

Memorandum

To: Honorable Betty T. Yee, Chairwoman
Honorable Jerome E. Horton, Vice Chair
Honorable Bill Leonard
Honorable Michelle Steel
Honorable John Chiang

Date: October 30, 2009

From: Kristine Cazadd, Chief Counsel
Legal Department



Gil Haas, Jr., Chief
Investigations & Special Operations Division



Subject: **Item M 1 Other Chief Counsel Matters: Opinion & Recommendation on Federal Ban and Attorney General's De-Listing of Flavored Cigarettes and Roll-Your-Own Tobacco Products; Board Approval Requested.**

Effective September 22, 2009, cigarettes that contain certain characterizing flavors are considered adulterated under the Federal Food, Drug and Cosmetic Act (the Act) as amended by the Family Smoking Prevention and Tobacco Control Act (FSPTCA). The FSPTCA (Pub.L. No. 111-31 (June 22, 2009) 123 Stat. 1776.) provides the Food and Drug Administration (FDA) with regulatory authority over the manufacture, marketing and distributing of tobacco products. Specifically, new section 907(a)(1)(A) provides a special rule regarding the tobacco standard for cigarettes.

This special rule for cigarettes prohibits a cigarette or any of its component parts (including the tobacco, filter, or paper) from containing, as a constituent (including a smoke constituent) or additive, an artificial or natural flavor (other than tobacco or menthol) or an herb or spice, including strawberry, grape, orange, clove, cinnamon, pineapple, vanilla, coconut, licorice, cocoa, chocolate, cherry, or coffee, that is a characterizing flavor of the tobacco product or tobacco smoke. Products that fail to meet this standard are considered adulterated and are unlawful to sell under the federal ban. Extensive educational outreach recommended.

Impact on Businesses selling Cigarette and Tobacco Products

The California Department of Justice (DOJ) removed certain manufacturers' brand families and/or brand styles from the California Tobacco Directory, on September 25, 2009, in response to the federal ban on manufacturing, marketing and sales of adulterated cigarettes and roll-your-

own (RYO) tobacco. To date, the brand families and/or brand styles removed from the Tobacco Directory are those that have been voluntarily identified by the product manufacturers as not in compliance with the FSPTCA. We understand that DOJ will eventually not rely exclusively on manufacturers self-identifying adulterated products and will remove additional products from the Tobacco Directory whenever DOJ determines a product is subject to the federal ban.

DOJ's present removal of the voluntarily identified adulterated cigarettes and RYO tobacco from the Tobacco Directory is in response to the primacy of federal statutory law with regard to which cigarette and tobacco products can be lawfully sold in the United States, including California. Accordingly, it would be improper for the DOJ to list a product, or allow a product to continue to be listed, on the Tobacco Directory when the sale of that product is illegal under federal law, regardless of the manufacturer's or importer's current compliance status under the Master Settlement Agreement (MSA) and related California law. Moreover, staff assumes that escrow payments from nonparticipating manufacturers for flavored cigarette and RYO tobacco products will necessarily cease as a result of the federal ban. Accordingly, staff assumes that all such products will eventually become noncompliant with the MSA and related California law to the extent illegal sales of these products persist.

The Tobacco Directory was created by enactment of Assembly Bill 71. (AB 71 (Horton), Stats. 2003, ch. 890; Rev. & Tax Code, § 30165.1). The law improves compliance by tobacco manufacturers who either have not joined or have failed to comply fully with requirements for "participating manufacturers" under the MSA or "non-participating manufacturers" under related California law. Only cigarettes and RYO tobacco that are listed in the Tobacco Directory can be lawfully possessed or sold in California. Specifically, it is illegal to put a state tax stamp on cigarettes or pay the state tax on RYO tobacco unless the manufacturer and the brand family are listed in the Tobacco Directory. It also is illegal to possess or sell such products in California unless the manufacturer and the brand family are listed in the Tobacco Directory. Violations of the law are subject to civil and criminal penalties, and products not listed in the Tobacco Directory are subject to seizure as contraband.

Enforcement Issues

Since the implementation of the Tobacco Directory in 2004, the Board's Investigations Division (ID) has conducted 957 seizures of nonlisted products (commonly referred to as "non-MSA compliant products"). When the product is not listed in the Tobacco Directory, each seizure is documented in detail to show that: (1) the product is noncompliant; (2) the product was distributed, stored or possessed sale; and (3) the seizure was properly noticed. Such a showing establishes that the products were not erroneously or illegally seized. As is the case whenever ID seizes cigarettes or tobacco products for violations of California law, persons objecting to seizures of non-Directory listed products are provided an administrative petition process. (Rev. & Tax. Code, § 30436 et seq.)

The enforcement and administrative appellate costs associated with seizing flavored cigarettes and RYO tobacco could be significant and may not be absorbable in light of current budgetary constraints. Based on a Q&A prepared by the FDA, the FSPTCA does not provide for funds for state and local grants to offset potential administrative costs. The FDA has also provided notification in their publication issued on September 22, 2009, titled "Guidance for Industry and

FDA,” advising that “...before taking enforcement action, it is the agency’s general practice to issue Warning Letters to firms notifying them that they or their products are in violation of the law and to provide them with the opportunity to voluntarily come into compliance.” However, this publication further provides that the “FDA also reserves the right to take enforcement action to protect public health without first issuing a Warning Letter.” Because of the unfunded costs associated with seizing MSA-compliant flavored cigarettes and RYO tobacco, until such time as California distributors/retailers are sufficiently informed, staff believes it is premature to initiate a seizure program for flavored cigarettes and RYO tobacco and that the Board’s available resources should be focused on conducting an effective educational outreach program. Such an approach would also be consistent with the FDA’s general practice of issuing warnings and promoting voluntary compliance before taking direct enforcement actions.

Recommendation

Accordingly, with regard to the removal of the products identified in Attachment A from the Tobacco Directory, staff believes the best current course of action would be for ID to educate impacted taxpayers about the federal ban, advising sellers: (1) frequently check the Tobacco Directory for a list of authorized products; (2) to remove delisted products from their inventories, and (3) that if such voluntary compliance is not achieved, the products may be subject to seizure by the BOE, FDA or local law enforcement if found in their stock or inventory.

An outreach program is necessary due to the limited notification disseminated by the FDA with regard to the federal ban. The FDA’s outreach and educational efforts pertaining to the ban were primarily comprised of Public Service Announcements to media outlets, notifications to manufacturers, health tobacco control groups, and those required to be licensed by the federal Tobacco Trade Bureau, which does not include California state licensed distributors, wholesalers or retailers. Staff’s proposed outreach program will include, but would not be limited to, the following elements:

- Enhance the BOE’s web posting regarding the Licensing Act, emphasizing the importance of only purchasing products listed in the Tobacco Directory;
- Add links to relevant FDA website information on the BOE website, cigarette and tobacco program webpage;
- Include an article on the FDA ban in the annual Excise Taxes Division Newsletter that is mailed to all registrants in December;
- Post an article on the BOE website in early November;
- Send the article out via email distribution using the Cigarette Distributor & Wholesale ListServe;
- Provide the attached Fact Sheet when conducting inspections and post a copy to the BOE’s website.

During the initial outreach period, ID staff conducting inspections will provide the Fact Sheet on Banned Flavored Cigarettes and Roll-Your-Own Tobacco (Attachment B). The Fact Sheet will notify distributors, wholesalers and retailers to remove their banned products that are

noncompliant with the Tobacco Directory from their sales stock and/or sales inventories and to segregate it for future disposition. Inspected licensees will also be advised that any future inspection in which these products are identified may result in a seizure pursuant to a violation of Revenue and Taxation Code section 30165.1, subdivision (e), or notification to FDA, or both.

In the event that voluntary compliance cannot be achieved through taxpayer outreach or the seizure of noncompliant flavored cigarette and RYO tobacco appears to be necessary, staff will revisit this matter with the Board to receive direction regarding the institution of administrative seizures and other enforcement actions and determining the availability of program resources.

Approved:



Ramon J. Hirsig
Executive Director

RS:sw

Attachments Attachment A – Recent Changes to Directory, a listing of Flavored Cigarettes and RYO removed from the Tobacco Directory

Attachment B – Proposed Fact Sheet to hand out during inspections

cc (w/attachments):

Mr. Ramon J. Hirsig MIC:73
Mr. David Gau MIC:63
Mr. Randy Silva MIC 42
Ms. Lynn Bartolo MIC:56

RECENT CHANGES TO DIRECTORY

Tobacco Product Manufacturer	Brand Family	Date
ADDED:		
None		
DELETED:		
M/s Dhanraj	Zanzibar (all)	9/25/09
M/s Dhanraj	Dhyan Bidis (styles: Strawberry, Wild Cherry, Mint, Grape, Vanilla)	9/25/09
ADDED:		
None		
DELETED:		
Kretek International	Dreams (styles: Belgian Blend French Blend, Jubilee Blend)	10/23/09
P.T. Djarum	Djarum (styles: Bali Hai, Black, Gold, Lights, Red, Special, Splash, Super, Cherry, Vanilla, Black Supersmooth, Supersmooth)	9/25/09
Sherman 1400 Broadway N.Y.C. Inc.	A Hint of Mint	9/25/09
	Classic (style: Mint)	9/25/09
	A Touch of Clove	9/25/09
	Naturals (style: Mint)	9/25/09
	New York Cut (style: Mint)	9/25/09
Top Tobacco, LP	Wildfire – RYO (styles: New York Vanilla, Island Margarita, Sunrise Strawberry, Velvet Peach, Cherries Jubilee)	9/25/09
Truth and Liberty Manufacturing Company	Fresh Blend – RYO (styles: Clove, Cinnamon, Amaretto, Peach, Chocolate, Vanilla Caramel)	9/25/09
Von Eicken Group	Dimitrino Botschafter (style: Botschafter Vanilla)	9/25/09
	Springwater (styles: Cherry, Vanilla)	9/25/09
	F&K – RYO (styles: Fine Cut Cherry, Fine Cut Chocolate, Fine Cut Vanilla)	9/25/09

FACT SHEET

Banned Flavored Cigarettes & Roll-Your-Own Tobacco

Federal Ban on Flavored Cigarettes

Effective September 22, 2009, cigarettes that contain certain characterizing flavors are considered adulterated by the Federal Drug Administration (FDA) under the Federal Food, Drug and Cosmetic Act (the Act) as amended by the Family Smoking Prevention and Control Act (FSPTCA). <http://www.fda.gov/TobaccoProducts/default.htm>

Manufacturers, distributors, and retailers may be subject to injunction actions, civil money penalties and/or criminal prosecution for violating the requirements of the Act. The FDA has indicated intent to use the full range of enforcement tools within the Agency's authority to ensure compliance with the new requirement.

Impact on California Businesses Selling Cigarettes and Tobacco Products

Cigarettes banned by the FSPTCA have been and may continue to be removed from the California Tobacco Directory by California's Attorney General. The Tobacco Directory was created by enactment Assembly Bill 71 (AB71 (Horton), Stats. 2003, ch. 890; Rev. & Tax Code, 30165.1.). The law requires tobacco manufacturers to report their cigarette and roll-your-own tobacco brands to the Attorney General.

It is illegal to put a state tax stamp on cigarettes or pay the state tax on roll-your-own tobacco unless the manufacturer and the brand family are listed in the Directory.

It also is illegal to sell, offer or possess for sale, in this state, or import for personal consumption in this state, cigarettes or roll-your-own tobacco products if the manufacturer and brand family are not listed in the Tobacco Directory.

Violations of the law are subject to civil and criminal penalties, and products not listed in the Tobacco Directory can be seized as contraband. (Rev. & Tax. Code §30165.1, sub. (e).)

Ensuring Compliance with the California Tobacco Directory

To ensure compliance, sell only those cigarette and roll-your-own tobacco products listed on the Tobacco Directory. The Directory can be found at <http://ag.ca.gov/tobacco/directory.htm>.

** Please note that tobacco products commonly known as "little cigars" currently do not have to be listed in the Tobacco Directory in order to be lawfully sold in California. The Attorney General may decide in the future to require that certain brands of little cigars be listed in the Tobacco Directory.