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Introduction

Chairman Scott, it is a pleasure to submit these remarks in support of the proposed "Smuggled Tobacco Prevention Act of 2008." I would like to provide the Committee with some background on tobacco smuggling in the United States and how, I believe, this Act will greatly reduce the illicit trade in tobacco as it relates to the United States. My opinions are my own, and based upon more than 33 years in law enforcement and specifically, more than 20 years experience in enforcing U.S. customs laws, with 14 of those years enforcing and studying matters directly related to cigarette smuggling and transnational organized crime. I will discuss some of the specifics of this proposed legislation and provide some background on the illicit trade in tobacco.

Background

The United States has been a source and transshipment country for contraband cigarettes for approximately 50 years. I would like to quote from the prepared remarks that were submitted to the Senate Appropriations Committee in March 2000, by then U.S. Customs Commissioner Raymond W. Kelly:

International cigarette smuggling has grown to a multi-billion dollar a year illegal enterprise linked to transnational organized crime and international terrorism. Profits from cigarette smuggling rival those of narcotic trafficking. The United States plays an important role as a source and transshipment country. Additionally, large sums of money related to cigarette smuggling flow through U.S. financial institutions.¹

Since March 2000, the illicit trade in all tobacco products has increased dramatically in the United States. The contraband products include those smuggled into the United States, those legally manufactured domestically and diverted to the illicit market, and those illegally manufactured in the United States.

Cigarette Packaging

Please allow me to briefly describe tobacco packaging so everyone can understand the issues:

- Pack = 20 cigarettes (internationally 5, 10, 25 cigarette packs exist).
- Carton = 10 Packs, 200 cigarettes.

- Master Case = 10,000 cigarettes (internationally 12,000 cigarettes).
- 40 Foot Container = 1,000 master cases, 10 million cigarettes.

Sources of Illicit Tobacco

Tobacco is a legal commodity that is traded throughout the world, but price differences between nations and domestically, between states and provinces, have created a demand for contraband tobacco products. These cigarettes fall into several categories:

- Cigarettes purchased in nations, states, or provinces with low tax rates and smuggled into nations, states, or provinces with higher tax rates.
- Counterfeit cigarettes.
- Illicitly manufactured cigarettes.
- Cigarettes fraudulently diverted from Export Warehouses, Customs Bonded Warehouses, Foreign and Free Trade Zones.
- Stolen cigarettes, ranging from store burglaries to thefts of container-sized shipments in foreign, interstate or interprovincial commerce.

Tobacco Smuggling Overview

Several groups of the Italian Mafia, Russian and Asian Organized criminal groups, Colombian narco-traffickers are or have been involved in tobacco smuggling in Europe, Asia, North and Latin America. Non-traditional organized criminal groups operating between the United States and Canada are currently involved in the contraband trade in tobacco, including illicit manufacturing, smuggling, and money laundering.

In addition to producing counterfeit cigarettes, illegally manufacturing other cigarettes, and trafficking in contraband cigarettes, criminal organizations have used cigarettes as a commodity to launder the proceeds of other criminal activity and to facilitate various international trade fraud schemes. In Europe, some of these trade fraud schemes are known as Value Added Tax (VAT) Carousel Fraud.² Cigarettes have been used to launder large cocaine and other drug smuggling proceeds in what is known as the Black Market Peso Exchange.³ Trade Based Money Laundering was described in detail in a Financial Action Task Force report that was published in June 2006.⁴ These organized crime groups operate through corruption and intimidation and are not afraid to use violence to further their business goals.

The terrorist organizations referred to in Mr. Kelly's testimony were the Real Irish Republican Army (IRA), and the Kurdistan Workers Party (PKK). The Real IRA and other factions of the IRA have smuggled cigarettes and other commercial products to fund terrorist activity in Northern Ireland and the United Kingdom for decades. In the

United States, we have seen persons linked to Hezbollah convicted of offenses related to trafficking in contraband cigarettes in schemes to provide material support to terrorism. The PKK was linked to cigarette smuggling into Iraq that benefited the family of Saddam Hussein. The Real IRA, Hezbollah, and the PKK are internationally recognized as terrorist organizations.

Here are some examples of ongoing or long-term smuggling of tobacco products that directly impacted or are currently affecting the United States:

Case Studies - North America

The Saint Regis – Mohawk Reservation or Reserve, also known as the Akwasasne, straddles the international border between the United States and Canada. In 1997, an organized smuggling group with links to Italian and Russian organized crime that operated on the Akwasasne smuggled large volumes of cigarettes and liquor into Canada from the United States in violation of the laws of both countries. The money laundering case was the largest ever in the Northern District of New York and involved criminal transactions that totaled more than \$687 million.⁵ This case resulted in the first guilty plea from a major tobacco manufacturer when Northern Brands International, a subsidiary of RJ Reynolds Company, pled guilty to violating Customs laws and forfeited \$10 million and paid a fine of \$5 million.⁶

The smuggling activity continued along the border between the United States and Canada. The Criminal Intelligence Service Canada (CISC), *2005 Annual Report on Organized Crime in Canada*, was the most recent CISC report to specially address the illicit tobacco trade and the role of organized crime in that trade.⁷ The report made reference to tobacco products manufactured illegally in the United States, packaged in plastic bags, and smuggled to Canada for sale.⁸ The plastic bag packaging is a growing trend worldwide, which makes tracking and tracing cigarettes even more difficult. The 2004 report specifically linked the Hells Angels motorcycle gang and Asian Organized Crime to commodity smuggling conducted by organized crime groups operating along the international border between Canada and the United States.⁹ The 2003 report listed the origins of illicit tobacco products as the United States, South America, Asia and the Middle East.¹⁰

In 2002, a criminal investigation led by U.S. Immigration and Customs Enforcement resulted in criminal charges of several people in Texas, New York, and California. The group was charged with distributing 2,313 master cases of counterfeit cigarettes with a retail value of approximately \$5.4 million.¹¹ The indictment also alleged that 5,616 master cases of cigarettes were shipped by the organization with a total loss of revenue to the federal and state governments of approximately \$9.2 million.¹² The following excerpt from the press release from the U.S. Attorney's Office for the Western District of Texas described the scheme:¹³

The Organization employed different techniques to smuggle and introduce into the commerce of the United States contraband and counterfeit cigarettes. These

included, but were not limited to, the manipulation of the Customs in-bond system. The defendants attempted to achieve this by making false and fraudulent material statements and representations to U.S. Customs authorities by presenting altered and falsified documents and by submitting fraudulent “pedimentos”, Mexican Customs documents.

These pedimentos reflected that the contraband cigarettes had been exported from the United States to Mexico when, in truth, the contraband cigarettes had been smuggled and introduced into the commerce of the United States. The various documents used by the defendants were intended to convince anyone who inspected these documents that taxes and duties were not due and owing to U.S. Customs authorities, and/or the states of Texas, California and New York, on any cigarettes associated with these documents. The Organization modified and adapted its smuggling techniques in direct response to any measurable success by law enforcement in curtailing its illegal activities.

The investigation revealed that the counterfeit cigarettes were shipped in containers on international waters from Asia to the United States. It is known that at least two containers of counterfeit cigarettes arrived at the port of entry in Long Beach, California. To prevent detection by U.S. Customs authorities, the defendants caused the shipments of counterfeit cigarettes to be manifested as other merchandise, for example “toys” and “plastic goods.” When the counterfeit cigarettes arrived at the port of entry, the members of the organization attempted to unload, smuggle and distribute the counterfeit cigarettes in the United States.

Some of the elements in the Doggett bill would have greatly assisted in the investigation and prosecution of this and other cases. The export bonds, wholesaler’s permits, and more uniform record keeping may well have prevented this scheme.

Case Study – Europe

In 1961 the free port in Tangiers, Morocco was closed and the cigarette smuggling operations that operated there for a decade were moved to the former Yugoslavia and Albania.¹⁴ This relocation greatly benefited the Camorra, an Italian organized crime group from the Naples area.¹⁵ When those states failed in the early 1990s, the Camorra and other criminal groups quickly took advantage of the instability in the region and again expanded their criminal enterprises in the region.

In 1999, a report issued by the Italian Anti Mafia Commission, identified Albania as major transshipment point for cigarettes smuggled to Italy and various countries in the Middle East.¹⁶ Reports from multiple sources stated that the Prime Minister of Montenegro at that time, Milo Djukanovic, granted smuggling rights to several people in exchange for substantial bribes. Djukanovic was implicated in cigarette smuggling in testimony in an Italian court by a leading figure in Italian cigarette smuggling with links to the Camorra who claimed that he personally negotiated cigarette smuggling rights

from Montenegro with Djukanovic.¹⁷ Milo Djukanovic was recently re-elected as the Prime Minister of Montenegro.

The Balkans region remains deeply involved in cigarette smuggling and criminal investigations into illicit activities dating back into the 1990s. In June 2007, a story in the *SE Times* reported that Italian prosecutors were about to charge Milo Djukanovic and others for their participation in a criminal enterprise involved cigarette smuggling and money laundering from 1994 to 2002.¹⁸ Also in June 2007, it was reported that Serbia's special organized crime prosecutor announced that they began an investigation of Mira Markovic, Slobadan Milosevic's widow, and her son, Marko Milosevic, for cigarette smuggling between 1996 and 2001 that reportedly earned them tens of millions of Euros.¹⁹

The situation in the Balkans impacted not only Europe, but also the United States. Some of the smuggled cigarettes were manufactured in the United States and proceeds from the illicit activity were laundered in the United States. High level government corruption and failed states are a cause for concern of all nations.

Unique Serial Numbers and Other Marks

Historically, law enforcement has lacked the ability to trace contraband tobacco products. Invoices frequently described container shipments of cigarettes simply as: "American Made," without identifying the brand. The shipments were sold several times while the cigarettes were in transit, the invoices were faxed or otherwise transmitted many times, resulting in critical data being blurred in transmission or possibly altered between transmissions. The cigarette packages and cartons lacked unique serial numbers that were readable by law enforcement authorities. The unique numbers found on master cases were often removed by traffickers to hinder law enforcement efforts to trace the cigarettes. The requirement of the Doggett bill to mark individual packages with unique serial numbers and markings will make it easier to distinguish diverted or stolen cigarettes from those legally introduced into commerce.

The unique serial numbers and high tech stamp described in the Doggett bill will significantly aid law enforcement authorities in the United States and our international partners to track and trace cigarettes that originated in the United States. The State of California and the countries of Brazil, Malaysia, and Turkey have introduced marking regimes similar to those described in the Doggett bill. Canada recently contracted for a comparable system. California has publicly reported a reduction in contraband trafficking and increased revenue collection with a high tech stamping system, which has paid for itself. The loss of revenue to the United States, state and local governments (depending on the state and locality) for one 40 foot container of cigarettes can easily exceed one million dollars.

Export Bonds

For nearly 50 years cigarettes manufactured in the United States have been exported to brokers who introduced these cigarettes into the black market. The lack of enforcement and financial accountability by the exporters fueled this illicit trade. The export bonds required by the Doggett bill would force exporters to exercise more due diligence in ensuring their products are not smuggled back into the United States or into another country.

Wholesale Permits

It is important that all manufacturers, wholesalers, importers, and export warehouse proprietors have an appropriate permit to conduct business related to tobacco products. The permits are important in ensuring due diligence in the supply chain. A permit system would aid law enforcement agencies in their efforts to identify criminal elements in the tobacco trade who might seek a permit in the United States to smuggle tobacco products into, through or from the United States. The information sharing provisions in the Doggett bill would allow the exchange of this data with international regulatory and law enforcement partners, thus enhancing law enforcement efforts directed at transnational organized crime groups.

Control of Manufacturing Equipment

Increasingly sophisticated equipment is being used in illicit cigarette manufacturing in the United States and throughout the world. The equipment is used to produce counterfeit and other tobacco products. The mechanisms to control the equipment utilized in the manufacturing and application of cigarette tax stamps would be an important tool in suppressing both the counterfeiting and illicit manufacturing of tobacco products and will make it more difficult to illicitly manufacture cigarettes. The Doggett bill is not intended to control devices that an individual would use to make cigarettes for their personal use, but rather that equipment, which has commercial applications.

Record Keeping

The Doggett bill does not call for businesses engaged in the tobacco trade to maintain records that they currently do not maintain for federal, state, and local governments. What the bill requires is more specificity in their record keeping. In my experience, if the businesses maintained records; they contained the vague or non-existent references as to country of origin, false or inappropriate harmonized tariff schedule classifications, and incomplete information as to the parties in the transactions. Given the fraud that has historically been associated with the tobacco trade, I do not believe it is not unreasonable for the government to mandate accurate record keeping.

Creation of Right of Action for State Tobacco Administrators for Failure to Report

State tobacco administrators have the primary responsibility for the collection of tobacco taxes and in some instances, state sales taxes. The changes proposed in the Doggett bill would provide a legal remedy for the states to take action in the U.S. District Courts. Given the interstate and international nature of the tobacco trade, this is often the best venue. In addition, the states have been active, and in some cases assumed in leading role in the pursuit of criminal organizations involved in the illicit tobacco trade. The Doggett bill does not delegate any authority to the states, nor does it infringe on tribal sovereignty.

Conclusion

The overview of the tobacco smuggling schemes in North America and the Balkans described in these remarks illustrated three of many long-term tobacco smuggling scenarios that involved or involve organized criminal groups, allegations of high level corruption of national governments in the Balkans, issues that directly affect or affected the security and the commerce of the United States and our closest friends and allies. The criminal activity associated with tobacco smuggling is not benign. The criminal and terrorists groups involved in this activity are doing so for personal enrichment, funding or laundering the proceeds of other criminal activities, or to finance terrorist acts.

Generally speaking, law enforcement in the United States, several states and many other nations has been inadequately funded, trained, networked with domestic and international partners, conflicted with ever-changing priorities, or lack the legal framework to adequately address the illicit tobacco trade. Many offenses associated with the illicit tobacco trade lack severe penalties associated with drug or arms trafficking. Enforcement in the United States and other nations did not receive high priority because the crime was looked upon as “the other guy’s problem” or the trans-shipment locations were profiting from foreign or free trade zone activity, freight handling, and associated financial transactions. Transnational organized crime, in any form is not “the other guy’s problem,” it is the responsibility of all nations.

The “Smuggled Tobacco Prevention Act of 2008” will eliminate many of these shortcomings in the United States. Thank you for opportunity to appear before the Committee on this important matter.

¹ U.S. Congress, Senate, 2001, Committee on Appropriations, Subcommittee on Treasury and General Government, 106th Congress, 2nd Session, 30 March 2000, Internet, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=2001_sapp_tre_1&docid=f:62810.wais, accessed: 17 March 2008.

² Europa, Press Room, Press Releases, EU coherent strategy against fiscal fraud – Frequently Asked Questions Brussels, 31 May 2006, Internet, available from: <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/221>, accessed 28 April 2008.

³ FinCEN, Advisory Issue 12, June 1999, Internet, available from: <http://www.fincen.gov/advis12.html>, accessed: 28 April 2008.

⁴ Financial Action Task Force on Money Laundering, *TRADE BASED MONEY LAUNDERING*, 23 June 2006, Internet, <http://www.fatf-gafi.org/dataoec/60/25/37038272.pdf>, accessed 12 November 2007.

⁵ U.S. Department of Justice, *Distinguished Service Commemorative Presented to John Colledge United States Customs Service, re: United States v. Miller et. al.*, Syracuse, New York, 30 November 2000.

⁶ Ibid.

⁷ The Criminal Intelligence Service Canada, *2005 Annual Report on Organized Crime in Canada*, Ottawa, 20-21, available from: http://www.cisc.gc.ca/annual_reports/annual_report2005/document/annual_report_2005_e.pdf, Internet, accessed: 15 January 2008.

⁸ Ibid.

⁹ The Criminal Intelligence Service Canada, *2004 Annual Report on Organized Crime in Canada*, Ottawa, 21, available from: http://www.cisc.gc.ca/annual_reports/annual_report2004/document/cisc_2004_annual_report.pdf, Internet, accessed: 15 January 2008.

¹⁰ The Criminal Intelligence Service Canada, *2003 Annual Report on Organized Crime in Canada*, Ottawa, 19, available from: http://www.cisc.gc.ca/annual_reports/annual_report2003/Document/cisc_annual_report_2003.pdf, accessed: 15 January 2008.

¹¹ U.S. Department of Justice, U.S. Attorney's Office, Western District of Texas, Press Release, 11 April 2005, Internet, available from: www.usdoj.gov/usao/txw/press_releases/2005/Abraham.sen.pdf, accessed: 28 April 2008.

¹² Ibid.

¹³ Ibid.

¹⁴ Behan, Tom. *The Camorra*, 43-44, London: Routledge, 1996.

¹⁵ Ibid.

¹⁶ Center for Public Integrity. *Tobacco Companies Linked to Criminal Organizations in Cigarette Smuggling, Italy*. available from: <http://www.publicintegrity.org/report.aspx?aid=354>; Internet; accessed 14 January 2008.

¹⁷ Ibid.

¹⁸ SE Times, *Italian prosecutors to charge former Montenegrin officials with cigarette smuggling*, 24 June 2007, Internet, http://www.balkantimes.com/ocoon/setimes/xhtml/en_GB/features/setimes/newsbriefs/2007/06/24/nb-04, accessed 10 January 2008.

¹⁹ Reuters, *Milosevic widow, son in cigarette smuggling probe*, 11 June 2007, Internet, <http://www.reuters.com/article/worldNews/idUSL1181733220070611>, accessed 10 January 2008.