

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N Street, Room 121

Sacramento, California

REPORTER'S TRANSCRIPT

JUNE 6, 2007

INTERESTED PARTIES MEETING

FLAVORED MALT BEVERAGES

Reported by: Beverly D. Toms

No. CSR 1662

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P R E S E N T

Panel:

Mike Hale

Lynn Bartolo

Randy Ferris

David Gau

Monica Brisbane

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## INDEX OF SPEAKERS

1		
2	SPEAKER:	PAGE
3	JOHN JONASKO	19
4	SCOTT DICKEY	22
5	JUDY WALSH-JACKSON	32
6	MICHELLE SIMON	36
7	SARA KEWIN	40
8	KATIE LUCAS	44
9	WILL CHEESMAN	45
10	SCOTT VARNER	46
11	JOHN HOLTZMAN	50
12	MARC SORINI	51
13	ALLYSON HAUCK	54
14	FRED JONES	68
15	KATIE ANDERSON	73
16	JAMES DU	74
17	BRUCE LIVINGSTON	92

---oOo---

18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

1 Sacramento, California

2 June 6, 2007

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4 MR. GAU: Good morning all. First of all I'd  
5 like to welcome you to the second Interested Parties  
6 Meeting regarding the proposed regulations for flavored  
7 malt beverages that would -- if went through, would tax  
8 them as distilled spirits.

9 For the record, my name is David Gau. I'm the  
10 Deputy Director here for the Property and Special Taxes  
11 Department.

12 As you are aware, the Board voted in December  
13 in speeding the grant of petition made by the Students  
14 Making a Community Change and the California Youth  
15 Council to initiate the rulemaking process regarding the  
16 classification and tax rates for flavored malt  
17 beverages.

18 We held a -- our first Interested Parties  
19 Meeting back in February, and so based on your verbal  
20 and written input we have developed a second discussion  
21 paper that did go out back in mid-May. That was  
22 provided to the interested parties.

23 So, the second issue paper included the staff  
24 analysis that summarizes all the input that we received  
25 and the comments, and as directed by the Board now with  
26 this second paper has this draft regulatory language  
27 that would tax FMBs as distilled spirits.

28 So, today -- the purpose of our meeting today

1 is to really get into the technical parts of the draft  
2 regulations and the Board's administration thereof. So,  
3 we are looking for comment along those lines today.

4 Now, you may wish to address other issues  
5 arising from this second issue -- discussion paper and  
6 -- and these regulations. However, I'd emphasize and  
7 what we'll probably monitor today is we're going to try  
8 and break up some of the initial public testimony into  
9 two parts. What we'd like to do is take those folks  
10 that would like to just go on record as support or  
11 opposed, that group first. Okay.

12 And we'll -- we'll -- if you want and they'd  
13 like, you can also submit, quote, to staff, any written  
14 submission that you have. And we'd be glad to take  
15 that.

16 We'd like to, you know, run this and be done by  
17 noon. And I know there's a lot of technical issues that  
18 we really need to deal with. So, if we can try to  
19 follow that line, we'd love -- excuse me, we'd like  
20 to -- we want to hear from you, support or opposed  
21 people first, and then we will get into the people that  
22 have comments regarding the regulations, specific  
23 comments in the regulation and any administration  
24 difficulties that they see or that they think we should  
25 be made aware of. We would like to take that group  
26 next.

27 So, I know we have sign-up sheets. I haven't  
28 seen the final groupings of those, but we're going to

1 try and organize -- that way we'd appreciate your  
2 cooperation in doing that.

3 So, we've -- as you can see we've established  
4 microphones at the front. So, whenever one's most  
5 convenient, you're welcome to come forward with the --  
6 after we do some more introductions and background here.

7 At that point, I believe Mike Hale will be  
8 calling people forward and if we can get that arranged  
9 that way it would be much appreciated and hopefully we  
10 can have a very efficient meeting today with a lot of  
11 good communication and -- and more insight provided.

12 So, also at this meeting as you are probably  
13 aware and as last time, we are streaming this one on the  
14 worldwide web. The beta for the audio, excuse me. So,  
15 whenever you're making public comment for the -- and we  
16 are also transcribing with a Court Reporter -- it would  
17 certainly help if you'd -- what you need to do is state  
18 your name, any association affiliation and especially if  
19 you're in support or opposed, if you would make that  
20 clear up front.

21 At this point then I guess what I'd like to do  
22 is introduce the Board staff that's up here. First of  
23 all on the -- on the far end down there is Lynn Bartolo.  
24 She's the Chief of the Excise Taxes Division here at the  
25 Board of Equalization.

26 Next to her is Mike Hale.

27 MR. HALE: Good morning.

28 MR. GAU: Business Tax Specialist.

1           Monica Brisbane is a Tax Counsel here in our  
2     Legal Department.

3           MS. BRISBANE: Good morning.

4           MR. GAU: As well as Randy Ferris. So, they'll  
5     be monitoring and providing comment and also a lot of  
6     the -- probably the technical issues will be dealt with  
7     up front here.

8           Staff is around the room. I noted that most of  
9     the people with the green badges are -- are the staff,  
10    and if we can help facilitate this meeting in any way,  
11    we certainly would be glad to.

12           At this point I would like to turn to Leila  
13    Khabbaz, who is going to talk a little bit about the  
14    Board of Equalization's Business Taxes Committee  
15    process. Basically, what the results of today, how that  
16    will all culminate, where we're headed with this,  
17    ultimately to -- back to the Board Members in August.

18           MS. KHABBAZ: Thank you, David.

19           Welcome again and good morning. My name is  
20    Leila Khabbaz. I'm with the Business Taxes Committee  
21    team in the Sales and Use Tax Department. Generally,  
22    our staff prepares the analysis that goes before the  
23    Board for decision to the Business Taxes Committee.

24           I was asked to come in today and kind of guide  
25    you through the Business Taxes Committee process and the  
26    rulemaking process.

27           The Board of Equalization follows a two-phase  
28    rulemaking process. The first phase is an informal

1 phase and this is the one we're in right now. It really  
2 consists of hearing regulatory language and working with  
3 the interested parties on that language and their  
4 submissions.

5 The second phase is the formal rulemaking phase  
6 and it's mandated by law. Leading up to the formal  
7 phase of the rulemaking is this process. This process  
8 as to this particular issue, the flavored malt  
9 beverages, began in February of 2007. You will -- we  
10 already issued two discussion papers, as David  
11 mentioned. There was the interested parties meeting and  
12 this is the second one.

13 Following this meeting will be a formal issue  
14 paper that will be issued by staff on August 3rd, and  
15 that issue paper will include recommendation for the  
16 Business Taxes Committee to take action on.

17 The Business Taxes Committee will meet on  
18 August 14 on this issue. It is composed of the Board  
19 Members, themselves, sitting in as a committee. You may  
20 choose to sign up to speak before the committee on  
21 August 14 at 9:30.

22 Following the committee meeting, the committee,  
23 itself, makes a recommendation for the Board action.  
24 The Board approves the committee report and decides  
25 whether to authorize publication of the regulation.  
26 This is then generally the same day or the next day via  
27 the minutes of the Business Taxes Committee.

28 When the Board approves the regulation -- for a

1 proposed regulation, we enter the formal rulemaking  
2 process. It mainly consists of a 45-day public comment  
3 period followed by a public hearing of the proposed  
4 regulatory action.

5 Should the Board approve the regulation on  
6 August 14, the public hearing for this regulation would  
7 be held either in October or November. I'm not sure. I  
8 think it's November. But you will be notified.

9 At the public hearing, the Board considers  
10 written and oral testimony and ultimately decides to  
11 adopt, repeal or amend the regulation. The adopted  
12 regulation will then be submitted to the Office of  
13 Administrative Law for final review and approval.  
14 That's when it becomes law.

15 If you'd like more information on the  
16 rulemaking process, the Board of Equalization web site  
17 has a wonderful two-page description of the detailed  
18 process. If you go to the main menu of the Board of  
19 Equalization's web site at [boe.ca.gov](http://boe.ca.gov) and you enter  
20 "rulemaking in the upper right-hand side, you can search  
21 for rulemaking you will hit that site. It has good  
22 information.

23 And unless you have any questions regarding  
24 what goes on after that and the rulemaking process, I  
25 will turn the meeting over to Lynn Bartolo.

26 Seeing you have no questions, Lynn, you're on.

27 MS. BARTOLO: Thank you. Welcome to our second  
28 Interested Parties Meeting to discuss the draft

1 regulations on flavored malt beverages. I am Lynn  
2 Bartolo. I'm the Chief of the Excise Taxes Division and  
3 it is my staff who register the accounts who are  
4 licensed by the Department of Alcoholic Beverages. We  
5 administer the tax collection for ABC and we process tax  
6 returns.

7           It is my staff who will be responsible for  
8 administering any changes that might come from this  
9 process.

10           The discussion paper, which is included in the  
11 packet that hopefully you picked up outside, summarizes  
12 our understanding of the public comments that we have  
13 already received. We have listed out a couple of  
14 alternatives and with the assistance of our Legal staff  
15 drafted proposed language for discussion here today.

16           I would like to thank all of you that have  
17 submitted written submissions. These -- these  
18 submissions have been copied and distributed not only to  
19 Excise Tax Division's staff, but to the Board Members  
20 and their staff.

21           The focus of today's meeting again will be the  
22 draft language and any issues you may have pertaining to  
23 the proposed change, the associated processes and  
24 hopefully we'll be able to answer any questions that you  
25 may have.

26           At this time I'd like to turn over -- turn this  
27 over to our moderator, Mike Hale, and he will discuss  
28 further the -- the process for today.

1           MR. HALE: Thank you, Lynn. Again, my name is  
2 Mike Hale. I work for Lynn in the Excise Taxes Division  
3 and I'll be the moderator for today's meeting.

4           I would first like to review for you a couple  
5 of points the staff has made in the second discussion  
6 paper.

7           First I will discuss the issue of the Board's  
8 jurisdiction to classify flavored malt beverages and the  
9 locations that may or may not be able to sell those  
10 products.

11          Second, I will briefly go over the three draft  
12 regulations and I will follow up this review with some  
13 guidelines on how the meeting will be conducted today.

14          As Lynn indicated, copies of the agenda for  
15 today's meeting, the second discussion paper, the draft  
16 regulations and a packet that contains all of the  
17 interested parties' submissions to date, are available  
18 at the sign-in counter at the front door.

19          We will be using a speaker sign-up process  
20 that's similar -- we're -- we are going to modify it a  
21 little bit, but along the lines of what we did in the  
22 first meeting. So, if you intend to speak, we'd  
23 appreciate it if you would sign up, and that's available  
24 at the front door.

25          We will be modifying the -- the speaker  
26 process. To a certain extent we want to open it up a  
27 little bit more to a -- a roundtable discussion. And I  
28 will get into more on how we -- we would like that to go

1 in just a bit.

2           Regarding the classification of flavored malt  
3 beverages, commencing on January 1, 1955 and pursuant to  
4 a constitutional amendment, the Department of Alcoholic  
5 Beverage Control was given the exclusive power to  
6 license, to manufacture, importation and sale of  
7 alcoholic beverages in this state.

8           As a result of this change in law, ABC is  
9 assigned the responsibility for the licensing of all  
10 locations that sell alcoholic beverages in California.  
11 The ABC has advised the BOE of its present intention to  
12 continue classifying flavored malt beverages as beer.

13           As ABC licensing is controlling over sales of  
14 alcoholic beverages in this State, it is the staff's  
15 view that BOE may not impose additional licensing  
16 limitations on the ABC.

17           As we see it, the BOE does not have  
18 jurisdiction to impose limits on where flavored malt  
19 beverages may be sold because it is the ABC that clearly  
20 has the exclusive power to license the manufacture,  
21 importation and sale of alcoholic beverages in  
22 California.

23           With that said, the ABC is of the opinion that  
24 no statutes empower or authorize the ABC to direct the  
25 BOE how to classify any alcoholic beverage for taxation  
26 purposes. We agree with this opinion and therefore this  
27 rulemaking process as discussed in the second issue  
28 paper will pertain to the classification of FMBs for tax

1 purposes.

2 Next I would like to briefly recap the draft  
3 regulatory language that was developed as an initial  
4 step to meet the Board's directive to proposed  
5 regulatory language to tax FMBs as distilled spirits if  
6 they ultimately so adopt that approach.

7 The complete text of the three draft  
8 regulations is available as Exhibit 1 of the handout.  
9 The three proposed regulations would first define  
10 distilled spirits to include an alcoholic -- alcoholic  
11 beverage except wine which contains a half percent or  
12 more alcohol from flavors or ingredients containing  
13 alcohol from distillation.

14 Next, establish a presumption that alcoholic  
15 beverages except wine that contain a half percent or  
16 more alcohol from these flavors or ingredients  
17 containing alcohol from distillation.

18 And, three, allow a -- the manufacturer the  
19 ability to rebut this presumption as to any particular  
20 alcoholic beverage by filing a statement under penalty  
21 of perjury that specifies the sources and amount of  
22 alcohol contained in the beverage.

23 Additionally, these regulations authorize the  
24 BOE to require manufacturers to file a copy of their  
25 Statement of Process or the formula that is filed with  
26 the Alcohol, Tobacco, Tax and Trade Bureau for any of  
27 these products.

28 The intent of these draft regulations is to tax

1 FMBS as distilled spirits and traditional beer products  
2 as beer. The half percent threshold was appropriated  
3 from the TTB regulatory process for purposes of  
4 establishing the necessary dividing line.

5 During the Federal rulemaking process  
6 traditional beer companies indicated that their products  
7 were generally under this threshold. The bright line  
8 threshold also provides FMB manufacturers a clear  
9 standard in the event they desire to reformulate their  
10 products.

11 Our purpose here today is to hear your comments  
12 on this draft regulatory language. We want to allow you  
13 a full opportunity for you to propose suggested  
14 revisions or -- or alternatives before the final issue  
15 for this topic -- topic is submitted to our Business  
16 Taxes Committee.

17 We encourage you again to follow up today's  
18 verbal presentations with your written submissions.

19 With that said, we're going to open up the  
20 floor for your public comment. As David mentioned  
21 earlier, we're going to try to break this up into two  
22 groups.

23 First of all, as indicated on the speaker cards  
24 that were handed out as you entered the room, we ask  
25 that if you are here today to voice just your position,  
26 you're either in favor or opposed and do not intend to  
27 offer comment regarding the draft regulations or other  
28 issues, that when it is your turn to speak that you

1 limit what you have to say here. Just state your name,  
2 your affiliation or organization you may represent, and  
3 whether you are in favor or opposed and your position  
4 will be noted. Then return to your seat.

5 We're going to call everybody up that falls  
6 under that category to these three microphones. And  
7 then after that, we will open it up to a second group  
8 where we will -- that may want to discuss some more  
9 specific issues in the regulations.

10 What we'll do at that point is I'll call  
11 speakers forward three at a time as we did in the first  
12 meeting. You can come forward to one of the three  
13 microphones located here at the front of the room and  
14 wait until you are called upon to make your presentation  
15 regarding the regulations.

16 Another thing we're going to try this time, if  
17 during the presentations you may want to make a comment  
18 on something that's being said, please feel free to come  
19 forward and line up at these microphones. Wait your  
20 turn. We'll indicate when you may make the comment, and  
21 we want to open up the meeting a little bit more to that  
22 type of discussion.

23 Speakers will not be required to -- to answer  
24 questions if they do not desire to do so. If upon the  
25 completion of a presentation you do not want to answer  
26 any questions, just return to your seat.

27 And I think with that I would like to invite  
28 anyone forward that would like to voice their position

1 for or against these regulations.

2 Come on down.

3 MR. NELSON: Good morning. Scott Nelson. I'm  
4 opposed.

5 MR. HALE: Thank you, Scott.

6 MR. FONG: I'm James David Fong. Students  
7 Making a Community Change. And I'm for this petition.  
8 2258 and 2259.

9 MR. HALE: Thank you. Sir.

10 REV. JAMES BUTLER: Reverend James Butler from  
11 the California Council on Alcohol Problems. I am in  
12 support of a regulation that will classify and tax these  
13 products as distilled spirits.

14 MR. HALE: Thank you.

15 Feel free to come on down and line up at a  
16 microphone.

17 MR. JORDAN: My name is Jimmy Jordan. And I'm  
18 from California Council. And I'm in favor of it.

19 MR. HALE: Thank you, Jimmy.

20 MR. CHEESMAN: My name is Will Cheesman. I'm  
21 with the San Diego County Policy Panel on Youth Access  
22 to Alcohol. And we are in favor of taxing as distilled  
23 spirits.

24 MR. HALE: Thank you.

25 MR. KOOLER: Good morning. Dr. Jim Kooler,  
26 California Friday Night Live Partnership. And we're in  
27 support of your Alternative number 1, where you did a  
28 good job looking into the (inaudible).

1 MR. HALE: Thank you.

2 MR. SKIPPA: My name is Mike Skippa. I  
3 represent the Marin County Advisory Board on Alcohol and  
4 other Drug Problems. And we are in support of the  
5 reclassification of alcopops and the proper taxation of  
6 such. And I have a resolution signed by the Board.

7 MR. HALE: Thank you, sir.

8 MR. LEMMON: Good morning. I'm Brian Lemmon.  
9 I'm with the beer industry and I oppose.

10 MR. HALE: Thank you.

11 MR. STAUDER: Good morning. My name is Cory  
12 Stauder. I'm also with the beer industry and I'm also  
13 opposed.

14 MR. LUCIO: Good morning. My name is Gustavo  
15 Lucio, also with the beer industry and opposed, as well.

16 MR. HALE: Thank you.

17 MS. NEWBORN: My name is Joanne Newborn. I'm  
18 in the beer industry and I'm opposed.

19 MR. HALE: Thank you.

20 Anyone else that would merely like to speak in  
21 favor or -- or opposition, come -- come on down at this  
22 time.

23 MS. GOODMAN: My name -- my name is Julia  
24 Goodman. I'm a Public Health grad. student at U. C.  
25 Berkeley and an intern with the Marin Institute. And  
26 I'm in support.

27 MR. HALE: Thank you.

28 MS. BLACKSTON: My name is Michelle Blackston

1 and I'm a resident of Monterey County. And I'm opposed.

2 MR. HALE: Thank you.

3 Hopefully we're going to get all your names  
4 marked off so we don't call you down again.

5 Anyone else?

6 All right, at this point then we're going to  
7 open up the meeting to the -- the more formal  
8 discussions of the issues.

9 The first -- I'll call you up three at a time.  
10 Come to -- come forward to any of the three microphones  
11 that's convenient to you. And then we'll -- we'll call  
12 the first speaker to -- to actually speak.

13 The first name John Jan -- Janosko, DBI  
14 Beverage. Good morning, John.

15 MR. JANOSKO: You did pretty good with that.  
16 Probably better than I would do.

17 MR. DALE: Scott Dickey.

18 And Judy Walsh.

19 John, if you'd like to go ahead and start.

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1 JOHNJANOSKO

2 MR. JANOSKO: Do you hear me all right with  
3 this, or do I need to move it?

4 MR. HALE: Sounds great.

5 MR. JANOSKO: Good. Thank you. I'm John  
6 Janosko. I'm the Vice-President and General Manager  
7 with DBI Beverage, a beer distributor in West  
8 Sacramento. And we cover about eight counties in  
9 Northern California.

10 And I just had a couple of points I wanted to  
11 make. I feel sorry for all you folks that have to read  
12 all of these materials. I thought I got a Workers'  
13 Comp. claim when I went to pick it up.

14 But, you know, I started looking at some of  
15 these statistics in there and I -- I think it's pretty  
16 difficult to weed through all of them, but I wanted to  
17 offer a few of them from my -- from my point of view.

18 I sell these products. Probably the majority  
19 of them as far as the industry -- industry is concerned  
20 I represent Smirnoff products, Mike's Hard Lemon --  
21 Mike's Hard Lemonade -- Lemonade and Seagram's coolers.

22 And just to give you an idea of what's going on  
23 with these products, I can't speak for -- for where the  
24 young folks come from or what's going on down there, but  
25 in the Sacramento area, over the last two years our  
26 business is down 18 percent on these products. Down 12  
27 percent. Down 12.8 this past year. And the year prior  
28 to that down 5.9.

1           So, I can tell you that nationally sales of  
2 these products are very, very soft. Statewide sales of  
3 these products are very, very soft. So, if there's --  
4 we're seeing a lot of people move over toward them or  
5 gravitate to them, I don't know where there is any  
6 empirical information that would support that.

7           And I would just ask you folks to -- to think  
8 about that and look at that a little bit because I just  
9 don't see it in the numbers that young people are moving  
10 towards this.

11           The other thing I would say is that if they are  
12 getting these products, it is illegal. You need to  
13 figure out a way to stop that, and you need to figure  
14 out who's giving it to them. Is it their friends? Is  
15 it their parents? And is it -- or is it a retailer?

16           And I would say that I can't understand how a  
17 retailer would risk a \$10,000 fine, the suspension of  
18 their license for their business to make 90 cents on a  
19 24-ounce bottle or about 42 cents on a single serving.  
20 That doesn't make sense to me that somebody would --  
21 that would risk their business to make that kind of  
22 profit -- profit on these products.

23           A couple other quick points I wanted to make.  
24 These products account for about four percent of my  
25 sales. About 6 percent of my profitability. We employ  
26 187 positions -- 187 people in this area. All of them  
27 have benefits. And, you know, if these products are  
28 taxed as a distilled spirit, sales will decline even

1 further and, unfortunately, you have to make adjustments  
2 to -- to your work force.

3           Two other quick points. I was unaware of the  
4 fact that flavored wines are going to get an exemption.  
5 I don't understand how that works. You know, the beer  
6 industry here, a lot of people think California is all  
7 about wine. California is now the largest producer of  
8 beer in the United States. It's a big -- it's a big  
9 business here. It's very important to the State and to  
10 the industry. And I think you need to take a look at  
11 that and recognize that.

12           And I guess that about sums up my point. Any  
13 questions, I'd be more than happy to try and answer  
14 them.

15           MR. HALE: Any comment from the room?

16           MR. HALE: All right. Thank you, John.

17           MR. JANOSKO: Thank you. I appreciate it.

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1 SCOTTDICKEY

2 MR. HALE: Scott.

3 MR. DICKEY: Good morning. My name is Scott  
4 Dickey. I'm an attorney with Renne, Sloan, Holtzman and  
5 Sakai in San Francisco. And I'm here today on behalf of  
6 the petitioners in the County of Santa Clara versus the  
7 State Board of Equalization.

8 When I spoke to you at the February hearing,  
9 when we had a proposed regulation for you, I -- I made  
10 clear that I think that the ultimate issue for the Board  
11 to deal with with respect to alcopops is one of -- of  
12 factfinding, of investigation. You need to know what  
13 these products are so that they can be taxed properly.

14 I think that from the Board's proposal we are  
15 seeing that there's some agreement from staff, at least,  
16 on that particular issue, that it -- that the Board's  
17 proposal as well as ours is aimed at getting at what  
18 these products are, what's put into them, how they get  
19 their alcohol. What -- whether they are in fact  
20 distilled spirits or -- or beer.

21 And I think that is -- that is absolutely a  
22 step in the right direction. I don't know how -- how  
23 much you've spoken with counsel about this, but we had a  
24 hearing on our petition last week. The Board, as I'm  
25 sure you know, demurred. The Court ultimately held the  
26 petition in abeyance to allow the regulatory process to  
27 go forward, feeling that there was room in that process  
28 for rulemaking that will help resolve some of the issues

1 that the Court had, as well which have to go to  
2 specifically what these products are, how they're made,  
3 what's in them.

4 I think that if we can take anything sort of  
5 constructively from the -- from the Court holding this  
6 in abeyance, we -- we can take the fact that the Court  
7 is very interested in the Board moving forward with  
8 regulations that actually address these issues.

9 And so, I think ultimately what -- what I need  
10 to convey to you today is that of the three options that  
11 you produced, the first and the second one are really  
12 the only ones the Board should realistically be  
13 considering.

14 The third option to do nothing and maintain the  
15 status quo isn't going to be the right way to go here.  
16 It -- it doesn't make sense as -- as a practical matter  
17 simply because there -- there are multiple reasons to  
18 suspect that these products are being misclassified  
19 as -- as beers and mis-taxed as beers.

20 And the way to get to that is through  
21 investigation and -- the Board's regula -- the Board's  
22 proposed regulation and our regulation try to get to  
23 that very point, although from slightly different  
24 directions.

25 I would point out at this point that I think  
26 it's pretty clear from our interested party letter and  
27 from the arguments we made to the Court that it's really  
28 not our view that the Board has the kind of discretion

1 to -- to come up with a standard that -- that isn't  
2 completely consistent with what the Legislature has said  
3 in terms of the definitions of beer, wine and distilled  
4 spirits, which is why we think our proposal is the  
5 better of them.

6           However, having said that, if the Board  
7 believes that a .5 percent standard is an appropriate  
8 standard, then it should adopt that, alternatively.

9           I want to talk before I -- before I sit down a  
10 little bit about the alcohol industry's position on what  
11 these products are in terms of how they get their  
12 alcohol content.

13           We heard last February and we saw in the  
14 interested party letter from the Flavored Malt Beverage  
15 Coalition that it's their position that these products  
16 obtain their alcohol from flavorings and not from  
17 something that they consider to be beverage alcohol.

18           I think that we've made very clear in our  
19 interested party letter that -- that under Business and  
20 Profession Code Section 23004 those products, even if  
21 the flavorings are the source of -- of the distilled  
22 spirit alcohol and alcopops, those products are  
23 alcoholic beverages for purposes of -- the flavorings,  
24 themselves, are alcoholic beverages for purposes of  
25 California law, because under California law anything  
26 that can be consumed as a beverage when mixed or diluted  
27 with anything else is an alcoholic beverage. And so it  
28 falls -- it would still fall within the -- the scope of

1 distilled spirits.

2           Ultimately, the flavorings is not flavorings  
3 argument is -- is moot if the Board goes forward with a  
4 regulation that gets us to investigating what these  
5 products are so that they can proper -- be properly  
6 taxed, which is why I think that it's -- it is  
7 absolutely imperative that the Board choose either the  
8 first or the second option.

9           And as a final comment, I'd like to -- I'd like  
10 to -- to direct the Court -- the Court -- excuse me, I'd  
11 like to direct staff and the Board to our interested  
12 party letter where we discuss the -- the practical  
13 effect of reclassifying these as -- alcopops as -- as  
14 distilled spirits for taxation purposes, with --  
15 on small markets, on groceries and that sort of thing.  
16 I think if you -- if you look at that analysis that we  
17 presented in -- in our interested party letter, you will  
18 see that there is really ultimately diminimus --  
19 diminimus effect on income if these things are --  
20 for -- for the purposes of the retailer, at least, if  
21 these things are -- are properly taxed as distilled  
22 spirits as opposed to as beer.

23           And if you have any questions, I'd be happy to  
24 answer them.

25           MR. HALE: I would just point out that although  
26 we're going to look at the issue of taxation as we said  
27 in the discussion paper, we believe the Board could not  
28 limit these type of stores from selling the product.

1 That rests with ABC.

2 MR. DICKEY: We're not --

3 MR. HALE: Just to clarify.

4 MR. DICKEY: We -- we don't disagree. I don't  
5 think that -- obviously, the -- the Board is not the  
6 regulatory agency, it's the taxing agency --

7 MR. HALE: Right.

8 MR. DICKEY: -- and we understand that  
9 and that's, I think, part of the analysis for it. The  
10 effect on retailers, too, these products aren't going to  
11 go off the market. They're not going to be pulled off  
12 the shelves.

13 MR. HALE: Right.

14 MR. DICKEY: They're just going to be taxed  
15 properly.

16 MR. HALE: Thank you. Did you have a question  
17 or a comment?

18 MS. WALSH-JACKSON: I'm the next speaker, thank  
19 you.

20 MR. HALE: Oh, thanks. Sneak around.

21 MS. WALSH-JACKSON: Waiting patiently.

22 MR. HALE: All right, thank you, Scott.

23 MR. FERRIS: Mike, if I might. Randy Ferris  
24 from the Legal Department. Just a -- a very small point  
25 of clarification. It may be hair splitting but I don't  
26 think that it would be fair to characterize Alternative  
27 1 as the Board's proposal. It's just draft regulatory  
28 language for the Board's consideration. It's -- it's

1 not a proposal that the Board is making at this point.

2 It's just --

3 MR. DICKEY: But it's a proposal from Board  
4 staff, though.

5 MR. FERRIS: It's an alternative that has been  
6 drafted by staff that we feel would --

7 MR. DICKEY: Thank you.

8 MR. FERRIS: -- would be congruent with the  
9 Board's direction that they have some language to  
10 consider.

11 MR. DICKEY: Okay, thank you.

12 MR. HALE: Thank you, Scott.

13 Before we go into your comments, I'm going to  
14 call forward the next three speakers. It will be  
15 Michelle Simon. Sara Kewin. Alisa Scheller.

16 Go ahead, Judy Walsh.

17 MS. BLAKE: Excuse me, sir.

18 MR. HALE: Yes.

19 MS. BLAKE: My name is Sue Blake and I'm with  
20 Board Member Bill Leonard's office. Could I just ask a  
21 quick question of Scott?

22 MR. HALE: Oh, please do.

23 MS. BLAKE: Thank you. I -- perhaps I  
24 misunderstood something and I just wanted to give you a  
25 chance to clarify.

26 MR. DICKEY: I keep trying to get away from the  
27 microphone.

28 MS. BLAKE: I know and I'm a little bit out of

1 custom because I have my own microphone over here, so I  
2 just wanted you to clarify it, I think that you said  
3 that anything with alcohol that's added to one of these  
4 beverages changes it into a distilled spirit, is that  
5 correct?

6 MR. DICKEY: Under our reading of the law, if  
7 an alcoholic beverage contains any amount or kind of  
8 distilled spirit, it is a distilled spirit for all  
9 purposes.

10 MS. BRISBANE: And I had a followup question  
11 for you. The alternative that you propose, one of the  
12 comments that were made was that it appears that it  
13 would include potentially every product. What -- what  
14 would then fall under the definition of beer?

15 If -- if we assume as I understand it most  
16 flavorings have alcohol in them to be -- to produce the  
17 flavor and many, if not all, beers have some type of  
18 flavoring in them, then I would assume alcohol, then  
19 what would fall under the definition of beer?

20 MR. DICKEY: Well, I think that gets to the  
21 ultimate problem that the -- the Board faces in this  
22 regulatory process, and that is that we don't know what  
23 is in beer. We've been -- we've had representations  
24 by -- by the alcohol industry that they put hops  
25 extracts or other flavorings in that contain distilled  
26 spirits. But we don't know the amount or the kind of  
27 the distilled spirits.

28 We believe that under the letter of the law as

1 the Legislature wrote it, that the -- the Attorney  
2 General has viewed it, as this Board has viewed it -- I  
3 believe, actually, Ms. Brisbane, you wrote that  
4 letter -- if there is a distilled spirit in traditional  
5 beer, then under our reading of the law that is going to  
6 require classification as a distilled spirit. And that  
7 may be an issue for the Legislature, but it's not sort  
8 of an issue at this level for the Board.

9 As I said earlier, because we take a very  
10 strict construction of the Business and Profession Code  
11 and its -- and its language, we don't think that the  
12 Board has the discretion to adopt a .5 percent standard.

13 Having said that, if the Board disagrees with  
14 us on that point, it's a very practical solution to the  
15 problem. So, you know, they should -- they should do  
16 what they can. We're not going -- we're not interested  
17 in this process in bringing beer -- traditional beer,  
18 the sort of Heinekens and the Bud Lights and the  
19 Coronas, whatever, into the -- the definition of -- of  
20 distilled spirits. It's specifically these products  
21 that are made to look like soda pops that are sickly  
22 sweet that are appealing to kids that obtain, at least  
23 from our understanding, from -- from studies done by the  
24 Federal government on this, get most of their alcohol  
25 from distilled spirits that we're -- that we're handing  
26 out.

27 These are products that are -- that are made  
28 to -- you know, made in such a way that the -- the

1 manufacturer can -- can sort of shamelessly claim that  
2 they're -- they're flavored malt beverages, but in fact  
3 75 percent or more of their alcohol comes from distilled  
4 spirits.

5 And so, it's -- it's a -- we -- we are trying  
6 to get at a -- a practice that is trying to take an  
7 advantage of the regulatory time as it exists now, not  
8 at trying to classify all alcoholic beverages as  
9 distilled spirits.

10 Does that answer your question?

11 MS. BRISBANE: Yeah, I just wanted to make sure  
12 I understood what your alternative was in trying to come  
13 up with some proposals for the Board, where there may be  
14 issues on the alternatives. But then it's a yes, thank  
15 you very much.

16 MR. DICKEY: Thank you

17 MR. HALE: Marc, would you like to speak?

18 Marc --

19 MR. SORINI: Right

20 MR. HALE: -- would you like to come forward  
21 and make a -- question there?

22 MR. SORINI: Well -- well, just one thing,  
23 Scott, as you know, the Federal government completed its  
24 rulemaking. There are not any products on the market  
25 now that derive a majority of their alcohol from flavors  
26 and other non-beverage products. That's Federal law.

27 MR. DICKEY: It is true the TTB rulemaking  
28 process wound up with a 51/49 percent standard I think

1 is the -- is the ultimate way that it turned out.

2 I think that even at that, that almost half of  
3 the alcohol coming from distilled spirits, they have a  
4 problem under California law. And I would remind the  
5 Board that the -- the California law is the one that  
6 applies here, the Federal rules do not.

7 MR. HALE: Thank you, Scott.

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1 JUDY WALSH-JACKSON

2 MR. HALE: Judy, thank you for your patience.

3 MS. WALSH-JACKSON: Sure.

4 MR. HALE: Go ahead and make --

5 MS. WALSH-JACKSON: Thank you, Mr. Dickey, for  
6 your comments. And my name is Judy Walsh-Jackson and  
7 I'm with the California Coalition on Alcopops and Youth.  
8 Nice to see you all again. Thank you for allowing us to  
9 speak again on this very important issue.

10 I have a very simple technical question, and  
11 that is, why -- why do alcopops manufacturers start with  
12 beer but then remove the beer? Why is that? That's my  
13 technical question.

14 Why do they remove the beer, and why don't they  
15 call them beer in other countries? And how much  
16 distilled alcohol do they really contain?

17 So, that's my question of the day. And I would  
18 just like to reinforce that we are talking about the  
19 final product, the final product is alcopops. It's not  
20 whether the individual ingredients in an alcopop are  
21 alcoholic beverages, but rather the alcopops that are  
22 actually marketed and sold to consumers that are  
23 alcoholic beverages are distilled spirits.

24 It's not about categorizing flavorings or  
25 extracts. It is about categorizing an alcoholic  
26 beverage. The final product, the beverage that is  
27 packaged and sold as is for drinking and not for adding  
28 to cakes or muffins or pies or cookies.

1           We are strongly in support of Alternative  
2 number 1. The California Coalition on Alcopops and  
3 Youth is comprised of many, many, many organizations  
4 around the State representing thousands of Californians.  
5 In fact, I'm from San Diego County and our school  
6 district, San Diego Unified School District, passed a  
7 resolution to support the young people's petition.

8           San Diego alone represents 100,000 students.  
9 So, Californians want you to do the right thing. And  
10 I'm perplexed as well, just -- I have a question based  
11 on the gentleman that spoke here before me, not in  
12 answering the -- the other question but I am perplexed  
13 as to why the State would gift the alcohol industry 40  
14 to 50 million dollars per year.

15           So, that's my second question of the day. And  
16 I -- I really hope that the Board will make the right  
17 decision and adopt Alternative number 1 because we  
18 believe that Alternative 1 is effective policy. It  
19 would treat alcopops as distilled spirits and beer as  
20 traditional beer.

21           For Alternative number 2, the Coalition does  
22 not take that argument at face value. The Coalition  
23 hopes that the Board would require proof of the claim by  
24 the industry before dismissing the alternative.

25           So, thank you very much for allowing us the  
26 opportunity to speak.

27           MR. HALE: Thank you very much. Sara, I'm not  
28 sure, I think is next.

1 MS. SIMON: I'm Michelle.

2 MR. HALE: Oh, I'm sorry. Michelle, you're

3 next.

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1 MICHELLESIMON

2 MR. SIMON: Okay. Michelle Simon. I'm the  
3 Research and Policy Director from the Marin Institute.  
4 And I want to also thank the Board for allowing us this  
5 opportunity to speak to you today.

6 I think it's really important for us to try to  
7 put this issue in a bit more of a global perspective and  
8 that's something we don't often do in this country.

9 So, I want to make three points along those  
10 lines. And the first is the real corporate manipulation  
11 of the -- the regulatory environment, and we have  
12 industry's own admission of this manipulation, and that  
13 they have invented this entire category of flavored malt  
14 beverages. Specifically for the U. S. market.

15 And we have evidence of this by the Smirnoff  
16 Ice web site which says right here that the product in  
17 the UK is made with vodka and then they have a little  
18 disclaimer which says "except in the U. S. and the U. S.  
19 supplied markets where it is a flavored malt beverage."

20 So, obviously, they have created this category,  
21 invented it out of whole cloth, for the purpose of  
22 taking advantage of the U. S. regulatory scheme.

23 Another point of evidence of this is an article  
24 from the Seattle Times this year, which talks about  
25 Mike's Hard Lemonade. So, Smirnoff Ice has about half  
26 the U. S. market, Mike's Hard Lemonade is the next  
27 highest most popular drink.

28 And in Canada, where Mike's Hard Lemonade

1 emanates, Mike's spikes its drinks with vodka.

2 In the U. S. because of tax and distribution  
3 issues, it uses a malt base. Okay. Why does industry  
4 do this? Well, let's see what industry says about why  
5 they do this.

6 Here's an article from the Beverage Industry  
7 News, this year, March-April issue, in which it says in  
8 the U. S. the beverages are made with barley malt due to  
9 regulatory reasons. Outside the U. S. actual vodka is  
10 used. This allows FMBs to be classified as beer, which  
11 has advantages.

12 There are less restrictions about where they  
13 can be sold. The beverages have a lower tax rate. And  
14 the beverages can be distributed like beer. These are  
15 all obviously very advantageous to industry.

16 But it's funny how in other countries they're  
17 not doing all this hand-wringing, right, about, oh, my  
18 God, how do we classify these beverages? What about  
19 beer? They're not having that problem. They're just  
20 going ahead and taxing them even at higher rates than we  
21 are even talking about doing here.

22 So, I want to give you an idea of what's going  
23 on in other countries.

24 So, let's talk about the UK. Right. Currently  
25 the UK taxes alcopops at a rate of eight times the  
26 current California rate. In Germany it's 16 times.  
27 Switzerland, a whopping 20 times higher. These are the  
28 current tax rates in these countries, many times higher

1 than what is currently done in California.

2           Interestingly, Germany and Switzerland created  
3 an entire new category. So, they weren't even looking  
4 at taxing as beer or distilled spirits; they created a  
5 new category to specifically tax alcopops and then went  
6 higher than distilled spirits.

7           So, even if we were to correctly classify FMBs  
8 in this country as distilled spirits, the taxes in other  
9 countries would still be higher.

10           So, in the UK it would be twice as high.  
11 Again, thinking about if we were to change the tax from  
12 beer to distilled spirits in California, Germany's tax  
13 would still be four times higher. Switzerland, five  
14 times higher. That should really put this in  
15 perspective.

16           So, all this complaining about increasing the  
17 tax is really just a little bit in California. In other  
18 countries they're doing it many times more.

19           Most importantly, in these countries that have  
20 increased the taxes, they have seen a significant drop  
21 in consumption. And that's really why we're here. And  
22 I know that BOE doesn't like to talk about policy and is  
23 it fit for kids and all this, but, you know what, it's  
24 important. And it is an important consideration because  
25 these products are targeting young people.

26           So, what's happened in these countries that  
27 have significantly increased the taxes? Well, in the UK  
28 sales dropped by 43 percent over a four-year period. In

1 Switzerland, imports of alcopops dropped by about 60  
2 percent, after the tax increase. Germany, most  
3 significantly alcopops sales dropped a whopping 75  
4 percent. And most importantly than that, alcopop  
5 consumption went down 50 percent among teenagers  
6 because, according to a survey, quote, "alcopops became  
7 too expensive."

8           And that's what this is about and that's why  
9 industry is scared to death of any increase in taxes  
10 here. And we have every reason to believe that in  
11 California we would experience a similar drop in  
12 consumption. And our office is -- right now we're  
13 working on data to make those projections.

14           And we'll also be submitting that data in a  
15 later report, which we will estimate the dropping in  
16 consumption, the cost savings -- significant cost  
17 savings to the State of California and, most  
18 importantly, potential lives saved.

19           So, the State of California should not continue  
20 to allow itself to be manipulated by this industry that  
21 only has its profits as their primary motivation, and  
22 California, which likes to think of itself as a leader  
23 in the country, right, should also be a leader in the  
24 world and not be falling behind these other countries.

25           It's time to put California's youth ahead of  
26 corporate profits. Thank you very much.

27           MR. HALE: Thank you, Michelle.

28           I think --

1           MR. GAU: Thank you for -- I would thank you  
2 for your comments, as well. I would like to emphasize  
3 again that we would like to really specifically address  
4 the -- the regulation and -- and the administration on  
5 the Board, the taxation of that in order that we  
6 can hopefully get out of here timely.

7           So, again, speakers, if you would, keep your  
8 comments short. And if they're of a technical nature,  
9 that's what we're to engage in, on that kind of  
10 conversation. Thank you

11           MR. HALE: Thank you, David.

12           I think our next speaker was Sara.

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1 SARA KEWIN

2 MS. KEWIN: Is this okay? Okay.

3 Hi. My name is Sara Kewin and I go to C. K.  
4 McClatchy High School, which is right here in  
5 Sacramento. It's actually right down there. And over  
6 there we're preparing for our graduation ceremony, which  
7 is on Friday. And this time of year with all the  
8 graduations you hear a lot of stories about how, you  
9 know, kids get drunk and they crash their car and they  
10 die. And I know that alcopops would be the cause of  
11 some of these accidents because they're alluring.  
12 They're deceptively sweet. And they have a dangerously  
13 high alcohol content level.

14 And I'd like to reference a Federal research  
15 report called, "Monitoring the Future." And that states  
16 that 30 percent of the seniors, the 12th graders, that  
17 they interviewed had alcopops in the month leading up to  
18 their interview. 30 percent. That's three out of ten.  
19 That's three out of ten of my senior friends who will be  
20 walking the stage this Friday.

21 MS. BRISBANE: Sara, we're talking about you as  
22 in support --

23 MS. KEWIN: In support.

24 MS. BRISBANE: -- of the Board's efforts?

25 MS. KEWIN: Yes.

26 MS. BRISBANE: Okay.

27 MS. KEWIN: And I'm in 11th grade and so the  
28 report actually didn't have statistics for my grade, so

1 I averaged the statistics for the 10th and 12th graders,  
2 and that's 26.5 percent, I believe. That's one out of  
3 four. One out of four of my classmates who have -- who  
4 before that interview had had alcopops in the month  
5 leading up to that interview.

6 And I belong to Girl Scouts. And for the past  
7 ten years that I've been in Girl Scouts I have been  
8 taught to love my sister Girl Scouts. And I know that  
9 some of that 26.5 percent will be current or former  
10 sisters and I don't want anything to happen to them.  
11 Because alcopops taste -- they don't look like beer.  
12 They don't taste like beer. And they're not packaged as  
13 beer. So, how can they be classified as beer?

14 California law is very clear that alcopops is  
15 misclassified and they contain distilled spirits and  
16 they are therefore not beer, even if the alcohol  
17 industry says they are.

18 I support the reclassification of alcopops from  
19 beer to distilled spirits, and I urge the Board to do  
20 the right thing and classify alcopops as distilled  
21 spirits.

22 MR. HALE: All right. Thank you, Sara.

23 Again, our focus here today is to discuss  
24 the -- the draft regulations. If your intention is to  
25 come forward and -- and state whether you are in favor  
26 of taxing or in opposition, please, as we did with the  
27 first group, just -- just state your position for the  
28 record and then return to your seat.

1           We would like to move on to the technical  
2 issues of the second discussion paper.

3           MR. LO FASO: Mike, can I make a comment?

4           MR. HALE: Please do.

5           MR. LO FASO: Alan LoFaso from Board Member  
6 Yee's office.

7           I want to really encourage the members of the  
8 general public, I think there's a perception out there  
9 that some of the underlying policy issues which motivate  
10 you are not of concern to us. That is not true. I  
11 really want you to -- to hear that.

12           But one of the things that staff is trying to  
13 help us do is because we are not a law-making entity, we  
14 have to work with the law we have. And some of you  
15 are -- have come to this meeting once before and you  
16 know there's this legal debate about what "beverage  
17 purpose" means. And different people have different  
18 viewpoints.

19           We spent a fair amount of time in our last  
20 meeting on that one point. We actually have to get to  
21 some additional points about how we're going to make  
22 this presumption work. And you even heard, you know,  
23 Mr. Dickey offer some distinctions on how his  
24 presumption works versus the one that the Board staff  
25 came up with.

26           So, if the Board is going to grapple with this  
27 issue, the Board has to get into the technical issues  
28 and that's why -- that's what we want to talk about.

1 But I really want you to know, it's not that we don't --  
2 we're not concerned about underage drinking; we're not  
3 concerned about -- about the formulations and what may  
4 or may not be -- I just wanted to add that.

5 MR. HALE: Thank you, Alan.

6 Katie Lucas.

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KATIELUCAS

MS. LUCAS: My name is Katie Lucas. On behalf of the Girl Scout Councils of California representing approximately 300 girls and volunteers in California, we are in strong support of Alternative number 1 of the draft paper. And -- and in light of being brief, those are my arguments.

Thank you very much.

MR. HALE: Thank you. The next speakers that I've called forward are Will Chessman, Scott Varner. And John --

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1 WILLCHEESMAN.

2 MR. CHEESMAN: Good evening -- good morning.  
3 My name is Will Cheesman. I'm with the San Diego County  
4 Policy Panel on Youth Access to Alcohol.

5 And in light of recent comments, I would just  
6 like to make a -- a quick offer for Alternative 1,  
7 perhaps. And that is they talk about .5 and where is  
8 this -- you know, all these products might contain some  
9 form of distilled spirit.

10 I would like to offer that -- that maybe we  
11 should look at the primary source of alcohol in those  
12 products, not necessarily just the -- you know, that  
13 they exist at all. But the primary source.

14 My understanding is that malt beverages and  
15 beer, and wine for that matter, all get their primary  
16 source of alcohol from fermentation. That is different  
17 from distillation.

18 If you look up in the dictionary, distilled is  
19 a completely different form of defining alcohol.  
20 Fermentation is -- is through that, so is -- is a  
21 natural process and distillation is the boiling and  
22 separating of chemicals.

23 So, I would just to offer that up as maybe to  
24 clear up the confusion that might come up with, you  
25 know, does it contain any distilled spirits, whatsoever.

26 So, thank you.

27 MR. HALE: Thank you, Will.

28 ---oOo---

1 SCOTT VARNER

2 MR. VARNER: Hi. Good morning. My name is  
3 Scott Varner. I'm more nervous than I thought I'd be  
4 so I'll try and be brief. And I hope I'm meeting your  
5 objective of discussing -- discussing the merits of our  
6 second discussion paper. If not, feel free to cut me  
7 off.

8 I've worked the better part of the last 20  
9 years in the beverage industry, both alcoholic and  
10 non-alcoholic, and I've had the opportunity to work on  
11 many of the products and brands and companies that have  
12 been discussed here today and at our previous interested  
13 party meeting where I did not speak.

14 But I wanted to specifically talk about page 4  
15 of 8, the bottom of page 4 of 8, which is Section C,  
16 number 1, and really talk about what's -- provide some  
17 technical detail, but also talk about the objective of  
18 why we're here, which is a noble objective, which is  
19 addressing that, underage drinking of course.

20 It seems that taxation and classification is a  
21 tactic therein, but I'd like to specifically talk about  
22 what would get accomplished if indeed this -- this would  
23 pass.

24 And if you read in number 1, it says that the  
25 BOE, you all can take a giant step in addressing this  
26 epidemic. We all agree it's an epidemic, and I just  
27 want to quickly question that premise with a couple of  
28 facts.

1           Flavored malt beverages or as some people are  
2 referring to them as alcopops, represent a very, very  
3 small segment of the beer industry. And we -- we in the  
4 industry look at what's called consumption data. And  
5 anybody can get it. Companies like -- public like  
6 companies like IRI or Nielsen, and what they do is they  
7 register products, they get scanned through the  
8 register.

9           Well, roughly -- for flavored malt beverages  
10 roughly for every 38 cases of beer that are purchased,  
11 one case of a flavored malt beverage is purchased. I  
12 mention that only to give you context that it is a  
13 relatively small segment of the beer industry and we're  
14 not even talking wine and spirits. Out of the total  
15 alcohol it's a very small segment.

16           So, what gets accomplished if -- if they get  
17 taxed? Well, they'll get moved out of the -- the beer  
18 section and they'll get put in the warm shelf over by  
19 the spirits.

20           Well, currently -- currently -- I didn't  
21 mention, I currently work for Mark Anthony Brands, and  
22 we have Mike's Hard Lemonade. Mike's Hard Lemonade is  
23 probably one of the dominant players in this category.  
24 If you go to a grocery store, their price is \$7.99, more  
25 or less, a six-pack. The goal is to be in line with  
26 products like Heineken and Corona.

27           So, being cheap and excessive is not --  
28 certainly not the intent here.

1           But if this gets accomplished you'll have  
2 roughly \$2 added to each six-pack and it will be moved  
3 out of the category. And in essence these brands will  
4 cease to exist. They're going to go out of business in  
5 California.

6           I've heard a lot of talk about \$40 million in,  
7 quote-unquote, lost tax revenue. These products are  
8 going to go away, there's going to be very little tax  
9 revenue, if that's an objective.

10           So, just note that it's a very small segment,  
11 it's a very insignificant segment, when you look at  
12 total consumption. And it's also a very expensive  
13 segment when you look at the major players.

14           There's been talk about sickly sweet and soda  
15 pop type products, but if you're going to expand the  
16 realm and talk about products that seem to be sweet or  
17 alluring, then you got to look at fruit flavored beer.  
18 Is that sickly sweet and alluring? I'm not saying it is  
19 or it isn't, but you have to open up again, based on the  
20 objective of addressing consumption and underage  
21 drinking.

22           Why are wine coolers getting a free pass? A  
23 Product like California Cooler, which is coming back on  
24 the market, doesn't say wine, it doesn't look like wine.  
25 It's not in a wine bottle. It's fruit-flavored and  
26 sweet and it's relatively inexpensive, as is a product  
27 like Bartles and James.

28           So, what are we trying to accomplish here and

1 what ultimately gets accomplished if you all pass this?  
2 And I just want to offer, A, size of segment. B, price  
3 of segment. In reality, the products will go away. You  
4 will see consumption gone. But will you accomplish  
5 anything vis-a-vis underage drinking?

6 And I would surmise to say just based on the  
7 size of the segment, no, it's still going to be a  
8 prevalent industry and they're still going to be cheap  
9 except for product.

10 So, it's a complex problem and we shall be part  
11 of the solution. But I'm not so sure that this  
12 objective addresses the objective.

13 Thank you.

14 MR. HALE: Thank you, Will.

15 I'd like to call Scott Varner.

16 MR. VARNER: I was Scott.

17 MR. HALE: Oh.

18 MR. VARNER: Or I am Scott.

19 MR. HALE: I'm reading your writing here. John  
20 Hollerman, from Renne Sloan. John Handley.

21 Beth, did you want to -- Beth Lindley of the  
22 BOE signed up as a speaker.

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1 JOHNHOLTZMAN

2 MR. HOLTZMAN: I'm John Holtzman from Renne  
3 Sloan, but I'll just defer to the comments of Mr.  
4 Dickey.

5 MR. HALE: Thank you.

6 MR. HOLTZMAN: And thank you for really an  
7 excellent open process. We really appreciate all the  
8 thought that -- that the staff has put into this.

9 MR. HALE: Thank you very much.

10 Marc Sorini, Allyson Hauck and Fred Jones will  
11 be our next three speakers.

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1 MARCSORINI

2 MR. SORINI: I'd prefer this so I don't have  
3 to -- my neck is sore enough from the -- playing with  
4 the kids over the weekend.

5 I'm Marc Sorini, representing the Flavored Malt  
6 Beverage Coalition and I, like many of the other  
7 speakers, we really appreciate the really significant  
8 effort that you folks have been putting into this. It's  
9 quite clear from the second discussion paper that  
10 you've educated yourself about the category and -- and  
11 really come a long way.

12 However, when we look at the -- the three  
13 alternatives, Option 1, Option 2, Option 3, we continue  
14 to believe that Option 3 is the only option available to  
15 to you. There is, we think, four reasons for that.

16 The first is something that we've discussed at  
17 length, which is the whole flavor versus distilled  
18 spirit distinction. And if you bear with me, I will  
19 bore you with that a little bit more. I -- I know you  
20 heard quite a bit about it in February.

21 The second point, however, is that if --  
22 looking at Option 1, if the Board really thinks it has  
23 discretion that in effect a flavored malt beverage -- at  
24 least a flavored malt beverage with more than .5 percent  
25 alcohol by volume is neither fish nor fowl and therefore  
26 fits within some sort of no man's land that you have to  
27 gap fill, then California law -- not Federal law, but  
28 California law, directs you to follow Federal law.

1           So, I think if there is some gap filling to be  
2 done, we don't agree that there does -- but if there  
3 does, you need to follow Federal law.

4           I think the third point we'd like to point out  
5 is that when you look at the -- I believe it's Section  
6 22 of Article 20 of the Constitution, it's very clear  
7 that the -- the Legislature that enacted that  
8 constitutional provision had a very limited role for the  
9 BOE. And in fact it very carefully chose language  
10 suggesting that when it comes to these sort of gap  
11 filling things -- and I know Mr. Botting is going to  
12 disagree with me on this, so I'm up here talking about  
13 ABC jurisdiction knowing that the ABC is not on the same  
14 page but I believe that when you look at -- when you  
15 look at the language chosen and if you look at the  
16 entire regulatory and -- and statutory scheme that's  
17 grown over the last 50 years, it's very clear that when  
18 you come into an issue that involves social policy as --  
19 as you pointed out, everybody needs to be concerned  
20 about underage drinking. But this is a tax body. And  
21 this is a body that has neither the expertise or the  
22 jurisdiction to do that.

23           And we believe that really goes right to the  
24 fundamental authority of the Board when you're talking  
25 about that kind of quasi-legislative line drawing that  
26 has been proposed in the second discussion paper in  
27 Option 1.

28           And then the final point I think is that by

1 drawing some of the lines that were drawn in -- in  
2 Option 1, in particular the one that gives, if you will,  
3 a free pass to any flavors in wine -- I mean if -- if  
4 the statutory interpretation that you're working off of  
5 is that its dilutions and mixtures, and dilutions and  
6 mixtures can include something that is not for beverage  
7 purposes, then it is unfathomable to me why you would  
8 exempt wine other than this is California, of course,  
9 and the California wine industry tends to get what it  
10 wants.

11 So, those are my four points. I'd be happy to  
12 answer any questions and in particular further elaborate  
13 on any of the points that are relatively new compared to  
14 my discussion in -- in February.

15 MR. HALE: Thank you, Marc. Staff, any -- any  
16 comments?

17 All right, thank you very much.

18 MR. SORINI: All right, thanks.

19 MR. HALE: I know you will follow that up with  
20 a written submission. Thank you.

21 MR. SORINI: It's been known to happen.

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1 ALLYSONHAUCK

2 MS. HAUCK: Hi, my name is -- yes, thank you.  
3 My name is Allyson Hauck. I'm with the Pacific  
4 Institute for Research and Evaluation. I'm a Legal  
5 Policy Researcher there, and we've been researching and  
6 studying drinks, the taxation and legal issues around  
7 them for quite a few years now.

8 I just first wanted to address one point made  
9 by the previous speaker and that is that California law  
10 does not mandate that you follow Federal law. You may  
11 follow -- there's a -- the TTB was very clear in their  
12 regulations that they were not mandating the states to  
13 follow these laws. They were putting together  
14 guidelines for the Federal regulation, not for the  
15 states. States were to follow their own laws.

16 There is no requirement that California look to  
17 the TTB's regulations. So, I just wanted to make that  
18 point. And a lot of my other points have already been  
19 made by other people so I -- I won't go into detail  
20 with them, but what I think is one of the most important  
21 issues here is that we realize that the Board is trying  
22 to do the right thing and we appreciate the placing the  
23 burden on the industry as Alternative 1 and 2 do. And  
24 the reason that we are so in support of that is because  
25 we really feel that the process to create these  
26 distinctions has been disingenuous. Not only that they  
27 only use fermented -- start with a fermented base in  
28 this -- in this country as they don't do in other

1 countries, but they start with it and then they remove  
2 it.

3 Why do they remove it? And we believe that  
4 it's a deceptive thing that they're doing to get these  
5 products to be cheap. It's not that they keep that  
6 fermented drink in there in its entirety, they remove  
7 it.

8 So, in this rulemaking process we really,  
9 really encourage the staff to do the factfinding, to  
10 figure out what is in these drinks. That is relevant  
11 information for taxing these products. What is in these  
12 drinks? What is the alcohol content of these drinks?

13 And I think that one of the things that is so  
14 frustrating for the advocacy groups that are represented  
15 here today is that we don't know. And maybe that's not  
16 relevant information for us, for whatever proprietary  
17 reasons, but as the acting agency it's relevant  
18 information because California law says that distilled  
19 spirits are distilled spirits and a fermented drink --  
20 alcohol is beer.

21 So, it's information that -- that I  
22 really encourage you to obtain. And I think that 1 and  
23 2 leap -- take us towards that.

24 And the -- I -- I understand that the policy  
25 considerations are something that you've heard in the  
26 past and we're here to talk about the technical  
27 alternatives. The -- the thing that is difficult is  
28 that because Alternative 3 is still on the table,

1 it's of concern to us because we really do not feel that  
2 that is following the law. And, you know, the industry  
3 has been here today saying that it's about parents, it's  
4 about retailers. It's also about industry  
5 responsibility. We do not believe they are behaving  
6 responsibility -- responsibly in self-regulating.

7 And you as a taxing agency have some measure to  
8 hold them accountable to be a responsible player here.  
9 It's about everybody being responsible, including this  
10 industry.

11 So, I just encourage you today to do the  
12 factfinding. Why are these drinks made the way they  
13 are? And how are they really made? We know that the  
14 Federal government, when they did their testing in 2003,  
15 did find that the majority of the alcohol was distilled  
16 spirits. They say it's different now. Do we know that?  
17 Do you know that? Do you honestly know that?

18 We hope that you are getting that information,  
19 and we just encourage you to really continue with the  
20 factfinding process.

21 Thank you very much.

22 MR. HALE: Thank you, Allyson.

23 Well, before Fred makes his statements we'll  
24 call up Julia Goodman, James Dee and Jimmy Jordan.

25 MR. HUDSON: I have a question for the last  
26 speaker, but I'll -- if anyone else had a question, I  
27 can wait.

28 I'm Tom Hudson from Board Member Bill Leonard's

1 office. I -- I've heard over and over again this  
2 comment that the manufacturers are removing something  
3 from beer so that they can replace it, I guess, with  
4 what I keep hearing is distilled spirits. Like gin or  
5 vodka or something.

6 But I've heard that over and over again.  
7 You've identified yourself representing a research  
8 institute. What research have you done and what does  
9 that indicate is being removed from this product?

10 MS. HAUCK: If you look at the TTB final rule,  
11 and we can definitely get that for you, I believe --

12 MR. HUDSON: I read the entire rule. Go ahead.

13 MS. HAUCK: -- there is -- in that they say  
14 that the -- the beer is -- the -- I think it's the  
15 color, the flavor and the odor is removed. And why, I  
16 think it -- the speaker before me would be better to  
17 explain that.

18 It's not done in other countries. It's only  
19 done in this country and our assumption, only our  
20 assumption, we don't have the information. We're  
21 looking to you to get that information.

22 MR. HUDSON: Do you know, since you've  
23 identified the Federal rule, they identify it 100 --  
24 excuse me, they didn't identify it, they claimed that  
25 they tested 114 products. We don't know if any of those  
26 are sold in California today.

27 Do you know? Do you have any information about  
28 that?

1 MS. HAUCK: That's not information we were able  
2 to get even through the --

3 MR. HUDSON: But when you say that, you don't  
4 really know that any of the products we're talking about  
5 today were covered in that study?

6 MS. HAUCK: We don't know that. Actually,  
7 we --

8 MR. HUDSON: Neither do we, so --

9 MS. HAUCK: Yeah, exactly. And that's where --  
10 we're hoping that that's information you can get. We  
11 don't know what's in these products now. We're assuming  
12 that it's 49/51 percent but we're assuming that. And  
13 we're assuming that because they say so. And they, to  
14 me, haven't been responsible in -- in producing these  
15 products so I don't take that at face value. And we  
16 hope you don't.

17 MR. LO FASO: Can I ask you actually one  
18 followup question on what you just said?

19 Let's assume that the Board adopts Alternative  
20 Number 1, which is 0.5 percent standard.

21 MS. HAUCK: Right.

22 MR. LO FASO: Are we going to be concerned  
23 whether it's 40 percent or 60 percent or 80 percent or  
24 are we just going to tax it as a distilled spirit once  
25 we find out it's -- well, actually once we presume  
26 it's --

27 MS. HAUCK: It's over .5 percent.

28 MR. LO FASO: -- over .5 percent based on, I

1 assume, its labeling?

2 MS. HAUCK: Right.

3 MR. LO FASO: But then when we tax it, if we  
4 get information that tells us what its formulation is --  
5 let's just say for the sake of discussion the  
6 information we get is in excess of half a percentage  
7 point --

8 MS. HAUCK: (Inaudible).

9 MR. LO FASO: -- that's the end of it. That's  
10 the end of it, right? Because it's -- because it's got  
11 more than a half a percent of distilled spirit. Right?

12 MS. HAUCK: Well, I -- with the laws that you  
13 were given in California, we do believe that's the end  
14 of it. And I do agree with -- with Scott Dickey that we  
15 don't believe that the -- the BOE has discretion. We  
16 read the distilled spirits definition to say if it has  
17 distilled spirits in it or mixtures, they're -- it's a  
18 distilled spirit.

19 So, I understand what you're doing with  
20 Alternative 1 and, you know, because anything below .5  
21 percent is not -- you know, it's alcoholic beverage,  
22 that's when you get your threshold, .5 percent.

23 So that diminimus standard we agree with,  
24 about, yes, if it's over .5 percent I think the only  
25 alternative at that point, I think that's where any  
26 discretion, if there is any, that's where it ends and  
27 the next step is to go to the Legislature if it's not  
28 working that way.

1           Is that what you're asking? So if there's like  
2 a flavored beer with like a lemon flavoring in it and  
3 it's point -- 1 percent distilled spirit, where does  
4 that go?

5           MR. LO FASO: My question was just directed at  
6 what I think is the limited purpose that we're going to  
7 use this information that we're going attempt to get.  
8 That is my question, the point I was making.

9           MS. HAUCK: Okay. Great. And I think -- I  
10 think that diminimus standard would address some of the  
11 flavoring. I don't know that it would, but it would  
12 address some of your more traditional (inaudible)  
13 flavored beer, like your summer brews or things like  
14 that. And that's what I think we're getting at.  
15 Addressing those. We're not trying to take out beer in  
16 the traditional beer category; we're trying to target  
17 these products, these alcopops. And we believe that  
18 Alternative 1 does that.

19           So, I hope that answers your question. Okay.

20           MR. HALE: Marc Sorini.

21           MR. SORINI: I'd just like to point out a  
22 couple of things. My argument is not that the Federal  
23 government -- I think everybody in this room agrees that  
24 the Federal government does not preempt California law  
25 on this point. But the point is and I'll -- I'll read  
26 the statute.

27           "The Board shall adopt such rules and  
28 regulations as may be necessary to coordinate so far as

1 permitted by provisions of this part the system of beer  
2 and wine taxation imposed by this part with the system  
3 of beer and wine taxation imposed by the Internal  
4 Revenue Code."

5           So, the point is that California, while the  
6 Federal government doesn't force California to adopt the  
7 Federal standards, where there is discretion California  
8 by California legislative (inaudible) has to follow  
9 the -- the Federal standard. And it's very important  
10 to parse the language and it's so far as permitted by  
11 the provisions of this part.

12           So, the Legislature did the smart thing. They  
13 said, "Look, we're not going to surrender to the Feds.  
14 We, the legislative body, have the power to overrule  
15 what the Feds are telling us to do."

16           However, as the second -- as Option 1 clearly  
17 claims, Option 1 says we've got discretion. It's  
18 neither fish nor fowl. We don't agree with that, I know  
19 Mr. Dickey doesn't agree with that on different sides.  
20 I guess the one thing we agree on -- we don't -- we  
21 don't agree with that point.

22           But the point is if you conclude that in fact  
23 you have that discretion that it's neither fish nor  
24 fowl, then -- and I don't remember the number, but  
25 it's Code section 32152 compels the result that you  
26 follow Federal law when you're slicing and dicing based  
27 on your discretionary authority.

28           We think the law is absolutely clear and I

1 think the purpose of the law is really being served  
2 here.

3 In other words, one of the suggestions you had,  
4 as well, do we know what's in it. Well, the Federal  
5 government is already doing this. They have a very  
6 expensive process. They handle -- every flavor  
7 containing alcohol has to be approved and reviewed by a  
8 very expensive laboratory that's up in Anondale,  
9 Maryland, and they're the ones who look at this. Then  
10 once the formula for the final product comes in,  
11 remember what I said in February, you can't put vodka,  
12 you can't put gin, you can't put whiskey into a malt  
13 beverage. What you can do is you can put a flavor in  
14 there.

15 And so, the formula goes into the Federal  
16 government and it will say, "Here is my formula for xyz  
17 malt beverage product," and they're going to check that  
18 each and every one of those flavors has been deemed  
19 unfit for beverage purposes.

20 Now, what's being suggested here is essentially  
21 duplicating that process for California. We would  
22 submit to you that's a waste of resources. We'd also  
23 submit to you that's exactly what the -- the California  
24 Legislature sought to preclude. Where you have  
25 discretion, save the resources and defer to the Federal  
26 government.

27 MR. HALE: Thank you, Marc.

28 MS. HAUCK: May I just ask a followup to that?

1 MR. HALE: Please do.

2 MS. HAUCK: I just have a question. I don't  
3 know if you're able to speak to this, but when the  
4 Federal government did do their original 2003 study,  
5 they found that some of those beverages had 75 percent  
6 to 99 percent distilled spirits.

7 MR. SORINI: That's no longer true.

8 MS. HAUCK: That's no longer true. So, that's  
9 a different type of alcohol that was used before because  
10 it was --

11 MR. SORINI: No, it wasn't -- it wasn't a  
12 different kind of alcohol. See, now -- now we're going  
13 to get into some really interesting semantics.

14 In California, distilled spirit has to be a  
15 product fit for beverage purposes. Similarly under the  
16 FAA act, when they used the term "distilled spirit"  
17 they're talking about a product fit for beverage  
18 purposes.

19 Now, when you quote line from the Federal  
20 rulemaking they were using the term "distilled spirit"  
21 under the Federal Internal Revenue Code purposes. Under  
22 that code, distilled spirits covers the waterfront; it  
23 covers flavors, it covers alcohol for hospital use; it  
24 covers alcohol in denatured products.

25 So, it covers the waterfront. But semantically  
26 any of the products that are unfit for beverage use in  
27 California are not distilled spirits, cannot be  
28 distilled spirits.

1           That's -- at least that's certainly what we  
2 think the correct interpretation of the law is. So, no,  
3 that is exactly the same alcohol. The fact that the  
4 Federal government used the term "distilled spirits" is  
5 because they were speaking to it under the IRC, not  
6 under the California statutory definition, which  
7 qualifies it as an alcoholic beverage which is fit for  
8 beverage use.

9           MR. FERRIS: And -- Randy Ferris from the Legal  
10 Department. Just to clarify, it's not the Legal  
11 Department's understanding that the Alternative 1 is  
12 creating some sort of neither fish nor fowl category. I  
13 mean, Alternative 1 and 2 would be making a statutory  
14 interpretation that would say this is a distilled  
15 spirit. And once that has been accomplished, then the  
16 statute that you have cited, which talks about if it's a  
17 beer then conform as much as you can to the Federal  
18 rules, would -- so there's -- there's another step --  
19 prior step.

20           First you have to classify it. If you know  
21 it's a beer, then the statute says you should align your  
22 rules as much as you can with the Federal statutory and  
23 regulatory scheme. But Alternative 1 and 2 are actually  
24 pushing it -- the analysis up a level to decide is it a  
25 beer or not.

26           MR. SORINI: Right.

27           MR. FERRIS: But we agree with you,  
28 once something is a beer under the statute, then we

1 should be aligning our rules as much as we can with  
2 the -- the Federal.

3 MR. HALE: I'm sorry, Fred, I actually need to  
4 stop this for a moment. We're going to take a 15-minute  
5 break and we will reconvene at 11:35. We'll start with  
6 you.

7 MR. JONES: Can I just say one thing before we  
8 get back to --

9 MR. HALE: Sure. Go ahead.

10 MR. JONES: Because I think it's an important  
11 clarification. Marc's, I'm afraid, hiding the ball a  
12 little bit. If you read the Code sections, the B & P  
13 Code sections closely, he's referring to a product -- a  
14 final product called distilled spirits which must be fit  
15 for alcohol -- for beverage use. But the section right  
16 before that, 23004, talks about what to put into these  
17 products. And it says that those may be fit for  
18 beverage purposes either alone or when diluted mixture  
19 combined with other substances.

20 So, the ingredients themselves may not have to  
21 be stand alone fit for beverage purposes. But the final  
22 product, a distilled spirit, has to be.

23 MR. HALE: Right. Well, thank you. And,  
24 again, these are the arguments on both sides that were  
25 clearly stated in -- you know, at the first meeting and  
26 in the --

27 MR. JONES: Right.

28 MR. HALE: -- the papers we've received today.

1 MR. JONES: But I do have comments after the  
2 break.

3 MR. HALE: I think everybody is clear, and I  
4 appreciate that.

5 MS. BARTOLO: You'll be next.

6 MR. VARNER: Right. Let's take one more  
7 comment because it's on point right here.

8 Yeah, the quick comment, there's been some  
9 discussion about disingenuous and/or deceptive  
10 manufacturing in the United States vis-a-vis Europe.  
11 The only thing I know gas taxes in DAT and central  
12 Europe. I don't know European or Canadian tax codes.

13 I can just tell the audience here that to make  
14 this product, FMB, with vodka, is far less expensive  
15 than to go through this beer process. It's really,  
16 really expensive.

17 So, I would surmise that the makers of --  
18 whatever, Mike's or -- or Smirnoff, would say it's a  
19 pain in the neck to do this in the United States, but  
20 they have to based on the laws if they want to compete  
21 in the category they're trying to compete in, which is  
22 to create an adjunct to the category no different  
23 than -- that was -- that was the goal.

24 So, it's very -- it's a pain in the neck to  
25 make it for the United States, but they have to based on  
26 the laws.

27 MR. HALE: All right. Thank you. We'll break  
28 until 11:35.

1 (Whereupon a short recess was taken.)

2 ---oOo---

3 MR. HALE: All right, if you can go ahead and  
4 take your seats, we'll resume the meeting.

5 Fred Jones, if you could come forward. And  
6 thank you for your patience for getting cut off there.

7 Before Fred speaks, I'd like to call the next  
8 two speakers. Kellie Goodwin and James Du are our last  
9 two speakers for this part of the meeting

10 Go ahead, Fred.

11 ---oOo---

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FREDJONES

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2 MR. JONES: Thank you. My name is Fred Jones  
3 and I represent California Council on Alcohol Problems,  
4 which is also part of this alcopops and youth coalition,  
5 which is law enforcement, health professionals, city and  
6 county governments and concerned citizens organizations.  
7 And youth groups, by the way, which started this whole  
8 petition.

9 I had one just response on the policy issue of  
10 why the two biggest products, Smirnoff and Mike's Hard  
11 Lemonade, evidently are dropping in sales. And  
12 collectively, I think they represent at least 60 percent  
13 of this market. Which according to, I think the 2004  
14 figures, FMBs are only about three percent of the beer  
15 industry. It's a sliver. And I'll concede that point.

16 It's because the FMB competition is increasing.  
17 There's a lot more products now coming on line. And as  
18 of two weeks ago, one just dropped off line, Spikes by  
19 Anhaueser Busch. And yet, even though it's only three  
20 percent of the market, beer market, according to the  
21 University of Michigan study, which you heard the Girl  
22 Scouts present earlier, FMBs are now the preferred  
23 choice for young females, underage females. Over beer.

24 So, even though it's a sliver of the overall  
25 beer market, the numbers disturbingly paint a very  
26 clear -- clear picture that who are using these  
27 products. And so, the price of these products have a  
28 direct bearing to the access of these products to young

1 females. And I think that's why the fight is being  
2 fought by the industry.

3 I wanted to focus on the legal issue, my  
4 comments on this hops extract issue. Because I think  
5 that's a relevant one. We, the supporters of the  
6 petition, either Alternative 1 or in my opinion  
7 Alternative 2, are acceptable -- are not trying to make  
8 it indistinguishable between traditional beer and  
9 distilled spirits. That's not our intent.

10 I don't know if it's a disingenuous argument or  
11 not whether hops extract of distilled spirit is the only  
12 means by which hops can be part of the brewing process.  
13 From what I've learned, they have natural hops options.  
14 There's a powdered hops option. So, it may be easier in  
15 a brewing process to add a liquid, i.e. a distilled  
16 extract, but it's not a necessary element to the brewing  
17 process.

18 And if you properly follow the clear letter of  
19 the law in California, it means, yes, it's going to be  
20 an inconvenience to the manufacturer if any amount of  
21 distilled spirit is added. Now, the litigation, that's  
22 separate from this whole effort. The reason why the  
23 attorneys on our side of the argument have to argue the  
24 black letter of the law says you have no discretion,  
25 because that's their whole case. If they give you any  
26 degree of discretion, the Court could throw out this  
27 case.

28 At a political level, which is what I frankly

1 think this is all about, I think there has to be some  
2 degree of discretion. And the .5 percent, which is the  
3 diminimus allowing for a trace element of the final  
4 product to maybe even allow for this distilled extract  
5 to be a substitute for the powder or natural, would  
6 accommodate the manufacturers. And I'm willing to  
7 consider that and support that, if necessary.

8           And I think there's enough both of the TTB  
9 ruling process and in California Code that that .5  
10 percent has enough statutory and regulatory authority to  
11 carry the day. And our attorneys in the litigation  
12 can't really come out today and say that, because of the  
13 litigation.

14           So, either Alternative 1 or Alternative 2 works  
15 fine. Right before we went to break, though, I thought  
16 we attorneys would call it a party admission, that the  
17 gentleman spoke right before our break, and he admitted  
18 it, the reason why they're going through this game of  
19 starting with the malt beverage, distilling out  
20 basically the malt beverage, the taste, the color, the  
21 smell and who knows what else -- and that's a real big  
22 question, who does know what else other than the  
23 industry? It's because they want these products sold as  
24 beer, taxed as beer, distributed as beer.

25           And the gentleman admitted that's a more costly  
26 process. But clearly it's not more costly than the  
27 \$3.30 per gallon tax if it was indeed a distilled spirit  
28 and they just used vodka to do it. Like they do in

1 every other country.

2 And the reason why they're doing it in every  
3 other country and not here is because of this loophole  
4 at our Federal level. The Federal level created this  
5 loophole, the 49/51. But that is only -- it's not a  
6 rule, it's not a law, it's not a statute that we have to  
7 follow. It's simply a guide. And for the last 40 years  
8 I admit ATF and now it's TTB, has filled the vacuum for  
9 use State agencies. So, you don't have to have the  
10 expertise to follow all of this and to follow the  
11 labeling and so forth.

12 Unfortunately, now, after they made this 49/51  
13 percent, which is so clearly violative of our clear  
14 black and white letter of the law here in California, at  
15 this point we have to break from the Federal government,  
16 the regulators, and say, "I'm sorry, we cannot follow  
17 your guideline, vis-a-vis this issue."

18 Bill Lockyer stated that very clearly, much  
19 more eloquently than I, last year. In fact, he stated  
20 it -- it was two years ago in response to an  
21 industry-sponsored bill in the California State  
22 Legislature, that attempted to codify the Federal rule  
23 here in California. I would call that party admission  
24 number two.

25 The industry acknowledged that our laws did not  
26 allow and were not consistent with the Federal ruling.  
27 And, therefore, they gutted, amended the bill in August  
28 to try to jam it through the Legislature. And the

1 Governor vetoed it and said we needed to take a breath  
2 here and consider what are these products. And that's  
3 what's led us here.

4 If that AB 417 was passed and signed into law,  
5 we wouldn't be here today. So, that's party admission  
6 two, that they know they're not consistent with  
7 California law.

8 If you hear any more today or in future  
9 correspondences from the industry about all sorts of  
10 issues; vanilla extract, hops extract, traditional  
11 beers, these are factual issues. You should have the  
12 authority to ask them hard questions. And if they argue  
13 proprietary rights, then I'm sorry, the burden is on  
14 them and they're not meeting it.

15 So, we strongly support Alternative 1 and,  
16 secondarily, Alternative 2.

17 MR. HALE: Thank you. Kellie.

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1 MS. GOODWIN: Hello, my name is Kellie Goodwin  
2 and I am speaking on behalf of the California Youth  
3 Council.

4 We are strongly in support of Alternative 1.  
5 And I would also like to thank you for focusing on the  
6 issue at hand, which is taxation of these beverages and  
7 not getting distracted by other arguments of flavoring  
8 and what not. Thank you

9 MR. HALE: Thank you. James.

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1 JAMESDU

2 MR. DU: I'm James Du from Students for Making  
3 a Community Change. I'm here to talk about tax. That's  
4 what BOE does, not social (inaudible) issue. Mike here  
5 earlier mentioned that research that the Federal  
6 government did. Actually, (inaudible) -- is that  
7 correct? Okay. And how it shows the alcoholic content  
8 of the FMBs.

9 Why doesn't the BO use -- BOE use the  
10 information from the Federal government to determine  
11 that the FMB is .5 percent higher from the -- that has  
12 alcohol from .5 percent higher from the distilled  
13 flavorings to see if it meets the California regulations  
14 instead of all this talk about the other stuff that  
15 everyone has been talking about, social and political?  
16 It's a simple tax. That's it, basically.

17 MR. HALE: Thank you.

18 Marc.

19 MR. SORINI: Well, I'll answer your question,  
20 which was a very good one. The reason is because that  
21 study which was done in 2001-2002, the products are  
22 different now. That the alcohol content by Federal law  
23 has had to have come down as far as its contribution  
24 from flavors. But a couple of things I'd like to  
25 respond to.

26 One -- one was the -- right before the break  
27 the suggestion that the appropriate definition to look  
28 at is the definition, I believe, of -- of alcohol

1 beverage, which says that it can be anything that is  
2 diluted at all. And I think I briefly briefed the --  
3 the staff on this in my May 10th letter.

4 That position has two problems with it. The  
5 first is that it really would repeal the clear exemption  
6 in California Code for flavors. I mean, you got to --  
7 you got to have something potable when diluted to have a  
8 flavor, otherwise it's not a flavor, it's what you put  
9 inside you. And virtually all alcohol -- I mean, the  
10 other problem you got with that is that virt-- not even  
11 virtually all alcohol, any alcohol that is ethyl alcohol  
12 can be rendered fit for beverage purposes if you dilute  
13 it enough.

14 I mean, if you talk about the 190 proof 55  
15 pound drums that are going into the chip manufacturers  
16 for the cleaning room; whether you're talking about the  
17 alcohol that's going into flavors; whether you're  
18 talking about the alcohol that's being used as an  
19 extractive in the fruit industry, et cetera, all of that  
20 alcohol ultimately can be diluted down and -- and be  
21 drinkable.

22 So, I think both as a matter of California law  
23 because of the exemption for flavors and other  
24 industrial alcohol products and, number two, just  
25 because of a massive problem with what you would do if  
26 you were to buy that argument, I don't think that  
27 really -- I don't think that humps.

28 MR. JONES: Can I respond, Marc?

1 MR. SORINI: Sure.

2 MR. JONES: The problem with your argument, if  
3 I may --

4 MR. HALE: Please.

5 MR. JONES: I'm not asking you to tax mouth  
6 wash as distilled spirits or ethanol as a distilled  
7 spirit. I'm asking you for the final product that  
8 these distilled spirits are added into to be taxed as  
9 distilled spirits. But I'm not asking you that. The  
10 Legislature is demanding it because it's in the code.

11 So, we're talking about elements that you add  
12 into a product. They may or may not be fit for beverage  
13 purposes alone on their own, but if they are part of an  
14 element of a product that is retailed as an alcoholic  
15 beverage, and that was a distilled spirit element, the  
16 final product should be taxed as such.

17 MR. SORINI: And I think my answer to that is  
18 when you walk through the definitions that can't be the  
19 answer. Recall -- as he just conceded, a flavor is not  
20 going to be taxed as an alcoholic beverage. All right.  
21 The only way he gets to say these are distilled spirits  
22 is looking at the distilled spirit definition. And the  
23 distilled spirit definition says it is an alcoholic  
24 beverage, okay. Then it gives a set of examples which  
25 very significantly says "alcohol for beverage use."

26 And then it says, "all the dilutions and  
27 mixtures thereof." Thereof what? Of an alcoholic  
28 beverage.

1           In other words, how can you take something  
2 that's not a beverage, it's an orange, and then say that  
3 if I slice off a piece of it and put it into -- this is  
4 probably a bad analogy so I'm just going to stick to the  
5 statutory code -- if it's not a distilled  
6 spirit, because I was going to get into kumquats and  
7 bananas -- but it's not an alcoholic beverage at the  
8 start. And you start with beer, okay.

9           Now, if you put this non-alcoholic beverage  
10 into something, it doesn't as a matter of clear plain  
11 text statutory interpretation convert that product into  
12 a distilled spirit. You can't get there -- you can't  
13 climb that ladder under the Code's definition of  
14 distilled spirits, I would respectfully submit.

15           MR. JONES: May I respond?

16           MR. LO FASO: I have a question --

17           MR. HALE: Just briefly.

18           MR. LO FASO: -- in response.

19           MR. JONES: Oh, go ahead.

20           MR. LO FASO: No, please go.

21           MR. JONES: Okay. You're making my argument  
22 sound like I'm bootstrapping. I'm not. I'm only  
23 referring to two Code sections, B & P Code Sections.  
24 The first Section 23004, which is entitled, "Alcoholic  
25 Beverage", that defines anything that is either fit for  
26 beverage purpose alone or when mixed, diluted or  
27 combined with other substances. Okay.

28           MR. SORINI: So, you're taxing mouth wash.

1           MR. JONES:  If that's the finding of the Board,  
2   so be it.  But this petition is based on a product that  
3   clearly has a large percentage of distilled spirits  
4   added to it.  And that is clearly a dilution or a  
5   mixture thereof of a distilled spirit using an alcoholic  
6   beverage.  For purposes of this petition --

7           MR. LO FASO:  Okay, okay, there's been a second  
8   colloquy.  Stipulated you disagree over what  
9   the beverage purpose language means.  I want to go to  
10  the regulations we're talking about.  And understanding  
11  this legal disagreement about the statute, I guess I'd  
12  like to ask industry, with regard to -- to your view on  
13  the statute, but let's just say for the sake of  
14  discussion, hypothetically, that the Board of  
15  Equalization adopts these three regulations in whatever  
16  time it does.  And July 8th -- excuse me, July 1, 2008  
17  rolls around, are you all going to start reporting tax  
18  on the beverages that contain alcohol from flavors --  
19  I'm not going to reread the language, but you know what  
20  the language is in the reg.

21           Do you agree that -- are you going -- that this  
22  language here defines your products as distilled --  
23  distilled spirits?  That's my question.  Not -- not what  
24  the statute says, what proposed Regulation 2559 says.

25           MR. SORINI:  The answer is this, if you  
26  have a -- if you have a product, and I think the  
27  proposed language in the regulation is interesting.  The  
28  statutory basis for this is that supposedly there are

1 distilled spirits here. But I noted that both Option 2  
2 proposed by the proponents of this rule, but also Option  
3 1, don't use the term "distilled spirit" in the  
4 regulation, which I kind of thought as -- as a bit of a  
5 concession in my mind which is you kind of recognize  
6 that what exactly is a distilled spirit clearer.

7           So, you took a much broader approach and said,  
8 I think something like any liquid with -- with distilled  
9 alcohol. So, certainly if there is more than .5  
10 percent -- and maybe -- could I take a look at what the  
11 language is?

12           MR. LO FASO: I want to read it now, since you  
13 read it. It says, "unless the contrary is established  
14 any alcoholic beverage except wine is presumed  
15 contained -- is presumed to contain 0.5 percent or more  
16 alcohol by volume derived from flavors or other  
17 ingredients containing alcohol obtained from  
18 distillation.

19           MR. SORINI: That -- that's the language,  
20 obtaining alcohol from distillation, which in my mind is  
21 a concession that really the distilled spirit definition  
22 and -- and what you're getting at here are two different  
23 things.

24           But, yeah, if it's more than .5 percent alcohol  
25 from distillation coming from a flavoring system, then I  
26 think -- which would be allowed under the Federal  
27 system, then under this rule this would be a reporting  
28 rule.

1           MR. HUDSON: Can I ask something real quick on  
2 this? Maybe I should address my comment to either Marc  
3 or Fred Jones on this. But the way I'm reading  
4 Regulation -- proposed Regulation 2559, where it says,  
5 "Unless the contrary is established, any alcoholic  
6 beverage except wine is presumed to contain" blah, blah,  
7 blah.

8           Okay, so, we've had numerous speakers say that  
9 they're not trying to tax all beer -- all traditional  
10 beer in California as distilled spirits. And yet we  
11 have a proposed regulation which we've had speaker after  
12 speaker advocate and indicate that they support, which  
13 would do precisely that, that every single beer sold  
14 anywhere in California of, you know, any quantity, any  
15 size establishment, any micro-brew, every single one of  
16 these is now going to be taxed as a distilled spirit  
17 unless we can prove something to the contrary.

18           We can get into issues of proof in a second,  
19 but I just think it's significant that you're saying you  
20 support something that would tax every single beer as a  
21 distilled spirit.

22           MR. JONES: Yeah, Tom, I'm glad you asked that  
23 question. My comments were directed to Alternative 1  
24 and 2, not to the regulation. And to be totally candid,  
25 Randy, I just read these regs. this morning. And I've  
26 now read Reg. 2559 about six times, and I can't help but  
27 conclude the same that Mr. Hudson just concluded. But  
28 somehow you're trying to make all alcoholic products

1 distilled spirits.

2 So, I am frankly as an attorney troubled with  
3 Regulation 2559. But certainly 2558 is appropriate and  
4 the rebuttal presumption is fine, as well.

5 But my understanding, correct me if I'm wrong,  
6 Randy, that 2559 would do exactly what Tom is saying, if  
7 you got .5 percent or more you're a distilled spirit.

8 UNIDENTIFIED SPEAKER: That all products are  
9 distilled spirits.

10 MR. JONES: Right.

11 It does create a rebuttable presumption.

12 Okay, so it's saying every one is a distilled  
13 spirit until you come and show us otherwise, is  
14 essentially what you're trying to say. I understand  
15 what you're saying.

16 Well, I just -- for purposes of reading, it  
17 makes a lot more sense having the alternative approach.  
18 But I just think that's -- again, I may not be able to  
19 speak for my coalition, but for my --

20 MR. LO FASO: Which alternative are you talking  
21 about, Fred?

22 MR. JONES: I'm sorry?

23 MR. LO FASO: Which alternative? You said a  
24 lot more profitable to have an alternative approach.  
25 Which one?

26 MR. JONES: Yeah, 2559 is essentially saying --

27 MR. LO FASO: Alternative 1 is the three  
28 regulations, that all of that encompasses Alternative 1.

1 MR. JONES: Right. But, again --

2 MR. LO FASO: But my question --

3 MR. JONES: This is the first time I've read  
4 it.

5 MR. LO FASO: Okay, my question to you, you  
6 prefer Alternative 2 or do you prefer Alternative 1?  
7 And if that's -- that's a fine answer, but I hope you'll  
8 address that in your comments, if you do.

9 MR. JONES: Yeah. I'm not trying to not answer  
10 your question. I'm just saying on the regulations you  
11 just read, I'll respond to those. To me, you're going  
12 to cause a lot of unnecessary angst to say every alcohol  
13 product except wine in California is a distilled spirit  
14 unless every manufacturer comes before this Board and  
15 proves otherwise. That's going to be a problem

16 MR. LO FASO: That's understood, Fred. So, I'm  
17 not trying to engage in semantic discussion. What I'm  
18 suggesting is if you -- if you prefer Alternative 2,  
19 okay. If you prefer Alternative 1, but you see a flaw  
20 in Alternative 1, I hope you'll help us out.

21 MR. JONES: I'm willing -- if -- if Alternative  
22 1 is going to be strictly read as requiring every  
23 alcoholic product with the exception of wine to be  
24 considered as a distilled spirit until the manufacturer  
25 clarifies otherwise, I have a -- just a procedural  
26 process-oriented concern about.

27 MR. FERRIS: Can I comment on that? Randy  
28 Ferris from the Legal Department. And perhaps we've

1 misunderstood Alternative 2, but our understanding of  
2 Alternative 2, because it doesn't have the diminimus  
3 threshold in it, is it would -- it would -- it would be  
4 irrebuttable, you know. Once they produce their  
5 documents that show the composition of the  
6 manufacturing, it's going to be an irrebuttable  
7 conclusive presumption.

8           And so, Alternative 2, if indeed these -- all  
9 of those products do contain at least some drop of  
10 alcohol obtained from a distillation process,  
11 Alternative 2 would result in basically all alcoholic  
12 beverages except wine being taxed as distilled spirits.

13           Alternative 1 is an attempt to at least create  
14 some sort of diminimus threshold that would be easily  
15 rebuttable by legitimate, traditional beer brewers, but  
16 that we wouldn't have to waste a lot of time and  
17 resources concentrating on products that nobody is  
18 concerned about.

19           So, we view Alternative -- unless we've  
20 misunderstood Alternative 2, we feel Alternative 2 is  
21 ultimately creating an irrebuttable conclusive  
22 presumption that any product that has one drop of  
23 distilled alcohol in it is a distilled spirit.

24           So, I'm -- I'm not sure I understand your  
25 objection to Alternative 1 because Alternative 2 is a  
26 fortiori more burdensome, to use a lawyerly expression.

27           MS. BARTOLO: And if -- if I may add, we -- we  
28 set the date -- the effective date of the regulation far

1 enough out so that we could establish procedures and  
2 policies and work with the industry to carve out the  
3 traditional beer and -- and give them time to file the  
4 paperwork with us so that they can rebut the  
5 presumption. And so, I'm glad we're on this topic to  
6 discuss actually some of these issues and concerns, but  
7 that was why we had July 1, 2008, because we know  
8 there's going to be some examination of records and --  
9 and some identification of product.

10 MR. JONES: Yeah, and I think I addressed the  
11 issue earlier. We've got this ongoing -- and I don't  
12 say "we", but there is ongoing litigation. And then  
13 there's this rulemaking process. And there's a  
14 different standard or burden for each of those.

15 I see this more of a -- I don't want to use  
16 this word politically, although I did earlier -- more of  
17 a flexible conversation and more practical. And I have  
18 to concede Tom's point, that the idea that all products  
19 are by definition distilled spirits until they prove  
20 otherwise is, I think, problematic. I think it's  
21 doable, though, given the time frame and so forth.

22 But I'm just saying from a practical vantage  
23 point your Alternative 1 is fine. If there's a  
24 diminimus trace amount because of some hops extract that  
25 they decide voluntarily to use and it doesn't create the  
26 final product alcohol concentration more than a half  
27 percent by that, I'm fine with that, from a practical  
28 vantage point.

1           From a legal vantage point, do you really have  
2 that discretion? I frankly think it would be moot if  
3 the Board adopts Alternative 1.

4           MR. LO FASO: But -- but, Fred, I don't  
5 understand because I understood Alternative 2 also  
6 created a presumption which contains some of the same  
7 things that I just believe you just characterized as  
8 problematic. Do I misunderstand or can we just assume  
9 at this juncture that 1 and 2 both rely on the  
10 presumption structure and start talking in this meeting  
11 about how the presumption structure is going to work?

12           MR. JONES: I think we're going to have to  
13 discuss about presumptions. The reason why, from our  
14 vantage point, we're presuming these products have  
15 distilled spirits because that's what the industry is  
16 claiming, even down to the hops extract. So, I think  
17 the presumption that there's distilled spirits is just  
18 that, it's a presumption.

19           The question for this Board is, do you have the  
20 discretion to allow trace elements of distilled spirits  
21 and not call the final product a distilled spirit? You  
22 do have that discretion. Now, the lawyers in litigation  
23 say you can't. That's -- that's their burden to have  
24 to -- to prove.

25           But from a practical vantage point you can  
26 allow for a diminimus amount of distilled spirits in a  
27 traditional beer product. We're fine with that because  
28 we're going after a product that's not about trace

1 element or diminimus. We're going after products that  
2 have a boat load, percentagewise, of distilled  
3 flavoring. Distilled spirits, whatever you want to call  
4 it, they're distilled.

5 MR. LO FASO: Understood, Fred, but the writing  
6 of the language, itself -- now, I understand that the  
7 diminimus issue is a point of difference between  
8 Alternatives 1 and 2. So, let me ask the question  
9 another way.

10 If Alternative 2 presumes that alcoholic  
11 beverages are distilled spirits unless they prove  
12 otherwise, under Alternative 2 please explain to me how  
13 Coors Light is not taxed as a distilled spirit, as a  
14 practical matter.

15 MR. JONES: I think that was a question you  
16 asked for Marc and it's probably more appropriate to put  
17 to him because he knows what's being put in these  
18 products.

19 MR. LO FASO: But you're proposing -- somebody  
20 on your side is proposing Alternative 2, so I just want  
21 you to tell how it would.

22 MR. JONES: I'll defer to the person who  
23 actually wrote the letter, if he's comfortable. But  
24 from my point of view, to answer your question directly,  
25 I am prepared to accept a diminimus .5 percent. Now,  
26 whether you do that as a presumption on the front end or  
27 swear under perjury on the back end, that's up to you to  
28 decide.

1 I think from a practical vantage point working  
2 with the industry makes sense.

3 MR. LO FASO: In fairness, Fred, I'm going to  
4 ask the industry, too, how they think the presumption is  
5 going to work with a diminimus or non-diminimus  
6 standard. But I'm just trying to get to the presumption  
7 and not get lost on it.

8 MR. JONES: I understand.

9 MR. LO FASO: If somebody wants to -- if  
10 somebody wants to answer that you defer to, Fred, on how  
11 it's going to work.

12 MR. JONES: Okay.

13 MR. DICKEY: So, under our proposal --

14 MS. BARTOLO: State your name, please.

15 MR. DICKEY: I'm sorry. Scott Dickey, Renne  
16 Sloan, on behalf of the petitioners in the Santa Clara  
17 County versus the State Board of Equalization.

18 Our proposal is a recognition of our position,  
19 and, you know, I know that Randy Ferris disagrees with  
20 me on this, but our position that under the existing  
21 legislative scheme a product that contains any amount or  
22 kind of distilled spirit is -- is an alcoholic beverage.  
23 Any amount or kind of a distilled spirit is a distilled  
24 spirit for all purposes.

25 So, it does not have a diminimus -- diminimus  
26 standard. And the industry has -- has said that that  
27 would automatically encompass a wide swath of other  
28 products.

1           We don't know that. We -- we are -- we are  
2 working on data that we have been able to get from the  
3 Federal government. What we -- what we have suggests  
4 that -- that everything in the category that we're  
5 trying to deal with, which is alcopops, not beer,  
6 is within the -- would -- would be a distilled spirit  
7 for purposes of -- of the California legislative scheme.  
8 And that to be consistent with the scheme the -- the  
9 proposal has to recognize that any amount or kind of  
10 distilled spirit makes it a distilled spirit.

11           Now, I will also remind the -- the panel that  
12 when I spoke earlier about this, we don't think that the  
13 Board has discretion to -- to come up with a diminimus  
14 standard under existing law. But if the Board disagrees  
15 with us, we -- we do think that a diminimus standard is  
16 a practical solution. And if you want to approach to  
17 that by adopting the Alternative 1 or by some  
18 modification of Alternative 2, that's okay. Just there  
19 needs to be recognition that there needs to be some  
20 investigation on -- on what these things are and how  
21 much distilled spirits are in them and taxing  
22 accordingly.

23           MR. LO FASO: Two followup questions.

24           MR. DICKEY: Two, okay.

25           MR. LO FASO: Okay. Tom, I keep being told --  
26 and I don't know this, and I understand that neither you  
27 nor I know this, I'll get to that in a moment or at some  
28 point, hopefully -- that there is some product out there

1 that is a beer, understood as a beer, sold as a beer,  
2 that might have some trace elements of flavor that comes  
3 from distillation.

4 And the question is whether we're going to be  
5 classifying that as a distilled spirit. I'm  
6 understanding from what you say that we're legally  
7 compelled to.

8 MR. DICKEY: Right

9 MR. LO FASO: So, are you then advocating that  
10 the Board pass a rule that, as it's been suggested to  
11 me, indicates that hops extract or some flavor element  
12 in a beer might contain a trace of distilled spirit,  
13 that we have to tax those products as distilled spirits?

14 MR. DICKEY: That is our position. Yeah,  
15 absolutely. The law does not give you the discretion to  
16 exclude products that have just a diminimus amount of  
17 distilled spirits from the definition of distilled  
18 spirits.

19 MR. HUDSON: Can I follow that up with a  
20 related question to that? Tom Hudson, Tax Counsel for  
21 Bill Leonard. Question for you then on that, with  
22 regard to both Alternative 1 and Alternative 2.

23 Now we're talking about a regulation that as a  
24 matter of simple drafting, things that contain no  
25 distilled spirits at all, no distilled alcohol, no  
26 flavorings of any kind, would automatically be a  
27 distilled spirit for tax purposes regardless of whether  
28 they contain those things or not.

1           So, unless they can prove otherwise, every  
2 single one of those products would be a distilled  
3 spirit.

4           MR. DICKEY: I'm sorry, Tom, are you asking me  
5 to defend Alternative number 1?

6           MR. HUDSON: I'm asking is that your position,  
7 is that -- if you're reading it the same way I am, so I  
8 want to know you're reading it the same way I am and  
9 that's what you're proposing is -- is the right  
10 solution, that every single product, whether it contains  
11 any distilled alcohol or not, whether it has any  
12 flavorings or not, every single beer in California would  
13 be taxed as a distilled spirit unless they could prove  
14 they're not.

15           MR. DICKEY: I have not proposed that. And I  
16 am not proposing that here. In fact, I'm proposing  
17 proposal number 2, which doesn't include a rebuttable  
18 presumption but also doesn't automatically classify  
19 every product as distilled spirits, or trying to find  
20 a -- a middle path that doesn't eliminate -- that --  
21 that allows the -- the State Board of Equalization to  
22 conduct its investigation without coming to the  
23 automatic presumption that everything is -- is one thing  
24 or the other.

25           It's -- it's a find out the facts, then make  
26 the classification.

27           MR. FERRIS: Randy Ferris, Legal Department.  
28 My understanding of Alternative 2 is that it -- it's

1 basically all the -- the companies are going to have to  
2 give us a lot of documentary -- documentation and then  
3 the burden is going to be on us to figure out if there's  
4 a molecule of alcohol from distillation.

5 MR. DICKEY: I don't think that's correct. No,  
6 that is not how we're -- how we phrased proposal 2.

7 Proposal 2 requires the producers of alcoholic  
8 beverages to provide a -- documentation, which could be  
9 a single form, that indicates the amount of distilled  
10 spirits in -- in the total product. I believe the  
11 amount of distilled spirits in the flavoring and amount  
12 of the flavoring that's used in the total product.

13 So, you aren't going to be having to look at  
14 anything at that level. In fact, I think the goal with  
15 our proposal is to reduce the burden on the Board to --  
16 to the -- to the lowest level possible, while putting  
17 the burden where it belongs, which is the alcohol  
18 industry, the taxpayer, to identify what it is that  
19 they're producing so that it can be properly taxed.

20 MR. FERRIS: Okay.

21 MR. DICKEY: So -- so we're not -- we're not  
22 trying to get the Board to go through some complex  
23 chemical analysis. We think that the -- the industry  
24 should be providing that analysis, itself, as a taxpayer  
25 under -- under the existing tax laws.

26 MR. LIVINGSTON: Could I speak to Option 1?

27 MR. HALE: Please, you've been waiting.

28 Thank you.



1 that everything is a distilled spirit, because there is  
2 a lot of distillation that's being added to products  
3 these days that wasn't added -- what is it, 80 years  
4 ago, when these statutes were written.

5 But it seems to me that then the -- the primary  
6 problem which Scott is getting into a little bit is, is  
7 there room in such a regulation to allow that some trace  
8 element of distilled spirit can be allowed even in a  
9 beer.

10 And since, you know, there's -- beer is defined  
11 in your statutes as any product of fermentation, I don't  
12 know if that's the exact word, but it uses the any --  
13 the word "any" and not "all" I believe. And your --  
14 it's a practical solution that you're offering. It has  
15 some basis in the Federal regulatory process in terms of  
16 there wasn't an argument against that .5 percent  
17 standard. It gives you the information that is given  
18 much more strongly on many more products in -- in Option  
19 2, but without having a huge burden on you to research  
20 all of these Federal reportings.

21 So, it's -- it's practical and it achieves the  
22 purpose, which is to try to regulate alcopops and still  
23 leaving plenty of room for the beer industry to produce  
24 fermented beer products. And if there -- those kind of  
25 sweetened beers, they're not trying to hide the fact  
26 that they're beers. Neither -- neither are wines trying  
27 to hide the fact that they're wines -- wine coolers or  
28 derived from wine.

1           But beer that wants to be beer and tastes a  
2 little sweeter, it's a flavoring issue, but it's not  
3 marketed to kids. They're boutique beers. They're much  
4 like micro-beers.

5           And we don't -- we don't care about that as  
6 much. It's not marketed to youth. It's not meant to  
7 hook kids at an early age. If you take 100 adults who  
8 are alcoholics, 97 of them started binge drinking when  
9 they were underage. And that's the products that we're  
10 trying to get at.

11           We think that you did a smart move here in  
12 establishing a presumption of distilled spirits, which  
13 is what the statutes really back up, but you're -- but  
14 you're being very -- very benevolent and smart  
15 about allowing the option for the beer industry to come  
16 back and say, yeah, we -- we add some flavoring, mostly  
17 to make it taste like beer or to make it taste a little  
18 better, but not to market to kids.

19           So, that's why we're happy with it.

20           MR. HALE: Okay. Thank you. Any followup?

21           UNIDENTIFIED SPEAKER: I'll follow up.

22           Actually, if the beer industry wants to come back and  
23 respond to that by saying, well, .5 is a little hard,  
24 maybe .75 or 1 percent makes sense, because of the  
25 amount of stuff we do, that we have to add to get hops  
26 or malt into it, it seems to me that's the argument that  
27 you really need to hear from.

28           MR. FERRIS: Randy Ferris, Legal Department.

1           And just to piggyback on that as the time is  
2 now past the noon hour and we're -- we're here as long  
3 as we need to be in order to get all the information  
4 that we need.

5           Now is the time if there is some specific  
6 things to offer us in terms of alternative language or  
7 different approaches that should be taken to proposed  
8 regulatory language or specific concerns about how this  
9 would be administered, we really need to -- to hear from  
10 you on that. We're not here -- this is an open meeting  
11 so we can solicit the input. We put some ideas out  
12 there not because anyone is wedded to them in any  
13 specific kind of way, but because we're trying to get  
14 the discussion rolling. But we need specific feedback  
15 and specific critique or different alternatives so that  
16 we can have the maximum amount of information so that we  
17 can make the best possible list of all alternatives for  
18 our Board to consider when they convene in August, to  
19 think about those things.

20           MR. HALE: Thank you. I would just add to  
21 that, items you may want -- industry may want to  
22 consider if this happens to be adopted. We have issues  
23 of return filings. Would there be a floor stock tax?  
24 Any of these other kind of issues that may impact  
25 industry that you'd like to address, this would be  
26 the -- the time to bring that forward.

27           Go ahead, Marc.

28           MR. SORINI: One of the things that has come

1 out on a number of occasions, I know you brought it up,  
2 was this -- I guess mistrust of the industry, and so we  
3 don't really know what's in it. We -- we submit all of  
4 that to the Federal government, and so if one of the  
5 issues here is simply a question of you -- of the State  
6 of California want to be exercising some independent  
7 role of confirming -- confirming that we're meeting the  
8 Federal standard, my guess is -- and I haven't asked my  
9 client here, so a little disclaimer there -- but my  
10 guess is that they would be willing to do that.

11 And -- I mean, and the Federal -- and the  
12 Federal system, as I said, I think you're really in some  
13 way starting to duplicate the Federal system.

14 But if you want to police the 51/49 percent  
15 standard, the Federal government has for products below  
16 6 percent and the one and a half percent standard that  
17 they have for products above 6 percent -- then my guess  
18 is that's something that -- that can be done in order to  
19 address any concerns that, well, gee, we don't know if  
20 that's true -- we could probably come up with something  
21 that could be submitted to the State of California  
22 and -- and I would see that as a -- as an acceptable  
23 solution.

24 DR. KOOLER: Dr. Jim Kooler, California Friday  
25 Night Partnership. And I'm intrigued by Marc's  
26 recommendation and would suggest that if that  
27 information is already on file, that we use that  
28 information and implement 2558 and eliminate 2559 and

1 59.1. And follow the information that's already on  
2 file. And if the information within the Federal  
3 government provides us with what we need to do and  
4 there's any distilled flavorings in there, that we have  
5 what we need to be able to implement the guidelines that  
6 you implemented with Alternative number 1.

7 MR. HALE: Thank you.

8 MR. SORINI: Listen, we've never hidden the  
9 fact that there's alcohol from flavors in these  
10 products. And -- and I know you guys love to, you know,  
11 make the -- make the conspiratory theory, and, oh, we're  
12 hiding this. I mean, we're not going to hand out  
13 publicly our formula because, like any food manufacturer  
14 or other manufacturer, that's important proprietary  
15 information.

16 But, no one is going to sit here and say, oh,  
17 there's no alcohol from -- from -- from flavorings in  
18 there. That is nothing we've ever hidden.

19 So, to the extent that information is provided  
20 to the -- is provided to the Board with appropriate  
21 safeguards -- now there have to be appropriate  
22 safeguards, obviously it's highly sensitive confidential  
23 information when you're talking about formulas.

24 My guess is they're willing to do that. The  
25 question then is, what's the standard. And we  
26 respectfully submit -- you know, I know you appropriated  
27 the .5 percent standard from the Federal rulemaking  
28 process, and as somebody alluded to, but I think it's

1 very significant that the Federal government rejected  
2 that standard and went for a 51/49 percent standard,  
3 unless anyone say, well, that's because the industry sat  
4 on them.

5 I mean, supporters of the .5 percent standard  
6 included Anhaueser Busch, Miller Brewing Company, Coors  
7 Brewing Company, the National Beer Wholesalers  
8 Association and virtually the entire industry. So --  
9 so, the .5 percent standard was rejected on the merits  
10 by the Federal government, and we think that once  
11 you've evaluated this whole issue it's the sensible  
12 standard.

13 MR. JONES: Marc, if I may just clarify that  
14 point. The .5 percent was to say that it's -- it's an  
15 alcoholic product. And that's what the TTB was using.  
16 If it has less than a half percent of alcohol, then  
17 we're not even going to get into the discussion whether  
18 it's an FMB or a beer or a distilled spirit or wine.  
19 It's not any of them.

20 Moreover, again, Section 23003 of the B & P  
21 Code section -- I'm sorry, 4, Section 23004, defining  
22 alcoholic beverage says, "contains one half of one  
23 percent or more of alcohol by volume." So, it's also a  
24 State standard, a State statute.

25 And so we're not talking -- you're mixing  
26 apples and oranges. The .5 is a threshold to determine  
27 whether their product or an element is an alcoholic  
28 product of beverage.

1           The other -- now the apple is at what point  
2 does it become a distilled spirit? And --

3           MR. SORINI: At .49.

4           MR. JONES: Well, that's what the Federal  
5 government said, but they don't have B & P Code Section  
6 23005, which says if you mix any of those beverages,  
7 distilled beverages, the final product is a distilled  
8 beverage.

9           DR. KOOLER: Just to reinforce, I don't think  
10 we're interested in the formula but just to follow how  
11 Alternative 1 could be implemented. I believe that was  
12 the question of the day. And I believe if that  
13 information is available, provides the data without  
14 duplicating the expensive effort used in Maryland, to  
15 use that information to follow up .558, which is to  
16 allow 59 and 59.1 to be moved, and make our life much  
17 simpler via, as you say, being very effective in using  
18 Federal resources.

19           MR. HALE: Thank you. Was there a comment?

20           MR. TERRY: Yes, thank you. My name is Park  
21 Terry. I'm with the Greenberg Torrance firm and I'm  
22 representing Miller Brewing Company. I wanted to get  
23 back to the regulation, itself, because I did have  
24 a -- a particular question about the wine exception and  
25 the rationale that the staff used in adopting that. And  
26 I guess I'd like to hear that, and then there's a  
27 secondary question.

28           If in fact we follow that rationale, it seems

1 to me that if you add wine to a distilled spirit, which  
2 everybody seems to think is not -- you know, puts it in  
3 a distilled spirit category -- are we in effect saying  
4 that no amount of wine when added to a distilled spirit  
5 would cause it to be taxed as a distilled spirit?

6 Sort of the flip side of -- of reading this  
7 particular regulation.

8 So, anyway, I'd like to hear a staff comment on  
9 that.

10 MR. HALE: I'll refer it to Legal Counsel.

11 MR. FERRIS: Well, part of the -- and Monica  
12 may have some more specific things to say about this,  
13 but I think the California statutory definition of wine  
14 expressly permits certain distilled products to be  
15 added, depending upon -- they have to, I think, be  
16 naturally related to wine.

17 MS. BRISBANE: The same agricultural product.

18 MR. FERRIS: Right. And so the statutory  
19 definition of wine allows for distilled alcohol to be  
20 added to it and still be a wine.

21 MS. MANDEL: Is that 45 --

22 MR. FERRIS: Brandies and other things like  
23 that.

24 MR. TERRY: Yeah.

25 MR. FERRIS: So that's -- that's why, we don't  
26 have the statutory authority to bring wine into this  
27 because the Legislature has already said that wine can  
28 have certain kinds of distilled alcohol in it.

1 MR. TERRY: If it -- I guess the question,  
2 though, is -- is what is the product then. If you -- if  
3 you were to mix wine, say, 50-50 with distilled spirits  
4 and come up with a product, where does that -- where  
5 would that fit? Because your regulation says that it is  
6 an alcoholic beverage except it contains wine.

7 MS. BRISBANE: It's a product --

8 MR. TERRY: And it --

9 MS. BRISBANE: This is Monica Brisbane from the  
10 Legal Department. If the product met the definition of  
11 wine, if it had the authorized distilled spirit added to  
12 the initial product, then it would not fall within this  
13 regulation because it met the definition of wine. So,  
14 you'd have to know what the alcohol -- the distilled  
15 product that was being added to that wine to see whether  
16 or not it would meet the wine definition and then be out  
17 of the presumptions, or whether it would not, because it  
18 now has distilled spirits in it that don't -- are not  
19 allowed under the wine definition.

20 MR. TERRY: Okay. Could I --

21 MS. BRISBANE: Now, that's the simple way that  
22 we thought about it. I mean, we didn't go into any --  
23 you know, nobody lobbied us and said, oh, this is  
24 California and there's wine. And we grow a lot of wine.

25 MR. TERRY: But I --

26 MS. BRISBANE: So, it had -- it had nothing to  
27 do with that.

28 MR. TERRY: I -- and I do want to get back to

1 that --

2 MS. BRISBANE: That's probably --

3 MR. TERRY: -- that question, the first  
4 question, which is what was the rationale for excluding  
5 wine when it seems that the -- the logic of the  
6 arguments of the proponents of -- of this proposal  
7 would -- would be that it has -- almost has to be  
8 included by definition.

9 MR. FERRIS: Because the statutes prevent them  
10 from making that argument. If the statutes didn't  
11 prevent them, I believe that they would be making that  
12 argument, as well.

13 MR. LO FASO: And just for the record, Section  
14 23007, Park, defines distillation.

15 MR. TERRY: Are you going to read that?

16 MS. MANDEL: Marcy Mandel -- they never  
17 make the mikes short enough -- State Controller's  
18 office.

19 My question, without reading all the statutes  
20 and everything then is -- is whether you have -- with  
21 the question that comes up with wine, and you're saying,  
22 well, it's all defined in the statute, do we need -- if  
23 these -- this Alternative 1 regulatory language in terms  
24 of getting comments on -- on does this work as a whole,  
25 and does it need anything else, do we need something  
26 that references the definition of wine to -- to clarify  
27 that somehow? Some of those other comments as part of  
28 the regulatory.

1 MS. BRISBANE: This is Monica Brisbane again.  
2 Randy can -- can chime in, as well. Because we start  
3 with an alcoholic beverage, wine is an alcoholic  
4 beverage, so if we don't put the exception there with  
5 wine then we would --

6 MS. MANDEL: No, I understand that. I meant in  
7 terms of --

8 MS. BRISBANE: Okay.

9 MS. MANDEL: -- of -- of -- then maybe it just  
10 goes in your issue paper of why -- why wine is out and  
11 is there a separate definition of wine that somehow --  
12 you know, I just want to make sure that the --

13 MS. BRISBANE: Because he closed the whole  
14 circle --

15 MS. MANDEL: -- the tax is the whole circle --  
16 yeah.

17 MR. JONES: Although you are referencing on all  
18 three proposed regulations of B & P Section 23007, which  
19 is what you were referring to earlier, where it says  
20 grape brandy, fruit brandy or spirits of wine distilled  
21 from a particular agricultural product or products of  
22 which the wine is made.

23 So, it's -- it's pretty clear in Section 23007.

24 MR. FERRIS: But Ms. Mandel's point is well  
25 taken and we'll include that in the final.

26 MR. SORINI: Except that as -- if the Board is  
27 going to say that in essence the alcoholic flavors when  
28 they exceed the .5 percent standard or some other

1 standard is going to be presumed distilled spirits, I  
2 guarantee you nobody is making flavors from brandy or  
3 other agricultural spirits. They're making it from  
4 grain neutral spirits because they want a neutral base.

5 So if you have a flavored wine for your logic  
6 to hold up, it doesn't -- as Park pointed out, the logic  
7 and conclusion consistency I think is -- is manifest.

8 I mean, nobody -- these are not wine spirits, I  
9 guarantee you. A flavored wine is getting alcohol not  
10 from brandy, not from any other wine spirits. In fact,  
11 I'm sure if you went to one of the flavor manufacturers  
12 and said, "Make me a flavor with -- with brandy," they  
13 would look at you cross-eyed, like what are you, kidding  
14 me? You want a neutral base and the neutral base is  
15 supplied by neutral spirits.

16 So, I don't think you can justify the exemption  
17 of wine based on that authorization of the use of wine  
18 spirits. In fact, Federal law has the same standard for  
19 wine spirits. You can use brandy and grapes. You can  
20 use orange brandy in orange wine, et cetera.

21 But then in addition to that there is a 4  
22 percent allowance, up to 4 percent of the alcohol in a  
23 wine product can come from other non-beverage products.  
24 In other words, flavors. So, it's very clear the  
25 Federal government wouldn't have made that regulation  
26 but for the fact that people were putting flavors in  
27 wine. Indeed, you can look on a shelf and you can see  
28 wines that will say on the label, "wine with natural

1 flavors."

2 And those are going to have alcohol in them  
3 from the flavoring system in the same way as you got  
4 products here.

5 And, indeed, that 4 percent limit means that  
6 you're going to have greater amounts of alcohol in some  
7 wine products potentially than you could possibly have  
8 under the current Federal standard for beer.

9 Remember, it's a 51/49 standard up to 6  
10 percent. So, the most -- the most alcohol that could be  
11 contributed to a beer product from a flavoring system  
12 under the current Federal standard is just under 3  
13 percent. With wine it can go up to 4 percent.

14 So, I agree with Park's point, which is from a  
15 logical standpoint it just does not make sense. And,  
16 frankly, if you say, well, we don't think that there are  
17 wine products out there, then it's not a problem and why  
18 give them the exemption.

19 It -- it strikes me that there's a -- there's  
20 a very big problem here from just a logical policy  
21 standpoint. If you're really being animated by the  
22 definition of "distilled spirits" you got to treat them  
23 equally.

24 MR. JONES: If I may, because I think actually  
25 Marc and Park and I agree on something -- I think it  
26 would be important in each of these three regulations to  
27 clarify that "except for wine as defined in Section  
28 23007" would alleviate that concern.

1 MR. HALE: Thank you.

2 MR. LO FASO: Actually, just about what Tom was  
3 saying, is Marc has suggested there are some products  
4 that could be classified as distilled spirits in this  
5 regulation along the lines that define -- that Fred just  
6 offered.

7 But, Marc, would you care to just address your  
8 industry's view on the breadth of the regulation as  
9 proposed in terms of, let's just say, defining a  
10 beverage that contains flavoring -- flavorings with more  
11 than a half a percent of alcohol from distillation?

12 What -- what that means in the real world.

13 MR. SORINI: I think -- well, first of all,  
14 we're going to -- and I wish I represented the whole  
15 industry because it would be more fees. Ha ha.

16 But, no, I'm here representing the coalition.  
17 That's a lawyer joke.

18 But on behalf of the coalition, you know, we  
19 really were formed in response to the TTB's original  
20 proposal, which was a .5 percent standard at a Federal  
21 level. And -- and argue persuasively -- and again this  
22 is not a case of the industry overwhelming the poor --  
23 the poor agency. We were -- it was a rigorously debated  
24 thing with the industry very deeply split on what the  
25 appropriate standard was. .5 percent versus the 51/49  
26 percent for products up to 6 percent, and then a much  
27 stricter limit for products that really exceed the  
28 standard -- the standard strength of -- well, the

1 strength of a standard beer.

2 You know, obviously, I -- I'm a big fan of some  
3 of your California micro brewers, and there are some  
4 very strong beers out there. But -- but most beers are  
5 below 6 percent. So, you got that sort of doable thing.  
6 That's what we think the appropriate standard is.

7 We -- we supported that at the Federal level  
8 and we would support the appropriate 51/49 percent  
9 standard here for products below 6 percent. And then  
10 for the products above 6 percent of 1.5 percent cap  
11 on -- on alcohol content from added non-beverage  
12 products.

13 MR. LO FASO: I'm not sure you answered my  
14 question. And -- and I'm -- I -- I --

15 MR. SORINI: I'm sorry, I thought I did.

16 MR. LO FASO: I'd love to get you to name some  
17 products, and I know you won't do it. But I keep  
18 hearing about -- you know, there's -- there's a  
19 reference to a hypothetical pumpkin ale in the -- in the  
20 Federal rule, which --

21 MR. HUDSON: It's across the street, it's not  
22 hypothetical.

23 MR. LO FASO: My interpretation of the Federal  
24 reg. Okay. Well, obviously my drinking habits are  
25 now -- you know, whatever.

26 Those were discussed as traditional beers in  
27 the Federal Register reg. But those would be distilled  
28 spirits under some of the regulations we're talking

1 about if the flavorings or --

2 MR. SORINI: That's right.

3 MR. LO FASO: Based on what you can tell me --  
4 I mean, now, I mean, I'm still -- I don't know how much  
5 alcohol component is in the flavoring. I don't know  
6 how -- if you dilute the -- the flavoring's overall  
7 contribution to the alcohol content, you get under  
8 the .5 percent standard. Anything you can tell me to  
9 help me understand how this plays out.

10 MR. SORINI: That's a great question. One of  
11 the interesting things that happened during -- during  
12 the Federal rulemaking was that several of the --  
13 several of the companies came out strongly in favor of  
14 the .5 percent standard, and they promptly rolled out  
15 versions of their FMB products, and these weren't  
16 pumpkin ales, these were FMB products. Products -- and,  
17 again, to -- to ask just to digress a little bit to  
18 answer the question, well, why would you do this? It's  
19 because you're trying to get a beer drinking occasion in  
20 a -- a product that sort of has the same convenience and  
21 drinking occasion as beer, but does not taste like beer.  
22 And there are plenty of adult consumers that enjoy that.

23 So, these are products that don't taste like  
24 conventional beer, but that the manufacturers who were  
25 supporting the .5 percent standard actually rolled out  
26 and -- and touted very strongly as, hey, this is -- this  
27 is something that we can live with because we can make  
28 these products under that standard.

1           Now, not surprisingly, these were the companies  
2 that could -- that could move more liquid through more  
3 barrels in this country than -- than any other -- than  
4 any other company.

5           But -- but the point is, I guess, that it is at  
6 least in certain places possible to make a product  
7 below .5 percent using -- using technology. Because,  
8 again, what you do is you take your beer base, the  
9 alcohol stays in, the water stays in, but you take out  
10 all the proteins and other stuff that gives it the  
11 traditional color and taste. That's what you're trying  
12 to do. You're trying to appeal to a consumer that may  
13 want to be at the bar but you have something in a  
14 12-ounce bottle but, you know what, they don't like the  
15 taste of hops. So, you take that out. That's the sort  
16 of idea.

17           So, it is possible that there are products out  
18 there that are below .5 percent. Certainly it's  
19 possible to make them, because I've tasted them, I saw  
20 them at the NCSLA three years ago, four years ago, which  
21 was when these other manufacturers sort of rolled out  
22 their prototypes.

23           But -- but I think the industry right now is  
24 following the 51/49 percent standard, which would  
25 then -- which would then be upset by -- by this  
26 California problem.

27           Did -- did that answer your -- I hope that  
28 answered your question.

1 MR. LO FASO: Well, I'll go -- I'll go to Tom  
2 for naming the specific products but, yes.

3 MR. TERRY: I just wanted to follow up a little  
4 bit on Alan's question, and this was more of a personal  
5 experience I had last week. My own daughter, who  
6 brought by some -- I guess it was a strawberry flavored  
7 beer and it was labeled as a beer, it's not an FMB,  
8 which I tasted and which had no sense of beer taste. It  
9 was -- was fairly sweet. And I guess the point I'm  
10 trying to make here is that I think if anybody is under  
11 the illusion that passing this regulation will eliminate  
12 these sweet beers that people seem to be concerned  
13 about, I'm not sure that's going to happen. I think --  
14 you know, I think people should be cautious about the  
15 assumption or reaching to the conclusion that setting a  
16 0.5 percent standard will just make this product go  
17 away.

18 MR. HALE: Thank you. Any followup from staff?  
19 Tom.

20 MR. HUDSON: One issue that we haven't -- Tom  
21 Hudson again from Bill Leonard's office. A question  
22 that we haven't really covered too much, and I have  
23 our criminal law expert, Sue Blake, next to me whose  
24 practiced in this area a lot more than I have, and kind  
25 of a question I had about how this Alternative 1 reg --  
26 regulation as it's listed here in draft form, 2559.1,  
27 how you would rebut the presumption.

28 Essentially, we're -- we're proposing to rebut

1 the presumption you would file a statement under penalty  
2 of perjury that your product didn't contain ingredients  
3 from or more than .5 percent ingredients from distilled  
4 alcohol. And the filing of that statement would then be  
5 the proof that you were not a distilled spirit and could  
6 be taxed at the -- the beer rate.

7 My technical question has to do with the  
8 standards for perjury and, frankly, when you're talking  
9 about out-of-state beer manufacturers and you're talking  
10 about a process where they know and we know and now  
11 everybody in the audience knows, that we can't test for  
12 ethyl alcohol whether or not it's been boiled. There's  
13 no test for that.

14 So, you know, proving beyond reasonable doubt  
15 to a jury that -- that this person has perjured  
16 themselves is -- is essentially an impossibility. They  
17 know it and we know it. Then essentially you've created  
18 a nonsense standard where somebody forgot to file a  
19 piece of paper because they're a micro brewery and they  
20 didn't think their product would ever be considered a  
21 flavored malt beverage by anybody, but because they  
22 didn't have a piece of paper on file for that new batch  
23 where they used a different kind of yeast, they're  
24 essentially going to be taxed at the distilled spirit  
25 rate; and somebody else who's selling the very product  
26 that we're supposedly trying to target, or at the least  
27 the proponents of these regulations are supposedly  
28 trying to target, somebody taxing those very products

1 gets out of it by filing a piece of paper falsely.

2 It just -- so it seems like Alice in  
3 Wonderland. It doesn't seem like it's achieving any  
4 kind of result. And I'd like to hear from the  
5 proponents, particularly on the staff drafted regulation  
6 2559.1, how they think this -- this under penalty of  
7 perjury would work in the real world. And how we would  
8 ever convict anybody, particularly out-of-state  
9 manufacturers, of perjury?

10 MR. FERRIS: Randy Ferris from the Legal  
11 Department. Again, just a hair-splitting point of  
12 clarification, that staff is not a proponent of  
13 Alternative 1. We are trying to faithfully execute the  
14 Board's will, but they have some regulatory language to  
15 consider. And so, we're trying to draft that.

16 We do believe that based on the limited  
17 knowledge we have in this whole process, it's designed  
18 to -- to educate us, as well as the Board Members, so  
19 that we can give the most effective alternative to the  
20 Board for their consideration.

21 I lost -- I lost my sentence in the middle of  
22 that. But we do think that within the -- within our  
23 present knowledge that we have, this was our best  
24 attempt at trying to get the ball rolling, to get the --  
25 to further discussion on these things.

26 We do -- it is our understanding that these  
27 manufacturers have to file these types of reports, which  
28 we can acquire under the -- the regulation, and that

1 there's some meaning to this report because the Federal  
2 government has to decide the 51/49 percent standard.

3 So, we believe that there must be something in  
4 these reports that's credible upon which the Federal  
5 government can make its determination of does it exceed  
6 49 percent of alcohol content from a distillation  
7 process.

8 So, as long as the statement under penalty of  
9 perjury is being signed by a percipient witness, and we  
10 would require that, it should be someone who's  
11 knowledgeable about how the product is made. We believe  
12 that the documentation that already has to be provided  
13 to the Federal government would suffice to catch  
14 somebody in a lie if -- if they were idiotic enough to  
15 try to do that. And I don't think that anyone in the  
16 industry would try to do that because I think they do  
17 try to observe the laws that are imposed upon them.

18 MR. TERRY: Sorry, I just wanted to make a  
19 related point on that item, as well. Because the tax,  
20 as I understand it, is collected from beer in-state from  
21 the manufacturer, but if it's imported from out of state  
22 the tax is collected from the licensed importer or  
23 distributor.

24 It does seem to me that you do have a -- a  
25 potential disconnect between the person who's making a  
26 statement or filing a statement about its alcohol  
27 content and the -- and the actual taxpayer. And I don't  
28 have a position on that, I just want to make you aware

1 that there -- there is a potential area of dispute if --  
2 if at some point it turns out that the filing made by  
3 the manufacturer is challenged, and then you got the  
4 taxpayer being a -- a whole different person.

5 MR. HALE: Marc, did you have a comment?

6 MR. SORINI: Two of a different nature. The  
7 first, is there an equivalent of a -- it's 26 USC 6103,  
8 which is the confidentiality of tax return information  
9 in California? There is. So, any kind of submission  
10 that -- that the industry would make, we would want to  
11 have some sort of -- some sort of guarantee that these  
12 will be treated as -- as highly -- highly proprietary.

13 And, again, I -- our -- our view is that there  
14 doesn't need to be any -- doesn't need to be any  
15 submissions here but -- but, again, I think it may be  
16 that in order to verify the 51/49 standard if you want  
17 to see some sort of submission, the one issue that's  
18 going to be there is confidentiality, that it can't be  
19 (inaudible) or something similar.

20 The second issue is -- is more for Lynn because  
21 I know you're administering the tax. I know the  
22 registration for the tax is done by the ABC license  
23 filings. And so, now you have the potential for people  
24 who are only licensed as beer and therefore -- I guess  
25 they're only registered as beer taxpayers, but  
26 potentially if there is a change in standard they would  
27 be treated as distilled spirit taxpayers, and how's that  
28 going to be handled?

1 MS. BARTOLO: Well, we -- they're not -- the  
2 tax implication on the product that they're handling  
3 would change, but not the -- a difference in how we  
4 treat them as a taxpayer. Because we do base our  
5 registration on ABC'S licensing levels.

6 IDENTIFIED SPEAKER: They would be registered  
7 as a beer taxpayer.

8 MS. BARTOLO: They would continue to be  
9 registered as a beer taxpayer because this product is  
10 something that they can be penalized under that license  
11 for them to handle.

12 However, if they handle that product and it's  
13 taxed at a different rate then they'll be remitting tax  
14 at a different rate for that product.

15 MR. HALE: If we change it for the returns for  
16 that.

17 MS. BARTOLO: Tax return forms. Outreach plan.  
18 List the products. All of those things. And that's why  
19 we need the time -- we put the July date out there to  
20 give us all the time to hold workshops with industry,  
21 find out what's acceptable, ensure that we have an  
22 outreach plan so everyone is on board with the changes.  
23 All of those things.

24 MR. HALE: And this has been great, to identify  
25 some of those technical issues if these regulations were  
26 adopted.

27 MS. MANDEL: Can I -- because I nodded "yes" on  
28 the -- oh, I have my glasses on, now I can see you -- I

1    nodded "yes" and you guys are probably nodding "yes" on  
2    confidentiality of tax return information.

3            If -- if somebody -- if these regulations went  
4    in and somebody came forward at a Board hearing because  
5    they were getting taxed on a certain product that now  
6    they say, "Hey, wait, now I have information," our  
7    upcoming Board hearing rules -- I just want to make sure  
8    that there's a complete -- I don't want to be the one on  
9    which they're relying about whether it's confidential or  
10   not. But -- because I nodded faster than you. So, if  
11   you could --

12           MS. BRISBANE: Well, if -- this is Monica  
13   Brisbane from the Legal Department. I think generally  
14   speaking that point -- that is the case. And we -- I  
15   hadn't thought about it with respect to the Rules of  
16   Practice. We probably have to think about how that  
17   might play out if somebody is going to be disputing  
18   their tax, and how that might work.

19           So, we haven't thought about that all the way  
20   through with respect to the Rules of Practice and the  
21   taxpayer coming in before the Board in an open session.

22           This program also has -- does not have the  
23   standard confidentiality provision that the other  
24   programs have. It's actually a little bit different.  
25   And it -- it provides some protection for wine growers,  
26   I think, a lot. And I don't want to get into it -- what  
27   California is known for, I guess.

28           So, I have looked into relying on the

1 Government Code section, but it's always better to have  
2 a statutory section in the program. So, it's something  
3 that we're going to have to be very cognizant of with  
4 this because we are -- we do appreciate the -- the  
5 highly confidential nature of the product.

6 So, it's something that -- that I thought of  
7 since we put out the issue paper that needs to be  
8 addressed in the formal paper because --

9 MS. MANDEL: Something --

10 MS. BRISBANE: -- we don't want to be caught  
11 now having to produce the -- the documents that we --

12 MS. MANDEL: Right.

13 MS. BRISBANE: -- would say. So, it is an  
14 unusual missed program.

15 MS. MANDEL: So, what you would probably see in  
16 the final issue paper that went to the Board would be  
17 that -- a concern about confidentiality of the  
18 manufacturers, blah di blah, whatever the official thing  
19 is -- was raised.

20 And this program -- because I think I nodded  
21 "yes" quickly. It is a little bit of a surprise when we  
22 have a disconnect between different tax programs and --  
23 and those sort of administrative rules that apply to  
24 them, particularly confidentiality.

25 MS. BRISBANE: Right. And that's true.

26 MS. MANDEL: It was a surprise to me, so that  
27 the final issue paper would have potentially then a  
28 suggestion of something else.

1 MS. BRISBANE: That's what we're contemplating,  
2 yes. I had already thought about that. So, we'll make  
3 sure that is addressed in the final paper to the Board.  
4 Because it is something I thought of since the issue  
5 paper went out.

6 MR. LO FASO: I had a question on  
7 confidentiality and (inaudible). But -- and we -- we've  
8 come a way on some of our assumptions here and some of  
9 the proponents have taken a different view on exactly  
10 the presumption structure. And I have a question about  
11 that.

12 But -- but my question specifically to Marcy's  
13 question is, as I understand Alternative 1, it's a  
14 distilled spirit unless you have shown the Board that  
15 it's not by the penalty of perjury statement or  
16 whatever.

17 Maybe I'm incorrect, but I understood Marcy's  
18 point, which was about confidentiality in the Board  
19 hearing.

20 MS. MANDEL: Marcy's point is -- always is  
21 trying to clarify everybody else's point.

22 MR. LO FASO: Okay. Well, I'm going to further  
23 clarify.

24 MS. MANDEL: Okay.

25 MR. LO FASO: I -- I envisioned a scenario  
26 where it was being -- where the -- the taxpayer was --  
27 was taxing it as a beer and the Board issued a  
28 determination saying it was an incorrect amount of tax

1 because they should have paid it as a distilled spirit,  
2 and the dispute in front of the Board hearing is whether  
3 it was a distilled spirit or a beer. And the taxpayer  
4 has industry information that indicates -- let's just  
5 say conclusively that it is in fact a beer.

6 With regard to the structure of the regulation,  
7 itself, is it the fact that it is a beer that causes the  
8 taxpayer to win the day of that hearing, or must the  
9 manufacturer not give the information to the taxpayer,  
10 but if he had -- if the manufacturer had not given the  
11 information to the Board in the form of the penalty of  
12 perjury statement, or whatever is -- else is provided  
13 for in the reg. -- if that had not happened prior to  
14 the sale of these beverages for which this determination  
15 has been issued, I'm not sure that the taxpayer could  
16 even bring this information into the Board hearing.

17 MR. FERRIS: If the Board were to promulgate  
18 something like Alternative 1, I think the -- the  
19 administrative implication of that would be that the  
20 Department would have to develop some sort of approved,  
21 you know, list of what kinds of products fall on the --  
22 the beer side of the line and what kind of products fall  
23 on the distilled spirit side of the line. And that  
24 there would be provisions that an importer or someone  
25 else that isn't necessarily privy to the proprietary  
26 information could rely upon the Board's findings with  
27 respect to that, and that that would be, I think, a  
28 conclusive type of win for them.

1 I mean, if we post it on our approved list that  
2 this is a beer, or I guess it would probably be more  
3 this is a distilled spirit what have you, but they could  
4 rely on that. And they would win on that basis and  
5 would not need to bring in proprietary information that  
6 they wouldn't have available to them, anyway.

7 So, this -- this is more of an administrative  
8 detail about we would actually have to implement this.  
9 But it seems that there would have to be some sort of  
10 approved list that people could rely on.

11 MS. BRISBANE: Like the tobacco -- something  
12 like the tobacco directory, something like that, that we  
13 would do. There would be a date certain in there. It's  
14 obviously something we need to work out more details  
15 about, but I think it was -- two points, I guess, of  
16 Marcy Jo.

17 With that, we do need to think how and when or  
18 if these things could come to the Board that there could  
19 be an issue with the confidentiality, whether it be  
20 because the -- the manufacturer doesn't agree with what  
21 staff is saying as to whether or not it's a beer or a  
22 distilled spirit. There would have to be some type of  
23 review of that if they didn't agree and if, you know,  
24 hadn't put -- put it all the way through that if that  
25 goes to the Board and that's in open session, that's a  
26 problem for the manufacturer.

27 So, there's a couple different where -- ways  
28 there could be problems with the confidentiality. But

1 if the -- let's say -- I think I'm getting to your  
2 question, if the manufacturer decided, for whatever  
3 reason, it wasn't going to overcome the presumption,  
4 then that taxpayer who's not a manufacturer has to pay  
5 it at a distilled spirit rate. That's how I'm putting  
6 that -- that regulation forward.

7 So, if that's what you're, you know,  
8 confirming, then that would be the case. I mean, the  
9 manufacturer could decide, "I don't even -- I don't want  
10 to go through the trouble. I don't want my products  
11 sold in California unless the person who's going to sell  
12 it is going to pay the distilled spirit tax rates."

13 And that could be up to the manufacturer to  
14 decide and that could obviously change the market. So,  
15 yes, it is a presumption and the person who's a  
16 taxpayer, if they're not the manufacturer they're stuck  
17 with the distilled spirit rate unless they could get the  
18 manufacturer to overcome the presumption and the  
19 manufacturer could actually overcome the presumption.

20 MR. FERRIS: Get on our list.

21 MR. LO FASO: Right. I think you gathered my  
22 question wasn't really about confidentiality. My  
23 question is really who gets to provide what information  
24 to who, to what end. AKA, can you provide it to the  
25 taxpayer and that have an effect or must you provide it  
26 to BOE to get your effect.

27 But I'm going to segue to the -- my next  
28 question, which is there was a suggestion by Dr. Kooler

1 that we take a different approach of not do the  
2 presumption structure in 2559 and 2559.1 and that we do  
3 2558, and he, of course, was teeing off Mr. Sorini's  
4 comment about, you know, information being provided to  
5 the Board.

6 I -- I just wanted to get a comment from staff  
7 about how it would work if everybody is just going to  
8 give information to the Board and the Board is --  
9 without the presumption structure is going to be asked  
10 to just take all these -- these reports that -- that  
11 these manufacturers submit to the TTB, and figure out,  
12 okay, that one is -- that one's distilled spirit under  
13 the .5 standard, that one's distilled under the .5  
14 standard, that one's not a distilled spirit under the .5  
15 standard.

16 Is that -- that's a different workload dynamic  
17 than the presumption structure offered in Alternative 1  
18 as it stands now, is that correct?

19 MR. HALE: That sounds like a large workload  
20 and it is something we have not addressed, specifically.

21 We took the regulations in total to begin with.

22 The -- the workload we are just beginning to  
23 think about to get in mind what we're going to be having  
24 to address in the formal issue paper on -- on that side  
25 of it.

26 As far as going with just 2558, if we eliminate  
27 the presumption we are going to have a large analytical  
28 workload, as I see it, and beyond that I can't really

1 comment.

2 MR. FERRIS: It basically becomes Alternative 2  
3 with --

4 MS. BRISBANE: With a diminimus standard.

5 MR. FERRIS: -- with a diminimus standard  
6 added.

7 MR. LO FASO: Okay. I was wondering if -- if  
8 ABC was here and if ABC would comment if they're in a  
9 position to give the Board any technical help on this.

10 MR. HALE: Hi, Matt.

11 MR. BOTTING: ABC is here.

12 MR. HALE: Matthew Botting, Legal Counsel for  
13 the Alcoholic Beverage Control.

14 MR. BOTTING: Any particular problem that you  
15 would like technical help on?

16 MR. LO FASO: Well, since I don't know what  
17 these -- I forgot what they're called, Statements of  
18 Process that are -- that -- that are -- that are  
19 provided to TTB, I -- I don't know what they look like  
20 so I don't know what staff has to do to figure out if  
21 the .5 standard is met or not.

22 And if -- or even to determine whether there is  
23 any distilled alcohol at all, and if ABC will help BOE  
24 figure that out.

25 MR. BOTTING: Well, as a practical matter we do  
26 not require these -- these Statements of Process or  
27 formulas. We do not believe we have the legal authority  
28 to insist upon them which is, you know, part of the

1 issue that we were dealing with.

2 I have seen some in my capacity in private  
3 practice, and I didn't understand them then and I doubt  
4 I would understand them now. There's a lot of chemistry  
5 involved and I didn't do very well at that at school.

6 So, I'm -- I'm not sure, I think you need a  
7 certain level of expertise to figure out exactly what  
8 the -- what the makeup of the product is.

9 But just as a -- also as a practical matter,  
10 because every single beer product sold in the State of  
11 California is required to have on file with the ABC a  
12 copy of its label, we do have a -- a -- a very general  
13 sense of the potential workload involved for you.

14 I did a quick survey this morning. We've got  
15 about ten file cabinet drawers full of these labels that  
16 are submitted to the ABC. Most of those -- like one,  
17 two -- three pages long. It's a very thin file so the  
18 five file cabinet drawers is a lot of paper. And if  
19 you're going to talk about getting Statements of Process  
20 or formulas on every single one of those, that's a fair  
21 amount of paperwork.

22 MR. LO FASO: To -- just to clarify, my  
23 question assumed that you didn't have to compel it  
24 because the BOE already had it and shared it with ABC.  
25 I'm also assuming that the confidentiality umbrella  
26 extends to ABC.

27 And from -- as attorney to attorney, the  
28 assumption was it wasn't going to be ABC attorneys who

1 were going to look at them, but ABC chemists. And I  
2 don't know what the ABC staff is.

3 MR. BOTTING: We don't have ABC chemists.  
4 We -- we have no one presently to be able to look at  
5 these things and know what they tell us. You know, and  
6 this again gets back to the whole notion that I spoke  
7 about in February, that -- that our position has been  
8 all along that the definitions are not as clear either  
9 side as everyone else seems to think they are. And,  
10 therefore, we look to these external sources, in this  
11 case the TTB, the Federal regulatory agency that does  
12 receive these and makes that determination this is a  
13 beer product, this is a distilled spirit. Based upon  
14 those Statements of Process.

15 I'm not sure if that answered the question or  
16 would help in any respect, but --

17 MR. LO FASO: Thank you.

18 MR. HALE: Thanks, Matt.

19 MR. BOTTING: Thank you.

20 MR. HALE: Any other comments or questions?

21 Well, we've gone about an hour longer than we  
22 planned, but that was -- that was good. What I'd like  
23 to go over here is the remaining schedule for this  
24 process.

25 Again, we -- we strongly encourage you to  
26 submit written submissions to back up the verbal  
27 presentations today. These will be incorporated in the  
28 final -- excuse me, the formal issue paper.

1           Your written submissions would be due to us no  
2 later than June 21st. The formal issue paper then is to  
3 be developed, and we will mail it on August 3rd and  
4 again the Business Taxes Committee will meet on this  
5 matter on August 14th at 9:30 in this room. And  
6 you're -- you are welcome to be here and make  
7 presentations at that time.

8           If there's nothing else, thank you very much.  
9 And that concludes our meeting for today.

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I, BEVERLY D. TOMS, Hearing Reporter for the California State Board of Equalization certify that on June 6, 2007 I recorded verbatim, in shorthand, to the best of my ability, the proceedings in the above-entitled hearing; that I transcribed the shorthand writing into typewriting; and that the preceding 126 pages constitute a complete and accurate transcription of the shorthand writing.

Dated: July 17, 2006.

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BEVERLY D. TOMS