

FACTSHEET

ABOUT THE AGREEMENT BETWEEN THE EU AND PHILIP MORRIS INTERNATIONAL

In 2004, the European Commission and ten EU Member States reached a twelve year agreement with Philip Morris International (PMI) to tackle the problem of illicit trade in tobacco products. Since then, all EU Member States have become parties to the agreement. The Agreement was followed by further Agreements with Japan Tobacco International (JTI Agreement) in December 2007, British American Tobacco (BAT Agreement) in July 2010 and Imperial Tobacco (ITL Agreement), in September 2010.

This factsheet identifies key facts and questions arising out of the current negotiations to renew the 2004 PMI Agreement. Meanwhile, PMI is suing the EU over the 2014 Tobacco Products Directive, including its provisions on security and the tracking & tracing of illicit tobacco products.

But first... A bit of history of the EU Agreements with the world's four largest tobacco companies:

In 2000, the European Commission (EC) and ten EU Member States (MS) launched a lawsuit against three global tobacco companies: Philip Morris International; R.J. Reynolds; and Japan Tobacco International; accusing the companies of *'an ongoing global scheme to smuggle cigarettes, launder the proceeds of narcotics trafficking, obstruct government oversight of the tobacco industry, fix prices, bribe foreign public officials, and conduct illegal trade with terrorist groups and state sponsors of terrorism'*.¹ Following legal proceedings, the lawsuit was concluded with PMI and JTI settling their cases in 2004 and 2007 respectively, with payments totalling over \$1.6 billion from the companies to the European Commission and the Member States, in recognition of tax losses from illicit trade.² PMI settled its lawsuit through a legally binding Agreement. The Agreement's classified negotiations started in 2001, shortly after the legal proceedings against PMI began.³

WHAT ARE THE KEY ELEMENTS OF THE PMI AGREEMENT?

Under its Agreement, PMI is required to make annual payments of \$1.25 billion for 12 years and to control the future smuggling of its cigarettes through a range of measures. These include:^{4 5}

- Controlling the distribution system and the contractors which PMI supplies with cigarettes.
- Tracking and tracing measures, which should allow authorities to independently trace smuggled cigarettes back to the contractor who purchased them from PMI.
- Seizure payments equivalent to the evaded taxes, to be made at once in the event of any seizure of genuine PMI products above the threshold of 50,000 cigarettes.
- Limits on sales to match legitimate demand in the stated destination market, to prevent oversupplying and consequent diversion of tobacco products into illicit channels.

WHAT ARE THE KEY QUESTIONS RELATED TO THE PMI AGREEMENT?

Is the money paid to the EU and the MS used to combat illicit trade?



The EU budget receives 9.7% of the fixed annual payments made by the four tobacco companies (including PMI) with which the EU has Agreements. The remaining 90.3% goes to individual Member State treasuries. The payments received by the EC and the MS are not earmarked for any particular purpose and very few MS share any information about the payments.⁶ Therefore, it is unclear how the money generated by the Agreement is being used.⁷

Is the PMI Agreement fit for purpose?



Ten years ago, when the Agreement was first negotiated, the EU mostly recorded large seizures of illicit tobacco. However, the EU illicit market has since changed and current illicit cigarette seizures consist of less than 7,500 cigarettes per seizure on average (far less than the 50,000 cigarettes threshold for seizure payments). Therefore, seizure payments for illicit cigarettes have proved surprisingly small so far. For example, only 0.5% of the 3.8 billion seized cigarettes in the EU in 2012 were found to be genuine.⁸

Do customs officers determine whether seizures are genuine of counterfeit products?



Customs officials rely on the industry to determine whether cigarettes are genuine (eligible for the payments) or counterfeit (not eligible for seizure-based payments).⁹ According to all the Agreements, the relevant manufacturer, in this instance PMI, is entitled to examine the seized cigarettes, and send a report on their authenticity to OLAF. If the manufacturer concludes that the cigarettes are counterfeit, the report must contain documentation and examination results demonstrating that conclusion.

Is there an independent assessment of whether products are genuine of counterfeit?



The Agreement provides that this determination is made by the manufacturer. However, if OLAF or any participating Member State disagrees, the matter should be referred to an independent laboratory identified in the Agreement.¹⁰ Since the first Agreement came into effect until 31 October 2013, seized cigarettes have never been analysed by the independent laboratory and all determination has instead been based on the assessments of the tobacco industry.¹¹

How do PMI and the other major tobacco companies decide whether seizures are genuine or counterfeit?



Tobacco manufacturers rely on a system called Codentify® which was developed internally by PMI and licensed without payment for use by the other tobacco companies (JTI, BAT, ITL).¹² As part of the Agreement requirement to develop a mechanism for restricting smuggling, Codentify® digitally generates a 12 number algorithm and applies it to a cigarette pack. It is supposed to facilitate easier tracking of cigarette packs through the supply chain by authenticating them with an individual scannable code which contains, among other information, the date, origin, tax level and destination of the product.¹³

Is the PMI Agreement effective in helping MS to regain lost revenues?



The intention behind seizure-based payments in the PMI Agreement was, on the one hand, to deter PMI from further involvement in the illicit cigarette trade of its own products by punishing the company each time there was a large seizure of its cigarettes and, on the other hand, to find a way for EU Member States to recover lost taxes. However, the determination of whether seized cigarettes are genuine or counterfeit is essentially made by the company. It is perhaps not surprising therefore that the tobacco industry has to date found the majority of seized cigarettes to be counterfeit, resulting in low payments for seized cigarettes, and meaning that MS governments have not been compensated for lost revenue. Out of the total number of seized cigarettes, 3.2 billion (78%) were claimed to be counterfeit cigarettes in the period 2004-2013.¹⁴

Does PMI support the traceability measures established in EU legislation?



In 2014, PMI (joined by BAT, ITL and other tobacco companies) challenged the EU's Tobacco Products Directive (2014/40/EU) before the Court of Justice of the European Union (CJEU).¹⁵ The complaint seeks the annulment of the entire Directive, including Article 15 which requires an EU-wide tracking and tracing system for the legal supply chain and visible and invisible security features. The judicial review could take up to three years.¹⁶ This means that OLAF is considering the renewal of a legal agreement with a company which is attacking EU law while offering PMI the possibility to continue to control the tracking and tracing system based on its own technology (Codentify®).

Has OLAF done an impact assessment (IA) on the PMI Agreement?



The Juncker Commission has stated that *“to ensure that EU action is effective, the Commission will assess the impact of policies, legislation, trade agreements and other measures at every stage - from planning to implementation and review”*¹⁷. But the Commission has also stated that the Agreement is effective, without having carried out an impact assessment. According to official statements, the Commission services and Member States have already had an *“exploratory meeting”* with PMI and discussions concerning a renewal of the Agreement are ongoing.¹⁸

Are ongoing discussions about renewing the PMI Agreement respecting the Framework Convention on Tobacco Control (FCTC)?



The FCTC is the first international health treaty, which was developed in response to the globalisation of the tobacco epidemic. The EU and all its MS have ratified the treaty and therefore have legal obligations to implement its articles. The guidelines for FCTC Article 5.3, which were developed through an intergovernmental process and unanimously adopted by the Conference of the Parties (COP), require Parties to be accountable and transparent in all their dealings with the tobacco industry. The guidelines also specify that Parties should interact with the tobacco industry *'only when and to the extent strictly necessary to enable them to effectively regulate the tobacco industry and tobacco products'*.¹⁹ It is not clear if the interaction between the Commission (including OLAF) and PMI is *"strictly necessary"* because the content of these meetings have been kept secret. In the past 10 years, access to documents requests show that OLAF has had numerous meetings with PMI and the other three main tobacco manufacturers, but no detailed information regarding those meetings has been released.^{20 21} The partnership between the EU and PMI may contravene Article FCTC 5.3, which states that parties should not accept, support or endorse 'partnerships' with the tobacco industry in any initiative linked to setting or implementing public health policies.²²

Are there other mechanisms to control the illicit trade of tobacco control in the EU?



In addition to Article 15 of the Tobacco Products Directive, mentioned above, the EU has other available measures to combat the illicit tobacco trade. The Protocol to Eliminate Illicit Trade in Tobacco Products (ITP), negotiated under the World Health Organisation's Framework Convention on Tobacco Control, was adopted on 12 November 2012 at the fifth session of the Conference of the Parties and is currently open for ratification, acceptance, approval or accession by the Parties to the WHO FCTC. The EU signed the Protocol on 20 December 2013. On the 4th May 2015 the European Commission made an announcement stating that the EU should ratify the Protocol, urging the Council to adopt this decision with the consent of the European Parliament.²³ The ITP provides tools for preventing and counteracting the illicit tobacco trade through international cooperation and national measures to control the supply chain of tobacco products.²⁴ Despite tobacco industry claims, and based on available information used by PMI and other major tobacco manufacturers to track their products, Codentify[®], has not been shown to meet the requirements of Article 8.2 ITP, that the tracking and tracing system has to be *"controlled by the Party"*.²⁵ The ITP should provide a global system, independent of the tobacco industry, and therefore should be a more effective solution to the illicit trade problem than the current PMI Agreement and other Agreements with the major tobacco multinationals. SPF strongly urges the EU and all EU Member States to ratify or accede to the Protocol, and to become Parties, as has already been done by Austria, France and Spain.

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