

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N Street, Room 121

Sacramento, California

REPORTER'S TRANSCRIPT

NOVEMBER 15, 2007

ITEM F3

PROPOSED ADOPTION OF ALCOHOLIC BEVERAGE TAX
REGULATION 2558. Distilled Spirits, REGULATION 2559.
Presumption - Distilled Spirits, REGULATION 2559.1.
Rebuttable Presumption - Distilled Spirits,
REGULATION 2559.3, Internet List and
REGULATION 2559.5, Correct Classification

Reported by: Beverly D. Toms

No. CSR 1662

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P R E S E N T

For the Board
of Equalization:

Betty Yee
Chair

Judy Chu
Vice-Chair

Bill Leonard
Member

Michelle Steel
Member

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

Diane Olson
Chief, Board Proceedings
Division

Board Proceedings Staff:

Monica Brisbane

Randy Ferris

Lynn Bartolo

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1 Sacramento, California

2 November 15, 2007

3 ---oOO---

4 MS. YEE: Next item.

5 MS. OLSON: Next item is F3, Flavored Malt
6 Beverages, Proposed Adoption of Alcohol Beverage Tax
7 Regulation 2558, Distilled Spirits. Regulation 2559,
8 Presumption Distilled Spirits. Regulation 2559.1,
9 Rebuttable Presumption Distilled Spirits. Regulation
10 2559.3, Internet List. And Regulation 2559.5 --

11 MR. LEONARD: Ferris isn't going to read that,
12 is he?

13 MS. OLSON: -- Correct Classification.

14 MS. YEE: Okay.

15 MS. OLSON: Ms. Brisbane will make -- make the
16 presentation. We have ten speakers.

17 MS. YEE: Okay. And I'm already going to tell
18 Mr. Ferris you got three minutes.

19 But why don't we do this, on this we have a
20 number of speakers. We will allow three minutes per
21 speaker. If I could ask you to please start taking
22 seats up at the front while the issue is introduced.

23 Speakers, please come forward.

24 Okay.

25 MS. BRISBANE: Monica Brisbane from the Legal
26 Department. With me are Randy Ferris and Lynn Bartolo.

27 On August 14th, the Board authorized
28 publication of the proposed alcoholic beverage

1 Regulations 2558, 2559, 2559.1, 2559.3 and 2559.5. The
2 notice of public hearing was published on September
3 14th. Today is the noticed time and place for the
4 public hearing. Following the public hearing the Board
5 may adopt the proposed regulations.

6 MS. YEE: Very well. Thank you very much.
7 Let's have our first three speakers come forward. If
8 you'll take seats --

9 MR. JONES: Madam Chair, do you want those that
10 are in opposition to your voted regulation first?

11 MS. YEE: How -- who in the room is in
12 opposition?

13 Okay.

14 Let me have you come forward. I suspect that
15 your comments will overlap. So let's hear from the
16 opponents first.

17 ---Ooo---

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MARC SORINI

MR. SORINI: Good morning, Madam Chairman, Members of the Board. My name is Marc Sorini and if I could --

MS. YEE: Mr. Sorini, if you're more comfortable sitting, you may.

MR. SORINI: I'd be happy to.

MS. YEE: Okay.

MR. SORINI: Could I start by asking for additional time. We have two speakers. We've coordinated our programs and we'd like to have a little bit more than three minutes each to present.

If you would indulge us, we would greatly appreciate it.

MS. YEE: Okay. Why don't you get started and then we'll see how you go.

MR. LEONARD: Maybe it would be better to do ten minutes per side and let them decide how to divide it up on each side.

MS. YEE: Let's see, we've got numerous speakers on the other side. Okay, why -- why don't we -- we'll give you ten minutes for your presentation and then we'll see if any additional time is required beyond that.

MR. SORINI: I greatly appreciate your -- your accommodation. As I said, I'm Marc Sorini. I'm here on behalf of the Flavored Malt Beverage coalition and the coalition represents companies that collectively produce

1 and market approximately three-quarters of the flavored
2 malt beverages that are sold in the United States today.

3 We want to -- we have obviously submitted
4 written comments and will rest on many issues on the
5 material that's been submitted, but I'd like to take the
6 time to just concentrate on three particular issues.

7 The first one is the -- the inconsistency of
8 the proposed regulations with the governing statutes and
9 law that the -- that the Board is charged with -- with
10 enforcing. It's very clear, as we have pointed out
11 previously, that a flavor is a non-beverage product.
12 That's right in the Code, it's Section -- I believe it's
13 23112, a flavor is not a distilled spirit.

14 And yet the proposed regulation in essence says
15 that by adding that non-beverage product to a beer
16 magically it transforms into a distilled spirit, which
17 is defined as a beverage product.

18 The Board in all its issue papers has yet to
19 articulate an explanation for how that magic alchemy and
20 transformation takes place. We certainly haven't seen
21 any.

22 Second of all, the -- the very clear statutory
23 definition of beer, which encompasses any product made
24 from the fermentation of grain, as the Board concedes is
25 broad enough to encompass a -- a flavored malt beverage.
26 Therefore, what we see is an interpretation of the Code
27 of the distilled spirit statute that is at odds with
28 that statute in favor of taking a product that quite

1 clearly fits within the beer category and taking it out
2 of that category.

3 Also, if one looks at the slight of hand that's
4 done that -- that accomplishes this in the regulation,
5 it rewrites the operative language of the statute. The
6 distilled spirit definition very clearly speaks to a
7 beverage product. And to sidestep it -- and the
8 implicit response to my challenge to the Board, which is
9 how does one create the alchemy of turning a
10 non-beverage product into a beverage product, well, it's
11 right there in the proposed regulation.

12 The language changes from an alcoholic beverage
13 to a product containing distilled alcohol. The
14 Legislature could have said that when they wrote the
15 statute. They didn't. They said a beverage product.

16 So we think this is quite clearly contrary to
17 law. But the Board goes further. The Board,
18 recognizing that it doesn't have the expertise or the
19 resources to actually administer a program that would
20 try to separate out alcohol beverages based on the
21 alcohol that's in them creates a presumption. A
22 presumption that all beer is a distilled spirit.

23 Now, I think the one thing everybody in this
24 room, in fact even the speakers behind me, would agree
25 upon, is that if you have a beer product that is
26 fermented, that derives every molecule of alcohol from
27 the fermentation of a grain, that's clearly a beer
28 product. And yet the proposed rules in effect say, no,

1 that's a distilled spirits product. It's a distilled
2 spirits product unless one takes certain affirmative
3 steps, affirmative proof, to show that it's not.

4 We believe that that is quite clearly beyond
5 the Board's authority to do. It's very inconsistent
6 with the statute. So in our view there is a serious
7 consistency problem with the proposed regulations that
8 cannot be cured.

9 Second, and I'm going to touch on this briefly,
10 but I think the presumption underlines the second
11 problem with this rule, which is the authority of the
12 Board to conduct this. There's a very good reason why
13 this Board lacks the resources and the expertise to be
14 able to make the distinctions that would be necessary to
15 try to make the rule that has been proposed work, even
16 if it could be supported under the law.

17 The reason is that there is no jurisdiction
18 within this Board to actually regulate in the way the
19 Board is regulating. Section 20 of the California
20 Constitution is quite clear, the sole authority to
21 regulate alcoholic beverages is with the ABC.

22 And by the way, the ABC agrees with that
23 position. The sole authority rests with the ABC. The
24 Board's authority is quite constrained. It is to -- it
25 is to tax on account of those activities that have been
26 regulated and defined by the ABC.

27 So we think there's a serious authority problem
28 that the Board has in trying to regulate the way it has

1 here. In fact, it's not a serious problem, it is simply
2 an insurmountable obstacle for this Board. You don't
3 have the authority to do what you've -- what you've set
4 out to do in the proposed regulations.

5 Moreover, if you look at the reasoning, any
6 fair reading of the record, and we've -- we've been at
7 this since December of 2000 and -- 2006.

8 Any fair reading of the record demonstrates
9 that there is one reason and one reason only why the
10 Board has voted the way it's voted, which is very
11 laudable but misguided efforts to do something about the
12 issue of underage drinking.

13 That's the reason that the petition was filed
14 in October 2006. That's the stated reason why the Board
15 voted both in December of 2006 and in -- and in August
16 of 2007. That is the only reason that's ever been
17 articulated before the Board for the reason for acting.
18 And that is quite clearly a temperance concern, which is
19 within the exclusive jurisdiction of the -- of the ABC.

20 The third point that I want to stress here is
21 the ambiguity -- the critical and in fact fatal
22 ambiguity of the proposed regulations on the status of
23 wine.

24 Throughout these proceedings the Board has in
25 effect made statements that would seem to suggest that
26 in fact wine is completely exempt from the proposed
27 rule. And as we pointed out in prior commentary, the --
28 the problem with that approach is that it pretty clearly

1 discriminates. What it says is a non-beverage product
2 when added to a beverage product magically transformed
3 if it's a beer but it doesn't magically transform if
4 it's a wine. We, by the way, would agree that it does
5 not transform.

6 But there's a discriminatory treatment in
7 interpreting the distilled spirit definition.

8 So in the last issue paper the -- the Board in
9 essence said, "Oh, no, wait a minute. If a product
10 contains flavors that have alcohol, and the record is
11 clear the alcohol in flavors is not brandy, it's neutral
12 spirits, then in fact wine would be subject to the
13 presumption.

14 And so we have a very, very troubling
15 situation. Either you're going to sweep in an entire
16 industry, the wine industry, under these rules without
17 giving them adequate notice or opportunity to respond,
18 or you're going to treat very arbitrarily and in a way
19 that we believe is in violation of the Commerce Clause
20 given the relative sources of those products, wine, but
21 as it's written now and given the statements that have
22 been in the record to date from the Board, there's a
23 critical ambiguity there that must be solved.

24 Thank you very much.

25 Mr. Livingston.

26 ---oOo---

1 GENELIVINGSTON

2 MR. LIVINGSTON: Madam Chair, good morning.
3 Members of the Board. I'm Gene Livingston with the law
4 firm of Greenberg Truitt (phonetic) here in the
5 Sacramento office. And I'm here today on behalf of
6 Miller Brewing Company. And as some of you know, I was
7 the first Director of the Office of Administrative Law.
8 And if I were Director today and this regulation came
9 before me, I would reject it. I would reject it for the
10 two grounds that Mr. Sorini just mentioned. This Board
11 does not have authority to adopt this regulation and the
12 regulation is inconsistent with the statutes that it
13 purports to implement, interpret, make specific.

14 Let me explain. The theory of the regulation
15 is that this Board exercises concurrent jurisdiction
16 with that of the Department of Alcoholic Beverage
17 Control in classifying alcoholic beverages.

18 That's not the case at all. There is no legal
19 basis in either the Revenue and Taxation Code or the
20 Business and Professions Code where you can find
21 authority for you to do this.

22 And let me just mention a few quick reasons for
23 why I reached the conclusion that in fact the
24 Legislature and the people intended for the ABC to
25 exercise exclusive jurisdiction in terms of classifying
26 alcoholic beverages.

27 Once upon a time this Board of course did
28 classify alcoholic beverages. You regulated the entire

1 liquor industry. From the time of the repeal of
2 national prohibition until 1954 when Prop 3. passed.
3 And of course you'll recall during the early '50s that
4 was a very dark history for this Board. Artie Samich
5 reigned as the King of Lobbyists in the liquor industry.

6 During that time there were very questionable
7 activities involved in issuing licenses. Those came to
8 light later when Casper Weinburger chaired a joint
9 committee of the Legislature and conducted hearings from
10 one end of the State to the other.

11 A number of Board staff members were convicted.
12 A Board member fled to Mexico to -- to avoid criminal
13 prosecution. That resulted in the passage of
14 Proposition 3 that the Legislature put on the ballot.
15 And the purpose of Proposition 3 is of course today
16 Section 22 of Article 20 of the Constitution, and it
17 created the Department of Alcoholic Beverage Control,
18 and it gave them exclusive authority to regulate. And
19 it left with you the power to assess and collect taxes.

20 Now, had the people and the Legislature been
21 asked in 1954, "Do you intend for the Board of
22 Equalization to exercise concurrent jurisdiction with
23 the Department in classifying alcoholic beverages," --

24 MS. OLSON: Time has expired.

25 MR. LIVINGSTON: -- the answer would have been
26 a resounding no, because there was no way that anybody
27 wanted to give this Board at that time, because of that
28 history, discretion. And it was placed in the hands of

1 the Department.

2 But you can look at other indicia in the Code
3 to find the same conclusion.

4 You cite as authority a provision in the
5 Revenue and Taxation Code. That statute says you can
6 adopt regulations to implement the provisions of this
7 part. That's part 14 in the Revenue and Taxation Code.

8 You purport to interpret provisions in the
9 Business and Professions Code, Section 23004, '05, '06
10 and '07. Your authority does not extend to implementing
11 and interpreting or making specific any of those
12 provisions at all.

13 On the other hand, when you look at the
14 authority of the ABC that's set out in the Business and
15 Professions Code, not only is it given authority to
16 adopt regulations with respect to provisions in the
17 Business and Professions Code, the Alcoholic Beverage
18 Control Act, but also to implement the provisions of
19 Section 22, Article 20 of the Constitution.

20 So, in essence, what the Legislature intended
21 and what the people approved by a two-thirds vote was to
22 give the ABC exclusive authority to even make decisions
23 that affects the taxation.

24 But you can look also at the whole licensing
25 scheme that's set out in the Business and Professions
26 Code and see the interplay between that and the -- the
27 Revenue and Taxation Code.

28 Essentially, the Department of Alcoholic

1 Beverage Control makes two decisions when it issues a
2 license. What is the activity that this entity is
3 engaging in? Manufacturing, distribution, sale. And
4 what are the alcoholic beverages that are involved?
5 Beer, wine, distilled spirits.

6 Then the law requires that Department to send
7 to you a copy of the license. Not just a name and an
8 address of the licensee, but the license -- so that you
9 know that this is a manufacturer of a beer product, for
10 example.

11 And you are then to base your taxes on the
12 basis of the license that has been issued by the ABC.
13 It's only the ABC that has authority to make a
14 classification of the alcoholic beverages involved, and
15 it does that when it issues that license.

16 In addition, as Mr. Sorini mentioned,
17 essentially what your regulation has done is to remove
18 from the statutory definition of distilled spirits any
19 reference to alcoholic beverage. And that makes that
20 regulation inconsistent with the statute.

21 So it would be -- again, as I said, if I were
22 Director today and this regulation were submitted to me,
23 I -- I would reject it.

24 I urge this Board on behalf of Miller Brewing
25 Company to drop this regulation, and if you believe that
26 the FMB should be classified differently, to ask the
27 Legislature to do that. That's where the role belongs
28 and it does not belong with this Board in adopting a

1 regulation for which you have no authority.

2 Thank you.

3 MS. YEE: Thank you, Mr. Livingston. And I
4 appreciate both your comments with respect to the issue
5 around our authority. I just -- I wanted to make a
6 couple of observations on that point, if I may.

7 I guess I'm perplexed in terms of how ABC views
8 its role today. And I would just note that in the brief
9 in opposition to the lawsuit, the 2006 lawsuit, I
10 believe ABC in a footnote did not agree with
11 your assessment relative to the -- this Board's
12 authority and also stated in that footnote that this
13 Board had separate authority.

14 Now, albeit whether it's squarely on with
15 respect to what we're contemplating with this regulation
16 may be of question. Also I know that our staff has had
17 extensive conversations with the ABC and, frankly, the
18 whole construct of this rebuttable presumption concept
19 that we have before us in the proposed regulation was
20 something that was developed at the suggestion of ABC.

21 So I'm not sure where they believe they stand
22 with respect to their authority. Either they're
23 shirking their responsibility, but I do think that
24 certainly they believe that we've got some modicum of
25 authority to act here.

26 MR. LIVINGSTON: May I respond to a couple of
27 those points?

28 MS. YEE: Please.

1 MR. LIVINGSTON: First with respect to where
2 the ABC stands today, they have submitted comments
3 urging you to abandon this regulation and to allow the
4 Legislature to deal with it. And the comments
5 specifically address that footnote and says that what it
6 intended was to acknowledge that you have the authority
7 to collect taxes, but not to classify alcoholic
8 beverages.

9 And it goes on to point out that if you have
10 the authority, if you exercise the authority to classify
11 alcoholic beverages and do that in a way different than
12 the -- the Department has, that that can create chaos in
13 the marketplace.

14 So, I think that's where the ABC is. In terms
15 also of -- of where entities have been in the past, the
16 Wine Institute has also submitted comments today urging
17 you to abandon this regulation. And attached to their
18 comments are letters that have been written by Board
19 staff, and particularly containing legal analysis in the
20 past, where that analysis seems to admit that the ABC
21 has exclusive authority to classify not just for
22 licensing purposes but for all purposes.

23 So, there may be a change in position we're
24 seeing here.

25 And then I don't think it's fair to say that
26 the ABC is shirking its responsibility or duties. It
27 has classified FMBs as beer. And that's consistent with
28 what has happened at the -- the Federal level, as you

1 know.

2 And -- and it sets out, as it did in -- in the
3 litigation in its Memorandum of Points and Authorities,
4 which attaches to its comments here, that it had a
5 reasonable basis for -- for making that conclusion.

6 But, again, the -- the Department urges you to
7 allow the Legislature to address this if you think that
8 a change should be made.

9 MS. YEE: Okay. Thank you.

10 May I ask the staff -- I don't want to lose
11 kind of the -- this concern that's been raised with
12 respect to wine, in terms of what is contemplated in the
13 proposed regulation, and is it consistent with what we
14 have certainly rendered with respect to other opinions
15 or -- or responses to inquiries in the past.

16 MR. FERRIS: Randy Ferris from the Legal
17 Department. I'm sure you'll ask followup questions if
18 I'm not adequately addressing your concern. But
19 throughout the rulemaking process in -- in the language
20 that is before you for authorization, we've consistently
21 been aware that the statutory definition of wine creates
22 different parameters for -- for what types of -- for the
23 alcohol content, where it's derived from. References to
24 flavors, all of the kind of things are in that statutory
25 definition.

26 And it is not within -- we don't believe it's
27 within the scope of the Board's authority to go beyond
28 what the Legislature has said in that statute.

1 And so therefore we have carved out wine as
2 defined by statute from the presumption that we're
3 creating by rule if -- if the Board so acts.

4 So, currently if there is some sort of product
5 that is a -- a wine-related product that falls outside
6 the statutory definition of wine, we don't need a
7 presumption. It's already a distilled spirit. So
8 we're -- nothing new is being done here.

9 If -- if in response to some sort -- a
10 regulation industry was to begin to reformulate and use
11 a wine base in such a way that they moved themselves
12 outside the parameters of the statutory definition of
13 wine, then of course they would be subject to the same
14 presumption that -- that any other maker of an alcoholic
15 beverage would be.

16 But we don't anticipate that -- that happening
17 and it's our understanding that products that currently
18 are wine under statute will -- will continue to be wine.
19 These regulations would have no effect on that.

20 MS. YEE: Okay. Mr. Sorini.

21 MR. SORINI: If -- if I might ask the following
22 question, the Family Wine Makers of California, for
23 example, have submitted comments in this rulemaking and
24 they have indicated in fact that the flavors in wine
25 products generally are not made from the like
26 agricultural product. As the record has shown from
27 earlier presentations that the Coalition has made,
28 flavors are generally made by a grain-neutral spirit

1 base, and therefore there is not brandy-based flavors.

2 And so I would like to ask the Board or -- or
3 Mr. Ferris if there is a wine product flavored with --
4 with a flavor that contains a grain-based alcohol -- and
5 I would submit that probably that's all flavored wines,
6 what's the Board's position on its classification?

7 Because simply referring to the wine definition
8 really begs the question because, of course, brewers for
9 years have been putting flavors in beer and relying on
10 the beer definition to believe in good faith and
11 continue to believe that those products are beer.

12 And it's this Board's re-interpretation of the
13 distilled spirit definition that's only cast a question
14 on it.

15 So how would a product that contains alcohol
16 from flavors that's not made from a like agricultural
17 product -- how is that going to be treated under the
18 Board's interpretation?

19 MS. YEE: Okay.

20 Mr. Ferris.

21 MR. FERRIS: I -- I'm not aware that the
22 submission from the industry that you referred to is --
23 that they are -- are you saying that they're admitting
24 that they actually are a distilled spirit because they
25 fall outside the --

26 MR. SORINI: They're certainly not admitting
27 that they're a distilled spirit. They're pointing out
28 the fact that flavors contain alcohol. Alcohol in

1 flavors is generally derived from grain-neutral spirits.
2 And grain-neutral spirits, according to the Board's
3 interpretation of the distilled spirit definition as
4 applied to beer is -- is that that is magically
5 transformed into a distilled spirit.

6 I certainly don't agree with that position. I
7 don't think the wine industry would agree with that
8 position, either. But given the Board's position toward
9 the way these flavors should be treated, I would like to
10 know how that then applies when it's being applied -- or
11 when those products are being added to a wine product as
12 opposed to a beer product.

13 MS. BRISBANE: As I understand the definition
14 of wine, it does provide for not only the addition of
15 distilled spirits from the same agricultural products
16 but also an amount of flavoring up to a certain
17 percentage.

18 So presumably they're already meeting that
19 definition of wine and they would continue to meet that
20 definition.

21 MR. SORINI: Could -- could you point that out
22 in the Code? I -- I don't believe there is any
23 flavor --

24 MS. BRISBANE: Which does not contain more than
25 15 percent added flavoring, coloring and blending
26 materials. As long as the alcoholic content is not more
27 than 24 percent.

28 MR. SORINI: So you're saying --

1 MS. BRISBANE: And again, we would -- we would
2 stay within the definition of wine as the Alcoholic
3 Beverage Control would -- would tell us, you know, what
4 is a wine. We're not trying to rewrite the statutory
5 definitions; we're trying to provide clarity where the
6 statutes do not provide clarity, which I think ABC has
7 clearly said this area is very confusing.

8 MR. FERRIS: Right. ABC has said, repeatedly,
9 that these Alcopop or FMB products -- they agree with us
10 that they don't fit neatly into a category, that it is
11 ambiguous, and that's why interpretation is necessary.

12 We have not received any information from ABC
13 that they think that these wine products that are being
14 referred to have a similar ambiguity surrounding them.
15 So it's not our expectation that there is any problem
16 there.

17 MS. YEE: Okay.

18 MR. FERRIS: The reason why we need these
19 regulations is to provide clarity when ABC and this
20 Board is saying there needs to be some clarity on this
21 product.

22 We -- we have not heard that about these other
23 products.

24 MS. YEE: Okay. Very well.

25 Before I have you leave your seats, other
26 questions or comments directed at the testimony we've
27 just heard?

28 Okay.

1 MR. LIVINGSTON: Madam Chair, could I just
2 address the last comment Mr. Ferris made about --

3 MS. YEE: Briefly, Mr. Livingston, yes.

4 MR. LIVINGSTON: -- about the necessity. I --
5 I know that the Board cites its necessity to -- a need
6 to -- to clarify the -- the alleged ambiguity. But what
7 you have to demonstrate is not that there is lack of
8 clarity on the statute, but why you chose this specific
9 regulation. And as the materials the Board staff put
10 together in the past indicate, you could have gone
11 either way.

12 You could have said that FMBs are beer. You
13 could have said they were distilled spirits under your
14 own analysis. Again, we don't agree with that but that
15 was your analysis.

16 And so why did you choose distilled spirits?
17 And there's nothing in the record to demonstrate the
18 necessity for that.

19 MS. YEE: Very well. Thank you both very much.
20 You may want to sit tight in case there are other
21 questions.

22 Why don't we have the proponents come forward.
23 Maybe be seated three at a time.

24 And you'll have up to three minutes each.

25 MR. JONES: And if I may use the precedent of
26 Mr. Sorini for a few extra minutes, we'll keep well
27 within our half an hour.

28 I've primarily been asked to respond --

1 MS. YEE: Well, how many speakers do you have,
2 all together?
3 I see two behind you.
4 MR. JONES: Yeah, total of five.
5 MS. YEE: Okay.
6 MR. JONES: But each of them will take about a
7 minute.
8 UNIDENTIFIED SPEAKER: Or less.
9 MR. JONES: Or less.
10 MS. YEE: Okay. I'm going to --
11 MR. JONES: If you'd like me to go last --
12 MS. YEE: I will --
13 MR. JONES: -- after they all speak --
14 MS. YEE: I will -- I'll set the clock at 15
15 minutes and then let's see where we are.
16 MR. JONES: Okay.
17 MS. YEE: Okay. But please, if you could, try
18 to just state the highlights and avoid duplication of
19 your comments, that would be appreciated.
20 MR. JONES: Absolutely.
21 MS. YEE: Okay.
22 ---oOo---

1 FREDJONES

2 MR. JONES: My name is Fred Jones. I'm here on
3 behalf of the California Council on Alcohol Problems and
4 also speaking on behalf of the broader Alcopops and
5 Youth Coalition. We want to thank you for your vote in
6 moving forward these regulations.

7 I thought before today that today's hearing was
8 limited to the technical issues before it goes off to
9 OAL, which are limited to was there a proper rulemaking
10 process, and certainly the -- the long deliberative and
11 very inclusive process we have all followed in the last
12 ten months show that you've clearly met that.

13 And then the other is the meets the six
14 criteria of proper regulatory language. And I don't
15 think there's any question after this long delivera --
16 deliberative process that you have not met those two
17 standards that OAL expects.

18 There's no way I'm going to be able to respond
19 to the very long brief provided by the FMB Coalition.
20 But I thought this conversation about wine is very
21 instructive of trying to divine legislative intent in
22 definitions.

23 Within B&P Code Section 23007 the defining --
24 definition of wine, it actually allows for spirits to be
25 added to wine, and yet still be considered wine. There
26 is no similar provision in the definition of beer. In
27 fact, beer is very limited in its type of definition.

28 That contrasts with '05, the definition of

1 distilled spirits, which is actually very broad,
2 including all dilution and mixtures thereof of these
3 distillation products. Some being beverage use, some
4 being spirits of wine, whiskey, rum, brandy, gin or all
5 dilutions and mixtures thereof.

6 So the clear definitions of the Legislature I
7 think are there in these Code sections. So spirits may
8 be added to wine provided they don't exceed that 15
9 percent added flavoring, and provided their 24 percent
10 alcohol by volume is not exceeded.

11 There is no provision like that for beer. And
12 distilled spirits is broadly defined. What's more, the
13 Legislature two years ago in one month passed AB 417,
14 Agazarian (phonetic), an admission on behalf of the
15 Legislature that FMBs did not squarely fit the
16 definition of beer and hence the need to clarify or
17 expand the definition of beer to expressly include FMBs
18 as beer.

19 Fortunately, the Governor vetoed that bill and
20 asked for a vigorous discussion about these products and
21 this is one of the outcomes. It's unfortunate that the
22 ABC Department has not acted on the classification
23 vis-a-vis the point of sale, but for purposes of
24 taxation you have constitutional prerogative over that
25 issue. That is also in Article 20, Section 22, this
26 Board's constitutional prerogative to properly tax
27 alcoholic beverages.

28 Yes, there was a Leg. counsel opinion that says

1 you don't have the authority. There's also an Attorney
2 General's opinion that says these are clearly distilled
3 spirits. None of those decisions are binding upon you.

4 Various lawyers, you can take whatever weight
5 the may, but they all skirt the issue, and I would like
6 to ask Leg. counsel, "Do you think these are distilled
7 spirits," and maybe the FMB Coalition asked Leg. counsel
8 and we don't have that before us because they might have
9 got an answer they didn't like.

10 It's clear these products are distilled
11 spirits, they need to be taxed as such. And if I can
12 remind this Board, you are only clarifying what your
13 constitutional prerogative is, and that is to properly
14 tax these products. This all -- only came to a head in
15 January 2006, when the Federal agency primarily
16 responsible for labelling decided to come up with this
17 51/49 percent rule. Before that, State regulatory
18 bodies, and frankly Legislators, had no idea what the
19 ingredients were to these alcopop products.

20 In fact, ABC admitted in their lawsuit, in
21 defense of the lawsuit that members of our coalition
22 filed against them -- they don't even know what all the
23 ingredients are in these concoctions. But what is
24 clear, and Bill Lockyer when he was Attorney General
25 made it absolutely clear, if it includes distilled
26 spirits, the final product's a distilled spirit.

27 It's our position that any amount of distilled
28 spirits triggers that. However, your staff has made a

1 recommendation, your Board has adopted -- approved it,
2 to allow a diminimus .5 percent. The reason that came
3 out is because it was the industry that argued there is
4 distilled spirits in beer from the natural fermentation
5 process. A diminimus amount they said, but they're the
6 ones that brought this inconsistency to light.

7 And you responded I believe in a very
8 reasonable clear and now it will be a bright line test.
9 And I believe that should be the primary consideration
10 for OAL. Does industry know what their responsibilities
11 are vis-a-vis these products and taxation? I think the
12 record, the long extensive deliberative and inclusive
13 interested parties efforts that this Board conducted,
14 are clear on that.

15 Thank you.

16 MS. YEE: Thank you, Mr. Jones.

17 Please, next speaker.

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1 MICHAELSCIPPA

2 MR. SCIPPA: Madam Chair and distinguished
3 Board Membesrs, I'm Michael Skipppa from Marin
4 Institute, the alcohol industry watchdog. And I want to
5 thank you for the opportunity to add a few more comments
6 today, as well as to thank you once again for your
7 decision, your majority decision, in August to tax
8 alcopops correctly as distilled spirits.

9 But it appears as though Diageo, the makers and
10 marketers of the world's best selling alcopop, Smirnoff
11 Ice, seem to think they can convince the public that the
12 BOE is hiking taxes or creating a new tax. And we all
13 know that's just not true, that what you are really
14 doing is simply correcting a taxing error that Diageo
15 and other alcopops makers have encouraged at the expense
16 of the State of California and our youth.

17 By exploiting this incorrect taxation for
18 years, Diageo and other alcohol companies have reaped
19 tens of millions of dollars in avoided taxes.

20 So, you know, why do you think the USA is the
21 only country where Diageo sells Smirnoff Ice where the
22 product contains flavored malted beverage? Everywhere
23 else in the world it's vodka.

24 So in this country we have a tax loophole that
25 allows FMBs to be classified as beer and not as
26 distilled spirits. It's simply a tax dodge.

27 And as I said, we thank you for the correction
28 that you've set in motion in August. Marin

1 Institute's continued -- Marin Institute continues to
2 support those actions that you did. And we are pleased
3 to report that there are other states, most notably Utah
4 and North Carolina, where citizens are campaigning for
5 the same goal, the proper taxation of alcopops as
6 distilled spirits, to collect the legal taxes due and
7 put those beverages further beyond the reach of underage
8 drinkers.

9 So with those efforts it looks like Diageo or
10 perhaps some other distillers are going to have to
11 continue to put color ads like this directing people to
12 disrespectfully named and misleading web sites. And
13 there's nothing -- this is nothing more, really, than a
14 well-heeled effort to derail democracy in action, an
15 effort we hope will fail because people are more
16 important than these corporate profits.

17 Thank you.

18 MS. YEE: Thank you very much, Mr. Scippa.
19 Please, next speaker.

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1 JIMMY JORDAN

2 MR. JORDAN: Good afternoon. My name is Jimmy
3 Jordan. I am one of the original petitioners who wrote
4 the petition.

5 It's -- I know it's your responsibility to
6 correctly tax -- or collect taxes, but the industry has
7 made it hard for you to do that with these alcopops.
8 The law is very clear and any amount of distilled
9 spirits should be taxed as a -- distilled spirits.

10 Myself with only -- so far only a high school
11 education can clearly understand the language used in
12 this regulation, but still alcopops are being taxed as
13 beer.

14 We again are not here to make a new tax, but to
15 enforce ones already in place. We're not here to -- for
16 you to reclassify, but to correct -- properly correct
17 the error that's been made and to properly collect the
18 taxes for distilled spirits.

19 The industry has been behind us the whole
20 process, trying to defend their points. They have been
21 fighting hard. Why is that? Why are they so -- why are
22 they fighting so hard with all these big power
23 attorneys?

24 Is this their gateway trying to gain new
25 drinkers? As far as I know, there is just a three
26 percent sliver of their market -- alcopops is just a
27 three percent sliver of their market. So why -- why so
28 much commotion and why so much fighting back?

1 We also knew -- we also knew this petition and
2 positive tax collection increase a price would -- was
3 and would not be the solution to underage drinking but a
4 step of many to the maxis to youth.

5 Thank you again so much by correcting the error
6 of the tax collection. And I'm also sorry about the
7 negative slams against the Board.

8 Thank you.

9 MS. YEE: Thank you very much, Mr. Jordan.
10 Other speakers? Please.

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KATIE LUCAS

MS. LUCAS: Hi. My name is Katie Lucas. I represent the Girl Scout Councils of California. I'll be brief.

After ten months of interested party hearings in which Mr. Livingston and Sorini's concerns have been brought forth and debated vigorously in open hearings, through public comments and private meetings, the Girl Scout Councils of California commend the Board's courage to do their Constitutional duty by correctly taxing these products under California law.

On behalf of the approximately 300 thousand girls I represent and other young women in our state, which the American Medical Association believes are the primary target of these distilled spirit products, we urge the Board's formal adoption of taxing these products as distilled spirits.

Thank you.

MS. YEE: Thank you very much, Ms. Lucas.
Are there other speakers in support?

Okay.

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1 JANESEA MADRID

2 MS. MADRID: Hi. My name is Janessa Madrid and
3 I am a Senior at Galt High School. I'm here today
4 because I have faith on this Board and on the law that
5 it will do the right thing and be consistent with our
6 petition.

7 Meeting Controller John Chiang and hearing him
8 speak really encouraged me to keep forward with this
9 petition. Adopting this motion would be a great thing
10 for all of California.

11 I commend you for all of your time, your
12 actions and the regulations that you have been following
13 through with.

14 Thank you very much.

15 MS. YEE: Thank you, Ms. Madrid.

16 Thank you very much.

17 Questions or comments, Members?

18 Dr. Chu.

19 DR. CHU: Well, I voted for this regulation in
20 August, and today after receiving positive newspaper
21 editorials from all around the State, and from -- after
22 receiving hundreds of positive comments from
23 constituents around the State, I feel even more strongly
24 about voting yes on these regulations.

25 And it's on two grounds; tax policy as well as
26 social policy. With, of course, the tax policy being
27 the most important.

28 On the tax policy, it's clear, flavored malt

1 beverages have not been taxed accurately. There's a
2 great deal of ambiguity. This regulation corrects that.
3 When flavored malt beverages were invented in the '90s
4 they did not come under scrutiny. They remained in the
5 gray area as something in between beer and distilled
6 liquor, something that starts with a fermented base of
7 beer but then has distilled spirits flavoring.

8 As the Attorney General has stated, any product
9 with distilled flavorings should be considered to be
10 distilled liquor.

11 With this ruling, we provide accuracy and
12 clarity so that the taxation on these drinks precisely
13 reflect its makeup and of course we do have the
14 authority to do this under Revenue and Taxation Code
15 32451, in which the BOE has the authority to promulgate
16 regulations relating to the administration and
17 enforcement of the alcoholic beverage tax law.

18 On the social policy, of course I'm equally in
19 support. Alcopops were invented as an alcoholic drink
20 to be particularly appealing to young people. The
21 sweetening of these drinks, the bright packaging, the
22 innocuous names like Mike's Hard Lemonade, the shrinking
23 of the word "alcohol" on these labels for these drinks,
24 these are all meant to entice young people into
25 drinking.

26 This ruling will send a signal to youth that
27 these drinks are indeed hard liquor because these drinks
28 will have costs that are similar to hard liquor. It

1 will make it harder for young people to access these
2 drinks, and it can only be helpful in reducing underage
3 drinking.

4 MS. YEE: Very well. Thank you, Dr. Chu.

5 Other questions or comments, Members?

6 MR. LEONARD: I -- I just want to -- if I
7 could, Madam Chair, call attention --

8 MS. YEE: Yes, Mr. Leonard

9 MR. LEONARD: -- to the Leg. Counsel opinion
10 and the letter from ABC. Those are new to our docket
11 from the last hearing. And I -- I'm very sympathetic
12 with the issue, but I'm no longer a Legislator. And
13 this is tax policy, as Dr. Chu said, and actually we
14 don't have the authority to do tax policy. We implement
15 tax laws.

16 It -- it is -- it's not within our purview. I
17 think it would be incumbent upon this Board to -- now
18 that we've taken such deep notice of the issue, to -- to
19 work our legislative colleagues to develop a legislative
20 solution that deals with all the issues that have been
21 raised by both proponents of the change and opponents,
22 so that we could have a comprehensive statute that
23 really does good tax policy as well as good social
24 policy.

25 And so my -- my "no" vote on the regulation
26 again is not on the merits of the issue, it's -- I think
27 we're exceeding our authority. We're going to tie up
28 our Legal Department and all sorts of complications down

1 the line.

2 And -- and that's assuming OAL even approves
3 it, and I -- I -- I wouldn't give that a great chance
4 right now.

5 MS. YEE: Okay. Thank you, Mr. Leonard.

6 Other questions or comments?

7 Okay. Hearing none, is there a motion?

8 DR. CHU: Move to approve the regulation.

9 MS. YEE: Okay. A motion by Dr. Chu to adopt
10 the proposed regulation.

11 Is there a second?

12 MS. MANDEL: Second.

13 MS. YEE: Seconded by Ms. Mandel.

14 Please call the roll.

15 MS. OLSON: Madam Chairwoman.

16 MS. YEE: Aye.

17 MS. OLSON: Mr. Leonard.

18 MR. LEONARD: No.

19 MS. OLSON: Ms. Steel.

20 MS. STEEL: No.

21 MS. OLSON: Dr. Chu.

22 DR. CHU: Aye.

23 MS. OLSON: Ms. Mandel.

24 MS. MANDEL: Aye.

25 MS. OLSON: Motion passes.

26 MS. YEE: That motion carries.

27 Thank you very much.

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