



EU-TOBACCO INDUSTRY AGREEMENTS AND BEYOND

MARINA FOLTEA



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Marina Foltea

Institute of Law Studies, Polish Academy of Sciences



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AGREEMENTS AND BEYOND



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Marina Foltea, PhD
Institute of Law Studies, Polish Academy of Sciences

Review: Abrie du Plessis, Trade Law Centre (TRALAC)

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Institute of Law Studies

Polish Academy of Sciences

Nowy Świat 72 (Staszic Palace)

00-330 Warsaw

e-mail: wydawnictwo@inp.pan.pl



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1. INTRODUCTION

Member States receive fiscal revenue from legal tobacco sales of over €90 billion annually. At the same time, it is estimated that the smuggling of tobacco products results in a loss of public revenue to EU budgets of more than €10 billion annually.¹ The smuggling of tobacco products undermines public health policies by making especially cigarettes available in an uncontrolled sales environment and at a substantial discount compared to legal sales channels.² Illicit trade in tobacco products is a main source of revenue for organised crime, and it has in some cases been linked to terrorist groups.³

1.1. The types of illicit trade in tobacco products in the EU

Illicit tobacco products were traditionally split into *contraband* (genuine cigarettes bought in a low-taxed country and then smuggled into and resold in a higher-taxed country in breach of the fiscal laws of the higher-taxed country) and *counterfeit* (fraudulently branded cigarettes that are manufactured illegally and sold by a party other than the brand owner). In the EU context, contraband can be sourced from outside the EU and sold within the EU without paying the applicable taxes and duties, or it can be sourced from a lower-taxed EU Member State and sold illegally in another EU Member State with higher duties and taxes.

Illicit trade in tobacco products is a clandestine activity in constant fluctuation and change. Over the last decade there has been a marked increase in the so-called cheap whites phenomenon, whereby cigarettes not originating from the major manufacturers are brought into the EU without the payment of taxes and duties and then sold outside the legal distribution network.⁴

To this evolving picture must be added that legal producers within the EU sometimes simulate fictitious exports or smuggle back their real exports without paying duties and taxes.

1 See Questions and Answers on: Fighting the illicit trade of tobacco products, 14 August 2015, https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/q_and_a_en.pdf [access:16.03.2020].

2 See [Protocol to eliminate illicit trade in tobacco products adopted by the Conference of the Parties to the WHO FCTC] *Overview*, https://www.who.int/fctc/protocol/illicit_trade/protocol-publication/en/ [access:16.03.2020].

3 See Questions and Answers on: Fighting.

4 See *Ibid*, p. 2, footnote 4.

There are also illegal factories within the EU which target the black market outright and produce cigarettes without paying applicable taxes.

1.2. The EU Commission and illicit trade in tobacco products

At the EU level OLAF, the European Anti-fraud Office, amongst many other activities, carries out investigations into tobacco smuggling that causes revenue losses to the EU and its Member States. It is an administrative investigative body, and the only one at the EU level which has a mandate in this area. In conjunction with the EU Commission it has actively addressed tobacco-related illicit trade issues over the last three decades. Its activities in this field has, amongst others, culminated in anti-fraud agreements (hereafter referred to as the ‘Industry Agreements’) which were concluded between the EU, Member States and the four major EU tobacco manufacturers between 2004 and 2010.⁵

In 2013, the EU Commission published a comprehensive strategy⁶ to combat cigarette smuggling. This strategy proposes specific actions in four key areas:

- » Measures to decrease incentives for smuggling activities;
- » Measures to improve the security of the supply chain (with specific reference to the signature of the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products);
- » Stronger enforcement by tax, customs, police and border authorities. Included under this heading are joint customs operations, the provision of technical and financial assistance to Member States and Non-EU countries in order to strengthen their capacities, enhancing the exchange of information at the EU and international level in order to improve cooperation, and setting up an independent laboratory for the analysis of cigarettes;
- » Deterrent sanctions for illicitly trading in tobacco products.

In the view which the Commission then held,⁷ the four Industry Agreements concluded earlier complemented this EU strategy, and as recently as 2015 it still commended the four Industry Agreements for covering more than four-fifths of EU tobacco consumption and for their global reach. It however also by then indicated that it was ‘reassessing the continued policy relevance of such contractual tools⁸’, and it eventually decided not to seek a renewal of the PMI Agreement after its expiry date.

1.3. The aim and structure of this study

The aim of this study is to consider the role which the Industry Agreements have played in addressing illicit trade in the EU, what the post-Agreement reality looks like, and what role the remaining or similar agreements, either at the EU or Member State level, could play in future. In order to do so, this study will consider the following:

⁵ The text of these Agreements can be found on the OLAF website https://ec.europa.eu/anti-fraud/home_en.

⁶ See Communication from the Commission to the Council and the European Parliament, COM(2013) 324 final. Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - A comprehensive EU Strategy, SWD(2013) 193 final, 6.06.2013, <https://op.europa.eu/pl/publication-detail/-/publication/31038587-4530-4489-9209-11004f68e2f5/language-en> [access: 16.03.2020].

⁷ Ibid, p. 4, footnote 6.

⁸ Ibid.

- » Introduction (Section 1);
- » The history and content of the four Industry Agreements (Section 2);
- » The advantages to the parties thereto (Section 3);
- » Criticisms raised in respect of the four Agreements by the tobacco control community⁹ and other stakeholders and the Commission's responses to those criticisms¹⁰ (Section 4);
- » The Technical Assessment of the PMI Agreement by the Commission¹¹ and its justifications in respect of its final decision not to negotiate a renewal (Section 5);
- » The legal ramifications of Article 5.3 of the WHO FCTC (Section 6);
- » The political ramifications of Article 5.3 of the WHO FCTC (Section 7);
- » The status and trends on illicit trade in tobacco products in the EU (Section 8);
- » The contribution of TPD 2014 to the control of illicit trade (Section 9);
- » Recommendations on the optimal relationship between the EU and industry (Section 10);
- » Concluding remarks (Section 11).

9 A comprehensive summary can be found in: L. Joossens, A.B. Gilmore, M. Stoklosa, H. Ross, *Assessment of the European Union's Illicit Trade Agreements with the Four Major Transnational Tobacco Companies*, 'Tobacco Control' 2016, vol. 25, iss. 3, pp. 254-260, www.doi.org/10.1136/tobaccocontrol-2014-05221 [not registered], <https://tobaccocontrol.bmj.com/content/25/3/254.citation-tools> [access: 17.03.2020].

10 See Questions and Answers on: Fighting; *Tobacco Agreements. Follow-up Written Questions to Commissioner Georgieva*, https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/epq_tobacco_en.pdf [access: 17.03.2020].

11 See Commission Staff Working Document. Technical assessment of the experience made with the Anti-Contraband and Anti-Counterfeit Agreement and General Release of 9 July 2004 among Philip Morris International and affiliates, the Union and its Member States, SWD(2016) 44 final, 24.2.2016, <https://ec.europa.eu/transparency/regdoc/rep/10102/2016/EN/SWD-2016-44-F1-EN-MAIN.PDF> [access: 17.03.2020].

2. THE HISTORY AND CONTENT OF THE FOUR INDUSTRY AGREEMENTS

2.1. The history

During the 1990s tobacco smuggling took on significant dimensions in the EU, leading to substantial fiscal losses and other negative outcomes for the EU and its Member States. Amongst the actions taken by the EU to address this was a litigation initiated in 2001 before US courts by the EU and 10 Member States against multinational cigarette manufacturers.¹² Philip Morris International Inc. was one of the defendants, and the case took its course through the US court system.¹³

With the outcome of this litigation uncertain, discussions commenced on the option to achieve the objectives of the EU and the Member States by seeking to secure binding commitment from PMI through a private law agreement that could be enforced by the courts. After intensive negotiations, the Anti-Contraband and Anti-Counterfeit Agreement and General Release (The PMI Agreement), was signed in July 2004 by all Parties concerned.¹⁴ It resolved the need for further litigation and was agreed to remain in force until July 2016, pending the negotiation of a possible renewal.

12 See Decided of US District Court for the Eastern District of New York of 16 July 2001, *The European Community, Plaintiff, v. RJR Nabisco, Inc., et al., Department of Amazonas, et al., Plaintiffs, v. Philip Morris Companies, Inc., et al.*, (00-CV-06617) (NGG) (VVP), (00-CV-02881) (NGG) (VVP), 150 F. Supp. 2d 456; <http://uniset.ca/other/cs6/150FSupp2d456.html> [access: 17.03.2020].

13 See *Background: Legal Action by the European Commission Against Cigarette Smuggling*, <https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/background.pdf> [access: 17.03.2020].

14 See Anti-contraband and anti-counterfeit agreement and general release dated as of July 9, 2004 among Philip Morris International Inc., Philip Morris Products Inc., Philip Morris Duty Free Inc., and Philip Morris World Trade Sarl the European Community represented by the European Commission and each Member State listed on the signature pages hereto, https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/agreement_2004.pdf [access: 17.03.2020].

Subsequently, largely similar agreements were concluded with Japan Tobacco International (JTI),¹⁵ British American Tobacco (BAT)¹⁶ and Imperial Tobacco Limited (ITL).¹⁷ Being the first, the PMI Agreement served as a model for the later Agreements, and it will be analysed in detail, while relevant additions found in the other Agreements will be noted. It should also be noted at this stage that while the Agreements with PMI, JTI and ITL expressly resolved ongoing or potential litigation, no such resolution was sought when the BAT Agreement was negotiated.

2.2. Key forward-looking provisions of the PMI Agreement

Under the PMI Agreement, PMI confirmed its commitment to its internal Fiscal Compliance Policy¹⁸. It undertook to be bound by protocols, approved by the EC, with regards to the sale distribution, and storage of cigarettes. These ‘EC Compliance Protocols’ form part of the Agreement.¹⁹ They cover due diligence (also known as ‘know your customer’ or ‘KYC’), which restricts sales and resales to pre-approved contractors. They further contain restrictions on the methods of payment in order to curtail money-laundering. They finally contain provisions on business volume limitation – sales must be commensurate with legitimate demand.

PMI undertook to comply, as far as is commercially feasible, with the Tracking and Tracing Protocols which form part of the Agreement²⁰ and to provide, detailed analyses of seizures by the Member States including, where applicable, shipping details and customer information.²¹ It committed to provide other reasonable assistance, both direct and indirect, to the EC and Member States, as set out in various parts of the Agreement.²² This amongst other matters involved cooperation with OLAF and Member States’ law enforcement agencies.

The Agreement provides for annual Certificates of Compliance by PMI,²³ to be discussed at an annual meeting with OLAF and Member States.²⁴ These Certificates can be challenged by the EU, with such challenges leading to either audits or arbitration.²⁵ In respect of qualifying seizures of genuine PMI cigarettes by a participating Member State, PMI agreed also to make a supplemental payment to compensate the EC and participating Member States for their lost taxes and duties in an amount equal to 100% of the taxes and duties which would have been assessed had the seized cigarettes been distributed legally.²⁶ In addition to such payments, PMI undertook to make an additional payment of four times the amount of lost taxes and

15 See Japan Tobacco International (JTI) Cooperation Agreement, https://ec.europa.eu/anti-fraud/investigations/eu-revenue/japan_tobacco_2007_en [access: 17.03.2020]. It is a collection of agreements.

16 See Anti-Fraud Agreement with BAT of 15 July 2010, https://ec.europa.eu/anti-fraud/investigations/eu-revenue/bat_en [access: 17.03.2020]. There is an original agreement plus an amendment.

17 See *Imperial Tobacco Limited (ITL) 2010*, https://ec.europa.eu/anti-fraud/investigations/eu-revenue/imperial_tobacco_en [access: 17.03.2020]. There is a Main Agreement and a Mutual Cessation Agreement.

18 Article 2, Section 2.01 of the PMI Agreement.

19 Ibid.

20 Ibid, Article 5 Section 5.01.

21 Ibid, Article 4, Section 4.01(c).

22 Ibid, Article 3, Section 3.01(a).

23 Ibid, Article 2, Section 2.02(a).

24 Ibid, Article 2, Section 2.02(d).

25 Ibid, Article 2, Section 2.02 (d) and (e).

26 Ibid, Article 4, Section 4.01(f)(i).

duties if the cigarettes seized, when added to the number of PMI cigarettes already seized in the same calendar year in Member States that were Member States on 1 January 2004, exceeds the so-called Baseline Amount.²⁷

Seizure payments also applied to seizures which occurred in non-participating Member States, with the qualification that they were then limited to a payment to the EC of the part of the lost taxes and duties which the non-participating Member State would have remitted to the EC.²⁸ New EU Member States only qualified for seizure payments after they have joined, and also after they have achieved an agreed reduction in illicit trade within their territories over an agreed period.²⁹

The PMI Agreement resolves any actual and potential civil litigation that was or could have been brought in respect of any alleged actions or omissions which took place before its commencement.³⁰ In essence PMI was absolutely and unconditionally released from any such actions by either the EU or the participating Member States. In order to secure this release, PMI agreed to pay the EU and the initial 10 participating Member States a total amount of \$1 billion dollar in annual instalments, the last to be paid after the 12th year of the agreement.³¹

2.3. Other significant provisions and outcomes of the PMI Agreement

The Agreement was initially signed by the EU and 10 Member States. Over time, the EU enlarged, first from 15 to 25 and later to 28 Member states. A number of provisions in the Agreement provide for new Member States taking up their rights only gradually.³² Over time all 28 Member States joined the Agreement.

The Agreement states that the amounts paid by PMI to the EU and Member States *may* serve as a source of additional funding for anti-contraband and anti-counterfeit activities.³³ Over the years, Member States received 90,3% of payments, and the general EU budget 9,7%.³⁴ The parties acknowledge that compliance with the Agreement is consistent with EC and applicable national laws and with the Treaty Establishing the European Community.³⁵ This acknowledgement is relevant to subsequent legal debates about the applicability and effect of Article 5.3 of the WHO Framework Convention on Tobacco Control (WHO FCTC).

In respect of seizure payments, PMI effectively accepted no-fault liability and also waived any defences based on being legally compliant with applicable laws.³⁶ In order to avoid double jeopardy (which occurs when a person or entity is prosecuted or punished

27 Ibid, Article 4, Section 4.01(f)(ii).

28 Ibid, Article 4, Section 4.01(g)(i).

29 Ibid, Article 4, Section 4.01(0).

30 Ibid, Article 9.

31 Ibid, Appendix C.

32 Ibid, Article 4, Section 4.01(g)(i).

33 Ibid, Article 3, Section 3.01(a).

34 See SWD(2016) 44 final, p. 4.

35 PMI Agreement, Article 7, Section 7.03.

36 Ibid, Article 4, Section 4.01(h).

twice for the same offence) for PMI, it is allowed to set-off any amounts which may be claimed as a result of alleged legal non-compliance in respect of any seizure, against and up to the total amount of annual seizure payments it has already made on a no-fault basis.³⁷

The Agreement acknowledges that the future adoption and implementation of generally applicable legislative measures to address illicit trade may render parts of the it obsolete.³⁸ It also foresees the possibility that the EU and its Member States could conclude similar agreements with other tobacco manufacturers and it allowed PMI to insist on equal treatment if any treatment in a subsequent agreement is more favourable than that afforded to PMI.³⁹

The baseline amount was calculated as 90 million cigarettes, which is half of the total combined contraband PMI cigarettes seized by Member States who were States on 1 January 2004 during the calendar years ended December 31, 2001 and December 31, 2002. Provision is made for the baseline amount to be revised by agreement as more Member States participate or more new Member States join the EU.⁴⁰ Seizures below a certain number of cigarettes (50 000) from the same manufacturing batch are presumed to have been acquired at the retail level and are not qualifying seizures.⁴¹ Seizures of counterfeit cigarettes are not qualifying seizures.⁴² PMI had also the right to inspect samples of seizures and to make a determination whether they are contraband or counterfeit.⁴³

2.4. The subsequent Industry Agreements with JTI, BAT and ITL

The three Industry Agreements concluded subsequent to the PMI Agreement were heavily influenced by the PMI Agreement. Almost all the mechanisms in the PMI Agreement appear in some shape or form in these Agreements, with only small differences on substance and sometimes timing.

In the case of the BAT Agreement the baseline amount was 150 million cigarettes right from the start, and some flexibility was built into the Agreement on the size of a qualifying seizure being reduced over a period of time.⁴⁴

The best place to revisit the content of these Agreements in more detail will be later on in the study, when an evaluation will be made as to which benefits for the EC and the Member States will fall away once these Agreements have also expired.

37 Ibid, Article 10.

38 An example would be generally applicable legislative measures on tracking and tracing.

39 Ibid, Article 13, Section 13.4.

40 Ibid, Article 1 – Definitions.

41 Ibid, Article 4, Section 4.01(k)(iii).

42 See definition of contraband cigarettes in Article 1, PMI Agreement.

43 Ibid, Article 4, Section 4.01(b) – (d) and Appendix F.

44 Ibid, Article 4, Section 3.7(j).

2.5. The amendments to the PMI Agreement

The only amendment to the PMI Agreement took place when the Parties agreed in 2014 to increase the baseline amount, the amount above which total annual seizures of genuine PMI product would trigger an additional payment of 400% of the duties and taxes lost, from 90 million cigarettes to 450 million cigarettes.⁴⁵ The reason for the increase was the fact that a significant number of new Member States, most of which with substantive illicit trade volumes, joined the EU and then also the Agreement over time. The baseline eventually agreed was lower than the amount OLAF was willing to accept and, as a *quid pro quo* for the higher baseline, new seizure payments in respect of Member States were allowed from when they joined, as opposed to the staggered conditional time line for seizure payments to them provided for in the original Agreement.⁴⁶ A further reason was that it was done after taking into account the baseline amounts in the subsequent Industry agreements.⁴⁷

⁴⁵ See the details provided in response to questions 7a and 13 in *Tobacco Agreements. Follow-up*, p. 3-4, 7.

⁴⁶ SWD(2016) 44 final, p. 18, footnote 34.

⁴⁷ *Ibid*; *Tobacco Agreements. Follow-up*, p. 7.

3. BENEFITS OF THE FOUR INDUSTRY AGREEMENTS

3.1. The benefits to the EC and its Member States

The Commission itself has pointed out that the four agreements cover more than 80% of the tobacco products placed on the EU market and that they have a global reach. They oblige the four manufacturers to accept a much greater responsibility than what the applicable legal and legislative dispensation required at the time, compelling them to put controls in place to meet that responsibility, to accept no-fault liability in instances where contraband escaped such controls, and to put in place oversight and audit mechanisms to ensure compliance.

The Agreements also provide funding to the EC and its Member States, with an implied but not binding requirement that some of it will be spent on addressing illicit trade, and they provide for cooperation in general on illicit trade issues, but in quite a non-specified manner. They also provide for a significant reduction in the administrative burden for the tobacco companies on the one hand and the EC and its Member States on the other hand.

The seizure payments provide incentives to the tobacco manufacturers and to the Member States. The better the companies control their downstream supply chain, the lower their risk. The more intensive the efforts of the authorities to seize illicitly trade product, the higher the payments they receive. Better controls over the movement of the cigarettes of the major manufacturers in theory also free up law enforcement authorities so that they can then address smaller traders.

3.2. The benefits to the four tobacco manufacturers

The Agreements also provide the tobacco manufacturers with clear benefits, in that they define and demarcate their newly agreed responsibilities clearly, provide clarity about and input into enforcement and protect them from double jeopardy. These benefits are part of a balance which the Agreements clearly set out to achieve.

The benefits of the Industry Agreements to the parties will be dealt with in more detail at a later stage when they are compared to the post-agreement scenario. It is clear however that these instruments in effect provide the EU and its Member States with more monetary resources to fight illicit trade, with the opportunity to reallocate investigative and administrative resources

to illicit trade by other players and to benefit from cooperation which also addresses illicit trade by other players. In respect of this, some questions arise:

- » Did the displacement of the products of the four manufacturers in the illicit trade chain by cheap whites take place despite a significant reallocation of these monetary and administrative resources and the extra cooperation, or is there more scope for such actions to be put in place or extended? (Section 8 below).
- » Will moving on from the Agreements to generally applicable legislative solutions cover all the benefits currently provided by the Agreements? (Section 9 below). Especially important here is the issue of global reach and the timing of the global implementation of the Illicit Trade Protocol.
- » Is there a risk that moving from the Agreements to the use of generally applicable legislative solutions will do little more than to maintain the *status quo* in respect of the four manufacturers, and still leave major risks in respect of those operating completely illegally? (Section 9 below)
- » Is there still scope in this overall picture of the future for agreements or other forms of cooperation with the legal tobacco industry? This will be addressed in the final part of this study (Section 10 below).

4. CRITICISMS OF THE FOUR AGREEMENTS

4.1. An introduction to the in-principle criticisms

Tax and price measures aimed at reducing the demand for tobacco products are recognised as an essential element of comprehensive tobacco control policies. Conversely, it can be said that illicit trade weakens tobacco control efforts, as it undermines the demand reduction sought by price and tax policies. The link between tobacco control and the fight against illicit trade is confirmed by the fact that soon after the WHO Framework Convention on Tobacco Control entered into force, the Parties to it negotiated and agreed the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products (The Illicit Trade Protocol or ITP⁴⁸), as was foreseen by Article 15 of the WHO FCTC.

There is a strongly-held view amongst the tobacco control community that the effect of the four Industry Agreements was to establish extensive systems of cooperation between the transnational tobacco companies and the EU ‘at a time when the broader regulatory trend was one of exclusion’.⁴⁹ The debate on tobacco industry exclusion has its roots in Article 5.3 of the WHO FCTC, which reads as follows: ‘In setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law⁵⁰.’

This article, which was followed up by a set of non-binding Guidelines adopted by the Conference of the Parties of the WHO FCTC in 2008, and which was also revisited when the Illicit Trade Protocol was negotiated, is central to this study, and a discussion on its history and ramifications follows further on in this study (Sections 6 and 7 below).

Besides its in-principle objection to the Industry Agreements based on Article 5.3, the tobacco control community and other stakeholders have also over the last 15 years raised criticisms of the Agreements themselves, criticisms on how the Agreements are managed

48 *Protocol to eliminate illicit trade in tobacco products*, Geneva 2013, https://apps.who.int/iris/bitstream/handle/10665/80873/9789241505246_eng.pdf?sequence=1 [access: 18.03.2020].

49 L. Joossens, A.B. Gilmore, M. Stoklosa, H. Ross, *Assessment*, pp. 254-260. Most of the objections to the Industry Agreements discussed in this part of the study were taken from this Assessment.

50 Article 5.3 of the WHO Framework Convention on Tobacco Control, Geneva 2005, <https://apps.who.int/iris/bitstream/handle/10665/42811/9241591013.pdf?sequence=1> [access: 17.03.2020].

and criticisms of what the Agreements have achieved. Over several years these criticisms were taken up by the European Parliament (EP) as part of its oversight role, and questions were addressed at the EU Commission. The Commission, in conjunction with OLAF, provided several sets of responses to them.⁵¹ These interactions, some at the at the European Parliament level, gave rise to a further significant development, in that the EU Commission eventually undertook to do a Technical Assessment of the experience made with the PMI Agreement. It was clear from the beginning that this assessment was going to play a decisive role in the decision whether to enter into new negotiations with PMI in order to renew the Agreement.

In the end Commission decided not to enter into negotiations on the possible renewal of the Agreement, and it appears likely that it will also take the same view in respect of the other three Agreements. A proper analysis of the criticisms of the Agreements, the responses from the Commission and the views contained in the Technical Assessment by the Commission is an essential element of this study, as it can provide learnings on which recommendations about any future approaches can be based.

4.2. The criticisms and the responses by the Commission

4.2.1. Criticism of co-operation with the tobacco industry

The main objection to the Agreements is that they constitute a breach of what is seen as an established regulatory trend towards tobacco industry exclusion. tobacco industry exclusion is portrayed not only as a regulatory trend, but as an obligation under Public International Law. This study will set out the full background to this issue and the responses of the Commission at a later stage, in order to determine their impact on any possible post-Agreement cooperation between the tobacco industry, the EU and the Member States (Sections 6 and 7 below).

4.2.2. Criticisms of the agreements

The release of PMI, JTI and ITL from possible historical civil liability, and the fear that any renewals of the Agreements may do the same. The Commission's view was that the outcome of such litigation was uncertain and that the participating Member states was in agreement that the intended objectives could be more effectively achieved by the Agreements. The Commission, having decided not to renew the PMI Agreement, also appears not to have any plans to negotiate renewals of any of the remaining Agreements.

No payments to either the EC or Member States are earmarked for fighting illicit trade, and there is little evidence that any of this money has been used for this purpose. The Commission has pointed out that fiscal rules applicable at both the EU and Member State level precluded such earmarking. It also does not have reliable information as to whether the money paid over in fact led to significant increases in expenditure on initiatives to curb illicit trade. The effect of this is that the Commission cannot prove any definitive causal link between the financial payments made in terms of the agreements and any reductions or curtailments of illicit trade.

The mechanism of a baseline amount before the tobacco manufacturers becomes liable for a penalty on top of paying compensation neutralises what could have been an important incentive to control their supply chains. The Commission explained on several occasions that

51 See Questions and Answers on: Fighting; *Tobacco Agreements. Follow-up*; SWD(2016) 44 final.

the baseline amount does not affect the compensatory payments provided for in the Agreements in any way, as it only applies in relation to additional penalties which become payable if and when the baseline is exceeded.

The mechanism for amending the baseline amount and the actual amendment that was negotiated with PMI. The PMI Agreement provided for the baseline amount to be increased by agreement as more Member States would join the EU. After 13 more countries, mostly forming the Eastern Border of the EU joined, the baseline was renegotiated from 90 million to 450 million cigarettes. As a *quid pro quo* for this, all new Member States were provided with immediate access to seizure payments.

The claim that adjusting the baseline amount affected normal seizure payments. There was an apparent misunderstanding that the increase in the baseline amount would affect the normal seizure payments negatively. The Commission pointed out that this was not the case, and that in any event, neither the lower or the higher baseline amount was ever reached over the term of the PMI Agreement.

The claim that the threshold for qualifying seizures, which has the effect that no compensation is payable for seizures smaller than a predetermined size, meant that seizure payments were made in respect of only a small percentage of seizures. The Commission accepted the fact that, over the period, seizure payments were paid in respect of a very small percentage of the actual seizures which took place. It however pointed out that two other factors were much more decisive in this respect than the size limitation on qualifying seizures. The first factor was that significant numbers of seizures were counterfeit and therefore did not qualify, and the second factor was that, over time, the relatively new phenomenon of cheap whites started to dominate the seizures. The Commission has considered a third possibility, namely that of so-called anti-trafficking, and it has in the case of BAT agreed a revision of the qualifying seizure size down to 7 500 cigarettes per seizure.

The fact that the tobacco manufacturers themselves are entrusted with determining whether seizures are genuine or counterfeit product, is seen as creating an incentive for making false determinations and avoiding payments. The Commission did initially rely solely on the determination by the tobacco manufacturers, but it over time also used a laboratory in the UK to selectively verify the findings. It did not find a single instance where a tobacco manufacturer made a false determination. In order to finally resolve this issue, the Commission has now established a dedicated testing facility in Geel in Belgium.

The fact that the manufacturers may, in terms of the three remaining agreements, terminate their monetary payments if there are significant failures to meet their reasonable expectations under the Agreements. There are currently no indications that the other three manufacturers are considering such a step.

4.2.3. Criticisms about transparency, accountability and oversight

Parts of the Agreements are not public, the arbitration procedures are confidential, requests for information are refused, and there is a lack of access to documents exchanged between OLAF and the four manufacturers. The tobacco control community, being part of civil society, has consistently claimed that there is a lack of transparency and also a lack of accountability in respect of the Industry Agreements. Again based on the policy directions expressed in the

WHO FCTC and the Illicit Trade Protocol, the tobacco control community insists on a special role in relation to tobacco control, possibly even down to the operational and administrative levels of government. At the EU and Member State level, these are novel concepts in respect of which few rules exist. The Commission has, for its part, published what it could and divulged what it could, in line with the provisions in the Agreements, and in line with its own rules and procedures. It has also cooperated fully in all the initiatives of the EP to ensure greater transparency and clarity about oversight. As a result, there is currently a great deal of information in the public domain. The issue of transparency will remain a significant part of any future discussions on cooperation of any kind with the tobacco industry.

4.2.4. Criticisms on the management of the agreements

Mistrust in how lost taxes and duties are calculated, in OLAF's delegated power to amend the Agreements, in service providers used by OLAF and in the manner in which illicit trade is estimated. The relationship between curbing illicit trade and effective tobacco control makes the issue one which straddles the areas of revenue collection, law enforcement and public health. The public health dimension is relatively new and is gaining prominence due to the WHO FCTC and the Illicit Trade Protocol, while governments are still catching up with the allocation of clear responsibilities in what is now a multi-strand issue. A specific issue which has come to the fore repeatedly is how overall illicit trade in tobacco products in the EU is estimated (See Section 8 below). This figure is important as it has different bearings on fiscal, law enforcement and health policies respectively. Mistrust based on jurisdictional differences will need to be addressed going forward.

4.2.5. Criticisms related to reliance on the tobacco manufacturers

Mistrust in the recording of production codes by the Industry, in the tobacco industry tracking and tracing systems and in the use of industry data on illicit trade. The Commission has indicated that, over time, the tobacco companies had contracted the recording of production codes to an independent third party and that PMI had over time extended its tracking and tracing system from master carton to carton to pack level. Most of the concerns raised about tracking and tracing and the role of the industry has now become moot in the EU, as the newly introduced EU system will supersede the tracking and tracing provisions in the Industry Agreements in relation to product intended for the EU. An analysis may however be necessary as to whether and by when the EU tracking and tracing system, together with the implementation of tracking and tracing in high-risk third countries, will yield all the benefits already provided by the PMI Agreement. The issue of the use of industry data on illicit trade however remains current, with criticism of a study done for PMI by KPMG (Project Star), a relatively recent example. The Commission has clarified how it approaches industry data, but criticisms remain (See Section 8 below).

4.2.6. Criticisms related to the alleged effect of the agreements on illicit trade in the EU

This is a complex area, as there are diverging views on this. This study will further on consider what happened to illicit trade in tobacco products in the EU terms of both absolute and relative volumes, and also in terms of the composition of such illicitly traded product, over the period of the Industry Agreements (See Section 8 below). For current purposes the following preliminary observations by the Commission should be noted:

- » A very large percentage of the products seized as originating from the four manufacturers which concluded the Industry Agreements, was in fact counterfeit.
- » Seizures of genuine product from the four manufacturers declined significantly over the period.
- » Seizures of counterfeit products sold under the brands of the four manufacturers also declined significantly over the period.
- » Seizures of other illicitly traded tobacco products, commonly referred to as ‘cheap whites’, increased significantly over the period, and effectively displaced the previous two categories in the seizure pattern.
- » The overall effect was that while Illicit trade in tobacco products declined slightly in absolute terms, it remained stable or increased slightly in relative terms.

This outcome created a situation where it was claimed that the Industry Agreements had no real impact on illicit trade, and even that genuine product from the four manufacturers remained the mainstay of all products seized. The Commission countered these claims by setting out the changes in illicit trade patterns which it had observed over the period, but it was still challenged to explain the benefits of the four Agreements. For this purpose, it did a technical assessment of the PMI Agreement, the outcome of which was always going to be a key influencer of its future approach to these kind of agreements.

5. THE TECHNICAL ASSESSMENT OF THE PMI AGREEMENT BY THE COMMISSION

The European Commission finalised its technical assessment of the PMI Agreement in February 2016.⁵² From the Commission Staff Working Document, the following key observations should be noted:

- » It found that the Agreement has provided financial benefits to public revenue at EC and Member State level.
- » As it could not demonstrate the extent to which the additional revenue had been spent on initiatives to reduce illicit trade, it did not claim any causal link between these receipts and any reductions in illicit trade.
- » It instead elected to focus on the view that the PMI Agreement had effectively met what the Commission chooses to see as its main objective, namely reducing PMI contraband, and reducing it significantly.
- » It found that while PMI contraband has been reduced, illicit trade had broadly stayed stable in absolute terms and had increased in relative terms.
- » It acknowledged that cooperation from PMI, including the provision of information, had a significant direct investigative value. It did not attempt to quantify the impact of this.
- » It pointed out that the Commission had over time addressed concerns about the transparency of the implementation of the Agreement, and that it had created an independent laboratory to test allegedly counterfeit products.
- » It covered the major changes in the marketplace for illicit cigarettes, such as the displacement of genuine cigarettes by counterfeit products, and then the further displacement of major Industry brands by cheap whites, in detail.
- » It expressed the view that these changes may require a change in strategy from the Commission, and a redirection of the resources currently allocated to the Industry Agreements.

52 See SWD(2016) 44 final.

- » It expressed concerns about the agreements possibly bringing anti-fraud policy, if not EU policy, too close for comfort to the tobacco manufacturers, about having agreements with manufacturers who have challenged certain provisions of the Tobacco Products Directive of 2014 (the ‘new TPD’), and about the reputational risk of having agreements with the tobacco industry.
- » It expressed concerns about being seen as undertaking enforcement action in conjunction with parts of the tobacco industry.
- » It did not elaborate on its earlier replies on the impact of Article 5.3 on the Industry Agreements, wherein it described them as being ‘exempted’ from Article 5.3.⁵³
- » It then covered the major changes in the legislative setting which have taken place over the last decade, and specifically the new TPD (the tracking and tracing provisions which came into effect in May 2019 and the Illicit Trade Protocol, which covering the third party country angle plus additional measures still to be put in place).
- » It expressed the view that these newly available legislative tools, in conjunction with the Commission’s continuously updated Action Plans, will be sufficient to address the issue of illicit trade going forward.
- » It surmised that, even in the instance where the Industry Agreements are not renewed, many of their benefits to the EC and the Member States will remain.

As was widely expected, the Commission eventually announced that it was not going to negotiate a renewal to the PMI Agreement. Given that illicit trade in tobacco products is still at the same level as it was 20 years ago, this raises the question as to whether there could still be a real need for the authorities and the legal industry to cooperate wherever possible in order to reduce its incidence. Addressing this question is one of the aims of this study.

It will therefore analyse what has happened in trends on illicit trade over the last two decades, which benefits of the Industry Agreements will stay in place and which will be lost, to what extent the additional regulatory tools will be effective in addressing the loss of those benefits (and over which time span), and ultimately whether and in what form future cooperation with the legal industry can still make a contribution to reducing illicit trade.

53 See answer to Question 18: *Tobacco agreements. Follow-up*, p. 9-10.

6. THE LEGAL RAMIFICATIONS OF ARTICLE 5.3 OF THE WHO FCTC

Article 5 of the WHO FCTC contains the general obligations under the Convention, and requires Parties to establish essential infrastructure for tobacco control, including a national coordinating mechanism, and to develop and implement comprehensive, multi-sectoral tobacco-control strategies, plans and legislation to prevent and reduce tobacco use, nicotine addiction and exposure to tobacco smoke. One of its sub-articles, Article 5.3, is regarded as one of the most important cross-cutting provisions of the Convention.⁵⁴ It reads as follows:

‘In setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law.’

This provision has been central to a range of discussions and decisions by the FCTC Conference of the Parties (COP) since the original FCTC text was agreed at the 6th International Negotiating Body (INB6) 28 February 2003. It is also one of the Articles for which a set of Guidelines⁵⁵ was developed to assist Parties with its implementation, despite the fact that the original FCTC text did not envisage such Guidelines for this specific provision.⁵⁶

This part of the study will focus on the manner in which Article 5.3, its Guidelines and its eventual incorporation into The Protocol to Eliminate Illicit Trade in Tobacco Products have over time impacted on the Agreements between the European Union and its Member States and the four major EU Tobacco Manufacturers. An important *caveat* to highlight at this stage is that the author throughout had to keep in mind that while there are strict legal rules and legal interpretations on the one hand, there are also political considerations and developments on the other hand. For this reason, this study will also consider the impact which political developments around the FCTC and the Illicit Trade Protocol had on the Industry Agreements.

54 See *The WHO Framework Convention on Tobacco Control: an overview*, https://www.who.int/fctc/about/WHO_FCTC_summary_January2015.pdf?ua=1 [access: 17.03.2020].

55 See Guidelines for implementation of Article 5.3 of the WHO Framework Convention on Tobacco Control on the protection of public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry, Decision FCTC/COP3(7), https://www.who.int/fctc/guidelines/adopted/article_5_3/en/ [access: 17.03.2020].

56 Article 7 only provides for Guidelines on Articles 8 to 13.

6.1. The Framework Convention on Tobacco Control (FCTC)

6.1.1. The negotiating history of Article 5.3

Article 32 of the Vienna Convention on the Law of Treaties (VCLT) stipulates that the negotiating history, also known as the *travaux préparatoires*, can assist in clarifying the meaning of a treaty provision. The VCLT however places this form of interpretation as secondary to the ordinary meaning of the authenticated text of a treaty (see Articles 31 and 32).⁵⁷

In the period before formal negotiations commenced, the World Health Organisation (WHO) invited written submissions and oral testimonies about the proposed FCTC.⁵⁸ In its submissions the tobacco industry mentioned cooperation between itself and the WHO in several of its testimonies, while others who made submissions felt that clear differences remained between public health goals and the objectives of tobacco companies.

In her comments on the public hearings, the then WHO Director General, Dr Gro Harlem Brundtland, expressed the wish that ‘the immediate implementation of the measures that are known to have a sustained impact on reducing tobacco use [...] can be undertaken without interference by tobacco companies’.⁵⁹ Her concerns about clear differences of purpose on established tobacco control measures however did not in her view preclude interaction on other measures, such as for example the industry’s offer on cooperation on potentially reduced harm products. In this area she in fact invited the tobacco companies to provide their views on product modification to the applicable Scientific Advisory Committee of the WHO.

The first Intergovernmental Negotiating Body of the FCTC (INB1) started out with a proposed draft set of elements for a WHO Framework Convention on Tobacco Control.⁶⁰ There were no references to Article 5.3 type considerations in this early provisional text. A tentative Chair’s text of the FCTC⁶¹ was subsequently prepared for INB2. It also contained no reference to Article 5.3 considerations. At INB2 however, these considerations were indeed raised, and the Summary Record⁶² of the proceedings indicate that a negotiating country

57 For full text see Vienna Convention on the law of treaties (with annex). Concluded at Vienna on 23.05.1969, ‘Treaty Series. Treaties and International Agreements Registered of Filed and Recorded with the Secretariat of the United Nations’ 1987, vol. 1155, item 18232, <https://treaties.un.org/doc/publication/unts/volume%201155/volume-1155-i-18232-english.pdf> [access: 17.03.2020].

58 WHO Intergovernmental Negotiating Body on the WHO Framework Convention on Tobacco Control. 1st session. Provisional agenda item 4, A/FCTC/INB1/INF.DOC./1, 14.10.2000: Secretariat update: Public hearings on the Framework Convention on Tobacco Control, <https://apps.who.int/gb/fctc/PDF/inb1/e1inbid1.pdf> [access: 17.03.2020].

59 Statement WHO/6: Who Director-General’s response to the tobacco hearings, 13.10.2000, https://www.who.int/tobacco/framework/public_hearings/dghearings_en.pdf [access: 17.03.2020].

60 WHO Intergovernmental Negotiating Body on the WHO Framework Convention on Tobacco Control. 1st session. Provisional agenda item 8, A/FCTC/INB1/2, 26.07.2000: Proposed draft elements for a WHO Framework Convention on Tobacco Control: Provisional texts with comments of the working group, <https://apps.who.int/gb/fctc/PDF/inb1/e1inb2.pdf> [access: 17.03.2020].

61 WHO Intergovernmental Negotiating Body on the WHO Framework Convention on Tobacco Control. 2nd session, A/FCTC/INB2/2, 9.01.2001: Chair’s text of a Framework Convention on Tobacco Control, <http://apps.who.int/gb/fctc/PDF/inb2/e2inb2.pdf> [access: 17.03.2020].

62 See WHO Intergovernmental Negotiating Body on the WHO Framework Convention on Tobacco Control. 2nd session, A/FCTC/INB2/SR, 30.04.–4.05.2001: Summary records, http://apps.who.int/gb/fctc/PDF/inb2/FINAL_FCTC_INB2_SR_COMPILATION.pdf [access: 17.03.2020].

proposed the insertion of the following paragraph into the General Obligations section of the text: ‘The Parties shall adopt and ensure satisfactory implementation of measures to protect public health policy from undue interference by tobacco companies, their subsidiaries and affiliated parties’⁶³.

The negotiating activities at INB3 and INB4 focused on Annexes dealt with by Working Groups. The wording shown above stayed the same at INB3, but were changed slightly during INB4 to read as follows: ‘The Parties shall adopt and ensure satisfactory implementation of measures to protect public health policy from undue interference by tobacco companies, their subsidiaries affiliated parties and other entities’⁶⁴.

A New Chair’s text of the proposed Framework Convention on Tobacco Control appeared at the start of INB5.⁶⁵ It contained the following wording: ‘5.3 In setting and implementing their public health policies, the Parties shall avoid undue interference by the tobacco industry’.

At INB5 various proposals were discussed, with the following two inputs providing an indication of the thinking at the time:

- » Textual proposal by a grouping of negotiating States:
‘Except for required consultations and other matters, in accordance with national law, the Parties shall ensure that the tobacco industry is excluded from the development and finalization of public health policy’.⁶⁶ (This would be added and the word ‘undue’ would be deleted).
- » Intervention by a participating Non-Governmental Organisation:
‘if the framework convention was to succeed, it must include provisions to prohibit interference by the tobacco industry in public health policy’;
‘called upon countries to strengthen Article 5, paragraph 3, by removing the word «undue» before «interference»’;
‘maintained that the tobacco transnationals had disqualified themselves from playing any role in public health policy’.⁶⁷
- » The revised Chair’s text published before INB6⁶⁸ was subsequently amended to read as follows:
‘5.3. In setting and implementing their public health policies with respect to tobacco control, Parties should act in such a way as to protect these policies from commercial and other vested interests of the tobacco industry.’

63 Ibid, p. 133.

64 WHO Intergovernmental Negotiating Body of the WHO Framework Convention on Tobacco Control, 4th session, Provisional agenda item 4, A/FCTC/INB4/2(a), 24.01.2002, p. 4, <https://apps.who.int/gb/fctc/PDF/inb4/rinb42a.pdf> [access: 17.03.2020].

65 WHO Intergovernmental Negotiating Body of the WHO Framework Convention on Tobacco Control, 5th session, A/FCTC/INB5/2, 25.06.2002: New Chair’s text of a Framework Convention on Tobacco Control, p. 6, <http://apps.who.int/gb/fctc/PDF/inb5/einb52.pdf> [access: 17.03.2020].

66 See WHO Intergovernmental Negotiating Body of the WHO Framework Convention on Tobacco Control, 5th session, A/FCTC/INB5/SR, 14–25.10.2002: Summary records, p. 13, http://apps.who.int/gb/fctc/PDF/inb5/FINAL_FCTC_INB5_SR_COMPILATION.pdf [access: 17.03.2020].

67 Ibid, p. 22.

68 WHO Intergovernmental Negotiating Body of the WHO Framework Convention on Tobacco Control, 6th session, Provisional agenda item 3, A/FCTC/INB6/2, 13.01.2003: Chair’s text of a Framework Convention on Tobacco Control, (Revised), <http://apps.who.int/gb/fctc/PDF/inb6/einb62.pdf> [access: 17.03.2020].

- » At INB6 this part of the text was discussed in the second informal group and the text was strengthened by replacing ‘should’ with ‘shall’. The text submitted to the final plenary session of INB6 and agreed to be ready for submission to the Fifty-sixth World Health Assembly⁶⁹ therefore reads as follows:
 ‘5.3. In setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law’.
- » This final wording should also be read in the context of the following wording included in the preamble to the FCTC:
 ‘Recognizing the need to be alert to any efforts by the tobacco industry to undermine or subvert tobacco control efforts and the need to be informed of activities of the tobacco industry that have a negative impact on tobacco control efforts’.

6.1.2. Comment on the wording of FCTC Article 5.3

When the FCTC was negotiated there clearly was a view that the tobacco industry could either oppose the adoption of proven tobacco control measures, or would undermine their implementation. On the policymaking side, this eventually generated a debate about the appropriate role of the industry. Some recognised its generally recognised right to make input into the policymaking process, others recognised this right but felt that the Industry could in some cases behave in an undue manner and oversight was necessary, and there was a third view which felt that all such rights should be removed. Removing these rights, which were clearly-established and well-entrenched at the national level in most countries, was a challenge, as was the task of defining at exactly which point participation in policymaking would amount to ‘undue interference’.

By the time the Guidelines were being drafted, the term ‘participation in policymaking’ had itself become an issue, with especially international NGOs claiming it effectively made the industry co-regulators. The solution reached at INB5 and INB6 is typical of the way multilateral negotiations function: it was to remove the reference to ‘undue’ interference and in doing so weaken the rights of the industry, but then to in a way reinstate the rights of the industry by adding the phrase ‘in accordance with national law’. The effect of this addition is that the determination of the participatory rights of the industry remains solely within the national domain, and is not overridden by the provisions of the FCTC.

On the cooperation side, the finally adopted wording provides no direct guidance. It would however be correct to point out that in the public hearings and in the response of the DG there was a clear sense of discomfort about cooperating with the industry in areas of established tobacco control which were perceived to present direct conflicts of interest. It would similarly be within the discretion of a national government to conclude that such cooperation may in its view appear to weaken rather than strengthen its tobacco control policies. A national

⁶⁹ WHO Intergovernmental Negotiating Body of the WHO Framework Convention on Tobacco Control, 6th session, Agenda item 4, A/FCTC/INB6/5, 3.03.2003: Draft WHO Framework Convention on Tobacco Control, <http://apps.who.int/gb/ftc/PDF/inb6/einb65.pdf> [access: 17.03.2020].

government may of course also choose to follow the recommendations of any applicable Guidelines covering this issue.

The Industry Agreements however raise questions about a type of cooperation which falls in a different area from what is described above. The reason for this is that activities to combat illicit trade are neither traditional nor solely tobacco control measures, and that it indeed appears possible to demonstrate a shared purpose and a common benefit between governments and the industry in these areas. For this type of cooperation to be declared unacceptable, if only politically, a further determination will have to be made, which is that it could somehow indirectly influence the approach of a given government towards implementing effective tobacco control measures. This determination would be for national governments to make, and they may feel comfortable about it, even if it is claimed that non-binding guidelines recommend a different approach.

The next step is to consider how the Article 5.3 Guideline were developed, the legal status of these Guidelines, the areas covered by them, and what their legal or political impact on cooperation could be.

6.1.3. The development of the Article 5.3 Guidelines

Article 7 of the FCTC provides that each Party shall adopt and implement effective legislative, executive, administrative or other measures necessary to implement its obligations pursuant to Articles 8 to 13, and that the Conference of the Parties shall propose appropriate guidelines for the implementation of the provisions of these Articles.

Even though there is no provision for guidelines to be proposed in relation to any other FCTC articles such as Article 5.3, COP2 adopted a decision⁷⁰ to establish a working group to elaborate guidelines for the implementation of Article 5.3. The working group subsequently submitted a set of draft guidelines for adoption by COP3.⁷¹ During COP3 a working group was set up to revisit this draft, and the amended draft was adopted by the final Plenary Session.⁷²

6.1.4. A note on the legal status of FCTC Guidelines

The FCTC is a novel type of convention which aims to achieve its objectives ‘by providing a framework for tobacco control measures to be implemented by the Parties at the national, regional and international levels’⁷³. As such it departs from traditional treaty law in that many of its proposed measures solely takes effect at the national level, and that it can therefore be said to encroach on the national policy space. As a counterweight to this, the binding obligations

70 WHO FCTC Conference of the Parties to the WHO Framework Convention on Tobacco Control, 7th session, Delhi, India, 7-12.11.2016, Decision FCTC/COP2(14) of 12.11.2016: Further development of the partial guidelines for implementation of Articles 9 and 10 of the WHO FCTC (Regulation of the contents of tobacco products and regulation of tobacco product disclosures), [https://www.who.int/fctc/cop/cop7/FCTC_COP7\(14\)_EN.pdf](https://www.who.int/fctc/cop/cop7/FCTC_COP7(14)_EN.pdf) [access: 17.03.2020].

71 WHO FCTC Conference of the Parties to the WHO Framework Convention on Tobacco Control, 3rd session Durban, South Africa, 17-22.11.2008, Provisional agenda 4.2, FCTC/COP/3/5, 21.08.2008, https://apps.who.int/gb/fctc/PDF/cop3/FCTC_COP3_5-en.pdf [access: 17.03.2020].

72 Guidelines for implementation of Article 5.3.

73 Article 3 WHO Framework Convention on Tobacco Control Resolution (WHA 56.1) adopted by the World Health Assembly, 21.05.2003, https://www.who.int/tobacco/framework/final_text/en/ [access: 17.03.2020].

in the FCTC are open to national interpretation, there are several qualifiers such as references to resourcing and national circumstances and priorities, and the system does not actually have an effective dispute resolution mechanism. The FCTC text states that the Conference of the Parties ‘shall propose appropriate guidelines for the implementation of the provisions of Articles 8 to 13’. The standard manner in which the FCTC process describes these guidelines is that they are non-binding and propose best practices which Parties can implement as they deem appropriate.⁷⁴

The use of guidelines on the implementation of treaty provisions is not a common practice in international law. In order to provide an appropriate perspective based on international law principles, the following paragraphs set out what can be seen as the limitations on the use of guidelines on treaty implementation:

- » Guidelines are not agreed international law, in that they are not subject to long-accepted negotiation and ratification processes. In the FCTC context they can be adopted by a qualified majority decision⁷⁵, and they are proposed to the Parties for use by them as they deem appropriate.
- » Guidelines are neither amendments, nor additions to the binding provisions of the FCTC. Such additions and amendments are instead addressed by Article 28 of the Convention.
- » Guidelines are not subsequently agreed interpretations of the Convention in terms of Article 31(3)(a) of the VCLT, nor do they in terms of Article 31(3)(b) constitute subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation.⁷⁶
- » Guidelines cannot be used to make the FCTC applicable to circumstances and conditions not clearly covered by the agreed text of the FCTC. An example of this is the current debate at COP level on the applicability of the Convention to Electronic Nicotine Delivery systems (ENDS).
- » Guidelines, having been ‘proposed’⁷⁷ by the COP at the multilateral level, are not directly applicable at the national level. Neither can they be equated to binding international law, as they do not fall within the generally recognised sources of public international law, namely treaty law and customary international law.⁷⁸
- » Guidelines being non-binding, are not currently included in any Reporting Mechanisms on FCTC implementation. This is a reflection of their non-binding nature.

74 See Guidelines and policy options and recommendations for implementation of the WHO FCTC, <https://www.who.int/fctc/guidelines/en/> [access: 17.03.2020].

75 Rule 50 of *WHO Framework Convention on Tobacco Control. Rules of Procedure*, 2018 ed., Geneva 2019, <https://www.who.int/fctc/cop/who-fctc-rules-of-procedures-2019.pdf?ua=1> [access: 17.03.2020].

76 VCLT Article 31 (3): *There shall be taken into account, together with the context: (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation.*

77 Article 7 FCTC.

78 See P. Allot, *The Concept of International Law*, ‘European Journal for International Law’ 1999, vol. 10, 38-47, <http://www.ejil.org/pdfs/10/1/577.pdf> [access: 17.03.2020].

- » Portraying the alleged breach of a Guideline as a breach of the original FCTC provision would appear to be unsound. By the same logic, the use of the text of a Guideline to exempt a Party from complying with a clear obligation under an FCTC provision would not be possible.

6.1.5. The context in which the Article 5.3 Guidelines were adopted

With Guidelines not being a widespread activity in treaty law and with the Article 5.3 Guidelines amongst the very first to be drafted⁷⁹, the text proposed to COP3 can probably be described as not having taken full cognisance of the limitations set out in the previous section. It would also be fair to comment that COP3 was pressured for time and keen to adopt the draft. From the records of the proceedings it is clear that instead of addressing the shortcomings of the proposed text, an alternative scenario evolved. It firstly consisted of the apparent assurance provided by the fact that the Guidelines were explicitly described as non-binding, with the implication that they can be adopted with less scrutiny than what would otherwise be applied to such a text. Secondly, for those Parties who still remained cautious about the implications of adopting the text as it stood, the following paragraph was added to the Introduction to the Guidelines:

‘5. Without prejudice to the sovereign right of the Parties to determine and establish their tobacco control policies, Parties are encouraged to implement these guidelines to the extent possible in accordance with their national law.’

The effect of this is that the Guidelines are best described as legally non-binding, and that any final decision on their implementation rests with the national government of a Party, but that they can on the other hand also be regarded as politically persuasive. The official FCTC website describes Guidelines as follows: ‘The guidelines and policy options and recommendations are developed through a wide consultative and intergovernmental process established by the Conference of the Parties (COP) and are acknowledged by the Parties as a valuable tool in implementation of the Convention.’

6.1.6. FCTC Article 5.3 Guidelines as relevant to cooperation with the industry

The operative part of the Guidelines broadly consists of Guiding Principles, Recommended Activities and ‘Agreed’ Measures. The following extract provides the full set of Guiding Principles and Recommended Activities:

- » Guiding Principles

Principle 1: There is a fundamental and irreconcilable conflict between the tobacco industry’s interests and public health policy interests.

Principle 2: Parties, when dealing with the tobacco industry or those working to further its interests, should be accountable and transparent.

⁷⁹ Guidelines for implementation of Article 5.3’ of the WHO Framework Convention on Tobacco Control, Conference of the Parties, Decision WHO FCTC/COP2(14), http://www.apps.who.int/gb/fctc/PDF/cop3/FCTC_COP3_8-en.pdf [access: 1.02.2011].

Principle 3: Parties should require the tobacco industry and those working to further its interests to operate and act in a manner that is accountable and transparent.

Principle 4: Because their products are lethal, the tobacco industry should not be granted incentives to establish or run their businesses.

» Recommended Activities

- (1.) Raise awareness about the addictive and harmful nature of tobacco products and about tobacco industry interference with Parties' tobacco control policies.
- (2.) Establish measures to limit interactions with the tobacco industry and ensure the transparency of those interactions that occur.
- (3.) Reject partnerships and non-binding or non-enforceable agreements with the tobacco industry.
- (4.) Avoid conflicts of interest for government officials and employees.
- (5.) Require that information provided by the tobacco industry be transparent and accurate.
- (6.) De-normalize and, to the extent possible, regulate activities described as 'socially responsible' by the tobacco industry, including but not limited to activities described as 'corporate social responsibility'.
- (7.) Do not give preferential treatment to the tobacco industry.
- (8.) Treat State-owned tobacco industry in the same way as any other tobacco industry.

The Guidelines then continues to list a range of measures described as 'Agreed measures for protecting public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry'. The 'agreed measures' wording could create the impression that the Parties created binding obligations, but the overall wording of the instrument does not support such an interpretation.

For the purpose of this study, the actions listed under firstly establishing measures to limit interactions with the tobacco industry and ensure the transparency of those interactions that occur, and secondly rejecting partnerships and non-binding or non-enforceable agreements with the tobacco industry are the most relevant, as they can potentially affect cooperation between governments and the tobacco industry on illicit trade in tobacco products.

6.1.7. The measures listed in the FCTC Article 5.3 Guidelines

For the purpose of completeness, the actual wording to be considered is as follows: 'Establish measures to limit interactions with the tobacco industry and ensure the transparency of those interactions that occur'.

In setting and implementing public health policies with respect to tobacco control, any necessary interaction with the tobacco industry should be carried out by Parties in such a way as to avoid the creation of any perception of a real or potential partnership or cooperation resulting from or on account of such interaction. In the event the tobacco industry engages in any conduct that may create such a perception, Parties should act to prevent or correct this perception.

» Recommendations

Parties should interact with the tobacco industry only when and to the extent strictly necessary to enable them to effectively regulate the tobacco industry and tobacco products.

Where interactions with the tobacco industry are necessary, Parties should ensure that such interactions are conducted transparently. Whenever possible, interactions should be conducted in public, for example through public hearings, public notice of interactions, disclosure of records of such interactions to the public.

Reject partnerships and non-binding or non-enforceable agreements with the tobacco industry. The tobacco industry should not be a partner in any initiative linked to setting or implementing public health policies, given that its interests are in direct conflict with the goals of public health.

» Recommendations

Parties should not accept, support or endorse partnerships and non-binding or non-enforceable agreements as well as any voluntary arrangement with the tobacco industry or any entity or person working to further its interests.

Parties should not accept, support or endorse the tobacco industry organizing, promoting, participating in, or performing, youth, public education or any initiatives that are directly or indirectly related to tobacco control.

Parties should not accept, support or endorse any voluntary code of conduct or instrument drafted by the tobacco industry that is offered as a substitute for legally enforceable tobacco control measures.

Parties should not accept, support or endorse any offer for assistance or proposed tobacco control legislation or policy drafted by or in collaboration with the tobacco industry.

6.1.8. The key questions relating to measures and recommendations

The wording above reflects the historical view on the regulatory history of tobacco products which the Working Group on the Article 5.3 Guidelines felt necessary to address. The view was that historically, the industry had opposed the adoption and implementation of proven direct tobacco control measures, and that any industry involvement in adoption or implementation had to be limited to what was necessary and transparent, and that partnerships and non-binding agreements on such measures were improper. What the whole section, and in fact the Guidelines, do not clearly address, is whether, when and how these measures could or should be applied in the area of addressing illicit trade in tobacco products. This question will be addressed further on in this study.

Some of the other listed measures such as those on corporate social responsibility are also relevant, as they confirm that a political dimension has over time entered into the FCTC Article 5.3 debate, up to the point of actively campaigning against the tobacco industry. The increased political (as opposed to legal) focus of the FCTC over time, and its possible impact on cooperation with the tobacco industry on illicit trade will be dealt with in the latter part of the study. Before these questions are addressed, it is necessary to also consider the negotiating history of the Protocol on Illicit Trade. The negotiations took place at a time when the FCTC had not only already entered into force, but also when the Article 5.3 Guidelines had already been adopted.

6.2. The Protocol to Eliminate Illicit Trade in Tobacco Products

The issue of illicit trade in tobacco products formed part of the FCTC discussions right from the beginning, as illustrated by the following text which appeared in the proposed draft elements for a WHO Framework Convention on Tobacco Control tabled at INB1: ‘Deeply concerned about the illegal transboundary traffic in cigarettes and other tobacco products and recognizing that coordinated action is necessary to eradicate illicit traffic’.⁸⁰

Illicit trade is regarded as highly relevant to tobacco control mainly because it undermines price and tax measures aimed at reducing the demand for tobacco products.⁸¹ It is also one of the few areas with a real cross-border impact, and the illicit trade issue was therefore relevant for arguing that there was a need for an international response through a treaty such as the FCTC. The FCTC therefore not only contains a set of provisions on illicit trade in Article 15, it was also decided very early on at COP1 to embark on negotiating a protocol on addressing illicit trade in tobacco products.⁸² This Protocol was negotiated from 2008 until 2012 by way of five INBs. It entered into force on 25 September 2018 and currently has 56 Parties.⁸³ A country cannot be a party to the Illicit Trade Protocol if it is not already a party to the FCTC.⁸⁴

6.2.1. The incorporation of FCTC Article 5.3 in the Illicit Trade Protocol

The first Chair’s text of the Illicit Trade Protocol, tabled at INB2⁸⁵, listed the proposed general obligations of the Parties in six paragraphs under the title Part II: General Obligations.⁸⁶ An

80 A/FCTC/INB1/2, p. 3.

81 See *Protocol to Eliminate Illicit Trade in Tobacco Products*, <https://www.who.int/fctc/protocol/en/> [access: 17.03.2020].

82 WHO Elaboration of protocols: Elaboration of a template for a protocol on cross-border tobacco advertising, promotion and sponsorship. Conference of the Parties to WHO Framework Convention on Tobacco Control 2nd session, FCTC/COP1(16), 19.04.2007, http://apps.who.int/gb/fctc/PDF/cop2/FCTC_COP2_10-en.pdf [access: 17.03.2020].

83 See Protocol to Eliminate Illicit Trade in Tobacco Products, Seoul 12.11.2012, https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IX-4-a&chapter=9&lang=en [access: 17.03.2020].

84 Article 33(4) of the FCTC.

85 WHO FCTC Conference of the Parties Intergovernmental Negotiating Body on a Protocol on Illicit Trade in Tobacco Products, 2nd session, Geneva, 20–25.10.2008, Provisional agenda item 5, FCTC/COP/INB-IT/2/3, 18.08.2008: Chairperson’s text for a Protocol on Illicit Trade in Tobacco Products, https://apps.who.int/gb/fctc/PDF/it2/FCTC_COP_INB_IT2_3-en.pdf [access: 17.03.2020].

86 *Ibid*, Part II: General Obligations:

1. Parties shall adopt and implement appropriate measures to control or regulate the supply chain of tobacco, tobacco products, and manufacturing equipment [and key inputs] used in the manufacture of tobacco products in order to prevent, detect and investigate illicit trade, and shall cooperate with one another to this end.
2. Parties shall take appropriate measures to increase the effectiveness of customs, police and other relevant regulatory agencies responsible for preventing, deterring, detecting, investigating and eliminating all forms of illicit trade in tobacco, tobacco products, or manufacturing equipment [or key inputs] used in the manufacture of tobacco products.
3. Parties shall adopt clear and effective measures for technical assistance and financial support, capacity building and international cooperation including measures that assure the availability to, and exchange with, the competent authorities of production and trade data for all forms of tobacco, tobacco products, and manufacturing equipment [and key inputs] used in the manufacture of tobacco products originating within their territory.
4. Parties shall cooperate closely with one another, consistent with their respective domestic legal and administrative systems, in order to enhance the effectiveness of law enforcement action to combat the offences covered by this Protocol.
5. Parties shall cooperate and communicate with relevant organizations and bodies in the exchange of information covered by this Protocol.

important aspect of this first draft is that it appeared not to incorporate Article 5 of the FCTC in full, but limited its incorporation into the proposed General Obligations section to the context that cooperation to raise financial resources should also apply in the case of the Protocol.⁸⁷

The sixth paragraph therefore reads as follows: ‘In addition to the provisions of Article 5 of the WHO Framework Convention on Tobacco Control, Parties shall, within means and resources at their disposal, cooperate to raise financial resources for effective implementation of this Protocol through bilateral and multilateral funding mechanisms.’

The text published in the run-up to INB3⁸⁸ however contained a significant change, in that it fully incorporated Article 5 of the FCTC into the Illicit Trade Protocol. From INB3 onwards and up to the final text agreed at INB5⁸⁹, Article 4 (General Obligations) of the Illicit Trade Protocol therefore starts with a subsection 1 which acts as a *chapeau* and reads as follows: ‘4.1. In addition to the provisions of Article 5 of the WHO Framework Convention on Tobacco Control, Parties shall...’(text of General Obligations listed as found in footnote 86 of this study).

From INB3 until the start of INB5 this draft Article 4 stayed the same, but at INB5 an additional Article 4.2 was added to the final text as follows: ‘In implementing their obligations under this Protocol, Parties shall ensure the maximum possible transparency with respect to any interactions they may have with the tobacco industry’.

The first point to make in this context is that the inclusion of FCTC Article 5.3 into the text of the Protocol initially took place in what can be described as an unobtrusive manner. The second point is that the addition of Article 4.2 probably confirms that the negotiators were of the view that more interaction with the industry would be necessary under the Protocol than under the FCTC.

6.2.2. Other relevant references

The following three direct or indirect references of the Illicit Trade Protocol to FCTC Article 5.3 deserve a mention and comment:

Preamble

Mindful of Article 5.3 of the WHO Framework Convention on Tobacco Control in which Parties agree that in setting and implementing their public health policies with respect to

6. In addition to the provisions of Article 5 of the WHO Framework Convention on Tobacco Control, Parties shall, within means and resources at their disposal, cooperate to raise financial resources for effective implementation of this Protocol through bilateral and multilateral funding mechanisms.

87 Article 5.6 of FCTC: ‘The Parties shall, within means and resources at their disposal, cooperate to raise financial resources for effective implementation of the Convention through bilateral and multilateral funding mechanisms.’

88 WHO FCTC, Conference of the Parties Intergovernmental Negotiating Body on a Protocol on Illicit Trade in Tobacco Products, 3rd session Geneva Switzerland, 28.06.-5.07.2009, FCTC/COP/INB-IT/3/3, 23.04.2009: Revised Chairperson’s text for a Protocol on Illicit Trade in Tobacco Products, https://apps.who.int/gb/fctc/PDF/it3/FCTC_INB_IT3_3-en.pdf [access: 17.03.2020].

89 WHO FCTC, Conference of the Parties Intergovernmental Negotiating Body on a Protocol on Illicit Trade in Tobacco Products, 5th session, Geneva, Switzerland, 29.03.-4.04.2012, Agenda item 5.1, FCTC/COP/INB-IT/5/5, 4.04.2002: Draft Protocol to Eliminate Illicit Trade in Tobacco Products, http://apps.who.int/gb/fctc/PDF/it5/FCTC_COP_INB-IT5_5-en.pdf [access: 17.03.2020].

tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law;

Emphasizing the need to be alert to any efforts by the tobacco industry to undermine or subvert strategies to combat illicit trade in tobacco products and the need to be informed of activities of the tobacco industry that have a negative impact on strategies to combat illicit trade in tobacco products [...]

The paragraphs above were added at INB5 at the request of Parties which wanted a clearer emphasis on the Article 5.3 approach than what had already been achieved by incorporating the whole of Article 5 of the FCTC in Article 4 of the Protocol.⁹⁰

Article 8 Tracking and Tracing

12. Obligations assigned to a Party shall not be performed by or delegated to the tobacco industry.

13. Each Party shall ensure that its competent authorities, in participating in the tracking and tracing regime, interact with the tobacco industry and those representing the interests of the tobacco industry only to the extent strictly necessary in the implementation of this Article.

14. Each Party may require the tobacco industry to bear any costs associated with that Party's obligations under this Article.

The possibility of developing tracking and tracing systems was already mentioned during the initial public hearings on a possible Framework Convention on Tobacco Control.⁹¹ The tobacco industry, and specifically PMI, subsequently started working on such systems. The PMI system was initially proprietary, but it later on divested itself of its interests in it and it became an independent offer.⁹²

The paragraphs above, though ostensibly focused on securing the integrity of tracking and tracing systems, are also susceptible to being used by economic operators keen to eliminate fair competition and a commercially neutral approach by advocating a discriminatory application of FCTC Article 5.3.⁹³ This issue, which falls outside the scope of this study, is

90 WHO FCTC, Summary records of INB5, pp. 152, 211, <https://ezcollab.who.int/inb5summaryrecords> [access: 17.03.2020].

91 A/FCTC/INB1/INF.DOC./1, par. 7.

92 For criticisms of Codentify, see A.B. Gilmore, A.W.A. Gallagher, A. Rowell, *Tobacco Industry's Elaborate Attempts to Control a Global Track and Trace System and Fundamentally Undermine the Illicit Trade Protocol*, 'Tobacco Control' 2019, vol. 28, pp. 127–140, www.doi.org/10.1136/tobaccocontrol-2017-054191.

93 For more on this, see the response of the EU Commission to criticisms levelled at the EU's commercially neutral approach to tracking and tracing by the Framework Convention Alliances (FCA). The Commission, having concluded that the FCA was promoting a single provider of a turnkey system, reacted as follows: *However, favouring one single solution creates a monopoly and the creation of a monopoly always bears serious risks of which the I TP Parties should be aware. In particular, it stifles technical development and is likely to lead to a lock-in situation in which a single provider focuses on maximising its long-term economic gains. A single provider that is free of effective competition and exposed to a wrong set of incentives, e.g. remuneration per traceable item, will be subject to the same economic incentives as the tobacco industry, i.e. both sides will be interested in maximising the long-term volume of the tobacco market. This invites tacit, if not even explicit, collusion between the two sides.* See Letter of European Commission Directorate-General for Health and Food Safety to the Framework Convention

due to come up at the Expert Group on tracking and tracing put in place by the first Meeting of the Parties (MOP1) of the Protocol.⁹⁴

Article 36 Financial Resources

7. Parties may require the tobacco industry to bear any costs associated with a Party's obligations to achieve the objectives of this Protocol, in compliance with Article 5.3 of the WHO Framework Convention on Tobacco Control.
8. Parties shall endeavour, subject to their domestic law, to achieve self-financing of the implementation of the Protocol including through the levying of taxes and other forms of charges on tobacco products.

There can be no doubt that Article 36.7 in particular will form part of any future discussions on possible cooperation agreements with the tobacco industry, especially if there is an overlap between the aims of any proposed agreements and the Illicit Trade Protocol.

6.2.3. The application of Article 5.3 to cooperation with the tobacco industry on control of illicit trade

It is clear that some of the criticisms of the agreements on illicit trade between the EU and the four major tobacco manufacturers are based on claims that they are incompatible with Article 5.3 of the FCTC.⁹⁵ Claims such as these could undoubtedly make governments cautious of concluding similar agreements. A question for this study to address is whether the claimed legal obstacles to such agreements are in fact established international law. As part of this, the following issues will have to be considered in addition to what has already been covered:

- » Most of the activities which a government may undertake in the field of illicit trade fall outside the list of traditional direct tobacco control measures. Although they arguably do fall within the definition of 'tobacco control' as defined in the FCTC⁹⁶, they are different in that they share a mix of objectives (fiscal, law enforcement and health), for most of their execution fall under different parts of government, and have different backgrounds and histories.
- » In the case of traditional direct tobacco control measures, it is now taken as an established fact that there is in almost all instances an irreconcilable conflict of interest between the tobacco industry and governments. The same cannot be said in the case of measures against illicit trade.

Alliance, SANTE.DDG1.B/[...](2019)6240287, <https://www.fctc.org/wp-content/uploads/2019/10/Letter-to-FCA-redacted-final.docx.pdf> [access: 17.03.2020].

94 WHO FCTC, Meeting of the Parties to the Protocol to Eliminate Illicit Trade in Tobacco Products, 1st session, Geneva, Switzerland, 8–10.10.2018, Decision FCTC/MOP1(6) of 10.10.2018: Tracking and tracing systems, including the global information sharing focal point and unique identification markings for cigarette packets and packages, [https://www.who.int/fctc/protocol/mop/FCTC_MOP1\(6\).pdf?ua=1](https://www.who.int/fctc/protocol/mop/FCTC_MOP1(6).pdf?ua=1) [access: 17.03.2020].

95 See Questions and Answers on: Fighting, paragraph 18.

96 Article 1(d) of FCTC: '«tobacco control» means a range of supply, demand and harm reduction strategies that aim to improve the health of a population by eliminating or reducing their consumption of tobacco products and exposure to tobacco smoke'.

There are therefore indications that there may be a need to differentiate between the FCTC and the Illicit Trade Protocol in relation to how FCTC Article 5.3 applies and is applied. Issues to be considered are necessity and the fact that there are obvious common objectives, together with possible safeguards, such as for example clear transparency rules. This study will in its findings and recommendations section consider how much scope there could still remain in a strictly legal sense for cooperation with the industry.

There is however another side to the FCTC, which is the political dimension. The FCTC is a unique type of international law, and political and ideological views contained in its text, its Guidelines and even in COP decisions may be as much a determinant of Party behaviours as are legally binding obligations. This study will therefore also include a brief overview of these developments, and will then for the purpose of its findings and recommendations section consider which of them make cooperation more difficult, and which of them could assist Parties in electing (and defending) a differentiated approach.

In the final part this study will also consider how the Meeting of the Parties (MOP) of the Illicit Trade Protocol may approach the issue of cooperation with the tobacco industry in matters relating to illicit trade in tobacco products. It will be covered in the section on informing policymakers on the optimal relationship between the EU and the industry in combatting illicit trade.

7. THE POLITICAL RAMIFICATIONS OF ARTICLE 5.3 OF THE WHO FCTC

Section 6 of this study covered the extent to which Article 5.3 could (or could not) apply or be applied to cooperation with the tobacco industry on matters relating to illicit trade. The approach was to consider the matter more from a strictly legal point of view, as opposed to a political one. As the study proceeded, it was realised that the FCTC, being a so-called framework convention also has a significant political impact at the national level where decisions on cooperation with the tobacco industry on illicit trade will have to be taken. For this reason, the following analysis of the political impact of the FCTC at the national level has been added.

7.1. The nature of the FCTC being a so-called framework convention

The following features of the FCTC highlights its nature as framework convention:

- » The FCTC provides Parties with a framework of tobacco control measures to be implemented at the national level.⁹⁷ As such it enters the national policy domain to a greater extent than traditional international treaties, specifically with respect to legislative measures which will only have an impact at the national, as opposed to the international level. In terms of traditional public international law, such measures are largely the domain of national governments, while international law restricts itself to the relationships between states and international governmental organisations.⁹⁸
- » The FCTC therefore contains less-detailed obligations than other conventions and allows Parties more liberty to interpret and implement it as they deem appropriate.⁹⁹ This was

97 Article 3 of FCTC.

98 See WHO Executive Board 97th session, Provisional agenda item 6, EB97/INF.DOC./4, 30.11.1995: The feasibility of developing an international instrument for tobacco control report by the Director-General, par. 12 and 14, https://apps.who.int/iris/bitstream/handle/10665/172800/EB97_Inf.Doc-4_eng.pdf?sequence=1&isAllowed=y [access: 17.03.2020]. The approach which was adopted was the convention-protocol approach, with mostly soft and broadly-stated obligations in the convention, to be followed by harder obligations set out in protocols. The only protocol referred to in the text is the Illicit Trade Protocol.

99 An example of an article framed in such vague terms is FCTC Article 9 on the regulation of the contents of tobacco products.

recognised when the treaty was negotiated, when it was agreed that the Conference of the Parties would at a later stage propose guidelines for the implementation of most of the main FCTC Articles. These guidelines, though non-binding, are at the same time politically persuasive.

- » The FCTC does not have an effective dispute resolution mechanism¹⁰⁰, and relies more on political persuasion than on legal force. This, in part, may cause Parties to apply less scrutiny to proposed decisions by the FCTC COP, and Parties could therefore be tempted to be less conservative in their approach to FCTC decisions than would be the case in more strictly binding traditional treaties.
- » Thus, the FCTC COP has taken initiatives not provided for in the Convention¹⁰¹, has taken decisions falling outside its own defined powers¹⁰², has taken ownership of issues not dealt with by the Convention¹⁰³ and has adopted various instruments not provided for in the Convention¹⁰⁴. With its strong emphasis on public health, the FCTC has elevated national health departments to the status of lead department on all matters relating to the convention (and in some instances even the ITP). It has elevated the standing and powers of such departments relative to other departments such as for example fiscal and law enforcement departments. This dimension has to be taken into account especially in the area of cooperation on addressing illicit trade in tobacco products, where other government departments now have to take into account FCTC imperatives and constraints, as interpreted by their health departments.
- » The FCTC Guidelines have added considerable detail to what were in many respects just vaguely stated obligations with a wide margin of interpretation. This is especially true of Article 5.3. The adopted Guidelines, though officially described¹⁰⁵ as non-binding, are politically persuasive and allows national governments to implement them as they see fit. They also play a role on reshaping the long-standing relationships between national government departments.

100 Article 27 of FCTC does not go beyond seeking resolution through diplomatic channels, and the COP has not adopted any *ad hoc* arbitration procedures which Parties may accept in terms of Article 27(2).

101 An example would be the adoption of Guidelines on Article 5.3.

102 An example would be the extension of the clearly defined powers and responsibilities of the FCTC Secretariat.

103 An example would be the issue of reduced ignition propensity cigarettes.

104 An example would be the Recommendations and Policy Options adopted in relation to Articles 17 and 18.

105 The official FCTC website only describes the guidelines as being ‘acknowledged by the Parties as a valuable tool in implementation of the Convention’. See *Adopted guidelines*, https://www.who.int/fctc/treaty_instruments/adopted/en/ [access: 17.03.2020]. The FCTC knowledge hub managed by the McCabe Centre for Law and Cancer states that ‘The guidelines to the WHO FCTC are intended to assist parties in implementing their obligations. They reflect scientific evidence, best practices, and the experience of parties’. It however also raises the possible argument that the UN International Law Commission has recognised (A/73/10, draft conclusion 11 and commentaries) that where the guidelines establish a shared interpretation of the parties, they constitute subsequent agreements and/or subsequent practice under article 31(3) of the Vienna Convention on the Law of Treaties, which must be taken into account in the interpretation of obligations under the WHO FCTC. See *Role of the WHO FCTC in Legal Challenges*, <https://untobaccocontrol.org/kh/legal-challenges/role-of-the-who-fctc/> [access: 17.03.2020]. This argument, based on a draft conclusion of the ILC, has so far not been raised or tested in any official FCTC context.

7.2. The FCTC approach to Article 5.3 over time

After a relatively quiet period it became clear in the run-up to COP6 the FCTC Secretariat had started to focus on the implementation of Article 5.3, and this eventually led to reports on such implementation being tabled at COP6 in 2014¹⁰⁶ and COP7 in 2016.¹⁰⁷ The COP itself then took further decisions on the implementation of Article 5.3 at COP6, COP7 and COP8.¹⁰⁸ The effect of these decisions was to move Article 5.3 to the centre of FCTC implementation.

Even before this, an action which clearly influenced the thinking of the FCTC Secretariat was taken at the fifth INB of the Illicit Trade Protocol in Geneva in April 2012. The issue under consideration was that the public gallery at the INB was mostly made up of representatives of the tobacco industry. This was not a novel development in itself, as such representatives had in earlier years observed the negotiations that took place during INB1 to INB6 of the WHO FCTC in a similar fashion. There was however a slightly different approach visible from the side of the industry, in that it was putting emphasis on cooperation between itself and authorities on illicit trade, and on the fact that in this area there was less of an irreconcilable conflict of interest between the industry and Governments.¹⁰⁹

Events at INB3 took a sudden turn when the Chair allowed a decision on the closing of the public gallery to be tabled, and subsequently excluded all members of the public from observing the proceedings.¹¹⁰ In a technical sense what happened is not controversial, as it is within the power of an INB to take decisions on its own temporary rules of procedure as it

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- 106 WHO FCTC Conference of the Parties to the WHO Framework Convention on Tobacco Control 6th session, Moscow, Russian Federation, 13–18.10.2014, Provisional agenda item 4.8, FCTC/COP/6/16, 14.07.2014: Implementation of Article 5.3 of the WHO FCTC: Evolving issues related to interference by the tobacco industry. Report of the Convention Secretariat, https://apps.who.int/gb/fctc/PDF/cop6/FCTC_COP6_16-en.pdf [access: 17.03.2020].
- 107 WHO FCTC, Conference of the Parties to the WHO Framework Convention on Tobacco Control, 7th session, Delhi, India, 7–12.11.2016, Provisional agenda item 5.3, FCTC/COP/7/7, 27.07.2016: Implementation of Article 5.3 of the WHO FCTC Report by the Convention Secretariat, https://www.who.int/fctc/cop/cop7/FCTC_COP_7_7_EN.pdf?ua=1 [access: 17.03.2020].
- 108 WHO FCTC, Conference of the Parties to the WHO Framework Convention on Tobacco Control, 6th session, Moscow, Russian Federation, 13–18.10.2014, Decision FCTC/COP6(14) of 18.10.2014: Protection of public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry, [https://apps.who.int/gb/fctc/PDF/cop6/FCTC_COP6\(14\)-en.pdf](https://apps.who.int/gb/fctc/PDF/cop6/FCTC_COP6(14)-en.pdf) [access: 17.03.2020]; WHO FCTC Conference of the Parties to the WHO Framework Convention on Tobacco Control 7th session, Delhi, India, 7-12.11.2016, Decision FCTC/COP7(8) of 12.11.2016: Protection of public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry, [https://www.who.int/fctc/cop/cop7/FCTC_COP7\(8\)_EN.pdf?ua=1](https://www.who.int/fctc/cop/cop7/FCTC_COP7(8)_EN.pdf?ua=1) [access: 17.03.2020]; WHO FCTC, Conference of the Parties to the WHO Framework Convention on Tobacco Control, 8th session, Geneva, Switzerland, 1–6.10.2018, Decision FCTC/COP8(18) of 6.10.2018: Protection of public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry, https://www.who.int/fctc/cop/sessions/cop8/FCTC__COP8%2818%29.pdf [access: 17.03.2020].
- 109 See *PMI Supports FCTC Protocol to Tackle Illicit Trade*, 8.10.2018, <https://www.pmi.com/media-center/press-releases/press-release-details/?newsId=14801> [access: 17.03.2020] for an example of a current industry position. The Industry view throughout was that there is no irreconcilable conflict of interests between it and regulators in the area of combatting illicit trade.
- 110 For the history see summary records of COP5: WHO FCTC Conference of the Parties to the WHO Framework Convention on Tobacco Control, 5th session, Seoul, Republic of Korea, 12–17.11.2012: Summary records of Committees, FCTC/COP/5/REC/2, Geneva 2013, http://apps.who.int/gb/fctc/PDF/it5/FCTC_COP_INB-IT5_REC1.pdf [access: 16.11.2012].

proceeds with negotiations. This decision however set a precedent for what was to follow a few years later at COP6.

At COP6 which took place in Moscow in October 2014, the public gallery was closed after the very first plenary session, and it was not reopened for the total duration of the COP. The practice to exclude the public from all but the main plenary session has since been made part of the Rules of Procedure of the COP.¹¹¹ COP6 then also yielded the first in-depth discussion of evolving issues related to Article 5.3, as set out in the later Reports prepared by the FCTC Secretariat. COP6 requested Parties to strengthen their implementation of FCTC Article 5.3 and intensify collaborative action to address tobacco industry efforts internationally; and urged Parties to raise awareness and adopt measures to implement Article 5.3 and its implementing Guidelines among all parts of government including diplomatic missions.

COP6 also gave the FCTC Secretariat the mandate to, in coordination with the WHO:

- (9.) examine the level of tobacco industry engagement in key international organizations which are in a position to contribute to WHO FCTC implementation, prepare a report on their impact on multi-sectoral collaboration for the implementation of the WHO FCTC, and make appropriate recommendations;
- (10.) seek collaboration with pertinent international organizations, including regional, and sub-regional organizations, to raise awareness of their role in contributing to Parties' implementation of Article 5.3 and that their administrative, financial and other decisions affect implementation of Article 5.3 of the WHO FCTC, by promoting the principles of Article 5.3 and its implementing Guidelines, including rejection of any direct or indirect contributions, technical and financial, from the tobacco industry;
- (11.) propose tools that will facilitate where appropriate raising awareness and assisting with implementation of Article 5.3 among all parts of government;
- (12.) identify and recommend options and sustainable mechanisms international cooperation on, and exchange of information related to, tobacco industry interference, building on the existing WHO tobacco industry Monitoring database or through a knowledge hub, in order to strengthen effective implementation of Article 5.3 of the WHO FCTC;
- (13.) stimulate the reporting of Parties' experiences in implementing Article 5.3 of the Convention through the reporting instrument of the WHO FCTC, and facilitate exchange of best practices through the establishment of a virtual community on the WHO FCTC information platform;
- (14.) develop and promote monitoring tools that would encourage voluntary and timely sharing of further information in order to enhance the monitoring of tobacco industry interference, including at the international level and regularly report on findings to Parties;
- (15.) continue to develop, and make available on a continuous basis, the technical capacity required to carry out the tasks listed above and provide technical assistance to Parties upon their request, to implement Article 5.3 of the Convention;
- (16.) report on its findings and activities to the seventh session of the COP.

111 Rule 32 of the amended *WHO Framework Convention on Tobacco Control. Rules of Procedure*, p. 12.

By COP7 a further Report from the Secretariat covered what has happened at Party level over the previous two years, and what the Secretariat did in the areas of its mandate. What follows is a short summary:

» Progress made by the Parties

Slightly more Parties reported giving the public more access to information on tobacco industry activities and 11 Parties reported including implementation of Article 5.3 as part of national legislation. More Parties reported work to inform other government departments about their 5.3 obligation, but the Secretariat expresses its disappointment that most reporting Parties did not follow all the recommendations in the Article 5.3 Guidelines.

» Examination of tobacco industry engagement in key international organisations:

The Secretariat requested a US-based NGO, Corporate Accountability International (CAI), to examine tobacco industry contact with a range in international organisations. CAI looked back many decades, and covered IGOs which are observers and non-observers to the COP, the ITGA, the International Hotel and Restaurant Association, the US and also the International Chamber of Commerce, the ITIC, INTA and also Industry CSR activities. The overall view of CAI was that even simple membership of the Industry or contact with an international organisation amounted to Industry interference. The Secretariat and the WHO also used the CAI report as the basis for a more specific joint paper on tobacco industry contacts with UN Agencies, and it then presented this joint paper at the UN Inter-Agency Task Force on the Prevention and Control of NCDs (UNIATF). This paper identified industry interaction with the ILO, the UN Global Compact, the UNCHR, UNODC and the WCO as challenges.

Seeking collaboration with international organizations on raising awareness of their role on Article 5.3: The Report stated that the Secretariat had presented a draft *Model Policy for agencies of the United Nations system on preventing tobacco industry interference* to UNIATF Members and that ECOSOC adopted a recommendation to encourage UNIATF Members to adopt it. The Report also stated that discussions have started with UN Commissioner for Human Rights to initiate and amendment of the UN *Guidelines on Cooperation between the United Nations and the Business Sector*.

The Report indicated that the Secretariat was taking it upon itself to take *ad hoc* actions to counter- whatever it deems to be industry interference. References were made to three diplomatic notes (on the ITIC meeting in Moscow, on the Codentify¹¹² tracking and tracing system and on Party delegations to FCTC COP), to an *amicus curiae* briefing in the WTO dispute, to taking on the EU about the PMI Industry Agreement, on state tobacco monopoly members in the Articles 9 and 10 Working Group and on the Tobacco Products Directive proceedings in the European Parliament.

Assisting FCFC Parties in their implementation of Article 5.3: The Report referred to the CAI report, and stated that the CAI has reviewed the available mechanisms. It mentioned the creation of tobacco industry observatories to monitor industry behaviour (by then already in place in Brazil, South Africa and Sri Lanka).

112 See footnote 109 for a link to a description of this system originally developed by Philip Morris International.

The Report listed a paper which it commissioned on the tobacco industry and illicit trade as a ‘related matter’ to Article 5.3. It was prepared by the same author who oversaw the CAI report. Its point of departure was that most of the actions which the tobacco industry has taken on illicit trade were forms of interference with the ratification and implementation of the Illicit Trade Protocol. The Report was published as an FCTC Secretariat Paper. It was referenced in an April 2016 *note verbale* to Parties in which the Secretariat criticised the Codentify¹¹³ tracking and tracing system.

It was clear by the end of COP7 that the FCTC Secretariat, which has limited powers under Article 24 of the Convention, has been afforded an extended role in relation to Article 5.3. Examples of its ongoing activities in this area included challenging China on its delegates to Working Groups, confronting the EU on its tobacco industry agreements, working pro-actively on commercial issues on tracking and tracing and publicly criticising IGOs, NGOs and international business bodies for their relations with the tobacco industry. These activities continued after COP7, with additional COP activity on the transparency of Party and observer delegations, and Codes of Conduct and Declaration of Interest requirements for Bureau Members and Regional Coordinators.¹¹⁴ There was also another COP8 decision on Article 5.3, emphasising all the themes covered above.

What is firstly significant for the purposes of this study is the fact that Article 5.3 has acquired an elevated position within the FCTC, that it is actively promoted at both the international and the national level, and that the existing views on undue influence, irreconcilable conflicts of interest and tobacco industry exclusion have become very entrenched at all levels.

The second important observation is in relation to illicit trade. It appears quite possible that in the area of combatting illicit trade, there could on a case-by case basis be less fundamental or even no conflicts of interest, and that transparent cooperation could be not only desirable but is probably necessary. The political reality at the FCTC COP (and increasingly at the MOP of the Illicit Trade Protocol) appears not to support this line of thought, as can be seen from the FCTC approach to the Interpol application for observer status¹¹⁵, and the ongoing debate about Industry solutions to tracking and tracing.

113 See footnote 109.

114 WHO FCTC, Conference of the Parties to the WHO Framework Convention on Tobacco Control, 8th session, Geneva, Switzerland, 1–6.10.2018, Decision FCTC/COP8(4) of 6.10.2018: Code of conduct and declaration of interest for the Members of the Bureau and the Regional Coordinators of the Conference of the Parties to the WHO Framework Convention on Tobacco Control and on proposed measures preventing and addressing possible conflicts of interest at the Convention Secretariat, https://www.who.int/fctc/cop/sessions/cop8/FCTC__COP8%284%29.pdf [access: 17.03.2020]; WHO FCTC Conference of the Parties to the WHO Framework Convention on Tobacco Control 8th session, Geneva, Switzerland, 1–6.10.2018, Decision FCTC/COP8(12) of 6.10.2018: Maximizing transparency of delegations from Parties and observers to the Conference of the Parties, its subsidiary bodies and other WHO FCTC meetings, [https://www.who.int/fctc/cop/sessions/cop8/FCTC__COP8\(12\).pdf?ua=1](https://www.who.int/fctc/cop/sessions/cop8/FCTC__COP8(12).pdf?ua=1) [access: 17.03.2020].

115 See WHO FCTC Conference of the Parties to the WHO Framework Convention on Tobacco Control, 6th session Moscow, Russian Federation, 13–18.10.2014, Decision FCTC/COP6(2) of 16.10.2014: Applications for the status of observer to the Conference of the Parties, [https://apps.who.int/gb/fctc/PDF/cop6/FCTC_COP6\(2\)-en.pdf](https://apps.who.int/gb/fctc/PDF/cop6/FCTC_COP6(2)-en.pdf) [access: 17.03.2020] and the reports which preceded it.

7.3. The political impact of these developments in the area of illicit trade in tobacco products

It appears difficult to escape the conclusion that Article 5.3 considerations will be part of any national discussions about Industry cooperation on addressing illicit trade in tobacco products, the more so in the case of discussions on national implementation of the Illicit Trade Protocol. These considerations will be raised in across-government discussions and may be raised by members of civil society active in tobacco control. The long-standing sole jurisdiction of fiscal and law enforcement authorities over these matters will be replaced by a much more complicated scenario of shared competence, a wider range of stakeholders and inputs based on claimed FCTC obligations.

8. THE STATUS AND TRENDS ON ILLICIT TRADE IN TOBACCO PRODUCTS IN THE EU

The purpose of this part of the study is to consider what impact the four Industry Agreements have had on both the overall volume of and the trends in illicitly-traded tobacco products in the EU. It is an area in which there are differences of opinion about the methodologies employed and the manner in which conclusions are drawn and presented¹¹⁶. This study cannot settle those debates, but it seems that there is enough common ground to make conclusions on the trends since the Agreements were concluded, and on the fact that the volume of tobacco products traded illegally remains a significant public policy issue.

The dates on which the four agreements were concluded were as follows:¹¹⁷

party of agreement	agreed on	expired / expiring on
Philip Morris International Inc. (PMI)	9/7/2004	9/7/2016
Japan Tobacco International (JTI)	14/12/2007	14/12/2022
British American Tobacco Holdings (BAT)	15/7/2010	15/7/2030
Imperial Tobacco Limited (ITL)	27/9/2010	27/9/2030

In what follows, the focus was first on data, then on conclusions on trends and then on conclusions on overall volumes. Before that, some background is provided below to the abovementioned controversy.

116 Tobacco industry data on illicit tobacco trade: a systematic review of existing assessments, A.W.A. Gallagher, K.A. Evans-Reeves, J.L. Hatchard, A.B Gilmore, *Tobacco Industry Data on Illicit Tobacco Trade: A Systematic Review of Existing Assessments*, 'Tobacco Control' 2019, vol. 28, iss. 3, pp. 334-345, <http://dx.doi.org/10.1136/tobaccocontrol-2018-054295>. This is a review of assessments which have taken place globally, while the focus of this Section is on the assessment of illicit trade in the EU. Generally speaking, our observation is that there are more data sources and more efforts to validate conclusions in the EU, and that while the Commission has been steering away from the use of Industry conclusions, its own conclusions do not differ significantly from those of the Industry.

117 *Tobacco smuggling*, https://ec.europa.eu/anti-fraud/investigations/eu-revenue/cigarette_smuggling_en [access: 17.03.2020].

8.1. The accuracy of research on the overall levels of illicit trade

It is commonly acknowledged that the illicit tobacco trade is difficult to measure due to its illegality, its global and changing nature and data collection and analysis complexities.¹¹⁸ The tobacco control community often expresses the view that the major tobacco companies have used self-funded data and studies to overstate the overall volumes of illicit trade during policy debates on newly-proposed tobacco control measures. An example of where illicit trade could directly influence policymaking would be in the setting of excise levels, where fiscal authorities would be hesitant to increase such taxes in the face of persistent and possibly increasing illicit trade. These concerns have caused the tobacco control community to question the data, methodologies and conclusions of Industry-funded studies.

As starting point was chosen the real, actual seizure data as coming from an official source. Therefore firstly list such data as has been made available by the EU Commission, thereafter move on to the Industry-funded conclusions, mostly produced through a series of studies done by KPMG on behalf of Philip Morris International, from time to time joined by other parts of the tobacco industry. It will provide more detail on the KMG studies when we report on them.

8.1.1. Data from the EU Commission on seizures of products from the four contracting tobacco companies

Total PMI cigarettes seized, as reported by Member States to the Commission (OLAF)¹¹⁹ under the PMI Agreement, broken down by genuine and counterfeit, 2006-2014 (in million):

Date of seizure	Total genuine	Total counterfeit
2006	116.09	403.20
2007	99.10	410.58
2008	76.49	157.60
2009	121.20	360.00
2010	58.76	359.85
2011	26.16	208.41
2012	21.09	102.79
2013	15.54	100.42
2014	13.55	89.04
Grand Total	547.98	2191.89

118 P. Reuter, M. Majmudar (eds), *Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from International Experiences*, Washington D.C 2015, https://www.nap.edu/login.php?record_id=19016&page=https%3A%2F%2Fwww.nap.edu%2Fdownload%2F19016 [access: 17.03.2020].

119 See Questions and Answers on: Fighting, p. 10.

Total BAT cigarettes seized, as reported by Member States to the Commission (OLAF) under the Agreement, broken down by genuine and counterfeit, 2010-2014 (in million):

Year	Total genuine	Total counterfeit
2010	36.31	3.69
2011	49.74	6.37
2012	59.94	3.43
2013	24.46	8.58
2014	3.98	-
Grand Total	174.46	22.08

Total JTI cigarettes seized, as reported by Member States to the Commission (OLAF) under the Agreement, broken down by genuine and counterfeit, 2007-2014 (in million):

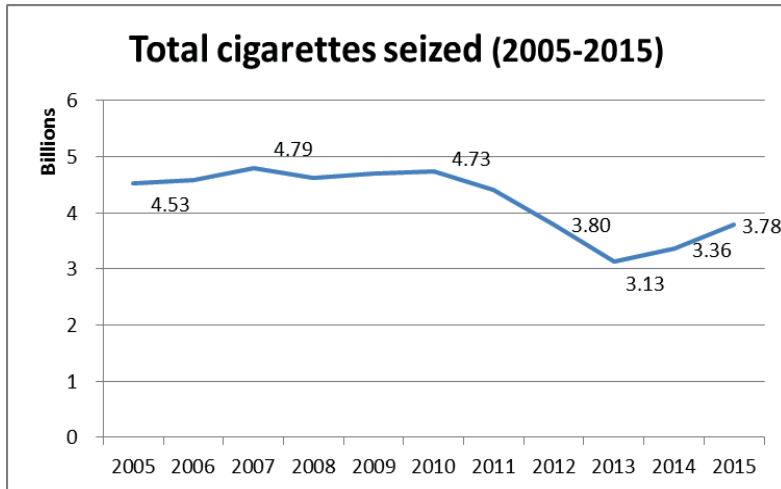
Year	Total genuine	Total counterfeit
2007	0.25	-
2008	7.12	9.42
2009	27.08	30.87
2010	34.91	73.66
2011	21.52	9.44
2012	21.22	9.2
2013	15.99	23.50
2014	8.27	5.20
Grand Total	136.36	161.3

Total ITL cigarettes seized, as reported by Member States to the Commission (OLAF) under the Agreement, broken down by genuine and counterfeit, 2010-2014 (in million):

Year	Total genuine	Total counterfeit
2010	1.87	-
2011	5.39	0.01
2012	15.42	32.86
2013	11.38	27.14
2014	5.61	20.07
Grand Total	39.67	80.09

The seizures of genuine cigarettes from the four major manufacturers declined significantly and consistently over the periods covered. The most complete data set (the one relating to PMI) shows that the seizure of counterfeit products significantly outnumbered that of genuine products from the very start. Although the seizure of counterfeits declined over the period, they did not decline at the rate seen with seizures of genuine cigarettes.

8.1.2. Data from the EU Commission on overall seizures¹²⁰



Total cigarette seizures declined from 2007 to 2013, but they then started an upward trend towards 2015. Total cigarette seizures also have to be considered in conjunction with total cigarette consumption, which is in a consistent downward trend. For this reason, it is necessary to consider seizures both in terms of absolute and relative terms, as an increase in the total number of seizures in a declining overall consumption pattern means that illicit trade as an activity is effectively on the increase.

8.1.3. Data from the EU Commission on seizures of 'cheap whites' 2012-2014

Year	Total (billions)	Contracted Industry Brands	Cheap whites
2012	3.80	0.266	3.534
2013	3.13	0.227	2.903
2014	3.36	0.146	3.214

This data from 2012¹²¹ onwards show how so-called cheap whites have become the overwhelming component of overall seizures as the seizures of both genuine Industry and counterfeit cigarettes have fallen.

120 See Report from the Commission to the Council and the European Parliament, Brussels, 12.5.2017 COM(2017) 235 final: Progress report on the implementation of the Commission Communication 'Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - a comprehensive EU strategy (Com (2013) 324 final of 6.6.2013)', p. 5, <https://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-235-F1-EN-MAIN-PART-1.PDF> [access: 17.03.2020].

121 See Ibid.

8.1.4. Project Stella Data

KPMG LLP has over the past 13 years conducted annual studies to quantify contraband and counterfeit incidence across the 28 EU Markets.¹²² Norway and Switzerland have also been included since 2014. For the sake of clarity, the project names and source of funding over this period were as follows:

Period	Project name	Commissioning entity
2018	Project Stella	Philip Morris International
2017	Project SUN	Royal United Services Institute (RUSI); funded by British American Tobacco and Philip Morris International.
2016	Project Stella	Royal United Services Institute (RUSI); funded by British American Tobacco, Philip Morris International and Imperial Tobacco Limited.
2013 - 2015	Project Stella	British American Tobacco plc, Imperial Tobacco Limited, Japan Tobacco International SA and Philip Morris International Management SA
2006 - 2012	Project STAR	Philip Morris International Management SA

KPMG uses what is referred to as its EU Flows Model in order to quantify the overall level of illicit trade in the EU as a whole and in the respective EU Member States¹²³. From 2018 onwards its Stella Report is also reviewed and refined by an Expert Panel, the members of which were approached by KPMG for their experience in studying and combatting illicit trade in tobacco products. This panel, plus ongoing refinements in its methodologies, were put in place in order to enhance the overall quality of these studies and their findings. The main findings reflected in the first Project Stella report of 2018 are as follows:

» Key trends

Illicit cigarette consumption (contraband and counterfeit) remained stable at 8.6% of total consumption, and is estimated at 43.6bn sticks across the EU. Volume reductions of the largest country-specific flows were replaced by counterfeit and Illicit Whites with no country-specific labelling.

» Challenges

The estimated number of counterfeit cigarettes grew by 33% to 5.5 billion, the highest level since the series of studies began in 2006. The estimate for Illicit Whites with no country-specific labelling grew by 15% to 9.5bn, the largest component of contraband and counterfeit in

122 See *Project Stella Report*, <https://www.stopillegal.com/docs/default-source/external-docs/kpmg-project-stella/kpmg-project-stella-illicit-cigarette-market-in-the-eu-executive-summary-june-2019.pdf> [access: 17.03.2020]

123 See *Project Stella. A study of the illicit cigarette market in the European Union, Norway and Switzerland, 2018 Results, Methodology and Appendices*, https://www.stopillegal.com/docs/default-source/external-docs/kpmg-project-stella/project-stella-methodology.pdf?sfvrsn=aea077d7_2 [access: 17.03.2020].

the study. These two categories (with no identifiable source country) accounted for 34% of contraband and counterfeit. There are indications that many of these cigarettes were manufactured illegally within the EU.

» Improvements

Illicit flows from the three largest source countries of Ukraine, Belarus and Algeria declined by 15% in total. This decline coincided with increased investment in enforcement, especially at border check-points at the Eastern EU border. However, there are also indications that cross-border smuggling appeared to be being replaced with intra-EU illicit manufacturing, demonstrating the flexibility of illicit cigarette trading networks.

» Contraband and Counterfeit consumption declined in 11 countries in the EU

Whilst the share of illicit consumption remained stable across the EU, successful volume reductions in some countries were offset by growth in Greece and the UK. The challenges faced in Greece and the UK are particularly pronounced as they also experienced some of the highest shares of illicit consumption within the EU, alongside Ireland and Latvia. Declining illicit volumes in Poland, Germany, Estonia and Finland illustrate efforts at border check points to reduce flows across the Eastern EU.

Illicit volumes grew in the Czech Republic, Greece, Italy and the UK, however France remained the largest contraband and counterfeit market by volume in the EU. Whilst overall total consumption continued its long-term decline, for the first time since 2014 total non-domestic volumes (illicit contraband and counterfeit plus legal non-domestic volumes) increased across the EU, driven by an increase in legal volumes, especially in France and Italy. This increase in legal non-domestic volumes is seen as an indication that consumers are willing to travel to purchase lower-priced cigarettes, especially in other EU countries. This trend is illustrated in France where consumers living closer to the border countries of Spain, Belgium and Luxembourg have taken advantage of the growing price difference between countries to increasingly purchase cigarettes abroad.

» Combined Contraband and Counterfeit volumes continued their decreasing trend, but counterfeit volumes increased

Counterfeit was the only category to show year on year volume growth in 2018, with Illicit Whites and other contraband declining. However, within the Illicit Whites category, the amount of Illicit Whites with no country specific labelling increased by 1.2 billion cigarettes. These two categories of illicit consumption, both of which have no identifiable source country and may have originated from within the EU, are growing.

» Illicit consumption sources

The conclusion therefore is that Illicit cigarette traders appear to have shifted their efforts to alternative sources of cheap cigarettes, especially counterfeit and Illicit Whites with no country specific labelling, which increased the combined share of these categories from 28% to 34%. As in prior years, illicit cigarettes coming from outside the EU remained the largest source of contraband and counterfeit consumption in the EU, but there was evidence of production of

both counterfeit and Illicit Whites with no country-specific labelling within the EU. Ukraine, Belarus and Algeria remained the largest country specific sources, but all declined as law enforcement efforts to restrict flows continued. The EU-labelled volume share of contraband and counterfeit has remained stable since 2015, mainly accounted for by flows from Poland and Romania to the highest priced countries such as the UK and Ireland.

- » Counterfeit consumption has increased in 15 EU countries

Counterfeit volumes increased by 1.4bn in 2018 to the highest level recorded since measurement began in 2013. The countries with the largest counterfeit volumes were Greece (1.5bn), UK (0.9bn) and Poland (0.8bn). There are indications that the increased EU volumes may be driven by illegal factories located within the EU, in particular in Greece, but also the UK, Poland, Spain and the Netherlands, where seizures and factory raids have taken place.

- » Illicit White brands consumption in the EU accounted for approximately 30% of Contraband and Counterfeit

Illicit Whites continue to be a major source of contraband and counterfeit volumes in the EU, with the largest brands at an EU level being Marble, NZ, and Regina. Marble replaced Fest as the largest Illicit Whites brand between 2014 and 2018. Fest, mainly with Belarusian labelling was identified in multiple countries close to the Eastern EU border, whilst Marble was predominantly identified in Romania where it is the largest illicit flow.

As in prior years the brands collected via the Empty Pack Surveys indicate that some of these Illicit Whites had Belarusian labelling, however, many have no health warnings or have Duty Free labelling in order to evade detection. These are for the purpose of the study categorised as Illicit Whites with no country specific labelling.

Whilst Illicit Whites have often been thought to originate in Belarus, Russia and Ukraine, law enforcement interviews also highlighted a belief that in some countries in the EU, such as Poland and Greece, there may also be an increase in domestic Illicit White production. In addition, seizures made of plastic bags full of cigarettes with no identifiable brand, indicated a trend towards Illicit White and counterfeit production rather than the smuggling of genuine brands.

8.2. The conclusions from the EU Commission on overall trends

The EU Commission published the Report to the Council and the European Parliament in June 2017 titled *Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - a comprehensive EU strategy*.¹²⁴ Despite the implementation of the 2013 Strategy at European and national levels in recent years, the extent of the illicit tobacco trade in the EU remains overall high and troubling. Quantifying a clandestine activity is inherently difficult. With this in mind, illicit tobacco consumption in the EU has been estimated by various sources to have remained broadly stable – in the range of 55 billion to 65 billion sticks – despite an overall decline in tobacco consumption in the EU. Seizures of illicit tobacco products in the EU have risen by a fifth over the last two years which indicates a

124 See COM(2017) 235 final, pp. 7-8.

stable or possibly even growing share of illicit cigarettes. In some Member States the share of the illicit market may well exceed one quarter of the entire tobacco market.

The average size of individual seizures has come down over recent years. Smuggling illicit tobacco products in very large quantities, in particular in containers, is less frequent today. Conversely, multiple border-crossings with smaller quantities are gaining in frequency; some of these are organised operations by criminal gangs. These small-scale activities pose different challenges to law enforcement authorities than containerised traffic.

As observed in February 2016, the composition of the illicit tobacco market has significantly changed over the years. Contraband from the major international producers is much less prominent in large seizures in the EU today than in the past. On the other hand, cheap whites and counterfeits (including the counterfeiting of cheap whites) dominate in large-scale seizures, and in particular in seizures related to containerised transport. In this context, the European Parliament has called on the Commission to take actions setting out new measures to tackle the problem of cheap whites.

The increasing consumption of shisha in the EU is reflected in Member States' substantial seizures of smuggled water pipe tobacco. Furthermore, there also seems to be an upsurge in illicit tobacco manufacturing inside the EU, which is a hypothesis supported by large-scale seizures of raw tobacco and the discovery of numerous illicit tobacco factories. In increasing illicit production inside the EU, smugglers may be reacting to more stringent monitoring of the EU's external borders.

The countries identified as key source and transit countries in the 2013 Strategy remain a source of concern, although the involvement of individual countries seems to be shifting. There now seems to be more diverse sourcing in East Asia, whereas smuggling from China may have declined. Moreover, the weakening of governance structures in countries such as Libya facilitates smuggling in the Mediterranean. Smuggling of Belarusian cheap whites, and transit and illicit production activities in the free zones in the UAE, remain of particular concern.

Criminals and smugglers continue to abuse certain customs and excise procedures allowing for the movement of goods under duty suspension. One of the scenarios used, which is lucrative to criminals, is that cigarettes are produced inside the EU and declared for export but are actually not exported or are smuggled back in the EU after export. Similarly, imports can be moved inside the customs union under the transit procedure using multiple fictitious movements in order to conceal the real destination of the cigarettes. Instead, these cigarettes are distributed illegally on the EU illicit market without payment of VAT and excise.

8.3. The common ground of conclusions of EU Commission and Project Stella

After comparing the conclusions of the EU Commission with those of Project Stella, the following areas of common ground can be noted:

- » The Commission states that various sources estimate that the overall level of illicit tobacco consumption has in broad terms remained stable in the EU, despite the fact that the overall level of tobacco consumption is declining. It quotes a range of 55 to 65 billion sticks for the years of 2015 and 2016, which is higher than the Project Stella

figures of 53 billion for 2015 and 48,3 billion for 2016. It should be noted here that the Commission includes all tobacco products in its report, and that Project Stella does not. Be that as it may, the figures of the Commission, produced with a clear assertion that it did not rely on Industry-funded data, paints a picture which broadly coincides with the scenario produced by Project Stella, which is that while declining in absolute terms, illicit consumption remains stable or are increasing in relative terms.

- » The Commission and Project Stella conclusions broadly coincides on the view that the composition of the illicit tobacco market has changed significantly over the last decade. The Project Stella conclusions support the following conclusions of the Commission:
 - » The overall extent of the illicit tobacco trade in the EU remains high and troubling.
 - » Contraband from the major international producers is much less prominent in large seizures in the EU today than in the past.
 - » Smuggling illicit tobacco products in very large quantities, in particular in containers, is less frequent today. Conversely, multiple border-crossings with smaller quantities are gaining in frequency.
 - » Cheap whites and counterfeits (including the counterfeiting of cheap whites) currently dominate in large-scale seizures.
 - » There appears to be an upsurge in illicit tobacco manufacturing inside the EU, which is a hypothesis supported by large-scale seizures of raw tobacco and the discovery of numerous illicit tobacco factories.
 - » The involvement of key source and transit countries seems to be shifting.

Overall, there is in our view enough common ground between all the available reports and views on illicit trade in tobacco products in the EU to justify the conclusion that it remains a significant problem and that there are no major issues on defining the evolving problem definition in a manner which will not cause controversy.

8.4. Questions to be considered

The response of the Commission to the manner in which the illicit trade in tobacco products has evolved over the last decade can be found in its 2018 – 2022 Action Plan.¹²⁵ An important question is whether there is any role for Industry Cooperation in this Action Plan, and there are two dimensions, the Commission level and the Member State level. This will be part of the assessment in the final chapters of this study.

125 See Annex 1 to the Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee 2nd Action Plan to fight the illicit tobacco trade 2018-2022, COM(2018) 846 final, Brussels, 7.12.2018, https://ec.europa.eu/anti-fraud/sites/antifraud/files/communication_2nd_action_plan_fight_illicit_tobacco_trade_annex_en.pdf [access: 17.03.2020].

9. THE IMPACT OF TPD 2014 ON CONTROL OF ILLICIT TRADE IN TOBACCO

In its 2016 Assessment of the PMI Agreement¹²⁶, the EU Commission covered some major changes in the legislative setting which had taken place over the last decade, and specifically the new EU Tobacco Products Directive. It pointed out that the tracking and tracing and security feature measures included in the 2014 TPD still had to be put in place, and that these were to be followed by other measures, some taken as part of the implementation of the Illicit Trade Protocol. It expressed the view that these newly available legislative tools should be sufficient to address the issue of illicit trade going forward.

It is important at this stage to point out that the new TPD was adopted on 3 April 2014, and that the ITP only entered into force on 25 September 2018. The TPD therefore only addresses two pre-existing obligations under Article 15 of the FCTC, which is to implement a tracking and tracing system and to apply security features in order to allow for the identification of counterfeit products¹²⁷. For a complete picture of the full spectrum of measures on illicit trade being taken and being envisaged by the EU and its Member States, two further ongoing work streams have to be taken into account: The first is the EU Commission's 2nd Action Plan to fight the illicit tobacco trade 2018-2022¹²⁸ and the second is the ongoing implementation of the provisions of the WHO FCTC Protocol on Illicit Trade.

9.1. The applicable provisions of the 2014 Tobacco Products Directive

Article 15 and 16 of the 2014 Tobacco Products Directive are applicable to the issue of control of illicit trade in tobacco.

126 See SWD(2016) 44 final.

127 Articles 15 and 16 Directive 2014/40/EU of the European Parliament and of the Council of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC (Text with EEA relevance), OJ UE of 29.4.2014, L 127/1, https://ec.europa.eu/health/sites/health/files/tobacco/docs/dir_201440_en.pdf [access: 17.03.2020].

128 See COM(2018) 846 final.

Article 15 Traceability

1. *Member States shall ensure that all unit packets of tobacco products are marked with a unique identifier. In order to ensure the integrity of the unique identifier, it shall be irremovably printed or affixed, indelible and not hidden or interrupted in any form, including through tax stamps or price marks, or by the opening of the unit packet. In the case of tobacco products that are manufactured outside of the Union, the obligations laid down in this Article apply only to those that are destined for, or placed on, the Union market.*
2. *The unique identifier shall allow the following to be determined:*
 - a. *the date and place of manufacturing;*
 - b. *the manufacturing facility;*
 - c. *the machine used to manufacture the tobacco products;*
 - d. *the production shift or time of manufacture;*
 - e. *the product description;*
 - f. *the intended market of retail sale;*
 - g. *the intended shipment route;*
 - h. *where applicable, the importer into the Union;*
 - i. *the actual shipment route from manufacturing to the first retail outlet, including all warehouses used as well as the shipment date, shipment destination, point of departure and consignee;*
 - j. *the identity of all purchasers from manufacturing to the first retail outlet; and*
 - k. *the invoice, order number and payment records of all purchasers from manufacturing to the first retail outlet.*
1. *The information referred to in points (a), (b), (c), (d), (e), (f), (g) and, where applicable, (h) of paragraph 2 shall form part of the unique identifier.*
2. *Member States shall ensure that the information mentioned in points (i), (j) and (k) of paragraph 2 is electronically accessible by means of a link to the unique identifier.*
3. *Member States shall ensure that all economic operators involved in the trade of tobacco products, from the manufacturer to the last economic operator before the first retail outlet, record the entry of all unit packets into their possession, as well as all intermediate movements and the final exit of the unit packets from their possession. This obligation may be complied with by the marking and recording of aggregated packaging such as cartons, master cases or pallets, provided that the tracking and tracing of all unit packets remains possible. L 127/22 Official Journal of the European Union 29.4.2014 EN.*
4. *Member States shall ensure that all natural and legal persons engaged in the supply chain of tobacco products maintain complete and accurate records of all relevant transactions.*
5. *Member States shall ensure that the manufacturers of tobacco products provide all economic operators involved in the trade of tobacco products, from the manufacturer to the last economic operator before the first retail outlet, including importers, warehouses and transporting companies, with the equipment that is necessary for the recording of the tobacco products purchased, sold, stored, transported or otherwise handled. That equipment shall be able to read and transmit the recorded data electronically to a*

- data storage facility pursuant to paragraph 8.*
6. *Member States shall ensure that manufacturers and importers of tobacco products conclude data storage contracts with an independent third party, for the purpose of hosting the data storage facility for all relevant data. The data storage facility shall be physically located on the territory of the Union. The suitability of the third party, in particular its independence and technical capacities, as well as the data storage contract, shall be approved by the Commission.*
 7. *The third party's activities shall be monitored by an external auditor, who is proposed and paid by the tobacco manufacturer and approved by the Commission. The external auditor shall submit an annual report to the competent authorities and to the Commission, assessing in particular any irregularities in relation to access.*
 8. *Member States shall ensure that the Commission, the competent authorities of the Member States, and the external auditor have full access to the data storage facilities. In duly justified cases the Commission or the Member States may grant manufacturers or importers access to the stored data, provided that commercially sensitive information remains adequately protected in conformity with the relevant Union and national law.*
 9. *Recorded data shall not be modified or deleted by an economic operator involved in the trade of tobacco products.*
 10. *Member States shall ensure that personal data are only processed in accordance with the rules and safeguards laid down in Directive 95/46/EC.*
 11. *The Commission shall, by means of implementing acts:*
 - a. *determine the technical standards for the establishment and the operation of the tracking and tracing system as provided for in this Article, including the marking with a unique identifier, the recording, transmitting, processing and storing of data and access to stored data;*
 - b. *determine the technical standards for ensuring that the systems used for the unique identifier and the related functions are fully compatible with each other across the Union. Those implementing acts shall be adopted in accordance with the examination procedure referred to in Article 25(2).*
 12. *The Commission shall be empowered to adopt delegated acts in accordance with Article 27 to define the key elements of the data storage contracts referred to in paragraph 8 of this Article, such as duration, renewability, expertise required or confidentiality, including the regular monitoring and evaluation of those contracts.*
 13. *Paragraphs 1 to 10 shall apply to cigarettes and roll-your-own tobacco from 20 May 2019 and to tobacco products other than cigarettes and roll-your-own tobacco from 20 May 2024.*

Article 16 Security feature

1. *In addition to the unique identifier referred to in Article 15, Member States shall require that all unit packets of tobacco products, which are placed on the market, carry a tamper proof security feature, composed of visible and invisible elements. The security feature shall be irremovably printed or affixed, indelible and not hidden or*

interrupted in any form, including through tax stamps and price marks, or other elements imposed by legislation. Member States requiring tax stamps or national identification marks used for fiscal purposes may allow that they are used for the security feature provided that the tax stamps or national identification marks fulfil all of the technical standards and functions required under this Article. 29.4.2014 Official Journal of the European Union L 127/23 EN.

2. *The Commission shall, by means of implementing acts, define the technical standards for the security feature and their possible rotation and adapt them to scientific, market and technical developments. Those implementing acts shall be adopted in accordance with the examination procedure referred to in Article 25(2).*
3. *Paragraph 1 shall apply to cigarettes and roll-your-own tobacco from 20 May 2019 and to tobacco products other than cigarettes and roll-your-own tobacco from 20 May 2024.*

At the time of this study the EU and its Member States have now implemented these provisions, the implementation deadline of which was 20 May 2019. The manner in which they were implemented took into account the provisions on protecting the integrity of systems and data, and is the result of extensive consideration as to the appropriate role of the tobacco industry. The outcomes may well set a precedent for the implementation of these aspects of the ITP by other countries.

The EU Commission's 2nd Action Plan to fight the illicit tobacco trade 2018-2022 dated 7 December 2018 is another key instrument in the control of illicit. It falls within the responsibility of OLAF and its main headings are as follows:

Engaging key source and transit countries:

- » Multilateral relations – FCTC Protocol;
- » Bilateral relations – cooperation with a selection of other countries.

Limiting supply:

- » Securing the supply chain;
- » Limiting supply of input materials;
- » Strengthening the customs framework;
- » Strengthening enforcement, customs detection and sanctions.

Limiting demand:

- » Awareness raising;
- » Reduce incentives.

Analysis and intelligence:

- » Data collection and analysis;
- » Enhanced cooperation and coordination.

In short, this Action Plan from the Commission focuses on leading on tracking and tracing, and on how the implementation of a small selection of other ITP Articles may evolve over time. It also focuses on how neighbouring countries and a selection of other countries can be

encouraged to take a range of measures on illicit trade. It lastly lists a range of intra-EU measures which will be put in place in areas such as enforcement, detection, sanctions, investigations and data collection and analysis.

For the purpose of this study, it should be noted that the Action Plan does not in any way refer to any cooperation with the legal tobacco industry in relation to any of the initiatives it is proposing, even though such cooperation could possibly be appropriate and productive in certain of the areas to be covered. It should be noted that although the Commission did not mention Article 5.3 of the FCTC in detail in its decision to terminate the PMI Agreement, it expressed discomfort about being seen as undertaking enforcement action in conjunction with parts of the tobacco industry.¹²⁹

9.2. The cooperation of the EU with the tobacco industry

Both the EU and its 28 Member States are Parties to the ITP, and the EU has, pursuant to article 44 of the ITP submitted a Declaration of Competences specifying the categories and policy areas in respect of which the Member States of the EU have conferred competences upon the EU in the areas covered by the ITP.¹³⁰

The effect of this is that while certain aspects of ITP implementation resides with the EU, an extensive range of obligations have to be implemented by the Member States. This raises the question as to whether and in what form cooperation with the legal tobacco industry may still be appropriate.

The Commission has expressed the opinion that the Industry Agreements have in its view achieved their main purpose, which it sees as reducing illicit trade in the products of the four contracting Companies.¹³¹ It appears not to discount further cooperation, but then it appears that it does not see this as taking place on a formalised basis, as it points out that the ITP has a global reach and ‘contains many provisions broadly similar to those of the tobacco agreements’¹³².

From this approach, it seems clear that if there is a case for any further formal cooperation agreements, such a case will have to be made by the industry. It will have to be built up by considering the trends and challenges, the division of responsibility between the Commission and the Member States, and the concerns which will be raised by the wider stakeholder groups involving themselves in such a debate. It will have to focus on the Action Plans of the Commission and on the implementation of the Illicit Trade Protocol.¹³³

129 See SWD(2016) 44 final.

130 Annex COM(2015) 194 final, Declaration of competences by the European Union in respect of matters covered by the Protocol to Eliminate Illicit Trade in Tobacco Products (pursuant to article 44 of the protocol) to the Council Decision on the conclusion, on behalf of the European Union, of the Protocol to Eliminate Illicit Trade in Tobacco Products to the World Health Organisation’s Framework Convention on Tobacco Control, in so far as the provisions of the Protocol which do not fall under Title V of Part III of the Treaty on the Functioning of the European Union are concerned, Brussels, 4.5.2015, <https://eur-lex.europa.eu/legal-content/EN/TXI/HTML/?uri=CELEX:52015PC0194&from=EN> [access: 17.03.2020].

131 See SWD(2016) 44 final, p. 4.

132 See *Ibid.*, p. 7.

133 Any Industry role in respect of the implementation of the Protocol is a subject of debate. In political terms, the case for cooperation will have to be made by Protocol Parties, taking into account the legal and political considerations related to Article 5.3 of FCTC.

9.3. The benefits potentially lost through the expiry and non-renewal of the Industry Agreements

The aim is to identify whether any gaps will be left which can be addressed by either formal or *ad hoc* cooperation. A point to take into account here is that the slow ratification of the Illicit Trade Protocol meant that the new Tobacco Products Directive only deals with Traceability and Security Features¹³⁴, and that the implementation of most of Parts II and III of the ITP is still to commence. A question which has to be considered is whether the EU will take the lead on some of these provisions or whether it would take the slower approach of moving along in step with developments taking place at the MOPs of the ITP.

Below, each of the benefits of the PMI Agreement to each of its Parties will be covered, and the study will then consider a) to what extent they already been delivered, b) to what extent they will survive the non-renewal of the Agreement, and c) to what extent the benefit could be replaced by legislative tools or other initiatives by the Commission, and also by when:

- » PMI confirms its commitment to its internal Fiscal Compliance Policy: This PMI policy, which preceded the Agreement, will most likely stay in place. The only question will probably be whether generally applicable legislation will eventually require all EU manufacturers and importers to have similar policies in place. In the same vein it appears unlikely that PMI will discontinue its current anti-diversion initiatives.¹³⁵
- » PMI undertakes to be bound by protocols, approved by the EC, with regards to the sale distribution, and storage of cigarettes. These ‘EC Compliance Protocols’ form part of the Agreement. They cover due diligence, which restricts sales and resales to pre-approved contractors. They further contain restrictions on the methods of payment in order to curtail money-laundering and provisions on business volume limitation – sales must be commensurate with legitimate demand: In strict technical terms, these protocols should now fall away, to be replaced by generally applicable legislation flowing from the implementation of the ITP.
- » PMI undertakes to comply, as far as is commercially feasible, with the Tracking and Tracing Protocols which form part of the Agreement: This will fall away, to be replaced by the transposed Tracking and Tracing requirements of the new Tobacco Products Directive. These requirements will only apply to PMI products manufactured by it (outside and inside the EU) for placing on the EU market. Other PMI products falling outside of this category may still make their way into the EU through illegal channels. If not counterfeit, they may still comply with PMI’s voluntary Tracking and Tracing measures as it has rolled them out world-wide, but the ability of the EU to trace their movement may be an issue until they are eventually marked in accordance with the global tracking and tracing system foreseen by the ITP.
- » PMI undertakes to provide detailed analyses of seizures by the Member States including, where applicable, shipping details and customer information: In strict technical terms,

134 Articles 15 and 16 of EU Tobacco Products Directive.

135 See *Anti-diversion*, https://www.stopillegal.com/pmism_commitment/anti-diversion [access: 17.03.2020].

these obligations should now fall away, to be replaced by generally applicable legislation flowing from the implementation of the ITP.

- » PMI undertakes to provide other reasonable assistance, both direct and indirect, to the EC and Member States, as set out in various parts of the Agreement. This amongst other matters involve cooperation with OLAF and Member States' law enforcement agencies: Despite being no longer obliged to do so, PMI will likely be keen to continue with providing assistance to law enforcement agencies. A point to note here is that, because of the growth in illicit whites, assistance could now mainly be in respect of the alleged misconduct of other parties.
- » The agreement provides for annual Certificates of Compliance by PMI, to be discussed at an annual meeting with Olaf and Member States. These Certificates, produced by PMI as part of its internal compliance oversight and covering all the obligations in the Agreement, can be challenged by the EU, with such challenges leading to either audits or arbitration. In strict technical terms, these obligations should now fall away, to be replaced by generally applicable legislation flowing from the implementation of the ITP.
- » In respect of qualifying seizures of genuine PMI cigarettes by a participating Member State, PMI agrees to make a supplemental payment to compensate the EC and participating Member States for their lost taxes and duties in an amount equal to 100% of the taxes and duties which would have been assessed had the seized cigarettes been distributed legally. These payments will now fall away. They may be replaced by generally applicable legislation to achieve the purposes of Articles 14 and 15 of the IT, but it should be noted that any declaration of conduct to be unlawful and any liability to be imposed, have to be consistent with EU and national legal principles.¹³⁶
- » In addition to such payments, PMI undertakes to make an additional payment of four times the amount of lost taxes and duties if the cigarettes seized, when added to the number of PMI cigarettes already seized in the same calendar year in Member States that were Member States on 1 January 2004, exceeds the so-called Baseline Amount: These payments, which never featured in any event, will now fall away. They may similarly be replaced by generally applicable legislation to achieve the purposes of Articles 14 and 15 of the IT, but, as pointed out above, any liability to be imposed have to be consistent with EU and national legal principles.
- » Seizure payments also apply to seizures which occurred in non-participating Member States, with the qualification that they are then limited to a payment to the EC of the part of the lost taxes and duties which the non-participating Member State would have remitted to the EC. These provisions are no longer relevant.
- » New EU member States only qualify for seizure payments after they have joined, and also after they have achieved an agreed reduction in illicit trade within their territories over an agreed period. These provisions are no longer relevant. The PMI Agreement resolves any actual and potential civil litigation that was or could have been brought in respect of any alleged actions or omissions which took place before its commencement. In essence PMI is absolutely and unconditionally released from any such actions by either the EU or the participating Member States. The effect of these provisions will remain in place.

136 See wording of Articles 14 and 15 of ITP.

- » In order to secure this release, PMI agreed to pay the EU and the initial 10 participating Member States a total amount of \$1 billion dollar in annual instalments, the last to be paid after the 12th year of the agreement: All these payments have now been made.
- » The Agreement states that the amounts paid by PMI to the EU and Member States may serve as a source of additional funding for anti-contraband and anti-counterfeit activities. Over the years, Member States received 90,3% of payments, and the general EU budget 9,7%.: This flow of funding has ended with the non-renewal of the Agreement.
- » The parties acknowledge that compliance with the Agreement is consistent with EC and applicable national laws and with the Treaty Establishing the European Community. This acknowledgement is relevant to subsequent legal debates about the applicability and effect of Article 5.3 of the WHO Framework Convention on Tobacco Control (WHO FCTC). This acknowledgment remains relevant in relation to future debates on Article 5.3, especially in relation to the implementation of the ITP.
- » In respect of seizure payments, PMI effectively accepts no-fault liability and also waives any defences based on being legally compliant with applicable laws: This dispensation no longer applies. Any future attempts to hold PMI liable for seizures of its products will have to be based on either proven principles of civil and criminal law, or on legislative measures which are consistent with EU and Member State legal principles.
- » In order to avoid double jeopardy for PMI, it is allowed to set-off any amounts which may be claimed as a result of alleged legal non-compliance in respect of any seizure, against and up to the total amount of annual seizure payments it has already made on a no-fault basis: This protection will now fall away for PMI.
- » The Agreement acknowledges that the future adoption and implementation of generally applicable legislative measures to address illicit trade may render some of its parts obsolete. In the case of the PMI Agreement, its non-renewal renders this provision irrelevant. In the case of the other Agreements, the EU and Member States will still enjoy some of the benefits while they embark on implementing the ITP.
- » The Agreement foresees the possibility that the EU and its Member States could conclude similar agreements with other tobacco manufacturers and it allows PMI to insist on equal treatment if any treatment in a subsequent agreement is more favourable than that afforded to PMI: No longer relevant.
- » Seizures below a certain number of cigarettes (50 000) from the same manufacturing batch are presumed to have been acquired at the retail level and are not qualifying seizures: This protection in relation to smaller seizures now falls away. Any potential liability for manufacturers will depend on which legislative measures are put in place.
- » Seizures of counterfeit cigarettes are not qualifying seizures: This was for the avoidance of doubt. It in any case appears to be legally possible to hold manufacturers accountable for the actions of those counterfeiting their products.
- » PMI has the right to inspect samples of seizures and to make a determination whether they are contraband or counterfeit: PMI will still have a right to request such samples as part of its right to defend itself against any future civil or criminal liability claims.

9.4. The emerging picture in the new reality

PMI is likely to continue to exercise strict controls over its supply chain both in the EU and in countries outside of the EU. Under such circumstances, it may not be possible to prove criminal or civil liability for PMI in terms of existing civil or criminal law. Any attempts to impose criminal or civil liability by for example legislation will have to be tailored to be consistent with EU or national law. Detailed requirements as to how PMI or other manufactures must conduct their business, will also afford them the defence of legal compliance. The effect of this is that in relation to seizures originating from the major manufacturers, but with no complicity from them, law enforcement agencies will have to shift their attention to the actual smugglers in order to recoup any lost taxes and duties.

This raises the question as to what level of cooperation from PMI could still be helpful to such authorities, and in what type of arrangement or instrument it could be embodied. This question and the answers to it will have to take cognisance of the current political climate around agreements with the tobacco industry. A point to consider here is the issue of implementation time lines. The EU has by now put in place measures on Tracking and Tracing and Security features. It could be placing a lot of confidence on the other measures to be put in place in terms of Parts III (Supply Chain Control) and IV (Offences) of the ITP, but these measures may take a considerable period of time within the EU and even longer in actual and potential source countries for illicit trade outside the EU.

10. THE OPTIMAL RELATIONSHIP BETWEEN THE EU AND THE INDUSTRY: RECOMMENDATIONS

This study shows that formal cooperation between the EU and its Member States and the tobacco industry faces considerable challenges, but that a case can be made for such cooperation to continue. In what follows below, the challenges and opportunities is set out in a point-by-point format which can help understand the optimal relationship which can be built among relevant players. The following challenges need to be considered in further cooperation of the EU with the industry:

- » The legal dimension of Article 5.3;
- » The political dimension of Article 5.3;
- » The EU belief that newly-introduced and upcoming measures are sufficient;
- » The discomfort of the EU on working with some parts of the industry in policing the conduct of others;
- » Addressing real and perceived conflicts of interest;
- » Accommodating the concerns of civil society.

This challenges need to be hold against the opportunities this cooperation may reserve for the future. The following could be considered as part of this exercise:

- » Preserving all forms of cooperation recognised to have made a contribution to combatting illicit trade;
- » Cooperation to ensure that proven best practices are turned into generally applicable measures;
- » Cooperation to ensure that the aim of implementing the ITP as widely as possible is achieved;
- » Filling the inevitable gaps flowing from the long time line and eventual uneven implementation of the ITP;
- » Revisiting the MOP of the Illicit Trade Protocol. Is there scope for it to lead on providing clarity on when cooperation is ‘necessary’, and on how it can be achieved in a fully transparent manner?’

- » Revisiting the role which Memoranda of Understanding can play at especially the Member State level, taking into account the challenges listed above.

The environment within which to inform policy makers on these issues has been made more challenging by the past debates in the EU about the Industry Agreements and by the political dimension of FCTC Article 5.3. A cause of concern is that the MOP of the Illicit Trade Protocol may be dominated by FCTC Article 5.3 considerations to the extent that valuable opportunities for cooperation on issues of common interest may be lost. It is important therefore to address the outlook at MOP2 and further MOPs and whether ITP implementation presents an opportunity for informing policymakers on the issue of cooperation.

It is also deemed important to consider the dimension on cooperation on the behaviour of the Contracting Parties themselves, as opposed to cooperation on monitoring and enforcing the law in relation to the behaviour of other players. Care has to be taken in this area not to compromise the integrity of generally applicable laws and procedures.

Given the nature of the tobacco debate and the special role claimed by and afforded to civil society, the study lastly considered the issue of inclusivity and its implications. It may be advisable to consider right from the start how to accommodate the views of civil society when engaging on cooperation between the industry and the EU and Member States.

Communication with authorities on the issues presented by Article 5.3 of the FCTC is challenging, as Article 5.3 could be regarded by the same authorities as discouraging such discussions themselves. Despite this, an orderly and transparent discussion on Article 5.3 should produce an understanding that agreements with the industry can still meet the requirements of Article 5.3, as it is applied in national law. If such an understanding is achieved, the authority involved will have to understand that its actions in this area may become the subject of criticism from other parts of its government, from non-governmental organisations and even from multilateral arrangements such as the WHO FCTC itself. Officials may find this prospect intimidating, and this may impact their willingness to conclude legal arrangements or even enter into discussions. They may want to seek internal alignment within their governments before being willing to participate in any proposed initiatives.

This overall scenario is made more complicated by the fact that the MOP of the Illicit Trade Protocol is still forming its views on these matters. From the experience at MOP1, it appears that there is a risk that it would maintain the position of the FCTC COP on cooperation with the industry, which would scupper the much more apparent benefits of industry cooperation in the area of combatting illicit trade. Any authority which is considering a legally binding cooperation agreement with the tobacco industry will have to be able to illustrate its clear benefits, its legality in all respects, and also the extra steps it has taken to safeguard itself against allegations, mainly of a political nature, that the arrangement still in some way undermines public health policy.¹³⁷ The onus appears to be on the tobacco industry to design and promote proposed dispensations which will yield clear benefits beyond what can be achieved by generally

137 The current focus of the MOP on the issue of tracking and tracing and of the role of the Industry and other players in it, is an important process, as it will shape COP and ITP Party views on other forms of cooperation with the industry.

applicable legislation, and which are set up and managed in such a manner as to be capable of addressing any legal or political criticisms levelled at them.

Against this background, the following recommendations can be extracted from this study which may apply to tobacco industry parties to the Industry Agreements in the view of improving their share of contribution to the control of illicit trade in tobacco:

- » Maintain all initiatives which measure and review the changes and trends in illicit trade in the EU over time;
- » Conduct a full review of the changes of the attitude of regulators towards cooperating with the industry, and of the newly-found confidence of regulators in new, generally applicable legislative measures on illicit trade, tracking and tracing being a prime example.
- » Cooperate as best as possible with all EU implementation of measures to combat illicit trade, focussing not only on the formulation of the measures, but also on their implementation. Engage to ensure that they are implemented in a manner which addresses the evolving challenges of illicit trade.
- » Identify any benefits to the EU which it will have lost as a result of the cancellation of the Industry Agreements.
- » Identify the gaps in current and upcoming EU measures which can still be addressed through cooperation with the legal tobacco industry.
- » Allow the EU authorities some time to review the effectiveness and efficiency of the new approach over time. Part of this would be to recognise that the 2014 TPD only partly implements the ITP and that other measures are to follow.
- » Depending on the outcome of above, start building a case for new forms of cooperation, taking into account the constraints posed by Article 5.3, the challenges in working with authorities when they police the activities of entities which will describe themselves as competitors, and the fact that the onus will be on the industry to make the case for formal cooperation.
- » Consider shifting resources towards ensuring that measures flowing from the ITP are applied in a manner which will have a real impact on illicit trade.

11. CONCLUDING REMARKS

The main conclusion of this study is that the current political climate and the optimism about the efficacy of the generally-applicable measures provided for in the ITP may make formal agreements on cooperation between the tobacco industry and the EU and its Member States difficult to achieve in the short to medium term.

The prospects for any new formal agreements may however improve over time. Allegedly there are no compelling arguments in either EU or international law which precludes formal cooperation for which a case can be made, and which can be tailored to the actual (and perceived) requirements of the FCTC Article 5.3 environment. The EU will however have to be assertive in its response to criticisms which may be levelled at it.

The industry may in this interim period want to redirect its resources towards ensuring that measures flowing from the ITP are applied evenly and in manner where they will have the greatest impact on the problem of illicit trade in tobacco products.

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ABSTRACT

Illicit trade in tobacco products undermines public health and lead to significant tax losses for Governments. From around 2001, attempts to hold international tobacco manufacturers liable for tobacco products originating from within their supply chains led them to conclude far-reaching Cooperation Agreements with the European Union (EU) and its Member States. These agreements resulted in significant reductions in illicit trade in their products in Europe, but market dynamics caused the products of these manufacturers to be replaced by other illicit products.

The Framework WHO Framework Convention on Tobacco Control (FCTC) and its subsequent Protocol on Illicit Trade (ITP), had a significant impact on the approach of the multilateral system and of national governments towards cooperation with the legal tobacco industry, while it at the same time proposed a range of new measures to address illicit trade. This caused the EU to review its Agreements with the tobacco industry and for the EU to conclude that they had addressed their intended purpose and that the way forward was to solely rely on new measures adopted as part of the 2014 EU Tobacco Products Directive (TPD).

These developments raise significant questions about the way forward: What is the history and what are the learnings from the Industry Agreements? Are their benefits fully addressed by the 2014 TPD? Is there still scope for cooperating with the legal tobacco industry and what are the challenges to be overcome in this area?



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The Framework WHO Framework Convention on Tobacco Control (FCTC) and its subsequent Protocol on Illicit Trade (ITP), had a significant impact on the approach of the multilateral system and of national governments towards cooperation with the legal tobacco industry, while it at the same time proposed a range of new measures to address illicit trade.

These developments raise significant questions about the way forward: What is the history and what are the learnings from the Industry Agreements? Are their benefits fully addressed by the 2014 TPD? Is there still scope for cooperating with the legal tobacco industry and what are the challenges to be overcome in this area?

Dr Marina Foltea is Assistant Professor at Institute of Law Studies, the Polish Academy of Sciences, focusing on legal aspects in the control of illicit trade in the EU. She is Founder and Managing Director of Trade Pacts, Geneva. Her main areas of expertise are international economic agreements and organisations, notably the WTO, FTAs and International Investment Agreements (IIAs). She specializes in the WTO accessions, market access, trade policy reviews, dispute settlement. Since September 2016 she is on the Indicative List of WTO Panels, which makes her eligible to solve WTO disputes. Starting 2019, Dr Foltea is one of the five experts sitting on the WTO Permanent Group of Experts on Subsidies and Countervailing Measures.

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