

Briefing Note: Fourth Session of the Intergovernmental Negotiating Body on an Illicit Trade Protocol

Geneva 14th March to 21st March 2010

CUSTOMER IDENTIFICATION AND VERIFICATION [DUE DILIGENCE] (Article 6)

1. The Framework Convention Alliance believes that businesses involved in the tobacco industry should be required to conduct due diligence on those with whom they trade. It is unacceptable that the industry should be able to sell its products to dubious customers in the supply chain and then evade all responsibility for what happens next.
2. FCA recommends that the concept of “*customer identification and verification*” in Article 6 be removed and replaced with the term “*due diligence*”. The term “*customer*” is not broad enough to cover the range of persons dealt with by the draft provision, and the concept of “*identification and verification*” is only part of the broader concept of ‘reasonable investigation’ included in the definition of due diligence in draft Article 1.
3. FCA believes that due diligence is a duty – and a cost – that properly belongs with the businesses themselves and not with government or a state agency. For governments to conduct due diligence would mean costly and unnecessary bureaucracy; they should focus on running an effective licensing system (Article 5). If governments conduct due diligence instead of the companies in the supply chain, then the latter would effectively be absolved of liability for diversion of their product into illegal channels.
4. Businesses that manufacture tobacco products or the equipment or key inputs used in manufacturing them, and those that trade in tobacco, tobacco products or the equipment or key inputs used in manufacturing them, whether importing, exporting, brokering, warehousing or wholesaling them, should know their customers. They should collect key facts, keep records, and report any actions or omissions that they have good reason to think are suspicious.
5. It is important to see due diligence obligations as fitting logically and powerfully with other supply chain control measures: licensing, tracking and tracing, record-keeping, and other “security and preventive” measures. Taken together, they provide a set of tools to tackle illicit trade. Each reinforces the other, so if one is removed all the remainder are weakened.



FCA Position

6. FCA supports the broad intent of Article 6, but considers that it requires some significant changes to be fully effective, specifically:
 - An amendment to Article 6.1 to clearly place the responsibility for due diligence on participants in the supply chain. The suggestion that Parties might conduct due diligence themselves is a misunderstanding of the purpose of due diligence obligations and should be removed.
 - Clarification of the categories of natural or legal persons to which due diligence requirements will apply. As recommended in relation to Article 5.1, Article 6.1 should cover persons engaged in commercial:
 - manufacturing, import, export, warehousing, brokering or wholesaling of tobacco products
 - import, export, warehousing, primary processing, wholesaling or brokering of tobacco (excluding wholesaling or primary processing by the grower)
 - manufacturing, import, export, brokering or wholesaling of cigarette papers, filter tow or manufacturing equipment used in the manufacture of tobacco products, and retailing of manufacturing equipment.
 - Amending the definition of 'due diligence' in Article 1 to read: *“Due diligence” means conducting a reasonable, state-of-the-art investigation for the purpose of ascertaining whether a legal or natural person is complying with or can reasonably be expected to comply with **all applicable laws and regulations relating to the elimination of illicit trade in tobacco products.***
 - Simplifying the components of due diligence in Article 6.2 to avoid duplicating the requirements for information in a licence application under Article 5.3.
 - Replacing the proposed obligation in Article 6.3 *‘to conduct further due diligence’* whenever there is a *‘material change in circumstances’* with an obligation to monitor commercial transactions in pursuance of the covered activities and notify authorities of any suspicious activities or omissions.
 - Replacing the provisions relating to “blocked customers” with a simplified provision which ensures the application of an effective licensing system and require Parties, where there is evidence that a licensee is unfit to conduct its activities (including evidence of engagement in illicit trade), to take effective measures to require that all other persons engaged in relevant activities cease commercial transactions with that person. Article 12 of the Protocol (Unlawful conduct including criminal offences) should make it unlawful for a licensee to engage in commercial transactions with any person who should be, but is not, licensed in accordance with Article 5.
7. FCA recognises that requiring growers, retailers and transporters to conduct due diligence on other participants in the tobacco product supply chain will not be practical in all Parties, but considers that Parties should be encouraged to include

these important links in the supply chain within their due diligence systems when feasible, as for licensing under Article 5.

8. We therefore recommend including an additional provision requiring Parties to endeavour, to the extent considered appropriate, to apply due diligence requirements to persons engaged in commercial growing of tobacco, retailing of tobacco, tobacco products, cigarette papers or filter tow, and transporting of tobacco, tobacco products, cigarette papers, filter tow or manufacturing equipment used in the manufacture of tobacco products.

Blocking (Articles 6.6-6.9)

8. FCA supports the prevention of further participation in the tobacco product supply chain by persons who have engaged in illicit trade at a level serious enough to warrant exclusion from relevant commercial activities. However, FCA does not consider the proposed application of a complex 'blocking' system operated partly by government and partly by commercial actors to be an appropriate method of achieving this result.
9. FCA notes that draft Articles 6.6-6.9 appear to be modelled on provisions of agreements between the European Community and Philip Morris and Japan Tobacco International. A 'blocked customer' system may be practicable and effective in this context, with a single, large, well-resourced commercial entity agreeing to apply 'blocking' measures to its customers in communication with a competent authority. But the proposed application of such a system to a wide range of persons throughout the supply chain, across a large number of jurisdictions, raises significant problems. The draft provisions suggest a competent authority providing any person covered by the requirements with 'sufficient evidence' of wrongdoing by another person, engaging in an 'administrative procedure', and then leaving it to the first-mentioned person to 'block' the other person and inform the competent authority of the 'blocking'. 'Blocked' persons would be prevented from engaging in business, and all Parties would be required to 'recognize "blocked" designations' made in other Parties.
10. FCA considers that a system which 'blocks' persons from conducting business should be operated by Parties, rather than by private commercial actors, should not be unduly complex, and should respect due process requirements, which may differ between Parties. FCA considers that the most reasonable and practicable method of achieving the aims of the proposed 'blocked customer' provisions is:
 - the application of an effective licensing system, in combination with the proposed requirement in draft Article 6.2 that licensees be required, as part of their due diligence obligations, to establish that relevant persons with whom they transact also hold valid licences. If a competent authority becomes aware that a person has or may have engaged in illicit trade – whether through information provided in a licence application, notification of a change to this information, notification of a reasonable suspicion by a person who engages in a transaction with the licensee, or any other means – and this information indicates that the person is unfit to conduct activities referred to in Article 5.1, the competent authority should refuse to grant a licence to the person, or suspend or cancel the person's licence, as proposed above in relation to draft Article 5.3. If a person does not hold a valid licence to engage in relevant activities, other persons will have notice that the person does not have the

approval of the competent authority or authorities to engage in those activities – and should be prohibited from engaging in relevant commercial transactions with the person (as proposed below in relation to draft Article 12 (Unlawful conduct including criminal offences)); and

- the inclusion of a provision requiring Parties, where there is evidence that any person engaged in the activities referred to in Article 5.1 is unfit to conduct such activities – including evidence that the person has engaged in illicit trade – to take effective measures to require that all other persons engaged in activities referred to in Article 5.1 cease commercial transactions in pursuance of such activities with that person. Where the person is required to hold a licence in the Party’s jurisdiction, the application of effective sanctions for engaging in commercial transactions with an unlicensed person may be a sufficiently effective measure. However, additional measures, such as orders to cease trading with the person, may be required, particularly where the person is operating outside the Party’s jurisdiction and is therefore not required to be issued with a licence by the Party.

Key Amendment

11. Replacing Article 6.6

“Each Party shall take effective measures to require that all natural and legal persons referred to in paragraph 1 of this Article cease commercial transactions in pursuance of the activities referred to in Article 5.1, including transactions relating to the supply of tobacco, tobacco products, cigarette papers, filter tow or manufacturing equipment used in the manufacture of tobacco products, with any person who is unfit to conduct the activities referred to in Article 5.1.”