Eye on the tobacco industry

An update on current Canadian tobacco industry activities

October-December 2009

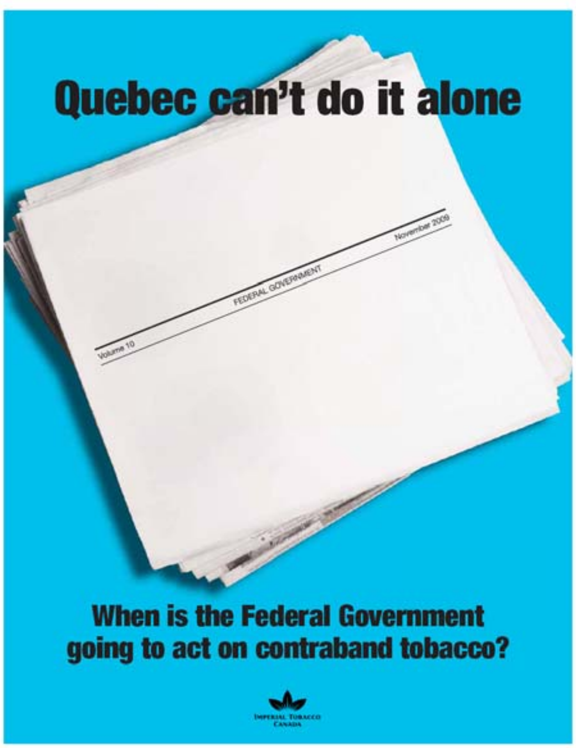
Imperial praises Quebec's Bill 59, criticizes federal inaction on contraband

Quebec's move to crack down on the sale and possession of contraband tobacco was met with praise by Imperial Tobacco Canada (ITC) in November. Meanwhile, the company criticized the federal government's inaction.

Quebec's Bill 59, which came into force in November, is intended to stop purchases and sales of illegal cigarettes. The law (a) grants new powers to police to seize illegal tobacco products and manufacturing materials and to impound vehicles used to transport contraband (b) gives municipalities the power to intervene to prosecute contraband tobacco activities in their regions, and (c) increases financial penalties for the possession and/or sale of illegal tobacco. The law makes Quebec the first jurisdiction in Canada to allow municipalities to keep the assets (related to contraband tobacco crimes) seized by their police forces, as long as arrests lead to convictions.[1] This measure creates a strong incentive for local law enforcement efforts.

But, in ads published in *The Hill Times* newspaper and in a press release, ITC said the province cannot successfully fight contraband alone. John Clayton, vice president of corporate affairs for ITC, reiterated the company's call on the federal government to act:

> There are a number of issues, such as border security, that cannot be addressed by provincial authorities and for which the federal government must take action.



ITC published these ads regarding Quebec's passage of Bill 59 in The Hill Times *newspaper Nov. 30th*.

> When will other ministers join Minister Jean-Pierre Blackburn in recognizing the consequences of contraband and start demonstrating the leadership promised in the 2008 contraband tobacco enforcement strategy, including shutting down illegal factories?[2]

Imperial claims that more than one-third of tobacco sold in Canada is contraband. In Quebec and Ontario, the company said the illegal market share is 40% and 50%, respectively.

ITC's criticism of the federal government is not unwarranted. Recent media reports indicate the contraband problem is not being resolved.

25 organized crime groups operate in Cornwall, Akwesasne

In November, RCMP Sgt. Michael Harvey said there are now 25 criminal organizations involved in the contraband tobacco business in Cornwall and Akwesasne.[3] These groups smuggle products made at illegal factories on the St. Regis Reservation across the border into Canada.

The RCMP has previously indicated that there are 105 known criminal organizations selling contraband nationwide. The groups range from small 'mom and pop' operations, to biker gangs and international crime groups, with the latter also engaging in the smuggling of firearms, illicit drugs and, sometimes, even people.

Illegal sales at Kahnawake flourish

Le Journal de Montréal reported in November that cheap candy-flavoured cigarillos popular with teens and young adults are widely available for sale at Kahnawake.[4] [5] A reporter with *The National Post* also visited the reserve and concluded that the laws of the country are not being evenly enforced. For example, there is illegal tobacco advertising on the reserve promoting a contest to win a new car if you buy cigarettes there.[6]

Imperial pleased with B.C. court ruling, says federal government is 'senior partner' in tobacco industry

Imperial Tobacco Canada was pleased when the B.C. Court of Appeal ruled in December that the federal government should be included as a third party in two lawsuits in the province. One lawsuit is the B.C. government's health-care cost recovery litigation. The other is the *Knight v. Imperial Tobacco* class action, which seeks to recover money from tobacco manufacturers for wrongly leading smokers to believe 'light' and 'mild' cigarettes were less hazardous than 'regular' ones.

In both instances, ITC sought to have the federal government named as a third party defendant, so that if the tobacco industry is found guilty, the government would have to reimburse the industry for damages. In a press release, Donald McCarty, ITC's vice president of law, said the record will be set straight:

> The B.C. decision will demonstrate that the Government of Canada has known about the risks associated with smoking for decades and that it instigated and promoted the development and sale of lower-tar tobacco products. The Government of Canada has been a senior partner of

> the tobacco industry for decades. They have legalized tobacco in Canada, heavily regulated it, and taxed it to the tune of billions of dollars every year.

Gouvernement du Canada Government of Canada

IMPERIAL TOBACCO CANADA

However, the Court of Appeal decision is open to appeal to the Supreme Court of Canada. And, as tobacco control legal expert Rob Cunningham of the Canadian Cancer Society noted, the decision wasn't all bad news:

> Compared to the initial third party claim of the tobacco industry, the judgments narrowed the scope of issues that the tobacco industry would be allowed to even pursue as a third party claim against the federal government.… But it is important to note that does not mean that the federal government will be liable, it only means that the issue would have to be determined at trial.

At trial, the federal government can be expected to oppose vehemently attempts by Imperial to have the court transfer liability or impose financial penalties onto it.

Rather than admit that it lied about the risks of its products, lied about addiction, lied about its manipulation of nicotine, lied that its marketing has not targeted kids, and lied about the risks of second-hand smoke, the tobacco industry's legal strategy is to blame others and shift responsibility. This is just the latest example.

However, as has occurred elsewhere, including in the United States (where Judge Gladys Kessler found the tobacco industry guilty of racketeering and fraud), the industry must be held accountable in Canada.

Quebec's attempt to recover health care costs 'sheer hypocrisy': Imperial

Media reports indicating that Quebec Justice Minister Kathleen Weil has asked prosecutors to start preparing to launch a lawsuit to recover health care costs from tobacco companies related to treating sick and dying smokers had Imperial Tobacco fuming in October.

When Bill 43, the enabling legislation that allows Quebec to sue tobacco companies, was introduced in May, a Health Department study noted that health care costs related to treated current and former smokers amount to $4 billion annually in the province.

The Montreal Gazette said Quebec may seek up to $30 billion. Health Minister Yves Bolduc said the province will argue in court that the tobacco industry knew for decades that its products were addictive and deadly but that it withheld this information from consumers and governments.[7]

Quebec Justice Minister Kathleen Weil

Imperial spokesperson Eric Gagnon said Quebec's move was "sheer hypocrisy," considering all the money it collects in tobacco tax revenues. Gagnon said governments are incorrectly battling the legal industry, while illegal tobacco sales are booming. Now that 10 provinces in Canada have adopted enabling legislation, it is only be a matter of time before the tobacco industry's lies are exposed.

Internal documents show Imperial hid evidence of cigarettes being addictive, causing cancer

Documents ordered destroyed by Imperial's parent company, British American Tobacco, have serious implications for industry liability and litigation currently underway in Canada.

That was the conclusion of the authors of a report published in October in the *Canadian Medical Association Journal* titled "Destroyed documents: uncovering the science that Imperial Tobacco Canada sought to conceal."[8]

Scientific evidence in the studies linking cigarettes to addiction and carcinogens demonstrate that at least as far back as 1967 Imperial had evidence detailing the harmfulness of its products.

Had the studies been shared with government officials, rather than being concealed, targeted tobacco control initiatives likely would have been launched by governments sooner, and the tobacco epidemic would have claimed fewer lives.

U.S. tobacco CEOs lied under oath in 1994 about the addictiveness of nicotine. In Canada, Imperial Tobacco destroyed reports linking cigarettes to cancer and addiction.

Philip Morris International reports significant jump in Canadian sales

In October, Philip Morris International (PMI) released its 3rd quarter results for 2009 and reported a 7.1% increase in cigarette shipment volumes in Canada compared to the 2nd quarter.

PMI, which owns Rothmans, Benson & Hedges in Canada, said the total legal tax-paid cigarette market in Canada grew 6.1% in the 3rd quarter, "primarily reflecting strong government enforcement measures to reduce contraband sales."[9]

PMI attributed its 0.3 increase in market share to higher sales of its premium-priced *Belmont* brand and its value brands *Next* and *Quebec Classique*. PMI's market share (currently at 33.9%) likely would have grown more had sales of its *Number 7* and *Canadian Classics* brands not decreased at the same time.

JTI-Macdonald continues to enjoy bankruptcy protection under CCAA

JTI-Macdonald's bankruptcy protection under the *Companies' Creditors Arrangement Act (CCAA)* has been extended to March 15, 2010.

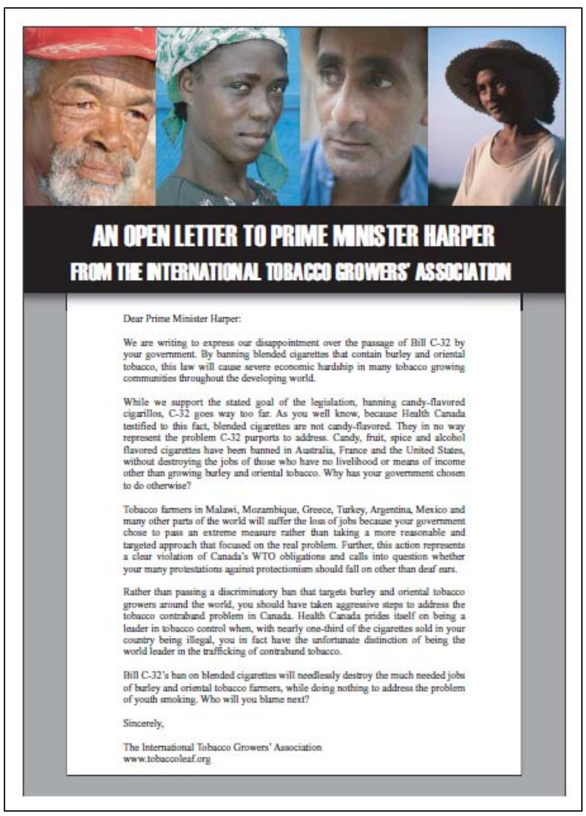
JTI-MACDONALD

This protection has been in place since August 2004, when the Quebec government obtained a court judgment ordering the company to immediately pay $1.4 billion in unpaid taxes due to smuggling allegations.

Meanwhile, Japan Tobacco Inc., owner of JTI-MC, increased its annual profit prediction by 8%, based on increased market share of popular global brands *Camel* and *Winston*.

Philip Morris International continues to fight Bill C-32

Philip Morris International (PMI), along with U.S. burley tobacco growers and various other tobacco industry groups, appealed to U.S. President Barack Obama in October to launch a World Trade Organization challenge against Canada's Bill C-32, the *Cracking Down on Tobacco Marketing Aimed at Youth Act*.[10] [11] The International Tobacco Growers' Association also published a full-page ad in *The Hill Times* newspaper directed at Prime Minister Stephen Harper (see below).



AN OPEN LETTER TO PRIME MINISTER HARPER
FROM THE INTERNATIONAL TOBACCO GROWERS' ASSOCIATION

Dear Prime Minister Harper:

We are writing to express our disappointment over the passage of Bill C-32 by your government. By banning blended cigarettes that contain burley and oriental tobacco, this law will cause severe economic hardship in many tobacco growing communities throughout the developing world.

While we support the stated goal of the legislation, banning candy-flavored cigarillos, C-32 goes way too far. As you well know, because Health Canada testified to this fact, blended cigarettes are not candy-flavored. They in no way represent the problem C-32 purports to address. Candy, fruit, spice and alcohol flavored cigarettes have been banned in Australia, France and the United States, without destroying the jobs of those who have no livelihood or means of income other than growing burley and oriental tobacco. Why has your government chosen to do otherwise?

Tobacco farmers in Malawi, Mozambique, Greece, Turkey, Argentina, Mexico and many other parts of the world will suffer the loss of jobs because your government chose to pass an extreme measure rather than taking a more reasonable and targeted approach that focused on the real problem. Further, this action represents a clear violation of Canada's WTO obligations and calls into question whether your many protestations against protectionism should fall on other than deaf ears.

Rather than passing a discriminatory ban that targets burley and oriental tobacco growers around the world, you should have taken aggressive steps to address the tobacco contraband problem in Canada. Health Canada prides itself on being a leader in tobacco control when, with nearly one-third of the cigarettes sold in your country being illegal, you in fact have the unfortunate distinction of being the world leader in the trafficking of contraband tobacco.

Bill C-32's ban on blended cigarettes will needlessly destroy the much needed jobs of burley and oriental tobacco farmers, while doing nothing to address the problem of youth smoking. Who will you blame next?

Sincerely,

The International Tobacco Growers' Association
www.tobaccoleaf.org

However, Bill C-32 sped through both the House of Commons and Senate of Canada and achieved Royal Assent on October 8th. While the Bill did get through the Senate fairly quickly, there was a lot of drama. The industry ran an intense and focused campaign aimed at Senators and particularly members of the Quebec Conservative caucus, leading Conservative Senator Hugh Segal to abstain from voting on the bill, as opposed to voting against the bill, "out of loyalty to my government."

Moreover, Senate support was only assured when Health Canada officials clarified that the ban on flavourings and additives applies only to tobacco products manufactured for the Canadian market: "Bill C-32 contains clause 4 that is meant to target prohibited additives used in the manufacturing of products solely for the Canadian market." In other words, the manufacture of American-blend cigarettes which contain banned additives at the RBH plant in Quebec City for the export market—a cause of significant opposition to the bill—should not be affected by the bill.

Immediately upon Royal Assent, tobacco ads published in newspaper and magazines sold in Canada were banned. (The only two remaining forms of permitted advertisements are ads in publications mailed directly to a named adult and signs in adult-only businesses, such as bars). The Bill also bans candy flavoured tobacco products at the manufacture/import level as of April 6, 2010, and bans the same products at the retail level as of July 5, 2010.

There are reasons to be optimistic that PMI's efforts to fight the Bill will be unsuccessful. The Obama Administration appears to have little interest in challenging another country's tobacco control legislation. This is consistent with an Executive Order of President Bill Clinton, which remains in force. PMI, however, is reportedly lobbying other WTO member-countries to find an alternative source of support for a challenge.

Marlboro usage grows; fueled by new pack designs and product changes

In a presentation to investors in November, PMI CEO Louis C. Camilleri forecasted that 2010 would be good to the company, predicting a 1% increase in sales and a 6-8% increase in annual operating profits. Despite the fact that the cigarette market is relatively resilient to economic downturns compared to most consumer goods, Camilleri said global PMI sales volume dropped by 2% over the previous year. Revenue nonetheless continued to grow due to the company's "strong pricing policy."

Camilleri focused much of his presentation on convincing the investment community that the company's forecast of increased sales volume remains realistic and achievable:

> Our future volume performance will clearly be a function of several parameters that include total consumption trends, geographic mix, market share growth, and other key factors such as absolute and relative retail prices, excise tax levels, consumer disposable income and demographic trends, as well as developments on the regulatory front and their impact on societal attitudes to smoking.[12]

While indicating that significant, widespread, and sustained excise tax increases could disrupt the predicted growth, Camilleri expressed confidence that this would not happen because governments around the world have recognized that "sharp increases lead to huge volatility in revenues and can spur unintended consequences in the form of illicit trade."

A key part of the growth strategy outlined by Camilleri is the growth in PMI's leading brand portfolio—Marlboro. Much of the growth is being driven by the "the new Marlboro architecture," which includes three lines—Marlboro Red, Marlboro Gold and Marlboro Fresh—that are differentiated by new package designs and changes to the product, such as new varieties of menthol cigarettes that include mentholated capsules and different types of menthol flavors. (See examples below).

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