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## In-Store RYO Production: Fighting Back the TTB

*A leading RYO machine manufacturer squares off in court with the federal government; court enters preliminary injunction prohibiting the TTB from regulating in-store production of roll-your-own cigarettes.*

**>BY BRYAN M. HAYNES**

A federal judge in Akron, Ohio has entered a preliminary injunction prohibiting the Alcohol and Tobacco Tax and Trade Bureau (TTB) of the United States Treasury Department from further regulating in-store production of roll-your-own cigarettes by consumers. TTB's Ruling No. 2010-4, "Cigarette-making Machines in Retail Establishments," issued on September 30, 2010 ("the TTB Ruling"), took the unprecedented step of classifying an individual's production of cigarettes in a retail environment, for his or her own

personal consumption or use, as the manufacture of tobacco products. Under the TTB Ruling, retailers who supply machines—whether electronic or manual—for consumers to produce cigarettes in a retail environment for personal use would have been classified as "manufacturers of tobacco products" under the Internal Revenue Code and subject to the same permitting requirements as industrial-scale manufacturers.

RYO Machine Rental, LLC ("RYO Machine"), a company that manufactures the RYO Filling Stations that would

have been subject to the TTB Ruling, along with a distributor that sells the RYO Filling Stations and a retailer who allows consumers to use the machines, successfully challenged the TTB Ruling. The federal court's decision is currently on appeal to the Sixth Circuit Court of Appeals in Cincinnati.

### FROM HANDROLLING TO CARTON PRODUCTION

Consumers can produce cigarettes for their personal use in a number of different ways. Consumers may purchase packaged tobacco and cigarette papers and roll the cigarettes either by hand or by using a hand-rolling machine. Consumers may also purchase tobacco and pre-fabricated cigarette tubes (comprising all parts of the cigarette except the tobacco, including cigarette paper, tipping paper, and filter).

*>Above: Phil Accordino, co-owner of RYO Machine Rental LLC, builds, sells, and leases customer-operated in-store machines with an ATM-like interface that produce a carton of cigarettes in about 10 minutes.*

As a practical matter it is virtually impossible for consumers to produce cigarettes by hand using tubes. Since at least the 1930s, consumers have used tabletop and handheld cigarette-making machines to produce cigarettes using tubes and packaged tobacco. The most basic of these models are made of plastic and operate manually to form the tobacco into a roll and push the tobacco into the tube. They make one cigarette at a time.

There are also a variety of electronic machines that consumers use to produce cigarettes for their personal use using tobacco and tubes, including the RYO Filling Stations manufactured by RYO Machine. Most of these electronic machines

are capable of producing 200 cigarettes every 20 minutes. Consumers can produce 200 cigarettes using the RYO Filling Station about every 10 minutes.

#### THE RYO FILLING STATION

The RYO Filling Stations are not significantly different from the electronic cigarette machines that have been used by consumers for many years, except the RYO Filling Stations are more efficient, although nowhere near as efficient as the commercial machines used in TTB-licensed factories. For example, even the most antiquated machines used in factories today produce about 800 cigarettes

per minute. The most advanced machines used in factories today produce about 20,000 cigarettes per minute. The RYO Filling Station produces about 20 cigarettes per minute, or 2.5 percent of the production capacity of the most antiquated commercial machines and 0.1 percent of the production capacity of the most advanced commercial machines. The RYO Station would have to operate continuously for more than 16 hours to make the same number of cigarettes that advanced machines make in one minute.

RYO Filling Station distributors and retailers are required to follow all federal, state, and local laws applicable to the machines and their use. Retailers are strictly prohibited from selling finished cigarettes produced by the machines to consumers. Retailers are also strictly prohibited from using the machines to produce cigarettes for consumers; rather, consumers operate the machines on their own, using a user interface similar to an ATM. The retailer's involvement in the operation of the machine is limited to repairs and maintenance.



➤ The TTB ruling asserts that any retailer who provides the use of *any* machine, including the RYO Filling Station, for consumers to produce cigarettes for their personal use, is deemed to be a manufacturer of tobacco products...[and] must comply with various Internal Revenue Code provisions applicable to industrial-scale manufacturers, including obtaining a permit to manufacture tobacco products, obtaining a bond...

Whether produced manually or electronically, cigarettes produced by consumers for their personal use are already subject to federal excise taxes assessed by TTB. Cigarette papers are taxed at a rate of 12.6 cents per 200. Cigarette tubes are

per minute. The most advanced machines used in factories today produce about 20,000 cigarettes per minute. The RYO Filling Station produces about 20 cigarettes per minute, or 2.5 percent of the production capacity of the most antiquated commercial machines and 0.1 percent of the production capacity of the most advanced commercial machines. The RYO Station would have to operate continuously for more than 16 hours to make the same number of cigarettes that advanced machines make in one minute.

duce cigarettes with the RYO Filling Station only for their personal use.

**INSIDE THE TTB RULING**  
The TTB ruling asserts that any retailer who provides the use of any machine, including the RYO Filling Station, for consumers to produce cigarettes for their personal use, is deemed to be a manufacturer of tobacco products. The TTB ruling states that a retailer must comply with various Internal Revenue Code provisions applicable to industrial-scale manufacturers, including obtaining a permit to manufacture tobacco products, obtaining a bond, complying with record-keeping requirements, and complying with packaging requirements. The TTB ruling also asserts that the retailer must pay additional taxes associated with the consumer's production of cigarettes, totaling

duce cigarettes with the RYO Filling Station only for their personal use.



about \$10.00 for 200 cigarettes.

The TTB ruling notes that it is illegal to manufacture cigarettes without a permit and cites the criminal and civil penalties associated with the illegal manufacture of cigarettes. TTB asserted that retailers must immediately discontinue the use of machines such as the RYO Filling Station until they receive a TTB permit to manufacture tobacco products, effectively shutting down the entire industry.

Under the TTB Ruling, any retailer that provides a machine for consumers to produce cigarettes, in a retail environment for personal use or consumption, would have been regulated as a manufacturer of tobacco products. The TTB Ruling would cover the full range of machines discussed above, that have been in use for many years without TTB regulation, ranging from the simple manual plastic machines that produce one cigarette at a time, to the manual crank machines, to the slower electronic machines, to the more efficient RYO Filling Stations.

#### A CHALLENGE IN FEDERAL COURT

RYO Machine Rental, Tobacco Outlet Express and Tightwad Tobacco, LLC challenged the TTB Ruling on October 28, 2010 in the United States District Court for the Northern District of Ohio. The plaintiffs asked the court to prohibit enforcement of the TTB Ruling. The plaintiffs requested a temporary restraining order and preliminary injunction against the ruling until the case could be heard on the merits, as well as a permanent injunction against the ruling.

The plaintiffs argued that the TTB Ruling directly contradicts the pertinent provisions of the Internal Revenue Code, which provide that consumers who produce cigarettes for personal use are not manufacturers of tobacco products. Specifically, the ruling contradicts the congressional definition of "manufacturer[s] of tobacco products" as "any person who manufactures cigars, cigarettes, smokeless tobacco, pipe tobacco, or roll-your-own tobacco except that such term shall not include...a person who pro-

duces cigars, cigarettes, smokeless tobacco, pipe tobacco, or roll-your-own tobacco solely for the person's own personal consumption or use ...".

The plaintiffs also argued that the TTB Ruling was not the product of notice and comment rulemaking as required by the Administrative Procedure Act. By defining retailers as "manufacturers of tobacco products," the TTB Ruling purported to obligate entire new classes of businesses to apply for and obtain a permit from TTB. The plaintiffs asserted that TTB's failure to undergo the formal notice and comment rulemaking process when issuing the TTB Ruling invalidates the rule.

Finally, the plaintiffs argued that the TTB Ruling was inconsistent with TTB's hands-off approach to so-called "Brew-on premises." Like the manufacture of tobacco products, TTB is also authorized by Congress to regulate breweries and to collect taxes on the production of beer. Like the personal use exemption for the manufacture of tobacco products, the

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production of beer is exempt from TTB regulation and taxation so long as the beer is produced by adults "for personal or family use and not for sale," subject to specified quantity limits.

"Brew-on premises" are functionally indistinguishable from the consumer production, in retail environments, of cigarettes using materials purchased from the retailer. Proprietors of "Brew-on premises" may furnish space, brewing equipment, ingredients, bottling supplies, and advice and expertise to consumers. They may also furnish raw materials used in the production of beer to consumers. They may assist consumers, including cleaning, maintaining and repairing equipment.

Consistent with the personal use exemption for the production of beer in retail environments, TTB has ruled that a person may operate a "Brew-on premises" meeting the foregoing requirements without qualifying as a licensed brewery or paying federal excise taxes on beer produced by consumers at the facility, so long as the


proprietor of the "Brew-on premises" does not provide physical assistance to consumers in the production of beer or provide finished product to consumers. Because the personal use exemption for the regulation and taxation of breweries is worded almost identically to the personal use exemption for the regulation and taxation of tobacco product manufacturing, the plaintiffs argued that no meaningful distinction can be drawn between the operations of TTB-authorized "Brew-on premises" and the operations of retailers that allow consumers to rent RYO Filling Stations to produce cigarettes for personal use.

#### THE COURT'S DECISION

After initially denying the plaintiffs' request for a temporary restraining order, the court held a hearing on November 12, 2010 and entered a November 15, 2010 temporary restraining order, which prohibited TTB from enforcing the TTB Ruling. Then on December 14, 2010, the court entered a preliminary injunction prohibiting TTB

from enforcing the ruling pending the final resolution of the case. The effect of the court's decision is that the RYO Filling Stations are permitted to operate indefinitely without regulation by TTB.

In entering the injunction, the court found that the plaintiffs were likely to succeed in their claim that TTB violated the Administrative Procedure Act by issuing the ruling without inviting notice and comment from the public. The court also found that the plaintiffs were likely to suffer irreparable harm as a result of the ruling, which would either prohibit or significantly impact consumers' ability to use the RYO Filling Stations.

TTB appealed the preliminary injunction on February 11, 2011. Pending appeal, the court's preliminary injunction remains intact. 

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