 2016 budgets for New Brunswick, Ontario, Newfoundland & Labrador and Nova Scotia. As well, governments continue to press on with further efforts to control the contraband market. For example, the New Brunswick and Ontario governments have both announced the creation of new provincial enforcement teams, similar to the effective ACCES program in Quebec, which will focus uniquely on combatting the illicit tobacco trade.^{8,9} The recent success of Operation

⁷ Philip Morris International. *SEC Filings: Annual report which provides a comprehensive overview of the company for the past year*. 20 February 2015. http://investors.pmi.com/phoenix.zhtml?c=146476&p=irol-sec&secCat01Enhanced.1_rs=11&secCat01Enhanced.1_rc=10. Accessed March 2015.

⁸ Corriveau, M. « Une nouvelle unité pour s'attaquer à la contrebande de tabac au N.-B. » Radio-Canada, le 16 février 2016. <http://ici.radio-canada.ca/regions/atlantique/2016/02/16/012-acadie-nouveau-brunswick-contrebande-tabac-unite-enquete.shtml>. Accessed March 2016.

⁹ Ministry of Community Safety and Correctional Services. *Ontario Creating New Enforcement Team to Combat Contraband Tobacco*. Press release, January 25th, 2016.

Tarantula at the end of March, the largest operation ever led against contraband tobacco in Quebec and Ontario according to the Quebec Provincial Police, is yet more proof that governments are on the right track by adopting new policies and investing new resources to keep the illicit tobacco trade in check.¹⁰

The National Coalition Against Contraband Tobacco (NCACT), a close ally of Canadian tobacco companies, recently worked with the Macdonald-Laurier Institute, first to deliver two workshops on illicit tobacco in 2015, followed by an alarmist report in 2016 about the contraband market in Canada.¹¹ The report suggests that proceeds from the illicit cigarette trade are funding terrorist activities¹² and that the contraband cigarette market in Ontario could possibly be as large as the legal market. This analysis contrasts with reports from tobacco manufacturers to their investors showing the contraband market significantly dropping in Canada after it reached its peak in 2008.^{13,14} Fortunately, the report does not advocate for a tobacco tax rollback. It also proposes solutions to address the issue that are similar to the ones already advocated in the past by the tobacco control community, such as better controls of raw materials or tax revenue sharing with First Nations. This report will undoubtedly be part of the NCACT's arsenal to try and persuade government officials to focus their attention solely on the illicit tobacco trade.

E-cigarettes

The Canadian market

The rise in popularity of vaping is both a threat and an opportunity for the tobacco industry in Canada. E-cigarettes are a potential threat to the tobacco companies' market and hence profits, since tobacco cigarettes are still far more profitable than their electronic counterparts. At the same time e-cigarettes present an opportunity for tobacco companies to transition out of the cigarette business or to increase their total market by offering products that appeal to smokers, former smokers, and non-smokers. At present because the sale of e-cigarettes with nicotine is not legal in Canada, the Canadian market

<https://news.ontario.ca/mcscs/en/2016/01/ontario-creating-new-enforcement-team-to-combat-contraband-tobacco.html>. Accessed March 2016.

¹⁰ Laframboise, K. *SQ targets contraband tobacco, money laundering in raids*. CBC News, March 30, 2016. <http://www.cbc.ca/news/canada/montreal/quebec-raids-contraband-tobacco-operation-international-1.3511876>. Accessed March 2016.

¹¹ Leuprecht, C. *Smoking Gun: Strategic Containment of Contraband Tobacco and Cigarette Trafficking in Canada*. A Macdonald-Laurier Institute Publication, March 2016. <http://www.macdonaldlaurier.ca/files/pdf/MLLeuprechtContrabandPaper-03-16-WebReady.pdf>. Accessed March 2016.

¹² To our knowledge there has been only one such alleged case in the US but none in Canada. Brady, B. *NY cigarette-smuggling ring may have terror link*. CNN, 17 May 2013. <http://www.cnn.com/2013/05/17/us/new-york-cigarette-ring/>. Accessed March 2015.

¹³ Mortensen, J. R. *Investor Day – LA&C Region*. Philip Morris International, Lausanne, June 21, 2012. <http://investors.pmi.com/phoenix.zhtml?c=146476&p=irol-presentations>. Accessed March 2016.

¹⁴ Withington, N. *Anti-illicit trade: scale and opportunities*. British American Tobacco, 2011. [http://www.bat.com/group/sites/UK_9ZTFM.nsf/vwPagesWebLive/DO8GLGU/\\$FILE/05_Neil%20Withington%20-%20Anti%20Illicit%20Trade%20-%20Scale%20and%20Opportunities.pdf?openelement](http://www.bat.com/group/sites/UK_9ZTFM.nsf/vwPagesWebLive/DO8GLGU/$FILE/05_Neil%20Withington%20-%20Anti%20Illicit%20Trade%20-%20Scale%20and%20Opportunities.pdf?openelement). Accessed March 2016.

includes just one tobacco company among the top selling brands, as shown in the table below.¹⁵ This is in stark contrast to the US and the UK, where the market is dominated by brands owned by Big Tobacco.

Brand	Company
Smoke NV	Smoke NV Inc. <ul style="list-style-type: none"> Established in 2009 in Alberta by a group of physicians; recently expanded sales to select overseas countries Acquired in 2016 by Dawson Gold Corp. (mining) Recently began selling tank systems, in addition to rechargeable and disposable first generation devices
Vapur	Casa Cubana <ul style="list-style-type: none"> Privately owned and operated tobacco company Established in 1998 in Quebec Began selling e-liquid/cartridges with nicotine in 2015 at convenience stores
Dune	Dune Vapor Group Inc. <ul style="list-style-type: none"> Privately held company, based in Calgary, Alberta Sells e-liquid with nicotine
180 Smoke	180 Smoke LLC <ul style="list-style-type: none"> Established in 2012 by a group of ex-smokers and surgeons Initially crowd-sourced Sells cartomizers and “made in Canada” e-liquid with nicotine
Esmoker	Esmoker Canada Inc. <ul style="list-style-type: none"> Founded in 2011 by two Canadian entrepreneurs Sells cartridges with nicotine and Canadian-made e-juice with nicotine

The regulatory environment

How the federal government decides to regulate e-cigarettes will have a big impact on the market. It is anticipated that if e-cigarettes with nicotine continue to be regulated as drugs and if Health Canada begins enforcing this restriction, only larger tobacco companies would have the resources to go through the lengthy and costly evaluation process for market approval. To date, only BAT has been granted medicinal licences (and only in the UK) for two of its products—Voke and e-Voke. Voke is a nicotine inhaler that resembles a tobacco cigarette but does not produce any vapour, and e-Voke is a traditional e-cigarette with a battery and atomiser (heating element). The status of these products as medicines means that when they are launched in the UK, they can make health claims and be prescribed by healthcare practitioners as cessation devices—a world’s first for a tobacco company. However, here in Canada, if the sale of e-cigarettes with nicotine is legalized, for example, by regulating e-cigarettes as tobacco products, this would throw open the market to the brands currently promoted and sold by Big Tobacco in other countries around the world.

¹⁵ Euromonitor International. *Passport : Vapour Devices in Canada*. August 2015.

In response to pressure from all sides of the issue, including provincial governments, then federal Health Minister Rona Ambrose referred the issue to the Standing Committee on Health. Following several weeks of hearings in the fall of 2014, the Health Committee issued its report in March 2015. The Committee called for e-cigarettes—both with and without nicotine—to be regulated under a new legislative framework or, if this was not deemed practical, under the *Tobacco Act*. The specific measures are in line with those NSRA has been advocating for and include the following:

- Product standards
- Accurate labelling; no unproven health claims; child-safe packaging
- Ban on sales to minors
- Ban on use in federal workplaces
- Restrictions on advertising/promotion
- No cross branding with a tobacco product
- Ban on flavours targeting youth
- Funding for research.

The federal government had 120 days to issue a response, according to Parliamentary procedure, but it failed to do so before calling a federal election.

In the absence of federal direction, many provinces moved to fill the legislative void. Indeed, six provinces—Nova Scotia, British Columbia, New Brunswick, PEI, Manitoba, and Quebec—implemented legislation in 2015. Although a bill was passed in Ontario in 2015, the provisions go into effect in 2016. Other provinces have taken a very similar approach to e-cigarettes, with a few notable differences: a ban on sales to minors; a ban on use where smoking is banned; ban on sales where tobacco sales are banned; and a ban on point-of-sale promotion, including display. Most provinces exempt vape shops and/or tobacconists from the point-of-sale restrictions, provided minors are not permitted access. To date, Manitoba is the only province to permit testing of devices/flavours in specialty vape shops.¹⁶ Concerns about the risk of e-cigarettes renormalizing smoking, and about second-hand vapour posing a possible health risk, have also prompted 38 Canadian municipalities to pass bylaws banning or restricting vaping in public places and workplaces.¹⁷

Industry tactics

Litigation

Tobacco companies have a long history of using litigation and the threat of litigation to intimidate and discourage policymakers from passing effective tobacco control laws. Even if a case launched by a tobacco company appears unwinnable from the outset, litigation is still a useful tactic: it slows down the

¹⁶ For more detailed information on the provisions of the provincial laws, see Non-Smokers' Rights Association, *Provincial/Territorial E-Cigarette Legislation in Canada*, 1 January 2016. http://www.nsr-aadnf.ca/cms/index.cfm?group_id=2440

¹⁷ Smoking and Health Action Foundation / Non-Smokers' Rights Association. *Smoke-Free Laws Database*. Accessed March 2016. <http://database.nonsmokersrights.ca/>

progress of tobacco control while at the same time drains governments of time and money. The disruption to policymaking brought by litigation and appeals can sometimes be years long, and a lawsuit can serve to dissuade other jurisdictions from passing similar laws. How effective a proposed measure is can be assessed using what is colloquially known as “the scream test:” the louder a tobacco company complains or actually sues about something, the more effective the measure.

Two new provincial laws passed the scream test in 2015 with flying colours:

- On March 1st, 2016, Imperial Tobacco launched a lawsuit against *Quebec’s Act to bolster tobacco control* (Bill 44), claiming in part that “*Bill 44 bans flavoured tobacco products, including menthol cigarettes, despite the fact that such a ban is likely to result in the growth of an already-significant illegal cigarette market in Quebec. The bill also imposes unjustified packaging restrictions that go over and above the current Federal regulations.*”
- Also in March 2016, Imperial Tobacco Canada launched a lawsuit against the government of New Brunswick for its prohibition on the sale of menthol cigarettes. Claiming the province stepped beyond its legislative authority, ITC asserts that the measure could prove to be counter-productive, driving more smokers to the illegal market.

Use of front groups

Tobacco manufacturers have understood for a long time that tobacco tax increases seriously undermine the viability of their market and that the best way for them to oppose an aggressive tobacco taxation policy is to continuously focus attention on the contraband market. The intent is to lead decision makers to believe that manufacturers have a genuine concern for public health in wanting to see the availability of cheap illegal tobacco products reduced or eliminated. However, their real concern is to safeguard their own profits by bringing customers back to the legal market. The contraband market is also used as leverage to discourage governments from taking any further action to regulate legal tobacco products.

The lion’s share of tobacco industry public relations efforts on contraband comes from its main front groups, the National Coalition Against Contraband Tobacco (NCACT) and the Canadian Convenience Stores Association (CCSA), as well as its provincial counterparts, such as the Ontario Convenience Stores Association (OCSA). Both groups are comprised of members of the business community, including tobacco industry representatives. In August 2015, during public hearings on Bill 44: *An Act to bolster tobacco control* before the Health and Social Services Committee of the Quebec National Assembly, their spokespersons were extensively interrogated to disclose their main funders. Not surprisingly, they stubbornly refused to answer any question which leaves little doubt about their link with the tobacco industry.

The federal Liberal government’s commitment to introduce plain and standardized tobacco packages in Canada will undoubtedly lead to more efforts on behalf of the industry and its front groups to portray contraband tobacco as the most pressing tobacco control issue, such as this full page ad which was published this past February in The Hill Times.

Next generation products

As smoking prevalence continues its long decline in Canada as well as in other developed countries, tobacco manufacturers are moving towards next generation products (NGPs) to remain profitable. The tobacco industry’s sole goal in developing new products is to maximize shareholder value, by keeping current smokers in the market and/or attracting new customers. Given the unequivocal evidence that most of the health consequences from tobacco use stem from inhaling the toxins produced during combustion, product innovation in recent years has focused on non-combustible tobacco and nicotine products.

None of the big three tobacco manufacturers is currently marketing next generation products in Canada; however, all three parent companies are investing heavily in research and product development, with BAT alone having spent over \$900 million CAD. BAT is projecting that the global NGP market will triple in value to \$15.6 billion CAD by 2020,¹⁸ and Euromonitor predicts that the vapour products market in Canada will reach \$59 million CAD by 2019.¹⁹ Referred to as “risk-reduced products” (RRPs) by PMI, the company’s stated ambition is to convince all current adult smokers that intend to continue smoking to switch to RRP as soon as possible. PMI reports that it is currently working on four product platforms at various stages of development and assessment: Platforms 1 & 2 are tobacco “heat-not-burn” products and Platforms 3 & 4 are e-vapour products.

¹⁸ British American Tobacco. Investor Day 2015. *Leading in Next Generation Products*.

[www.bat.com/group/sites/UK_9ZTFCM.nsf/vwPagesWebLive/DOA26K3L/\\$FILE/09_Leading_in_Next_Generation_Products_v2.pdf](http://www.bat.com/group/sites/UK_9ZTFCM.nsf/vwPagesWebLive/DOA26K3L/$FILE/09_Leading_in_Next_Generation_Products_v2.pdf). Accessed March 2016.

¹⁹ Euromonitor International. *Passport – Vapour Devices in Canada*. August 2015.

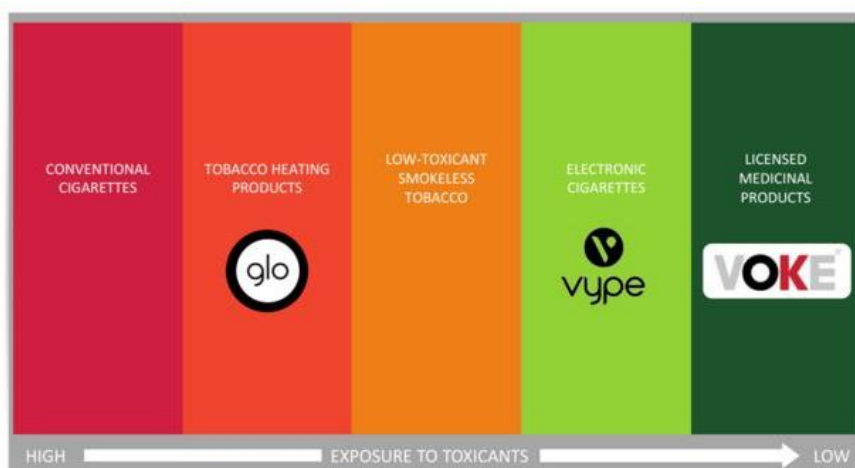
Platform 1 is represented by a product called iQOS, which possibly stands for “I quit ordinary smoking.” A Marlboro tobacco “heat stick,” about half the length of a regular cigarette, fits into an electronic



cylindrical device which maintains the temperature of the tobacco below combustion levels. iQOS is currently being test-marketed in Italy, Japan, Switzerland, Russia, Portugal and Romania. In the United States, industry analysts at Wells Fargo believe iQOS is a game-changing technology, *“with the potential to usher in a new public ethos and disposition towards smoking, aligning [Philip Morris] with on-trend aspirations for healthier living, improving smokers’ health trajectories and the way they feel about themselves as*

smokers, effectively redefining the smoking experience.” Wells Fargo estimates that iQOS could displace a third of the U.S. combustible cigarette market by 2025, increase smoking prevalence and boost Philip Morris shares by a whopping \$25-\$30 USD.²⁰ Significantly, Philip Morris is on track to submit a Modified Risk Tobacco Products application as well as a Premarket Tobacco Application to the American Food and Drug Administration (FDA) for iQOS this year. It is anticipated that if both applications are accepted, iQOS could be on store shelves with no health claims in 2017, and with reduced risk health claims in 2018—a first for tobacco manufacturers in the United States.

As illustrated below, British American Tobacco (BAT) is currently active in 3 NGP categories, as reported to shareholders in a recent Investor Day presentation. In 2011 BAT confirmed that it had established a start-up company, Nicoventures Limited, *“a consumer focused nicotine company bringing licensed inhaled nicotine products to smokers wanting to replace, reduce or stop smoking.”*



²⁰ Wells Fargo Securities. *Equity Research: PM – Changing the World One Smoker at a Time*. March 9, 2016.

Other international tobacco manufacturers, including JTI, are also jumping into the burgeoning NGP market. PAX and PAX2 by Ploom and marketed by JTI, are portable herbal vaporizers with an “oven” that takes tobacco or other material, but not e-liquid.

Corporate social responsibility: science and scientific collaboration

Big Tobacco is working hard to convince the world that its days of secret laboratories and junk science wars are over. Presumably recognizing the opportunity in next generation products to rebrand themselves as honest, open and good corporate citizens, BAT and PMI have strategically chosen to take a very public approach to sharing information about their research and scientific activities. Indeed, both BAT and PMI have dedicated science websites (www.BAT-science.com and www.pmiscience.com) where visitors can access reports, conference presentations and peer-reviewed articles, and where friendly photographs of their scientists along with descriptions of their work are posted. In 2015 BAT published its second Science & Technology Report in which it details progress and aspirations in different scientific areas of harm reduction. BAT also launched a Twitter handle in 2015 (@BAT_Sci) to “encourage genuine two-way engagement,” and proudly reports being invited to attend international scientific conferences and to engage in dialogue with other scientists, academics, regulators and public health stakeholders. More than just participating, BAT has also started hosting national and international scientific conferences at its new 300-seat auditorium at its Southampton site, including meetings of the Chromatography Society, the British Mass Spectrometry Society, the British Carbon Group, the Institute for Food Science & Technology, and the In Vitro Testing Industrial Platform.

PMI has also stated the importance of sharing its harm reduction work with the international scientific community, and has launched something it calls the *sbv IMPROVER project*, which stands for systems biology verification: Industrial Methodology for PROcess VERification in Research. Using a crowd-sourcing approach to verify methods and concepts, PMI has hosted a series of IMPROVER challenges.

The introduction and consumer acceptance of harm-reduced, next generation products could mark a paradigm shift in the traditional tobacco market and underscores the importance of appropriate regulation to maximize public health. Just as it has in the past, Big Tobacco is working hard to shape the regulatory environment in which its products will be sold. BAT openly reports that it seeks to “*participate fully in the development of national and international standards aimed at phasing out poorly manufactured products and safeguarding consumers.*” In fact, BAT states that it and Nicoventures were strong contributors to the e-cigarette guidelines published by the UK British Standards Institution in June 2015.

While some may believe that BAT and PMI have consumers’ health in their best interests, all this focus on science and harm reduction corporate social responsibility feels like a carefully orchestrated public relations campaign. While it is true that NGPs will likely reduce individual harm, this is a sidebar to the more important goal of keeping smokers in the nicotine market, expanding the nicotine market to new consumers, and increasing shareholder value. Big Tobacco says that their new products are for adult smokers; however, given the steady decline of smokers in Canada and other developed countries, their business models would be fatally flawed without setting their sights on other potential consumers.

Scientific collaboration and FCTC Article 5.3

All of this feel good, open scientific and regulatory collaboration also poses a serious problem for the implementation of Article 5.3 of the Framework Convention on Tobacco Control, “Protection of public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry.” Next generation products without tobacco that are harm-reduced or actual cessation devices offer tobacco companies a back door to a seat at the tobacco control negotiating table. However, the sole purpose of Article 5.3 is to keep them out of policy development and implementation. There are no clear answers to this issue and many divergent opinions among public health and tobacco control advocates. Just as Big Tobacco is reinventing itself, so too must policy makers employ flexibility and creativity to meet the challenge of timely and appropriate regulation in this rapidly evolving field.

Conclusions

In many ways Big Tobacco is at a crossroads. Smoking prevalence in Canada has been on the decline for years, and the industry faces mounting pressure daily in the form of legislation, regulation and big ticket litigation. Tactics to address these pressures, such as endless appeals, counter-litigation, the use of front groups and corporate social responsibility have worked to a degree; however, it appears that these strategies may be financially unsustainable in the long run.

The introduction of harm-reduced, next generation products could mark a paradigm shift in the traditional tobacco market, and offers a rare opportunity for tobacco manufacturers to cleanse their reputations and reinvent themselves as 21st century nicotine companies. Clearly there is a pressing need for government regulation to keep pace with this rapidly evolving market, and policy makers should be wary of manufacturers like BAT at the table helping to shape the regulatory environment in which their next generation products will be sold. The Canadian federal Standing Committee on Health has called for a new legislative framework that would reflect the shifting tobacco/nicotine market and contains regulatory measures advocated for by the NSRA. In the interest of reducing the terrible toll caused by tobacco, public health advocates and policy makers must allow their decisions to be guided by scientific evidence, recognizing the potential public health benefits to be gained from next generation products, while remaining vigilant to tobacco/nicotine company tactics focused squarely on the endless pursuit of higher profits.