Public Health and Tobacco Policy Center

Tobacco Price Promotion:
Policy Responses to Industry Price Manipulation

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This work provides educational materials and research support for policy initiatives. The legal information provided does not constitute and cannot be relied upon as legal advice.

Table of Contents

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Introduction

The evidence is undeniable—people smoke more when cigarettes cost less. Tobacco companies are well aware of this behavior and have crafted innovative and intricate price-related strategies to dissuade current tobacco users from quitting and to entice new customers (primarily youth) to purchase their products. With coupons, "buy one get one free" offers, undisclosed payments to retailers, and other methods, tobacco companies seek to offset higher prices caused by increases in tobacco taxes and keep their products attractive to price-sensitive customers.

Policymakers, however, can respond to these tobacco industry efforts with their own creative policy responses. As the tobacco companies know – and fear – keeping the price of tobacco products high will reduce use, especially among young people. The State of New York has been a national leader in the use of pricing policies to bolster the impact of its tobacco control program. New York currently imposes an excise tax of $4.35 on each pack of cigarettes – the highest tax in the nation. Additionally, the state is reducing tax evasion by cracking down on the sale of untaxed cigarettes by Native American retailers, eliminating a major loophole that has undermined the public health impact of the state's excise tax. Finally, New York has enacted a minimum price law that requires that all cigarettes be sold at a minimum price determined by a statutory formula. As a result of these policies, the price of cigarettes is now higher in New York than in any other state.[1]

In response to New York's efforts, and similar efforts around the country, tobacco companies have manipulated the prices of

their products at locations where tobacco is sold (i.e., the point-of-sale), and they have spent heavily to advertise these price promotions. After the Master Settlement Agreement (MSA) in 1998, the industry substantially expanded its marketing and promotional expenditures targeting the point-of-sale.[2] The industry has increasingly used this point-of-sale marketing to highlight price discounts, such as multi-pack specials.[3] Although promotional spending at the point-of-sale has decreased somewhat since its peak in 2003, it is still the case that "per-pack promotional spending remains more than doubled since the MSA, with cigarette marketing increasingly dominated by spending on price-reducing promotions."[4] This is troubling because youth and young adult smokers are particularly sensitive to retail advertising and price promotion and such strategies encourage initiation and continuation of tobacco use.[5]

According to the Federal Trade Commission, the tobacco industry spent approximately $7.17 billion on payments to cigarette retailers and wholesalers to reduce the price of cigarettes to consumers in 2008 (that latest year for which information is available).[6] Tobacco companies also spent approximately $360 million on discount coupons redeemable by consumers for reduced price cigarettes.[7] All told, more than

82% of all advertising and promotional spending by the industry is focused on reducing the price of their products at the point-of-sale. The reason for such extensive spending by the industry on price-related promotions is obvious: price discounts increase tobacco use in measurable and predictable ways. [8]

This report is intended to provide a broad overview of and introduction to price-related strategies that New York and its local communities might utilize to combat the tobacco industry's aggressive price promotions and strengthen their existing tobacco control programs. Part I briefly examines the relationship between tobacco use and tobacco prices, including a look at excise taxes (the most "tried-and-true" pricing strategy employed by states) and tobacco companies' responses to them. Part II describes policy options that may be implemented (or enhanced) to counteract the tobacco industry's price promotion strategies, including minimum price laws, limitations on discount coupons, and restrictions on retailer and wholesaler price discount programs. Finally, Part III describes some of the legal issues that communities should consider when crafting these policies.

Part I: Tobacco Use and Tobacco Prices

There is a direct and predictable relationship between the price of tobacco products and tobacco consumption.[9] The availability of inexpensive tobacco products leads to an increase in the number of smokers, particularly among younger populations.[10] Similarly, higher tobacco prices lead to a reduction in tobacco use, even when accounting for the addictive properties of nicotine.[11] On average, studies show that a ten percent increase in the price of cigarettes causes a three to five percent decrease in purchases.[12]

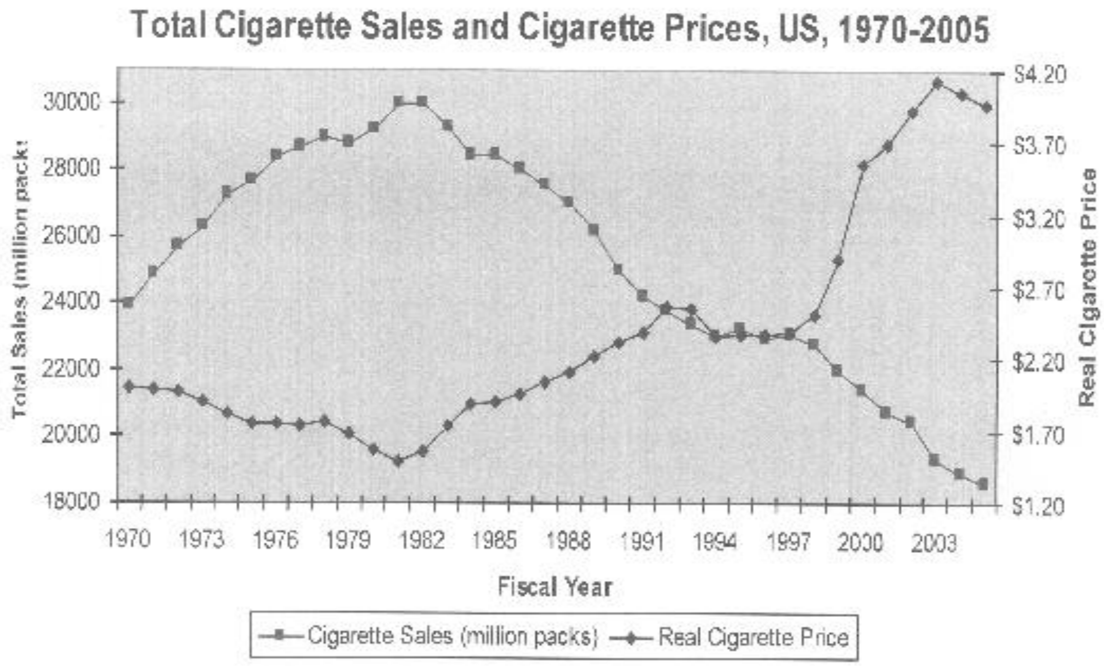
Studies show that higher tobacco prices reduce smoking rates through a number of different mechanisms. Higher prices lead to reduced smoking initiation among youth, reduced consumption among current smokers, and an increase in cessation (with fewer relapses among former smokers).[13] Price increases have a greater effect on youth, with one study concluding that smoking rates among teens were three times more responsive to price increases in comparison to adult smoking rates.[14] Other studies have shown similar effects with price increases on other, non-cigarette tobacco products.[15]

There are several reasons price increases have a significantly greater impact on youth smoking prevalence. Most importantly, cigarette purchases make up a larger portion of a young person's disposable income than they do for adults.[16] Additionally, youth are typically less heavily addicted than adult smokers, making it easier to quit.[17]

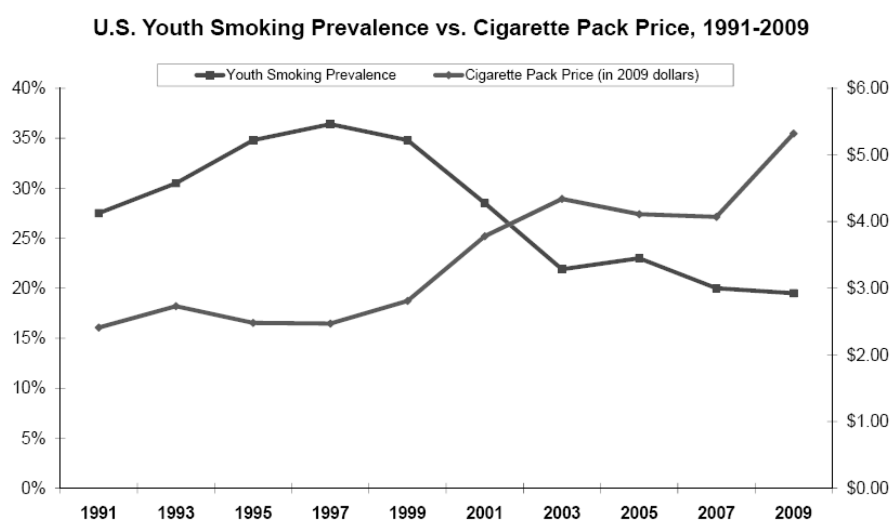
According to Frank Chaloupka, an economist and leading expert on price-related tobacco policies, academic studies suggest that a 10 percent increase in price:

- Reduces smoking prevalence among youth by nearly seven percent
- Reduces average cigarette consumption among young smokers by over six percent
- Cuts the probability of starting to smoke by about three percent
- Reduces initiating daily smoking by nearly nine percent, and
- Reduces initiating heavy daily smoking by over 10 percent.[18]

Thus, maintaining high prices on cigarettes could have a significant long-term impact on overall smoking prevalence and on public health by reducing youth smoking rates.



Source: Frank Chaloupka, *Tobacco Control Lessons Learned: The impact of state and local policies*, 14 (ImpacTEEN, Research Paper Series No. 38, 2010).



Source: Campaign for Tobacco-Free Kids, Raising Cigarette Taxes Reduces Smoking, Especially Among Kids (And the Cigarette Companies Know It) (November 2009), available at http://www.tobaccofreekids.org/research/factsheets/pdf/0146.pdf.

Price Regulation Works: The Example of Taxation

Taxation is the primary method by which state governments have attempted to increase cigarette prices. Currently, the federal government taxes cigarettes at a rate of $1.01 per pack.[19] All states and the District of Columbia tax cigarettes at rates ranging from $0.17 (MO) to $4.35 (NY) per pack.[20] (Other tobacco products are also taxed by states, but often at a rate less than that for cigarettes.[21]) State and local governments can reduce tobacco use (and also raise revenue) by increasing tobacco excise taxes further.[22]

New York has made particularly effective use of its tobacco tax policies in recent years. Currently, New York imposes the highest state cigarette tax in the country. Cigarettes and little cigars are subject to a tax of $4.35 per pack of 20.[23] (New York City imposes an additional tax of $1.50 per pack.) Cigars and most other non-cigarette tobacco products are taxed at a rate of 75% of the wholesale price.[24] Not only has New York imposed high taxes on tobacco products, but the state has also been aggressive in addressing the evasion of these taxes, particularly in connection with cigarette sales by Native American tobacco retailers to non-tribal members.[25] These measures ensure high prices for cigarettes and other tobacco products throughout New York.

Notwithstanding the efforts of New York and other states to maintain high prices on cigarettes and other tobacco products, tobacco companies are constantly developing ways to manipulate prices in order to offset the effect of higher taxes.

Tobacco Company Price Discounting

Tobacco manufacturers are well aware that smoking rates are affected by cigarette prices and that increased taxes lead to decreased sales. In fact, discount pricing has been a key marketing tool for tobacco companies since the late 1880s.[26] Currently, tobacco companies spend ***more money on price discounts than on any other form of tobacco promotion***. In 2008, the tobacco industry spent more than *$8.25 billion* on price discounts.[27] This accounted for more than 82% of the industry's overall marketing expenditures.[28] Included in this total is more than *$7.1 billion* in incentive payments made to wholesalers and retailers as inducements to reduce tobacco prices (e.g., buy-downs and off-invoice discounts, which are discussed in more detail below), as well as $414 million that the industry spent on discount coupons and sampling (the distribution of free tobacco products or coupons for free products).[29] Clearly, the industry realizes that manipulating prices at the retail level is crucial to recruiting new smokers and retaining current consumers. In addition, as the industry knows well, the use of promotional offers has generally been found to be highest among the youngest smokers.[30]

The tobacco industry does not spend its money indiscriminately; it carefully targets its price promotions to get the best return on its spending. Tobacco documents show that the industry has used a variety of price-related strategies to target certain demographic groups. For example, in the 1980's RJ Reynolds targeted young men in the Midwest with "6 pack" buy-three-get-three-free discounts. This strategy has been credited with increasing the consumption of Camels among that population during that

In the Industry's Own Words…

“If prices were 10% higher, 12-17 incidence [youth smoking] would be 11.9% lower.”

-R.J. Reynolds Executive D.S. Burrows, “Estimated Change in Industry Trend Following Federal Excise Tax Increase,” September 20, 1982

“Jeffrey Harris of MIT calculated…that the 1982-83 round of price increases caused two million adults to quit smoking and prevented 600,000 teenagers from starting to smoke…We don't need to have that happen again.”

--Philip Morris Executive Jon Zoler, “Handling An Excise Tax Increase,” September 3, 1987

“In order to lessen the impact of [a Federal Excise Tax] increase on consumers, PM-USA should …[i]ncrease coupon values and/or raise couponing levels on selected brands in both the full margin and price/value categories.”

--Philip Morris “FET Contingency Strategy” Memo, 1990

“The New Jersey state legislature recently voted to increase tobacco taxes in July, 1990. The attached media plan provides a means of distributing coupons to [Philip Morris] smokers in the state, on an ‘urgent’ timetable, in order to counter any ill effects of that tax increase.”

--Letter from Wanda Johnson, Media Supervisor at Leo Burnett U.S.A. to Sheila Spicehandler, Philip Morris, regarding the “New Jersey Tobacco Tax Plan,” July 11, 1990

“We believe that increases in excises and similar taxes have had an adverse impact on sales of cigarettes. In addition, we believe that future increases, the extent of which cannot be predicted, could result in further volume declines for the cigarette industry, including Lorillard Tobacco.

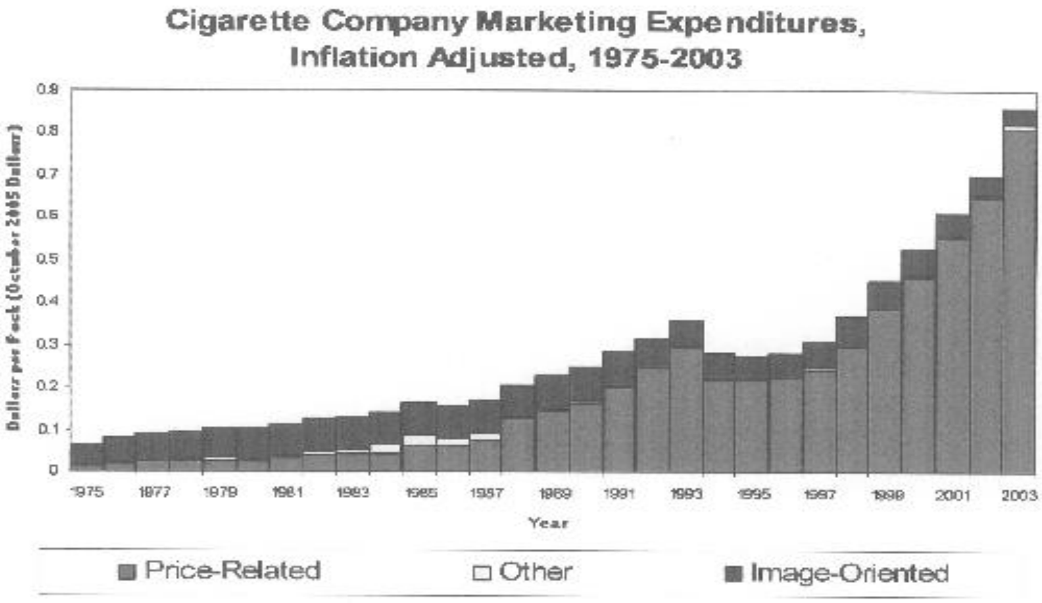
--Lorillard Tobacco 10-Q Report, November 4, 2008

time period.[31] In addition, discount and multipack coupons have been found to be “particularly appealing” to women, youth and minorities – price-sensitive groups that have been specifically targeted by the industry.[32]

Understanding Discounting Methods

The tobacco industry has been very creative in developing pricing strategies to reduce the real price paid per pack of cigarettes. Discounts may be offered to wholesalers and retailers or directly to consumers. The particular strategies range from publicly-distributed coupons to more complex financial arrangements with retailers.[33]

Tobacco companies use a combination of these methods to pursue their strategic aims, and understanding them is critical for tobacco control advocates seeking to develop appropriate and effective policy responses.



Source: Frank Chaloupka, Tobacco Control Lessons Learned: The impact of state and local policies, 14 (ImpacTEEN, Research Paper Series No. 38, 2010).

Some of the key tactics are:

Discount Coupons – A voucher distributed by a seller or manufacturer to a consumer, allowing the consumer to obtain a stated reduction in price on a specific tobacco product or products. Such pricing mechanisms allow premium tobacco brands to maintain their brand image (as a higher-end product) while competing with generic brands and other competitive premium brands on price. Often these coupons are targeted to appeal to specific demographic groups based on self-identified price sensitivity or as determined by industry studies. Such coupons may be attached to packs of certain brands or directly mailed to targeted consumers, among other distribution mechanisms.

Off-Invoice Discounts – A promotion in which a manufacturer offers a wholesaler a price reduction in return for the purchase of specific quantities of goods within a specified time.[34] It may be thought of as a discount for stocking a specific product to promote the purchase of a particular brand. The discount is not deducted from the invoice, but rather paid or credited separately to the wholesaler. Such a discount could then be passed down to the retailer and, subsequently, to the consumer.

Buy-Down Programs – An agreement between a manufacturer and retailer through which the retailer is paid a rebate for sales of a particular brand of cigarettes. The rebate is paid either for the sale of a specific quantity of cigarettes or for the sale of cigarettes sold over a specified period of time. Like off-invoice discounts, this type of promotion may be used to encourage the purchase of a particular brand. Additionally, the manufacturer may choose the specific retailers to which it offers the program, resulting in community- and state-wide price differentials.[35] These programs may be thought of as “paperless coupons” because the cigarettes sold in connection with buy-downs are typically discounted at the point-of-sale.[36]

Wholesale Pricing Agreement – A program administered by a cigarette wholesaler and sponsored by a manufacturer, through which a wholesaler agrees to pay a retailer a rebate for the sale of particular brands of cigarettes.[37] The wholesaler is later reimbursed for these rebates by the manufacturer, and may be paid an additional fee for administering the program. Like buy-downs, manufacturers use this type of program to reduce the price of tobacco products to consumers (who may think of this program as a "paperless coupon" as well) and to encourage retailers to carry and promote their brands.

Retail Value-Added Promotion – A promotion that includes the sale of multiple packages for a single combined price (e.g., "buy one get one free" offers) or offers of free tobacco products with the purchase of another type of tobacco product.

As can be seen from this (non-exhaustive) list, tobacco companies have a wide range of price-related marketing techniques that they can strategically deploy in order to encourage tobacco use and offset the impact of tobacco tax increases. State and local governments must be flexible and creative in responding to these promotional strategies and to others that the industry might develop in the future.

Part II: Policy Options

State and local governments can respond to the tobacco industry's efforts to reduce the price of cigarettes by enacting laws that restrict product discounting. This section presents an overview of pricing policies that some state and local governments have adopted, as well as others that state and local governments might consider implementing.

Minimum Price Laws

Minimum price laws prohibit retailers from selling tobacco products below a statutory minimum price. State governments have been utilizing cigarette minimum price regulations since the 1940s.[38] Generally, these laws require a minimum percent markup to the wholesale price of cigarettes.[39] As of December 31, 2009, 25 states had minimum price laws for cigarettes.[40]

New York's minimum price law, the Cigarette Marketing Standards Act, provides a specific formula for calculating the minimum price below which cigarettes cannot be sold.[41] The formula is based on the invoice price of the cigarettes purchased from the manufacturer (the manufacturer's list price). At each level that the cigarettes progress down the distribution chain (tax stamping agent, then wholesaler, then retailer) the cost of doing business must be added to the invoice price in order to reach the minimum sale price. For example, if the manufacturer's list price (per carton of 10 packs) is $36.04, the cost to the stamping agent (who purchases the cigarettes from the manufacturer and also purchases the tax stamps) would be $79.54 ($36.04 list price + $43.50 in taxes).[42] (The minimum price in New York City would be higher, to account for the City's additional cigarette tax.) The minimum price of the same carton of cigarettes sold to a retail dealer would be $82.83 ($79.54 + $3.29 for the stamping agent's cost of doing business), and the minimum retail sales price to the consumer would be $88.62 (or $8.86 a pack), which includes an additional markup for the retailer's operational costs.[43] More information about New York's minimum price law can be found on the website of the New York State Department of Taxation and Finance, http://www.tax.ny.gov.

Research suggests that, like taxation, minimum price laws that raise the price of cigarettes may have a positive impact on public health by reducing cigarette consumption.[44] However, many of the current minimum price laws have loopholes that allow tobacco companies to implement retail incentive programs that undercut the laws' effectiveness by reducing the actual prices charged to consumers.[45] Many state minimum price laws consider only the manufacturers' standard invoice prices and do not factor in the rebates offered to wholesalers or retailers. This creates a significant opportunity for cigarette companies to evade the minimum price laws.[46] New York's minimum price law prohibits any retailer or wholesaler price discounts that bring the sale price below the statutory minimum.[47] This provision has been upheld by New York's highest court and helps to reduce the effect of retail incentive programs.[48]

While New York's minimum price law prohibits certain discounts, the allowance of others permits manufactures to circumvent the law and reduce the price of cigarettes through other discounting mechanisms. New York could strengthen its minimum price law or implement complementary price controls to close these loopholes and keep the price of tobacco products high. For example, the state might change its minimum price formula to include a minimum manufacturers' list price.[49] This would reduce the industry's ability to manipulate the price of products sold to wholesalers or other distributers. Additionally, New York could apply a minimum price requirement to non-cigarette tobacco products. The state could also amend the law to expressly prohibit the use of other discount mechanisms, such as coupons or value-added promotions, which reduce the actual price paid by consumers below the statutory minimum price.

Coupon Restrictions

As discussed above, tobacco companies use coupons – often targeted to attract particular demographic groups – in order to counter the effects of higher tobacco prices. Current federal and New York law include some redemption of tobacco coupons, but these existing laws leave many gaps that could be addressed by more robust state and local policies.

At the federal level, the Family Smoking Prevention and Tobacco Control Act (FSPTCA), enacted by Congress in 2009, prohibits the redemption of coupons for tobacco products by mail.[50] Beyond this, however, the law does not address the sale of cigarettes and other tobacco products at discount prices. (Importantly, neither does the law restrict the authority of state and local governments to adopt stricter regulations on the sale of discounted tobacco products.[51]) At the state level, New York law prohibits the distribution of coupons that can be redeemed for free tobacco products.[52] This law, however, is very narrow in scope. It contains numerous exceptions, allowing for the distribution of coupons in bars, through the mail, or in newspapers or other publications (among other exceptions). In addition, it applies only to the distribution of coupons for *free* tobacco products. New York law does not restrict the distribution of coupons offering discounted (but not free) tobacco products.

Other states have laws relating to coupon distribution that are similarly outdated. For example, since the early 1990s, California law has prohibited the distribution of coupons that can be redeemed for cigarettes or smokeless tobacco "at no cost or at nominal cost."[53] Like New York's law, California's law applies only to the distribution of such coupons in public places. Similarly, the state of Hawaii prohibits the distribution of coupons redeemable for tobacco products on public property or within 1,000 feet of a school.[54] These laws, while well-intentioned, are too limited in scope to have any significant impact on the distribution or use of tobacco coupons. New York and other states should consider more comprehensive laws that would restrict the distribution of *discount* coupons (coupons redeemable for a discounted product, rather than a free or nominal cost product) and eliminate the exemptions in existing laws.

While New York and other state and local governments have thus far enacted laws limiting the *distribution* of certain coupons, another policy option would be to restrict the *redemption* of discount coupons. Such a law could prohibit tobacco retailers within a specific jurisdiction—or those operating under a specific licensing scheme—from redeeming coupons that reduce the price of cigarettes or other tobacco products. (As discussed below, this approach might help to minimize the legal complications that might otherwise arise with more stringent restrictions on coupon distribution.) At a minimum, such laws could prohibit the redemption of coupons that reduce the price of the cigarettes below the statutory minimum.[55]

Restrictions on Retail and Wholesale Price Discount Programs

As discussed above, off-invoice discounts, buy-downs and wholesale pricing agreements reduce the price of tobacco products for consumers by paying retailers or wholesalers a rebate for selling specific products. These rebates are then passed on to consumers through reduced prices at the point-of-sale. While state and local governments do not currently restrict these rebate programs directly,[56] regulating or prohibiting their use could significantly enhance the effectiveness of other price-related tobacco control measures (while at the same time leveling the playing field for tobacco retailers).

New York and other states (as well as local governments) might consider prohibiting the use of these rebate programs. Private agreements between manufacturers and retailers (as well those involving wholesalers) can be restricted or prohibited under the police power granted to the states if there is a valid public health justification. The minimum price laws discussed above are an existing example of such a restriction. Given the strong evidence tying tobacco prices to smoking prevalence, as well as the need for the state to regulate practices that undermine the effectiveness of its cigarette excise tax, state and local governments would likely be able to justify restrictions on promotional payments to retailers if challenged in court. (The relevant legal issues are discussed in more detail in the following section.)

Notably, the use of similar incentive payments in the alcoholic beverage industry has been restricted. In the 1990's, the Bureau of Alcohol, Tobacco and Firearms adopted regulations prohibiting the payment of promotional allowances to retailers in connection with the sale of alcoholic beverages.[57] While this action was taken largely to protect smaller wineries and breweries from being excluded from stores (because they could not provide the promotional allowances offered by larger rivals), there was some concern that such payments create an unfair relationship between alcohol beverage manufacturers and retailers, and produce excessive promotion of alcohol use at the point-of-sale.[58] Alcohol is regulated differently from tobacco,[59] but employing similar restrictions on tobacco promotions may similarly help reduce tobacco promotion at the point-of-sale and also alleviate some of the pressure that retailers may feel to participate in these promotional programs.[60]

Restricting Retail Value-Added Promotions

Tobacco companies reduce the prices of their products by offering multiple packs (e.g., "buy-one-get-one-free" offers) or by adding a different tobacco product as a bonus at the point-of-sale. In 2008, the industry spent $732.8 million on retail value-added promotions involving free cigarettes.[61] An additional $11 million was spent on the distribution of free non-cigarette items, such as smokeless tobacco and cigars.[62]

States may consider restricting or prohibiting these types of promotions in order to maintain higher prices for cigarettes. Massachusetts, for example, uses its minimum price law to prohibit sales involving bonus packs of cigarettes.[63] Specifically, its law requires that each item included in a combination sale meet the statutory minimum price.[64] New York could include a similar provision within its existing minimum price law.

New York could also prohibit cross-promotions that add free non-cigarette tobacco products (such as smokeless tobacco) to packs of cigarettes. If the state established a minimum price law for non-cigarette tobacco items, it could require that the price paid by consumers for tobacco products sold in combination meet the minimum price for each product. Even without such a minimum price law for non-cigarette tobacco products, the distribution of free products with the purchase of cigarettes could be prohibited directly. Enacting such a law would help to prevent cigarette companies from undermining the state's efforts to encourage cessation by encouraging the dual use of cigarettes (in places where smoking is permitted) and smokeless tobacco products (in workplaces and other areas where smoking is prohibited).[65]

Massachusetts General Laws Chapter 64C §13

…(e) In all advertisements, offers for sale or sales involving two or more items at a combined price, and in all advertisements, offers for sale or sales involving the giving of any concession of any kind whatsoever (whether it be coupons or otherwise), the retailer's or wholesaler's selling price shall not be below the "cost to the retailer" or the "cost to the wholesaler," respectively, of all articles, products, commodities and concessions included in such transactions.

Sunshine or Disclosure Requirements

While the tobacco industry reports the total dollar amount spent on cigarette advertising and promotions (among other expenditures),[66] the specific price incentives provided to individual retailers are unknown. As discussed above, the tobacco industry uses price promotions to target specific demographic groups. A mandatory disclosure law would give states additional data concerning the price manipulation strategies employed in their communities and allow policymakers to respond appropriately.

A mandatory disclosure or "sunshine" law would require tobacco manufacturers to publicly disclose payments and discounts provided to all retailers. States already require similar financial disclosures, such as political campaign donations.[67] Not only would such disclosures potentially stigmatize such payments and discounts (and possibly encourage the industry to reduce them), but it would provide tobacco control advocates with additional data to promote more effective tobacco control measures (such as restrictions on retailer discount programs).[68] Further, the information would more clearly illustrate the price disparities among different communities within the state, providing policymakers with the information they need to address the industry practice of targeting minority communities and other demographic groups.

Part III: Legal Issues to Consider

State and local governments have broad authority to regulate the pricing of tobacco products, and the Family Smoking Prevention and Tobacco Control Act (FSPTCA) explicitly preserves the right of state and local governments to enact such restrictions. Nevertheless, there are some important legal considerations that must be kept in mind as such regulations are drafted—such as whether legal authority exists for the particular regulation and, if so, whether any federal law limits that authority. The following section will discuss some of the primary legal questions that will arise when state and local governments pursue price controls for tobacco products.

State and Local Authority to Implement Price Regulation of Tobacco Products

The State of New York, like all states, has broad "police powers" to enact laws that promote and protect the public health and welfare of its residents. The police powers of the states have been described as "[t]he inherent authority of the state (and, through delegation, local government) to enact laws and promulgate regulations to protect, preserve, and promote the health, safety, morals, and general welfare of the people."[69] Because commercial relationships often have a significant impact on health, the "authority [of a state government] to make regulations of commerce is as absolute as its power to pass health laws, except insofar as it has been restricted by the constitution of the United States."[70]

By virtue of the New York Constitution and state law, local governments in New York have similar authority.[71] In fact, local governments in New York have regulated the prices of other products in the past, and those regulations have been upheld by the courts.[72] Moreover, the New York Court of Appeals has specifically recognized that local governments in New York can impose price regulations on tobacco products for the public health under the police power granted to them by the State.[73]

Federal Preemption

The Supremacy Clause of the United States Constitution establishes that the laws of the United States "shall be the supreme law of the land; … any Thing in the Constitution or laws of any state to the Contrary notwithstanding."[74] Thus, in certain circumstances federal law can preempt (or bar) state and local lawmaking on a particular subject. A federal statute may include specific language stating that the law will preempt any state or local law that relates to the same topic. Additionally, if conflicting federal and state laws exist that govern the same legal issue, the federal law will preempt the state law.

In the area of tobacco control, the Federal Cigarette Labeling and Advertising Act (FCLAA) contains a preemption provision that was amended by the FSPTCA in 2009. The amended preemption provision permits state and local governments to "impose specific bans or restrictions on the time, place, and manner, but not content, of the advertising or promotion of any cigarettes."[75] Thus, while states and local governments cannot regulate the content of cigarette advertisements, they have authority to regulate when, where and how cigarettes are marketed.[76]

Tobacco companies may challenge price regulation of tobacco products as being preempted by the FSPTCA itself. They may argue that the expanded federal role in regulating tobacco products implicitly preempts additional action by state and local governments. However, the law contains an express provision that permits state and local governments to regulate the sale and distribution of tobacco products.

The law states in pertinent part that state and local laws relating to the "sale, distribution, possession, exposure to, access to, advertising and promotion of, or use of tobacco products by individuals of any age" may be more stringent than federal law.[77] Laws relating to coupons and price promotions would likely be considered related to the sale of tobacco products, and Congress clearly intended an active role for state and local governments in enacting such measures.[78] Thus, state and local governments are not preempted by the FSPTCA from enacting stricter minimum price laws or other measures that address price promotions.

Commerce Clause

The Commerce Clause of the United States Constitution grants the federal government broad authority to regulate commerce "among the several States."[79] Because only the federal government (and not the states) has authority to regulate interstate commerce, the Supreme Court has recognized a "dormant" Commerce Clause doctrine under which state and local governments cannot unduly interfere with interstate business transactions.[80] When state laws interfere with interstate commerce, the court will assess whether the regulation's benefits to the public outweigh the burdens placed on interstate commerce.[81] Although this is a test that tobacco control regulations might be able to satisfy, state and local governments can avoid a dormant Commerce Clause issue altogether by ensuring that its laws apply only to commerce taking place solely within its borders.

For example, New York's minimum price law affects only sales of tobacco products within the state, and therefore does not raise any Commerce Clause issues. By contrast, a restriction on the distribution of discount coupons may raise Commerce Clause questions if it purports to regulate the distribution of coupons across state lines (e.g., those included in regional or national publications). To overcome any objections arising out of the Commerce Clause, a regulation of the distribution of discount coupons might be crafted to apply only to coupons distributed solely within the state. Alternatively, a law could restrict or prohibit only the *redemption* of discount coupons by tobacco retailers within that jurisdiction.

First Amendment

Commercial speech is the communication of information for economic reasons, including promotions and advertising intended to increase demand for consumer products.[82] Such speech may be protected by the First Amendment provision that "Congress shall make no law…abridging the freedom of speech," but this protection is not absolute.[83]

The tobacco industry has pursued First Amendment challenges against laws that regulate its ability to advertise or promote its products.[84] Coupons, in addition to reducing the price of tobacco products, may also constitute commercial advertisements or promotions if they contain information about the product or brand. Thus, any regulation of discount coupons must clearly regulate the commercial transaction rather than the commercial speech conveyed through the coupon.

Assuming that price-related laws are clearly drafted to restrict only *conduct* (price discounts) and not *speech*, these laws will likely be upheld without the need for any serious First Amendment review.[85] These laws should be drafted to regulate the use of coupons or price discounts without otherwise preventing tobacco companies from communicating truthful information about their products and their prices.

Conclusion

There is a direct correlation between the price of tobacco products and smoking rates. The industry knows this and uses price promotions to attract new customers and maintain the loyalty of current tobacco users. Policymakers can and should respond by using price-related regulations to reduce smoking rates. New York has been a leader in utilizing tobacco taxes to improve the health of its citizens. It can build upon this effort by implementing complementary pricing strategies to keep tobacco companies from reducing the price of cigarettes and other tobacco products. Among the options to consider are:

- Enhancing the state's minimum price law for cigarettes (e.g., establishing a minimum manufacturers' list price);
- Restricting the distribution or redemption of discount coupons for tobacco products;
- Limiting discounts and incentive programs offered by tobacco manufacturers to retailers; and
- Prohibiting "buy one get one free" and other value-added promotional discounts.

By working to counteract the industry's most effective price-related strategies, New York can protect children from smoking initiation and help adults who want to quit to do so successfully.

Citations

[1] In 2010, the average price of pack of cigarettes in New York was $9.11, the highest in the nation by a significant margin. Rhode Island was second with an average price of $7.58. Ann Boonn, Campaign for Tobacco-Free Kids, *State Excise and Sales Taxes per Pack of Cigarettes: Total Amounts and State Rankings* (June 28, 2011), *available at* http://www.tobaccofreekids.org/research/factsheets/pdf/0202.pdf.

[2] Frank Chaloupka, *Why is Tobacco Price Manipulation a Problem?* in TOBACCO RETAIL PRICE MANIPULATION POLICY STRATEGY SUMMIT PROCEEDINGS, 3, 3 (Cal. Dep't of Pub. Health, Cal. Tobacco Control Program, 2008). Marketing expenditures for the industry increased steadily from 1970 to their peak in 2003. FTC, CIGARETTE REPORT FOR 2007 AND 2008 (2011).

[3] Chaloupka, *Price Manipulation, supra* note 2, at 3.

[4] *Id.* at 5.

[5] *See* Brett R. Loomis et al., *The Association of Retail Promotions for Cigarettes with the Master Settlement Agreement, Tobacco Control Programmes and Cigarette Excise Taxes*, 15 TOBACCO CONTROL 458, 462 (2006).

[6] FTC, *supra* note 2, at 1.

[7] *Id.* at 6.

[8] Chaloupka, *Price Manipulation, supra* note 2, at 4.

[9] *See* F.J. Chaloupka et al., *Tax, Price and Cigarette Smoking: Evidence from the Tobacco Documents and Implications for Tobacco Company Marketing Strategies*, 11 TOBACCO CONTROL i62, i63 (Supp. 1 2002).

[10] *See* Michelle Leverett et al., *Tobacco Use: The Impact of Prices*, 30 J.L. MED. & ETHICS 88, 89 (2002); Frank Chaloupka, *Tobacco Control Lessons Learned: The Impact of State and Local Policies*, 14 (ImpacTEEN, Research Paper Series No. 38, 2010); *see also* Frank J. Chaloupka *Macro-social Influences: The Effects of Prices and Tobacco-Control Policies on the Demand for Tobacco Products*, 1 NIC. & TOB. RSCH s105, s106 (Supp. 1, 1999).

[11] Chaloupka, *Lessons Learned*, supra note 10, at 11.

[12] *See* U.S. DEP'T OF HEALTH & HUMAN SERV., REDUCING TOBACCO USE: A REPORT OF THE SURGEON GENERAL 331 (2000) [hereinafter SURGEON GENERAL'S REPORT]. *See also, id*. at 323; and Chaloupka, *Tax, supra* note 9, at i64 (estimating a 2.5-5 percent decrease).

[13] *See* SURGEON GENERAL'S REPORT, *supra* note 12 323, 326-33, 337 (2000); and Chaloupka, *Tax, supra* note 9, at i64.

[14] Leverett, *supra* note 10, at 89; Chaloupka, *Lessons Learned, supra* note 10, at 13-14 . *See* SURGEON GENERAL'S REPORT, supra note 12, at 329, 334, 337, and 359. *See also* Chaloupka, *Macro-Social Influences, supra* note 10, at S106. *Cf*. Family Smoking Prevention and Tobacco Control Act, Pub. L. No. 111-31, 123 Stat. 1776, 1778 (2009) (findings recognize that children tend to be more price sensitive than adults).

[15] Chaloupka, *Lessons Learned, supra* note 10, at 14.

[16] Chaloupka, *Price Manipulation, supra* note 2, at 4.

[17] *Id.*

[18] *Id.*

[19] *See* 26 U.S.C. § 5701(b)(2009); *see* SURGEON GENERAL'S REPORT, *supra* note 12, at 338.

[20] Ann Boonn, Campaign for Tobacco-Free Kids, *State Cigarette Excise Tax Rates & Rankings*, (June 28, 2011), *available at* http://www.tobaccofreekids.org/research/factsheets/pdf/0097.pdf.

[21] *See* Ann Boonn, Campaign for Tobacco-Free Kids, *State Excise Tax Rates for Non-Cigarette Tobacco Products*, (June 28, 2011), *available at* http://www.tobaccofreekids.org/research/factsheets/pdf/0169.pdf.

[22] Cancer Action Network, American Cancer Society, *Saving Lives, Saving Money: A State-by-State Report on the Health and Economic Impact of Tobacco Taxes*, 41 (2011) (estimating that a $1 increase in cigarette taxes would prevent 47,700 youth from ever smoking in New York).

[23] N.Y. TAX LAW §471 (West, Westlaw through L.2011, chapter 495).

[24] N.Y. TAX LAW §471B (West, Westlaw through L.2011, chapter 495).

[25] *See Oneida Nation of N.Y. v. Cuomo,* 645 F.3d 154, 160 (2d Cir. 2011). New York has begun to implement its tax collection system to ensure payment of taxes on cigarettes sold to non-tribal tobacco consumers.

[26] *See* Chaloupka, *Tax*, *supra* note 9, at i62.

[27] FTC, *supra* note 2, at Table 2D (includes Price Discounts, Coupons and Retail Value-Added categories). Promotional allowances paid to retailers and wholesalers for things like volume rebates and marketing incentive payments amounted to an additional $9.3 million in 2008.

[28] *See id*.

[29] *Id.*

[30] Victoria M. White et al., *Cigarette Promotional Offers: Who Takes Advantage?*, 30 AM. J. PREVENTATIVE MED. 225, 227 (2006).

[31] F.V. Creighton, Camel Growth Among Males 18-24 years old in the Midwest, Jul. 25, 1986, bates no. 505727418-505727431 *available at* http://legacy.library.ucsf.edu/tid/pda72d00; *see* White, *supra* note 30, at 229.

[32] White, *supra* note 30, at 228.

[33] Some of these arrangements come in the form of contracts between a tobacco company and a retailer, which offer incentive payments in exchange for marketing, stocking and displaying certain brands as determined by the tobacco company. Such arrangements are discussed in more detail in our technical report entitled Tobacco Product Display Bans (October 2010) *available at* http://www.tobaccopolicycenter.org/documents/CPHTP_Display_Report_October2010.pdf. While such incentive payments may be used by some retailers to reduce the price of tobacco products, the focus of this report is the price discount programs—or payments made by the industry to wholesalers and retailers specifically to reduce the price of cigarettes at the retail level.

[34] Tobacco Control Legal Consortium, Price-Related Promotions for Tobacco Products: An Introduction to Key Terms & Concepts, 1, note 2, July 2011.

[35] *Id.* at 1.

[36] *See* Lorillard Tobacco Co. v. Roth, 786 N.E.2d 7, 9 (N.Y. 2003)

[37] Master-type programs usually include other requirements imposed on the wholesaler, such as the stocking of certain products or maintaining a specific inventory of certain products. This report, however, will focus solely on the price discounting that occurs under these programs.

[38] KM Ribisl et al., CDC, *State Cigarette Minimum Price Laws – United States, 2009*, 59 MORBIDITY AND MORTALITY WEEKLY REPORT 13, 389, 389 (April 9, 2010).

[39] *Id.*

[40] *Id.*

[41] N.Y. TAX LAW §484(a)(1) (West, Westlaw through L.2011, chapter 495). The cost includes the basic cost of cigarettes, plus the cost of doing business, including, but not limited to, labor, rent, depreciation, selling costs, maintenance of equipment. N.Y. TAX LAW §484(b)(1)(A) (West, Westlaw through L.2011, chapter 495).

[42] N.Y. State Dep't of Tax'n & Fin., Minimum Wholesale and Retail Cigarette Prices, Publication 509 (Jul. 2011).

[43] *Id.*

[44] *See* Ellen C. Feighery et al., *How do Minimum Cigarette Price Laws Affect Cigarette Prices at the Retail Level?*, 14 TOBACCO CONTROL 80, 80 (2005); *see also* SURGEON GENERAL'S REPORT, supra note 12, at 337; *see also* Chaloupka, *Tax, supra* note 9, at i64.

[45] Feighery, *Minimum*, *supra* note 44, at 80; s*ee, e.g*., S. Chapman & B. Freeman, *Regulating the Tobacco Retail Environment: Beyond Reducing Sales to Minors*, 18 TOBACCO CONTROL 496, 499 (2009) ("Minimum price policies will be more effective in keeping cigarette prices high if price discounting to retailers is not permitted."). *See also Mass. Shelves "Buy Down" Plan,* CONVENIENCE STORE NEWS (Nov. 11, 2002) *available at* http://www.csnews.com/top-story-mass._shelves__buy_down__plan-52063.html.

[46] *See* Feighery, *Minimum*, *supra* note 44, at 80-81 and 83.

[47] N.Y. STATE DEPT. OF TAX'N & FIN., CIGARETTE MANUFACTURERS' PROMOTIONAL PROGRAMS AND THE CIGARETTE MARKETING STANDARDS ACT, TSB-M-00(2)M, Article 20-A *available at* http://www.tax.ny.gov/pdf/memos/cigarette/m00_2m.pdf.

[48] Lorillard, 786 N.E.2d at 13.

[49] E. Feighery et al., *Discussion of Policy Options for Addressing Retail Tobacco Price Manipulation*, TOBACCO RETAIL PRICE MANIPULATION POLICY STRATEGY SUMMIT PROCEEDINGS, 21, 21 (Cal. Dep't of Pub. Health, Cal. Tobacco Control Program, 2008).

[50] Family Smoking Prevention and Tobacco Control Act, Pub. L. No. 111-31, 123 Stat. 1776, 1781. 1796 (2009).

[51] Family Smoking Prevention and Tobacco Control Act, Pub. L. No. 111-31, 123 Stat. 1776, 1823, 1846 (2009).

[52] N.Y. PUB. HEALTH LAW §1399-bb (West, Westlaw through L.2011, chapter 495).

[53] CAL. HLTH & SAFETY CODE §118950(b) and (c)(1) (West, Westlaw through Ch. 360 of 2011 Reg. Sess. And Ch. 11, and 13-16 of 2011-12 1st Ex. Sess.).

[54] HAW. REV. STAT. §328J-17 (West, Westlaw through Act 235 of the 2011 Reg. Sess.).

[55] *See e.g.* MASS. DEP'T OF REVENUE DIRECTIVE 03-14 (2003) (explaining that coupons reducing the price of cigarettes below the statutory minimum are prohibited).

[56] As discussed, some states regulate them in the context of their minimum price laws. *See, e.g.,* N.Y. STATE DEP'T OF TAX'N & FIN., PROMOTIONAL PROGRAMS, *supra* note 47 and MASS. DEP'T OF REVENUE, DIRECTIVE 02-2, CIGARETTE MANUFACTURER PROMOTIONAL PROGRAMS (2002).

[57] Gregory T. Gundlach and Paul N. Bloom, *Slotting Allowances and the Retail Sale of Alcohol Beverages*, 17 JOURNAL OF PUBLIC POLICY & MARKETING 173, 173 (1998); Federal Alcohol Administration Act, 27 C.F.R. § 6.152 (2011); Unfair Trade Practices Under the Federal Alcohol Administration Act, 60 Fed. Reg. 20,402.

[58] Paul N. Bloom, *Role of Slotting Fees and Trade Promotions in Shaping How Tobacco Is Marketed in Retail Stores*, 10 TOBACCO CONTROL 340, 342-43 (2001).

[59] The 21st Amendment, which ended prohibition, grants states "virtually complete control" over the importation and distribution of alcohol within their borders and "substantial discretion to establish other liquor regulations." California Retail Liquor Dealers Assoc. v. Midcal Aluminum, Inc., 100 S.Ct. 937, 946 (1980). See U.S. CONST. amend. XXI, § 2.

[60] Bloom, *Role of Slotting Fees, supra* note 58, at 343.

[61] FTC, *supra* note 2, at 6 and Table 2D.

[62] *Id*. It should be noted that the Family Smoking Prevention and Tobacco Control Act now prohibits promotions involving non-tobacco items. The amount spent on retail value-added promotions involving non-cigarette tobacco products was not reported separately to the FTC.

[63] MASS. GEN. LAWS ch. 64C, §13(e) (West, Westlaw through Ch 123 of the 2011 1st Ann. Sess.).

[64] *Id.*

[65] *See* Scott L Tomar et al., *Patterns of dual use of cigarettes and smokeless tobacco among US males: findings from national surveys*, 19 TOBACCO CONTROL 104, 104107 (2010); Ann Boonn, Campaign for Tobacco Free Kids, *The Danger From Dissolvable and Other Smokeless Tobacco Products* (2011) *available at* http://www.tobaccofreekids.org/research/factsheets/pdf/0363.pdf.

[66] *See, e.g.,* FTC, *supra* note 2.

[67] *See, e.g*., NY ELEC LAW §14-102 (West, Westlaw through L.2011, ch. 495).

[68] Feighery, *Discussion*, *supra* note 49, at 27.

[69] LAWRENCE O. GOSTIN, PUBLIC HEALTH LAW: POWER, DUTY RESTRAINT 92 (2nd ed. 2008).

[70] Nebbia v. New York, 291 U.S. 502, 524 (1934).

[71] *See* N.Y. CONST., art. IX, §2(c) (2011) (granting local governments in New York State the authority to regulate with respect to the "safety, health and well-being" of their residents, so long as local laws do not conflict with state laws.)

[72] *See* People v. Lewis, 58 N.Y.S.2d 223 (1945)

[73] People v. Cook, 34 N.Y.2d 100 (1974). In a challenge by a tobacco retailer to a New York City law which taxed cigarettes based on tar and nicotine content, the court found that the New York State Constitution and New York state law granted authority to local governments to adopt local laws relating to the health of its citizens. Where a local law has been enacted in relation to the promotion of the public health, there are only two limitations: (1) the law must not be inconsistent with constitutional or other general law; and (2) exercise of police power to enact the law must not be prohibited by the Legislature. The court found that the New York City law was properly related to health and not inconsistent with existing law. Moreover, according to the court's opinion, "[p]rice regulation is just another form of regulation to be gauged by its relation to the common weal."

[74] U.S. CONST., Article IV, §2.

[75] Family Smoking Prevention and Tobacco Control Act, Pub. L. No. 111-31, 123 Stat. 1776, 1846 (2009).

[76] Even though some courts have ruled in the past the laws restricting the distribution of free samples were preempted, under the revised preemption provision these laws would likely be considered permissible "manner" restrictions. Beyond laws that prohibit free samples, no court has ever held price regulations to be preempted by the FCLAA. *See* Lorillard Tobacco Co. v. Reilly, 533 U.S. 525, 550 (U.S. 2001) (noting that under the FCLAA, "States remain free to . . . regulate conduct with respect to cigarette use and sales").

[77] 21 U.S.C. § 387(p) (2011).

[78] The law also provides that it "does not affect the authority of a state or local government to prohibit or otherwise restrict the distribution of free samples of smokeless tobacco." 123 Stat. 1776, 1831 (2009).

[79] U.S. CONST. art. I, §8.

[80] *See* Granholm v. Heald, 544 U.S. 460 (2005); West Lynn Creamery v. Healy, 512 U.S. 186 (1994); Gibbons v. Ogden, 22 U.S. 1 (1824).

[81] *See* Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) ("Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.").

[82] *See* Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y., 447 U.S. 557, 561 (1980).

[83] U.S. CONST. amend. I. *See* Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc., 425 U.S. 748, 770 (1976) ("In concluding that commercial speech, like other varieties, is protected, we of course do not hold that it can never be regulated in any way. Some forms of commercial speech regulation are surely permissible.")

[84] *See, e.g.,* Reilly, 533 U.S. at 565.

[85] *See* United States v. O'Brien, 391 U.S. 367 (1968) (holding that expressive speech can be limited if the purpose of the restriction is unrelated to the suppression of free expression and the regulation is not overbroad); Lorillard, 533 U.S. at 569 (upholding restriction on self-service tobacco displays, applying the *O'Brien* test).

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