STATEMENT OF JAE YOUNG CHO
PRESIDENT OF KT&G USA CORPORATION
BEFORE THE U.S. INTERNATIONAL TRADE COMMISSION

4th Tier Cigarettes from Korea
January 8, 2020

Good morning. My name is Jae Young Cho. I am the President of KT&G USA, a wholly-owned subsidiary of KT&G Corporation. KT&G Corporation is engaged in all stages of the cigarette manufacturing process, from primary tobacco blending to final packaging. I have been working KT&G for more than twenty years, and the last two with KT&G USA. As President of KT&G USA, I am responsible for KT&G's sales, marketing, and business development activities in the United States.

I appreciate the opportunity to share my company's experience in the U.S. market and to correct important misstatements in the Petition. I will begin by briefly describing the structure of the market for cigarettes in the United States and the nature of competition within the industry. Then, I will address the physical characteristics of so-called "fourth tier" cigarettes and other cigarettes.

Structure of the Industry in the United States

Turning to my first point, I understand that the Petitioner in this case has separated the market for cigarettes into four distinct subindustries or "tiers," with KT&G being part of the so-called "fourth tier." While some use "tiers" to describe the market, they are referring to a loose pricing continuum for cigarettes sold in the United States, not distinct product markets. There is no clear dividing line between a "fourth tier" cigarette and a "third tier" or any other cigarette. Any cigarette's classification into a particular "tier" is a function of price alone. It says nothing specific about the physical characteristics of the cigarette or how it was produced. And even the pricing distinctions are fluid and imprecise.

There is no universally accepted definition of the tiers in this price system, and many in the industry do not recognize any fourth tier at all. For example, Management Science Associates and Euromonitor do not classify the market into four "tiers." Instead they rely on three general pricing categories, and use different words for each. In the case of MSAi, the tiers are "super premium," "premium," or "branded discount"; in the case of Euromonitor, they are "premium," "mid-price," and "economy".

As my colleague Candice White will describe in more detail, cigarette manufacturers can and do regularly compete across these price tiers. In other words, KT&G is in direct competition not just with Cheyenne, Xcaliber, and other small producers, but also with bigger producers such as Liggett and even with the "Majors," Philip Morris and RJR. Moreover, most domestic producers do not limit their production to only one tier; they produce cigarettes that sell at a variety of price points, across the spectrum.

KT&G's Presence In the U.S. Market

I'd like to briefly summarize my company's history in the U.S. market. KT&G has been in the U.S. market with high quality products for over twenty years. With respect to production, KT&G uses an integrated production process that is similar to that of most major U.S. manufacturers that the Petition characterizes as outside the fourth tier. As far as I am aware, other companies that produce discount cigarettes for the U.S. market, including Liggett, Commonwealth, and JTI, also have primary production facilities.

While our market share has fluctuated over time depending on market conditions, KT&G is only a very small part of the overall U.S. cigarette industry in which we compete. In recent years, the "Majors" have been very aggressive in their marketing programs and pricing

strategies. In many instances, this results in cigarettes produced by the Majors being the lowest priced at retail. As my colleague will explain, we compete with brands produced by the Majors, Liggett, and Commonwealth, in addition to brands produced by the Petitioner.

Physical Characteristics of Fourth Tier Cigarettes As Compared With All Other Cigarettes

Finally, I'd like to address the physical characteristics and uses of cigarettes produced in the United States. Cigarettes are fairly uniform in their construction and identical in their end use, which is smoking. When removed from their packaging, cigarettes sold at different price levels are difficult for consumers to identify. As part of our market research, we conduct blind taste tests with consumers. When we ask them to try two cigarette brands, one premium and the other discount, consumers routinely cannot identify the premium brand.

The definition of "fourth tier cigarettes" that the ITC has used in this investigation covers all cigarettes. The physical characteristics in that definition are rolled in paper, longer than 7 centimeters, shorter than 12 centimeters, and less than 1.3 centimeters in diameter. I am not familiar with any cigarettes sold in the United States that are outside of this definition.

In my experience there are no clear dividing lines that differentiate a fourth tier cigarette from a third-tier cigarette or any other cigarette. One thing that is clear: the dividing lines proposed by the Petitioner do not exist. I will address each in turn.

- Regarding stem content, the Petitioner claims that fourth tier cigarettes generally have a stem content greater than 10 percent. In my experience, no such cut-off exists. KT&G's Consumer Research Team has sampled cigarettes sold in the U.S. market for various physical properties, including stem content. They found that some Cheyenne and Xcaliber cigarettes had stem content below 10 percent. Other supposedly non 4th-tier cigarettes had more than 10% stems. Examples include Montego and Eagle 20, made by

Liggett, which Petitioner says is a third-tier manufacturer. We can provide further details in our brief.

- Regarding filter type, the Petitioner claims that fourth tier cigarettes typically have single component filters, and that this makes them different from other cigarettes. But filter type affects the strength of the cigarette flavor -- it does not signal any particular product type or price point. For example, certain premium brand cigarettes such as Marlboros have single component filters, just like so-called 4th tier cigarettes.
- Regarding packaging, the Petition claims that fourth tier cigarettes, unlike other cigarettes, are typically sold in a box with basic printing and without a rounded internal corner. Again, this is not accurate. The packaging for Xcaliber's discount brands and the premium Marlboro brand are very similar.

Closing/Summary

In closing, I do not recognize the market described in the Petition. The competition that KT&G, Xcaliber, and Cheyenne face in the United States is very different from what the Petition claims. I want to thank you for your time today, and I would be pleased to answer any questions about the cigarette industry or KT&G.