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RCMP Criminal Intelligence

Strategic Intelligence Assessment

FEDERAL TOBACCO CONTROL STRATEGY (FTCS)
THE ILLICIT TOBACCO MARKET IN CANADA
JANUARY – DECEMBER 2006





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SUMMARY



- The total number of cartons of cigarettes seized (including unmarked bags of 200 cigarettes) has increased from 369,169 in 2005 to 472,268 in 2006.
- The increasing availability of contraband tobacco is of concern, as it has reached a historical high. In 2006, RCMP seizures surpassed the 1994 benchmark when the black market was considered out of control.
- The product most commonly seized was the unmarked clear bag of cigarettes (200 per bag).
- A large proportion of all contraband tobacco seized in Canada can be traced back to manufacturers on the U.S. portion of the Akwesasne Reserve near Cornwall, Ontario.
- Organized crime is involved in the manufacturing and distribution of illicit tobacco products throughout Canada. The scope of organized crime activity extends to include money laundering, intimidation and coercion, drug trafficking, human smuggling, and firearm trafficking.
- Contraband prices have decreased across the country, both at street and manufacturer levels. This may be attributed to competition between suppliers as their increased production is creating an overabundance of products available on the market.
- ‘Smoke shacks’ located on Aboriginal reserves in Central Canada remain a significant point of sale for the underground market.
- Containers of counterfeit cigarettes originating from China continued to arrive in B.C. During this reporting period, the seizure of counterfeit cigarettes were reported in British Columbia, Ontario, Quebec and New Brunswick.
- Transportation and courier services were used across the country in the movement of contraband tobacco at the street level of distribution.
- Egyptian water pipe tobacco continued to surface in large cities.

INTRODUCTION

This report is designed to present an overview of contraband tobacco activity based on seizures, and operational reports from the RCMP and its partners. This report covers January 1, 2006 to December 31, 2006.

The illicit sales of contraband tobacco contribute to a major underground economy worth billions of dollars. Traditionally seen as a victimless crime, tobacco trafficking is now regarded as a significant source of income for all levels of organized crime who reinvest the enormous profits to support criminal activities.

The illicit tobacco market of today is characterized by the involvement of criminal groups. The Akwesasne Mohawk Reserve, which borders Quebec, Ontario, and New York State, continues to produce a large amount of tobacco products. The illegal manufacturing operations located on the Kahnawake Reserve near Montreal Quebec, has also bolstered production capabilities.

Sea Containers of counterfeit cigarettes originating from China continued to be smuggled into the country. These products, most of which were fraudulently marked for the Ontario and Quebec markets, were intercepted at the Port of Vancouver. During this reporting period, counterfeit cigarettes were found at the street level in British Columbia, Ontario, Quebec and New Brunswick.

Cigarette seizures have increased by 28 % from 2005 to 2006. Unmarked bags, each containing 200 cigarettes and suspected of being manufactured on the Akwesasne and Kahnawake Reserves, were seized throughout Canada. Consumers of these products can save up to \$60 per carton by evading all otherwise applicable taxes.



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COMPONENTS OF THE ILLICIT TOBACCO MARKET — CANADA



International / Cross Border Smuggling¹

Marine:

Container loads of illegal cigarettes are transported via cargo ships to or through Canada. These containers arrived through marine ports in Vancouver, some destined for the Toronto area.

Waterways also offer opportunities for international tobacco smuggling. In Atlantic Canada, tobacco is being smuggled from Pleasant Point, Maine to mainland New Brunswick. This modus operandi has been occurring for decades.

The St. Lawrence River in the Cornwall-Akwesasne area has traditionally been used to smuggle contraband to and from Canada due to its geographic and political complexity. The main commodities being smuggled cross-border from Canada into the U.S. are marijuana, ecstasy and illegal migrants while weapons, cocaine and contraband cigarettes are moved from the U.S. into Canada. This area continues to be exploited by organized crime groups from large centres such as Montreal, Ottawa and Toronto.

Land:

Vehicles used to smuggle tobacco products between the ports of entry include trucks, cars, snowmobiles and all terrain vehicles. Cross-border smuggling via transport trucks appears to be used far less often than in prior decades, possibly due to stringent enforcement at the ports of entry, thus increasing the risk of interception and conveyance seizure.

Mail / Internet / Air:

Courier companies and postal services continue to be the primary modes of distribution in Newfoundland. The originators are most often located in Ontario and Quebec. Organized crime is rarely involved and the sender and recipient are often close acquaintances or family.

The Internet provides the infrastructure for mail order schemes and internet based distribution networks. The Internet also offers alternate methods for purchasing low cost cigarettes by connecting customers with suppliers through a select number of chat rooms, and social networking forums.

Although illegal Internet and mail order sales are not currently a prevalent problem in Canada, they have been identified as problematic in the United States.

¹ International smuggling refers to the movement of contraband from overseas. Cross Border smuggling refers to smuggling from the United States.

Inter-Provincial Diversion

Despite provincial tax disparities between the Central, Atlantic and Western provinces, this type of diversion remains minimal. This is mainly due to the availability of lower cost products from Akwesasne and Kahnawake.

Intra-Provincial Diversion

High volumes of GST-exempt cigarettes sold to First Nations have been diverted to be sold by off-reserve retailers. This scheme has allowed organized crime syndicates as well as profit-driven individuals throughout Canada to defraud the federal government of millions of dollars.

While GST evasion fraud has been reported throughout the country, it appears to be more significant in Ontario where a greater population base fuels a stronger demand.

Counterfeit and Illicit Manufacturing

Counterfeiters aim to deceive customers by offering cheaper products which may pass as their usual brand. However, in many cases the product is unpalatable, leading consumers to file a complaint with the retailer or the manufacturer of the brand they have purchased. An analysis of the RCMP seizures executed throughout 2006 revealed that 22% of products were counterfeit cigarettes that had been illegally imported from China.

Illicit manufacturing continues on the Akwesasne Reserve, located near Cornwall, Ontario. This reserve is jurisdictionally complex as it borders two countries, and is made up of two Canadian provinces, as well as one U.S. state. Criminal activity in the Akwesasne area includes illegal cross border activities as well as the illicit manufacturing of cigarettes on the U.S. side of the reserve. For the most part, cigarettes encountered in this area are packaged in clear unmarked bags (200 cigarettes) then distributed throughout Canada.

Of note, the RCMP Customs and Excise Section in Cornwall-Valleyfield along with its policing partners seized 239,322 cartons in 2006, approximately half of the RCMP's yearly total.

Illicit manufacturing, both domestic and foreign, supplies the majority of contraband in Canada. In addition to the cigarettes sold in clear plastic bags, several unfamiliar brands of fine cut tobacco products were seized mainly in Atlantic Canada where demand for this product remains high. It is suspected that most fine cut tobacco originates from unlawful manufacturing facilities in Central Canada.

In 2006 street prices declined considerably which is suspected to be the result of an overabundance of contraband on the market.

TRENDS IN THE ILLICIT TOBACCO MARKET



Organized Crime

A large proportion of crime groups involved in the illicit tobacco trade operate at the local or intra-provincial level while a smaller number of groups have a scope of operation that spreads inter-provincially, or across the border into the U.S. and internationally into Asia.

Several crime groups are responsible for smuggling large volumes of cigarettes from Akwesasne to locations along the Canadian shore of the St. Lawrence River. Smuggling in this area is sometimes done in plain sight by boat and snowmobile. Information indicates that return trips to the U.S. involve the transportation of other commodities such as proceeds derived from trafficking contraband, drugs and humans.

Cigarettes manufactured on the U.S. side of Akwesasne and counterfeit cigarettes originating from China constitute the main sources of illicit tobacco importation in Canada. Crime groups in Vancouver and Toronto are using marine containers to smuggle counterfeit cigarettes as well as other commodities originating from China. These counterfeit cigarettes primarily enter the country via marine ports in Vancouver and are shipped by train or land transportation to destinations in British Columbia, Ontario, Quebec and New Brunswick.

Associated Criminality

The illicit market of tobacco trafficking also involves other peripheral criminal activities that inflict negative socio-economic effects. Several occurrences of tobacco related crimes have indeed been reported across the country in 2006. For example, there were a series of thefts and robberies of cigarettes in the Atlantic and Northwest Regions as well as tobacco thefts from farmers in Central Canada.

The use of violence is also part of the peripheral crimes conducted along with tobacco thefts. For example, the majority of the tobacco related thefts or robberies in Winnipeg involve the use of weapons. Also, acts of intimidation and violence have been reported to have occurred at Kahnawake smoke shacks.

Regional Overview

Atlantic Region

The number of cartons seized by the RCMP in this region amounted to 49,808. Although this represents only 10% of total Canadian seizures, this area is the second largest centre for contraband in Canada following the Central Region. Investigations have demonstrated that Atlantic Canada encompasses a large client base for Kahnawake and Akwesasne based suppliers.

The vast majority of product is routed through New Brunswick, which enables already-established networks in that province to act as distributors for the rest of the region.

Central Region

Unmarked bags, each containing 200 cigarettes, were the most popular and prevalent product in this region. The largest producers of the clear bags of cigarettes are located on the Kahnawake Reserve and on the U.S. side of Akwesasne.

Buildings and trailers designed mainly for the purpose of cigarette sales on reserves are referred to as “smoke shacks”. These are not usually licensed with the province and they commonly offer contraband products. For persons living in the vicinity of a First Nations reserve, smoke shacks and smoke shops are still the easiest way to acquire contraband tobacco products. While not all retail stores on First Nations reserves sell illegal products, they do offer tax exempt cigarettes which also attract a large number of non-Native consumers.

Quebec:

Kahnawake remains a significant manufacturing/distribution point for contraband tobacco, as it caters to different levels of clients ranging from individuals with no or little criminal background, to runners who service larger tobacco trafficking networks.

Project BLUETTE:

In April 2006, Operation Bluette successfully dismantled a tobacco distribution network that was responsible for the loss of approximately \$35 million in provincial and federal tax revenue. This network was operating in the Ottawa/Gatineau region and transported upwards of 500 cases per week from Akwesasne to warehouses in the National Capital Region. In addition to tobacco trafficking, a cell of this network was also involved in drug trafficking.

Ontario

Products smuggled from the Akwesasne / Cornwall area are distributed throughout the country. Once smuggled into Canada, contraband is often transported by cube vans or larger trucks to other warehouses for street level distribution.

Some tobacco retailers have also been advertising their product on the Internet.

Unmarked or native manufactured contraband cigarettes were reported in Barrie, Georgian Bay, Orillia, Rama and Muskoka Lakes. The cigarettes are being sold from private residences, places of employment and convenience stores.

A large quantity of water-pipe tobacco was seized on 2006-07-31 by the RCMP Toronto East Customs and Excise Section. A total of 28 cases (280 kilograms) of product was seized in the Scarborough area all of which did not bear the required Excise Duty (tax paid indicia) markings.

The RCMP Toronto East Customs and Excise Section were involved in an investigation which dealt with seven marine containers containing counterfeit cigarettes. A total of five

seizures were effected which netted illicit Chinese cigarettes and 88,500 cartons of counterfeit DuMaurier and Players cigarettes

North West Region

The provinces in the North West Region (AB, SK, MB) reported an influx of contraband tobacco products in 2006. The movement of tobacco through this region is conducted by criminal groups with ties to Central Canada. The contraband is obtained from reserves in Quebec and Ontario. The types of products seized reflect this trend as native manufactured cigarettes and fine cut tobacco were predominant in the area.

Courier services and bus lines continue to be exploited for the purpose of delivering contraband, a trend that is now widespread throughout the country.

Fine cut tobacco has also surfaced in this region. On March 5, 2006, police in Moose Jaw, SK stopped a minivan for a seatbelt infraction. A strong odour of raw tobacco emanated from the vehicle and the vehicle appeared lived-in. A search revealed garbage bags containing 143 kg of fine cut tobacco.

The presence of contraband from overseas is still minimal compared with the high prevalence of products coming from reserves in Central Canada.

Pacific Region

British Columbia was the main point of entry for counterfeit cigarettes from China. The Port of Vancouver has seen increased occurrences of this type of commodity.

Personal vehicles are used to transport contraband. On 2006-10-18, 35 cartons of All Natural Native cigarettes were seized from a vehicle that had been stopped for speeding on Vancouver Island. The contraband originated from a First Nations community located in Quebec.

Moving vans have also been used to transport large amounts of tobacco. For example, a search warrant executed at a commercial storage locker in Surrey uncovered 408 kgs of fine cut tobacco with a street value of \$30,000.

Commercial couriers, cargo bus and Canada Post are used to ship contraband tobacco products.

Violence associated to tobacco trafficking is mostly seen through armed store robberies. These robberies typically involved small weapons that were used to coerce the store attendant. In July 2006, one million dollars worth of Players “Light” cigarettes was stolen in Delta, BC. The load had been stored in a semi-trailer located in a commercial warehouse compound.

GLOBAL OVERVIEW OF TOBACCO TRAFFICKING



According to the World Health Organization (WHO), tobacco consumption is the leading preventable cause of death in the world, causing an estimated 4.9 million deaths a year. This has enticed several countries to consider measures that would reduce the rates of uptake and consumption of tobacco. In June of 2003, the WHO Framework Convention on Tobacco Control (FCTC) was developed to implement global and comprehensive policies on tobacco control, including monitoring tobacco trafficking levels. Canada is among the 149 countries that have ratified the treaty thus far.

On the legitimate side of the tobacco market, Europe and Asia are the two main exporters, accounting for 79 % of world exports. In Asia alone, exports have increased by 22% during the past three years. One of the significant trade routes identified was from the Republic of Korea to the Middle East. According the World Customs Organization (WCO), seizure levels have reached their highest level since 2001.² Western Europe remains the most significant area for quantities of contraband seizures by authorities, accounting for half of global seizures. Smuggling, tax evasion, illicit manufacturing, and counterfeiting constitute the usual sources of black market tobacco. The chief source of contraband varies from region to region and its inherent characteristics are a function of geography, financial factors such as cross border tax differentials, and legal / regulatory frameworks which influence the opportunistic aspects of tobacco trafficking.

Over half of cigarettes seized and reported to the WCO were intercepted at seaports, with more than one third of seizures occurring at nine seaports.³ China and the United Arab Emirates were the main departing countries for smuggling routes that resulted in seizures in 2006, both in number of cases and in quantities of contraband cigarettes.

The production of counterfeit tobacco remains high and new brands were detected in the last year. Illicit production was reported to have occurred in the Czech Republic, the United Kingdom, Austria, Slovakia, Greece, the Russian Federation, Poland, Romania, Ukraine, China, and the United Arab Emirates. All regions except for West Africa and South America reported increased interceptions of counterfeit shipments, and most were from China, whose State Tobacco Monopoly Administration announced the seizure of 9.07 billion counterfeit cigarettes in 2006.⁴

2 World Customs Organization - Customs and Tobacco Report 2006.

3 These nine seaports are Hamburg (DE), Valencia (ES), Shenzhen (CN), Gioia Tauro (IT), Barcelona (ES), Vancouver (CA), Rotterdam (NL), Piraeus (GR), Algeciras (ES).

4 World Customs Organization - Customs and Tobacco Report 2006.

CONCLUSIONS / OUTLOOK

All regions in Canada reported increased levels of tobacco trafficking during 2006. Furthermore, these increased levels of tobacco trafficking correspond to reports that clandestine production of tobacco products is gaining momentum in Central Canada.

The RCMP seized a total of 472,268 cartons of cigarettes and 24,673 bags of fine cut tobacco in 2006. This represents an increase of 28% since 2005 in cigarette seizures and a 64% decrease for volumes of fine cut tobacco seized during the last two years. Although a 64% decrease is significant, it only serves to demonstrate that the market for fine cut tobacco is declining rapidly to minimal amounts while the market for cigarettes increases exponentially. In spite of the reduction in fine cut tobacco, when combining seizures of cigarettes with seizures of fine cut tobacco, total tobacco seizures for 2006 greatly exceeded those for 2005. Seizure levels are now 3.5% higher than the historical 1994 levels.

With an accrued illicit production, 2006 street prices dropped considerably. This could indicate that the supply side of the market is nearing saturation, and in which case, producers would have to adjust their levels of production to keep their business viable. In any case, based on strong demand, and on total estimated production capacity, the availability of products is not expected to decrease in 2007.

In line with its mandate, the RCMP continues to aim for the reduction of the threat and impact of organized crime presence in Canada, including those involved in cross-border smuggling operations. The assessment of the problematic areas demonstrates that higher levels of criminality are present in regions where enforcement is less stringent such as between the ports of entry.



The increasing availability of contraband tobacco is a concern, as it has reached a historical high. In 2006, RCMP seizures surpassed the 1994 benchmark when the black market was considered out of control.

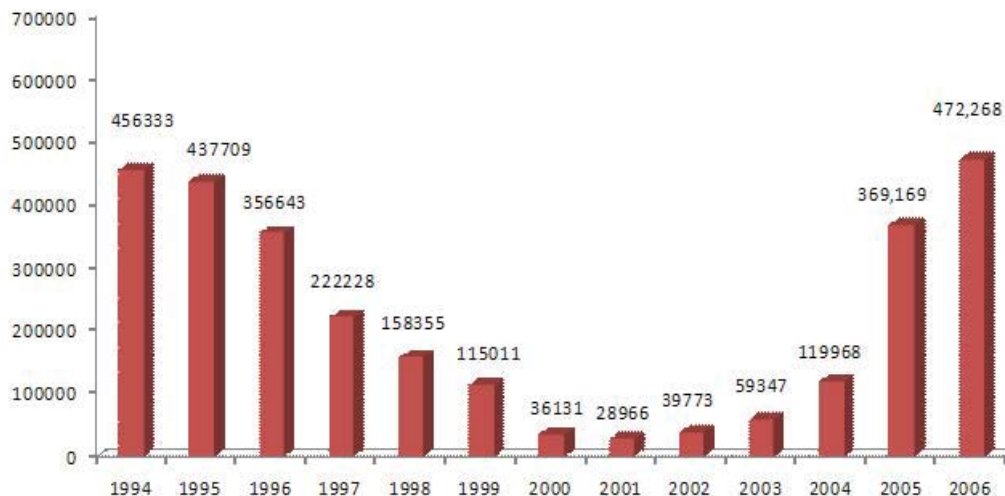


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APPENDICES

APENDIX “A” SEIZURE STATISTICS*

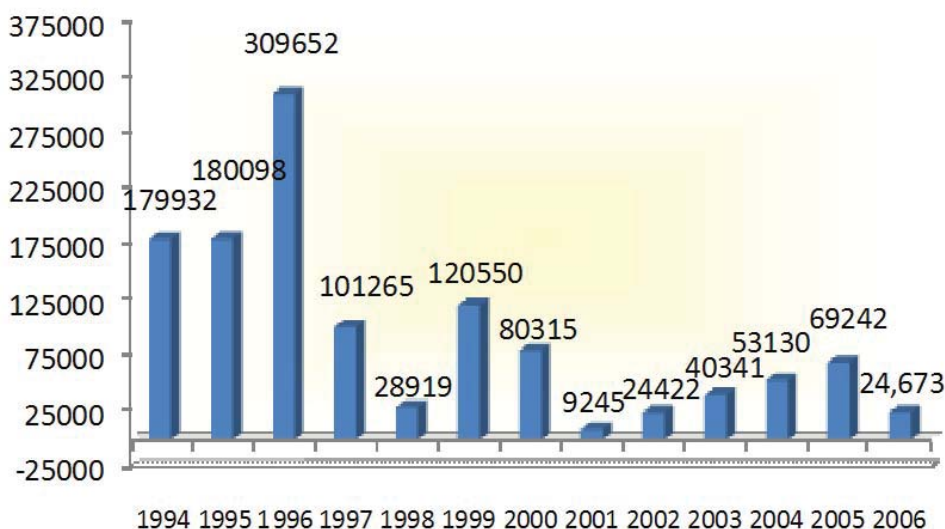
RCMP CIGARETTE SEIZURES



CARTONS

2006: 472,268 CARTONS

RCMP FINE CUT TOBACCO SEIZURES



BAG (200GR)

2006: 24,673 BAGS

* Please note that some of these RCMP seizures were conducted conjointly with partner agencies.