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*Admitted in the District of Columbia

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Alcohol and Tobacco Tax and
Trade Bureau
Regulations and Rulings Division
1310 G Street, NW
Suite 200
Washington, DC 20220

Attn: Mr. Frank Foote

Re: Notice No. 65/Tax Classification of Cigars and Cigarettes

Dear Mr. Foote:

This submission is made on behalf of John Middleton, Inc. ("John Middleton") as an initial comment to the Alcohol Tobacco Tax and Trade Bureau ("TTB"), regarding TTB's Notice of Proposed Rulemaking No. 65, Tax Classification of Cigars and Cigarettes ("Notice"). See, 71 Fed.Reg. 62506 (October 25, 2006). This comment is limited to issues related to TTB's reducing sugars analysis and its tobacco blend assumptions which are the underlying basis of proposed amendments of 27 CFR §40.12, §41.12, and §44.12, specifically paragraphs (a)(1)(ii), (2)(b)(2), and (2)(b)(3) (ii). John Middleton reserves its rights to make additional comments on this limited subject and intends to submit more extensive comments related to the overall Notice prior to the close of the comment period on March 26, 2007

I. BACKGROUND

John Middleton is a fifth generation family-owned manufacturer of pipe tobacco and cigars filled with pipe tobacco headquartered in King of Prussia, Pa. Founded in 1856 by John Middleton, the company began as a single store tobacco retailer. In 1958, the firm divested of its retail operations to focus on its pipe tobacco manufacturing business. In 1968, John Middleton began manufacturing and marketing its first cigar filled with pipe tobacco. Over the past 40 years, John Middleton has developed its pipe tobacco filled large cigars into a major force in the U.S. cigar market. Sales of John Middleton large cigars represent approximately 23% of unit sales of large cigars and approximately 16% of the combined large cigar and little cigar market—a significant market presence given John Middleton does not produce or market little cigar products.

II. SUMMARY OF COMMENT

The premise of the Notice and the resulting proposed §40.12 (a)(1)(ii), which would require that a cigar have no more than 3.0 percent by weight of total reducing sugars, and §40.12 (2)(b)(ii), classifying a cigarette as having greater than 3.0 percent by weight of reducing sugars, are fundamentally flawed. TTB's reducing sugars study, used as the underlying empirical basis to establish the proposed levels for cigar and cigarette reducing sugars, failed to test a category of cigars that represents approximately one quarter of the U.S. cigar market—cigars containing pipe tobacco as their filler. If these products were in fact tested, the results from the reducing sugar study would have been significantly different than published and the rule could not have been written as proposed. In addition, if TTB had tested cigars using pipe tobacco as their filler, TTB would have found that pipe tobacco cigars are produced using a tobacco blend made up principally of burley tobacco with a minor amount of flue-cured tobaccos. These findings would have affected the structure of proposed §40.12 (b)(3)(iii).

By definition, pipe tobacco is manufactured to achieve various flavors, smoothness, and aroma specific to that tobacco product segment and unlike those of any other smoking product. Its reducing sugars not only exceed the proposed 3.0 proposed standard, but in most instances the reducing sugars will be equal to or at the high end of most cigarettes. Thus, under the Notice, a cigar filled with pipe tobacco that is wrapped in a substance containing tobacco, unlike its cigar tobacco filled competitors, will be defined as a cigarette. The rule as proposed discriminates against a significant segment of the cigar market due to the incomplete and flawed sampling method used in the underlying study. Therefore, dependence on reducing sugars as a test to differentiate cigars and cigarettes fails as a reliable objective test- at best it provides an incomplete and unreliable benchmark for such a distinction. Additionally, the assumption related to the tobacco blends used in cigars and cigarettes is equally flawed.

Adoption of the rule as proposed will result in the reclassification of John Middleton large cigars, long classified by TTB as large cigars, to be cigarettes and taxed accordingly. Such an outcome would be contrary to the intent of the statute.

III. THE REDUCING SUGARS STUDY WAS FUNDAMENTALLY FLAWED

A. The Reducing Sugars Study Conclusions Resulted From Incorrect Assumptions

In choosing to focus on reducing sugars as a significant chemical difference between cigars and cigarettes, TTB properly noted that the total reducing sugars varies significantly depending on the processing of the various types of tobacco, such as flue-cured, air-cured and cigar. However, TTB then went on to make an erroneous assumption that only in the manufacturing of cigarette tobacco blends, sugars are added. In doing so, TTB failed to recognize that pipe tobacco is used as cigar filler and that rather large quantities of sugar (in comparison to cigarette tobacco blends) are added when manufacturing typical pipe tobacco blends. This broad generalization about the

manufacturing methods used to produce cigar and cigarette fillers led to a false underlying assumption upon which the study was based:

Therefore, TTB surmised that comparing sugar content in the filler tobacco used in cigars to the sugar content in the filler tobacco used in cigarettes might yield a clear objective line of distinction between these two classes of tobacco products.

Notice, 71 Fed. Reg. 62509.

At the time TTB issued its Notice, it had only tested 46 of the 190 large cigars and little cigar products it had obtained. Based on the data supplied in the Notice, it appears that none of the 46 cigars tested had pipe tobacco as its filler. The decision to issue the Notice prior to testing all major brands led to two additional generalizations about cigars and resulted in an incomplete and flawed data profile. This flawed data led to incorrect conclusions that resulted in a fundamentally flawed proposal to establish an objective standard based on the reducing sugars levels found in cigars and cigarettes.

The first underlying assumption as stated in the Notice was:

Our study was grounded on the fact that cigars and cigarettes contain different blends of tobacco' cigarettes are made primarily from flue cured or light air cured (burley) and oriental (Turkish) tobaccos, whereas cigars are usually made from air-cured and fermented tobaccos. Id.

The second critical generalization that became an underlying false assumption in the reducing sugars study is

Furthermore, sugar is often added directly to cigarette filler tobaccos to "balance" smoke flavor. In contrast, cigars are manufactured from processed tobaccos that contain relatively low levels of sugars. Id.

If, in fact, TTB had tested John Middleton cigars or other cigar brands that used pipe tobacco as their filler it would have found that (i) its underlying generalizations and assumptions were incorrect; (ii) its reducing sugars study results were significantly different than expected and published; and (iii) that reliance **solely** on a reducing sugars test as a basis to create a "bright line" objective test standard to differentiate cigars and cigarettes is scientifically flawed and unrealistic.

B. Cigars Using Pipe Tobacco As Their Filler Contain Significant Levels of Burley Tobacco And Reducing Sugars

1. *Burley is the tobacco of choice for John Middleton cigars*

All of the cigars John Middleton produces use pipe tobacco as their filler. The pipe tobacco used in the cigars is the same pipe tobacco John Middleton manufacturers for commercial sale as pipe tobacco.

The predominant tobacco used by John Middleton in producing its pipe tobacco cigar blends is burley because of its ability to soak-up or “drink” liquefied casing (flavoring) materials. Small amounts of flue-cured tobaccos may be included in the tobacco leaf formula but they are a very small percentage of the blend and are used to mainly provide visual attraction for the pipe smoker. Some pipe tobaccos rely more heavily on flue-cured tobaccos but these are less popular in the USA than burley blends. As noted in the Notice, it is the “[f]lue cured tobaccos which are high in reducing sugars.” Burley, in contrast, has virtually no reducing sugars. In fact if TTB were to run its reducing sugar study on pipe tobacco blends prior to the addition of casings to the blend, the results would be consistent with the cigar reducing sugar findings published in the Notice.

2. *Pipe Tobacco Casings Contain High Levels of Reducing Sugars*

Pipe tobacco is produced using proprietary formulas that combine leaf blends with flavoring ingredients and sugarsto create a special flavor, smell, and draw for the pipe smoker.

The first step, as noted above, requires a formula for the careful selection and blending of various leaf grades and crop growth years with burley representing the predominant leaf. Next, various casing ingredients (flavorings) are assembled by formula and liquefied in hot water. This mixture is sometimes referred to as a “casing sauce”. The casing ingredients are very typical of those used in the baking industry such as, licorice, cocoa, sugars, and molasses. By far sugars are the most dominant casing ingredient. Sugar is important to provide balance and smoothness to the smoke taste while providing a cooler, slower burning smoke, all of which are very necessary attributes sought by the pipe smoker. At this point, when the leaf tobacco and casing sauce have been joined into the wet mixture contains approximately one-half tobacco leaf and one-half casing sauce.

The wet mixture is then passed through a hot-air dryer to remove excess moisture and “bake” the product using heat and time. Lastly, the pipe tobacco is cut, sifted and a top flavoring is applied. Generally pipe tobaccos will contain both large and small pieces as these are necessary to properly pack and control the burn in a pipe. The top dressing is used to provide a specific flavor to the pipe tobacco that is brand specific and forms the brand’s unique signature aroma and taste.

IV. REDUCING SUGAR LEVELS CANNOT BE A SOLE CRITERIA FOR DEFINING A PRODUCT AS A CIGARETTE

John Middleton's primary purpose of this comment is to focus TTB on the underlying flaws in its proposed objective test, not to challenge TTB's goal to establish an objective test. In fact, with some supplemental work, setting a reliable objective test that incorporates a reducing sugar standard may be possible. However, the test as proposed cannot, without more data, achieve TTB's goal.

Proposed rule §41.12(b)(2) requires that a tobacco product is classified as a cigarette if "[I]t consists of a roll of tobacco that contains more than 3.0 percent by weight of total reducing sugars and that is wrapped in a substance containing tobacco." The proposed rule is neither reflective of the intent of the underlying statute nor is it the stated intention of the Notice. The Notice clearly states: "These clarifications are intended to reduce possible revenue losses through the misclassification of cigarettes as little cigars."

Notwithstanding the stated intention, under the proposed rule a cigar using pipe tobacco as its filler wrapped in a substance containing tobacco will be classified as a cigarette. If the cigar is a large cigar—it is a cigarette. If it is packaged as a cigar—it is a cigarette. If it is sold as a cigar—it is a cigarette. If it has been classified for 40 years as a cigar—it is a cigarette. Adoption of a rule that takes a product that has historically been classified and marketed as a large cigar and reclassifies it as a cigarette based **solely** on its reducing sugars level is neither based on valid data nor is it objective.

John Middleton cigars are not small cigars, more less cigarettes. Yet, the proposed rule will result in their being taxed as cigarettes. As a practical matter, it is very difficult to produce a small cigar using pipe tobacco as its filler. The casings in pipe tobacco significantly increase the weight of the product making the statutory definition of a small cigar "weighing not more than 3 pounds per thousand" hard to achieve. Additionally, the unique cut of pipe tobacco would make it difficult to fill a small cigar or cigarette wrapper in a manner that would be acceptable to the consumer. As a result, John Middleton has never produced a small pipe tobacco cigar and TTB consistently classified John Middleton Pipe Tobacco cigars accordingly.

Simply stated, the reducing sugars study outcome, upon which the proposed rule was based, failed to test for the reducing sugars of a type of cigar that makes up approximately one quarter of the large cigar market. This resulted in a flawed scientific study and similarly a flawed proposed rule.

V. FILLER PRIMARILY CONSISTING OF BURLEY TOBACCO IS NOT DE FACTO A CIGARETTE

Even if TTB corrects its proposal so as to recognize that certain cigars contain significantly more reducing sugars than 3.0 percent by weight, cigars using pipe tobacco as its filler would still be classified as a cigarette under the Notice.

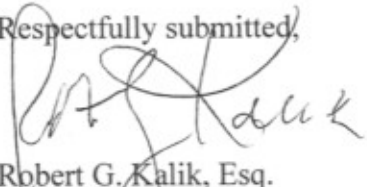
Most cigars using pipe tobacco as its filler are of the machine-made type and as such, are wrapped in a substance containing tobacco. Given that such cigars have a filler consisting primarily of burley tobacco, they would be classified as a cigarette under §40.12(b)(3)(iii). As noted above, burley tobacco is the predominant tobacco used in John Middleton pipe tobacco cigars. John Middleton blends use upwards of 65% burley. Given this, an objective rule that defines a tobacco product using burley tobacco as a cigarette fails – it ignores the existence of a critical segment of the cigar market and results in large cigars using burley tobaccos to be reclassified as cigarettes. Again, this outcome would not be consistent with the statute or consistent with the stated intent of the Notice.

VI. CONCLUSION

The proposed reducing sugars standard and filler standard for establishing a clear objective difference between cigars and cigarettes needs to be re-studied, re-evaluated, and amended in light of the incomplete study upon which it was based. In both cases, further testing and the use of additional or alternative criteria to supplement the proposed standards could achieve TTB's goal to establish a bright line objective standard for differentiating cigars and cigarettes.

John Middleton urges TTB to either withdraw the Notice until it conducts the necessary research to correct the deficiencies in its underlying research or alternatively, to issue an amendment to the Notice correcting the fundamental flaws addressed in these comments.

Respectfully submitted,



Robert G. Kalik, Esq.

Counsel for John Middleton, Inc.