

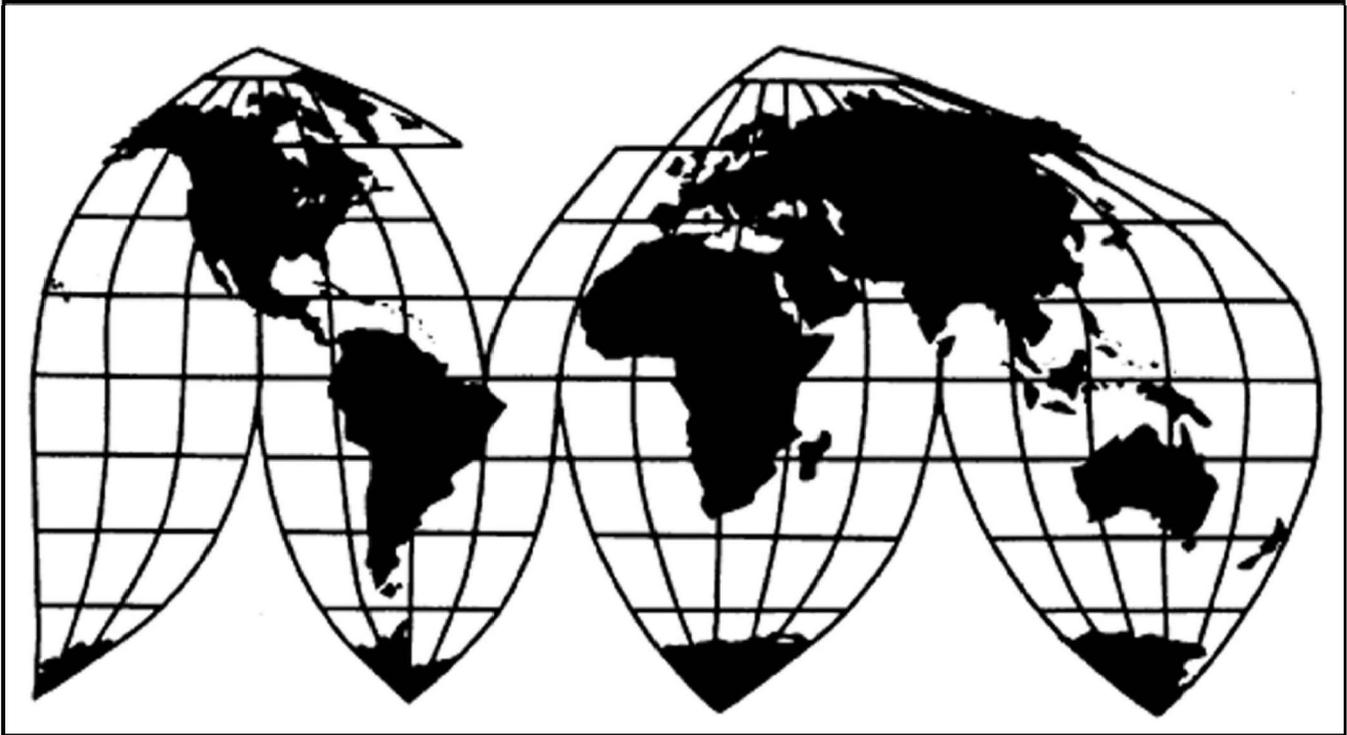
# 4th Tier Cigarettes from Korea

Investigation No. 731-TA-1465 (Preliminary)

Publication 5016

February 2020

**U.S. International Trade Commission**



Washington, DC 20436

# U.S. International Trade Commission

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# U.S. International Trade Commission

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Note.—Information that would reveal confidential operations of individual concerns may not be published. Such information is identified by brackets in confidential reports and is deleted and replaced with asterisks (\*\*\*) in public reports.

# UNITED STATES INTERNATIONAL TRADE COMMISSION

Investigation No. 731-TA-1465 (Preliminary)

4th Tier Cigarettes from Korea

## DETERMINATION

On the basis of the record<sup>1</sup> developed in the subject investigation, the United States International Trade Commission (“Commission”) determines, pursuant to the Tariff Act of 1930 (“the Act”), that there is a reasonable indication that an industry in the United States is threatened with material injury by reason of imports of 4th tier cigarettes from Korea, provided for in subheading 2402.20.80 of the Harmonized Tariff Schedule of the United States, that are alleged to be sold in the United States at less than fair value (“LTFV”).<sup>2</sup>

## COMMENCEMENT OF FINAL PHASE INVESTIGATION

Pursuant to section 207.18 of the Commission’s rules, the Commission also gives notice of the commencement of the final phase of its investigation. The Commission will issue a final phase notice of scheduling, which will be published in the *Federal Register* as provided in section 207.21 of the Commission’s rules, upon notice from the U.S. Department of Commerce (“Commerce”) of an affirmative preliminary determination in the investigation under section 733(b) of the Act, or, if the preliminary determination is negative, upon notice of an affirmative final determination in that investigation under section 735(a) of the Act. Parties that filed entries of appearance in the preliminary phase of the investigation need not enter a separate appearance for the final phase of the investigation. Industrial users, and, if the merchandise under investigation is sold at the retail level, representative consumer organizations have the right to appear as parties in Commission antidumping investigation. The Secretary will prepare a public service list containing the names and addresses of all persons, or their representatives, who are parties to the investigation.

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<sup>1</sup> The record is defined in sec. 207.2(f) of the Commission’s Rules of Practice and Procedure (19 CFR 207.2(f)).

<sup>2</sup> *4th Tier Cigarettes From the Republic of Korea: Initiation of Less-Than-Fair-Value Investigation*; 85 FR 2390, January 15, 2020.

## **BACKGROUND**

On December 18, 2019, the Coalition Against Korean Cigarettes, Xcaliber International, Pryor, Oklahoma, and Cheyenne International, Grover, North Carolina filed a petition with the Commission and Commerce, alleging that an industry in the United States is materially injured or threatened with material injury by reason of LTFV imports of 4th Tier Cigarettes from Korea. Accordingly, effective December 18, 2019, the Commission instituted antidumping duty investigation No. 731-TA-1465 (Preliminary).

Notice of the institution of the Commission's investigation and of a public conference to be held in connection therewith was given by posting copies of the notice in the Office of the Secretary, U.S. International Trade Commission, Washington, DC, and by publishing the notice in the *Federal Register* on December 26, 2019 (84 FR 70997). The conference was held in Washington, DC, on January 8, 2020, and all persons who requested the opportunity were permitted to appear in person or by counsel.

## Views of the Commission

Based on the record in the preliminary phase of this investigation, we determine that there is a reasonable indication that an industry in the United States is threatened with material injury by reason of imports of 4th tier cigarettes from Korea that are allegedly sold in the United States at less than fair value (“LTFV”).

### I. The Legal Standard for Preliminary Determinations

The legal standard for preliminary antidumping duty determinations requires the Commission to determine, based upon the information available at the time of the preliminary determinations, whether there is a reasonable indication that a domestic industry is materially injured or threatened with material injury, or that the establishment of an industry is materially retarded, by reason of the allegedly unfairly traded imports.<sup>1</sup> In applying this standard, the Commission weighs the evidence before it and determines whether “(1) the record as a whole contains clear and convincing evidence that there is no material injury or threat of such injury; and (2) no likelihood exists that contrary evidence will arise in a final investigation.”<sup>2</sup>

### II. Background

**Parties to the Investigation.** Petitioner is the Coalition Against Korean Cigarettes, consisting of Xcaliber International (“Xcaliber”) and Cheyenne International (“Cheyenne”), domestic producers of 4th tier cigarettes (“CAKC” or “petitioner”). Petitioner submitted a postconference brief and witnesses from Xcaliber appeared at the staff conference, represented by counsel.

KT&G Corporation, a producer and exporter of 4th tier cigarettes in Korea, and KT&G USA Corporation, an importer of the subject merchandise, (collectively, “KT&G”) submitted a joint postconference brief. Representatives from KT&G appeared at the staff conference, represented by counsel.

**Data Coverage.** U.S. industry data are based on the questionnaire responses of three producers estimated to account for the \*\*\* of 4th tier cigarettes in 2018.<sup>3</sup> U.S. import data are based on the questionnaire responses from four U.S. importers, accounting for \*\*\* U.S. imports

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<sup>1</sup> 19 U.S.C. §§ 1671b(a), 1673b(a) (2000); *see also American Lamb Co. v. United States*, 785 F.2d 994, 1001-04 (Fed. Cir. 1986) (“*American Lamb Co.*”); *Aristech Chem. Corp. v. United States*, 20 CIT 353, 354-55 (1996).

<sup>2</sup> *American Lamb Co.*, 785 F.2d at 1001; *see also Texas Crushed Stone Co. v. United States*, 35 F.3d 1535, 1543 (Fed. Cir. 1994).

<sup>3</sup> Confidential Report INV-SS-007 (Jan. 27, 2020) (“CR”) and Public Report (“PR”) at I-4 and III-1.

of subject merchandise from Korea and \*\*\* percent of U.S. imports from nonsubject sources.<sup>4</sup> The Commission received a response to its foreign producer questionnaire from KT&G Corporation in Korea. Its exports to the United States accounted for \*\*\* exports of subject merchandise to the United States.<sup>5</sup>

### III. Domestic Like Product

In determining whether there is a reasonable indication that an industry in the United States is materially injured or threatened with material injury by reason of imports of the subject merchandise, the Commission first defines the “domestic like product” and the “industry.”<sup>6</sup> Section 771(4)(A) of the Tariff Act of 1930, as amended (“the Tariff Act”), defines the relevant domestic industry as the “producers as a whole of a domestic like product, or those producers whose collective output of a domestic like product constitutes a major proportion of the total domestic production of the product.”<sup>7</sup> In turn, the Tariff Act defines “domestic like product” as “a product which is like, or in the absence of like, most similar in characteristics and uses with, the article subject to an investigation.”<sup>8</sup>

The decision regarding the appropriate domestic like product(s) in an investigation is a factual determination, and the Commission has applied the statutory standard of “like” or “most similar in characteristics and uses” on a case-by-case basis.<sup>9</sup> No single factor is dispositive, and the Commission may consider other factors it deems relevant based on the facts of a particular investigation.<sup>10</sup> The Commission looks for clear dividing lines among possible like products and disregards minor variations.<sup>11</sup> Although the Commission must accept

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<sup>4</sup> CR/PR at I-4 and IV-1.

<sup>5</sup> See CR/PR at I-4 and VII-3.

<sup>6</sup> 19 U.S.C. § 1677(4)(A).

<sup>7</sup> 19 U.S.C. § 1677(4)(A).

<sup>8</sup> 19 U.S.C. § 1677(10).

<sup>9</sup> See, e.g., *Cleo Inc. v. United States*, 501 F.3d 1291, 1299 (Fed. Cir. 2007) (“*Cleo*”); *NEC Corp. v. Department of Commerce*, 36 F. Supp. 2d 380, 383 (Ct. Int’l Trade 1998); *Nippon Steel Corp. v. United States*, 19 CIT 450, 455 (1995) (“*Nippon*”); *Torrington Co. v. United States*, 747 F. Supp. 744, 749 n.3 (Ct. Int’l Trade 1990) (“*Torrington*”), *aff’d*, 938 F.2d 1278 (Fed. Cir. 1991) (“every like product determination ‘must be made on the particular record at issue’ and the ‘unique facts of each case’”). The Commission generally considers a number of factors including the following: (1) physical characteristics and uses; (2) interchangeability; (3) channels of distribution; (4) customer and producer perceptions of the products; (5) common manufacturing facilities, production processes, and production employees; and, where appropriate, (6) price. See *Nippon*, 19 CIT at 455 n.4; *Timken Co. v. United States*, 913 F. Supp. 580, 584 (Ct. Int’l Trade 1996).

<sup>10</sup> See, e.g., S. Rep. No. 96-249 at 90-91 (1979).

<sup>11</sup> See, e.g., *Nippon*, 19 CIT at 455; *Torrington*, 747 F. Supp. at 748-49; see also S. Rep. No. 96-249 at 90-91 (Congress has indicated that the like product standard should not be interpreted in “such a

Commerce's determination as to the scope of the imported merchandise that is subsidized and/or sold at LTFV,<sup>12</sup> the Commission determines what domestic product is like the imported articles Commerce has identified.<sup>13</sup> The Commission may, where appropriate, include domestic articles in the domestic like product in addition to those described in the scope.<sup>14</sup>

#### **A. Scope Definition**

In its notice of initiation, Commerce defined the imported merchandise within the scope of the investigation as:

certain tobacco cigarettes, commonly referred to as "4th tier cigarettes." The subject cigarettes are composed of a tobacco blend rolled in paper, have a nominal minimum total length of 7.0 cm but do not exceed 12.0 cm in total nominal length, and have a nominal diameter of less than 1.3 cm. These sizes of cigarettes are frequently referred to as "Kings" and "100's," but subject merchandise that meets the physical description of the scope is included regardless of the marketing description of the size of the cigarettes. Subject merchandise typically has a tobacco blend that consists of 10% or more tobacco stems.

Subject merchandise is typically sold in packs of 20 cigarettes per pack which generally includes the marking "20 Class A Cigarettes" but are included regardless of packaging. 4th tier cigarette packages are typically

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(...Continued)

narrow fashion as to permit minor differences in physical characteristics or uses to lead to the conclusion that the product and article are not 'like' each other, nor should the definition of 'like product' be interpreted in such a fashion as to prevent consideration of an industry adversely affected by the imports under consideration.").

<sup>12</sup> See, e.g., *USEC, Inc. v. United States*, 34 Fed. App'x 725, 730 (Fed. Cir. 2002) ("The ITC may not modify the class or kind of imported merchandise examined by Commerce."); *Algoma Steel Corp. v. United States*, 688 F. Supp. 639, 644 (Ct. Int'l Trade 1988), *aff'd*, 865 F.3d 240 (Fed. Cir.), *cert. denied*, 492 U.S. 919 (1989).

<sup>13</sup> *Hosiden Corp. v. Advanced Display Mfrs.*, 85 F.3d 1561, 1568 (Fed. Cir. 1996) (the Commission may find a single like product corresponding to several different classes or kinds defined by Commerce); *Cleo*, 501 F.3d at 1298 n.1 ("Commerce's {scope} finding does not control the Commission's {like product} determination."); *Torrington*, 747 F. Supp. at 748-52 (affirming the Commission's determination defining six like products in investigations where Commerce found five classes or kinds).

<sup>14</sup> See, e.g., *Pure Magnesium from China and Israel*, Inv. Nos. 701-TA-403 and 731-TA-895-96 (Final), USITC Pub. 3467 at 8 n.34 (Nov. 2001); *Torrington*, 747 F. Supp. at 748-49 (holding that the Commission is not legally required to limit the domestic like product to the product advocated by the petitioner, co-extensive with the scope).

sold in boxes without a rounded internal corner and without embossed aluminum foil inside the pack.

Both menthol and non-menthol cigarettes and cigarettes with or without a filter attached are covered by the scope of this investigation.

Merchandise covered by this investigation is currently classified in the Harmonized Tariff Schedule of the United States (HTSUS) under subheading 2402.20.8000. This HTSUS subheading is provided for convenience and customs purposes; the written description of the scope of the investigation is dispositive.<sup>15</sup>

Cigarettes are combustible tobacco products rolled in paper that deliver nicotine. They may or may not have a filter and are sold in packs of 20 cigarettes in either 100's (100mm) or Kings (85mm) lengths. Cigarettes are sold at a wide range of price levels in the United States and according to one retailer association can be grouped into four tiers: Premium, Branded Discount, Sub-Generic/Private Label, and 4th Tier.<sup>16</sup>

While there is no single definition for 4th tier cigarettes, there is a consensus that 4th tier cigarettes are deeply discounted. 4th tier cigarettes may contain a higher percentage of tobacco stems, consisting of 10 to 40 percent tobacco stems compared with non-4th tier cigarettes which may contain less than 10 percent stems. 4th tier cigarettes also typically use a single-component filter while non-4th tier cigarettes may use multi-segmented filters.<sup>17</sup> In addition, 4<sup>th</sup> tier cigarettes may use a lower quality paper, *i.e.*, wood pulp, than non-4th tier cigarettes which typically use higher quality flax pulp paper.<sup>18</sup>

## **B. Arguments of the Parties**

*Petitioner's Arguments.* Petitioner argues that the Commission should define a single domestic like product that is coextensive with the scope of the investigation, which includes only 4th tier cigarettes. It argues that 4th tier cigarettes are physically distinct from non-4th tier cigarettes primarily because, unlike other cigarettes, 4th tier cigarettes have more than 10

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<sup>15</sup> *4th Tier Cigarettes from the Republic of Korea: Initiation of Less-Than-Fair-Value Investigation*, 85 Fed. Reg. 2390 (Jan. 15, 2020).

<sup>16</sup> CR/PR at I-6 (National Association of Convenience Stores). We note that two other organizations, Management Science Associates, Inc., and Euromonitor, group cigarettes into three price categories. *Id.*

<sup>17</sup> CR/PR at I-7.

<sup>18</sup> Petitioner's Brief at 7.

percent stems in their tobacco blend. The higher stem content of the tobacco is an important distinction, according to petitioner.<sup>19</sup> Because of the higher stem content of the tobacco, petitioner argues that producers and customers perceive 4th tier cigarettes to be cheaper and lower quality cigarettes with a less smooth smoking experience than non-4th tier cigarettes. In addition to the tobacco, petitioner contends that non-4th tier cigarettes use more complex filter designs than 4th tier cigarettes, such as multi-segmented filters.<sup>20</sup> Petitioner also asserts that 4th tier cigarettes use paper that is generally of wood pulp as compared to non-4th tier cigarettes that use a flax pulp paper.<sup>21</sup> In addition, petitioner asserts that there are significant differences in price – 4th tier cigarettes are consistently priced lower than non-4th tier cigarettes.<sup>22</sup>

Petitioner also contends that 4th tier cigarettes lack interchangeability with other cigarettes because of their lower quality, and it argues that their distribution network differs from other cigarettes. Petitioner adds that 4th tier cigarettes are produced in different production facilities than other cigarettes and the 4th tier cigarette producers are not vertically integrated like the producers of other cigarettes.<sup>23</sup> Finally, petitioner argues that 4th tier cigarettes sell for substantially lower prices than other cigarettes and lack brand loyalty.<sup>24</sup>

*Respondent's Arguments.* KT&G asserts that all six of the Commission's domestic like product factors support defining the domestic like product more broadly than 4th tier cigarettes to include all cigarettes. KT&G claims that its research, conducted prior to the investigation, shows that the stem content of the tobacco does not form a reliable dividing line between 4th tier and non-4th tier cigarettes. KT&G likewise disputes that filters and paper are different for 4th tier cigarettes.<sup>25</sup>

KT&G further argues that all cigarettes are interchangeable because they are all used for smoking, despite purchasers having preferences for particular brands.<sup>26</sup> It contends that all cigarettes are produced through essentially the same manufacturing process, even though 4th tier producers purchase tobacco rather than blending their own.<sup>27</sup> KT&G claims that all domestic cigarettes are sold through similar channels of distribution in the U.S. market because

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<sup>19</sup> Petitioner's Brief, Answers to Questions at 15-18.

<sup>20</sup> Petitioner's Brief at 7 and Answers to Questions at 19.

<sup>21</sup> Petitioner's Brief at 7-8.

<sup>22</sup> See Petition at 13; Petitioner's Brief at 12-13 (claiming 4th tier cigarettes sell 30 to 50 percent less than premium cigarettes).

<sup>23</sup> Petitioner's Brief at 8-9.

<sup>24</sup> Petitioner's Brief at 8, 12-13.

<sup>25</sup> KT&G's Brief at 10-12.

<sup>26</sup> KT&G's Brief at 14-15.

<sup>27</sup> KT&G's Brief at 14-16.

all producers initially sell their cigarettes directly to distributors/wholesalers and it disputes petitioner's claim that national chain stores only carry non-4th tier cigarettes.<sup>28</sup>

According to KT&G, producers and customers perceive 4th tier cigarettes to be a price category but not a distinct product. KT&G further contends that all cigarettes sold in the United States are in the same market along a pricing continuum, and there is a general understanding that 4th tier cigarettes are sold at the lower end of the price spectrum. It submits that there is no clear dividing line between the price of a 4th tier cigarette and a 3rd tier cigarette, or any other cigarette.<sup>29</sup>

### C. Analysis

Based on the limited record, we define a single domestic like product consisting of 4th tier cigarettes coextensive with the scope of the investigation. In any final phase investigation, we plan to gather additional information concerning whether it is appropriate to define the domestic like product more broadly than Commerce's scope definition.<sup>30</sup> We now examine and discuss the Commission's traditional domestic like product factors.

*Physical Characteristics and Uses.* 4th tier and other cigarettes are both tobacco products that consist of tobacco rolled in paper.<sup>31</sup> From this perspective, the products are very similar. As noted, petitioner and KT&G disagree whether there are any important differences in the physical characteristics of 4th tier and other cigarettes. Petitioner claims that tobacco with stem content over 10 percent, as measured by the tobacco blend recipes provided to FDA, is a "bright line" between 4th tier cigarettes and other cigarettes. KT&G, however, disputes that stem content provides a dividing line between 4th tier and other cigarettes and provides a report of its testing of multiple cigarette brands in support of its arguments.<sup>32</sup> Petitioner identifies a single component filter as a bright line separating 4th tier cigarettes from other

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<sup>28</sup> KT&G's Brief at 16-17.

<sup>29</sup> KT&G's Brief at 18-20.

<sup>30</sup> Accordingly, in any final phase investigation, the parties are invited to address how the Commission should define the domestic like product in their pre-hearing and post-hearings briefs, and to provide any supporting evidence for the record. In particular, the parties are requested to address the Commission's six traditional factors for defining the domestic like product. *See also* footnote 54, *infra* (inviting the parties in their comments on the draft questionnaires to indicate what information concerning other categories of cigarettes or price tiers should be gathered in the final phase of the investigation).

<sup>31</sup> CR/PR at I-6.

<sup>32</sup> KT&G's report indicates that non-4th tier cigarettes can exceed 10 percent stem content and one of \*\*\* products has less than 10 percent stems. *See* KT&G's Brief at 11 and Attachment B (Affidavit of Seung-Yong Lee and KT&G Report). Petitioner provides little evidence for its assertion that non-4th tier cigarettes contain tobacco that is always under 10 percent stem content. *See* Petitioner's Brief, Exhibit 2 (Statement of \*\*\*); Petition at Exhibit I-10 (Statement of \*\*\*).

cigarettes which it claims use more complex filters, but again KT&G disputes this claim.<sup>33</sup> Petitioner has also pointed to differences in paper, foil, and packaging, but these appear to be minor distinctions.<sup>34</sup>

The Commission also asked domestic producers and importers in the questionnaires to comment on the comparability of 4th tier and other cigarettes with respect to the domestic like product factors.<sup>35</sup> Their responses with respect to physical characteristics are somewhat mixed though a majority of the responses indicated that 4th tier cigarettes are at least mostly comparable with non-4th tier cigarettes.<sup>36</sup> One U.S. producer and two U.S. importers indicated that they were fully comparable, and two U.S. importers reported that they are mostly comparable. Two U.S. producers indicated that they are not comparable.<sup>37</sup> With respect to uses for 4th tier cigarettes and other cigarettes, both are only used for smoking.

*Interchangeability.* Both 4th tier cigarettes and other cigarettes appear to be interchangeable in that they are both used only for smoking. Petitioner contends that differences in tobacco result in 4th tier cigarettes being less satisfying to smoke than other cigarettes and that brand loyalty to non-4th tier cigarettes means that they are not used interchangeably with 4th tier cigarettes.<sup>38</sup>

The responses to the questionnaires concerning interchangeability were mixed. One U.S. producer and one U.S. importer indicated that they were fully interchangeable, and three importers indicated that they were mostly interchangeable.<sup>39</sup> Two U.S. producers indicated that 4th tier cigarettes and other cigarettes were never interchangeable.<sup>40</sup>

*Manufacturing Facilities, Production Processes, and Employees.* The record indicates that 4th tier cigarettes and other cigarettes are produced by different producers in different facilities with different employees.<sup>41</sup> No domestic producer manufactures both 4th tier cigarettes and other cigarettes.<sup>42</sup>

The process used to produce 4th tier and other cigarettes is identical, with one possible exception. Specifically, producers of 4th tier cigarettes purchase tobacco blends for the production of 4th tier cigarettes while producers of other cigarettes are vertically integrated,

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<sup>33</sup> See Petitioner's Brief at 5, 5 n.16; KT&G's Brief at 11 and Attachment B (Affidavit of Seung-Yong Lee).

<sup>34</sup> See CR/PR at D-7; Petitioner's Brief at 7, Answers to Questions at 19.

<sup>35</sup> See CR/PR at Appendix D.

<sup>36</sup> CR/PR at Table D-3.

<sup>37</sup> CR/PR at Table D-3.

<sup>38</sup> Petitioner's Brief at 7, Answers to Questions at 19.

<sup>39</sup> See CR/PR at Table D-3.

<sup>40</sup> See CR/PR at Table D-3.

<sup>41</sup> See CR/PR at D-9.

<sup>42</sup> CR/PR at III-6.

growing and blending their own tobacco.<sup>43</sup> However, according to KT&G, non-4th tier producers may also purchase tobacco blends rather than producing their own.<sup>44</sup>

In responding to the questionnaires with respect to this factor (manufacturing facilities, production processes and employees), two U.S. producers indicated that they were not comparable, while one U.S. producer indicated they were somewhat comparable or similar.<sup>45</sup> The four U.S. importers indicated that they were mostly comparable.<sup>46</sup>

*Channels of Distribution.* Although both 4th tier cigarettes and other cigarettes are sold through distributors, the record is unclear whether there are significant differences in the channels of distribution. Petitioner claims that 4th tier cigarettes have a unique channel of distribution because they are sold through different distributors to different retailers than other cigarettes; they claim that this difference is in part due to the efforts of the major tobacco companies to block 4th tier cigarettes from the same channels of distribution as other cigarettes with Every Day Low Price (“EDLP”) contracts.<sup>47</sup>

In responding to the questionnaires, one U.S. producer and two importers reported that the channels of distribution are mostly comparable, one U.S. importer reported that channels of distribution are fully comparable, and one indicated they are somewhat comparable.<sup>48</sup> Two U.S. producers indicated that the channels of distribution are never comparable.<sup>49</sup>

*Producer and Customer Perceptions.* Petitioner and KT&G disagree whether 4th tier cigarettes are perceived by producers and customers to be a separate product.<sup>50</sup> In responding to the questionnaires concerning perceptions in the market, two U.S. producers and one U.S. importer indicated that 4th tier cigarettes are not perceived to be comparable to other cigarettes. One U.S. producer reported that 4th tier cigarettes are somewhat comparable to other cigarettes, and three U.S. importers indicated they are mostly comparable.<sup>51</sup>

*Price.* The record indicates that 4th tier cigarettes are priced lower than other cigarettes, but the parties disagree whether there is a clear break between prices of 4<sup>th</sup> tier and other cigarettes or whether there is a continuum of prices for all cigarettes.<sup>52</sup> In their questionnaire responses, three U.S. producers and three U.S. importers indicated that 4th tier

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<sup>43</sup> CR/PR at D-9. *See also* Conf. Tr. at 49-50 (non-4th tier producers vertically integrated) (Pickard).

<sup>44</sup> *See* Conf. Tr. at 186 (major producers purchase some tobacco blends) (Aranoff).

<sup>45</sup> *See* CR/PR at Table D-3.

<sup>46</sup> *See* CR/PR at Table D-3.

<sup>47</sup> Petitioner’s Brief at 8-9.

<sup>48</sup> CR/PR at Table D-3.

<sup>49</sup> CR/PR at Table D-3.

<sup>50</sup> *See* Petitioner’s Brief at 10; KT&G’s Brief at 17-19.

<sup>51</sup> CR/PR at Table D-3. As noted above, the National Association of Convenience Stores has identified 4th tier cigarettes as a category of cigarettes. CR/PR at I-6 n.9.

<sup>52</sup> *See* Petitioner’s Brief at 12-13; KT&G’s Brief at 19.

cigarettes and other cigarettes are not comparably priced, while one U.S. importer indicated they are somewhat comparably priced.<sup>53</sup>

*Conclusion.* We define the domestic like product as 4th tier cigarettes for purposes of our preliminary determination. At this preliminary stage of the investigation the record evidence is limited with respect to the six like product factors and largely disputed by the parties. While we acknowledge that evidence regarding some of the domestic like product factors suggests that it may be appropriate to define the domestic like product more broadly than the scope definition, as discussed above, there is evidence suggesting there are differences between 4th tier cigarettes and other cigarettes with respect to pricing, manufacturing facilities, and production employees, that support defining the like product as 4<sup>th</sup> tier cigarettes co-extensive with the scope. Other evidence, as discussed below, is ambiguous.

We note that the current record suggests significant overlap in terms of their physical characteristics and uses and interchangeability between 4th tier and other cigarettes but is particularly ambiguous with respect to differences in channels of distribution, producer and customer perceptions, and whether there are distinct price categories. Moreover, the majority of the domestic like product factors are disputed by the parties, and the questionnaire responses from market participants were mostly mixed. Importers generally reported comparability between the products, whereas the domestic producers most often reported that the products were not comparable. Obtaining questionnaire responses from other cigarette producers, as well as purchasers that are familiar with both types of cigarettes, will likely provide better information concerning the domestic like product factors in any final phase investigation.

On this limited record, we define the domestic like product to include only 4th tier cigarettes coextensive with the scope for purposes of the preliminary phase of the investigation. We plan to revisit in any final phase investigation whether there is a clear dividing line between different tiers of cigarettes. We will seek information from market participants familiar with different types of cigarettes.<sup>54</sup>

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<sup>53</sup> CR/PR at Table D-3.

<sup>54</sup> We intend to further examine differences in physical characteristics (*e.g.*, tobacco stem content), customer perceptions, and any other differences between 4th tier cigarettes and non-4th tier cigarettes in any final phase investigation. We invite the parties in their comments on the draft questionnaires to indicate what information concerning other categories of cigarettes or price tiers should be gathered in the final phase of the investigation.

## IV. Domestic Industry

The domestic industry is defined as the domestic “producers as a whole of a domestic like product, or those producers whose collective output of a domestic like product constitutes a major proportion of the total domestic production of the product.”<sup>55</sup> In defining the domestic industry, the Commission’s general practice has been to include in the industry producers of all domestic production of the like product, whether toll-produced, captively consumed, or sold in the domestic merchant market.

There are no related parties in this investigation or other domestic industry issues.<sup>56</sup> Accordingly, we define the domestic industry to include all U.S. producers of 4th tier cigarettes.

## V. Reasonable Indication of Threat of Material Injury by Reason of Subject Imports<sup>57</sup>

### A. Legal Standards

In the preliminary phase of antidumping and countervailing duty investigations, the Commission determines whether there is a reasonable indication that an industry in the United States is materially injured or threatened with material injury by reason of the imports under investigation.<sup>58</sup> In making this determination, the Commission must consider the volume of subject imports, their effect on prices for the domestic like product, and their impact on domestic producers of the domestic like product, but only in the context of U.S. production operations.<sup>59</sup> The statute defines “material injury” as “harm which is not inconsequential,

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<sup>55</sup> 19 U.S.C. § 1677(4)(A).

<sup>56</sup> See 19 U.S.C. § 1677(4)(B).

<sup>57</sup> Pursuant to Section 771(24) of the Tariff Act, imports from a subject country of merchandise corresponding to a domestic like product shall be deemed negligible if they account for less than three percent (or four percent in the case of a developing country in a countervailing duty investigation) of all such merchandise imported into the United States during the most recent 12 months for which data are available preceding the filing of the petition. See 19 U.S.C. §§ 1671b(a), 1673b(a), 1677(24)(A)(i), 1677(24)(B); see also 15 C.F.R. § 2013.1 (developing countries for purposes of 19 U.S.C. § 1677(36)).

The data from the Commission’s questionnaires indicate that from December 2018 to November 2019, the 12-month period preceding the filing of the petition, imports from Korea accounted for \*\*\* percent of total imports of 4th tier cigarettes. CR/PR at Table IV-3. Because this percentage exceeds the applicable statutory threshold, we find that subject imports from Korea are not negligible.

<sup>58</sup> 19 U.S.C. §§ 1671b(a), 1673b(a).

<sup>59</sup> 19 U.S.C. § 1677(7)(B). The Commission “may consider such other economic factors as are relevant to the determination” but shall “identify each {such} factor ... {a}nd explain in full its relevance to the determination.” 19 U.S.C. § 1677(7)(B).

immaterial, or unimportant.”<sup>60</sup> In assessing whether there is a reasonable indication that the domestic industry is materially injured or threatened with material injury by reason of subject imports, we consider all relevant economic factors that bear on the state of the industry in the United States.<sup>61</sup> No single factor is dispositive, and all relevant factors are considered “within the context of the business cycle and conditions of competition that are distinctive to the affected industry.”<sup>62</sup>

Although the statute requires the Commission to determine whether the domestic industry is “materially injured or threatened with material injury by reason of” unfairly traded imports,<sup>63</sup> it does not define the phrase “by reason of,” indicating that this aspect of the injury analysis is left to the Commission’s reasonable exercise of its discretion.<sup>64</sup> In identifying a causal link, if any, between subject imports and material injury to the domestic industry, the Commission examines the facts of record that relate to the significance of the volume and price effects of the subject imports and any impact of those imports on the condition of the domestic industry. This evaluation under the “by reason of” standard must ensure that subject imports are more than a minimal or tangential cause of injury and that there is a sufficient causal, not merely a temporal, nexus between subject imports and material injury.<sup>65</sup>

In many investigations, there are other economic factors at work, some or all of which may also be having adverse effects on the domestic industry. Such economic factors might include nonsubject imports; changes in technology, demand, or consumer tastes; competition among domestic producers; or management decisions by domestic producers. The legislative history explains that the Commission must examine factors other than subject imports to ensure that it is not attributing injury from other factors to the subject imports, thereby inflating an otherwise tangential cause of injury into one that satisfies the statutory material

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<sup>60</sup> 19 U.S.C. § 1677(7)(A).

<sup>61</sup> 19 U.S.C. § 1677(7)(C)(iii).

<sup>62</sup> 19 U.S.C. § 1677(7)(C)(iii).

<sup>63</sup> 19 U.S.C. §§ 1671d(b), 1673d(b).

<sup>64</sup> *Angus Chemical Co. v. United States*, 140 F.3d 1478, 1484-85 (Fed. Cir. 1998) (“{T}he statute does not ‘compel the commissioners’ to employ {a particular methodology}.”), *aff’g*, 944 F. Supp. 943, 951 (Ct. Int’l Trade 1996).

<sup>65</sup> The Federal Circuit, in addressing the causation standard of the statute, observed that “[a]s long as its effects are not merely incidental, tangential, or trivial, the foreign product sold at less than fair value meets the causation requirement.” *Nippon Steel Corp. v. USITC*, 345 F.3d 1379, 1384 (Fed. Cir. 2003). This was further ratified in *Mittal Steel Point Lisas Ltd. v. United States*, 542 F.3d 867, 873 (Fed. Cir. 2008), where the Federal Circuit, quoting *Gerald Metals, Inc. v. United States*, 132 F.3d 716, 722 (Fed. Cir. 1997) (“*Gerald Metals*”), stated that “this court requires evidence in the record ‘to show that the harm occurred “by reason of” the LTFV imports, not by reason of a minimal or tangential contribution to material harm caused by LTFV goods.’” See also *Nippon Steel Corp. v. United States*, 458 F.3d 1345, 1357 (Fed. Cir. 2006); *Taiwan Semiconductor Industry Ass’n v. USITC*, 266 F.3d 1339, 1345 (Fed. Cir. 2001).

injury threshold.<sup>66</sup> In performing its examination, however, the Commission need not isolate the injury caused by other factors from injury caused by unfairly traded imports.<sup>67</sup> Nor does the “by reason of” standard require that unfairly traded imports be the “principal” cause of injury or contemplate that injury from unfairly traded imports be weighed against other factors, such as nonsubject imports, which may be contributing to overall injury to an industry.<sup>68</sup> It is clear that the existence of injury caused by other factors does not compel a negative determination.<sup>69</sup>

Assessment of whether material injury or threat thereof to the domestic industry is “by reason of” subject imports “does not require the Commission to address the causation issue in any particular way” as long as “the injury to the domestic industry can reasonably be attributed to the subject imports.”<sup>70</sup> The Commission ensures that it has “evidence in the record” to

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<sup>66</sup> SAA at 851–52 (1994) (“{T}he Commission must examine other factors to ensure that it is not attributing injury from other sources to the subject imports.”); S. Rep. 96-249 at 75 (1979) (the Commission “will consider information which indicates that harm is caused by factors other than less-than-fair-value imports.”); H.R. Rep. 96-317 at 47 (1979) (“in examining the overall injury being experienced by a domestic industry, the ITC will take into account evidence presented to it which demonstrates that the harm attributed by the petitioner to the subsidized or dumped imports is attributable to such other factors;” those factors include “the volume and prices of nonsubsidized imports or imports sold at fair value, contraction in demand or changes in patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry”); *accord Mittal Steel*, 542 F.3d at 877.

<sup>67</sup> SAA at 851–52 (“{T}he Commission need not isolate the injury caused by other factors from injury caused by unfair imports.”); *Taiwan Semiconductor Industry Ass’n*, 266 F.3d at 1345 (“{T}he Commission need not isolate the injury caused by other factors from injury caused by unfair imports ... . Rather, the Commission must examine other factors to ensure that it is not attributing injury from other sources to the subject imports.” (emphasis in original)); *Asociacion de Productores de Salmon y Trucha de Chile AG v. United States*, 180 F. Supp. 2d 1360, 1375 (Ct. Int’l Trade 2002) (“{t}he Commission is not required to isolate the effects of subject imports from other factors contributing to injury” or make “bright-line distinctions” between the effects of subject imports and other causes.); *see also Softwood Lumber from Canada*, Inv. Nos. 701-TA-414 and 731-TA-928 (Remand), USITC Pub. 3658 at 100–01 (Dec. 2003) (Commission recognized that “{i}f an alleged other factor is found not to have or threaten to have injurious effects to the domestic industry, *i.e.*, it is not an ‘other causal factor,’ then there is nothing to further examine regarding attribution to injury”), *citing Gerald Metals*, 132 F.3d at 722 (the statute “does not suggest that an importer of LTFV goods can escape countervailing duties by finding some tangential or minor cause unrelated to the LTFV goods that contributed to the harmful effects on domestic market prices.”).

<sup>68</sup> S. Rep. 96-249 at 74–75; H.R. Rep. 96-317 at 47.

<sup>69</sup> *See Nippon Steel Corp.*, 345 F.3d at 1381 (“an affirmative material-injury determination under the statute requires no more than a substantial-factor showing. That is, the ‘dumping’ need not be the sole or principal cause of injury.”).

<sup>70</sup> *Mittal Steel*, 542 F.3d at 876, 878; *see also id.* at 873 (“While the Commission may not enter an affirmative determination unless it finds that a domestic industry is materially injured ‘by reason of’

“show that the harm occurred ‘by reason of’ the LTFV imports,” and that it is “not attributing injury from other sources to the subject imports.”<sup>71</sup> The Federal Circuit has examined and affirmed various Commission methodologies and has disavowed “rigid adherence to a specific formula.”<sup>72</sup>

The question of whether the material injury or threat thereof threshold for subject imports is satisfied notwithstanding any injury from other factors is factual, subject to review under the substantial evidence standard.<sup>73</sup> Congress has delegated this factual finding to the Commission because of the agency’s institutional expertise in resolving injury issues.<sup>74</sup>

Section 771(7)(F) of the Tariff Act directs the Commission to determine whether the U.S. industry is threatened with material injury by reason of the subject imports by analyzing whether “further dumped or subsidized imports are imminent and whether material injury by reason of imports would occur unless an order is issued or a suspension agreement is accepted.”<sup>75</sup> The Commission may not make such a determination “on the basis of mere conjecture or supposition,” and considers the threat factors “as a whole” in making its determination whether dumped or subsidized imports are imminent and whether material injury by reason of subject imports would occur unless an order is issued.<sup>76</sup> In making our determination, we consider all statutory threat factors that are relevant to this investigation.<sup>77</sup>

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(...Continued)

subject imports, the Commission is not required to follow a single methodology for making that determination ... {and has} broad discretion with respect to its choice of methodology.”), *citing United States Steel Group v. United States*, 96 F.3d 1352, 1362 (Fed. Cir. 1996) and S. Rep. 96-249 at 75. In its decision in *Swift-Train v. United States*, 793 F.3d 1355 (Fed. Cir. 2015), the Federal Circuit affirmed the Commission’s causation analysis as comports with the Court’s guidance in *Mittal Steel*.

<sup>71</sup> *Mittal Steel*, 542 F.3d at 873 (quoting from *Gerald Metals*, 132 F.3d at 722), 877–79. We note that one relevant “other factor” may involve the presence of significant volumes of price-competitive nonsubject imports in the U.S. market, particularly when a commodity product is at issue. In appropriate cases, the Commission collects information regarding nonsubject imports and producers in nonsubject countries in order to conduct its analysis.

<sup>72</sup> *Nucor Corp. v. United States*, 414 F.3d 1331, 1336, 1341 (Fed. Cir. 2005); *see also Mittal Steel*, 542 F.3d at 879 (“*Bratsk* did not read into the antidumping statute a Procrustean formula for determining whether a domestic injury was ‘by reason’ of subject imports.”).

<sup>73</sup> We provide in our discussion below an analysis of other known factors that may have caused any material injury or threat thereof experienced by the domestic industry.

<sup>74</sup> *Mittal Steel*, 542 F.3d at 873; *Nippon Steel Corp.*, 458 F.3d at 1350, *citing U.S. Steel Group*, 96 F.3d at 1357; S. Rep. 96-249 at 75 (“The determination of the ITC with respect to causation is ... complex and difficult, and is a matter for the judgment of the ITC.”).

<sup>75</sup> 19 U.S.C. § 1677(7)(F)(ii).

<sup>76</sup> 19 U.S.C. § 1677(7)(F)(ii).

<sup>77</sup> These factors are as follows:

(I) if a countervailable subsidy is involved, such information as may be presented to it by the administering authority as to the nature of the subsidy (particularly as to whether the countervailable

## B. Conditions of Competition and the Business Cycle

The following conditions of competition inform our analysis of whether there is a reasonable indication of threat of material injury by reason of subject imports.

### 1. Demand Conditions

Overall demand for cigarettes has been in secular decline for many years due to the health risks associated with smoking.<sup>78</sup> Increasing regulation and the availability of smoking alternatives (*e.g.*, electronic cigarettes) reportedly have contributed to lower demand.<sup>79</sup> The federal government and state governments also impose excise taxes on cigarettes to reduce their consumption. The state taxes vary widely by state.<sup>80</sup>

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(...Continued)

subsidy is a subsidy described in Article 3 or 6.1 of the Subsidies Agreement) and whether imports of the subject merchandise are likely to increase,

(II) any existing unused production capacity or imminent, substantial increase in production capacity in the exporting country indicating the likelihood of substantially increased imports of the subject merchandise into the United States, taking into account the availability of other export markets to absorb any additional exports,

(III) a significant rate of increase of the volume or market penetration of imports of the subject merchandise indicating the likelihood of substantially increased imports,

(IV) whether imports of the subject merchandise are entering at prices that are likely to have a significant depressing or suppressing effect on domestic prices and are likely to increase demand for further imports,

(V) inventories of the subject merchandise,

(VI) the potential for product-shifting if production facilities in the foreign country, which can be used to produce the subject merchandise, are currently being used to produce other products,

...

(VIII) the actual and potential negative effects on the existing development and production efforts of the domestic industry, including efforts to develop a derivative or more advanced version of the domestic like product, and

(IX) any other demonstrable adverse trends that indicate the probability that there is likely to be material injury by reason of imports (or sale for importation) of the subject merchandise (whether or not it is actually being imported at the time).

19 U.S.C. § 1677(7)(F)(i). To organize our analysis, we discuss the applicable statutory threat factors using the same volume/price/impact framework that applies to our material injury analysis. Statutory threat factors (I), (II), (III), (V), and (VI) are discussed in the analysis of subject import volume. Statutory threat factor (IV) is discussed in the analysis of subject import price effects. Statutory factors (VIII) and (IX) are discussed in the analysis of impact. Statutory factor (VII) concerning raw and processed agricultural products is inapplicable to this investigation.

<sup>78</sup> See CR/PR at II-6; KT&G's Brief at 21.

<sup>79</sup> See CR/PR at II-6; KT&G's Brief at 21.

<sup>80</sup> See CR/PR at Fig. I-1.

Although demand for cigarettes, including economy brand cigarettes, is reportedly declining over the long term, apparent U.S. consumption of 4th tier cigarettes and all cigarettes increased during the period of investigation (“POI”).<sup>81</sup> Apparent U.S. consumption based on quantity increased overall by \*\*\* percent during 2016-18 and was \*\*\* percent higher during January-September 2019 (“interim 2019”) compared to interim 2018.<sup>82</sup> Apparent U.S. consumption of 4th tier cigarettes totaled \*\*\* cartons in 2016, \*\*\* cartons in 2017, and \*\*\* cartons in 2018.<sup>83</sup>

## 2. Supply Conditions

The domestic industry’s sales, and to a lesser extent sales of the subject imports, are concentrated in certain regions of the United States.<sup>84</sup> The domestic industry’s products are primarily sold in the Southeast and Midwest regions while the majority of the subject imports are shipped to the Southeast, Central Southwest, and the Midwest regions.<sup>85</sup> Xcaliber’s and Cheyenne’s sales are concentrated in Missouri and the surrounding states, Dosal focuses on Texas, Florida, and other parts of the Southeast, and \*\*\* sells in the Northeast.<sup>86</sup> Petitioner argues that KT&G’s sales expanded from the central United States to more areas of the country during the POI.<sup>87</sup>

The domestic industry was the largest source of supply over the POI.<sup>88</sup> Its share of apparent U.S. consumption increased from \*\*\* percent in 2016 to \*\*\* percent in 2017 and

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<sup>81</sup> See CR/PR at II-6, Table IV-4. The limited data the Commission has collected in the preliminary phase of the investigation concerning the total cigarette market suggest that apparent U.S. consumption of all cigarettes increased from \*\*\* cartons in 2016 to \*\*\* in 2017 and then declined to \*\*\* in 2018. See CR/PR at Table D-4.

<sup>82</sup> CR/PR at IV-7.

<sup>83</sup> CR/PR at Table IV-4. Apparent U.S. consumption was \*\*\* cartons in interim 2018 and \*\*\* cartons in interim 2019. *Id.* A carton of cigarettes contains 10 packs of cigarettes and each pack contains 20 cigarettes.

<sup>84</sup> See CR/PR at Table II-2.

<sup>85</sup> See CR/PR at Table II-2.

<sup>86</sup> CR/PR at III-1 n.1.

<sup>87</sup> Petitioner’s Brief at 21-22. In any final phase of the investigation, we intend to gather additional information concerning the extent to which subject imports increased their presence in more regions of the country.

<sup>88</sup> CR/PR at Tables IV-4, C-1. The Commission received usable questionnaire responses from three domestic producers of 4th tier cigarettes; a questionnaire from a fourth producer, \*\*\*, was \*\*\*. CR/PR at III-1 n.1. Staff additionally sent U.S. producer questionnaires to \*\*\*, Inc. and \*\*\*. Both firms indicated that they \*\*\* cigarettes. CR/PR at III-1 n.2.

then declined somewhat to \*\*\* percent in 2018;<sup>89</sup> it was \*\*\* percentage points lower in interim 2019, at \*\*\* percent, than in interim 2018, at \*\*\* percent.<sup>90</sup>

The domestic industry's capacity increased from \*\*\* cartons in 2016 to \*\*\* cartons in 2018; it was \*\*\* cartons in interim 2018 and \*\*\* cartons in interim 2019.<sup>91</sup> Two domestic producers exited the industry during the POI.<sup>92</sup>

Subject imports were the second largest source of supply to the U.S. market during the POI. Their share of apparent U.S. consumption decreased from \*\*\* percent in 2016 to \*\*\* percent in 2017, and then grew to \*\*\* percent in 2018; it was \*\*\* percentage points higher in interim 2019, at \*\*\* percent, than in interim 2018, at \*\*\* percent.<sup>93</sup>

Nonsubject imports were the smallest source of supply during the POI. Their share of apparent U.S. consumption increased from \*\*\* percent in 2016 to \*\*\* percent in 2017 and then decreased to \*\*\* percent in 2018;<sup>94</sup> their share was \*\*\* percentage points lower in interim 2019, at \*\*\* percent, than in interim 2018, at \*\*\* percent.<sup>95</sup> Based on questionnaire responses, the primary sources of nonsubject imports were \*\*\* and \*\*\*.<sup>96</sup>

### **3. Master Settlement Agreement**

In 1998, the four largest U.S. cigarette producers at the time, Philip Morris, R.J. Reynolds, Brown & Williamson, and Lorillard (collectively, "the Majors" or Original Participating Members ("OPMs")) settled with U.S. subfederal governments that included 46 states (all states excluding Florida, Minnesota, Mississippi, and Texas), the District of Columbia, and five U.S. territories (collectively referred to as the "Settling States").<sup>97</sup> Tobacco producers that become a signatory after the Master Settlement Agreement ("MSA") date are referred to as Subsequent Participating Members ("SPMs"). Under the MSA, OPMs, and SPMs are released from past and future legal claims for costs incurred by the Settling States for tobacco-related illnesses. In

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<sup>89</sup> CR/PR at Tables IV-4, C-1.

<sup>90</sup> CR/PR at Tables IV-4, C-1.

<sup>91</sup> CR/PR at Tables III-5, C-1.

<sup>92</sup> Sandia Tobacco of New Mexico filed for bankruptcy in September 2016 and S&M Brands of Virginia shut down operations in March 2019. CR/PR at Table III-3. Their results are not included in the Commission's data concerning the domestic industry as they were unable to provide usable questionnaire responses. CR/PR at III-1, III-1 n.1.

<sup>93</sup> CR/PR at Tables IV-4 C-1.

<sup>94</sup> CR/PR at Tables IV-4, C-1.

<sup>95</sup> CR/PR at Tables IV-4, C-1.

<sup>96</sup> CR/PR at IV-1 n.2.

<sup>97</sup> CR/PR at I-10.

exchange, OPMs and SPMs agreed to make annual payments in perpetuity to the Settling States and to substantially restrict tobacco-related marketing.<sup>98</sup>

Subsequent to the MSA, Settling States required cigarette manufacturers to either become a signatory to the MSA or remain Non-Participating Manufacturers (“NPMs”) and fund escrow accounts.<sup>99</sup> The NPM escrow payments were designed to create parity in the market by eliminating the advantage that the NPMs have relative to the OPMs and SPMs because NPMs do not have to make the MSA payments to the Settling States.<sup>100</sup>

Because all 4th tier cigarette producers, as well as KT&G, are NPMs, they are required to make payments into escrow accounts, with amounts based on the number of cigarettes sold in each state.<sup>101</sup> NPM escrow account funds are expected to be used to satisfy future tobacco-related judgments and/or settlements in the Settling States.<sup>102</sup> NPM escrow payments vary by state with Missouri notably having a less onerous escrow obligation.<sup>103</sup> Florida and Texas are not MSA Settling States and do not have any NPM escrow obligations.<sup>104</sup> Because various producers sell in different states and regions, their NPM escrow payments \*\*\*.<sup>105</sup>

#### 4. Substitutability and Other Conditions

All responding domestic producers and U.S. importers reported that the domestic product and subject imports are either “always” or “frequently” interchangeable.<sup>106</sup> We find for purposes of this preliminary determination that there is a high degree of substitutability between the subject imports and the domestic product.<sup>107</sup>

The record also indicates that price is an important factor in purchasing decisions. Five of eight purchasers reported that price or low cost was an important factor in their purchasing decisions.<sup>108</sup> Consumers of 4th tier cigarettes are said to seek the lowest-priced product available.<sup>109</sup> Most U.S. producers reported that differences other than price were “never”

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<sup>98</sup> CR/PR at I-10 to I-11.

<sup>99</sup> CR/PR at I-10 to I-11; Petitioner’s Brief at 19-20.

<sup>100</sup> CR/PR at VI-1; Conf. Tr. at 109 (Estes) and 156 (Smith).

<sup>101</sup> See CR/PR at I-10 to I-11; KT&G’s Brief at 34.

<sup>102</sup> Unutilized NPM escrow funds are to be returned to NPMs for unrestricted use 25 years after the date the funds were placed into the escrow. As no escrow payments have reached the 25-year mark, it is unclear what percentage of deposited escrow funds (if any) will be returned to NPMs. CR/PR at I-11; Petitioner’s Brief at 19-20.

<sup>103</sup> CR/PR at VI-15, VI-15 to VI-16 n.27.

<sup>104</sup> KT&G’s Brief at 33-34.

<sup>105</sup> See CR/PR at Tables II-2, VI-4.

<sup>106</sup> CR/PR at Table II-5.

<sup>107</sup> CR/PR at II-8.

<sup>108</sup> CR/PR at II-8.

<sup>109</sup> Conf. Tr. at 61 (Taylor), 62 (Smith), (102 (Phillips)).

important in purchasing decisions, whereas most importers reported that such factors are “frequently” important in comparing subject imports and the domestic like product.<sup>110</sup>

The cigarette market is divided into four tiers according to the National Association of Convenience Stores (“NACS”): Premium, Branded Discount, Sub-Generic/Private Label, and 4th Tier.<sup>111</sup> Branding is important for the sale and marketing of the premium brands of cigarettes.<sup>112</sup> On the other hand, the record shows that purchasers of 4th tier cigarettes are not as brand-conscious as purchasers of cigarettes in the higher tiers.<sup>113</sup>

The Tobacco Control Act (“TCA”) enacted in 2009 authorizes the FDA to regulate the manufacture, distribution, and marketing of current and new tobacco products in the United States. It substantially limits the sale and marketing of tobacco products.<sup>114</sup> States and other localities have additional restrictions on the marketing, sale, and consumption of tobacco products.<sup>115</sup>

Tobacco is the primary raw material used to produce 4th tier cigarettes.<sup>116</sup> Domestic producers purchase the tobacco used to produce 4th tier cigarettes.<sup>117</sup> Raw material costs accounted for less than \*\*\* percent of the cost of goods sold (“COGS”) during the POI while other factory costs were the largest component of COGS.<sup>118</sup>

Both importers and the domestic producers sell from their inventories and lead times are less than a week.<sup>119</sup> \*\*\*.<sup>120</sup> Some major non-4th tier producers use EDLP contracts that prevent retailers from pricing 4th tier cigarettes below their own, which effectively excludes 4th tier cigarettes from certain retailers with EDLP contracts.<sup>121</sup>

### C. Likely Volume of Subject Imports

Subject import volume increased overall during the first three full years of the POI and was substantially higher during interim 2019 than in interim 2018. The volume of subject

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<sup>110</sup> CR/PR at Table II-6.

<sup>111</sup> CR/PR at I-6, I-6 n.9. *See also* KT&G’s Brief, Exhibit 49 (NACS, State of the Industry Report (2018)). In any final phase investigations, we will examine the differences between the tiers and the extent to which there is competition among the tiers.

<sup>112</sup> *See* CR/PR at D-4; Conf. Tr. at 148-150 (White).

<sup>113</sup> CR/PR at I-7. The petitioner maintains that purchasers of 4th tier cigarettes do not have brand loyalty; rather, price is the most important factor. Petitioner’s Brief at 8.

<sup>114</sup> CR/PR at I-9.

<sup>115</sup> *See* KT&G’s Brief at 22.

<sup>116</sup> CR/PR at V-1, Table VI-1.

<sup>117</sup> CR/PR at D-9.

<sup>118</sup> CR/PR at V-1.

<sup>119</sup> CR/PR at II-8.

<sup>120</sup> CR/PR at Table V-2.

<sup>121</sup> *See* CR/PR at I-7 and D-6.

imports decreased from \*\*\* cartons in 2016 to \*\*\* cartons in 2017 and then increased to \*\*\* cartons in 2018; subject imports were higher in interim 2019, at \*\*\* cartons, than in interim 2018, at \*\*\* cartons.<sup>122</sup> In sum, the volume of subject imports was \*\*\* percent higher in 2018 than in 2017 and \*\*\* percent higher in interim 2019 than in interim 2018.<sup>123</sup> Thus, subject import volume increased rapidly during the latter portion of the POI and interim 2019 enabling subject imports to increase their share of the U.S. market.

Subject imports' share of apparent U.S. consumption fluctuated but increased during the latter portion of the POI. Their market share initially decreased from \*\*\* percent in 2016 to \*\*\* percent in 2017, but then increased to \*\*\* percent in 2018;<sup>124</sup> it was higher in interim 2019, at \*\*\* percent, than in interim 2018, at \*\*\* percent.<sup>125</sup> As we explain below, we find that the increase in subject import volume and market penetration, as well as the significant rate of those increases, observed during the latter portion of the POI and interim 2019 indicate the likelihood of substantially increased imports in the imminent future.

The subject 4th tier cigarette industry in Korea consists of \*\*\*, but it reportedly is the fifth largest cigarette producer in the world and only produces 4th tier cigarettes.<sup>126</sup> KT&G Corporation's questionnaire response indicates that its production capacity \*\*\* from \*\*\* cartons in 2016 to \*\*\* cartons in 2018.<sup>127</sup> It forecasts that its capacity will, however, \*\*\* cartons in 2019 and 2020.<sup>128</sup> While its production \*\*\* during the three years of the POI, KT&G Corporation anticipates that its \*\*\*.<sup>129</sup>

KT&G Corporation reported \*\*\* throughout the POI.<sup>130</sup> KT&G Corporation's excess capacity totaled \*\*\* cartons in interim 2019.<sup>131</sup> This figure \*\*\* the \*\*\* cartons of subject imports that entered in interim 2019 and is more than \*\*\* apparent U.S. consumption during

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<sup>122</sup> CR/PR at Table IV-2.

<sup>123</sup> See CR/PR at Table IV-2.

<sup>124</sup> CR/PR at Table IV-4.

<sup>125</sup> CR/PR at Table IV-4.

<sup>126</sup> See CR/PR at VII-6, Table VII-3; Petitioner's Brief at Exhibit 4 (excerpts from KT&G USA's website). Respondent \*\*\*. CR/PR at VII-3. It is a large multinational corporation with global manufacturing and distribution networks. See Petition at Exhibit I-7.

<sup>127</sup> CR/PR at Table VII-3.

<sup>128</sup> CR/PR at Table VII-3.

<sup>129</sup> Its production decreased from \*\*\* cartons in 2016 to \*\*\* cartons in 2017 and \*\*\* cartons in 2018, but it was higher in interim 2019, at \*\*\* cartons, than in interim 2018, at \*\*\* cartons. CR/PR at Table VII-3. It projects that its production will be \*\*\* cartons in 2019 and \*\*\* cartons in 2020. *Id.*

<sup>130</sup> See CR/PR at Table VII-3. KT&G Corporation's capacity utilization \*\*\* from \*\*\* percent in 2016 to \*\*\* percent in 2017 and \*\*\* percent in 2018; it was \*\*\* in interim 2019, at \*\*\* percent, than in interim 2018, at \*\*\* percent. CR/PR at Table VII-3. KT&G Corporation projected its capacity utilization rate to be \*\*\* percent in 2019 and \*\*\* percent in 2020. *Id.*

<sup>131</sup> Derived from CR/PR at Table VII-3.

that interim period.<sup>132</sup> KT&G Corporation also forecasts that its excess capacity will \*\*\* relative to that reported in 2018.<sup>133</sup>

The record also indicates that KT&G Corporation is export-oriented, exporting almost \*\*\*.<sup>134</sup> Its total export shipments, as a share of its total shipments, \*\*\* from \*\*\* percent in 2016 to \*\*\* percent in 2017 and then \*\*\* to \*\*\* percent in 2018; they were \*\*\* in interim 2019 at \*\*\* percent, than in interim 2018, at \*\*\* percent.<sup>135</sup> KT&G Corporation's export shipments to the United States, as a share of its total shipments, \*\*\* later in the POI. They \*\*\* from \*\*\* percent in 2016 to \*\*\* percent in 2017 but then increased to \*\*\* percent in 2018; they were also \*\*\* in interim 2019, at \*\*\* percent, than in interim 2018, at \*\*\* percent.<sup>136</sup>

Significantly, KT&G Corporation projects that its \*\*\*. While subject imports totaled \*\*\* cartons in 2018, KT&G Corporation projects that its export shipments to the United States will be \*\*\* cartons in 2019 and \*\*\* cartons in 2020.<sup>137</sup> KT&G USA also reported that it had arranged imports of \*\*\* cartons for October 2019 through December 2019.<sup>138</sup> Given that subject imports during interim 2019 totaled \*\*\* cartons, the record indicates that subject imports during 2019 are scheduled to exceed \*\*\* cartons, an amount that \*\*\* cartons for 2019, and represents a \*\*\* percent, over the \*\*\* cartons of subject imports during 2018.<sup>139</sup>

Also of note, KT&G Corporation reported \*\*\* end-of-period inventories late in the POI.<sup>140</sup> Its inventories in interim 2019 of \*\*\* cartons exceeded the \*\*\* cartons of apparent U.S. consumption in that period.<sup>141</sup> KT&G USA's inventories of subject imports \*\*\*.<sup>142</sup>

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<sup>132</sup> *Derived from* CR/PR at Tables IV-4, VII-3, C-1.

<sup>133</sup> KT&G Corporation projected its excess capacity to be \*\*\* cartons in 2019 and \*\*\* cartons in 2020. *See* CR/PR at Table VII-3.

<sup>134</sup> CR/PR at Table VII-3.

<sup>135</sup> CR/PR at Table VII-3. KT&G Corporation's total export shipments increased from \*\*\* cartons in 2016 to \*\*\* cartons in 2017 and then declined to \*\*\* cartons in 2018; they were \*\*\* cartons in interim 2018 and \*\*\* cartons in interim 2019. *Id.*

<sup>136</sup> CR/PR at Table VII-3. Its export shipments to the United States \*\*\* from \*\*\* cartons in 2016 to \*\*\* cartons in 2017 and \*\*\* cartons in 2018. They were higher at \*\*\* cartons in interim 2019 compared to \*\*\* cartons in interim 2018. *Id.*

<sup>137</sup> CR/PR at Table VII-3. While subject imports totaled \*\*\* cartons in 2018, KT&G Corporation projects that its export shipments to the United States will be \*\*\* cartons in 2019 and \*\*\* cartons in 2020. CR/PR at Table VII-3.

<sup>138</sup> CR/PR at Table VII-6.

<sup>139</sup> *See* CR/PR at Table IV-2.

<sup>140</sup> KT&G Corporation's reported end-of-period inventories of subject merchandise \*\*\* from \*\*\* cartons in 2016 to \*\*\* cartons in 2017 and then increased to \*\*\* cartons in 2018; they were \*\*\* in interim 2019, at \*\*\* cartons, than in interim 2018, at \*\*\* cartons. CR/PR at Table VII-3. Its end-of-period inventories are projected to be \*\*\* cartons in 2019 and \*\*\* cartons in 2020. *Id.* The ratio of its end-of-period inventories to production decreased from \*\*\* percent in 2016 to \*\*\* percent in 2017 and then increased to \*\*\* percent in 2018. *Id.* The ratio was \*\*\* percent in interim 2018 and \*\*\* percent in interim 2019. The ratio is projected to be \*\*\* percent in 2019 and \*\*\* percent in 2020. *Id.*

In light of the rapid increases in subject import volume and market penetration observed during the latter portion of the POI, the \*\*\* of the subject industry, its demonstrated ability and \*\*\* exports to the United States, and its \*\*\* of the subject merchandise, we conclude that there is a likelihood of substantially increased subject imports into the United States in the imminent future.<sup>143</sup>

#### **D. Likely Price Effects of the Subject Imports**

As explained above in Section V.B.4, the record indicates that there is a high degree of substitutability between domestically produced 4th tier cigarettes and subject imports and that price is an important factor in purchasing decisions.

The Commission collected quarterly pricing data on three different 4th tier cigarette products shipped to unrelated U.S. customers in either Missouri or Oklahoma between January 2016 and September 2019.<sup>144</sup> Three U.S. producers<sup>145</sup> and one importer submitted usable pricing data on sales of the requested products, although not all firms reported pricing for all products for all quarters.<sup>146</sup> Pricing data reported by these firms accounted for approximately

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(...Continued)

<sup>141</sup> See CR/PR at Tables IV-4 and VII-3. KT&G Corporation indicated that \*\*\*. KT&G's Questionnaire Response at II-10. KT&G USA also recently opened a new distribution center in Fort Worth, Texas. Petitioner's Brief at 46, Exhibit 40.

<sup>142</sup> U.S. importers' inventories of subject imports increased from \*\*\* cartons in 2016 to \*\*\* cartons in 2017 and \*\*\* cartons in 2018; they were higher in interim 2019, at \*\*\* cartons, than in interim 2018, at \*\*\* cartons. CR/PR at Table VII-5. The ratio of U.S. importers' end-of-period inventories of subject imports to U.S. shipments of subject imports \*\*\* from \*\*\* percent in 2016 to \*\*\* percent in 2017 and \*\*\* percent in 2018. *Id.* This ratio was \*\*\* percent in interim 2018 and \*\*\* percent in interim 2019. *Id.*

<sup>143</sup> With respect to the potential for product-shifting, the responding Korean producer \*\*\*. CR/PR at Table II-5, VII-6.

<sup>144</sup> CR/PR at V-4. The pricing products are: (1) Non-menthol, Full Flavor, Length 100, Non-Menthol 4th tier cigarette (*i.e.*, Edgefield Red Box/THIS Red Box or equivalent offerings) sold in Missouri; (2) Non-menthol, Ultralight Flavor, Length 100, Non-Menthol 4th tier cigarette (*i.e.*, Edgefield Gold/THIS Blue Box or equivalent offerings) sold in Missouri; (3) Menthol, Length 100, Menthol 4th tier cigarette (*i.e.*, Edgefield Menthol Box/THIS Menthol Box or equivalent offerings) sold in Missouri; (4) Non-menthol, Full Flavor, Length 100, Non-Menthol 4th tier cigarette (*i.e.*, Edgefield Red Box/THIS Red Box or equivalent offerings) sold in Oklahoma; (5) Non-menthol, Ultralight Flavor, Length 100, Non-Menthol 4th tier cigarette (*i.e.*, Edgefield Gold/THIS Blue Box or equivalent offerings) sold in Oklahoma; and (6) Menthol, Length 100, Menthol 4th tier cigarette (*i.e.*, Edgefield Menthol Box/THIS Menthol Box or equivalent offerings) sold in Oklahoma. CR/PR at V-4.

<sup>145</sup> Dosal only reported a very \*\*\* during the POI. See Dosal's Producer Questionnaire at IV-2b. Consequently, the \*\*\*.

<sup>146</sup> CR/PR at V-4.

\*\*\* percent of U.S. producers' U.S. commercial shipments of 4th tier cigarettes and \*\*\* percent of U.S. commercial shipments of subject merchandise from Korea in 2018.<sup>147</sup>

Although the price comparison data indicate predominant overselling by subject imports over the course of the entire POI,<sup>148</sup> the frequency of underselling increased during the latter portion of the POI. The \*\*\* of the subject import shipments (\*\*\* cartons or \*\*\* percent) that undersold the domestic product were shipped during 2018 and interim 2019.<sup>149 150</sup>

We have also considered price trends for the domestic like product and subject imports. Prices for the three domestically produced pricing products sold in Missouri increased from the first quarter of 2016 to the third quarter of 2019.<sup>151</sup> Prices for the three domestic pricing products sold in Oklahoma declined over the same period, with the decrease primarily during the last quarter of 2017 and 2018.<sup>152</sup>

With respect to subject imports, prices for shipments of the subject imports decreased overall for all six pricing products during the POI, with the decrease starting in early 2018 and

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<sup>147</sup> CR/PR at V-4.

<sup>148</sup> During the POI, subject imports undersold the domestic like product in \*\*\* of \*\*\* monthly comparisons for a total volume of \*\*\* cartons (\*\*\* percent of subject import volumes in pricing comparisons). CR/PR at Table V-10. The margins of underselling ranged from \*\*\* percent to \*\*\* percent, with an average underselling margin of \*\*\* percent. *Id.* Subject imports oversold the domestic like product in \*\*\* of \*\*\* monthly comparisons for a total volume of \*\*\* cartons (\*\*\* percent of subject import volumes in pricing comparisons). The margins of overselling ranged from \*\*\* percent to \*\*\* percent, with an average overselling margin of \*\*\* percent. *Id.*

We note that the data for sales into Missouri (Products 1-3) show mixed over- and under-selling (with all underselling starting in the fourth quarter of 2017) whereas data for sales into Oklahoma (Products 4-6) show universal overselling. Petitioner claims that most of its sales reported for Oklahoma were ultimately destined for sale out of that state and thus may not have been comparable to the data reported for subject imports. Petitioner's Brief at 28. In any final phase investigation, we intend to ensure that the data collected are comparable. We invite the parties in comments on draft questionnaires to suggest appropriate product definitions.

<sup>149</sup> *Derived from* CR/PR at Tables V-3 to V-8. During interim 2019, subject imports undersold the domestic like product in \*\*\* of \*\*\* quarterly comparisons. On a volume basis, \*\*\* of \*\*\* cartons undersold the domestic like product during interim 2019. *Derived from* CR/PR at Tables V-3 to V-8. Moreover, the margins of underselling increased during the second half of 2018 and interim 2019. *See* CR/PR at Figs. V-2, V-3 and V-4.

<sup>150</sup> Additionally, four of eight purchasers that responded to the preliminary phase lost sales/lost revenue survey reported that the subject imports were priced lower than the U.S. product, and two of these purchasers reported that the lower price of the subject imports was a primary reason for the decision to purchase subject imports rather than domestically produced product. CR/PR at V-23. They reported purchasing \*\*\* cartons of subject imports instead of domestic product because of lower prices. *Id.* Further, two of the eight responding purchasers also reported that U.S. producers had reduced prices in order to compete with lower-priced imports from Korea. CR/PR at V-25.

<sup>151</sup> *See* CR/PR at Fig. V-8.

<sup>152</sup> *See* CR/PR at Fig. V-8.

continuing during the latter portion of the period.<sup>153</sup> Prices of subject imports were particularly low in interim 2019, the period in which the volume of subject imports was greatest.

As described above, apparent U.S. consumption \*\*\* overall over the POI.<sup>154</sup> The industry's raw material costs and COGS per carton \*\*\*.<sup>155</sup> The domestic industry's ratio of COGS to net sales \*\*\*, \*\*\* from \*\*\* percent in 2016 to \*\*\* percent in 2017 and then increasing to \*\*\* percent in 2018.<sup>156</sup> The domestic industry's COGS to net sales ratio was \*\*\* in interim 2019, at \*\*\* percent, than in interim 2018, at \*\*\* percent.<sup>157</sup>

Based on the current record, we find that there is a reasonable indication that the underselling by subject imports observed in 2018 and interim 2019 will likely intensify in the imminent future. We described above how the volume of subject imports is likely to increase significantly in the imminent future. In light of the high degree of substitutability between the domestic like product and subject imports, and the importance of price in purchasing decisions, we find that substantially increased volumes of subject imports will likely displace sales of the domestic like product by engaging in significant underselling. This in turn is likely to further increase demand for subject imports and displace sales of the domestic like product.

This displacement will likely serve to reduce the domestic industry's production, sales, shipments, and market share in the imminent future. Accordingly, we find that subject imports are entering the U.S. market at prices that are likely to have a significant depressing or suppressing effect on domestic prices and are likely to increase demand for further subject imports in the imminent future.<sup>158</sup>

#### **E. Likely Impact of the Subject Imports<sup>159</sup>**

The domestic industry's output indicia generally increased over the POI. The domestic industry's capacity, production, U.S. shipments, and net sales all increased over most of the

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<sup>153</sup> See CR/PR at Fig. V-9.

<sup>154</sup> See CR/PR at Tables IV-4, C-1.

<sup>155</sup> See CR/PR at Table VI-1. The domestic industry's average COGS per carton increased from \$\*\*\* per carton in 2016 to \$\*\*\* per carton in 2018. It was higher in interim 2019, at \$\*\*\* per carton, than in interim 2018, at \$\*\*\* per carton. The domestic industry's raw material costs increased from \$\*\*\* per carton in 2016 to \$\*\*\* per carton in 2018. It was higher in interim 2019, at \$\*\*\* per carton, than in interim 2018, at \$\*\*\* per carton. CR/PR at Table VI-1.

<sup>156</sup> CR/PR at Table VI-1.

<sup>157</sup> CR/PR at Table VI-1.

<sup>158</sup> For a discussion of petitioner's allegations of price depression and price suppression, see Petitioner's Brief at 30-34.

<sup>159</sup> In its notice initiating the antidumping duty investigation, Commerce reported estimated antidumping duty margins of 7.10 to 113.06 percent for subject imports from Korea. *4th Tier Cigarettes from the Republic of Korea: Initiation of Less-Than-Fair-Value Investigation*, 85 Fed. Reg. 2390, 2393 (Jan. 15, 2020).

period.<sup>160</sup> The domestic industry's capacity utilization rate declined over the three full years but was higher in the interim period comparison.<sup>161</sup> Further, while the domestic industry's market share \*\*\* from 2016 to 2017, it \*\*\* from 2017 to 2018 and was \*\*\* in interim 2019 than in interim 2018.<sup>162</sup> The domestic industry's end-of-period inventories increased irregularly from 2016 to 2018, and were higher in interim 2019 than in interim 2018.<sup>163</sup>

Virtually all of the domestic industry's employment related indicators increased overall during the POI, including production and related workers ("PRWs"), total hours worked, hours

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<sup>160</sup> The domestic industry's capacity increased from 2016 to 2018, but it was slightly lower in interim 2019 than in interim 2018. CR/PR at Tables III-5, C-1. Capacity increased from \*\*\* cartons in 2016 to \*\*\* cartons in 2017 and \*\*\* cartons in 2018; it was \*\*\* cartons in interim 2018 and \*\*\* cartons in interim 2019. *Id.* The domestic industry's production increased from \*\*\* cartons in 2016 to \*\*\* cartons in 2017, and \*\*\* cartons in 2018. CR/PR at Tables III-5, C-1. Its production was higher in interim 2019, at \*\*\* cartons, than in interim 2018, at \*\*\* cartons. *Id.*

The domestic industry's U.S. shipments increased from \*\*\* cartons in 2016 to \*\*\* cartons in 2017 and \*\*\* cartons in 2018. CR/PR at Tables III-7, C-1. Its U.S. shipments were higher in interim 2019, at \*\*\* cartons, than in interim 2018, at \*\*\* cartons. *Id.*

<sup>161</sup> The domestic industry's capacity utilization fluctuated, but declined overall, falling from \*\*\* percent in 2016 to \*\*\* percent in 2017 and then increasing to \*\*\* percent in 2018. CR/PR at Tables III-5, C-1. Its capacity utilization was higher in interim 2019, at \*\*\* percent, than in interim 2018, at \*\*\* percent. *Id.*

<sup>162</sup> The domestic industry's market share increased from \*\*\* percent in 2016 to \*\*\* percent in 2017 and then fell to \*\*\* percent in 2018. CR/PR at Tables IV-4, C-1. Its market share was lower in interim 2019, at \*\*\* percent, than in interim 2018, at \*\*\* percent. *Id.*

<sup>163</sup> U.S. producers' end-of-period inventories were \*\*\* cartons in 2016, \*\*\* cartons in 2017, \*\*\* cartons in 2018, \*\*\* cartons in interim 2018, and \*\*\* cartons in interim 2019. CR/PR at Tables III-8 & C-1. As a ratio to total shipments, the domestic industry's end-of-period inventories declined from \*\*\* percent in 2016 to \*\*\* percent in 2017 and \*\*\* percent in 2018; it was \*\*\* percent in interim 2018 and \*\*\* percent in interim 2019. *Id.*

worked per PRW, wages paid, hourly wages, and unit labor costs.<sup>164</sup> Productivity, however decreased from 2016 to 2018, and was lower in interim 2019 than in interim 2018.<sup>165</sup>

Although the domestic industry's sales revenues<sup>166</sup> and gross profit increased,<sup>167</sup> most of the domestic industry's other financial indicators<sup>168</sup> declined during the period of investigation, due in part to rising escrow payments.<sup>169</sup> After increasing from 2016 to 2017, the domestic

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<sup>164</sup> The domestic industry's number of PRWs increased from \*\*\* in 2016 to \*\*\* in 2017 and to \*\*\* in 2018; it was \*\*\* in interim 2018 and \*\*\* in interim 2019. CR/PR at Tables III-9, C-1. Total hours worked increased from \*\*\* in 2016 to \*\*\* in 2017 to \*\*\* in 2018; they were \*\*\* in interim 2018 and \*\*\* in interim 2019. *Id.* Hours worked per PRW declined from \*\*\* hours in 2016 to \*\*\* hours in 2017, and then increased to \*\*\* hours in 2018; they were \*\*\* hours in interim 2018 and \*\*\* hours in interim 2019. Wages paid increased from \$\*\*\* in 2016 to \$\*\*\* in 2017, and \$\*\*\* in 2018; they were \$\*\*\* in interim 2018 and \$\*\*\* in interim 2019. *Id.* The domestic industry's hourly wages decreased from \$\*\*\* in 2016 to \$\*\*\* in 2017 and then increased to \$\*\*\* in 2018; they were \$\*\*\* in interim 2018 and \$\*\*\* in interim 2019. *Id.* Unit labor costs increased from \$\*\*\* per carton in 2016 and 2017 to \$\*\*\* per carton in 2018; they were higher in interim 2019, at \$\*\*\* per carton, than in interim 2018, at \$\*\*\* per carton. *Id.*

<sup>165</sup> Productivity in cartons per hour decreased from \*\*\* in 2016 to \*\*\* in 2017 and \*\*\* in 2018; it was \*\*\* cartons per hour in interim 2018 and \*\*\* cartons per hour in interim 2019. CR/PR at Table III-9.

<sup>166</sup> The domestic industry's net sales revenues increased from \$\*\*\* in 2016 to \$\*\*\* in 2017 and to \$\*\*\* in 2018; they were \$\*\*\* in interim 2018 and \$\*\*\* in interim 2019. CR/PR at Tables VI-1, C-1.

<sup>167</sup> The domestic industry's gross profit increased from \$\*\*\* in 2016 to \$\*\*\* in 2017 and \$\*\*\* in 2018; it was \$\*\*\* in interim 2018 and \$\*\*\* in interim 2019. CR/PR at Tables VI-1, C-1.

<sup>168</sup> While all 4th tier cigarette producers are subject to NPM escrow payments, U.S. producers are not uniform in terms of how they consider NPM escrow payments for financial reporting purposes. While some include the NPM escrow payments directly as a cost/expense in determining financial results, others exclude them entirely. Because of these differences and in order to provide a consistent basis to evaluate the U.S. industry's financial results, the NPM escrow payments of all U.S. producers were classified as a separate operating expense below selling, general, and administrative (SG&A) expenses. See CR/PR at VI-14 to VI-15. We intend to further examine the role of NPM escrow payments in the domestic industry's financial performance in any final phase investigation.

<sup>169</sup> The industry's \*\*\*. See CR/PR at Table VI-4. In short, because \*\*\*. See CR/PR at VI-16, Table VI-4.

industry's operating income,<sup>170</sup> net income,<sup>171</sup> and cash flow<sup>172</sup> declined in 2018 to levels below 2016. The industry's operating and net income ratios declined steadily from 2016 to 2018.<sup>173</sup>

The domestic industry's capital expenditures and research and development expenditures also \*\*\* from 2016 to 2018, but were \*\*\* in interim 2019 than in interim 2018.<sup>174</sup> The domestic industry's assets increased overall from 2016 to 2018 while its return on assets declined.<sup>175</sup>

As noted, Sandia Tobacco and S&M Brands ceased production during the POI and laid off approximately 100 workers. Petitioner submitted brief statements from officials of both companies that attribute their closures in part to competition from low-priced subject imports.<sup>176</sup> Xcaliber reported that an initial public offering of stock had to be cancelled in part due to subject imports.<sup>177</sup> Domestic producers reported a substantial number of negative effects on investment and on growth and development due to subject imports during the POI.<sup>178</sup>

We found above that there is a reasonable indication that subject imports are likely both to enter the U.S. market in substantially increasing volumes and to engage in significant price depressing or suppressing effects on prices of the domestic like product in the imminent future. For purposes of the preliminary phase of this investigation, we conclude that the likely substantially increasing volumes of low priced subject imports will likely displace sales of the domestic like product and cause the domestic industry to lose market share, which will likely

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<sup>170</sup> The domestic industry's operating income was \$\*\*\* in 2016, \$\*\*\* in 2017, and \$\*\*\* in 2018; it was \$\*\*\* in interim 2018, and \$\*\*\* in interim 2019. CR/PR at Tables VI-1, C-1.

<sup>171</sup> The domestic industry's net income was \$\*\*\* in 2016, \$\*\*\* in 2017, and \$\*\*\* in 2018; it was \$\*\*\* in interim 2018, and \$\*\*\* in interim 2019. CR/PR at Tables VI-1, C-1. The industry's net income was higher in interim 2019 due to increased other income, primarily investment income. See CR/PR at VI-17 n.30.

<sup>172</sup> The industry's cash flow increased from \$\*\*\* in 2016 to \$\*\*\* in 2017 and then decreased to \$\*\*\* in 2018; it was \$\*\*\* in interim 2018 and \$\*\*\* in interim 2019. CR/PR at Tables VI-1, C-1.

<sup>173</sup> The domestic industry's operating income to net sales ratio declined from \*\*\* percent in 2016 to \*\*\* percent in 2017 and \*\*\* percent in 2018. CR/PR at Tables VI-1, C-1. The ratio was \*\*\* percent in interim 2018 and \*\*\* percent in interim 2019. *Id.* The domestic industry's net income to net sales ratio declined from \*\*\* percent in 2016 to \*\*\* percent in 2017 and \*\*\* percent in 2018. CR/PR at Tables VI-1, C-1. The ratio was \*\*\* percent in interim 2018 and \*\*\* percent in interim 2019. *Id.*

<sup>174</sup> Capital expenditures fell from \$\*\*\* in 2016 to \$\*\*\* in 2017 and \$\*\*\* in 2018; they were \$\*\*\* in interim 2018, and \$\*\*\* in interim 2019. CR/PR at Tables VI-5, C-1. Research and development expenses declined from \$\*\*\* in 2016 to \$\*\*\* in 2017 and \$\*\*\* in 2018; they were \$\*\*\* in interim 2018 and in interim 2019. CR/PR at Table VI-5.

<sup>175</sup> See CR/PR at Table VI-6.

<sup>176</sup> CR/PR at Table III-3; Petitioner's Brief, Exhibits 3 and 22 (Declarations of \*\*\*).

<sup>177</sup> Conf. Tr. at 301-32 (Smith); CR/PR at Table VI-8 (noting also the \*\*\*).

<sup>178</sup> CR/PR at Tables VI-7 and VI-8.

lead to adverse effects on the domestic industry's output, revenues and financial performance in the imminent future.

We have also considered factors other than subject imports to ensure that we are not attributing any threat of material injury from other such factors to the subject imports. Nonsubject imports had an appreciable presence in the U.S. market throughout the POI. However, nonsubject imports' market share declined in interim 2019, while subject imports increased significantly and gained market share primarily at the expense of the domestic industry.<sup>179</sup> Furthermore, while the unit values of subject imports were above those of the nonsubject imports during 2016-2018, the unit values of subject imports fell below those of the nonsubject imports during interim 2019, suggesting that they likely will be priced more aggressively than nonsubject imports.<sup>180</sup> Given these considerations, we find the likely imminent adverse effects of subject imports due to likely increases in subject import volume and market share are distinct from any effects attributable to the nonsubject imports. Moreover, apparent U.S. consumption grew over the period and there is no information to indicate that adverse demand conditions in the U.S. market would explain the adverse effects on the domestic industry that we find likely in the imminent future.

## **VI. Conclusion**

For the reasons stated above, we determine that there is a reasonable indication that an industry in the United States is threatened with material injury by reason of subject imports of 4th tier cigarettes from Korea that are allegedly sold in the United States at LTFV.

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<sup>179</sup> CR/PR at Tables IV-4, C-1.

<sup>180</sup> See CR/PR at Table IV-2.



# Part I: Introduction

## Background

This investigation results from a petition filed with the U.S. Department of Commerce (“Commerce”) and the U.S. International Trade Commission (“USITC” or “Commission”) by the Coalition Against Korea Cigarettes (“CAKC”), the coalition members are Xcaliber International (“Xcaliber”), Pryor, Oklahoma and Cheyenne International (“Cheyenne”), Grover, North Carolina, on December 18, 2019, alleging that an industry in the United States is materially injured and threatened with material injury by reason of less-than-fair-value (“LTFV”) imports of 4th tier cigarettes<sup>1</sup> from Korea. The following tabulation provides information relating to the background of these/this investigation(s).<sup>2 3</sup>

Effective date	Action
December 18, 2019	Petition filed with Commerce and the Commission; institution of Commission investigations (84 FR 70997, December 26, 2019)
January 8, 2020	Commission’s conference
January 7, 2020	Commerce’s notice of initiation (85 FR 2390, January 15, 2020)
January 31, 2020	Commission’s vote
February 3, 2020	Commission’s determination
February 10, 2020	Commission’s views

## Statutory criteria

Section 771(7)(B) of the Tariff Act of 1930 (the “Act”) (19 U.S.C. § 1677(7)(B)) provides that in making its determinations of injury to an industry in the United States, the Commission--

*shall consider (I) the volume of imports of the subject merchandise, (II) the effect of imports of that merchandise on prices in the United States for domestic like products, and (III) the impact of imports of such*

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<sup>1</sup> See the section entitled “The subject merchandise” in Part I of this report for a complete description of the merchandise subject in this proceeding.

<sup>2</sup> Pertinent *Federal Register* notices are referenced in appendix A, and may be found at the Commission’s website ([www.usitc.gov](http://www.usitc.gov)).

<sup>3</sup> Appendix B presents for the witnesses who appeared at the Commission’s conference. (continued...)

*merchandise on domestic producers of domestic like products, but only in the context of production operations within the United States; and. . . may consider such other economic factors as are relevant to the determination regarding whether there is material injury by reason of imports.*

Section 771(7)(C) of the Act (19 U.S.C. § 1677(7)(C)) further provides that--<sup>4</sup>

*In evaluating the volume of imports of merchandise, the Commission shall consider whether the volume of imports of the merchandise, or any increase in that volume, either in absolute terms or relative to production or consumption in the United States is significant. . . .In evaluating the effect of imports of such merchandise on prices, the Commission shall consider whether. . . (I) there has been significant price underselling by the imported merchandise as compared with the price of domestic like products of the United States, and (II) the effect of imports of such merchandise otherwise depresses prices to a significant degree or prevents price increases, which otherwise would have occurred, to a significant degree. . . . In examining the impact required to be considered under subparagraph (B)(i)(III), the Commission shall evaluate (within the context of the business cycle and conditions of competition that are distinctive to the affected industry) all relevant economic factors which have a bearing on the state of the industry in the United States, including, but not limited to. . . (I) actual and potential decline in output, sales, market share, gross profits, operating profits, net profits, ability to service debt, productivity, return on investments, return on assets, and utilization of capacity, (II) factors affecting domestic prices, (III) actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital, and investment, (IV) actual and potential negative effects on the existing development and production efforts of the domestic industry, including efforts to develop a derivative or more advanced version of the domestic like product, and (V) in {an antidumping investigation}, the magnitude of the margin of dumping.*

*In addition, Section 771(7)(J) of the Act (19 U.S.C. § 1677(7)(J)) provides that—<sup>5</sup>*

*(J) EFFECT OF PROFITABILITY.—The Commission may not determine that there is no material injury or threat of material injury to an industry in the United States merely because that industry is profitable or because the performance of that industry has recently improved.*

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<sup>4</sup> Amended by PL 114-27 (as signed, June 29, 2015), Trade Preferences Extension Act of 2015.

<sup>5</sup> Amended by PL 114-27 (as signed, June 29, 2015), Trade Preferences Extension Act of 2015.

## Organization of report

Part I of this report presents information on the subject merchandise, alleged dumping margins, and domestic like product. Part II of this report presents information on conditions of competition and other relevant economic factors. Part III presents information on the condition of the U.S. industry, including data on capacity, production, shipments, inventories, and employment. Parts IV and V present the volume of subject imports and pricing of domestic and imported products, respectively. Part VI presents information on the financial experience of U.S. producers. Part VII presents the statutory requirements and information obtained for use in the Commission's consideration of the question of threat of material injury as well as information regarding nonsubject countries.

## Market summary

4th tier cigarettes are tobacco cigarettes rolled in paper ranging in from 7.0 cm and 12.0 cm in length. Much like other types of cigarettes, 4th tier cigarettes are generally sold in packs of 20 cigarettes or in cartons consisting of 10 packs of cigarettes. 4th tier cigarettes are distinguished from other types of cigarettes by the stem content of the tobacco. 4th tier cigarette tobacco consists of 10-40 percent tobacco stems while non-4th tier cigarette tobacco consists of less than 10 percent tobacco stems.

The leading U.S. producers of 4th tier cigarettes are \*\*\* while the leading producer of 4th tier cigarettes outside the United States includes KT&G of Korea. The leading U.S. importer of 4th tier cigarettes from Korea is KT&G USA, while the leading importers of product from nonsubject countries (primarily Canada) includes \*\*\*. U.S. purchasers of 4th tier cigarettes are firms that purchase 4th tier cigarettes from domestic producers and U.S. importers; leading purchasers include \*\*\*.

Apparent U.S. consumption of 4th tier cigarettes totaled approximately \*\*\* in 2018. Currently, four firms are known to produce 4th tier cigarettes in the United States. U.S. producers' U.S. shipments of 4th tier cigarettes totaled \*\*\* in 2018, and accounted for \*\*\* percent of apparent U.S. consumption by quantity and \*\*\* percent by value. U.S. importers' U.S. shipments from subject sources totaled \*\*\* in 2018, and accounted for \*\*\* percent of apparent U.S. consumption by quantity and \*\*\* percent by value. U.S. importers' U.S. shipments from nonsubject sources totaled \*\*\* in 2018,

and accounted for \*\*\* percent of apparent U.S. consumption by quantity and \*\*\* percent by value.

## **Summary data and data sources**

A summary of data collected in this investigation is presented in appendix C, table C-1. Except as noted, U.S. industry data are based on questionnaire responses of the three firms that accounted for \*\*\* of U.S. production of 4th tier cigarettes during 2018. U.S. imports are based on the questionnaire responses of two firms that submitted useable U.S. importers questionnaires representing \*\*\* U.S. imports from Korea in 2018 under HTS statistical reporting number 2402.20.8000. Korean industry data are based on the questionnaire response from the one firm (KT&G) that accounted for \*\*\* Korean production of 4th tier cigarettes.

## **Previous and related investigations**

4th tier cigarettes have not been the subject of any prior countervailing or antidumping duty investigations in the United States.

## **Nature and extent of alleged sales at LTFV**

### **Alleged sales at LTFV**

On January 15, 2020, Commerce published a notice in the *Federal Register* of the initiation of its antidumping duty investigation on 4th tier cigarettes from Korea.<sup>6</sup> Commerce has initiated the antidumping duty investigation based on the export price, the normal value based on home market price quotes obtained through market research for cigarettes produced in and sold, or offered for sale, in Korea, and the normal value based on the constructed value. Based on comparisons of the export price to the normal value in accordance with sections 772 and 773 of the Act, the estimated dumping margin for 4th tier cigarettes from Korea ranges from 7.10 to 113.06 percent.

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<sup>6</sup> *4th Tier Cigarettes From the Republic of Korea: Initiation of Less-Than-Fair-Value Investigation*; 85 FR 2390, January 15, 2020.

## The subject merchandise

### Commerce's scope

In the current proceeding, Commerce has defined the scope as follows:<sup>7</sup>

*The merchandise covered by this investigation is certain tobacco cigarettes, commonly referred to as "4th tier cigarettes." The subject cigarettes are composed of a tobacco blend rolled in paper, have a nominal minimum total length of 7.0 cm but do not exceed 12.0 cm in total nominal length, and have a nominal diameter of less than 1.3 cm. These sizes of cigarettes are frequently referred to as "Kings" and "100's," but subject merchandise that meets the physical description of the scope is included regardless of the marketing description of the size of the cigarettes. Subject merchandise typically has a tobacco blend that consists of 10% or more tobacco stems.*

*Subject merchandise is typically sold in packs of 20 cigarettes per pack which generally includes the marking "20 Class A Cigarettes" but are included regardless of packaging. 4th tier cigarette packages are typically sold in boxes without a rounded internal corner and without embossed aluminum foil inside the pack.*

*Both menthol and non-menthol cigarettes and cigarettes with or without a filter attached are covered by the scope of this investigation.*

*Merchandise covered by this investigation is currently classified in the Harmonized Tariff Schedule of the United States (HTSUS) under subheading 2402.20.8000. This HTSUS subheading is provided for convenience and customs purposes; the written description of the scope of the investigation is dispositive.*

### Tariff treatment

Based upon the scope set forth by Commerce, information available to the Commission indicates that the merchandise subject to this investigation are imported under statistical reporting number 2402.20.8000 in the following provisions of the Harmonized Tariff Schedule of the United States ("HTS"). The 2019 general rate of duty is \$1.05/kg and 2.3 percent *ad valorem* for HTS subheading 2402.20.80 and may be subject to Federal Excise Tax (26 U.S.C.

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<sup>7</sup> 85 FR 2390, January 15, 2020.

5701). Decisions on the tariff classification and treatment of imported goods are within the authority of U.S. Customs and Border Protection.

## The product

### Description and applications

Cigarettes are combustible tobacco products rolled in paper and delivering nicotine. They may or may not have a filter and are sold in packs of 20 cigarettes in either 100's (100mm) or King's (85mm) lengths.<sup>8</sup> The packaging and lengths are regulated by the U.S. Food and Drug Administration ("FDA").

Cigarettes are sold at a wide range of price levels in the U.S. and can be grouped into four tiers: Premium, Branded Discount, Sub-Generic/Private Label, and 4th Tier.<sup>9</sup> In 2017, four firms, Altria (parent company of Philip Morris USA), Reynolds American Inc. (parent company of R.J. Reynolds and Lorillard Tobacco), ITG Brands ("the majors") and middle-tier producer, Liggett, accounted for roughly 92 percent of domestic sales of all cigarettes.<sup>10</sup> These firms produce cigarettes in tiers 1-3.<sup>11</sup> Four firms, Xcaliber, Cheyenne, Native Trading, and Dosal, produce 4th tier cigarettes in the U.S.<sup>12</sup>

While there is no single definition for a 4th tier cigarette, there is a consensus that 4th tier cigarettes are deeply discounted products. Originally, the National Association of Convenience Stores loosely defined 4th tier cigarettes as belonging to the bottom quartile of prices. Currently, firms self-identify which tier their cigarettes brands are contained in.<sup>13</sup>

4th tier cigarettes may contain a higher percentage of tobacco stems, consisting of 10 to 40 percent tobacco stems compared with non-4th tier cigarettes which typically contain less

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<sup>8</sup> Petition, p. 3; Questionnaire response of \*\*\*.

<sup>9</sup> "NACS Category Definitions." Research Documents, National Association of Convenience Stores, 2018, [www.convenience.org/Research/Documents/NACSCategoryDefinitions.pdf](http://www.convenience.org/Research/Documents/NACSCategoryDefinitions.pdf). Two other organizations, Management Science Associates, Inc. and Euromonitor, group cigarettes into three price tiers.

<sup>10</sup> "Economic Trends in Tobacco." Centers for Disease Control and Prevention, Centers for Disease Control and Prevention, 23 July 2019, [www.cdc.gov/tobacco/data\\_statistics/fact\\_sheets/economics/econ\\_facts/index.htm](http://www.cdc.gov/tobacco/data_statistics/fact_sheets/economics/econ_facts/index.htm).

<sup>11</sup> Conference transcript, p. 14, (Aranoff).

<sup>12</sup> Conference transcript, p. 77, (Pickard).

<sup>13</sup> Phone call with NACS representative, January 13, 2020. Research firms have completed SKU to NACS tier mapping, however due to time constraints Commission staff was unable to obtain this data. (continued...)

than 10 percent stems.<sup>14</sup> Additionally, 4th tier cigarettes typically use a single-component filter while non-4th tier cigarettes may use multi-segmented filters.<sup>15</sup>

Brand loyalty is generally strong in non-4th tier cigarettes while 4th tier cigarettes see lower levels of brand loyalty.<sup>16</sup> All cigarettes are sold through distributors and wholesalers. Historically, 4th tier cigarette producers utilize a unique distribution network who focus primarily on their brands. Non-4th tier cigarette producers also maintain unique distribution networks. While all producers of cigarettes offer rebate programs to distributors and wholesalers, the Majors also offer sales to share programs and Every Day Low Price contracts to retailers.<sup>17</sup>

### ***Regulatory environment***

The manufacture and sale of tobacco products, including cigarettes, in the U.S. is highly regulated. According to the U.S. Food and Drug Administration (“FDA”), any firm that makes, modifies, mixes, manufactures fabricates, assembles, processes, labels, repacks, relabels, or imports any tobacco product is considered a manufacturer. The FDA requires firms to report and pay user fees<sup>18</sup> and register and re-register their establishments and submit product lists, including labeling and advertisements. Manufacturers are also required to submit tobacco health documents and ingredient listings, including quantities of harmful and potentially harmful constituents, on any new products entering the market since June 22, 2009. Furthermore, all packaging and advertisements must include required warning statements.<sup>19</sup> Importers of tobacco products who do not also manufacture or process tobacco products are

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<sup>14</sup> Petition, p. 3.

<sup>15</sup> Petitioner’s post conference brief pp. 5-7

<sup>16</sup> Dawes, John. “Cigarette Brand Loyalty and Purchase Patterns: An Examination Using US Consumer Panel Data.” *Journal of Business Research*, vol. 67, no. 9, 2014, pp. 1933–1943; Questionnaire response of \*\*\*.

<sup>17</sup> Petitioner brief pp. 8-9; Conference transcript p. 25 (Nicholas).

<sup>18</sup> Tobacco user fees are taxes paid to the Alcohol and Tobacco Tax and Trace Bureau at the U.S. Department of the Treasury. In 2018, approximately 86.5 percent of fees were paid by cigarette manufacturers, regardless of tier. Center for Tobacco Products. “Tobacco User Fee Assessment Formulation by Product Class.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/manufacturing/tobacco-user-fee-assessment-formulation-product-class](http://www.fda.gov/tobacco-products/manufacturing/tobacco-user-fee-assessment-formulation-product-class). See also: Bugher, Tim. “TTB: Tobacco Statistics.” TTBGov - Tobacco, [www.ttb.gov/resources/data-statistics/tobacco](http://www.ttb.gov/resources/data-statistics/tobacco).

<sup>19</sup> Center for Tobacco Products. “Manufacturing Tobacco Products.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/compliance-enforcement-training/manufacturing](http://www.fda.gov/tobacco-products/compliance-enforcement-training/manufacturing). (continued...)

not required to register their establishment or products but must comply with all other regulations.<sup>20</sup>

All tobacco products commercially marketed prior to February 15, 2007 are considered “grandfathered tobacco products” and though they are regulated under the Federal Food, Drug, and Cosmetic Act (“FD&C”), they are not considered new tobacco products and therefore not required to obtain premarket authorization.<sup>21</sup> Any product not commercially marketed in the U.S. as of February 15, 2017 is considered a new tobacco product and may only be legally marketed in the U.S. with a marketing order from the FDA. For manufacturers wishing to market a new tobacco product they have three potential pathways. First, producers may submit a Substantial Equivalence (“SE”) report. SE reports may be used by firms to market a new tobacco product that the FDA has determined is substantially equivalent to a predicate product or the SE report shows the new tobacco product does not raise different public health questions.<sup>22</sup> Grandfathered products may serve as predicate tobacco product for use in SE reports.<sup>23</sup> Second, producers may request an exemption from demonstrating substantial equivalence. This pathway is appropriate when the new tobacco product is modifying a previous product by adding or removing a tobacco additive, or by altering the quantity of an existing additive.<sup>24</sup>

If filing an SE report or SE exemption does not apply to a new tobacco product, manufacturers may submit a Premarket Tobacco Product Application (“PMTA”). The FDA will only approve a PMTA if the product is appropriate for the protection of the public health; manufacturing methods, facilities, and controls confirm to regulations issued under section 906(e) (21 U.S.C. 387f(e)) of the FD&C Act; the labeling is not false or misleading; and the

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<sup>20</sup> Center for Tobacco Products. “Importing and Exporting.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/products-guidance-regulations/importing-and-exporting](http://www.fda.gov/tobacco-products/products-guidance-regulations/importing-and-exporting).

<sup>21</sup> Center for Tobacco Products. “Grandfathered Tobacco Products.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/market-and-distribute-tobacco-product/grandfathered-tobacco-products](http://www.fda.gov/tobacco-products/market-and-distribute-tobacco-product/grandfathered-tobacco-products).

<sup>22</sup> Center for Tobacco Products. “Substantial Equivalence.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/market-and-distribute-tobacco-product/substantial-equivalence](http://www.fda.gov/tobacco-products/market-and-distribute-tobacco-product/substantial-equivalence).

<sup>23</sup> Center for Tobacco Products. “Grandfathered Tobacco Products.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/market-and-distribute-tobacco-product/grandfathered-tobacco-products](http://www.fda.gov/tobacco-products/market-and-distribute-tobacco-product/grandfathered-tobacco-products).

<sup>24</sup> Center for Tobacco Products. “Market and Distribute a Tobacco Product.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/products-guidance-regulations/market-and-distribute-tobacco-product](http://www.fda.gov/tobacco-products/products-guidance-regulations/market-and-distribute-tobacco-product).

(continued...)

product complies with tobacco product standards in effect under section 907 (21 U.S.C. 387g) of the FD&C Act.<sup>25</sup>

The sale of cigarettes is also regulated under the Family Smoking Prevention and Tobacco Control Act (“Tobacco Control Act”).<sup>26</sup> Retailers are required to check the photo ID of everyone under the age of 27 and only sell cigarettes and other tobacco products to customers over the legal age limit.<sup>27</sup> Historically, sales of cigarettes have been limited to adults aged 18 years or older. On December 20, 2019, legislation was enacted raising the minimum age of the sale of tobacco products to 21.<sup>28</sup> Retailers also cannot sell cigarettes in a vending machine, give away samples or sell products in amounts smaller than a pack of 20 cigarettes. Additionally, retailers cannot sell flavored cigarettes (except menthol) or tobacco products without a warning statement on the package. Furthermore, retailers must display a warning statement on all advertisements for cigarettes or other tobacco products.<sup>29</sup>

### ***Taxation***

In addition to a highly regulated market, cigarette manufacturers are subject to a variety of state and local taxes, as well as state and federal excise taxes. The federal excise tax rate is \$1.01 per pack while other taxes vary by location. Figure I-1 illustrates excise tax rates by state.

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<sup>25</sup> Center for Tobacco Products. “Applications for Premarket Review of New Tobacco Products.” U.S. Food and Drug Administration, FDA, [www.fda.gov/regulatory-information/search-fda-guidance-documents/applications-premarket-review-new-tobacco-products](http://www.fda.gov/regulatory-information/search-fda-guidance-documents/applications-premarket-review-new-tobacco-products), p. 2.

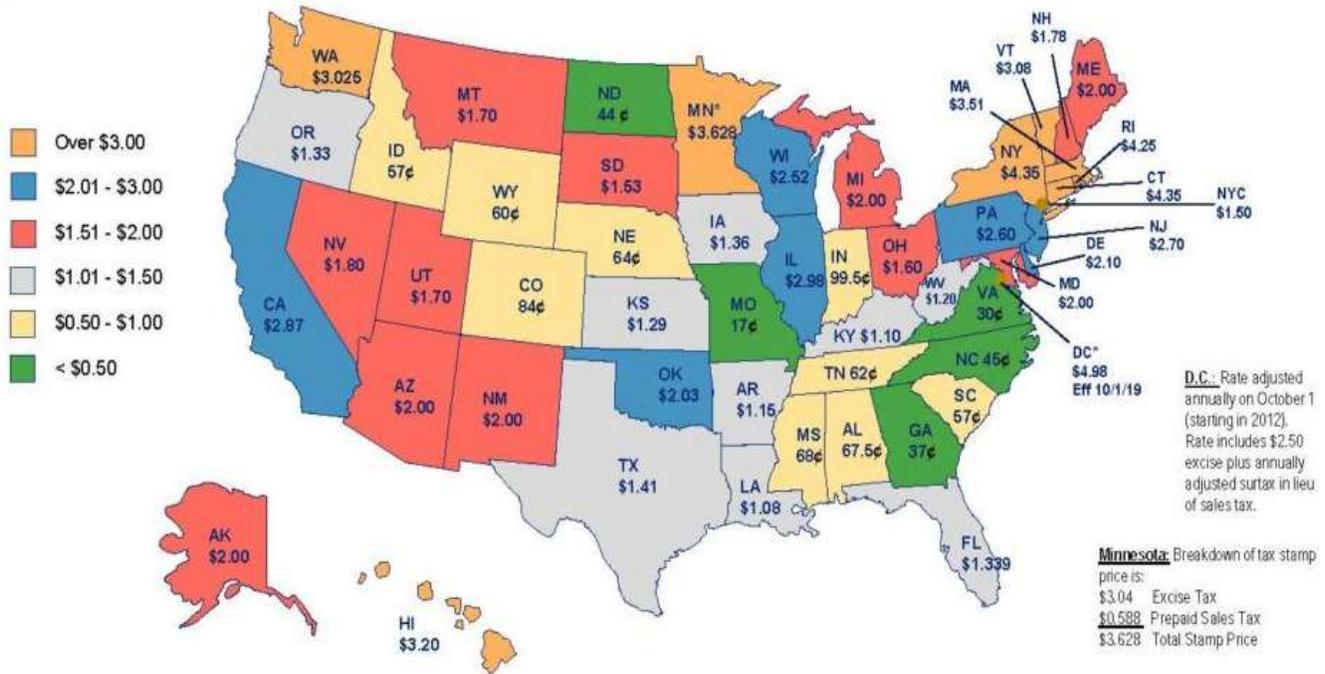
<sup>26</sup> Center for Tobacco Products. “Retailer Regulations and Guidance.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/retailer-regulations-and-guidance](http://www.fda.gov/tobacco-products/retailer-regulations-and-guidance).

<sup>27</sup> Center for Tobacco Products. “Selling Tobacco Products in Retail Stores.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/retail-sales-tobacco-products/selling-tobacco-products-retail-stores](http://www.fda.gov/tobacco-products/retail-sales-tobacco-products/selling-tobacco-products-retail-stores).

<sup>28</sup> Center for Tobacco Products. “Legislation Raises Minimum Age of Sale of Tobacco Products to 21.” U.S. Food and Drug Administration, FDA, 2019, [www.fda.gov/tobacco-products/ctp-newsroom/newly-signed-legislation-raises-federal-minimum-age-sale-tobacco-products-21](http://www.fda.gov/tobacco-products/ctp-newsroom/newly-signed-legislation-raises-federal-minimum-age-sale-tobacco-products-21).

<sup>29</sup> Center for Tobacco Products. “Selling Tobacco Products in Retail Stores.” U.S. Food and Drug Administration, FDA, [www.fda.gov/tobacco-products/retail-sales-tobacco-products/selling-tobacco-products-retail-stores](http://www.fda.gov/tobacco-products/retail-sales-tobacco-products/selling-tobacco-products-retail-stores).

**Figure I-1**  
**4th tier cigarettes: State cigarette excise tax rates per 20-pack, as of August 2019.**



Source: Cigar Association of America, Inc, accessed January 16, 2020.

**Master Settlement Agreement**

In 1998, the tobacco Master Settlement Agreement (“MSA”) settled state litigation against the four (now three) major tobacco companies, as well as 45 smaller tobacco companies, for health care costs and other damages related to cigarette smoking.<sup>30</sup> Forty-six states along with the District of Columbia, Puerto Rico, and four territories are state signatories.<sup>31</sup> The major tobacco companies are considered Original Participating Members (“OPMs”) and the 45 smaller companies are considered Subsequent Participating Members (“SPMs”). OPMs and SPMS agreed to restrict marketing efforts, contribute \$1.5 billion to establish the American Legacy Foundation, and pay billions of dollars to states annually and in

<sup>30</sup> The three major tobacco companies that were the original participating manufacturers are Lorillard, Philip Morris and R.J. Reynolds. Lorillard and R.J. Reynolds are currently both owned by Reynolds American.

<sup>31</sup> Mississippi, Minnesota, Florida, and Texas settled separately with the major tobacco companies. (continued...)

perpetuity.<sup>32</sup> Non-Participating Members (“NPMs”)<sup>33</sup> make payments to each state of \$0.0188482 per unit sold and held in escrow.<sup>34</sup> After 25 years, provided the funds were not used by states to cover cigarette-related costs, the payments would be returned to the NPMs.<sup>35</sup> However, if an NPM’s escrow payments are larger than if they had joined the MSA as an SPM, they receive a refund for the excess amount paid. Historically, this has led to NPMs concentrating sales in a few states.<sup>36</sup>

## **Manufacturing processes**

The primary ingredient in cigarettes is tobacco, grown in the United States primarily in North Carolina, Kentucky, and Virginia due to these states’ mild and sunny climate.<sup>37</sup> Domestic tobacco consists of the brightleaf variety and the burley variety and cigarettes produced in the U.S. are proprietary blends of these types of tobacco along with imported oriental, also known as Turkish, tobacco. Once harvested, the tobacco is cured (dried) and leaf stems and veins are separated from the lamina. The lamina will then be aged for up to two years, mellowing and developing the tobacco flavor. Following the aging process, lamina is further processed and blended for cigarette production. Cigarettes contain a brand-specific blend of the lamina along with reconstituted leaf (“RL”), blended leaf (“BL”), improved stem (“IS”), expanded stem (“ES”), and expanded tobacco (“ET”).

RL is stems, small lamina, and other small particles of tobacco recovered from manufacturing processes. The RL is processed into sheets to resemble lamina. Nicotine levels in RL is 20 to 25 percent lower than nicotine levels in raw tobacco. BL is burley stems and small tobacco particles recovered from tobacco processing. It is ground to a uniform size and then processed into sheets to resemble lamina. IS, ES, and ET are made from tobacco components

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<sup>32</sup> National Association of Attorneys General. “The ABCs of the Tobacco Master Settlement Agreement”. NAAG, [www.naag.org/publications/naagazette/volume\\_1\\_number\\_2/the\\_abcs\\_of\\_the\\_tobacco\\_master\\_settlement\\_agreement.php](http://www.naag.org/publications/naagazette/volume_1_number_2/the_abcs_of_the_tobacco_master_settlement_agreement.php).

<sup>33</sup> Based on the current definition of 4th tier cigarettes, all manufacturers of 4th tier cigarettes are NPMs.

<sup>34</sup> Kan. Stat. § 50-6a03(b)(1); see also Okla. Stat. tit. 37, § 600.23(A)(2).

<sup>35</sup> Conference transcript, p. 90 (Estes); Master Settlement Agreement, pp. 30-39.

<sup>36</sup> Miller, Validity, Construction, Application, and Effect of Master Settlement Agreement (MSA) Between Tobacco Companies and Various States, and State Statutes Implementing Agreement; Use and Distribution of MSA Proceeds, 25 A.L.R. 6th 435, 461n.13 (2007), pp. 464, 469.

<sup>37</sup> Shahbandeh, M. “Leading U.S. States in Tobacco Production, 2018.” Statista, 13 Feb. 2019, [www.statista.com/statistics/192022/top-10-tobacco-producing-us-states/](http://www.statista.com/statistics/192022/top-10-tobacco-producing-us-states/); “Tobacco.” USDA, United States Department of Agriculture, [www.nass.usda.gov/Charts\\_and\\_Maps/A\\_to\\_Z/in-tobacco.php](http://www.nass.usda.gov/Charts_and_Maps/A_to_Z/in-tobacco.php). (continued...)

that have been puffed up to increase volume without increasing weight, resulting in lower costs of production and lower total amounts of tobacco used per cigarette. These expanded products also contain less tar and nicotine than lamina. Following the processing of the lamina, RL, BL, ES, ES, and ET, the components are blended and transported to cigarette manufacturing facilities.<sup>38</sup>

The Majors are typically vertically integrated and process, cut, and blend their own tobacco blends. Smaller cigarette manufacturers, such as tier four manufacturers, typically purchase blended tobacco from primary processors.<sup>39</sup> The blended tobacco is fed into a cigarette making machines where it is rolled in paper to form a continuous cigarette rod. The rod is cut to brand-specific lengths and delivered to tipping machines where filters are applied.<sup>40</sup> Filters can either be single component or multicomponent. A single component filter is made from thin sheets of cellulose acetate whereas a multicomponent filter consists of additions such as activated carbon.<sup>41</sup> The finished cigarettes are then packaged and shipped to customers.<sup>42</sup>

In the U.S., 4th tier cigarettes are produced in Florida, New York, North Carolina, and New York.<sup>43</sup> The Majors maintain production facilities near their primary processing operations in North Carolina and Virginia.<sup>44</sup>

## **Domestic like product issues**

The Commission's decision regarding the appropriate domestic product(s) that are "like" the subject imported product is based on a number of factors including: (1) physical characteristics and uses; (2) interchangeability; (3) channels of distribution; (4) common manufacturing facilities, production processes, and production employees; (5) customer and

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<sup>38</sup> Philip Morris. How Cigarettes Are Made. YouTube, 2013, [youtu.be/8vBtq8-Snm8](https://youtu.be/8vBtq8-Snm8).

<sup>39</sup> Conference transcript, pp. 19-20, (Phillips). Respondent firm, KT&G is a vertically integrated 4th tier producer.

<sup>40</sup> Conference transcript, pp. 20-22 (Phillips); Philip Morris. How Cigarettes Are Made. YouTube, 2013, [youtu.be/8vBtq8-Snm8](https://youtu.be/8vBtq8-Snm8). While the basic production process is the same, tier four producers in the U.S. tend to manufacture cigarettes on older, less efficient machinery and run fewer machines at a time. Post conference brief.

<sup>41</sup> Conference transcript, pp. 18-19 (Phillips).

<sup>42</sup> Conference transcript, p. 22 (Phillips).

<sup>43</sup> Conference transcript, p. 121 (Pickard).

<sup>44</sup> "Who We Are." PMI, [www.pmi.com/who-we-are/overview](http://www.pmi.com/who-we-are/overview); "About Us." R.J. Reynolds Tobacco Company, [www.rjrt.com/transforming-tobacco/](http://www.rjrt.com/transforming-tobacco/); "ITG Brands to Close NC Cigarette Plant, Eliminating 110 Jobs." Industrial Equipment News (IEN) &nbsp;, 22 Oct. 2019, [www.ien.com/operations/news/21093391/itg-brands-to-close-nc-cigarette-plant-eliminating-110-jobs](http://www.ien.com/operations/news/21093391/itg-brands-to-close-nc-cigarette-plant-eliminating-110-jobs). (continued...)

producer perceptions; and (6) price. The petitioner proposes a single like product, co-extensive with the scope.<sup>45</sup> Respondents argue in its post conference brief that the domestic like product that is coextensive with scope is already expanded far beyond the so-called 4th tier.<sup>46</sup> Appendix D presents a summary of U.S. producers' and U.S. importers' responses on the comparability of 4<sup>th</sup> tier cigarettes versus all other cigarettes and full narrative responses to the questions on the comparability of these products.

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<sup>45</sup> Conference transcript, p. 25.

<sup>46</sup> Respondents' postconference brief, p. 7.

## **Part II: Conditions of competition in the U.S. market**

### **U.S. market characteristics**

Fourth tier cigarettes are tobacco cigarettes rolled in paper ranging in from 7.0 cm and 12.0 cm in length. Like other types of cigarettes, 4th tier cigarettes are generally sold in packs of 20 cigarettes or in cartons consisting of 10 packs of cigarettes, totaling 200 cigarettes. Fourth tier cigarettes are distinguished from other types of cigarettes by the stem content of the tobacco. Fourth tier cigarette tobacco typically consists of 10-40 percent tobacco stems while non-4th tier cigarette tobacco consists of less than 10 percent tobacco stems.

Apparent U.S. consumption of 4th tier cigarettes increased from January 2016 to December 2018. Overall, apparent U.S. consumption in 2018 was \*\*\* percent higher than in 2016.

All U.S. producers (3 of 3) and all importers (4 of 4) indicated that there had been no significant changes in the product range, mix, or marketing of 4th tier cigarettes since January 1, 2016.

### **Channels of distribution**

U.S. producers sold over \*\*\* percent of 4th tier cigarettes to distributors during the period of investigation and the remainder to retailers. Only one responding U.S. producer, \*\*\*, reported selling 4th tier cigarettes to retailers. \*\*\* decreased sales of 4th tier cigarettes to retailers but increased sales to distributors from 2016 to 2018 while other U.S. producers increased or maintained their sales. This caused the proportion of 4th tier cigarettes sold to retailers to decrease from 2016 to 2018. This trend of decreased sales has continued into the interim of 2019, even though the number of cartons \*\*\* has sold to retailers and distributors has increased. Increased sales by U.S. producer \*\*\* to distributors have decreased the relative share of total shipment that U.S. producers sell to retailers. Importers sold \*\*\* their 4th tier cigarettes to distributors throughout the period, as shown in table II-1. Neither \*\*\* reported selling 4th tier cigarettes directly to end users.

**Table II-1**

**4th tier cigarettes: U.S. producers' and importers' U.S. shipments, by sources and channels of distribution, 2016-18, January to September 2018, and January to September 2019**

\* \* \* \* \*

Note.--Shares and ratios shown as "0.0" represent values greater than zero, but less than "0.05" percent.

Source: Compiled from data submitted in response to Commission questionnaires.

## Geographic distribution

U.S. producers and the subject importer reported distributing some portion of their sales to all regions of the contiguous United States. However, U.S. producers reported that over \*\*\* percent of their sales were in the Midwestern and Southeastern regions of the United States while the Northeastern and Pacific Coast regions accounted for less than \*\*\* percent of total sales (table II-2). While U.S. producers' distribution of sales overlap, some regions of the United States have one dominant U.S. producer that supplied the majority of sales to the region's market. U.S. producer \*\*\* supplied \*\*\* percent of the U.S.-produced 4th tier cigarettes sold in the Southeast region. U.S. producer \*\*\* supplied the Central Southwest region with \*\*\* percent of U.S.-produced 4th tier cigarettes, the Mountains region with \*\*\* percent, and the Pacific coast with \*\*\* percent. The Midwest and Northeast regions are supplied by two U.S. producers, \*\*\*, who supplied \*\*\* percent and \*\*\* percent of U.S.-produced 4th tier cigarettes to the Midwest and \*\*\* percent and \*\*\* percent to the Northeast respectively. The distribution of sales for importers is less concentrated than U.S. producers. \*\*\* reported that the Midwestern and the Southeastern regions accounted for just over half of its sales, while the Central Southwestern region made up over \*\*\* percent of \*\*\*'s sales and the Pacific Coast region accounted for over \*\*\* percent (table II-2). For U.S. producers, \*\*\* percent of sales were within 100 miles of their production facility, \*\*\* percent were between 101 and 1,000 miles, and \*\*\* percent were over 1,000 miles. \*\*\* sold \*\*\* percent within 100 miles of their U.S. point of shipment, \*\*\* percent between 101 and 1,000 miles, and \*\*\* percent over 1,000 miles.

**Table II-2**  
**4th tier cigarettes: Share of geographic market areas in the United States served by U.S. producers and U.S. importers**

Region	U.S. producers	Importers
Northeast	***	***
Midwest	***	***
Southeast	***	***
Central Southwest	***	***
Mountain	***	***
Pacific Coast	***	***
Other	***	***
All regions (except Other)	100.0	100.0
Reporting firms	100.0	100.0

<sup>1</sup>Note: All other U.S. markets, including AK, HI, PR, and VI.

Source: Compiled from data submitted in response to Commission questionnaires.

## Supply and demand considerations

### U.S. supply

Table II-3 provides a summary of the supply factors regarding 4th tier cigarettes from the United States and Korea.

**Table II-3**  
**4th tier cigarettes: U.S. and foreign industry factors that affect ability to increase shipments to the United States**

Item	2016	2018	2016	2018	2016	2018	Shipments by market in 2018 (percent)		Able to shift to alternate products
	Capacity (1,000 cartons)		Capacity utilization (percent)		Inventories as a ratio to total shipments (percent)		Home market shipments	Exports to non-U.S. markets	No. of firms reporting "yes"
United States	***	***	***	***	***	***	***	***	3 of 3
Korea	***	***	***	***	***	***	***	***	***

Note: Responding U.S. producers accounted for over 50 percent of U.S. production of 4th tier cigarettes in 2018. Responding foreign producer/exporter firms accounted for over 75 percent of U.S. imports of 4th tier cigarettes from Korea during 2018. For additional data on the number of responding firms and their share of U.S. production and of U.S. imports from each subject country, please refer to Part I, "Summary Data and Data Sources."

Source: Compiled from data submitted in response to Commission questionnaires.

### Domestic production

Based on available information, U.S. producers of 4th tier cigarettes have the ability to respond to changes in demand with large changes in the quantity of shipments to the U.S. market. The main contributing factors to this degree of responsiveness of supply are the availability of unused capacity, low-to-moderate inventory levels, and the ability to shift production away from producing other products to 4th tier cigarettes. The main limiting factor to this degree of responsiveness is that U.S. producers have no substantial ability to divert shipments from other markets.

Domestic capacity to produce 4th tier cigarettes increased faster than U.S. production of 4th tier cigarettes from 2016 to 2018, leading capacity utilization to decline during this time. U.S. producers' inventories increased from 2016 to 2018. All responding U.S. producers (3 of 3) stated that they could switch production from other products to 4th tier cigarettes. U.S. producers reportedly can produce filtered cigars and non-4th tier cigarettes on the same high-speed cigarette makers used to produce 4th tier cigarettes. U.S. producers reported that the factors affecting their ability to shift production from alternate products include adjusting and

reconfiguring machinery, the cost of leaving machinery idle while changes to production were made, and the labor cost to clean and reconfigure equipment. One U.S. producer, \*\*\*, reported that each time the machines were turned over, the change \*\*\* of labor and lost production costs.

### **Subject imports from Korea**

Based on available information, \*\*\* has the ability to respond to changes in demand with moderate changes in the quantity of shipments to the U.S. market. The main contributing factors to this degree of responsiveness of supply are a considerable ability to divert shipments from other markets, some available capacity, and low-to-moderate inventories. \*\*\* reported that it \*\*\* shift production from other products to 4th tier cigarettes, which restricts the responsiveness of supply.

\*\*\*'s total reported Korean capacity to produce 4th tier cigarettes was more than \*\*\* times the total capacity reported by U.S. producers in 2018. Korean imports accounted for \*\*\* percent of U.S. apparent consumption of 4th tier cigarettes in 2018. \*\*\* reported capacity and capacity utilization decreased from 2016 to 2018. \*\*\*'s inventories increased over the period. The Korean producer reported \*\*\* percent shipments of 4th tier cigarettes to export markets other than the United States in 2018.

### **Imports from nonsubject sources**

In terms of quantity, imports of 4th tier cigarettes from nonsubject sources to the United States decreased from 2016 to 2018. In terms of value, imports of 4th tier cigarettes from nonsubject sources to the United States decreased from 2016 to 2018. Imports from nonsubject sources were \*\*\* percent of total imports in terms of quantity and \*\*\* percent of total imports in terms of value in 2018.<sup>1</sup>

### **Supply constraints**

All responding U.S. producers reported no supply constraints. The majority of responding importers (3 of 4) did not report any supply constraints. Importer \*\*\* reported that supply constraints are caused by logistical difficulties such as shipping delays and port strikes.

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<sup>1</sup> Staff was unable to identify imports of 4th tier cigarettes from individual nonsubject countries.

## **U.S. demand**

Based on available information, the overall demand for 4th tier cigarettes is likely to experience small-to-moderate changes in response to changes in price. Price increases across all types of cigarettes decreases cigarette consumption. Furthermore, price increases of 4th tier cigarettes increase above the price of other cigarettes, may cause consumers of 4th tier cigarettes to purchase higher quality non-4th tier cigarettes. However, cigarettes are addictive and changes in prices have limited impact on demand.

## **Business cycles**

The majority of U.S. producers (2 of 3) and the majority of importers (3 of 4) indicated that the market was not subject to business cycles or conditions of competition. Half of responding U.S. producers (1 of 2) reported that business cycles or conditions of competition had changed since 2016. U.S. producer \*\*\* reported that electronic nicotine delivery systems (ENDS) which are commonly known as vapes or E-cigs changed the conditions of competition since 2016. No importers reported that the conditions on competition had changed since 2016.

## **Demand trends**

Most U.S. producers reported that U.S. demand for 4th tier cigarettes increased since January 1, 2016. Most importers reported that U.S. demand for 4th tier cigarettes had decreased since January 1, 2016 (Table II-4). U.S. producer \*\*\* reported that pricing and economic factors had caused demand for 4th tier cigarettes to fluctuate. One importer, \*\*\*, reported that U.S. demand for 4th tier cigarettes had not changed since January 1, 2016. Importer \*\*\* reported that marketing studies by Euromonitor and studies conducted by the Center for Disease Control indicate that U.S. demand for all cigarettes is decreasing and demand for “economy brand” cigarettes is also decreasing. It also reported that the size of the U.S. tobacco market will continue to decrease in the future. Even though the majority of U.S. producers (2 of 3) reported that differences in state and local taxes did not cause any divergence in demand. The largest producer ( \*\*\*) reported that they did.

**Table II-4****4th tier cigarettes: Firms' perceptions regarding demand in the United States and outside of the United States**

Item	Number of firms reporting			
	Increase	No change	Decrease	Fluctuate
Demand inside the United States:				
U.S. producers	2	---	---	1
Importers	---	1	3	---
Demand outside the United States:				
U.S. producers	---	---	---	1
Importers	---	1	2	---

Source: Compiled from data submitted in response to Commission questionnaires.

**Regulations**

The majority of responding U.S. producers (2 of 3) and the majority of responding importers (3 of 4) reported that U.S. regulation of tobacco products had not changed their firms desire or ability to sell 4th tier cigarettes in the United States. U.S. producer \*\*\* reported that increased FDA oversight, increased taxes, Master Settlement Agreement charges, and Nonparticipating manufacturer fees had negatively impacted their sales. Importer \*\*\* reported that tax increases on the state level lead to a price increased and decreased demand. One U.S. producer, \*\*\*, reported barriers to entry to markets outside of the United States in the form of duties, taxes, and other regulatory issues.

**Brand loyalty**

All U.S. producers reported that while consumers of non-4th tier cigarettes were brand conscious and usually do not switch brands, consumers of 4th tier cigarettes typically smoke multiple brands and are price sensitive when making their purchasing decisions. All importers reported that brand loyalty was not high among consumers of 4th tier cigarettes. Importer \*\*\* reported that consumers request the cheapest product in the store. Importer \*\*\* reported that a survey conducted in August 2019 indicated that \*\*\* percent of consumers of premium brands of cigarettes had previously searched for the cheapest products, \*\*\* percent of participants responded that they had smoked secondary brands at some point, and \*\*\* percent of participants who reported that they smoke secondary brands when they don't have the financial ability to buy the main brands.

## **Substitute products**

All responding U.S. producers (3 of 3) and one importer, \*\*\*, reported that there were no substitutes for 4th tier cigarettes. The other importer, \*\*\*, reported that all combustible cigarettes were interchangeable. The majority of U.S. producers (2 of 3) reported that smoking alternatives, such as ENDS, has not affected the demand for 4th tier cigarettes. U.S. producer \*\*\* reported that smoking alternatives had a negative impact on other cigarette tiers but that they had not seem any impact on the 4th tier market. U.S. producer \*\*\* reported that some combustible cigarette consumers have changed to ENDS.

## **Substitutability issues**

The degree of substitution between domestic and imported 4th tier cigarettes depends upon such factors as relative prices, quality (e.g., grade standards, defect rates, etc.), and conditions of sale (e.g., price discounts/rebates, lead times between order and delivery dates, reliability of supply, product services, etc.). Based on available data, staff believes that there is a high degree of substitutability between domestically produced 4th tier cigarettes and 4th tier cigarettes imported from Korea.

## **Lead times**

U.S. producers reported \*\*\* percent of their commercial shipments came from inventories, with lead times averaging \*\*\* days. \*\*\* reported sourcing \*\*\* percent of sales from U.S. inventories with lead times averaging \*\*\* days.

## **Factors affecting purchasing decisions**

Purchasers responding to lost sales lost revenue allegations<sup>2</sup> were asked to identify the main purchasing factors their firm considered in their purchasing decisions for 4th tier cigarettes. A majority of purchasers (5 of 8) reported that price or consumer demand for a low-cost cigarette was an important factor in their purchasing decisions. Additionally, three purchasers listed quality as an important purchasing factor, three listed marketing requirements or programs, two listed availability, and one listed consistency.

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<sup>2</sup> This information is compiled from responses by purchasers identified by Petitioners. See Part V for additional information.

## Comparison of U.S.-produced and imported 4th tier cigarettes

In order to determine whether U.S.-produced 4th tier cigarettes can generally be used in the same applications as imports from Korea, U.S. producers and importers were asked whether the products can always, frequently, sometimes, or never be used interchangeably. As show in table II-5, all responding U.S. producers and importers reported that 4th tier cigarettes from the United States, Korea, and nonsubject countries were “always” or “frequently” interchangeable.

**Table II-5**  
**4th tier cigarettes: Interchangeability between product produced in the United States and in other countries, by country pair**

Country pair	U.S. producers				U.S. importers			
	A	F	S	N	A	F	S	N
United States vs. Korea	2	1	---	---	2	2	---	---
United States vs. Other	2	1	---	---	1	3	---	---
Korea vs. Other	1	1	---	---	1	3	---	---

Note.—A=Always, F=Frequently, S=Sometimes, N=Never.

Source: Compiled from data submitted in response to Commission questionnaires.

All responding U.S. producers reported that factors other than price are “sometimes” or “never” significant when comparing 4th tier cigarettes produced in the United States, Korea, and nonsubject countries. U.S. producer \*\*\* reported that its inventory was consistently and reliably available for purchase and its staff was available to aid consumers. All importers reported that factors other than price are “always” or “frequently” significant when comparing 4th tier cigarettes produced in the United States, Korea, and nonsubject countries (table II-6). Importer \*\*\* reported that while prices can incentivize consumers to try a certain product, it is not an absolute factor in consumers decision to buy main or secondary brands. Importer \*\*\* reported that the Nielsen consumer survey found that “fulfillment” was the most important factor for purchasers of cigarettes, price was the second most important factor, followed by taste, convenience, flavor, product type, the filter and/or cigarette paper used, and brand.

**Table II-6**

**4th tier cigarettes: Perceived importance of factors other than price between product produced in the United States and in other countries, by country pair**

Country pair	U.S. producers				U.S. importers			
	A	F	S	N	A	F	S	N
United States vs. Korea	---	---	1	2	1	2	---	---
United States vs. Other	---	---	1	2	1	2	---	---
Korea vs. Other	---	---	1	1	1	2	---	---

Note.—A=Always, F=Frequently, S=Sometimes, N=Never.

Source: Compiled from data submitted in response to Commission questionnaires.

## Part III: U.S. producers' production, shipments, and employment

The Commission analyzes a number of factors in making injury determinations (see 19 U.S.C. §§ 1677(7)(B) and 1677(7)(C)). Information on the dumping margins was presented in *Part I* of this report and information on the volume and pricing of imports of the subject merchandise is presented in *Part IV* and *Part V*. Information on the other factors specified is presented in this section and/or *Part VI* and (except as noted) is based on the questionnaire responses of three firms that accounted for the vast majority of U.S. production of 4th tier cigarettes during 2018.

### U.S. producers

The Commission issued a U.S. producer questionnaire to four firms based on information contained in the petition, and three additional firms found through staff research. Three firms provided usable data on their productive operations.<sup>1</sup> Staff believes that these responses represent most of the U.S. production of 4th tier cigarettes.<sup>2</sup>

Table III-1 lists U.S. producers of 4th tier cigarettes, their production locations, positions on the petition, and shares of total production.

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<sup>1</sup> Staff received incomplete or unusable questionnaire responses from \*\*\*. These submissions were missing all or part of the requested trade, financial, and pricing data, and therefore are not included in this section or any other section of this report unless otherwise noted.\*\*\*.\*\*\*.

<sup>2</sup> Staff additionally sent U.S. producer questionnaires to the majors,\*\*\*.

**Table III-1**

**4th tier cigarettes: U.S. producers of 4th tier cigarettes, their positions on the petition, production locations, and shares of reported production, 2018**

Firm	Position on petition	Production location(s)	Share of production (percent)
Cheyenne	Petitioner	Grover, NC	***
Dosal	***	Opa Locka, FL	***
Xcaliber	Petitioner	Pryor, OK	***
Total			***

Source: Compiled from data submitted in response to Commission questionnaires.

Table III-2 presents information on U.S. producers' ownership, related and/or affiliated firms of 4th tier cigarettes.

**Table III-2**

**4th tier cigarettes: U.S. producers' ownership, related and/or affiliated firms**

\* \* \* \* \*

Table III-3 presents important industry events for 4th tier cigarettes, since January 1, 2016.

**Table III-3**

**4th tier cigarettes: important industry events, since January 1, 2016**

Date		Company / Item	Action
Year	Month		
2016	May	Xcaliber	Xcaliber announced plans to acquire 4 <sup>th</sup> tier cigarette manufacturer Tantus Brands. <sup>1</sup>
2016	June	S&M Brands	S&M brands filed a lawsuit against the Attorney General of the State of North Carolina, Claiming it had made payments into its escrow account in excess of its obligations, and requesting a refund. An amended complaint was filed on September 26, 2017. <sup>2</sup>
2016	September	Sandia	Sandia Tobacco of New Mexico filed a voluntary petition under Chapter 11 of the Bankruptcy Code in September 2016. <sup>3</sup>
2017	May	Xcaliber	Announced purchase of a new cigarette manufacturing line with a rated speed of 10,000 cigarettes per minutes. Xcaliber expected to have line operational by November 2017. <sup>4</sup>
2018		Dosal Tobacco	Dosal Tobacco opened an Export & International Sales division in 2018 in an effort to expand internationally. <sup>5</sup>
2019	March	S&M Brands	S&M Brands was sold to an undisclosed buyer, shutting down operations in March 2019 and laying off 50 employees. <sup>6</sup>

Table continued on next page.

**Table III-3--Continued**

**4th tier cigarettes: important industry events, since January 1, 2016**

<sup>1</sup> “Xcaliber to acquire Tantus Brands” The Tobacco Wire, May 6, 2016. Accessed January 17, 2020. <https://www.tobaccoreporter.com/2016/05/xcaliber-to-acquire-tantus-predicate-brands/>

<sup>2</sup> S&M Brands, Inc. V. Stein, 2018 NBC 26. Accessed January 17, 2020. <https://www.nccourts.gov/documents/business-court-opinions/sm-brands-inc-v-stein-2018-ncbc-26>

<sup>3</sup> Mem. Op.; *In re Sandia Tobacco Mfrs., Inc.*, No. 16-12335-jl 1 (D.N.M. July 26, 2019), ECF No. 485, [https://www.govinfo.gov/app/details/USCOURTS-nmb-1\\_16-bk-12335/USCOURTS-nmb-1\\_16-bk-12335-2](https://www.govinfo.gov/app/details/USCOURTS-nmb-1_16-bk-12335/USCOURTS-nmb-1_16-bk-12335-2)

<sup>4</sup> Xcaliber International "Xcaliber International Announces Purchase of New Cigarette Manufacturing Line" Cision PR Newswire. May 24, 2017. Accessed January 17, 2020. <https://www.abqjournal.com/874125/feds-sue-sandia-tobacco-for-4-7m.html>

<sup>5</sup> Dosal Tobbaco, Company profile. Accessed January 17, 2020, <http://www.dosal.com/company-profile>

<sup>6</sup> “S&M Brands Sells Three Lines - Cigarette Manufacturing Ceases at Keysville Facility”, Southside Messenger. (Mar. 14, 2019), <http://southsidemessenger.com/sm-brands-sells-three-lines-cigarette-manufacturing-ceases-at-keysville-facility/>; “S&M Brands sold, operation shuttered”, South Boston News & Record and Mecklenburg Sun (Mar. 13, 2019), [http://www.sovanow.com/index.php?/news/article/sm\\_brands\\_sold\\_operation\\_shuttered/](http://www.sovanow.com/index.php?/news/article/sm_brands_sold_operation_shuttered/).

Table III-4 presents U.S. producers’ reported changes in operations since January 1, 2016.

**Table III-4**

**4th tier cigarettes: U.S. producers’ reported changes in operations, since January 1, 2016**

\* \* \* \* \*

**U.S. production, capacity, and capacity utilization**

Table III-5 and figure III-1 present U.S. producers’ production, capacity, and capacity utilization for 2016-18, and the January-September (interim) periods in 2018 and 2019. U.S. producers’ capacity increased by \*\*\* percent from 2016 to 2018, but it was lower by \*\*\* percent in interim 2019 than interim 2018.<sup>3</sup> Total production increased by \*\*\* percent from

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<sup>3</sup> At the Commission’s conference, an Xcaliber employee indicated that the U.S. domestic manufacturers have the capacity to produce all 4th tier cigarettes in the United States from a capacity standpoint. Conference transcript, p. 71 (Smith).

(continued...)

2016 to 2018, and it was higher in interim 2019 than interim 2018 by \*\*\* percent.<sup>45</sup> Capacity utilization decreased by \*\*\* percentage points from 2016 to 2018, but it was higher by \*\*\* percentage points in interim 2019 than in interim 2018.

**Table III-5**  
**4th tier cigarettes: U.S. producers' production, capacity, and capacity utilization, 2016-18, January to September 2018, and January to September 2019**

Firm	Calendar year			January to September	
	2016	2017	2018	2018	2019
<b>Capacity (cartons)</b>					
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
All firms	***	***	***	***	***
<b>Production (cartons)</b>					
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
All firms	***	***	***	***	***
<b>Capacity utilization (percent)</b>					
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
All firms	***	***	***	***	***
<b>Share of production (percent)</b>					
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
All firms	100.0	100.0	100.0	100.0	100.0

Source: Compiled from data submitted in response to Commission questionnaires.

<sup>4</sup> Prior to its shutdown in March 2019, S&M Brands indicated \*\*\*. Email message from \*\*\*, January 8, 2020.

<sup>5</sup> \*\*\* indicated that it had an overall production capacity of \*\*\*. \*\*\*, U.S producer questionnaire response, section II-7.

**Figure III-1**

**4th tier cigarettes: U.S. producers' production, capacity, and capacity utilization, 2016-18, January to September 2018, and January to September 2019**

\* \* \* \* \*

**Alternative products**

As shown in table III-6, approximately \*\*\* percent of the product produced during 2016-18 by U.S. producers was 4th tier cigarettes. U.S. producers of 4th tier cigarettes are able to produce products other than 4th tier cigarettes on their production lines. Two firms (\*\*\*) reported producing cigars. Total production increased by \*\*\* percent during 2016-18, and was higher in interim 2019 than during interim 2018. Overall capacity utilization decreased by \*\*\* percentage points during 2016-18, but it was higher during interim 2019 than during interim 2018. Overall capacity increased by \*\*\* percent from 2016 to 2017, but \*\*\*.

**Table III-6**

**4<sup>th</sup> tier cigarettes: U.S. producers' overall plant capacity and production on the same equipment as subject production, 2016-18, January to September 2018, and January to September 2019**

\* \* \* \* \*

**U.S. producers' U.S. shipments and exports**

Table III-7 presents U.S. producers' U.S. shipments, export shipments, and total shipments for 2016-18, January to September 2018, and January to September 2019. From 2016 to 2018, the quantity of U.S. shipments increased by \*\*\* percent and were higher by \*\*\* percent in interim 2019 than interim 2018. During 2016-18, the value of U.S. shipments increased by \*\*\* percent and were higher by \*\*\* percent during interim 2019 than in interim 2018. The unit values for total shipments increased by \*\*\* during 2016-18 but were lower by \*\*\* during interim 2019 than in interim 2018. From 2016 to 2018, U.S. producers' export shipments were \*\*\* and decreased by \*\*\* percent based on quantity and \*\*\* based on value, respectively.<sup>6,7</sup> Export shipments were lower interim 2019 than in interim 2018 based on quantity and value. Export

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<sup>6</sup> \*\*\*. Email message from \*\*\*, January 15, 2020.

<sup>7</sup> \*\*\*. \*\*\* U.S. producer questionnaire response, section II-7.

shipment unit values were \*\*\*. The difference in unit values of U.S. shipments and export shipments is \*\*\*. This can be largely attributed to the U.S. regulatory framework.

**Table III-7**  
**4th tier cigarettes: U.S. producers' U.S. shipments, exports shipments, and total shipments, 2016-18, January to September 2018, and January to September 2019**

\* \* \* \* \*

## **U.S. producers' inventories**

Table III-8 presents U.S. producers' end-of-period inventories and the ratio of these inventories to U.S. producers' production, U.S. shipments, and total shipments for 2016-18, January to September 2018, and January to September 2019. These data show that U.S. producers' inventories increased by \*\*\* percent during 2016-18 and were higher by \*\*\* percent during interim 2019 compared to interim 2018.<sup>8</sup> The ratios of inventories to

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<sup>8</sup> Based on the three U.S. producers' combined questionnaire responses, \*\*\*. Cheyenne, Dosal, and Xcaliber's questionnaire responses, section II-7.

production, U.S. shipments, and total shipments all increased irregularly during 2016-18, but were lower during interim 2019 compared to interim 2018.

**Table III-8**  
**4th tier cigarettes: U.S. producers' inventories, 2016-18, January to September 2018, and January to September 2019**

\* \* \* \* \*

## **U.S. producers' imports and purchases**

U.S. producers indicated that they did not import and purchase of 4th tier cigarettes at any point dating back to January 1, 2016.

## **U.S. employment, wages, and productivity**

Table III-9 shows U.S. producers' employment-related data.<sup>9 10</sup> These data show that U.S. producers' PRWs, total hours worked, hours per PRW, wages paid, and hourly wages all increased during 2016-18 and were higher during interim 2019 compared to 2018. Productivity decreased by \*\*\* percent during 2016-18, and was lower by \*\*\* percent during interim 2019 compared to interim 2018. Unit labor costs (dollars per carton) increased by \*\*\* from 2016 to 2018, and were higher during interim 2019 compared to interim 2018.

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<sup>9</sup> \*\*\*.\*\*\*.

<sup>10</sup> S&M Brands Inc. closed in early 2019 and the majority of its 87 employees have been laid off. Petition, exhibit 21.

**Table III-9**

**4th tier cigarettes: Average number of production and related workers, hours worked, wages paid to such employees, hourly wages, productivity, and unit labor costs, 2016-18, January to September 2018, and January to September 2019**

\* \* \* \* \*

## Part IV: U.S. imports, apparent U.S. consumption, and market shares

### U.S. importers

The Commission issued importer questionnaires to 35 firms believed to be importers of subject 4th tier cigarettes, as well as to all U.S. producers of 4th tier cigarettes.<sup>1</sup> Usable questionnaire responses were received from four companies. As discussed in Part I, U.S. import data are based on the questionnaire responses of the four firms that submitted useable U.S. importers questionnaires representing \*\*\* U.S. imports from Korea, \*\*\* percent of U.S. imports from nonsubject sources, and \*\*\* percent of total U.S. imports, based on quantity in 2018 under HTS statistical reporting number 2402.20.8000, and as a ratio of U.S. importer questionnaire data to official U.S. import statistics.<sup>2</sup> Table IV-1 lists all responding U.S.

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<sup>1</sup> The Commission issued questionnaires to those firms identified in the petition, along with firms that, based on a review of data provided by U.S. Customs and Border Protection (“Customs”), may have accounted for more than one percent of total imports under HTS statistical reporting number 2402.20.8000 in 2018. One firm \*\*\* indicated it did not import 4th tier cigarettes.

<sup>2</sup> The Commission received U.S. importer questionnaire responses from three nonsubject importers, which included Native Wholesale Supply, Lake Erie Tobacco, and Tabacosusa. \*\*\*. These two firms combined imports of 4th tier cigarettes represented approximately \*\*\* percent of all U.S. imports from \*\*\* in 2018. \*\*\* is a U.S. importer that brought in its 4th tier cigarettes \*\*\* U.S. imports of 4th tier cigarettes from \*\*\* in 2018. Nonsubject importer coverage may include a sizeable amount of imports of out-of-scope cigarettes under HTS statistical reporting number 2402.20.8000, and therefore the \*\*\* percent coverage of nonsubject imports during 2018 are likely understated.

importers of 4th tier cigarettes from Korea and other sources, their locations, and their shares of U.S. imports, in 2018.<sup>3 4</sup>

**Table IV-1**  
**4th tier cigarettes: U.S. importers, their headquarters, and share of total imports by source, 2018**

Firm	Headquarters	Share of imports by source (percent)		
		Korea	Nonsubject sources	All import sources
KT&G	Plano, TX	***	***	***
Lake Erie	Kill Buck, NY	***	***	***
Native Wholesale	Perrysburg, NY	***	***	***
Tabacosusa	Easton, PA	***	***	***
Total		***	***	***

Note.--Shares and ratios shown as "0.0" represent values greater than zero, but less than "0.05" percent.

Source: Compiled from data submitted in response to Commission questionnaires.

## U.S. imports

Table IV-2 and figure IV-1 present data for U.S. imports of 4th tier cigarettes from Korea and all other sources for 2016-18, January to September 2018, and January to September 2019. From 2016 to 2018, U.S. imports of 4th tier cigarettes from subject sources increased by \*\*\* percent, and were \*\*\* percent higher during interim 2019 compared to interim 2018. The average unit value of U.S. imports of 4th tier cigarettes from Korea fell by \*\*\* during 2016-18, and was lower by \*\*\* during interim period 2019 compared to interim period 2018.

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<sup>3</sup> \*\*\* completed a U.S. importer questionnaire, but its response was not included. \*\*\* indicated that "\*\*\*\*."\*\*\* indicated that it had imported \*\*\*\*.\*\*\*, U.S. importer questionnaire response, sections II-5a, II-7 and II-8.

<sup>4</sup> \*\*\* did not provide an importers' questionnaire response, but reported that it imported \*\*\* of 4th tier cigarettes in 2018. \*\*\* indicated that \*\*\* further indicated the cigarettes that his company imports are from \*\*\*. Email message from \*\*\*, January 15, 2020.

As a share of both quantity and value, U.S. imports from Korea accounted for \*\*\* percent and \*\*\* percent of total imports, respectively during 2018. As a share of the quantity of all imports of 4th tier cigarettes, imports from Korea increased by \*\*\* percentage points during 2016-18, and were \*\*\* percentage points higher in interim 2019 compared to interim 2018. As a share of value of all imports of 4th tier cigarettes, imports from Korea decreased by \*\*\* percentage points during 2016-18, but were \*\*\* percentage points higher during interim 2019 compared to interim 2018.

From 2016 to 2018, U.S. imports of 4th tier cigarettes from nonsubject sources increased by approximately \*\*\* percent based on quantity and \*\*\* percent based on value, and were \*\*\* percent and \*\*\* percent, respectively higher during interim 2019 compared to interim 2018. The average unit value for nonsubject imports of 4th tier cigarettes decreased by \*\*\* during 2016-18, and were \*\*\* in the interim period of 2019 compared to 2018.

During 2016-18, U.S. imports of 4th tier cigarettes from all sources increased by \*\*\* percent based on quantity and were \*\*\* percent higher during interim 2019 compared to interim 2018. The average unit value for all sources of imports of 4th tier cigarettes decreased by \*\*\* during 2016-18 and was lower by \*\*\* during interim 2019 than in interim 2018.

As a ratio to U.S. production, imports from all import sources, nonsubject sources, and Korea decreased during 2016-18, but subject imports and all import sources were higher during interim 2019 compared to interim 2018 (nonsubject imports were lower).

**Table IV-2**

**4th tier cigarettes: U.S. imports by source, 2016-18, January to September 2018, and January to September 2019**

Item	Calendar year			January to September	
	2016	2017	2018	2018	2019
	<b>Quantity (cartons)</b>				
U.S. imports from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***
	<b>Value (1,000 dollars)</b>				
U.S. imports from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***
	<b>Unit value (dollars per carton)</b>				
U.S. imports from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***
	<b>Share of quantity (percent)</b>				
U.S. imports from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***
	<b>Share of value (percent)</b>				
U.S. imports from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***
	<b>Ratio to U.S. production</b>				
U.S. imports from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***

Note.--Shares and ratios shown as "0.0" represent values greater than zero, but less than "0.05" percent.

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure IV-1**  
**4th tier cigarettes: U.S. import volumes and AUVs, 2016-18, January to September 2018, and**  
**January to September 2019**

\* \* \* \* \*

## Negligibility

The statute requires that an investigation be terminated without an injury determination if imports of the subject merchandise are found to be negligible.<sup>5</sup> Negligible imports are generally defined in the Act, as amended, as imports from a country of merchandise corresponding to a domestic like product where such imports account for less than 3 percent of the volume of all such merchandise imported into the United States in the most recent 12-month period for which data are available that precedes the filing of the petition or the initiation of the investigation. However, if there are imports of such merchandise from a number of countries subject to investigations initiated on the same day that individually account for less than 3 percent of the total volume of the subject merchandise, and if the imports from those countries collectively account for more than 7 percent of the volume of all such merchandise imported into the United States during the applicable 12-month period, then imports from such countries are deemed not to be negligible.<sup>6</sup> Based on U.S. importer questionnaire responses, imports from Korea accounted for \*\*\* percent of total imports of 4th tier cigarettes by quantity during 2018. Table IV-3 presents U.S imports in the twelve months preceding the filing of the petition, December 2018 through November 2019.

**Table IV-3**  
**4th tier cigarettes: U.S. imports in the twelve-month period preceding the filing of the petition, December 2018 through November 2019**

Item	December 2018 through November 2019	
	Quantity (cartons)	Share quantity (percent)
U.S. imports from.-- Korea	***	***
Nonsubject sources	***	***
All import sources	***	***

Note.--Shares and ratios shown as "0.0" represent values greater than zero, but less than "0.05" percent.

Source: Compiled from data submitted in response to Commission questionnaires.

<sup>5</sup> Sections 703(a)(1), 705(b)(1), 733(a)(1), and 735(b)(1) of the Act (19 U.S.C. §§ 1671b(a)(1), 1671d(b)(1), 1673b(a)(1), and 1673d(b)(1)).

<sup>6</sup> Section 771 (24) of the Act (19 U.S.C § 1677(24)).

## Apparent U.S. consumption

Table IV-4 presents data on apparent U.S. consumption and U.S. market shares for 4th tier cigarettes. Apparent U.S. consumption based on quantity increased overall by \*\*\* percent during 2016-18, and was \*\*\* percent higher during interim 2019 compared to interim 2018. Apparent consumption based on value was \*\*\* percent higher during 2016-18, and was \*\*\* percent higher during interim 2019 than during interim 2018. U.S. producers' U.S. shipments based on quantity and value increased by \*\*\* percent and \*\*\* percent during 2016-18, respectively, and were higher by \*\*\* percent and \*\*\* percent respectively during interim 2019 compared to interim 2018.

During 2016-18, U.S. importers' U.S. shipments from Korea as a share of total apparent consumption quantity and value decreased by \*\*\* percentage points and \*\*\* percentage points, respectively, but were higher during interim 2019 than in interim 2018 by \*\*\* percentage points based on quantity and \*\*\* percentage points based on value.

During 2016-18, U.S. importers' U.S. shipments from nonsubject sources as a share of total apparent consumption quantity decreased by \*\*\* percentage points and increased by \*\*\* percentage points based on value, and were lower in interim 2019 than in interim 2018 by \*\*\* percentage points based on quantity and \*\*\* percentage points based on value.

During 2016-18, U.S. importers' U.S. shipments from all import sources as a share of total apparent consumption quantity and value decreased by \*\*\* percentage points and \*\*\* percentage points, respectively, but were higher during interim 2019 than in interim 2018 by \*\*\* percentage points based on quantity and \*\*\* percentage points based on value.

**Table IV-4**

**4th tier cigarettes: U.S. shipments of domestic product, U.S. shipments of imports, and apparent U.S. consumption, 2016-18, January to September 2018, and January to September 2019**

Item	Calendar year			January to September	
	2016	2017	2018	2018	2019
	<b>Quantity (cartons)</b>				
U.S. producers' U.S. shipments	***	***	***	***	***
U.S. importers' U.S. shipments from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***
Apparent U.S. consumption	***	***	***	***	***
	<b>Value (1,000 dollars)</b>				
U.S. producers' U.S. shipments	***	***	***	***	***
U.S. importers' U.S. shipments from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***
Apparent U.S. consumption	***	***	***	***	***
	<b>Share of quantity (percent)</b>				
U.S. producers' U.S. shipments	***	***	***	***	***
U.S. importers' U.S. shipments from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***
	<b>Share of value (percent)</b>				
U.S. producers' U.S. shipments	***	***	***	***	***
U.S. importers' U.S. shipments from.-- Korea	***	***	***	***	***
Nonsubject sources	***	***	***	***	***
All import sources	***	***	***	***	***

Note.--Shares and ratios shown as "0.0" represent values greater than zero, but less than "0.05" percent.

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure IV-2**  
**4th tier cigarettes: Apparent consumption, 2016-18, January to September 2018, and January to September 2019**

\* \* \* \* \*

## Part V: Pricing data

### Factors affecting prices

#### Raw material costs

Fourth tier cigarettes are primarily made of blended tobacco that is wrapped in cigarette paper and joined with a filter tip. Factory costs are the largest component of the total cost of goods sold (“COGS”) for 4th tier cigarettes (see chapter VI). Raw material made up less than \*\*\* percent of the total COGS throughout the period of investigation. U.S. producers reported that the composition of COGS remained roughly the same throughout the period.

All responding U.S. producers (3 of 3) indicated that raw material costs had increased since January 1, 2016. U.S. producer \*\*\* stated that the increase in material costs were due to increases in the cost of tobacco. U.S. producer \*\*\* reported that they make periodic price adjustments to absorb raw material cost increases. All responding importers reported that raw material costs fluctuated over the period.

#### Transportation costs to the U.S. market

Transportation costs from 4th tier cigarettes shipped from Korea to the United States averaged 1.9 percent during 2018. These estimates were derived from official import data and represent the transportation and other charges on imports.<sup>1</sup>

#### U.S. inland transportation costs

All responding U.S. producers (3 of 3) reported that they typically arrange transportation, with estimated U.S. inland transportation costs ranging from 1 to 17 percent. The only responding subject importer, \*\*\* reported that it typically arranges transportation, with estimated U.S. inland transportation costs of just over \*\*\* percent.

#### Exchange rates

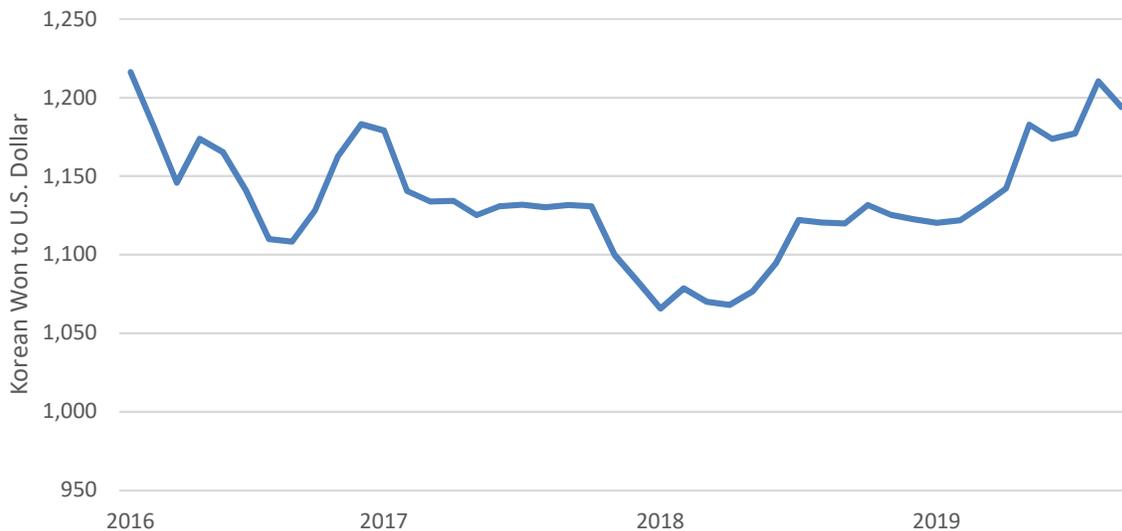
The value of the Korean won, relative to the of the U.S. dollar, fluctuated throughout the period of investigation. While the value of the Korean won decreased relative to the U.S.

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<sup>1</sup> The estimated transportation costs were obtained by subtracting the customs value from the c.i.f. value of the imports for 2018 and then dividing by the customs value based on the HTS subheading 2402.20.8000

dollar from January 2016 to January 2018, it began to regain value in January 2018 and was approximately the same value relative to the U.S. dollar in September 2019 as it was in January 2016 (figure V-1).

**Figure V-1**  
**Exchange Rates: Korean Won to U.S. dollar exchange rate, weekly, January 2016 to December 2018**



Source: Federal Reserve Economic Data (FRED), Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org>, retrieved January 15, 2020

## Pricing practices

### Pricing methods

U.S. producers and importers reported using price lists to set prices for 4th tier cigarettes (table V-1).

**Table V-1**  
**4th tier cigarettes: U.S. producers' and importers' reported price setting methods, by number of responding firms<sup>1</sup>**

Method	U.S. producers	U.S. importers
Transaction-by-transaction	---	---
Contract	---	---
Set price list	3	3
Other	---	1
Responding firms	3	4

Note: The sum of responses down may not add up to the total number of responding firms as each firm was instructed to check all applicable price setting methods employed.

Source: Compiled from data submitted in response to Commission questionnaires.

U.S. producers and importers reported selling all of their 4th tier cigarettes in the spot market (table V-2). All responding U.S. producers reported that they do not negotiate prices.

**Table V-2**  
**4th tier cigarettes: U.S. producers' and importers' shares of U.S. commercial shipments by type of sale, 2018**

\* \* \* \* \*

Note: Because of rounding, figures may not add to the totals shown.

Source: Compiled from data submitted in response to Commission questionnaires.

### **Sales terms and discounts**

The majority of U.S. producers (2 of 3) and the only responding importer, \*\*\* reported that they typically quoted prices on a delivered basis. Two U.S. producers reported they have other discount policies. U.S. producer \*\*\* reported using term discounts, and U.S. producer \*\*\* reported that discounts vary state to state, wholesaler to wholesaler, and brand to brand. Importers reported using quantity and other discounts. Importers \*\*\* both reported using promotional discounts and rebates for a fixed period of time.

## Price data

The Commission requested U.S. producers and importers to provide quarterly data for the total quantity and f.o.b. value of the following 4th tier cigarettes products shipped to unrelated U.S. customers from January 2016 through September 2019.<sup>2</sup>

**Product 1.**-- Non-menthol, Full Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Red Box/THIS Red Box or equivalent offerings) sold in Missouri

**Product 2.**-- Non-menthol, Ultralight Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Gold/THIS Blue Box or equivalent offerings) sold in Missouri

**Product 3.**-- Menthol, Length 100, Menthol 4th tier cigarette (i.e. Edgefield Menthol Box/THIS Menthol Box or equivalent offerings) sold in Missouri

**Product 4.**-- Non-menthol, Full Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Red Box/THIS Red Box or equivalent offerings) sold in Oklahoma

**Product 5.**-- Non-menthol, Ultralight Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Gold/THIS Blue Box or equivalent offerings) sold in Oklahoma

**Product 6.**-- Menthol, Length 100, Menthol 4th tier cigarette (i.e. Edgefield Menthol Box/THIS Menthol Box or equivalent offerings) sold in Oklahoma

Three U.S. producers and one importer provided usable pricing data for sales of the requested products, although not all firms reported pricing for all products for all quarters.<sup>3</sup> Pricing data reported by these firms accounted for approximately \*\*\* percent of U.S. producers' shipments of 4th tier cigarettes and \*\*\* percent of U.S. shipments of 4th tier cigarettes imported from Korea in 2018.

Price data for products 1-6 are presented in tables V-3 to V-8 and figures V-2 to V-7.

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<sup>2</sup> Petitioners note that even though their distributors are located in Missouri and Oklahoma, pricing data may not be comparable due to the differences in rebates, paid by the producer, offered in different States in the distributor distribution network.

<sup>3</sup> Per-unit pricing data are calculated from total quantity and total value data provided by U.S. producers and importers. The precision and variation of these figures may be affected by rounding, limited quantities, and producer or importer estimates.

**Table V-3**  
**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product <sup>1</sup>, and margins of underselling/(overselling), by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 1: Non-menthol, Full Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Red Box/THIS Red Box or equivalent offerings) sold in Missouri.

Source: Compiled from data submitted in response to Commission questionnaires.

**Table V-4**  
**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 2<sup>1</sup>, and margins of underselling/(overselling), by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 2: Non-menthol, Ultralight Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Gold/THIS Blue Box or equivalent offerings) sold in Missouri.

Source: Compiled from data submitted in response to Commission questionnaires.

**Table V-5**  
**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 3<sup>1</sup>, and margins of underselling/(overselling), by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 3: Menthol, Length 100, Menthol 4th tier cigarette (i.e. Edgefield Menthol Box/THIS Menthol Box or equivalent offerings) sold in Missouri.

Source: Compiled from data submitted in response to Commission questionnaires.

**Table V-6**  
**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 4<sup>1</sup>, and margins of underselling/(overselling), by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 4: Non-menthol, Full Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Red Box/THIS Red Box or equivalent offerings) sold in Oklahoma.

Source: Compiled from data submitted in response to Commission questionnaires.

**Table V-7**

**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 5<sup>1</sup>, and margins of underselling/(overselling), by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 5: Non-menthol, Ultralight Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Gold/THIS Blue Box or equivalent offerings) sold in Oklahoma.

Source: Compiled from data submitted in response to Commission questionnaires

**Table V-8**  
**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 6<sup>1</sup>, and margins of underselling/(overselling), by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 6: Menthol, Length 100, Menthol 4th tier cigarette (i.e. Edgefield Menthol Box/THIS Menthol Box or equivalent offerings) sold in Oklahoma.

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure V-2**

**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 1<sup>1</sup>, by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 1: Non-menthol, Full Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Red Box/THIS Red Box or equivalent offerings) sold in Missouri.

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure V-3**  
**4th tier cigarettes: Weighted-average prices and quantities of domestic and imported product 2<sup>1</sup>,  
by quarters, January 2016-December 2018**

\* \* \* \* \*

<sup>1</sup> Product 2: Non-menthol, Ultralight Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Gold/THIS Blue Box or equivalent offerings) sold in Missouri.

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure V-4**  
**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 3<sup>1</sup>, by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 3: Menthol, Length 100, Menthol 4th tier cigarette (i.e. Edgefield Menthol Box/THIS Menthol Box or equivalent offerings) sold in Missouri.

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure V-5**  
**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 4<sup>1</sup>, by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 4: Non-menthol, Full Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Red Box/THIS Red Box or equivalent offerings) sold in Oklahoma.

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure V-6**  
**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 5<sup>1</sup>, by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 5: Non-menthol, Ultralight Flavor, Length 100, Non-Menthol 4th tier cigarette (i.e. Edgefield Gold/THIS Blue Box or equivalent offerings) sold in Oklahoma.

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure V-7**  
**4th tier cigarettes: Weighted-average f.o.b. prices and quantities of domestic and imported product 6<sup>1</sup>, by quarter, January 2016 through September 2019**

\* \* \* \* \*

<sup>1</sup> Product 6: Menthol, Length 100, Menthol 4th tier cigarette (i.e. Edgefield Menthol Box/THIS Menthol Box or equivalent offerings) sold in Oklahoma.

Source: Compiled from data submitted in response to Commission questionnaires.

## Price trends

Prices of domestically produced 4th tier cigarettes increased in Missouri while decreasing in Oklahoma from 2016 to 2018, while prices decreased for Korean produced 4th tier cigarettes in both Missouri and Oklahoma. Table V-9 summarizes the price trends, by country and by product. As shown in the table, domestic price increases in Missouri ranged from \*\*\* percent to \*\*\* percent, while domestic price decreases in Oklahoma ranged from \*\*\* percent to \*\*\* percent. Korean price decreases ranged from \*\*\* percent to \*\*\* percent during the same period.

The indexed price data in figure V-8 compares the prices of products sold by U.S. producers in Missouri (products 1-3) to the prices of products sold by U.S. producers in Oklahoma (products 4-6). As shown in the figure, U.S. producer prices in Missouri increased in every quarter while prices in Oklahoma were relatively constant until the fourth quarter of 2017, after which they decreased through the third quarter of 2019.

Figure V-9 compares the indexed prices of subject imports sold in Missouri (products 1-3) to the prices of subject imports sold in Oklahoma (products 4-6). As shown in the figure prices for subject imports sold in Missouri were relatively constant until the second quarter of 2018, after which they decreased until the third quarter of 2019. The prices of subject imports sold in Oklahoma were relatively constant until the fourth quarter of 2017, after which they decreased until the third quarter of 2019.

**Table V-9**

**4th tier cigarettes: Number of quarters containing observations low price, high price, and change in price over period, by product and source, January 2016 through September 2019**

\* \* \* \* \*

Note: Percentage change from the first quarter in which data were available to the last quarter in which price data were available.

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure V-8**  
**4th tier cigarettes: Indexed U.S. producer prices, January 2016 through September 2019**

\* \* \* \* \*

Source: Compiled from data submitted in response to Commission questionnaires.

**Figure V-9**  
**4th tier cigarettes: Indexed subject U.S. importer prices, January 2016 through September 2019**

\* \* \* \* \*

Source: Compiled from data submitted in response to Commission questionnaires.

## Price comparisons

As shown in table V-10, prices for 4th tier cigarettes imported from Korea were below those for U.S.-produced 4th tier cigarettes in \*\*\* of \*\*\* instances ( \*\*\* million cartons) and were between \*\*\* and \*\*\* percent below domestic prices. In the remaining \*\*\* instances ( \*\*\* cartons), prices for 4th tier cigarettes were between \*\*\* and \*\*\* percent above the price of domestic 4th tier cigarettes.

**Table V-10**  
**4th tier cigarettes: Instances of underselling/overselling and the range and average of margins, by product and by country, January 2016 through September 2019**

Source	Underselling				
	Number of quarters	Quantity (cartons)	Average margin (percent)	Margin Range (percent)	
				Min	Max
Product 1	8	***	***	***	***
Product 2	8	***	***	***	***
Product 3	8	***	***	***	***
Product 4	---	---	---	---	---
Product 5	---	---	---	---	---
Product 6	---	---	---	---	---
Total, underselling	24	***	***	***	***
Source	(Overselling)				
	Number of quarters	Quantity (cartons)	Average margin (percent)	Margin Range (percent)	
				Min	Max
Product 1	7	***	***	***	***
Product 2	7	***	***	***	***
Product 3	7	***	***	***	***
Product 4	15	***	***	***	***
Product 5	15	***	***	***	***
Product 6	15	***	***	***	***
Total, overselling	66	***	***	***	***

Note: These data include only quarters in which there is a comparison between the U.S. and subject product.

Source: Compiled from data submitted in response to Commission questionnaires.

## Lost sales and lost revenue

The Commission requested that U.S. producers of 4th tier cigarettes reported purchasers where they experienced instances of lost sales or revenue due to competition from imports of 4th tier cigarettes from Korea during 2016-2018. Petitioners identified 36 firms where they alleged that they had lost sales or revenues. All responding U.S. producers reported that they had lost sales, two reported that they had reduced prices, and one had rolled back announced price increases.

Staff contacted 36 purchasers and received eight usable responses.<sup>4</sup> Responding purchasers reported purchasing \*\*\* cartons of 4th tier cigarettes during 2016-2018 (table V-11). Between 2016 and 2018, responding purchasers purchased \*\*\* percent from U.S. producers, \*\*\* percent from Korea, and \*\*\* from all other countries.

**Table V-11**  
**4th tier cigarettes: Purchasers' responses to purchasing patterns**

\* \* \* \* \*

Note: Includes all other sources and unknown sources.

Note: Percentage points (pp) change: Change in the share of the firm's total purchases of domestic and/or subject country imports between first and last years.

Source: Compiled from data submitted in response to Commission questionnaires.

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<sup>4</sup> The Commission received responses from three purchasers ( \*\*\*) that were late and illegible which were not included in the data. Staff has not included these responses

Purchasers were asked about changes in the purchasing patterns from different sources since January 1, 2016 (table V-12). The majority of responding purchasers (4 firms) reported increased purchases of domestically produced 4th tier cigarettes, two firms reported that their purchases fluctuated, and two firm reported that purchases were constant. Purchasers' responses to changes in their purchasing patterns from Korea were mixed with a plurality (3 of 8) of purchasers reporting that purchases from Korea had increased. A majority of responding purchasers (2 of 3) reported that they did not purchase 4th tier cigarettes from nonsubject countries and all responding purchasers (3 of 3) reported that they did not purchase 4th tier cigarettes from unknown sources.

Purchaser \*\*\* reported that it increased purchases of U.S.-produced 4th tier cigarettes because they offered lower prices and decreased purchases of Korean 4th tier cigarettes because the structure of the sales incentive would have damaged the sale of other profitable brands that were already in their inventory. Purchaser \*\*\* reported that they had increased purchases of 4th tier cigarettes produced in both the United States and Korea as low-priced cigarettes gained increased market share in the U.S. market.

**Table V-12**  
**4th tier cigarettes: Changes in purchase patterns from U.S., subject, and nonsubject countries**

Source of purchases	Did not purchase	Decreased	Increased	Constant	Fluctuated
United States	---	---	4	2	2
Korea	---	2	3	2	1
Nonsubject sources	2	---	---	1	---
Sources unknown	3	---	---	---	---

Source: Compiled from data submitted in response to Commission questionnaires.

Of the eight responding purchasers, four reported that they had purchased 4th tier cigarettes imported from Korea instead of U.S.-produced produced since 2016. Four firms reported that imported 4<sup>th</sup> tier cigarettes were priced lower than domestic 4th tier cigarettes and two of these firms reported that price was the primary reason that they purchased imported product. Three purchasers ( \*\*\*) estimated that the quantity of 4th tier cigarettes from Korea purchased instead of domestic product totaled \*\*\* cartons (table V-13).



Two of the eight responding purchasers reported that U.S. producers had reduced prices in order to compete with lower-priced imports from Korea. Purchaser \*\*\* reported that the domestic producers reduced prices and undertook efforts to maintain market share. Three purchasers reported that U.S. producers did not know if U.S. producers had reduced prices and three reported that U.S. producers had not reduced prices (table V-14). Purchasers \*\*\* estimated price reductions between \*\*\* percent and \*\*\* percent.

**Table V-14**  
**4th tier cigarettes: Purchasers' responses to U.S. producer price reductions, by firm**

Purchaser	Producers reduced price (Y/N)	If produced reduced prices:	
		Estimated U.S. price reduction (percent)	Additional information, if available
***	***	***	***
***	***	***	***
***	***	***	***
***	***	***	***
***	***	***	***
***	***	***	***
***	***	***	***
***	***	***	***
Total / average	Yes--2; No--3	***	

Source: Compiled from data submitted in response to Commission questionnaires.

# Part VI: Financial experience of U.S. producers

## Background

Three U.S. producers, Cheyenne, Dosal, and Xcaliber, reported usable financial results on their 4th tier cigarette operations.<sup>1</sup> While varying to some extent by company, 4th tier cigarette sales represent the \*\*\* of each company's sales.<sup>2</sup> On a cumulative basis, \*\*\* accounted for the largest share of total sales quantity (\*\*\* percent, followed by \*\*\* (\*\*\*) percent, and \*\*\* (\*\*\*) percent.

The U.S. industry's operations reflect (directly and/or indirectly) various events/activities that took place during the period: Xcaliber's acquisition of Tantus Tobacco,<sup>3</sup> Xcaliber's unsuccessful initial public offering (IPO) of common stock,<sup>4</sup> \*\*\*,<sup>5</sup> and the market exit of several U.S. producers \*\*\*. The manner in which these events/activities impacted the U.S. industry's financial results is discussed below.<sup>6</sup>

All of the responding U.S. producers are subject to non-participating manufacturer (NPM) escrow payments on cigarette sales made in MSA settling states. In general, NPM escrow payments were instituted pursuant to the MSA to create parity between NPMs and cigarette

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<sup>1</sup> \*\*\*.

\*\*\*. USITC auditor preliminary-phase notes.

<sup>2</sup> With respect to its overall establishment operations, \*\*\* reported the lowest share of 4th tier cigarette sales to total sales (\*\*\* percent). \*\*\* (\*\*\*) percent) and \*\*\* (\*\*\*) percent) accounted for the remainder. \*\*\* U.S. producer questionnaires, responses to III-5.

<sup>3</sup> Conference transcript, p. 23 (Nichols).

<sup>4</sup> Conference transcript, p. 30 (Smith).

<sup>5</sup> \*\*\* U.S. producer questionnaire, responses to II-2, III-13 (note 1).

<sup>6</sup> \*\*\* did not report financial results for the part of the period they had operations. While the sales of remaining U.S. producers were reportedly impacted to some extent (see *Revenue* section below), \*\*\* market exit is not directly reflected in the U.S. industry's financial results.

producers directly subject to MSA payments.<sup>7</sup> <sup>8</sup> The impact of NPM escrow payments on the U.S. industry's financial results is discussed in the *NPM escrow payments* section below.

## Operations on 4th Tier Cigarettes

Table VI-1 and table VI-2, respectively, present financial results on 4th tier cigarettes and corresponding changes in average per carton values. Table VI-3 presents a variance analysis of these financial results. Table VI-4 presents selected financial results information by firm.<sup>9</sup>

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<sup>7</sup> Conference transcript, p. 109 (Estes). NPM escrow payments, which are to be held for 25 years, were established so that NPMs would have funds available to settle any future tobacco-related lawsuits brought by MSA states. How these funds will ultimately be disposed of is unknown. Ibid. Conference transcript, p. 32 (Smith). Petitioners' postconference brief, p. 20.

<sup>8</sup> Some non-MSA settling states reportedly impose NPM fees, which, according to one U.S. producer, are unambiguously an expense for financial reporting purposes. USITC auditor preliminary-phase notes. In contrast and as described in the *NPM escrow payments* section below, NPM escrow payments represent a grey area with respect to how they are classified for financial reporting purposes.

<sup>9</sup> The Commission's traditional variance analysis is calculated in three parts: sales variance, cost of goods sold (COGS) variance, and selling, general, and administrative (SG&A) expenses variance. An additional variance, specific to this case, has been added for NPM escrow payments. Each part consists of a price variance (in the case of the sales variance) or a cost or expense variance (in the case of the COGS and SG&A expense variances), and a volume variance. The sales or cost/expense variance is calculated as the change in unit price or per-unit cost/expense times the new volume, while the volume variance is calculated as the change in volume times the old unit price or per-unit cost/expense. As summarized at the bottom of the table, the price variance is from sales, the cost/expense variance is the sum of those items from COG and SG&A variances, respectively, and the volume variance is the sum of the volume components of the net sales, COGS, and SG&A expenses variances. The Commission's variance analysis is generally more meaningful when product mix remains the same throughout the period. While noting that there are no 4th tier cigarette sub-products, Petitioners' postconference brief stated \*\*\*. Petitioners' postconference brief (Exhibit 1), p. 5. \*\*\*. While there were some variations in product mix during the period, they generally appear to be minor.

Table VI-1

4th tier cigarettes: Results of operations of U.S. producers, 2016-18, January-September 2018, and January-September 2019

Item	Calendar year			January to September	
	2016	2017	2018	2018	2019
	<b>Quantity (cartons)</b>				
Total net sales	***	***	***	***	***
	<b>Value (1,000 dollars)</b>				
Total net sales	***	***	***	***	***
Cost of goods sold.--					
Raw materials	***	***	***	***	***
Direct labor	***	***	***	***	***
Other factory costs	***	***	***	***	***
Total COGS	***	***	***	***	***
Gross profit or (loss)	***	***	***	***	***
SG&A expense	***	***	***	***	***
NPM escrow payments	***	***	***	***	***
Operating income or (loss)	***	***	***	***	***
Interest expense	***	***	***	***	***
All other expenses	***	***	***	***	***
All other income	***	***	***	***	***
Net income or (loss)	***	***	***	***	***
Depreciation/amortization	***	***	***	***	***
Cash flow	***	***	***	***	***
	<b>Ratio to net sales (percent)</b>				
Cost of goods sold.--					
Raw materials	***	***	***	***	***
Direct labor	***	***	***	***	***
Other factory costs	***	***	***	***	***
Average COGS	***	***	***	***	***
Gross profit or (loss)	***	***	***	***	***
SG&A expense	***	***	***	***	***
NPM escrow payments	***	***	***	***	***
Operating income or (loss)	***	***	***	***	***
Net income or (loss)	***	***	***	***	***

Table continued on next page.

**Table VI-1—Continued**  
**4th tier cigarettes: Results of operations of U.S. producers, 2016-18, January-September 2018, and January-September 2019**

Item	Calendar year			January to September	
	2016	2017	2018	2018	2019
	<b>Ratio to total COGS (percent)</b>				
Cost of goods sold.--					
Raw materials	***	***	***	***	***
Direct labor	***	***	***	***	***
Other factory costs	***	***	***	***	***
Average COGS	***	***	***	***	***
	<b>Unit value (dollars per carton)</b>				
Total net sales	***	***	***	***	***
Cost of goods sold.--					
Raw materials	***	***	***	***	***
Direct labor	***	***	***	***	***
Other factory costs	***	***	***	***	***
Average COGS	***	***	***	***	***
Gross profit or (loss)	***	***	***	***	***
SG&A expense	***	***	***	***	***
NPM escrow payments	***	***	***	***	***
Operating income or (loss)	***	***	***	***	***
Net income or (loss)	***	***	***	***	***
	<b>Number of firms reporting</b>				
Operating losses	***	***	***	***	***
Net losses	***	***	***	***	***
Data	***	***	***	***	***

Source: Compiled from data submitted in response to Commission questionnaires.

**Table VI-2**  
**4th tier cigarettes: Changes in AUV's, 2016-18, January-September 2018, and January-September 2019**

Item	Between calendar years			Between partial year period
	2016-18	2016-17	2017-18	2018-19
	<b>Change in AUVs (dollars per carton)</b>			
Total net sales	***	***	***	***
Cost of goods sold.--				
Raw materials	***	***	***	***
Direct labor	***	***	***	***
Other factory costs	***	***	***	***
Average COGS	***	***	***	***
Gross profit or (loss)	***	***	***	***
SG&A expense	***	***	***	***
NPM escrow payments	***	***	***	***
Operating income or (loss)	***	***	***	***
Net income or (loss)	***	***	***	***

Source: Compiled from data submitted in response to Commission questionnaires.

**Table VI-3**

**4th tier cigarettes: Variance analysis on operations of U.S. producers, 2016-18, January-September 2018, and January-September 2019**

Item	Between calendar years			Between partial year period
	2016-18	2016-17	2017-18	2018-19
	<b>Value (1,000 dollars)</b>			
Net sales:				
Price variance	***	***	***	***
Volume variance	***	***	***	***
Net sales variance	***	***	***	***
COGS:				
Cost variance	***	***	***	***
Volume variance	***	***	***	***
COGS variance	***	***	***	***
Gross profit variance	***	***	***	***
SG&A expenses:				
Cost/expense variance	***	***	***	***
Volume variance	***	***	***	***
Total SG&A expense variance	***	***	***	***
NPM escrow payments:				
Cost/expense variance	***	***	***	***
Volume variance	***	***	***	***
Total NPM escrow payments variance	***	***	***	***
Operating income variance	***	***	***	***
Summarized (at the operating income level) as:				
Price variance	***	***	***	***
Net cost/expense variance	***	***	***	***
Net volume variance	***	***	***	***

Source: Compiled from data submitted in response to Commission questionnaires.

Table VI-4

4th tier cigarettes: Results of operations of U.S. producers, by firm, 2016-18, January-September 2018, and January-September 2019

Item	Calendar year			January to September	
	2016	2017	2018	2018	2019
	<b>Total net sales (cartons)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Total net sales quantity	***	***	***	***	***
	<b>Total net sales (1,000 dollars)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Total net sales value	***	***	***	***	***
	<b>Cost of goods sold (1,000 dollars)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Total COGS	***	***	***	***	***
	<b>Gross profit or (loss) (1,000 dollars)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Total gross profit or (loss)	***	***	***	***	***
	<b>SG&amp;A expenses (1,000 dollars)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Total SG&A expenses	***	***	***	***	***
	<b>NPM escrow payments (1,000 dollars)<sup>1</sup></b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber <sup>2</sup>	***	***	***	***	***
Total NPM escrow payments	***	***	***	***	***

Table continued on next page.

**Table VI-4—Continued**  
**4th tier cigarettes: Results of operations of U.S. producers, by firm, 2016-18, January-September 2018, and January-September 2019**

Item	Calendar year			January to September	
	2016	2017	2018	2018	2019
	<b>Operating income or (loss) (1,000 dollars)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Total operating income or (loss)	***	***	***	***	***
	<b>Net income or (loss) (1,000 dollars)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Total net income or (loss)	***	***	***	***	***
	<b>COGS to net sales ratio (percent)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average COGS to net sales ratio	***	***	***	***	***
	<b>Gross profit or (loss) to net sales ratio (percent)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average gross profit or (loss) to net sales ratio	***	***	***	***	***
	<b>SG&amp;A expense to net sales ratio (percent)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average SG&A expense to net sales ratio	***	***	***	***	***
	<b>NPM escrow payments to net sales ratio (percent)<sup>1</sup></b>				
Cheyenne <sup>3</sup>	***	***	***	***	***
Dosal <sup>3</sup>	***	***	***	***	***
Xcaliber <sup>2 3</sup>	***	***	***	***	***
Average NPM escrow payments to net sales ratio	***	***	***	***	***

Table continued on next page.

**Table VI-4—Continued**  
**4th tier cigarettes: Results of operations of U.S. producers, by firm, 2016-18, January-September 2018, and January-September 2019**

Item	Calendar year			January to September	
	2016	2017	2018	2018	2019
	<b>Operating income or (loss) to net sales ratio (percent)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average operating income or (loss) to net sales ratio	***	***	***	***	***
	<b>Net income or (loss) to net sales ratio (percent)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average net income or (loss) to net sales ratio	***	***	***	***	***
	<b>Unit net sales value (dollars per carton)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average unit net sales value	***	***	***	***	***
	<b>Unit raw materials (dollars per carton)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average unit raw materials	***	***	***	***	***
	<b>Unit direct labor (dollars per carton)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average unit direct labor	***	***	***	***	***
	<b>Unit other factory costs (dollars per carton)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average unit other factory costs	***	***	***	***	***

Table continued on next page.

**Table VI-4—Continued**  
**4th tier cigarettes: Results of operations of U.S. producers, by firm, 2016-18, January-September 2018, and January-September 2019**

Item	Calendar year			January to September	
	2016	2017	2018	2018	2019
	<b>Unit COGS (dollars per carton)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average unit COGS	***	***	***	***	***
	<b>Unit gross profit or (loss) (dollars per carton)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average unit gross profit or (loss)	***	***	***	***	***
	<b>Unit SG&amp;A expenses (dollars per carton)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average unit SG&A expense	***	***	***	***	***
	<b>Unit NPM escrow payments (dollars per carton)<sup>1</sup></b>				
Cheyenne <sup>3</sup>	***	***	***	***	***
Dosal <sup>3</sup>	***	***	***	***	***
Xcaliber <sup>2 3</sup>	***	***	***	***	***
Average unit NPM escrow payments	***	***	***	***	***
	<b>Unit operating income or (loss) (dollars per carton)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average unit operating income or (loss)	***	***	***	***	***
	<b>Unit net income or (loss) (dollars per carton)</b>				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Average unit net income or (loss)	***	***	***	***	***

<sup>1</sup> NPM escrow payments are classified as an operating expense to determine operating income (see *NPM escrow payment* section).

<sup>2</sup> \*\*\*. USITC auditor preliminary-phase notes.

<sup>3</sup> The company-specific NPM escrow payments ratio to net sales and average per carton amounts reflect variations in the quantity of sales being made to specific states (see *NPM escrow payment* section).

Source: Compiled from data submitted in response to Commission questionnaires.

## Revenue

Commercial sales, which primarily represent U.S. commercial shipments, were the only category of revenue reported.<sup>10</sup> A single revenue line item is therefore presented in the relevant tables above.

## Quantity

The U.S. industry's total sales quantity increased modestly throughout the full-year period and was higher in January-September 2019 compared to January-September 2018. The increases in 2017 and 2018 total sales quantity were accounted for by \*\*\*, offsetting declines of varying magnitude reported by \*\*\* in 2017 and amplifying the modest increases reported by \*\*\* in 2018. Similarly, the higher overall sales quantity in January-September 2019 compared to January-September 2018 was primarily attributable to \*\*\*. While \*\*\* confirmed that the increasing level of sales was related to its \*\*\*, its corresponding \*\*\* were not a factor.<sup>11</sup>

## Value

Sales values are net of relevant rebates, which reportedly increased during the period.<sup>12</sup> In addition to traditional manufacturing costs, revenue attempts to recover various other costs such as FDA fees, excise taxes, and NPM escrow payments and/or fees. It should be noted that federal excise taxes are the obligation of the manufacturer, while state excise taxes are the responsibility of the stamping entity.<sup>13</sup>

Changes in company-specific average sales value were directionally the same only in 2017 with all U.S. producers reporting increasing average sales of varying magnitude in that year. The subsequent company-specific pattern of directional change in average sales value was

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<sup>10</sup> \*\*\*. \*\*\* U.S. producer questionnaire, response to II-7.

<sup>11</sup> Petitioners' postconference brief (Exhibit 1), p. 5. \*\*\*. Ibid.

<sup>12</sup> Conference transcript, p 105 (Pickard); pp. 31-32 (Smith).

<sup>13</sup> The stamping entity could be the manufacturer or the wholesaler. \*\*\*. USITC auditor preliminary phase notes. In contrast, Xcaliber indicated that all stamping of its cigarettes is done by wholesalers. Conference transcript, p. 137 (Smith).

mixed. In 2018 and between the interim periods, the overall decline in average sales value was primarily attributable to \*\*\*.

Notwithstanding the overall decline in average sales value in 2018 and between the interim periods, total revenue increased due to higher sales quantity. As shown in the revenue section of the variance analysis (table VI-3), positive sales volume variances more than offset the impact of negative price variances (2017-18, interim 2018-19) and amplified the impact of the period's only positive price variance (2016-17).

### **Cost of goods sold and gross profit or loss**

As noted in the *NPM escrow payments* section below and to the extent included in COGS, NPM escrow payments have been reclassified as a separate operating expense below SG&A expenses.

### **Raw materials**

Total raw material cost was the second largest component of COGS, ranging from \*\*\* percent of total COGS (2016 and 2017) to \*\*\* percent (January-September 2019). In addition to tobacco, which was identified as the primary raw material cost, raw material cost includes \*\*\*.<sup>14</sup>

The directional change in company-specific average raw material costs was mixed in 2016-17 with \*\*\* reporting increases and \*\*\* reporting a decline. In 2017-18, all U.S. producers reported increases. Between the interim periods the pattern was again mixed with \*\*\* reporting higher average raw material costs in January-September 2019 compared to January-September 2018 and \*\*\* reporting lower average raw material costs. During the full-year period, the most notable company-specific change in average raw material cost was the \*\*\* percent increase reported by \*\*\* in 2018. In addition to generally higher raw material costs, \*\*\* attributed this increase to \*\*\*.<sup>15</sup>

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<sup>14</sup> Petitioners' postconference brief (Exhibit 1), p. 2. \*\*\*. E-mail with attachment from \*\*\*, January 13, 2020.

<sup>15</sup> \*\*\*. Petitioners' postconference brief (Exhibit 1), p. 2. As generally indicated during testimony at the staff conference, company-specific tobacco cost would vary to some extent based on the underlying tobacco blends used.

## Direct labor

Direct labor was the smallest component of COGS and ranged from \*\*\* percent of total COGS (2016 and 2017) to \*\*\* percent (2018 and January-September 2019). Table VI-4 shows that \*\*\* average direct labor cost was relatively close throughout the period, while \*\*\* was higher, generally suggesting that \*\*\* used a somewhat broader definition of direct labor as compared to \*\*\*.

## Other factory costs

Other factory costs, the largest component of COGS throughout the period, ranged from \*\*\* percent of total COGS (January-September 2019) to \*\*\* percent (2016). While other factory costs include traditional manufacturing overhead items, a large share represents federal excise taxes and FDA user fees. Because a relatively small share of manufacturing costs is considered \*\*\*, increases in capacity utilization reportedly have a \*\*\* impact on average COGS.<sup>16</sup>

Similar to average raw material cost and with adjustment to eliminate NPM escrow payments from \*\*\* other factory costs (see *NPM escrow payments* section), table VI-4 shows that \*\*\* reported average other factory costs that were similar, while \*\*\* average other factory costs was higher.<sup>17</sup> The pattern of directional changes in company-specific average other factory costs was mixed and generally modest in terms of magnitude of change. On an overall basis, the U.S. industry's average other factory costs remained within a relatively narrow range throughout the period.

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<sup>16</sup> \*\*\*. Petitioners' postconference brief (Exhibit 1), p. 7. \*\*\*. E-mail with attachment from \*\*\*, January 13, 2020.

<sup>17</sup> One source of this difference may be the extent to which manufacturers are also acting as their own stamping agent. \*\*\*. USITC auditor preliminary-phase notes. In contrast, Xcaliber indicated that stamping and the state excise tax on the sale of its cigarettes is incurred entirely by the wholesaler. Conference transcript, p. 97, p. 137 (Smith).

## COGS

The U.S. industry's average COGS increased in 2017 and 2018 and then was marginally higher in January-September 2019 compared to January-September 2018. On a company-specific basis, directional changes in average COGS were mixed and therefore partially offsetting. Notable company-specific increases in average COGS were limited to \*\*\* (2017) and \*\*\* (2018), reflecting changes in average other factory costs and average raw material, respectively.<sup>18</sup>

## Gross profit or loss

Total gross profit increased throughout the period. In 2017, this was due to both higher sales quantity and a modest expansion of gross profit ratio (total gross profit divided by total revenue). In 2018, the gross profit ratio contracted such that the increase in total gross profit was solely a function of higher sales quantity. Similarly and despite a further contraction in the gross profit ratio, January-September 2019 total gross profit was higher compared to January-September 2018 due to higher sales quantity.<sup>19</sup>

On a company-specific basis, \*\*\* generated gross profit ratios that were similar during most of the period but then diverged. \*\*\* reported the lowest company-specific gross profit ratio, which remained within a relatively narrow range and was marginally higher in January-June 2019 compared to January-June 2018. The divergence in \*\*\* gross profit ratios between the interim periods reflects \*\*\* higher average sales value and lower average COGS and \*\*\* lower average sales value. To a lesser extent, \*\*\* higher average COGS, principally the other factory costs component, also contributed to the contraction of its gross profit ratio at the end of the period.

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<sup>18</sup> Prior to revision by \*\*\*, the increase in its 2017 average other factory costs was more substantial. The reason for \*\*\* higher average raw material cost is described in footnote 15.

<sup>19</sup> The expansion in gross profit ratio in 2017 generally reflects higher average sales value, which more than offset the corresponding increase in average COGS. In 2018 and January-September 2019, the contraction in gross profit ratio reflects a decline in average sales value that was amplified by a modest increase in average COGS.

## Operating expenses and operating income or loss

### SG&A expenses

Total SG&A expenses were at their lowest and highest levels in 2017 and 2018, respectively. Fluctuations in the level of total SG&A expenses, in part, reflect non-recurring items reported by \*\*\*.<sup>20</sup> Corresponding SG&A expenses ratios (total SG&A expenses divided by total revenue) remained within a relatively narrow range throughout the full-year period and then were somewhat lower in January-September 2019 compared to January-September 2018.

On a company-specific basis, \*\*\* SG&A expense ratios were about the same during the full-year period, while \*\*\* SG&A expense ratio was lower. Table VI-4 shows that \*\*\* SG&A expense ratio declined to its lowest level in January-September 2019, which reflects, in part, the absence of non-recurring items included in previous-period SG&A expenses (see footnote 20).

### NPM escrow payments

U.S. producers vary in terms of whether NPM escrow payments are included or excluded as an income statement expense/cost item: \*\*\* includes NPM escrow payments as part of COGS and therefore as a component of its income statement; \*\*\* exclude NPM escrow payments from their respective income statements.<sup>21 22</sup> While different NPM escrow payment classifications have been chosen by U.S. producers and

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<sup>20</sup> \*\*\*. \*\*\* U.S. producer questionnaire, response to III-10. Petitioners' postconference brief (Exhibit 1), p. 7. \*\*\*. \*\*\* U.S. producer questionnaire, response to III-10.

The level of \*\*\* total SG&A expenses was higher in 2016 due to costs associated with an \*\*\*. USITC auditor preliminary-phase notes.

<sup>21</sup> These differences also impact the balance sheet: \*\*\*. U.S. producer questionnaires, responses to III-9c. E-mail with attachment from \*\*\*, January 13, 2020.

<sup>22</sup> \*\*\*. Petitioners' postconference brief (Exhibit 1). USITC auditor preliminary-phase notes.

sanctioned by external auditors,<sup>23</sup> a consistent format is necessary in order to evaluate the U.S. industry's financial results in this section of the report. Accordingly, staff has reclassified NPM escrow payments as a separate operating expense below SG&A expenses.<sup>24</sup>

NPM escrow payments obligations are triggered when an excise stamp is affixed to the cigarette pack.<sup>25</sup> Since manufacturers can act as their own stamping agents, in addition to selling to wholesaler stamping agents,<sup>26</sup> when the NPM escrow obligation is incurred can vary. As shown in table VI-4, the total amount of NPM escrow payments, average per carton amount, and ratio to net sales, differ on a company-specific basis. In general, this reflects variations in the mix of states in which cigarettes are being sold. For example, \*\*\* in Florida, a non-settling state that does not require NPM escrow payments. In contrast and while \*\*\* reported a larger level of NPM escrow payments compared to \*\*\*, its NPM escrow payments are \*\*\* compared to \*\*\* because it has a \*\*\* share of sales in Missouri, an MSA state with a low effective NPM escrow payment obligation.<sup>27</sup>

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<sup>23</sup> While the notes to the audited financial statements of both companies describe the MSA and the NPM escrow obligation (e-mail with attachment from Wiley Rein (Counsel for Petitioners), January 17, 2020), neither appear to describe specifically why \*\*\* were adopted. \*\*\*.

<sup>24</sup> Treating NPM escrow payments as an operating expense is, in part, supported by the fact that \*\*\* U.S. producer (\*\*\*) already classifies its NPM escrow payments as an income statement item. Additionally, \*\*\* U.S. producers treat NPM escrow payments as an expense for \*\*\*. Petitioners' post conference brief also noted a number of instances when financial results, net of NPM escrow payments, were considered more relevant by third parties: \*\*\*; pursuant to Xcaliber's unsuccessful IPO, prospective investors considered \*\*\*. Petitioners' postconference brief (Exhibit 17), pp. 7-8. From the perspective of internal decision making, it was also noted that MSA-related obligations impact budgeting, the determination of cash available to make production-related capital expenditures and discretionary R&D, as well as disbursement of capital to shareholders. Petitioners' postconference brief (Exhibit 17), p. 7.

<sup>25</sup> Conference transcript, p. 136 (Estes).

<sup>26</sup> USITC auditor preliminary-phase notes.

<sup>27</sup> \*\*\*. E-mail with attachment from Wiley Rein (Counsel for Petitioners), January 17, 2020.

Total NPM escrow payments increased throughout the full-year period and were also higher in January-September 2019 compared to January-September 2018. As a ratio to net sales, NPM escrow payments also increased. Both of these trends appear to be consistent with the increasing sales quantities and lower average sales value reported by \*\*\*, the U.S. producer \*\*\* exposed to NPM escrow payment obligations.

### **Operating income or loss**

In conjunction with the contraction of gross profit ratios in 2018 and January-September 2019, the increasing NPM escrow payments to net sales ratio, when classified as an operating item, contributed to the decline in operating income in 2018 and lower operating income ratio in January-September 2019 compared to January-September 2018.<sup>28</sup>

On a company-specific basis, \*\*\* generated the highest operating income ratios throughout the period. While \*\*\* reported similar operating income ratios in 2016 and 2017, \*\*\* operating income ratio declined in 2018 and was lower in January-September 2019 compared to January-September 2018. In contrast, \*\*\* operating income ratio increased somewhat in 2018 and was higher in January-September 2019 compared to January-September 2018. As compared to \*\*\*, \*\*\* better financial performance at the operating income level generally reflects stable gross profit ratios and NPM escrow payment to sales ratios that remained low throughout the period (\*\*\*) or were somewhat higher but relatively stable (\*\*\*)).

### **Interest expense, other expenses and income, and net income or loss**

While \*\*\* both reported interest expense, \*\*\* generally reported larger period-specific amounts. \*\*\* reported no interest expense during the period. \*\*\* was the \*\*\* U.S. producer to report other expenses, which increased to

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<sup>28</sup> As noted previously, \*\*\* do not formally classify NPM escrow payments as an income statement item. In contrast, \*\*\* classifies NPM escrow payments as a component of COGS.

their highest level in January-September 2019.<sup>29</sup> \*\*\* U.S. producers reported other income throughout the period.<sup>30</sup>

Directionally, net income and operating income followed the same pattern throughout the period with total net income somewhat higher due to the presence of net other income.

## Capital expenditures and research and development expenses

Table VI-5 presents the U.S. producers' capital expenditures and research and development (R&D) expenses related to 4th tier cigarettes.

**Table VI-5**  
**4th tier cigarettes: Capital expenditures and research and development (R&D) expenses of U.S. producers, by firm, 2016-18, January-September 2018, and January-September 2019**

Item	Calendar year			January to September	
	2016	2017	2018	2018	2019
	Capital expenditures (1,000 dollars)				
Cheyenne	***	***	***	***	***
Dosal	***	***	***	***	***
Xcaliber	***	***	***	***	***
Total capital expenditures	***	***	***	***	***
	Research and development expenses (1,000 dollars)				
Cheyenne	***	***	***	***	***
Dosal <sup>1</sup>	***	***	***	***	***
Xcaliber <sup>1</sup>	***	***	***	***	***
Total research and development expenses	***	***	***	***	***

<sup>1</sup> R&D expenses reflect FDA equivalency testing and related items.

Source: Compiled from data submitted in response to Commission questionnaires.

<sup>29</sup> \*\*\*. \*\*\* U.S. producer questionnaire, response to III-10. \*\*\*. Petitioners' postconference brief (Exhibit 1), p. 7.

<sup>30</sup> \*\*\*. E-mail with attachment from \*\*\*, January 13, 2020.

\*\*\*, which reported the \*\*\* level of other income during the full-year period, stated that it \*\*\*. Petitioners' postconference brief (Exhibit 1), p. 8.

While \*\*\* both reported capital expenditures during the period, \*\*\* accounted for substantial majority.<sup>31</sup> \*\*\*.<sup>32</sup>

\*\*\*.<sup>33</sup> As described by an Xcaliber company official, all R&D is “. . . directed towards the FDA to maintain our certifications and sell products to states.”<sup>34</sup> With regard to a prospective Xcaliber R&D lab to conduct required testing, it was noted “we can do a lot of these tests inhouse in a long-term capacity it could save the company money.”<sup>35</sup> Xcaliber’s construction of the R&D lab has reportedly not taken place due to cashflow constraints.

## **Assets and return on assets**

Table VI-6 presents data on the U.S. producers’ total net assets and operating return on net assets related to operations on 4th tier cigarettes.<sup>36</sup>

As originally reported, the total assets of \*\*\* included restricted cash balances related to NPM escrow payments. In contrast, \*\*\* reported total asset amounts that effectively excluded cash related to NPM escrow payments.<sup>37</sup> Because financial results presented in this section of the report classify NPM escrow payments as an operating

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<sup>31</sup> \*\*\*. \*\*\* U.S. producer questionnaire, response to III-13 (note 1).

<sup>32</sup> \*\*\* U.S. producer questionnaire, response to III-13 (note 1).

<sup>33</sup> \*\*\*. USITC auditor preliminary-phase notes. \*\*\*.

<sup>34</sup> Conference transcript, p. 115 (Phillips).

<sup>35</sup> Conference transcript, p. 116 (Phillips).

<sup>36</sup> With respect to a company’s overall operations, staff notes that a total asset value (i.e., the bottom-line value on the asset side of a company’s balance sheet) reflects an aggregation of a number of current and non-current assets, which, in many instances, are not product specific. In most cases, allocation factors are necessary in order to report total asset values on a product-specific basis. The ability of U.S. producers to assign total asset values to discrete product lines affects the meaningfulness of operating return on net assets (see table VI-6 (note 2)).

<sup>37</sup> \*\*\*. \*\*\* U.S. producer questionnaire, response to III-9c. E-mail with attachment from Wiley Rein (Counsel for Petitioners), January 17, 2020.

**Table VI-6**  
**4th tier cigarettes: U.S. producers' total net assets and operating return on net assets, by firm, 2016-18**

Firm	Calendar years		
	2016	2017	2018
	<b>Total net assets (1,000 dollars)</b>		
Cheyenne	***	***	***
Dosal <sup>1</sup>	***	***	***
Xcaliber <sup>1</sup>	***	***	***
Total net assets	***	***	***
	<b>Operating return on assets (percent)</b>		
Cheyenne <sup>2</sup>	***	***	***
Dosal	***	***	***
Xcaliber	***	***	***
Average operating return on net assets	***	***	***

<sup>1</sup> \*\*\*

<sup>2</sup> \*\*\*. Petitioners' postconference brief (Exhibit 1), p. 2.

Source: Compiled from data submitted in response to Commission questionnaires.

expense (see *NPM escrow payments* section), total assets and the calculation of operating return on net assets exclude restricted cash related to NPM escrow payments.<sup>38</sup>

## Capital and investment

The Commission requested the U.S. producers of 4th tier cigarettes to describe any actual or potential negative effects on their return on investment or its growth, investment, ability to raise capital, existing development and production efforts (including efforts to develop a derivative or more advanced version of the product), or the scale of capital investments as a result of imports of 4th tier cigarettes from Korea. Table VI-7 tabulates the responses regarding actual negative effects on investment, growth, and development, as well as anticipated negative effects. Table VI-8 presents the narrative responses of the U.S. producers regarding actual and anticipated negative effects on investment, growth, and development.

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<sup>38</sup> USITC auditor preliminary-phase notes.

**Table VI-7**

**4th tier cigarettes: Negative effects of imports from subject sources on investment, growth, and development since January 1, 2016**

Item	No	Yes
Negative effects on investment	***	***
Cancellation, postponement, or rejection of expansion projects		***
Denial or rejection of investment proposal		***
Reduction in the size of capital investments		***
Return on specific investments negatively impacted		***
Other		***
Negative effects on growth and development	***	***
Rejection of bank loans		***
Lowering of credit rating		***
Problem related to the issue of stocks or bonds		***
Ability to service debt		***
Other		***
Anticipated negative effects of imports	***	***

Source: Compiled from data submitted in response to Commission questionnaires.

**Table VI-8**

**4th tier cigarettes: Narrative responses of U.S. producers regarding actual and anticipated negative effects of imports from Korea on investment, growth, and development since January 1, 2016**

Effects/Firm	Narrative
<b>Negative impact on investment</b>	
<b>Cancellation, postponement, or rejection of expansion projects:</b>	
***	***
<b>Reduction in the size of capital investments:</b>	
***	***
<b>Return on specific investments negatively impacted:</b>	
***	***
<b>Other:</b>	
***	***

Table continued on next page.

**Table VI-8—Continued**

**4th tier cigarettes: Narrative responses of U.S. producers regarding actual and anticipated negative effects of imports from subject sources on investment, growth, and development since January 1, 2016**

Effects/Firm	Narrative
<b>Negative impact on growth and development</b>	
<b>Rejection of bank loans:</b>	
***	***
<b>Lowering of credit rating:</b>	
***	***
<b>Problem related to the issue of stocks or bonds:</b>	
***	***
<b>Other:</b>	
***	***
***	***
***	***
<b>Anticipated effects of imports</b>	
***	***
***	***
***	***

Source: Compiled from data submitted in response to Commission questionnaires.



## Part VII: Threat considerations and information on nonsubject countries

Section 771(7)(F)(i) of the Act (19 U.S.C. § 1677(7)(F)(i)) provides that—

*In determining whether an industry in the United States is threatened with material injury by reason of imports (or sales for importation) of the subject merchandise, the Commission shall consider, among other relevant economic factors<sup>1</sup>--*

- (I) if a countervailable subsidy is involved, such information as may be presented to it by the administering authority as to the nature of the subsidy (particularly as to whether the countervailable subsidy is a subsidy described in Article 3 or 6.1 of the Subsidies Agreement), and whether imports of the subject merchandise are likely to increase,*
- (II) any existing unused production capacity or imminent, substantial increase in production capacity in the exporting country indicating the likelihood of substantially increased imports of the subject merchandise into the United States, taking into account the availability of other export markets to absorb any additional exports,*
- (III) a significant rate of increase of the volume or market penetration of imports of the subject merchandise indicating the likelihood of substantially increased imports,*
- (IV) whether imports of the subject merchandise are entering at prices that are likely to have a significant depressing or suppressing effect on domestic prices, and are likely to increase demand for further imports,*
- (V) inventories of the subject merchandise,*

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<sup>1</sup> Section 771(7)(F)(ii) of the Act (19 U.S.C. § 1677(7)(F)(ii)) provides that “The Commission shall consider {these factors} . . . as a whole in making a determination of whether further dumped or subsidized imports are imminent and whether material injury by reason of imports would occur unless an order is issued or a suspension agreement is accepted under this title. The presence or absence of any factor which the Commission is required to consider . . . shall not necessarily give decisive guidance with respect to the determination. Such a determination may not be made on the basis of mere conjecture or supposition.”

- (VI) *the potential for product-shifting if production facilities in the foreign country, which can be used to produce the subject merchandise, are currently being used to produce other products,*
- (VII) *in any investigation under this title which involves imports of both a raw agricultural product (within the meaning of paragraph (4)(E)(iv)) and any product processed from such raw agricultural product, the likelihood that there will be increased imports, by reason of product shifting, if there is an affirmative determination by the Commission under section 705(b)(1) or 735(b)(1) with respect to either the raw agricultural product or the processed agricultural product (but not both),*
- (VIII) *the actual and potential negative effects on the existing development and production efforts of the domestic industry, including efforts to develop a derivative or more advanced version of the domestic like product, and*
- (IX) *any other demonstrable adverse trends that indicate the probability that there is likely to be material injury by reason of imports (or sale for importation) of the subject merchandise (whether or not it is actually being imported at the time).<sup>2</sup>*

Information on the volume and pricing of imports of the subject merchandise is presented in *Parts IV* and *V*; and information on the effects of imports of the subject merchandise on U.S. producers' existing development and production efforts is presented in *Part VI*. Information on inventories of the subject merchandise; foreign producers' operations, including the potential for "product-shifting;" any other threat indicators, if applicable; and any dumping in third-country markets, follows. Also presented in this section of the report is information obtained for consideration by the Commission on nonsubject countries.

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<sup>2</sup> Section 771(7)(F)(iii) of the Act (19 U.S.C. § 1677(7)(F)(iii)) further provides that, in antidumping investigations, ". . . the Commission shall consider whether dumping in the markets of foreign countries (as evidenced by dumping findings or antidumping remedies in other WTO member markets against the same class or kind of merchandise manufactured or exported by the same party as under investigation) suggests a threat of material injury to the domestic industry."

(continued...)

## The industry in Korea

The Commission issued foreign producers’ or exporters’ questionnaires to one firm believed to produce and/or export 4th tier cigarettes from Korea, KT&G Corporation (“KT&G”).<sup>3</sup> A usable response to the Commission’s questionnaire was received from KT&G. This firm’s exports to the United States accounted for approximately \*\*\* percent of U.S. imports of 4th tier cigarettes from Korea in 2018. According to estimates requested of the responding Korean producer, its production of 4th tier cigarettes in Korea accounts for approximately \*\*\* percent of overall production of 4th tier cigarettes in Korea. Table VII-1 presents information on the 4th tier cigarettes operations of the responding producers and exporters in Korea.

**Table VII-1**  
**4th tier cigarettes: Summary data for producers in Korea, 2018**

<b>Firm</b>	<b>Production (cartons)</b>	<b>Share of reported production (percent)</b>	<b>Exports to the United States (cartons)</b>	<b>Share of reported exports to the United States (percent)</b>	<b>Total shipments (cartons)</b>	<b>Share of firm’s total shipments exported to the United States (percent)</b>
KT&G	***	***	***	***	***	***
Total	***	***	***	***	***	***

Source: Compiled from data submitted in response to Commission questionnaires.

## Changes in operations

As presented in table VII-2, KT&G reported several operational and organizational changes since January 1, 2016.

**Table VII-2**  
**4th tier cigarettes: Korea producers' reported changes in operations, since January 1, 2016**

\* \* \* \* \*

## Operations on 4th tier cigarettes

Table VII-3 presents information on the 4th tier cigarettes operations of producer KT&G in Korea. During 2016-18, Korean capacity to produce 4th tier cigarettes fluctuated, but

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<sup>3</sup> This firm was identified through a review of information submitted in the petition and contained in \*\*\* records.

decreased overall by \*\*\* percent, while capacity was higher by \*\*\* percent during interim 2019 compared to interim 2018. During 2016-18, Korean production decreased by \*\*\* percent, while production was higher by \*\*\* percent during interim 2019 compared to interim 2018. Capacity utilization decreased by \*\*\* percentage points from 2016-18, and it was lower by \*\*\* percentage points during interim 2019 compared to interim 2018.

Exports to the United States decreased by \*\*\* percent during 2016-18 but were \*\*\* percent higher during interim 2019 compared to interim 2018. Export shipments to all other markets fluctuated but decreased by \*\*\* percent during 2016-18 and were lower during interim 2019 compared to interim 2018.<sup>4</sup> Commercial home market shipments decreased by \*\*\* percent during 2016-18, and were lower during interim 2019 compared to interim 2018.<sup>5</sup> In 2018, home market shipments accounted for \*\*\* percent of KT&G's total shipments, while exports accounted for \*\*\* percent of total shipments, based on quantity.<sup>6</sup>

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<sup>4</sup> KT&G identified \*\*\* as its principal export markets, which combined accounted for \*\*\* of total exports during 2018. The United States is projected to account for approximately \*\*\* of total exports of 4th tier cigarettes from Korea in 2020. KT&G foreign producer questionnaire, section II-8.

<sup>5</sup> In its questionnaire response, KT&G indicated \*\*\*. Staff amended the \*\*\* Email message from \*\*\*, January 14, 2020.

<sup>6</sup> KT&G identified its primary export markets during 2018, which included a breakdown of its \*\*\* of 4th tier cigarettes exported from Korea. The countries and their percentage of exports of 4th tier cigarettes from Korea include; \*\*\*. Email message from \*\*\*, January 17, 2020.

**Table VII-3**

**4th tier cigarettes: Data for producers in Korea, 2016-18, January to September 2018, January to September 2019, and projections for calendar years 2019 and 2020**

\* \* \* \* \*

Table continued on next page.

**Table VII-3--Continued**

**4th tier cigarettes: Data for producers in Korea, 2016-18, January to September 2018, January to September 2019, and projections for calendar years 2019 and 2020**

\* \* \* \* \*

**Alternative products**

There were no other products produced on the same equipment as 4th tier cigarettes from January 1, 2016 through September 30, 2019.

**Exports**

According to GTA, the leading export markets for all cigarettes from Korea are Japan, United Arab Emirates (“UAE”), and Hong Kong (table VII-4). During 2018, the United States was the seventh export market for all cigarettes from Korea, accounting for 4.5 percent.

**Table VII-4**  
**All cigarettes: Exports from Korea, 2016-18**

Destination market	Calendar year		
	2016	2017	2018
	<b>Quantity (number)</b>		
United States	138,944,700	134,121,024	125,325,120
Japan	522,025,793	891,828,492	890,502,220
United Arab Emirates	1,161,162,061	1,216,252,831	544,627,367
Hong Kong	97,365,471	97,686,901	229,750,412
Thailand	96,150,500	216,567,000	204,250,000
Libya	65,565,000	60,828,500	156,715,500
Vietnam	245,198,000	247,708,620	127,092,500
Taiwan	89,100,953	90,591,418	104,540,993
Bolivia	73,138,600	107,911,500	71,005,000
All other destination markets	591,309,688	577,003,663	309,963,553
Total exports	3,079,960,766	3,640,499,949	2,763,772,665
	<b>Value (1,000 dollars)</b>		
United States	103,863	94,860	60,380
Japan	142,753	209,783	212,979
United Arab Emirates	374,768	409,326	164,955
Hong Kong	28,856	30,385	73,014
Thailand	34,015	74,445	71,212
Libya	13,163	8,670	21,905
Vietnam	88,987	88,312	43,112
Taiwan	27,622	27,711	30,305
Bolivia	14,924	22,460	14,312
All other destination markets	152,626	159,609	99,999
Total exports	981,578	1,125,560	792,173

Table continued on next page.

**Table VII-4—Continued**  
**All cigarettes: Exports from Korea, 2016-18**

Destination market	Calendar year		
	2016	2017	2018
	<b>Unit value (dollars per number)</b>		
United States	0.75	0.71	0.48
Japan	0.27	0.24	0.24
United Arab Emirates	0.32	0.34	0.30
Hong Kong	0.30	0.31	0.32
Thailand	0.35	0.34	0.35
Libya	0.20	0.14	0.14
Vietnam	0.36	0.36	0.34
Taiwan	0.31	0.31	0.29
Bolivia	0.20	0.21	0.20
All other destination markets	0.26	0.28	0.32
Total exports	0.32	0.31	0.29
	<b>Share of quantity (percent)</b>		
United States	4.5	3.7	4.5
Japan	16.9	24.5	32.2
United Arab Emirates	37.7	33.4	19.7
Hong Kong	3.2	2.7	8.3
Thailand	3.1	5.9	7.4
Libya	2.1	1.7	5.7
Vietnam	8.0	6.8	4.6
Taiwan	2.9	2.5	3.8
Bolivia	2.4	3.0	2.6
All other destination markets	19.2	15.8	11.2
Total exports	100.0	100.0	100.0

Note.--Shares and ratios shown as "0.0" represent values greater than zero, but less than "0.05" percent. United States is shown at the top, all remaining top export destinations shown in descending order of 2018 data. Quantity data not converted, shown as reported.

Source: Official exports statistics under HS subheading 2402.20 as reported by Korea Customs and Trade Development Institution in the Global Trade Atlas database, accessed 12/27/2019.

## U.S. inventories of imported merchandise

Table VII-5 presents data on U.S. importers' reported inventories of 4th tier cigarettes. During 2016-18, U.S. importers' end-of-period inventories of imports from Korea increased by \*\*\* percent, and were \*\*\* percent higher during 2019 than during 2018. KT&G USA was the only subject importer. U.S. importers' end-of-period inventories from nonsubject sources fluctuated from 2016-18, but overall decreased by \*\*\* percent, and were lower by \*\*\* percent during 2019 than during 2018. KT&G was the only subject importer.

**Table VII-5**  
**4th tier cigarettes: U.S. importers' inventories, 2016-18, January to September 2018, and January to September 2019**

\* \* \* \* \*

## **U.S. importers' outstanding orders**

The Commission requested importers to indicate whether they imported or arranged for the importation of 4th tier cigarettes from Korea after September 30, 2019 (table VII-6). During October 2019 through March 2020, responding subject U.S. importers reported \*\*\* of arranged imports of 4th tier cigarettes from subject countries with the majority (approximately \*\*\* percent) arriving in October through December 2019. Arranged imports from Korea accounted for approximately \*\*\* percent of 4th tier cigarettes from October 1, 2019 and September 30, 2020. There were no arranged imports after March 31, 2020.

**Table VII-6**  
**4th tier cigarettes: Arranged imports, October 2019 through September 2020**

\* \* \* \* \*

## Antidumping or countervailing duty orders in third-country markets

There are no known trade remedy actions on 4th tier cigarettes in third-country markets.

## Information on nonsubject countries

### The industry in Canada

According to official import statistics, Canada is the leading source of imports of all cigarettes. In 2018, the U.S. imported 3.9 million units.<sup>7</sup> In 2016, there were 15.39 billion cigarettes produced, however cigarette imports exceeded cigarette exports.<sup>8</sup> The tobacco industry in Canada is divided into premium cigarette brands, mainstream cigarette brands, deep discount cigarette brands, other tobacco products, and tobacco stemming and redrying. Total revenue in the tobacco industry in Canada in 2019 was roughly \$2 billion with an annual growth rate of 6.9 percent from 2014 to 2019. The market is dominated by two firms: Rothmans, Benson & Hedges Inc. (“RBH”), a subsidiary of Phillip Morris International, and JTI-Macdonald Corp. RBH is the largest fully integrated Canadian cigarette manufacturer.<sup>9</sup> Cigarette sales in Canada have declined from 2001 to 2017 in both absolute and per capita terms.<sup>10</sup> The Government of Canada (“GOC”) has found that discount and premium cigarettes have the same physical characteristics and that discount cigarettes have gained “considerable market share” from premium and other tier cigarettes. GOC has also cited evidence that individuals will switch from premium to discount brands in lieu of quitting or reducing the number of cigarettes.<sup>11</sup>

Table VII-7 presents exports of all cigarettes from Canada, based on value, by destination market during 2016-18. From 2016-2018, the United States was the largest destination market for all of Canada’s cigarettes’ exports with at least 95.4 percent share of value in each year.

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<sup>7</sup> USITC Dataweb, accessed January 17, 2020.

<sup>8</sup> Tobacco Atlas: <https://tobaccoatlas.org/country/canada/>

<sup>9</sup> <https://www.ibisworld.com/canada/market-research-reports/cigarette-tobacco-manufacturing-industry/>

<sup>10</sup> <https://uwaterloo.ca/tobacco-use-canada/adult-tobacco-use/cigarette-sales-and-sources>

<sup>11</sup> <https://www.canada.ca/en/health-canada/services/publications/healthy-living/discount-cigarettes.html>

**Table VII-7**  
**All cigarettes: Canada exports by destination market, 2016-18**

Destination market	Calendar year		
	2016	2017	2018
	<b>Value (1,000 dollars)</b>		
United States	90,660	103,135	103,150
Vietnam	408	1,082	665
France	---	112	485
Singapore	2,939	1,553	209
Netherlands	---	---	116
Guatemala	125	---	62
Brazil	3	17	32
Belize	---	46	---
Costa Rica	---	9	---
All other destination markets	888	1,087	---
Total exports	95,023	107,041	104,720
	<b>Share of value (percent)</b>		
United States	95.4	96.4	98.5
Vietnam	0.4	1.0	0.6
France	---	0.1	0.5
Singapore	3.1	1.5	0.2
Netherlands	---	---	0.1
Guatemala	0.1	---	0.1
Brazil	0.0	0.0	0.0
Belize	---	0.0	---
Costa Rica	---	0.0	---
All other destination markets	0.9	1.0	---
Total exports	100.0	100.0	100.0

Note.--Shares and ratios shown as "0.0" represent values greater than zero, but less than "0.05" percent. United States is shown at the top, all remaining top export destinations shown in descending order of 2018 data.

Source: Official exports statistics under HS subheading 2402.20 as reported by Statistics Canada in the Global Trade Atlas database, accessed 1/24/2020.

## The industry in Turkey

According to official import statistics, Turkey is the second largest source of nonsubject imports of all cigarettes and the third largest source of all cigarettes. In 2018, the U.S. imported 1.4 million units.<sup>12</sup> In 2016, there were roughly 160 billion cigarettes produced in Turkey. In 2014, 0.3 percent of agricultural land was devoted to agricultural cultivation, producing 74,696 metric tons of tobacco.<sup>13</sup> The Turkish cigarette industry is dominated by transnational tobacco

<sup>12</sup> USITC Dataweb, accessed January 17, 2020.

<sup>13</sup> Tobacco Atlas: <https://tobaccoatlas.org/country/turkey/>

(continued...)

companies (“TTCs”), controlling over 99 percent of the market in 2015.<sup>14</sup> Until 2008, government owned Tekel was the only domestic manufacturer with several TTCs including, Philip Morris and Imperial Tobacco (the parent company of U.S. firm ITG Brands), also manufacturing cigarettes in Turkey.<sup>15</sup> In 2008, Tekel was acquired by British American Tobacco (“BAT”). Turkey is also one of the largest sources of Oriental, also known as Turkish, tobacco.<sup>16</sup>

## The industry in Paraguay

According to official import statistics, Paraguay is the sixth largest source of nonsubject imports of all cigarettes and the seventh largest source of all cigarettes.<sup>17</sup> In 2018, the U.S. imported 42 thousand units.<sup>18</sup> Cigarette manufacturing is dominated by Tabacaler del Este (“Tabesa”). Tabesa is one of two Latin American tobacco companies that actively exports to the United States, actively selling its brand Palermo in seven U.S. states: Delaware, Georgia, Illinois, Kansas, Utah, Virginia, and West Virginia. Cigarette production in Paraguay has grown from virtually zero in 1989 to over 45 billion units in 2017.<sup>19</sup>

Table VII-8 presents global exports data (based on value) for all cigarettes by exporter for 2016-18.

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<sup>14</sup> <https://bmcpublihealth.biomedcentral.com/articles/10.1186/s12889-018-5071-z>

<sup>15</sup> <https://www.businesswire.com/news/home/20061109005054/en/Cigarettes-Dominate-Turkish-Tobacco-Market-Consists-Local>

<sup>16</sup> <https://www.coresta.org/abstracts/tobacco-production-turkey-28070.html>

<sup>17</sup> According to questionnaire data, Paraguay was a major nonsubject source of 4th tier cigarettes.

<sup>18</sup> USITC Dataweb, accessed January 17, 2020.

<sup>19</sup> <https://globalizationandhealth.biomedcentral.com/articles/10.1186/s12992-018-0412-3#Sec4>

**Table VII-8**  
**All cigarettes: Global exports by Exporter, 2016-18**

Exporter	Calendar year		
	2016	2017	2018
	<b>Value (1,000 dollars)</b>		
United States	989,018	900,326	1,071,936
South Korea	981,578	1,125,560	792,173
United Arab Emirates	831,449	212,915	4,204,090
Poland	1,955,717	2,927,165	3,356,135
Germany	3,475,896	3,025,840	2,790,071
Netherlands	1,702,923	1,631,499	1,281,554
Hong Kong	1,123,012	1,000,385	1,137,721
Singapore	1,147,535	1,047,359	1,054,441
Indonesia	738,279	821,768	856,559
Lithuania	400,227	540,143	850,398
Czech Republic	818,454	881,259	726,165
China	634,751	575,781	721,043
All other exporters	6,711,255	6,652,560	6,650,372
Total	21,510,093	21,342,559	25,492,659
	<b>Share of value (percent)</b>		
United States	4.6	4.2	4.2
South Korea	4.6	5.3	3.1
United Arab Emirates	3.9	1.0	16.5
Poland	9.1	13.7	13.2
Germany	16.2	14.2	10.9
Netherlands	7.9	7.6	5.0
Hong Kong	5.2	4.7	4.5
Singapore	5.3	4.9	4.1
Indonesia	3.4	3.9	3.4
Lithuania	1.9	2.5	3.3
Czech Republic	3.8	4.1	2.8
China	3.0	2.7	2.8
All other exporters	31.2	31.2	26.1
Total	100.0	100.0	100.0

Note.--Shares and ratios shown as "0.0" represent values greater than zero, but less than "0.05" percent.

Source: Official exports statistics under HS subheading 2402.20 reported by various national statistical authorities in the Global Trade Atlas database, accessed 12/27/2019.



**APPENDIX A**

***FEDERAL REGISTER NOTICES***



The Commission makes available notices relevant to its investigations and reviews on its website, [www.usitc.gov](http://www.usitc.gov). In addition, the following tabulation presents, in chronological order, *Federal Register* notices issued by the Commission and Commerce during the current proceeding.

<b>Citation</b>	<b>Title</b>	<b>Link</b>
84 FR 70997, December 26, 2019	<i>4th Tier Cigarettes From Korea; Institution of Antidumping Duty Investigation and Scheduling of Preliminary Phase Investigation</i>	<a href="https://www.govinfo.gov/content/pkg/FR-2019-12-26/pdf/2019-27722.pdf">https://www.govinfo.gov/content/pkg/FR-2019-12-26/pdf/2019-27722.pdf</a>
85 FR 2390, January 15, 2020	<i>4th Tier Cigarettes From the Republic of Korea: Initiation of Less-Than-Fair-Value Investigation</i>	<a href="https://www.govinfo.gov/content/pkg/FR-2020-01-15/pdf/2020-00452.pdf">https://www.govinfo.gov/content/pkg/FR-2020-01-15/pdf/2020-00452.pdf</a>



**APPENDIX B**

**LIST OF STAFF CONFERENCE WITNESSES**



## CALENDAR OF PUBLIC PRELIMINARY CONFERENCE

Those listed below appeared as witnesses at the United States International Trade Commission's preliminary conference:

**Subject:** 4th Tier Cigarettes from Korea

**Inv. No.:** 731-TA-1465 (Preliminary)

**Date and Time:** January 8, 2020 - 9:30 a.m.

Sessions were held in connection with this preliminary phase investigation in Courtroom B (Room 111), 500 E Street, SW., Washington, DC.

### **OPENING REMARKS:**

In Support of Imposition (**Daniel B. Pickard**, Wiley Rein LLP)

In Opposition to Imposition (**Shara L. Aranoff**, Covington & Burling LLP)

### **In Support of the Imposition of Antidumping Duty Orders:**

Wiley Rein LLP  
Washington, DC  
on behalf of

Coalition Against Korean Cigarettes ("CAKC")

**Derick Taylor**, Chief Executive Officer, Xcaliber International

**Eric Estes**, General Counsel, Xcaliber International

**Jay Smith**, Chief Financial Officer, Xcaliber International

**Joe Nicholas**, National Sales Manager, Xcaliber International

**Jesse Phillips**, Assistant Director of Research and Development,  
Xcaliber International

**Bruce Freeman**, Associate General Counsel, Xcaliber International

**Professor Allison Koester**, Professor of Accounting, Georgetown

**In Support of the Imposition of  
Antidumping Duty Orders (continued):**

Claire Webster, Law Clerk, Wiley Rein LLP

**Daniel B. Pickard** ) – OF COUNSEL

**In Opposition to the Imposition of  
Antidumping Duty Orders:**

Covington & Burling LLP  
Washington, DC  
on behalf of

KT&G Corporation  
KT&G USA Corporation

**Jae Young Cho**, President, KT&G USA Corporation

**Byung Uk Yoon**, Director of Marketing, KT&G USA Corporation

**Candice White**, Regional Sales Manager of North Central Region,  
KT&GUSA Corporation

**Kyeong-Soo Kim**, Interpreter, TransPerfect Legal Solutions

**Shara L. Aranoff** )  
 ) – OF COUNSEL  
**James M. Smith** )

**REBUTTAL/CLOSING REMARKS:**

In Support of Imposition (**Daniel B. Pickard**, Wiley Rein LLP)

In Opposition to Imposition (**Shara L. Aranoff**, Covington & Burling LLP)

**-END-**

**APPENDIX C**  
**SUMMARY DATA**



**Table C-1**

**4th tier cigarettes: Summary data concerning the U.S. market, 2016-18, January to September 2018, and January to September 2019**

(Quantity=cartons; Value=1,000 dollars; Unit values, unit labor costs, and unit expenses=dollars per carton; Period changes=percent—exceptions noted)

	Reported data					Period changes			
	Calendar year		2018	January to September		Calendar year			Jan-Sep 2018-19
	2016	2017		2018	2018	2016-18	2016-17	2017-18	
U.S. consumption quantity:									
Amount.....	***	***	***	***	***	▲***	▼***	▲***	▲***
Producers' share (fn1).....	***	***	***	***	***	▲***	▲***	▼***	▼***
Importers' share (fn1):									
Korea.....	***	***	***	***	***	▼***	▼***	▲***	▲***
Nonsubject sources.....	***	***	***	***	***	▼***	▲***	▼***	▼***
All import sources.....	***	***	***	***	***	▼***	▼***	▲***	▲***
U.S. consumption value:									
Amount.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Producers' share (fn1).....	***	***	***	***	***	▲***	▲***	▼***	▼***
Importers' share (fn1):									
Korea.....	***	***	***	***	***	▼***	▼***	▲***	▲***
Nonsubject sources.....	***	***	***	***	***	▲***	▲***	▼***	▼***
All import sources.....	***	***	***	***	***	▼***	▼***	▲***	▲***
U.S. importers' U.S. shipments of imports from:									
Korea:									
Quantity.....	***	***	***	***	***	▼***	▼***	▲***	▲***
Value.....	***	***	***	***	***	▼***	▼***	▲***	▲***
Unit value.....	***	***	***	***	***	▼***	▲***	▼***	▼***
Ending inventory quantity.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Nonsubject sources:									
Quantity.....	***	***	***	***	***	▼***	▲***	▼***	▲***
Value.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Unit value.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Ending inventory quantity.....	***	***	***	***	***	▼***	▼***	▲***	▼***
All import sources:									
Quantity.....	***	***	***	***	***	▼***	▼***	▲***	▲***
Value.....	***	***	***	***	***	▼***	▼***	▲***	▲***
Unit value.....	***	***	***	***	***	▲***	▲***	▼***	▼***
Ending inventory quantity.....	***	***	***	***	***	▲***	▼***	▲***	▲***
U.S. producers':									
Average capacity quantity.....	***	***	***	***	***	▲***	▲***	▲***	▼***
Production quantity.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Capacity utilization (fn1).....	***	***	***	***	***	▼***	▼***	▲***	▲***
U.S. shipments:									
Quantity.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Value.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Unit value.....	***	***	***	***	***	▲***	▲***	▼***	▼***
Export shipments:									
Quantity.....	***	***	***	***	***	▼***	▼***	▲***	▼***
Value.....	***	***	***	***	***	▼***	▼***	▲***	▼***
Unit value.....	***	***	***	***	***	▼***	▼***	▲***	▲***
Ending inventory quantity.....	***	***	***	***	***	▲***	▲***	▼***	▲***
Inventories/total shipments (fn1).....	***	***	***	***	***	▲***	▲***	▼***	▼***
Production workers.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Hours worked (1,000s).....	***	***	***	***	***	▲***	▲***	▲***	▲***
Wages paid (\$1,000).....	***	***	***	***	***	▲***	▲***	▲***	▲***
Hourly wages (dollars per hour).....	***	***	***	***	***	▲***	▼***	▲***	▲***
Productivity (cartons per hour).....	***	***	***	***	***	▼***	▼***	▼***	▼***
Unit labor costs.....	***	***	***	***	***	▲***	▼***	▲***	▲***

Table continued on next page.

**Table C-1--Continued**

**4th tier cigarettes: Summary data concerning the U.S. market, 2016-18, January to September 2018, and January to September 2019**

(Quantity=cartons; Value=1,000 dollars; Unit values, unit labor costs, and unit expenses=dollars per carton; Period changes=percent--exceptions noted)

	Reported data					Period changes			
	Calendar year		2018	January to September		Calendar year			Jan-Sep 2018-19
	2016	2017		2018	2018	2016-18	2016-17	2017-18	
Net sales:									
Quantity.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Value.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Unit value.....	***	***	***	***	***	▲***	▲***	▼***	▼***
Cost of goods sold (COGS).....	***	***	***	***	***	▲***	▲***	▲***	▲***
Gross profit or (loss) (fn2).....	***	***	***	***	***	▲***	▲***	▲***	▲***
SG&A expenses.....	***	***	***	***	***	▲***	▼***	▲***	▼***
NPM escrow payments.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Operating income or (loss) (fn2).....	***	***	***	***	***	▼***	▲***	▼***	▼***
Net income or (loss) (fn2).....	***	***	***	***	***	▼***	▲***	▼***	▲***
Capital expenditures.....	***	***	***	***	***	▼***	▼***	▼***	▲***
Unit COGS.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Unit SG&A expenses.....	***	***	***	***	***	▼***	▼***	▲***	▼***
Unit NPM escrow payments.....	***	***	***	***	***	▲***	▲***	▲***	▲***
Unit operating income or (loss) (fn2)...	***	***	***	***	***	▼***	▼***	▼***	▼***
Unit net income or (loss) (fn2).....	***	***	***	***	***	▼***	▼***	▼***	▼***
COGS/sales (fn1).....	***	***	***	***	***	▲***	▼***	▲***	▲***
Operating income or (loss)/sales (fn1)	***	***	***	***	***	▼***	▼***	▼***	▼***
Net income or (loss)/sales (fn1).....	***	***	***	***	***	▼***	▼***	▼***	▼***

Notes:

Note.--Shares and ratios shown as "0.0" percent represent non-zero values less than "0.05" percent (if positive) and greater than "(0.05)" percent (if negative). Zeroes, null values, and undefined calculations are suppressed and shown as "----". Period changes preceded by a "▲" represent an increase, while period changes preceded by a "▼" represent a decrease.

fn1.--Reported data are in percent and period changes are in percentage points.

fn2.--Percent changes only calculated when both comparison values represent profits; The directional change in profitability provided when one or both comparison values represent a loss.

Source: Compiled from data submitted in response to Commission questionnaires.

**APPENDIX D**

**U.S. PRODUCERS' AND IMPORTERS' COMPARISONS OF  
PRODUCTS BY THE LIKE PRODUCT FACTORS**



Tables D-1 (U.S. producers), D-2 (U.S. importers), D-3 (comparisons of cigarettes), and D-4 (total consumption of all cigarettes) present a summary of U.S. producers' and importers' responses on the comparability of 4th tier cigarettes versus all other cigarettes. Each table includes the six like product factors and the narratives provided by U.S. producers and importers.

**Table D-1**  
**4th tier cigarettes: U.S. producers' comparisons of products by the like product factors**

\* \* \* \* \*

Table continued on next page.

**Table D-1—Continued**  
**4th tier cigarettes: U.S. producers' comparisons of products by the like product factors**

\* \* \* \* \*

**Table D-2**  
**4th tier cigarettes: U.S. importers' comparisons of products by the like product factors**

\* \* \* \* \*

**Table D-2--Continued**  
**4th tier cigarettes: U.S. importers' comparisons of products by the like product factors**

\* \* \* \* \*

**Table D-3**  
**4th tier cigarettes: U.S. producers' and U.S. importers' comparisons of in-scope 4th tier cigarettes vs. all other cigarettes**

Factor	U.S. producers				U.S. importers			
	F	M	S	N	F	M	S	N
	<b>Count of firms</b>							
Physical characteristics	1	---	---	2	2	2	---	---
Interchangeability	1	---	---	2	1	3	---	---
Manufacturing	---	---	1	2	---	4	---	---
Channels	---	1	---	2	1	2	1	---
Perceptions	---	---	1	2	---	3	---	1
Price	---	---	---	3	---	---	1	3

Source: Compiled from data submitted in response to Commission questionnaires.

Table D-3 presents U.S. producers' and U.S. importers comparisons of in-scope 4th tier cigarettes versus all other cigarettes. For the analysis of each of the following six factors the responses are categorized as follows:

- F: fully comparable or the same, *i.e.*, have no differentiation between them;
- M: mostly comparable or similar;
- S: somewhat comparable or similar;
- N: never or not-at-all comparable or similar; or
- O: no familiarity with products.

### **Physical characteristics and uses**

Three U.S. producers and four U.S. importers addressed the physical characteristics and end uses of 4th tier cigarettes compared to all other cigarettes. Two U.S. producers indicated that they were never or not-at-all comparable or similar, while one producer and the four U.S. importers indicated that they were (two) fully comparable or the same or (two) mostly comparable or the same.

At the Commission's conference, the petitioner indicated that there were additional physical characteristics that include; filters, cigarette papers, and two differences regarding packaging (particularly the rounded corner inside the package). The rounded corner differs from the non-4th tier cigarettes stamped or embossed in aluminum foil.<sup>1</sup> The petitioner further indicated that these differences are regulated by the Food and Drug Administration.

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<sup>1</sup> Conference transcript, pp. 78-79 (Pickard).

(continued...)

In its postconference brief, the petitioner contends that the ten percent stem content in the tobacco blend is a bright line that separates 4th tier cigarettes from non-4th tier products.<sup>2</sup>

In its postconference brief, the respondents asserted that while the petitioner has proposed a variety of physical characteristics that distinguish 4th tier cigarettes from other domestic cigarettes, none provides a clear dividing line.<sup>3</sup>

## **Interchangeability**

Three U.S. producers and four U.S. importers addressed the question of the ability to substitute products with the same products in the same application of 4th tier cigarettes compared to all other cigarettes. Two U.S. producers indicated that they were never or not-at-all comparable or similar, while the four U.S. importers indicated that they were either fully comparable or the same or mostly comparable or similar.

In its postconference brief, the respondents indicated that because all cigarettes are interchangeable in their end use of smoking, smokers with certain brand preferences will still smoke other cigarettes based on availability, location, weather, exposure to advertising, or simply because they prefer a different flavor profile on any given day.<sup>4</sup>

## **Channels of distribution**

Three U.S. producers and four U.S. importers addressed the basis through which the channels of distribution of 4th tier cigarettes are sold compared to all other cigarettes. Two U.S. producers indicated that they were never or not-at-all comparable or similar, while the four U.S. importers had varied responses.

In its postconference brief, the petitioner contended that 4th tier cigarettes are marketed and sold differently compared to all other cigarettes.<sup>5</sup>

In its postconference brief, the respondents stated that all domestic cigarettes are sold through the same channels of distribution in the U.S. market, and that there is no distinct channel of distribution for 4th tier cigarettes.<sup>6</sup>

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<sup>2</sup> Petitioners postconference brief, p. 5.

<sup>3</sup> Respondents postconference brief, p. 9.

<sup>4</sup> Respondents postconference brief, p. 15.

<sup>5</sup> Petitioners postconference brief, p. 9.

<sup>6</sup> Petitioners postconference brief, p. 17.

## **Customer and producer perceptions**

Three U.S. producers and four U.S. importers addressed the question of whether for 4th tier cigarettes compared to all other cigarettes regarding market perceptions. Three U.S. producers indicated that they were either never or not-at-all comparable or similar and somewhat comparable or similar, while three of the four U.S. importers indicated mostly comparable or the same and one indicated it was never similar or comparable.

In its postconference brief, the respondents indicated that neither customers or producers perceive there to be a separate category of 4<sup>th</sup> tier cigarettes in the market made up of only cigarettes produced by the four producers the petitioner identifies as the domestic industry.<sup>7</sup>

In its postconference brief, the petitioner contends that customers perceive 4th tier cigarettes to be cheaper, of lower quality, and have customers that are not typically brand loyal.<sup>8</sup>

## **Manufacturing facilities and production employees**

Three U.S. producers and four U.S. importers addressed the basis of whether for 4th tier cigarettes compared to all other cigarettes are manufactured in the same facilities, from the same inputs, on the same/shared machinery and equipment, and using the same employees. Three U.S. producers indicated that they were either never or not-at-all comparable or similar and somewhat comparable or similar, while all four U.S. importers indicated that they were mostly comparable or similar.

In its postconference brief, the petitioner indicated that non-4th tier cigarette producers are vertically integrated, while 4th tier cigarette manufacturers buy their tobacco blends for further processing.<sup>9</sup> At the Commission's conference, the petitioner indicated that there are zero employees in the United States who both manufacture 4th tier and non-4th tier cigarettes.<sup>10</sup>

In its postconference brief, the respondents indicated that there are domestic producers with primary production capability producing cigarettes to be sold at various pricing points, including discount brands.<sup>11</sup>

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<sup>7</sup> Respondents postconference brief, p. 17.

<sup>8</sup> Petitioners postconference brief, p. 10.

<sup>9</sup> Petition, p. 13.

<sup>10</sup> Conference transcript, p. 49 (Pickard).

<sup>11</sup> Respondents postconference brief, p. 16.

## **Price**

Three U.S. producers and four U.S. importers addressed the question of whether for 4th tier cigarettes compared to all other cigarettes regarding price. Three U.S. producers indicated that they were either never or not-at-all comparable or similar, while the four U.S. importers indicated that they were never similar or comparable or somewhat similar and comparable.

At the Commission's conference, the respondents indicated that the tier that the cigarettes are categorized by are determined by whether it is relatively higher or relatively lower priced.<sup>12</sup>

At the Commission's conference, the petitioner's indicated that 4th tier cigarettes are price sensitive and they (customers) will switch back and forth in terms of price, but they won't be alternating between premium and 4th tier cigarettes. As far as the general rule, non-4th tier stay within their tier and 4th tier cigarettes stay within their tier.<sup>13</sup>

## **U.S. consumption of all cigarettes**

Table D-4 presents data on U.S. consumption of all cigarettes from all tiers and their market shares during 2016-18, January to September 2018, and January to September 2019. These data for all cigarettes were combined from questionnaire responses, official U.S. import statistics, and the Federal Trade Commission's Cigarette Report for 2017.

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<sup>12</sup> Conference transcript, p. 214 (Aranoff).

<sup>13</sup> Conference transcript, p. 101 (Pickard).

**Table D-4**  
**All cigarettes: U.S. consumption and market shares, 2016-18, January to September 2018, and**  
**January to September 2019**

\* \* \* \* \*

