

MINUTES OF THE HOUSE COMMITTEE ON FEDERAL AND STATE AFFAIRS.

The meeting was called to order by Chairperson Bill Mason at 1:30 p.m. on February 18, 2003 in Room 313-S of the Capitol.

All members were present except: Representative Judith Loganbill

Committee staff present: Russell Mills, Legislative Research Department
Mary Torrence, Office of Revisor of Statutes
Rose Marie Glatt, Committee Secretary

Conferees appearing before the committee: **Proponents:**

Bart Freedman, Attorney, Brown & Williamson Tobacco
(no written testimony)

Prof. Dwight Lee, PhD, University of Georgia

Dan Tri, Star Fuel Centers, Inc., Overland Park, KS

Mark Boswell, Midway Oil, Wichita, KS

Ricky Voss, John's Cigarette Outlets, Merriam, KS

William J. Murphy, Wilcops, Inc., Atchison

Al Alfano, Bassman, Mitchell & Alfano, Wash.D.C.

(written testimony only)

Opponents:

Julie Hein, R. J. Reynolds Tobacco

John Bottenberg, Phillip Morris, U.S.A.

Others attending: See Attached

HB 2042 - Prohibitions on cigarette manufacturers requirements of retailers of cigarettes.

Bart Freedman, Brown & Williamson, distributed the testimony of Al Alfano, Bassman, Mitchell & Alfano. He expressed support of **HB 2042**, stating the bill is designed to provide retailers in the State of Kansas the freedom to manage their stores in the manner best suited to their business (Attachment 1). He explained the importance of shelf and display space to the small retail business. The bill would prohibit manufacturers from conditioning discounts and other promotional incentives on the retailer's agreement to restrict the display, advertising and promotion of competing brands.

Dr. Dwight Lee, University of Georgia, appeared in favor of **HB 2042** (Attachment 2). The bill would make it illegal for one manufacturer to withhold discounts to retailers unless they impose restrictions on the shelf and display space available to competing brands. The bill leaves cigarette manufacturers free to make discounts available. It does nothing to prevent manufacturers from paying retailers for promotional displays and any amount of shelf space they want - as long as a manufacturer doesn't restrict the retailer's ability to sell display and shelf space to other manufacturers.

Dan Tri, Star Fuel Centers, Inc., rose in support of **HB 2042** (Attachment 3). The bill would allow retailers of cigarettes to promote and market all brands of cigarettes fairly. Retailers would keep more sales in the state by having more promotions helping to eliminate some of the cross border purchasing. Other products in the retail business have space allowance contracts, however none are controlled by any one company. He urged passage of the bill.

Mark Boswell, Midway Oil, spoke favorably of **HB 2042** (Attachment 4). Midway Oil is the largest independent retailer in Wichita and currently does not participate in Philip Morris discount programs. He believed that it was in his customers best interest for owners to have the freedom to display and advertise cigarettes in their own store. He urged the Committee to pass the bill in order that everyone may compete on an even basis.

Rick Voss, John's Cigarette Outlet, rose in support of **HB 2042** (Attachment 5). He stated that the bill provided a level playing field for all manufacturers who sell cigarettes. He presented one hundred eighty-two signed declarations from retailers that supported legislation to prohibit manufacturers from limiting retailers from displaying manufacturers' cigarettes in the way they want to promote and display them. (One copy is attached and remainder are on file in 170-W, office of Representative Bill Mason, Chairman of the Federal and State Affairs Committee).

William J. Murphy, Wilcops, Inc., voiced his support of **HB 2042**. He expressed concern over the contract restrictions and business practices of Philip Morris regarding shelf space in his store and the impact that has on their business (No written testimony). He urged passage of the bill.

Discussion followed regarding; specifics of the restrictive Philip Morris contract, industries where competition for shelf space is applied and changes that would occur with the enactment of the bill.

Julie Hein, Hein Law Firm, Chartered, representing R .J. Reynolds Tobacco Company, appeared in opposition to **HB 2042** (Attachment 6). R. J. Reynolds has joined Brown and Williams in a lawsuit against Philip Morris regarding restraint of trade, however they believe that the actions that are occurring are governed by applicable federal law. **HB 2042** is detrimental to the solution of the problem and new legislation would result in new litigation, that would be costly and time consuming to the parties and taxpayers of the state.

John C. Bottenberg, Philip Morris USA, voiced his opposition to **HB 2042** (Attachment 7). He stated that the bill would severely limit the terms on which retailers are able to enter into merchandising agreements with cigarette manufacturers.

Discussion followed regarding: enforcement of current legislation regarding restraint of trade and the difference between the bill and the on-going anti-trust lawsuit.

The hearing was closed on **HB 2042**. The meeting adjourned at 2:50 p.m. with the next meeting scheduled for February 19, 1:30 p.m., room 313-S at the Capitol.

HOUSE FEDERAL & STATE AFFAIRS COMMITTEE GUEST LIST

DATE February 18, 2003

NAME	REPRESENTING
Dwight R. Lutz	Brown & Williamson
Barton H. Freedman	Brown & Williamson
John C. Botterby	PHILIP MORRIS USA
GRANT L. BERGMANN	PHILIP MORRIS USA
Ed Hubbell	B+W tol
Randy Morris	B+W Tobacco
Rick Voss	B+W TOB
MARK BOSWELL	B+W TOB
Bill Murphy	B+W TOB (Quick Step) Atkinsons
Daniel A. Mi	Star Fuel Centers
Daryl Carter	B+W Tobacco
Randy MAHAN	B+W TOBACCO
Shawn Ruffman	B+W Tobacco
TOM PALACE	PMCA OF KANSAS
Andy Shaw	PMCA of KS
Amy Campbell	KABR

**BEFORE THE COMMITTEE ON FEDERAL AND STATE AFFAIRS OF
THE KANSAS HOUSE OF REPRESENTATIVES**

**Testimony of Alphonse M. Alfano
In Support of House Bill No. 2042**

Mr. Chairman, members of the Committee:

I would like to thank you for this opportunity to testify before the Committee on Federal and State Affairs on House Bill No. 2042, a bill designed to provide retailers in the State of Kansas with the freedom to manage their stores in the manner best suited to their needs and the needs of their customers. This freedom has been severely curtailed, if not eliminated, by various cigarette manufacturers' programs that deprive retailers of the opportunity to display, advertise and promote the brands of their competitors. Before addressing the manner in which the subject Bill redresses these practices, it would be useful at the outset to recount briefly the nature and seriousness of the problem, beginning with the importance of cigarette sales to retailers.

Cigarette sales are extremely important to retailers. With respect to convenience stores, for example, cigarette sales contribute 38% of the retailer's true profit because of the customer traffic that cigarettes attract. Customers visit convenience stores to purchase cigarettes more often than they do to purchase any other product. When they visit the store, they purchase other high margin items 62% of the time. The ability to attract adult smokers, therefore, can be a make or break situation for the overwhelming majority of retailers, especially small retailers that compete with larger chains.

For these reasons, the competitiveness of the majority of retailers is dependent on their ability to offer cigarettes at competitive prices, especially the major brands that maintain the largest market shares. The Marlboro brand alone, for example, has a larger market share than the next ten market share leaders combined. If retailers are to survive in this intensively competitive climate, they must offer Marlboros and the other market share leaders at the same

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price as their competitors. If they cannot, they lose not only the cigarette sales but the customer traffic these sales engender.

In order to offer competitive prices, retailers must receive the same discounts from cigarette manufacturers as their competitors. Cigarette sales from manufacturers to retailers are highly discount-oriented. Manufacturers, like Philip Morris, offer discounts as high as \$7.50 per carton. Philip Morris and other manufacturers will offer these deep discounts to retailers only if they sign lengthy contracts in which they agree to severely restrict (and often eliminate) the retailer's ability to promote, display, and advertise competing brands. Under the Philip Morris' "Retail Leaders" program, for example, competing brands must be placed in inconspicuous locations (usually below the counter) where they are not visible to the consumer. Signage is also severely restricted, and retailers are required to display and stock more of the manufacturer's brands than is necessary to meet customer demand. At least one manufacturer requires that its brands be the lowest priced in the store, thus inflating the cost of discount brands that compete on price.

The impact of these restrictions can only be understood in the context of the pervasive regulatory scheme that limits cigarette advertising, display, and promotion. Under the Master Settlement Agreement ("MSA") between the various states' attorneys general and cigarette manufacturers, the advertising and promotion of cigarettes is, for all intents and purposes, limited to in-store advertising and promotion. In most cases, it is limited to the point-of-sale, that is, at the counter where cigarettes (and signage) are displayed on a "rack" attached to the wall. Thus, manufacturers can leverage their vast and unequal bargaining power to require the retailer to market this important product category in a manner that suits the manufacturer's needs and not those of the retailer.

These programs are successful because convenience store owners and other retailers, especially small retailers, are dependent upon on the deep discounts offered by the market share leaders, without which they cannot compete. However, retailers are now rebelling against these coercive practices. Some 13,000 retailers nationwide have signed declarations

supporting legislation to put an end to these practices. In Kansas, over one hundred retailers have signed a declaration pledging their support to this legislation.

The objective of the Bill is simple. It prohibits manufacturers from *conditioning* discounts and other promotional incentives on the retailer's agreement to restrict the display, advertising and promotion of competing brands. See Section 1(c). In Section 1(a), the Bill explicitly authorizes manufacturers to enter into and participate in any other form of merchandizing, advertising, display or consumer discount or promotional agreement with a retailer. Manufacturers may also enter into agreements providing retailers with compensation for promoting and displaying their products. See Section 1(b). All promotional activities are authorized, therefore, including those that condition the discounts on a retailer's efforts to discourage youth smoking, so long as they do not tie the hands of the retailer with respect to competing brands.

If the Bill were enacted, retailers would be free to decide whether, and to what extent, any brand will be displayed or stocked in their stores. If the retailer decides to give all of its visible space to a single manufacturer, the retailer may do so as a matter of choice and not as a requirement of receiving promotional assistance. If the Bill were enacted, retailers would decide how, when, and where to display products, and would be able to display them in a manner that suits their needs and the needs of their customers, and not those of the manufacturer.

I would be happy to answer any questions you may have concerning the need for the Bill, its purposes and objectives, and how it deals with the problems addressed herein.

TESTIMONY ON HOUSE BILL NO. 2042
KANSAS STATE LEGISLATURE
TOPEKA, KANSAS
18 FEBRUARY 2003
Dwight R. Lee
University of Georgia
Terry College of Business
Economics Department
Athens, Georgia
Phone: (706)542-3970

I'm Dwight Lee from the University of Georgia, where I have taught economics since 1985. I appreciate the opportunity to testify before you this afternoon. I have been asked by Brown and Williamson to comment in favor of House Bill No. 2042. This bill addresses serious concerns over Philip Morris's use of its dominant market share to trap retailers into agreements that 1) harm retailers by reducing their control over their stores and 2) harm consumers by undermining the competition from smaller cigarette producers.

House Bill No. 2042 prevents any cigarette manufacturer from tying discounts and promotion of its brands to a retailer's ability to display and promote other manufacturer's brands, which is what Philip Morris's Retail Leaders program does. Of particular importance the Bill prevents one manufacturer from requiring a retailer to give it a specified percentage of his shelf and display space. Philip Morris argues that retailers voluntarily sign agreements to give its brands a certain percentage of shelf and display space, and that legislation making that illegal, like House Bill No. 2042, would restrict the ability of retailers to merchandise cigarettes as they choose. In fact, exactly the opposite is true.

Consider the fact that an offer to discount Marlboro, and other Philip Morris brands, is not one that retailers can afford to reject, not when those discounts are being made by other retailers in the area. Marlboro has almost 40 percent of the market—a larger share than the

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next 8 most popular brands combined—and Philip Morris brands altogether have approximately 50 percent of the market. So a retailer can put a significant portion of his cigarette sales at serious risk by not signing on with Philip Morris's Retailer Leaders program when his competitors have signed on. Few retailers can afford this risk, especially convenience stores where 35.8 percent of in-store revenue came from cigarettes in 2000.

This means that even though all retailers in a market area may be opposed to Philip Morris's Leaders program because of the restrictions it imposes on their ability to display non Philip Morris brands, each retailer can feel trapped into signing on anyway. Each retailer knows that if she loses much of her ability to discount Philip Morris brands, other retailers can capture a big portion of her cigarette sales by agreeing to the Phillip Morris terms.

There is nothing wrong with a producer discounting its product, or paying retailers for shelf space. And House Bill No. 2042 would do nothing to prevent retailers from receiving discounts from cigarette manufacturers or from selling shelf space to them. But the Bill would make it illegal for one manufacturer to withhold discounts to retailers unless they impose restrictions on the shelf and display space available to competing brands. This is what Philip Morris is doing now by requiring that retailers provide their brands with a specified percentage of the shelf-space, and the most visible shelf space, when they sign up for the Leaders program discounts. Under this condition, which would be outlawed by House Bill No. 2042, if a retailer wants to sell additional shelf space to a Philip Morris competitor, she could do so only by *giving* Philip Morris enough additional, and the more visible, space to maintain its specified percentage. Outlawing this practice would benefit retailers by increasing the competition for their shelf space and giving them more control in allocating shelf space to best accommodate their customers.

House Bill 2042 would also prevent Philip Morris from using its dominant market share to reduce the competition from other cigarette manufacturers. The evidence is clear that sales of a brand decline when customers have difficulty seeing it on the shelves, as is the case with

many non Philip Morris brands because of the restrictions imposed on retailers by the Leaders program.

Let me use an analogy that legislators will identify with. Assume you are running for an office against an incumbent. You certainly wouldn't object to the incumbent buying TV and radio time to run his campaign ads. That would be legitimate competition. But what if the incumbent uses his power to get the media outlets to agree not only to run his campaign ads, but also to restrict the number of your ads to a small percentage of his, in which case they could sell you additional time only if they gave him, free of charge, enough additional time to keep your percentage at the same low level? Furthermore, the incumbent also requires that that the media outlets run all his ads at prime time, but run your ads only from 2 to 5 in the morning. If the incumbent and media outlets signed such an agreement, you wouldn't say, "well that's alright, it's just legitimate competition." You would recognize immediately that the agreement was an unlawful and unfair restriction on competition and object strongly. The legislation being considered today, House Bill 2042, is motivated by the recognition that the Retail Leaders agreements that Philip Morris is signing with retailers are just as unfair and anticompetitive.

I want to emphasize that this legislation leaves cigarette manufacturers free to make discounts available. And it does nothing to prevent manufacturers from paying retailers for promotional displays and any amount of shelf space they want—as long as a manufacturer doesn't restrict the retailer's ability to sell display and shelf space to other manufacturers. It is these restrictions that allow Philip Morris to use its market dominance to undermine competition.

House Bill No. 2024

Testimonial of Daniel Tri
Director of Operations
Star Fuel Centers, Inc

I support Bill No. 2024 because it allows retailers of cigarettes to promote and market all brands of cigarettes fairly. The current market is controlled by dominant companies who control the market through the use of contracts that unfairly restrict my ability to market all brands of cigarettes.

The separation of buy down monies from other placement contracts would allow me to promote all products to my customers. With the increases in cigarette taxes in the state of Kansas I need every avenue to promote and try to maintain my cigarette sales. Too many companies are controlling what product at what price, I can sale cigarettes in my stores. Bill 2024 will keep all companies on a fair marketing platform.

Cigarette sales are critical to the profits of my stores and are also a large revenue source to the state of Kansas. This bill will keep more sales in the state by allowing Kansas retailers to have more promotions helping to eliminate some of the cross border purchasing.

The bill also stops all cigarette companies from contracting for space bases upon percentages. This allows me, as a retailer to give some space to all manufactures based on my marketing objectives not the cigarette companics.

Other products have space allowance contracts. None are controlled by any one company. None has a huge market share over any other so all products are still merchandised and promoted in the stores. These other products have no restrictions on advertising, marketing, and promotions. Cigarettes are tightly controlled, very little advertising is allowed and promotions are limited to where and how they can happen. For any one company to be allowed to eliminate space and promotion of any other companies' product is not fair trade because of the restrictions in the market.

This bill does not stop any company from selling, marketing or promoting their product. It allows all cigarette companies to have the ability to place their produ ct in stores, and gives the retailers true choice as to which they wish to market and promote cigarettes with. It allows all retailers to compete on an even level selling their product.

Thank You



Daniel Tri

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February 19 2003

FEDERAL & STATE AFFAIRS COMMITTEE
300 SW 10th Street
Topeka, KS 66612

Dear Committee Members:

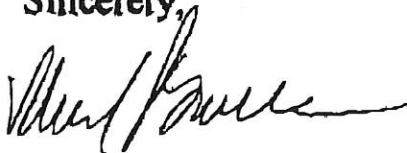
Thank you for your time and allowing me to speak before your committee hearing on February 18th.

I am President of Midway Oil Co. in Wichita, Kansas. I have 10 stores in Kansas.

I am writing to ask you to vote for HB 2042. The bill would prohibit cigarette manufactures from requiring a specified percentage of space in my store as a condition for participating in their merchandising programs.

Right now, if I want to participate in their programs, I lose control of how I display and advertise cigarettes in my own store and Philip Morris also wants to control what the other companies do in my stores.

Sincerely,



Mark Boswell
President, Midway Oil

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MEMORANDUM

TO: THE KANSAS COMMITTEE ON FEDERAL AND STATE AFFAIRS
FROM: RICK VOSS, JOHN'S CIGARETTE OUTLET
SUBJECT: TESTIMONY ON BILL NO. 2042
DATE: 02/21/03

I would like to summarize my testimony given on February 18, 2003. I am a cigarette retailer from Kansas City. I own and operate four cigarette outlets; three of these are in Kansas. I have stores in Overland Park, Shawnee, and KCK and have been in business for 10 years. I live in Kansas and pay taxes in Kansas. I have a family, a wife and two sons, age 7 and 9 who need me to bring home a paycheck.

I was not motivated to speak in favor of this bill because of any loyalty or lack thereof to any particular cigarette manufacturer. I am motivated to show my support for this bill because it is what my business needs.

As a cigarette retailer, I must maintain a level playing field for all manufacturers who participate in the promotion and selling of cigarettes in my stores. Allowing the field to be tilted in favor of any manufacturer will decrease the amount of competitive promotional activity in my operation, and I will not be able to sell my products at the lowest price. My customers will take their business down the street.

Currently, cigarette manufacturers are using their merchandising agreements to eliminate competition by limiting the amount of displays, buy downs, product levels, etc. of any competitive product. This is wrong, cigarette manufacturers should use their merchandising agreements to enhance their own sales and to ensure that they can compete, instead they are using these agreements to attempt to eliminate the chance for their competition to do business.

Please do not confuse this issue by assuming it is simply an issue between Brown & Williamson Tobacco and Philip Morris. This issue is much bigger than that. This is an issue about fair trade and a retailer's right to this fair trade. To say that because PM is the industry leader and should be allowed to enjoy its power over the competition is wrong. This is like saying that because an NFL Football team won the championship game that they can now have 12 players on the field and that any competing team must reduce the roster to 10 players.

In a fair trade environment, one that offers a level playing field to all competing companies, it is wrong to allow "Company A" to regulate, govern, and dictate the sales practices of "Company B".

Please accept this summary of my testimony as written record of my support for House Bill no. 2042.

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State of KANSAS

County of BENO

Declaration

The undersigned, JERRIE PITTS, hereby declares and states the following:

1. My name is JERRIE PITTS. I am a resident of HUTCHINSON, KANSAS and am over 21 years of age. The statements made in this Declaration are based on my first hand knowledge, except where I state to the contrary.
2. I am ONE of ONE BSL SMOKE SHOP, a retailer of cigarettes and other products located at 619 E 4TH AVE, HUTCHINSON, KANSAS. My store sells many brands and varieties of cigarettes that are made and sold by several different cigarette manufacturers.
3. Various cigarette manufacturers offer different merchandising and promotional programs to cigarette retailers. I want to be able to receive and participate in the merchandising and promotional programs from all cigarette manufacturers with which I choose to deal, without any manufacturer dictating how I display and sell my various cigarettes.
4. Currently, some cigarette manufacturers' merchandising and promotional programs, which I have no real choice but to accept for competitive reasons, limit me from promoting, displaying and/or advertising other manufacturers' cigarettes in the way that I want to promote, display or advertise them.

5. I support legislation to prohibit cigarette manufacturers from limiting or restricting cigarette retailers from promoting, displaying and/or advertising other manufacturers' cigarettes in the way that they want to promote, display or advertise them. I believe that such a prohibition against manufacturers will return to me the ability to operate and manage my own store as I see fit without my being unfairly pressured by any cigarette manufacturer.

James A. Potts

Subscribed to before me
this the 19th day of October, 2002.

Kenneth M. K...
Witness

HEIN LAW FIRM, CHARTERED

5845 SW 29th Street, Topeka, KS 66614-2462

Phone: (785) 273-1441

Fax: (785) 273-9243

Ronald R. Hein

Attorney-at-Law

Email: rhein@heinlaw.com

Testimony re: HB 2042
House Federal and State Affairs Committee
Presented by Ronald R. Hein
on behalf of
R. J. Reynolds Tobacco Company
February 18, 2003

Mr. Chairman, Members of the Committee:

My name is Ron Hein, and I am legislative counsel for R. J. Reynolds Tobacco Company.

R. J. Reynolds opposes HB 2042. Brown and Williamson (B&W) is promoting this legislation. R. J. Reynolds agrees with them on some of the arguments they have made about practices which have occurred in the market place. For the record, R. J. Reynolds has joined B&W in bringing a lawsuit against Philip Morris for actions we believe are in restraint of trade. Because that litigation is pending, I am not authorized nor will I go into detail about some of the actions which are the subject of that litigation.

However, we strongly disagree with B&W on their efforts to initiate new and duplicative legislation at the state level or otherwise regarding attempting to prohibit such activities. R.J. Reynolds strongly believes that the actions which are occurring are governed by applicable federal law. We also believe that legislation such as HB 2042 is not only unnecessary, but is perhaps detrimental to the solution of the problems which are occurring.

Federal anti-trust and restraint of trade law is well established, and to initiate state legislation in different states, as B&W is currently doing, will create a patchwork of different states' legislation to attempt to deal with an issue which is truly interstate in nature. There is no need for this type of legislation. The litigation which has been commenced, and in which R. J. Reynolds has joined B&W, is the appropriate and proper remedy to solve the problems cited by B&W. Additional legislation is not the answer.

New legislation will ultimately result in new litigation, which would be costly and time consuming, not only to the parties, but to the tax payers of the state who must pay for the judicial system which will hear the litigation. It is probable that ultimately the litigation would be consolidated with the existing litigation, and the net effect of this legislation will be additional legal confusion, additional litigation, additional cost, and, perhaps, additional delay that would work to the detriment of not only R.J. Reynolds, but also to B&W.

We strongly urge you to defeat HB 2042, and to allow the courts to deal with the pending litigation.

Thank you very much for permitting me to testify, and I will be happy

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MEMORANDUM

TO: Rep. Mason, Chairperson
House Federal and State Affairs Committee

FROM: John C. Bottenberg Kathy Damron
Lobbyist, Philip Morris USA Lobbyist, Philip Morris USA

DATE: February 18, 2003

RE: Opposition to HB-2042

House Bill 2042 is an attempt led by Brown & Williamson to help enact legislation in Kansas that would severely limit the terms on which retailers are able to enter into merchandising agreements with cigarette manufacturers. This legislation could harm retailers and set a dangerous and potentially unconstitutional precedent that strikes at the heart of traditional retailing practices.

If enacted, this legislation (HB-2042) could, among other things:

- Severely limit the terms on which retailers are able to enter into merchandising agreements with the cigarette manufacturers of their choice.
- Significantly limit the options for merchandising programs, potentially affecting the retailers' bottom line.
- Benefit retailers in neighboring states who may not be subject to similar anti-competitive merchandising restrictions.
- Tilt the playing field in the already competitive cigarette marketplace by picking winners and losers among competing tobacco companies.
- Outlaw space-to-share merchandising contracts, setting a dangerous precedent whereby other consumer products companies could be tempted to seek similar legislation aimed at the competitive practices of their marketplace rivals.

The so-called "Retail Rights" legislation actually takes away retailers' rights. It is special interest legislation that would benefit some cigarette manufacturers by giving them an unwarranted advantage at the expense of retailers, consumers, wholesalers, and other manufacturers.

**PLEASE OPPOSE
HB-2042**

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