

Regulating Tobacco Product Pricing: Guidelines for State and Local Governments



Tobacco Control
Legal Consortium



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Regulating Tobacco Product Pricing: Guidelines for State and Local Governments

On June 22, 2009, President Barack Obama signed into law the Family Smoking Prevention and Tobacco Control Act, giving the U.S. Food and Drug Administration (FDA) comprehensive authority to regulate the manufacturing, marketing, and sale of tobacco products. The Act represents the most sweeping action taken to date to reduce what remains the leading preventable cause of death in the United States.

In addition to granting the FDA power to establish tobacco product standards, the new law gives the agency wide-ranging authority to regulate tobacco product marketing and advertising. The Act leaves state and local governments free to restrict the sale, distribution and possession of tobacco products. State and local governments are considering appropriate price-related controls they can enact to regulate the marketing of tobacco products. The Tobacco Control Legal Consortium, a collaborative network of legal centers, has prepared this summary of guidelines and drafting tips to help governments identify tobacco product price controls, such as regulating coupons and setting minimum price requirements, and potential ways these strategies might be limited by federal law.

Introduction

Inexpensive tobacco products increase rates of tobacco use, particularly among young adults and minors. Tobacco manufacturers exploit the appeal of these products by using coupons and other price-related incentives to market them. In response, many states have raised excise taxes on cigarettes and other tobacco products to increase their prices and make these products less attractive to consumers.¹ Raising tobacco taxes has proven to be the most effective way to decrease tobacco use in the U.S.²

Through price-related marketing strategies, tobacco manufacturers can exploit the price sensitivity of users and potential users, as well as dampen the effects of tobacco taxes. These strategies often promote sales of specific brands, sales in specific geographic locations and sales among particular groups of people. For this reason, state and local governments may wish to consider other price-related regulations in addition to taxes. States and localities have broad legal authority to regulate the distribution of tobacco products, which includes the regulation of price-related marketing strategies.

This publication discusses potential regulatory oversight of the tobacco industry's price-related marketing strategies in light of the new federal tobacco legislation. Section I briefly overviews taxation as a

tobacco control measure. Section II describes common price-related marketing strategies used by tobacco manufacturers. Section III examines two price-related regulatory tools that state and local governments might want to consider: coupon restrictions and minimum pricing. Section IV addresses common legal questions about these regulatory tools, including the authority of state and local governments to enact them. In many cases, local governments have the authority to establish restrictions on coupons, but should defer to state governments in the area of minimum pricing.

I. Tobacco Taxation

Study after study has shown that cigarette prices affect smoking rates—as cigarette prices increase, smoking rates decrease, even though the nicotine contained in tobacco products is highly addictive.³ Increasing the price of a pack of cigarettes by ten percent has been shown to reduce smoking rates by an average of three to five percent as more smokers quit and fewer potential smokers start.⁴ This effect is greatest among youth, who are particularly sensitive to price.⁵

Accordingly, states and more recently the federal government have increased tobacco taxes – both to decrease tobacco use and to generate revenue.⁶ The average state cigarette tax is \$1.45.⁷ Taxes range from \$0.17 in Missouri to \$4.75 in New York.⁸ In 2009, the

Coupon Regulation

Some states already regulate coupons to keep free tobacco products from being distributed to the public.²⁷ For example, California passed a tobacco distribution law that bans anyone from handing out free or nominal cost coupons or other gifts that can be redeemed for smokeless tobacco products or cigarettes.²⁸ The ban prohibits distribution in all public places and private property that is open to the general public.²⁹ The law states that:

(b) It is unlawful for any person, agent, or employee of a person in the business of selling or distributing smokeless tobacco or cigarettes to engage in the nonsale distribution of any smokeless tobacco or cigarettes to any person in any public building, park or playground, or on any public sidewalk, street, or other public grounds, or on any private property that is open to the general public.

(c) For purposes of this section:

(1) “Nonsale distribution” means to give smokeless tobacco or cigarettes to the general public at no cost, or at nominal cost, or to give coupons, coupon offers, gift certificates, gift cards, or other similar offers, or rebate offers for smokeless tobacco or cigarettes to the general public at no cost or at nominal cost. Distribution of tobacco products, coupons, coupon offers, gift certificates, gift cards, or other similar offers, or rebate offers in connection with the sale of another item, including tobacco products, cigarette lighters, magazines, or newspapers shall not constitute nonsale distribution.³⁰

While there are some exceptions,³¹ it is significant that the prohibited promotions include coupons, gift cards and rebates.

Policy makers interested in passing a comparable law should keep in mind the provisions that help make California’s law particularly effective, such as those that limit the reach of the law to areas open to the public and those that specify the broad range of activities that are prohibited. The law also expressly states that it is not preemptive.³² This allows cities and counties to enact similar, but stricter regulations that take into account special circumstances that might

exist in a particular location. The law also carries civil penalties, with escalating fines ranging from \$200 for the first offense to \$1,000 for the third offense and onward.³³ Establishing monetary penalties allows for more effective enforcement, as does explicitly allowing localities to place greater restrictions on the sale or distribution of tobacco.³⁴

Minimum Price Laws

Another regulatory strategy that state and local governments might consider is a minimum price law.³⁶ Approximately half the states set a minimum price for cigarettes.³⁶ In general, the minimum price is the wholesale cost of cigarettes paid by the retailer plus an additional amount, representing the business cost for the retailer. No retailer is allowed to sell cigarettes below the minimum price. Even though cigarette manufacturers ultimately set the wholesale cost of cigarettes, minimum price regulations impede manufacturers’ efforts to manipulate retail prices either geographically or by brand.³⁷ In other words, cigarette manufacturers have less opportunity to dampen the effect of tobacco tax increases, to vary pricing geographically, to target various populations according to their price sensitivity or to subsidize brands that are most commonly used by minors who might experiment with tobacco products.



Despite the prevalence of minimum price laws, many have loopholes that undercut their effectiveness, such as retailer incentive programs. Two commonly used tobacco retailer incentives are called *buy-down programs* and *master-type programs*.³⁸ Under a buy-down program, the manufacturer offers a retailer a rebate for sales of a particular brand of tobacco product, either for a specific quantity of that product or for a quantity of that product sold over a predetermined period of time.³⁹ The manufacturer can pick and choose which retailers or communities it offers the buy-down incentive. The master-type program uses the same approach, but it is administered by a wholesale distributor.⁴⁰

Unfortunately, many state minimum price laws allow retailers participating in buy-downs and master-type programs to sell products below the presumptive minimum price.⁴¹ In fact, one study found that retail prices were not significantly different in states with minimum price laws compared to states without such laws, suggesting that including trade discounts in the minimum pricing formula undercuts the effectiveness of minimum price laws.⁴² States interested in reducing the impact of price-related marketing may look to Massachusetts's regulatory efforts, which prohibit buy-downs and master-type programs from circumventing the intended effect of minimum price laws.⁴³ In addition, Massachusetts allows the use of coupons only if they do not reduce the price to below the presumptive minimum price.⁴⁴ States wishing to reduce the ability of tobacco manufacturers to use buy-downs, master-type programs and other such incentives to target certain groups or areas may want to consider adopting the Massachusetts approach to minimum pricing. Their focus should be on setting reasonable minimum prices that can be simply calculated, and successfully applied and enforced.

IV. Legal Questions Regarding Coupon and Minimum Price Laws

State and local governments considering tobacco price controls need to ensure that the laws will withstand legal challenges. They must ask two key questions. First, does the state or local government have the authority to enact such public health laws? Second, even if authority exists, does federal law block the state or local government from taking action? These questions are discussed below.

State and Local Authority to Establish Coupon and Minimum Price Laws

The United States Constitution recognizes that each state has certain inherent legal authority, such as its power to protect the welfare, health and safety of its people—sometimes referred to as the “police power.”⁴⁵ Most states then grant limited authority to local governments.⁴⁶ Such authorization is established through the state's constitution in a “Home Rule Amendment”⁴⁷ or through a direct delegation of legal authority by statute.⁴⁸

Many state and local governments have exercised their police power to regulate tobacco sales beyond what the federal government has done.⁴⁹ Their efforts are supported by a substantial body of research showing that the price of tobacco products affects smoking rates, and that keeping inexpensive tobacco products off store shelves lowers smoking rates, particularly among youth.⁵⁰ The New York case *Lorillard Tobacco Company v. Roth* demonstrates that states also have the legal authority to prohibit buy-down and master-type programs from undercutting minimum price laws.⁵¹ In *Lorillard*, the New York Department of Taxation and Finance prohibited buy-downs and master-type programs unless they were made available to all retailers in the state, which effectively prevented cigarette manufacturers from using these retailer incentives to target certain populations and communities.⁵² The New York Court of Appeals upheld the restriction.⁵³ It found that buy-down and master-type programs “create a kind of price differentiation among retailers” that the state's minimum price laws were “meant to prohibit.”⁵⁴

In *People v. R.J. Reynolds Tobacco Company*, the California Supreme Court determined that states have the legal authority to prohibit price-related marketing practices such as the distribution of free or nominal cost coupons redeemable for tobacco products.⁵⁵ In this case, the California Attorney General sued the R.J. Reynolds Tobacco Company after it distributed the equivalent of 108,155 packs of cigarettes to almost 15,000 people at street fairs, automobile racing events, music festivals and beer festivals.⁵⁶ R.J. Reynolds challenged the legal validity of the law on various grounds, but the court concluded that the law fell squarely within the state's legal authority to regulate the distribution of tobacco products.⁵⁷

It is important to note that while restrictions on coupons and minimum price laws established at the state level have been upheld, no similar restrictions at the municipal level have been evaluated by any courts of appeal. If they have the authority to do

so under state law, local governments can impose tobacco control laws stricter than similar state laws.⁵⁸ However, because nearly half the states have some type of minimum price law for cigarettes, public health practitioners considering this policy option may wish to seek implementation at the state level.⁵⁹

Federal Law Questions

State and local governments should be aware of federal provisions that could impact their efforts to regulate the use of tobacco coupons and to enact minimum price laws. Three of those federal provisions are (1) the Family Smoking Prevention and Tobacco Control Act, (2) the Dormant Commerce Clause and (3) the First Amendment. While these laws do not directly prohibit coupon restrictions or minimum price laws, policymakers should understand the limits those federal laws place on state and local efforts.

The Family Smoking Prevention and Tobacco Control Act

The recent enactment of the Family Smoking Prevention and Tobacco Control Act of 2009 (“the FDA law”) authorizes the Food and Drug Administration to regulate tobacco products.⁶⁰ It also preserves the traditional role that state and local governments have in trying to reduce tobacco use.⁶¹ The language of the FDA law states:

[N]othing in this chapter, or rules promulgated under this chapter, shall be construed to limit the authority of . . . a State or political subdivision of a State . . . to enact, adopt, promulgate, and enforce any law, rule, regulation, or other measure with respect to tobacco products that is in addition to, or more stringent than, requirements established under this chapter, including a law, rule, regulation, or other measure relating to or prohibiting the sale, distribution, possession, exposure to, access to, advertising and promotion of, or use of tobacco products by individuals of any age, information reporting to the State, or measures relating to fire safety standards for tobacco products. No provision of this chapter shall limit or otherwise affect any State, tribal, or local taxation of tobacco products.⁶²

Despite some exceptions to this broad affirmation of state and local governmental authority in the area

of tobacco control, the FDA law makes it clear that state and local governments retain their authority to regulate tobacco product distribution, which includes the regulation of coupons and minimum pricing. Indeed, the FDA law states 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.”⁶³ Therefore, states and localities are not preempted or constrained by the FDA law, and can pass laws that are stricter than that federal law.

This same conclusion was reached in a case decided in 2005 involving California’s law prohibiting the distribution of coupons for free cigarettes.⁶⁴ At the time of this case, the Federal Cigarette Labeling and Advertising Act preempted state and local laws governing cigarette promotion. When allegations were made that R.J. Reynolds was violating this law, the company argued that the law was invalid because the Federal Cigarette Labeling and Advertising Act preempted the California law. R.J. Reynolds reasoned that its distribution of coupons for free cigarettes was promotional in nature, as opposed to the distribution of tobacco products. The California Supreme Court disagreed and stated that “Congress intended that the [s]tates remain free . . . to regulate conduct with respect to cigarette use and sales.”⁶⁵ The Court also stated:

If the [Federal Cigarette Labeling and Advertising Act]’s bar on state regulation of the promotion of cigarettes extends to barring state regulation of distribution, that prohibition could not logically be confined to non-sale distribution. Discount sales of cigarettes, sales accompanied by rebate offers, and the distribution of coupons entitling a holder to receive free or discounted cigarettes could equally be considered a form of promotion of cigarette sales and use. Thus, such a broad definition would infringe on the state’s retained powers to regulate cigarette use and sales.⁶⁶

The Court’s reasoning squarely places the restriction of discount coupons and other price promotions within the states’ authority to regulate tobacco distribution and use. Thus, the FDA law’s provision allowing state and local governments to regulate the distribution and use of tobacco products does not preempt state or local governments from regulating pricing.

Dormant Commerce Clause

Under the Dormant Commerce Clause doctrine, states cannot regulate products in a way that would unduly burden interstate commerce.⁶⁷ If a tobacco price regulation is challenged under the Dormant Commerce Clause, the court would examine whether the law’s benefits outweigh any burdens it places on interstate commerce, and in doing so would consider whether the law favors local businesses over out-of-state businesses.⁶⁸ Thus, laws setting minimum pricing of tobacco products, if drafted carefully to ensure they impact in-state and out-of-state retailers equally, are likely to withstand a challenge under the Dormant Commerce Clause doctrine.

Whether laws regulating tobacco product coupons survive a Dormant Commerce Clause challenge would depend on the conduct those laws seek to regulate. A law banning the distribution of coupons might violate the Dormant Commerce Clause if it unfairly burdened tobacco manufacturers who would have to modify a national or regional coupon distribution effort. To avoid this difficulty, state and local governments could instead prohibit the redemption of coupons in their jurisdiction. In this manner, coupons could still be printed and distributed nationally but would simply not be redeemable in the state or locality that bans or regulates the coupons.

First Amendment

The communication of product information to customers is a type of commercial speech that usually receives First Amendment protection.⁶⁹ Speech is generally considered “commercial” when communication is for an economic reason, such as when a business communicates to its potential customers.⁷⁰ The tobacco industry has vigorously challenged laws that attempt to regulate tobacco advertising and promotion.⁷¹ Besides reducing price, discount coupons may convey additional information about the tobacco product or brand. This promotional quality could have made lawmakers wary of challenges under both the First Amendment and, as discussed above, the Federal Cigarette Labeling and Advertising Act, and may be the reason why price discount coupons are not widely regulated. Still, as discussed below, price control laws regulate transactions, not speech, and should thus withstand First Amendment challenge. For a discussion of the issues surrounding

the Federal Cigarette Labeling and Advertising Act, see our publication *Regulating Tobacco Marketing: “Commercial Speech” Guidelines for State and Local Governments*. Minimum pricing regulations are not likely to be challenged under commercial speech grounds because they have no apparent relation to the communication of product information.

If a law is challenged on First Amendment grounds, the court would likely apply the four-part test developed in *Central Hudson Gas & Electric Corporation v. Public Service Commission of New York*, to determine whether the law unconstitutionally infringes upon commercial speech. The test considers (1) whether the “communication is neither misleading nor related to unlawful activity”; only if so will the courts further examine whether (2) the government “assert[s] a substantial interest to be achieved by restrictions on commercial speech,” (3) the law “directly advance[s] the state interest involved,” and (4) “the governmental interest could be served as well by a more limited restriction on commercial speech. . . .”⁷²

If drafted appropriately, discount coupon regulation may face, but should withstand, any commercial speech challenge. As with minimum price laws, discount coupons function as a pricing tool, not as a speech regulation.⁷³ Because a court would likely find discount coupon regulation to be a transactional regulation, the court would not likely apply the First Amendment analysis. As such, coupon laws if faced with such a legal challenge are likely to survive constitutional muster.

In *44 Liquormart, Inc. v. Rhode Island*, the U.S. Supreme Court found that a state law restricting advertising of retail alcohol prices outside of stores violated commercial speech protection.⁷⁴ The Court stated:

It is perfectly obvious that alternative forms of regulation that would not involve any restriction on speech would be more likely to achieve the State’s goal of promoting temperance. As the State’s own expert conceded, higher prices can be maintained either by direct regulation or by increased taxation.⁷⁵

The concurring opinion also found that there were better fits to increasing liquor prices than banning price advertising—referring, as the majority opinion did, to Rhode Island’s expert who suggested setting minimum prices or increasing sales taxes as other

measures.⁷⁶ It can be similarly argued that regulating price promotions is a non-speech way to lower cigarette use by keeping the consumer price of cigarettes high—“without intruding on sellers’ ability to provide truthful, nonmisleading information to customers.”⁷⁷

The FDA law, and its accompanying regulations, contains a provision banning the free distribution of tobacco product samples, stating that, with certain limited exceptions, “no manufacturer, distributor, or retailer may distribute or cause to be distributed any free samples of cigarettes, smokeless tobacco, or other tobacco products. . . .”⁷⁸ In *Commonwealth Brands, Inc. v. United States*, tobacco manufacturers claimed that this provision was unduly burdensome and that there were alternatives other than restricting commercial speech that would accomplish the governmental objectives.⁷⁹ In response, the federal government pointed out that the effectiveness of tobacco price increases alone is limited because “tobacco companies use targeted discounts to ‘population subgroups that are more price-sensitive (e.g. young smokers not yet addicted), countering the depressing effect of general price increases on smoking.”⁸⁰ The government also argued that state and local laws could address this limitation by banning these targeted discounts. In a summary judgment ruling, the trial court held, in part, that the federal free samples ban does not even “implicate, let alone violate,” the First Amendment, because it “clearly regulates the distribution of a product, not speech—and even if thought of as a speech restriction, it would seem fully permissible as a restriction on price, i.e., tobacco products cannot be free.”⁸¹ Thus, state and local efforts to ban targeted discounts should also be considered price restrictions that do not implicate the First Amendment.

It is important to note that even if a price regulation has the effect of infringing speech, the regulation is not necessarily invalid. A recent unpublished Ninth Circuit decision regarding a San Francisco ordinance banning the sale of tobacco products in pharmacies indicates the current reasoning of courts.⁸² Philip Morris argued that the ban infringed on its speech because its “product itself is a form of advertisement” and the ban affected the company’s decision to keep the pharmacies in its “‘Retail Leaders’ program, which provides retailers with advertising and promotional materials.”⁸³ The appeals court affirmed the district court’s decision to uphold the ordinance, pointing out that the sale of tobacco products is not a protected

“expressive activity” like advertising.⁸⁴ Furthermore, “even if the ordinance did have the inevitable effect of singling out expressive activity, ‘a differential burden . . . is insufficient by itself to raise First Amendment concerns’”—and “[t]he censorial motive plaintiffs attribute to defendants is always present when government restricts sales of a product. That can’t be sufficient.”⁸⁵ Similarly, state or local coupon restrictions validly regulate transactions even if the restrictions have an incidental effect on commercial speech.

Conclusion

Although the new FDA law prohibits free samples of tobacco products, tobacco manufacturers in the U.S. still continue to distribute or sell cigarettes and other tobacco products at greatly reduced and below-market prices. State and local governments have the authority to eliminate the sharply discounted sales of tobacco products. They can do this by passing cost controls, such as prohibiting tobacco product coupons and setting minimum price requirements. To help prevent these regulatory measures from legal attacks, laws need to be drafted carefully and concisely, with a clear eye on Commerce Clause implications and other possible legal challenges.

The following chart may be helpful when state and local governments draft price-related controls that regulate the marketing of tobacco products in their jurisdictions. Because it provides an overview of tests that might be applied to new tobacco marketing laws challenged in court, it can be used to draft the strongest laws possible. For more information on Commerce Clause considerations when drafting state and local regulations that restrict tobacco advertising and promotion, see the Tobacco Control Legal Consortium’s *Regulating Tobacco Advertising and Promotion: A “Commerce Clause” Overview for State & Local Governments and Regulating Tobacco Retailers: Guidelines for State and Local Governments* (2010). For information on related Commercial Speech considerations, see the Tobacco Control Legal Consortium’s *Regulating Tobacco Marketing: “Commercial Speech” Guidelines for State and Local Governments* (2010); *Regulating Tobacco Marketing: “Commercial Speech” Factsheet for State and Local Governments* (2010); and *Regulating Tobacco Marketing: “Commercial Speech” Flowchart for State and Local Governments* (2010).

Select Tobacco Product Pricing Regulations and Legal Tests Applied by Courts

Type of regulation	Possible legal challenge	Test applied by courts	Notes and drafting tips
<p>State / local law restricting or prohibiting tobacco coupons</p> <p>Example: Banning free or nominal cost coupons or gifts redeemable for tobacco products. See CALIFORNIA HEALTH & SAFETY CODE §§ 11895 (2009).</p>	<p>No federal preemption concerns</p>	<p>See the Family Smoking Prevention and Tobacco Control Act of 2009,* and the Federal Cigarette Labeling and Advertising Act</p>	<ul style="list-style-type: none"> • State governments are free to regulate tobacco product distribution, including the regulation of coupons. • Local authority is established through a state constitution, such as a Home Rule Amendment, or through delegation by state statute.
	<p>Dormant Commerce Clause</p>	<p><i>Pike v. Bruce Church, Inc.</i>, 397 U.S. 137 (1970)</p> <p>4 prongs:</p> <ol style="list-style-type: none"> 1) Does the state government have authority to pass the law? 2) Does the law discriminate against interstate commerce? 3) Does the law promote a legitimate local interest? 4) Does the burden on interstate commerce exceed the local public health interest (purpose)? 	<ul style="list-style-type: none"> • State governments are free to pass tobacco product pricing regulations. • Fully document the problem that the law was drafted to solve and include a careful, thorough analysis of how the law would affect interstate commerce. • Clearly state the government's goal in enacting the law since this helps show the law promotes a legitimate local interest. • Explain why the law's approach must be taken and why other approaches to solving the problem that have a lesser impact on interstate commerce would not work or, if they were tried before, have not worked in the past. • Ensure that the new law imposes the least amount of burden on interstate commerce, while still achieving the law's goal. o Example: Prohibit coupons from being redeemed in the state or locality regulating them. <p>Specific Notes</p> <ul style="list-style-type: none"> • Ensure that prohibited tobacco products include coupons, gift cards and rebates.

*The Family Smoking Prevention and Tobacco Control Act, Pub. L. Nol. 111-31, 123 Stat. 1776 (codified, in relevant part, at 15 U.S.C.A. §§ 1333-34 and 21 U.S.C.A. § 301 et seq. (West 2010)).

Select Tobacco Product Pricing Regulations and Legal Tests Applied by Courts

Type of regulation	Possible legal challenge	Test applied by courts	Notes and drafting tips
<p>State / local law restricting or prohibiting tobacco coupons</p> <p>Example: Banning free or nominal cost coupons or gifts redeemable for tobacco products. See CALIFORNIA HEALTH & SAFETY CODE §§ 11895 (2009).</p>	<p>First Amendment ("Commercial Speech")</p>	<p><i>Central Hudson Gas v. Public Services Commission</i>, 447 U.S. 557 (1980):</p> <p>4 prongs:</p> <ol style="list-style-type: none"> 1) Is the restricted speech false, deceptive, or advertising illegal activities? 2) Is the law justified by a substantial governmental interest? 3) Does the law directly advance the governmental interest? 4) Is there a reasonable fit between the goal (the governments' interest) and the means chosen to accomplish the goal? <p>OR</p> <ol style="list-style-type: none"> 4) Does the law restrict the least possible amount of speech necessary to achieve its goal? 	<ul style="list-style-type: none"> • Fully document the problem that the law was drafted to solve and include a careful, thorough analysis in the law's findings of how the law would affect commercial speech. • Clearly state the government's goal in enacting the law since this helps show the law satisfied prong two: that the government has a substantial interest in solving the problem, and prong three: that the law as written will achieve the goal it seeks. • Explain how the law clearly advances the objective the government enacted the law to achieve. • Indicate in the findings why the law's goal is met without a larger than necessary impact on interstate commerce. o Example: Prohibit coupons from being redeemed in the state or locality regulating them. <p>For more information on drafting tobacco control laws and First Amendment issues, see the Tobacco Control Legal Consortium's <i>Regulating Tobacco Marketing: "Commercial Speech" Guidelines for State and Local Governments</i>; <i>Regulating Tobacco Marketing: A "Commercial Speech" Factsheet for State and Local Governments</i>; and <i>Regulating Tobacco Marketing: A "Commercial Speech" Flowchart for State and Local Governments</i> (2010).</p>
<p>State and local minimum price laws for tobacco products</p>	<p>No federal preemption concerns</p>	<p>See the Family Smoking Prevention and Tobacco Control Act of 2009</p>	<ul style="list-style-type: none"> • State governments are free to regulate tobacco product distribution, including the regulation of coupons. • Local authority is established through a state constitution, such as a Home Rule Amendment, or through delegation by state statute.

Select Tobacco Product Pricing Regulations and Legal Tests Applied by Courts

Type of regulation	Possible legal challenge	Test applied by courts	Notes and drafting tips
	Dormant Commerce Clause	Pike balancing test. (See above for prongs.)	<p>See General Tips above.</p> <p>Specific Notes</p> <ul style="list-style-type: none"> • Consider implementing minimum price laws at state, rather than local level, particularly if the state already has established a minimum price law. • Draft laws that do not allow buy-downs, master-type programs and similar incentives that could undermine minimum price laws. • If coupons may still be redeemed in the jurisdiction, draft the law so that it does not allow redemption of coupons if doing so would undermine minimum price laws. • If the law has an incidental effect on interstate commerce, show that the burden is outweighed by the public health goals of the law.
	First Amendment ("Commercial Speech")	<i>Central Hudson Gas v. Public Services Commission</i> , 447 U.S. 557 (1980). (See above for prongs.)	<p>See General Tips above.</p> <p>Specific Notes</p> <ul style="list-style-type: none"> • Show that even if the law has an incidental effect on commercial speech, it functions as a pricing tool, rather than a speech regulation. • See Tobacco Control Legal Consortium's Commercial Speech resources above.

Endnotes

- 1 See U.S. DEP'T OF HEALTH & HUMAN SERVS., REDUCING TOBACCO USE: A REPORT OF THE SURGEON GENERAL 359 (2000).
- 2 See *id.*
- 3 See Frank 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. I 2002). This observance can be termed the price elasticity of demand, which measures how changing the determinant of price affects the demand for the item. see N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 90 (4th ed. 2006).
- 4 See *id.*
- 5 See Frank Chaloupka, *Macro-Social Influences: The Effects of Prices and Tobacco Control Policies on the Demand for Tobacco Products*, 1 Nicotine & Tobacco Research S105 (Supp. 1 1999); see also John A. Taurus, *Public Policy and Smoking Cessation Among Young Adults in the United States*, 68 HEALTH POLICY 321 (2004).
- 6 U.S. DEP'T OF HEALTH & HUMAN SERVS., *supra* note 1.
- 7 Campaign for Tobacco-Free Kids, Map of State Cigarette Tax Rates, <http://tobaccofreekids.org/research/factsheets/pdf/0222.pdf> (last visited July 16, 2010).
- 8 *Id.*
- 9 See 26 U.S.C. § 5701(b) (2009); U.S. DEP'T OF HEALTH & HUMAN SERVS., *supra* note 1, at 338; and Campaign for Tobacco-Free Kids, *supra* note 7.
- 10 See Chaloupka, *supra* note 3.
- 11 See *id.*
- 12 See *id.*
- 13 Campaign for Tobacco-Free Kids, *State Excise Tax Rates for Non-Cigarette Tobacco Products* (2010), <http://www.tobaccofreekids.org/research/factsheets/pdf/0169.pdf> (last visited June 15, 2010).
- 14 See State House News Service, *Report: Smokeless Tobacco, Cigars Outpace Youth Cigarette Smoking*, BOSTON HERALD, March 24, 2010.
- 15 Expenditures on price promotions reflect the importance the cigarette industry places on price-based marketing strategies. Price promotion annual expenditures increased from \$1 billion to \$2.4 billion in the early nineties shortly after an increase in the federal cigarette excise tax. see Chaloupka, *supra* note 5. The period after the Master Settlement Agreement also saw a sharp increase in price promotion expenditures, jumping to \$3.1 billion from 1997 to 1999. see *id.* For price coupons, expenditures increased from \$650.7 million to \$870.1 million in just two years from 2003 to 2005. see FED. TRADE COMM'N, CIGARETTE REPORT FOR 2004 AND 2005 7 (2007). In 2006, the cigarette industry spent \$9.21 billion on promotional allowances to retailers or wholesalers in order to reduce the price of cigarettes to consumers. see FED. TRADE COMM'N, CIGARETTE REPORT FOR 2006 4 (2009).
- 16 Leo Burnett, Philip Morris USA Proposition 99: Tobacco Tax Initiative California Defense Plan, Sept. 22, 1988, Bates no. 2048486666–2048486686, available at <http://legacy.library.ucsf.edu/tid/pvw65e00>.
- 17 See *id.*
- 18 See *id.*
- 19 See *id.*
- 20 See *id.*; see also Chaloupka, *supra* note 3.
- 21 Philip Morris, Excise Tax Consumer Program, Jan. 1, 1987, Bates no. 2072926741–2072926742, available at <http://legacy.library.ucsf.edu/tid/usf01b00>.
- 22 Victoria M. White et al., *Cigarette Promotional Offers Who Takes Advantage?*, 30 AM. J. PREVENTATIVE MED. 225, 228 (2006).
- 23 Fran 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 also White, *supra* note 25, at 229.
- 24 Diane S. Burrows, *Younger Adult Smokers: Strategies and Opportunities*, Feb. 29, 1984, Bates no. 501928462–501928550, available at <http://legacy.library.ucsf.edu/tid/fet29d00>.
- 25 See *id.*
- 26 Family Smoking Prevention and Tobacco Control Act, Pub. L. No. 111-31, 123 Stat. 1776, 1781, 1796 (2009).
- 27 See, e.g., HAW. REV. STAT. § 328J-17(a) (2007); MD. CODE CRIM. LAW § 10-107(a) (2008); and TEX. HEALTH & SAFETY CODE § 161.087(a) (2007).
- 28 CAL. HEALTH & SAFETY CODE § 11895 (2009), added by Stats. 1995, ch. 415 (S.B. 1360), § 6, amended by Stats. 2001, ch. 376 (S.B. 757), § 3, Stats. 2007, ch. 455 (A.B. 1585) § 2.

- 29 *Id.*
- 30 CAL. HEALTH & SAFETY CODE § 118950(b)–(c)(1).
- 31 See CAL. HEALTH & SAFETY CODE §§ 118950(f)–(g).
- 32 CAL. HEALTH & SAFETY CODE § 118950(e) (2007) (“Neither this section nor any other provision of law shall invalidate an ordinance of, or prohibit the adoption of an ordinance by, a city or county regulating distribution of smokeless tobacco or cigarette samples within its boundaries that is more restrictive than this section. An ordinance that imposes greater restrictions on the sale or distribution of tobacco than this section shall govern, to the extent of any inconsistency between it and this section.”).
- 33 CAL. HEALTH & SAFETY CODE § 118950(d) (2009) (“Any person who violates this section shall be liable for a civil penalty of not less than two hundred dollars (\$200) for one act, five hundred dollars (\$500) for two acts, and one thousand dollars (\$1,000) for each subsequent act constituting a violation. Each distribution of a single package, coupon, coupon offer, gift certificates, gift cards, or other similar offers, or rebate offer to an individual member of the general public in violation of this section shall be considered a separate violation.”).
- 34 See *id.*
- 35 See, e.g., MASS. GEN. LAWS ch. 64C § 12 (2009) (“No person shall be permitted to sell cigarettes as ‘loss-leaders’ with intent to injure competitors or to destroy competition, and the commissioner shall enforce sections thirteen to twenty-one, inclusive, in order to prohibit such sales and stabilize and increase collections under this chapter.”). For Massachusetts minimum price laws, see *id.* §§ 12–21; and MASS. REGS. CODE tit. 830 § 64C.14.1 (2009). It should be kept in mind that minimum price laws were designed to prevent unfair competition between large and small businesses.
- 36 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).
- 37 See Ellen C. Feighery et al., *Retailer Participation in Cigarette Company Incentive Programs Is Related to Increased Levels of Cigarette Advertising and Cheaper Cigarette Prices in Stores*, 38 PREVENTATIVE MED. 876 (2004). See also Convenience Store News, Mass. Shelves “Buy-Down” Plan, Nov. 11, 2002, http://www.csnews.com/csn/search/article_display.jsp?vnu_content_id=1758969 (last visited June 15, 2010); Ellen C. Feighery et al., *How Tobacco Companies Ensure Prime Placement of Their Advertising and Products in Stores: Interviews with Retailers About Tobacco Company Incentive Programmes*, 12 TOBACCO CONTROL 184 (2003) (noting that “the retailers in this study described several strategies used by tobacco companies to drive down prices including volume based discounts, buydowns, and special offers such as multi-pack discounts” and “virtually all retailers who were interviewed participate in buydowns.”).
- 38 See Feighery, *supra* note 36.
- 39 See Mass. Dep’t of Rev. Directive 02-2 (Mar. 15, 2002).
- 40 See *id.*
- 41 Generally in the formula, trade discounts are subtracted from the minimum wholesale price as part of determining the minimum retail price. Therefore the trade discounts lower the minimum price amount. see Feighery, *supra* note 36.
- 42 See *id.*
- 43 Mass. Dep’t of Rev. Directive 02-2 (Mar. 15, 2002); see also Bruce Mohl, *Bay State Cigarette Prices May Become Highest in U.S.*, BOSTON GLOBE, June, 5, 2002:
- Retailers such as CVS are able to charge less than the official minimum retail price because they receive payments called buy-downs from cigarette manufacturers that allow them to cut their retail price. Kalell [director in the Revenue Department’s audit division] said the average buy-down has increased from 10 cents to 20 cents a pack several years ago to an average of about 60 cents today. The buy-downs apparently vary from retailer to retailer and differ in duration. But because most manufacturers match each others’ buy-downs, the result is that cigarettes are almost always being discounted. “I began to ask myself why I make these calculations when no one pays attention,” Kalell said.
- 44 See Mass. Dep’t of Rev. Directive 03-14 (Dec. 12, 2003). see also MASS. GEN. LAWS ch. 64C, § 13(e) (2009) (“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.”). The redemption of the coupon does not affect the wholesale or retail presumptive minimum cost. Mass. Dep’t of Rev. Directive 03-14 (Dec. 12, 2003).
- For brief examples of how other states handle taxes, coupons and buy-downs, see Mississippi State Tax Comm’n, Notice to All Retail Tobacco Permit Holders, Notice 72-02-003 (June 24, 2008) (alerting how buy-down payments from tobacco companies are no longer subject to sales tax unless they are identified to the customer as a third party manufacturer discount, tobacco products bought with discount coupons are generally taxable on the full price, and coupon and buy-down reimbursements are subject to income tax); and Comptroller of Md., Tobacco Tax Administrative Releases, No. TT-4, Subject: Promotional Allowances and Cigarette “Buydowns” (June 1, 1995) (addressing how coupons may be issued and guidelines for buy-downs).

- 45 See James G. Hodge Jr., *Implementing Modern Public Health Goals through Government: An Examination of New Federalism and Public Health Law*, 14 J. CONTEMP. HEALTH L. & POL'Y 93, 94 (1997). See also LAWRENCE O. GOSTIN, *Public Health Law; Power, Duty Restraint* 79 (2d ed. 2008). Gostin defines police power as:
- The 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. To achieve these communal benefits, the state retains the power to restrict, within federal and state constitutional limits, private interests—including personal interests in autonomy, privacy, association, and liberty, as well as economic interests in freedom to contract and uses of property.
- 46 See 56 Am. Jur. 2d *Municipal Corporations* § 107 (2009).
- 47 See *id.* at § 109.
- 48 E.g. Mass. Gen. L. c. 111, § 31 (noting that “Boards of health may make reasonable health regulations”).
- 49 Laura D. Hermer, *Municipal Home Rule in New York: Tobacco Control at the Local Level*, 65 BROOK. L. REV. 321, 327, 367 (1999).
- 50 See U.S. DEP'T OF HEALTH & HUMAN SERVS., *supra* note 1.
- 51 *Lorillard Tobacco Co. v. Roth*, 786 N.E.2d 7 (N.Y. 2003).
- 52 *Id.* at 10.
- 53 *Id.* at 14.
- 54 *Id.* at 13.
- 55 *People v. R.J. Reynolds Tobacco Co.*, 124 P.3d 408 (Cal. 2005).
- 56 *Id.* at 410–11.
- 57 *Id.* at 423.
- 58 See *Vatore v. Comm'r of Consumer Affairs*, 634 N.E.2d 958, 959, 960–61 (N.Y. 1994).
- 59 The case *People v. Cook* provides an example of an exception to the notion that minimum pricing is most effectively pursued at the state level. 312 N.E.2d 452 (N.Y. 1974). In that case, a tobacco retailer challenged the legal authority of New York City to require tobacco products be sold pursuant to a graduated pricing scale according to the amount of tar in the product. *Id.* at 104. Products with more tar were required to be more expensive. *Id.* The court found that “the State itself could properly require a price differential under its police power to regulate matters concerning health” and such power flowed to the city so that “the price differential is a proper exercise of the police power by the city.” *Id.* at 456.
- 60 Family Smoking Prevention and Tobacco Control Act, *supra* note 26, at 1796 (“The Secretary may by regulation require restrictions on the sale and distribution of a tobacco product, including restrictions on the access to, and the advertising and promotion of, the tobacco product . . .”). The Act finds a need for “comprehensive” and “stringent” regulation of tobacco products, including over their “sale, promotion and distribution” particularly because state and federal “governments have lacked the legal and regulatory authority and resources they need . . .” *Id.* at 1777. The Act also finds that “[c]hildren, who tend to be more price sensitive than adults, are influenced by advertising and promotion practices that result in drastically reduced cigarette prices”—signaling one of several key areas where it is necessary “to address the public health crisis created by the actions of the tobacco industry.” *Id.* at 1778.
- 61 See, e.g., U.S. Food & Drug Admin., *Frequently Asked Questions on the Passage of the Family Smoking Prevention and Tobacco Control Act (FSPTCA)*, <http://www.fda.gov/TobaccoProducts/NewsEvents/ucm173174.htm> (last visited June 15, 2010) (“In addition to the provisions outlined in the FSPTCA, states, localities, and tribal governments can impose requirements that are in addition to or more stringent than FDA requirements. For example, states may: * Impose specific bans or restrictions on the time, place, and manner – but not the content – of cigarette advertising. * May prohibit or restrict the distribution or free samples of smokeless tobacco in any location. * May tax tobacco products.”). See also Christopher N. Banthin & Richard A. Daynard, *Room for Two in Tobacco Control: Limits on the Preemptive Scope of the Proposed Legislation Granting FDA Oversight of Tobacco*, 11 J. HEALTH CARE L. & POL'Y 57, 66 (2008) (addressing the substantially similar proposed legislation before its passage).
- 62 Family Smoking Prevention and Tobacco Control Act, *supra* note 26, at 1823. The Act also amends the Federal Cigarette Labeling and Advertising Act to expand state and local authority to regulate advertising and promotions:
- Section 5 of the Federal Cigarette Labeling and Advertising Act (15 U.S.C. 1334) is amended by adding at the end the following:
- “(c) Exception.—Notwithstanding subsection (b), a State or locality may enact statutes and promulgate regulations, based on smoking and health, that take effect after the effective date of the Family Smoking Prevention and Tobacco Control Act, imposing specific bans or restrictions on the time, place, and manner, but not content, of the advertising or promotion of any cigarettes.”
- Id.* at 1846.

- 63 *Id.* at 1831.
- 64 See discussion of *People v. R.J. Reynolds Tobacco Co.*, *supra* Part IV.
- 65 *R.J. Reynolds Tobacco Co.*, 124 P.3d at 419 (quoting *Lorillard Tobacco Co. v. Reilly* 533 U.S. 525 (2001)).
- 66 See *id.*
- 67 See, e.g., *Granholm v. Heald*, 544 U.S. 460 (2005); *West Lynn Creamery v. Healy*, 512 U.S. 186 (1994); and *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951).
- 68 See ERWIN CHERMERINSKY, Section 5.3 *The Dormant Commerce Clause*, CONSTITUTIONAL LAW PRINCIPLES AND POLICIES 306–338 (1997).
- 69 Cf. *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996).
- 70 See *Nike v. Kasky*, 539 U.S. 654 (2003). For more information on drafting tobacco control laws and First Amendment issues, see the Tobacco Control Legal Consortium’s *Regulating Tobacco Marketing: “Commercial Speech” Guidelines for State and Local Governments* (2010); *Regulating Tobacco Marketing: A “Commercial Speech” Factsheet for State and Local Governments* (2010); and *Regulating Tobacco Marketing: A “Commercial Speech” Flowchart for State and Local Governments* (2010).
- 71 See, e.g., *Lorillard Tobacco Co.*, 533 U.S. 525.
- 72 *Central Hudson Gas & Electric Corp. v. Pub. Serv. Comm’n of N.Y.*, 447 U.S. 557, 564 (1980).
- 73 Cf. *Lorillard Tobacco Co.*, 533 U.S. at 569 (treating restrictions on tobacco self-service displays as permissible regulation of tobacco sales, distinct from speech).
- 74 *44 Liquormart, Inc.*, 517 U.S. at 508.
- 75 *Id.* at 508 (internal citations omitted).
- 76 See *id.* at 530 (O’Connor, J., concurring) (“If the target is simply higher prices generally to discourage consumption, the regulation imposes too great, and unnecessary, a prohibition on speech in order to achieve it. The State has other methods at its disposal—methods that would more directly accomplish this stated goal without intruding on sellers’ ability to provide truthful, nonmisleading information to customers. Indeed, Rhode Island’s own expert conceded that ‘the objective of lowering consumption of alcohol by banning price advertising could be accomplished by establishing minimum prices and/or by increasing sales taxes on alcoholic beverages.’ A tax, for example, is not normally very difficult to administer and would have a far more certain and direct effect on prices, without any restriction on speech.”).
- 77 See *id.*
- 78 Family Smoking Prevention and Tobacco Control Act, *supra* note 26, at 1831.
- 79 678 F. Supp. 2d 512, 538 (W.D. Ky. 2010).
- 80 *Id.*
- 81 See *id.* at 537; see also Memorandum in Support of Motion for Summary Judgment of Plaintiffs at 23–25 (“[i]ncreasing the price of tobacco products, which has been shown to decrease consumption[,]” “would be successful in reducing youth tobacco use,” citing that “[r]esearchers in Florida have ‘attribute[d] the decrease[s] in overall rates of underage smoking . . . to similar factors: national anti-smoking ad campaigns aimed at youth, price increases, and decreased availability of cigarettes to minors”).
- 82 *Philip Morris USA, Inc. v. City & County of San Francisco*, 2009 U.S. App. LEXIS 20142 (9th Cir. Sept. 9, 2009).
- 83 *Philip Morris USA, Inc. v. City & County of San Francisco*, 2008 U.S. Dist. LEXIS 101933, at *4 (N.D. Cal. Dec 5, 2008), *aff’d*, 2009 U.S. App. LEXIS 20142.
- 84 *Philip Morris USA, Inc.*, 2009 U.S. App. LEXIS 20142, at *1–*2.
- 85 *Id.* at *2–*3 (italics in original) (quoting *Leathers v. Medlock*, 499 U.S. 439, 452 (1991)) (citing by comparison to *44 Liquormart, Inc.*, 517 U.S. at 508–12 and *Lorillard Tobacco Co.*, 533 U.S. at 550).

About the Tobacco Control Legal Consortium

The Tobacco Control Legal Consortium is a network of legal programs supporting tobacco control policy change throughout the United States. Drawing on the expertise of its collaborating legal centers, the Consortium works to assist communities with urgent legal needs and to increase the legal resources available to the tobacco control movement. The Consortium's coordinating office, located at William Mitchell College of Law in St. Paul, Minnesota, fields requests for legal technical assistance and coordinates the delivery of services by the collaborating legal resource centers. Our legal technical assistance includes help with legislative drafting; legal research, analysis and strategy; training and presentations; preparation of friend-of-the-court legal briefs; and litigation support.

