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**REPORT TO THE MANAGEMENT
OF PHILIP MORRIS U.S.A.
REGARDING IMPLEMENTATION OF
THE ACTION AGAINST ACCESS PROGRAM**

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I. BACKGROUND AND INTRODUCTION

On June 27, 1995, Philip Morris U.S.A. ("PMUSA") announced the Action Against Access program ("the AAA program"), a voluntary undertaking that the company described as "a new initiative to attack the problem of youth smoking." The AAA program consisted of several elements, each of which, according to the company, was intended to deny minors access to tobacco products at retail. PMUSA announced that it would implement many elements of the AAA program unilaterally, and would seek to implement the remaining steps in cooperation with other parties (e.g., wholesale and retail trade associations, and other tobacco manufacturers) interested in issues relating to the marketing and sale of tobacco products. As announced, the AAA program consisted of the following elements:

1. The printing of a notice reading "Underage Sale Prohibited" on all packs and cartons of Philip Morris brand cigarettes.
2. The immediate discontinuation of free cigarette sampling to consumers.
3. The immediate discontinuation of cigarette distribution through the mail.
4. The denial of merchandising benefits to participants in PMUSA's retail incentive programs who are fined or convicted for selling tobacco products to minors. In addition, PMUSA established an incentive program that requires retailers to display point-of-sale signage regarding minimum age laws, train employees on these laws, and obey them, as a condition of participation.
5. The placement by PMUSA's retail sales force of minimum age signs and related materials, prepared in conjunction with the company's "Ask First/It's the Law" program, at the more than 200,000 retail outlets that participate in the company's retail incentive programs. The company announced also that it would seek the cooperation of trade associations to ensure that these materials would be made available to retail outlets that the

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PMUSA sales force does not visit. In January 1996, PMUSA discontinued the "Ask First/It's the Law" program and supported the "We Card" program sponsored by the multi-industry Coalition for Responsible Tobacco Retailing. PMUSA's support of the We Card program is examined in Section III.E. below.

6. The implementation of a program to reward members of the public who notify PMUSA of an unauthorized use of the company's trademarks, as part of an overall effort to prevent the use of Philip Morris brand names or logos on any items (including, for example, video games or toys) that are marketed to minors.

7. Working with other interested parties to seek enactment of state legislation that would: (a) require the licensing of retail establishments that sell cigarettes, coupled with enforcement measures to identify and sanction retailers who sell cigarettes to minors; (b) prevent the purchase by minors of cigarettes from vending machines; (c) require that all cigarettes sold in retail establishments to which minors have access be within the line of sight of, or within the control of, a store clerk; and (d) require the posting of minimum age signs in all retail outlets that sell cigarettes.

The implementation of the AAA program has occurred during a period of substantial controversy surrounding the U.S. tobacco industry, some elements of which relate directly to the use of tobacco products by minors. One aspect of the ongoing controversy relates to the August 28, 1996 publication by the U.S. Food and Drug Administration ("FDA") of a set of regulations that, for the first time, vests authority in the FDA to regulate the marketing, sale and distribution of cigarettes. The regulations are based on the FDA's position that cigarettes constitute a "nicotine delivery device" over which the FDA has jurisdiction under existing law. Certain of the FDA regulations became effective on February 28, 1997.

The FDA regulations impose a variety of new restrictions upon the manufacture, packaging, marketing, distribution and sale of cigarettes and smokeless tobacco products. The rules prohibit the sale of cigarettes to persons under the age of 18, and require retailers to verify the age of purchasers of cigarettes through visual inspection and, if necessary, a photographic identification card. In addition, the regulations prohibit the use of electronic or mechanical devices for providing cigarettes to a retail purchaser, establish a minimum mandatory package size of 20 cigarettes, and prohibit all impersonal modes of cigarette sales, including vending machines, self-service displays,

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mail-order sales and mail-order redemption of coupons. The FDA has also imposed a prohibition on free samples of cigarette products, as well as numerous restrictions on the format and content of print advertising of cigarettes. The more stringent of these rules apply to advertising in publications having a youth readership (defined as persons under 18 years of age) of more than 15 percent or at least 2 million.

In the Summer of 1995, Philip Morris and other plaintiffs (including other cigarette manufacturers) filed suit in the United States District Court for the Middle District of North Carolina, seeking to enjoin implementation of the FDA regulations. The plaintiffs argue that FDA lacks statutory authority to regulate the marketing and sale of tobacco products. This litigation is ongoing as of the date of this report.

In May 1996, PMUSA and the United States Tobacco Company proposed comprehensive federal legislation to address most of the issues to which the FDA regulations relate. The company stated that it would support enactment of the legislation only if the FDA were precluded from exercising jurisdiction over tobacco products. The principal elements of the PMUSA proposal include the following:

- Establishing a federal minimum age of 18 for sales of tobacco products, and requiring photo identification for purchases by anyone who appears to be under 21 years of age;
- Prohibiting vending machine and mail-order sales of cigarettes, as well as the distribution of individual cigarettes or packages containing fewer than 20 cigarettes;
- Banning all outdoor advertising of tobacco products within 1,000 feet of any public playground or elementary or secondary school;
- Banning all tobacco billboards of less than 225 square feet, regardless of location, and prohibiting tobacco advertising in or on trains, subways, buses and taxis;
- Prohibiting tobacco product advertising in or on video games, or at video arcades or family amusement centers (other than those to which minors are denied access);

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- Banning payments for the use or placement of tobacco products or advertisements in movies or television programs;
- Limiting magazine advertising of tobacco products to publications for which adults represent at least 85% of the subscribers;
- Banning sales and gifts to consumers of non-tobacco-related products that display tobacco product names or logos (e.g., t-shirts, hats, jackets and bags);
- Limiting permanent tobacco product advertising to facilities dedicated primarily to motor sports or rodeo productions; and
- Limiting tobacco brand-name sponsorship to events for which at least 75% of those in attendance are expected to be 18 years of age or older. Corporate sponsorship would be permitted by tobacco companies whose company name was in existence prior to January 1, 1995.
- Vesting enforcement authority in the Federal Trade Commission, the Department of Health and Human Services and the Justice Department, and requiring tobacco manufacturers to pay a total of \$250 million over a five-year period to pay for administration and enforcement of the program, and for materials to support retailer compliance.

No legislation along these lines was introduced in the U.S. Congress in 1996, although press reports indicated that certain Members of Congress were considering sponsorship of the proposed legislation.

At the time it announced the AAA program, PMUSA disclosed that it had retained our firm to conduct an independent audit of the company's implementation of the program, and to report our findings and recommendations to senior management. We wish to emphasize that our mandate is limited to an examination and evaluation of the actions taken by PMUSA to implement the measures that it announced in June 1995. We have been not asked to provide, and we have not undertaken to provide, any advice on the broader policy issues or business judgments that arise from the current political and regulatory environment -- including, for example, whether voluntary initiatives such as the AAA program constitute a reasonable alternative to FDA regulation of cigarette sales and marketing, or whether there

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are additional steps that PMUSA should take in attempting to make it more difficult for minors to purchase tobacco products.

We have, at all stages of our review, held the company to a high standard of commitment and performance with respect to the AAA program. We informed PMUSA at the commencement of our audit that we expected that the company would make a determined effort to implement each element of the AAA program thoroughly and effectively -- and this is the test that we have applied in conducting our examination and preparing this report.

As described above, certain elements of the AAA program constitute immediate, unilateral steps taken by PMUSA (e.g., the discontinuation of mailing of cigarette products), while others involve longer-term initiatives (e.g., the effort to enact state legislation relating to cigarette sales to minors). In July 1996, we provided an interim report to PMUSA management that focused primarily on the unilateral, shorter-term program elements that were immediately implemented, including the printing of "Underage Sale Prohibited" notices on cigarette packs and cartons, and the discontinuation of mailings and free distributions of cigarettes. We provided also our preliminary findings and recommendations regarding all other elements of the AAA program.

In this report, we review and update our initial findings and recommendations regarding the unilateral elements of the AAA program, and provide many new findings and recommendations regarding the more detailed elements of the program. As discussed below, we believe that continued oversight may be warranted with respect to two program elements: the effort to enact state legislation to restrict youth access to tobacco products, and the implementation of the Responsible Retailer Program.

The next section will provide an Executive Summary of the report, and the following sections will provide our detailed findings and recommendations with respect to each element of the AAA program.

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II. EXECUTIVE SUMMARY

The following is a summary of our principal findings and recommendations regarding each element of the AAA program:

1. Overall Conclusions.

- PMUSA has made a good-faith effort to implement each element of the AAA program. As of January 31, 1997, some aspects of the AAA program have been more successfully implemented than others. The AAA program elements over which PMUSA had complete control -- underage sale notice, the discontinuation of free samples and of mailing cigarettes, and rewarding the identification of infringements of PMUSA trademarks -- have been fully and effectively implemented.
- The element of the AAA program over which PMUSA exercised significant influence -- the placement of minimum age signage and related materials in retail stores with PMUSA merchandising agreements -- has been implemented with substantial, if not complete, success.
- In the area of state legislation, PMUSA has achieved important initial successes in a number of states, with the clear possibility of additional successes in the coming legislative session. PMUSA should continue its efforts in this area.
- One aspect of the AAA program cannot be deemed a success as of the date of this report: the denial of merchandising benefits to retailers who violate underage sale laws. This lack of success is not due to PMUSA's lack of sincerity or effort (indeed, PMUSA did take appropriate actions in the limited number of cases where it obtained information on retailers that had violated the law), but instead is due to the general unavailability of state or local government data on fined or convicted retailers. PMUSA should take substantial additional steps to convince states to collect and share this data.

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2. Printing of "Underage Sale Prohibited" Notice On All Packs and Cartons of Philip Morris Brand Cigarettes.

Findings:

- PMUSA accomplished in all material respects its objective of introducing a new "Underage Sale Prohibited" notice on all packs and cartons of Philip Morris brand cigarettes by the end of 1995 -- and, in fact, achieved this goal with respect to the vast majority of its product offerings (including its most popular brand names) well in advance of the year-end deadline.
 - Our field survey found that over 90% of packs and cartons of PMUSA's highest-volume cigarette brands offered for sale in late 1996 contained the "Underage Sale Prohibited" notice. We found also, however, that a significant percentage of packs and cartons of lower-volume brands (including Cambridge, Players and Bristol Lights) being offered for sale nationwide still do not carry the AAA notice.
- 3. Discontinuation of Free Samples of Philip Morris Brand Cigarettes.**

Findings:

- The company fulfilled its commitment to discontinue providing free cigarette samples to consumers upon the announcement of the AAA program.
- 4. Termination of Mailing of Philip Morris Brand Cigarettes.**

Findings:

- PMUSA fulfilled its commitment to terminate the mailing of cigarette products to consumers upon the announcement of the AAA program.

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5. Denial of Merchandising Benefits to Retailers Who Are Fined or Convicted of Selling Tobacco Products to Minors.

Findings:

- PMUSA has encountered unexpected obstacles in implementing its pledge to withhold benefits from retail accounts with whom it has a merchandising agreement who are fined or convicted of selling cigarettes to minors. Because of unanticipated changes in proposed federal regulations, the company's initial (and reasonable) assumption that reliable data would be available from the states to track enforcement actions against retailers is no longer valid.
- When PMUSA discovered that most state governments do not collect data on retailers that are fined or convicted for selling cigarettes to minors, the company made a determined effort to obtain this information from various local government entities. However, the company's efforts have not produced a significant amount of data on fined/convicted retailers. Fine/conviction data was only received from six states, and it appears reasonable to expect that such data will be available from only an additional five states in the near future.
- As of January 31, 1997 PMUSA had obtained fine/conviction data on 641 stores from state and local governments, of which data on 462 stores were "valid" (i.e., the records were complete and the offense occurred after the effective date of the program). 286 of these 462 stores had a merchandising agreement with PMUSA (and thus received benefits that PMUSA could withhold). PMUSA took the following actions with regard to these 286 stores:
 - It issued 286 "warning letters" to advise the retailers that PMUSA would waive the suspension of merchandising benefits for the referenced violation only if the store pledged to comply with the We Card program; and
 - It issued 16 one-month benefits suspensions ((1) 13 stores had two convictions, and the second offense thus triggered the benefits suspension, (2) one store was convicted twice and declined to comply with the We Card program, and thus received two suspensions, and (3) one store was convicted once and declined to

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comply with the We Card program after their first fine/conviction).

- There is room for PMUSA to improve its implementation of the withholding of merchandising benefits. Territory Sales Managers ("TSMs") are uncertain about the extent of their responsibility for implementing the enforcement/penalty aspects of the program, and retailers are generally unfamiliar with the program. In our view, these findings are largely attributable to the fact that PMUSA has not been able to obtain the enforcement data from state and local officials needed to implement the sanctions program nationwide.
- Our survey and interview data indicate clearly that a broadly implemented PMUSA program of withholding merchandising benefits from noncompliant retailers would be a significant deterrent to the illegal sale of cigarettes to minors -- and, in some states, would be more effective than the penalties available under anti-youth access laws.

Recommendations:

- Given the significant potential deterrent effect of this incentive program, PMUSA should continue to make every effort to obtain retailer fine/conviction data from each state.
- Because PMUSA's good-faith efforts to obtain fine/conviction data through direct contacts with state and local governments have yielded disappointing results to date, the company should devote additional resources to this program and take additional steps to obtain the data, including:
 - significantly expanding its use of its network of government affairs representatives and consultants to encourage state agencies to collect and provide this data, and, in appropriate cases, to obtain information directly from local governments;
 - seeking the amendment of state law, in the context of supporting AAA legislation, to require state collection of this data; and
 - taking more aggressive action to expedite the data collection and distribution process in those states (including Florida, Kentucky, and Vermont) that have indicated an ability to provide this data,

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and in those states (including New Jersey and Rhode Island) that have indicated they are working on a process to provide this data.

- We propose to continue our review of this element of the AAA program and provide an update one year from now.
6. **Placement of Minimum Age Signs and Related Materials in Retail Outlets That Participate in PMUSA's Incentive Programs.**

Findings:

- Our field survey found that over 85% of retail outlets display some form of signage relating to tobacco sales restrictions, and that stores with which PMUSA has a merchandising agreement are more likely than PMUSA's other accounts to display such signage. In addition, managers and clerks in such stores are more likely to have received training relating to the sale of tobacco products.
- Convenience stores and gas stations, which are widely viewed as prime targets of minors seeking to purchase cigarettes, are among the categories of retail stores that displayed the highest percentage of PMUSA-sponsored minimum-age signage.
- The level of familiarity with and commitment exhibited by TSM's to the We Card program -- although not as high as their dedication to the "Ask First/It's The Law" initiative -- is nonetheless high, both in absolute terms and when compared with other recent promotional campaigns for PMUSA products that the TSMs have implemented.
- TSMs believe that there exists a genuine institutional commitment to the AAA program at all levels within PMUSA. However, while over 84% of TSMs believe that corporate headquarters has either a "fairly strong" or a "very strong" commitment to the program, less than half believe that their Unit Manager displays these levels of commitment. TSMs also place greater emphasis on communications received from Unit Managers than on those received from headquarters. These findings suggest that it would be beneficial for PMUSA to reinforce Unit Managers' awareness of and commitment to the AAA and We Card programs.
- Retail store managers and clerks are generally familiar with laws governing tobacco sales. In those instances in which they are mistaken

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regarding applicable laws, they tend to err on the side of caution. PMUSA's accounts with merchandising agreements are more knowledgeable about applicable state and local laws than its other accounts. This indicates that TSM training and commitment may have a beneficial impact on retailer knowledge and behavior.

- TSMs clearly want to participate successfully in the We Card and Responsible Retailer programs. We believe that they (and their Unit Managers) would benefit from renewed training, a clearer statement of mission, and the development of qualitative benchmarks of the success of these programs.
 - With respect to retailers, PMUSA has substantially achieved its objectives of placing minimum-age materials in stores and educating retailers about underage tobacco sales laws. Retailers would clearly benefit, however, from renewed education about the non-signage aspects of the We Card program and about the compliance/enforcement elements of the Responsible Retailer Program.
- 7. Implementation of Program to Reward Members of the Public Who Identify Unauthorized Uses of Philip Morris Trademarks.**

Findings:

- We are satisfied that the AAA trademark program has been implemented in a manner consistent with its original design.
 - The program does not represent a radical departure from PMUSA's traditional practices with regard to trademark enforcement. In view of the fact that trademark protection is an essential element of PMUSA's business, it is not surprising that the trademark program has not revealed any instances of widespread infringement of which the company was not already aware.
- 8. Efforts to Support the Enactment of State Legislation Relating to the Use of Tobacco Products by Minors.**

Findings:

- PMUSA has, to date, fulfilled its promise to attempt to enact reasonable state legislation embodying the AAA agenda. PMUSA's initial AAA

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legislative proposals were comprehensive, and the company sought legislative action in the states where it had a reasonable opportunity to pass legislation.

- When confronted with political opposition to a major AAA element (usually line-of-sight or licensing provisions), PMUSA usually took reasonable, pragmatic approaches to attain those elements of the AAA bill for which adequate political support existed. PMUSA was usually pragmatic about the local preemption issue, with the debatable (but minor) exceptions of South Carolina and Kentucky.
- Eight states have enacted new anti-youth access laws, due in part to PMUSA's efforts. Six of these laws clearly improve prior law. Fourteen states considered legislation that contained major portions of the AAA agenda, 10 of which contained full licensing regimes, and this bodes well for future positive legislative action.
- PMUSA should continue the legislative efforts it initiated for the 1996 legislative session. In particular, it should focus on enactment of the comprehensive legislation that was considered in ten states in 1996 but did not receive final approval.
- PMUSA should pay additional attention to: (1) improving weak laws that are coupled with local preemption in states such as Indiana, Kentucky, and South Carolina, and (2) supporting adequate funding for the agencies charged with enforcing the anti-youth access regimes in each state.
- We propose to continue our review of PMUSA's state legislative efforts in 1997 and to update our findings after the completion of the 1997 legislative sessions.

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III. FINDINGS AND RECOMMENDATIONS REGARDING EACH ELEMENT OF THE AAA PROGRAM

In the following sections, we set forth our findings and recommendations regarding each element of the AAA program, and, in appropriate cases, identify areas that may warrant further examination.

A. Printing of "Underage Sale Prohibited" Notices On All Packs and Cartons of Philip Morris Brand Cigarettes

PMUSA's objective with regard to this program element was to introduce by the end of 1995 a new "Underage Sale Prohibited" notice on all packs and cartons of Philip Morris brand cigarettes sold within the United States. Based on our meetings with company representatives who were involved in the implementation of this program element, and our review of relevant company records, we have determined that PMUSA introduced the new legend well within its established deadline through a process that involved a high degree of interdepartmental coordination and noteworthy commitment on the part of responsible personnel.

Our review included several meetings at PMUSA's New York headquarters, and at the company's Richmond, Virginia manufacturing facility, with company personnel who were responsible for the day-to-day implementation of this program element. The departments and functions represented by these individuals included Packaging Technical Services (both New York and Richmond), production planning, packaging materials purchasing and inventory management, and implementation of printing activities. We reviewed background documents relating to, among other things, the process underlying the design of the new notice, the formal policies and procedures that governed the transition to the new packs and cartons (i.e., those that bear the AAA legend), and Pack Conversion Status Reports, which summarize, for each of Philip Morris' 400+ product codes,^{1/} the date on which the change to the new packs and cartons occurred.

^{1/} A single "product code" represents a specific combination of brand family (e.g., Marlboro or Basic), product features (e.g., king-size, lights, menthol) and packaging option (e.g., soft pack or flip-top box).

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We found that PMUSA achieved its objective with respect to the introduction of the new package notice under very challenging circumstances. For example, while PMUSA had established a formal deadline of December 31, 1995 for completing the transition to the notice-bearing packs and cartons, the teams responsible for implementing this transition established a more aggressive deadline -- of October 1, 1995 -- for attaining a "significant market presence" of products bearing the new legend. With this objective in mind, the company assigned a priority to its highest volume brands -- Marlboro and Basic -- and, according to the records that we reviewed, had by October 1, 1995 introduced the new notice-bearing packs and cartons on product codes representing approximately 85% of the company's total domestic cigarette sales.

In addition, we were advised that the typical turn-around time for implementing a graphics change for a single Philip Morris cigarette brand is 4-6 weeks, in a process that includes the design of the new graphics and the engraving of new printing cylinders to incorporate the graphics and color changes. The implementation of the AAA notice required the company and its printing contractors to change graphics and engrave new cylinders for all pack and carton types of each cigarette brand on a much more aggressive timetable.

We noted that there were a few product codes for which the transition to the new packs and cartons did not occur until early 1996. Based on the documents that we reviewed and the explanations provided by company representatives, we are satisfied that the majority of these relatively few product types represented either low-volume brand types for which packs and cartons are printed infrequently, or generic brands (which PMUSA manufactures under contract for unrelated parties who own the brand names) that were assigned a lower priority than Philip Morris brands. The product codes for which a year-end transition was not achieved represented less than two percent of the company's projected annual domestic cigarette sales for 1995.

As the final step in our review of this program element, during the nationwide field audit of PMUSA retail accounts conducted by Hoffmann Research Associates ("HRA") in connection with our audit of the We Card program, HRA interviewers randomly inspected retailers' cigarette inventories to determine the proportion of Philip Morris brand cigarettes currently offered for sale that bear the AAA notice. (The HRA report is included at Exhibit A, and is discussed in detail in Section III.E. below.) HRA found that over 90% of packs and cartons of PMUSA's higher-volume brands currently offered for sale nationwide (including Marlboro, Marlboro Lights, Basic, Virginia Slims and Merit) include the "Underage Sale Prohibited" notice. HRA found also,

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however, that a smaller percentage of PMUSA's lower-volume brands currently held in retail accounts' inventories bear the AAA legend. These include Benson & Hedges Lights (83.6% of packs, 87.8% of cartons), Cambridge (77.5% of packs, 80.8% of cartons), Players (66.1% of packs, 74.4% of cartons) and Bristol Lights (55.1% of packs, 70.4% of cartons). These findings likely reflect slow turnover of these brands. We recommend that PMUSA instruct its TSMs to examine their accounts' stocks of these brands to ensure that aging packs and cartons that do not bear the AAA notice are replaced expeditiously.

B. Discontinuation of Free Samples Of Philip Morris Brand Cigarettes

In this element of the AAA program, PMUSA pledged to discontinue immediately the provision of free cigarette samples to consumers. To examine the company's activities, we met in New York with PMUSA's Vice President of Marketing Services, who described the steps taken by the company to discontinue free cigarette samples. We also reviewed relevant background documents relating to this initiative.

We were informed that, prior to the introduction of the AAA program, PMUSA generally provided free cigarette samples to consumers in only two situations: (1) the distribution of free packs of cigarettes in connection with special promotional events, such as "bar nights" (at which PM requires that the attendance be limited to persons 21 or older), and (2) the mailing of samples of new cigarette brands to consumers, who have certified they are smokers 21 or older, in specified test markets.^{2/} We are satisfied that PMUSA promptly suspended the first category of activities upon the announcement of the AAA program. In addition, none of the information that we reviewed contradicts the company's representation to us that it discontinued the second type of activity approximately one year prior to the commencement of the AAA program.

We reviewed copies of memoranda through which the President and CEO of PMUSA notified the company's sales force of the termination of sampling activities. We reviewed also copies of internal correspondence

^{2/} The AAA policy does not apply to the provision of complimentary packs of cigarettes at dinners and other social functions that Philip Morris hosts, and for which the company controls the guest list. In our view, this minor exception to the policy is unremarkable.

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relating to two marketing events that took place during July 1995, immediately following the announcement of the AAA program: the "Cheyenne Frontier Days" event in Cheyenne, Wyoming, and the "Black Expo USA" in Oakland, California. In each case, the list of Philip Morris event-related activities referred specifically to on-site "sales" of tobacco products "to smokers 21 years of age or older." The memoranda stipulate that the cigarette sales (as well as distributions of branded incentive items) will occur at sites to be agreed upon by Philip Morris and the event sponsor.

We reviewed also copies of intercompany correspondence relating to the company's sponsorship of Marlboro Team Penske and Indy Car Racing events. Each of the documents we reviewed indicated that (1) promotional materials that were provided without charge to event attendees consisted only of merchandise such as coffee cups, ashtrays and banners, and did not include cigarette products; (2) such items were provided only to smokers who were 21 years of age or older; and (3) Marlboro operated a Pack Sales Trailer at each event, at which smokers who were 21 years of age or older received "incentive items" in exchange for a purchase of a specified pack of cigarettes.

With respect to the mailing of new or "test" brands of cigarettes, we were informed that the last such promotion occurred approximately three years ago, when PMUSA mailed packs of the "Dave" brand of cigarettes to adult smokers in test markets in Colorado and Washington state. We were further advised that PMUSA had begun to phase out promotional product mailings long before the AAA program was developed, due primarily to increasing state restrictions on direct mailings of tobacco products.

In summary, it appears that upon the announcement of the AAA program PMUSA discontinued all promotional activities that involved the provision of free cigarette samples, and that this policy remains in effect.

C. Discontinuation of Mailing of Philip Morris Brand Cigarettes

This program element entailed an immediate discontinuation of the mailing of packs or cartons of cigarettes to consumers. We understand that these so-called "live product" mailings previously occurred primarily in three situations: (1) for reimbursement of consumers who were dissatisfied with Philip Morris-brand cigarettes that they had purchased; (2) as a gesture of goodwill to consumers who contacted the company to complain about a problem, not relating to product quality, that they encountered in connection

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with the purchase or use of Philip Morris brand cigarettes; and (3) in response to catalogue promotions, in which consumers typically could redeem a specified quantity of Universal Product Code symbols from a brand of Philip Morris cigarettes, and receive a free carton of cigarettes in return.

As a substitute for direct mailings of cigarette products, PMUSA has instituted a coupon redemption system pursuant to which, upon providing written verification to PMUSA that s/he is a smoker 21 years of age or older, a qualifying consumer will receive coupons for a stated quantity of packs or cartons of Philip Morris brand cigarettes. These coupons may be redeemed at any retail outlet, where the retailers can verify the customer's age.

Our objective was to verify that PMUSA terminated cigarette mailings immediately upon the announcement of the AAA program, and that the coupon program was promptly instituted. Our review consisted, among other things, of the following:

- Meetings in PMUSA's New York headquarters with senior company executives who were responsible for the implementation of this element of the AAA program.
- Interviews in the New York headquarters with the individuals responsible for maintaining the company's database of adult smokers who have expressed a willingness to receive promotional materials from Philip Morris.
- Interviews in New York with the managers of fulfillment for PMUSA's Marlboro brand and other premium brands, who oversee product fulfillment for all promotions relating to their respective brands (e.g., the recent "Marlboro Unlimited" campaign, and catalogue promotions involving other premium brands, such as "Club Cambridge").
- Visits to PMUSA's Consumer Affairs department in New York and Quality Assurance department in Richmond, during which we interviewed personnel responsible for handling consumer complaints and inquiries, reviewed the master logs and other systems that PMUSA introduced to control the dissemination of cigarette product coupons, and examined relevant background documents.

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- A visit to the PreCon facility in Richmond, which functions primarily as a contract assembler of special package types of Philip Morris brand cigarette packs and cartons (e.g., two-for-one packages) that cannot be produced efficiently at PMUSA's highly automated manufacturing plant. Prior to the institution of the AAA program, PreCon was involved also in the packing, labeling and mailing of cigarette packs and cartons to consumers who were participating in catalogue redemptions or other PMUSA marketing promotions.
- A review of several categories of background documents, including internal correspondence relating to the coupon fulfillment program, formal policies and procedures relating to coupon control and dissemination, order fulfillment guidelines and procedures, random samples of records obtained from the Consumer Affairs and Quality Assurance departments (as described below), and correspondence between PMUSA and Catalogue Resources, Inc. ("CRI"), a company that provides order fulfillment services to PMUSA in connection with catalogue promotions.

Our findings with respect to this program element are as follows:

1. Database Management. We have confirmed to our satisfaction that it was PMUSA's policy prior to the commencement of the AAA program to obtain written verification of a consumer's age (on an Age Verification Form; or "AVF")^{3/} before adding the consumer's name and other descriptive information into the company's direct marketing database. We were informed that the institution of the AAA program necessitated only one change to the procedures employed by the database development group: namely, that the language in the AVF that formerly expressed the consumer's willingness to receive cigarette products in the mail was revised to refer to product coupons. The information provided to us indicates that this change was instituted promptly upon the announcement of the AAA program.

^{3/} The operative language of a typical AVF is as follows: "By signing this form, you certify that you are a smoker 21 years of age or older, and that you are willing to receive cigarette coupons and branded incentive items in the mail, subject to applicable state and federal laws."

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2. Implementation of Coupon Program by New York Consumer Affairs Department. We interviewed and observed personnel in the New York Consumer Affairs department who receive and process consumer correspondence (both written and telephonic). Our objectives were to (a) observe first-hand the processing of telephone calls and written correspondence that previously would have resulted in the mailing of cigarette products; (b) examine the control log that is used to record the mailing of coupons to consumers; and (c) verify that the department discontinued the mailing of cigarette packs and cartons immediately upon the institution of the AAA program.

We learned that the Consumer Affairs department only infrequently receives correspondence of the type that, prior to the initiation of the AAA program, would have resulted in the mailing of cigarette products to consumers.^{4/} In fact, during the period June 18-August 12, 1995, Consumer Affairs received only four contacts from consumers that would have warranted the mailing of cigarette products, as a goodwill gesture, under the pre-AAA procedures. Three of these communications were received after June 27, 1995, the date on which PMUSA announced the AAA program. The records we reviewed indicate that in each of these cases the company sent to the consumers in question, after receiving a completed AVF, a coupon redeemable for one carton of cigarettes. We are satisfied, based on our review, that the New York Consumer Affairs department immediately terminated the mailing of cigarette products upon the announcement of the AAA program.^{5/}

^{4/} As an example, we observed on the day of our visit the processing of a letter from a consumer who complained that the retailer from whom she purchased a pack of Marlboro Lights had sold her a pack bearing the legend "Part of promotional unit not for individual resale." The retailer in question apparently had separated the contents of a promotional "two-for-one" package in order to sell both packs of cigarettes. The consumer had submitted a signed AVF as requested by PMUSA in its initial response to her letter. We observed the final step in the process, which entailed the mailing of two cigarette pack coupons and the making of an appropriate entry in the coupon master log/database.

^{5/} It should be noted that the Consumer Affairs department apparently did not receive a stock of coupons until sometime in the fall of 1995. The processing of the coupon mailings to the three consumers mentioned above was handled by the Quality Assurance department in Richmond. For other consumers who contacted the Consumer Affairs department prior to the date on which the
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3. Implementation of Coupon Program by Richmond Quality Assurance Department. The Quality Assurance department handles the vast majority of consumer complaints that formerly gave rise to the mailing of cartons of cigarettes to consumers. Our objective was to verify that no mailings of cigarette products occurred after the June 27, 1995 effective date of the AAA program. Because the Quality Assurance department handles a much larger volume of consumer correspondence that results in the company providing replacement products, we reviewed only a sample of such correspondence that PMUSA received in the period immediately following the institution of the AAA program. Specifically, the company provided, at our request, an alphabetized listing of the consumers who contacted a single Quality Assurance representative during the month of July 1995. There were 329 names on this list, from which we randomly selected 31 names. The company provided copies of all records and correspondence relating to each of these 31 cases.

The following summarizes our review of these records:

- In four of the 31 cases, there was no final disposition of the customer's complaint because the customer did not return the AVF that PMUSA had sent upon receipt of the complaint.
- In one case, the company sent a \$2.50 reimbursement check to a customer who was identified in the database as a "minor." We informed PMUSA of this finding, and were advised that the Quality Assurance department commonly uses the term "minor" to refer to consumers who are less than 21 years of age, but satisfy state minimum age requirements (19 years of age in three states, 18 years in the remaining states). For these consumers, the company provides reimbursement in the form of checks rather than product coupons. Anyone under 18 does not receive reimbursements or coupons.
- In each of the other 26 cases, the company sent one or more coupons to the customer following receipt of a completed AVF.

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department received a stock of coupons, and whose complaints warranted "compensation" in the form of cigarette products, Consumer Affairs sent a "delay letter" which informed the customers that they would receive a coupon on or about a specified date.

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In none of these cases did the company mail cigarette products to the complaining consumer.

We conducted a follow-up audit of Quality Assurance department records in late 1996. Specifically, we requested a list of all consumers who contacted the department during the period October 1-11, 1996. PMUSA supplied a contact list for this period, which contained 537 names. We selected 44 names at random from this list, and PMUSA provided copies of computer records and correspondence relating to these contacts.

The following summarizes our review of these records:

- In eight of the 44 cases, there was no final disposition of the customer's complaint because the customer did not return the AVF that PMUSA had sent upon receipt of the complaint.
- In three cases, the records indicate that PMUSA sent coupons (or, in once case, a check) to a consumer without first having received a signed AVF.
- In two cases, the database entries are ambiguous, indicating that a coupon should be sent when the consumer had not returned a completed AVF. There is no indication that coupons were, in fact, sent in either case, and, according to PMUSA, the language in question is merely a shorthand reference to the fact that coupons will be sent upon receipt of the AVF.
- In one case, the AVF sent by PMUSA was returned because it was sent to an incorrect address, and no further action was taken because the company did not have a correct telephone number at which to contact the consumer.
- In each of the other 30 cases, the company sent one or more coupons to the customer following receipt of a completed AVF (or, in one case, a check, since the customer was a Minnesota resident, where, according to PMUSA, the sending of coupons is prohibited by law). In none of these cases did the company mail cigarette products to the complaining consumer.^{6/}

^{6/} It should be noted that in one case the database entry refers to the
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In short, of the 75 cases we tested, we noted only 2-4 possible instances of noncompliance with the AAA guidelines. Each of these appears, however, to reflect only an inadvertent error. In no case were cigarette packs or coupons mailed to the consumer.

4. Termination of Cigarette Mailings by PreCon. The final element of our audit involved an effort to verify that PreCon discontinued its cigarette mailing activities promptly upon the announcement of the AAA program. During our meetings in New York and Richmond, we obtained descriptions of and documents regarding the process through which, prior to the AAA program, CRI would collect orders from, and prepare mailing labels for, customers who ordered free cartons of cigarettes through catalog promotions. CRI would then forward these labels, along with electronic instructions, to PreCon, where the cartons would be labeled and mailed. At the time the AAA program was announced, special promotions were underway with respect to the Cambridge and Virginia Slims brands. We met in Richmond with Lenny Kosco, PMUSA's representative at PreCon, and reviewed correspondence and records exchanged by CRI and PreCon during the period surrounding the announcement of the AAA program.^{7/} Based on our review, we have confirmed to our satisfaction that PreCon promptly discontinued the mailing of cigarette products upon the announcement of the AAA program.^{8/}

^{6/} (...continued)

sending of "packs to the customer. PMUSA has informed us that this is merely a shorthand reference which indicates that pack coupons were sent. This indeed appears to be the case, as this entry also includes the identification numbers of the coupons.

^{7/} Mr. Kosco informed us that, when he was notified of the terms of the program, he instructed his staff to unwrap a large number of cartons of cigarettes that had already been wrapped and labeled for mailing, and to return the product to the Richmond plant.

^{8/} It should be noted that PreCon continues to mail cartons of cigarettes to PMUSA executives and retirees, pursuant to programs through which the company provides a monthly allotment of free cigarettes to each category of persons.

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**D. Denial of Merchandising Benefits to Retailers
Who Are Fined or Convicted of Selling Tobacco
Products to Minors**

In this element of the AAA program, PMUSA promised to withhold merchandising benefits from retailers who are fined or convicted of selling cigarettes to minors. In our interim report, we noted that PMUSA embarked on this portion of the AAA program in June of 1995 under the reasonable belief that retailer fine/conviction data would be available at the state government level because of the proposed regulations from the Substance Abuse and Mental Health Services Administration ("SAMHSA") implementing the "Synar Amendment" to SAMHSA's FY 1993 Reauthorization Act (42 U.S.C. § 300x-26(a)(1)). As also noted in our interim report, the final SAMHSA regulations did not require state compilation of data on fined/convicted retailers, and PMUSA has accordingly encountered great difficulty in identifying state or local government entities that collect useful data. As of January 31, 1997, this situation has improved slightly but not substantially, despite a concerted effort by PMUSA to obtain the necessary data.

1. Background

In June 1995, PMUSA promised to deny merchandising benefits^{2/} to participants in its retail incentive programs who are fined or convicted for selling tobacco products to minors. Introduced in December 1995 as the "Responsible Retailer Program," the rules of this program provide that any participating retail outlet that is fined or convicted after January 1, 1996 of selling cigarettes to minors is subject to: (1) automatic ineligibility for a \$5 million incentive fund to be distributed among qualifying retailers in early 1997, (2) a one-month suspension of regular merchandising benefits for the first offense, unless the retailer enrolls and participates in the We Card program, and (3) additional one-month suspensions for second or subsequent offenses, except that three violations in a 12-month period (beginning on the date of the first conviction that resulted in a suspension) will result in a four-month suspension of merchandising benefits.

^{2/} These benefits are provided pursuant to written contracts in which retailers agree to promote PMUSA products in their establishment according to guidelines that determine the level of benefits that they will receive from PMUSA.

In order to withhold benefits from a retailer, PMUSA must obtain information from an appropriate state or local agency that the retailer in question has been fined or convicted of selling cigarettes to minors, and that any appeals of such action have been completed and resolved against the retailer. PMUSA intended to rely on regular reports of fine/conviction data from all states and began soliciting this data on December 19, 1995 with a letter of request to each state. We determined in our interim report that PMUSA reasonably read the August 26, 1993 proposed SAMHSA regulations as requiring collection of data on fined/convicted retailers at the state level.

On January 19, 1996, SAMHSA published its Final Rule implementing the Synar Amendment, which effectively deleted the requirement that states retain data on fined/convicted retailers. The subsequent responses from the states to PMUSA's request letter indicated that very few of them would be compiling the data PMUSA sought. As of June 1996, we found that: (1) Florida had informed PMUSA that it possessed the requested data and would provide it to PMUSA; and (2) Washington, Oregon and the city of Newton, Massachusetts had transmitted names of fined/convicted retailers pursuant to PMUSA's request. No other states responded that they had the ability or inclination to provide such information in the near future.

We determined in our interim report that PMUSA had acted reasonably when devising this benefits-withholding mechanism in June and December of 1995, given the content of the proposed SAMHSA regulations. We concluded, however, that in view of the contents of the final regulation and the reluctance of most states to compile the necessary data, PMUSA revise its approach to implementing this program element.

2. Scope of Review

We have conducted ongoing interviews of PMUSA senior management and employees responsible for this aspect of the AAA program. We have reviewed the company's correspondence with all 50 states on this matter, as well as its correspondence with numerous local units of government and with retailers who have been warned or suspended under this program. We have also reviewed all internal PMUSA memos relating to this program as well as the company's central file of all information it has received from states and localities relating to retailer fine/conviction data. We present the following information as of January 31, 1997, unless otherwise noted.

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3. Findings

Importance of sanction. PMUSA Section Sales Directors (“SSDs”) told us that the withholding of merchandising payments is one of the most significant sanctions that a retailer might experience for underage tobacco sales, largely because the economic consequences are usually as serious and sometimes more serious than the civil fine levels in most states. For example, civil fines for underage tobacco sales tend to range between \$50-\$300 for the first two violations of the law, while the median monthly PMUSA Retail Masters merchandising payment is \$277 per month. The importance of PMUSA’s sanction of withholding merchandising benefits is further reflected in the TSM survey discussed in Section III.E. below, in which 74.6% of the TSMs believed that the loss of merchandising benefits would be either “somewhat effective” (36.3%) or “very effective” (37.3%) in deterring retailers from making underage sales. See HRA Survey, p. 77, Table IV-24. Given that PMUSA has merchandising agreements with over 200,000 retail outlets throughout the United States, this aspect of AAA could have a significant impact on retailer behavior if PMUSA can determine when retailers have violated the law and are subject to sanction under the AAA program.

PMUSA efforts to obtain fine/conviction data. As noted in our interim report, as of June 1996 a large number of states did not possess data regarding retailers that were fined for violation of their state underage tobacco sales laws. PMUSA’s response was:

- to send three general distributions of correspondence to the states on: (1) December 19, 1995, (2) February 28-29, 1996, and (3) July 3, 1996;
- to reply to each response to these letters shortly after they were received; and
- to pursue any suggested alternative sources of the information when a state reported it had no central data, including seeking such data from local governments.

A detailed summary of PMUSA’s correspondence with each state is provided at Exhibit B. We have confirmed, through an audit of PMUSA’s files, that the written communications referred to in Exhibit B were sent and received by PMUSA. The company’s search for fine/conviction data has been coordinated

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by a Manager in PMUSA's Trade & Business Programs division in its New York corporate headquarters.

In many cases PMUSA was referred to other state agencies, or to local governments, as potential sources of fine and conviction data. PMUSA has followed up on each referral. Follow-up actions have included written and telephonic communications. In many instances, PMUSA was referred to other entities and ultimately was unable to locate the data. When a state informed PMUSA that it did not have the data and was unaware of any source for such data, PMUSA tended to cease active pursuit of the data in that state and pursued unresolved or more promising sources of data in other states.

Results of data requests. The state and local government responses to PMUSA's request for data on fined/convicted retailers, as of January 31, 1997, can be summarized as follows:

1. Five states have informed PMUSA that they have instituted a process that either has already produced fine/conviction information or will do so shortly.
2. Six states have informed PMUSA that they are currently working on a process to produce fine/conviction data. These responses range from "we're exploring a mechanism" (Arizona) to the testing of a system intended to be in operation shortly (New Jersey).
3. Nine states referred PMUSA to local units of government, and in three of those states local units of government responded with fine/conviction information.
4. Sixteen states responded to PMUSA's inquiries but have either provided insufficient information or referred PMUSA to other potential sources of information from which no response has been received.
5. Seven states have informed PMUSA that they do not collect the information or do not issue fines or convictions for underage tobacco sales.
6. Six states have not responded to any of the PMUSA communications.

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7. One state is in active litigation with PMUSA (Mississippi), and no communications have occurred since March 26, 1996, due to the litigation.

Exhibit C provides a table summarizing the status of the data requests. For the nine states that referred PMUSA to a local unit of government, a summary of PMUSA's actions to contact these local entities and any responses received to date is attached at Exhibit D. For the 16 states that have responded but have not provided PMUSA with sufficient information to take the next step, a summary of the nature of each response and the current status is attached at Exhibit E.

Fine/conviction results. Two states (Oregon and Washington) have provided PMUSA with state-level information specifying which retailers in each state have been fined or convicted, and on what date, for underage tobacco sales. Local entities in four states, Massachusetts, Iowa, Nebraska and New York, have provided PMUSA with information specifying which retailers in the locality have been fined or convicted, and on what date, for underage tobacco sales. One state, Minnesota, provided PMUSA with data on fined or convicted retailers in October of 1995^{10/} but has not provided any further fine/conviction information since then -- despite three written PMUSA requests to do so. We have therefore placed Minnesota in the category of states that have not responded. In total, PMUSA has received information on fines/convictions from states and localities that relate to 641 retail outlets in the United States. A table summarizing state and local government data on fines and convictions is attached at Exhibit F.

PMUSA actions in response to conviction information. PMUSA initially reviewed information submitted on each of the 641 retailers to determine if each notification was "valid." In most cases, information determined to be invalid either: (1) failed to provide sufficient information for PMUSA to identify the retailer or to establish that a fine or conviction occurred (in which case additional information was requested of the providing agency) or (2) related to a conviction before the June 27, 1995 effective date of the program. Of the 641 stores with respect to which fine/conviction information was submitted, 462 reports had been determined valid as of February 5, 1997.

^{10/} This data related to alleged violations occurring both before and after the effective date of the merchandising benefits withholding program.

PMUSA next separated the valid data on 462 stores into "workload" and "non-workload" accounts. A "non-workload" account is a store with which PMUSA does not have a merchandising agreement or otherwise have contact through its sales force -- and thus provides no benefits to withhold. One hundred seventy-five stores fell into this category. While PMUSA did not provide any merchandising benefits to such stores that could be withheld, it did send a We Card program kit and a letter to each store observing that it had come to PMUSA's attention that an employee had been fined or convicted for violating underage tobacco sale laws and encouraging the retailer to enroll in the We Card program and comply with the law. A sample of this letter appears at Exhibit G.

Valid data existed for 286 stores with which PMUSA has a merchandising agreement. Of these 286, there were 284 instances of a "first conviction," in response to which PMUSA sent a letter advising the retailer that a suspension of benefits would be waived if the retailer agreed to follow the terms of the We Card program. PMUSA records indicate that these types of warnings were sent to each of the 284 retailers, and that PMUSA personnel followed up with those stores to secure a commitment to implement the elements of the We Card program in order to avoid a suspension of benefits.

Within these 286 stores, however, there were also 14 instances of a second conviction. In each case, PMUSA suspended the merchandising benefits of those stores for one month. This overlap in numbers is due to the fact that some of the stores in this category had two violations, and had to pledge to satisfy the elements of We Card or else have their convictions count as "1st and 2nd," rather than as "warning and 1st." Two stores with first violations declined to enroll or follow We Card, and their benefits were suspended as well. In total, PMUSA has sent 284 warning letters and imposed suspensions in 16 cases to date.

Enrollment in Responsible Retailer Program. We noted in our interim report that, as of June 30, 1996, only 22.3% of the over 200,000 stores with which PMUSA has a merchandising agreement had enrolled in RRP. In September 1996, PMUSA instructed its Territory Sales Managers to be more aggressive in encouraging their retail accounts to enroll in RRP. As of January 30, 1997, according to PMUSA's figures, 55.4% of "workload" retailers, or 124,437 stores, had enrolled in RRP.

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4. Analysis

There is no question that PMUSA has invested significant time and resources in seeking to implement this element of the AAA program. The correspondence files with state and local government agencies are voluminous. Indeed, PMUSA should be commended for undertaking to contact local governments when state agencies did not possess the data (for example, 988 counties in Iowa alone were contacted). In addition, despite a slow start (noted in our interim report) because of an apparent preoccupation with the format of the fine/conviction information it did receive, PMUSA now appears to have a well-functioning system in place for logging conviction data, analyzing it, seeking clarification of data that is incomplete, and contacting retailers that have been fined or convicted. PMUSA has mailed 284 warning letters and imposed 16 suspensions. This is a small number when compared to the over 200,000 retail accounts subject to this AAA element, but it is also a significant number in view of the fact that enforcement data is presently available from only five states. PMUSA deserves an "A for effort" in these respects.

However, the fact remains that fine/conviction data is not available from 45 states, and while this number may fall to as low as 40 in the near future, PMUSA was certainly presuming more than a 20% success rate when it devised this element of the AAA program. The effects of this failure to impose meaningful sanctions on retailers in more than a few states are reflected in the HRA survey of retailer attitudes, where the retail community's knowledge of PMUSA initiatives/sanctions is low, and over half of the retail community perceives tobacco companies as not being committed to preventing youth access to tobacco. See HRA Study, pp. 148-149.^{11/}

It is clear that the data collection effort simply became overwhelming once the SAMHSA regulations deleted requirements for retention of information on fined/convicted retailers at the state level. While PMUSA should not be criticized for making an earnest attempt to obtain the data from localities, the experience over the past six months indicates that this effort is unlikely to produce meaningful results.

Successful retrieval of state enforcement data is all the more important to the success of the AAA program given the clear message we

^{11/} It should be noted that, in order to blind respondents to the sponsor of the survey, HRA was not able to ask what retailer perceptions were of PMUSA's specific commitment to reducing youth access.

received from our field surveys that the threat of suspension of PMUSA merchandising benefits is an important deterrent in the retail community. PMUSA should be commended for attempting diligently to implement this initiative with a combination of state and local data. However, now that this approach appears to be deficient in a large number of states, PMUSA must revise its approach.

In our interim report, we suggested that PMUSA expand its state legislative initiative to amend state laws to require the retention of this data at the state level. This suggestion was followed in Rhode Island, where PMUSA representatives testified before the agencies implementing the new Rhode Island law in support of a regulation to require such data. In response, Rhode Island has informed PMUSA that it anticipates being able to provide retailer fine/conviction data shortly. This effort needs to be broadened to the many other states where legislation will be considered in 1997.

In our interim report, we recommended that PMUSA only pay out the \$5 million incentive fund to retailers who enroll in RRP and certify that they have not been the subject of a fine or conviction for underage cigarette sales, given the lack of confirming data from most states. We noted also that Florida's initial promise of information on convicted retailers in March of 1996, but the failure of that state to provide any such information as of June 30, 1996, is puzzling. In response to these concerns, PMUSA has informed us that: (1) PMUSA will distribute the \$5 million fund with a notice to each retailer that, should it later come to the company's attention that it had been fined or convicted during 1996, appropriate action consistent with the AAA program would be taken; and (2) Florida continues to provide no information despite repeated contacts, possibly because of Florida's ongoing litigation against tobacco companies for recovery of its Medicaid expenses for purported cigarette-related health care costs.

We continue to believe that requiring a specific retailer certification that no fine/conviction occurred in 1996 provides more integrity to the \$5 million incentive fund process and would serve an important educational function. With regard to Florida, the apparent existence of the necessary data indicates that every conceivable means should be used to obtain it -- including, possibly, resort to the media. Such an effort would at least confirm that another factor outside of PMUSA's control is preventing the use of Florida data.

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In short, we reemphasize our principal conclusion: there is clear evidence that, in the few states where PMUSA has obtained retailer fine/conviction data, it acts on it, and that these retailers suffer consequences that are significant. Therefore, PMUSA should now take serious additional steps to ensure that this system will be in place in as many states as possible, as soon as possible.

5. Recommendations

PMUSA's commendable effort to obtain existing data from state and local governments has resulted in a low success rate for reasons largely beyond the company's control. However, given the potential for the RRP to positively influence retailer behavior, PMUSA should take substantial additional steps to ensure that states collect this information and make it available. To this end, we recommend the following:

- PMUSA should expand its use of its extensive network of government affairs representatives, legal advisors and other consultants throughout the country to encourage state agencies to collect this data and transmit it to PMUSA -- and, if necessary, to retrieve information directly at the local level wherever it exists. The example of Rhode Island is noteworthy and should be repeated in as many states as possible.
- A number of states will be considering AAA legislation during 1997. PMUSA should seek to include provisions that would require (and provide funding for) state collection of enforcement data:
- PMUSA should take more aggressive action in states that have indicated enforcement data is, or soon will be, available. Florida, Kentucky, New Jersey and Vermont are examples of these states. PMUSA should expand its communications with the responsible officials in these states, including follow-up calls from regional PMUSA government affairs representatives, and perhaps offering any technical assistance that might be helpful. For example, PMUSA has informed us that Washington state's Liquor Control Board ("LCB") is the model collector and provider of data on fined/convicted retailers, and that it will be meeting with LCB officials to determine how Washington's success could be communicated to other states. PMUSA should share the helpful

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information it receives from Washington LCB officials with relevant agencies in other states.

PMUSA has taken an important first step in its attempt to hold retailers responsible for their behavior toward complying with underage tobacco sale laws. In our view, it is time for PMUSA to take significant additional steps. We propose to continue our review of this complicated but crucial initiative.

E. Placement of Minimum Age Signs and Related Materials In Retail Outlets That Participate in PMUSA's Incentive Programs

As noted above, at the time that PMUSA announced the AAA program, the company had already begun to implement, through its field sales force, a unilateral initiative entitled "Ask First/Its the Law" ("AFITL"). The AFITL program involved the distribution to PMUSA's workload accounts of point-of-sale signage and educational materials relating to underage sales laws on a state-by-state basis. In the early stages of our audit, we reviewed program materials and survey data maintained by PMUSA regarding (1) penetration of AFITL materials among the company's workload accounts, and (2) consumer identification with the AFITL program and materials. In addition, we participated in field visits with PMUSA sales representatives in the Washington, D.C. area to observe the interaction between the company's sales force and their retail accounts with regard to the "selling in" of AFITL.

The materials we reviewed and the employee and retailer interviews we conducted indicated that PMUSA was making a determined effort to implement AFITL, and that the company's retail workload accounts were generally receptive to the materials and their purpose. We did not, however, conduct a scientific survey of the AFITL program because, shortly after we commenced our audit, PMUSA announced that it would support the "We Card" program sponsored by the Coalition for Responsible Tobacco Retailing (the "Coalition").^{12/} The We Card program, which was formally launched in

^{12/} The Coalition's membership includes the Tobacco Institute (of which Philip Morris is a member), the National Association of Convenience Stores, the Food Marketing Institute, the National Grocers Association, the International Mass Retail Association, the American Wholesale Marketers Association, NATSO (representing America's Travel Plazas and Truckstops), the National
(continued...)

December 1995, provides to participating retailers a set of point-of-sale materials (including signs, pins, window/door decals, and age of purchase calendars and stickers), as well as employee training materials (including booklets and video and cassette tapes) that summarize applicable state underage sales laws and provide tutorials on how and when to request identification from a customer who wishes to purchase cigarettes.

We undertook a three-part examination of the We Card program and of PMUSA's efforts to promote it. First, we reviewed We Card training materials and attended a We Card training session to evaluate first-hand the effectiveness of the support that PMUSA and other Coalition members are providing to store owners and their employees. Second, we commissioned two nationwide surveys that examined (1) the adequacy and effectiveness of PMUSA's efforts to engender support for the We Card program among its sales representatives, and (2) the level of familiarity with, and commitment to, the We Card program exhibited by retail establishments with which PMUSA has an established relationship. Third, we conducted in-person interviews with several of PMUSA's Section Sales Directors, in order to gain a better understanding of the way in which the AAA/We Card program is perceived and implemented by middle management. The following sections discuss these activities in greater detail.

1. Examination of We Card Training Program

We met early last year with Brennan Dawson, Senior Vice President for Public Affairs of the Tobacco Institute, the organization that oversees implementation of the We Card program. Ms. Dawson reviewed for us the history of the program, and the various channels through which retail establishments could be made aware of the program. We learned also that the members of the Coalition (including PMUSA) are not directly responsible for providing We Card materials to their customers or member organizations. Instead, members of the Coalition provide information to their customers or members regarding the manner in which program materials may be obtained. We Card materials are distributed by a North Carolina-based fulfillment company with which the Coalition has contracted.

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American Wholesale Grocers Association, the National Association of Chain Drug Stores, the National Retail Federation and the Smokeless Tobacco Institute.

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The Coalition has undertaken also to train the member companies of its members, either through in-house presentations (at major corporations) or at conventions and trade shows, as well as the general retail community at seminars held throughout the country. Some Coalition members (including, for example, the National Association of Convenience Stores) have assumed this responsibility directly, and provide training about the We Card program at periodic seminars and programs held throughout the country for their members. The purpose of these activities is to ensure that store owners and other managerial personnel will be equipped to train their employees on the use of We Card materials and on techniques of age verification. These efforts to "train the trainers" are obviously critical to the ultimate success of the We Card program.

PMUSA discontinued its direct training activities when it terminated the AFITL initiative, and now provides indirect support for Coalition-sponsored training programs. We were not asked by the Coalition to evaluate their We Card training programs. PMUSA has, however, pledged its full support to each element of the We Card program. In this regard, we attended a We Card training session in order to evaluate its content and the manner of presentation, and to gauge the impressions and reactions of attendees.

We attended a We Card Retail Training Seminar that was held in Perrysburg, Ohio (suburban Toledo) on August 27, 1996. The seminar was sponsored by several state-level trade associations, including the Ohio Association of Convenience Stores, the Ohio Council of Retail Merchants, the Ohio Grocers Association, the Ohio Petroleum Marketers Association, the Ohio Petroleum Retailers and Repair Association, and the Ohio Association of Tobacco and Candy Distributors. The Coalition and the National Association of Convenience Stores also supported the program. The seminar lasted three hours, and was attended by approximately 90 persons. Attendees represented a variety of positions within various categories of retail establishments, but consisted primarily of store managers and owners -- although there were many clerks in attendance as well.

The session was conducted by Kate Zschech, a professional trainer who formerly worked for the National Association of Convenience Stores, and now works independently. The program was recorded on videotape, for use by other retailers and for distribution in response to press inquiries regarding the We Card program.

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Seminar attendees uniformly expressed concern about the potential impact on their business of a fine or arrest for selling tobacco to minors. Approximately 40 percent of attendees stated that their establishment had been the target of a police "sting" operation -- i.e., an attempted purchase of cigarettes, under police supervision, by a person who objectively appears to be younger than 18 years old -- during the past year. The sanctions that could be imposed against the employees or their store in the event of a sale of cigarettes to a minor provided a strong incentive for seminar participants to understand and comply with the law.

In our view, the training session was very effective, in terms of both format (for example, the question-and-answer technique was employed constructively) and content. A recurring theme of the presentation was the importance of establishing a store-level culture of intolerance for tobacco sales to underage customers. A related theme was the importance of monitoring state and federal legislative developments relating to underage smoking, and of participating in the regulatory process. Ms. Zschech provided constructive suggestions for making the most effective use of the various point-of-sale materials included in the We Card kit, and of ensuring that employee training is an ongoing commitment rather than a one-time event.

We spoke informally with several seminar attendees after the program concluded. Each person with whom we spoke found the program to be very helpful, and expressed strong support for the We Card program. Based on our observations, it appears that PMUSA is playing an effective, albeit largely invisible, role in supporting the We Card training effort. Representatives of the sponsoring organizations acknowledged in private conversations that PMUSA had been very helpful in coordinating training events in Ohio. In addition, the PMUSA representative who attended the Perrysburg session appeared to be well acquainted with, and to enjoy a good working relationship with, the trade association representatives. Overall, we were satisfied with PMUSA's efforts in support of the We Card training efforts taking place in Ohio.

2. TSM and Retailer Surveys

One of the more challenging features of this aspect of our audit is that the We Card program is not directly controlled by PMUSA, and consequently that many other parties (principally the other members of the Coalition) are in a position to influence retailer perceptions and attitudes toward the program, and to determine its ultimate success. Our principal objective was

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to develop an audit plan that would meaningfully examine PMUSA's efforts with respect to the We Card program, and avoid laying blame at the company's feet for negative outcomes that it could not reasonably influence, or, at the other extreme, giving credit to the company for positive outcomes that may have been influenced significantly by the actions of others.

We determined that in order to conduct a meaningful review of the We Card program under these guiding principles, it would be necessary to conduct a scientific nationwide survey not only to measure the effectiveness of the program, but also to assess the adequacy of PMUSA's specific efforts to promote it. PMUSA accepted our recommendation to retain HRA to conduct a comprehensive survey of TSMs and the company's Retail Masters and other workload accounts concerning their knowledge of and commitment to the We Card program (as well as the preceding AFITL initiative).

We believe that PMUSA deserves credit for recognizing that a comprehensive (and, from a business standpoint, intrusive) field survey of its TSMs and retail accounts was necessary to produce a credible independent survey of the AAA program. The HRA surveys were thorough and probing, and, as described below, involved contacts with (1) 600 present and former TSMs who have daily contact with tobacco retailers and are responsible for implementing many aspects of the AAA program, and (2) 2,000 retail establishments that have a formal marketing relationship with PMUSA.

The HRA surveys were an expensive undertaking, and PMUSA readily provided the assistance we requested in connection with the design and implementation of them. The TSM and retail surveys were extensive, the results were very reliable from a statistical perspective, and every precaution was taken, with PMUSA's full cooperation, to ensure anonymity of the respondents, and thus the integrity of the results. While we and HRA received technical advice from PMUSA about how to survey PMUSA employees and how to identify retail accounts, the company did not interfere with our efforts to conduct the surveys, and did not object to the substantive content of either of them. We believe PMUSA should be commended for its willingness to submit to a survey of this scope and independence, and to bear the relatively high costs that are necessary to conduct a survey of this magnitude and degree of reliability. This willingness alone indicates to us that PMUSA is serious about the AAA program.

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Our principal objectives with respect to the TSM survey were as follows:

- Assessing the adequacy and success of the training provided to TSMs by PMUSA regarding the AFITL and We Card programs;
- Testing TSMs' recollection of specific elements of the We Card and AFITL, as well as PMUSA's unilateral incentive/enforcement component of We Card, entitled the Responsible Retailer Program ("RRP");
- Measuring the efforts of PMUSA and TSMs to educate retailers regarding the RRP, and the success achieved to date in implementing the program;
- Testing TSMs' knowledge of tobacco-related laws applicable in their territory; and
- Measuring PMUSA's and TSMs' commitment to the We Card initiative and the RRP.

With respect to the retailer survey, we were interested primarily in examining the following issues:

- The presence and visibility of We Card, AFITL or other point-of-sale materials relating to tobacco age restrictions;
- The adequacy and effectiveness of training provided to retailers concerning age-restricted tobacco sales;
- Retailer knowledge of applicable laws relating to tobacco sales;
- Retailer attitudes regarding underage use of tobacco products and the level of commitment of cigarette manufacturers to reducing underage smoking; and
- Retailer experience with and assessment of AFITL, We Card and the RRP.

In addition to the two surveys conducted by HRA, we conducted in-depth interviews with six of PMUSA's 22 Section Sales Directors ("SSDs"),

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as well as certain Senior Account Managers and Unit Managers. We selected SSDs at random, with an effort to achieve a balance among PMUSA's five U.S. sales regions. These interviews introduced us to an important level of middle management between PMUSA's corporate headquarters and the TSMs, and shed additional light on the issues explored in the HRA surveys.

In the following sections, we discuss the highlights and principal findings of the TSM and retailer surveys and our SSD interviews. HRA's final report is reproduced at Exhibit A, and warrants a careful reading in its entirety.

The TSM Survey

Based upon information provided by PMUSA, HRA selected at random 400 of PMUSA's more than 2,000 sales territories, from which it derived a sample of 560 active and 40 inactive PMUSA employees who had served as TSMs in these territories during the period May 1995-August 1996.^{13/} This sample design provided a sampling error of $\pm 5\%$ of the population values 95% of the time. HRA succeeded in completing interviews with 499 active and 17 former TSMs, which constituted 89% and 42.5% of the sample populations, respectively. We were very pleased with the high response rates achieved by HRA, which adds great credibility to the survey results.

The survey clearly indicates that TSMs are very busy people; for example, over 89% of the respondents stated that it is "somewhat difficult" or "very difficult" to cover all of their required daily activities. Over 71% of TSMs reported that their workload has increased during the past year. When asked how long they spend, on average, with each retail contact during a store visit, over 79% of TSMs reported that they spend 20 minutes or less. Most TSMs (over 82%) find it difficult to keep up with the volume of information provided by PMUSA management, and 52.4% reported that it is "somewhat difficult" or "very difficult" for them to identify the programs and initiatives that have top management priority at any given time. The vast majority of TSMs reported that management priorities have shifted from one initiative to another either "somewhat often" (46.0%) or "very frequently" (42.1%) over the past 15 months.

^{13/} PMUSA requested that we exclude from the sample former TSMs who had been terminated by the company for cause. HRA advised us that the potential bias that would be introduced by including such persons in the sample would outweigh the probative value of the information they would provide, and we therefore agreed to exclude them from the survey.

We learned that TSMs receive information from many sources within the PMUSA organization, and that they assign differing levels of importance to information received from different sources. For example, information received from PMUSA's Corporate Affairs department in New York -- from where many aspects of AAA are overseen -- is viewed as "extremely important" by only 25.6% of TSMs, whereas information provided by the TSMs' immediate supervisor, the Unit Manager, is viewed as "extremely important" by 91.5% of TSMs. Information received from the corporate-level Sales division, the ultimate overseer of the TSMs, is viewed as "extremely important" by 48.3% of TSMs. These findings are relevant because almost all intracompany correspondence relating to the AAA program originates from headquarters.

One of the many interesting findings of the HRA survey is that TSMs felt a higher degree of involvement with and commitment to the AFITL program than they do with respect to the We Card program. When asked to explain their principal responsibilities with regard to AFITL, most TSMs described their roles in terms of distributing program materials to their accounts, assisting retailers in placing POS materials, and encouraging/educating their accounts with respect to program participation and compliance with applicable laws. When the TSMs were asked the same question with regard to the We Card program, their responses indicated a lower level of personal commitment to the initiative -- for example, most TSMs reported that their role was to encourage retailers to obtain program materials and sign pledge cards to enroll in the RRP. Only one in three TSMs stated that it was their responsibility to educate retailers about the We Card program.

We believe that these findings are attributable to fundamental differences between AFITL and the We Card program. AFITL was a PMUSA initiative that the TSMs were directly responsible for implementing -- by, for example, distributing program kits and educating their accounts about the program and the use of the POS materials. The We Card program, by contrast, is a multilateral effort in which PMUSA is one of many supporters and in which the responsibility for distributing program kits has been assigned to a third-party fulfillment house. As a result, TSMs appear to feel a lesser degree of "ownership" of the We Card program, and view their role as involving more the ministerial tasks of returning signed enrollment cards and ensuring that signage is placed in stores.

While it certainly was logical for PMUSA to join a coordinated campaign among the tobacco and retail industries to standardize retail POS

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materials, PMUSA might wish to consider introducing additional internal measures to attempt to bring to the We Card program the stronger sense of connection that TSM's felt with respect to AFITL. We recommend that PMUSA revise its internal training to place greater emphasis on the need to educate retailers regarding We Card and the RRP, rather than relying to such a great extent on quantitative benchmarks of the program's success (e.g., the number of stores in each territory in which We Card signage is displayed).

Notwithstanding these differences, the HRA survey clearly indicates that TSMs' familiarity with and commitment to the We Card program is strong when compared with other recent PMUSA promotional campaigns that they have been responsible for implementing. In order to provide some context for evaluating the survey results with respect to the We Card program, and as part of their effort to blind respondents as to the purpose of the survey, HRA asked TSMs a variety of questions about a recent PMUSA product-related sales promotion. Only 90.1% of TSMs recalled the program, as compared with the 97% who remembered the We Card program. Moreover, the median percentage of accounts that participated in the recent promotion was only 20%, as compared with median We Card participation rates of 86% for independent accounts and 60% for chain store accounts.^{14/}

The survey indicates that TSMs are uncertain about their responsibility for implementing the enforcement/penalty aspect of the RRP. The majority of TSMs (71.5%) are aware of the \$5 million reward fund. When asked, in an unprompted manner, to define their role in implementing RRP, however, most TSMs explained that they were responsible for encouraging retailers to return pledge cards to enroll in the program. Only one in three TSMs stated that their role included educating retailers about the RRP, and only 1.4% reported that they are responsible for enforcing compliance with the program. When asked specifically whether they had a role in enforcing the RRP, 30.9% of TSMs said yes, 57.8% said no and 11.3% did not respond.

We believe that there are two reasons for this ambivalence relating to the enforcement aspect of RRP. First, as discussed at pages 16-19 of the HRA report, various internal company memoranda have suggested that TSMs would play some role in enforcing the penalty aspects of the RRP, while, at the same time, management has repeatedly stressed that the TSMs are not directly

^{14/} This difference in enrollment rates between chains and independents is mostly attributable to the fact that many large chains have their own age-restricted campaigns in place.

responsible for withholding merchandising benefits from retailers who violate the program. We believe that TSMs would benefit from a clearer statement of their specific duties in this regard.

Second, and more fundamentally, we believe that TSMs' ambivalence about the enforcement elements of the RRP relates to the fact that PMUSA has thus far taken virtually no enforcement action, for the reasons explained in Section III.D. above. This message came through clearly in our SSD interviews as well: the lack of state enforcement data has made it impossible for PMUSA to implement the penalty provisions of the RRP. As more time has passed without any large-scale enforcement actions being taken, field personnel are becoming increasingly uncertain about this aspect of the program and their role in implementing it. We believe that it would be beneficial for PMUSA to review with TSMs the fundamental elements of the RRP, provide an update regarding the imposition of sanctions against retail accounts and the ongoing effort to obtain state enforcement data, and clarify the exact role of TSMs in the penalty components of the program.

TSMs clearly believe that there exists a genuine institutional commitment to the AAA and We Card programs at all levels within PMUSA. It is interesting to note, however, that while 84.1% of TSMs believe that corporate headquarters has either a "fairly strong" or "very strong" commitment to AAA/We Card, only 49.8% believe that their Unit Manager has the same level of commitment to these programs. Given that, as noted above, TSMs place higher priority on communications received from their Unit Managers than those originating at corporate headquarters, PMUSA may wish to consider providing periodic training or other reminders to Unit Managers of the importance of these initiatives and of their responsibility to maintain a high level of commitment on the part of the TSMs.

It appears also that TSMs would benefit from renewed training with regard to AAA and We Card. While over 92% of TSMs reported that they feel "fairly comfortable" (26.2%) or "very comfortable" (66.5%) promoting the AAA and We Card programs to their retail accounts, 39.2% stated that they have not been provided with sufficient information to respond to customers' questions regarding these programs. This finding is not surprising, in view of the fact that, as noted above, TSMs are constantly confronted with new information regarding sales and marketing promotions from a variety of sources within the organization. Unlike most PMUSA sales promotions, which have a relatively limited duration, the AAA/We Card programs are a constant feature of the TSMs' set of responsibilities. It might therefore be beneficial to

provide periodic updates and reminders concerning the fundamental features of these programs, to ensure that TSMs maintain a high level of familiarity with them.

In summary, the TSM survey clearly indicates that PMUSA has attempted in good faith to implement the AAA/We Card programs and the RRP through its field sales force, and has been largely successful in this effort. The TSMs surveyed were, for the most part, aware of these programs, felt comfortable "pitching" them to their accounts, and were familiar with some (but not all) aspects of the programs. When TSM awareness of and commitment to We Card and the RRP is compared with recent PMUSA promotional campaigns, the TSMs score no worse, and in some respects score higher.

The enforcement/penalty element of the RRP (and, specifically, the TSMs' role in implementing it) is an area of considerable uncertainty -- due primarily to the fact that PMUSA's enforcement efforts have been largely unsuccessful to date because of the unexpected difficulty the company has encountered in obtaining retailer fine and conviction data from the states.

TSMs place a higher degree of emphasis on communications received from their Unit Managers and District and Section offices than they do on information received from corporate headquarters, and they perceive their Unit Managers' level of commitment to AAA/We Card to be less than the headquarters commitment (although they believe that, overall, the level of commitment is relatively high in both cases). TSMs clearly want to participate successfully in AAA/We Card. We believe that they (and their Unit Managers) would benefit from renewed program training and a clearer statement of mission.

The Retailer Survey

HRA drew a sample of 2,000 retail stores from the approximately 213,000 retail establishments with which PMUSA has a formal marketing agreement. These stores were taken from a stratified sample of 153 of the 400 territories that were used to select the TSM sample. In this manner, HRA accomplished our objective of being able to match the efforts and perceptions regarding AAA/We Card of a select group of TSMs with the knowledge and attitudes of the retailers on whom those same TSMs call on a regular basis. The sample design employed by HRA provided a sampling error of $\pm 4\%$ of the population values 95% of the time.

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HRA took great care in the selection and training of field interviewers. These efforts are described at pages 47-48 of the HRA report. HRA completed site visits and interviews at 1,636 of the 2,000 stores in the sample, for an overall response rate of 81.8%, which is remarkable by comparison to standard measures for marketing research and is consistent with the demands of scientific research. We appreciate the time and effort that HRA invested in the design and execution of the retailer survey; these efforts, combined with the impressive response rate achieved, give us great confidence in the accuracy of the results.

HRA found that 85.8% of the stores visited displayed some form of signage concerning tobacco-related age restrictions. Of these stores, 65% displayed AFITL or We Card signage. In addition, there was a statistically significant difference in the penetration of AFITL/We Card signage between stores with which PMUSA has a marketing agreement and those with which it does not. This suggests that PMUSA's selling efforts with regard to AFITL and We Card have made a difference.

The majority of store managers (73.1%) and store clerks (79.2%) interviewed by HRA reported that they have received some form of training relating to the sale of tobacco products. Managers and clerks in stores with which PMUSA has a marketing agreement were more likely to have had such training than those from stores with which PMUSA does not have a formal relationship. When asked specifically whether they were familiar with the AFITL program, only 39.1% of store managers and 45.6% of store owners interviewed responded affirmatively. Of the managers and owners who received AFITL signage, almost 94% displayed the signs and other materials, and almost 63% of these believe that the signage helped reduce attempts by underage persons to purchase tobacco products.

With respect to the We Card program, only 32.4% of store owners and managers reported that a tobacco company representative had talked to them about restricting tobacco sales to minors. However, of those who did report such a contact, PMUSA was mentioned most often as the company whose representative had raised the issue. Of the 254 owners and managers who recalled discussing the We Card program with a Philip Morris TSM, almost 75% recalled being encouraged to order the We Card materials, almost 68% recalled being advised on laws regarding underage tobacco sales, and almost 60% had been provided a 1-800 number to order program materials, and had been advised on penalties for violations of tobacco sales restrictions as well as on how the laws are enforced in the locality.

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It is interesting to note that convenience stores and gas stations are among the categories of stores that displayed the highest penetration of We Card or AFITL signage -- 77.6% and 72.9%, respectively. These types of retail outlets are often located near schools, and are widely viewed as prime targets of minors seeking to purchase cigarettes. It thus appears that the TSMs have concentrated their We Card and AFITL selling efforts on the types of establishments at which risk of underage access to cigarettes is greatest.

The survey findings were less encouraging with respect to the RRP. Only 21% of store owners and 6% of store managers were aware of any incentive program offered by a tobacco company to curb underage sales, and only 54 owners and managers (or 5.5%) of the 917 owners/managers who responded to this question reported that they were participants in the RRP. The survey data indicate that PMUSA's Retail Masters accounts are much more likely to be aware of and to participate in the RRP than non-Retail Masters accounts.

We believe that this overall lack of familiarity with RRP derives from the fact that, by the time the survey was conducted, almost a year had passed since PMUSA's announcement of the RRP. During this period, PMUSA had not taken any significant action under the RRP. For example, the \$5 million award fund was not scheduled to be distributed until 1997. More importantly, as we discuss in detail elsewhere in this report, PMUSA's inability to obtain law enforcement data from the states prevented the company from taking any meaningful action to implement the penalty provisions of the RRP during 1996. It is therefore not surprising, in our view, that the retail community is largely unaware of the program's existence.

HRA also surveyed store owner/manager and sales clerk knowledge of tobacco sales laws in their respective jurisdictions. In brief, HRA found that most managers/owners and clerks know the legal age at which tobacco may be sold in their state, and know whether the person who sells tobacco products to a minor can be sanctioned under the law. Most managers/owners and clerks are also aware of whether their state requires that signs be posted regarding minimum age requirements for tobacco purchases. However, the vast majority of managers/owners and clerks gave an incorrect response when asked if the store's tobacco license could be revoked in the event of a violation of the law, and almost half answered incorrectly when asked if the store could be fined for violating tobacco sales laws.

A more detailed analysis of the responses relating to applicable laws reveals that, for the most part, PMUSA's Retail Masters accounts are more knowledgeable than non-Retail Masters accounts. (See pages 127-29 of the HRA report.) In addition, HRA detected a high level of correlation between TSMs who were knowledgeable about applicable state and local laws and the knowledge levels of the retail accounts on which they call. While this finding does not establish scientifically that well-trained TSMs do a better job of educating their accounts, it does indicate more generally that TSM training and familiarity with the We Card program may have a beneficial impact on retailer knowledge and behavior.

These results indicate overall that, while employees of stores with which PMUSA makes frequent contact are more likely to have accurate knowledge of applicable tobacco sales laws, there nonetheless exists considerable room for improvement in educating retail accounts about applicable tobacco sales laws. The survey results suggest also that the educational and training materials included in the We Card kits have not been fully utilized by the retail community.

Responses to other questions in the HRA survey also indicate that We Card training and POS materials are not being used in the intended manner. For example, when store owners/managers and sales clerks were asked how they determine whether a customer is old enough to buy tobacco products, in both cases the majority replied that they calculate the customer's age from their ID card. A much smaller percentage stated that they compare the birth date shown on the ID card with the cut-off date shown on the We Card calendar. In addition, when asked how they respond when a customer who has been refused tobacco products becomes aggressive, only 0.1% of managers/owners and 0.3% of sales clerks gave the response indicated by the We Card training materials: namely, make the sale (but do not ring up the sale) and then notify the manager.

HRA also surveyed retailers' general attitudes about underage smoking and the tobacco industry's actions regarding this issue. While store owners/managers and sales clerks responded overwhelmingly that they have a responsibility to prevent underage customers from purchasing tobacco products, a higher percentage of both groups believes that retailers have a responsibility to prevent underage purchases of alcohol. Almost two-thirds of store managers/owners stated that they do not believe that tobacco companies are really committed to preventing underage persons from buying tobacco. A majority of both groups believes that underage smoking is either a "serious" or

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a "very serious" problem in their area, although, interestingly, there are significant regional differences to these responses (see pages 150-53 of the HRA report).

In short, it appears that the educational or "retailer awareness" aspects of the AFITL/We Card programs have been largely successful. Substantial signage is present in retail stores, and store owners/managers and clerks believe that the signage is an important deterrent to underage tobacco purchases. Retailers are also, with minor exceptions, generally knowledgeable regarding legal prohibitions on underage sales, and the majority believe that underage smoking is a serious problem.

However, retailer awareness of PMUSA's involvement in the We Card program, and of the existence and purpose of the RRP, is disappointingly low, and retailer perception of the tobacco industry's commitment to controlling youth smoking is lower than their perception of the alcohol industry's commitment to preventing underage drinking. This is undoubtedly due in part to the fact that, with minor exceptions, PMUSA has not withheld the merchandising benefits of noncompliant retailers under the RRP, because the company has been unable to obtain data on fined or convicted retailers in most states. We would expect that, once a system is in place to collect such data on a timely basis and PMUSA begins imposing sanctions in larger numbers, retailer awareness will rise significantly. In any event, there is room for improvement in educating retailers about the non-signage aspects of the We Card program, and reinforcing the specific elements of the RRP.

3. The SSD Interviews

As is apparent from the preceding discussion, most of our audit activities involved either meetings and examination of records at the PMUSA headquarters level, or field surveys of TSMs and retailers. We recognized, however, that our examination would be incomplete unless we spoke with key people in the PMUSA chain of command between headquarters and the field. With this objective in mind, during the late summer and fall of 1996 we conducted a series of interviews with SSDs representing each of PMUSA's five sales regions. We were interested in assessing the SSDs' commitment to the AAA program and their views regarding the manner in which it was being implemented. We were especially interested in determining whether there were any points in the line of communication between headquarters and the TSMs where the message of PMUSA management with respect to AAA was being manipulated or ignored in any significant way.

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We spent approximately two hours with each SSD, and asked a variety of questions regarding AAA/We Card and the RRP. Each of the SSDs expressed a firm conviction that PMUSA management is serious about implementing the AAA program. Most noted specifically that it is unusual for senior PMUSA executives such as CEO Jim Morgan and Senior Vice President Craig Johnson to invest as much time and effort in any single initiative as they had to the AAA program, and that this fact alone convinced them of the company's commitment to the program.

The SSDs' principal complaint about the AAA program related to the surprise manner in which it was announced in June 1995. They recalled being deluged by calls from representatives of large chain accounts who were upset that PMUSA had not consulted with them prior to announcing the program, and having to concede that they, too, had been surprised by the announcement. Most SSDs also complimented management, however, on providing detailed program information immediately after the program was announced, and of following up on inquiries from the field with conference calls and helpful Q&A-format information packets. One SSD stated that management had "released [the We Card program] before it was ready to fire," but attributed this fact to external factors that dictated the timing of the program announcement.

We gained from our SSD interviews the impression that AAA was in many respects a non-traditional PMUSA initiative -- and, specifically, that most problems surrounding program implementation arose from the fact that, at the outset, PMUSA lacked an infrastructure to support the program and provide meaningful feedback to TSMs. We have learned over the course of our audit that PMUSA is a numbers-driven organization. Sales and marketing objectives are frequently expressed in numerical terms, and TSMs usually measure their progress by reference to quantitative benchmarks. The SSDs told us that no such benchmarks existed in the early stages of the AAA program, and that this might have made it somewhat difficult initially for TSMs to integrate the program into their overall in-store efforts.

Following the introduction of the RRP in January 1996, one quantitative benchmark was created under AAA -- namely, the percentage of each TSM's accounts that have enrolled in the program by returning a pledge card. While we believe that this is a helpful addition to the program, we believe there is a risk that TSMs might come to rely on this measurement to an excessive degree, and be tempted to conclude that they have fulfilled their basic mission under We Card once they achieve a high RRP enrollment rate. The

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true test of a TSM's success under AAA/We Card is obviously much broader (including, for example, the important educational element), and we hope that PMUSA will be mindful of this fact as its review of TSM performance under these programs evolves.

The SSD interviews also confirmed the finding of the HRA survey that there exists a great deal of confusion in the field concerning the RRP and, in particular, its penalty provisions. Most of the SSDs we interviewed were unaware of the status of PMUSA's efforts to obtain state enforcement data, and most were uncertain of whether PMUSA had imposed any penalties under the RRP in their Section. The SSDs believe that the threat of withholding merchandising benefits is a powerful incentive for retailers to comply with the We Card program. Several of them expressed the concern, however, that a prolonged absence of meaningful enforcement action will weaken the deterrent effect of the threatened sanctions. We share this concern, and, as we discuss elsewhere, believe that the lack of a reliable program to obtain state enforcement data is the most significant threat to the ultimate success of the AAA program.

The SSDs told us that their retail accounts have generally accepted the AAA/We Card programs, and that most feel a direct responsibility to curb cigarette sales to minors. Two SSDs stated that the retail community was looking for help on this issue prior to the announcement of AAA, and that, after the initial controversy subsided regarding the lack of prior notice to retailers, they have come to appreciate the AAA program and participate willingly in it.

Our interviews also reinforced the message of the HRA survey that it would be beneficial for PMUSA to provide more routine and detailed training materials and updates to TSMs regarding AAA/We Card. Each of the SSDs with whom we spoke acknowledged the risk that a long-term initiative like AAA can become lost in the flurry of weekly internal correspondence regarding new sales promotions and related issues. When asked what specific training new TSMs receive with respect to the AAA program, one SSD recalled only a two-page insert in the TSM training manual.^{15/} Another SSD suggested that PMUSA revise its AAA training efforts to provide greater focus on

^{15/} We have been informed that PMUSA's revised TSM training program as of September 1996 includes a 45-minute segment devoted to the AAA program and provides a 15-page reference guide and other materials relating to We Card.

substantive business issues (i.e., how rigorous implementation of the program can benefit PMUSA's business) and less on quantitative benchmarks (such as RRP enrollment rates). We believe that, now that RRP enrollment is substantial, this is a useful recommendation.

In summary, the SSD interviews confirmed our overall sense of the interaction between corporate headquarters and the field sales force with respect to AAA and the We Card program. We detected no serious gaps in communication between senior management and the field, and found no evidence of a lack of dedication to the AAA program at middle management levels. The SSDs uniformly support the AAA program and appreciate its importance, both to management and to their business. Their criticisms relate more to the details of program implementation than to the basic purpose or philosophy of the program. The SSDs offered constructive suggestions for program improvement which we believe warrant careful consideration by management.

F. Implementation of Program to Reward Members of the Public Who Identify Unauthorized Uses of Philip Morris Trademarks

In this element of the AAA program, PMUSA instituted a program to reward members of the public who notify PMUSA of an unauthorized use of the company's trademarks. We met in New York in January 1996 with members of PMUSA's General Counsel's office who are responsible for trademark enforcement activities. We were informed that the worldwide employees of Philip Morris and its affiliated operating companies (e.g., Oscar Mayer) have traditionally been the company's "first line of defense" against trademark infringement.

In this regard, the company provides regular information to its employees regarding the importance to the company of trademark protection and the need for employees to seek out unauthorized uses of Philip Morris brand names and logos as part of their overall role as the company's "eyes and ears" in retail stores. We learned also that PMUSA's corporate policy has always prohibited the licensing of cigarette-related trademarks for uses relating to children's products, and that, in the United States, the company's trademarks are not licensed to third parties, and are used only for cigarette packaging and for products used in connection with PMUSA's own marketing programs.

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We were informed that in cases where an infringing product is identified, the PMUSA Trademark Group sends a cease-and-desist letter to the retailer, distributor, importer and/or manufacturer of the merchandise, and requests that the recipient return a signed copy. According to the officials with whom we met, this action leads to a cessation of infringement in approximately 90% of the cases identified.

It is our impression that company officials believed that, in view of the company's longstanding and apparently successful program to combat trademark infringement, it would be difficult to identify additional steps in the context of the AAA program to combat the use of Philip Morris trademarks in products targeted to children. The company ultimately decided upon a course of action consisting of two elements.

The more significant step involved the establishment by PMUSA of a reward program for information that enables the company to take action against a trademark infringement.^{16/} The key elements of the program are as follows:

- | | |
|-------------|--|
| Eligibility | Any person who notifies PMUSA of an infringement in a manner that satisfies the program criteria is eligible to receive an award. As an initial matter, however, the company decided to publicize the program to only three categories of eligible participants: (i) approximately 2 million "active" customers of Philip Morris (persons who have demonstrated in the past an interest and willingness to become involved in issues relating to Philip Morris tobacco products); (ii) Philip Morris workload accounts; and (iii) employees of Philip Morris Companies, Inc. |
| Awards | 1. For the first person who provides information leading to termination of the manufacture or importation of an infringing product, a cash reward of \$100.00. |

^{16/} In the other part of this program, PMUSA republished updated versions of print advertisements concerning its trademark infringement policy that were initially prepared in connection with a settlement of a 1990 action by PMUSA against Sega, the electronic games manufacturer.

2. For the first person who provides information leading to the termination of sale of an infringing item by a retail establishment, a gift. The gift(s) are selected in consultation with Philip Morris' purchasing department. The gifts must not be oriented toward tobacco use, and must not bear Philip Morris brand logos.

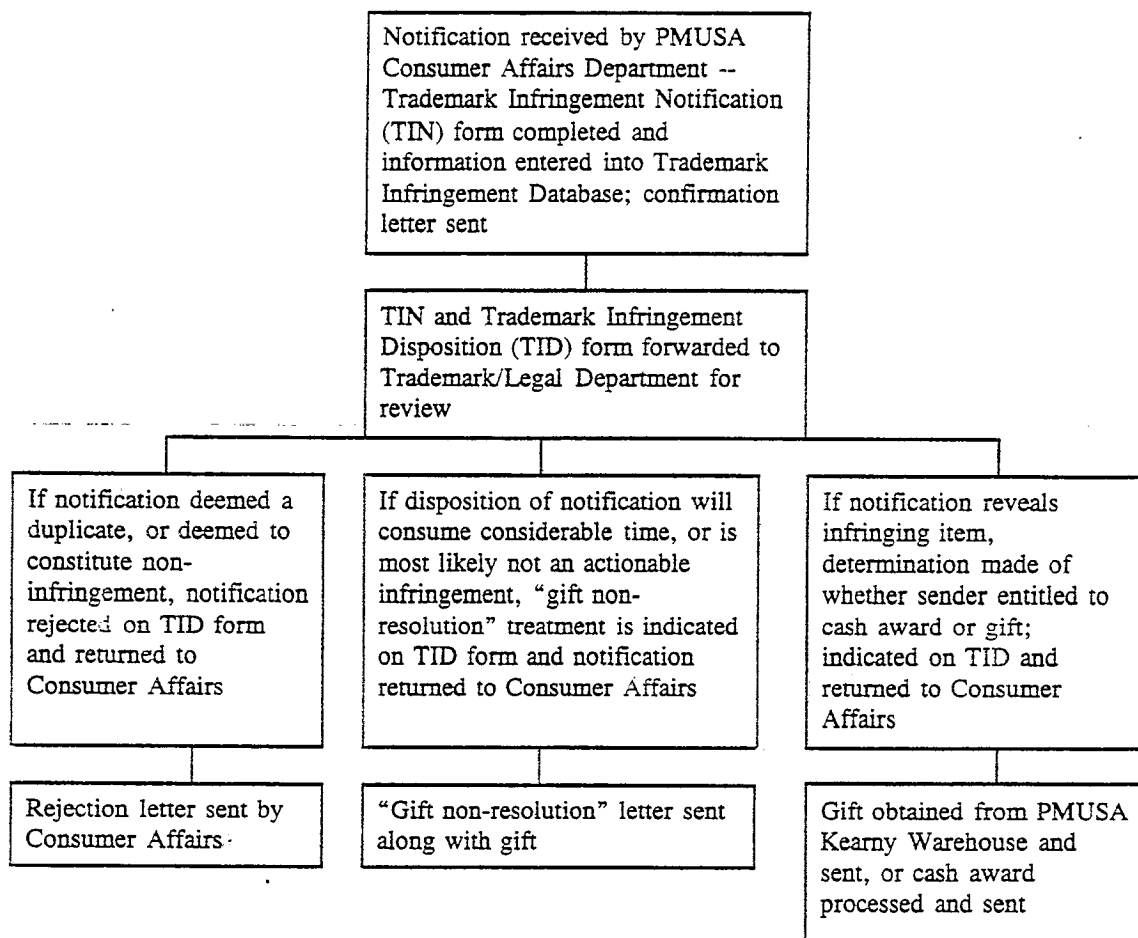
Limitations Only one gift per infringement may be awarded to any person, and one gift may be awarded per store in which an infringing product is identified.

We asked why PMUSA decided to announce this program to only three groups of participants that are relatively small in number when compared to the public at large. We were informed that this decision was based on two considerations. First, these three groups are highly attuned to Philip Morris brands in their role as the company's day-to-day contacts with retail merchants, or as loyal customers. Second, PMUSA expected that the trademark program would yield little, if any, material information concerning infringement with which it was not already familiar, and was concerned that if the program were announced to the general public, a negative consumer backlash might arise if a large number of people provided information in response to which no prize was awarded (because Philip Morris was already aware of the infringement, or because other customers had already reported the same product).

We reviewed copies of announcements and articles that appeared in (1) the April 4, 1996 edition of the Philip Morris Globe, in which PMUSA communicated the details of the Trademark Infringement Notification Program to its employees; (2) the Spring 1996 edition of the PM USA NewsLine, in which the company announced this program element to its employees and workload accounts; (3) the May/June 1996 edition of Smokers' Advocate, in which PMUSA's network of active consumers was informed about the program; and (4) the Fall 1996 edition of the PM USA NewsLine, in which the trademark program was summarized and the successful participation in the program of two Philip Morris employees was highlighted.

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We reviewed also the written procedures through which PMUSA processes notifications delivered to the company under this program. The process can be summarized as follows:



We met in New York on November 6, 1996 with the officials responsible for implementation of the trademark reward program. We were informed that, as of that date, the Consumer Affairs Department had received 26 notifications of potentially infringing products under the program. Of these, five notifications resulted in a \$100 cash award, nine notifications resulted in a gift reward, four notifications had been deemed non-qualifying, and eight notifications (or 31% of the total) were still under review by the Trademark/Legal Department. Of the five notifications for which a cash award was paid, three were submitted by PMUSA employees; of the nine notifications for which a gift was awarded, seven were submitted by PMUSA employees.

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PMUSA has provided an update on the status of the eight notifications that were pending on November 6, 1996. As of February 27, 1997, six of these notifications were still under review, and two had been resolved. PMUSA determined that no infringement occurred in these two cases, and therefore no awards were issued.

As an example of an identified infringement for which a cash reward was given, a PMUSA employee provided a copy of a "Personal Comforts" catalogue published by the Michigan Bulb Company. The catalogue contained two advertisements for products that purportedly remove nicotine and other additives from cigarettes. In one advertisement, for the "Phase-Out" system, a pack of PMUSA's Basic cigarettes was included in the photograph of the product. In the second advertisement, for a product called the "Nicotine Remover," the top of a pack of Marlboro cigarettes (including the distinctive "red roof" design and the Philip Morris corporate emblem) was included in the product illustration. In response to a cease-and-desist letter from PMUSA, the Senior Vice President and Chief Operating Officer of the Michigan Bulb Company informed PMUSA that the company's 1997 catalog (which would be introduced on January 1, 1997) would not include the advertisement that showed the Basic pack, and would include a revised version of the "Nicotine Remover" advertisement which would eliminate the Marlboro pack "resemblance."

Based on our review of these materials and our discussions with PMUSA personnel responsible for the trademark program, we are satisfied that the program is being implemented in a manner consistent with its original design. We would, however, appreciate being provided information regarding the final disposition of the six notifications of alleged infringement that were still being reviewed as of February 27, 1997.

It appears that the trademark program has not caused a significant increase in the number of unauthorized trademark uses that are reported to the company, and that, to date, no widespread infringement has been reported of which the company was not already aware. In view of the fact that trademark protection is an essential element of PMUSA's business, and a function to which the company devotes considerable resources, the relatively unremarkable results recorded to date under this program might simply reflect the fact that the company's pre-AAA efforts to combat trademark infringement already captured the majority of material infringements.

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We do not have a firm basis for making any findings with respect to this question. We would, however, be interested in learning if the scope or structure of the trademark program is changed in the future. (We had been informed at the commencement of the program that PMUSA would evaluate the program at three-month intervals and make revisions as necessary.) For example, if the program were expanded to include a broader group of eligible participants, and total notifications did not increase appreciably, this would lend further support to the proposition that PMUSA's efforts to defend its trademarks prior to the introduction of the AAA program had already created an environment in which trademark abuses directed at underage smokers would be relatively small in number. If, on the other hand, expanding the universe of program participants yielded a significant increase in the number of notifications, this would indicate that the initial program design was too limited in scope.

**G. Efforts to Support the Enactment of State
Legislation Relating to the Use of Tobacco
Products by Minors**

In this element of the AAA program, PMUSA agreed to support state legislation that would: (1) require the licensing of retail establishments that sell cigarettes, coupled with enforcement measures to identify and sanction retailers who sell cigarettes to minors; (2) prevent the purchase by minors of cigarettes from vending machines; (3) require that all cigarettes sold in retail establishments to which minors have access be within the line of sight of, or within the control of, a store clerk; and (4) require the posting of minimum age signs in all outlets that sell cigarettes.

We noted in our interim report that, as of June 10, 1996:

- Six states had enacted legislation;
- One state legislature had sent legislation to the Governor, who vetoed it;
- Eight states had failed to take final action on the legislation before the end of session;
- Two states had affirmatively voted against such legislation;

- Six states had legislation pending;
- Eight states did not convene sessions (or held "budget only" sessions) in 1996;
- Eight states held a session but no AAA-related legislation was introduced; and
- Eleven states had no AAA legislation introduced, or held no session in 1996, but had existing laws that contain the principal elements^{17/} of the AAA legislation.

Between June 10 and December 31, 1996, we interviewed state legislators in four states in which legislation was considered but failed -- Minnesota, Colorado, Arizona and Wisconsin -- and we interviewed PMUSA employees responsible for legislation in the following 18 states in which legislation was considered:

Alabama, Connecticut, Florida, Georgia, Hawaii, Idaho, Indiana, Kentucky, Massachusetts, Michigan, Missouri, Nebraska, Ohio, Pennsylvania, Rhode Island, South Carolina, West Virginia and Wisconsin.

We also interviewed representatives of retail organizations and anti-tobacco health organizations involved in legislation in many of these states.

The final results for state legislation, as of December 31, 1996, are as follows:

- Eight states enacted AAA legislation: Connecticut, Delaware, Georgia, Kansas, Kentucky, Rhode Island, South Carolina and Virginia;
- The Governor of Indiana vetoed legislation presented to him by the legislature;

^{17/} That is, they at least require retailer licensing, impose penalties against retailers for sales to minors, and contain proof of age and warning sign requirements.

- Fourteen states defeated or failed to complete action on AAA legislation: Alabama, Arizona, Colorado, Hawaii, Idaho, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, Ohio, Pennsylvania, Wisconsin and West Virginia;
- Eight states did not convene sessions (or held "budget only" sessions) in 1996: Louisiana, Maine, North Carolina, North Dakota, New Mexico, Nevada, Oregon and Texas;
- Eight states held a session but no AAA-related legislation was introduced: California, Illinois, Mississippi, Oklahoma, South Dakota, Tennessee, Utah and New Hampshire; and
- Eleven states had no AAA legislation introduced, or held no session last year, but had existing laws that contain the principal elements^{18/} of the AAA legislation: Arkansas, Alaska, Florida, Iowa, Maryland, Montana, New Jersey, New York, Vermont, Washington and Wyoming.

Our review of PMUSA's actions in the states of Delaware, Kansas and Virginia were included in our interim report.^{19/} This report will summarize our findings in the remaining states in which legislation either passed or was introduced but did not pass. We will then report our overall conclusions about PMUSA's AAA-related legislative activities during 1996.

1. State-By-State Results

Alabama

Legislation passed the Alabama House in 1996 which would have enacted a substantial portion of the AAA agenda. However, the legislation was not considered by the full Senate and died at the end of the 1996 session.

Findings. Current Alabama law does not require a specific license for the retail sale of tobacco, imposes fines of \$10-\$50 for illegal sales

^{18/} That is, they at least require retailer licensing, impose penalties against retailers for sales to minors, and contain proof of age and warning sign requirements.

^{19/} A copy of this section of the interim report is included at Exhibit H.

to minors (including the possibility of imprisonment or hard labor for 30 days), and authorizes localities to impose a "license tax" on vending machines. The House-passed legislation would have: (1) imposed a licensing requirement on all retail outlets selling cigarettes, (2) designated the Alabama Alcoholic Beverage Control Board (AABCB) as the agency responsible for regulating and enforcing laws prohibiting the sale of tobacco to minors, (3) granted the AABCB authority to conduct unannounced inspections of retailer compliance with the law, including the use of minors in such inspections, and (4) preempted local laws on the topic. An amendment on the House floor deleted the bill's earlier authority for the AABCB to revoke a license after a third or subsequent violation within a four-year period.

PMUSA representatives informed us that retail interests were opposed to most of the bill, and that legislation of this type has been a contentious issue between PMUSA and the retail community for the past three years. Despite numerous meetings on the topic, PMUSA was never able to obtain retailer agreement to any of the significant portions of the AAA agenda. The central area of retailer concern was authority for the AABCB to enforce the rules and conduct compliance checks, although retail interests were also responsible for deletion of the license revocation provisions. When the legislation appeared stalled in the Senate, PMUSA discussed deleting the uniformity language in exchange for local government support for the legislation. However, this trade-off still would not have produced sufficient votes to pass the legislation in the Senate, and the legislation died there when the 1996 session adjourned.

Analysis. PMUSA took direct actions in this state to enact a substantial portion of the AAA agenda. However, the opposition of retail organizations proved insurmountable, even after PMUSA considered dropping uniformity provisions in order to obtain additional votes. In the face of a majority of Alabama Senators opposing the legislation, PMUSA took all actions within reason to attempt to enact the bill.

Arizona

Legislation in this state was particularly noteworthy because: (1) comprehensive AAA legislation was introduced and passed in the Senate, (2) the legislation was reported to the floor by the relevant House committees, but (3) the Speaker of the Arizona House refused to let the legislation come to final consideration on the House floor, and the legislation died. We traveled to

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Arizona and interviewed PMUSA representatives, representatives of retail interests, and the House and Senate sponsors of the AAA legislation.

Findings. Current Arizona law contains only penalties for sales to minors. Despite retail-community concern over excessive regulation, legislation was introduced in the Arizona Senate with tobacco and retail industry support which: (1) imposed a licensing requirement on the sale of tobacco, (2) included authority for the suspension or revocation of this license after three or more instances of illegal sales to minors, (3) required proof of age for persons appearing under 18 years of age, (4) gave the Department of Liquor Licenses and Control authority to use minors in unannounced inspections, and (5) required vending machines to be either supervised, located in premises inaccessible to minors, or equipped with lock-out devices. Finally, the bill contained a preemption provision, but allowed local governments to prohibit smoking in any place of public accommodation except a bar and exempted from state preemption any local ordinance enacted before January 1, 1996 and any ordinance enacted by initiative on or before April 1, 1996.

Local units of government and anti-smoking organizations were the principal opponents of the legislation. Their opposition contributed to the close vote on final passage in the Senate (16-14). Both sponsors of the legislation (Sen. Tom Patterson and Rep. Pat Conner) objected to characterizations of the bill as "pro-tobacco" when in fact it imposed substantial restrictions on youth access to cigarettes. In particular, the sponsors believed that the licensing regime gave the state substantial new tools to detect and punish retailers who sold cigarettes to minors. House sponsor Pat Conner credited Senate sponsor Tom Patterson, a physician and formerly Majority Leader of the Senate, with moving the legislation through the Senate and giving it strong momentum in the House.

When the bill was eligible for House floor consideration, the Speaker of the House refused to allow it to be considered, even though (according to Rep. Conner) there was a clear majority of support for the legislation. Both Rep. Conner and Sen. Patterson told us that the Speaker was lobbied by anti-smoking groups and local government representatives (including the Mayor of Phoenix) to kill the bill because of its preemption provisions. Rep. Conner and Sen. Patterson had two meetings with the Speaker in an attempt to change his mind, and they proposed changes -- including the offer of deleting the preemption language -- which the Speaker refused to accept. We were informed by a number of persons that some of the factors contributing to his opposition were his personal objection to smoking and the domination of the

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district he represented by the city of Mesa, which had previously enacted a strict local smoking ban (even though the legislation grandfathered the Mesa ordinance).

Rep. Conner and Sen. Patterson informed us that PMUSA was a sincere and active member of the coalition supporting the legislation, and even supported the final offer of deleting preemption (although each stressed the importance of uniformity in a state with 100 units of local government.) The bill sponsors criticized the media and anti-smoking organizations for describing the legislation as a "pro-tobacco" bill when in fact it would have reduced youth access to cigarettes, and they found it ironic that the Speaker received credit for being anti-smoking when he defeated an anti-smoking bill.

The only criticism we heard of PMUSA came from retail interests, who stated that, in hindsight, PMUSA and the other tobacco companies should have stayed further in the background, knowing that anti-tobacco groups would criticize any bill supported by the tobacco industry. Sen. Patterson observed that he had been criticized by other physicians for sponsoring the bill, but when he read the provisions to them their criticism usually evaporated. He was particularly critical of the positions taken by anti-tobacco organizations that had opposed the legislation, because he viewed them as crucial to the defeat of a bill that would have made substantial improvements in Arizona's ability to curb youth smoking.

Analysis. In Arizona, retail and tobacco interests supported a comprehensive legislative scheme to deter youth access to cigarettes, but this legislation was defeated when opponents labeled it "pro-tobacco." While PMUSA's strategy of playing such a visible role might be questioned, PMUSA ideally would be encouraged to support meaningful legislation without fear of political retribution. While state uniformity laws are not essential to deter youth access to cigarettes, they are reasonable in a state with comprehensive AAA legislation, and in Arizona the local preemption was moderate, prospective only, and apparently still a viable option if the Speaker of the House had relented. In short, PMUSA acted reasonably and consistently to achieve its AAA legislative objectives.

Colorado

A comprehensive AAA bill (which included licensing and license-revocation provisions) was introduced and approved by a Senate Committee,

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but was defeated before final Senate action in the wake of fierce public criticism by anti-tobacco organizations.

Findings. Existing Colorado law includes penalties for underage sales, proof of age requirements, an affirmative defense upon such proof, warning sign requirements, and "constant supervision" rules for vending machines. The 1996 legislation was introduced by Senator Al Meiklejohn (R), chairman of the Senate Business Affairs Committee. It contained the following provisions: (1) enhanced penalties against persons committing second or subsequent offenses; (2) a licensing requirement for the retail sale of tobacco products, the revenues from which would be used for enforcement of the legislation by the Liquor Enforcement Division; (3) license suspension upon a fourth violation in a two-year period of underage tobacco sale rules, and license revocation upon a fifth violation in a two-year period of underage tobacco sale rules; (4) authority for the Liquor Enforcement Division to conduct unannounced inspections, and to enlist minors to test compliance with the underage sale rules; and (5) preemption of local laws.

According to a PMUSA government affairs consultant, retail associations^{20/} were the key public backers of the legislation, and the tobacco industry provided support in a less visible manner. The final legislation was introduced late in the session (Colorado's term is only 120 days) -- largely because the retail groups spent a substantial amount of time negotiating its text. While the result was a comprehensive licensing, penalty and enforcement scheme, the late introduction gave proponents little time to respond to the many criticisms of the bill and undercut support for the legislation. A coalition of anti-tobacco organizations opposed the legislation, primarily because of the preemption provision."^{21/} This consultant noted also that the retail community had a number of priority items on their legislative agenda, and that the AAA legislation did not receive the support necessary to counteract the fierce assault from anti-tobacco organizations.

^{20/} These associations included the Colorado Retail Council, the Colorado Petroleum Marketers & Convenience Store Association, the Rocky Mountain Food Dealers Association and the Rocky Mountain Oil & Gas Association.

^{21/} The coalition included the American Cancer Society-Colorado Division, American Lung Association of Colorado, American Heart Association of Colorado, Colorado Medical Society, Colorado Hospital Association, and GASP. See Coalition Flyer at Exhibit I.

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PMUSA moved in to fill the vacuum, but this strategy had some political risk, and the anti-tobacco groups were able to label the bill a "tobacco bill" in its lobbying efforts to defeat it. While a slim margin in support of the bill existed on the Senate floor initially, the lobbying campaign against it likely placed its support at slightly less than a majority. Therefore, when the bill was reported from the Business Affairs Committee to the Appropriations Committee (required because of the bill's revenue raising provision), and because Colorado law requires a vote on all legislation introduced, the Appropriations Committee defeated the bill in order to avoid a Senate floor fight of which the outcome was uncertain.

Senator Al Meiklejohn observed that anti-tobacco organizations "terribly misrepresented" the bill to the media, which nonetheless reported each allegation. The anti-tobacco groups created an "hysteria" in the media, according to Meiklejohn, and the lateness of the session provided him with insufficient time to "educate my colleagues about the bill," which he characterized as being "100 times more effective than current Colorado law" in preventing youth access to cigarettes. However, anti-tobacco organizations claimed that the legislation "let merchants off the hook," and he noted that they particularly focused on the local preemption provisions of the legislation.^{22/}

Senator Meiklejohn told us that, in the wake of this barrage of criticism, he was not certain that a majority of Senators supported the bill. In order to avoid forcing his colleagues to vote for legislation that their opponents would brand as a "tobacco bill" without the assurance that it would pass, he asked the chairman of the Appropriations Committee not to send the bill to the floor. We asked whether deleting the uniformity provision would have provided the margin of victory (a tactic that PMUSA representatives informed us that PMUSA had suggested). Senator Meiklejohn responded that while this tactic might have provided the margin of victory in the Senate, it also would have alienated the retail community and doomed the bill's chances in the House.

Senator Meiklejohn did not have any direct contact with Philip Morris during this process. However, he stated that he and his colleagues were aware that the tobacco industry supported the bill, and he understood that PMUSA had supported and worked for passage of the legislation. He saved his

^{22/} One example he gave of misrepresentation of his bill was a claim that the bill would preempt Boulder local ordinances prohibiting smoking in certain public places.

critical comments for anti-tobacco organizations, which he saw as dividing into two camps: (1) true ideological opponents of any form of smoking, and (2) others who have an economic interest in maintaining the anti-smoking issue (either from private fundraising or federal funding).

Analysis. PMUSA's efforts were consistent with its commitment to advance comprehensive AAA legislation. The legislation introduced included licensing and license revocation, and PMUSA worked with retail interests in promoting the bill in the Colorado legislature (and even suggested deleting the local preemption provision in an attempt to obtain passage). Responsibility for the defeat of the legislation appears to lie squarely in the hands of anti-tobacco organizations. While criticism might be in order for the late introduction of the legislation, the retail community appears to share at least equal blame for the time delay. We believe that PMUSA made a politically reasonable choice to let the retail community take the lead public advocacy role.

Connecticut

Findings. Legislation in this state is noteworthy because it resulted in a new law that: (1) created new authority for tobacco license suspension and required such suspension after a third violation, (2) substantially expanded the class of persons liable and raised the fine amount (from \$50-100 to \$100-\$500) in the event of an underage tobacco sale, (3) strengthened existing warning sign requirements, (4) required annual reports from the Commissioner of Revenue Services on the retailer compliance and the results of unannounced retailer inspections, (5) placed substantial new restrictions on vending machine sales of cigarettes, including the requirement of a face-to-face interaction or display of identification with an adult supervisor before the vending machine may be activated and (6) restricted sampling to areas/events that are inaccessible to minors and required all cigarettes to be maintained in original manufacturer's packaging (with warning labels).

The legislation was the product of a negotiation facilitated by the office of Connecticut Governor John Rowland. Competing legislation was being advanced by: (1) retail organizations and tobacco manufacturers and (2) anti-tobacco organizations. Connecticut has a bicameral committee system (making conference committees unnecessary), and the legislation was debated and perfected at the committee level. The retail community objected to line-of-sight provisions, which ultimately were not included in the bill. However, retail interests agreed to the enhanced penalty structure and concurred that, after the third violation, license suspension was appropriate.

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According to PMUSA representatives who were part of the negotiating coalition and spoke directly with state legislators, the most contentious issue involved the enhanced restrictions on vending machines, on which PMUSA did not take a position. While retail and tobacco interests asked for a provision preempting local laws in the early stages of the negotiation, this request met with strong resistance and the legislation was approved without any language on this point (existing law explicitly allows local government to impose stricter rules on vending machines).

Anti-tobacco organizations supported a stricter bill, which included a total vending machine ban and harsher license revocation provisions. Nonetheless, all sides agreed that the resulting compromise was worthy of support, and the bill was approved in committee and on the floor of each House by unanimous or near-unanimous votes. The Governor signed the legislation on June 6, 1996.

Analysis. Connecticut's consideration of AAA legislation appears to be a model of "good government." While each side requested provisions that the other side found unacceptable (e.g., uniformity, vending machine bans, stricter license revocation), a constructive negotiating climate was created by the Governor's office and interested state legislators, such that each side remained at the bargaining table and ultimately agreed to compromise legislation. PMUSA was a constructive participant in this process, which resulted in substantial additions to Connecticut law consistent with the AAA agenda.

Florida

Florida is a difficult state to categorize because of the broad reach of existing law. Current Florida law: (1) requires tobacco retailers to be licensed, (2) imposes penalties on persons selling to minors, (3) subjects licenses to revocation for repeat violations, (4) provides an affirmative defense to retailers if identification is checked, (5) requires warning signs in retail outlets, (6) gives authority for unannounced retail inspections to the Division of Alcoholic Beverages & Tobacco, (7) requires vending machines to be in a supervisor's unobstructed line of sight and (8) prohibits the sale of single or loose cigarettes. PMUSA representatives informed us that they publicly supported the legislation that enacted these requirements approximately four years ago.

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Findings. Legislation was introduced in Florida in 1996 which: (1) imposed penalties on minors who attempted to purchase tobacco products, including the possibility of driver's license suspension, and (2) allowed vending machines to be operated if they were equipped with lock-out devices. PMUSA representatives informed us that they publicly commented in favor of the legislation but did not actively support it, given the narrow range of issues it addressed. PMUSA will attempt to secure enactment during 1997 of the remaining aspect of the AAA agenda that Florida has not adopted: line-of-sight requirements.

Analysis. Because Florida already contains a large majority of the AAA agenda on its books, it was reasonable for PMUSA to concentrate its resources on other states during 1996.

Georgia

Georgia enacted legislation containing certain AAA provisions in 1996.

Findings. Prior Georgia law required the licensing of tobacco retailers by the Commissioner of Revenue (but contained no revocation authority), imposed misdemeanor penalties on underage tobacco sales, required warning signs, authorized unannounced inspections by the Department of Public Safety (in conjunction with local police), and required the registration of vending machines and their placement in areas inaccessible to minors. The 1996 additions to the Georgia law were not substantial: (1) creation of a duty on the part of any retailer who would reasonably doubt whether a cigarette purchaser is 18 years of age to request and review proper identification, and (2) creation of an inference that a retailer knowingly sold tobacco products to a minor if he or she failed to request identification from a person who is proven to be under 18.

PMUSA representatives informed us that the bill was supported by the retail community and tobacco manufacturers. PMUSA proposed adding license revocation and line-of-sight provisions to the legislation, but the retail community objected to both items and other tobacco manufacturers objected to line-of-sight requirements. Therefore, these provisions were not included. The legislation moved swiftly through House committees, passed the full House by a 91-4 vote, was reported by the Senate Judiciary Committee and then approved by the full Senate by a vote of 40-0. From nearly the beginning of its consideration, the state Lung Association supported the bill (the Heart and

Cancer associations were only tangentially involved in the process). Georgia law does not have a state uniformity rule. On April 2, 1996, Governor Zell Miller signed the legislation.

PMUSA representatives noted that the licensing requirement and the unannounced inspection authority were enacted in 1993, and that while this was before announcement of the AAA initiative, PMUSA nonetheless supported addition of these provisions to Georgia law.

Analysis. While this is one of the least comprehensive AAA bills enacted in 1996, proof-of-age requirements (and the penalty-related incentives to obtain such proof) are significant additions to Georgia law. The legislation received nearly unanimous support within the legislature and little outside opposition. PMUSA requested that license revocation and line of sight be added to the legislation, but retail organizations and other tobacco manufacturers objected. The decision to move forward without these provisions was a reasonable exercise of strategic legislative judgment, particularly given the fact that no preemption provision was included. In addition, PMUSA's support for licensing requirements and unannounced inspection authority in 1993 should be noted. In short, PMUSA acted consistently with its AAA objectives in Georgia.

Hawaii

Comprehensive legislation was considered in this state but did not pass.

Findings. Current Hawaii law has no effective licensing requirement for retailers, but imposes penalties for sale to minors, penalizes minors who purchase tobacco products, requires warning signs and restricts vending machines to places that prohibit minors. Legislation reported by the Senate Consumer Protection Committee contained the following provisions: (1) retail licensing requirements administered by the state Liquor Commission, (2) retention of the license fee by the Commission to offset its enforcement costs, (3) authority for the Commission to refuse to grant or renew a license for "substantial violations" of underage sale rules during the previous year, (4) requirement that proof of age be displayed if purchaser appears to be under 18, (5) requirement that the license and a warning sign be posted, (6) creation of unannounced retail inspection authority (with no explicit permission for or denial of right to use minors), (7) existing vending machines must have lock-out devices and be under constant supervision, (8) retailer must maintain cigarettes

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within line of sight of cashier or other employee and (9) no sale permitted of single cigarettes, or cigarettes not in their original packaging.

This comprehensive legislation was not moved in the House, largely because of opposition from anti-tobacco organizations. However, a House bill supported by the state Liquor Commission which contained licensing requirements only was adopted and sent to the Senate. The Senate chose to take up the comprehensive industry bill (allowing the House-passed bill to die in committee). This bill was reported by the committee to the full Senate, but this occurred somewhat late in the session and failed to receive action by the full Senate before the "crossover deadline" for House consideration. It therefore died at that point.

PMUSA representatives believe that sufficient votes existed in the Senate to pass the legislation, although the vote could have been close. The bill died in the Senate not because of opposition by any particular organization, but because of year-end political battles over other legislative issues (in particular, debate on legislation regarding Hawaii's "same sex marriage" law). The distraction of controversial bills late in the session doomed a number of bills (of which the AAA bill was only one) to inattention by the end of the 1996 session.

Analysis. This legislation was perhaps the most comprehensive in the nation, containing licensing requirements, authority for license revocation, and line-of-sight requirements, and did not contain local preemption. PMUSA clearly achieved its goal of obtaining introduction of comprehensive AAA legislation; it was unfortunate that other legislative initiatives prevented complete action on it. We expect that Hawaii would be a prime target for activity on AAA legislation in the next session of the legislature.

Idaho

Legislation was considered by the Idaho legislature in 1996 but did not pass.

Findings. Current Idaho law requires tobacco retailers to obtain a license from the state tax commission, provides fines for sales to minors of up to \$100 for the first offense and \$300 or six months in jail for second or subsequent offenses, and restricts vending machines to places that are inaccessible to minors. Legislation supported by the retail and tobacco industries was introduced and passed by the Idaho House which: (1) amended the fine structure to impose misdemeanor penalties on any person who sells or

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distributes cigarettes to minors, (2) created an affirmative defense for retailers who requested proof of age from a tobacco purchaser, (3) created unannounced inspection authority (with use of minors authorized) in the Department of Law Enforcement, through use of local law enforcement officers, (4) required cigarettes to be in the original manufacturer packaging and (5) preempted local laws on the topic.

PMUSA representatives informed us that they met in late 1995 with retail interests and proposed including license revocation, line of sight, and signage requirements in the legislation. The retail community was strongly opposed to each provision, and PMUSA concluded that it could not pass legislation in this generally retailer-sympathetic body in the face of their opposition. PMUSA joined with the retail industry in support of the introduced legislation.

When the bill was taken up on the House floor, an amendment was added to provide local governments with the authority to pass laws that are more stringent than the state rule. When the bill was sent to the Senate, the Senate State Affairs committee removed the local authority provision, and the full Senate then passed the committee version of the bill and returned the bill to the House with one day left in the session. However, the House leadership refused to schedule a concurrence vote, and the legislation died at the end of the 1996 session. PMUSA representatives attribute the defeat of this legislation to a combination of anti-tobacco-group opposition and retail-community ambivalence toward a bill without local preemption.

Analysis. This is a difficult state to assess. Given the apparent sympathy that business interests enjoy generally in Idaho, PMUSA cannot be faulted for adopting a strategy that deferred to retail opposition to license-revocation authority. Nonetheless, the legislation did not possess much meat on its bones, and thus even signage requirements were not included. PMUSA did not take a rigid position regarding the existence of uniformity language, which was deleted by the full House and ultimately not insisted upon by the full Senate, so this legislation does not fall into the troubling category of "weak laws, preempted localities." The legislation appears to have failed because no majority was committed to working through the differing Senate and House positions on issues such as local preemption when legislative time was running out. PMUSA's actions in the next session of the Idaho legislature are critical to our developing a final AAA verdict on this state.

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Indiana.

Findings. The legislative events here were unique: Indiana was the only state where a legislature passed a bill, PMUSA did not work in support of the bill, and the Governor vetoed the legislation.

Current Indiana law does not have any licensing rules, but it does impose up to \$500 in fines for sales to minors, require warning signs, and restrict vending machines to places to which minors do not have access.

PMUSA proposed that retail organizations join them in introducing a comprehensive AAA bill. However, retailers refused to accept any licensing regime and stated their interest in repealing local licensing in Marion County (in which Indianapolis is located). Thus, the legislation that was ultimately introduced provided only for unannounced inspections conducted by the Indiana Division of Mental Health (with explicit prohibitions on the use of minors in such inspections), and preempted local laws regarding the sale, distribution or display of tobacco products. In conference committee, the bill was amended to exempt "transient" merchants from the bill's rules and to prohibit "tobacco only" stores and tobacco billboards from within 200 feet of any school. The conference version was passed 55-40 in the House but by only 26-23 in the Senate, and Governor Bayh vetoed the legislation on March 19, 1996. In his veto statement, the Governor criticized the preemption of local laws and the general weakness of the anti-youth-access provisions in the bill. The veto was not overridden in 1996, but it was overridden on February 11, 1997.

PMUSA representatives informed us that, when the retail organizations refused to include other important aspects of the AAA agenda and decided to advance the bill nonetheless, its Indiana lobbyists were ordered to "lie low" and not work on the bill as it moved through the legislative process. A PMUSA representative was officially quoted as saying that PMUSA "neither supports nor opposes" the legislation, and we were informed that PMUSA was "not disappointed" that the Governor vetoed the legislation. Anti-tobacco organizations opposed the legislation and applauded the Governor's veto, and retail organizations strongly defended the legislation.

Analysis. PMUSA's efforts to advance the AAA agenda in this state were rebuffed by the retail community. Once this occurred, PMUSA expended no resources to support or enact legislation, nor did it criticize the Governor's veto. This would appear consistent with the AAA objective of

enacting meaningful reforms of state youth access laws. Given the Indiana bill's failure to enact a licensing regime, and given its resultingly tepid additions to current Indiana law (only unannounced inspection authority was added, with a specific prohibition on the use of minors), it was reasonable for PMUSA not to oppose the Governor's veto. Preempting a local government from imposing a license regime, given this fact situation, would appear more harmful than helpful in reducing youth access to tobacco products.

The only remaining question is, should PMUSA have done more to address the weaknesses in the 1996 Indiana legislation? We were informed that Indiana retail organizations were unyielding in their opposition. In other states where a tobacco-retailer impasse occurred, the typical result was that no legislation was introduced. In this state, the retailers were determined to move forward, and PMUSA decided to distance itself from the bill. Given these political circumstances, PMUSA does not appear deserving of criticism, but rather of continued scrutiny of its activities during subsequent sessions of the Indiana legislature. Even though the legislature overrode the Governor's veto early in 1997, additional legislative opportunities to improve anti-youth-access laws are likely to present themselves in the coming sessions, and PMUSA should be attentive to them.

Kentucky

Legislation in this state is noteworthy because it resulted in a new youth access law in Kentucky.

Findings. The Kentucky legislation did not contain a licensing provision because the retail community was adamantly opposed. Instead, it: (1) increased existing fines for selling cigarettes to minors or failing to post warning signage,^{23/} (2) imposed fines on minors who attempted to purchase tobacco products, (3) required any person issuing free samples of tobacco products to obtain proof of age from persons appearing to be underage, (4) increased existing fines against retail establishments that failed to comply with vending machine line of sight requirements and (5) required proof of age from any person attempting to buy cigarettes who appears under 18 years of age.

^{23/} First offense penalties were increased from \$10-25 to \$100-500, second and subsequent offenses were increased from \$25-50 to \$500-1,000. New KRS 438.310(4).

PMUSA representatives informed us that the Kentucky Farm Bureau agreed to lead a coalition of retail organizations and the tobacco industry in support of the legislation. In drafting the legislation, PMUSA suggested that retailer licensing be included, but retail organizations adamantly objected and stated that they would oppose the bill if it contained such a provision. In addition to the provisions described above, a line-of-sight provision was also included. This coalition then met with the Governor of Kentucky, presented the proposal, and obtained his support. Subsequently, some members of the tobacco industry (not including PMUSA) objected to the line-of-sight provisions on intra-industry competition grounds. Thus, when the bill was reported out of Senate committee, an amendment deleting the line-of-sight language was adopted. PMUSA decided not to oppose this amendment because of the political strength of the other tobacco companies in Kentucky.

The legislation faced little opposition in the Kentucky Senate or House. No significant amendments were offered, and none other than the line-of-sight deletion was adopted. While anti-tobacco organizations criticized the legislation as not going far enough, their strength was not sufficient to amend or defeat the legislation. Uniform tobacco regulations are already a feature of state law, and anti-tobacco organizations made no attempt to repeal it. The legislation was signed by Governor Paul Patton (D) on March 5, 1996.

Analysis. PMUSA appears to have achieved as much of its AAA agenda as was politically possible in Kentucky. Company representatives suggested the inclusion of licensing and almost obtained the inclusion of line-of-sight requirements. When it became impossible to achieve those objectives, PMUSA supported legislation that strengthened existing enforcement regimes. Given that retail opposition to licensing appears firm and commanding of a legislative majority in Kentucky for the time being, PMUSA's actions were rational. However, preemption of local laws when no licensing regime is in place is not helpful to the anti-youth-access mission, and this state should remain on PMUSA's "unfinished business" list for 1997.

Massachusetts

Legislation was considered in Massachusetts during 1995-96 but no final action was taken.

Findings. Current Massachusetts law requires State Department of Revenue licensing of tobacco retailers, allows local units of government to require a local retail tobacco license, prohibits license renewal (required every

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two years) if a retailer has committed four violations of underage tobacco sale laws in a three-year period, imposes graduated penalties (beginning at \$100) for sale to underage persons and requires that the state tobacco sale law be posted in retail outlets.

Legislation passed the Massachusetts House which: (1) required local (city or town) board of health licensing of tobacco retailers, (2) provided local boards of health with authority to impose graduated fines similar to current law for violations, (3) authorized local boards of health to suspend local tobacco licenses in the event of three violations in a one-year period, (4) established explicit proof-of-age provisions, (5) required tobacco retail employees to be trained in "the legal sale of tobacco products," (6) authorized retailer inspections by local boards of health, (7) required retailers to post plain-language warning signs, (8) outlawed self-service tobacco displays not located within 10 feet of a checkout counter or in the plain view of the clerk and (9) explicitly allowed localities to pass additional ordinances on this topic. State penalties were preempted if a local government action was commenced.

The legislation was drafted and supported by retail interests, with the support of PMUSA. Retail organizations took the leading role in seeking passage, given the level of political hostility in Massachusetts to tobacco interests. While supporters of the legislation favored a local preemption rule, particularly given the level of local anti-tobacco activity in Massachusetts, there were not sufficient votes in the House to approve such a provision. Nonetheless, the retail organizations allowed the bill to pass the House because they believed that the Senate might be willing to include preemption. However, as the session neared its end in 1996, it became apparent that there were not sufficient votes in the Senate for outright preemption of local rules. The legislation died in the Ways & Means Committee at the end of the 1996 session. PMUSA concurred with retail interests that legislation with explicit authority for additional local regulation was not worthy of passage, because it would simply perpetuate the current system of proliferating, and widely varying, tobacco regulations at the local level.

PMUSA representatives informed us, however, that they intend to sponsor legislation in 1997 with generally the same AAA provisions, plus a compromise on local preemption that would: (1) allow elected local governmental entities (such as city councils) to enact laws in addition to the state statute, but (2) preempt the authority of non-elected local regulatory bodies from promulgating additional regulations on the topic. Retail interests and

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PMUSA also intend to engage the major health associations in negotiations to develop an acceptable version of the legislation.^{24/}

Analysis. PMUSA supported legislation in this state that contained most of the main AAA components -- including line-of-sight, a particular achievement given the retail-community opposition in other states. However, the legislation faltered when retailers refused to advance the legislation without preemption of local laws or regulations. It is apparent that the Massachusetts political climate is not favorable to AAA legislation if only tobacco manufacturers support it. Therefore, PMUSA's acquiescence to the retail-community position on the 1996 House-passed bill, and its strategy for enacting similar legislation in 1997, appears reasonable. Further, given the comprehensive nature of the legislation, insistence on some level of state uniformity was not an unreasonable position for PMUSA to take.

Michigan

The Michigan House and Senate passed legislation containing various AAA initiatives, but the bill died in a conference committee at the end of the 1996 session.

Findings. Current Michigan law prohibits the sale of tobacco products to minors (\$50 fine), requires the posting of warning signs in retail outlets, restricts vending machines to places that are inaccessible to minors and prohibits sales of cigarettes separate from their original package. Additionally, state law prohibits local restrictions on the sale or licensure of tobacco products, a provision enacted as part of a compromise that enabled a public referendum proposing to raise excise taxes on cigarettes to be placed on the ballot (which tax was subsequently approved).

Legislation was introduced in early 1995 and considered in 1996 which would have: (1) increased fines for underage sales to a graduated series of \$100, \$150 and \$500 penalties (within a two-year period), (2) required cigarette products at retail locations to be within the line of sight of the clerk or supervisor, (3) created an affirmative defense to the penalties if a retailer examined proof of age or if a retailer has a written policy for employees

^{24/} For example, PMUSA representatives informed us that some anti-tobacco organizations also opposed the line-of-sight provisions in the legislation because they detract from their proposal to allow the sale of tobacco products only from locked cases or containers.

specifying how to avoid underage sales and that policy has been and continues to be enforced, (4) provided unannounced retailer inspection authority, with the right to use minors in such inspections, for the Department of Public Health and (5) prohibited sales of cigarettes separate from their package or in packs of less than 20.

Licensing provisions were not included because of objection from the retail community. The Governor also stated his objection to licensing. When the above legislation was reported to the full House, an amendment was adopted that repealed the local preemption provisions of current law. The bill was then sent to the Senate, which refused to concur with the House bill and requested a conference. The Senate objected to the repeal of uniformity, in large part because the Senate was the body responsible for the earlier agreement to increase cigarette excise taxes and impose statewide uniformity on the sale or licensure of tobacco products. No conference committee agreement was reached and the bill died with the end of the 1996 session.

PMUSA representatives informed us that a near stalemate exists in this state that does not bode well for passage of AAA legislation in the near future. The uniformity law was recently imposed as part of a legislative agreement allowing a public referendum on increasing tobacco excise taxes, and PMUSA will not unilaterally reopen this previous political compromise. Conversely, retail interests and Michigan Governor John Engler are adamantly opposed to licensing, despite PMUSA's public support of this measure. No legislation is likely to be successful if the current rigidity of positions on licensing (by retailers) and deletion of uniformity (by anti-tobacco organizations) persists.

Analysis. In this difficult situation, PMUSA accomplished about as much as was reasonably achievable. It stated its support for inclusion of licensing in combination with other AAA measures but is not likely to overturn strong retailer and other opposition to this provision. While we would normally be skeptical of insisting on uniformity in legislation that does not contain licensing, the history of the excise tax debate in Michigan cannot be disregarded and uniformity can be reasonably viewed as a political reality -- at least for the immediate future. Therefore, it would be understandable if legislation in this state were not given priority during the 1997 session.

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Minnesota

Despite the fact that a comprehensive AAA bill was introduced and reported out of House committee, defeat of the bill's "uniformity" provision through aggressive lobbying by anti-tobacco organizations caused such objection from the retail community that the bill's sponsor pulled the bill from further consideration.

Findings. In May 1995, prior to PMUSA's announcement of the AAA program, legislation passed the Minnesota Senate which: (1) authorized local governments to license tobacco retailers, (2) imposed graduated penalties against tobacco licensees or their employees for sale of tobacco products to persons under 18, (3) required suspension of the license if a third violation occurred within a 24-month period, (4) provided an affirmative defense to the penalties if a licensee reasonably relied on documentary proof of age, (5) required unannounced inspections of all tobacco licensees at least once every two years and (6) imposed signage and training requirements on tobacco licensees. The Senate bill did not preempt local laws in these areas.

In February 1996, the House Commerce Committee approved the Senate bill, with the following changes: (1) local authorities would be required to license tobacco retailers, (2) retailers must display tobacco products "within the line of sight and immediate vicinity of a cashier or other employee" and (3) local rules or ordinances on this subject would be preempted, except when a retailer commits a fourth violation in a two-year period, or if the rule or ordinance was in effect prior to the date of enactment of this bill. An attempt to delete the local preemption language was defeated in committee by a vote of 14-12.

After the House Commerce Committee approved the legislation, an amendment to delete the uniformity provision was proposed on the House floor. After substantial lobbying by anti-tobacco organizations, this amendment passed by a vote of 76-54. Retail interests opposed this change, and the bill's sponsor, Representative Loren Jennings (D), withdrew the bill from consideration. While attempts were made after this point to find support for a compromise position, and while PMUSA employees and representatives informed us that PMUSA suggested that the legislation be allowed to advance without the preemption provision, no compromise was reached.

In a personal interview we conducted, Rep. Jennings commended the retail community for supporting a comprehensive bill to deter youth access

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to cigarettes -- including licensing, license revocation, unannounced inspection authority, and line-of-sight requirements. While Jennings viewed the tobacco industry as "reluctant" supporters of the legislation, he noted that PMUSA was more supportive than the rest of the industry and did publicly and actively advocate passage of the legislation. Jennings thought the legislation was a "good, tough" bill that could have serious consequences for noncompliant retailers. He viewed the local preemption provision as essential.^{25/} He believed that the bill that emerged from the House Commerce was so tough that additional local enforcement was not necessary. Nonetheless, he agreed to grandfather existing local ordinances, and allow localities to reassert their jurisdiction after the fourth violation within two years by a retailer.

After the local preemption provision was deleted by the full House, Rep. Jennings canvassed Members to determine whether reconsideration of the amendment was possible. He concluded that reconsideration would not change the result, so he decided not to pursue the bill further during 1996 because of the inordinate burden it would place on the retail community -- particularly smaller stores. He was contacted by some legislators and interest group representatives proposing the option of allowing the bill to move forward and attempting to resolve the local preemption issue in conference committee. However, Rep. Jennings chose not to do so because the Senate version also did not preempt local laws, and he did not believe he could obtain successful resolution of the issue if both bills failed to preempt local laws. He informed us that Philip Morris representatives appeared disappointed by his withdrawal of the bill and appeared willing to allow the legislation to move forward despite the defeat of preemption.

Rep. Jennings blamed the bill's demise on: (1) the need of anti-tobacco organizations to be able to target localities for anti-tobacco activity, and thus their opposition to preemption, and (2) his belief that Minnesota Attorney General Hubert H. Humphrey III "played politics" with the anti-smoking issue. He stated that Humphrey was "doing a disservice to youth" by opposing local preemption in order to obtain the support of these organizations for his other political aspirations. Jennings encouraged retail and tobacco interests to expand their educational efforts next year to counter "largely unfounded" criticisms of the legislation, but was skeptical about the chances for passage of the bill in the future if the Attorney General remains a vocal opponent.

^{25/} There are 1,200 units of local government in Minnesota. Rep. Jennings noted, "how does a policeman enforce the laws, and how does the owner of a chain store train his employees, if we do not preempt local laws?"

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Analysis. PMUSA appears to have made every attempt to obtain enactment of a comprehensive AAA bill in Minnesota, and failed to do so for reasons entirely beyond its control. The sponsor of the legislation viewed PMUSA as "sincere" in its support of the legislation, and even noted that PMUSA did not object to moving forward without local preemption -- a position that Rep. Jennings believed was unfair to retail interests. The legislation included a line-of-sight requirement, which was politically unobtainable in many other states that considered legislation during 1995-1996. In short, PMUSA worked earnestly to obtain enactment of AAA legislation in Minnesota.

Missouri

Findings. Legislation was considered in the Missouri legislature during 1996 but did not pass. Current Missouri law imposes fines for underage sales, requires proof of age if a person appears to be under 18, and requires the posting of warning signs. Local authority is expressly reserved. The legislation under consideration included: (1) a licensing requirement for tobacco retailers, (2) authority for the Division of Alcohol and Tobacco Control (a new division) to suspend or revoke licenses for second or subsequent violations of underage sale prohibition, (3) graduated civil fines for employees of retail stores who sell cigarettes to minors, (4) proof-of-age requirements, and creation of an affirmative defense for the retailer if such proof is requested, (5) warning sign requirements (subject to \$100 fine for failure to comply), (6) random inspection authority created in the new division, with authority to use minors in such inspections, (7) restrictions on use of vending machines and (8) preemption of local laws regarding sale, distribution, displaying, sampling and promotion. The bill also required maintenance of original manufacturer packaging and prohibited sampling of tobacco products within 500 feet of institutions such as schools.

The legislation was supported by a coalition of retail interests and the tobacco industry. Because of opposition from retail associations, line-of-sight provisions were not included in the original legislation. The bills were passed by the Senate and House Public Health Committees in February, and attempts made in the Senate committee to delete the preemption language were defeated.

Anti-tobacco organizations opposed the legislation on the ground that the state tobacco division had inadequate power and the local preemption provision would prevent thorough enforcement of the ban on underage cigarette

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sales. When the legislation reached the House floor, an amendment to delete local preemption was proposed with the support of health care, local government, and anti-tobacco organizations. The amendment prevailed by a vote of 83-64. A similar amendment was adopted by the full Senate, 21-10. Retail organizations, including the Missouri Retailers Association and the Missouri Association of Convenience Stores, objected strongly to this development, arguing that a patchwork quilt of local laws would make compliance difficult and employee training nearly impossible.^{26/}

The Senate sponsor, Sen. Bill McKenna (D), agreed with the retail organizations, stating that imposing a state-wide licensing requirement on retailers would be unfair if they could also be subject to additional, stricter local ordinances. He further observed that, if local laws were preempted for alcohol sale laws, tobacco sales should be treated no differently.^{27/}

Because of retailer opposition to the deletion of local preemption, no final action was taken on the bill. Philip Morris informed us that their representatives asked the retail groups to reconsider their position, but they refused. This reluctance was due primarily to recent passage of an ordinance in St. Louis County that provided for licensing of tobacco retailers and subjected them to penalties for underage sales, and the retail community's resultant concern that this would expose them -- in one of the state's most populous areas -- to overlapping rules regarding licensing and fines. Philip Morris then requested that the legislature's leadership bring the bill up for a final vote, but the leadership was not willing to do so in light of retail opposition to the bill as amended, and the legislation died at the end of the session on May 17, 1996.

Analysis. Retail and tobacco organizations combined to support comprehensive AAA legislation in Missouri, including licensing, license revocation and random inspection authority through the use of minors. When local preemption provisions were deleted, PMUSA attempted to convince the legislature to adopt the legislation nonetheless, but could not convince the Senate sponsor, the legislative leadership, or interested retail organizations to do so. In our view, PMUSA made a good-faith effort to obtain enactment of meaningful AAA legislation in Missouri in 1996.

^{26/} See "Single Standard Needed On Cigarettes Sales," a retail-sponsored op-ed piece from the St. Louis Post-Dispatch, Feb. 15, 1996.

^{27/} St. Louis Post-Dispatch, April 30, 1996.

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Nebraska

Legislation was introduced in the Nebraska legislature in 1996 but no action was taken.

Findings. Nebraska presently requires licensing of tobacco retailers at the municipal or county level, grants local courts the ability to suspend the license in the case of sale to minors, imposes a class III misdemeanor penalty against licensees for underage tobacco sales, and places certain local and access restrictions on vending machines.

The proposed legislation contained the following changes: (1) retailer licensing would be the responsibility of the state Department of Health; (2) licenses would be suspended in the event of a third or subsequent violation of underage sale laws; (3) penalties for violation would include first offense, a warning, second offense, \$50 fine, third and subsequent offense, \$50 fine plus possibility of tobacco license suspension; (4) fine proceeds would be held in a segregated fund to finance state tobacco enforcement activities; (5) retailers would be required to attest to training of employees and to display underage tobacco sale warning signs; (6) a retailer compliance program would be established, and local authorities would be authorized to use minors to test compliance; and (7) local laws regulating the sale, distribution, marketing, display or promotion of tobacco products would be preempted. Line-of-sight provisions were not included because, even though PMUSA and convenience store representatives supported it, the Nebraska Retail Grocers Association did not.

The legislation was supported by a coalition of retail interests and tobacco manufacturers. This coalition had previously worked with the state Department of Health to develop tobacco sales training programs for retail employees. However, despite retail and tobacco industry support for legislation in 1996, the Nebraska Department of Health did not support legislative action in 1996 and specifically opposed local preemption and the requirement that law enforcement officers participate in retail compliance testing. Anti-tobacco organizations opposed the legislation, objecting in particular to local preemption and the prohibition on using private citizens in retail compliance testing.

According to PMUSA representatives, the "short session" in 1996 (60 days, versus 90 days in 1997), worked to frustrate consideration of the

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legislation in 1996.^{28/} The legislation's sponsor informed PMUSA that there was inadequate time to complete action on the bill in 1996, and thus there would be committee hearings but no committee vote on the matter. PMUSA requested that the Governor's office intercede and encourage consideration of the bill, but it was reportedly told that no time existed to consider the bill in 1996. A representative of the Nebraska Retail Federation with whom we spoke did not disagree with this assessment, but did note that the presence of tobacco industry support for the legislation did cause some concern among some state legislators. PMUSA representatives disagreed with this observation, observing that while the political climate in some states required PMUSA to play a secondary role in AAA legislation, Nebraska was not such a case. Newspaper articles tend to support PMUSA's interpretation.^{29/} PMUSA representatives are optimistic that the legislation will pass in the longer 1997 session, and predict that the local preemption provision might not be included in next year's bill.

Analysis. PMUSA supported comprehensive AAA legislation in Nebraska in 1996, attempted to include line-of-sight provisions but met with retailer resistance, made public statements of support for the legislation, and met with key Nebraska officials in an attempt to obtain final consideration of the legislation. While it is somewhat troubling that a retail organization considered tobacco industry support to be potentially problematic in that state, this appears to be a question more of tactics than of commitment to the AAA agenda, and it does not diminish our view that PMUSA took the actions in Nebraska that it promised to take when it announced the AAA program.

Ohio

Findings. Legislation was considered in Ohio during 1995-1996 but did not pass. It contained the following provisions: (1) a prohibition on minors purchasing cigarettes, (2) creation of an employee training and certification program, (3) a proof-of-age requirement, (4) creation of unannounced inspection authority by local law enforcement, through use of

^{28/} It should be noted that Nebraska has a unicameral legislature, thus requiring committee action and a floor vote in only one body before a bill is presented to the Governor.

^{29/} See, e.g., "Bills fall short as session nears end," *Lincoln Journal Star*, March 28, 1996. "The limited time remaining in this year's legislative session makes it likely that a host of proposals before the Legislature will never have the chance to become law."

supervised minors, in which local health departments may participate and (5) preemption of local laws. In addition, the legislation would have banned sampling of cigarettes within 500 feet of a school and required cigarettes and smokeless tobacco to be sold only in the manufacturer's original packaging.

Ohio has required the licensing of tobacco retailers since the 1950s. While license revocation authority was considered by proponents of the legislation, retail interests strongly objected and PMUSA decided that alienating these interests would threaten the political support necessary to pass the other elements of the legislation. Thus, license revocation provisions were not added. Retail representatives also objected to line-of-sight provisions. Anti-tobacco organizations objected to the state preemption provisions and focused their criticism in particular on the proposed preemption of local ordinances banning smoking in certain public places. They mounted a substantial public relations campaign in opposition to the legislation.

The legislation was introduced in the House in April 1995, was the subject of 13 hearings, and was carried over into 1996. On January 10, 1996, the Local Government Committee reported the legislation to the House floor. At that time, the House sponsor of the legislation left the chamber to fill a vacant Senate seat. This loss of sponsorship, coupled with the House Speaker's reluctance to move the bill in the face of opposition from anti-tobacco groups, prevented the bill from moving further.

In an attempt to defuse the controversy, PMUSA participated in a negotiating session with representatives of the American Heart, Lung and Cancer associations. These health groups proposed a list of 17 changes to the bill, of which PMUSA consented to 15. The most significant agreed changes were: (1) local health departments being empowered to conduct compliance checks and to issue citations for violations, (2) creation of an alternative tier of graduated civil fines for violations, applicable to sales clerks and store owners, (3) conforming proof-of-age requirements to those for alcohol purchases, (4) authorizing the Ohio Department of Health to provide grants to local governments to defray the costs of compliance audits and (5) deleting preemption of local ordinances relating to smoking in public places. However, two issues remained unagreed: a proposal to grant new powers to county commissioners to ban smoking, and the proposed retention of retailer fines collected by local health departments to defray their cost of further compliance checks. With no consensus apparent, the legislation died with the end of the 1996 session.

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Analysis. PMUSA encountered two unfortunate political situations in Ohio: the unwillingness of the retail community to agree to license revocation provisions, and the House Speaker's unwillingness to move legislation that was opposed by anti-tobacco organizations. Nonetheless, PMUSA deserves credit for its serious attempt to negotiate an agreement with its opponents, and its agreement to consider as part of these negotiations items of interest to anti-tobacco organizations -- including additional local controls over retailer compliance and state funding for such local actions.

Pennsylvania

Legislation was introduced and considered in Pennsylvania during 1996 but no final action was taken.

Findings. The Pennsylvania legislation (S.1008) was one of the most comprehensive underage smoking bills in the country. It provided for: (1) mandatory suspension of licenses after the third offense within a two-year period (current law only required tobacco retailers to be licensed); (2) increased, graduated penalties for tobacco sales to minors of (i) \$50 to \$100, in the case of an employee, and (ii) \$150 to \$600 in the case of a tobacco license holder; (3) retailer affirmative defenses for checking proof of age; (4) warning sign requirements, with 800-numbers for reporting violations; (5) unannounced retailer inspection authority by the Department of Health and Agriculture, with authority to use minors in the process; (6) limitations on vending machines to premises where persons under 18 are not admitted; (7) requirements that tobacco products be located within a clerk's line of sight or under his or her direct control; and (8) preemption of local laws, except that existing local ordinances would be grandfathered. The legislation also required cigarettes to be sold only in the original manufacturer's packaging, and banned cigarette sampling within 500 feet of schools.

The bill was drafted by Sen. Melissa Hart (R), and was supported by PMUSA and the retail community. The bill was referred to the Senate Finance Committee, of which Sen. Hart is the chair, and she suggested that health organizations, such as the American Heart, Lung and Cancer associations be approached to determine whether it would be possible to reach consensus on a bill. However, these organizations refused to support the legislation if it contained the local preemption provision, and their support (or lack of objection) was not obtained.

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The Finance Committee never approved the bill. According to a local editorial, the legislation died because of opposition to the local preemption provisions by the American Cancer Society, American Lung Association and American Heart Association.^{30/} PMUSA representatives told us, however, that the anti-tobacco organizations were probably not politically capable of defeating the legislation over the local preemption issue. Instead, the bill did not move out of committee because of opposition by some tobacco manufacturers to portions of the bill's tobacco control provisions, including the line-of-sight requirement and a requirement that the warning sign make specific reference to adverse health effects of cigarettes. Lack of unanimity in the tobacco industry caused the bill's sponsor to be reluctant to move the bill out of her committee. With objection from some tobacco interests, and with opposition to uniform state rules from anti-tobacco organizations, the legislation died at the end of the session.

Analysis. The Pennsylvania experience is difficult to assess. While anti-tobacco organizations raised objection to local preemption, this was not the defining issue in Pennsylvania because the sponsor and the Republican-controlled legislature apparently supported the retail community's interest in a uniform state law on the topic. Editorial support also existed for this position.^{31/} Rather, the bill appears to have faltered because its comprehensive adoption of the AAA agenda antagonized PMUSA's competitors in the tobacco industry. In a similar situation in Kentucky, PMUSA representatives speculated that line-of-sight provisions in that legislation prompted opposition from one tobacco manufacturer, and it is possible that inclusion of this provision prompted objection in Pennsylvania from another such manufacturer.

PMUSA should be commended for advancing legislation in Pennsylvania that is among the most faithful to the AAA agenda of any in the country. Conversely, PMUSA could be criticized for failing to drop the offending language in order to unify the tobacco industry and achieve otherwise positive and substantial improvements to Pennsylvania's youth access laws. Because this appears to be a question of legislative strategy, however, and not a question of PMUSA's sincerity in attempting to enact the AAA state legislative program, our criticism is qualified. It is clear that PMUSA took significant

^{30/} "Smoke Screen: Local control isn't a hot enough issue to derail efforts to curb youth smoking." *Harrisburg Patriot News*, May 28, 1996.

^{31/} "We think Hart's bill is strong enough, even with the pre-emption language, and we urge the health organizations to take another look at it." *Id.*

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actions to enact the AAA agenda in Pennsylvania in 1996, and that this state should be placed on its list of unfinished business for 1997.

Rhode Island

AAA legislation resulted in enactment of a new Rhode Island law in August 1996.

Findings. Rhode Island law already required tobacco retailers to be licensed, imposed penalties on persons who sold tobacco to minors, authorized the suspension of tobacco licensees upon commission of third or subsequent violations of the underage sale ban within any 60-day period, required the posting of state law in retail stores, limited vending machines to those within direct line of sight or with lock-out devices, and prohibited sales of cigarettes in packs of less than 20.

The 1996 bill added the following new provisions: (1) enhanced license revocation authority for third and subsequent violations over a 3-year period (as opposed to over a 60-day period); (2) enhancement of second and subsequent employer penalties, from \$200 for second offense and \$300 for third offense within any 60-day period, to \$200 for second offenses, \$300 for third offenses, and \$500 for a fourth offense within a 3-year period; (3) required posting of a sign explicitly describing the prohibition on sales to minors; (4) designation of the Department of Health as the agency responsible for enforcement; (5) creation of unannounced retail inspection authority, and authorization of use of minors in such inspections; (6) a prohibition on sampling of cigarettes within 500 feet of schools or to minors; and (7) a prohibition on sales of single cigarettes and on distribution of cigarettes through the mail.

Senate legislation (S. 2804) was considered and reported by the relevant committee. In addition to the provisions mentioned above, S. 2804 included also a ban on all sampling of cigarettes, and allowed private citizens to bring enforcement actions against retailers. On this basis, the retail community and other tobacco organizations opposed S. 2804, and PMUSA remained neutral. When the Senate committee deleted the citizen action provision and amended the sampling limitation to within 500 feet of a school, retail and tobacco organizations supported the legislation and PMUSA joined in that support. The legislation then passed the Senate, and upon referral to the House Judiciary Committee an amendment was offered that would preempt local laws on these topics. That amendment failed, but PMUSA supported the bill

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nonetheless. The House then made minor amendments, the Senate concurred in those amendments, and the Governor signed the bill on August 7, 1996.

PMUSA was a public supporter of this legislation and has since submitted written and oral testimony to the Rhode Island Department of Health in support of the bill, also recommending that it implement the legislation in a manner that facilitates PMUSA's ability to identify retailers that are fined or convicted for underage tobacco sales.

Analysis. PMUSA supported legislation through to enactment that replaced ineffective penalties with sanctions that are more likely to be enforced. In addition, PMUSA worked with other industry groups to introduce legislation that included line-of-sight requirements -- an accomplishment that has been elusive in other states because of retailer opposition. PMUSA deserves credit for obtaining the line-of-sight provision in the legislation that the industry presented. Indeed, the legislation was initially in a form that retailers and other tobacco manufacturers considered unacceptable, but PMUSA worked with them and with the sponsor to make appropriate amendments. As a result, legislation was enacted that was consistent with the AAA agenda and that met with the Governor's approval. PMUSA's actions were plainly consistent with the AAA agenda.

South Carolina

Action in the South Carolina legislature in 1996 resulted in the enactment of a portion of the AAA agenda.

Findings. Prior South Carolina law contained no licensing provisions but did penalize the seller of tobacco to underage persons through fines of \$25-\$100, imprisonment of 2-12 months, or both. The new law added the following provisions: (1) an increase in fine levels to \$25 for the first offense, \$50 for the second offenses, and at least \$100 and/or between 60 days and 1 year in jail for third and subsequent offenses; (2) authority for the Department of Revenue and Taxation to conduct unannounced inspections of tobacco retailers, and to use minors in such inspections; (3) a prohibition on providing tobacco samples to persons under the age of 18, and a proof-of-age requirement if sampling to a person who appears under 18; (4) a prohibition on smoking in certain public places, including public schools, other indoor facilities providing children's services (such as day care facilities), health care facilities, and most government offices; and (5) preemption of any local laws

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passed after the date of enactment of this law that would regulate the sale of tobacco products.

The legislation was originally introduced in 1995 and was passed by the Senate on May 28, 1996 (with modest amendments). The House concurred in the Senate amendments on June 12, 1996, and the Governor signed the legislation on June 18, 1996. There were no major battles over the legislation, in part because anti-tobacco organizations were not as active in this state as in many others.

PMUSA representatives informed us that they attempted to form a coalition with retail interests but could not develop substantial support from them. They were told that, if licensing or line-of-sight provisions were included in the legislation, the retail community would oppose it. PMUSA's discussions with state legislators also indicated that there was not majority support for a licensing requirement. Similar retail opposition was voiced over proof-of-age and signage requirements. While anti-tobacco organizations did oppose the uniformity provisions of the bill, they were not successful in deleting it (although the original version of the uniformity section was amended to grandfather local laws in effect on the date of the law's enactment). PMUSA played a much more prominent role in advancing the legislation than it did in many other states.

Analysis. The enactment of any new law is a notable achievement. However, the lack of any provisions in the bill relating to licensing, proof of age, signage or vending machines, coupled with preemption of local laws, detracts from the significance of the achievement. A better bill was clearly not politically possible given the lack of support from the retail community for more stringent requirements. PMUSA thus took a lead role and supported through to enactment a bill that incorporated as much of the AAA bill as was politically feasible. We do not criticize PMUSA's handling of this case, but believe that the Company should continue to seek opportunities to enact licensing regimes in this state, whether at the state or local level.

West Virginia

Legislation containing many key AAA priorities was introduced in the West Virginia legislature in 1996 but no substantive action was taken.

Findings. Current West Virginia law on youth access is relatively modest in scope: the statute imposes fines of between \$10 and \$300 for illegal

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tobacco sales to minors, and it permits unannounced retailer inspections by the Division of Public Safety and local law enforcement. State Senator Martha Walker introduced legislation in 1996, which PMUSA helped draft, that:

- (1) required tobacco retailers to obtain a license from the Alcoholic Beverage Control Commission (ABCC),
- (2) suspended licenses for up to 30 days for third and subsequent violations in a two-year period,
- (3) revised current penalties for underage sales to impose a graduated system of penalties from \$100 to \$500,
- (4) required proof of age if there is reason to believe that a purchaser is under 18 (with an accompanying affirmative defense),
- (5) required the posting of warning signs,
- (6) provided unannounced inspection authority to the ABCC along with local law enforcement, in which minors may be used,
- (7) required vending machine supervision and lock-out devices, or placement in areas that are inaccessible to minors,
- (8) required cigarettes to be within the line of sight of the clerk or other retail supervisor,
- (9) preempted local laws on the sale, display, advertising, promotion and use of cigarettes, and
- (10) required cigarettes to be in the manufacturer's original packaging, and prohibited sampling within 500 feet of a school. In short, the entire AAA agenda was included in the legislation.

PMUSA was unable to convince the retail community to support licensing and line-of sight-provisions. As a consequence, this legislation did not receive committee consideration. A similar bill drafted by the West Virginia Department of Health contained licensing requirements and banned vending machines, self-service displays and sampling. Retail interests strongly opposed the Department of Health bill, and the tobacco industry was divided on it. PMUSA took no public position on this bill, but did not work to oppose it. This bill also died after a committee hearing.

Analysis. PMUSA acted consistently with its AAA agenda in introducing a comprehensive bill. Given strong retail opposition and no consideration of any bill on the topic, the company's actions in this state in 1997 will determine whether its AAA objectives will be fulfilled.

Wisconsin

Findings. Legislative activity in Wisconsin in 1995-96 was decidedly different than that which occurred in any other state. Wisconsin had already enacted most elements of the AAA program in the early 1990's, including: (1) Department of Revenue licensing, (2) penalties for underage tobacco sales, (3) authority to suspend tobacco licenses in the event of second or subsequent violation, (4) affirmative defenses for retailers, (5) a requirement

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that warning signs be posted, (6) no vending machines allowed within 500 feet of a school and (7) state preemption of inconsistent local regulations. In 1995, legislation was advanced by anti-tobacco organizations (A.B. 516) that would have repealed the local preemption provisions of current law.

A.B. 516 was opposed by the retail community, including the Wisconsin Merchants Federation, the Tavern League of Wisconsin, the Petroleum Marketers Association of Wisconsin and the Wisconsin Association of Convenience Stores. (See Jan. 25, 1996 memo to "All Wisconsin Legislators" from this coalition at Exhibit J.) Because Wisconsin law already contained the major elements of AAA, Philip Morris joined the retail community in opposition to this legislation. A.B. 516 nonetheless was approved by the committees of jurisdiction, and on January 30, 1996, a motion was made to take the legislation to the floor. That motion failed by a 47-51 party-line vote (Republicans controlled the Assembly in 1996). However, there was concern among the Assembly leadership that the motion would be approved on a second vote.

The Rules Committee reported the bill on March 21, 1996, and floor action was scheduled -- although not promised -- to occur shortly thereafter. PMUSA representatives met with the Speaker of the Assembly immediately thereafter, and a negotiation period ensued that involved the interested legislators, retail organizations, the tobacco industry (primarily represented by PMUSA) and certain anti-tobacco organizations, including the Heart, Lung and Cancer associations. The negotiations were unsuccessful and the legislation died without floor consideration at the end of the session.

In the March-April 1996 negotiating session, anti-tobacco organizations took the following positions: (1) existing tobacco license fees should be increased from \$5 to \$50; (2) current penalties against underage sale should be increased; (3) tobacco license revocation should occur automatically in a greater list of circumstances; (4) vending machines should only be permitted in a limited number of places; (5) undercover compliance operations should occur at least once per year for each licensee, such "sting" operations should be funded from revenues from the license fees, and non-governmental entities should be allowed to conduct the stings; and (6) local boards of health should have authority to impose regulations on tobacco sales that are stricter than the state law.

The retail and tobacco industries responded by offering the following: (1) strict limitations on cigarette sampling to avoid locations where

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underage persons are present; (2) penalties against underage persons falsely asserting that they are over 18; (3) certification by each employee of a retail tobacco licensee that s/he has read a summary of Wisconsin's underage tobacco sale laws, including the penalties applicable to such employee if s/he participates in underage tobacco sales; (4) reduction of an underage tobacco sale penalty to \$100 if the retailer complied with the employee certification requirement, except that such mitigation may only be enjoyed once in any 12-month period; (5) retail compliance audits to be conducted by state health, employment and law enforcement agencies, in cooperation with local law enforcement agencies, in a manner consistent with Synar Amendment requirements; and (6) a ban on smoking in the office of any health care provider or in any enclosed area of a state or local building in which health care services are delivered to children or pregnant women.

Lung Association representatives initially supported the retailer-tobacco counter-proposal, but the Heart and Cancer Associations did not, and senior Lung Association officials later retracted their endorsement. See Exhibit K. The disagreement centered on the insistence of the two health organizations to delete local preemption -- which made the legislation unpalatable to retail organizations. PMUSA representatives informed us that, if uniformity laws were not on the books in a particular state, they would likely support legislation that contained the remaining AAA provisions -- particularly if the state's law did not include retailer licensing and license revocation provisions. However, in states like Wisconsin that already have a licensing regime and a uniformity law, PMUSA is unlikely to abandon its coalition with retail organizations when anti-tobacco organizations seek to repeal uniformity.

Wisconsin Representative (and now Majority Leader) Steven Foti (R) chaired the March-April 1996 negotiating session. In our interview with him, he confirmed the general information we were given about the negotiations and made the following observations. First, there were not always just two sides, but sometimes four, given the divisions that existed between PMUSA and other tobacco interests (cigarettes and smokeless), the retail interests, and the Heart/Lung/Cancer groups. In addition, PMUSA was initially very reasonable in its willingness to sit down with all sides and identifying general areas of agreement; however, when the conceptual issues were boiled down to legislative language, all sides (including PMUSA) began taking harder positions, such that disagreement became inevitable. Of all of the parties involved, on a scale of one to ten (one being very reasonable, ten being very unreasonable), convenience store representatives would receive a "one," PMUSA would receive a "three" (because of its later tenaciousness on

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legislative language), and the Heart/Lung/Cancer groups would receive an "eight" (they did not seem interested in any agreement until the last minutes).

Analysis. PMUSA's involvement in this state began as a defensive action, and not unreasonably so given that Wisconsin law contained most of the elements of the AAA legislative program. However, when asked to negotiate with anti-tobacco organizations by the Speaker of the Assembly, PMUSA did so and advanced provisions such as retailer compliance programs, employee training incentives, and smoking bans in health care provider facilities. State legislators involved in the negotiations commented that PMUSA was quite insistent on specific legislative language but did participate in the negotiations in good faith. In short, PMUSA acted consistently with its announced AAA legislative program in this state.

2. Views Of Anti-Tobacco Organizations

Findings.

We interviewed representatives of major health organizations who closely follow state legislation relating to underage smoking. These organizations have opposed state legislation supported by PMUSA, and they provided us with the following comments on the legislation described above.

- Major health organizations are steadfastly opposed to legislation that preempts local laws because anti-youth access enforcement efforts have been the most successful at the local level. Woodridge, Illinois, is frequently cited as the most effective local enforcement model.^{32/}
- The general strategy of the tobacco industry (not just PMUSA) has been to seek weak state legislation that preempts stronger local laws. Examples of such legislation are Indiana and Kentucky.

^{32/} Ordinance No. 89-15 of the Village of Woodridge, Illinois requires: (1) retailer licensing, (2) posting of warning signs, (3) attribution of improper acts of retail employees to holder of tobacco license, (4) lock-out devices on vending machines not in areas inaccessible to minors, (5) mayor to consider license revocation or \$500 fine in case of licensee violation of the underage sale laws, and (6) \$25-\$50 fines against minors who purchase or possess tobacco products.

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- Examples of typical provisions contained in "weak" bills are:
(1) penalties against retailers who "knowingly" sell cigarettes to children, where no requirement exists to request proof of age;
(2) designation of an overburdened, underfunded or disinterested state agency as the entity in charge of compliance and enforcement; (3) "line-of-sight" or "lock-out device" exceptions to bans on vending machines, which are commonly disregarded;
(4) disallowance of private-organization involvement in monitoring retailer compliance; and (5) low fine levels.
- Examples of additional local rules that should not be preempted by the state are: (1) higher penalty levels and longer license suspension periods, (2) total bans on vending machines, (3) prohibitions on self-service displays of cigarettes and (4) private-organization participation in retailer compliance checks.
- No AAA legislation has been proposed that is sufficiently comprehensive such that a uniformity clause would be acceptable. However, some health organizations admitted that the Minnesota legislation, had it passed with a uniformity provision, would have presented a "difficult choice." Legislation in Arizona and Colorado was viewed as not strong enough to justify abandoning the option of seeking tougher local laws.

We asked these groups two questions that some state legislators asked (rhetorically) of us. First, why would they oppose a AAA bill with statewide uniformity if it were comprehensive (i.e., contained licensing, license revocation, reasonable fines, and unannounced inspection authority) given that a "patchwork quilt" of local laws makes retailer compliance difficult? Second, in a state where there is little existing on the law books, why seek a "perfect" bill allowing additional local laws if a large improvement in the status quo can be made through a uniform state law?

The responses we received can be summarized as follows:

- The "patchwork quilt" argument is a red-herring, because it is not difficult to train a retail employee to ask for ID from people who appear underage; nor is it difficult to restrict cigarettes to "behind the counter only" in a locality that requires it.

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- A uniform state law that truly improved the status quo would present a serious question, but thus far each proposed or enacted state law has contained such a serious defect (i.e., low penalties, weak enforcement agency, insufficient enforcement resources, ineffective warning signs (i.e., without a warning as to health effects of cigarettes)) that a true improvement in the status quo has not presented itself.

One health advocate observed, "three thousand youths start smoking each day, and one thousand of them will die of tobacco-related diseases; but the tobacco industry needs youth sales, that is their future." Another health advocate observed, "if Philip Morris is interested in reducing youth access, it shouldn't be opposing the FDA rule. Or, it should adopt the legislative recommendations of the State Attorneys General Report, *No Sale*."

No Sale: Youth, Tobacco and Responsible Retailing^{33/} was a report issued in 1994 by a group of 12 state Attorneys General that provided recommendations for reducing youth access to tobacco products. The report made the following recommendations for state legislation:

1. Legislatures should be wary of solutions advanced by the tobacco industry.
2. State legislation should not preempt local ordinances.
3. State laws should create or require a licensing system for tobacco sales.
4. The licensing and enforcement system should be self-supporting.
5. The licensing system should use graduated fines, with license suspension for repeat offenses.
6. The law should include positive incentives for responsible retailing.
7. The law should require periodic compliance checks.

^{33/} Working Group of 12 State Attorneys General, *No Sale: Youth, Tobacco and Responsible Retailing. Developing Responsible Retail Sales Practices and Legislation to Reduce Illegal Tobacco Sales to Minors*. (December 1994).

8. The law should not limit who may conduct compliance tests.
9. State laws should limit youth access to tobacco by restricting vending machine sales and prohibiting free sampling.
10. State laws should require driver's licenses to be designed to make age identification easy.

Analysis.

An evaluation of the policy positions of anti-tobacco organizations is beyond the scope of this report. We have, however, considered the merit of their criticisms of the AAA legislative agenda, and have reached the following conclusions:

1. Inherent value of local enforcement. Health organizations place an inherent value on local rules and enforcement, arguing that whatever the state law provides, anti-youth access measures are always more effectively implemented through an aggressive, committed local enforcement regime. PMUSA has not insisted on uniformity when the AAA legislation is otherwise beneficial (for example, in Kansas and Minnesota), but it promised in June 1995 to work with retail organizations to pass such legislation, and in most states retail organizations have either insisted upon uniformity or have strongly advocated its inclusion. Retail organizations argue that it is unfair to subject them to a multitude of local laws because it makes compliance confusing, frustrates the proper training of store clerks, and effectively reduces the ability of retailers to combat underage sales.

Both arguments are logically coherent and supported by the facts in particular states. We compared the proposed tobacco legislation to laws regulating products that are frequently considered in the same category: alcohol and firearms. This comparison also yields a mixed result.

- **Alcohol.** All alcoholic beverages are subject to some uniform state rules and are regulated by a central state authority. Some states only allow the sale of some or all alcoholic beverages through a state entity, while others grant licenses to wholesalers and retailers to engage in such sales. However, a majority of the states permit local variations on the uniform state rules, with the most frequent being: (a) hours of retail operation, (b) categories

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of establishments that may sell alcoholic beverages and (c) whether a local jurisdiction wishes to ban alcohol sales outright.^{34/} In short, alcohol laws involve a combination of state and local regulation.

- **Firearms.** Forty-one states have uniform state rules on firearm ownership, purchase or possession. These laws generally provide that local jurisdictions may not impose rules on firearm ownership, sale or possession that are more restrictive than the state standard. Thirty-six of the 41 states have enacted legislation on the subject, and the remaining five states arrived at a uniform state standard through court decisions.^{35/} In short, there is substantial statewide uniformity on firearms laws.

We conclude that an "absolute" position on statewide uniformity -- either pro or con -- is not reflected in parallel legal regimes and is not justified in the tobacco context given the wide variation in state conditions and rules. However, a valid argument exists for local authority in some states, as we discuss below.

2. Value of local regulation under particularly weak or strong state laws. Representatives of major health organizations noted that some states that preempt local regulation of tobacco sales have very weak state enforcement regimes. Thus, in states such as Indiana, Kentucky and South Carolina, where there is no licensing requirement but more restrictive local laws are preempted, a valid argument exists that the AAA agenda would be furthered by local regulation of retailers if a reasonable licensing requirement, with authority for suspension or revocation, were imposed. Local preemption laws in such states clearly frustrate the goal of AAA legislation.

Conversely, insertion of local preemption provisions in legislation that contains most or all of the AAA agenda (particularly licensing, revocation authority, reasonable fines and unannounced inspection authority with use of minors) does not frustrate the AAA agenda. While reasonable people can disagree over whether a state law is sufficiently comprehensive to justify a uniformity clause, the regimes proposed by legislation in Minnesota, Colorado

^{34/} See, Distilled Spirits Council of the United States, Inc., *Summary of State Laws and Regulations Relating to Distilled Spirits*, Twenty-Ninth Ed. (January 1996).

^{35/} National Rifle Association, *NRA State Firearm Law Summaries* (1996).

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and Arizona, and which were enacted in Connecticut, Delaware and Rhode Island, all contain reasonable versions of the principal AAA elements, and would not appear compromised by any accompanying uniformity rules.

3. Other criticisms. Other criticisms of AAA legislation by major health organizations are of varying, but not particularly compelling, persuasiveness.

- **State agency in charge.** Whether a state agency is "committed" to AAA enforcement and whether it is properly funded to handle new enforcement regimes are legitimate questions. Retailers have legitimate concerns that a completely self-funded enforcement mechanism will create a perpetual cycle of higher license fees, but some use of the fee for enforcement appears rational. Most important, obtaining additional funds for an agency, or increasing its attention to enforcement, can be achieved in the on-going legislative process. While not a convincing justification for opposing an otherwise comprehensive AAA bill, proper funding of enforcement is an important issue.
- **Particularly vigilant localities.** Local jurisdictions that have focused on youth access issues should not be penalized for their foresight. However, most state bills containing uniformity clauses have "grandfathered" local rules in effect on the date of the bill's enactment. To the extent a grandfather clause is missing, it would be reasonable to add it. Continued criticism of otherwise comprehensive legislation with a uniformity/grandfather clause does not appear reasonable.
- **Legislation advanced by the tobacco industry.** The *No Sale* report criticized legislation which penalized the "knowing" or "intentional" sale of tobacco to minors, and endorsed the Surgeon General's recommendation that legislatures should first enact penalties against persons and entities selling tobacco to minors before addressing whether the minors themselves should be penalized. These proposals articulate sound public policy but are somewhat dated given that, in 1996, state legislation based on the AAA proposal did not contain these culpability requirements.
- **Use of private organizations in unannounced inspections.** Criticizing legislation for not allowing private organizations to

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participate in compliance testing is unreasonable. It is a central tenet of U.S. law that any action taken by the government against or in relation to a person or entity should proceed in a neutral, unbiased manner. Governmental use of organizations with a particular point of view on tobacco (or any other product) when testing retail compliance with laws relating to that product would raise serious questions of fairness and impartiality.^{36/} While it is not clear whether a due process violation would occur under this proposal, due process issues are certainly implicated.

Analysis summary. *Per se* objection to or support for uniformity clauses in youth access legislation is not justified by comparable laws or by the factual situation in particular states. Criticism of uniformity rules may be reasonable when the controlling state law and legislation are substantially incomplete (e.g., when a licensing regime does not exist); conversely, insistence on local authority may be unreasonable when the controlling state legislation is comprehensive. While some of the other criticisms of the AAA legislation in the various states are worthy of consideration (such as ensuring adequate funding for state enforcement agencies or including grandfather clauses in any uniformity rules), these issues should not be permitted to control the ultimate success or failure of the AAA legislative effort.

3. Conclusions On PMUSA's State Legislative Efforts

Nationwide results for 1996. Thirty-one states were prospects for AAA legislative initiatives in 1996 because their legislatures were in session (and such legislation would be germane), existing laws did not already include most or all of the AAA agenda, or both. AAA legislation was introduced in 23 of these states. Eight bills were passed by the legislature and signed by the Governor. One bill was passed by the legislature but vetoed by the Governor. Two bills were affirmatively defeated in roll call votes in a committee or a particular legislative body. Twelve bills did not proceed to final legislative action.

"Success" is difficult to quantify in the legislative context. While PMUSA devoted significant lobbying resources to state AAA legislation, its

^{36/} For example, no organization has suggested that the FCC be allowed to delegate its cable television anti-obscenity enforcement authority to the Christian Coalition.

relative influence varies from state to state, and like any other private entity attempting to change public laws, it must respond to a variety of competing interests. PMUSA pledged in June 1995 to "work with retailers, state policy makers, law enforcement officials and others to achieve our goals" -- namely, the "enactment of reasonable state legislation" that comprises the specific initiatives that this section has described and reviewed. Given that PMUSA did not promise to enact legislation in all 50 states by a date certain, our conclusions about this element of the AAA program will not be based solely on how many states enacted AAA legislation during 1996. Rather, we will focus on the sincerity of PMUSA's efforts in the 31 states in which such legislation was eligible for consideration. Standing alone, the fact that eight new state laws now implement some or all aspects of the AAA agenda is a positive development, and legislative consideration of AAA bills in 15 other states also demonstrates PMUSA's support for and work toward enactment of this legislation in these states.

States without legislation. One important question is why legislation was not introduced in the eight states where the legislatures were in an appropriate session and state laws did not already embody the elements of the AAA agenda. PMUSA representatives informed us that any decision to take no action was based on state-specific circumstances which indicated that legislation would not be successful or otherwise counseled against introducing and advocating an AAA bill. For example, in California, retail interests, particularly grocers' representatives, were not willing to join PMUSA in supporting legislation to create a licensing regime, particularly given the passage in late 1995 of vending machine restrictions. In Illinois, PMUSA met with retailers and other tobacco manufacturers to propose AAA legislation, but there was near unanimous opposition to introducing such a bill during a short session in which control of the Assembly was at stake and the leadership was not interested in tackling potentially controversial issues. In New Hampshire, a licensing regime (without revocation) had been enacted during the 1994-95 session, and retail interests were unwilling to pursue any further legislation before reviewing the implementation of the licensing requirement. In Oklahoma, only license revocation and line-of-sight provisions were not included in existing law, and retail interests were not willing to seek additional measures -- particularly given the threat of anti-tobacco interests to repeal the current local preemption law.

In South Dakota, a 1995 law had imposed penalties for sale to minors, created proof of age/affirmative defense rules, authorized unannounced inspections, and placed restrictions on vending machine placement, and while

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licensing/revocation provisions were not including in this legislation, retail interests were concerned that raising these issues would jeopardize state uniformity rules. In Tennessee, when PMUSA proposed that licensing and revocation authority be added to the law, retail interests objected loudly and strongly -- an objection that was reinforced by the Speaker of the Tennessee House (himself a tobacco wholesaler with a likely disinclination to antagonize his retail customers). In Utah, retail interests strongly opposed adding licensing to the law, and in Mississippi, a bitter fight over tobacco excise taxes in 1996 counseled deferral of AAA legislation until 1997.

PMUSA's decision not to pursue the AAA agenda in 1996 in each of these eight states appears to be based on a legitimate concern that adequate political support to obtain serious consideration of AAA legislation was lacking. When the natural AAA political coalition is not present, or when the legislative leadership indicates its unwillingness to consider the legislation, it is not unreasonable for PMUSA to concentrate its political resources elsewhere. There do not appear to be justifiable grounds to criticize PMUSA over its failure to obtain introduction and consideration of AAA legislation in these states. However, its actions in some of these states during 1997-98 merit further review, particularly in California, Illinois, Mississippi and New Hampshire (given that the 1996 political conditions in those states likely were temporal).

Comprehensiveness of legislative proposal. In nearly every state, PMUSA proposed that legislation be introduced that contained licensing requirements, reasonable fine levels, authority to suspend or revoke licenses upon repeated violations, warning sign requirements, proof of age/affirmative defense requirements, authority for unannounced inspections of retailers, line-of-sight provisions and restrictions on the placement of or access to vending machines. This agenda (particularly the line-of-sight requirements) was often trimmed back by other parties. However, even absent the line-of-sight provision, PMUSA's model state legislation is remarkably similar to that proposed by the working group of State Attorneys General in *No Sale*, and to the local ordinance in Woodridge, Illinois that is frequently held up as a local model by anti-tobacco organizations.

The only major element from the Woodridge ordinance that is missing from the AAA model is authority to suspend a tobacco retail license upon the first violation. Most state bills only allowed revocation after multiple offenses, and this appears to be a reasonable position, given that civil fines are almost always available for the first offense.

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The AAA model bill does not explicitly contain the following recommendations of the State Attorneys General: (1) categorical avoidance of local preemption, (2) funding of the enforcement system through licensing revenues, (3) permitting private organizations to conduct compliance tests and (4) designing state drivers' licenses to facilitate age identification. With regard to these absent elements, we would note that: (1) as discussed elsewhere in this report, there is no single right answer to the question of local preemption; (2) while self-funding is not a portion of the AAA agenda, it has been included in some bills that PMUSA has supported, and a compromise on this issue would appear reasonable; (3) as discussed elsewhere, private-organization participation in compliance tests would be fundamentally unfair to the subjects of such tests; and (4) drivers' license alteration was viewed as beyond the scope of the AAA legislation, but could be a constructive separate item for legislative action that PMUSA is unlikely to oppose.

In short, even based on the standards noted with approval by anti-tobacco organizations, the AAA agenda is reasonably comprehensive and complete.

Licensing. Licensing regimes for tobacco retailers (including the possibility of suspension or revocation after multiple violations) is the key provision of the AAA bill. PMUSA, anti-tobacco organizations and the State Attorneys General working group are in agreement on this issue. Because it is the tool that most effectively imposes state control over the retail sale of cigarettes, licensing has met with strong retail opposition in many states. In our interviews with PMUSA representatives in the states where legislation was considered, each told us that licensing was either included in the legislation or recommended for inclusion by PMUSA. In some cases, retail interests objected, and PMUSA did not insist further if agreement on other aspects of the AAA agenda was achieved and if retailers had the political strength to block legislation that contained licensing.^{37/} We confirmed PMUSA's assertion that licensing was politically untenable, for example, by speaking with the sponsor of the AAA legislation in Virginia, who agreed that there was not sufficient support in the legislature for retailer licensing.

^{37/} In some cases, objection was heard to license revocation authority rather than to any licensing at all (for example, in Georgia).

We find that PMUSA advanced licensing/license revocation provisions in 14 states where it was politically feasible to do so^{38/} and did not do so in 8 states where retailer or other opposition made it politically unfeasible.^{39/} It should be emphasized that PMUSA proposed inclusion of licensing in all states where legislation was introduced. Four states enacted new or improved licensing regimes in 1996. Ten state legislatures considered legislation that included new or improved licensing regimes. The fact that some state legislatures were unwilling to support licensing is a simple political reality. Under the circumstances, PMUSA took reasonable, pragmatic steps to advance licensing rules in as many states as possible, and did not jeopardize enactment of other aspects of the AAA agenda when insufficient political support for licensing existed. In almost every state this was a common-sense reaction to the political landscape.

Line of Sight. Line-of-sight proposals met with nearly universal retailer opposition. This provision was included in only four bills,^{40/} none of which was enacted. Not only did most retailers find the provision overly intrusive into the way they conduct daily business, but other tobacco manufacturers in some states believed that it would disadvantage them against the industry leaders (i.e., Philip Morris). PMUSA representatives told us that, while they suggested inclusion of line-of-sight provisions in all 1996 legislation, in retrospect, this might not have been the most realistic approach from a political standpoint. It is our view that, while line-of-sight requirements are an important tool in preventing minors from having retail access to cigarettes, they are not nearly as important to enforcement as are licensing and unannounced inspection authority. Line-of-sight requirements are only effective to the extent store clerks are vigilant. Meaningful penalties actually encourage such vigilance, and licensing and unannounced inspections are the tools through which the penalties can be effectively implemented. PMUSA did not allow opposition to line-of-sight provisions to impede otherwise beneficial AAA legislation, and we believe that this approach was reasonable.

^{38/} Arizona, Colorado, Connecticut, Delaware, Hawaii, Kansas, Massachusetts, Minnesota, Missouri, Nebraska, Pennsylvania, Rhode Island and West Virginia. Alabama is also included on this list, even though retailers there vehemently oppose licensing.

^{39/} Georgia, Idaho, Indiana, Kentucky, Michigan, Ohio, South Carolina and Virginia.

^{40/} Hawaii, Massachusetts, Minnesota and Pennsylvania.

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Uniformity. Statewide uniformity, or state preemption of local laws, was not included in the AAA model bill. However, it became the political flashpoint in a number of state legislatures when it was included in AAA legislation and anti-tobacco organizations objected. PMUSA was not doctrinaire in its approach to this issue, agreeing with its inclusion in most states where retail groups insisted, but encouraging its deletion in most states when it became the only obstacle to a substantial improvement in youth access laws.

Anti-tobacco organizations raised legitimate concerns about weak AAA bills (in states such as Indiana and South Carolina) where uniformity was imposed but no element of licensing was included. Notably, PMUSA did not support (or oppose) the Indiana bill because it was too weak, and it supported the South Carolina bill given the substantial political opposition to licensing. In other states with uniformity but no licensing (such as Virginia), we have confirmed that PMUSA sought the inclusion of licensing but was confronted with insurmountable opposition. We do not criticize PMUSA's strategic decisions in these states but instead raise the following issues for further review: (1) whether PMUSA will work for further improvements in these laws in this year's legislative session, or as soon as the political opposition to licensing notably diminishes; and (2) if anti-tobacco organizations propose to delete uniformity in these states, whether PMUSA will participate constructively in the debate, if not support deletion outright.

As noted above, we find no compelling arguments to uniformly support or oppose local preemption, and to its credit, PMUSA took this pragmatic approach as well. Thus, we have no quarrel with the company's decision to maintain its coalition with retail interests and attempt to insist on uniformity in bills with complete licensing regimes, such as the ones in Arizona, Colorado, Massachusetts and Missouri. PMUSA's attempt to convince retail interests to continue to support the Minnesota legislation after uniformity was deleted was commendable, as was its decision (adopted by the legislature) to delete uniformity in the Kansas legislation and to help facilitate the bill's enactment. In states where uniformity had been enacted previously in exchange for restrictions on retailers or tobacco companies (a tobacco excise tax increase in Michigan, and a full licensing regime in Wisconsin), PMUSA opposition to deletion of uniformity was reasonable and appropriate.

In short, PMUSA took a practical, non-ideological approach to uniformity provisions in almost every state. The exceptions -- Kentucky, South Carolina, and perhaps Virginia -- contained sufficient questions of political

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strategy such that, rather than criticize the decision to proceed with weaker legislation and uniformity, we propose to continue our review of legislative activity in these states.

Proper funding of enforcement agencies. We believe that anti-tobacco organizations raise a legitimate issue over the need to fund sufficiently the state agency responsible for enforcing tobacco sales laws. Additionally, reasonable arguments exist on both sides regarding the extent to which the licensing system should fund the enforcement efforts, and some compromise on this point would be logical. Proper funding of enforcement can always be dealt with in subsequent appropriations bills and should not derail an otherwise beneficial youth access bill. However, PMUSA should pay ongoing attention to this issue.

Overall Conclusions.

We believe that PMUSA has, to date, fulfilled its promise to attempt to enact reasonable state legislation embodying the AAA agenda. We base this conclusion on the following factors:

- PMUSA sought legislative action in most states where it had a reasonable opportunity to pass legislation.
- The AAA legislation that it proposed in nearly every state was comprehensive.
- When confronted with political opposition to a major AAA element (usually line-of-sight or licensing provisions), PMUSA usually took reasonable, pragmatic approaches that attempted to attain those elements of the AAA bill for which adequate political support existed.
- PMUSA was usually pragmatic about the local preemption issue, with a few exceptions noted below.
- Eight states have enacted new anti-youth access laws due, in part, to PMUSA's efforts. Six of these laws clearly improve prior law.
- Fourteen states considered legislation that contained major portions of the AAA agenda, 10 of which contained full licensing regimes, and this bodes well for future positive legislative action.

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We do have concerns about the cases of South Carolina and Kentucky. Even though the political reality in those states suggests that it will be very difficult to enact statewide or local licensing, PMUSA should not fail to revisit these states in the near future. We propose another review of whether licensing is enacted or local preemption is deleted or curtailed in 1997.

Statutory change in the nation's 50 states does not occur in one year, or even in three. However, with minor exceptions, PMUSA has substantially participated in a positive legislative movement that is off to a good start. Only time will tell if this momentum will be sustained, but the current indications are favorable. We recommend that further analysis of state anti-youth access legislation be conducted during 1997 with respect to the following matters: (1) any improvements in the weak AAA laws coupled with local preemption in states such as Indiana, (2) the results of legislative activity in the ten states that considered comprehensive AAA legislation but did not complete action in 1996 and (3) the extent to which sufficient funding is provided to new or existing AAA regimes, and PMUSA's support for such funding.

IV. SUMMARY CONCLUSIONS AND RECOMMENDATIONS

PMUSA has made a good-faith effort to implement each element of the AAA program. As of January 31, 1997, some aspects of the AAA program have been more successfully implemented than others. The key to success has usually been PMUSA's ability to implement a program element unilaterally (e.g., instituting the "Underage Sale Prohibited" notices, and discontinuing product sampling and mailings). By contrast, in areas in which factors beyond the company's immediate control have played a significant role (e.g., the efforts to enact state legislation and to obtain retailer fine/conviction data from the states), PMUSA's success rate has been lower. We are satisfied, however, with PMUSA's commitment to each program element, and can report without qualification that, whether it met with immediate success or initial frustration, PMUSA has worked diligently in furtherance of the objectives of the AAA program.

The AAA program aspects over which PMUSA had complete control -- "Underage Sale Prohibited" labeling, discontinuation of free samples, discontinuation of the mailing of PMUSA cigarettes, and rewarding identification of unauthorized use of PMUSA trademarks -- have for the most part been fully and effectively implemented.

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The portion of the AAA program over which PMUSA had significant control -- the placement of minimum age signage and related POS materials in retail outlets with PMUSA merchandizing agreements -- has been implemented with substantial, if not complete, success. Given the structure of the We Card program, retailers must still affirmatively act before the appropriate warning materials are displayed in their stores. Nonetheless, over 60% of the retail stores with which PMUSA has a merchandising agreement have posted We Card signage (or that of its predecessor, AFITL), and 80% of all retail stores have some form of age tobacco signage. Importantly, the types of stores that are viewed as the most common retail outlets for underage tobacco sales -- convenience stores, tobacco stores and gas station stores -- are much more likely than other categories of outlets to possess We Card signage. This is an important fact, given that a large majority of the retailers surveyed believe that the warning signs do deter many minors from attempting to purchase cigarettes.

The HRA survey suggests that TSMs would benefit from renewed training with regard to the specific elements of the We Card program and the RRP, especially in the areas of state tobacco sales laws and the enforcement aspects of the RRP. The survey indicates also that, despite the high level of retail account enrollment in the RRP, most of PMUSA's retail accounts are unfamiliar with the specific program elements, and do not recognize Philip Morris as the sponsor of the program. We believe that the TSMs' focus on the one quantifiable aspect of the RRP -- namely, the enrollment rate, as measured by returned pledge cards -- should be complemented by a renewed effort to educate retailers about the specific elements of the We Card program and the RRP, and that PMUSA should now develop qualitative measures of the success of these efforts.

Additionally, we wish to reiterate our appreciation of PMUSA's willingness to submit to an extensive, independent survey of the practices of their sales force and the retail accounts they serve. The HRA survey helped us immeasurably in assessing the key factors on which we had to report and may serve as a valuable resource for many future initiatives (by PMUSA and others) intended to prevent retail sales of tobacco products to minors.

In the area of state legislation, PMUSA achieved important initial successes in a number of states. In addition, it advanced meaningful legislation in a significant number of other states that is likely to lead to strong new anti-youth-access laws in the near term. While there are a few instances of questionable legislative decisions or strategies, these are the exceptions to the

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rule. For the most part, PMUSA has initiated an important legislative trend that should result in a substantial improvement in state laws intended to prohibit the sale of tobacco products to minors. However, because of the scope of this project, the fact that PMUSA has only had one year of legislative opportunity between the announcement of the AAA program and the date of this report, the difficulty of steering legislation through to enactment, and the fact that follow-up legislative actions are necessary in some states, we propose to continue our review of the state legislative element of the AAA program and update our findings in early 1998.

One aspect of the AAA program cannot be deemed a success as of the date of this report: the denial of merchandising benefits to retailers who are fined or convicted of selling tobacco products to minors. This lack of success does not reflect an absence of effort or sincerity on the part of PMUSA. Indeed, PMUSA did take the actions it promised with regard to the relatively small number of retailers on which it received fine/conviction data. Rather, the current status of this element of the AAA program is due to PMUSA's unexpected inability to obtain data from more than a handful of state and local governments. Because a number of sources indicate that the denial of merchandising benefits would be a substantial and effective deterrent against retailer noncompliance with anti-youth access laws, PMUSA now needs to take significant new steps to convince states to provide this data or otherwise make the threat of PMUSA sanctions against noncompliant retailers a reality in all 50 states. Given the large amount of unfinished work on this aspect of the AAA program, we propose to continue our review and issue a status report in early 1998.

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March 31, 1997

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TABLE OF EXHIBITS

- Exhibit A: Report of Hoffmann Research Associates
- Exhibit B: Detailed summary of PMUSA's correspondence with each state
- Exhibit C: Table summarizing the status of the data requests
- Exhibit D: Summary of PMUSA's actions to contact local entities and any responses received
- Exhibit E: Summary of unresolved state responses
- Exhibit F: Table summarizing state and local government data on fines and convictions
- Exhibit G: Standard PMUSA letter encouraging fined/convicted retailer to enroll in the We Card program and comply with the law
- Exhibit H: Colorado anti-tobacco coalition legislative flyer
- Exhibit I: Findings from Interim Report on Virginia, Delaware and Kansas
- Exhibit J: Jan. 25, 1996 memo to "All Wisconsin Legislators" from retail community
- Exhibit K: Wisconsin Lung Association endorsement of legislation, and subsequent retraction of such endorsement