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Commissioners
Victorian Law Reform Commission
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By email: law.reform@lawreform.vic.gov.au

Dear Commissioners

Regulatory Regimes and Organised Crime – Submission

I am pleased to provide Philip Morris Limited's submission to the Victorian Law Reform Commission's review of the regulatory regimes to prevent organised crime infiltrating lawful occupations and industries.

Illicit trade in tobacco products

The illicit trade in tobacco products is a major issue for both Victoria and Australia, severely impacting small retail businesses and government revenues, while profiting criminals, including major organised crime networks. There are very significant levels of illicit trade in Australia, with Victoria being a hotspot across the supply chain from illegal importation and unlawful domestic growing through to the retail level, with well-known organised crime groups involved at every level.

The World Health Organization has stated that *"the illicit trade of tobacco products is a major global concern, including health, legal and economic, governance and corruption."* They note that the illicit tobacco trade *"has security implications through financing organised crime, including drugs, human and arms trafficking, as well as terrorism."*

These concerns are echoed locally by a number of Commonwealth agencies. On 23 February 2015, Mr Roman Quaadvlieg APM, CEO of the Australian Customs and Border Protection Service (now known as the Australian Border Force) gave evidence to the Senate Legal and Constitutional Affairs Legislation Committee:

"We have established an Organised Crime Branch, and that is in recognition of the fact that transnational crime has become poly-criminal and polymorphous. In that, I mean by example that organised crime syndicates of a transnational nature, whether they are a resident here or offshore, are engaged in syndicated, sophisticated organised crime which transcends the entirety of the portfolio's spectrum of activities. For example, they may be involved in importation of narcotics, the details of which I have provided you just now. They may be involved in syndicated slavery. They may be involved in human trafficking for the purposes of sexual slavery. They may be involved in the organised importation of illicit tobacco. These are organised crime syndicates that are not just resilient but agile, nimble, flexible and working together with significant assets across the entirety of our areas of operation."

In relation to the involvement of organised crime in illicit tobacco, Mr Quaedy said:

"...it is becoming a phenomenon which is much more than in the past as an involvement of serious and organised crime. Serious and organised crime will use the same infrastructural spine upon which it imports prohibited drugs to import tobacco. Let me give you some examples. Tobacco is one of our six primary operational priorities that I set in the middle of last year. In the six months of this financial year to date we have 51 active cases of illegal tobacco under investigation. We have made 46 detections of tobacco for some 80 tonnes of loose leaf tobacco and 20-odd million loose cigarettes. That has a revenue concomitant estimation of around \$52 million. We are seeing an increase in organised crime entities involved in this. I put it down partially to the fact that the excise in duty payable on tobacco is increasing. We are halfway through a four-year incremental increase to a tune of 12.5 per cent."

The Australian Crime Commission's *Organised Crime in Australia 2015* report includes illegal tobacco in its section titled *Crimes in the Mainstream Economy*, which begins as follows:

"Organised crime remains entrenched within the illegal tobacco market in Australia. It continues to perceive involvement in this market as a low risk, high profit enterprise."

It goes on to say:

"It is highly likely that the illegal tobacco market will remain attractive for serious and organised crime groups because of the very large profits that can be made with very low risk."

The *Illicit tobacco in Australia 2014 Full Year Report* prepared by KPMG gives an indication of the size of the problem:

- Illicit tobacco consumption in Australia is at a record high and now represents 14.5% of total consumption or nearly 2.6 million kilograms with an increase of almost 30% in the last two years.
- The black market in tobacco cost the Australian Government approximately \$1.35 billion in excise tax foregone in 2014.
- Cigarette prices in Australia are more than 75% higher than the most expensive non Australasian market. This large price differential between Australia and nearby markets creates smuggling opportunities for those involved in the illicit tobacco market.
- The growth in the tobacco black market was driven by a massive increase in illicit unbranded tobacco, or 'chop chop', much of which is imported through or grown in Victoria.

These findings are consistent with the Commonwealth Government's National Drug Strategy Household Survey released last year which found that almost 20% of smokers had seen tobacco products without plain packaging and at least 10% had purchased at least one of these packs.

Our research and investigations show illegal cigarettes and chop chop are most commonly sold knowingly by unscrupulous traders with little regard for the law, including dedicated illegal retailers as well as small takeaway and grocery shops, tobacconists and supermarkets. There is also a small but growing number of people buying illegal cigarettes over the internet.

Victorian regulation

At present, Victoria has minimal regulation to deal with the illicit trade in tobacco products and what exists, is rarely (if ever) used as it is exceptionally difficult to prove the offence. For example, section 11A of the *Victorian Tobacco Act 1987* attempts to prohibit certain aspects of illicit trade relating to the non-payment of Commonwealth Excise Tax or Excise Equivalent Customs Duty:

11A Offence to possess certain tobacco products

A person who carries on a tobacco retailing business or a tobacco wholesaling business must not, without reasonable excuse, have in the person's possession or under the person's control, any tobacco products that the person knows or ought reasonably to know—

*(a) are smuggled goods or prohibited imports within the meaning of the **Customs Act 1901** of the Commonwealth; or*

*(b) are excisable goods within the meaning of the **Excise Act 1901** of the Commonwealth upon which excise duty has not been paid.*

*Penalty: In the case of a natural person, 240 penalty units;
In the case of a body corporate, 1200 penalty units.*

However, determining that products are “smuggled goods or prohibited imports” or “excisable goods” is extremely difficult in practice. The harder an offence is to prove, especially for an offence likely to attract a relatively small penalty, the less likely it will be considered worth the investment of resources in enforcement and prosecution for a regulatory or law enforcement agency.

That said, implementing the reforms contemplated in the Appendix: Answers to Questions, would provide a comprehensive approach, ensuring clearly defined requirements and appropriate penalties for non-compliance.

More generally, there are a range of Commonwealth offences generally committed by those engaging in the illicit trade in tobacco products, which are far more likely to be able to be enforced by Victorian regulators and law enforcement agencies. These include selling or offering for sale tobacco products:

1. in non-compliant packaging in contravention of the *Tobacco Plain Packaging Act 2011*; and
2. without compliant health warnings in contravention of the *Competition and Consumer (Tobacco) Information Standard 2011*.

It is also notable that the penalties associated with these Commonwealth Offences are harsher than those contemplated by Victorian legislation. For example, the maximum penalty for a breach of Section 11A above is 240 penalty units, while the equivalent penalty in the Commonwealth *Customs Act 1901* is a maximum of ten years in prison. Such disparities must be addressed.

I **enclose** two reports which provide a comprehensive review of options to regulate the tobacco supply chain and consider the role of intermediaries involved in it. I believe these contain a significant amount of information that will assist your review, but also highlight the need for Commonwealth law reform to support the efforts of the Victorian Government.

I also **enclose** a copy of the Hong Kong Organized and Serious Crimes Ordinance (“OSCO”), which is relevant to your consideration of the broader issue of organised crime infiltrating lawful occupations and industries. While Philip Morris Limited does not endorse OSCO as a whole, it is worth reviewing from the perspective of provisions to enhance enforcement and deterrence in the fight against illicit trade in tobacco products as a component of the more general problem. In particular, powers to confiscate the proceeds of crime, place a charge over property, shift the burden of proof to the defendants to rebut statutory assumptions that the property received was a proceed of crime together with enhanced sentencing provision under OSCO are all effective tools in the fight against criminal syndicates.

Finally, I **enclose** a number of media reports from last year in relation to the seizure of what is alleged to be a large quantity of illicit tobacco linked to organised crime. This is not a lone report, but rather one of many demonstrating the entrenched nature of organised crime in the illicit tobacco trade.

Please do not hesitate to contact [REDACTED] or telephone (03) 8531 1054 if you have any questions about this matter or if we can be of assistance to you in your work.

Yours sincerely

[REDACTED]

Patrick Muttart
Director Corporate Affairs
Australia, New Zealand and Pacific Islands

Enclosures:

1. BASCAP paper on 'Roles and Responsibilities of Intermediaries: Fighting counterfeiting and piracy in the supply chain'
2. INTERPOL Legal Handbook on Countering Illicit Trade in Tobacco Products: A guide for Policy-Makers (June 2014)
3. KPMG Illicit tobacco in Australia 2014 Full Year Report
4. Hong Kong Organized and Serious Crimes Ordinance
5. Illicit tobacco – organised crime news reports

Appendix: Answers to Questions

1 What changes or additions would you make to the information presented in Table 1 (pages 23–26) and Table 2 (pages 31–32) regarding the purposes of infiltration? You may wish to comment on occupations or industries that are not listed in Tables 1 or 2.

Addition of the Tobacco Supply Chain to Table 1 as follows:

Occupation or Industry: Tobacco

Possible purpose of infiltration:

- Distribution of illicit goods
 - Access to established tobacco retail distribution networks for illicit tobacco products
 - Retail distribution of other unlawful products (synthetic cannabis and other drugs, counterfeit pharmaceuticals, electronics and other goods, unlawful drug paraphernalia)
- Concealment or laundering of the proceeds of crime
 - Intermingling of lawful tobacco sales (typically cash) with unlawful revenue from tobacco smuggling, retailing and related offences
 - Use of tobacco as a tradeable commodity to hide the proceeds of crime, both at the retail level (e.g. cartons of cigarettes in exchange for stolen goods) and trade-based money laundering in the convention sense.
- Obfuscation of criminal conduct
 - Disguising an illicit tobacco retailer as a legitimate tobacco retailer
 - Intermingling of lawful and unlawful goods
- Exploitation of competitive advantage
 - Direct and indirect coercion of retailers to sell illicit tobacco

2 Is the draft model for assessing the risk of infiltration (pages 32–37) a helpful way to assess the risk of organised crime group infiltration of lawful occupations and industries?

Yes.

3 What changes or additions would you make to the draft model for assessing the risk of infiltration (pages 32–37)?

There should be an element introduced to take account of the ability to generate large profits from the involvement of organised crime due to avoidance of taxation on the **product** (e.g. tobacco excise tax and excise equivalent customs duty) or other **product regulation** (e.g. tobacco with respect to laws on plain packaging and health warnings). These ‘opportunities’ may not arise as a result of Victorian legislation.

4 Having regard to the regulatory tools described in Chapter 4, which regulatory tools are, or might be, useful in addressing each of the risks identified in the draft model for assessing the risk of infiltration (pages 32–37)?

See below.

5 For the purpose of preventing organised crime group infiltration of lawful occupations and industries, what are the advantages and disadvantages of regulation by: (a) a traditional occupation or industry regulator such as the Business Licensing Authority (b) Victoria Police (c) both a traditional regulator and Victoria Police?

While there is significant regulation of the tobacco sector at the retail level, the main disadvantage of the traditional regulator, the Department of Health & Human Services (DHHS), is that it shows no interest or appetite in fulfilling its existing responsibilities, let alone accepting new ones to prevent the infiltration of organised crime. Please see the attached letter from [REDACTED] which excludes mention of the DHHS’s legislated role in enforcement, while emphasising the responsibility of other bodies, including Victoria Police.

The advantages of a different traditional regulator working with the Victoria Police include:

- a) Genuine appetite for administration and enforcement of existing laws;

- b) Comprehensive powers enabling enforcement against those involved in the illicit trade in tobacco products, such as the ability to make test purchases and conduct raids/seizures of illicit product; and
c) The ability of Victoria Police to adequately deal with the security and safety concerns involved when enforcing the law against those involved in organised crime.

The focus of regulation of tobacco in the retail sector is around compliance with point of sale requirements and would be better regulated by Consumer Affairs Victoria in combination with Victoria Police.

6 If a regulator is required to prevent the infiltration of organised crime groups into an occupation or industry, how does this affect, or how might this affect, the pursuit of its other regulatory purposes and objects (whether positively or negatively)?

The addition of new regulatory purposes and objects would complement existing requirements, in that the trade in illicit tobacco undermines all the health purposes and objectives which currently exist.

7 In seeking to prevent the infiltration of organised crime groups into lawful occupations and industries, is it useful to regulate entry into an occupation or industry (for example, by requiring would-be entrants to obtain a licence)?

Yes. Philip Morris Limited supports a policy framework that regulates the legal supply chain and severely penalises those involved in illicit trade. This could include the introduction of a registration scheme for tobacco retailing in Victoria, similar to the Tobacco Retailing Notification (TRN) scheme in New South Wales, where:

- all those wishing to sell tobacco are required to notify the Director-General of the Ministry of Health if they intend to engage in tobacco retailing; and
- retailers can register their business details for free on the on-line Government Licensing Service;
- all persons or organisations engaged in tobacco retailing are required to make a notification, including specialist tobacconists, owners or lessees of tobacco vending machines and occupiers of premises with tobacco vending machines (pubs, clubs and the casino).

Licensing of the tobacco supply chain is a key theme of national and international law relating to the tobacco industry and are supported by Philip Morris Limited on the basis that they are implemented efficiently in order to avoid additional regulatory burden on business. It is worth noting (as the consultation paper does on page 43 in quoting from the 2014/2-15 Competition Policy Review) that licences can act as a barrier to entry and require valuable time to prepare and administer, which results in day to day compliance costs.

Any provision for licensing, such as the New South Wales TRN scheme, needs to minimise the cost and lead times required to gain and then maintain licences. In addition, the agency responsible for the new licences needs to work in conjunction with existing licence arrangements. Continued consultation with the industry will be necessary to ensure that such measures are implemented in an efficient manner.

8 In seeking to prevent the infiltration of organised crime groups into lawful occupations and industries, what are the costs and benefits of any of the following:

- (a) positive licensing regimes
- (b) negative licensing regimes
- (c) registration schemes
- (d) rules relating to the effective control of a business
- (e) rules relating to who may be employed in a business
- (f) rules relating to re-entry
- (g) other entry-regulation tools that you would like to comment on?

Costs and benefits may apply to a range of stakeholders, including regulators, Victoria Police, business operators, business employees, and business customers.

See above.

9 In seeking to prevent the infiltration of organised crime groups into lawful occupations and industries, what are the costs and benefits of group-based licence exclusions?

We do not support such regulations in relation to the tobacco industry given the system proposed above for entry into the industry.

10 In seeking to prevent the infiltration of organised crime groups into lawful occupations and industries, is it useful to monitor an occupation or industry?

Yes. In the tobacco industry, it is essential that the retail sector be subject to a comprehensive and effective monitoring program.

11 When monitoring an occupation or industry in order to prevent or detect the infiltration of organised crime groups, what are the costs and benefits of any of the following:

- (a) short licence periods/regular licence renewals
- (b) a complaints-based model versus an inspection-based model
- (c) investigative powers (or particular investigative powers)
- (d) prohibited practices
- (e) record-keeping obligations
- (f) continuous disclosure obligations
- (g) other monitoring tools that you would like to comment on?

Costs and benefits may apply to a range of stakeholders, including regulators, Victoria Police, business operators, business employees, and business customers.

Philip Morris Limited believes strongly that an inspection-based model is essential and that the following regulatory measures should be part of any tobacco policy framework to combat illicit trade and apply equally to all participants regardless of the size of their business:

- **“Know your customer”:** Legal tobacco manufacturers, wholesalers, distributors and transporters should be required to conduct due diligence with respect to their customers. Such requirements would likely require Federal and State regulation to be effective.
- **Tracking and tracing:** Tracking is the ability to monitor finished goods as they make their way through the supply chain from the point of manufacture. Tracing is the ability to recreate the movement of goods up to a certain point in the supply chain to help determine if the product was diverted into illegal channels at some point in the process. Tracking and tracing help to combat the diversion of genuine products. Such requirements would require Federal regulation to be effective and should be referred as a priority.
- **Record keeping:** The legal tobacco supply chain should be required to maintain complete and accurate records of all relevant transactions for five years and to make records available to relevant authorities.

Tough penalties and strong enforcement

There are numerous ways of tackling the problem of the illegal cigarette trade, but little can be achieved without tough penalties and strong enforcement. If not punished adequately, illicit tobacco trade is a low risk, high-profit crime. Given the huge profits derived from cigarette smuggling, the penalties for those convicted are much less significant than for those convicted, for example, of smuggling drugs or weapons. This encourages criminals to shift from the latter to the former and has been evident in the re-emergence of domestic growing of tobacco in Victoria.

Prohibited practices

There are several ways governments can make illegal tobacco trade less attractive to criminals, including:

- Implementing rules such as zero-tolerance for anyone (including consumers) in possession of counterfeit or non-compliant tobacco products (e.g. packets not in plain packaging);
- Routinely destroying seized products and any associated equipment (e.g. tobacco processing or manufacturing equipment);
- Forfeiting assets of convicted tobacco traffickers; and
- Entering into agreements with the legal tobacco industry to share resources and information.

Investigative powers and enforcement

As noted in the attached letter, existing Victorian laws in relation to investigative powers are thoroughly inadequate and even if changed, implementing laws to criminalise the illicit trade in tobacco products are not effective without adequate enforcement and strict application of meaningful penalties.

All too often, governments are not fully aware of the scale or consequences of the illicit cigarette trade and tackling the problem is not given sufficient priority.

The investigative powers referred to in the consultation paper are essential, at the minimum:

- require a licensee or any person who has possession, custody or control of documents relating to the licensed business to answer questions, supply information and provide documents related to the licensed business;
- require an employee of a licensee to answer questions or provide information with respect to any activity regulated by the legislation;
- require a public body and other specified people (such as a financial institution) to answer questions and supply information relating to a licensed business; and
- enter and search premises and seize suspected items.

The successful elements of an enforcement strategy against illicit trade include:

- Deterrent legislation, such as asset forfeiture laws and laws that provide for deterrent prison sentences for convicted illicit tobacco traders;
- Well-funded law enforcement teams, with a mandate to take action against illicit tobacco as a key government priority;
- Properly trained officers who are knowledgeable about illicit trade and armed with the right tools, such as tobacco testing equipment, container scanners, mobile scanners for trucks and sniffer dogs;
- Funding intelligence efforts, enabling law enforcement to investigate the criminal networks;
- Partnerships with the legitimate industry, which are critical for sharing intelligence among manufacturers, retailers and the public; and
- Clear ethics policies and fair remuneration for enforcement authorities to overcome corruption.

While there may be some cost involved in business compliance, many of the requirements to enable the above are already required. For example, business records are required to be maintained for taxation purposes.

12 What are the most useful ways of detecting people (particularly organised crime groups) who are operating in a lawful occupation or industry without the required authorisation (such as a licence)?

Please see above in relation to regular monitoring and partnerships with the legal tobacco industry, which are critical for sharing intelligence among manufacturers, retailers and the public. The legitimate industry will rapidly provide information to regulators and law enforcement if there is confidence in the system of enforcement.

With respect to enforcement, existing offences are exceedingly hard to prove, even where illicit trade is detected. This should also be considered by the review.

13 Which enforcement measures are useful, or might be useful, in preventing organised crime group infiltration of lawful occupations and industries?

As noted above, the illicit trade in tobacco products is a high-profit, low-risk activity.

A retailer involved in the illicit trade can undercut the legitimate market while making larger profits and increasing turnover, with almost zero chance of enforcement. Existing penalties only encourage further illicit trade as on the rare occasion of a retailer being fined. They can 'make up' the value of the fine in a small number of days through re-engaging in illicit trade. Base-level penalties for retailers need to be far greater, including a minimum fine linked to both the value of the illicit products seized and penalty units. A recent case in New South Wales involved the seizure from a retailer of millions of cigarettes and significant proceeds of crime, yet yielded a fine of only \$7,000.

Fundamentally, criminal sanctions must be introduced including incarceration and asset forfeiture, to act as a deterrent. The illicit tobacco trade is a very serious problem with respect to crime, health and typically involves defrauding the Commonwealth revenue. At a Commonwealth level, the maximum penalty available under the *Customs Act 1901* is 10 years in prison, while breaches of health warnings or plain packaging legislation may trigger maximum fines in the hundreds of thousands of dollars per pack for individual retailers. Current penalties in Victoria are thoroughly inadequate and serve to encourage rather than discourage the growth of the illicit tobacco trade.

14 In seeking to prevent the infiltration of organised crime groups into lawful occupations and industries, is it useful to regulate the exit of people from an occupation or industry? Which tools are, or might be, useful for this purpose?

It is common for retailers investigated or convicted of illicit trade offences to sell or transfer the licence to third parties, often relatives or other parties which are not at 'arm's-length', so that penalties may be harder to implement or further offences detected would be recorded as another 'first offence'. In addition, it is common for people involved to have a direct or indirect interest in more than one retailer, so as to maintain supply in the case of legal disruption. This might be difficult to reconcile with the notification scheme but could be left to the discretion of the regulator.

15 Are there any problems with current information-sharing arrangements? If so, how might these problems be overcome? Information-sharing arrangements can refer to information sharing between regulators and Victoria Police, between different Victorian regulators, between Victorian and interstate regulators, and between any other agencies that hold relevant information.

N/A

16 Please comment on the extent to which regulatory tools that may be used to prevent the infiltration of organised crime groups into lawful occupations and industries may:

(a) insufficiently protect the rights of people affected by decisions of the regulator

(b) insufficiently protect the rights of any other stakeholder

(c) impose additional burdens on regulators, courts and/or tribunals in relation to the provision of reasons for decisions and opportunities for review.

With respect to insufficient protection of the rights of other stakeholders, some form of 'private remedy' should be considered to enable those involved in the tobacco industry to take action against those involved in the illicit trade in tobacco products directly.

At present, a tobacco manufacturer can typically only take action to prevent the illicit trade of tobacco products if they are a brand owner and their products are counterfeited. The illegal importation of non-trademark infringing products (which represents the vast majority of illicit trade), can only be enforced by government departments and agencies, placing major resource constraints on overall enforcement.

A provision for private prosecution such as exists at the Federal level or another similar remedy would enhance the Government's ability to address the challenge of organised crime infiltrating lawful occupations and industries.

17 In seeking to prevent the infiltration of organised crime groups into lawful occupations and industries:

(a) What issues are, or might be, better dealt with through legal responses other than occupation/industry-based regulatory regimes (including but not limited to the 'other legal responses' described at pages 66–68)?

(b) What issues are, or might be, better dealt with through occupation/industry-based regulatory regimes rather than other legal responses?

Please note the discussion of OSCO in Hong Kong in the cover letter. The interaction between the 'other legal responses' described at pages 66–68 of the consultation paper and existing / proposed measures to combat the illicit trade in tobacco products should be considered.

For example, licencing through a TRN, combined with record-keeping requirements may provide substantial evidence of illicit trade in tobacco products (or lack of proof of legitimate trade), which could then be a focus of anti-money laundering laws, asset forfeiture and confiscation, unexplained wealth orders at the State level, combined with Commonwealth civil asset confiscation orders and reviews by the Australian Taxation Office.