

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N Street, Room 121

Sacramento, California

REPORTER'S TRANSCRIPT

AUGUST 14, 2007

BUSINESS TAXES COMMITTEE

FLAVORED MALT BEVERAGES

Reported by: Beverly D. Toms

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P R E S E N T

For the Committee:

Betty Yee
Chairwoman

Judy Chu
Member

Bill Leonard
Member

Michelle Steel
Member

Marcy Jo Mandel
Appearing for John Chiang,
State Controller (per
Government Code
Section 7.9)

Gary Evans, Acting
Chief, Board Proceedings
Division

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Sacramento, California

August 14, 2007

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MR. EVANS: Next item is the Business Taxes Committee. Ms. Yee is the Committee Chairman.

MS. YEE: Thank you, Mr. Evans. Good morning, Ladies and Gentlemen.

Let me just spend a little time talking about the structure of the committee this morning.

What I'd like to do is first just talk about how we will proceed with the introduction of the issue and the discussion. For those of you in the audience that are awaiting your individual appeals case, I expect this discussion will last for at least an hour. So, just in terms of a time check.

What I intend to do is to have the staff introduce the issue, and while the issue is being introduced I would like to ask both proponents and opponents on the issue before us to coordinate among themselves.

We will allow 30 minutes for public comment by the proponents, as well as 30 minutes by the opponents, of the rule change in this matter. I believe, Mr. Evans, is there a room set up to -- where the proponents

1 can gather and -- and organize themselves?

2 MR. EVANS: Yes, I believe the Dronenburg room
3 is open.

4 MS. YEE: Okay. And is someone from your
5 staff already coordinating that particular group?

6 MR. HALE: Mike Hale, Excise Taxes. I believe
7 that group has already coordinated their presentation.

8 MS. YEE: Very good. Very well. Thank you.
9 And then we'll open it up for discussion with the Board
10 Members.

11 And with that in mind, after the discussion and
12 any potential action on this issue we will take a
13 ten-minute break before proceeding with the remainder of
14 the Board meeting. Okay.

15 Good morning, Mr. McGuire and Ms. Bartolo. Do
16 you want to proceed to introduce the issue.

17 MR. MCGUIRE: Good morning. I'm Jeff McGuire
18 with the Sales and Use Tax. With me today is Lynn
19 Bartolo and Mike Hale of our Excise Tax Division. And
20 Randy Ferris and Monica Brisbane of our Legal
21 Department.

22 We have one agenda item for your consideration
23 today concerning the taxation and classification under
24 the Alcoholic Beverage Tax Law of flavored malt
25 beverages, also known as FMBs.

26 This issue was initiated by an October 2006
27 letter from the California Friday Night Live
28 Partnership, the Students Making a Community Change

1 and the California Youth Council, which was petitioning
2 the Board to adopt a regulation to tax FMBs as distilled
3 spirits and/or amend Regulation 2530.

4 FMBs, as you know, are currently classified and
5 taxed at the same rate as beer, which is lower than the
6 rate for distilled spirits. In response to the
7 petition, in December of 2006 the Board voted to direct
8 staff to initiate the rulemaking process and to hold a
9 series of public meetings with interested parties to
10 discuss the classification and taxation of FMBs for the
11 purpose of offering alternatives, and to prepare draft
12 regulatory language for consideration by the Board.

13 Interested parties meetings were held on
14 February 22nd and June 6th of this year. Approximately
15 100 written submissions have been received that
16 reiterate and expand upon the oral presentations at the
17 interested parties meetings.

18 As a result we have three alternatives for your
19 consideration today. Alternative 1 would create new
20 regulations 2558, 2559, 2559.1, .3 and .5 so that
21 flavored malt beverages would be taxed as distilled
22 spirits while traditional beer products would still be
23 taxed as beer.

24 Alternative 2, which is proposed by the
25 plaintiffs in the County of Santa Clara, et al versus
26 Board of Equalization, recommends revisions to
27 Regulation 2500 that appears to presume that any
28 alcoholic beverage with any amount of alcohol derived

1 from the distillation process would meet the definition
2 of distilled spirits for tax purposes.

3 Finally, Alternative 3, which is consistent
4 with the Department of Alcoholic Beverage Control's
5 current classification practices for licensing purposes,
6 would make no regulatory change and continue to tax
7 flavored malt beverages as beer.

8 Following the comments by the interested
9 parties today, staff is available to answer any
10 questions you may have.

11 MS. YEE: Thank you very much. Let me first
12 call for public comment by the proponents of the rule
13 change. And you'll have a total of 30 minutes.

14 Mr. Evans, if you'll set the clock at 30
15 minutes we will notify you at ten-minute increments of
16 your time left

17 MR. EVANS: And if you'd please state your name
18 and who you represent.

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JIMMYJORDAN

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JIMMY JORDAN: Okay. Good morning. My name is

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Jimmy Jordan. I am part of the California Council. And

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I'm here to represent the California Council by being

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one -- one of the original petitioners. I would like to

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say -- see the properly taxed -- oh, sorry, I'd like to

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see the -- the tax properly taxed on distilled spirits.

12

Our petition is not meant to alter the current

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classification of additional beer. Our petition was

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meant for one reason, to correctly tax alcopops the way

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they should be, as distilled spirits and not what

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they're being taxed now, as beer.

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We did not write this petition to create a new

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tax, but to enforce one that's already in place. Our

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petition is about the classification of alcopops and not

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at all about the tax on food coloring and rubbing

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alcohol.

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I don't think I've ever seen or heard my peers

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trying to get drunk off these products. It's just

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industry trying to distract the Board from the real

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problem, which is alcopops. These drinks are clearly

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distilled spirits under California law. Therefore, they

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must be regulated as such. By being taxed as a beer,

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California is losing well-needed -- well-needed tax

1 revenue estimated around \$40 million, which could be
2 easily used for educational systems or prevention
3 efforts to enforce -- ensure the young people of
4 California have a safe environment to grow up in. After
5 all, we are the future.

6 We know -- we believe California regulation
7 states it clearly, any amount of distilled spirits
8 should be taxed as a distilled spirit.

9 I have been part of this issue for about a year
10 now. Through this process the Board has been more than
11 willing to assist us on this issue. I would like to
12 thank you guys for everything you have done so far, and
13 everything you guys hopefully will do in the future.

14 We know it's your job to correctly tax
15 alcopops. The right thing is never the easy thing to
16 do.

17 Thank you.

18 MS. YEE: Thank you very much. Ms. Steel.

19 MS. STEEL: How old are you, if it's okay to
20 ask?

21 JIMMY JORDAN: I'm 18.

22 MS. STEEL: Do you drink?

23 JIMMY JORDAN: No

24 MS. STEEL: Okay.

25 MS. YEE: Thank you. Next speaker, please.

26 Next speaker, please.

27 MR. EVANS: Please move to the -- to the
28 microphone, the next speaker.

1 alcohol, whether it's a spirit -- alcohol spirit, beer
2 or wine, that contains more than one half of one percent
3 of alcohol by volume. And it can be in any form. It
4 can be a liquid. It can be a solid. It doesn't have to
5 have to be a beverage to be considered an alcoholic
6 beverage in California. All it has to happen is at some
7 point if it can be mixed with something else or diluted
8 or something to be added to it so that it's something
9 you would actually drink, it is an alcoholic beverage
10 even if it isn't something you would even traditionally
11 think of drinking, like a powder or a -- a gelatin.

12 The Legislature then breaks down the types of
13 alcoholic beverages that you can have into three very
14 distinct categories. There are only three types of
15 alcoholic beverages in California. There's beer.
16 There's wine. There's distilled spirits. These
17 categories are set forth in Business and Profession Code
18 Sections 23,005 through 23,007. And they are mutually
19 exclusive.

20 A beer has to be a product that is made from
21 malt or hops or barley or other ordinary beer
22 ingredients and fermented in water. A wine is something
23 that is fermented from the juice of grapes or certain
24 types of fruits. Wine can also include distillations
25 of wine so that you can raise like four to five wines,
26 brandies, cognacs, that sort of thing. And then there's
27 distilled spirits which are not fermented products but
28 products that are developed through the distillation of

1 another alcohol. And they are -- are typically -- a
2 distilled spirit is anything that is distilled from an
3 agricultural product. And it includes whiskey, rum,
4 brandy and gin. And also according to the State law all
5 dilutions and mixtures thereof.

6 The distinct nature of each of these
7 definitions is clear from a number of factors. First,
8 the Board understands this. Back in 1997 the Board was
9 approached by a manufacturer who wanted to know how to
10 tax and classify a product that would be a combination
11 of beer and distilled spirits. After looking at the
12 definitions in the Business and Professions Code, Board
13 staff advised, and I'm quoting here, that the definition
14 of beer does not include any circumstances under which
15 beer mixed with distilled spirits will still come within
16 the definition of beer. Therefore, a product including
17 beer in any amount or kind of distilled spirits will not
18 meet the definition of beer and will instead be a
19 distilled spirit and taxed as such.

20 Eight years later this Board went to the
21 Attorney General and asked the Attorney General for a
22 position on that same question; what would happen if you
23 had a beer mixed with a distilled spirit? And the
24 Attorney General, after looking at the definitions in
25 the -- in the Business and Profession Code, and looking
26 at some cases against the State Board of Equalization or
27 involving the State Board of Equalization, involving the
28 question of what happens when you mix a distilled spirit

1 with other forms of alcohol, came to the same conclusion
2 and said that a product that includes beer in any amount
3 or kind of distilled spirits is a distilled spirit or
4 dilution or mixture thereof and must be taxed and
5 classified in California as a distilled spirit.

6 So, we have those sources to tell us these are
7 distinct categories and it can only be beer or a
8 distilled spirit. We know from the legislation that it
9 can only be that because of the definitions and because
10 of the way the California Legislature treats these
11 different types of products.

12 Beer and wine products are regulated much more
13 loosely than distilled spirits. The taxes are a lot
14 lower. Beer and wine is taxed at 20 cents a gallon.
15 Distilled spirits is \$3.30 a gallon if it's under 100
16 proof. If it's over 100 proof it's \$6.60 a gallon.

17 They can be sold in -- distilled spirits can
18 only be sold in -- in certain locations. Beer and wine
19 can be sold in far -- far more places within the State
20 and by far more classes of people within the State.

21 So, what we've come to is that we have a
22 classification system that only allows these flavored
23 malt beverages, which we call alcopops, to be classified
24 in one way, and the Board's sort of acceptance of the
25 Department of Alcoholic Beverage Control's passive
26 acceptance of the -- the manufacturer's marketing of
27 those things as beer products.

28 But we have a lot of information at this point

1 that suggests that they aren't beer products. We know
2 from a study conducted by the United States Tax and
3 Trade Bureau -- Alcohol and Tobacco Tax and Trade Bureau
4 in 2003 that of the 114 alcopops on -- on the market at
5 the time, 96 percent of them got more than
6 three-quarters of their alcohol from distilled spirits.
7 That may have changed because the Federal regulations
8 have changed in a way that allow a -- a malt beverage,
9 which is the Federal word for beer, to be a malt
10 beverage even if it has up to 49 percent of its alcohol
11 from distilled spirits.

12 But nevertheless we know that these things
13 contain a lot from that study. The State of Maine in
14 2005 passed -- passed legislation that just created a
15 new class -- category of flavored malt beverages called
16 low alcohol spirits, where if it derived more than half
17 a percent of it -- no, I'm sorry, low alcohol spirits,
18 if it has any distilled spirits at all, as long as it's
19 under 6 percent alcohol then it's -- it would qualify as
20 a low alcohol spirit. And the manufacturers voluntarily
21 working with the scheme produced a list of the products
22 that they produce that they say have distilled spirits
23 in them. And there are over a hundred of them and I
24 believe that most, if not all of them, are sold in
25 California.

26 We also have the manufacturers here today
27 who -- whose representatives have over time in -- in
28 this process, either admitted or not denied that

1 their -- their products contained distilled spirits.
2 They disagree as to the consequences of that or the
3 nature of the distilled spirits that are put in there,
4 but they don't -- they don't dispute that they actually
5 have distilled spirits flavorings in them.

6 So, we are at a juncture where we need to move
7 the -- the process forward. The Board needs to adopt
8 regulations that in some way aid the -- assist the Board
9 in identifying those products that are being sold that
10 contain distilled spirits, that are currently being
11 classified as beer so that they can properly tax and
12 regulate these things going forward.

13 MR. EVANS: 20 minutes remaining.

14 MR. DICKEY: I have a few things that I'd like
15 to say before I pass the mike off to my colleagues about
16 the -- some of the things that have been raised by
17 the -- by the alcohol industry.

18 First, I understand that it's industry's
19 position that if the -- if the Board adopts new
20 regulations that create .5 percent standard, that they
21 will simply remanufacture the products so that they all
22 fall underneath that -- that level.

23 That is we think a red herring but ultimately
24 irrelevant, because if they do reformulate their
25 products to fall within the standards, if the Board
26 adopts a .5 percent standard, then those products are
27 going to be fine. We're not interested in pulling
28 alcopops from the shelves; we want them to be taxed

1 properly. And if they can do it in a way that doesn't
2 involve significant amounts of distilled spirits,
3 then -- and falls within the standards set by this
4 Board, then I think that we would be okay with that.

5 And in -- in any event, material they presented
6 to the Board suggests that the reformulation to that
7 level would both be extremely costly and very
8 speculative because they worry about the loss of the
9 flavor profile of the product in -- in the food
10 industry. That -- that means a possibility it will drop
11 off in the marketability and salability of the products.

12 The second point that I want to address is
13 they -- they challenge the exemption of wine from the
14 regulation, and I point out as I did in the very
15 beginning that the -- the laws involving wine
16 specifically permit the use of certain types of
17 distilled spirits, and so it is appropriate that wine
18 not be included and the presumption that the product is
19 a distilled spirit.

20 And, finally, the industry argues that the
21 Department of Alcoholic Beverage Control is the
22 classifying agency here. That isn't true. I mean, it's
23 true for purposes of licensing and who can sell these
24 things, but for purposes of taxation this Board is
25 the -- the agency that has to figure out what it's
26 taxing. And it's incumbent upon the industry to tell
27 you what it is that they are producing so that you can
28 tax it properly.

1 The regulations that we have presented, the
2 ones that staff has presented, both get to that ultimate
3 goal and we would urge you to vote in favor of those
4 regulations.

5 Before I pass the microphone to my colleagues,
6 I'd like to -- I'd be happy to answer any questions you
7 have, but I'd also be happy to come back after the --
8 the parties have given their -- their speech, if you
9 have any.

10 MS. YEE: Mr. Leonard.

11 MR. LEONARD: I -- I did have one question.
12 I'm glad you brought it up because I was going to ask.
13 I have not had a chance to research what Maine did and
14 it seems like kind of a reasonable alternative to this.
15 Was it the -- who did it? Was it done by legislation
16 and statute or was it done by regulation of a Tax Board?

17 MR. DICKEY: It was -- it was a revision of
18 the -- of the statutes.

19 MR. LEONARD: Of the statute. By the Maine
20 Legislature?

21 MR. DICKEY: Yes.

22 I'm sorry. I'm -- (inaudible)

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FREDJONES

FRED JONES: Mr. Leonard, Fred Jones,
California Council on Alcohol Problems.

Actually, after the TTB'S ruling of this 51/49 percent, the Maine Attorney General, because they don't have an ABC Department like we do, made a decision that their existing laws, which includes low alcohol spirits category, was sufficient. So, they in fact did not pass any new laws.

In fact, I have a letter --

MR. LEONARD: So, the A.G. didn't define the current regulatory scheme to fit the new rule. So, it may not be parallel to our situation then.

MR. JONES: Well --

MS. YEE: Mr. Leonard, maybe I can clarify.
There are four classifications in the Maine statute --

MR. LEONARD: Right

MS. YEE: -- for alcoholic beverages.

MR. LEONARD: There always have been then.

MS. YEE: But with the reclassification of flavored malt beverages it was deemed appropriate to fit those under the --

MR. LEONARD: Okay.

MS. YEE: -- low alcohol --

1 MR. LEONARD: And those four categories are
2 created by legislation.

3 MS. YEE: Statutory by legislation. Thank you.

4 MR. LEONARD: Somewhat previously.

5 Thank you. Thank you much.

6 MR. EVANS: If I could remind the speakers to
7 speak into the microphone, please.

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MICHELESIMON

MS. SIMON: Thank you. My name is Michele Simon and I'm the Research and Policy Director for the Marin Institute. I'd like to thank the Board for this opportunity to speak and I'd like to help put this issue into more of a global context. Something we don't often do is think about how our tax schemes compare to other countries. And in a report that the Marin Institute put out last month we did exactly that and we did provide this report to you. And I just want to draw your attention to the chart which shows the comparison of tax rates on alcopops in other countries to both the current California rate and what we're proposing to do here today, which is to increase the rate.

In the UK the tax rate is about eight times as much as the current tax rate. In Germany it's 16 times. In Switzerland it's a whopping 20 times higher than the current California tax rate.

Even if we were to properly classify alcopops in California as distilled spirits, these other countries would still have much higher tax rates. The UK's tax would still be twice as high. The German tax four times as high. And the Swiss tax five times as high. So, that's just to put this into some context of

1 what we're asking for is really not much of an increase
2 if we look at the context globally.

3 What's interesting is that both Germany and
4 Switzerland went even further than what we're asking for
5 in that they created a separate category for taxing
6 alcopops, and that tax rate was higher than their
7 current distilled spirits rate. So, then that's going
8 over and above what we're asking for. And yet in these
9 countries industry chose not to reformulate, the
10 regulatory sky did not fall. The government regulators
11 there just figured out how to do it.

12 And as a result of these increases they have
13 seen dramatic drops in consumption in these countries.
14 In the UK, sales dropped by 43 percent over four years.
15 In Germany, alcopop consumption went down 50 percent
16 among teenagers according to a survey because alcopops
17 became too expensive.

18 So we wanted to look at what would such a tax
19 increase -- what kind of impact would a tax increase
20 have here in California. What we did was we used data
21 from those countries, again way ahead of us, have
22 several years of experience in how these increased taxes
23 have actually in--- affected consumption.

24 So, to do that we first actually calculated the
25 current impact of underage consumption of these
26 products. This isn't just a theoretical issue.
27 Underage drinking is a significant public health
28 problem. And by our estimates, California spends a

1 whopping \$1.25 billion every year -- this is both in
2 public and private money -- dealing with the various
3 harm caused by underage consumption of alcopops.

4 More importantly, 60 lives a year are lost. 60
5 underage youth die each year as a result of drinking
6 these products. But the good news is that if we were to
7 increase the tax, if we were to correctly classify these
8 products, we could actually save money and lives. By
9 our calculation consumption would drop because we know
10 youth are so sensitive to price. With the increased tax
11 prices go up, consumption goes down.

12 We estimate that consump -- that drop in
13 consumption would be 35 percent. Applying that 35
14 percent to those figures I just gave, that translates to
15 a savings of \$437 million a year.

16 More importantly, we could save the lives of 21
17 youth, every single year. Now, industry has done its
18 own economic analysis which they provided and they say
19 that an increased tax would burden them to the extent of
20 \$28 million a year. The reformulation that they say
21 they would undergo would cost them \$28 million over four
22 years.

23 Now, we're not disputing their analysis. Let's
24 just take that figure and compare it to what we
25 estimate, which I just described. \$7 million for one
26 year compared to a savings of \$437 million a year. 62
27 times as much or net gain of \$430 million, not to
28 mention saving the lives of 21 youth and preventing

1 countless harm.

2 A really interesting thing is when you look at
3 this from a global perspective is that this category
4 that industry likes to call flavored malt beverages is
5 basically invented for the U. S. market. And I want to
6 give you some evidence of that.

7 The first piece of evidence comes from an
8 article from this year in the Seattle Times, which
9 describes and is talking about Mike's Hard Lemonade.
10 And they say in Canada Mike's spikes its drinks with
11 vodka. But in the U. S., because of tax and
12 distribution issues, it uses a malt base that tastes
13 clean enough to stay out of the way of other flavors.

14 Another piece of evidence we have comes from a
15 industry trade journal called Beverage Industry News,
16 again earlier this year. And this whole article is
17 about this category, flavored malt beverages. And they
18 explain how in the U. S. the beverages are made with
19 barley malt due to regulatory abuses. Outside the U. S.
20 actual vodka is used.

21 This allows FMBs to be classified as beer,
22 which has advantages. There are less restrictions about
23 where they can be sold. The beverages have a lower tax
24 rate. And they can be distributed as beer.

25 The final piece of evidence I'd like to draw
26 your attention to, which is in the packet that you were
27 handed, is a screen shot from Smirnoff.com. This is
28 Smirnoff Ice. This is one of the top selling products

1 in the U. S. but it comes from the UK. So, this is a
2 screen shot that touts the fact that this product,
3 Smirnoff Ice, is made with Smirnoff vodka. But the
4 funny thing is there's a little asterisk here and the
5 disclaimer says, "Except in the U. S. and the U. S.
6 supplied markets where Smirnoff Ice is a malt beverage."

7 We're asking this Board to not allow industry
8 to continue to engage in this shameless charade of
9 exploiting the regulatory process, taking advantage of
10 lower tax rates, not to mention the exploitation of our
11 young people.

12 Please do the right thing and tax alcopops as
13 distilled spirits. The future of our youth depends upon
14 it. Thank you.

15 MS. YEE: Thank you very much. Next speaker.

16 MR. EVANS: You -- you have ten minutes
17 remaining.

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FREDJONES

MR. JONES: Board, my name is Fred Jones again. California Council on Alcohol Problems. I'm here actually to discuss a little bit about the State of Maine, Mr. Leonard, and related specifically to the staff comments about this effort possibly having non-absorbable costs of 5.5 staffers with BOE.

I'm at a loss knowing what Maine has already gone through justifying where five and half staffers will be needed by BOE to implement this change. We had sent your staff a two-page letter from the Special Assistant to the Attorney General of Maine that I think is directly on point.

Ms. Yee, you mention that how they have four categories. There are two distilled spirit categories depending on how much alcohol by content. So they basically have two distilled spirits.

If it's less than 6 percent by content, then they call it a low alcohol spirits. If it's more than that then it's just a spirit. But nevertheless they have two spirits classifications.

And some of the FMBs have more than 6 percent by volume. So, some of them are considered spirits, some of them are considered low alcohol spirits.

1 A little background from their letter.
2 Basically in 2003, when the TTB made their ruling, it
3 caught all the states off guard. In fact, it caught a
4 lot of the industry off guard, who were -- actually the
5 biggest producers were fine with a .5 percent standard
6 for distilled spirits. And so, it was kind of
7 surprising when the TTB said, no, we'll allow it to
8 half, the 49 percent.

9 So it surprised not only states but even the
10 industry, some of the biggest players. When that
11 happened, this was the first time Maine officials
12 learned that the labeling of these beverages as malt
13 beverages was inconsistent with how these beverages
14 should be classified and taxed under Maine law. And by
15 the way, I would say this is very consistent with
16 California law.

17 Before taking action, State officials waited to
18 see if TTB would reclassify these beverages. When TTB
19 failed to take the step, Maine decided it was necessary
20 to reclassify these beverages to be consistent with
21 State law.

22 And I really want to highlight some of these
23 phrases. Maine's process of reclassification was
24 essentially seamless. They sent a letter out on March
25 2005 to all the manufacturers and said, "If you have
26 distilled spirits in your products, you're going to be
27 considered a distilled spirit for taxing purposes." As
28 well as for licensing. But for purposes of today taxing

1 is sufficient.

2 The entire process was concluded in the fall of
3 2005 without any problems. That's a quote from the
4 Attorney General's office. So, they started in spring
5 and by fall they had a registry of all the FMBs that
6 were on the market that were being sold in Maine. And I
7 have the four-page -- you can go on line right now,
8 there's four pages on the Maine home page -- A. G.'s home
9 page that shows you the list of their FMB products.

10 So that everybody knows. The retailers, the
11 wholesalers, the public knows exactly which products.

12 And the manufacturers willingly and voluntarily
13 submitted that list. No formal -- again I'm quoting
14 directly from Ms. Miler's letter. "No formal challenge
15 to the reclassification was mounted by the industry. No
16 suits were filed to block the reclassification. Our
17 process was relatively simple and did not involve the
18 creation of a new class of beverage or a new license."

19 So, they did it within existing regs. and
20 existing law, and simply looking at our California law,
21 which is consistent with theirs, it appears this will be
22 just as essentially seamless and therefore I'm not quite
23 sure how much absorbable cost to your staff will be
24 incurred by pursuing this new either Alternative 1 or
25 Alternative 2. Thank you.

26 MS. YEE: Thank you very much. Next speaker,
27 please.

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VANESSAMADLIN

MS. MADLIN: Hi. I'm Vanessa -- Vanessa Madlin and I'm here with the California Youth Council.

MS. YEE: Vanessa, can you speak right into the microphone, please. Thank you.

MS. MADLIN: The only thing that we're asking for you today is to please do the right thing and tax these products appropriately. This petition really means a lot not only to our youth but also to the State of California. \$40 million can really make a difference in a variety of areas. So, please, take an extra minute and think about the difference your vote can make for the State of California.

We do recognize the implementation may be hard, but we all know that the right thing isn't always the easiest thing. We do believe you have the skills to implement this petition and the ability to do the right thing.

Here are many postcards, thousands, from many youth throughout the State just like me that ask you to please do the right thing and vote yes to this petition. They're from youth and adults. Actually, throughout the State.

Thank you.

1 MS. YEE: Thank you very much.

2 Mr. McGuire, do you want to accept those so
3 that we can actually have them as part of the record?

4 Thank you very much.

5 Next speaker, please.

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7 JUDY WALSH-JACKSON

8 MS. WALSH-JACKSON: Good morning. My name is
9 Judy Walsh-Jackson and I'm the chair of the California
10 Coalition on Alcopops and Youth. And the speakers who
11 have come before you this morning are members of this
12 coalition. And many of the coalition members are in the
13 audience with us today.

14 We're a broad coalition that's very diverse,
15 that includes community groups, faith-based groups. We
16 have someone from the medical community with us today.
17 Parents. Teachers. The PTA. Girl Scouts. And a lot
18 of young people. Law enforcement. And those are just a
19 few of our partners that I've mentioned.

20 We've come together to address the problem --
21 the growing problem of underage drinking in general and
22 specifically alcopops, which as you know flavored malt
23 beverages that are marketed to and popular with the
24 underage drinkers, particularly girls.

25 We commend the young people from the California
26 Friday Night Live Partnership, Students for a Community
27 Change and the California Youth Council for submitting
28 the petition to the Board on October 25, 2006. We would

1 also like to commend and thank the Board for accepting
2 their petition, and the staff for undergoing this
3 process to address and respond to the young people's
4 important request.

5 The coalition supports taxing alcopops as
6 distilled spirits, obviously, and the draft regulatory
7 language accomplishes this goal. Alternative 1 would
8 help to reduce, as you've heard, youth alcohol
9 consumption and the problems related to it. We
10 appreciate the efforts of the BOE staff to craft
11 regulations that achieve the goals of the young people's
12 petition.

13 And as you have heard over and over this
14 morning, we need regulatory change. And there are
15 thousands and thousands and thousands of Californians
16 across this great State. The great citizens of our
17 State support the proper taxation of alcopops as
18 distilled spirits. Thousands of Californians have sent
19 postcards asking for your yes vote.

20 Schools -- school districts, including the San
21 Diego Unified school District and many other districts
22 across the State have passed resolutions in support of
23 this. Counties have passed resolutions. City Councils
24 have passed resolutions. And even the American Medical
25 Association passed a resolution last summer issuing a
26 call to stop alcoholic beverages with special appeal to
27 youth.

28 And I quote, "Our Surgeon General has stated

1 that underage alcohol consumption is a major problem
2 facing our country and results in enormous health and
3 safety consequences in all sectors of our community.
4 Underage drinking has remained at consistently high
5 levels. Our AMA, the American Medical Association," and
6 we actually have someone here this morning from U. C.
7 Davis to represent the medical community -- "Our AMA
8 urges producers and distributors of alcoholic beverages
9 to discontinue advertising directed toward youth and
10 supports policies to address alcohol industry marketing
11 and manufacturing and that our American Medical
12 Association advocate for a ban on products such as
13 alcopops that have special appeal to youths under the
14 age of 21."

15 We know that there is trepidation among the
16 Board. This is a new thing. And we ask that -- that
17 you remember there's as much risk in doing nothing as in
18 doing something. And we reiterate the young people's
19 request, that the desire to do the thing right does not
20 prevent you from doing the right thing, and we really
21 appreciate all the time and resources that you've spent
22 looking at this issue, discussing it, supporting the
23 young people by accepting the petition.

24 MR. EVANS: You have one minute remaining.

25 MS. WALSH-JACKSON: And thank you for your
26 time. Please vote yes.

27 MS. YEE: Thank you very much. Next speaker,
28 please.

1 Does that conclude the speakers on the
2 proponent side?

3 Okay, could -- could I just -- maybe by display
4 of a show of hands, how many are in the audience that
5 are supporting the rule change today?

6 Very good. Thank you very much.

7 Okay. We will now start the public comment
8 from the opponents of the proposed regulation --
9 proposed regulation.

10 Will the speakers come forward.

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MARC E.SORINI

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MS. YEE: Okay, we'll now start the public comments from the opponents of the proposed regulation. Have the speakers come forward.

First speaker, please?

MR. EVANS: Please introduce yourself for the record and who you represent. And you'll have 3 minutes.

MR. SORINI: Good morning, Members of the Board and staff. My name is Marc Sorini and I'm here on behalf of the Flavored Malt Beverage Coalition. Is this working?

MS. YEE: Speak right into it, Marc, please.

MR. SORINI: I'm here on behalf of the Flavored Malt Beverage Coalition.

Let me do this -- the Elvis thing.

Marc Sorini on behalf of the Flavored Malt Beverage Coalition. And we appreciate this time to once again present our views to the Board and to the staff. As you know, the Coalition represents companies that produce approximately three-quarters of the flavored malt beverages distributed and sold throughout the United States. And so, obviously, this issue has great

1 importance to the Coalition's members.
2 Now, you've already heard from us in several submissions
3 to the Board why we think this is a -- both Alternative
4 1 and Alternative 2 are deeply flawed, both legally and
5 factually. And I am going to rest on those submissions
6 for a lot of my detail.

7 But I do want to highlight a few points, five
8 in particular. First, we believe -- just to run down
9 the five and then I'm going to elaborate a little
10 further.

11 But first, we believe very strongly that the
12 law is clear, except that we don't agree with it. So, I
13 guess me and the proponents of Alternative 2 agree on
14 that one thing, but we think the law compels something
15 very differently. A product that is a beer product
16 cannot be transformed into a distilled spirit product by
17 the addition of something that is not a distilled spirit
18 but is, in fact, a non beverage flavor exempted from the
19 California Alcohol Code by the -- I think it's
20 Section 22112.

21 But, No. 2, we believe that the -- we believe
22 that Code Section 32152, which compels this Board, as a
23 matter of California law, to follow federal law in the
24 case where the Board has discretion is directly
25 applicable here.

26 And I'm going to explain why we think the issue
27 paper in itself really supports that position quite
28 strongly.

1 Point 3, we believe that -- the we believe that
2 the issues here, underage drinking, are very important
3 and we certainly want to work with the State of
4 California, the members of -- the member companies want
5 to work with State of California in a variety of ways,
6 work with the petitioners to address underage drinking.

7 But this is not the forum, it's not the time,
8 it's not the place. Instead the legislature was quite
9 clear, we believe, when the legislature invested the ABC
10 with the discretion and with the regulatory authority to
11 administer the ABC Act and interpret the ABC Act.

12 And that this Board, by essentially trying to do policy
13 making with respect to that Act, is -- is acting in a
14 way that violates or steps upon the exclusive
15 jurisdiction of the ABC.

16 Fourth, we think that -- we think that the wine
17 distinction is unsupportable, notwithstanding some of
18 the comments in the issue paper, we believe that they
19 misconstrued both the facts concerning the production of
20 wine and the production of flavors.

21 Because of that, we think that there is a
22 significant constitutional issue here, a commerce clause
23 issue, which is that by exempting flavored wines -- and
24 there are quite a few flavored wines, virtually all of
25 them made in the State of California -- and yet imposing
26 a massive tax increase on the flavored beers, most of
27 which are made outside of California, we think that's a
28 disparate impact on interstate commerce that violates

1 the commerce clause.

2 And then finally, and I will let one of
3 colleagues address the study that was presented here by
4 the -- by some of the petitioners, but certainly we
5 believe the record is clear this is going to have a
6 substantial adverse economic interest, economic impact
7 on California businesses to the tune of \$28 million. We
8 think that's an important consideration here.

9 So, point 1, why is the law clear? The
10 definition of an alcoholic beverage, notwithstanding --
11 and I heard Mr. Dickey that it includes anything that,
12 if it's diluted, can be rendered into something that is
13 potable.

14 Well, that's clearly not true. And, of course,
15 every flavor, any vanilla extract, any product that's
16 made for consumption in a food product is capable of
17 being rendered potable. The code is very clear, flavors,
18 which do contain distilled alcohol, are specifically
19 exempted.

20 So, then we go to the definition of beer.
21 Well, beer is any product made from, essentially,
22 fermented grain, which all flavored malt beverages have
23 at least -- at least the majority of their alcohol from
24 the fermented beer base, particularly for products that
25 are over 6 percent, which the higher strength, something
26 a little bit higher in strength than beer, then the
27 percentage is a very high percentage of the alcohol in
28 those products coming from fermented beer.

1 If you take a distilled spirit, a distilled
2 spirit is defined as an alcoholic beverage. In other
3 words, it can't be a flavor. As a matter of law,
4 flavors have been cut out.

5 And then it does have that dilutions and
6 mixtures. But it says, "dilutions and mixtures thereof."
7 In other words, you've got to have an alcoholic
8 beverage -- a gin, a vodka, a rum to start with for the
9 addition of some dilution or mixture of that liquid into
10 something else to render that liquid a distilled spirit.

11 So, we think the law is absolutely clear here.
12 We simply do not see, and frankly haven't seen anything
13 in the issue paper, that would convince us otherwise.
14 We think the law is very clear as a matter of law these
15 products are beer.

16 But even -- even if one accepts what the
17 tentative conclusion supporting Alternative 1 was, which
18 is that -- that there is some discretion here on the
19 part of the Board to try to interpret the law and make a
20 classification based on what are allegedly ambiguous
21 products within the current system, well, then, we think
22 the answer is still clear.

23 Government Code Section 32152 directs this
24 Board to follow federal law. And here's what the issue
25 paper had to say on that, which I thought was very
26 telling, it says,

27 "A Section 32152 would not apply to the
28 taxation of FMBs if the Board were to conclude

1 as a matter of law that FMBs are not properly
2 classified as a beer or wine for tax purposes."

3 And I did a little bit of emphasis there, as a
4 matter of law. We would agree with that.

5 Of course, the legislature can decide that if a
6 product -- if they don't want to follow federal law, and
7 makes a clear directive to that effect, then this Board
8 is -- does not have to follow federal law. We would
9 agree with that.

10 But the key is whether the legislature has
11 spoken clearly and directed this Board to depart from
12 federal law. Here the issue paper, as well as the
13 pleadings in the Santa Clara County litigation, are very
14 clear -- are very clear in saying that the law is not
15 clear. The position of this Board has been that, in
16 fact, it has discretion when looking at how to tax
17 these products.

18 Where there is discretion, in other words,
19 where there is something that's not compelled as a
20 matter of law, we think Section 32152 then compels the
21 result that this Board needs to follow and act
22 consistently with federal law.

23 The third point, in 1955 -- up until 1955, as
24 most of you -- I am sure all of you know, excuse me --
25 the Board had the exclusive jurisdiction over both the
26 regulation and the taxation of alcoholic beverages. In
27 that year the -- in that year the legislature saw fit to
28 amend the very constitution of the State and give

1 virtually all of those regulatory functions over to --
2 over to the ABC.

3 Now there was, and I, of course, agree with
4 some of the petitioners that you do have the power to
5 assess taxes, but if you look at the language -- if you
6 look at the language both in the constitution and in the
7 enabling legislation, it seems to envision a fairly
8 narrow role for the Board. It is to assess taxes on
9 account of the regulatory things that the agency has
10 exclusive jurisdiction over. So, I would suggest that
11 that did not -- that did not imply that the Board was to
12 exercise independent rulemaking or independent policy
13 making judgments, particularly where that independent
14 policy making decisions really aren't tied to sort of
15 classic tax jurisdiction issues.

16 And what we're talking about here and what, of
17 course, the petitioners -- what you have heard here are
18 social policy issues -- certainly not something that one
19 would expect a tax board to be leading the policy making
20 on. This is something that, frankly, the legislature
21 ought to be doing. But if the legislature hasn't, then
22 we believe that the legislature has commanded that the
23 body to be dealing with this is the ABC and certainly
24 not the BOE.

25 So, we think that's a very relevant, relevant
26 consideration for you to think about when you are --
27 when you are looking at that.

28 Moreover, it is very difficult to believe, in

1 my mind, that any legislature -- when you try to go back
2 and read the minds of the legislature in 1955 and think
3 about what they were saying, it's inconceivable to me
4 that they would have ever considered that the
5 fundamental definitions in the ABC Act would be applied
6 and interpreted in two very different ways by the two
7 boards or the two administrative agencies that were
8 interpreting them.

9 So, we think that for all those reasons the
10 Board really should not act here. It would be violating
11 the exclusive jurisdiction of the ABC as commanded by
12 the legislature.

13 MR. EVANS: Twenty minutes remaining.

14 MR. SORINI: Next I'd like to talk a little bit
15 about this wine issue because the issue paper does point
16 out correctly that wine can be fortified.

17 Wine can be fortified, however, with what federally I
18 would call wine spirits, because most wine is made from
19 grapes -- that means brandy.

20 And the statute is quite clear here. It's that wine can
21 be fortified with distillates distilled from the
22 particular agriculture product or products of which the
23 wine is made. That's a very narrow exception when it
24 comes to spirits.

25 And, by the way, the reason that was necessary
26 was because those are really distilled spirits, they're
27 fit for beverage use, they're not flavors, they're not
28 otherwise exempted from the -- from the ABC Act. And,

1 therefore, in order to allow that fortification to take
2 place, adding spirits to an otherwise fermented product,
3 you had to have an explicit statutory exception. But
4 note that it's a narrow one.

5 Now the suggestion here and the suggestion made
6 by Mr. Dickey earlier was, "Well, that really then takes
7 the flavored wines off the table."

8 Well, I'd submit to you that that's definitely
9 not the case. Nobody in the flavor industry is making
10 wine -- is making flavors from brandy.

11 In fact, for example, in the record you'll see
12 the TTB tutorial, the TTB tutorial on the addition -- or
13 on how you register and file flavors. That presumes --
14 the presumption when you're clicking through that is
15 that you're using grain neutral spirits. And from a
16 cost perspective and from what's available on an
17 industry perspective, you know that flavors are being
18 made by grain neutral spirits, so, they would not be
19 covered by this very narrow exception.

20 Now we think that that doesn't matter because,
21 of course, our position is that the flavors don't render
22 any fermented product into a distilled spirit.

23 But if you make the presumption for one, you
24 have to make the presumption for the other. Because you
25 are both interpreting the distilled spirit definition.
26 And therein, we think, is where you have a commerce
27 clause issue.

28 The issue paper says, "Well, we can

1 constitutionally make distinctions between beer, wine,
2 and spirits." The Coalition doesn't agree with that.
3 The point is, though, that you are making a
4 discriminatory distinction as to how the distilled
5 spirit definition is being applied to products that are
6 like from the criteria that has been set up in
7 Alternatives No. 1 and 2, which is whether there is
8 alcohol from flavors in these products.

9 So, somehow that same alcohol in flavors has
10 one effect when applied to beer and another effect or no
11 effect when applied to wine. We think that the net
12 effect is that you're exempting a vast majority of
13 competitive products that have to virtually be made in
14 California at the expense of the products that are
15 almost invariably imported into California from outside
16 the state. We think that has commerce clause
17 implications.

18 And then finally, I'd like to further highlight
19 the study that was submitted. We went and asked ECS,
20 which is a very reputable and well-known economic firm
21 in Washington, D. C. to take a look at the rulemaking.
22 Poll members -- this was not based on speculation --
23 they polled both California wholesalers as well as
24 flavored malt beverage manufacturers and concluded that
25 there would be a \$28 million dollar impact, negative
26 impact, on businesses within California.

27 The law in California does require this Board
28 to consider that impact when assessing any new rule.

1 And we would urge that you do that as well,

2 Well, I've droned on for quite a long time.

3 So, if you have any questions, I'd happy to answer any
4 of them.

5 MS. YEE: Thank you, Mr. Sorini.

6 MR. SORINI: Thank you.

7 MS. YEE: Okay, let's move to the next speaker,
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5 LARADUNBAR.

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7 MS. DUNBAR: Good morning, Lara Diaz Dunbar on
8 behalf of the California Restaurant Association.

9 And I am here today on behalf of the CRA to express
10 our -- urge you to keep on classifying FMBs, flavored
11 malt beverages, as beer as opposed to distilled spirits.
12 Specifically, we oppose Alternatives No. 1 and 2 and do
13 support Alternative 3. We do this for many reasons.

14 The CRA represents more than 22,000 members. A
15 large portion of our membership are the smaller,
16 independently owned restaurants and smaller mom and
17 pops, who, in many instances, can only obtain beer and
18 wine licenses. And so, offering these flavored malt
19 beverages is a way for them to remain competitive with
20 larger outfits, larger chains who may have on sale
21 general licenses, which typically are harder to obtain,
22 more expensive, et cetera. And so, you know, this
23 really does go to the heart of the smaller mom and pop
24 restaurants.

25 Certainly restauranteurs in general make very
26 narrow profit margins. The labor costs are high, the
27 liability issues are high and on average they earn only
28 between 3 to 5 percent out of every dollar that they

1 bring in.

2 So, this increase of a tax burden from 20 cents
3 a gallon, if it's classified as a beer, to, you know,
4 \$3.30 a gallon as a distilled spirit, would certainly
5 have an impact and make it quite unaffordable for many
6 restauranteurs.

7 I do want to address the issue of underage
8 drinking. Some of the proponents may say that alcopops
9 may lead to underage drinking, it's geared towards
10 youth. But we certainly don't see that as the case in
11 the restaurant industry particularly. FMBs, I think,
12 since they've been around, underage drinking has
13 increased, but has decreased. And most of them are sold
14 for off premises consumption, not in restaurants.

15 And the restaurant industry takes the underage
16 drinking laws very seriously. There is a lot of
17 liability consequences. Certainly our restauranteurs,
18 you know, treat any sale of alcohol the same -- whether
19 you are selling a glass of wine, a beer or Smirnoff Ice,
20 they're going to card you. And, you know, it's not that
21 we -- so, in our industry, you know, the underage issue
22 has not come into play. We do a lot to curb underage
23 drinking.

24 And the CRA sponsors a safe class which is
25 geared towards training alcohol -- responsible training
26 for alcoholic beverage service, which is the same as the
27 ABC lead training class. So, we encourage our members
28 and all their employees to take this training class.

1 Just last year we partnered with the ABC on
2 their minor decoy operations, their sting operations
3 when they received increased funding last summer. And
4 we reached out to all our members and all of our
5 nonmember restaurants and really encouraged them on tips
6 and red flags on identifying underage drinkers to
7 really, you know, take either the service aid class or
8 the lead class to train their employees to properly
9 serve alcohol.

10 Thirdly, I don't want to be duplicative, but I
11 think it's important to point out of the policy reasons
12 why we feel that it should be -- remain classified as a
13 beer. Certainly the federal government treats it as a
14 beer. The ABC treats it as a beer. And it has
15 basically the same alcohol content as a beer, 3 to 5
16 percent and the fermentation requisite is there, it's a
17 malt-based beverage.

18 So, for those reasons and others, we
19 respectfully urge you to keep on classifying it as a
20 beer.

21 Thank you.

22 MS. YEE: Thank you very much.

23 Next speaker, please?

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KRISTINPOWER

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MS. POWER: Good morning, Kristin Power, California Grocers Association. We represent supermarkets, regional chains, as well as mass merchandisers and convenience store operators.

As such, we are very concerned about prevention of underage drinking. We are partnering with ABC and the local law enforcement agencies with the lead training as well as conducting training within our own markets.

And it is imperative for us to be sure we are operating within compliance with the State regulatory statutes with respect to licensing and sale of all alcoholic beverages.

With that being said, we believe that this is not it is appropriate way of addressing the age -- the issue of underage drinking.

We ask your support of Alternative 3.

MS. YEE: Thank you very much.

Next speaker?

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HEIDI BARSUGLIA

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MS. BARSUGLIA: Heidi Barsuglia on behalf of
the California Retailers Association.

Our members support the current classification of the
flavored malt beverages as beer. Our members are
certainly supportive of vigorously enforcing the current
law, which prohibits the sale of alcohol to minors of
any kind, regardless of how that alcohol is classified.

Because of this and for the reasons already
articulated today, we ask your support on Alternative 3.

MS. YEE: Thank you very much.

Next speaker?

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DENNISLOPER

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MR. LOPER: Dennis Loper, representing the California Beer and Beverage Distributors Association, here in support of Alternative 3.

Mr. Sorini referred to the ECS study, which is an economic study. He pointed out that the wholesales, which are my members, would be severely disadvantaged by Alternatives 1 and 2.

We also think that there is some major administrative problems for our members.

And we ask for your support of No. 3.

MS. YEE: Thank you very much.

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ROBERT MICHAELS

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MR. MICHAELS: Thank you.

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My name is Robert Michaels. i am a professor
of economics at California State University Fullerton.

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And I was asked to look at the Marin
Institute's reports on the alleged effects of raising
taxes on FMBs in particular.

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Among other things I do as a professor, I
co-edit a major economic academic journal. And I see
literally Hundreds of research papers a year go past my
desk. This paper would not pass the most minimal
standards for acceptable research. This paper is, in
fact, impossible to track down where most of its data
comes from. Where you can track down where its data
comes from, what you find out is that almost every piece
of data that they use certainly is biased in a direction
that seems to favor the pro tax point of view.

23

MR. EVANS: Ten minutes remaining.

24

MR. MICHAELS: What?

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MR. EVANS: You have ten minutes remaining in
your time.

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MR. MICHAELS: They overestimate California's
consumption of FMBs, which could be easily estimated

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1 from just looking at shipment data, by close to
2 200 percent.

3 They estimate costs of FMB use by minors. They
4 are overestimating the cost by a factor of probably 4 or
5 500 percent.

6 I detailed the derivation of these figures in
7 the report that I have. Some of them were impossible to
8 reconstruct, but even if you wanted to accept those
9 figures at face value, the report makes a claim that I
10 suspect most of us would find was incredible.

11 Essentially what it is saying is that on the
12 basis of European experience that raising the taxes on
13 FMBs in particular is not going to be inducing any
14 substitution by underage drinkers to other alcoholic
15 beverages.

16 They have one piece of information for that,
17 which is a survey taken in Germany in 2005. In 2004
18 Germany raised its tax rate on FMBs by a fairly
19 substantial amount. And they then repeated the survey
20 of drinkers that they took in 2004. They found that
21 underage drinkers were consuming a very large amount
22 less of FMBs and, in fact, they were also consuming less
23 in the way of other beverages.

24 So far so good, except oddly enough, the Marin
25 study is missing a much more important piece of data.
26 Exactly that same survey was taken in 2007, underage
27 drinkers, looking at the longer term effect of an FMB
28 tax increase. And what they found out was, in fact,

1 yes, FMBs were still down, but total alcohol consumption
2 by people under age 18 was, in fact, up by about 15
3 percent. The substitutions had been towards beer and,
4 to a lesser extent, towards stronger beverages. It's
5 odd that they did not choose to mention this evidence.

6 Their other -- they take a trip to England and
7 try to use statistics from there. It turns out that the
8 statistics they use have nothing to do with underage
9 drinking. They are all about total liquor shipments of
10 various types, total alcohol shipments of various types,
11 to the entire population of England. They can make no
12 inferences at all.

13 Other countries they look at, Switzerland,
14 essentially their study is based on a single newspaper
15 article. And when you go beyond that newspaper article,
16 you, in fact, find evidence that there is substitution
17 and that's actually in official Swiss government
18 documents.

19 So, I don't know what's going on with the
20 study, but it does not meet any minimal standards of
21 quality. It uses data in an incredibly selective way.

22 And what's really interesting is that partway
23 through the study, when its authors are trying to tell
24 you why it is that they believe that increasing the tax
25 on FMBs will decrease underage drinking of all alcoholic
26 beverages and there will be no other effect, they refer
27 to it as a speculation on their part. That's their
28 actual words.

1 That it is. It is a demonstrably empty
2 speculation. Any data that go against it, they chose
3 not to present. Any data on the background of the
4 problem in the US is, in fact, either impossible to
5 reconstruct or appears to be quite strongly biased.

6 On this basis I urge you to reject that study
7 as any guidance whatsoever to what the policy should be
8 that this commission offers on FMB taxation.

9 Thank you.

10 MS. YEE: Thank you very much.

11 Next speaker, please?

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JOHN HANDLEY

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MR. HANDLEY: Madam Chair, Members, John Handley, with the California Independent Grocers Association.

And in respective remedy, I ask your support for Alternative 3.

Thank you.

MS. YEE: Thank you very much.

Other speakers?

Accordingly, may I have a show of hands of those in the audience that are opposed to any rule change in this matter?

Okay, very well, thank you very much. Members, I do want to open it up for discussion and questions.

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MS. YEE: Let me begin by making a brief

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statement, if I could. First I want to thank the staff

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for doing a tremendous job in terms of bringing this

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issue forward before us in formulating a regulation that

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you had to put together not under the most desirable of

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circumstances. Certainly the vagueness of the existing

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statutes and the potential litigation.

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And so, I want to commend you for the focus of

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the work that you've done and what's before us today.

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We've heard a great deal of comment from both

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sides of this issue and let -- let me just say from the

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outset that -- that I intend to support the proposed

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regulation as developed by staff because it is an

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important element that can make a difference in the

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human toll and suffering, particularly among our youth,

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for underage drinking.

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I also want to acknowledge the advocacy

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movement that's been created around this issue involving

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our youth. Several of us on the Board have had the

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opportunity to meet with dozens of youth over the last

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several months to hear their perspectives and

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experiences among their peers around the consumption of

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flavored malt beverages.

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And I also want to thank the representatives

1 from the alcoholic beverage industry, the retail
2 industry and the restaurant and bar industry for their
3 input. I think all of them, I believe, have provided
4 information in good faith in furthering our staff's
5 understanding of the challenges of the alternatives that
6 are before us. And, quite frankly, even when not
7 necessarily in your best interest.

8 The Board's action here today, if we decide to
9 adopt the reg -- any of the regulations before us
10 calling for a change is really just the begin --
11 beginning of the work to minimize access to and
12 consumption of flavored malt beverages by underage
13 drinkers. I have chosen -- I have chosen amidst great
14 criticism for not instead participating in public
15 rallies and press conferences to focus for the last six
16 months on how a Board adopted regulation could work
17 successfully.

18 And at the end of the day if we're going to do
19 something here, I feel a great deal about how to make it
20 work to make sure it does make a difference in the lives
21 of our youth and their health.

22 And I say this with a separate deal of
23 seriousness and -- because this is tough. This is
24 tough. And I take great issue with the testimony around
25 the lack of need for additional resources to make this
26 successful. We are not Maine and we are not the ABC.

27 I think staff has appropriately identified
28 several implementation concerns in its issue paper and I

1 really want to highlight those today because I think it
2 sets the stage for what's to come in terms of future
3 challenges, and I hope that proponents who are in favor
4 of a change here will step up to the plate and continue
5 your commitment to be sure that we get all of the
6 clarification and the tools that we need to have a
7 successful program here.

8 Let me first speak about the authority. I
9 think the staff appropriately found, as articulated in
10 the issue paper, that this Board doesn't have authority
11 in the form of specific legislative authorization to
12 classify flavored malt beverages. And I know in
13 meetings with both sides of this issue I think there
14 have been statements made about how flavored malt
15 beverages don't neatly fit within the definition of beer
16 and flavored malt beverages do not neatly fit within the
17 definition of distilled spirits.

18 And I think it's really because of the
19 vagueness of the statute on that question that the staff
20 has found that this Board can go either way in
21 classifying flavored malt beverages as either beer or
22 distilled spirits.

23 However, it is the basis of our authority which
24 is also the basis of our challenges. All of the
25 disagreement I believe during the interested parties
26 process regarding the meaning of beverage purpose, where
27 the industry argues it only applies before dilution and
28 the proponents say it applies after dilution, sets us up

1 for some real challenges in classifying flavored malt
2 beverages either way under the current statutory scheme.

3 This Board is not a Court, in the sense that we
4 don't simply rule on the question extractly. We are
5 going to need to administer this decision we make if in
6 fact it is to make a regulatory change on the basis of
7 this vague statute. So, really the legal question is
8 how we classify flavored malt beverages based on the
9 source of the alcohol.

10 There generally has been no debate that most
11 flavored malt beverages, at least the ones that were
12 focused on, contain roughly the same volume of alcohol
13 as beer. The issue in essence is whether the alcohol is
14 from fermentation or distillation and how much.

15 That leaves us with the challenge of
16 administering a standard that examines the source of the
17 alcohol in flavored malt beverages, and as I understand
18 its position, even the Department of Alcoholic Beverage
19 Control finds the statute ambiguous but relies on the
20 Federal government's classification. And in doing that,
21 of course, avails the agency of tremendous assistance
22 from the Feds. ABC gets a lot of assistance from the
23 Feds in classifying these beverages; expertise to
24 examine the chemical sources of the alcohol that even
25 ABC advises it does not have.

26 So, in fact Alternative 1 before us today
27 begins with the other agency's classification as beer,
28 throws it out, presumes it to be the opposite and leaves

1 this Board with the requirement to implement a new
2 classification system that does not currently exist.
3 That's the reality.

4 Not an excuse not to move forward, but that is
5 the reality. We don't know the extent to which the
6 industry will provide all the information we need to
7 develop the list of flavored malt beverages to tax as
8 distilled spirits. Even if they do not provide the
9 information, this agency needs to be able to verify the
10 information and no agency can compel a standard and base
11 a tax rate on it and not be prepared to independently
12 verify the information forwarded to it by industry.
13 That is how we ensure that we have successful
14 implementation.

15 We have looked at the State of Maine as
16 suggested by the Senator for the Study of Law and
17 Enforcement Policy, which notes that Maine's
18 reclassification of flavored malt beverages as distilled
19 spirits was seamless.

20 As we have already heard, Maine's statutes
21 provide much clearer authority than do California's.
22 Specifically, its various classification of alcoholic
23 beverages, including low alcohol spirit products under
24 which most flavored malt beverages fit.

25 And, more importantly, its product registration
26 requirement which really gives the State of Maine and
27 its enforcers a lot of information about how to look at
28 these products.

1 Again, not a reason not to move forward with
2 the regulation before us today.

3 Staff will continue to work on examining
4 Maine's program as well as seek assistance from the ABC
5 here in California.

6 One issue that was not mentioned that I do want
7 to raise because this is a little bit of a tax
8 administration's -- tax administrator's nightmare is the
9 point of taxation is not the same for products
10 classified as beer and distilled spirits. Simply put,
11 the lesser rate of tax for beer is paid at the
12 manufacturer or importer level and the higher distilled
13 spirits tax is passed down through documented exempt
14 wholesale transactions at or near the point of sale to
15 the retailer.

16 In other words, the tax on beer is paid at the
17 beginning of the distribution chain by the manufacturer
18 and the higher tax on distilled spirits is paid near the
19 end by the last vendor who sells to the retailer, who
20 makes the final retail sale to the customer.

21 Again, not a reason not to go forward with the
22 regulation today.

23 But this will entail an increased workload to
24 perform systems and forms revisions to account for the
25 new transactions and reporting of flavored malt
26 beverages.

27 In essence, the point of taxation for flavored
28 malt beverages defined as distilled spirits moves up the

1 distribution chain to be paid by the original
2 manufacturer or importer. And this is unique to
3 flavored malt beverages that are treated as distilled
4 spirits for taxation and licensed as beer.

5 Finally, I think our staff would wholeheartedly
6 agree that this agency is wading in uncharted territory
7 to attempt a regulation which we currently do not have
8 the resources available or resources to be able to
9 direct to do so.

10 The first priority among our challenges is to
11 secure the funding necessary to do the work leading up
12 to the July 1, 2008 effective date as proposed in the
13 regulation.

14 As I stated earlier, the Board's action is just
15 the beginning of the work ahead to successfully
16 implement a program that will protect the future of our
17 youth. I am sure that with the commitment and ongoing
18 advocacy of the proponents here and specifically, Ms.
19 Chu, your leadership as our Legislative Committee Chair
20 and formerly as Fiscal Policy Leader in the State
21 Assembly, this agency will secure the necessary funding
22 for this important program.

23 I want to just lay that out, we've had numerous
24 meetings. I think many of us up on the dais have had
25 numerous meetings with both sides, certainly with
26 staff and this is not an easy task but I do think on
27 balance we ought not lose sight of the overarching
28 policy concern.

1 Thank you very much. Other Members?

2 Ms. Chu.

3 MS. CHU: Well, I support Alternative 1. I
4 think Alternative 1 is reasonable. It requires that
5 alcoholic beverages with a .5 percent or more distilled
6 liquor flavoring be classified as distilled liquor. And
7 it will clearly place flavored malt beverages in that
8 category and they will then be taxed at \$3.30 a gallon
9 versus the beer rate of 20 cents a gallon.

10 I think it's really important to take this
11 step. When flavored malt beverages were invented in the
12 '90s they did not come under scrutiny. They remained in
13 the gray area all these years. And yet they start with
14 a fermented base of beer and then are infused with a
15 distilled liquor flavoring.

16 And so, what is it? Is it beer or is it
17 distilled liquor? Clarity is needed and this
18 alternative says that these products are indeed
19 distilled spirits.

20 It's critical for the BOE to provide accuracy
21 on this issue and to issue a ruling so that there is a
22 taxation ruling that -- that reflects its true makeup as
23 a beverage.

24 Now, the opposition says that we don't have the
25 authority and says that -- that we in the State must
26 follow Federal law according to Government Code 32152,
27 but I look at the Revenue and Taxation Code 32451, which
28 says that the Board has the authority to promulgate

1 regulations relating to the administration and
2 enforcement of the Alcoholic Beverage Tax Law. And that
3 while we have generally deferred to ABC regarding the
4 classification of alcoholic beverages, the Board retains
5 the ability to classify such beverages for purposes of
6 taxation.

7 Now, we can choose, however, to diverge from
8 the ABC classification system and we are not bound to
9 follow Federal law in this regard. And that's what I
10 think we should do, diverge from Federal law and diverge
11 from the ABC. I wish the ABC would come along with us,
12 but I think this is an important first step.

13 Now, let me say that this issue has come a long
14 way. I am actually voting in a consistent way to when
15 the issue was brought up in the Assembly in the summer
16 of 2005. I thought that it should have been classified
17 as distilled liquor then. But it didn't go anywhere,
18 and thank goodness the young people did not give up.

19 They brought the issue to the Board of
20 Equalization in December 2006, and have followed through
21 every step of the way in these nine months. Though the
22 issue that is before us has to do with accurate taxation
23 of flavored malt beverages, I believe that the ultimate
24 effect of this taxation will be very positive. The
25 ruling will send a signal to youth that these drinks are
26 hard liquor because these drinks will have costs that
27 are similar to hard liquor. It will make it harder for
28 young people to access this drink, and that can only be

1 helpful in reducing underage drinking.

2 MS. YEE: Thank you very much, Ms. Chu. Other
3 comments? Ms. Steel.

4 MS. STEEL: Well, it's great to hear so many
5 who are sharing their views here that including Girl
6 Scouts. They were rallying yesterday in front of BOE
7 building and, you know, my mother actually has a diamond
8 cross trophy over the -- that was been given every three
9 years to the leaders in Girl Scouts. And plus I was
10 raised as a Girl Scout for all my life when I was
11 teenage -- you know, teenager.

12 And it was really hard to see them -- that
13 involved in politics. Having said that, underage
14 drinking is a serious problem in California that, you
15 know, as a mother of two teenage daughters, this issue
16 is very close and personal to me. And I want to make
17 sure that my daughters, like the rest of California
18 teenagers, are not able to legally purchase alcoholic
19 beverages.

20 However, raising taxes by over 1500 percent of
21 some alcoholic beverages will not stop underage
22 drinking. The Board of Equalization shouldn't create a
23 new tax on taste.

24 Studies prove that underage drinkers consume
25 all different types of alcohol, including hard alcohol,
26 which is already subject to this higher tax. And simply
27 put, higher taxes won't stop underage drinking.

28 While this new tax increase won't stop underage

1 drinking, it will hurt thousands of small businesses.
2 Here in California there are 35,000 small restaurants
3 and family-owned markets have beverage licenses to
4 distribute beer and wine. This tax increase make it
5 more difficult for these small business to comply with
6 California's alcohol and tax law.

7 This taste tax makes it more difficult for
8 small business to compete with large corporate
9 restaurant chains. Small businesses are the backbone of
10 our State economy. Our tax policy needs to encourage
11 these businesses, not create obstacles to compete.

12 The Board of Equalization shouldn't create a
13 new tax on taste. And having said that, this issue
14 isn't a tax matter. Santa Clara County versus BOE, the
15 Court said that this is an issue of legislative
16 interpretation. It's not the Board of Equalization job
17 to decide this issue. Only the State Legislature can
18 address an issue of this magnitude with such wide range
19 and policy implications.

20 That's why I recommend that Board oppose this
21 new taste tax and send it back to the Legislature.

22 MS. YEE: Thank you, Ms. Steel.

23 Other comments?

24 Mr. Leonard. Ms. Mandel.

25 MS. MANDEL: I have a statement that I'd like
26 to read on behalf of State Controller John Chiang.
27 "Flavored malt beverages should be taxed as distilled
28 spirits because they fall under the category of

1 distilled spirits as written in California law.

2 "The Attorney General has found that beer is
3 any alcoholic beverage obtained by fermentation while
4 distilled spirits are beverages that contain any amount,
5 mixture or dilution of distilled spirits.

6 "This is where the argument over whether
7 alcopops should be treated as liquor or beer begins and
8 ends. Specifically, alcopops include alcohol from a
9 distillation process as opposed to being solely from
10 fermentation. That puts these alcoholic beverages in
11 the distilled spirit category rather than the beer
12 category. Especially as the BOE regulations would use
13 the basic .5 percent alcohol content threshold as the
14 governing standard for classification.

15 "While today's vote," which I'm anticipating
16 based on the comments -- "While today's vote is about
17 fair taxation, taxing flavored malt beverages as liquor
18 will also help reduce their popularity with young people
19 by simply pricing the product out of their reach.
20 Taxing alcopops as liquor doesn't address all the
21 impacts or the treatment of underage drinking and there
22 is more work to do.

23 "The State's Department of Alcoholic Beverage
24 Control should move to classify alcopops as distilled
25 spirits to step up our enforcement against underage
26 drinking and alcohol abuse."

27 MS. YEE: Thank you, Ms. Mandel.

28 Mr. Leonard.

1 MR. LEONARD: I really appreciate the
2 discussion that's gone on today and I'm -- I wish I were
3 a legislator because I think the five of us might be
4 able to actually write a law that made sense that was
5 least burdensome on manufacturers and retailers and easy
6 to understand by the public and had a fair taxation
7 scheme.

8 Unfortunately, we're -- we're not legislators
9 and I'm -- I'm concerned about the path that the
10 majority is -- is about to take. At the same time,
11 being very sympathetic with the issues that have been
12 raised.

13 As many of you know, I was the author of the
14 legislation to lower the drunk driving standard to .08.
15 I tried to go to .05 and didn't get there. Still like
16 to see that, but I'm no longer a legislator.

17 There is in my research about drunk driving,
18 the truth that it's beer and wine that's the greater
19 consumption that causes the drunk driving violations.
20 Without absolving distilled spirits drinkers from
21 responsibility, they're -- they're a smaller piece of
22 the problem.

23 To the extent that by tax policy we change
24 social behavior, if the majority is right in increasing
25 the taxes on flavored malt beverages I hope it's -- and
26 I know it's not -- not the majority's intent but it
27 seems to me an obvious unintended consequence is to
28 drive teenage drinkers, so to speak, to beer and wine,

1 which because they appear to be diluted almost are in
2 some people's mind less dangerous to consume and get
3 behind the wheel. And the truth is they're not.

4 It also strikes me that the taxation scheme,
5 the classification scheme of alcohol that the
6 Legislature did in the 1930s is no longer relevant. Not
7 just the new product creation, but the whole culture,
8 how those products are marketed has all changed so much
9 that the taxation difference that we live with today
10 doesn't make sense.

11 Beer and wine are not 11 times less dangerous
12 than vodka and gin. Or vice versa. And so, I -- that
13 the Legislature really to get into this. Whether or not
14 this Board goes forward, I -- I think -- and we do it
15 with its own regulatory process, I think we should ask
16 the Legislature to take a look at the evidence we've
17 collected, the information presented today by all
18 parties, and to really look at rewriting all of the
19 State's laws, sitting down with us and ABC, of how we
20 classify these alcohols. How we license the
21 establishments. How we tax it. How it's distributed
22 and controlled as a -- as a product.

23 Because no matter what we do today, the scheme
24 still won't make sense. It still will be irrational, be
25 hard to understand. And that's part of the resource
26 issue I think the Chairman alluded to that we'll have to
27 make some distinctions that aren't based on good
28 chemistry, but based on what we think is -- is good

1 social policy, which is right at the edge of our
2 authority, if not beyond it, as a taxing agency.

3 So, my -- my support today is -- is
4 for actually an Alternative 4. I think we should
5 aggressively ask the Legislature to intervene. To do
6 nothing is not responsible. But to help deal with all
7 the interest groups, go to the Legislature and to do
8 something as quickly as possible. It seems the most
9 reasonable to me.

10 For example, one of the issues is we're talking
11 about alcohol content and trying to find where that
12 molecule came from, either a distilled spirit or a
13 fermented spirit -- a fermented molecule, which
14 chemistry can't tell the difference but we can
15 supposedly because of where it came from.

16 But the truth is, is what we're after is -- is
17 the consumption of it, particularly when it rates the
18 issues like alcoholism and drunk driving. If the
19 product is diluted, and I know some people that -- cover
20 your ears, those that like wine -- actually dilute their
21 wine.

22 If the product is diluted, the consumption is a
23 different level of alcohol than if it's not. A lot of
24 the distilled spirits are designed and marketed to be
25 diluted with water or soda or others before they're
26 consumed, which makes the consumption point in some
27 cases less alcoholic than wine or beer. Now, which is
28 not as easily or -- marketed or designed or culturally

1 arranged to be diluted.

2 So, we have -- we have a real issue here which
3 it's -- so many aspects of it are beyond our scope.

4 I -- I would really urge the Board to create an
5 Alternative 4, to sit down with our legislative
6 committee and work to sponsor legislation to deal with
7 the whole issue of classification of alcohols; beers,
8 wines and distilled spirits. I'm intrigued with the
9 Maine scheme that talks about alcohol percent levels of
10 the product as sold as -- and maybe even go beyond that
11 of not even care where it came from.

12 The -- the Federal model is -- is not a good
13 one to follow. I don't know our extent of our authority
14 to ignore it. I wish I could. Hope we could find out
15 more how we could -- how we could do that, or seek
16 waivers, if necessary.

17 But I would propose to the Board an Alternative
18 4, that we aggressively seek legislation to deal with
19 this important issue.

20 MS. YEE: Very well. Thank you, Mr. Leonard.

21 Other questions or comments, Members?

22 Okay. Maybe I could just ask the staff, if I
23 could, to address some of the resource problems. And
24 this is, as I said, the beginning of the process. And
25 if the Board were to adopt a rule change today, I
26 believe the calendar takes us into the early part of
27 next year --

28 MS. BARTOLO: Yes.

1 MS. YEE: -- when the rule would become
2 effective. Do you believe the July 1, 2008 date is
3 still workable?

4 MS. BARTOLO: Because the draft regs. -- this
5 is Lynn Bartolo, Excise Taxes Division. The draft regs.
6 cast a broad rebuttable presumption affecting all
7 non-wine alcoholic beverages. This creates a
8 substantial work -- new workload for us. The volume of
9 submissions will be at least initially -- because we do
10 not know how many products are out in the market.

11 I think the July '08 date is quite ambitious
12 for us to accomplish, knowing that we wouldn't get
13 rolling with the final regs. out of OAL until March.

14 So, -- and the -- and the other aspect of that,
15 not just the staffing concerns, I have 14 staff
16 currently who administer the Alcoholic Beverage Program.
17 We -- we do not have discretionary time to absorb the
18 work. We do not have the costs -- funding to absorb
19 what we'll need to have for revisions and our system
20 changes.

21 But more importantly we need to provide the
22 taxpayers with sufficient time to understand the new
23 requirements and do an outreach. We also need to give
24 them every opportunity to submit their product
25 statements. And then we'll need lead time to process
26 all of that.

27 The ABC does not have a database tracking these
28 products so we will be tasked with creating the first

1 database to catalog and classify these products and make
2 it available on the internet to all of the industry, who
3 will be required to -- to verify the rate of tax to
4 charge.

5 So, if -- with the adequate -- with inadequate
6 staffing and funding, I'm -- I'm very concerned that we
7 may not make a July '08 implementation date.

8 MS. YEE: Okay. Let me ask you, it seems to me
9 that there are some existing sources of information that
10 could be helpful here. And the reason I talk about the
11 Maine product registration requirement is that I don't
12 believe we have such a counterpart requirement here in
13 California, and that all ABC keeps in its files are
14 copies of product labels. Which don't really --

15 MS. BARTOLO: Yes.

16 MS. YEE: -- take us to the amount of level and
17 detail that we need to really examine.

18 So, it looks as if -- but at least they may in
19 part be able to help us identify some of the products
20 that are in the marketplace. Certainly the State of
21 Maine has done that. So, that's kind of a beginning. I
22 guess --

23 MS. BARTOLO: ABC does not track this product.
24 They do not classify or require product information from
25 their licensees.

26 MS. YEE: Okay. All right. So, it sounds like
27 the resource issue is really the critical one in terms
28 of being sure that you have additional bodies to

1 essentially start this new workload.

2 MS. BARTOLO: We -- I have contacted the --
3 the Federal Tobacco -- Alcohol, Tobacco Tax and Trade
4 Bureau and they pointed me to the label submission web
5 site. So, I did just a check yesterday, pointing out
6 the alcoholic beverage categories that we're looking at
7 for the State of California, and 14,000 new products
8 were submitted to the TTB just in the first seven months
9 of this year.

10 So, those are the new products that we will
11 be -- coming under our examination. And we still have
12 the current products that are on our -- on the shelves
13 here in the -- the marketplace that we'll have to deal
14 with.

15 MS. YEE: All right, very well. Thank you.

16 Other questions or comments, Members?

17 Is there a motion?

18 MS. CHU: Well, I make a motion to support
19 Alternative 1.

20 MS. YEE: Okay. We have a motion by Ms. Chu to
21 support Alternative 1. Is there a second?

22 MS. MANDEL: Second.

23 MS. YEE: Second by Ms. Mandel. Please call
24 the roll.

25 MR. EVANS: Madam Chairwoman.

26 MS. YEE: Aye.

27 MR. EVANS: Ms. Steel.

28 MS. STEEL: No.

1 MR. EVANS: Mr. Leonard.

2 MR. LEONARD: No.

3 MR. EVANS: Ms. Mandel.

4 MS. MANDEL: Aye.

5 MR. EVANS: Ms. Chu.

6 MS. CHU: Aye.

7 MR. EVANS: Motion passes.

8 MS. YEE: Okay. Could I just ask staff if you
9 could take note of Mr. Leonard's Alternative 4? It may
10 be as we're trying to figure out this implementation
11 that there may be some additional issues that might
12 warrant some legislative clarification versus kind of
13 opening up the whole statutory scheme.

14 Okay. Thank you all very much.

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REPORTER'S CERTIFICATE.

State of California)
) ss
County of Sacramento)

I, JULI PRICE JACKSON Hearing Reporter for the California State Board of Equalization certify that on August 14, 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 pages 33 through 54 constitute a complete and accurate transcription of the shorthand writing.

Dated: August 30, 2007.

JULI PRICE JACKSON
Hearing Reporter

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