

# DISTRIBUTION CHANNELS

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## STAMPING IN CALIFORNIA

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If you aren't doing business in the state of California, chances are you are not familiar with its Alternative Cigarette Tax Stamp Program (ACTS). Developed to help combat counterfeit stamping, the program was signed into law on September 28, 2002, and was fully implemented on January 1, 2005.

As part of the program, the California State Board of Equalization (BOE) was required to replace the heat-applied decal tax stamp with an encrypted stamp containing information that could be read by a scanning device.

Currently, 47 states require proof that state cigarette taxes have been paid by marking the cigarette boxes with stamps. All but one of these states utilize a heat applied stamp.

With these taxes increasing across the country, reaching as high as \$2.50 per box, the risk of counterfeiting has grown. Jim Bonhivert, president and CEO of SICPA Securink, a leader in security inks for banknotes and value documents based in Springfield, VA, says California distributors have been harmed to the tune of about \$400 million by counterfeiting.

To combat this problem, California decided to ratchet up the level of security by requiring encrypted information on stamps that includes the name and address of the distributor affixing the stamp, the date the

stamp was affixed and its denominational value.

But the real story is how SICPA, the prime contractor for California, and Chicago-based Meyercord Revenue, which served as SICPA's subcontractor, came together to make it all happen.

## How it all began

In December 2003, California issued its first invitation to bid on the program. According to Mike Zimmer, who served as general manager of Meyercord at that time, the SICPA team put together a bid proposal and submitted it.

Although the team won the bid, the state discovered there was no money in its budget to pay for the program, so it was put on hold until May of 2004. At that time, the SICPA team submitted its proposal again during the bidding process and won.

However, a second company that had also bid on this project lodged a protest, which further delayed the program. This was resolved through the courts on December 23, 2004, with SICPA retaining its win.

In the meantime, Meyercord partnered with SICPA to provide the equipment and technology for this tax stamp venture. "Our company provided the equipment and service in accordance to state specifications

using SICPA's technology. This provided the infrastructure for data gathering. So, once the cigarette stamp is applied, a camera records the data and SICPA collects and stores the information for the state," Zimmer explains.

It turned out that winning the bidding process and developing the required technology was only the beginning. The real test came when it was time to implement the program.

"The period from January through the end of April was painful," Zimmer says.

Even though the deadline for implementation was not etched in stone, BOE was looking for quick turnaround with the machine installations and execution.

The first machine under the new program was installed on January 10, 2005, at distributor Core-Mark's Oregon location. By the time the project was completed, Meyercord had installed approximately 57 machines in 15 weeks.

According to Tim Arends, who served as Meyercord's machine unit business manager at the time and now is general manager, the BOE's tight time frame essentially meant that a year's worth of equipment needed to be installed in four months. "This was a new process for distributors and everyone to try and resolve at the same time. There were times we were



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doing four to five machine installations a week,” he says.

“We had teams of people go into the location and remove the old equipment before installing the new units. We would train folks to get it operational. A different team would do the follow-up training,” Zimmer says. “Although we were given time by the BOE to make sure this program was implemented properly, I would not want to go through a four-month implementation period again.”

The bulk of the equipment was up and running by the week ending on May 6, 2005. Taking into account the four to eight weeks of machine modifications, the program was fully operational, and the satisfaction of participating distributors kicked in by June.

According to Stephen Wass, operations director at SICPA, there is a substantial data management structure behind the program. “It covers stamp ordering, which is done automatically on web-based applications, right through to stamp making, applications and auditing. We provide reports to BOE regarding activities of stamp ordering and application, giving them a lot of data they didn’t have previously, for a more active investigation throughout the state. This is why the program scares off potential counterfeiters,” he says.

## Distributors get on board

From a distributors’ standpoint, the task of implementing new cigarette stamping machines that were not subsidized was daunting. “We had to work hard to help the California distributors overcome their reluctance. This equipment is quite a bit more sophisticated, but at the same time, it also is more productive,” Arends says. It was a matter of convincing distributors that they were losing revenues due to counterfeiting and showing them the benefits of this new technology.

Rich Kimmelman, director of warehousing at Core-Mark, says his company had no options but to comply with the program using the new machines. “Meyercord was easy to work with, in terms of swapping out the equipment. There were delays in the development of these machines that pushed the process back. Anytime something like that happens, it impedes the operation because we didn’t know when the process would be completed,” he says.

Unlike the old machines, which were operated manually, the new systems involved software and more sophisticated technology. As a result, it took time for the bugs to be worked out.

And, as with any large-scale project, there were a few hurdles to overcome. For example, Kimmelman says

the new machine and tax stamp applicator are larger in size than the old machines, so space modifications were required to accommodate it. Also, the machine required new cigarette case packers, which are used to put cigarettes in boxes after stamping.

Probably the biggest and most unwelcome change was that the newer technology and machines are more expensive to own and operate. “Still, once the machines were broken in, the productivity was comparable to what we experienced with the old equipment,” Kimmelman says. “Plus, the new equipment operates cleaner due to the way rolls of stamps are handled.”

Another advantage is that the machines are tied into a modem line, so there is direct communication to the machine for debugging. Also, software or updates are automatically downloaded, Kimmelman says.

In addition, Meyercord built these new systems with additional safety features that Kimmelman says are beneficial. These include safety interlocks that prohibit the machine from operating unless its safety features are engaged.

There were a couple of minor part modifications installed by Meyercord and a software upgrade along the way, but it wasn’t long before Core-Mark’s new machines were up and running smoothly. “Meyercord



worked with us to make the machines operable,” he says. “We’ve been operating these machines for well over a year and a half, and there have been no issues. In fact, we’ve noticed productivity is a bit higher,” Kimmelman says.

Irwindale, CA-based Kennedy Wholesale also was one of the first distributors to institute the machines. According to Robert Kennedy, CEO, the delays caused by the contested bid process and resulting court proceedings, in addition to the short time frame in getting this new technology up and running for the large number of distributors simultaneously, was challenging. “Despite my doubts that Meyercord would be able to do the job they proposed to do, they accomplished it,” he says.

Kennedy credits Zimmer for using all of his assets to make the deadline, yet acknowledges that there were mistakes along the way. “For example, they mis-specified the air compressors and we ended up having to upgrade. And we had to pirate machines for parts,” he says.

Arends concurs that field modifications were done on the fly. “This made it more difficult to coordinate and work it all out,” he says.

Although Kennedy Wholesale was a low volume stamper and is no longer in the cigarette business, the year the machines operated went better than anticipated, Kennedy says. “Meyercord got the job done,” he adds.

Yet, there are improvements he says can make the equipment even

more useful for distributors. Kennedy says in his experience with the machines, distributors were not able to access the stamp information. “If a cigarette box was mis-shipped, I had no ability to see the information on the stamp. I should be able to record the stamp number and find out when I applied that stamp. It would be helpful to know that. Last I heard, SICPA and Meyercord were working on a better reader,” he notes.

Says Kennedy, “The compressed timeframe made it more difficult and took a tremendous amount of management time. Any other state that does this needs to allow more time after the bid process to come up with laws. The manufacturer also needs time to get ready to ramp-up and make good on his bid.”

### The result

Despite the trials and tribulations, the switchover was successful. After implementation was completed, the BOE conducted a survey of the equipment and went to the distributors to get statistical information that helped determine if the system was compliant. “Up time on the equipment was 96.6 percent, which was more than adequate for passing BOE’s test,” says Wass. There are currently about 65 of the stamping machines in operation.

“After installing the equipment, we wanted more run time on the machines to make sure they were field proven. This has been resolved in California and won’t be an issue moving forward,” Arends says.

With future installations of this type, Meyercord plans to extend the conversion period with these systems to give everyone involved more time to ease into the program and work things out at both a distributor and state level.

All in all, Bonhivert says California’s innovative program has been successful. “BOE went public and picked up \$120 million of tax revenue in the first year of the program. By taking the 87-cent tax per pack that California is collecting by moving to the new system and multiplying that by the cost of cigarettes, you get approximately \$500 million [in extra revenue] for distributors,” he says.

It is the surge in counterfeiting, which many attribute to the rising cost of cigarettes, that will drive a change in the cigarette stamping industry. “This program is a positive solution to a growing problem,” says Bonhivert. “Distributors should see this as a positive, because they will make more money in the long run. Even though the equipment is more expensive, the profits will override this.”

Many predict more states will eventually join California in battling counterfeit tobacco sales. “Other states are looking at this system, and there is legislation pending in other states such as New York,” Bonhivert says. This is positive news for both the tobacco industry and distributors. ■

*Lisa White is a food industry writer based in Cary, IL.*

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