NATIONAL TOBACCO®

Ron Tully
V. P. New Projects & Initiatives

VIA ELECTRONIC SUBMISSION

Honorable John Lewis, Chairman
Subcommittee on Oversight, Committee on Ways and Means
United States House of Representatives
Washington DC

June 10, 2010

Re: Hearing on TTB Report on Tobacco Smuggling

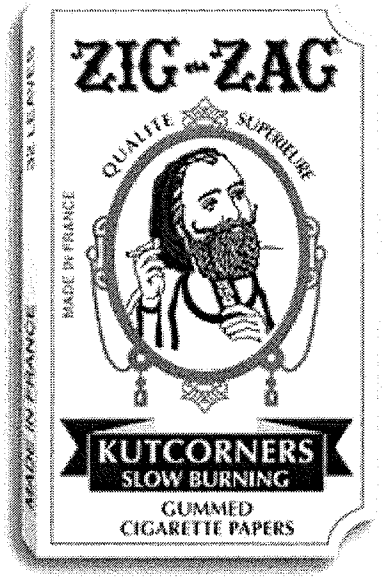
Dear Mr. Chairman:

We are submitting this letter on behalf of National Tobacco Company LP ("NTC"), 3029 West Muhammad Ali Blvd, Louisville, KY 40212, in response to the Committee's invitation to comment upon its May 27, 2010, hearing related to the *Department of the Treasury Report to Congress on Federal Tobacco Receipts Lost Due to Illicit Trade and Recommendations for Increased Enforcement* (February 4, 2010).

NTC is a licensed importer, manufacturer and distributor of tobacco products. NTC imports *ZIG-ZAG*® cigarette papers and tubes, *ZIG-ZAG*® cigars and *ZIG-ZAG*® cigar wraps. In the United States, NTC manufactures *ZIG-ZAG*® cigarettes, *ZIG-ZAG*® and *Stoker's*® brand roll-your-own cigarette tobacco, *ZIG-ZAG*® roll-your-own cigar tobacco, *Red Cap*™ brand traditional pipe tobacco, and smokeless tobacco products sold under the *Beech-Nut*®, *Durango*®, *Trophy*®, and *Stoker's*® brands.

The *ZIG-ZAG*® brand has a long history. In the mid-19th Century, during the battle of Sevastopol, a French soldier (also known as a "Zouave") had his clay pipe broken by a bullet. Necessity being the mother of invention, the Zouave began rolling his tobacco in a piece of paper torn from a bag of gunpowder.

In 1894, the French Braunstein Brothers perfected the process of interleaving cigarette papers in a zig-zag (interleaved) manner and introduced a cigarette paper booklet under the name *ZIG-ZAG*®. In 1900, *ZIG-ZAG*® gained international recognition when it was awarded a gold medal at the Universal Exposition in Paris. For over 100 years the image of Le Zouave (also known as "the Smoking Man") has been a universally recognized symbol for *ZIG-ZAG*® tobacco products.



ZIG-ZAG® cigarette papers have been available for sale in the United States since the 1930s. The rights to use the brand in the United States and Canada were originally held by the US Smokeless Tobacco Company until they were transferred to North Atlantic Trading Company in the early 1990s, and then to NTC's sister company, North Atlantic Operating

Company, Inc ('NAOC') Company in 1998. Rights to use the *ZIG-ZAG*® brand outside the United States and Canada are substantially held by Republic Technologies a subsidiary of Republic Tobacco Group.

Because *ZIG-ZAG*® is such a long-standing and highly regarded tobacco brand, *ZIG-ZAG*® products are frequent targets for counterfeiters and gray marketeers. NAOC's experience in enforcing its rights to the *ZIG-ZAG*® brand illustrates how difficult it can be for a licensed importer or manufacturer such as NTC to stop tobacco smuggling and tobacco product counterfeiting.

1. The United States should enact legislation prohibiting the importation of gray market tobacco products.

In the early 2000's, NAOC was engaged in a long-running trademark/copyright enforcement battle with the Makki family of Dearborn, Michigan. The judgments and injunctions obtained by NAOC through the courts did little to deter the Makkis, who resumed their illegal activities as soon as they left the courthouse. In 2001, the United States District Court for the Northern District of Texas held Adham Makki, Tarek Makki and Joseph "Jihad" Makki in contempt for violating a prior order enjoining them from selling counterfeit *ZIG-ZAG*® cigarette papers, violations which caused more than $5 million in damages to the plaintiffs.

Only when NTC/NAOC invited the Federal Government's Joint Terrorism Task Force to launch an investigation after the 9/11 terrorist attacks, did the extent of the Makki family activities and criminal relationships become fully known. The Makkis were engaged in a vast conspiracy to manufacture, distribute and sell counterfeit *ZIG-ZAG*® cigarette papers. A 2006 federal indictment alleged that Imad Hammoud and his partner Hassan Makki, along with numerous other individuals ran a multi-million dollar contraband tobacco products trafficking organization. The illegal enterprise operated internationally from Lebanon, Canada, China,

Brazil and Paraguay, and domestically from Dearborn, Michigan, throughout the United States. The proceeds of the conspiracy were reportedly used to support the activities of a foreign terrorist organization, *i.e.*, Hezbollah.

In another instance, Republic Technologies' sold *ZIG-ZAG*® products to the Al Hallak Trading Company, it's authorized Syrian distributor. Al Hallak in turn sold and diverted these Syrian Zig-Zag products to Abdulkader Adnan Adie in California. Adie later pled guilty to taking the Syrian cigarette paper booklets out of their Syrian packaging and repackaging them in counterfeit cartons made to look like the legitimate packaging cartons used by NAOC. The counterfeit products were sold in the United States, likely evading appropriate excise and state sales taxes.

In a third incident, Wajdi Abdulaziz Beydoun, a Lebanese national living in Michigan, pled guilty to conspiracy to traffic in counterfeit goods and trafficking in counterfeit goods. Beydoun conspired with others to import cigarette papers falsely trademarked as "Zig-Zags" for resale in the United States. The conspirators purchased low-quality papers abroad and sent the papers to Mexico. They had counterfeit NAOC Zig-Zag® booklet covers and packaging cartons for high quality *ZIG-ZAG*® papers printed in the United States and sent to Mexico, where inmates in a women's prison repackaged the cheap papers into the counterfeit packages, creating a total of over one million counterfeit booklets. Mexican officials retained fifteen percent of the booklets as payment for the labor, the remainder being smuggled to Beydoun in the United States for sale in Michigan and Louisiana.

A common thread running through many of these schemes is that the counterfeit and/or smuggled tobacco products entered the stream of commerce as legitimate goods manufactured for sale outside the United States by Republic Technologies. The foreign products were then

diverted to the United States and passed through United States customs as gray market goods. Under current law, federal authorities will not interfere with such shipments even though the imported products clearly violate United States copyrights and trademarks, and, in the case of tobacco products, are very likely to be diverted into the underground economy and distributed without the payment of lawful excise taxes. Such gray market tobacco sales fuel organized crime, support funding of international terrorism and thwart the public health initiatives of state and federal governments.

For these reasons, NTC believes the Committee should introduce legislation that would require United States customs authorities to extend the prohibitions on the importation of gray market tobacco products to cigarette papers, tubes and other excisable tobacco products. Such a prohibition would be an effective deterrent to tobacco smuggling because smugglers themselves generally lack the expertise and manufacturing capacity to actually produce tobacco products. Tobacco smugglers and counterfeiters often thrive by simply diverting legitimate products into the black market and repackaging such products for introduction into regular US commerce. By stopping gray market goods at the border, Congress can cut off an important source of supply for tobacco smugglers in a manner that is far more effective than relying on the limited civil remedies available to trademark holders. As NTC's experience demonstrates, a company can track illicit goods once such goods hit the stream of commerce and can work with federal agencies to mitigate the impact of such illicit sales, but smugglers can only truly be stopped when the federal government exercises its police authority at and within its borders. One of the most effective places to exercise that authority is at point of entry at the border. The United States should enact legislation prohibiting the importation of such gray market tobacco products and requiring United States customs authorities to enforce that prohibition in respect of such

products, and to actively investigate the source and origin of such diverted products to the USA back to the original point of manufacture.

2. The United States should impose sanctions for the possession of gray market or counterfeit tobacco products.

The United States should also adopt legislation that would result in appropriate sanctions being imposed on those found in possession of gray market or counterfeit tobacco products. At a minimum, persons knowingly engaged in the sale or distribution of gray market or counterfeit tobacco products at any level should automatically lose their state and/or federal licenses to deal in such tobacco products.

Distributors or retailers who receive offers of gray market or counterfeit tobacco products should also be required to report such offers to the appropriate enforcement agencies or at minimum to the trademark owners. The failure to report such offers should result in appropriate sanctions, including the possible suspension of tobacco licenses.

Additionally, manufacturers and importers of tobacco products who are approached by persons to import, manufacture or distribute tobacco products into the USA that appear to have dubious origins should be required under their licensing obligations to TTB, to report such persons to federal authorities. Further, any information obtained by foreign manufacturers regulated by any US federal agency, or any licensed US manufacturers and importers on potential counterfeiting, gray good activity and contraband in respect of tobacco products should be reported to the TTB as a condition of such federal licensing.

3. **The United States should adopt reasonable track and trace requirements for tobacco products.**

NTC supports the adoption of reasonable track and trace requirements for tobacco products. Such procedures should be the minimum necessary to determine a reliable documented chain of custody for tobacco products as they move from importer to distributor and into retail sale. Further, Congress should require border agents to maintain records of violative instances of diverted, gray good or counterfeit products and establish a directory of foreign and domestic manufacturers and importers known to participate in such activities, and to provide such list to other federal agencies involved in the regulation of tobacco products on an annual basis.

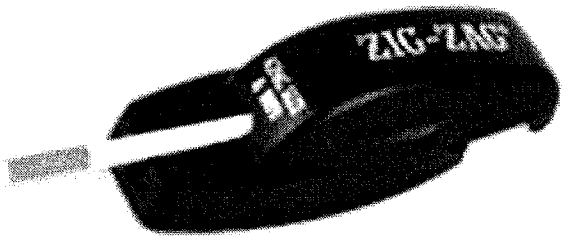
4. **Definition of "Tobacco Production Machine" in HR 5178 should be revised to exclude small quantity roll-your-own cigarette making devices.**

At the hearing held on May 27, 2010, the Subcommittee on Oversight heard testimony on HR 7158, the "Smuggled Tobacco Prevention Act of 2010." While NTC generally supports the bill's effort to restrict the availability of commercial cigarette-manufacturing machines to licensed cigarette manufacturers, distributors or retailers, the definition of "Tobacco Production Machine" may be overbroad. The definition set forth in the bill provides:

> (5) TOBACCO PRODUCTION MACHINE.—For purposes of this subsection, the term 'tobacco production machine' means any machine (or component integral to the operation of such a machine) used to manufacture, process, or package tobacco products or to apply unique identification markings to packages of tobacco products.

On its face, this definition would also cover the small hand-rolling and make-your-own cigarette making and rolling devices that are used by consumers to use make-your-own and roll-

your-own tobacco at a rate of only one or two cigarettes or cigars at a time. NTC does not believe it is the intent of the legislation to regulate such low-quantity devices for hand-making cigarettes.



NTC recommends that the definition of a tobacco production machine in HR 5178 be amended to exclude devices that are not capable of producing cigarettes in substantial quantities. NTC suggests that the definition of tobacco production machines should not effectively ban those small consumer electronic or mechanical devices capable of producing, under normal conditions, no more than two or three cigarettes or cigars per minute. However the definition of a 'Tobacco Production Machine' should apply to a table-top or stand-alone electronic or mechanical make-your-own cigarette or cigar making machine used at a retail point of sale to manufacture cigarettes by or for a consumer.

5. **Enforcement operations should not cause financial harm to legitimate tobacco companies.**

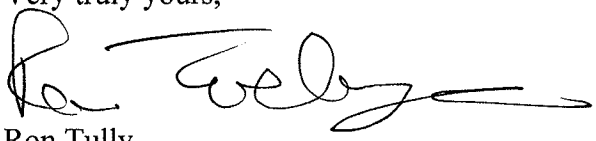
The Treasury Department's *Report to Congress on Federal Tobacco Receipts Lost Due to Illicit Trade and Recommendations for Increased Enforcement* contains enumerated recommendations. Recommendation number 3 suggests that Congress "Allow enforcement

officials to pay investigative expenses with proceeds gained through undercover operations." Report at 11-12.

While NTC supports adequate funding for tobacco enforcement operations, such funding should not be obtained by conducting activities that cause financial harm to legitimate tobacco companies. The sale of smuggled or counterfeit *ZIG-ZAG*® tobacco products causes harm to NTC through lost sales and the dilution of the value of its trademarks and copyrights, whether such sales are made by criminals or undercover agents. Congress should not adopt legislation that has the perverse result of encouraging federal agents to engage in undercover operations on a commercial scale that will cause economic harm to legitimate tobacco businesses.

Thank you for your consideration of these comments. If you have any questions or require any additional information, please do not hesitate to contact us.

Very truly yours,



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