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Office of the Secretary
Federal Trade Commission
Room 159
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Re: Cigarette and Smokeless Tobacco Report

These comments are submitted in response to the Commission's April 10, 2001 Federal Register notice requesting comments on whether the Commission should continue to issue reports on the sales, advertising, and promotion of cigarettes and smokeless tobacco products, as well as on the formats for such reports. I am submitting these comments on behalf of the members of the National Association of Attorneys General.

We believe that the Commission's report on the sales, advertising, and promotion of cigarettes are an essential and indispensable resource for those seeking to monitor the marketing programs of the major cigarette and smokeless tobacco manufacturers, and are particularly important to the States that are seeking to enforce the provisions of the Master Settlement Agreement ("MSA") and the STMSA. We urge the Commission in the strongest possible way to continue publication of the reports in at least the level of detail currently provided in order for the States to fulfill their enforcement obligations under the MSA.

Background:

The National Association of Attorneys General ("NAAG") is a non-profit association whose members are the attorneys general of all 50 states of the United States, the District of Columbia, Puerto Rico, and four U.S. territories. NAAG is submitting these comments on behalf of all its members. Forty-six states, the District of Columbia, Puerto Rico, and four U.S. territories (the "Settling States") are parties to the Master Settlement Agreement ("MSA"), a comprehensive litigation settlement agreement between themselves and certain tobacco product manufacturers (the

"Participating Manufacturers"). Most of the Settling States are also parties to the Smokeless Tobacco Master Settlement Agreement ("STMSA") an agreement similar to the MSA to which U.S. Smokeless Tobacco Company is a party. More than 30 tobacco product manufacturers have joined the MSA and companies are continuing to join. Four States have separate settlement agreements with tobacco companies settling their litigation. Those agreements contain public health provisions and other provisions that raise many issues similar to those discussed below.

The MSA resulted from the settlement of litigation brought individually by each of the States against the major tobacco companies. The MSA recites that the purpose of this litigation was "to further the Settling States' policies regarding public health, including policies adopted to achieve a significant reduction in smoking by Youth," and that both the Settling States and the Participating Manufacturers (i.e., the tobacco companies that signed the MSA) "are committed to reducing underage tobacco use by discouraging such use and by preventing Youth access to Tobacco Products." Furthermore, the Agreement and the uniform consent decrees accompanying it state that it is "necessary in order to further the Settling States' policies designed to reduce Youth smoking, to promote the public health and to secure monetary payments to the Settling States."

The data contained in the FTC reports is essential for us to achieve the goals set forth in the MSA. The MSA provides:

- A prohibition on Participating Manufacturers' taking "any action, directly or indirectly, to target Youth within any Settling State in the advertising, promotion or marketing of Tobacco Products, or tak[ing] any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within any Settling State." (III.a)
- A prohibition on the use of cartoons in advertising, promotion, packaging or labeling of Tobacco Products. (III.b)
- Restrictions on tobacco brand name sponsorship of entertainment or sports events. (III.c)
- A ban on most forms of outdoor advertising and on all transit advertising by tobacco companies. (III.d)
- Prohibitions on payments to the media for promotion of tobacco products. (III.e)
- Restrictions on tobacco brand name merchandise. (III.f)
- Restrictions on distribution of free samples. (III.g)
- A ban on sales of cigarette packs containing fewer than twenty cigarettes (III.k)

- A requirement that Participating Manufacturers promulgate or reaffirm corporate principles that express and explain their commitment to comply with the provisions of the MSA and the reduction of the use of Tobacco Products by Youth and to encourage their employees to identify additional methods to reduce Youth access to, and incidence of use of, Tobacco Products. (III.I)

The Attorney General of each Settling State is principally responsible for enforcement of the MSA in that State and can seek permanent injunctive relief. Pursuant to the MSA, NAAG provides "coordination and facilitation for the implementation and enforcement of the MSA on behalf of the Attorneys General." NAAG's performance of these functions is supervised by the NAAG Tobacco Committee, which I chair.

The FTC's Report

The Commission's reports on cigarette advertising and promotion play an important role in the Settling States' enforcement of the MSA's restrictions. They provide a gauge by which to measure the overall effectiveness of those restrictions. They assist the States in determining where the Participating Manufacturers are directing their marketing resources, which is vital to the States' efforts to decide where to direct their own efforts at youth smoking prevention. For example, a large increase in spending on magazine advertising from 1998 to 1999 suggested that the Participating Manufacturers had shifted some of their advertising resources from billboards (banned by the MSA) to print media. This led to several investigations of the tobacco manufacturers' magazine advertisement placements by states and public health groups. Similarly, large increases in the companies' point-of-sale promotional activities in the past few years have suggested that the retail environment is an increasingly important area in which to concentrate efforts to reduce underage smoking. The reports also provide useful information for enforcement of state youth access laws.

It is highly instructive to have reports, such as this, that contain information on the full gamut of advertising, promotion and marketing practices. Having this information not only guides the Attorneys General in enforcing the MSA, but it also provides information about priorities for investigation and enforcement of state laws concerning the marketing of cigarettes. For example, knowing that the cigarette manufacturers increased expenditures on Retail Value Added and Promotional Allowances by a total of \$3.5 billion between 1997 and 1999 provides important information about the areas in which law enforcement investigative efforts might be concentrated.

It is important for the States to continue to have information not only about aggregate expenditures for advertising, promotion, and marketing, but also to have information about expenditures broken down by category. The FTC Reports are the only authoritative source of such information, and the loss of this information would be a grievous blow to state law enforcement efforts. The information provided by the FTC Reports is particularly significant because the MSA provides the States with relatively limited information-gathering authority. Regular reporting, based

on information provided by the companies, provides the States with important data on a regular basis that otherwise would be unavailable.

In addition to the law enforcement functions served by the Reports with respect to advertising, promotion, and marketing, the Reports have important ramifications on payments by the Tobacco Product Manufacturers to the Settling States under the MSA. Payments to the States are subject to numerous adjustments, some of which can affect the level of payments by hundreds of millions or even billions of dollars. Under the complex provisions of the MSA, some such adjustments are dependent upon economic determinations about the factors causing changes in the market shares of participants. Because marketing programs are so important in affecting market share, the FTC figures provide an irreplaceable source of information about factors that may have affected market share from year to year. Loss of this source of information would make it vastly more difficult for such determinations to be made accurately and could jeopardize billions of dollars in payments to the States. In addition, the sales information gathered and published by the FTC is also highly relevant to the evaluation of figures on which billions of dollars in payments and adjustments under the MSA are based.

Under the MSA, the Participating Manufacturers' payments to the Settling States in a particular year may be subject to a downward adjustment (the "NPM Adjustment") if, among other conditions, the Participating Manufacturers experience a loss in market share in excess of two percentage points when compared to their 1997 market share, and an economic consulting firm chosen by the parties determines that the disadvantages the Participating Manufacturers experienced as a result of the MSA's provisions were a "significant factor" contributing to the market share loss. Among the "disadvantages" the Participating Manufacturers may point to are the advertising restrictions described above. Comparisons of the Participating Manufacturers' advertising, marketing, and promotional expenditures during the relevant years in all categories of expenditures could therefore be highly relevant to the "significant factor" determination and affect the disposition of hundreds of millions of dollars.

The Commission may receive comments stating that such reporting is expensive to the companies. The failure to have such information gathered and reported, however, could be vastly more expensive to the States and their citizens. Enforcement of the MSA and the other state consumer protection laws affecting the marketing of tobacco, particularly to minors, is a matter of paramount importance. Moreover, ensuring the accurate determination of payments to the States under the MSA could involve hundreds of millions or billions of dollars.

Changes to the Report.

The Notice also asks for suggestions on ways in which the Reports could be improved. We offer the following suggestions:

Categories of expenditures should be defined with as much specificity as possible to ensure that the companies' understanding of the categories is consistent so that aggregate information is accurately presented. The Commission should examine the definitions it uses to ensure that reporting companies are given adequate guidance.

The Reports should continue to break down expenditures into detailed categories. Aggregation at higher levels of generality would obscure very important developments in the market.

Consideration should be given to breaking down certain expenditures on a more detailed basis. The most recent FTC Report shows huge increases in expenditures for "Promotional Allowances" and "Retail Value Added." Breaking these expenditures down into components would provide a much clearer picture of activity in the marketplace. It is important to break these expenditures down into categories that distinguish price discounts from promotions that include distribution of promotional items.

With respect to reporting of "Specialty Item Distribution" the report should specify whether the expenditures listed include items without brand logos. Such information is important to help the Settling States enforce the prohibitions on Brand Name Merchandise in the MSA.

It is our understanding that the report does not include distribution of non-branded merchandise in any category (i.e., a giveaway of a tee-shirt with the purchase of cigarettes). If this is true, this is an important omission. Such distribution should be reported. If such items are distributed in connection with a purchase, such distribution could significantly influence consumer choice by effectively lowering the price of cigarettes sold in conjunction with such distribution. Such distribution therefore could influence any study of product and brand elasticity.

If "Specialty Item Distribution" includes items with brand logos, the report should specify the venue in which such items are distributed. Under the MSA, Brand Name Merchandise may be distributed only at Adult-Only establishments.

"Promotional allowances" have increased greatly in recent years. Breaking down this category into components such as fees paid for branded racks, slotting fees, and free standing displays would make such information far more useful. Many jurisdictions have determined that free standing displays undermine their youth access laws and have banned or restricted them. It would be instructive to have information on the components of "promotional allowances" to monitor activities affecting youth access.

The MSA distinguishes between "Brand Name Sponsorship" of events open to the general public and events held in Adult-Only Facilities. We believe expenditures for these categories are currently combined into the reporting line for "Public Entertainment." Listing these categories separately would provide a report that better supports monitoring of MSA compliance.

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The Commission should examine the components of reporting in the category for "Internet" and determine whether a further breakdown of expenditures of electronic advertising and marketing is warranted. In light of the growing marketing of cigarettes by electronic means and the problems such marketing poses for states in enforcing their revenue laws, the Commission should closely examine the activities included in this broad category and provide reporting that permits the states to monitor the directions in which electronic marketing is growing.

The Commission should attempt to publish its data on as expedited a basis as possible. While it is instructive to have data for 1999 available now, availability of data for 2000 would be even more helpful. In order to provide for more timely reporting, the Commission might consider reporting on a quarterly basis.

Currently, the Commission obtains and publishes information only from five companies. Consideration should be given to broadening the list of companies to give a more comprehensive view of industry conditions.

Consideration should be given to separate reporting for smokeless companies, whose sales and advertising have increased substantially in recent years.

The Commission should consider publication of the information it gathers on a company-by-company and brand-by-brand basis. Even if the Commission should decide not to provide full public access to such breakdowns, it should provide access to such information to law enforcement agencies for the purpose of enforcing state consumer protection laws and the provisions of the MSA.

For the reasons provided herein, we urge the Commission to continue publication of these reports and to consider the changes we have suggested.

Respectfully submitted,



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Chair, Tobacco Committee