Cigarette Minimum Price Laws

The Tobacco Control Legal Consortium has created this series of legal technical assistance guides to serve as a starting point for organizations interested in implementing certain tobacco control measures. We encourage you to consult with local legal counsel before attempting to implement these measures.¹ For more details about these policy considerations, please contact the Consortium.

Overview

Initiated by states in the mid-20th century, minimum price laws were intended to protect tobacco retailers from predatory business practices and to promote fair trade. Policymakers were concerned that large retailers, by virtue of their greater purchasing power, would select cigarettes to serve as “loss leaders” (i.e., items priced below cost or closer to cost than normal profit margins) to draw customers into their stores to the detriment of smaller retailers. Minimum price laws were designed to ensure fair competition among tobacco retailers, and did not originally have public health goals in mind.

Over time, minimum price laws have been recognized as a strategy to counteract the effects of tobacco manufacturers’ discounting practices. If structured carefully, such laws have the potential to prevent trade discounts from eroding the price increases – and resulting decreases in consumption – achieved through tobacco excise taxes. Minimum price laws are probably most effective if used as a complement to, and not a substitute for, high tobacco taxes. They, like other alternative pricing strategies such as laws restricting coupons and multi-pack discounts, can work in tandem with strong tobacco excise taxes to keep tobacco prices high and discourage consumption.

Half of U.S. jurisdictions – 25 states plus the District of Columbia – have minimum price laws for cigarettes.² At present, no U.S. state sets statutory minimum prices for other tobacco products, and no local government has attempted to regulate cigarette or tobacco product pricing through a local minimum price ordinance.³
This guide focuses on existing state cigarette minimum price statutes and regulations, but many of the concepts discussed are equally applicable to laws aimed at regulating the price of other tobacco products.

**Policy Benefits**

The price of cigarettes is significantly related to their consumption: when cigarette prices rise, people tend to smoke less or quit. Studies show that when tobacco companies lower tobacco product prices in the face of rising taxes, more people tend to purchase cigarettes, especially the young and new users.4

Data shows that cigarette manufacturers use trade discounts, coupons, and other price promotions to counteract the effects of tax increases and to suppress prices. The tobacco industry spends the largest share of its annual marketing budget on price discounts. In 2006 alone, the tobacco industry spent $12.49 billion on advertising and promotional expenditures.5 The largest single category of these expenditures – $9.21 billion, amounting to 73.7% of total advertising and promotional expenditures – was in the form of price discounts paid to cigarette retailers or wholesalers to reduce the price of cigarettes.6

Minimum price laws have the potential to counteract the tobacco industry’s price manipulation strategies, if they keep trade discounts from being factored into the minimum price calculation. Therefore, as explained below, minimum price laws should be structured so that trade discounts are not allowed to reduce the “basic cost” of cigarettes before the statutory wholesale or retail markup is applied.

**Calculating Minimum Price**

Minimum price laws prohibit tobacco wholesalers and retailers from selling cigarettes “below cost,” and define below cost sales as unfair trade practices. In other words, minimum price laws establish a “floor” price for cigarettes, and provide that cigarettes cannot legally be sold in the jurisdiction below this floor, except in limited circumstances.

Generally, minimum price laws contain formulas that specify wholesale and/or retail markups that are applied to the “basic cost” of cigarettes. Basic cost usually means the invoice cost of the cigarettes to the wholesaler or retailer,7 plus the full value of any stamps required by the state’s cigarette excise tax.8 Addition of the wholesale and/or retail markups to basic cost results in the minimum selling prices.

Minimum price laws typically define the terms “basic cost” and “cost to the wholesaler” and/or “cost to the retailer.” The latter terms refer to minimum percentage markups that are based on presumptions about wholesalers’ and retailers’ costs of doing business.9 Minimum price laws vary by jurisdiction in terms of the percentage markup required. The minimum percentage markup on the wholesale price of cigarettes ranges from 2% to
6.5%, while the minimum percentage markup on the retail price of cigarettes ranges from 6% to 25%.\textsuperscript{10}

By way of illustration:

\[
\text{Manufacturer’s Invoice Price} + \text{Excise Tax (State & Federal)} = \text{Basic Cost of Cigarettes}
\]

\[
\text{Statutory Wholesale Percentage Markup} (\text{or Wholesaler’s Actual Cost of Doing Business}) + \text{Statutory Retail Percentage Markup} (\text{or Retailer’s Actual Cost of Doing Business}) = \text{Minimum Wholesale Price} = \text{Minimum Retail Price}
\]

Minimum price laws set a formula for determining the legal selling price of cigarettes, but because wholesalers’ and retailers’ invoice costs vary,\textsuperscript{11} there is no one statutorily-set “minimum price.” Rather, every brand has its own minimum price.\textsuperscript{12} An alternative, untested approach would be to set one minimum retail price (e.g., $5.00/pack), and prohibit any pack of cigarettes from being sold below that price in the jurisdiction, regardless of actual wholesale or retail invoice cost.

**Policy Considerations**

**Addressing Trade Discounts:** Current minimum price laws are not necessarily effective for tobacco control purposes because they contain loopholes tobacco manufacturers use to manipulate prices. Tobacco companies can undermine the effectiveness of minimum price laws by offering trade discounts to manufacturers and retailers (like “buy-downs”\textsuperscript{13} and “master-type”\textsuperscript{14} programs). Because minimum price is determined by applying a minimum percentage markup to “basic cost” when cigarettes are sold from the manufacturer to the wholesaler, or the wholesaler to the retailer, the industry can manipulate minimum price by offering trade discounts that lower the base price. If trade discounts are applied to lower the base price of cigarettes, then the percentage markups
are applied to a new, discounted base price, resulting ultimately in a lower retail sales price for consumers. Therefore, for minimum price laws to be most effective, they should expressly exclude trade discounts from the formulas for calculating minimum price.

At present, seven states have minimum price laws that exclude trade discounts from the calculation of minimum price. New York uses a formula that prevents buy-downs from reducing cigarette prices below the presumptive minimum price. New Jersey prevents promotional payments from a cigarette manufacturer to a retailer or wholesaler from being considered in determining the cost of cigarettes. Some states have addressed the problem of trade discounting through non-legislative means such as Attorney General’s opinions or regulatory guidelines. For instance, in Massachusetts, the Department of Revenue issued a Directive that specifically states that cigarette manufacturers’ promotional pricing programs cannot be used to reduce the presumptive minimum price of cigarettes under the state’s minimum price law.

Limiting Exemptions: Existing minimum price laws contain a number of exemptions to their general rules prohibiting the sale of cigarettes below cost. Careful consideration should be given to the inclusion and scope of any exemption, so that the law’s purpose is not undermined.

- Some minimum price statutes exempt below cost isolated sales; “bona fide” sales to close out a business of selling cigarettes; and sales of defective, imperfect, or damaged cigarettes.
- Some states’ minimum price laws allow cigarette wholesalers or retailers to sell cigarettes below cost if they can prove they are doing so in a good faith effort to meet the prices of a competitor.

Providing for Strong Penalties: Minimum price laws should impose sufficient penalties to deter retailers and wholesalers from skirting their prohibitions. Violations of state minimum price laws can result in civil or criminal penalties, or both.

- Civil penalties: Violations can result in the suspension or revocation of a retailer’s or a wholesaler’s license; monetary fines increasing in amount with subsequent violations; a court order requiring the violations to stop; and, in some states, monetary damages three times the amount that is owed (known as “treble damages”).
- Criminal penalties: Violations of minimum price laws are typically defined as misdemeanor offenses, punishable by fines of $500 to $1,000, or up to 3 to 6 months’ imprisonment, depending on the jurisdiction.

Planning for Effective Enforcement: A minimum price law should include effective enforcement measures, and provide for sufficient funding and staffing to ensure retailers’ and wholesalers’ compliance with the law. It also may be beneficial to enable or require interagency cooperation, to ensure that public health considerations play into decisions about enforcement of minimum price laws. For instance, tobacco control programs could partner with state agencies that have enforcement authority over minimum price laws (usually, Departments of Revenue) to identify gaps in the law that
do not address other practices used by cigarette manufacturers and retailers to reduce cigarette prices, such as remote sales via the mail and the Internet, direct sales from manufacturers to consumers, and coupons and other direct-to-consumer discounts.

**Coordination with Other Pricing Laws:** Although minimum price laws that expressly prohibit trade discounts from being factored into the minimum price calculation can help to preserve the health benefits of tobacco taxes, passing other price-related policies may also be necessary to keep retail cigarette prices high. Jurisdictions might consider passing policies aimed at limiting retail price promotions along with minimum price laws, such as laws restricting the redemption of coupons or prohibiting buy-one-get-one free offers, as part of a comprehensive strategy to address the tobacco industry’s price-related tactics. For instance, Massachusetts allows the redemption of coupons only if they do not reduce the price of a pack of cigarettes below the presumptive minimum price.

**Potential Challenges**

Tobacco industry challenges to minimum price laws are not uncommon. Courts have generally upheld such laws and the authority of state agencies to issue regulations limiting the industry’s ability to use price discounting strategies to circumvent the laws’ prohibitions.

For instance, in *Lorillard v. Roth*, Lorillard Tobacco Company and a cigarette retailer sued the New York Department of Taxation and Finance after it issued an advisory memorandum interpreting the state's minimum price law. The Department found that the Cigarette Marketing Standards Act prohibited certain manufacturer promotional programs (buy-downs and master-type programs). At issue was whether retail sales made under these price promotions constituted below cost sales, and if so, whether the Department could presume that such sales were made with unlawful intent in violation of the Act. After two lower courts considered the issue, the Court of Appeals of New York ultimately upheld the Department’s position, and concluded that buy-downs and master-type promotions presumptively violated the state’s minimum price law and created the kind of price differentiation among retailers that the Act was intended to prohibit.

Additional legal issues to consider when drafting minimum price laws include the following:

**Authority to Regulate:** Generally speaking, courts have held that the enactment of cigarette minimum price laws and similar “sales below cost” restrictions is within the proper exercise of a state’s police power. Such statutes usually have been upheld against challenges that the legislature is involved in an area that does not relate to the public health, welfare, and safety. However, on occasion, courts have found that a legislature acted improperly, either because the particular statute was deemed unreasonable or because it constituted price-fixing.
Preemption: To date, minimum price laws have been passed only at the state level. State laws may expressly preempt local governments from acting in this area, or a court may find that local efforts to regulate cigarette pricing are impliedly preempted based on the comprehensiveness of a states’ cigarette taxation scheme.

Commerce Clause: Under the Dormant Commerce Clause doctrine, states cannot regulate products in a way that unduly burdens interstate commerce. If a minimum price law were challenged under the Commerce Clause, the court would examine whether the law’s benefits outweigh any burdens it places on interstate commerce. In conducting this inquiry, the court would consider whether the law favors local businesses over out-of-state businesses. Therefore, minimum price laws should treat retailers based in-state and out-of-state equally, to avoid potential challenges under the Dormant Commerce Clause.

Procedural Due Process: Some minimum price laws contain provisions allowing retailers to sell cigarettes at prices below the presumptive statutory minimum price if they can prove that they are doing so in a good faith effort to meet the prices of competitors. Typically, regulations implementing such statutory provisions require retailers to obtain prior approval from the Department of Revenue, after attending a hearing. If a minimum price law has this type of exception, its regulations should be drafted carefully to ensure that the administrative hearing process gives the retailer a full and fair opportunity to present evidence on all issues relevant to the department’s decision to grant or deny the exception. In the case of Duarte v. Commissioner of Revenue, the Supreme Judicial Court of Massachusetts cancelled a retailer’s license suspension and struck part of a Department of Revenue regulation on the grounds that the regulation limited the retailer’s statutory right to present evidence at the pre-suspension hearing. The court also found that the hearing process violated the retailer’s rights to procedural due process under both state and federal law because “the risk of erroneous deprivation” of the retailer's license was high.

In conclusion, because the tobacco industry is heavily invested in price promotions and will scrutinize minimum price laws that limit its ability to manipulate tobacco prices through such programs, policymakers should work closely with legal counsel to ensure careful drafting that minimizes the risks of litigation.

Select Legislation and Policies

Below are examples of minimum price laws from several states. If you consider adapting any language from these policies, take care to ensure the provision in question is practical and legal in your jurisdiction. Please note that the Tobacco Control Legal Consortium does not endorse or recommend any of the following policies. These examples are included simply to illustrate how various jurisdictions have approached minimum pricing of cigarettes.
<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Statute/Regulation/Directive</th>
<th>Select Excerpt of Text of Law</th>
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<tbody>
<tr>
<td>Arkansas</td>
<td>Arkansas Unfair Cigarette Sales Act Ark. Code §§ 4-75-701–714</td>
<td>(13) &quot;Gross invoice cost&quot; means the manufacturer's or wholesaler's price for the product sold as listed on the invoice to the wholesaler or retailer, as the case may be, before any deduction for allowances, whether manufacturer promotional allowances or otherwise, or for discounts of any kind; and (14) &quot;Manufacturer promotional allowance&quot; means any payment or compensation given by a manufacturer of cigarettes to wholesalers or to retailers to promote the sale of cigarettes and which the manufacturer requires the wholesaler to pass on to the retailer and the retailer to pass on to the retailer's customer. Ark. Code § 4-75-702.</td>
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<tr>
<td>District of Columbia</td>
<td>Cigarette Sales Below Cost Act D.C. Code §§ 28-4521–4527</td>
<td>… articles or products given gratis or payments made to a retailer or wholesaler for display, advertising, or promotion purposes shall not be considered in determining the cost of the articles or products. D.C. Code § 28-4521(3).</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>“Fair Pricing Provisions” of the Massachusetts Cigarette Tax Statute Mass. Gen. Laws. Ch. 64C, §§ 12–21</td>
<td>No person shall be permitted to sell cigarettes as &quot;loss-leaders&quot; with the intent to injure competitors or to destroy competition, and the commissioner shall enforce sections thirteen to twenty-one, inclusive, in order to prohibit such sales and stabilize and increase collections under this chapter. Mass. Gen. Laws. Ch. 64C, § 12.</td>
</tr>
<tr>
<td>Montana</td>
<td>Montana Cigarette Sales Act Mont. Code §§ 16-10-101 et. seq.</td>
<td>“Basic cost of cigarettes” means the list cost of cigarettes as reported to the department by the manufacturer without any deductions for discounts or taxes of any kind. Mont. Code § 16-10-103(1).</td>
</tr>
<tr>
<td>Nebraska</td>
<td>Nebraska Unfair Cigarette Sales Act Neb. Rev. Stat. §§ 59-1501–1518</td>
<td>Basic cost of cigarettes shall mean the replacement cost of cigarettes to the retailer or wholesaler, as the case may be, in the quantity last purchased, without subtracting any discounts, to which shall be added the full value of any stamps which may be required by any cigarette tax act of this state and by ordinance of any municipality of this state … Neb. Rev. Stat. § 59-1502(8).</td>
</tr>
<tr>
<td>New Jersey</td>
<td>New Jersey Unfair Cigarette Sales Act N.J. Stat. § 56: 7-1 et seq.</td>
<td>Merchandise given gratis or payment made to a retailer or wholesaler by the manufacturer thereof for display, or advertising, or promotion purposes, or otherwise, shall not be considered in determined</td>
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Cigarette Minimum Price Laws

New York

**Cigarette Marketing Standards Act**

N.Y. Tax Law §§ 483–489

New York State Dep’t of Taxation & Finance, Technical Services Branch Memorandum TSB-M-00(2)(M): Cigarette Manufacturers’ Promotional Programs and the Cigarette Marketing Standards Act

It shall be unlawful for any agent, wholesale dealer or retail dealer, with intent to injure competitors or destroy or substantially lessen competition, or with intend to avoid the collect or paying over of such taxes as may be required by law, to advertise, offer to sell, or sell cigarettes at less than cost of such agent wholesale dealer or retailer dealer …

N.Y. Tax Law §484(a)(1).

The term “cost of the agent” shall mean the basic cost of cigarettes plus the cost of doing business by the agent …

N.Y. Tax Law § 483(b).1.(A).

"Basic cost of cigarettes" shall mean the invoice cost of cigarettes to the agent who purchases from the manufacturer, or the replacement cost of cigarettes to the agent, in the quantity last purchased, whichever is lower, less all trade discounts, except discounts for cash, to which shall be added the full face value of any stamps which may be required by law.

N.Y. Tax Law § 483(a)(1).

Other Helpful Resources

The Tobacco Control Legal Consortium has a publication that covers guidelines for state and local governments on the pricing of tobacco products, which discusses minimum price laws as one potential strategy. The Tobacco Technical Assistance Consortium (TTAC) has a Pricing Strategies Toolkit that is designed to help tobacco control professionals working on tobacco price-related initiatives.

The Centers for Disease Control and Prevention (CDC) has published an article analyzing current state cigarette minimum price laws and suggesting ways in which they might be strengthened. The Proceedings from the Tobacco Retail Price Manipulation Policy Strategy Summit, sponsored by the California Department of Public Health in 2008, contain valuable information about minimum price laws and other price-related policy options. Finally, the Campaign for Tobacco-Free Kids has developed Model Legislation to Stop the Sale of Cigarettes at Below Legal Market Prices, which has a minimum pricing component and is available upon request.
Contact Us

Please feel free to contact the Tobacco Control Legal Consortium at publichealthlaw@wmitcell.edu with any questions about the information included in this guide or to discuss local concerns you may have about implementing such a policy.

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Notes

1 The information contained in this document is not intended to constitute or replace legal advice.
3 State laws may preempt local governments from acting in this area. In addition, local minimum price laws may be difficult to implement effectively at the local level.
6 Id.
7 This sum is the cost to a wholesaler or retailer of purchasing cigarettes, as it appears on a billing invoice. It is the same as the “invoice price” charged by the manufacturer.
9 Retailers and wholesalers have the option of establishing that their actual costs of doing business are lower than the statutory presumption, but practically speaking, few do so because prior approval must be obtained from the given state’s Department of Taxation or Revenue, and the process typically requires rather extensive documentation that must be filed annually. Further, any time the basic cost of cigarettes to the wholesaler or retailer increases, new documentation must be re-filed. See, e.g., Minn. Stat. § 325D.32, subd. 10(c).
10 CDC, supra note 2, at 389.
11 For instance, two similar wholesalers (or two like retailers) may pay different prices for the same brand and product of cigarettes from the same manufacturer because they paid different invoice costs. Such price differentials may be due to factors such as negotiating power of the parties involved, established business relationships between the parties, purchase commitments, sales volumes, and discounts based on promotional services provided.
12 In most states, Departments of Revenue publish Minimum Price Lists on an annual basis, to account for price increases by manufacturers and to assist wholesalers and retailers in determining the minimum allowable wholesale and retail prices for various brands of cigarettes sold in the state. See, e.g., New York State Dep’t of Taxation & Finance, Publication 508, Minimum Price List for Cigarettes, available at http://www.tax.ny.gov/pdf/publications/cigarette/pub508.pdf; New Jersey Div. of Taxation, Minimum Legal Prices on Cigarettes, available at http://www.state.nj.us/treasury/taxation/pdf/other_forms/mlpcig.pdf.
Under a buy-down program, the manufacturer offers a retailer a rebate for sales of a particular brand of tobacco product, either for a specific quantity of that product, or for a minimum quantity of that product sold over a predetermined period of time. The master-type program uses the same approach as a buy-down (see supra note 14), but the rebate is offered by a wholesale distributor to a retailer.

New York, the District of Columbia, Montana, Pennsylvania, Minnesota, Arkansas, and Nebraska’s minimum price statutes expressly prohibit trade discounts in calculating the minimum retail price for cigarettes. CDC, supra note 2, at 390.

New York Tax Law §§ 483(a)(1), 484. See also New York State Dep’t of Taxation & Finance, Cigarette Manufacturers’ Promotional Programs and the Cigarette Marketing Standards Act, Technical Services Branch Memorandum TSB-M-00(2)(M) (2000).

NEW JERSEY STAT. § 56:7-28(b).


See, e.g., MINN. STAT. § 325D.36.

See, e.g., Mass. Gen. Laws Ch. 64C, § 16.


Mississippi has issued a report noting that its enforcement efforts are hampered by insufficient funding and staffing. See Joint Legislative Cmte. on Performance Evaluation & Expenditure Review (PEER), A Review of the Department of Revenue’s Enforcement of Mississippi’s Unfair Cigarette Sales Law 13-14 (Oct. 12, 2010) (noting that only one Mississippi Department of Revenue employee is responsible for ensuring that the states’ roughly 7,500 licensed cigarette retailers and 145 licensed wholesalers comply with its minimum price law, by answering taxpayer questions, receiving complaints, conducting price checks, as well as performing other duties related to tobacco taxation).

CDC, supra note 2, at 390.


786 N.E.2d 7 (N.Y. 2003).


See, e.g., Simonetti v. State, 132 So.2d 252 (Ala. 1961) (upholding an Alabama statute prohibiting any wholesaler or retailer to sell, offer to sell, or advertise cigarettes at less than cost under the state’s general police power).

See, e.g., Strickland v. Rio Stores, Inc., 255 S.E.2d 714 (Ga. 1979) (holding that a statute and implementing regulation prohibiting the below cost sale of cigarettes by wholesalers violated due process, on the grounds that such sales were not “affected with a public interest” to the extent that the legislature could constitutionally restrict the rights of individuals to contract as to the price of cigarettes).


886 N.E.2d 656 (Mass. 2008).