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# THE DEPARTMENT OF THE TREASURY ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

## HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MAY 20, 2008

**Serial No. 110–85**

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

58–277 WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
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# THE DEPARTMENT OF THE TREASURY ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

**TUESDAY, MAY 20, 2008**

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 10:35 a.m., in room 1100, Longworth House Office Building, Hon. John Lewis (Chairman of the Subcommittee), presiding.

[The advisory announcing the hearing follows:]

# *ADVISORY*

FROM THE COMMITTEE ON WAYS AND MEANS

## SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
May 13, 2008
OV–8

CONTACT: (202) 225–5522

# Lewis Announces a Hearing on the Department of the Treasury Alcohol and Tobacco Tax and Trade Bureau

House Ways and Means Oversight Subcommittee Chairman John Lewis (D–GA) today announced that the Subcommittee on Oversight will hold a hearing on the Department of the Treasury's Alcohol and Tobacco Tax and Trade Bureau (TTB). **The hearing will take place on Tuesday, May 20, 2008, at 10:30 a.m., in the main Committee hearing room, 1100 Longworth House Office Building.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. The Honorable Lloyd Doggett, a Representative from the State of Texas, and John J. Manfreda, Administrator of TTB, have been invited to testify. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

**BACKGROUND:**

On January 24, 2003, the Homeland Security Act of 2002 separated the functions of the Bureau of Alcohol, Tobacco and Firearms into two organizations—TTB and the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF). TTB was established as a new bureau within the Department of the Treasury to: (1) collect excise taxes on alcohol, tobacco, firearms, and ammunition; (2) regulate alcohol and tobacco products; and (3) protect consumers. TTB is the primary Federal authority in the regulation of the alcohol and tobacco industries. ATF was established as a new bureau within the Department of Justice with jurisdiction over firearms enforcement and regulation, arson and explosives, and interstate trafficking of cigarettes.

TTB is the third largest tax collection agency in the Federal Government with nearly $15 billion in excise taxes collected last year from approximately 6,100 businesses. In addition, TTB regulates over 45,000 alcohol and tobacco business operations. It has approximately 550 employees and a budget of $93.5 million. The Administration's fiscal year 2009 proposed budget for TTB is $96.9 million, an increase of 3.6 percent over current levels.

In announcing the hearing, Chairman Lewis said, **"TTB has a broad range of responsibilities from tax collection to consumer protection and plays a critical role in our economy. I look forward to reviewing TTB's operations, including the impact of its separation from ATF. TTB must have the resources and authority it needs to protect the public and the revenue."**

**FOCUS OF THE HEARING:**

The hearing will review TTB's overall operations on its 5-year anniversary. The Subcommittee will examine: (1) TTB's budget and workload; (2) enforcement programs and compliance issues related to the collection of alcohol, tobacco, firearms, and ammunition excise taxes; (3) the immediate and long-term impact of the division of resources and responsibilities between TTB and ATF; and (4) administrative and other proposals related to TTB's operations.

**DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

**Please Note:** Any person(s) and/or organization(s) wishing to submit comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*110th Congress*" from the menu entitled, "*Committee Hearings*" (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Follow the online instructions, completing all informational forms and clicking "submit" on the final page. ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Tuesday, June 3, 2008**. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

**FORMATTING REQUIREMENTS:**

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TDD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

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Chairman LEWIS. Good morning. The hearing is now called to order. Today the Subcommittee on Oversight will review the operation of the Treasury's Alcohol and Tobacco Tax and Trade Bureau. It is the newest agency in the Department of Treasury, yet it collects the oldest of our Federal taxes—excise taxes on alcohol and tobacco.

This Subcommittee has not had a full review of TTB in over 15 years. This hearing is long overdue. TTB plays an important role in our government. This agency collects $15 billion in excise taxes each year, regulates the alcohol and tobacco markets, and protects the public.

It has been 75 years since the repeal of the Prohibition and the demands on TTB are growing. However, its budget has not. It has less than 600 employees and no law enforcement agents to oversee markets of almost $600 billion.

This does not count products sold outside the tax system. Illegal products threaten our health, our safety and our revenue.

I am concerned that TTB is not getting the respect it deserves given its broad and important mission.

The Subcommittee welcomes Mr. Manfreda and looks forward to his testimony.

[The prepared statement of the Honorable John Lewis follows:]

**Opening Statement of Congressman John Lewis (D-GA)**
**Hearing on the Department of the Treasury's**
**Alcohol and Tobacco Tax and Trade Bureau**
May 20, 2008

Today, the Subcommittee on Oversight will review the operations of the Department of the Treasury's Alcohol and Tobacco Tax and Trade Bureau ("TTB"). It is the newest agency in the Department of Treasury; yet, it collects the oldest of our Federal taxes—the excise taxes on alcohol and tobacco.

This Subcommittee has not had a full review of TTB in over fifteen years. This hearing is long overdue. TTB plays an important role in our government. This agency collects $15 billion in excise taxes each year, regulates the alcohol and tobacco markets, and protects the public.

It has been 75 years since the repeal of the Prohibition, and the demands on TTB are growing. However, its budget has not. It has less than 600 employees and no law enforcement agents to oversee markets of almost $600 billion. This does not count products sold outside the tax system. Illegal products threaten our health, our safety, and our revenue. I am concerned that TTB is not getting the respect it deserves given its broad and important mission. The Subcommittee welcomes Mr. Manfreda and looks forward to his testimony.

Thank you.

Chairman LEWIS. Now I am pleased to recognize my distinguished Ranking Member and my dear friend and my brother, Mr. Ramstad, for his opening statement.

Mr. RAMSTAD. Thank you very much, Mr. Chairman. Thank you for calling this hearing today. You are a dear friend and I am grateful to serve with you.

It does not seem possible that 5 years have passed since the responsibilities of the Bureau of Alcohol, Tobacco and Firearms were divided and placed into two different agencies.

I think we all recognize while the TTB might not be the most well known Federal agency, in fact, I bet if you did a survey of the 535 Members of Congress, a majority would not recognize the initials.

Nonetheless, as the Chairman pointed out, it is the government's third largest collector of revenue, bringing in the $15 billion in excise taxes to the Treasury each year.

It is a very critical agency, just the function of ensuring that domestically produced alcohol and tobacco products comply with Federal safety requirements is absolutely vital.

In other countries, we hear stories after stories of tainted alcohol and tobacco products. We do not hear of similar incidents in our country and that is a testament, I believe, to TTB's effectiveness. My hat goes off to the work that you are doing.

I know that your agency works closely with a number of Federal and State agencies, and I know Minnesota law enforcement has been grateful for your collaboration on a number of important cases in our State.

We are getting a good return, I believe, on our investment of taxpayer dollars. Of course, there is always more to be done, like with every agency and every organization.

There still are illegal sales of cigarettes and alcohol. We still need to emphasize the enforcement function and certainly, a concern of everybody on this Committee is cigarettes and alcohol, too common in the hands of minors, certainly a concern of all Americans.

Internet sales. Looking forward to hearing about whether we need to change any laws with respect to Internet sales. I know they pose special challenges. Also looking to hear from our good friend and colleague from Texas, Mr. Doggett, about the STOP Act.

Thanks again, Mr. Chairman, for the opportunity to review the budget and the operations of the TTB. I look forward to hearing from the witnesses and working together on these important issues.

Thank you and I yield back.

Chairman LEWIS. Thank you very much, Mr. Ramstad, for your statement.

Now we will hear from our witnesses. I ask that you limit your testimony to 5 minutes. Without objection, your entire statement will be included in the record.

It is my great pleasure and delight to introduce or just present one of our colleagues, Congressman Lloyd Doggett of Texas, a Member of the Committee on Ways and Means.

Mr. Doggett.

**STATEMENT OF THE HONORABLE LLOYD DOGGETT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS**

Mr. DOGGETT. Thank you, Mr. Chairman, Ranking Member Ramstad, and colleagues. I certainly share in the sentiments that each of you have just expressed concerning the Bureau.

While it has a number of responsibilities, I will focus in my brief testimony on just one of those, and that is tobacco, and specifically H.R. 5689, the Smuggled Tobacco Prevention Act or the STOP Act, that I have introduced as a sensible law enforcement approach to prevent the smuggling of tobacco.

Tobacco is the single largest illegally trafficked drug product on the planet. By reducing tobacco smuggling, I believe we can improve public health, collect more government revenue, and curb a source that has often been used by organized crime and terrorists.

Tax free black market tobacco is sold at lower prices, increasing consumption in tobacco related illness while denying much needed government revenue and sometimes financing terrorists.

An estimated 21 billion contraband cigarettes entered the U.S. market during one recent year. Almost half of these were international product or U.S. product for export coming back into the U.S. to evade Federal taxes and State and local taxes, and a little more than half represented internal cross-State smuggling from low tax States to high tax States.

The total lost revenue from illegal tobacco has been estimated at 2 to $4 billion each year in this country. It is not a small problem. Worldwide, there are an estimated 600 billion elicit cigarettes accounting for a loss of 40 to $50 billion in government revenue.

Of course, tax free cheaper tobacco means more nicotine addicts. About every 6 seconds, someone in this world dies from tobacco. That is why the enactment of this particular legislation has been important to public health groups like Tobacco Free Kids, which has filed testimony at this hearing, and the American Lung Association, which has endorsed the STOP Act.

Last year, when this very Committee was debating in this room the proposal to raise tobacco taxes in an effort to end the disgrace of so many uninsured children across our country, some of our colleagues on the Committee voiced concerns that more taxes would only result in more smuggling.

I believe that their concern was not unreasonable, but I believe it is an unreasonable excuse for opposing reasonable taxation of tobacco products.

When smuggling is the problem, law enforcement should be given the tools to prevent and control it. That is why the STOP Act would take the approach that it does.

Indeed, World Bank studies have suggested that the availability of smuggling is more related to a tolerance for smuggling and contraband sales than it is to the level of taxation.

Choosing between raising taxes and reducing tobacco smuggling really represents a false choice because we can reduce smuggling and recoup needed revenue at the same time.

Highly profitable tobacco smuggling can be used to advance a variety of criminal objectives. I commend our colleague and the Ranking Member of the House Committee on Homeland Security,

Representative Peter King, who recently released a revealing report entitled "Tobacco and Terror, How Cigarette Smuggling Is Funding Our Enemies Abroad."

In an interview with the Republican Members of the Committee on Homeland Security's staff, a convicted tobacco smuggler turned confidential informant for the State of New York admits "Tobacco smugglers' only fear is losing a load of cigarettes. We do not fear law enforcement. They'll pull us over, seize the load and maybe we'll get arrested, but most likely we won't. Worse case scenario, we go to jail for a couple of months before returning to smuggling.

Think about it. A small fish like me can make $50,000 a month working only a few hours each week. The big fish make hundreds of thousands a week, most of which goes to the Middle East in cash or trade transactions."

Among the groups that I have worked with over almost a decade is the Federation of Tax Administrators, an association of the principal tax and revenue collecting agencies in each of the 50 States. They are on the front lines of dealing with tobacco and tobacco smuggling.

I would ask the Committee's consent, I believe they will be filing written testimony after the hearing, but to include a letter from them and the testimony that Mr. John Colledge presented recently to the Judiciary Committee in support of the STOP Act.

[The information follows:]

**WRITTEN REMARKS OF JOHN W. COLLEDGE III**
**CONSULTANT, CUSTOM AND TRADE—ANTI-MONEY LAUNDERING**
**SPARKS, NEVADA**

**FOR THE**

**UNITED STATES HOUSE OF REPRESENTATIVES**
**COMMITTEE ON THE JUDICIARY**
**SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY**
**HEARING**

**MAY 1, 2008**

**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.

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[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.

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.

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[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.

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 a major transshipment point for cigarettes smuggled to Italy and various countries in the Middle East.[16] Reports from multiple sources stated that the Prime Minster 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 involving 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

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[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.

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 1 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.

**Recordkeeping**

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 recordkeeping. In my experience, if the businesses maintained records; they contained the vague or nonexistent 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 a 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 transshipment 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 the opportunity to appear before the Committee on this important matter.

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Mr. DOGGETT. The jurisdiction over the STOP Act is divided between our Committee and the Judiciary Committee which recently had a hearing on it. It was an insightful hearing. They deal with Alcohol and Tobacco, ATF, while we deal with TTB.

I am pleased to respond to questions about the STOP Act and about its objectives, and just appreciate the fact that the Committee is conducting this oversight hearing.

The STOP Act, which has been offered in various forms for almost a decade, is not going to be accepted in its current form by the tobacco industry.

What I am outlining today would be an approach that I hope eventually a future Congress will implement, but what I would like to do is see us take at least a few commonsense steps this session, I hope in a bipartisan fashion, to try to address tobacco smuggling and then have the Committee continue considering some of the high-tech approaches that other governments are using to really get at this problem in the future.

I welcome any questions you might have and thank you for this opportunity.

[The prepared statement of the Honorable Lloyd Doggett follows:]

**Prepared Statement of The Honorable Lloyd Doggett, a Representative in Congress from the State of Texas**

Chairman Lewis, Ranking Member Ramstad, and colleagues, thank you for conducting this oversight hearing and giving me this opportunity to discuss legislation pending before our Committee that concerns one of the major responsibilities of the Alcohol and Tobacco Tax and Trade Bureau. This is H.R. 5689, the Smuggled Tobacco Prevention Act of 2008, the STOP Act, a sensible law enforcement approach to prevent the smuggling of tobacco.

Tobacco is the single largest illegally trafficked legal product on the planet. By reducing tobacco smuggling, we can improve public health, collect more government revenue, and curb a source of funding for organized crime and terrorists.

"Tax-free" black-market tobacco is sold at lower prices, increasing consumption and tobacco-related illness, while denying much-needed government revenue and sometimes financing terrorist groups. An estimated 21 billion contraband cigarettes entered the U.S. market during one recent year; almost half of this represents international product or U.S. product for export coming back into the U.S. to evade Federal, State and local taxes, and a little more than half represents internal cross-State smuggling to evade State and local taxes. Total lost revenue from illegal tobacco is estimated at $2–$4 billion each year.

Worldwide, there are an estimated 600 billion illicit cigarettes, amounting to a loss of $40–50 billion in government revenue each year. And tax free, cheaper tobacco means more nicotine addicts. About every 6 seconds someone dies from tobacco. That is why enactment of anti-smuggling legislation is so important to public

health groups such as Tobacco Free Kids and the American Lung Association, which have endorsed the STOP Act.

Last year, when our Committee approved legislation to raise tobacco taxes in an effort to correct the disgrace of so many uninsured children across America, some of our colleagues here voiced concern that more taxes would only result in more smuggling. That is not an unreasonable concern, but it is an unreasonable excuse for opposing reasonable taxation of tobacco products. When smuggling is the problem, law enforcement should be given the tools to prevent and control it. That is what the STOP Act would do. Indeed, World Bank studies have shown that the availability of illicit tobacco is linked more closely to tolerance for contraband sales than to the level of taxation. Choosing between raising tobacco taxes and reducing tobacco smuggling represents a false choice because if we give our law enforcement officers the tools they need, we reduce smuggling and recoup needed revenue.

Highly profitable tobacco smuggling can be used to advance other criminal objectives including support for international terrorist organizations. I commend our colleague and Ranking Member of the House Committee on Homeland Security, Rep. Peter King, who recently released a revealing report entitled "*Tobacco and Terror: How Cigarette Smuggling is Funding our Enemies Abroad*." In an interview with the Committee on Homeland Security staff, a convicted tobacco smuggler, turned confidential informant for the State of New York admits:

Tobacco smugglers' only fear is losing a load of cigarettes. We do not fear law enforcement. They will pull us over, seize the load, and maybe we get arrested; but most likely we do not. Worst case scenario, we go to jail for a couple of months before returning to smuggling again. Think about it. A small fish like me can make $50,000 a month working only a few hours each week. The big fish make hundreds of thousands a week, most of which goes to the Middle East in cash or trade transactions.

Among the groups with whom I have worked almost a decade in developing the STOP Act is the Federation of Tax Administrators, an association of the principal tax and revenue collecting agencies in each of the 50 States, the District of Columbia, New York City and Puerto Rico. On the front lines of dealing with tobacco and the impact of tobacco smuggling across America, the Federation has submitted a letter of support for the STOP Act (Appendix A), which along with the written testimony that the Federation will be submitting after our hearing, I would ask for it to be made a part of our record. These administrators conclude that the legislation that I am proposing "will significantly reduce the smuggling of U.S. tobacco products and aid in the enforcement of State tobacco tax requirements across the country."

We share jurisdiction over these matters with the Judiciary Committee, which through its Subcommittee on Crime, Terrorism, and Homeland Security held an important hearing on the STOP Act only a few weeks ago concerning those of its provisions, which would be implemented by ATF, the Bureau of Alcohol, Tobacco, Firearms, and Explosives. The portion of the legislation that comes within our Committee today is that which concerns the Alcohol and Tobacco Tax and Trade Bureau and its responsibilities for collecting the Federal excise tax on tobacco products and preventing ineligible persons from entering the tobacco industry. I believe that TTB should be given additional tools and resources to address this criminal activity.

As a result of the Judiciary hearing, I have concluded that one provision would be better implemented by TTB rather than ATF, as I had originally proposed. That is the provision which would ban the sale of tobacco product manufacturing equipment to unlicensed persons in order to prevent the illegal use of such machinery and reduce the problem of illegal manufacturing.

With such a volume of smuggled tobacco, one of the objectives of the STOP Act is to be able to follow tobacco from manufacturer through the distribution chain, to be able to determine where particular tobacco that is smuggled was made and where it was supposed to be sold before it was diverted. Perhaps the best way to do that is to follow the example of the State of California and Canada by using state-of-the-art technology to apply a high-tech stamp during the manufacturing process, which cannot be easily counterfeited and which can contain complete information about the product to which it is attached. The stamp would contain encrypted information readable by a portable scanner, enabling enforcement officials to distinguish real tax stamps from counterfeits, identify who applied the stamp and initially sold the product, and obtain other information useful for tracking, tracing, and enforcement purposes.

Several companies have the capacity to implement such a system, and two of them, Authentix and SICPA Secure Ink, are submitting written testimony for the record of this hearing and have provided me with letters in support of my bill (Appendix B and C). In California, which contracted with SICPA, cigarette tax revenue increased by $100 million in the first 20 months after these new high-tech tax

stamps were introduced in 2005. In its testimony for today's hearing, SICPA indicates that it has developed similar stamp systems for both Brazil and Turkey. My bill allows the Secretary of the Treasury the flexibility to develop regulations that allow us to build on what has worked, and what can be improved, on the California model and from other countries.

While the STOP Act proposes this approach, it is clear that domestic tobacco manufacturers are not yet willing to accept it. While considering this requirement for enactment by a future Congress, I would ask the Committee to explore other provisions that I have advanced to see if we cannot achieve bipartisan agreement on a few steps that can be taken now in this Congress to make a difference in the battle against tobacco smuggling.

In addition to the illegal machinery provision that I mentioned, I believe that we should at least adopt provisions included in the STOP Act similar to those that were overwhelmingly approved by this Congress as a part of the Children's Health Insurance legislation that President Bush vetoed. These would **broaden authority to deny tobacco permits to manufacture or import tobacco and would condition permit issuance upon compliance with State and Federal laws**.

The STOP Act creates an audit trail, giving law enforcement access to information tobacco companies already have, improving law enforcement's ability to prevent illegal diversions of tobacco products and to identify and prosecute those who take part in this activity. Former U.S. Custom's agent John Colledge, with more than 20 years of Federal law enforcement service, testified earlier this year that "The unique serial numbers and high-tech stamp described in the Doggett bill will significantly aid law enforcement authorities in the U.S. and our international partners (Appendix D)."

Even if we are unable, in this Congress, to offer our law enforcement officers the advantages of a high-tech stamp that could be made easily available, we should at least require some unique, uniform serial number. This would give law enforcement officials access to the same information that the tobacco manufacturers already have. This measure is about arming our officers—arming them with the knowledge they need to fight increasingly sophisticated smugglers.

I believe that TTB agrees that adding serial numbers to the records to be maintained by manufacturers, importers, and wholesalers is a simple way to help tighten the audit trail.

The STOP Act, coupled with well-crafted regulations, will provide State and Federal law enforcement, regulatory, and prosecutorial agencies with valuable tools to fight tobacco smuggling.

This year over 150 nations are beginning to negotiate a set of rules for a worldwide effort to eliminate the illicit trade of tobacco as part of the Framework Convention on Tobacco Control in Geneva, Switzerland. The Bush Administration signed the Convention in 2004, but unfortunately, we are excluded from any participation in the ongoing negotiations on international smuggling and other issues because during the last 4 years, President Bush has not even bothered to submit this treaty for ratification to the Senate. As the world moves ahead with a protocol to keep cheap smuggled cigarettes out of the hands of children and profits out of the hands of criminals and terrorists, we should be part of the solution, not the problem.

The benefits of this bill can be measured in deaths and disease that are prevented, in enhanced quality of life for those who avoid nicotine addiction, and in billions of dollars saved in both lost revenue and health care costs. I am eager to work with all Members of our Committee in taking meaningful steps to more fully empower law enforcement as it is struggling with smuggling.

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Chairman LEWIS. Thank you very much, Mr. Doggett.

At this time, I will open it up for questions for Mr. Doggett. I ask that each Member follow the 5 minute rule.

Mr. Doggett, for many years, you have been a leader on the need to prevent smuggling. Can you just tell Members of the Subcommittee what can TTB do to discourage and prevent smuggling now under current law and label authority?

Mr. DOGGETT. I am not in any way critical of TTB. I think they are doing the job within the limits of their legislative authority.

All that I am looking to do is to try to supplement their ability to deal with this problem and the same for ATF.

If you have this evening a State Trooper on one of the interstates stop a truck for some traffic violation and they look in the back and they find it does not look like it came from one of the major cigarette manufacturers but is full of cartons of cigarettes, the question is whether or not that State Trooper and his superiors will have the information available that they need in order to determine where this tobacco came from, where it is headed, and whether it is likely to be the property of a criminal enterprise.

The tobacco manufacturers have the ability to trace their product now. I would like to be sure that law enforcement at TTB and right down to local law enforcement have access to the same information.

While I propose in the STOP Act a high-tech stamp that California, Canada, Turkey and Brazil are using, I think if we did as little as to just add four words to one of the sections concerning maintaining records with serial numbers, that would be helpful.

I proposed in the STOP Act originally that it be done by ATF, but after the Judiciary hearing, I think TTB is a better place, that we prohibit the sale of tobacco manufacturing equipment to those who are not already licensed to manufacture tobacco.

Chairman LEWIS. Mr. Doggett, where would you place a serial number? Would it be on each carton or each pack?

Mr. DOGGETT. I think it would be on each packet of cigarettes.

Chairman LEWIS. Is that feasible?

Mr. DOGGETT. Let me answer it in two ways. First, I think that there is already information the major tobacco manufacturers have. They are not a pen and pencil operation. It is a high-tech computer operation. I think they already have this information and they sometimes make it available voluntarily to TTB on request when they get the information.

What I have proposed that is new and I think is more far reaching than certainly this Congress and the industry is ready to accept at present is the use of a high-tech stamp.

California is doing that, and over 20 months of putting that high-tech stamp on for sales in California, they say they have collected an extra $100 million in State revenue.

Canada is going to this system, will have it implemented within, I believe, the next few months. Brazil and Turkey have implemented similar systems.

I believe that you have testimony that is submitted and any letters they have, I would again ask consent to incorporate as part of my testimony, from two companies that are involved in doing this kind of work already.

Mr. DOGGETT. They say it can be done fairly quickly, in a matter of months, and that it can save millions of dollars.

We are trying to have a seamless system where you can easily tell where this tobacco came from, where was it heading when it got diverted, and that is the goal here.

Chairman LEWIS. Thank you very much. Mr. Ramstad is recognized.

Mr. RAMSTAD. Thank you, Mr. Chairman. Mr. Doggett, thank you for your testimony about the STOP Act.

When you quantify the number of contraband cigarettes coming into this country every year at 21 billion, it certainly got the atten-

tion of everybody, I think, in the room. I again appreciate your work in this area.

Is current state of the law such that manufacturing equipment can be sold legally to unlicensed people?

Mr. DOGGETT. That is my understanding. We would clarify, one of these provisions that I say is unlike the high-tech stamps, which is not acceptable to the industry, I would think that this is a provision that we might be able to reach agreement on, that only those licensed through TTB should be able to obtain tobacco manufacturing equipment because they are the only people that are licensed to use it.

Mr. RAMSTAD. I was going to ask if there was any empirical data to support the efficacy of doing that, and you cited the California experience. Can you provide us with a summary of that?

Mr. DOGGETT. Yes, I can. I believe that the testimony offered by two companies who provide this kind of service, the one in California, I believe, is called SICPA. Its U.S. headquarters is based out here in Virginia. They have a system that they describe. It is SICPA Secure Ink, I believe it is called.

There is another company called Authentix. They have designed various systems. SICPA is providing the service in Turkey, in Brazil, in California, and in Canada.

I believe that looking at the testimony from these two companies, it gives you an idea of how the system could eventually be implemented, but as I say, I think it is probably unrealistic to assume that can be done in the short term, but I believe it is worth this Committee's further study for future implementation.

Mr. RAMSTAD. Just one final question, Mr. Chairman. Aside from the serial number requirement and the manufacturing equipment limit, that is limit on sales to unlicensed or restrict sales to unlicensed people, what else comprises the STOP Act? Are those the major two elements of the bill?

Mr. DOGGETT. There are a number of other elements. I would like to suggest one other I did not reach yet in my testimony that I believe would be important, and that is that when we debated the CHIP legislation, there actually were a few provisions that were included in that legislation. They were not debated or discussed, I believe, in this Committee, that Congress passed twice, and as you know, that was vetoed by the President.

Those provisions would broaden authority to deny tobacco permits to manufacture or import tobacco and would condition issuing a permit to import or manufacture tobacco on compliance with State and Federal laws. That is not smuggling, among other things. I think that would be a constructive step.

There are other provisions concerning trying to have a seamless distribution system, bonding, reporting, provisions I would like to see adopted at some point in the future, unlikely to occur this year.

What I am trying to look for are a few provisions that might carry us a few steps forward in the effort against smuggling, and then have the Committee to continue to consider these others, observe the experience of California, Canada, and these other countries, and see if it would not be in our interest from a revenue standpoint and from a public health standpoint to adopt these provisions eventually.

Mr. RAMSTAD. Again, I want to thank my friend from Texas for your testimony. There are few things more important than keeping cigarettes out of the hands of minors especially given the nature of nicotine, the addictive nature of nicotine, and the damage it causes, lost lives and so many diseases that are related.

Thank you for your work in this area and I yield back, Mr. Chairman.

Mr. DOGGETT. Thank you so much.

Mr. NEAL [Presiding]. Thank you, Mr. Ramstad.

Mr. Doggett, first, a word of thanks again as Mr. Ramstad has indicated for your leadership on this very issue.

Do you think it is feasible to implement a high-tech tax stamp on each package of cigarettes at the present time?

Mr. DOGGETT. I believe it is. California did provide the leadership on this. They have been in effect since 2005, and over the first 20 months, they were able to reduce smuggling and the sale of contraband tobacco by about $100 million.

The Canadian system is being implemented this year. The testimony from SICPA refers to the Turkish and Brazilian systems, with which I am not as familiar.

The technology is there. We all know about the use with all the problems after 9/11 of high technology to have a system that is not perfect on counterfeiting but reduces the counterfeiting, and through that stamp, a variety of information can be accessed about where it was manufactured, when it was manufactured, and where this product was headed.

That, I think, can be invaluable to not only Federal administration through TTB but through State and local administration, and that is why the Federation of Tax Administrators has joined the public health groups in endorsing this, and why Mr. Colledge, who has extensive experience that I referred to earlier, testified at the Judiciary Committee and felt this was so important to get adopted.

Mr. NEAL. How does your bill relate to the International Framework Convention for Tobacco Control?

Mr. DOGGETT. That is an important question and I must say a rather disappointing one. The United States under the Bush Administration participated in the negotiating of a Framework Convention with countries around the world to deal with this menace of tobacco, a menace that really has the potential, according to the World Health Organization, of killing more people than a whole series of other maladies put together.

The principal role, I think, that the United States played in those negotiations was try to weaken the Framework Convention just as much as it possibly could. Although there was some dispute about whether they would sign, then they signed the Framework Convention.

That was 4 years ago. Since that time, President Bush has never bothered to submit the Framework Convention to the Senate for approval, for ratification.

The Framework Convention Committee is meeting in Geneva this summer to look at this problem of tobacco smuggling and what should be done to address it. We will not have a seat at the table.

I believe that the legislation that I propose would be consistent with the objectives of the Framework Convention on smuggling,

only one aspect of the many public health issues associated with the international pandemic of nicotine addiction, but an important one.

I hope that next year the treaty is submitted and that we can get a seat at the table. This is a big problem. We also propose in the STOP Act for more information sharing between our government and foreign governments on this problem, and we ought to have a seat at a table like the Framework Convention to deal with this and other public health issues.

Mr. NEAL. Thank you. Mr. Nunes is recognized to inquire.

Mr. NUNES. Thank you, Mr. Chairman.

Mr. Doggett, thank you for appearing before us. I think we can all agree that contraband cigarettes are a huge problem that we have in the United States. It was very predictable as we have continued both at the Federal and State level to raise taxes on cigarettes that it creates a black market, underground market.

In your testimony, you talk a lot about the California proposal that was enacted in 1995 with the stamp—I mean in 2005. I think it is important—you testified that this has been an overwhelming success.

I think there is also evidence on the other side, being from California, that this has been a dismal failure to some degree. Now, it is very tough to police who is selling contraband cigarettes at the actual mini-market level. When there are mini-markets on every street corner nowadays, there is considerable problems associated with this stamp.

Within just a month after the stamp was enacted, there was already counterfeit stamps on the market.

I want to know, as we begin to air this out, and I will submit some information for the record, and I assume you will submit information for the record, and I think it is important to have these types of hearings, but we need to make sure that with policies like these that we do not end up in the same place where we are in California with now counterfeit stamps being enacted.

I do not know if you have any ideas about how we can ensure that we do not have the stamp duplicated, and what we can do in the future to make sure if your policy is enacted, that we do not have a continuing problem with contraband cigarettes.

Mr. DOGGETT. I welcome any information you have in that regard. I know you have some familiarity with your home area.

I would just say that the comments you have made run counter to what Governor Schwarzenegger's Administration has said about the success of this program and pointing to the additional revenues that have been raised through the program, and the fact that other jurisdictions are now looking at it.

I would again re-emphasize as I said at the beginning, this is the first State to do it. I am sure there are some things to work out in how it happens. We have as a practical matter at least the next year to take a look at how they are doing it and see what changes the Canadians make in the California approach, as well as to survey, which I have not yet, what experience Turkey and Brazil have had, two countries that have been very involved with tobacco through the years, but who have adopted this kind of system.

What I would look for now, as I said in my testimony, is are there a few areas that might help us address tobacco smuggling that could be more or less acceptable to the industry and could take us a few steps closer, a few more tools available to deal with tobacco smuggling this year.

We hope we can have a dialog about that.

Mr. NUNES. Thank you, Mr. Doggett.

Mr. Chairman, I would like to thank the Committee for holding this hearing. I will be submitting some information for the record. I think it is important that we air out all these issues so we get all the facts on the table before we try to proceed making law here in the Nation's Capitol.

Thank you and I yield back.

Mr. NEAL. Thank you. Your input is appreciated.

The gentleman from New Jersey, Mr. Pascrell, is recognized to inquire.

Mr. PASCRELL. Thank you, Mr. Chairman.

Mr. Doggett, what are the tobacco companies doing to counter cigarette racketeering?

Mr. DOGGETT. It depends on whether it helps or hurts them. This Committee has been involved in the past in considering legislation which became the law concerning grey marketing tobacco.

That was a situation where I think Philip Morris lost control of its own distribution chain and in some cases, product that was manufactured by its facilities in other countries was being brought back to create a cheaper grey market to compete with what Philip Morris made in this country.

There were changes made a couple of times in the past through legislation that had the support of the tobacco industry to get that passed.

On the other hand, there had been numerous situations around the world and in the United States where the tobacco industry appears to have been complicit in using smuggling directly or indirectly to build market share for its product.

Mr. PASCRELL. How does that work?

Mr. DOGGETT. One example——

Mr. PASCRELL. How does that work and what are the positions that have been opposed by the cigarette companies?

Mr. DOGGETT. One way it worked in New York State was that a distributor for RJR, who I think is still in prison, was involved in using tobacco smuggled through an Indian reservation to get into Canada.

Another way it has worked has been with reference to European Commission. Philip Morris, for example, has agreed to pay $1 billion to European Commission to settle charges concerning the role it played in tobacco smuggling and in other related activities in the——

Mr. PASCRELL. Did they admit to the smuggling, participating?

Mr. DOGGETT. They only agreed to pay $1 billion after they were charged with it, which is not a legal admission but I have not found them ready to give a billion here or a billion there just for the public good.

Mr. PASCRELL. Were they complicit?

Mr. DOGGETT. I believe they were and there are other examples. I am not focusing just on them. Japan Tobacco, which got involved, also has agreed to make payments to the European Commission.

There have been reports, for example, in Colombia, which we are very concerned about, in smuggling drugs up here, that a few years ago, four out of every five Marlboro's sold in Colombia were smuggled into Colombia.

It is a problem that has occurred around the world, not just with American companies, but where it has been in the interest to build market share at lower prices in certain countries, addicting other people's children to the same kind of problem that our children have had.

Mr. PASCRELL. In your estimation, what would be of great productivity here to respond to this great problem? What do the cigarette companies oppose that you think would have the greatest impact on the problem that you are trying to address? What do they oppose?

Mr. DOGGETT. I think they are certainly not agreeable to using the high-tech stamp yet.

Mr. PASCRELL. Why not? Because of cost?

Mr. DOGGETT. I believe there is some testimony that they filed in the Judiciary Committee that I should think they are filing here, that we will have Members raise here, expressing their concern about that, about bonding requirements, about labeling tobacco as to where it is headed.

I will let them make all their arguments on that. My objective today is to say are there not a few steps, the illegal machinery provision, the CHIP provisions, that we might take, the unique serial number provision, so that law enforcement will know what major tobacco manufacturers already know, are there not a few steps that we could come together on to advance this.

Then we can consider the experience Mr. Nunes referred to, the experience that I have heard of from California, and see how they mesh, and whether over the long haul, using the latest state-of-the-art technology, we can have a more seamless distribution system for this deadly product.

Mr. PASCRELL. Thank you. Mr. Chairman, I think the Members of the Committee, would profit from seeing either former testimony or reports from the Bureau itself, as to the extent of participation of cigarette companies in the aspect of smuggling and racketeering of cigarettes. I think it would be quite astonishing.

If we could get that, Mr. Chairman, I would appreciate it.

Mr. NEAL. I think that is a subject for further inquiry for sure.

Mr. PASCRELL. Thank you.

Mr. NEAL. Thank you, Mr. Pascrell. The gentleman from Virginia, Mr. Cantor, is recognized to inquire.

Mr. CANTOR. Thank you, Mr. Chairman. I want to thank the gentleman from Texas for his testimony.

Obviously, there are many points with which I think some Members would disagree with some of the allegations that have been made here regarding the tobacco companies' involvement in illegal activity and smuggling, et cetera.

I do think we ought to strive to try to set the record straight in any kind of testimony/evidence that we could see to try and clear that up. I, for one, am a little bit doubtful let's say as to some of the statements that have been made.

I do know that there has been a concerted effort here in Congress to try and put an end to the illegal importation of tobacco products. I know in 2000 and then in 2006, Congress passed the Imported Cigarette Compliance Act, tightened it up in 2006, and frankly dealt with some of the issues the gentleman from Texas raises here in insisting and requiring that all imported cigarettes comply with U.S. health warnings, ingredient disclosure laws, and also strengthening prohibitions on the diversion of export tobacco for domestic consumption.

What I think, Mr. Chairman, my question is beyond the sort of questions that have been raised about the high-tech stamp and whether it can be counterfeited, because I do think those questions have been raised, and we ought to take a look at that, but what we are really talking about is an allocation of resources and priority of how we are going to spend taxpayer dollars.

If Congress has already taken action really on point to what you are talking about, trying to limit the pirating, trying to limit the illegal importation, why are we not trying to enforce those laws? Why are we not using our resources to enforce those laws, and frankly go right to the crux of the matter, which is these Internet sales that are going on.

I know that you are a cosponsor of the PACT Act, and there are ways for us to try and put a stop to some of these evasion techniques that are going on out there, not only evading taxes but also promoting the illegal transaction and sale of cigarettes.

Again, I think what I would ask the gentleman from Texas is how does the STOP Act do anything other than that which Congress has already done? How do you promote what we are trying to do by requiring the stamping of a destination during the manufacturing process?

How does that do what we are trying to do instead of focusing on what we really should be focusing on, the Internet sales of tobacco?

Mr. DOGGETT. First, we are in agreement that Internet sales is one of those areas that has not been adequately addressed in any of the prior legislation, and I support that and I believe the tobacco industry does, too.

The legislation to which you refer is the grey marketing legislation that I mentioned in my earlier testimony, where Philip Morris and I think only Philip Morris was having a problem about some of its own product coming back into the United States and competing with product that it made here.

It was focused on grey marketing. It was not focused on black marketing. I actually tried—I think that came up in the Committee maybe just before you came onto the Committee. I tried to get some of these provisions included in that legislation unsuccessfully.

What I want is a seamless system, an audit trail. We have all seen those like World War II movies where people are using cigarettes as currency. This is in many ways almost like currency, and there is laundering that occurs of that currency.

I want to be able to follow the tobacco from the point of manufacture to the ultimate point of use, and have a seamless system in that regard.

I believe that a company like Philip Morris or RJR can essentially do that itself, has the information available, and by doing something like requiring the serial number to be available, which they provide sometimes voluntarily to TTB, to do that uniformly I think will help law enforcement.

I think the high-tech stamp could accomplish a lot of that, but just over the short term, why can we not agree on illegal machinery, on the provisions that were in the CHIP Act, putting the serial number on there, and allowing TTB to share information with foreign governments.

I do not think those are inconsistent or harmful to a tobacco industry with which, as you can tell, I disagree very strongly, but to a tobacco industry if it does indeed want to comply with the law and not be engaged in any kind of illicit traffic in tobacco.

Mr. CANTOR. Thank you so much.

Mr. NEAL. The gentleman from Ohio, Mr. Tiberi, is recognized to inquire.

Mr. TIBERI. Thank you, Mr. Chairman. Thank you, sir, for testifying today.

For the record, can you tell us a little bit about this high-tech stamp that we have been talking about and how it works?

Mr. DOGGETT. Yes. I believe that I would again refer you specifically to the testimony of two of the companies that compete against each other for providing such a stamp.

It is a stamp—I am not sure that it can be compared to the kind of information we are seeing on passports, as a stamp to try to reduce counterfeiting, but it attempts to use a high-tech stamp that would go on each pack.

It contains encrypted information that is readable by a portable scanner. It enables the enforcement officials to distinguish between real tax stamps and counterfeits. They identify who applied the stamp, who initially sold the product, and obtain other information that can be used in tracking and tracing the product for law enforcement purposes.

I think the two approaches of these companies, and I believe there is another company or two who are out there doing that that I have not had any contact with, I asked them to forward testimony concerning as much of the mechanics while protecting any business confidentiality they have, and to respond to some of these questions.

As you will get a chance to review their testimony about the different ways they do that, they say it is feasible to do this within a matter of months, that they can follow what they did in California using this portable scanner. They can do the same thing that they are helping Canada do, and have a much more seamless system.

Mr. TIBERI. Do they know or do you happen to know what the cost of implementing such an approach would be? Did they discuss that with you?

Mr. DOGGETT. I do not know the precise cost. I believe it is important to look at that. I do know the State of California says the result has been $100 million in additional revenue.

Mr. TIBERI. One final thought with respect to the labeling issue. If you have a manufacturer that is exporting a particular cigarette to Italy and is also exporting that same cigarette to France, what would be the benefits of doing that to neighboring countries, number one, and number two, what impact would that have on the U.S. manufacturer with respect to inventory?

Mr. DOGGETT. You are referring to a requirement that is in the STOP Act that I have not discussed yet.

Mr. TIBERI. Yes.

Mr. DOGGETT. But is definitely in the Act that requires a label as to where this product is going.

Mr. TIBERI. Correct.

Mr. DOGGETT. It may be, by the way, if the high-tech stamp provision is put in there eventually, that all of that can be included in the high-tech stamp, that it can be monitored that way rather than a separate stamp.

I will answer your question first by coming closer to home. There is also a requirement in there that if it is going to an Indian reservation, we do not make any changes in the laws concerning Indian reservations, but if it is destined for an Indian reservation, that you put that on there.

That goes to the heart of some of the concerns that Peter King and his staff have raised about the use of Indian reservations for what appears to be avoidance of taxes by some people in the State of New York.

As to the France and Italy example, I think maybe the best example is a place like Cyprus, Morocco, Bosnia, a small country that suddenly has billions of cigarettes going into that country. They are clearly not all destined for consumption in that country and that country may just be used as a trans-shipment point to get into other markets.

That is the purpose, just to try to track the tobacco as to where it is going. There may be a way to simplify the process from what I currently have in the STOP Act.

Mr. TIBERI. The STOP Act would still regulate cigarettes going to Italy and France as well?

Mr. DOGGETT. It would require telling us, when you ship them, where they are destined for. Are they going to Estonia, Bosnia, or are they really destined for some other place.

Mr. TIBERI. Are any of those countries asking for this regulation, to your knowledge?

Mr. DOGGETT. I am not sure about Bosnia. I believe all of the other countries are signatories to the Framework Convention, in which smuggling is a key part, and which they have already had some preliminary meetings and will meet again this Summer in Geneva to try to come up with stronger provisions to deal with tobacco struggling.

They put out a number of papers about how serious and growing a problem this is.

I think all those countries we mentioned, and I know France and Italy are participating in the Framework Convention negotiations.

Mr. TIBERI. Thank you. Thank you, Mr. Chairman.

Mr. NEAL. Thank you. Let me thank Mr. Doggett for his testimony this morning, and I would invite you, if you care to, Mr. Doggett, to join the Subcommittee for the rest of the hearing.

I also want to welcome Mr. Thompson, the gentleman from California, who is a Member of the full Committee on Ways and Means as well.

Mr. DOGGETT. Thank you so much and thank you for the insightful questions and comments of all our colleagues.

Mr. NEAL. I would now like to call the next witness. It is now my pleasure to introduce Mr. John Manfreda, the head of TTB.

Mr. Manfreda, would you proceed with testimony, please?

**STATEMENT OF JOHN J. MANFREDA, ADMINISTRATOR, U.S. DEPARTMENT OF THE TREASURY, ALCOHOL AND TOBACCO TAX AND TRADE BUREAU**

Mr. MANFREDA. Mr. Chairman, Congressman Ramstad and the distinguished Members of the Subcommittee, my name is John Manfreda, and I am the Administrator of the Alcohol and Tobacco Tax and Trade Bureau, which is known as TTB.

I appreciate your interest in our Bureau and appreciate today to report on the progress we have made since our creation in January 2003.

In the interest of time, I will be brief, but I request that my full statement be made a part of the record.

Mr. NEAL. So, ordered.

Mr. MANFREDA. TTB was created in the Department of Treasury with the enactment of the Homeland Security Act of 2002, which divided the former Bureau of Alcohol, Tobacco and Firearms into two new agencies.

In addition to creating TTB, the Homeland Security Act created the Bureau of Alcohol, Tobacco, Firearms and Explosives in the Department of Justice.

Our mandate at TTB is to collect taxes rightfully due and to ensure that alcohol beverages are produced, labeled, advertised and marketed in accordance with Federal law. Put another way, our objectives are to collect the revenue, protect the consumer and promote voluntary compliance.

TTB collects alcohol, tobacco, firearms and ammunition excise taxes pursuant to Chapters 51 and 52 and sections 4181 and 4182 of the Internal Revenue Code of 1986.

These products generate nearly $15 billion in annual Federal excise tax revenues. The excise taxes collected by TTB come from more than 6,100 businesses and the taxes are imposed and collected at the producer and importer level of operations.

Members of the regulated industries paying excise taxes are distilleries, breweries, bonded wineries, bonded wire cellars, manufacturers of cigarette papers and tubes, manufacturers of tobacco products, and manufacturers and importers of firearms and ammunition.

About 200 of the largest taxpayers account for 98 percent of the annual excise taxes that TTB collects. In fiscal year 2007, the majority of taxes that TTB collected were from tobacco and alcohol,

which accounted for roughly 49 percent each, with the remaining 2 percent from firearms and ammunition.

In addition to the collection of excise tax, TTB administers cover over payments to Puerto Rico and the Virgin Islands and also processes drawback claims.

Federal excise taxes collected on articles produced in Puerto Rico and the Virgin Islands and subsequently transported and sold in the United States are covered over into the treasuries of Puerto Rico and the Virgin Islands. In 2007, TTB processed $459 million in cover over payments from rum to Puerto Rico and $8 million to the Virgin Islands.

The alcohol and tobacco taxes are remitted to the Department of Treasury's General Fund and the firearms and ammunition excise taxes are remitted to the Fish and Wildlife Restoration Fund under the provisions of the Pittman-Robertson Act 1937.

In 2007, TTB collected $323 of revenue for every dollar spent to administer its tax collection operation. We attribute this success to a good working relationship with industry members as well as to the lean administrative overhead.

The commodities that we regulate are lawful in the United States. Furthermore, we recognize that these industries have a significant economic impact domestically.

For example, the annual economic impact from the wine, distilled spirits, and beer industries is approaching $500 billion and represents 3 to 4 percent of the Gross National Product. This is why we work to reduce delays and regulations that impede business, to promote voluntary compliance, and to refine our management practices.

TTB provides assistance to the Office of the United States Trade Representative in alcohol beverage and tobacco matters within the gambit of the World Trade Organization as well as negotiation of bilateral and multilateral free trade agreement issues related to wine and spirits.

We also know from experience that the illicit sale of tobacco and alcohol is financially lucrative and a known funding source for criminal and terrorist organizations.

An appropriate regulatory presence provides a deterrent against tax evasion schemes, and our efforts to keep ineligible persons from entering the alcohol and tobacco industries have been more focused since our creation as an independent bureau.

To ensure that only eligible persons enter into the business, TTB conducts criminal, personal and financial background checks and interviews prospective industry members.

Key to collecting all the revenue rightfully due is an active field presence.

When we were created in 2003, TTB was authorized to have 559 employees but began with only 326. Most of those positions were in our headquarters in Washington, D.C., our laboratories and our National Revenue Center. At that time, TTB had no field offices or CFO operation.

During the transition phase, we made key strategic decisions to make the best use of our limited resources. For example, to provide the most efficient and cost effective delivery of administrative and financial services, TTB decided to contract with the Bureau of Pub-

lic Debt's Administrative Resource Center to handle TTB's accounting, travel, procurement, human resources and financial management support services. We outsourced IT support services.

We also embraced teleworking, particularly in the field, which has allowed us to put our investigators and auditors where they will do the most good while saving the cost of unnecessary office space.

I am particularly committed to maintaining our partnerships with industry, other Federal and State agencies, and international organizations. By working together, we can meet industry and public expectations for a responsive, fair and efficient government.

Once again, thank you for affording me the opportunity to report on our progress since our creation and our challenges that still face us.

I appreciate the Subcommittee's interest in TTB and look forward to continuing to work with you, and will be happy to answer any questions you may have.

[The prepared statement of John J. Manfreda follows:]

**Prepared Statement of John J. Manfreda, Administrator, Alcohol and Tobacco Tax and Trade Bureau, United States Department of the Treasury**

**Introduction**

Mr. Chairman, Congressman Ramstad, and distinguished Members of the Subcommittee, I am pleased to be here today to report on the current operations and performance of the Alcohol and Tobacco Tax and Trade Bureau (TTB). We greatly appreciate your interest in our Bureau.

TTB was created within the Department of the Treasury in 2003 as a result of the Homeland Security Act of 2002. As a successor of the Bureau of Alcohol, Tobacco and Firearms, our mandate is to collect taxes owed, and to ensure that alcohol beverages are produced, labeled, advertised, and marketed in accordance with Federal law.

TTB administers Federal tax laws on alcohol, tobacco, firearms, and ammunition. Specifically, TTB is charged with the administration of Chapters 51 and 52, and sections 4181 and 4182 of the Internal Revenue Code of 1986 (IRC), as well as the Federal Alcohol Administration (FAA) Act and the Webb-Kenyon Act. Under these authorities, TTB is chiefly responsible for: (1) collecting alcohol, tobacco, firearms, and ammunition excise taxes, and classifying alcohol and tobacco products for excise tax purposes; (2) reviewing applications and issuing permits for distilled spirits and wine operations and for tobacco product manufacturing, warehousing, importing and exporting operations; (3) regulating the production, packaging, and storage of alcohol and tobacco products; and (4) ensuring that the labeling and advertising of alcohol beverages are not misleading and provide adequate information to the consumer. (Attachment A provides a more in-depth discussion of TTB's statutory authorities).

We recognize that the industries we regulate have a significant economic impact domestically. For example, the annual economic impact from the wine, distilled spirits, and beer industries is approaching $500 billion, and represents 3 to 4 percent of the Gross National Product.

When TTB was created in 2003, it was authorized to have 559 employees, but began with only 326 employees. Most of these positions were in our headquarters in Washington, D.C., our laboratories, and our National Revenue Center (NRC) in Cincinnati, Ohio. At the time, TTB had no field offices or CFO operation. In order to maximize our FTE allocations, we established a skeletal internal management staff, and contracted with the Bureau of Public Debt Administrative Resource Center (BPD ARC) to handle our accounting, travel, procurement, human resources and financial management support services. This allowed us to concentrate our FTEs on our primary mission.

Currently, TTB has approximately 150 employees working in our headquarters office and 180 employees working at the NRC. The remaining employees are located in field offices that have been established in several major U.S. cities, and at TTB's laboratory facilities in Maryland and California. The primary components that comprise the TTB organization include the Administrator, the Assistant Administrators for Headquarters Operations, Field Operations, Management/Chief Financial Officer, and Information Resources/Chief Information Officer. (Attachment B includes TTB organizational chart). TTB reports to the Office of Tax Policy in the Department of the Treasury.

TTB has transitioned its information technology support services from the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) to the private sector. The migration of IT support to the private sector includes the hosting of our custom business applications at a commercial site and the implementation of our office automation applications on our IT infrastructure.

In the 2007 Partnership for Public Service and Institute for the Study of Public Policy Implementation survey, "The Best Places to Work in the Federal Government," TTB ranked tenth on its rating of 222 programs in terms of best places to work, second for its family friendly environment, and sixth in strategic management. Human capital management remains the highest priority at the Bureau, along with fostering an environment of performance excellence and leadership continuity. The use of such human capital flexibilities as telework, flexible work schedule arrangements, student educational employment programs, student loan repayment program, health improvement program (which provides employees time for exercise), and performance system are the primary factors contributing to TTB's recognition as one of the best places to work. TTB's implementation of these initiatives not only enhances the recruitment and retention of highly skilled employees, but also provides facility cost savings to the Bureau that are invested in improved services to stakeholders.

The financial resources to support TTB core business activities under the FY 2009 President's Budget are $99,768,000, including $96,900,000 from direct appropriations and an estimate of $2,868,000 in offsetting collections, mainly from the Puerto Rico cover-over program.

**Mission**

TTB's mission is to collect alcohol, tobacco, firearms, and ammunition excise taxes that are rightfully due, to protect the consumer of alcohol beverages through compliance programs that are based upon education and enforcement to ensure a fair and even marketplace; and to assist industry members to understand and comply with Federal tax, product, and marketing requirements associated with the commodities we regulate. TTB has two primary strategic goals: (1) Collect the revenue and (2) Protect the public. These goals are closely integrated and the resources attributed to these functions are evenly distributed.

**I. COLLECT THE REVENUE**

TTB collects alcohol, tobacco, firearms, and ammunition excise taxes pursuant to Chapters 51, 52, and sections 4181 and 4182 of the IRC. These products generate nearly $15 billion in annual Federal excise tax revenues. The excise taxes collected by TTB come from more than 6,100 businesses, and these taxes are imposed and collected at the producer level of operations. (Note that excise taxes on imported products are collected by Customs and Border Protection). Members of the regulated industries paying excise taxes are distilleries, breweries, bonded wineries, bonded wine cellars, manufacturers of cigarette papers and tubes, manufacturers of tobacco products, and manufacturers and importers of firearms and ammunition. About 200 of the largest taxpayers account for 98 percent of the annual excise tax collected. In FY 2007, TTB collected the majority of taxes from tobacco (49 percent) and alcohol (49 percent), with the remaining two percent from firearms and ammunition. The alcohol and tobacco taxes we collect are remitted to the Department of the Treasury General Fund. The firearms and ammunition excise taxes we collect are remitted to the Fish and Wildlife Restoration Fund under provisions of the Pittman-Robertson Act of 1937.

The following table displays the amount of Federal excise taxes TTB collected from FY 2003 through FY 2007 by revenue type.

| Revenue Type | FY 2003 | FY 2004 | FY 2005 | FY 2006 | FY 2007 |
|---|---|---|---|---|---|
| **Alcohol** | $6,910,631,000 | $6,995,366,000 | $7,074,076,000 | $7,182,940,000 | $7,232,138,000 |
| **Tobacco** | $7,382,435,000 | $7,434,211,000 | $7,409,758,000 | $7,350,842,000 | $7,194,113,000 |
| **Firearms Ammunition Mfg.** | $193,414,000 | $216,006,000 | $225,818,000 | $249,578,000 | $287,835,000 |
| **Special Occupational Taxes*** | $103,781,000 | $100,562,000 | $10,190,000 | $2,895,000 | $2,808,000 |
| **TOTALS** | $14,590,261,000 | $14,746,145,000 | $14,719,842,000 | $14,786,255,000 | $14,716,894,000 |

*Special Occupational Taxes (SOT) were suspended on most alcohol taxpayers, effective July 1, 2005, and repealed for all alcohol taxpayers effective July 1, 2008.

In 2007, TTB collected $323 of revenue for every dollar spent to administer its tax-collection operation. TTB attributes this success to its professional working relationship with industry members as well as its lean administrative overhead. In 2005, TTB underwent a Program Assessment and Review Tool (PART) review by the Office of Management and Budget and received an effective rating for its Collect the Revenue Program.

In addition to the collection of excise tax, TTB administers cover-over payments to Puerto Rico and the Virgin Islands, and processes excise tax drawback claims. Federal excise taxes collected on articles produced in Puerto Rico and the Virgin Islands and subsequently transported and sold in the United States are "covered-over" (or paid) into the treasuries of Puerto Rico and the Virgin Islands. In FY 2007, TTB processed $459 million in cover-over payments from rum to Puerto Rico and $8 million to the Virgin Islands. Also, under current law, persons who use non-beverage alcohol in the manufacture of medicines, food products, flavors, extracts, or perfume and other non-potable products may be eligible to claim drawback of most of the excise taxes paid on distilled spirits used in their products. In FY 2007, TTB processed $332 million in such drawback claims.

One of the reasons we have been so effective in collecting the revenue rightfully due is an active field presence. TTB's Office of Field Operations conducts audits, investigations, and analyses to ensure the fair and uniform enforcement of all applicable laws and regulations within our jurisdiction. The staff also works to identify gaps in tax payment and any individuals illegally operating outside the excise tax system.

TTB's audit program is based upon a risk approach. We audit those taxpayers who, based upon a variety of factors, present the greatest risk to the collection of the revenue rightfully due. As a consequence, we audit approximately 90 percent of the revenue every three years. We also identify other risk factors that indicate likely noncompliance with the tax laws and include them in our audit schedule. From FY 2004 through FY 2007, our auditors and investigators identified approximately $25 million in tax, interest, and penalties and saw our voluntary compliance increase substantially, as explained in greater detail below.

To resolve our audit and investigative findings, TTB either collects the full amount due, or resolves these cases through offers in compromise when doubt as to liability or collectability is present, as provided under our IRC jurisdiction. Likewise, TTB also resolves some of these matters through adverse actions resulting in surrender or revocation of the permit under the IRC and FAA Act.

To maximize our enforcement capabilities, the Office of Field Operations reorganized and established a new Trade Analysis and Enforcement Division (TAED). TAED provides intelligence analysis for the purpose of identifying and developing targets for investigation and audit that would most likely reveal compliance violations. The intelligence gathered is also used to determine trends and schemes utilized to facilitate tax diversion, including tax fraud and evasion, and to provide assistance in the investigation of substantive cases. Results of all of these activities are fed into a risk model, which provides criteria for determining resource expenditures for future audits and investigations.

TTB recently established a Tobacco Laboratory within its Scientific Services Division. TAED and the Trade Investigations Division (TID) work closely with the Tobacco Laboratory to pursue and collect the tax liability on tobacco products. Using state-of-the-art equipment, the Tobacco Laboratory analyzes tobacco product samples to assist in tax classifications of tobacco products, including cigars, cigarettes, roll-your-own tobacco, pipe tobacco, chewing tobacco, and snuff. In FY 2007, TTB analyzed 157 tobacco product samples for tax classification purposes. The Tobacco Laboratory has established collaborative partnerships with the Centers for Disease Control and Prevention (CDC) and the Canada Border Services Agency (CBSA). In addition, the laboratory has become a member of the World Health Organization's Tobacco Laboratory Network (TobLabNet), a global tobacco testing laboratory network, which extends the laboratory's contact to the tobacco enforcement laboratories of more than 100 countries.

**Efficient Government**

One of TTB's goals in collecting the revenue is to administer laws and regulations in a way that imposes the least burden on the taxpayer. TTB does this through various voluntary compliance efforts such as implementing electronic government initiatives, engaging in open lines of communication, and conducting industry seminars.

- **Electronic Government**—TTB has recognized the need to provide the regulated industries with the option of electronically filing tax returns, tax payments, operational reports, and certificates of label approval. To this end, TTB

has implemented a streamlined and automated process for receiving tax returns, operational reports, and payments submitted through Pay.gov, which is designed to interface with existing TTB business systems. This system reduces paper, manual processing, and errors, and speeds up the payment process. In FY 2007, 98 percent of TTB's tax receipts were collected electronically.

- **Informing Taxpayers**—An open line of communication with the taxpayer is essential in achieving our goal of collecting all the revenue due. We keep industry members and the public primarily informed through TTB's Web site, www.ttb.gov. In 2007, TTB launched a new e-mail subscription service, TTB Updates, which provides visitors to our web site the option of subscribing to more than 70 web pages for e-mail alerts when content changes. This is an electronic government solution called GovDelivery and our customers enthusiastically embraced this innovative approach to information dissemination. By September 2007, more than 23,000 people subscribed to the updates, with an average customer subscribing to about 11 pages.
- **Seminars and Other Efforts**—TTB has pursued various other measures to promote voluntary compliance with the statutes and regulations we administer. TTB maintains consistent contact with taxpayers, through seminars, communications between industry members and our auditors, investigators incident to field visits, and through specialists who respond to requests for assistance. For example, in FY 2007, the Office of Field Operations alone held 17 compliance seminars, which were attended by more than 2,100 industry members. These seminars offered plain language guidance on how to comply with Federal laws and regulations. Since its first year in existence, TTB has seen its voluntary compliance rate rise (measured in the number of timely and accurate tax payments made) from 80 percent in 2003 to more than 86 percent in 2006. We have also made efforts to simplify our regulations to make them clearer and easier to understand.

## II. PROTECT THE PUBLIC

TTB's second key strategic goal is to protect the public and prevent consumer deception. TTB has implemented this mission by ensuring the integrity of: (1) regulated industries, (2) alcohol beverage products, and (3) the alcohol beverage marketplace.

**Integrity of the Regulated Industries**—TTB is committed to ensure the integrity of the regulated industries, in which the goal is to keep ineligible persons from entering the alcohol and tobacco industries. The illicit sale of tobacco and alcohol is financially lucrative, and a known funding source for criminal and terrorist enterprises. To ensure that only eligible persons enter into the business, TTB conducts background checks and in-depth interviews on all new applicants. In FY 2007, TTB issued 5,285 original and 22,336 amended permits.

Of these permit applications in FY 2007, TTB investigators conducted nearly 630 investigations of applicants to verify that they were qualified to operate under the applicable statutes. As a result of these screening and investigation efforts, an annual average of 10 percent of all original applications referred for investigation are either denied or withdrawn.

Integrity of Alcohol Beverage Products—Under the FAA Act, importers and bottlers of beverage alcohol are required to obtain certificates of label approval (COLAs), or a COLA-exemption approval, for most alcohol beverages prior to their introduction into interstate commerce. The intent is to prevent consumer deception and to ensure that the label on an alcohol beverage product provides the consumer with adequate information as to the identity and quality of the product. In FY 2003 TTB's Advertising, Labeling and Formulation Division (ALFD) processed more than 100,000 COLA applications, and by FY 2007 that number had risen to over 125,000 applications annually. Of these applications, 22 percent were rejected, returned for correction, withdrawn, or surrendered. Fifty-one percent of these FY 2007 applications were received through COLAs Online, an electronic system that allows alcohol industry members to submit label application information online, saving considerable time and money in making and processing applications.

TTB performs field investigations to verify the integrity of the product to ensure the accuracy of claims made on an alcoholic product's label, based on supporting records. For example, the investigation may include on-site review of production and bottling records (such as viticulture sourcing documents in the case of wine products), varietal traces, and review of production records to ensure they match approved formulas.

Other key TTB functions that ensure the integrity of alcohol beverage products include:

**Formulas for Domestic Alcohol Products**—TTB examines formulas for domestic wine, distilled spirits, and malt beverages and pre-import applications filed by alcohol importers to determine the proper identification of the product and to ensure that products are manufactured in accordance with Federal laws and regulations (as well as for tax-classification purposes).

**Laboratory Support**—TTB's Scientific Services Division's (SSD) laboratories conduct analyses of alcohol beverage products to ensure compliance with approved formulas and established standards of identity. In FY 2007, SSD analyzed more than 2,000 beverage alcohol samples for product integrity, pre-import analysis and other purposes.

**Alcohol Beverage Sampling Program**—TTB has recently expanded its Alcohol Beverage Sampling Program (ABSP) to include a statistically valid sampling model. In the new ABSP pilot program, TTB will collect samples of alcohol beverage products from the marketplace, and review their labels and conduct laboratory analyses. The purpose is to determine if the labels accurately describe the products that are in the bottles and are otherwise in compliance with our regulations. We will then take enforcement actions as appropriate.

**Contamination and Consumer Complaints**—As part of its mission to Protect the Public, TTB responds to contamination incidents and consumer complaints of mislabeled products. In these instances, we obtain samples of the product in order to conduct a lab analysis, and if appropriate, notify the producer to identify the extent of the problem. We take appropriate measures to ensure that the product does not present a threat to the consumer.

Integrity of the Alcohol Beverage Marketplace—TTB conducts investigations of unlawful trade practices to ensure that the alcohol beverage marketplace is free from anticompetitive practices that allow undue supplier influence over retailer purchasing decisions.

In addition, to ensure the integrity of the marketplace, we monitor written or oral advertisements or other statements used to induce sales of alcohol beverage products. The purpose is to prevent false or misleading claims, which may deceive the consumer.

TTB's International Trade Division (ITD) works to protect the integrity of the alcohol beverage marketplace by educating foreign governments about the laws and regulations that TTB administers regarding the importation of alcohol. In addition, ITD has participated in the negotiation and formation of the following recent international trade agreements:

**Agreement on Mutual Acceptance of Oenological Practices and Agreement on Requirements for Wine Labelling**—The World Wine Trade Group (WWTG) is an informal group of wine producing countries, comprised of Argentina, Australia, Canada, Chile, New Zealand, South Africa, and the United States to facilitate the international trade in wine. The group accounts for around 27 percent of world wine exports. In 2007, the United States exported $208 million in wine to its WWTG counterparts.

The WWTG has negotiated two agreements. The first is the Agreement on Mutual Acceptance of Oenological Practices, which recognizes common winemaking practices. The second agreement is the Agreement on Requirements for Wine Labeling, which recognizes the different regulatory requirements for placement of information on wine labels.

**United States/European Community Wine Agreement**—In 2006, the United States and the European Community (EC) signed the first phase of an Agreement on Trade in Wine, which provides for the recognition of existing current winemaking practices, as well as a consultative process for accepting new winemaking practices. The Agreement also provides for the simplification of certification requirements for U.S. wine exported to the European Community. U.S. and EC negotiators are currently meeting to establish a second phase of the agreement as provided for in the current accord. In 2007, the United States exported $458 million in wine to the European Community.

**United States/Mexico Trade in Tequila Agreement**—In 2006, the United States and Mexico signed an agreement that ensures the continuation of trade in Tequila without additional restrictions from Mexico.

**Cooperation With Other Federal and State Agencies and Other Organizations**

TTB partners with Federal and State agencies and other organizations to maintain the proper level of oversight to collect the revenue and to protect the public.

**Other Federal Agencies**—TTB works along with Customs Border Protection (CBP) in administering our jurisdiction with respect to imported products. Specifically, CBP ensures that importers have a valid permit as required under current law, that taxes on imported products are paid, and that alcohol beverages carry labels that TTB has approved prior to removal into domestic commerce. TTB also works with CBP in the development of its integrated International Trade Data System (ITDS), in order to facilitate verification of the authenticity of commercial goods being shipped into U.S. ports. TTB will use ITDS to identify and pursue persons who are importing without a permit and otherwise acting out of compliance with our jurisdiction. Where we discover smuggled alcohol, tobacco, or firearms, our policy is to refer these matters to CBP, Immigrations and Customs Enforcement and ATF, and work with them to enforce our respective jurisdictions. In addition, TTB and ATF have a Memorandum of Understanding (MOU) to provide access to the information essential for the accomplishment of our missions.

TTB works with the Food and Drug Administration (FDA) for expert advice on health and safety issues related to alcohol beverages. For example, we contact FDA when we encounter potentially adulterated alcohol beverages (as determined under the Federal Food, Drug and Cosmetic Act) so that we can take appropriate enforcement action under our statutes. TTB and FDA have an MOU to coordinate responses in regard to contaminated alcohol beverages. Likewise, we have worked with the FDA on our proposed rulemaking concerning the labeling of allergens on alcohol beverages.

TTB and the U.S. Department of Agriculture (USDA) share in the regulatory control of alcohol products that bear an organic claim on their labeling. TTB and the USDA have an MOU to allow for a timely concurrent review of alcohol beverage labels that bear an organic claim. In addition, TTB has assisted USDA in its administration of the Fair and Equitable Tobacco Reform Act by providing information related to tobacco products removed subject to tax by manufacturers and importers.

In addition, TTB provides assistance to the Office of the United States Trade Representative (USTR) in alcohol beverage and tobacco matters within the ambit of the World Trade Organization, as well as in the negotiation of bilateral and multilateral free trade agreement issues related to wine and spirits.

Finally, TTB and the Federal Trade Commission (FTC) have cross-jurisdictional authority in the area of beverage alcohol advertising. TTB has worked with FTC on several occasions in response to complaints about alcohol advertisements.

**States**—TTB has executed agreements with most State agencies responsible for alcohol and tobacco taxes for the purpose of sharing of tax information. TTB also consults with States to provide background information on permit applicants prior to the issuance of tobacco permits. We also work closely with States on matters involving our common jurisdiction.

**Other Contacts**—TTB also consults with other organizations for the purpose of understanding the industries, to gain intelligence on unlawful activities and to effectuate an enforcement scheme that fulfills our responsibilities without undue interference in our respective operations. For example, we consult with the Federation of Tax Administrators and the National Association of Attorneys General, the National Conference of State Liquor Administrators, and the National Association of Beverage Control Administrators.

**Significant Issues and Accomplishments**

**Establishment of an MOU with China's AQSIQ**—On December 11, 2007, TTB signed an MOU with China's General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), to protect the public and to establish a consistent channel for information exchange on imported and exported alcohol and tobacco products. The MOU establishes a consultative process to strengthen cooperation in the administration of import and export alcohol and tobacco regulations and compliance determinations. In addition, the MOU establishes processes to provide for the exchange of information with regard to the identity and quality of imported and exported alcohol and tobacco products.

**New Regulations for Distilled Spirits Plants Operations**—On May 8, 2008, TTB published a notice of proposed rulemaking (NPRM) in the Federal Register that proposes to amend our primary body of regulations governing distilled spirits

plants—27 CFR part 19. These regulations have not been updated since 1980 and therefore do not reflect current industry innovations and practices.

**Cigar and Cigarette Rulemaking**—In FY 2007, TTB published Notice No. 65, Tax Classification of Cigars and Cigarettes, which proposes changes to the regulations that govern the classification and labeling of cigars and cigarettes for Federal excise tax purposes under the IRC. These proposed regulatory changes address TTB's concerns regarding the adequacy of the current regulatory standards for distinguishing between cigars and cigarettes. The proposals clarify the application of existing statutory definitions and update and codify administrative policy in order to provide clearer and more objective tobacco product classification criteria. The clarifications contained in the NPRM are intended to reduce possible revenue losses through the misclassification of cigarettes as little cigars. We are currently analyzing the comments we received in response to this NPRM.

**Fuel Ethanol**—A major challenge facing TTB is the accelerated growth of alcohol fuel production. In 2005, total U.S. production of alcohol for fuel use was approximately four billion gallons, and in 2006 it was nearly five billion gallons. Current capacity is nearly seven billion gallons per year, and plants under construction will make an additional five billion gallons annually. Most alcohol fuel production comes from fewer than 150 large plants, but hundreds of smaller plants have applied for TTB permits in each of the last four fiscal years. Near the end of last year, TTB had 1,567 active alcohol fuel plants. From October 2007 through March 2008, TTB received 197 new applications for alcohol fuel plants. With the number of new permittees dramatically increasing, TTB is using resources to ensure this industry's compliance with the laws and regulations. This growth is expected to continue.

**American Viticultural Program**—American viticultural areas (AVAs) are designated as such under the authority granted in section 105(e) of the FAA Act to prescribe regulations concerning the labeling and bottling of alcohol beverages. An AVA is a delimited grape-growing region that is known to the public by a specific name and has distinguishing geographical features from its surrounding areas. By using an AVA name on a wine label, a wine producer may identify for the consumer the specific geographical area from which the grapes used in the wine originated.

TTB administers the AVA Program and, since TTB's inception in 2003, has approved 43 petitions to create or expand AVAs, and is currently processing 22 others. The petitions we have received since 2003 for establishing or expanding AVAs have involved grape-growing regions in the States of California, Idaho, Illinois, Indiana, Iowa, Minnesota, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Texas, Washington, and Wisconsin.

In November 2007, TTB published proposed revisions to our regulations covering the approval of AVAs. The general purpose of these proposed changes was to maintain the integrity of the program, and specific proposals were made to: (1) clarify the petition submission and review process; (2) clarify the standards for approving AVA; and (3) establish a rule that recognizes both a new AVA and an existing winery's brand label(s) that might be the same as the proposed AVA but outside of the proposed AVA boundaries, by "grandfathering" existing longstanding label use for wines that would not meet the AVA appellation standard. Regarding the last proposal, TTB simultaneously published an NPRM regarding the establishment of a specific viticultural area, and that rulemaking included a similar proposal intended to minimize the adverse economic impact on an existing brand label holder. In response to this NPRM, TTB received 183 detailed comments and approximately 1,170 form-letter and postcard comments. We are carefully analyzing the comments.

**Alcohol Products Labeling**—On July 31, 2007, TTB published Notice No. 73, Labeling and Advertising of Wines, Distilled Spirits, and Malt Beverages, to amend its regulations to require a statement of alcohol content, expressed as a percentage of alcohol by volume, on all alcohol beverage product labels. This NPRM also proposes to amend the labeling regulations to require a Serving Facts panel, which would include a statement of calorie, carbohydrate, fat, and protein content. The proposals would also allow industry members to disclose on the Serving Facts panel the number of U.S. fluid ounces of pure alcohol (ethyl alcohol) per serving as part of the statement of alcohol content referred to above. The proposed new regulations would also specify reference serving sizes for wine, distilled spirits, and malt beverages based on the amount of that beverage customarily consumed as a single serving. The NPRM proposes to make these new requirements mandatory three years after the date of publication of a final rule.

The comment period on Notice No. 73 closed on January 27, 2008. TTB received approximately 800 comments on Notice No. 73, and we are currently in the process of reviewing these comments.

**Allergen Labeling**—On July 26, 2006, TTB published T.D. TTB–53 setting forth interim regulations allowing voluntary labeling of major food allergens used in the production of alcohol beverage products. Under the interim regulations, producers, bottlers, and importers of wines, distilled spirits, and malt beverages may declare on a product label the presence of milk, eggs, fish, Crustacean shellfish, tree nuts, wheat, peanuts, and soybeans, as well as ingredients that contain protein derived from these foods, if any of those substances or ingredients were used in the production of the alcohol beverage. Once a producer decides to engage in allergen labeling, the interim regulations require the listing of all allergens used in production and specify how that labeling must be carried out. The interim regulations also set forth a petition procedure whereby a producer may obtain an exemption from the labeling for a particular allergen. On the same date, TTB published Notice No. 62, which proposes to make mandatory the voluntary allergen labeling regime.

These efforts stem from the passage of the Food Allergen Labeling and Consumer Protection Act of 2004, which amended the Food, Drug and Cosmetic Act by the inclusion of major food allergen labeling standards for products subject to that Act. The House Committee Report (H.R. Rep. No. 608, 108th Cong., 2d Sess., at 3 (2004)) accompanying the Act noted that the Committee expected TTB to issue regulations on allergen labeling for beverage alcohol products, and to work in cooperation with the FDA in this regard.

**TTB Import Safety Measures**—An Interagency Working Group on Import Safety was established in July of 2007 to conduct a thorough review of U.S. import safety practices and to determine where improvements could be made. As a result of TTB's involvement in the Working Group, where it served as a Treasury representative, we devised a number of recommendations meant to highlight the importance of import safety and work towards preventing and minimizing potential safety concerns. Of the eight recommendations, TTB has already implemented three: (1) implementation of a statistically valid alcohol beverage sampling program; (2) enhancing information-sharing with counterpart regulators in foreign countries; and (3) advising importers and producers to be vigilant about product safety. TTB is continuing efforts to implement the remaining recommendations.

Laboratory Accomplishments—In 2007, two TTB laboratories obtained ISO 17025 accreditation from the American Association for Laboratory Accreditation (A2LA), an accreditation body in the United States. ISO is a non-governmental organization that promotes the development of standardized methods to facilitate the international exchange of goods and services.

In 2006, TTB opened a new compliance laboratory in Walnut Creek, California. This laboratory provides support to TTB through routine product integrity testing, monitoring the regulatory compliance of both beverage and non-beverage alcohol products, and onsite and online technical assistance to regulated industries, TTB investigators, and auditors. Laboratory personnel test samples collected by TTB field personnel from on-site investigations and audits to determine if the products are in compliance with the correct tax class and standard of identity.

**Mission Impact on Trade**—TTB has been instrumental in helping domestic producers overcome foreign trade barriers based on the expertise of our laboratory to verify that domestic products (destined for export) comply with U.S. requirements. For example, when the European Union (EU) proposed setting a limit on the presence of Ochratoxin-A, a naturally occurring toxin in wines obtained from certain grape harvests, TTB provided an advanced screening process that demonstrated U.S. wines met the EU's standards, and were properly labeled as wine. In addition, in November 2005, German customs officials detained a bulk shipment of Rose Cabernet Sauvignon because they claimed that it was mislabeled. TTB assisted in U.S. Government efforts to respond to German concerns. Eventually the European Commission determined that the wine was properly labeled as Cabernet Sauvignon and entitled to be sold in Germany pursuant to the United States/European Community Wine Agreement. In June 2006, the shipment was released for sale.

TTB Tightens IT Security and Tests Continuity of Operations Procedures (COOP)—The protection of sensitive data has become a high priority for all Federal agencies. To minimize the risk of such a breach, TTB encrypts the hard drives of all employees' computers. All data stored on TTB computers are both password protected and encrypted, providing maximum privacy for all sensitive TTB and industry data. This encryption provides the most aggressive level of protection for personally identifiable information (PII), minimizing risk to Bureau personnel and our regulated industry members. As an additional security measure, TTB uses two-factor authentication for remote access to TTB resources. TTB also encrypts auxiliary/portable devices.

In FY 2007, we tested the reliability of our IT Infrastructure. The Bureau continued to operate through seven planned and unplanned power outages at our major data centers in Cincinnati, Ohio, and Washington, D.C. The data center monitoring and alerting equipment, robust backup power supplies, and personnel recall procedures were put to the test during each of the power outages. Equipment was restored with minimal damage and TTB productivity was uninterrupted. TTB's disaster recovery and COOP procedures were also tested when the TTB Headquarters building was flooded, during which the data center and several network wiring closets were covered with water. All TTB IT operations were up and running just four hours after the flooding incident occurred. Personnel could work remotely from their homes in the days following the incident and Bureau operations continued normally.

**TTB Expo**—In June 2008, TTB will hold a new educational event called TTB Expo 2008. While TTB staff have an excellent reputation for holding industry-specific seminars, this event will be on a much larger scale than anything we have attempted in the past. The Expo, which will span two full days, will be comprised of over 40 different educational seminars presented by TTB and other Federal and State representatives and is designed as a unique way to educate people about how to comply with the myriad laws, regulations, and policies affecting the alcohol, tobacco, and firearms and ammunition industries. Also, 16 exhibition booths will be open throughout the Expo, allowing attendees to spend one-on-one time with TTB experts and to obtain guidance and informative brochures regarding TTB regulations and requirements. Our goal in hosting this event is to "build bridges" between government and regulated industry members and to establish an ongoing and open dialog. Attendees of TTB Expo 2008 will have the opportunity to meet the TTB employees who process their tax returns and other TTB forms and to have all their questions answered by subject-matter experts. The Expo is open to all TTB regulated industry members as well as to persons interested in entering one of those businesses.

**Conclusion**

I appreciate the Subcommittee's interest in TTB and the opportunity you have afforded me to report on our progress since the Bureau's creation and on the challenges that still face us. I look forward to continuing to work with the Subcommittee as we strive to meet industry and public expectations for responsive, fair, and efficient government. I will be happy to answer any questions that you may have.

## Attachment A

## TTB's STATUTORY AUTHORITY

TTB is responsible for overseeing a comprehensive scheme of statutory provisions with respect to the regulation of alcohol, tobacco, firearms and ammunition under the Internal Revenue Code of 1986 (IRC), as well as additional authorities under the Federal Alcohol Administration Act (FAA Act) and the Webb-Kenyon Act.

Chapter 51 of the IRC contains the excise tax provisions relating to alcohol and the authorized operations of the various segments of the alcohol industry, including manufacturers of nonbeverage products, as well as tax-free and denatured alcohol. Specifically, TTB oversees the qualification and operation of distilleries, wineries, breweries, and industrial alcohol producers and users. TTB administers the tax classification of alcohol products and the collection of excise taxes on these products. TTB also administers the production, packaging, bottling, labeling, and storage requirements related to alcohol products under the IRC.

With respect to tobacco, TTB administers chapter 52 of the IRC, relating to the manufacture, importation, exportation, and distribution of tobacco products. Specifically, TTB qualifies and issues permits for tobacco product manufacturers and importers, and export warehouses, and oversees their operations. TTB classifies various classes of tobacco products for tax purposes, and collects the tax on such tobacco products, as provided under the statute and implementing regulations.

Under the FAA Act, TTB is responsible for regulating the authorized operations, labeling, advertising, and trade practices for those engaged in the alcohol-beverage industry. The FAA Act requires a permit for all persons engaged in the business as a producer (other than breweries), importer, or wholesaler of alcohol beverages, and provides for the suspension and revocation of those permits upon failure to comply with the laws relating to alcohol. The permit system ensures the integrity of the industry by preventing persons who are not likely to operate in accordance with the law from entering the trade.

The FAA Act also requires approved certificates of label approval (or exemptions from label approval) for most alcohol beverages bottled or sold in the United States.

This labeling requirement, along with related advertising provisions, ensures that consumers are provided with adequate and non-misleading information about the alcohol beverages they purchase. In addition, the FAA Act contains trade practice provisions, which regulate such practices as exclusive outlets, tied house arrangements, commercial bribery, and consignment sales. These provisions are intended to ensure fair dealing within the industry and to protect the consumer by prohibiting sales arrangements that result from anti-competitive practices.

In addition to the FAA Act and the IRC, TTB also administers the Webb-Kenyon Act, 27 U.S.C. section 122, which prohibits the shipment of alcohol beverages into a State in violation of its laws. This law was amended in 2000 to give States the authority to seek injunctive relief in Federal District Courts to enjoin shipments of alcohol in violation of State law. TTB also enforces the Alcohol Beverage Labeling Act, which requires that the Government Warning Statement appear on all products for sale or distribution in the United States.

Finally, TTB administers the excise tax on firearms and ammunition under IRC sections 4181 and 4182. Here the IRC imposes taxes on the sale or use of firearms and ammunition by the manufacturer, producer, or importer. Tax is imposed on the sale or use at the rates of 10 percent on pistols and revolvers and 11 percent on firearms (other than pistols and revolvers) and shells and cartridges. The Pittmann-Robertson Wildlife Restoration Act of 1937 requires that an amount of all of the revenue collected under section 4181 (firearms, shells, and cartridges) and section 4161(b) (bows and arrows) be covered into the Fish and Wildlife Restoration Fund, hunter safety programs, and maintenance of public target ranges for execution of programs.

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Mr. NEAL. Thank you for your testimony, Mr. Manfreda.

Can you tell the Committee what the size of the markets for products manufactured and sold completely outside our tax system are?

Mr. MANFREDA. Sir, I do not have any fixed data on that. I can give you studies that we have read but I do not know the validity of those studies.

Just recently, we have formed a Trade Analysis and Enforcement Division. It is an intelligence function within our Office of Field Operations to actually gather that kind of data and formulate a base strategy to deal with sources or operations outside the legal system.

Mr. NEAL. What other agencies do you work with to try to collect those taxes?

Mr. MANFREDA. We work with the ATF. We work with Customs and Border Protection. We work very well with ICE. Between 2007 and today, we have developed over 108 enforcement cases in the works. Included in the agencies that we work with are many State agencies for the illegal importation, unlawful manufacturing or moonshining operations where we partner with the States to help facilitate stopping the manufacturing of moonshine.

Mr. NEAL. Thank you. Now I would like to recognize the gentleman from Minnesota, my friend, Mr. Ramstad, to inquire.

Mr. RAMSTAD. I thank my friend. Thank you, Mr. Chairman. Thank you, Mr. Manfreda, for your stewardship at the TTB as well as for your testimony today.

Given the explosion, and I do not think that is hyperbolic to call it an explosion of the Internet, Internet sales must represent special challenges to your agency. I am speaking in terms of collecting the excise taxes that are owed as well as ensuring the safety of the products.

Do you agree with that and how are you addressing those challenges?

Mr. MANFREDA. Sir, they are a big challenge to us. Probably prevalent the most in acquiring compliance with international Internet sites. I think such sites are used to facilitate entry of smuggled or non-tax paid cigarettes into this country through those types of sales.

Domestically, we are finding that for the most part domestic sales that are occurring from lawful manufacturers are going out with the Federal excise tax paid. However, one area where there is non-compliance is with Indian reservations.

Mr. RAMSTAD. I do not want you to be in a position of having to reveal, not that you would, any undercover operations, but can you tell us if you have an unit that concentrates on sales over the Internet?

Mr. MANFREDA. We do not have a specific unit. We are without law enforcement agents. To the extent we find leads with this type of activity, we have to work with other sister agencies, either IRS, the ATF, or Customs and Border Protection.

Mr. RAMSTAD. I certainly understand that collaborative relationship. I was alluding to finding the leads. I know you do not have the law enforcement function per se.

The other question I wanted to ask, you mentioned in your testimony the cooperative relationship that TTB has with other Federal agencies, and I cited it in my opening statement, including the FTC, the Federal Trade Commission.

I understand the Senate is considering language in the FTC authorization bill regarding alcohol advertising and so-called slotting fees. Are these not areas that have traditionally been under the TTB jurisdiction?

The reason I ask is that we certainly want cooperation and collaboration, not duplication among Federal agencies.

Mr. MANFREDA. Absolutely, sir. In the advertising arena, we have worked well over the years with the Federal Trade Commission. Generally, when we have issues, they will defer to us with areas of alcohol and tobacco.

The slotting fee issue is not really new to us, not from a point that we regulate it. Slotting fees are illegal in the liquor industry period. Under the Federal Alcohol Administration Act, they have been considered an illegal activity since 1992 in our regulations.

From the point of view of looking into that, we already have the knowledge and the experience to deal with slotting fees in the alcohol beverage industry, and that would be duplication in our mind.

Mr. RAMSTAD. Vis-a-vis the Senate bill, you are not concerned about possible duplication?

Mr. MANFREDA. It would appear there could be duplication, if they are looking at what are slotting fees and what is the history of it in the liquor industry. We already have all that information and the experience in enforcing our laws and regulations with respect to that activity.

Mr. RAMSTAD. That would be my thought as well. I think that is a caveat for us on this side of the Capitol.

Again, I thank you, Mr. Manfreda. I have no further questions and yield back.

Mr. MANFREDA. Thank you.

Chairman LEWIS [Presiding]. Mr. Pascrell.

Mr. PASCRELL. Thank you, Mr. Chairman.

Administrator Manfreda, is the TTB aware that some shipments mainly from Internet based sales of alcohol are shipped outside the regulatory framework of some States? I think you are aware of that; correct?

Mr. MANFREDA. Yes, sir.

Mr. PASCRELL. I have in front of me a list of things that have been conducted by various watchdogs and ask unanimous consent that this list be submitted into the record, Mr. Chairman.

Chairman LEWIS. Without objection.

Mr. PASCRELL. This list demonstrates that businesses who sell alcohol online to consumers often ship directly to consumers in violation of State law, even to minors.

Is the TTB aware that certain of these shipments also reach minors? Are you aware of that, Administrator Manfreda?

Mr. MANFREDA. Sir, we have read about that.

Mr. PASCRELL. You are not aware of the list I have in my hand documenting such activities? Are you telling me that your department does not know about this?

Mr. MANFREDA. Sales to minors does occur through Internet sales; yes, sir. I am aware of that. I do not know what is on your list.

Mr. PASCRELL. When direct shipments of alcohol reach minors, would you not agree this is a significant public policy concern?

Mr. MANFREDA. Yes, sir.

Mr. PASCRELL. What is the TTB doing to combat the online sales of alcohol to minors and what kinds of resources are needed for you to ensure that kids are not purchasing alcohol on the Internet?

I want you to take your time to answer that, please. I would appreciate it.

Mr. MANFREDA. Basically, direct sales of alcohol products, if they are being sold from a retailer to individuals, does not run into our jurisdictions that we have control over.

We have control when a particular entity who is doing Internet sales changes their status by selling to another entity that will sell for retail sale.

For the most part, these direct sales are violating State laws. In the year 2001, we published an industry circular where we basically said that sales that are sold by permitees in violation of State laws violate the Webb-Kenyon Act.

We have limited resources able to throw at this problem, so what we basically did is we prioritized the need, the Federal interest need, given our limited resources to deal with these problems across the board and said in those types of transactions, if the chief law enforcement officer of the State or their attorney general asks us for help in dealing with these problems, we will look into the matter and decide whether or not to take action against the permitee's permit for violating the Webb-Kenyon Act under our laws.

That is what we have been doing with that issue.

Mr. PASCRELL. Administrator Manfreda, this could be a form of interstate commerce if you are going across State lines. It would seem to me that the Federal Government does have jurisdiction,

that you need to look into this, and we would like to know what resources you need to implement what I believe should be Federal oversight.

There are different laws, as you know better than I do in each State, and some stricter than others.

It would seem to me that we need to get a handle on alcohol, particularly going across State lines and being sold to minors. What you are saying really in essence is that the Federal Government—this is not our jurisdiction. We rely on the State law in terms of jurisdiction here, unless I am misinterpreting what you said.

Mr. MANFREDA. We are saying that basically these are violations of State law.

Mr. PASCRELL. There is no violation on Federal law if you are shipping alcohol across State lines to juveniles?

Mr. MANFREDA. Not under the laws we enforce.

Mr. PASCRELL. Mr. Chairman, I would take note of that and I think we need to do something about that. Not to give you more work, but to give you more resources to do what you should be responsible for.

Mr. MANFREDA. Sir, I absolutely agree with you as far as this is a serious problem and does need to be addressed.

Mr. PASCRELL. I am glad that you admitted that it is a serious problem. Thank you. Thank you, Mr. Chairman.

Chairman LEWIS. Mr. Nunes.

Mr. NUNES. Thank you, Mr. Chairman.

Mr. Manfreda, you have already testified that you are aware of these illegal sales of alcohol going to minors. Obviously, you have been contacted by the States on these issues.

This is kind of along the questioning that was just asked, but if you have appropriate resources, what can TTB do to enforce these laws? Is there anything that is being done today to combat this?

Mr. MANFREDA. We have been contacted by States but only in two instances, to my knowledge, and each of those instances involved just six bottles being sold over the Internet.

Mr. NUNES. What type of alcohol was that?

Mr. MANFREDA. I would rather not say. I am not even sure. I can get that for the Committee.

In those two instances, one, we contacted the permitee that was involved, and it was a mistake and they said they would never do it again and so far, they have not.

In the second situation, it was something that was so de minimis that we did not pursue it.

What we can do, sales in violation of State law is a Webb-Kenyon Act violation. We administer the Webb-Kenyon Act. Under the FAA Act, we have the ability to suspend or revoke a permit if one violates one of the conditions of your basic permit.

From a technical point of view, we have the ability to suspend or revoke a permit for violations of State law when they rise to the level where we would take action under the Webb-Kenyon Act.

Mr. NUNES. I know you are doing all you can. I want to switch the line of questioning to the food poisoning issues that you referred to in your testimony. I assume you are aware of the poisoned vodka that got out in Moscow and killed several hundred people, I believe.

There are several initiatives that the Congress has under consideration regarding imported food products.

Can you describe the processes, procedures and permit requirements that the Tax and Trade Bureau already has in place for beverage alcohol products to ensure that these products both imported and domestically produced are safe from contamination?

Mr. MANFREDA. Yes, sir. I would start with saying that every importer must be permitted under the Federal Alcohol Administration Act. When we issue those permits, we do background checks and we look at a person's financial standing, trade connections and business experience to decide whether or not he is likely to comply with Federal law. Really, only eligible people are given permits to import. That is the first control.

The second control is that we require what we call certificates of label approval for every alcoholic beverage before it can be removed from Customs' custody or into the domestic commerce of this country, removed by a bottler of such products.

That is basically what you see on every alcohol beverage bottle. It identifies what is in that bottle.

In a lot of cases with imports, we require pre-import samples, where we are able to identify what is going to be coming in from the sample.

From that point of view, we are able to do screening of those kinds of products and if we find it does not match up with what they say it is, we deny the certificate of label approval and it never gets to come into the country.

We have also initiated a market basket testing program where our investigators go out and from all levels of the distribution chain pull product samples and send it to our lab to identify basically that it is what is said on the label. It is verified from our scientific analysis back in our labs. We do that routinely.

Through 2005 to 2007, we actually analyzed 209 bottles for pesticide contamination. When we pull a bottle, out of those, 42 of them were domestic and 167 were foreign. All 42 of the domestic proved to be fine with no pesticide contamination, and out of the 167, there were 38 bottles that contained pesticides.

When we get a hit like that, we immediately go to EPA who identifies to us just what pesticides are authorized and which ones are not, and if it is authorized, we look to the Food and Drug Administration to determine whether the levels are acceptable.

In this case, there were six that had hits of unauthorized pesticides, but after talking with FDA, it was determined that the levels which they were at did not raise any health issue or concern.

We then would notify an importer to say this should not come back into this country again and we verify it at later dates to make sure the product is free of the pesticides.

Mr. NUNES. Thank you, Mr. Manfreda, for your testimony. I know you have a very difficult job.

Mr. Chairman, I have some news articles that I would like to submit for the record.

Chairman LEWIS. Without objection.

[The information follows:]

**Rep. Devin Nunes**
**Oversight Subcommittee Hearing on the Alcohol & Tobacco Tax & Trade Bureau**
**Tuesday, May 20, 10:30 a.m.**

*News reports regarding illegal online sales of alcohol- submitted for the record.*

**Boston Now (Massachusetts)**
**Court corks Wine.com for sales to minor**
**James O'Brien**
**March 19, 2008**

**The Daily Iowan**
**Delivery may have broken law**
**Eric Rodriguez**
**March 19, 2007**

**Kansas State Collegian**
**(college newspaper for Kansas State University)**
**distributed via University Wire, a news service similar to AP for college newspapers**
**Kristina Monroe**
**August 29, 2006**

**NBC Nightly News**
**Who is minding the Internet liquor store?**
**An NBC News investigation finds it easy for underage drinkers to buy online**
**Lea Thompson**
**Chief consumer correspondent**
**August 9, 2006**

**Pioneer Press (Minnesota)**
**Wine ordered online lands in teens' hands**
**Courier delivers liquor to teen; other laws are broken**
**Debra O'Connor**
**June 5, 2006**

**St. Petersburg Times (Florida)**
**Crist: No mail-order alcohol**
**The state should continue to ban mail-order alcohol to combat underage drinking, he says.**
**Alisa Ulferts**
**February 2, 2005**

**Seattle Post-Intelligencer**
**A few clicks can get minors liquor**
**Candace Heckman**
**August 9, 2004**

**USA TODAY**
**Ordering liquor online sets off legal challenges**
**Donna Leinwand**
**June 9, 2004**

**News Release (Massachusetts)**
**AG Reilly, ABCC Take Against Online Alcohol Retailers Accused of Selling to Underage College Students**
**June 8, 2004**

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**Boston Now**
**Court corks Wine.com for sales to minor**
**James O'Brien**
**March 19, 2008**

The Supreme Judicial Court ruled yesterday that an Oregon-based online wine retailer's Massachusetts sales license should be suspended for five days as punishment for selling wine to a commonwealth minor.

The state Alcoholic Beverages Control Commission handed down the ruling in 2005, but lawyers for Wine.com - whose Massachusetts office is eVineyard Retail Sales-Massachusetts, Inc. in Avon - petitioned, arguing the state Attorney General's sting operation was entrapment.

Employing a 19-year-old girl, investigators twice managed to get Wine.com to mail bottles to the minor after she gave a fictitious birth date on the website order form.

Wine.com's local office paid extra money for Federal Express to obtain a signature and proof of age from the girl, attorneys said, but the deliverer never did so.

The beverage commission slapped FedEx with a three-day suspension of its alcohol delivery license for its role.

The court rejected Wine.com's petition, citing establish attorney general procedures allowing "decoys to misrepresent their age."

At no time did the 19-year-old transmit false documents to Wine.com, according to the court. She simply used the company's website in a way "that could allow minors to make purchases by the simple expedience of misrepresenting their age."

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**The Daily Iowan**
**Delivery may have broken law**
**Eric Rodriguez**
**March 19, 2007**

The delivery man arrived at the apartment door of two UI students, laid the package at their feet, and asked for a signature.

The carton from the Illinois-based liquor retailer Binny's Beverage Depot held 24 bottles of Abita Golden Ale, and it was swiftly transferred to the awaiting students.

But the problems: the United Parcel Service delivery man failed to check identification - illustrating the ease for minors to get obtain alcohol via the Internet - and Binny's apparently shipped booze illegally to the Iowa City apartment.

The alcohol was delivered to a Daily Iowan reporter, who is of legal age, after he placed an order on Binnys.com. Under Iowa's liquor-regulatory statutes, the direct shipment of alcohol to any individual in the state, excluding certified wine makers, is banned.

Currently, Iowa Code 123.187 permits the reciprocal delivery of wines - shipments that may only be done by vintners. In addition, beer may only be sent by breweries to retailers, who would then sell the beverages, according to the Brewer and Wholesaler Agreements Chapter 123A.

Breaking these laws could lead to criminal charges for bootlegging, a serious misdemeanor that is punishable by fines ranging from $215 to $1,875 and up to one year behind bars. The individual who shipped the alcohol or the owner of the business that supplied the liquor usually face the charges.

"[Binny's Beverage Depot] is not authorized to bring liquor into the state [of Iowa]," said Lynn Walding, the administrator of the Iowa Alcoholic Beverages Division.

But Binny's isn't the only online liquor business that violates the law or is willing to do so. In a survey of various online alcohol retailers, *The Daily Iowan* found that five were willing to ship liquor illegally to Iowa.

The businesses included Texas retailer Specs Liquors, Berbiglia Wine and Spirits located in Kansas, New York-based Grand Wine Cellar, Minnesota liquor shop Surdyks Liquor Store and Gourmet Cheese Shop, and the Jug Shop in San Francisco.

In addition, consumers can type "alcohol" into the shopping search engine www.mysimon.com and retrieve 2,263 hits for businesses that would ship spirits and beers to consumers in Iowa.

Walding said shipping alcohol illegally across state lines is an issue for the Iowa Alcoholic Beverages Division.

Officials will send warnings to alcohol retailers as a result of Binny's shipment to the *DI* reporter, and they had planned prior to the incident to meet with major carriers, such as UPS and Federal Express, to discuss liquor shipments, Walding said.

Iowa City police Lt. Dan Sellers said shipping liquor to minors via online retailers wasn't an act he perceived was heavily abused. One way that police could help prevent liquor shipment to minors was for officers to cooperate with major carriers, he said.

"You could have an officer dress up as a UPS delivery person and check ID," he suggested.

The identification system currently in place can be easily circumvented. Anyone age 21 and older can sign for a package, even if her or his name isn't on the order, UPS spokesman Dan McMackin said.

Binny's is now under investigation by both UPS and the Illinois Liquor Control Commission. Company owner Michael Binstein said his business didn't mean to ship the beer illegally and that legal advisers were looking into Iowa's law.

The company's website states it is a misdemeanor or felony to ship alcoholic spirits to Michigan, Georgia, Indiana, Kentucky, Maryland, North Carolina, Tennessee, and Utah, among other states.

"We turn down over $3 million a year [to states we can't ship to]," Binstein said.

Ted Penesis, a spokesman for the Illinois Liquor Control Commission, said Binny's liquor license will either be fined, suspended, or revoked.

Binny's could also risk losing its contract with UPS due to the Feb. 19 shipment. The retailer broke an stipulation held by UPS that prohibits companies from shipping alcoholic beverages aside from wine via the carrier.

UPS' McMackin said the company was looking into the situation, and dropping Binny's contract could be an option. He also said UPS is not responsible for enforcing the law.

Yet, he added, the UPS driver who delivered the alcohol has been investigated because he did not ask for identification on the package ordered by the DI.

UPS delivery drivers are trained on how to deal with packages that require an "adult signature," noting that UPS keypads display a "see identification" reminder.

"We are not a police agency," McMackin said. "We don't expect to be, and we don't want to be."

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**Kansas State Collegian**
**(college newspaper for Kansas State University)**
**distributed via University Wire, a news service similar to AP for college newspapers**
**Kristina Monroe**
**August 29, 2006**

U-WIRE-08/29/2006-Kansas State U.: Some Kansas State U. minors admit to purchasing alcohol online (C) 2006 Kansas State Collegian Via U-WIRE

MANHATTAN, Kan. -- More than half a million minors have bought alcohol on the Internet. According to a survey by the Wine and Spirits Wholesalers of America Inc. released Aug. 10, 3.1 million minors between the ages of 14 and 20 have either bought alcohol on the Internet or know someone who has. In fact, 551,000 have admitted doing it themselves.

At least 20 states in the past year have passed laws that expand alcohol sales outside of the traditional ways to purchase it. This process breaks down the safeguards in place for face-to-face methods of purchasing alcohol.

"If we don't trust rushed FedEx and UPS drivers to card kids for cigarette shipments, why on Earth should anyone trust them to card kids for vodka and merlot shipments?" said WSWA CEO Juanita Duggan.

While several states have pushed for legislation allowing for Internet alcohol sales, nearly none regulates age checks.

WSWA's audit of lead alcohol-enforcement officials in all 50 states and Washington, D.C., found that 39 states and Washington, D.C., did not conduct any online alcohol compliance checks. Six additional states most likely did not conduct checks because they said they couldn't recall ever completing one, and only five states conducted isolated compliance checks, though none did them regularly.

The Manhattan area has statistics similar to the national numbers. In a recent survey, nearly half of the Kansas State University students polled who were under age 21 admitted to purchasing alcohol on the Internet or knowing someone who did.

"I would steer clear of that," said Jared Rizzo, president of Greeks Advocating the Mature Management of Alcohol, about purchasing alcohol online. "You never know what you'll get. It's a very risky thing."

Rizzo said he could not recall anyone in GAMMA attempting to purchase alcohol via the Internet and said his group does not encourage the practice. GAMMA advocates responsible alcohol use to all its members, no matter their age, he said.

A minor caught in possession of alcohol in Kansas will face a mandatory appearance in juvenile court, potential fines, jail time and a potential license suspension, no matter how the alcohol was purchased.

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**NBC Nightly News**
**Who is minding the Internet liquor store?**
**An NBC News investigation finds it easy for underage drinkers to buy online**
**Lea Thompson**
**Chief consumer correspondent**
**August 9, 2006**

WASHINGTON - While watching the movie Eurotrip last summer, incoming college freshman Rich DiBella and his buddies had an idea.

"The people in the movie had like this trippy hallucination, [a] weird feeling, and we wanted to see if the drink would give us the same feeling," he says.

The drink was 136-proof absinthe, and so their parents wouldn't find out, the teenagers ordered it online with a Visa gift credit card they got at a local bank.

"It's a lot easier because there's no ID'ing," says DiBella.

According to a new survey to be released Thursday, one in 10 teenagers have an under-aged friend who has ordered beer, wine or liquor over the Internet — more than a third think they can easily do it — and nearly half think they won't get caught.

"There hadn't been the evidence and now we have the evidence," says Juanita Duggan, with the Wine and Spirits Wholesalers of America.

The survey was paid for by Duggan's trade group, whose members compete against online sales, but clearly there is a problem. Massachusetts, Texas and Virginia have launched undercover investigations of online sales to minors and they all found it very easy to do.

So did NBC News. Two packages were delivered to a state where mail order alcohol is illegal — one was delivered to a 15-year-old who happened to be standing in the front yard, no questions asked. Only one came marked as alcohol. The others came in brown paper wrappers. There is no indication anywhere wine is in one, grain alcohol in the other.

And some online sellers blatantly flaunt the law. One Web site says it ships "discreetly in plain packaging." It warns making absinthe is illegal, but adds: "Don't worry we don't think the Feds will shoot a stun grenade through your window for placing a little online order."

What about those kids and their bottle of absinthe?

"It was just more of getting drunk fast and very, very drunk compared to like a beer or something like that," says Rich DiBella.

But he won't be ordering absinthe again. Not because it's illegal, but because he didn't like the taste.

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**Pioneer Press (Minnesota)**
**Wine ordered online lands in teens' hands**
**Courier delivers liquor to teen; other laws are broken**
**Debra O'Connor**
**June 5, 2006**

This spring, Minnesota wine fanciers were happy when a U.S. district judge's decision made it easier for them to buy wine online. Now, for example, small Sonoma wineries can advertise to Minnesotans, who can buy cabernets via their computers.

While this makes possible a considerable expansion of the Watchdog's sauvignon blanc universe, the change made the Pioneer Press wonder: Does it also make it possible for minors to buy wine online?

The Watchdog enlisted the aid of three families with teenagers and spent an unconventional afternoon using her company credit card to order liquor to be shipped to the teens in St. Paul, Rosemount and Eagan. From five Web sites, she ordered three bottles of wine, a bottle of vodka and a six-pack of beer. Every Web site required the Watchdog to lie through her teeth that the intended recipient was 21 or older. But because the shipper can't check your age online, that responsibility often falls to the courier who delivers the bottle.

Four of the five shipments ended up being illegal in some way.

In two cases, an underage kid was able to get the liquor.

A UPS courier handed over two shipments of wine to 14-year-old Marie Rutoski, who, after coming home from Rosemount Middle School, was shooting buckets in the driveway with her 12-year-old brother.

The courier first asked whether her parents were home, and she said no, Marie told the Watchdog. Then, she said, "He said, 'Your signature is going to have to do, then.' I had to sign something on his little keypad thing, and he said, 'Have a nice day,' and he left."

MOTHER DISMAYED

Marie's mother, Cheryl Rutoski, was dismayed that wine would be delivered in such a nonchalant manner.

"It's pretty scary to think that any kid could go online and order and get what they want," she said. "That's pretty surprising. You would think they'd have to be so careful nowadays."

Marie's wine shipments were illegal in different ways. One box was festooned with stickers: "Approved Wine Shipper. Alcoholic Beverages Cannot Be Delivered To Intoxicated Persons. Adult Signature Required — Min 21." The UPS courier clearly messed up that one.

"That's a regrettable mistake," said UPS spokesman Steve Holmes. Couriers are trained to check IDs and should not leave a box without doing so, he said.

The other package, which also contained wine, had no such stickers, but by state law, it should have. There was no way of telling the contents from looking at the box, so that delivery was the fault of the shipper, Wine Express. Unless, as Wine Express spokesman Josh Farrell suggested hopefully, the stickers fell off in transit. In any case, he said: "Certainly we don't intend to deliver alcohol to minors. We haven't had any other problems like this one." Or at least none that he's aware of, he acknowledged.

Plus, he said, ordering wine online is probably not going to become a craze for teenagers: "For the most part, kids aren't interested in drinking wine. It's expensive, and it doesn't mix well with orange juice."

PENALTIES URGED FOR DELIVERY COMPANIES

Paul Kaspszak, executive director of the Minnesota Municipal Beverage Association, was not surprised that a 14-year-old got wine even after being face-to-face with the courier. The stakes for providing alcohol to minors aren't as high with a delivery company as with a liquor retailer, where selling liquor to minors puts a license in jeopardy. His organization is against online buying. But if that's going to happen, he said, companies that deliver alcohol should have compliance checks and face penalties, just like liquor retailers do.

Two other deliveries were illegal not because they were delivered to a teen — they weren't — but because out-of-state retailers aren't supposed to ship beer and hard liquor to Minnesotans of any age. Shoppers Wines of New York sent green apple vodka to 16-year-old Rico Martinez of St. Paul. (His mother, Michelle, got stuck signing for it when the courier spotted her through the open door.)

"I'm sorry," said Shoppers Wines manager Ketan Shah, when informed of the transgression. "Usually (we) check. It shouldn't have happened."

A six-pack of Goose Island ale was sent to 14-year-old Preston Beyer of Eagan. Nobody was home when FedEx made three tries, and despite Preston's written request, the courier quite rightly refused to leave the beer without an adult signature. But as with the vodka, beer wasn't supposed to be sent to Minnesota, anyway. When the Watchdog called the seller, Internet Wines & Spirits, and explained the issue, the man to whom she was talking refused to give his name, then hung up.

CLERK ENFORCES RULES

The third bottle of wine was from a Minnesota winery, Fieldstone Vineyards. After some unsuccessful delivery attempts, Rico tried to pick up the strawberry wine. He was rebuffed by FedEx when a clerk demanded his ID and he said he'd forgotten it at home. So that worked out just as it's supposed to.

Studies and opinions vary about how much online sales might contribute to underage drinking. A 2004 National Academy of Science study reported that 10 percent of underage drinkers already buy alcohol online. But an article in Winebusiness.com contends that any online problem is small potatoes compared to minors persuading older friends and siblings to buy for them. One aspect of online ordering that would dampen a teen's interest is the shipping charges, which can cost more than the alcoholic beverage itself. The six-pack, for example, cost $9.81, but the shipping was $14.95.

As for the bottles that were successfully delivered, the Watchdog told the parents to keep and enjoy them. Or, if the Rutoskis aren't wine drinkers, they can cellar the Bourgogne Pinot Noir Vignerons de Buxy until 2013 — when Marie turns 21.

Editor's note: Feel like an underdog because of a problem with a business, government agency or school? Maybe the Pioneer Press Watchdog can help. Go to www.twincities.com and follow the link to our Watchdog home page. Or call 651-228-5419 or e-mail watchdog@pioneerpress.com.

WHAT'S THE LAW?

Here's the Minnesota law for buying alcohol online, according to Marlene Kjelsberg, supervisor in the state Alcohol and Gambling Enforcement Division of the Public Safety Department.

• Online stores can't sell or ship to minors.

• Getting the alcohol into the right hands is a dual responsibility: The shipper must put stickers on the box declaring that there's alcohol inside and that the person who signs for the box must be 21 or older; the delivery company can hand over the package only to customers who can prove they're at least 21.

• Wine only! No spirits or beer, even though some Web sites let such orders go through. The exception is if it's a Minnesota liquor dealer selling to a municipality that permits it.

• As is the case when liquor's sold in a bar or package store, it's illegal for the courier to turn over the package to someone who is obviously intoxicated.

• You can order a maximum of two cases of wine a year, with a maximum of nine liters a case.

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**St. Petersburg Times (Florida)**
**Crist: No mail-order alcohol**
**The state should continue to ban mail-order alcohol to combat underage drinking, he says.**
**Alisa Ulferts**
**February 2, 2005**

TALLAHASSEE - Ordinarily, Charlie Crist has a taste for issues that appeal to consumers.

But Florida's Republican attorney general is siding with the state's retailers and law enforcement officers in an ongoing debate over a state law banning mail-order alcohol.

To Crist, concerns about underage drinking trump the convenience of buying by mail.

Minors can too easily order alcohol through the mail, Crist said Tuesday, standing beside a 20-year-old Florida State University student Tuesday who ordered wine and tequila over the Internet at the behest of law enforcement.

"Current Florida law places appropriate hurdles in front of those who underage drink," said Crist, surrounded by law enforcement officers and representatives from the Florida Retail Federation.

Crist called the news conference to underscore his support for the law. He has already filed a brief with the U.S. Supreme Court, which has been asked to decide whether such bans violate the interstate commerce clause of the U.S. Constitution.

Twenty-four states, including Florida, prohibit mail order alcohol sales. Retail stores, which resent the competition, support the bans. Small wineries and breweries oppose them.

Crist, who is expected to run for governor in 2006, risks alienating fans of fine wines with his stance, but could gain some support among retailers and law enforcement. His position also differs with the current occupant of the governor's office.

Republican Gov. Jeb Bush thinks the ban is unconstitutional and ought to be repealed. "The idea you can only buy wine (from) a certain distribution system, I have always felt that was a little unjust," Bush said Tuesday.

State Sen. Paula Dockery, R-Lakeland, has filed a bill exempting wine from the state ban. "It's all protectionism," Dockery said.

As a freshman in the state House of Representatives, Dockery voted for the the ban, which she saw as a way to prevent people from avoiding state sales taxes as well as preventing underage drinking.

But wine enthusiasts were soon complaining that the law cut them off from some of their favorite wines, which can only be bought directly from winemakers.

For Dockery, the issue crystalized during a visit to California's Napa Valley wine country. Dockery bought a case of wine but was told she couldn't ship it home.

"If you go in person and they see you and you still can't get it shipped to your home, that doesn't make any sense," Dockery said.

Dockery's bill would require out-of-state wine shippers to be licensed, pay a $100 fee, collect information about who was buying and how much, pay the state sales tax monthly and obtain a photocopy of the purchaser's driver's license or other identification that shows a buyer's age.

Only wine would be covered, Dockery said, because she hasn't heard complaints from people about beer or spirits.

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**Seattle Post-Intelligencer**
**A few clicks can get minors liquor**
**Candace Heckman**
**August 9, 2004**

Forget the fake IDs. There's no need to bribe anyone into a trip to the liquor store, either.

All an underage person needs to get booze now is a credit card and a computer.

That's what a bunch of Gonzaga University students found out last month. They ordered liquor, beer and wine and had it delivered to their front doors without ever being questioned about their age.

Armed with full bottles and delivery receipts, the students are demanding that state Attorney General Christine Gregoire investigate several online companies selling and delivering alcohol to minors.

"Despite being underage, we were able to buy alcohol unchallenged from respected companies selling wine like Costco.com to less-known Internet sites that sell all forms of alcohol, including hard liquor," said Paul Schafer, president of Gonzaga's chapter of Collegians for a Constructive Tomorrow, the student organization that conducted the experiment.

The Gonzaga experiment touches the core of a national debate over local liquor control and interstate commerce. And as e-commerce continues to grow, Internet liquor sales are gaining popularity, even though they are illegal in most of the country. Selling hard liquor online to adults, as well as minors, is illegal in Washington. The state is among 18 states and one county in Maryland that directly control the sale of liquor within their borders, but Washington does allow limited online sales of wine.

"We believe the attorney general is not doing her job in enforcing an equal standard of the law," Schafer said. "A liquor-store owner will be fined and may lose his or her license if alcohol is sold to a minor, but there is no consequences, or no one checking, for the Internet retailers."

Most states, including many that ban any kind of interstate alcohol sales, are clinging to their right to enforce distribution laws both on the ground and online, while manufacturers, particularly the nation's wineries, are hoping to broaden their markets and ship products directly to consumers across state borders.

In Washington, Gregoire's staff has not decided what will be done about the Gonzaga request or the practice of online liquor sales, but state attorneys general are likely to act if presented with evidence, as they did in the case of Internet tobacco retailers two years ago, said spokeswoman Lori Takahashi.

In June, Massachusetts Attorney General Tom Reilly filed a lawsuit against four Internet retailers from four different states for selling alcohol to minors. Regulators also are investigating three other online retailers and three package delivery services for violating Massachusetts liquor laws.

Investigators do not know how many underage consumers are turning to online outlets over more traditional practices, such as using fake IDs or asking older friends to buy liquor for them, but the potential is there and enforcement officers are primarily concerned with restricting minors' access, said Reilly's spokeswoman, Sarah Nathan.

In Massachusetts, investigators had underage students from five Boston-area colleges order alcohol online. All of the students received their orders, including tequila and vodka, without being carded.

"If tequila is being sold online, it's being sold illegally. We'd be very concerned about that," said Bob Burdick, spokesman for the Washington State Liquor Control Board.

Costco's chief executive officer, Jim Sinegal, was concerned to hear that underage customers at Gonzaga University were able to buy wine from his company. Costco requires online purchasers to certify that they are over 21 and pays an extra fee to its delivery company to get an adult signature and check IDs, he said.

The Federal Trade Commission issued a report last year finding that online wine sales benefited consumers more than hurt states' ability to restrict sales to minors.

Washington's Gregoire has come out publicly in favor of allowing interstate shipment of wines nationwide. She and California's attorney general have been trying to rally their counterparts to favor opening direct shipment.

California and Washington are the largest wine-producing states in the country. Issaquah-based Costco is the largest retailer of wine nationwide, although its online business is only just beginning, Sinegal said.

The U.S. Supreme Court agreed in May to resolve legal conflicts over the direct shipment of alcohol over state lines. While one part of the Constitution allows for free commerce between states, another part gives authority over liquor laws directly to the states.

The debate stems from cases mainly between winemakers, who want the freedom to deliver their product wherever customers want it, and wholesale distributors, the middlemen states have set up to restrict access by keeping alcohol prices high and supply stable.

A federal appeals court ruling in New York held that the state's ban on interstate wine shipments was allowed under the 21st Amendment, which repealed Prohibition. But in a Michigan case, another federal appeals court struck down such a ban as a violation of the Constitution's commerce clause.

Although wine is generally not the drink of choice for young people, if keeping hard liquor out of the mouths of babes means restricting online wine sales, too, local governments should have the right to restrict it all, said Jim Ballard, executive director of the Michigan Association of Secondary School Principals.

"If a liquor store is making extra money selling to minors out the back door, eventually they'll be caught, and they'll be dealt with because they're right there, they're local," Ballard said. "That enforcement's not going to happen if the back door is in California."

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**USA TODAY**
**Ordering liquor online sets off legal challenges**
**Donna Leinwand**
**June 9, 2004**

Zack Vines came home from high school one day last October, logged on to his computer and, with a few clicks of a mouse, ordered liquor from several different online sites. He isn't sure which site ultimately came through, but a week later, a gallon of tequila — wrapped in a plain, brown package with no return address — was delivered to the Vines home in Franklin, Mich.

Unlike many teens who try to buy alcohol, Zack, 15 at the time, didn't need a fake ID: When the Web sites that Zack visited asked for his age, he simply lied. He paid about $30 for the tequila with a credit card his parents had given him to use in emergencies. The transaction, he says, took less than five minutes.

The purchase was an experiment overseen by Zack's father, Jason, a public relations man who has worked for liquor wholesalers. Jason Vines wanted to show how computer-savvy teenagers such as Zack can use the Internet to circumvent laws designed to keep alcohol from minors.

Ordering alcohol over the Internet isn't nearly as popular among minors as more traditional methods of getting booze, such as using fake IDs in liquor stores. But the ease and anonymity with which youths can buy alcohol from the rapidly growing number of sellers on the Internet is a key issue in a nationwide legal battle that reflects how technology could dramatically change the alcohol distribution system established after Prohibition ended in 1933.(Related item:Alcohol shipping regulations)

Last month, the Supreme Court agreed to resolve conflicting rulings by courts in New York and Michigan over whether states can ban out-of-state companies from shipping wine, beer and liquor directly to customers. Fifteen states have such bans; most of the rest have some limits on shipments.

The restrictions are part of a distribution system that requires wineries, breweries and distilleries to sell their products to state-licensed wholesalers, which then sell them to liquor stores. The laws make it easy for states to tax alcohol. And as an obstacle to underage drinking, the laws also require customers to purchase alcohol in face-to-face transactions in which IDs can be checked.

Critics say the laws have been made obsolete by the Internet and by the boom in U.S. vineyards, which have changed the landscape for alcohol sales.

The lawsuits challenging the state bans on direct shipments to customers have been brought by small, family-owned wineries, their wine connoisseur customers and a libertarian law firm. The wineries say the laws that force them to sell products through wholesalers keep them from competing with big-name wines that command space on liquor store shelves.

Wineries: Change the laws

The wineries say that the laws could be expanded to regulate the new marketplace created by the Internet without hindering states' ability to collect taxes, and that improved identification screenings online could discourage most people under the legal drinking age of 21 from ordering booze online.

Many states and wholesalers defend the laws. They say the system that requires alcohol to travel from producers to wholesalers to stores ensures that states can track the products, collect taxes and keep alcohol from kids. Some wholesalers call the Internet sellers "cyber-bootleggers" who are avoiding taxes and bypassing the state licensing and overhead costs of having brick-and-mortar stores.

For the Supreme Court, the disputes from New York and Michigan represent a conflict between the 21st Amendment, which gives states the right to regulate alcohol within their borders, and the Commerce Clause of the U.S. Constitution, which bars states from stifling interstate commerce.

Earlier this year, a U.S. appeals court in New York upheld that state's ban on interstate shipments. The decision came a few months after a federal appeals court in Michigan had gone the other way, overturning that state's ban on home shipments of alcohol by out-of-state retailers and wholesalers. Michigan Attorney General Mike Cox says he is appealing his state's case to the U.S. Supreme Court to try to protect the state's right to regulate alcohol. His appeal is supported by 37 other states.

"Internet sales complicate our ability to protect minors and collect taxes," says Cox, whose state took in $168.3 million from taxes on liquor, licenses, fees, fines and penalties, and beer and wine excise taxes in the year that ended Sept. 30. "This is really a states' rights issue vs. the federal government's use of the Commerce Clause to upset our regulation. So we're fighting for Michigan minors (and)...for the Constitution."

'This is a crazy law'

The debate over the wholesale distribution system involves sales of various types of alcohol, but the most aggressive challenges to direct-shipping bans are coming from small wineries that are seeking a niche in the marketplace.

Wine Spectator magazine lists 2,442 wineries in the USA, about twice the number of two decades ago. More than half of them are small vintners that produce fewer than 4,000 cases a year. About 50 big wineries dominate the industry, accounting for more than 85% of the wine produced in the USA.

The plaintiff in the New York case, Swedenburg Estate Vineyard of Middleburg, Va., is typical of the small vineyards that have jumped into the market. Juanita Swedenburg, her husband and son began growing grapes on their farm in 1980. A few years later, they began making wine. In peak years, they produce 2,500 cases.

Most of Swedenburg's sales are made in a small tasting room at the farm. Tourists, many from out of state, see the winery's sign along Route 50 and stop for samples.

After they return home, some visitors call the winery and ask Juanita Swedenburg to ship a case to them. But she has to tell many potential customers that she can't do so because direct shipments of alcohol to consumers are illegal in their home states. And although Virginia law allows limited alcohol shipments to state residents, sellers may not ship out of state.

"I thought, 'This is not right,' " she says. "This is a crazy law."

Swedenburg and the vintners' groups say the laws requiring alcohol sales to be done through wholesale distributors were designed for a time when there were far fewer products competing for shelf space in liquor stores.

Now, consumers in the USA can choose from more than 100,000 wine labels from around the globe. But the wholesale wine business is consolidating at a time when the number of labels is increasing, so small wineries such as Swedenburg's often have difficulty getting shelf space, says Tracy Genesen, legal director for the Sacramento-based Coalition for Free Trade, which was formed to represent wineries in lawsuits.

Genesen says that to survive, many small wineries need to reach buyers in different states, via the Internet or telephone.

Karen Gravois, spokeswoman for the Wine & Spirits Wholesalers of America, dismisses the notion that wholesalers neglect small wineries. Wholesalers represent thousands of small labels from the USA and around the world and are willing to help small wineries break into the market, Gravois says. She says the wine industry in the USA, with its $1 billion in annual sales, is trying to avoid regulation and increase its profit margins.

"It's a pseudo-, phony crisis that they are creating with a public affairs and legal campaign," she says of the push against state laws that require wholesalers to be the bridge between alcohol producers and consumers. "The public isn't calling for this. The government isn't calling for this. If the winery is willing to sell within the regulatory system, any consumer can get any bottle of wine they want."

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**News Release (Massachusetts)**
**AG Reilly, ABCC Take Against Online Alcohol Retailers Accused of Selling to Underage College Students**
**June 8, 2004**

BOSTON - Attorney General Tom Reilly is suing four out-of-state online retailers accused of violating the state's liquor laws and selling alcohol to underage buyers – area college students who participated in undercover stings initiated by AG Reilly and the Alcohol Beverages Control Commission (ABCC). AG Reilly also forwarded evidence against three other online alcohol retailers and three shippers to the ABCC, which has initiated administrative actions against these businesses.

AG Reilly detailed the court actions today at a joint press conference with Treasurer Timothy Cahill, who oversees the ABCC, announcing the results of their investigation into online alcohol sales in Massachusetts. The stings, conducted in 2002 and 2004, found that seven companies sold alcohol to underage buyers via the Internet and three shipping companies delivered shipments to underage buyers in violation of state law. AG Reilly has referred three of the Internet sellers who shipped alcohol to individuals under the age of 21 and three shipping companies to the ABCC.

"Alcohol can be lethal when placed in the wrong hands," AG Reilly said. "We have to do everything we can to keep alcohol away from our kids until they are old enough to make responsible decisions about its use."

"Alcohol is the number one substance abuse problem of today's youth," Treasurer

Cahill said. "I am proud that our offices are working together to address the critical issues of underage drinking and access to alcohol."

The four companies named in lawsuits are: Sherry-Lehmann Wines and Spirits of New York, NY, which operates www.sherrylehmann.com, Wine Globe of San Mateo, CA, which operates as www.wineglobe.com, Queen Anne Wines and Spirits Emporium of Teaneck, NJ, which operates as www.queenannewine.com, and Clubs of America of Lakemoor, IL, which operates as www.greatclubs.com.

In this spring's enforcement effort, AG Reilly's Office enlisted the help of five area colleges – Boston College, Northeastern University, Merrimack College, Stonehill College, and Bunker Hill Community College – who identified college students to participate in the undercover sting. These college students placed orders for alcohol from online sellers and had shipments sent directly to their homes. All transactions were done under the supervision of investigators from AG Reilly's Office. In each case, the underage college students were able to order beer, wine or hard liquor – including tequila and vodka – without having to verify their age. They then successfully received these shipments of alcohol without having to present identification indicating that he or she was 21 years old. The sting found that, at most, some sellers required the students to check a box indicating that he or she was at least 21. Other sellers did not ask for any proof of age. Regardless, all five college students received shipments at home without having to provide any form of identification or age verification. A similar sting conducted by the ABCC in 2002, also using an area college student, had similar results.

Based on evidence from the stings, AG Reilly and Treasurer Cahill also allege that FedEx on four different occasions failed to follow instructions on the outside of the package alerting company employees that alcohol was being sent and a signature from someone who is at least 21 was required.

AG Reilly and the ABCC initiated an investigation into online alcohol to address the pervasive problem of underage drinking. According to the National Center on Addiction and Substance Abuse at Columbia University (CASA), 87 percent of adults who drink had their first drink of alcohol before age 21. 2003 research from CASA also found that individuals who begin drinking before the age of 15 are four times more likely to become alcohol dependent than those who begin drinking at age 21. The CASA study also found that the prevalence of lifetime alcohol abuse is greater for those who begin drinking at age 14. The Massachusetts Youth Risk Behavior Survey, conducted by the Massachusetts Department of Education at 50 randomly selected public high schools across the Commonwealth in the spring of 2003, found that 1 in 4 public high school students had initiated alcohol use before the age of 13.

"I have seen for myself, as District Attorney and now as Attorney General, how destructive underage drinking can be to our children and to our families and communities in Massachusetts," AG Reilly said. "This is a serious problem, and making alcohol available online to young people — the segment of our population that is by far the most Internet-savvy — only makes that problem worse."

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Mr. NUNES. Thank you, Mr. Chairman. I yield back.

Chairman LEWIS. Thank you. Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman.

Administrator Manfreda, thank you very much for being with us. Let me concentrate my questions on some of the budgetary matters

that you have. Now that you have split up, we have this new agency that was created, ATF went its way, you went your way.

I have some concerns. You mentioned something astounding. For every dollar you have to use to collect revenues, excise taxes, you collect $323. I dare say that you are probably one of the most efficient Federal agencies when it comes to generating revenues that are due to the Federal Government so that we can do all the work that we need to, national defense, education, health care.

I would think that we would want to make sure that if there is a dollar that should be collected, we would give you the resources to collect that, since you collect $323 for every dollar you collect.

My understanding is never once in your 5 years of existence have you been given money by the Administration for enforcement, to hire your own enforcement agents. I know you have requested—TTB has requested money in your budget for enforcement agents but you have never been given the money.

If we were to get you money for enforcement agents, could you make use of those enforcement agents?

Mr. MANFREDA. Absolutely, sir. We have all the criminal jurisdictions under the Internal Revenue Code and the Federal Alcohol Administration Act to enforce. This is not duplicated by any other Federal agency. ATF has only tobacco jurisdiction with regard to the Contraband Cigarette Trafficking Act, which is a prime area where there is diversion and failure to pay State taxes.

For our purposes, we would need agents not only to enforce our criminal laws, but also to assist us in seizures, forfeitures and detention issues that arise in enforcing the laws which we administer; yes, sir.

Mr. BECERRA. Your agency collects something around $15 billion?

Mr. MANFREDA. Yes, sir.

Mr. BECERRA. In excise taxes that are owed by these various enterprises. You have never been given the authority to hire enforcement agents to do the enforcement work or given money to hire the enforcement agents for the work that you are under law prescribed to do, and I know you have established a division to study the issue of collecting some of this contraband product that is out there, because there is probably billions more that we could collect in excise taxes if we could get a grip on what is out there being sold in the black market.

I am not sure I understand why this Administration would not want to give you the resources. My understanding is that your $15 billion in excise taxes that you have collected, that has been pretty constant for the last 5 years; right?

Mr. MANFREDA. Yes, sir.

Mr. BECERRA. Would you say to me that over the last 5 years the consumption of alcohol, alcoholic beverages, and tobacco has remained constant?

Mr. MANFREDA. Pretty much.

Mr. BECERRA. There has been no increase?

Mr. MANFREDA. There has probably been decreases in tobacco.

Mr. BECERRA. In alcoholic beverages?

Mr. MANFREDA. Alcohol has grown in certain market areas and in others, it has decreased.

Mr. BECERRA. There is a very good chance that over the last 5 years, had you had the resources, where there has been an increase in consumption, which means therefore there should be an increase in taxes generated, that had you had the enforcement capability, you might have been able to pursue those areas where perhaps we have not had the highest degree of compliance?

Mr. MANFREDA. I would say that agents would assist us in enforcing those areas which are problematic to us.

Mr. BECERRA. Do you have any reports yet from this new division that was created to study the issue of contraband products?

Mr. MANFREDA. They are pretty much in their infancy, but we have the people hired for those positions and they are starting to collect data.

Mr. BECERRA. Can you please report to us on an ongoing basis on where you are with that? Obviously, I think Members in this Committee would be very interested in trying to help you move to a point where we are just not assessing the sale of contraband but we are trying to make sure that we deal with it so that it can be in an open market, not in a black market.

Mr. MANFREDA. Okay; yes, sir.

Mr. BECERRA. One last area of inquiry. I know my colleague, Mr. Thompson, will get into this more. I will just ask one question. If there is a second round for follow up questions, I will try to get into it more deeply.

I have a concern. My understanding is in reading some of the information about wines and other products that more and more Americans are into the issue of organic products and trying to make sure that we stay as healthy as possible.

I know some wines are labeled as organic wines, which in essence means they do not use certain pesticides for the growing of those grapes that are used to make that wine.

You all did some investigative work and you found that of 12 wines that you inspected, 10 contained pesticides. Of those 12 that you randomly selected, that is an 83 percent non-compliance rate by those wine growers in labeling, in mis-labeling their wines as organic.

I am not sure if that is the rule or if that is the exception with regard to how these vintners are labeling their wines, mis-labeling them as organic.

I hope to be able to pursue that line of questioning with you perhaps in the future to find out what you are doing to make sure that the American public is not being deceived by people who are trying to peddle certain products as organic when in fact they are not, and what we are doing to try to make sure that does not happen.

Mr. MANFREDA. Certainly, sir.

Mr. BECERRA. Appreciate that. Thank you, Mr. Chairman.

Chairman LEWIS. Mr. Tanner is recognized for inquiry.

Mr. TANNER. Thank you, Mr. Chairman. Thank you for being here. Where are you on the rules on definition of little cigars versus cigarettes, and the FTC, and for lack of a better term, putting in the FTC re-authorization in the Senate about alcohol regulation and so forth, could you comment on that, particularly as it regards the sale of beer?

Mr. MANFREDA. Certainly, sir. Regarding your first question, we are in rulemaking on the little cigar versus cigarette issue. As you know, under the Internal Revenue Code, the definitions for "cigar" kicks you out, and it says a cigar is any tobacco leaf which is wrapped in paper containing tobacco except that which is a cigarette. You have to flip into the cigarette. The cigarette is any leaf tobacco wrapped in tobacco paper because of its appearance, its labeling, its packaging, filter, is likely to be sold or offered for sale as a cigarette.

It is a very subjective determination. We went into rulemaking with a hope to take away the very subjective nature of that determination and to make it more scientific. We thought we had come up with a very good notice of proposed rule making to air.

As a result of the public comments, we found that our rule was not that good. It did have some issues and problems. We are now working with our own scientists and other scientists in different agencies to come up with probably a better platform to re-air this and get comment on it.

It was really more clarifying so we can give better guidance. Right now, with that kind of standard, it is very subjective. I think if we can rely on science, it takes that subjectivity and makes it a much more objective determination. We are working on that, sir. We are right in the middle of that.

The FTC, we think that is duplication of effort, especially in the area of slotting fees. Slotting fees have been an illegal activity in the alcohol industry for as far back as I can remember. If any agency has information on slotting fees, we have it, especially with regard to the alcohol beverage industry. We would think it is duplicative.

Mr. TANNER. Thank you.

Chairman LEWIS. Thank you, Mr. Tanner. Mr. Doggett is now recognized for his questions.

Mr. DOGGETT. Thank you, Mr. Chairman. Thank you for your testimony. As I was beginning mine earlier, I believe you and I first talked about almost 10 years ago when I was preparing the first draft of what is now the STOP Act, just to seek technical expertise of you and your colleagues about how the Act would work and fit with the kind of work that you do at the agency.

That was at a time when Treasury Secretary Larry Summers was publicly expressing a great deal of concern about tobacco smuggling. I realize through the intervening 10 years, you are now serving in a new Administration, and I thank you for the efforts that you are making.

My questions are not directed toward seeking endorsement, which I know is not forthcoming from the Administration to the STOP Act, but I would like to just ask you a few specifics along the lines of what I was saying to my colleagues.

Are there any steps that could be taken now, modest, that would be consistent with the work that you are doing? Let me ask you just a couple of specifics.

As I understand it, currently on any cigarette pack, you would have one of three identifiers. You would either have a slip on there that was a permit number of the factory. You would have the manufacturer's name and some piece of information that the manufac-

turer chooses to put on there, or you would have the manufacturer's name and city and State of factory for the product.

Is that basically the current regime?

Mr. MANFREDA. Yes, sir.

Mr. DOGGETT. My question to you is would it be helpful to the agency to have a standardized serial number, so that you may be able to get that sometimes voluntarily from the industry in a particular investigation, but so you would know from the outset the serial number and could trace back the information on the product?

Mr. MANFREDA. I would say that could be helpful to us. Currently, if you are looking at a specific individual pack in a retail outlet, there is no apparent indicia on the package to show that taxes have been paid.

We do not really have the capability of tracing that package all the way back to the manufacturer. From that point of view, a serial number may help.

I would say we had serial numbers on alcoholic beverages up to about 1982. They were basically done away with because it became a security issue and a compliance issue with maintaining the integrity of those serial numbers that were on the liquor bottles.

Mr. DOGGETT. We need to be mindful of that experience, but basically having the serial number on there could be an aid to law enforcement?

Mr. MANFREDA. Yes.

Mr. DOGGETT. Currently, is there anything to prevent me from going out and buying tobacco manufacturing machinery?

Mr. MANFREDA. None whatsoever, sir.

Mr. DOGGETT. Would it also be consistent with the efforts of the agency to make clear that just as you must have a permit to manufacture tobacco, that tobacco manufacturing equipment cannot be or should not be sold to those who lack such a permit?

Mr. MANFREDA. I have no problem with that.

Mr. DOGGETT. I referenced some of the provisions that Congress passed twice last year in the children's health insurance program. Those were provisions that would broaden the authority of TTB with reference to issuance of permits or the ability to revoke permits if there was a violation of State or Federal law.

Would that be consistent with——

Mr. MANFREDA. Sir, that would be very helpful. Under current law, under the Internal Revenue Code, if you look at the provisions controlling revocation and suspension, we are basically limited to anybody that violates the Internal Revenue Code provisions and the regs thereunder.

There are limiting factors to revocation. If we expand it to allow for suspension or revocation based on a violation of the Contraband Cigarette Trafficking Act and other statutes, Jenkins Act, that could be very helpful. They would be the type of individuals that you do not want in the business.

Mr. DOGGETT. Right. People that are really not legitimate distributors, wholesalers, manufacturers of tobacco. Those legitimate interests ought to have a concern for seeing that these people are not involved.

You find situations where you have good reason to believe there has been a violation of a law, but you are powerless to do anything about it because it is not within your jurisdiction?

Mr. MANFREDA. With existing permitees. If we have an applicant that has violations, the criteria is because of your business standing, financial standing and trade connections, you are not likely to comply, in that arena, we could say based on these other convictions, you are not likely to comply, so under that scenario, we could do something.

It sounds odd to have the authority with respect to application but not have it with respect to suspension or revocation.

Mr. DOGGETT. Thank you very much.

Chairman LEWIS. Mr. Thompson is now recognized for his questions.

Mr. THOMPSON. Thank you very much, Mr. Chairman.

Mr. Manfreda, thank you for being here. I want to say that John and I go back a long ways. We have worked together on a lot of things and have a good relationship. I consider him a friend.

Mr. Manfreda, your agency is proposing two new rules that I think are both wrong and, if adopted, are going to bring great harm to the wine industry and they trouble me a great deal.

The Congress prohibited misleading wine labels when they passed the Federal Alcohol Administration Act, and your agency was charged with enforcing that law, as you mentioned in your opening testimony.

In 1986, your agency concluded, and I will quote, "A geographic brand name of viticulture significance on a wine label indicates to consumers the origins of that wine." That means where those grapes are grown.

In your own manual, and I have a copy of it here, and without objection, Mr. Chairman, I would like to submit this to the record.

Chairman LEWIS. Without objection.

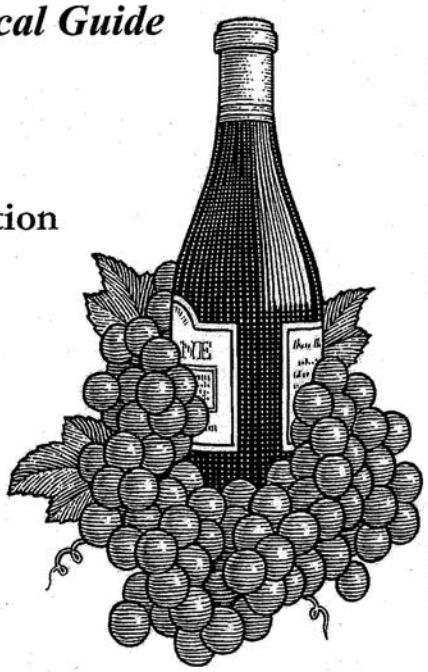
[The information follows:]

*Department of the Treasury*
*Alcohol & Tobacco Tax & Trade Bureau*

# THE BEVERAGE ALCOHOL MANUAL (BAM)

## *A Practical Guide*

**Basic Mandatory Labeling Information For WINE**



***VOLUME 1***

TTB P 5120.3 (04/2007)

# CHAPTER 4
# GEOGRAPHIC BRAND NAMES

## DEFINITIONS

Geographic Brand Name

A brand name with viticultural significance

Viticultural Significance

A brand name has viticultural significance if the brand name includes the name of:

A U.S. state or foreign equivalent

A U.S. county or foreign equivalent

An approved American or foreign viticultural area

A geographic area that:

- Actually exists **AND**
- Is described in at least two (2) reference materials as a grape-growing area

"New" Geographic Brand Name

A geographic brand name used on an application for certificate of label approval (COLA) submitted on or after July 7, 1986

"Grandfathered" Geographic Brand Name

A geographic brand name used on a certificate of label approval (COLA) issued prior to July 7, 1986

## REQUIREMENT FOR USE OF A "NEW" GEOGRAPHIC BRAND NAME

A "New" geographic brand name may be used **PROVIDED** the wine meets the appellation of origin requirements for the geographic area named in the brand name

APPELLATION REQUIREMENTS chart

The chart below identifies the appellation requirements for a geographic brand name that includes a state, a county, a viticultural area, etc.

**APPELLATION REQUIREMENTS**

| IF THE BRAND NAME INCLUDES THE NAME OF... | THE WINE... |
|---|---|
| A U.S. state | 1) Must be derived from not less than 75% of grapes, citrus or other fruit or other agricultural commodity grown in the named state AND<br>2) Must be fully finished (except for cellar treatment* and blending which does not result in an alteration of class and type) in the named state or an adjacent state AND<br>3) Must conform to the laws and regulations of the named state |
| The foreign equivalent of a U.S. state | 1) Must be derived from not less than 75% of grapes, citrus or other fruit or other agricultural commodity grown in the named foreign equivalent of a state AND<br>2) Must conform to the laws and regulations of the country in which the wine was produced |
| A U.S. county | 1) Must be derived from not less than 75% of grapes, citrus or other fruit or other agricultural commodity grown in the named county AND<br>2) Must be fully finished (except for cellar treatment* and blending which does not result in an alteration of class and type) in the state in which the named county is located AND<br>3) Must conform to the laws and regulations of the state in which the named county is located |
| The foreign equivalent of a U.S. county | 1) Must be derived from not less than 75% of grapes, citrus or other fruit or other agricultural commodity grown in the named foreign equivalent of a county AND<br>2) Must conform to the laws and regulations of the country in which the wine was produced |
| An approved American viticultural area | 1) Must be derived from not less than 85% of grapes grown in the named viticultural area AND<br>2) Must be fully finished (except for cellar treatment* and blending which does not result in an alteration of class and type) in the state in which the named viticultural area is located AND<br>3) Must conform to the laws and regulations of the state in which the named viticultural area is located |
| An approved foreign viticultural area | 1) Must be derived from not less than 85% of grapes grown in the named viticultural area AND<br>2) Must conform to the laws and regulations of the country in which the wine was produced |
| A geographic area that:<br>a) Actually exists and<br>b) Is described in at least two (2) reference materials as a grape-growing area | **CANNOT** be labeled with such a brand name |

*See CHAPTER 8, CELLAR TREATMENT

EXAMPLES chart

The chart below provides example geographic brand names with explanations of the acceptability/unacceptability of each

**EXAMPLES**

| BRAND NAME & CLASS AND TYPE DESIGNATION | BRAND NAME ACCEPTABLE IF | BRAND NAME UNACCEPTABLE BECAUSE |
|---|---|---|
| Washington Cellars<br>Apple Wine | 1) Not less than 75% of the volume of the wine is derived from apples grown in Washington State AND<br>2) The wine was fully finished (except for cellar treatment* and blending which does not result in an alteration of class and type) in Washington State AND<br>3) The wine conforms to the laws and regulations of Washington State | |
| Quebec Grande<br>Sparkling Wine | 1) Not less than 75% of the volume of the wine is derived from grapes grown in Quebec AND<br>2) The wine conforms to the laws and regulations of Canada | |
| Sonoma Coast Royale<br>Table Wine | 1) Not less than 85% of the volume of the wine is derived from grapes grown in the Sonoma Coast viticultural area AND<br>2) The wine was fully finished (except for cellar treatment* and blending which does not result in an alteration of class and type) in California AND<br>3) The wine conforms to the laws and regulations of California | |
| Muchacha de Rioja<br>Red Wine | 1) Not less than 85% of the volume of the wine is derived from grapes grown in the Rioja viticultural area AND<br>2) The wine conforms to the laws and regulations of Spain | |
| Virgin River Valley Serenade<br>White Wine | | "Virgin River Valley" is the name of a geographic area that:<br>a) Actually exists and<br>b) Is described in at least two (2) reference materials as a grape-growing area<br>**BUT**<br>"Virgin River Valley" is not an appellation of origin, i.e., it is not a state, county or approved viticultural area<br>**AND**<br>Therefore, the wine cannot meet the appellation of origin requirements for the geographic area named in the brand name |

*See CHAPTER 8, CELLAR TREATMENT

## REQUIREMENT FOR USE OF A "GRANDFATHERED" GEOGRAPHIC BRAND NAME

A "Grandfathered" geographic brand name may be used **PROVIDED**:

The wine meets the appellation of origin requirements for the geographic area named in the brand name.

**NOTE**: See APPELLATION REQUIREMENTS chart above **EXCEPT FOR** a brand name that includes the name of a geographic area that (a) actually exists and (b) is described in at least two (2) reference materials as a grape-growing area see APPELLATIONS FOR "GRANDFATHERED" GEOGRAPHIC BRAND NAMES chart below

**OR**

The wine is **LABELED WITH** an appellation of origin, in direct conjunction with the class and type designation, as outlined in the APPELLATIONS FOR "GRANDFATHERED" GEOGRAPHIC BRAND NAMES chart below

**OR**

The wine is labeled with a statement that is sufficient to dispel the impression that the geographic area suggested by the brand name is indicative of the origin of the wine

APPELLATIONS FOR "GRANDFATHERED" GEOGRAPHIC BRAND NAMES chart

The chart below identifies the specific type of appellation of origin required for a "grandfathered" geographic brand name based on the type of appellation of origin included in the brand name

**APPELLATIONS FOR "GRANDFATHERED" GEOGRAPHIC BRAND NAMES**

| IF THE BRAND NAME INCLUDES THE NAME OF... | THE WINE MUST BE LABELED WITH AN APPELLATION OF ORIGIN OF... |
|---|---|
| A U.S. state or a foreign equivalent of a U.S. state | 1) A U.S. state or foreign equivalent of a U.S. state OR<br>2) A U.S. county or foreign equivalent of a U.S. county OR<br>3) An approved American or foreign viticultural area |
| A U.S. county or a foreign equivalent of a U.S. county | 1) A U.S. county or foreign equivalent of a U.S. county OR<br>2) An approved American or foreign viticultural area |
| An approved American or foreign viticultural area | 1) A U.S. county or foreign equivalent of a U.S. county OR<br>2) An approved American or foreign viticultural area |
| A geographic area that:<br>a) Actually exists and<br>b) Is described in at least two (2) reference materials as a grape-growing area | 1) A U.S. county or foreign equivalent of a U.S. county OR<br>2) An approved American or foreign viticultural area |

Mr. THOMPSON. Your manual provides public guidance regarding geographic brand names, what is allowed or what is not allowed under the law and under the regulations.

I would like to quote from this also. It states and I quote "If the brand name includes the names of a geographic area that actually exists and is described in at least two reference materials as a grape growing area, the wine cannot be labeled with such a brand name."

I do not want them included, Mr. Chairman, but I would like unanimous consent to get the citations from these reference books included in the record. There are about 15 of them here, Mr. Chairman, that do in fact speak directly to the proposed rule.

Chairman LEWIS. Without objection, you just want the citation?

Mr. THOMPSON. Just the citations.

Chairman LEWIS. Without objection.

Mr. THOMPSON. They also go on to say that new brand names, "new" being after July 7, 1986, cannot be labeled with such a name also. I would like these put in the record and also while we are at it, I have a letter from about 57 Members, I think 17 from this Committee, opposed to that, and also a letter and statement from the Napa Valley Vintners opposing this as well.

Chairman LEWIS. Without objection.

[The information follows:]

March 18, 2008

Mr. Frank Foote
Director, Regulations and Rulings Division
Alcohol and Tobacco Tax and Trade Bureau
1310 G. Street, N.W., Suite 200-E
Washington, D.C. 20005

RE: Comments in Opposition to Notice of Proposed Rulemaking No. 77

Dear Mr. Foote:

Napa Valley Vintners ("NVV") is a trade association representing 309 local vintners. Over sixty-five percent (65%) of NVV's members have an annual production of less than 10,000 cases of wine, and ninety percent (90%) of NVV's members are family-owned wineries. The mission of NVV is to promote and protect the Napa Valley American viticultural area ("AVA"). NVV members include wineries that are located in, and produce wine from, the proposed Calistoga AVA. NVV has a vested interest in protecting the integrity of Calistoga as a grape growing area because it is encompassed within the larger Napa Valley appellation.

NVV, in association with its legal counsel, Dickenson, Peatman & Fogarty, hereby submits this comment to TTB's Notice No. 77, published in the November 20, 2007 edition of the Federal Register, Volume 72 at page 65256. NVV fully supports the creation of the Calistoga AVA but strongly opposes the proposal to specially grandfather, under any circumstances, the use of post-1986 "Calistoga" brand names for wine not in compliance with the Calistoga AVA standards. Such brands are inherently misleading to consumers.

There are several legal and factual bases for prohibiting the continued use of post-1986 "Calistoga" brand names for wine not in compliance with the Calistoga AVA standards. First, the Certificates of Label Approval ("COLAs") that have been issued for the "Calistoga" brand names being considered for grandfather use were mistakenly issued as Calistoga was a clearly-established term of viticultural significance at the time, and long before, the applications for such COLAs were submitted to TTB. Second, it is clear that use of a "Calistoga" brand name will mislead consumers into believing the wine is a Calistoga appellation wine, and no disclaimer can prevent consumers from being misled in this way. Third, the proposed grandfathering of "Calistoga" brand names is incompatible with U.S. international obligations pursuant to Article 23 of the Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS").

## I. The Post-1986 "Calistoga" Brand Name COLAs at Issue in Notice No. 77 Were Mistakenly issued and Should be Revoked.

A. Calistoga Constituted a Recognized Term of Viticultural Significance Prior to the Submission of Any Applications for the "Calistoga" Brand Name COLAs at Issue in Notice No. 77.

Contrary to assertions made by certain "Calistoga" wine brand owners in protesting the recognition of the Calistoga AVA, it cannot be disputed that Calistoga is a term of viticultural significance that was recognized as such for many years prior to the issuance of any of the COLAs for the "Calistoga" brand names at issue in Notice No. 77.

In acknowledging that there is substantial basis for the establishment of the Calistoga AVA, the TTB states that there "is ample evidence clearly showing that 'Calistoga' is the name by which the area is locally and regionally known and that the term 'Calistoga' by itself has been associated *historically* with viticulture..." 72 FR 65258 (emphasis added). In fact, Calistoga is one of the oldest viticultural areas in the United States. Calistoga was recognized by the trade and consumers as a viticultural area well before the 1998 COLA application for the Calistoga Cellars brand.

The geographical area that is the subject of the proposed Calistoga AVA is located in the upper end of California's Napa Valley. In 1845, John York purchased land in what later came to be known as Calistoga and planted a small vineyard. William Heintz, *California's Napa Valley, One Hundred Sixty Years of Winemaking* 61 (Scottwall Associates, 1999) (*see* Exhibit 1 attached hereto). In 1859, the land in the area was acquired by Sam Brannan. *Id.* Taking advantage of the warm springs in the area, Brannan built a resort destination and created the town's name – "Calistoga" – by linking "California" and "Saratoga," New York's famous spa destination. *Id*, at 62-63. In 1861, Brannan planted his first vineyard in Calistoga, and according to at least one source, was the largest grower in the Napa Valley with between 100,000 and 330,000 grape vines planted. *Id.* at 64.

In 1880, Alfred Tubbs purchased 275 acres of land in Calistoga and founded Chateau Montelena winery. George M. Taber, *Judgment of Paris* 118 (Scribner 2005) (*see* Exhibit 2 attached hereto). Chateau Montelena produced very good wines as the land and climate of the Calistoga area allow for the production of complex red wines. *Id.* Like most wineries in the United States, Chateau Montelena ceased the production of wine during prohibition and did not become fully operational again in any significant manner until it was purchased by James Barrett in 1972. *Id.* at 121. In 1976, the Calistoga winery made history in the famous "Judgment of Paris" where it's 1973 Chateau Montelena Chardonnay – a blend including Chardonnay grapes from Calistoga – defeated top white Burgundies in a tasting in Paris that put the California wine industry on the map. *Id.* at 143, 201-202.

Beginning in 1978, Chateau Montelena began producing its Cabernet Sauvignon exclusively from its 70 acre vineyard in Calistoga. Matt Kramer, *Making Sense of California Wine* 115-16 (William Morrow & Co. 1992) (*see* Exhibit 3 attached hereto). In 1992, the wine was characterized by well-known wine writer Matt Kramer as "Napa Valley Cabernet at its best" that "also shows what the Calistoga area can do." *Id* at 116.

One of Napa Valley's most famous vineyards, Eisele Vineyard, is also located in Calistoga. For many years, beginning in the 1970s, Joseph Phelps Vineyards produced a Cabernet Sauvignon from Eisele Vineyard, with the 1975 vintage receiving a ranking of 97 from wine writer James Laube in his book *California Great Cabernets*, leading Laube to compare the vineyard to a first-growth Bordeaux. Bullard, Robyn "Cabernet Makers to Watch Passing the Torch at Eisele Vineyard" *Wine Spectator*, November 15, 1994 (*see* Exhibit 4 attached hereto). Commenting on the same Phelps Eisele Vineyard wine, Kramer noted that the "scale is such that it could only be Californian; the intensity reflects its warmer Calistoga origins." Kramer *supra* at p. 136.

The long tradition of excellence of this Calistoga vineyard was continued by Bart and Daphne Araujo who, after acquiring the property in the early 1990s, continued to produce critically acclaimed wine from the property. The Araujos' 1992 Eisele Vineyard Cabernet garnered a 96 rating from Laube who noted it was "a grand wine that captures the greatness of this vineyard near Calistoga with its rich currant and mineral flavors." Laube, James "No Better Time to Buy" *Wine Spectator* December 15, 1995 (*see* Exhibit 5 attached hereto). In 1995, the Araujos' Eisele Vineyard Cabernet and Chateau Montelena's Estate Cabernet, both Calistoga wines, were identified by *Wine Spectator* among the two dozen all-star California Cabernets of "first rank" ahead of all others. Laube, James "Cabernet All-Stars: Year in and year out, the best California Cabernet Sauvignon's to buy when stocking a stellar Cabernet cellar" *Wine Spectator* December 15, 1995 (*see* Exhibit 6 attached hereto).

In addition to Chateau Montelena and Eisele Vineyard, numerous other wineries and vineyards have long contributed to, and benefited from, the wine-growing reputation of Calistoga, including Clos Pegase, Cuvaison Winery, Robert Pecota Winery, Sterling Vineyards and Storybook Mountain Vineyards. *See* Halliday, James *Wine Atlas of California* 36-47 (Viking Penguin 1993) (*see* Exhibit 7 attached hereto); Sullivan, Charles *A Companion to California Wine* 72, 254-55, 347-48, 351 (University of California Press 1998) (*see* Exhibit 8 attached hereto); Marcus, Kim "Wine Country's Most Relaxing Spot" *The Wine Spectator* May 31, 1990, 73 (*see* Exhibit 9 attached hereto).

The grape-growing region of Calistoga is also referenced in numerous pre-1998 publications discussing wine regions. Perhaps the most prominent and well-known is the *Wine Atlas of California* (published 1993) in which James Halliday dedicates one, eleven-page chapter to the Calistoga region. Halliday, *supra* Exhibit 7 at 35-47. Halliday discusses the history, climate, soil and viticulture, wine vintages, wine styles, growers, topography, geography and wineries of the Calistoga region. *Id.*

The highly-regarded international wine atlas authored by well-known wine writer Oz Clarke in 1995 also discusses the Calistoga region in its coverage of Napa Valley. Clarke, Oz *Oz Clarke's Wine Atlas, Wine & Wine Regions of the World* 238-241 (Little, Brown and Company 1995) (*see* Exhibit 10 attached hereto). Clarke notes that Calistoga "has a daytime climate hot enough to ripen every known red variety," "has good vineyards," and produces "startling Zinfandel" and "good results with Cabernet and

Merlot." *Id.* at 238-39. In identifying the top wineries of Napa Valley in 1995, Clarke identifies three located in the Calistoga region – Chateau Montelena, Cuvaison and Sterling. *Id.* at 241.

Charles Sullivan's encyclopedia on California wine – *A Companion to California Wine* (published 1998) – has an entry for "Calistoga" which identifies the term as referring to a "winegrowing region at the northern end of Napa Valley." Sullivan, *supra* at 51. The entry further states "[t]his portion of Napa Valley is quite warm and best suited to the production of Cabernet Sauvignon, Zinfandel, certain Rhône varieties, and Sauvignon blanc." *Id.* at 52 (*see* Exhibit 8 attached hereto).

The May 31, 1990 edition of the well-known wine magazine *The Wine Spectator*, titled "Napa Valley U.S.A.," features an article on Calistoga which begins by noting that the "serious wine aficionado can enjoy great estates such as Chateau Montelena, Cuvaison or Sterling." Marcus, Kim "Wine Country's Most Relaxing Spot" *The Wine Spectator* May 31, 1990, 71 (*see* Exhibit 9 attached hereto). The article further notes "[a]s you drive north on Highway 29 … about 4 miles north of St. Helena, you're into the Calistoga region proper, though still a few miles south of town itself." *Id.* Marcus also comments on the unique grapegrowing climate of Calistoga: "The contrast in climate between Carneros and Calistoga couldn't be greater … with Calistoga being the warmest region of all in Napa Valley. …Red grape varieties do best here." *Id.* at 72.

In his 1989 treatise, *California's Great Cabernets*, wine writer James Laube discusses California's great Cabernet regions, including Napa Valley. Laube, James *California's Great Cabernets* 33-38 (*Wine Spectator Press* 1989) (attached hereto as Exhibit 11). Laube utilizes a "commune" system to identify the different regions within Napa Valley since at the time of his book only four sub-appellations were recognized by BATF within Napa Valley. *Id.* at 36, 38. Laube identifies the valley floor townships, including Calistoga, as part of the commune system "because of their strong historical identification with winemaking in the valley." *Id.* at 38. In his more detailed discussion of Calistoga, Laube states "Northernmost of the communes, Calistoga is the hottest region on the valley floor." *Id.* at 44.

In his more comprehensive guide on California wine published in 1995 and aptly titled *California Wine*, Laube dedicates an entire chapter of the book to "Appellations and Vineyards." Laube, James *California Wine* 25 (*Wine Spectator Press* 1995) (attached hereto as Exhibit 12). Within this chapter Laube identifies "major appellations, including AVAs and counties," and singles out "Calistoga," stating it's "not an AVA, but sure to be one eventually as Napa Valley is further subdivided. This northernmost city in the valley is warm and excels with many grapes, but Cabernet is the star." *Id.* at 27, 29.

In 1983, the seminal wine encyclopedia *Hugh Johnson's Modern Encyclopedia of Wine* was published, and under the section titled "Appellations, Counties and Districts of California," "Calistoga" is recognized and referenced under "Napa," wherein Johnson states "Unofficially recognized appellations or sub-areas include Carneros, Mount Veeder, Yountville, Oakville, Rutherford (famous for Cabernet), St. Helena, Spring

Mountain and Calistoga on the western side ..." Johnson, Hugh *Hugh Johnson's Modern Encyclopedia of Wine* 416 (Mitchell Beazley Publishers, 1983) (attached hereto as Exhibit 13).

*The New Connoisseurs' Handbook of California Wines*, published in 1995, recognizes "Calistoga" in a section called "Wine Geography" stating "Calistoga provides a warmer climate for grape growing than its down-valley neighbors; its best-known products are the fat, rich Cabernets of Chateau Montelena and Robert Pecota, as well as the highly regarded Eisele Vineyard." Roby, Norman S. and Olken, Charles E. *Connoisseurs' Handbook of California Wines* 72 (Alfred A. Knopf 1995) (attached hereto as Exhibit 14).

The wine-writer Oz Clarke, in his 1996 tome *The Essential Wine Book*, discusses the Napa wine regions and states "indeed there has been a plan to define the boundaries of all of the main towns of the Napa, rather like the communes of the Médoc ...Rutherford, Oakville and St. Helena are the first of these new AVAs; Calistoga, Napa and Yountville could be next." Clarke, Oz *The Essential Wine Book* 264-65 (Simon & Schuster 1996) (attached hereto as Exhibit 15).

*The Complete Atlas of Wine*, published in 1997, in its discussion of Napa Valley states: "The overall Napa AVA was, by the mid-1990s, being organized into a string of smaller appellations, based on the main towns along the valley highway. From north to south, they will be Calistoga, St. Helena, Rutherford, Oakville, Yountville and Napa." Walton, Stuart *The Complete Atlas of Wine* 116-17 (Annes Publishing Limited 1997) (attached hereto as Exhibit 16).

In its section on the Napa Valley AVA, the 1993 edition of *The Wine Atlas of California and the Pacific Northwest* contains a subsection identified as "Calistoga to St. Helena" wherein the well-known vineyards and wineries located in Calistoga are listed and the climate is noted as being the warmest in the valley for grape growing. Thompson, Bob *The Wine Atlas of California and the Pacific Northwest* 40-41 (Simon & Schuster 1993) (attached hereto as Exhibit 17).

In another wine atlas, *Atlas of Wine*, published in 1989, one section discusses the wide range of wines produced in Napa Valley resulting from the varying microclimates in the valley. King, Alice *Atlas of Wine* 164 (W.H. Smith Publishers 1990) (attached hereto as Exhibit 18). The section goes on to note that the Napa Valley region stretches from Calistoga to Carneros and that Calistoga is hotter and is in Region III on the Davis scale for winegrowing climate. *Id.*

*Napa Valley Wine Book*, published in 1979, discusses the history and geography of Napa Valley, noting that Napa Valley comprises unique microclimates which allow it to produce a diverse range of wines. Hinkle, Richard Paul *Napa Valley Wine Book* 10 – 13 (Vintage Image 1979) (attached hereto as Exhibit 19). In discussing these different grape growing climates, the book states that "North of Lodi Lane and on into Calistoga the climate is classified as *transitional*. Distinctively warmer than its opposite, Carneros

(as pointed out by Mr. Tchelistcheff), the Calistoga area shows off Petite Sirah and Zinfandel, though many other grape varieties are grown here as well." *Id.* At 13.

All of this evidence indisputably demonstrates the recognition of "Calistoga" as a winegrowing region well prior to 1998.

B. The "Calistoga" Brand Name COLAs at Issue in Notice No. 77 Should Be Revoked Under the FAA Act and Established TTB Rules As Calistoga Was a Recognized Term of Viticultural Significance When the Applications for Such COLAs Were Submitted.

In 1986, ATF (TTB's predecessor, hereinafter referred to as "TTB") amended 27 CFR 4.39(i) concerning geographic brand names and thereby prohibited the use of brand names of viticultural significance unless the wine meets the appellation of origin requirements for the geographic area named in the brand. 27 CFR 4.39(i)(1). TTB's decision to amend the rule was based on its finding that a geographic brand name of viticultural significance on a label indicates to consumers the origin of the wine, that is, the place where the grapes are grown. 51 FR 20481. This is consistent with TTB's statutory obligations as set forth in 27 USC §205(e) to prevent misleading statements on labels.

This amendment to 27 CFR 4.39 also provided that, apart from names of states, counties and approved U.S. and foreign viticultural areas, a name also has viticultural significance "when found to have viticultural significance by the Director." 27 CFR 4.39(i)(3). In *The Beverage Alcohol Manual (BAM), A Practical Guide*, TTB explains in greater detail that a "brand name has viticultural significance if the brand name includes the name of …a geographic area that: →Actually exists AND → Is described in at least two (2) reference materials as a grape-growing area." *Id.* Vol. 1 at 4-1. The *BAM* further explains that where "new" brand names (i.e., those used on an application for a COLA submitted on or after July 7, 1986) include the name of a geographic area that actually exists and is described in at least two reference materials as a grape-growing area, the wine "**CANNOT** be labeled with such a brand name." *Id.* Vol. 1 at 4-2.

As the *BAM* goes on to explain through the use of an example, where the brand name includes the name of a geographic area that actually exists and is described in at least two reference materials as a grape-growing area, and the geographic area is not an appellation of origin, i.e., it is not a state, county or approved viticultural area, the wine cannot possibly meet the appellation of origin requirements for the geographic area named in the brand name, so the wine cannot be labeled with such brand name. *Id.* Vol. 1 at 4-3.

The first COLA application for the brand Calistoga Cellars was submitted to the TTB in 1998 (*see* Exhibit 20 attached hereto, COLA database search results for "Calistoga Cellars"), twelve years after the enactment of 27 CFR 4.39(i). As demonstrated above, in 1998 Calistoga was a geographic area that had existed for 120 years and had been described in numerous – far more than two! – reference materials as a

grape-growing area, including an 11-page chapter on the region in the *California Wine Atlas* published in 1993. Accordingly, at the time of submission of the first COLA application for Calistoga Cellars, "Calistoga" was indisputably a term of viticultural significance.

Therefore, the first COLA for Calistoga Cellars, as well as all subsequent COLAs for Calistoga Cellars and other "Calistoga" brands, including Calistoga Estate, were issued in violation of 27 CFR 4.39(i). As the evidence demonstrates, even in 1998, consumers recognized Calistoga as a grape-growing area, and the use of a "Calistoga" brand name on wine would deceive consumers as there was no recognized appellation for Calistoga that would guarantee the origin of a "Calistoga" brand wine.

Pursuant to 27 CFR §13.41, a previously-issued COLA may be revoked upon a finding that the label at issue is not in compliance with the applicable laws or regulations. As TTB noted in its final rulemaking for 27 CFR §13.41, TTB "reviews approximately 60,000 applications for certificates of label approval, exemptions from label approval, and distinctive liquor bottle approvals every year. Because errors occasionally occur in the approval process, there is a need for some type of revocation procedure." 64 FR 2122, 2122-23 (1999). TTB went on to note:

> The certificate of label approval was never intended to convey any type of proprietary interest to the certificate holder. On the contrary, Paragraph 1 of Form 5100.31 provides that 'This certificate is issued for [TTB] use only. This certificate does not constitute trademark protection.' Paragraph 2 of this form reminds applicants that the 'certificate does not relieve any person from liability for violations of the Federal Alcohol Administration Act.' The certificate of label approval is a statutorily mandated tool used to help [TTB] in its enforcement of the labeling requirements of the FAA Act.

*Id.* at 2123. As TTB further, rightly observed, "[a]n agency, like a court, can undo what is wrongfully done by virtue of its order." *Id.* at 2124 (*quoting United Gas Improvement Co. v. Callery Properties*, 382 U.S. 223, 229 (1965)).

In noting that the statutory purpose of protecting the consumer from misleading labels is not furthered by placing an artificial time constraint on TTB's ability to revoke a COLA, TTB indicated that the final rule on COLA revocation does not set forth a time limit for revocation. *Id.* at 2125.

The COLAs for the "Calistoga" brands that are the subject of the proposed grandfather provision outlined in Notice No. 77 are all geographically misleading in violation of 27 CFR 4.39(i), and were so at the time of the COLA applications. The evidence provided herewith can lead to no other conclusion. Accordingly, TTB should, in the absence of compliance with the mandated percentages, revoke all of these COLAs pursuant to the clearly-established procedures set forth in 27 CFR §13.41. Pursuant to

the appeal procedures set forth in 27 CFR §§ 13.42 – 13.45, all of the "Calistoga" COLA owners, including those not grandfathered under the proposed rulemaking, will have a full opportunity to disprove the viticultural significance of "Calistoga" at the time of their respective COLA applications, including the right of appeal to the federal courts. Thus, the revocation process is the most equitable process by which to protect consumers from deception and give the "Calistoga" brand owners the due process which they have repeatedly requested. *See* TTB-2007-0067-0007 (Comment of Eileen Z. Joseph).

While it is unfortunate that any of the "Calistoga" COLAs issued in the first place, TTB cannot be expected to perfectly assess each COLA application among the tens of thousands received each year to determine whether it is misleading as to origin. This is exactly why the COLA revocation procedures were formalized, to correct such errors.

Of course, the "Calistoga" COLA owners will decry such revocation as unjust and unfair. However, as succinctly explained by TTB in the final rulemaking for the revocation procedure formalized in 27 CFR §13.41 *et seq.* (*see* 64 FR 2122 (1999)), such complaints of unfairness have no basis under the notice provisions of the law, nor should there be any expectation of any right based on the issuance of the COLA. All of the "Calistoga" brand owners were on notice as to the geographic brand name requirements of 27 CFR 4.39(i) when they adopted their "Calistoga" brand names. *See Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 385 (1947) ("the appearance of rules and regulations in the Federal Register gives legal notice of their contents"). Furthermore, the revocation process is entirely just in that it nevertheless allows for due process through the appeals process.

All of the "Calistoga" brand owners adopted their "Calistoga" brand names with full knowledge of the viticultural significance of the term "Calistoga." For any of these brand owners to suggest otherwise is unbelievable, for even if they were so unsophisticated in the wine industry as not to know of the reputation of the Calistoga area, which is highly doubtful, a neophyte need only drive one mile in any direction from any of the Calistoga properties owned by these brand owners to see the acres upon acres of grape vines and realize that Calistoga is a wine growing region. In fact, the very selection of "Calistoga" as part of these brand names indicates that the brand owners saw value in being associated with Calistoga and the favorable impression created by this wine region among wine consumers.

While TTB may sympathize with the "Calistoga" brand owners' pleas because TTB did, in fact, issue COLAs for these brands, this should not drive the agency's policy. TTB's mission, as set forth in the FAA Act, is to protect consumers from misleading labeling as to origin of wine. The regulations that TTB has promulgated to achieve this have clear provisions related to the proper use of geographic brand names for wine encompassing terms of viticultural significance and clear procedures for revoking COLAs issued in violation of such provisions. Accordingly, any decision by TTB to grandfather the "Calistoga" brands instead of revoking the "Calistoga" brand COLAs would be arbitrary and capricious.

## II. The "Calistoga" Brand Names Are Misleading to Consumers, and This Cannot be Cured by Any Additional Dispelling Information.

As set forth in Notice No. 77, upon the recognition of the Calistoga AVA, any COLAs for "Calistoga" brand names not protected by the 1986 grandfather provision of 27 CFR 4.39(i)(2) or not used on wine in compliance with the Calistoga AVA would be in violation of 27 CFR 4.39(i)(3) as Calistoga will be legally recognized as an "appellation." 72 FR 65259. In enacting 27 CFR 4.39(i), TTB concluded that geographic brand names that encompass a recognized appellation are misleading if the wine does not comply with the appellation requirements because the geographic brand name indicates to consumers the origin of the wine, that is, the place where the grapes are grown. 51 FR 20481.

Nevertheless, TTB has proposed that "Calistoga" brand names in use for a certain period of time prior to the publication of the Notice of Proposed Rulemaking for the Calistoga AVA (March 31, 2005) may be used misdescriptively if the wine is labeled with information sufficient to "dispel the impression that the use of 'Calistoga' in the brand name conforms to the appellation of origin requirements." 72 FR 65258. This is an acknowledgment by TTB that without additional information the use of the proposed Calistoga appellation as part of a geographic brand name will be misleading and that this misleading impression needs to be dispelled if the "Calistoga" brand owners are to be allowed continued use of the "Calistoga" brands on wine not from the Calistoga AVA.

Evidence in the field of marketing has shown that the attempt to add dispelling information to prevent consumers from being misled by misleading geographic brand names generally does not work, and in the context of the purchasing environment for wine, the inclusion of additional information most certainly will not prevent consumers from being mislead concerning the origin of wine carrying "Calistoga" brand names.

### A. As a General Rule, Experience Has Shown That the Addition of Disclaimers or Information to Labels to Attempt to Prevent Consumers from Being Misled Does Not Work.

The concept of the use of a disclaimer to prevent consumer confusion is not a new one in consumer protection law. While some courts have found disclaimers to be an adequate remedy when they are sufficient to avoid substantially the risk of consumer confusion, more frequently courts have found disclaimers to be ineffective in preventing such confusion and have therefore required the party arguing for the proposed disclaimer to demonstrate its effectiveness. *Home Box Office, Inc. v. Showtime/The Movie Channel Inc.*, 832 F.2d 1311, 1315 (2d Cir. 1987).

This judicial skepticism over disclaimers is supported by the scholarly literature on the subject. In an article entitled "Why Disclaimers Fail," consumer behavior experts Jacob Jacoby and George Szybillo explain that disclaimers generally are not likely to be effective because the information provided does not automatically translate into the desired effect, i.e., comprehension. Jacoby, Jacob and Szybillo, George "Why

Disclaimers Fail" *The Trademark Reporter*, Vol. 84, at 225 (March-April 1994) (*see* Exhibit 21 attached hereto); *see also* Jacoby, Jacob and Raskopf, Lloyd "Disclaimers in Trademark Infringement: More Trouble Than They Are Worth?" *The Trademark Reporter*, Vol. 76 at 35 (1986) (*see* Exhibit 22 attached hereto).

Just because a person reads a message does not mean that he or she reads the entire message, or understands it, especially where the products carrying the message contain a considerable amount of information. *Id* at 226. Furthermore, just because a person is exposed to information does not necessarily mean that he or she attends to that information. *Id.* This is especially so for frequently purchased inexpensive products as most people pay attention to only a fraction of the information to which they are exposed. *Id.*

In assessing the degree of care exercised by purchasers of wine in the context of trademark infringement, the court in *E. & J. Gallo Winery v. Consorzio del Gallo Nero* noted that wine is an impulse product and that the average wine consumer was unsophisticated and susceptible to deception. 782 F.Supp. 457, 465 (N.D.Cal. 1991) *citing Taylor Wine Co. v. Bully Hill Vineyards, Inc.*, 569 F.2d 731, 733-34 (2d Cir. 1978); *accord Palm Bay Imports, Inc. v. Veuve Clicquot*, 396 F.3d 1369 (Fed. Cir. 2005) (champagne sold at $25 per bottle an inexpensive impulse product where consumers are susceptible to confusion). This indicates that the use of a disclaimer for Calistoga Cellars, as proposed by TTB, would have no impact on the relevant consumers.

The ineffectiveness of disclaimers was supported by an actual survey conducted by Jacoby. Consumers were tested to determine the impact of a disclaimer stating the producer of the product at issue was not affiliated with another similarly named producer. *Id.* at 228-237. The results indicated that the disclaimer failed to exert the desired impact on 85% of those respondents exposed to it. *Id.* at 235.

Another commentator also observed that a major reason for the failure of disclaimers is their susceptibility to market factors. Radin, Mitchell E. "Disclaimers as a Remedy for Trademark Infringement: Inadequacies and Alternatives" *The Trademark Reporter*, Vol. 76, at 65 (1986) (*see* Exhibit 23 attached hereto). Similar to Jacoby, Radin noted that certain market conditions, such as the bustling, self-service atmosphere of a supermarket, encourage consumers to exercise a low degree of care in a purchasing decision such that any descriptive labeling, including a disclaimer of association, is ignored. *Id.* at 66. Such difficulties are further heightened where "legal requirements and marketing techniques" result in numerous statements, claims and explanatory material appearing on packages and advertisements. *Id.* This is especially so for products that already have an extensive amount of package information as a consumer will face potential information overload and disregard any disclaimer statement. *Id.*

As set forth in more specific detail below, the concept of using a disclaimer or other dispelling label information to suggest that a "Calistoga" brand name wine is not a Calistoga AVA wine will be ineffective for the same reasons discussed by Jacoby and Radin – consumers will neither read nor absorb the disclaimer information in the retail

purchase environment. Furthermore, due to the unique manner in which wine is sold and marketed, in many instances consumers will not even be exposed to the dispelling label information when purchasing the product, thereby rendering it completely ineffective.

B. The Addition of Dispelling Information to "Calistoga" Brand Name Labels for Wine Will Not Prevent Consumers from Being Misled as to Origin Due to the Unique Consumer Purchasing Environment for Wine.

Generally, wine is purchased by consumers through one of three distribution channels: 1) off-premise brick and mortar retail outlets; 2) off-premise virtual or mail-order retail outlets; and 3) on-premise bars, restaurants, hospitality facilities, and the like. In every one of these retail channels, the proposed goal of dispelling the misleading nature of "Calistoga" brand names through the addition of surplus information to the wine label cannot be achieved.

1. Consumers Purchasing Wine in Retail Stores do Not Read Detailed Label Information and Instead Focus on Brand Names and Label Imagery.

As evidenced by multiple comments submitted by wine retailers, distributors and producers in opposition to the grandfathering of the "Calistoga" wine brand names, based on their experience, wine consumers generally do not spend much time reviewing the details of a wine label before making a purchase and instead base their purchasing decision on information such as the brand name. *See* TTB-2007-0068-0047 (Comment of Leslie Rudd, Dean & DeLuca); TTB-2007-0067-0025 (Comment of Rex Albright, Calistoga Chamber of Commerce); TTB-2007-0068-00—(Comment of Craig House, Bounty Hunter); TTB-2007-0068-0080 (Comment of Steven Hirsch, Heritage Wine Cellars)TTB-2007-0068-0058 (Comment of Patrick Stotesbery, Ladera Vineyards); TTB-2007-0068-0073 (Comment of Eric Sklar, Alpha Omega Winery); TTB-2007-0068-0062 (Comment of Shaun Richardson, Clos Pegase); TTB-2007-0068-0044 (Comment of Stephen Corley, Corley Family Vineyards); TTB-2007-0068-0084 (Comment of Richard Cacciato, Frederick Wildman and Sons). Thus, the inclusion of additional information on a label to dispel the notion that "Calistoga Cellars" brand wine is made from Calistoga AVA grapes would be ineffectual. Most consumers would still be misled by the brand name "Calistoga Cellars."

As previously discussed, the concept of consumer care in the purchase of wine has been evaluated by several different federal courts and the Trademark Trial and Appeal Board in the context of consumer confusion analyses related to trademarks. The findings support the fact that the majority of wine consumers do not exhibit very much care in their purchasing decisions. This is especially so with a wine like Calistoga Cellars which is mostly sold in the price range of $16 - $32 per bottle. *See* Exhibit 22 attached hereto (printout of Calistoga Cellars web site); *see Palm Bay*, 396 F.3d at 1376; *Consorzio del Gallo Nero*, 782 F.Supp. at 465; *see also E. & J. Gallo Winery v. Gallo Cattle Co.*, 967 F.2d 1280, 1293 (9th Cir. 1992) (consumers tend to exercise less care when purchasing lower cost items like wine and rely more on brand names); *Vigneron*

*Partners, LLC v. Woop Woop Wines Pty Ltd.*, 2006 WL 1214859 * 8 (N.D.Cal. 2006) (consumers may treat wine priced between $16 and $35 as an impulse purchase and not exercise great purchasing care); *In re Saviah Rose Winery, LLC*, 2006 WL 2414518 *4 (TTAB 2006) (even at $30/bottle, a bottle of wine could be an impulse purchase made by a consumer without a great degree of care); *In re Vina Lo Miranda Ltda.*, 2002 WL 732146 *3 (TTAB 2002) (many purchasers of wine are members of the general public who would not necessarily be likely to exercise the high degree of care necessary to prevent confusion).

Because wine purchasers do not exercise a high degree of care in purchasing wine, they most likely will be misled as to the origin of the wine when purchasing the Calistoga Cellars brand, and the inclusion of dispelling label information will not prevent consumers from being misled.

A recent case involving a trademark dispute related to the use of an image of Marilyn Monroe on wine is particularly instructive on this issue. In *Nova Wine, Inc. v. Adler Fels Winery LLC*, 467 F.Supp.2d 965 (N.D.Cal. 2006), plaintiff owned a trade dress right in a wine bottle package featuring the image of Marilyn Monroe, and defendant used virtually the same image on its own bottle of wine. *Id.* Defendant claimed that consumers would not be confused between the respective uses because defendant also included on its package the source identifying information ("name and address") required by 27 CFR §4.35 which distinguishes defendant from plaintiff. *Id.* at 981.

In addressing this contention, the Court found that consumers "in selecting wine, are much more concerned with the distinctive design of the wine label than with the textual information regarding geographic origin, the dangers of alcohol to pregnant women, the presence of sulfides, or any of the other legally required verbiage." *Id.* at 981-82. The Court thus held that "plaintiff is likely to show that the ordinary degree of care exercised by typical wine purchasers will not lead these purchasers to verify the source of the wine by reading the reverse side of the Marilyn Monroe label." *Id.*

In the case of Calistoga Cellars, consumers seeing the brand name will be mislead and believe the grapes for the wine emanate from the prestigious Calistoga appellation made famous by wineries such as Chateau Montelena, Cuvaison and Sterling. Any additional information required to be included by TTB to attempt to dispel such confusion will be ineffective as consumers will not go searching the label for the true origin of the wine before making the purchase. Indeed, why would a consumer seeing the brand "Calistoga Cellars" take the time to search the label to confirm what appears to be readily apparent, i.e., that the wine is made from grapes from the Calistoga area. *See* TTB-2007-0067-0045 (Comment of Leslie Rudd).

Thus, because most wine consumers are fairly unsophisticated and do not invest a great deal of time in reviewing the entire packaging for a wine, instead focusing on the brand name which is the most prominent feature on the label, TTB's attempt to require

additional information to dispel the misleading effect of certain "Calistoga" brand names will be ineffective.

2. Consumers Purchasing Wine from Online or Mail Order Retailers Will Be Misled by the Calistoga Brand Names

While only a small source of total off-premise sales of wine, the sale of wine over the Internet is growing at a remarkable pace. For example, online sales of wine during the 2007 holiday season were 35% above wine sales during the 2006 holiday season. "Online Wine Sales Flourish During Holidays" *See* Exhibit 24 attached hereto (*Wine Business, Daily News Links,* December 6, 2007).

Consumers purchasing wine in the virtual world or via mail-order make a purchasing decision before ever seeing the product label. *See* TTB-2007-0067-0045 (Comment of Leslie Rudd, Dean & DeLuca). Thus, the online or mail order purchase is based exclusively on the wine brand name and any other information the online or mail order retailer may choose to provide. *See* TTB-2007-0068-0047 (Comment of Leslie Rudd, Dean & DeLuca); TTB-2007-0068-00—(Comment of Craig House, Bounty Hunter); TTB-2007-0068-0058 (Comment of Patrick Stotesbery, Ladera Vineyards); TTB-2007-0068-0065 (Comment of David Pearson, Opus One); TTB-2007-0068-0086.1 (Comment of Laura Zahtila, Zahtila Vineyards).

One need look no further than the current online offerings of Calistoga Cellars wine to see that the inclusion of mandatory label information to attempt to dispel the misleading nature of the brand name will have absolutely no effect on the Internet shopper. *See* Exhibit 25, print-outs of Internet offerings of Calistoga Cellars wine. Most online and mail order retailers feature nothing more than the brand name of the wine at the point of sale, and even where they do provide additional information, it is very unlikely that that information would highlight that the brand name of the wine for sale is, in fact, misleading.

Since TTB has no authority to regulate the advertising of wine by third-party retailers, the only way in which TTB can prevent consumers from being misled in the online and mail-order distribution channel is by absolutely preventing the producers from using the misleading "Calistoga" brand names on wines not from Calistoga. TTB in this case must assert its regulatory authority under 27 CFR 4.39(i) to prohibit such misdescriptive and misleading labeling, as dispelling information on the label cannot accomplish this goal where consumers never see the label before purchasing the product.

3. Consumers Purchasing Wine On-Premise Will Be Misled by the Calistoga Brand Names

The purchasing environment with on-premise sale of wine at bars and restaurants is similar to that of Internet or mail-order retail sales. As explained in the various comments submitted by members of the restaurant industry, wine is purchased in bars or restaurants by the glass or by the bottle from a wine list or menu. *See* TTB-2007-0068-

0069 (Comment of Kevin Westlye, Golden Gate Restaurant Association); TTB-2007-0068-0047 (Comment of Leslie Rudd, Dean & DeLuca); TTB-2007-0067-0035 (Comment of Jeff Whitehead, River Terrace Inn); TTB-2007-0067-0025 (Comment of Rex Albright, Calistoga Chamber of Commerce). Thus, consumers will not see the wine label prior to making the purchasing decision and will base that decision on what appears on a wine list, not what appears on the label. *See* TTB-2007-0068-0069 (Comment of Kevin Westlye, Golden Gate Restaurant Association); TTB-2007-0068-0047 (Comment of Leslie Rudd, Dean & DeLuca); TTB-2007-0067-0035 (Comment of Jeff Whitehead, River Terrace Inn); TTB-2007-0068-00—(Comment of Craig House, Bounty Hunter); TTB-2007-0067-0025 (Comment of Rex Albright, Calistoga Chamber of Commerce); TTB-2007-0068-0073 (Comment of Eric Sklar, Alpha Omega Winery); TTB-2007-0068-0058 (Comment of Patrick Stotesbery, Ladera Vineyards); TTB-2007-0068-0044 (Comment of Stephen Corley, Corley Family Vineyards); TTB-2007-0068-0065 (Comment of David Pearson, Opus One); *see also Sutter Home Winery, Inc. v. Madrona Vineyards, L.P.*, 2005 WL 701599 (N.D.Cal. 2005) (non-brand name information on wine label will not prevent consumer confusion when consumers do not see it when ordering from a restaurant wine list).

The wine lists on which the Calistoga Cellars wines currently appear (*see* Exhibit 26, Internet print-outs of wine lists featuring Calistoga Cellars wine) are typical of most wine lists in that they feature only the most basic facts about the wine such as the brand name, varietal, vintage, appellation, and price. Furthermore, TTB has no regulatory authority to insure that third-party restaurateurs will place the dispelling information on the wine list, nor would they, as such information would stick out like a sore thumb relative to the typical information that appears on a wine list.

While some of these wine lists do, in fact, list the Calistoga Cellars wines' Napa Valley appellation, this only exacerbates the problem of consumers being misled. The Calistoga AVA is located within Napa Valley, and the use of the Napa Valley appellation in conjunction with the "Calistoga" brand name reinforces the misperception of the wine's Calistoga origin.

In fact, the geographic origin of Calistoga Cellars brand wine is so confusing that at least one restaurant has identified the geographic origin of the wine as "Calistoga" along with another brand of legitimate Calistoga origin, the Chateau Montelena Estate Cabernet Sauvignon. *See* Exhibit 27, Internet print out of Red Pheasant Inn wine list. This demonstrates that, not surprisingly, even sophisticated restaurateurs may be confused as to the geographic origin of Calistoga Cellars wine due to the use of Calistoga as part of the brand name.

In sum, consumers seeing "Calistoga" brand names on wine lists will believe the wine to be from the Calistoga AVA, and to the extent it is not, consumers will be misled regardless of any additional dispelling information which appears on the label because the label will not be seen by the consumer prior to ordering the wine.

C. The Addition of Dispelling Information to "Calistoga" Brand Name Labels for Wine Will Not Prevent Consumers from Being Misled as to Origin Due to the Nature of Marketing Channels for Wine.

Most advertising for wine to consumers occurs either via advertisements placed by retailers or by independent wine reviews by critics in publications. Each of these marketing channels motivates consumers to purchase the wine brands featured and influences the purchase decision absent any review of the label by the consumer.

Third-party retailer advertising of wines most often occurs through inserts in newspapers. These advertising inserts are all fairly standard in their advertisement of wine brands. While it is not unusual for the ads to feature an image of the wine bottle for the brand being advertised, the only wording that is usually legible in such images is the name of the brand, and little else. *See* Exhibit 28 attached hereto, copies of retailer advertising inserts featuring wine. Thus, any additional dispelling information added to the label would not be seen by the consumer in such advertisements even if the image of the package was included in such advertisement.

Furthermore, as demonstrated by the retailer ads, only the most basic information on the wine (e.g., brand name, varietal, bottle size and price) is provided in addition to the small image of the packaging. TTB cannot mandate that additional dispelling information be included in such third-party ads. Thus, consumers will be predisposed to buy "Calistoga" brand name wine based on such ads and will be misled by the brand name into thinking the wine is from the Calistoga AVA. Having been predisposed to purchase by the ad, the consumer will have little reason to further inspect the label at the retail location, especially to investigate the origin of the wine since the "Calistoga" brand name will cause the buyer to assume the wine is from the Calistoga AVA.

A similar situation is involved with wine reviews. Many consumers will seek out a wine brand based on a favorable review by a critic in a newspaper or wine publication. Typically, such reviews will discuss the taste and other characteristics of the wine itself. This is born out by the two reviews for Calistoga Cellars wine featured in *Wine Spectator*. *See* Exhibit 29 attached hereto, Internet printouts of *Wine Spectator* reviews for Calistoga Cellars.

As with the retailer advertising inserts, once a consumer sees a favorable review of the "Calistoga" brand name wine and seeks out the wine, there is little likelihood that prior to purchase he will survey the label to seek the "true" origin of the wine when such origin is assumed based on the brand name. A consumer who has read such a review and then encounters the brand in a bar or restaurant will not even have the opportunity to review the label for dispelling information and will order the wine under the mistaken impression that the wine is a Calistoga AVA wine.

D. Continued Use of 'Calistoga" Brand Names in Conjunction with Dispelling Information will Harm Consumers and Producers Using the Calistoga AVA.

For all the reasons cited above, the proposed rule allowing the owners of "Calistoga" brand names to use those brand names on non-Calistoga AVA wine, provided the label also includes information to dispel any misleading impression conveyed as to Calistoga origin, will not prevent consumers from being misled and will devalue the AVA thereby harming the legitimate users whose efforts established Calistoga as a winegrowing region in the first lace.

III. The Proposed Grandfather Provision Is Incompatible With Article 23 of TRIPS

The proposed grandfather provision for Calistoga brand names is also incompatible with TTB's obligations to protect geographical indications for wine pursuant to Article 23 of TRIPS. TRIPS, Article 22, defines geographical indications as "indications which identify a good as originating in the territory of a Member, or a region or locality in that territory, where a given *quality, reputation or other characteristic of the good* is essentially attributable to its geographical origin." (Emphasis added) TRIPS, Article 23(1), provides that "Each Member shall provide the legal means for interested parties to prevent use of a geographical indication identifying wines for wines not originating in the place indicated by the geographical indication in question ..., even where the true origin of the goods is indicated or the geographical indication is used in translation or accompanied by expressions such as 'kind', 'type', 'style', 'imitation' or the like."

In implementing the TRIPS Agreement through the Uruguay Round Agreements Act, Pub. L. 103-465, 103 Stat. 4809, Congress approved a Statement of Administrative Action which provides that: "The United States will implement the Agreement's provisions on geographical indications for wine and spirits through the labeling regulations of the Bureau of Alcohol, Tobacco and Firearms of the Department of the Treasury. The Agreement specifically recognizes that rights in geographic indications for wine and spirits may be enforced through administrative action." Statement of Administrative Action, Agreement on Trade-Related Aspects of Intellectual Property Rights, H. Doc. 103-316, Vol. 1, 103rd Cong., 2d Sess. 1000, 1994 WL 761796, §B.2.c (Sept. 27, 1994); 19 U.S.C. §§3511-12.

In its November 20, 2007, Notice of Proposed Rulemaking No. 78, Proposed Revisions of American Viticultural Area Regulations, TTB stated that "AVA designations allow vintners and consumers to attribute a given *quality, reputation, or other characteristic of a wine* made from grapes grown in an area to its geographic origin." 72 Fed.Reg. at 65261 (emphasis added). Thus, TTB recognizes that AVAs function as geographical indications under TRIPS, and the agency must enforce Article 23 administratively.

Under the strong common law tradition of the U.S., a geographical indication does not need to be "registered" in order to be protected against misuse on wine. This is most clearly demonstrated by the trademark examination rules of the U.S. Patent and Trademark Office ("USPTO").

Under the implementing rules for TRIPS Article 23, Congress indicated that Article 23 must also be enforced in the registration of trademarks for wine, an area of responsibility belonging to the USPTO. Statement of Administrative Action, TRIPS, H. Doc. 103-316, Vol. 1, 103rd Cong., 2d Sess. 1000, 1994 WL 761796, §B.1.e (Sept. 27, 1994); 19 U.S.C. §§3511-12. Where TTB is responsible for administratively enforcing TRIPS Article 23 in relation to use on wine labels, USPTO is responsible for enforcing TRIPS Article 23 in relation to the registration of trademarks for wine.

In the Trademark Manual of Examining Procedure ("TMEP"), the USPTO sets forth the elements to establish a prima facie case for the refusal to register a trademark for wine under TRIPS Article 23: 1) the primary significance of the relevant term is geographic; 2) purchasers would be likely to think that the goods originate in the geographic place identified in the mark, i.e., purchasers would make a goods/place association; 3) the goods do not originate in the place identified in the mark; 4) a purchaser's erroneous belief as to the geographic origin of the good would materially affect the purchaser decision to buy the wine; and 5) the mark was first used in commerce by the owner on or after January 1, 1996. TMEP § 1210.08(b). Thus, it is readily apparent that a term need not be "registered" as a geographical indication or AVA to be entitled to protection as a geographical indication under TRIPS and U.S. law.

As demonstrated by the discussion in the preceding sections, Calistoga plainly qualifies as a geographical indication and the mark Calistoga Cellars is not entitled to protection or use as a trademark for wine pursuant to the provisions of TRIPS Article 23. To wit: 1) "Calistoga" is a fanciful term coined by the founder of the town as a combination of "California" and "Saratoga" and has no meaning other than as a geographic term; 2) by TTB's own statements, the term "Calistoga" is viticulturally significant such that consumers associate the term with wine; 3) the Calistoga Cellars wine does not meet the appellation standards for use of "Calistoga;" 4) the singular significance of "Calistoga" as a geographic term and the reputation of Calistoga as a winegrowing region must materially affect the consumer purchasing decision related to the Calistoga Cellars wine; and 5) the Calistoga Cellars mark was not used in commerce until after 1998.

If TTB were to simply enforce 4.39(i) against the Calistoga Cellars brand and revoke the COLAs issued to Calistoga Cellars or require Calistoga Cellars to comply with the appellation requirements for the Calistoga AVA, TTB would fulfill its obligations pursuant to Article 23. Instead, TTB is proposing rules that are completely contrary to the requirements of Article 23 in sanctioning the continued deceptive use of Calistoga Cellars on wine not complying with the appellation requirements for the Calistoga AVA, provided the wine label includes dispelling information. The dispelling information requirement proposed by TTB as a "cure" to misuse, in fact, is expressly forbidden by Article 23 which prohibits the use of a geographical indication on wine not from the place identified "even where the true origin of the goods is indicated."

It is NVV's understanding that USTR has indicated that the U.S. is not under any treaty obligations to enforce Article 23 in relation to domestic geographical indications. However, even if that were so, should TTB decide not to apply Article 23 to domestic geographical indications, U.S. geographical indications for wine would receive a lower-level of protection in and from the U.S. than that afforded to foreign geographical indications for wine. Clearly, this was not Congress' intent. The USPTO, by contrast, applies the same Article 23 standard to all trademarks and geographical indications, regardless of origin. We submit that TTB, in this rulemaking, should make no decision that is contrary to the provisions of Article 23 or that disadvantages U.S. geographical indications relative to those of foreign countries.

IV. Alternative Resolution

As clearly demonstrated above, TTB's grandfather proposal is insupportable, and enactment of the proposed rule would be arbitrary and capricious. However, contrary to public assertions being made by Calistoga Cellars, NVV has no interest in causing it commercial harm. NVV believes it would be reasonable to allow Calistoga Cellars to phase out, over a three year period, its use of the Calistoga Cellars brand name on wine not complying with the appellation requirements for the Calistoga AVA. In this way, the Calistoga AVA would receive the full and proper protection it deserves, and any commercial harm to Calistoga Cellars could be minimized. TTB has utilized a similar sunset principle for varietal names and even for the implementation of its original appellation rules in T.D.-53.

V. Conclusion

As mandated by the FAA Act, TTB's primary function in the regulation of wine labeling is to protect consumers by ensuring that they are not mislead by the content of wine labels. Proposed rule 27 CFR §9.209 is directly contrary to this mandated purpose.

For all of the foregoing reasons, NVV strongly urges TTB to recognize the Calistoga AVA and amend the proposed rule, 27 CFR §9.209, to delete subpart (d), and to revoke the COLAs for those "Calistoga" brand names at issue in this notice; or in the alternative, to withdraw the proposed rule in its entirety

Mr. THOMPSON. Mr. Manfreda, I have a couple of questions on this issue that I would like to ask you. If a vintner submitted an application today with a Calistoga brand name on the label, would that label be approved under these standards?

Mr. MANFREDA. Which standards?

Mr. THOMPSON. Your standards.

Mr. MANFREDA. Yes, they would, currently.

Mr. THOMPSON. You would in fact approve a label with the name "Calistoga" on it?

Mr. MANFREDA. Yes, sir, because we are now in rulemaking on that point. We probably would approve it subject to an advisory that this matter and the use of the word "Calistoga" is subject to rulemaking and your ability to continue to use that may be subject to termination.

Mr. THOMPSON. Your manual states specifically that it cannot be done.

Mr. MANFREDA. That manual, sir, is purely a guidance document. If you look at the regulations which control this particular issue, under 4.39(i), this regulation specifically states as determined by a TTB official.

From our knowledge, there was no determination made at the time, in 1998 when we started approving the Calistoga label, that such term had viticultural significance.

Mr. THOMPSON. Mr. Manfreda, the Federal Government, when they passed the Federal Alcohol Administration Act, prohibited misleading wine labels. How in the world can you sit here and tell me that a wine label with a geographic destination would in fact be approved unless, of course, you can come back somehow and explain how that fruit comes from that specific area?

Mr. MANFREDA. Our laws basically say you cannot use a brand name of geographical significance or viticultural significance, and basically, that is determined by the agency.

Calistoga has not been officially determined to be——

Mr. THOMPSON. That is not what your rule says. As a matter of fact, it gives an example of the Virgin River Valley Serenade white wine, and it states "Virgin River Valley is the name of a geographic area that actually exists and is described in at least two reference materials as a grape growing area. Therefore, the wine cannot meet the appalachia of origin requirements for the geographic area named in the brand name."

Mr. MANFREDA. Again, that is a guidance document and it does not address Calistoga specifically. In fact, from our historical files——

Mr. THOMPSON. There are 15 references right here. You sat through the very, very tough hearings in the eighties on this issue. You were at the hearings in my district. In those hearings, one of the leading viticulturers in the world, and sadly to say, just passed away this weekend, Robert Mondavi, but he testified before that hearing that since 1937, "I've been crushing grapes in the Napa Valley. These grapes have come from the various areas of Napa County, Caymus, Yountville, Oakville, St. Helena, Calistoga. The wines have their own characteristics from each of these areas."

This is something that you know personally, with personal experience.

Mr. MANFREDA. Sir, that is the whole function of the rulemaking, to air this issue entirely to give people the ability to comment. If you remember, this rulemaking involves the application of the regulation that is already on the books that basically says a geographical brand name that is the name that has been in existence after 1986 does not fall within the grandfather clause of 4.39(i).

What we were trying to do here is see whether or not there are other approaches to this particular labeling issue other than terminating somebody's right to use a brand name that they have been using for over 12 years.

Mr. THOMPSON. You are mixing questions now. There is this very specific provision in the law, a revocation provision, that allows you to remove that if someone does in fact have a label that is not legitimate and not proper, and that revocation provision is probably what should be used in this particular case.

Mr. MANFREDA. I know that exists there, but we are still in rulemaking. It would be premature to pre-determine the outcome of this before the rulemaking finishes.

Mr. THOMPSON. You told me in my office when we talked about this that there may be some way to deal with this by placing a disclaimer on the Calistoga label, that in fact the grapes were not from Calistoga.

If that were to happen, how would a consumer know that the wine is not from Calistoga?

Mr. MANFREDA. If the disclaimer specifically said the grapes were not——

Mr. THOMPSON. On the wine bottle.

Mr. MANFREDA. Right in the same——

Mr. THOMPSON. What about the consumer who buys his or her wine in a restaurant off a wine list, sees it advertised and somehow draws the conclusion that it is from Calistoga, or in a wine review or for sale in a catalog or on the Internet?

Mr. MANFREDA. I think that is a very good point. You are going to the limitations of our jurisdiction over advertising materials. To the extent it would constitute advertising by an industry member, our rules can address that to make sure if the brand name is used, you have an appropriate disclaimer also present. We can cover it to the extent that we have jurisdiction over it, and for those areas we cannot reach, it is no more different than other issues that could come up and be treated similarly in those respected forums.

Mr. THOMPSON. Mr. Chairman, thank you for your indulgence, if I could, just one more question.

The label in question, Calistoga Cellars, has never applied to register its wine brand as a trademark with the U.S. Patent and Trademark Office. If it had, it would have been refused registration on the brand on the basis that it was deceptive because consumers associate the term "Calistoga" with the wine.

This is the holding of the PTO in the case of trademark applications to register similar marks, Calistoga Ranch and Calistoga Estate Vineyards for wine.

How do you justify TTB's protecting Calistoga Cellars when this position is in direct conflict with the government's lead agency on trademark matters?

Mr. MANFREDA. Sir, I will have to defer to the PTO. I am not familiar with their rules or regulations. I am familiar with what we are doing and what we are doing is trying to determine whether or not a label with a disclaimer would be not misleading to the consumer with regard to claiming Calistoga where the real source of the grapes are shown.

Mr. THOMPSON. There are other ways to deal with that, and we have talked about some of them. One would be a grace period whereby the label in question could start sourcing its grapes from the Calistoga area which the label is trying to mislead consumers to believe their wine is from. It could be like a 5 year period to get those grapes, and as you know, the Calistoga folks said they would get them, the fruit, to do this.

This is an important issue. This has been litigated and litigated and litigated. The California Supreme Court found that the issue that you are trying to protect, the businessperson who has this label, does not lose anything if they are required to have fruit in their wine that the label leads consumers to believe is in the wine, and it went all the way to the California Supreme Court and twice, it was refused certiorari at the U.S. Supreme Court.

There is plenty of legal ground to hang your hat on, and I would just strongly advise you to consider these things and consider the harm that is going to be done to an industry that across the board has benefited not only the industry but the consumers and the Treasury with this success.

We are trying to fix something here that is not broken.

Thank you, Mr. Chairman, for your patience.

Chairman LEWIS. I thank the gentleman from California, Mr. Thompson.

Mr. Manfreda, I am sorry I missed your testimony but I read it. I just have one question. You mentioned that you conduct background checks when you review alcohol and tobacco permits. How do you conduct criminal background checks without access to law enforcement databases? What do you look at to be sure there is no criminal record?

Mr. MANFREDA. Yes, sir. With our separation and split to a separate bureau, when we were part of ATF, we could use their law enforcement function to do NCIC checks. We had been advised by Justice in late 2005 and the beginning of 2006 that they did not consider us a law enforcement agency under their statute.

As a result of that, what it has caused us to do is use commercial databases, like Lexis-Nexis, Choice, different commercial databases to look at the background of individuals.

We also know that 28 States run fingerprinting for their permitees, and we always ask the States that are involved whether or not they have derogatory information on the individual that has applied for a Federal permit.

In addition, especially in the tobacco area because of ATF's CCT jurisdiction, we refer matters to them to find out if they have any adverse information regarding the individual.

That is what we have been doing to date. We do our own investigative work regarding the applicant as well.

Chairman LEWIS. Mr. Manfreda, I want to thank you for your time and being so patient. I thank you for your responding to the Members and for your testimony. The Subcommittee appreciates your views.

Is there any other business to come before the Subcommittee?

Mr. THOMPSON. Only one round?

Chairman LEWIS. Only one round? I think you had two, Mr. Thompson. You had two in one.

There being no further business, the hearing is now adjourned. Thank you very much.

[Whereupon, at 12:09 p.m., the hearing was adjourned.]

[Questions submitted by the Members to the Witnesses follow:]

[Questions from Mr. Cantor to Mr. Manfreda and Responses from Mr. Manfreda follow:]

**Question for the Record regarding the Ways and Means Oversight Subcommittee hearing on the Department of the Treasury Alcohol and Tobacco Tax and Trade Bureau**

Question

The TTB administers the Webb-Kenyon Act, which grants TTB authority to prevent alcohol shipments from one state to another in violation of the receiving state's laws. The explosion of e-commerce has also reached alcoholic beverages – beer, wine, spirits, even grain alcohol are all for sale on the Internet.

What action is TTB taking to help ensure that internet sales of alcohol are not sold in violation of state excise tax laws and state drinking age laws – and what sort of resources would the TTB need in order to adequately prevent online sales of alcohol from violating state excise tax and drinking age laws.

Answer

The Alcohol and Tobacco Tax and Trade Bureau (TTB) continues to adhere to the guidance set forth in ATF Ruling 2000-1, issued by our predecessor, in which we advised that we could under appropriate circumstances take administrative action against a basic permit where a basic permittee ships alcoholic beverages into a State in violation of the laws of that State. We advised that we would intervene when it is determined that there is a continuing, material, adverse impact upon a State through the actions of a basic permittee located outside the boundaries of the affected State. We noted that, while we are vested with authority to regulate interstate commerce in alcoholic beverages pursuant to the Federal Alcohol Administration Act (FAA Act), the extent of this authority does not extend to situations where an out-of-State retailer is making the shipment into the State of the consumer. The text of ATF Ruling 2000-1 is attached for your reference.

Since TTB's inception, we have received only two direct shipping referrals from states, both involving very limited quantities of alcohol, and we took appropriate enforcement action in both. Neither case involved shipping wine to a minor.

We have also developed and pursued cases where retailers were acting as wholesalers without the appropriate Basic Permit and selling large quantities of alcohol to out of state residents. One case was resolved with a $17,000 offer in compromise. Another case is being resolved with a $225,000.00 offer in compromise. In the latter case, the wholesaler involved stipulated to operating from an un-permitted location but would not stipulate to Webb-Kenyon violations.

Finally, TTB works closely with its state counterparts through our State Liaison and through our Office of Field Operations so that we can address matters of

mutual interest, including issues implicating Webb-Kenyon. Consistent with the 2001 Ruling, we rely upon the States to seek our assistance where they have found a continuing, material adverse impact upon them, based upon activities of those operating outside the state.

Based upon the above, we do not believe that additional resources are necessary to address Webb-Kenyon issues.

**ATF Ruling 2000 - 1**

**Direct Shipment Sales of Alcohol Beverages**

The Bureau of Alcohol, Tobacco and Firearms (ATF) has received a number of requests from various States for our assistance in the enforcement of State alcoholic beverage laws. The States are concerned with mail order sales and shipments made directly to consumers in the State from sellers located outside the State. These transactions usually involve small quantities of wine or beer shipped by out-of-State sellers (including beer and wine of the month clubs) and, when considered individually, seem to have a negligible effect on interstate commerce. Taken in the aggregate, however, these shipments result in a substantial revenue loss to the States of the purchasers. The National Conference of State Liquor Administrators has estimated that these types of interstate sales result in State tax revenue losses of tens of millions of dollars. The States are also concerned that shipments may be made to underaged drinkers.

The States have asked ATF whether these types of transactions violate the Webb-Kenyon Act, 27 U.S.C. § 122. The States have also asked about the circumstances under which ATF will take enforcement action against these types of transactions.

**Background**

The Twenty-first Amendment to the Constitution provides that the transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is prohibited.

The Liquor Law Repeal and Enforcement Act, known as the Webb-Kenyon Act, provides that the shipment or transportation, in any manner or by any means whatsoever, of any spirituous, vinous, malted, fermented, or other intoxicating liquor of any kind, from one State into any other State which said spirituous, vinous, malted, fermented, or other intoxicating liquor is intended, by any person interested therein, to be received, possessed, sold, or in any manner used, either

in the original package or otherwise, in violation of any law of such State is hereby prohibited. 27 U.S.C. §122.

The Federal Alcohol Administration Act (FAA Act), 27 U.S.C. § 203, requires a basic permit in order to engage in the business of importing into the United States, distilled spirits, wine or malt beverages. Likewise, a basic permit is required to engage in the business of distilling distilled spirits or producing wine. Finally, a basic permit is required for persons who engage in the business of purchasing for resale at wholesale distilled spirits, wine or malt beverages. 27 U.S.C. § 203. Retailers are not required to obtain basic permits under the FAA Act. The FAA Act provides that basic permits are conditioned upon, among other things, compliance with the Twenty-first Amendment and other Federal laws relating to its enforcement.
27 U.S.C. § 204(d).

Held: The Webb-Kenyon Act is a law relating to the enforcement of the Twenty-first Amendment and is a condition of the basic permit under 27 U.S.C. § 204(d) for violations of which ATF may suspend or revoke the basic permit.

Held Further: Under these provisions of law, ATF could under appropriate circumstances take administrative action against a basic permit where a basic permittee ships alcoholic beverages into a State in violation of the laws of that State. ATF will intervene when it is determined that there is a continuing, material, adverse impact upon a State through the actions of a basic permittee located outside the boundaries of the affected State. However, while ATF is vested with authority to regulate interstate commerce in alcoholic beverages pursuant to the FAA Act, the extent of this authority does not extend to situations where an out-of-State retailer is making the shipment into the State of the consumer.

27 U.S.C. 122, 27 U.S.C. 203; 27 U.S.C. 204 (d)

[Submissions for the Record follow:]

**Statement of Authentix**

Members of the Oversight Subcommittee of the U.S. House Ways and Means Committee, the Department of The Treasury's Alcohol and Tobacco Tax and Trade Bureau, Federal cigarette tax collection efforts are an important revenue generator for the U.S Government and the TTB is to be commended on its five year anniversary. However, there is more that could be done to efficiently and effectively collect Federal cigarette taxes. A high-tech Federal tax stamp for cigarettes harnessing new technologies such as digital stamping would provide the most effective method for Federal cigarette tax collection. Along with increased efficiency of tax collection, a Federal tax stamping program would help eliminate the ability of organized crime to highjack our economy through cigarette smuggling, diversion and counterfeiting. Authentix has harnessed nano-scale engineering and top-notch training programs to enable governments across the world such as India, Kenya, South Africa and Guyana to recoup billions of dollars in lost excise tax revenue over the course of the past 5 years.

As a global leader in excise tax recovery, the situation in the U.S. is a growing program with billions of dollars at stake at the Federal level. These precious tax dollars that provide our Nation with funds for schools, hospitals, roads, and defense are being high jacked by very sophisticated organized global crime rings.

A Snapshot of the Illegal Cigarette Problem

Some other sources put the total loss at over $1 Billion. The global trade in illicit cigarettes is estimate to represent over 10% of cigarettes sold globally—about 600 BILLION cigarettes.[1] Each year, the illicit tobacco trade potentially represents up to $US 50 billion worth of losses to governments worldwide.[2]

We all know, illicit trade in tobacco products significantly contributes to death and disease caused by tobacco consumption and to the rise in tobacco consumption by making cigarettes "cheaper, more accessible and more difficult to regulate."[3] As taxes in many States have climbed, so has the illicit cigarette trade. The Bureau of Alcohol, Tobacco, Firearms and Explosives estimates they made 35 arrests for tobacco trafficking in 2003 and 162 such arrests in 2005.[4] More than 700 new investigations have been opened in the past 5 years, according to Phillip Awe, the chief tobacco enforcer of the ATF.[5] As recent media articles have pointed out, the Bureau of Alcohol, Tobacco, Firearms and Explosives have found that Russian, Armenian, Ukranian, Chinese, Taiwanese, and Middle Eastern (mainly Pakistani, Lebanese and Syrian) organized crime groups are highly involved in the trafficking of contraband and counterfeit cigarettes and counterfeit tax stamps for profit.[6]

Examples of Illegal Cigarette Trafficking Schemes

Smuggling occurs in a variety of ways, including counterfeit and "grey" products, illegally manufactured, counterfeit tax stamps, Internet and postal schemes, theft, and smuggling across borders and into ports.

The Impact

As Mr. William Billingslea of the ATF states, "It's hard to exaggerate the harm caused by smuggling and counterfeiting. Governments miss out on tax revenue, legitimate manufacturers suffer lost sales and damage to their reputations, and consumers end up with inferior products. What's more, the profits from smuggling and counterfeiting provide seed money for other illegal activities such as organized crime and terrorism."[7]

What's Being Done Isn't Enough

- In the U.S., States rely on tobacco stamping technologies from the 1950's to protect tobacco tax revenues. These stamps have limited security and tracking features which makes it much easier for counterfeiters and smugglers to foil the tax recovery system in place.

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[1] "How Big Was the Global Illicit Tobacco Trade Problem in 2006?" Framework Convention Alliance (FCA). June, 2007.

[2] Ibid.

[3] "WHO takes aim at tobacco smuggling with new pact." Reuters. Feb. 15, 2008.

[4] "With Taxes on the Rise, Cigarette Smuggling Likely to Increase," Associated Press. April 11, 2008.

[5] Cigarette Trafficking Grows as Taxes Climb. The Heartland Institute, Budget & Tax News. June 1, 2006.

[6] "Illicit Cigarette Trafficking and the Funding of Terrorism." William Billingslea. ATF. The Police Chief Magazine. February 2004.

[7] The Counterfeit Trail. Tobacco Reporter magazine blog. February 2008.

Unlike many countries such as Canada, Malaysia and The Czech Republic, the U.S. currently does not have a Federal tax stamp and has no way of protecting our precious excise tax dollars. This is a great risk every day. There is legislation afoot, H.R. 5689, that is calling of the mandate of a digital tax stamp for cigarettes sold in the U.S.

H.R. 5689's mandate for a digital stamp follows best practices of many other countries from around the world that have implemented a "country" or Federal tax stamp and additionally ensures we, as a Nation, are using the best readily available technology such as a digital platform to ensure smugglers and organized crime can't counterfeit stamps like they do now. As shown in the picture below, here are a few examples from Russia, Poland, and The Czech Republic.

Some will say digital technology is immature and we should stay with the status quo. We would argue, and so would countries from around the world, as well as many of our Fortune 500 clients, that indeed the technology does exist and has enabled our clients to recover over $5 billion in lost revenues in the last 5 years.

The Authentix Digital Tax Stamp Solution is customizable to fit customer needs. The solution can authenticate, serialize and track cigarette packs as they move from distributors' warehouses throughout the supply chain.

A high-tech digital printed on demand Federal tax stamp would be a leapfrog advance from current countries practices and would significantly reduce the ability of criminals to get smuggled and counterfeit product into our country and thus reduce the ability of foreign operatives to highjack our valuable tax dollars.

ABOUT THE SOLUTION

**Authentix Offers a Better Solution**

Authentix offers a digital tax stamp solution that enables governments to collect tobacco tax revenues effectively and track the status of legally issued tax stamps electronically. By using digitally printed on-demand stamps with remote and field verification capability, this solution ensures a high level of security and data integrity, accurate and customizable reporting and makes it much easier for governments to recover lost tobacco tax dollars.

The Authentix Excise Tax Stamp Management System is a web based application. New users will be registered after they file an online request and complete an electronic application. The request will be directed to Authentix to verify completeness and will be forwarded to appropriate tax collection authorities for disposition. The applicant will be automatically notified; via e-mail, phone or fax, once a decision is made to approve, reject or when additional information is required. Authentix will act upon the request based on the decision made by the authorities. This process can take as little as few minutes or several days depending on the protocol set by the authorities for the review process.

Properly registered manufacturers will have access to their account through a secure web portal. Upon logging in on the system the manufacturer will be able to review status of pending orders, initiate new orders or otherwise manage his/her account The process of ordering new stamps will as simple as filling in and configuring an online order request form and specifying information about type of stamp required, stamp denomination, etc.

Individually serialized stamps will be delivered to manufacturers in singulated stacks for application on cigarette packs. Most cigarette manufacturing equipment has the capability to apply the stamps before cellophane wrapping is applied to the cigarette packs. Information about tax stamps used can be collected from the manufacturing/assembly line. This data will be aggregated and shall be forwarded to Authentix through a secure portal for archives and future investigations.

Only authorized revenue collection agency personnel will have access to this information. The system will provide full search and indexing capability to assist investigations for validating tax stamps as they are intercepted in the field (at distribution centers or at retail stores). Authentix will provide all required instruments for authenticating stamps and validating stamp IDs.

Authentix offers secure web-enabled architecture using HTTPS (128 bit SSL) and proprietary encryption technologies to facilitate exchange of information throughout the platform. Users are able to securely login using a standard web browser. Once access is granted by the firewalls, transaction processing layer will interact with various databases to respond to queries. All available databases (Reports, Audit, Stamps, Transaction and Notification) are physically isolated and protected behind a secondary firewall.

We recommend a phased deployment, by geography or by brands.

Carlyle Senior Advisor, Charles Rossotti, who from 1997 to 2002 served as Commissioner of Internal Revenue Service believes, "In particular, Authentix' Excise

Tax Recovery Programs provide government authorities with the ability to effectively authenticate and track goods to ensure tax revenues are optimized rather than lost altogether, a major problem, for example, in tobacco and oil and gas industries. I look forward to working with the Authentix team to further expand the company's global client base."

The Authentix solution enables law enforcement authorities to authenticate the digital stamps and verify the embedded information on the stamps in the field via simple-to-use and secure handheld instruments.

*Authentix digital tax stamp with multi-layered security features and track and trace technology.*

**Authentix Advantages**

- Multiple layers of security features leveraging nano-scale technology, tamper resistance and intaglio printing.
- Can track *each* stamp as applied and distributed.
- Delivers a digitally encrypted, counterfeit-resistant tax stamp.
- Each stamp carries a unique serialized identification code.

**Conclusion**

Authentix once again thanks the Committee on Ways and Means Oversight Subcommittee Department of The Treasury's Alcohol and Tobacco Tax and Trade Bureau for making valiant efforts to keep tobacco taxes from and urges the adoption of a more efficient way of monitoring, tracking and authenticating tobacco sales so they provide the maxium amount of Federal tax dollars.

**About Authentix**

Authentix is a trusted partner of Governments and Brand Owners Worldwide.

Authentix provides authentication solutions to the oil and gas, consumer goods, tobacco, spirits, banknote and agrochemical industries. Our client list includes Fortune 500 companies and governments across the globe. In the past 5 years, Authentix has helped our clients recover over $5 billion in lost revenues.

For more information, please contact Authentix at www.authentix.com.

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**Statement of Charles N. Whitaker**

Altria Client Services Inc. submits this written statement on behalf of Philip Morris USA Inc.[1] ("PM USA"), a leading domestic manufacturer of cigarettes.

PM USA commends the Subcommittee for holding a hearing on the important work of the Alcohol and Tobacco Tax and Trade Bureau ("TTB") and, more specifically, the topic of contraband tobacco products. As the Subcommittee is aware, the illegal sale of cigarettes and other tobacco products results in a variety of harms:

- It can result in lost tax revenues to Federal, State and local governments.
- It can undermine efforts to prevent youth access to cigarettes.
- It can be used by those engaged in contraband trafficking as a source of income to support other criminal activity.
- It can take business away from law-abiding wholesalers and retailers who fully comply with all applicable laws and thereby find themselves at a competitive disadvantage.
- It can result in substantial, unexpected tax bills for some consumers who purchase cigarettes falsely advertised as "tax free" over the Internet.
- And all of these harms can damage the integrity of PM USA's brands and undermine confidence in the distribution channels through which we intend our products to be distributed and sold to adult consumers.

Law enforcement agencies, State and Federal legislators, PM USA, and other private parties have focused considerable effort in recent years on curbing the illegal sales of tobacco products in the United States. PM USA supports effective and appropriate measures to combat illegal sales. Among its many efforts on this issue, PM USA has advocated—and continues to advocate—for well-designed legislation at both the Federal and State level that would reduce illegal sales. In particular:

- PM USA supported the enactment of the Imported Cigarette Compliance Act ("ICCA") in 2000;
- PM USA supported amendments strengthening the ICCA in 2006;

[1] PM USA is a wholly-owned subsidiary of Altria Group Inc. This submission also reflects the views of Altria Group subsidiaries John Middleton Co. and Philip Morris Duty Free, Inc.

- PM USA supported legislation in 2006 strengthening the Contraband Cigarette Trafficking Act ("CCTA"); and
- PM USA supports the enactment of model anti-contraband legislation at the State level.

In addition, PM USA supports the Prevent All Cigarette Trafficking Act ("PACT Act"), H.R. 4081. With the PACT Act, a bill that enjoys a broad base of support, Congress is presented with a vital opportunity to make real progress on illegal Internet sales of cigarettes and smokeless tobacco, a form of illegal sales that has not been adequately addressed at the Federal level. As explained more fully below, the PACT Act would significantly strengthen Federal laws governing the sale of such products over the Internet.

The Subcommittee heard testimony on May 20, 2008 on another anti-contraband bill, H.R. 5689, the Smuggled Tobacco Prevention Act ("STOP Act"). While PM USA supports a range of State and Federal legislative efforts designed to combat contraband and other forms of illegal sales, we do not support the STOP Act because we do not believe the STOP Act is reasonable, prudent, or likely to be effective in addressing contraband.

H.R. 5689—The STOP Act

The main provisions of the STOP Act are either not practical or unlikely to produce meaningful benefits. To begin with, many of the STOP Act's provisions seek to address the prevention of a specific subset of contraband—namely, illegal imports—that has already been the subject of significant Congressional action since the STOP Act was originally introduced in 1999. The current version of the STOP Act, which is essentially the same as the 1999 bill, does not appear to recognize these developments.

Illegal imports consist of products that are either manufactured abroad and illegally imported into the United States, or products that are manufactured in the United States and intended for export but that are illegally diverted into U.S. commerce. Recognizing the importance of this issue, Congress enacted the Imported Cigarette Compliance Act (ICCA) in 2000, making it illegal to import cigarettes bearing a U.S. trademark without the trademark owner's consent. The ICCA also requires that all imported cigarettes comply with U.S. health warnings and ingredient disclosure laws, and it strengthens prohibitions on the diversion into domestic commerce of cigarettes intended for export from the United States.[2] In 2006, Congress then strengthened both the ICCA and the Contraband Cigarette Trafficking Act ("CCTA").[3] PM USA supported each of these actions by Congress, and then reinforced these legislative efforts with private actions of its own filed against illegal importers.[4]

As a result of all of these efforts, we have seen a decline in recent years in the incidence of illegally imported cigarettes that appear in the United States. Today,

[2] 19 U.S.C. §§ 1681 et seq; 26 U.S.C. §§ 5754, 5761(c).

[3] The Tax Relief and Health Care Act of 2006 was enacted December 20, 2006. It amended the ICCA to, among other things, confirm that delivery sales of cigarettes (Internet or mail order sales) cannot qualify as personal use quantities and thus are not exempt from the importation requirements of the ICCA. It also extended the ICCA to smokeless tobacco products and authorized the States to seize cigarettes imported in violations of the ICCA. The USA Patriot Improvement and Reauthorization Act was enacted March 9, 2006. It amended the CCTA to, among other things, lower the threshold number of cigarettes that would constitute a violation from 60,000 (300 cartons) to 10,000 (50 cartons), authorize the Attorney General to promulgate regulations requiring that reports be filed by delivery sellers (other than tribal governments) for sales of cigarettes in quantities over 10,000 during a 1-month period, expand the Attorney General's authority to require recordkeeping by persons who ship or sell more than 10,000 cigarettes in a single transaction, extend the CCTA to cover smokeless tobacco products, and create certain enforcement rights for State and local governments and for private parties.

[4] PM USA has filed a number of actions against importers and sellers of illegally imported cigarettes that bear PM USA's trademarks. In one of its largest illegal import cases, PM USA filed an action against Otamedia Limited, then the largest Internet seller of illegally imported cigarettes to consumers in the United States. The lawsuit resulted in the closure of several international web sites that among them had imported more than 500,000 cartons of illegally imported cigarettes per month. The court permanently enjoined Otamedia from engaging in the sale of illegally imported cigarettes bearing PM USA trademarks into the United States, and ultimately awarded the defendant's key domain name, as well as $173 million in damages, to PM USA. See Philip Morris USA Inc. v. Otamedia Limited, 2005 U.S. Dist. LEXIS 1259 (S.D.N.Y. Jan. 28, 2005).

illegal cigarettes originating from overseas appears to be mostly counterfeit product, as to which the STOP Act provisions would not have any substantial effect.[5]

The STOP Act Would Impose Burdensome, Unworkable Requirements that are Unnecessary Given Existing Laws Prohibiting Illegal Imports

Against this backdrop, many of the STOP Act's major provisions would impose a series of burdensome requirements apparently intended to address the same illegal import issue that was the principal motivation behind the enactment and later strengthening of the ICCA.

Export Markings. The STOP Act's export marking provisions require the inclusion of certain information on each pack of cigarettes or other tobacco products intended for export, including a designation, in both English and the appropriate foreign language, of the country of final destination. It is not clear what purpose this requirement is intended to serve. To the extent that these export markings are intended to allow law enforcement agents or consumers to distinguish legitimate domestic product from illegally imported product, such markings are simply unnecessary. Under current Federal law, tobacco products intended for export already must bear unique markings on the pack, thus making it readily apparent on the face of the pack that it is not intended for sale within the United States.[6]

In addition to the dubious benefit of such markings, there are practical and cost implications. In the context of duty-free sales, particularly at international airports, it is not even clear how this requirement would operate. Manufacturers do not know at the time of manufacturing and packaging what the country of destination will be for individual purchasers of duty-free product. Thus, presumably manufacturers would have to produce separate inventories with separate packaging for every country to which a duty-free customer might travel, and would have to distribute these potentially hundreds of separate inventories to the duty free businesses. Even if that were possible, the requirement as it applies to the duty free shops is unclear. For the duty free shop, does the requirement mean that it may sell only product that is labeled with the traveler's country of citizenship? Or is it the country of immediate destination? Or, still a third possibility, the country in which the traveler intends to consume the product? In short, this requirement raises a series of questions even as to basic feasibility.

Import Markings. The STOP Act also creates new labeling requirements for imported tobacco products. Such products must carry a unique serial number identifying the manufacturer and importer, the location and date of importation, and any other information the Secretary may require. These labeling requirements raise logistical concerns for importers who would be required to print the importation date and location on every package. Importers could not comply with such requirements because the information is not available at the time of manufacturing when the package printing occurs, and the importers themselves have no ability to print information on packages of individual tobacco products after they are manufactured, wrapped in cellophane and packaged into cartons and cases.

Many of the STOP Act's Requirements for Domestic Tobacco Sales Impose Significant and Unnecessary Burdens with No Clear Benefit

Other provisions of the STOP Act aimed at sales of domestic tobacco products would impose significant and unnecessary burdens on law-abiding participants in the tobacco distribution chain without clear evidence that such burdens will produce meaningful benefits.

Federal Encrypted Tax Stamp. The STOP Act would require the implementation of a new Federal tax stamping system, one that would in particular mandate manufacturers to apply an encrypted tax stamp on each package of cigarettes and other tobacco products.

The anticipated benefits of this new and elaborate Federal tax stamp system are not clear. Tax avoidance is primarily a State excise tax issue, and for that reason tax stamping at the State level is an important component of the overall solution

[5] According to a 2004 GAO report, Customs and Border Patrol and Immigration and Customs Enforcement seized 1.7 million counterfeit cigarettes compared to only 225,000 genuine cigarettes during 2003. Prior to 2000, the number of illegal genuine cigarettes seized far exceeded counterfeits. See Cigarette Smuggling: Federal Law Enforcement Efforts and Seizures Increasing, GAO Report to the Chairman and Ranking Minority Member, Committee on Government Reform, House of Representatives (May 2004) at 21.

[6] Before removal from the factory, every package of tobacco products must be labeled with the words "Tax Exempt. For use outside U.S." or "U.S. Tax-exempt. For use outside U.S.," except where a stamp, sticker or notice, required by foreign country or U.S. possession that identifies such country or possession, is imprinted or affixed to the package. 26 U.S.C. § 5704(b); 27 C.F.R. § 44.185.

to addressing contraband cigarettes. Because excise tax rates vary from State to State, it is important that each State require that cigarettes distributed for sale in the State carry indicia (in the form of a tax stamp) of tax payment and of the intended location (State and/or locality) of sale. The Federal excise tax rate, by contrast, is uniform throughout the United States, and approximately 90% of it is paid by the several large manufacturers that produce most of the product sold for distribution. While there is evidence that Federal tax avoidance does occur—for example, with some products manufactured by some Native American entities—the preferable approach is not to impose a new tax stamping system on all manufacturers, but rather to emphasize targeted law enforcement efforts, which can be highly successful in promoting compliance at the Federal level.

In addition, the STOP Act in particular proposes the use of a tax stamp that would be "encrypted" with information such as the identity of the first purchaser from the manufacturer, that is, the wholesaler or distributor. Because diversion of tobacco products often occurs in the distribution chain many layers below the wholesaler, it is not clear what benefits this requirement is intended to have. Nevertheless, this requirement is not feasible in any event. One of the producers of this technology has described the practical limitations that impact any proposal to require manufacturers to embed the identities of downstream purchasers in a stamp that is applied at the point of manufacturing.[7] Manufacturers simply do not know the identity of the first or subsequent purchasers until well after the tax stamping would occur.

It is worth noting, furthermore, that all but three States require tax stamps,[8] and the States that require a tax stamp use serialized tax stamps, except California (California uses an encrypted tax stamp). The serialized tax stamp already enables law enforcement agents to trace an individual pack back to the wholesaler who stamped and sold the product. These tax stamps also have security features that enable law enforcement agents to immediately discern genuine from counterfeit stamps, using technology that is in widespread use today.

It is not clear the extent to which the STOP Act contemplates additional information to be contained on or in the stamp beyond a serial number and identity of the wholesaler. However, the delegation of authority that the STOP Act confers on the Secretary of Treasury to require the serial number to contain "additional information" could result in further requirements of uncertain law enforcement value, but that could impose serious burdens on participants in the distribution chain. Indeed, a number of sections of the STOP Act empower the Department of Treasury to create new or additional requirements other than those specified in the bill, which raises a concern as to the limits of the Department's power to add, through regulatory action, requirements that would compound the burdens of this legislation.

Burdens on Federal Agencies. It should also be noted that the provisions of the STOP Act would create new and substantial burdens on Federal agencies, thus potentially diverting resources from more effective anti-contraband efforts. The Federal tax stamp system under the STOP Act, for example, would entail establishing a new and extensive tax stamping regime at the Federal level, one that would require a range of new activities for the Department of Treasury and the TTB, including negotiating and overseeing the printing and distribution of tax stamps and the many other tasks that would be necessary to create from scratch and then administer a nationwide Federal tax stamp system. These substantial burdens on Federal agencies would be imposed without any clear law enforcement benefits, or at least without any benefits that could not be achieved more efficiently and effectively by working within existing State and Federal laws or by enacting alternative legislation, such as the PACT Act. In short, existing State stamping and licensing requirements, the requirements of the model State anti-contraband bill that PM USA supports, and the PACT Act, provide a more effective set of solutions to the problem of illegal trade of tobacco products.

PM USA Supports Legislative Solutions Other than the STOP Act to Address Illegal Tobacco Sales

PM USA believes that progress can more effectively be made by focusing attention on other legislative solutions, such as the PACT Act, which has been the subject of

[7] See Letter to Rep. Doggett from David Moxam, Authentix ("Cigarettes are manufactured on highly automated high speed packaging lines. In order to make the economy of scale work, cigarette manufacturers mass produce any given cigarette brand based on forecasts and without specific knowledge of end users (retail stores) demand. Therefore the information about when a package of cigarettes is purchased and by which retailer is not available at the time of manufacturing the cigarette packs.")

[8] Only North Carolina, South Carolina and North Dakota do not require a State tax stamp.

years of negotiation and drafting and has earned broad support among wholesalers, retailers, law enforcement agencies, and others.

H.R. 4081—The PACT Act

In contrast to the STOP Act, the PACT Act addresses a number of gaps in Federal law and provides an effective, workable regulatory scheme that comprehensively addresses a current and significant contraband problem: Internet sales of cigarettes and smokeless tobacco.

The PACT Act would regulate "remote" or "delivery" sales of cigarettes and smokeless tobacco products—i.e., sales, like those over the Internet, in which there is no face-to-face interaction between the seller and the consumer and where the products are delivered to the consumer by mail, common carrier or other delivery service. The gaps in Federal law include the absence of any age-verification requirements for cigarettes or smokeless products sold via the Internet or other remote methods, and the absence of effective measures to prevent delivery sellers of such products from evading excise and other State or local taxes. By closing these gaps, the PACT Act would give Federal and State authorities tools they need to take effective action against those who are exploiting the Internet and other remote sale methods. The PACT Act is the product of a long process of discussion and negotiation, and it has broad support. It strikes the appropriate balance between the needs of law enforcement and the legitimate interests of affected parties, and it should therefore be enacted.

There is little doubt that the current remote sale of cigarettes by Internet and other remote sellers is a problem with many adverse consequences. To understand these issues more clearly, it is important to first understand how remote sellers of cigarettes operate in today's marketplace.[9] Remote sellers of cigarettes are typically located in States with low cigarette excise taxes, in other countries, or on Native American reservations in which access to untaxed cigarettes is possible. Once these sellers obtain supplies of untaxed or low-taxed cigarettes, they are then able to sell the cigarettes over the Internet or by mail or telephone order to consumers in higher-tax jurisdictions, without paying the taxes or other amounts lawfully owed to the States and localities in which the consumers are located. Given the substantial excise tax disparities that exist between some States, remote sellers are able to create and then exploit an enormous and unfair competitive advantage over cigarette wholesalers and retailers who pay State and local taxes.[10] Indeed, the current business models of most cigarette remote sellers appear to be based on the non-payment of State and local taxes.

This is not an isolated or minor problem. The percentage of total Internet sales of cigarettes originating with domestic Internet sites—that is, sites located within the United States—has increased over the past few years. Based on PM USA's most recent analysis, the five largest websites—and seven of the top ten—are located in the United States. Against this backdrop, remote sales cause a range of harms across a variety of issues, including:

- The States lose substantial tax revenues.[11] For example, the New York State Department of Health estimated that the revenue losses to New York from Internet and telephone sales during 2006 were between $28 million and $33 million.[12] California estimates that it lost $190 million in tobacco taxes as a result of Internet sales in 2005.[13]
- Remote sales can undercut State laws intended to prevent youth access to cigarettes and other tobacco products. With remote sales, the transaction does not occur on a face-to-face basis, but rather between a purchaser in one State and a seller that is typically located outside of that State, often beyond the State's practical ability to regulate the seller's conduct. A State's ability to impose requirements on remote sales into that State can be limited, furthermore, by both legal and practical considerations. A recent illustration of the limits of States' ability to take comprehensive action in this area is the U.S. Supreme Court's

[9] The PACT Act refers to remote sales and remote sellers as "delivery sales" and "delivery sellers."

[10] In fiscal year 2000, the weighted average State cigarette excise tax was 41.2 cents per pack. (Bill Orzechowski & Rob Walker, The Tax Burden on Tobacco, vol. 42 (February 2008) (funded in part by PM USA)). Today it is more than double that at $1.05. (Internal PM USA data).

[11] In addition to causing tax losses to the States, Internet and other remote sales are often made without the deposit of the escrow amounts required on sales of cigarettes made by manufacturers who are not participating manufacturers under the Master Settlement Agreement.

[12] New York State Department of Health, Fourth Annual Independent Evaluation of New York's Tobacco Control Program, August 2007 at 2–18 and 2–19.

[13] Patrick Fleenor, California Schemin': Cigarette Tax Evasion and Crime in the Golden State, Tax Foundation Special Report, Oct. 2006, at 6–7.

decision in Rowe v. New Hampshire Motor Transport Association, in which the Court struck down elements of Maine's remote sales law. The Court concluded that certain aspects of that law—including the age-verification requirement it imposed on remote sales—were preempted by the Federal Aviation Administration Authorization Act.[14]

- Legitimate businesses are unfairly disadvantaged. The wholesalers and retailers who sell cigarettes in compliance with all applicable State excise tax and age-verification laws often operate on low margins. These law-abiding sellers are finding it increasingly difficult to compete with Internet and other remote sellers, who evade such laws to undercut market prices offered by legitimate wholesalers and retailers—prices that reflect the full cost of goods, including all taxes owed in the jurisdiction in which the cigarettes are delivered.

Existing Federal Law Has Gaps That Make it Inadequate To Effectively Deal With the Problems Created by Internet Sales

Existing Federal law, namely the Jenkins Act, 15 U.S.C. §§ 375 et seq, imposes limited regulatory requirements that were originally designed to prevent bootlegging of cigarettes. The Jenkins Act was enacted almost 60 years ago, long before the development of the modern infrastructures available today (most notably the Internet) that enable millions of consumers to purchase goods from businesses located in other States and countries without leaving their homes. The Jenkins Act's limited regulatory requirements have been overtaken by these developments, and are thus inadequate to today's needs.

For example, the Jenkins Act does not require the Internet or remote seller to pay applicable taxes on cigarettes shipped into a State, but rather only requires the seller to file reports to assist the State authorities in collecting taxes from the consumer. This is an inefficient and expensive way to collect the taxes and creates potentially unfair hardships for some possibly unsuspecting consumers. Moreover, the Jenkins Act does not require Internet or other remote sellers to comply with age-verification and other measures enacted by the States into which they are shipping cigarettes. In addition, violations of the Jenkins Act are punishable today only as misdemeanors, making it less likely that Federal prosecutors will invest their limited resources into prosecuting Internet and other remote sellers who violate that law's requirements.

The PACT Act Addresses These Gaps in Current Federal Law

The PACT Act amends existing Federal law in key respects in order to address the gaps in those laws and to provide workable and effective regulations governing Internet and other remote sales. Among other things, the PACT Act:

- Enhances existing Jenkins Act provisions. The PACT Act directly addresses problems with the current law in a number of ways.
- First, it expands the amount of information that must be reported by Internet and other remote sellers of cigarettes and smokeless tobacco and requires that the monthly reports be provided not only to the State taxing authorities but also to the United States Attorney General and to local and tribal governments that tax cigarettes.[15]
- Second, the PACT Act gives State, local and tribal authorities the right to bring a Federal cause of action in the United States district courts to enforce the Jenkins Act (including the new remote sale rules described below). These provisions give the authorities with the greatest incentives to enforce the Jenkins Act important information and legal remedies they need.
- Third, the PACT Act expressly provides cigarette manufacturers or importers holding Federal permits with a cause of action to enjoin violations of the Jenkins Act.[16]
- Fourth, the PACT Act makes violations of the Jenkins Act a felony, thus providing a more powerful deterrent to illegal conduct, and increasing the incentive

[14] 128 S. Ct. 989 (2008). Justice Ginsburg highlighted in her concurrence the need for Congressional action in light of these limits on States' power. "State measures to prevent youth access to tobacco ... are increasingly thwarted by the ease with which tobacco products can be purchased through the Internet. ... The FAAAA's broad preemption provisions, the Court holds, bar States from adopting [a] sensible enforcement strategy. ... Now alerted to the problem, Congress has the capacity to act with care and dispatch to provide an effective solution. Id. at 998.

[15] The PACT Act also requires the Attorney General of the United States to compile and publish a list of remote sellers who have not complied with the registration or other requirements of the Jenkins Act and prohibits the delivery of packages from non-compliers except in narrow circumstances. PACT Act, sec. 2.

[16] This cause of action for Federal permit holders would not apply against State, local and tribal governments.

for Federal prosecutors to invest their limited resources in cases involving Jenkins Act enforcement.[17]

- In addition, the PACT Act clarifies that the Jenkins Act covers remote sales originating on Native American reservations.
- Requires payment of State and local excise taxes on remote sales. Currently, no Federal law requires remote sellers to remit State excise taxes to the States in which delivery takes place. The PACT Act corrects this situation, by making Internet sellers clearly responsible for paying taxes to the State into which they are engaging in delivery sales. This change will prevent Internet and other remote sellers who do not collect taxes from unfairly competing with cigarette sellers who properly collect taxes, and from misleading consumers into believing they have no tax liability when purchasing these products on the Internet. This change will also assist States in collecting taxes, given the potential legal impediments faced by States when they attempt to collect taxes from out-of-State or foreign Internet sellers.
- Regulates delivery methods generally. Currently no Federal law regulates the delivery methods or the procedures for the delivery of remote sale cigarettes to consumers. The PACT Act expands current Federal law and provides for Federal regulation of remote sales of cigarettes, and specifically includes age-verification and shipping requirements. As Federal law, the PACT Act would not be subject to a preemption challenge such as in the Rowe case challenging Maine's laws.
- Makes cigarettes nonmailable and imposes reasonable requirements on common carriers. Currently, Federal law allows the use of the U.S. mails for remote sales of cigarettes and smokeless tobacco products. The PACT Act makes these products generally nonmailable via the U.S. Postal Service, consistent with the current treatment of other age-restricted products such as alcoholic beverages.[18] The PACT Act permits the shipment of cigarettes and smokeless tobacco by common carriers or other delivery services as long as the shipping, age-verification and other remote sales requirements outlined above are met.[19]
- Gives the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATFE) authority to inspect records and inventories of remote sellers. The PACT Act expressly gives ATFE the right to inspect the records and inventories of cigarette remote sellers. This provision of the PACT Act will help the ATFE identify both noncompliant sellers and noncompliant common carriers.

PM USA Supports the PACT Act

For the above reasons, PM USA strongly supports the PACT Act. This legislation will significantly strengthen Federal laws prohibiting illegal or tax-evading remote sales of cigarettes and smokeless tobacco products. This legislation will also benefit law enforcement by enhancing tools that can be used to identify, investigate, and prosecute remote sellers who evade the system of laws that govern the payment of taxes on these products.

## Statement of Consumer Federation of America

Consumer Federation of America commends you for holding a hearing on the overall operations of the Alcohol and Tobacco Tax and Trade Bureau (TTB).[1] It is critical that Congress provide oversight of Federal agencies to be sure that they are properly serving the public and carrying out the intent of Congress.

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[17] These criminal provisions would not apply to State, local or tribal governments. A common carrier or independent delivery service also will not be guilty of a felony unless a higher standard of proof is met. PACT Act, sec. 2.

[18] The PACT Act includes an exception for items mailed to or within Hawaii or Alaska. PACT Act, sec. 3.

[19] Federal legislation is necessary to effect this change as it is well-established that State laws cannot regulate what items the Postal Service carries or the terms on which it carries such items. See, e.g., N.Y. State Motor Truck Ass'n v. Pataki, 2004 WL 2937803, *10 (S.D.N.Y. Dec. 17, 2004) ("The State lacks the authority to regulate the Postal Service"). Congress, however, has plenary authority to regulate what can or cannot be carried by the U.S. mails.

[1] Consumer Federation of America is a nonprofit association of over 300 organizations, with a combined membership of over 50 million Americans. Member organizations include local, State, and national consumer advocacy groups, senior citizen associations, consumer cooperatives, trade unions and anti-hunger and food safety organizations. Since its founding in 1968, CFA has worked to advance the interest of American consumers through research, education and advocacy.

As you consider the operations and role of the TTB, I wanted to alert you to a statement made by a representative of the TTB in April regarding the Agency's mission. When asked about an alcohol labeling proposal before the Agency, TTB spokesman Art Resnick told a reporter that "We don't have a public health mandate."[2] This flies in the face of Congressional intent and public expectation. Overconsumption of alcohol is a serious public health problem and the TTB should be part of the solution, not merely an idle bystander.

Congress clearly expanded the mission of the TTB to include public health when it required a government warning label on alcoholic beverages in 1988. Section 202 of the Federal Alcohol Administration Act (27 U.S.C. 213) states, in part:

> "The Congress finds that the American public should be informed about the health hazards that may result from the consumption or abuse of alcoholic beverages, and has determined that it would be beneficial to provide a clear, nonconfusing reminder of such hazards. . . . It is therefore the policy of the Congress, and the purpose of this subchapter, to exercise the full reach of the Federal Government's constitutional powers in order to establish a comprehensive Federal program, in connection with the manufacture and sale of alcoholic beverages in or affecting interstate commerce, to deal with the provision of warning or other information with respect to any relationship between the consumption or abuse of alcoholic beverages and health. . . ."

This is a clear indication that Congress expects the mission of the TTB to include public health.

The TTB obviously wants to shirk this public health mission. This is most readily apparent in its proposed rule on labeling of alcoholic beverages, released in July 2007. The Agency agreed to include some basic information on its proposed Alcohol Facts label. Incredibly, however, the TTB did not propose to include information about alcohol content per serving on its proposed label, the most relevant information for consumers of alcoholic beverages. The Agency also did not see fit to include the Dietary Guidelines advice on moderate drinking, missing a perfect public health opportunity to educate consumers about the importance of safe and healthy alcohol consumption.

In Mr. Resnick's comment and the Agency's proposal on alcohol beverage labeling, the TTB is flaunting its disregard for the intent of Congress that the Agency's mission include protecting the public health. We urge you to impress upon the TTB the importance of this mission and encourage the Agency to carry out this mission as it fulfills its duties.

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**Statement of Matthew L. Myers**

In connection with this hearing on the activities of the Alcohol and Tobacco Tax and Trade Bureau (TTB), I would like to highlight for the Committee the serious problem of tobacco tax evasion and contraband trafficking in tobacco products and the related enforcement efforts of TTB and other Federal agencies. In that regard, we are very fortunate that a Member of the Ways and Means Committee, Representative Doggett, has introduced the Smuggled Tobacco Prevention Act (H.R. 5689), also known as the STOP Act, which is legislation to address the problem of smuggling and contraband trafficking of tobacco products. I strongly urge the Committee's support for this important legislation.

Existing Federal laws do not do enough to prevent and reduce contraband trafficking and other tobacco tax evasion. Current Federal law fails to create the kind of closed system of legal sales and deliveries among legal, licensed entities that is needed to make the diversion of legal tobacco products into illegal markets much more difficult. Current Federal law fails to establish the kind of record keeping and other tracking and tracing requirements and capabilities needed to identify such illegal diversions when they occur and facilitate related enforcement efforts. In addition, Federal law fails to establish the kinds of markings on tobacco products to make it easy to distinguish between legal tobacco products and counterfeit and smuggled versions.

Representative Doggett's STOP Act would correct each of these deficiencies in current Federal law, enabling TTB and other relevant Federal agencies to work to-

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[2] Zwilich T, "Groups Rip Watered-Down Alcohol Labels." *WebMD Medical News*, April 22, 2008, http://www.webmd.com/news/20080422/groups-rip-watered-down-alcohol-labels.

gether to sharply reduce the amount of tobacco tax evasion and other contraband trafficking in tobacco products that currently occurs.

Let me explain why the Campaign for Tobacco-Free Kids and other public health organizations—such as the American Cancer Society, the American Lung Association, and the American Heart Association—strongly support the passage of the STOP Act as an effective way to promote public health, reduce tobacco use, and help shrink the unnecessary harms and costs caused by tobacco use.

As the Members of this Committee are well aware, tobacco product smuggling and tax evasion are criminal activities that reduce government revenues and hurt honest businesses. That is reason enough to want to minimize the problem. But tobacco product smuggling and tax evasion also have serious public health consequences.

Counterfeit and smuggled cigarettes and other cigarettes sold free of applicable Federal or State taxes are offered to consumers at prices far lower than the prices charged by lawful tobacco product retailers. The sales of these illegally tax-free products undermine ongoing State and local efforts to reduce tobacco use by increasing tobacco tax rates. Studies show, for example, that every 10 percent increase in real cigarette prices will reduce overall use by approximately 3 or 4 percent and reduce the number of youth smokers by 6 or 7 percent. The corollary has also been proven true—decreases in cigarette prices—in this case from illegal cigarettes—increase tobacco use. The availability of cheap cigarettes therefore increases overall tobacco use, thereby leading to higher levels of tobacco-caused disease, deaths and costs. By reducing the easy access to contraband tobacco products and other tobacco products on which taxes have not been paid, these bills will assist in the effort to reduce tobacco use and its harms, especially among youth and lower-income persons.

Another key public health problem from contraband tobacco product trafficking is sales to kids. Black market vendors and other illegal sellers are much more likely to sell to underage buyers than legally operating retailers.

The sale of contraband tobacco products and other tobacco products on which no taxes have been paid also hurts public health by reducing the amount of government tobacco tax revenues available to fund tobacco prevention programs and other public health initiatives.

This problem is exacerbated by the fact that contraband cigarette trafficking can also reduce the annual tobacco settlement payments to the States. Those settlement payments are supposed to be adjusted downward based on actual U.S. cigarette consumption declines—but the MSA formulas are based solely on changes to legal cigarette sales. Accordingly, when smokers shift from legal to illegal cigarettes, consumption does not actually decline, but the MSA payments to the States do.

The illegal sale of tobacco products also opens the door to the sale of tobacco products that do not have the required health warnings, do not comply with State "fire-safe" laws to make cigarettes less likely to cause fires, and that contain levels of pesticides or other contaminants that legally manufactured cigarettes using legally grown domestic tobacco cannot contain. In addition, if the pending FDA tobacco product legislation (H.R. 1108) becomes law, FDA will likely issue product standards for cigarettes and other tobacco products designed to make them less harmful, and contraband versions could violate those product standards.

There is another public health reason to institute effective measures to minimize tobacco product smuggling and tax evasion. As mentioned earlier, tobacco tax increases are an especially effective way to increase tobacco product prices and, consequently, reduce tobacco use and its many harms and costs. The tobacco industry and its allies regularly argue against any significant tobacco tax increases, claiming they will drive more smokers to illegal cigarettes. The proper response to this argument is not to forego new tobacco tax increases and the public health benefits they produce, but to increase and improve government efforts to bring criminal contraband tobacco trafficking organizations to justice.

For all these reasons, minimizing tobacco product smuggling and tax evasion is not only good fiscal policy and good anti-crime policy but is also good public health policy.

Fortunately, the STOP Act demonstrates that there are measures that can be quickly implemented to prevent and reduce contraband tobacco product trafficking and put the related criminal organizations out of business.

The STOP Act (H.R. 5689) is the latest version of legislation that was introduced in prior Congresses and has undergone continuous improvement. Among other things, it takes advantage of the lessons learned from growing efforts worldwide to address the problem of cigarette and other tobacco product smuggling that crosses international borders and the problem of counterfeit tobacco products and counterfeit tax stamps.

The common sense principles behind the STOP Act are simple and effective:

- Make sure that it is difficult for illegal vendors to sell counterfeit tobacco products or make or sell counterfeit tax stamps and easy for enforcement officials and others to distinguish legal from illegal tobacco products. The STOP Act does that by requiring clear markings on tobacco product packages that identify the manufacturer and show where the products may be legally sold. The legislation requires new, readily available high-tech tax stamps that establish legality and cannot be effectively counterfeited, and it includes provisions to keep tobacco product manufacturing and tax-stamping machinery from getting into the hands of counterfeiters.
- Make it easier to track and trace tobacco products as they are transported from one business to another so that diversion to illegal distribution channels is more difficult and easier to spot. The STOP Act requires reasonable reporting and recordkeeping requirements by businesses throughout the distribution and delivery chain; adds tobacco product distributors into the Federal permit system that now applies to manufacturers, exporters and importers (creating a closed system of authorized legal businesses that can sell and deliver tobacco products to each other); provides for encrypted information on the high-tech tax stamps to identify not only the entities applying the tax stamp but also subsequent recipients; and establishes a system of export bonds to ensure that the tobacco products actually end up in legal markets where they are reportedly destined.
- Prohibit transactions that serve only to supply contraband trafficking. The STOP Act blocks sales of tobacco products that exceed the amount needed for personal use. For example, the bill stops the sale of more than 5,000 cigarettes (250 packs) to any single retail customer at any one time. Those kinds of large retail sales are needed only by those engaged in illegal smuggling and re-sales, and this bill would stop them.
- Untie the hands of Federal enforcement officials. To help enforcement efforts, the legislation creates more extensive Federal jurisdiction over contraband trafficking. The STOP Act makes the definition of contraband tobacco product clearer and more comprehensive. It includes all tobacco products for the first time, and would also enable Federal enforcement officials to stop and prosecute any contraband trafficking of more than 2,000 cigarettes (rather than the current jurisdictional minimum of 10,000 cigarettes).
- Protect citizens who report criminal trafficking acts. The STOP Act does that by providing new whistleblower protections for civic minded workers who witness contraband trafficking activity while on the job.
- Establish strong new financial incentives for good behavior and appropriately large financial disincentives for bad behavior. Rep. Doggett's legislation establishes new export bond requirements that would penalize exporters for allowing their shipments to be diverted from the reported legal destinations; provides clearer standards for proper behavior; establishes clearer descriptions of wrongful acts, and subjects lawbreakers to higher fines and penalties.

These examples of some of the key measures in the STOP Act provide a quick overview of this comprehensive and carefully thought-out legislation. By doing all these things, the STOP Act would make it much easier for TTB to accomplish its goal of collecting all Federal tobacco taxes that are legally owed on all the tobacco products consumed in this country.

Once passed into law, we believe the STOP Act will reduce contraband trafficking both within the United States and across its borders. Indeed, the STOP Act offers a model that the world's nations could follow both in the current development of the Illicit Trade Protocol of the Framework Convention on Tobacco Control (FCTC)—which the United States has signed but not yet ratified—and in subsequent efforts by individual countries to comply with the FCTC by passing their own stronger and more comprehensive national laws.

Some concerns have been raised over the STOP Act's tax stamping provision, but they primarily reflect misunderstandings about how the bill would work and the viability of currently available technologies. More specifically, some cigarette companies have complained that it is not technologically feasible to establish a Federal tax stamp for cigarettes. Their complaint ignores the fact that high-tech national tax stamps already exist in other countries (e.g., Brazil) and in one U.S. State (California). In addition, at least two major companies in the United States—SICPA and Authentix—already offer comprehensive digital tax stamping technologies and systems that could quickly be put into effect. While opponents have asked about the cost of establishing a new Federal cigarette tax stamp, high-tech tax stamps would bring in substantial new Federal revenues by stopping counterfeit sales and other contraband tobacco product trafficking—and that new revenue would be far greater than the cost of the new system. California is an excellent example. When California

implemented its own high-tech tax stamping system, revenues from cigarette taxes increased roughly $100 million dollars over the next twenty months despite no increase in the cigarette tax rate.

The only other major issue raised about the STOP Act to date has been a concern among some Indian Tribes that the Act might in some way weaken existing Tribal sovereignty rights. The STOP Act should be Tribal sovereignty neutral, and we believe that it is. Further, we understand that Representative Doggett is committed to ensuring that his bill is interpreted and applied that way, either by making whatever changes might be necessary or through appropriate legislative history.

Passing the STOP Act would not only cap current tobacco product smuggling and tax evasion, preventing it from getting any larger in the United States, but would also make the problem much smaller. These measures would increase the costs and reduce the profits from smuggling and tobacco-product related tax evasion. They would also close down lucrative opportunities for criminal and terrorist organizations. They would protect honest businesses from illegal competition, and they would increase public revenues at all levels of government.

As described above, passing the STOP Act would also work directly to improve public health by helping to reduce tobacco use and the horrible toll it takes on our country.

Thank you for this opportunity to submit this testimony for the Committee's consideration. If any Members or staff have any questions about my testimony or would like any additional information, they can contact me or any of the staff at the Campaign for Tobacco-Free Kids.

## Statement of SICPA Product Security

Chairman Lewis, Ranking Member Ramstad, and other Committee Members, we thank you for the opportunity to provide testimony for the printed record of this hearing. The information we provide we hope will answer possible questions on the feasibility of a Federal cigarette tax stamping system as proposed by Congressman Lloyd Doggett in H.R. 5689, the Smuggled Tobacco Prevention Act (the "STOP Act") as he testifies before your Committee today.

SICPA supports implementation of a Federal high-tech tax stamp system. Our experience has proven that a Federal system is feasible and successful in preventing counterfeiting and diversion while protecting government revenues and public safety.

SICPA offers support of the STOP Act based on our experience with tobacco stamping systems. Founded in 1927, SICPA is a trusted advisor to governments, central banks and brand owners providing security inks and integrated systems for anti-counterfeiting.

### Feasibility of a Federal Stamping System

It is currently feasible to use digital tax stamp technology to establish a Federal tax stamp or other tax-payment indicia for cigarettes. SICPA has experience in operating such systems in contracts with the Federal Governments in Brazil and Turkey and was recently awarded the contract for such a system in Canada. Provided the appropriate systems are in place, the following information could be read from the stamp by portable scanning devices in real-time at the point of inspection:

a. The denominated value of the stamp, meter impression or indicia.
b. A unique serial number or tracking code.
c. The name and address of the person purchasing (and, if different, of the person affixing) the stamp, meter impression, or indicia.
d. The date the stamp, meter impression or indicia was purchased, when it was affixed and the brand to which it was affixed.
e. The name and address of the person purchasing or otherwise receiving the tobacco product from the person who affixes the tax stamp, meter impression, or indicia and the date of such purchase or transfer.

SICPA systems worldwide have been customized with particular proprietary inks for visual authentication and encrypted with data similar to and beyond the desired items above that were priorities for Congressman Doggett.

### SICPATRACE® Solution

SICPA has designed our tax stamp solution with several key attributes:

- To provide overt and advanced covert deterrence against stamp counterfeiting.
- To provide secure stamp manufacturing and distribution processes.

- To minimize impact of the new program on key players (Federal Government, State governments, manufacturers, distributors) while enhancing their ability to control and monitor the program.
- To provide information technology to facilitate the ordering, distribution, authorization, audit, reconciliation and reporting of tax stamp application.
- To provide tools for to authenticate the tax stamps using individual features designed for each user group (enforcement, manufacturers, consumers, etc.)

Implementation of a Federal system would likely be carried out in a similar fashion to systems used in other Federal Government programs. Typically, a Federal stamp is produced in a secure environment under very strict production procedures to ensure full accountability for all stamps produced. Stamps are shipped to manufacturers where they are applied to packs prior to cellophane wrapping. All the recognized providers of cigarette packing equipment lines have tax stamp application modules available that they can readily install on cigarette manufacturers current lines. As stamps are applied to packs, the digital stamp is read thereby recording the stamp affixing and the brand to which it was applied. Subsequently the stamp can be read as it is packaged in a carton and case. As cases are shipped the unique numbers of the cases (and therefore the cartons and packs contained therein) are used to reference the destinations and each subsequent change in the chain of custody. In the U.S., such a system could be adopted without interfering with the rights of the States to apply their own State tax stamp as their current practices dictate.

High-tech tax stamps are extremely difficult to counterfeit and improve upon the current stamping systems based on old technology. Adapting technology used to protect documents of value (e.g. currency, transit tickets, passports, etc.) the technical sophistication of SICPA's proposed tax stamp will protect existing tax revenue from erosion due to counterfeiting while increasing revenues. The proposed approach would use layered security combining overt and covert counterfeit deterrent features in the printed design of the tax stamp. This approach provides multiple hurdles for counterfeiters and a ready ability to change or adjust individual features—enabling the governing body to stay ahead of counterfeiters without having to redesign the entire stamp every time a threat is discovered. The SICPA stamp design has built in flexibility to allow cost effective incremental features to be incorporated over time to continually improve counterfeit protection. While each feature is individually secure, the combination of overt, covert and machine readable security features provides a significant barrier of protection. Although copies of stamps will be attempted we provide sufficient sophisticated elements that they are virtually counterfeit proof.

**Costs and Implementation**

In the absence of detailed information on the number of manufacturers, number of manufacturing lines, separate locations, shipping and delivery methods, number of scanners required, etc., it is premature for us to provide an estimated timetable for implementation or approximate costs. In Turkey, the Federal system was implemented in 6 months and in Brazil it was completed in 8 months; the Federal system in Canada is planned to take 6 months. In all cases the requirements differ to some extent but give an indication of the time requirement. In the State of California, SICPA was awarded a contract in August 2004, and full implementation of the SICPATRACE® system began January 2005. By June 30th, 2005, the system was fully operational in the State, but this system only covered licensed distributors. Stamp costs will also vary substantially dependent on what is also to be provided by way of stamp content, equipment, information systems and other services, and therefore the indicative price range is very broad from $4.00 to $30.00 per thousand.

We respectfully decline to speculate on the amount of increased cigarette tax revenues the Federal Government would be likely to obtain from the introduction of a stamping system, with or without a tax increase. In the State of California, $125 million in revenues were recovered in the first 20 months of the SICPATRACE® system. It had been estimated that nearly $292 million was lost annually in the State. It is arguable that with any tax increase, the opportunity for counterfeiters becomes more lucrative and a digital stamp becomes more necessary.

The stamping of other tobacco products (OTP) is feasible using a similar stamp to that recommended for cigarettes. However, given the variety of products in terms of size, shape, packaging materials, etc., different machines may be required for different manufacturing environments but the principles remain the same as for cigarette packs. Again, due to limited information on the scope of such a system, we respectfully decline providing estimated cost information at this time.

**SICPA Systems: Proven Tobacco Stamping Success**

In order to provide additional information on the feasibility of a national system for Federal stamping, we include two case studies of our stamping systems on Fed-

eral levels which have been implemented with much success. Additionally, SICPA has been awarded the contract for Federal cigarette stamping in Canada, to be implemented following further negotiations with the Canada Revenue Agency. We hope this information will be helpful in determining how a Federal system in the U.S. could be established.

BRAZIL

SICPA is currently managing secure, nationwide tax stamp programs for Brazil. The program in Brazil provides fiscal stamps on packs that account for some 5.3 billion cigarettes per year. Elements of the system in Brazil include:

- Overt and covert security features for the fiscal stamp.
- Data Management System (DMS) to control national cigarette production, which will be integrated with the government's taxation system.
- Coding activation systems incorporated into the production lines at 152 manufacturer locations.
- Use of invisible SICPADATA® codes for product authentication, production control and track and trace.
- Supply and installation of hardware and software for track and trace and codification of the "intelligent tax stamp" with an overt security element.
- Technical support and ongoing training of technical personnel necessary for the fulfilment of the scope of this contract.

Turkey: TURKTRACE®

Turkey has become the first country in the world to implement a single technology to monitor all excisable tobacco, alcohol and beer products—more than seven billion packaged items per year. The product tracking system required the installation of non-intrusive automatic tracking units onto manufacturers' packing and filling lines for product monitoring and transmission of the relevant information to a central data management system. To handle the monitoring of imported products, dedicated facilities have been set-up close to customs points at Istanbul, Izmir and Mersin.

The reach of this tracking system is broad and extensive:

- 137 tobacco packing lines at 8 sites, applying 6 billion security stamps per year.
- 50 filling lines for alcohol products at 39 sites, applying 140 million security stamps per year.
- 24 filling lines for beer at 9 sites, applying 1 billion security codes per year.

**Conclusion**

SICPA applauds the efforts of lawmakers who have brought the issue of contraband cigarettes to national prominence. It is increasingly apparent that the safeguards currently in place against counterfeiting are not enough. By moving to an encrypted stamp system, the U.S. Government will protect legitimate tax revenue and protect national security. We have seen the success of such systems and trust that it is feasible in the U.S. We also believe such a system should complement, not hinder the efforts of individual States to control their own stamping programs, whether encrypted or not. We strongly believe that a Federal stamping system and a State stamping system are not mutually exclusive. Any Federal system should not undermine the efforts of an individual State to secure and monitor their own tax revenues.

SICPA thanks you for the opportunity to provide this additional information in support of a Federal stamping system. SICPA remains available as a resource for further information on system implementation and continues to encourage efforts against counterfeit and diverted products.

U.S. Immigration
and Customs
Enforcement

## News Releases

**April 15, 2005**

**11 ARRESTED AND $250,000 SEIZED IN BREAKUP OF MAJOR INLAND EMPIRE CONTRABAND CIGARETTE TRAFFICKING RING**

RIVERSIDE — Eleven people face federal criminal charges today following the breakup of a major contraband cigarette trafficking ring based here in the Inland Empire that investigators estimate cost the government and industry more than $1 million in lost taxes and revenues.

The nearly three-year undercover investigation by U.S. Immigration and Customs Enforcement (ICE) and the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) culminated this week with the arrest of 11 suspects and the seizure of more than $250,000 in currency. ICE and ATF received substantial assistance in the case from the California Board of Equalization, the Los Angeles County Sheriff's Department, the Internal Revenue Service, and the Federal Bureau of Investigation.

"Trafficking in counterfeit cigarettes is a multi-billion dollar international enterprise that robs financially strapped states like California of badly needed revenues," said Gary Pinkava, assistant special agent-in-charge for ICE investigations in Riverside and San Bernardino County. "ICE is working with its law enforcement partners to shut down schemes like this that enrich criminals and criminal organizations at the expense of our economy."

John A. Torres, special agent in charge of the Los Angeles field division of ATF, said the operation has dismantled one of the largest cigarette trafficking rings ever uncovered in the Inland Empire. "The violators in this case have caused the State of California to be defrauded out of hundreds of thousands of dollars in tax revenue. I have one message for the perpetrators - pay your vice taxes and you will avoid any problems with ATF or the State of California."

During the last three days, ICE and ATF agents executed search warrants at five Southland smoke shops, including three Payless Tobacco stores in Hesperia and Santa Paula, Smoker's Corner in Pomona, and the Tobacco Zone in Anaheim. In addition, investigators conducted searches at several storage facilities where the defendants stockpiled the illegal cigarettes. Besides the currency, those searches led to the seizure of more than 5,000 cartons of contraband cigarettes and approximately 3,800 counterfeit California tax stamps.

Court documents show that several of the defendants in the case orchestrated a scheme to import and distribute counterfeit cigarettes, primarily from China. It is alleged the

defendants affixed counterfeit tax stamps onto hundreds of thousands of packs of cigarettes. Many of these cigarettes were then distributed or delivered to smoke shops throughout the Southland.

Under California law, only cigarette distributors licensed by the California Board of Equalization are authorized to receive and possess cigarettes without California tax stamps. Distributors must purchase the tax stamps, at a cost of 87 cents a pack, and affix them to each package of cigarettes prior to their distribution. Individuals who traffic contraband commonly evade this state tax by placing counterfeit tax stamps onto packages of cigarettes.

The defendants in the case are:

- Daniel Araya, 42, of Lancaster, owner of Araya's Enterprise and Omega Distributors;
- Sivly Hang, 54, of Moreno Valley, obtained counterfeit cigarettes from China;
- Adel Shahin, 40, of Rancho Cucamonga, worked at "Tobacco 2 Go" in Apple Valley;
- Adnan Bawaneh, 38, Victorville, proprietor of "Tobacco 2 Go" in Apple Valley;
- Ghaleb Almasad, 61 of Hesperia, operated Payless Tobacco Shops in Hesperia and Santa Paula;
- Ahmad Almasad, 41, of Hesperia, operated Payless Tobacco Shops in Hesperia and Santa Paula;
- Ali Abdelhadi, 53, of Hesperia, operated Payless Tobacco Shops in Hesperia and Santa Paula;
- Samir Jaber, 38, of Corona, operated #1 Tobacco Zone in Anaheim;
- Ritesh Patel, 23, of Hershey, PA, former associate of Jayesh Thakkar;
- Jayesh Thakkar, 40, of La Palma; and
- Rabi Ayash, 39, of Palmdale.

If convicted, the defendants face up to five years in prison and a $250,000 fine on each count related to cigarette smuggling and trafficking.

U.S. Immigration and Customs Enforcement (ICE) was established in March 2003 as the largest investigative arm of the Department of Homeland Security. ICE is comprised of five integrated divisions that form a 21st century law enforcement agency with broad responsibilities for a number of key homeland security priorities.

Last Modified: Monday, March 20, 2006

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TESTIMONY OF MAURICE A. JOHN, SR., PRESIDENT OF THE
SENECA NATION OF INDIANS

before the

SUBCOMMITTEE ON OVERSIGHT

of the

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS & MEANS

OVERSIGHT HEARING ON THE ALCOHOL, TOBACCO TAX, AND TRADE BUREAU
OF THE U.S. DEPARTMENT OF THE TREASURY

May 20, 2008

INTRODUCTION

Mr. Chairman and members of the Committee, I submit this written testimony on behalf of the Seneca Nation of Indians and ask that it be included in the record of this hearing.

The Seneca Nation of Indians ("Nation") is recognized by the United States and the State of New York as a sovereign tribal government. The Nation is a signatory to numerous treaties and agreements with the United States which govern the relations between the Nation, the United States, and the State of New York, including matters regarding commerce and taxation. These treaties and agreements have their origins in deals under which vast land holdings were transferred out of Seneca Nation control in exchange for express security and protection guarantees by the United States for the remaining Nation lands.

SENECA NATION'S TERRITORIES ARE IMMUNE FROM STATE TAXATION

The Seneca Nation, our people and our lands, have been immune from State taxation since the United States was formed. Agreement after agreement has reiterated this tax immunity and our Nation's inherent, sovereign right to regulate conduct within our Territories. It is most notably protected by the United States through the Treaty of Canandaigua of 1794, 7 Stat. 44. This federal obligation -- to protect the immunity of the Seneca Nation and its Territories from the reach of taxation by the State of New York -- and to protect our inherent, sovereign right to regulate conduct within our Territories -- should be the focus of this Subcommittee.

SENECA NATION ENFORCES THE LAW

The Seneca Nation enforces a comprehensive Import-Export Law it enacted in 2006 to regulate sales of tobacco and other products on its Territories. The Nation established its own Import-Export Commission which regulates all aspects of tobacco and other product sales. Among other functions, the Commission –

- Prevents the importation of tobacco products into Nation Territories only by licensed stamping agents;
- Prevents the sale of tobacco products without the affixation of a Nation import stamp and payment of the required import fee;
- Defines unstamped cigarettes as contraband;
- Requires accurate accounting of all stamps issued to Nation authorized stamping agents;
- Prohibits cigarette sales in excess of 9,800 cigarettes (lower than the Federal threshold);
- Imposes severe penalties, including loss of business license, for trafficking in contraband cigarettes; and
- Prevents the sale of tobacco products to minors under age 18.

As a result of the enactment and enforcement of its own tribal law, the Nation has gained regulatory control of tobacco and other sales activities on its Territories.

SENECA NATION COOPERATES WITH THE BATFE & ATTTB

The Nation's aggressive implementation of its Import-Export law has greatly enhanced its capacity to cooperate with the federal Bureau of Alcohol, Tobacco, Firearms and Explosives (BATFE) and the federal Alcohol, Tobacco Tax, and Trade Bureau (ATTTB) in enforcing federal law on the Nation's Territories.

Within the past year, the Nation has successfully conducted three major investigations that have resulted in large-scale seizures of contraband cigarettes, two of which had the full support and involvement of the BATFE.

In July 2007, the Nation raided a smoke shop suspected of trafficking in unstamped cigarettes that resulted in the seizure of approximately 65,000 cartons of unstamped product. The

retailer forfeited a portion of the shipment, had its tobacco retailer license suspended, and paid a six-figure civil assessment and administrative fee to the Nation. The Nation also banished two non-Indians from doing business on the Nation's Territories for a period of two years.

One of the joint Nation-BATFE investigations involved action against non-Indian residents of the City of Salamanca who were illegally selling tobacco and motor fuel without collecting state taxes. The Nation, BATFE and the U.S. Postal Service worked cooperatively to issue the appropriate warrants and collection of evidence for further criminal proceedings.

Another joint Nation-BATFE investigation involved an undercover operation and led to the arrest of a Long Island-based New York State stamping agent who was illegally diverting cigarettes to an unlicensed retailer in violation of both Nation and Federal laws. The Nation imposed a six figure fine on the stamping agent and permanently banned the non-Indians from the Nation's Territory.

Since these investigations have concluded, we can discuss them. There are other ongoing investigations about which it would be counterproductive to discuss. Please be assured that as a government with law enforcement responsibilities for our Territories, the Seneca Nation of Indians is committed to cooperation with federal authorities in the implementation of federal and tribal law.

We have reason to believe that the foregoing investigations are among the largest tobacco enforcement actions taken by any regulatory agency within the past year. They have occurred as a result of the Nation's leadership, not despite it.

As a direct result of our Nation's enforcement of Nation law, the federal government receives federal excise tax revenue on all tobacco products sold on the Nation's Territories. Our Import-Export Commission is an ally, not the enemy, of the ATTTB and its mission to collect federal excise taxes on tobacco sales. We regret that Administrator Manfreda, in his oral testimony, stated generally that Indian reservations are not in compliance with federal excise tax requirements. While there may be other Indian nations in New York where the ATTTB has challenges with excise tax enforcement, the Seneca Nation is not one of them. If given the opportunity to revise and extend his remarks, we are confident that Administrator Manfreda would clarify his oral statement to reference the extensive cooperation the United States has enjoyed with the Seneca Nation's Import-Export Commission.

SENECA NATION CONTROLS TOBACCO SALES WITH A HIGH-TECH DIGITAL STAMP SYSTEM

The Seneca Nation has acquired the latest stamp and tracking technology that exceeds the systems in place in all other states other than California. We now have the ability to track all tobacco packages with a fool-proof stamp and electronic inventory infrastructure that can tell us the origin, tax, and other information on each product sold on our Territories.

We understand that Representative Nunez identified in his remarks at this hearing some challenges encountered by California in implementing similar technology but our use of this digital stamp system has been a success. We would be pleased to provide this Subcommittee with information on our experience with it.

SENECA NATION IS CONCERNED BY MIS-GUIDED REMARKS AT THIS HEARING

We are concerned by a few of the remarks of various Members and witnesses at this hearing. In particular, we vigorously dispute any reliance by this Subcommittee or its witnesses on the wildly inaccurate Judiciary Committee staff report issued several weeks ago by Representative Peter King, entitled *Tobacco and Terror: How Cigarette Smuggling is Funding our Enemies Abroad.*

That staff report charges that the Seneca Nation is complicit in the illegal trafficking of tobacco and somehow obstructs the collection and remittance of lawful tobacco taxes. That staff report is without basis in fact or law. The Nation is, in fact, a leading player on the national stage with respect to eliminating illegal tobacco trafficking activity, and has likely done more to curtail contraband trafficking in the past year than any State agency, including that of New York State.

The *Tobacco and Terror* staff report focuses extensively on Arab ties to contraband cigarette trafficking and asserts that the "smuggling networks rely primarily on access to Native American Indian Reservations for tax free cigarettes - for obvious reasons." Rather than cite repeated criminal proceedings to support this allegation, the Tobacco and Terror report simply cites an interview with unidentified federal and state law enforcement officers. Federal law enforcement officials tell a different story. At the Federal Tax Administrators Conference held in Madison, WI on August 26, 2007, it was reported that three recent contraband trafficking investigations all involved trafficking from low-tax states (such as South Carolina) to high tax states (such as New York). None involved trafficking from Indian nations generally and none involved the Seneca Nation.

There is no documented evidence that tobacco sales occurring on Indian lands support terrorism except for a single instance that occurred eight (8) years ago when two female members of the Seneca Nation sold cigarettes to some Arabs in Michigan who were later found to have links to a terrorist organization in the Middle East. These two women were prosecuted by the United States and punished for their involvement in selling the cigarettes involved in the scheme.

To malign the entire Seneca Nation for the actions of two of its members is preposterous. This is no more fair than it would be for Representative King to malign the entire State of New York government for the actions of these same two women, or to impugn the integrity of the

government of the State of Michigan because some of its Arab residents funneled sales proceeds to a terrorist organization overseas.

The inflammatory and unsupported allegations in the *Tobacco and Terror* report undermines public understanding of the Seneca Nation, its people, and its regulatory control over tobacco. It is painfully obvious to us that what is behind the *Tobacco and Terror* report is a transparent attempt by certain elements within New York State to hitch their self-serving cause to the fervor of a national anti-terrorism campaign.

Why would a Committee of the U.S. Congress be concerned about the collection of New York state excise taxes? No such taxes are lawfully owed on the Nation's Territories. This misplaced concern betrays a fundamental misunderstanding of federal Indian law and policy, as well as the treaties between the United States and the Seneca Nation.

CONCLUSION

The Seneca Nation asks that this Subcommittee honor our treaties and protect our inherent, sovereign right to regulate conduct on our Territories, including our immunity from State taxation. We also ask that this Subcommittee gather accurate, relevant, and reliable information regarding the Seneca Nation's regulation of tobacco sales taking place in our Territories.

Thank you for this opportunity to provide testimony and we ask that it be made part of the record of this hearing.

Oversight Hearing on the Alcohol, Tobacco Tax, and Trade Bureau of the U.S. Department of the Treasury
May 20, 2008

Statement on behalf of:

The Seneca Nation of Indians
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Oversight Hearing on the Alcohol, Tobacco Tax, and Trade Bureau of the U.S. Department of the Treasury
May 20, 2008

## Witness List

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Letter on Alcohol labeling

**Congress of the United States**
**Washington, DC 20515**

January 25, 2008

The Honorable Hank Paulson
Secretary of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

**RE: Alcohol and Tobacco Tax and Trade Bureau (TTB) Notice No. 73**

Dear Secretary Paulson:

The recent proposed rulemaking from TTB (Notice No. 73) represents a major change in alcohol labeling policy and could lead to the most significant revisions in wine label requirements in the history of the American wine industry. We recognize TTB's regulatory responsibility and its desire to provide consumers with useful information. However, we are very concerned that as written, this proposed rule could have a severely detrimental impact on the wine industry, while at the same time not really providing new or useful information for consumers.

As co-chairmen of the Congressional Wine Caucus, we have seen first hand the explosive growth that has occurred in the domestic wine industry over the last ten years. In that time the number of commercial wineries across the country has more than doubled to over 5,000 and the annual economic impact of the industry has grown to well over $100 billion. Roughly 98% of these wineries are small businesses and many of them are family-owned and operated.

Additionally, we believe that there is little concrete evidence to suggest that consumers need or want additional nutritional or caloric information when making decisions regarding wine consumption. It is incumbent upon TTB to balance whatever limited benefit this additional information may provide with the added burden these regulations would place on wineries and in particular smaller wineries.

Mandating serving fact information on wine labels would place an unreasonable burden on wineries and therefore TTB should make inclusion of such information voluntary, not mandatory. By requiring serving fact panels and nutritional analysis of all wines, TTB would be forcing significant new costs and production problems on wineries. The laboratory costs for the analysis combined with the added costs of newly designed labels could easily reach into the hundreds of thousands of dollars for a medium sized winery. The fact that TTB has proposed a 3 year phase in for these requirements does not eliminate this burden. At a minimum, should TTB move forward with requiring nutritional information on labels, it should allow for the use of typical values that encompass broad tolerances which would minimize the added costs and production disruptions.

The Honorable Hank Paulson
January 25, 2008
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As to the issue of alcoholic content labeling, we support TTB's decision to end any effort to define a "standard drink" and believe that TTB should continue its long standing requirement that alcoholic content be measured and labeled as a percentage of total volume. Given the fact that there is no clear definition of a standard drink, it makes little sense to allow for the use of what could be misleading or confusing information such as an equivalency graphic or a "fluid ounces per serving" statement.

As you move forward with this process we hope that you will keep in mind the many unique factors that impact the thousands of American wineries across the country. Further we ask that you do everything in your power to minimize the burden that any final regulations would place on this diverse, growing industry. We are confident that you can accomplish this goal while at the same time upholding your responsibility to the public.

Sincerely,

**MIKE THOMPSON**
Member of Congress

**GEORGE RADANOVICH**
Member of Congress

cc: Mr. John Manfreda, Administrator, TTB
cc: Mr. Frank Foote, Director, Regulations and Rulings Division, TTB

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