

ALASKA STATE LEGISLATURE
HOUSE LABOR AND COMMERCE STANDING COMMITTEE

April 12, 2010

3:21 p.m.

MEMBERS PRESENT

Representative Kurt Olson, Chair
Representative Mark Neuman, Vice Chair
Representative Mike Chenault
Representative Bob Lynn
Representative Tammie Wilson
Representative Robert L. "Bob" Buch
Representative Lindsey Holmes

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 117(L&C)

"An Act requiring the Department of Revenue to set the minimum price for cigarettes for sale by wholesalers and retailers; and prohibiting a wholesaler or retailer from selling at wholesale or retail cigarettes at a lower price than the price set by the Department of Revenue."

- MOVED HCS CSSB 117(L&C) OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

BILL: SB 117

SHORT TITLE: PRICE OF CIGARETTES

SPONSOR(s): SENATOR(s) MCGUIRE

02/20/09	(S)	READ THE FIRST TIME - REFERRALS
02/20/09	(S)	L&C, FIN
02/09/10	(S)	L&C AT 2:00 PM BELTZ 105 (TSBldg)
02/09/10	(S)	Heard & Held
02/09/10	(S)	MINUTE(L&C)
03/02/10	(S)	L&C AT 1:30 PM BELTZ 105 (TSBldg)
03/02/10	(S)	Moved CSSB 117(L&C) Out of Committee
03/02/10	(S)	MINUTE(L&C)
03/04/10	(S)	L&C RPT CS 3DP SAME TITLE
03/04/10	(S)	DP: PASKVAN, MEYER, DAVIS
03/29/10	(S)	FIN AT 9:00 AM SENATE FINANCE 532

03/29/10 (S) Heard & Held
03/29/10 (S) MINUTE(FIN)
04/02/10 (S) FIN RPT CS(L&C) 6DP 1NR
04/02/10 (S) DP: HOFFMAN, STEDMAN, HUGGINS, THOMAS,
EGAN, ELLIS
04/02/10 (S) NR: OLSON
04/02/10 (S) FIN AT 9:00 AM SENATE FINANCE 532
04/02/10 (S) Moved CSSB 117(FIN) Out of Committee
04/02/10 (S) MINUTE(FIN)
04/06/10 (S) TRANSMITTED TO (H)
04/06/10 (S) VERSION: CSSB 117(L&C)
04/07/10 (H) READ THE FIRST TIME - REFERRALS
04/07/10 (H) L&C
04/12/10 (H) L&C AT 3:15 PM BARNES 124

WITNESS REGISTER

ESTHER CHA, Staff
Senator Lesil McGuire
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Presented SB 117, on behalf of Senator Lesil McGuire, prime sponsor of the bill.

BOB EVANS, Lobbyist
ALTRIA Corporation
Anchorage, Alaska

POSITION STATEMENT: Testified during the discussion of SB 117.

JOHANNA BALES, Excise Audit Manager
Anchorage Office
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Testified and answered questions during the discussion of SB 117.

MIKE ELERDING
Ward Cove, Alaska

POSITION STATEMENT: Testified in support of SB 117.

ROGER HAMES
Hames Corporation
Sitka, Alaska

POSITION STATEMENT: Testified in support of SB 117.

CLIFF CRAMER, Vice-President of Sales & Marketing

Northern Sales Company

POSITION STATEMENT: Testified in support of SB 117.

ACTION NARRATIVE

[3:21:36 PM](#)

CHAIR KURT OLSON called the House Labor and Commerce Standing Committee meeting to order at 3:21 p.m. Representatives Buch, Chenault, T. Wilson, and Olson were present at the call to order. Representatives Holmes, Lynn, and Neuman arrived as the meeting was in progress.

[3:21:43 PM](#)

SB 117-PRICE OF CIGARETTES

[3:21:50 PM](#)

CHAIR OLSON announced that the only order of business would be CS FOR SENATE BILL NO. 117(L&C), "An Act requiring the Department of Revenue to set the minimum price for cigarettes for sale by wholesalers and retailers; and prohibiting a wholesaler or retailer from selling at wholesale or retail cigarettes at a lower price than the price set by the Department of Revenue." [Before the committee was CSSB 117(L&C)].

[3:21:56 PM](#)

ESTHER CHA, Staff, Senator Lesil McGuire, Alaska State Legislature, explained that SB 117 would close a loophole that has allowed large, high volume cigarette sellers to price their cigarettes at less than the minimum price set by law so long as they can prove their actual cost of doing business is lower than the mandated minimum price. This bill is limited only to address the exemption. The original purpose of Article 7 in AS 43 was to prevent wholesalers and retailers from using predatory pricing practices to sell cigarettes as a "loss leader." She paraphrased from the sponsor statement, which read as follows [original punctuation provided]:

Alaska, along with at least 23 other states, prohibits wholesale cigarette distributors and retailers from selling cigarettes below a state regulated minimum price. This reflects a public policy which seeks to prevent the use of cigarettes as a "loss leader" or a

bargain item. Furthermore, studies have shown that pricing cigarettes below cost has been linked to youth smoking.

However, current law contains a loophole which allows large, high-volume cigarette sellers to price their cigarettes at less than the minimum price set by law if they can prove their actual cost of doing business is lower than the mandated minimum price.

In order to qualify for the lower price, application for each cigarette brand must be made. The Department of Revenue must then review the financial data provided to see if the submission is available for an exception. This process of verifying the cost versus price calculations by brand is both expensive and time consuming for the agency. If the exception is granted, it changes the state minimum prices for all wholesalers and retailers. Consequently, cigarettes in effect become somewhat of a "loss leader" because the granted exemption price is at or below cost for some retailers, thus defeating the original purpose of setting a minimum price.

If CS SB 117 is passed, it requires the Department of Revenue to set the same minimum cigarette price for all vendors - regardless of size, volume, or accounting practices. Thereby promoting fairness by putting all cigarette sellers on the same playing field with regard to the state mandated minimum cigarette price. Furthermore, CS SB 117 would ensure that it will no longer be permissible for anyone to set a price any lower than that which the State establishes.

The percentages in CS SB 117 are based on a compromise between interested parties. As a result, major cigarette brands will experience an increase in price.

In the end, if passed, CS SB 117 will increase the price of cigarettes overall; will eliminate the labor and expense for the Department of Revenue in calculating exceptions to the minimum price; and it will promote fair and reasonable competition in the marketplace.

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MS. CHA explained that the statutory provision never really worked the way it was intended to do so. This bill would repeal AS 43.50.800 and replace it with AS 43.50.810, Section 6. The changes made in the committee substitute were to the percentages of mark-up allowed. She explained that changes to the percentages contained in the committee substitute represent a compromise reached between smaller retailers and wholesalers.

MS. CHA presented the details of the mark-up. The original bill contained a 4.5 percent mark-up for wholesale and 6 percent mark-up for retail. The committee substitute changes the minimum mark-up to 2 percent for wholesale and 4 percent mark-up for retail. The prices are higher than the current granted exception. Thus, it is possible the price of cigarettes may go up slightly, but not an exorbitant amount. The original reasoning behind fixing a minimum price on cigarettes is based on studies that demonstrated that increased prices provided a financial incentive for smokers to quit and discourage new smokers. She related that it is possible that "brands" for which no application was made could experience a decrease if the retailer decides to lower the price, but the sponsor does not expect that to happen. Lastly, by removing a wholesaler or retailer's ability to apply for an exemption would bring parity and balance back to competition.

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REPRESENTATIVE BUCH related that the parties involved have been contacted and all of the parties reached a compromise.

MS. CHA stated that the sponsor did not contact every wholesaler and retailer in Alaska, but contacted the major ones, who are supportive.

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REPRESENTATIVE T. WILSON asked for the number of exemptions.

MS. CHA thought the Department of Revenue would respond to the question, but she ventured that the percentage of wholesalers with exemptions is over 90 percent.

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REPRESENTATIVE T. WILSON did not see the loophole in the statute since the retailer must still prove something.

MS. CHA agreed. She explained the loophole comes into existence when one wholesaler can show the price is lower, it authorizes everyone else to price the cigarettes at the lower prices, which could result in cigarettes being a "loss leader" for some wholesalers who cannot demonstrate the lower price. She related a scenario in which a company shows its cost is \$6.50, but the cost for others is \$7.00 due to volume of sales or accounting practices. The minimum price would be set by formula in statute at \$7. A wholesaler whose cost is \$6.50 can set their price at \$6.50. However, everyone else is "given" that price. Therefore, all wholesalers will follow suit by setting their price at \$6.50 in order to be competitive in the marketplace. It creates the situation in which some wholesalers may be selling cigarettes as a "loss leader."

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REPRESENTATIVE T. WILSON asked if any studies show reductions in smoking occurs based on price.

MS. CHA deferred to the Department of Revenue. She offered that the committee substitute was based on a compromise, but she understood the original 4.5 percent and 6 percent were based on studies.

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REPRESENTATIVE CHENAULT asked whether cigarettes are the only commodity in which prices are set.

MS. CHA stated she did not know.

REPRESENTATIVE CHENAULT said he certainly does not want to encourage kids to smoke. He related that the cost of cigarettes may increase "a little bit" and he was not sure if that would be \$.03 or \$1.00. He agreed the higher cost of cigarettes can act to deter smoking, but he thought the same thing could happen if prices were changed for other products such as alcohol. He asked whether alcohol currently has a set price. He understood alcohol is taxed. He suggested that if we are concerned about people's health, perhaps the legislature should also set prices on cheeseburgers and french fries. He thought other commodities may cause as much or more mayhem in our society. He expressed concern that cigarettes are targeted.

[3:31:38 PM](#)

MS. CHA understood his concern. She pointed out that the minimum price for cigarettes is already set in statute.

REPRESENTATIVE CHENAULT related a scenario in which a manufacturer makes a widget for \$6, but it costs "Joe down the street" \$7 to produce the same widget. He pondered whether the manufacturers who can produce the widget for \$6.50 would benefit.

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REPRESENTATIVE T. WILSON asked whether any other state regulates the price of cigarettes.

MS. CHA answered yes, that 23 states regulate cigarette prices. She offered to provide the list to the committee. In further response to Representative T. Wilson, she said she did not know whether other states set prices on alcohol.

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REPRESENTATIVE T. WILSON made a motion to adopt Amendment 1, labeled 26-LS0386\S.1, Bullock, 4/9/10, which read:

Page 3, following line 4:

Insert a new bill section to read:

"* **Sec. 5.** AS 43.50.740(c) is amended to read:

(c) A manufacturer whose product is sold in the state directly or through an intermediary shall provide the department with a current price list for all brands of cigarettes of the manufacturer and shall notify the department at least **three** [10] days before a price **change** [INCREASE] takes effect."

Renumber the following bill sections accordingly.

CHAIR OLSON objected.

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MS. CHA explained that once the manufacturer establishes a minimum price, it would provide notice to the department at least 3 days prior to changing the price on its brands instead of the current requirement for 10 days notice. This bill would shorten the timeframe so retailer or wholesaler could sell the cigarettes at the new price.

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CHAIR OLSON asked whether the price might ever drop or if it only would increase.

MS. CHA said she was unsure.

REPRESENTATIVE CHENAULT related that Amendment 1 would reduce the prior notice timeframe from 10 days to 3 days that manufacturers are required to report to the state in order to increase the price of the cigarettes.

REPRESENTATIVE HOLMES agreed with Representative Chenault's understanding of the bill. She offered her belief that the manufacturers must notify the Department of Revenue when cigarette prices increase or decrease in price. Previously, the notice requirement applied only to increases in cigarette prices.

MS. CHA assumed that it is at the manufacturer's discretion as to whether the price would increase or decrease.

CHAIR OLSON agreed, noting the bill would provide flexibility in the event of "cigarette wars."

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REPRESENTATIVE T. WILSON asked for the benefits of adopting Amendment 1.

BOB EVANS, Lobbyist, ALTRIA Corporation, stated that Alaska is the only state that requires a ten-day notice. Thus, manufacturers must provide the Department of Revenue a ten-day notice in advance for any price increases, but wholesalers and retailers cannot obtain the product until after the ten-day notice period. He stated that this interferes with shipping and commerce. This bill will remedy the timing so the retailer and wholesaler can obtain the product more efficiently.

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REPRESENTATIVE BUCH asked for the reason that Amendment 1 reads "change" instead of "increase."

MR. EVANS said he thought that the actual cost of cigarettes was reduced in the past year. He related that Amendment 1 would allow for decreases in prices, although it may rarely happen.

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REPRESENTATIVE T. WILSON asked for the process to change the price in cigarettes.

MR. EVANS responded that the Department of Revenue (DOR) and most wholesalers want to know in advance of any increases. He understood the wholesalers agree with proposed Amendment 1. He related that Ms. Bales indicated that DOR needs several days notice to provide notice for the price change. This is the only state in the nation that has this provision. The problem for the manufacturer is that they must wait ten days prior to shipping. He stated that he cannot think of any reason for the initial ten-day notice requirement.

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REPRESENTATIVE NEUMAN referred to the campaign for "Tobacco Free Kids" brochure in members packets titled "Raising Cigarette Taxes Reduces Smoking, Especially Among Kids (And the Cigarette Companies Know It)" He related that that the cost of cigarettes skyrocketed between 2000-2007. He asked for the reason for the increased cost and if it is more expensive or the government has increased the "sin" taxes.

MS. CHA said she was not quite sure. She thought the DOR could answer the question, but she speculated it may be due to taxes.

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REPRESENTATIVE NEUMAN asked whether other communities tax cigarettes as a means of increasing their revenues.

MS. CHA responded that states and municipality can currently increase the taxes.

REPRESENTATIVE NEUMAN recalled some local governments have imposed smoke-free restaurants or bars.

MS. CHA agreed, but clarified that this bill does not address that issue.

REPRESENTATIVE NEUMAN offered his belief that government has stepped in on this industry since it is "politically correct." He asked where the government intervention and intrusion stops. Farmers grow legal crops of tobacco, he stated.

[3:46:20 PM](#)

JOHANNA BALES, Excise Audit Manager, Anchorage Office, Tax Division, Department of Revenue (DOR), introduced herself.

REPRESENTATIVE HOLMES asked whether the DOR has any issue or problem with Amendment 1.

MS. BALES stated that the DOR does not have any problem with Amendment 1. The department is required to perform a calculation but three days is enough lead time to do so.

CHAIR OLSON removed his objection.

There being no further objection, Amendment 1 was adopted.

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REPRESENTATIVE BUCH asked whether any price controls are in effect on any other commodity.

MS. BALES responded that the state sets prices on cigarettes but not on any other commodity. She provided a brief history on the minimum pricing statutes for cigarettes. In 2000, a bill passed the legislature that required a cigarette tax stamp and extra responsibilities for distributors to stamp products. The requirements for stamping resulted in a "hefty sum of money" for in state distributors. The requirement for stamping did not tend to cause problems for out-of-state distributors since their operations were larger and the companies had invested in stamping machines. The in state distributors wanted to have assurances that their prices would not be undercut. Thus, the in state distributors and retailers requested minimum prices be set. Additionally, the legislature did not want cigarettes to become the "loss leader" for big box stores. She said she thought it was important for the committee to understand that the minimum pricing statute currently in place was at the request of the in state cigarette distributors.

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REPRESENTATIVE CHENAULT asked for the minimum price for cigarettes.

MS. BALES answered that it depends the brand but each manufacturer has a different rate. In further response to Representative Chenault, she offered that for "Camel Filters Wides" the minimum price in Anchorage runs \$70 per carton. In further response to Representative Chenault, she indicated that \$54 is the cost for the areas outside Juneau, Anchorage Fairbanks, Matanuska-Susitna Borough, Fairbanks, and Sitka since the communities do not assess local taxes. Thus, they have lower prices on cigarettes.

REPRESENTATIVE T. WILSON related that the Fairbanks North Star Borough (FNSB) also taxes cigarettes.

MS. BALES, in response to Representative T. Wilson, agreed that manufacturers are still required to "stamp" cigarettes. In further response to Representative T. Wilson, she replied that the cost of "stamping" depends on the type of machine that is used. She pointed out that some machines have features that open the cases, the cartons, and will re-glue them. She offered her belief that the cost of the machines range from \$10,000 to \$20,000.

REPRESENTATIVE T. WILSON remarked that sends a weird message that cigarettes are isolated in their own category, separate from other products with health risks.

MS. BALES explained the problem with cigarettes is that this product is so highly regulated by federal and state government ranging from the taxes assessed and the ingredients. Additionally, fire safe cigarettes are regulated. She said, "I guess the question is, "Where do you stop? But, really for cigarettes, this particular regulation on cigarettes is actually pretty innocuous compared to the rest of it."

REPRESENTATIVE T. WILSON referred to the other part of this which is to prevent youth from smoking. She commented that our youth tend to have more discretionary money than adults. She asked whether the regulations could be deleted and the state simply increase additional taxes on cigarettes.

MS. BALES restated that the purpose of minimum pricing is a result of concern expressed by in state distributors. She explained that many smaller stores are struggling to compete with larger stores. Stamping was embraced by those who wanted

youth to stop smoking and they did not want cigarettes to be used by stores as "loss leaders". Thus, the minimum pricing served two purposes, but the main purpose was to address the concern of in state distributors.

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REPRESENTATIVE T. WILSON asked whether the reasons still exist.

MS. BALES answered yes. A large number of youth start smoking. In further response to Representative T. Wilson, she replied that smaller distributors are actually helped by the bill.

REPRESENTATIVE T. WILSON asked for examples of small distributors.

MS. BALES offered that several in state small distributors and privately owned distributors. She said she could not provide names.

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CHAIR OLSON asked whether the Department of Revenue (DOR) supports the bill.

MS. BALES answered yes. She explained that SB 117 removes the current requirement to audit anyone who wants to demonstrate the cost of doing business is less than the mandated minimum. She explained the DOR spends a substantial amount of time ranging between two to three months to conduct these audits. She offered her belief that this bill would be helpful administratively for the DOR and the companies.

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MIKE ELERDING stated that he is a small wholesale distributor who worked with the DOR to originally pass the bill to end predatory pricing practices. He offered that he is in very much in favor of SB 117.

ROGER HAMES, Hames Corporation, stated that he is a third generation retailer that owns four stores in Southeast Alaska. He testified in support of the bill as it brings parity.

CLIFF CRAMER, Vice-President of Sales & Marketing, stated that Northern Sales is a diverse distributor in Alaska that sells

candy, beverages, and tobacco products. He said that he strongly supports SB 117.

4:00:28 PM

CHAIR OLSON, after first determining no one else wished to testify, closed public testimony on SB 117.

REPRESENTATIVE NEUMAN moved to report SB 117, as amended out of committee with individual recommendations and the accompanying fiscal notes.

4:00:54 PM

REPRESENTATIVE T. WILSON objected.

4:01:02 PM

A roll call vote was taken. Representatives Buch, Chenault, Holmes, Lynn, Neuman, and Olson voted in favor of moving SB 117, as amended from the House Labor & Commerce Committee. Representative T. Wilson voted against it. Therefore, HCSSB 117(L&C) was reported out of the House Labor and Commerce Standing Committee by a vote of 6-1.

4:02:05 PM

ADJOURNMENT

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 4:02 p.m.