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Imperial Tobacco Limited



June 3, 1993

U.H.
REC'D - JUN 1993
Ansd _____

R. Don Brown
Chairman, President and
Chief Executive Officer

Mr. Ulrich Herzer
B.A.T. Industries
Windsor House
50 Victoria Street
London SW1H 0LN
England

*Ulrich Herzer
is preparing
a letter for me*

Dear Ulrich,

Let me express my appreciation for your taking time from your busy schedule to visit with us in Montreal. We enjoyed having you share our views of the Canadian industry's issues and Imperial's plans for continued growth. Further, we were all very appreciative of your openness and frankness regarding world tobacco and B.A.T.

As we discussed, I am writing in response to your letter of April 28, 1993 regarding our relationship with B.A.T. through our outstanding contractual relationship with Peter Jackson (Overseas) Ltd. Allow me to address the issues as outlined in your letter.

1. Temporary Royalty Rate Reduction:

The reduction of the Royalty rate from 5% to 2% for 1991 and 1992 was indeed intended to assist us with our increased marketing investment on du Maurier in the U.S. market. Roger is putting together the details regarding that investment, both in field costs to expand distribution and increase exposure, and advertising costs. The Royalty rate for 1993 has returned to 5%.

However, Federal tax increases here have created a difficult situation for us, and we ask your consideration of the following. As you are aware, smuggled cigarettes (due to exorbitant tax levels) represent nearly 30% of total sales in Canada, and the level is growing. Although we agreed to support the Federal government's effort to reduce smuggling by limiting our exports to the U.S.A., our competitors did not. Subsequently, we have decided to remove the limits on our exports to regain our share of Canadian smokers. To do otherwise would place the long-term welfare of our trademarks in the home market at great risk. Until the smuggling issue is resolved, an increasing volume of our domestic sales in Canada will be exported, then smuggled back for sale here. In the process, that (domestic) volume attracts Royalty.

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The intent of our agreement is to pay Royalty to P.J. (Overseas) on du Maurier cigarettes sold outside of Canada. You can appreciate that being in a situation of paying Royalty on volume actually sold in Canada, where I.T.L. is the trademark owner, not only impacts on earnings, but also renders us less competitive.

We can fairly accurately estimate those volumes sold outside of Canada and those returning from the total. We would ask you to consider an agreement whereby we would not pay Royalty on the volume actually sold in Canada or at worst at a considerably reduced Royalty rate.

2. Extension of the Licence to Mexico:

Upon agreement, we would spend considerable effort to improve our marketing and distribution in Mexico. While the result may be small at first, we feel such activity would be mutually beneficial, in that at least our product would be available to Canadian visitors (it is a popular vacation destination) who smoke our brands at home, and at the same time, protecting B.A.T.'s trademark ownership. For those reasons, we also suggest Player's be included as well.

We agree such an agreement should allow the removal of that country from the agreement, however, we feel a 12-month notice would be so short, it may restrict sufficient investment. We feel a longer term should be considered, with other ways of protecting both our interests built in.

3. Package design and trademark rights:

As I explained to you, we registered all our Canadian pack designs in the U.S. and as many trademarks as we could, for two reasons. In the case of Player's, we did so when we were considering our U.S. contract with Philip Morris, for obvious reasons. More importantly, we did so to protect us from "knock-off" brands made in the U.S. to be smuggled into Canada. (Native Indians already sell Canadian-type products, made in the U.S., names such as: "D.K.'s", a knock-off of du Maurier Kings and "Putter's", a knock-off of Player's). We are considering legal action in these cases. In fact, we have already successfully stopped the sale of a "Sailor's" brand that used the Player's pack design.

Du Maurier?
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As the interests of both B.A.T. and I.T.L. are fully protected by the current arrangement, we can see no reason to change — certainly not until we are secure from other threats due to smuggling.

I trust you will give consideration to our views regarding the issues raised in your letter and find them acceptable. We look forward to re-instating our contract as soon as possible. ?

Thanks for the response regarding the dates for the September T.S.G. meeting. I certainly understand. I will see what I can do to attend although it is a difficult week for us.

Sincerely,



c.c. B. Levin
R. Ackman

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BAT INDUSTRIES

Windsor House 50 Victoria Street London SW1H 0NL Telephone 071-222 7979 Fax 071-222 0122

John Herter
Director
Legal

SPC08/TF17/JMH

10th June 1993

R Don Brown Esq
Imperial Tobacco Limited
3810 St Antoine Street West
Montreal
Quebec H4C 1B5

Dear Don,

Thank you for your letter of June 3rd on which principally with respect to Peter Jackson (Overseas) Limited on which I have the following comments:

1. Temporary Royalty Rate Reduction.

We agree with your suggestion of maintaining the 5% royalty rate on all "genuine" exports of Du Maurier to the US market. Having regard to the obvious uncertainty surrounding the correctness of the figures for products smuggled back into Canada, we suggest that there should be a royalty rate of 2% on those other volumes. No doubt you will let me know if you feel that the accuracy around the estimation of the "genuine" exports to the US is such that a lower royalty even than 2% would be appropriate.

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2. Extension of the Licence to Mexico

First let me agree that we have no objection to including Players in the licence. However, in principle, we would prefer to retain a 12 month notice period.

YES WE DO!

LA MODERNA

Clearly if the licence continues, as we expect, for many years then any question of a failure to recover adequately your investment costs will not be relevant. However, I can see that such a concern might arise were the licence to be terminated (other than for cause) in its earlier stages.

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I didn't see this before it was sent.
What brands involved?

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With that point in mind, while I would not wish to change the drafting of the agreement in any way, if we were to terminate the agreement for our convenience during the first four or five years, say, we would certainly discuss with you appropriate compensation for your development of that market if you had not at that time obtained an adequate return for the quality and extent of your efforts in that market. ✓

3. Package Design and Trademark Rights

We certainly feel that in the best interest of maintaining a strong trademark, all the rights relating to trademarks and the like should be owned by the same company. Obviously in 1982 nobody considered the possibility that Imperial might want to acquire some subsidiary rights and, had the matter been raised then, there is no doubt to my mind that the proper answer would have been for Brown & Williamson to file for the ownership of the registered design rights and to licence the whole package (at no further royalty rate) to Imperial. With that in mind, I certainly consider that to be the best way forward since the division of rights between Brown & Williamson and Imperial Tobacco is in nobody's interest. ✓

I understand that making these simple changes would not in any way affect your ability to take the necessary actions to defend your market from infringers, counterfeiters and smugglers. We very much wish to support your efforts in that regard. ✓

Yours sincerely,

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