

## Exclusive: Philip Morris paid for India manufacturing despite ban on foreign investment – documents

[Aditya Kalra](#)

9 Min Read

NEW DELHI (Reuters) - Philip Morris International Inc has for years paid manufacturing costs to its Indian partner to make its Marlboro cigarettes, circumventing a nine-year-old government ban on foreign direct investment in the industry, internal company documents reviewed by Reuters showed.

The Indian government in 2010 prohibited foreign direct investment (FDI) in cigarette manufacturing, saying the measure would enhance its efforts to curb smoking.

Restricting foreign investment leaves cigarette manufacturing largely in the hands of domestic players, and is supposed to prevent any foreign-funded expansion. A year after the government's decision, Japan Tobacco exited India, citing an "unsustainable business model".

Philip Morris, though, stayed in India and used another route, according to company documents dated between May 2009 and January 2018. A year before the FDI ban, it struck an exclusive deal with India's Godfrey Phillips to locally manufacture the world-famous Marlboro cigarettes.

Ever since then, Godfrey has publicly acted as a contract manufacturer of Marlboro cigarettes in India, while Philip Morris's majority-owned local unit acts as a wholesale trading company and promotes the brand.

But dozens of internal company documents - including invoice bills, legal agreements, e-mails and accounting statements - show Philip Morris has for years indirectly paid costs related to Marlboro cigarette manufacturing in India.

Some former Indian enforcement officials said the practice of indirectly paying for manufacturing-related costs violates regulatory rules. However, some lawyers such as Pratibha Jain, a partner at Nishith Desai Associates, disagreed, pointing out that the federal rules did not explicitly prohibit such payments.

Philip Morris' director for corporate affairs in India, R. Venkatesh, in an e-mail, said the company's "business arrangements with Godfrey Phillips India comply with Indian Foreign Direct Investment Rules". He did not elaborate.

The company did not answer detailed questions for this article and did not offer any executive for interview, despite repeated requests from Reuters over the past month.

### MANUFACTURING CHARGES

Six invoices issued by Godfrey showed billing of 45.5 million Indian rupees (\$644,200) to Philip Morris between December 2013 and January 2018 for manufacturing-related charges. Philip Morris paid for items

ranging from large cigarette-making machines to costs of smaller equipment such as barcode scanners and printers deployed in Godfrey's factories.

One invoice from January 2018 sent from Godfrey to Philip Morris showed the Indian company had spent 206 million rupees (\$3 million) on capital expenditure for Marlboro-related manufacturing activities since 2009, though it was not clear how much of that was paid by Philip Morris.

Godfrey Phillips' head of corporate affairs, Harmanjit Singh, said in an email that all the commercial arrangements "are in complete compliance with the extant regulations governing the Indian Foreign Direct Investment and other applicable laws, and, incidentally, all transactions are in Indian Rupees. Also, it is our considered view that no illegality can be impugned to these commercial transactions between the parties."

Philip Morris' local unit and Godfrey arranged a mechanism for such transfer of funds around the time they struck the 2009 deal. A 94-page "procurement agreement" signed between the two sides that year, which is not public but has been reviewed by Reuters, said that Godfrey may acquire new machinery for solely manufacturing Marlboro cigarettes and will then "invoice PM (Philip Morris) India" for charges in a phased manner. Philip Morris "shall pay such invoice by bank transfer", the agreement said.

The agreement specified Philip Morris would make periodic payments calculated according to the normal depreciation charge of the machinery, plus 10 percent per annum on its net book value.

Other than those regular payments, Philip Morris also signed off on one-time expenses and refurbishment costs incurred by Godfrey on at least two occasions in 2013 and 2014, according to internal e-mails and accounting records. It then accounted those transactions internally under a heading "Packaging - Research", accounting records showed.

## **"THEY ARE CAMOUFLAGING"**

Three former officials and one former head of India's main financial crime-fighting agency, the Enforcement Directorate, reviewed the Philip Morris documents for Reuters and said the dealings should be investigated for circumventing India's foreign investment rules.

One of the former officials said that paying for machines to manufacture cigarettes essentially resulted in the promotion of cigarettes, and the government's intent of banning foreign direct investment in 2010 was to deter that.

Bhure Lal, a former head of India's Enforcement Directorate, said the companies "should be investigated ... they are camouflaging".

The current chief of India's Enforcement Directorate, Sanjay Kumar Mishra, did not respond to a request for comment.

If the Enforcement Directorate investigates a company and finds it to be in violation of the rules, Indian law allows it to impose a penalty of up to three times the amount contravened.

Jain of Nishith Desai Associates, which also advises global companies on foreign investment rules and reviewed the Philip Morris documents for Reuters, said the company was able to circumvent the FDI prohibition in cigarette manufacturing by paying for the machines through invoices. That's because the Indian regulations only restrict direct foreign investments into a company and were silent on such indirect payments for machines, she said.

"The company can argue in its defense that it is only funding the equipment purchases and not investing directly in an Indian cigarette manufacturing company, and they would be technically correct," Jain told Reuters.

## INDIA CIGARETTE MARKET

The Indian journey of Philip Morris, which is one of the world's largest international tobacco companies, began in the late 1960s when it acquired a majority stake in the London-based parent of Godfrey Phillips. It gradually reduced its stake in Godfrey over the years, in part due to regulatory changes, and currently holds a 25 percent equity stake.

Though India banned foreign investment in cigarette manufacturing in 2010, it still allowed tobacco companies to invest through technology collaboration and licensing agreements. Investments could also be made by forming a trading company.

Ahead of the 2010 ban, Philip Morris formed a new wholesale trading company with Godfrey. The New Delhi-headquartered local unit, named IPM India Wholesale Trading Pvt. Ltd, is 50.1 percent owned by the global tobacco giant, with the rest owned by Godfrey and an investment firm.

Among the payments outlined in the documents, Godfrey in January 2018 sent an invoice to Philip Morris's local unit for 10.2 million rupees (\$144,500), billing for charges for the preceding six-month period, an invoice showed. In August 2017, Godfrey sent an invoice for manufacturing-related charges of 9.5 million rupees (\$134,600).

The documents also showed that Philip Morris at times would discuss with Godfrey which type of equipment should be used for Marlboro manufacturing, and then sign off on related payments.

In July 2016, the head of Philip Morris's India supply chain operations, Nilay Mehta, asked a Godfrey Phillip executive in an e-mail to raise a purchase order for an embossing roller, a type of equipment used in cigarette manufacturing.

Given the equipment had to be used only for Marlboro manufacturing, "IPM will be picking the cost for this", Mehta said in an email to a Godfrey executive on July 26, 2016.

Mehta did not respond to an e-mail from Reuters.

India has 106 million smokers, second only to China, and a young demographic makes it an attractive market for tobacco companies.

Philip Morris is a small player in India's estimated \$12 billion cigarette market but has seen its market share rise steadily in recent years. That was aided by its marketing activities, such as advertising at roadside kiosks and free distribution of cigarettes at parties. Both tactics were described as illegal by health officials in a Reuters investigation published in 2017. ([reut.rs/2uy9vOr](https://reut.rs/2uy9vOr))