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Anthony Ciolli

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GRAY MARKET CIGARETTES

Anthony Ciolli

Within five years of the Multi-state Settlement Agreement between the tobacco industry and state attorney generals, the price of cigarettes in the United States nearly doubled, with taxes making up “approximately sixty percent of the total price of cigarettes.”¹ In the aftermath of these sudden price increases, “[h]undreds of web sites . . . sprung up to cater to customers . . . fed up with high cigarette prices.”² These websites market low cost brand-name cigarettes to Americans and are often owned by foreign nationals and operated outside the borders of the United States. Such cigarettes—often labeled “gray market” cigarettes—are “cigarettes manufactured for sale overseas” that are then “re-imported and sold without the manufacturer’s permission.”³ This essay will analyze the gray market cigarette problem and propose that state and federal governments change their strategy by targeting American purchasers rather than foreign intermediaries.

I. THE CURRENT STATE OF AFFAIRS

A. Gray Market Cigarettes: A Common Problem

Gray market cigarettes provide a common enemy for American cigarette manufacturers, federal and state governments, and anti-smoking organizations. Because foreign websites can sell gray market Marlboros, which normally sell for \$70 a carton in New York City, for a mere \$15 a carton,⁴ not only do cigarette manufacturers such as Philip Morris lose a significant portion of their profits, but federal, state, and

¹ Michael Kwon, *Filtering the Smoke Out of Cigarette Websites: A Technological Solution to Enforcing Judgments Against Offshore Websites*, 30 BROOK. J. INT’L L. 1067, 1071 (2005).

² John Reid Blackwell, *Tobacco Campaign: Major Companies Defend their Turf Against ‘Underground’ Competitors*, RICHMOND TIMES DISPATCH, Mar. 24, 2003, at D4.

³ Kwon, *supra* note 1, at 1072.

⁴ Marton Dunai, *Altria Unit Wins Cigarette Vendor’s Internet Address*, WALL ST. J., Aug. 25, 2004, at B2.

local governments do not receive any tax revenue from the sale.⁵ Due to their low prices and insufficient or non-existent identification methods, anti-smoking organizations have often attacked gray market cigarettes as being too easily accessible to children and too available to low-income individuals who could otherwise not afford them due to high taxes.⁶

B. Attacking International Intermediaries: The Inadequate Solution

However, despite all major stakeholders in the smoking debate being united on this issue, efforts to combat the importation of gray market cigarettes have been largely unsuccessful. Virtually all states, as well as the federal government, have forbidden the sale or distribution of re-imported cigarettes.⁷ Consequently, the individuals who operate websites that sell gray market cigarettes to Americans typically do no legitimate business in the United States and remain physically located in foreign countries, making it exceptionally difficult for federal or state governments to pursue criminal charges against the website owners and for cigarette manufacturers to enforce civil judgments against them.

The case of Otamedia provides perhaps the most notable example of the inadequacy of the current legal structure. Between 2000 and 2004, Otamedia, a Swiss company sometimes referred to as the “Tobacco Napster,” operated the Yesmoke.com and Yessmoke.com websites, which sold tax-free and deeply discounted re-imported Marlboro cigarettes primarily to Americans.⁸ When Philip Morris sued Otamedia for trademark infringement and related causes of action,⁹ Otamedia simply did not answer Philip Morris’s complaint and had a default judgment entered against it, “which enjoined it from selling cigarettes to U.S. consumers,” a judgment which it also ignored.¹⁰ Although the court later modified its order to mandate the transfer of

⁵ In 2003, state governments alone lost approximately \$552.4 million in tax revenue due to illegal cigarettes. David Pittman, *Ariz. Gunning for Buyers of Online Smokes*, TUCSON CITIZEN, Aug. 26, 2004, at 1D.

⁶ Kwon, *supra* note 1, at 1073.

⁷ Rebecca Deusser, *Panagiotakos Trying to Snuff Out Gray Market Cigarettes*, LOWELL SUN, Nov. 29, 2005, at 18.

⁸ Yesmoke, Introduction, <http://www.yesmoke.eu/26.html> (last visited Apr. 24, 2007).

⁹ *Philip Morris USA, Inc. v. Otamedia, Ltd.*, 331 F. Supp. 2d 228, 229 (S.D.N.Y. 2004).

¹⁰ Kwon, *supra* note 1, at 1068.

Yesmoke.com and Yessmoke.com—both U.S.-registered domain names—to Philip Morris,¹¹ Otamedia merely registered Yesmoke.ch and Yessmoke.ch in Switzerland and resumed business as usual.¹² In November 2004, after four years of operation and after re-importing more than six million cartons of Marlboros, the United States government was finally able to seize a large shipment of Otamedia cigarettes at JFK Airport; however, by this time Otamedia had ceased selling gray market Marlboros, instead choosing to export its own brand of cigarettes, “Yesmokes.”¹³

Not surprisingly, literally hundreds of foreign websites continue to operate today marketing gray market cigarettes to Americans, including many that have recently established themselves in hopes of filling the void left by Yesmoke.ch. The Republic of Moldova has become a popular host for such sites, with several prominent sites, such as CigOutlet.net and Cigarette-Sales-Online.com, now operating within its borders.¹⁴

II. A PROPOSAL FOR CHANGE

Attempts to curb the market for gray market cigarettes in the United States have failed largely due to the inability to enforce U.S. law on websites that operate exclusively in foreign nations. Because the owners of such sites are outside the reach of criminal prosecution and do not fear civil judgments in American courts, attempts to curtail the re-importation of cigarettes are unlikely to succeed when international intermediaries are the primary enforcement target.

Rather than continuing to focus exclusively on foreign intermediaries, governments should pass legislation to permit cigarette manufacturers to pursue causes of action against the Americans who purchase gray market cigarettes from these sites, just as copyright holders have the option of pursuing lawsuits against intermediary websites as well as individual downloaders for copyright infringement.¹⁵ Given the immense difficulty in shutting down the

¹¹ Philip Morris, 331 F. Supp. 2d at 247.

¹² Dunai, *supra* note 4.

¹³ Yesmoke, The Swiss Yesmoke Brand, <http://www.yesmoke.eu/1101.html> (last visited Apr. 24, 2007).

¹⁴ See Cigarette Sales Online, About Us, <http://www.cigarettes-sale-online.com/about.htm> (last visited Apr. 24, 2007); CigOutlet.net, About Us, <http://www.cigoutlet.net/about.html> (last visited Apr. 24, 2007).

¹⁵ CITE.

foreign suppliers of gray market cigarettes, significantly raising the potential costs of purchasing gray market cigarettes may yield greater results.

Some may question whether such a solution is practical—after all, given that foreign intermediaries often ignore the orders of American courts, the owner of a website such as CigOutlet.net is unlikely to voluntarily provide its customer list to Philip Morris so that it could initiate litigation against them.¹⁶ However, the website is not the only intermediary involved in the transaction—such websites depend on American credit card companies, such as Visa and MasterCard, to process orders.¹⁷ Thus, while a website operating out of Moldova with no American connections may not voluntarily provide a customer list or comply with a subpoena, established credit card companies with significant business ties to the United States are unlikely to disregard a court order or refuse to comply with American laws.

Another question is whether such lawsuits would be cost-effective for a cigarette company to pursue, given the high cost of litigation and potentially low ability to recover damages from individual defendants. The music industry's mass lawsuits against file sharers have demonstrated that, through the use of boilerplate complaints, cost-effective "assembly line" litigation is possible to engage in where settlement money from one wave of lawsuits is large enough to cover the costs of the next wave.¹⁸ Given the inherent differences in pursuing lawsuits against anonymous file sharers who must be identified by their internet service providers and pursuing lawsuits against individuals whose real name and address has been provided by a credit card company or other financial intermediary, lawsuits against those who purchase gray market cigarettes online are likely to be even more cost-effective than lawsuits against individual file-sharers. Obtaining such information from credit card companies would also greatly reduce the "mistaken identity" problem that has plagued litigation against individual file sharers.¹⁹

¹⁶ *But see* <http://www.news.com/Russia-agrees-to-shut-down-AllofMP#.com> (discussing Russia's agreement to shut down allofmp3.com website upon the U.S.'s request).

¹⁷ *See, e.g.*, CigOutlet.net, FAQ, <http://www.cigoutlet.net/faq.html> (last visited Apr. 24, 2007).

¹⁸ *See* Ray Beckerman, How the RIAA Litigation Process Works, <http://info.riaa.com/lawsuits.us/howriaa.htm> (last visited Apr. 24, 2007).

¹⁹ Plaintiff recording companies in file sharing cases have often been criticized for suing the wrong individual due to the inherent difficulties in tying an IP address to a

Furthermore, the ultimate goal of such lawsuits would not be to necessarily gouge or punish those specific purchasers, but to deter the general public from purchasing cigarettes online from such websites. Although some have argued that lawsuits against file sharers have not significantly deterred people from file sharing, the recording industry typically only files suit against a few hundred file sharers at a time, out of a population of literally millions.²⁰ Because the number of individuals who purchase gray market cigarettes from websites located abroad is likely far smaller—and those individuals easier to identify—than the number of file sharers, a wave of lawsuits would likely result a greater deterrent effect due to a larger percentage of the gray market purchaser population being subject to such litigation.

III. CONCLUDING REMARKS

The internet, the first medium of mass communication to truly transcend national borders, allows any individual or company to do business on a global scale, even when that business may undermine the public policy of a nation such as the United States. In the absence of a true world government that ensure that a nation's court judgments will always be enforced overseas, foreign websites that violate American law, such as those that sell gray market cigarettes to Americans, will continue to be the source of much frustration. But rather than exclusively focusing on futile attempts to shut down these out of reach intermediaries through the U.S. legal system, government should seek to create new remedies against those who play a critical role in the illegal activity. The government, by passing legislation that would allow cigarette manufacturers to pursue a private cause of action against individuals who purchase gray market cigarettes, would provide cigarette manufacturers with the vital tool they need to crack down on the gray market even when foreign sellers themselves are out of reach.

specific person. See, e.g., Jon Newton, *Santangelo Loses Lawyer, To Defend Herself in File Share Trial*, MP3 NEWSWIRE, Dec. 7, 2005, http://www.mp3newswire.net/stories/5002/santangelo_trial.htm.

²⁰ Thomas Mennecke, *File Sharing Population Level Through October*, SLYCK NEWS, Nov. 14, 2005, <http://www.slyck.com/news.php?story=991>.

