The Florida Senate

COMMITTEE MEETING EXPANDED AGENDA

BUDGET SUBCOMMITTEE ON FINANCE AND TAX
Senator Bogdanoff, Chair
Senator Altman, Vice Chair

MEETING DATE: Tuesday, December 7, 2010
TIME: 12:30 —2:00 p.m.
PLACE: 301 Senate Office Building

MEMBERS: Senator Bogdanoff, Chair; Senator Altman, Vice Chair; Senators Alexander, Gardiner, Margolis, Norman, and Sachs

TAB	BILL NO. and INTRODUCER	BILL DESCRIPTION and SENATE COMMITTEE ACTIONS	COMMITTEE ACTION
	Overview of Unemployment Compensation Tax		Presented
1	**Issue Brief 2011-218** (Tobacco Settlement and Non-Participating Manufacturers Issue Description and Background) Presentation		Not Considered

Fundamentals of Unemployment Compensation Programs

Senate Budget Subcommittee on Finance and Tax

December 7, 2010

History and Intent of the Unemployment Program

- State programs began in the 1930s due to high unemployment during the Depression.
- First federal program -- Social Security Act of 1935
- Florida's unemployment compensation program -- 1937
- Primary Goals:
  - Provide citizens with income during unemployment
  - Counteract the unemployment cycle

Florida Program Partners

U.S. Department of Labor

Agency for Workforce Innovation

(Administers Benefits)

Department of Revenue

(Administers Contributions (Taxes))

General Components of the Tax

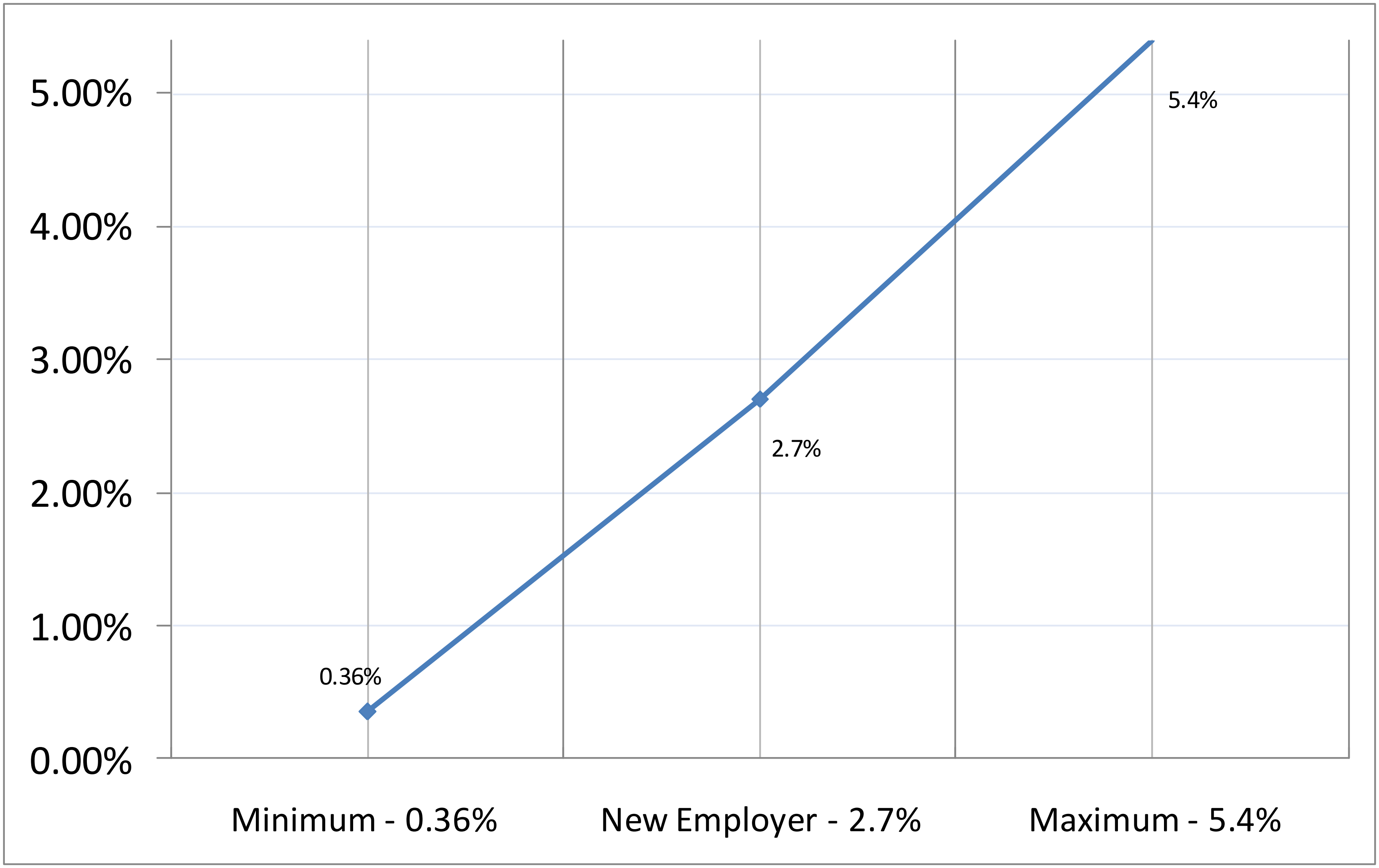
- Federal Tax Rate
  - 6.2% - 5.4% (credit) = 0.8%
- State Tax Rates
  - From 0.36% to 5.4%
- Tax Bases
  - $7,000

State Experience Rating Systems

- Benefit payments are tracked and allocated (“charged”) to employers.

- Employers with low benefit payments in relation to their total payroll have lower tax rates.

2010 Florida Tax Rates



2010 Florida Employer Tax Amount Per Employee

	Minimum Rate Employer	New Employer	Maximum Rate Employer
$7,000 Tax Base	$25.20	$189	$378

The Unemployment Compensation Trust Fund

- Trust Fund pays Unemployment Benefits

- Trust Fund Trigger Mechanisms
  - Negative Trigger lowers rates
  - Positive Trigger raises rates to recoup an acceptable balance over a statutory recoupment period – currently 3 years.

2009 Legislation – SB 810

- By late 2008, the increase in benefit payments was having a significant effect on the Unemployment Compensation Trust Fund balance.
- SB 810 (2009) increased the Florida tax base from $7,000 to $8,500 and lowered the trust fund trigger statutory recoupment period from 4 years to 3 years.
- SB 810 would have increased employer tax rates for calendar years 2010 through 2015.

2009 Trust Fund Insolvency

- In August 2009, the trust fund was depleted.
- Florida began borrowing funds from the federal government to pay unemployment benefits.
- By January 2010, tax rates were set to increase significantly.

2010 Legislation – HB 7033

- During the 2010 Regular Legislative Session, HB 7033 significantly reduced 2010 tax rates.

- The rate reduction was primarily accomplished by:
  - Delaying the 2009 tax base increase until January 1, 2012, and
  - Deactivating the Trust Fund Trigger until January 1, 2012.

- The legislation also provides for an assessment on employers in order to pay interest on federal loans.

Federal Loans

- As of December 2, 2010, Florida has borrowed approximately $1.82 Billion from the federal government in order to pay unemployment benefits.

- Interest payments are due in September 2011. The 2011 estimate is $61.4 million.

- Florida's 2010 legislation imposed a special interest assessment on all employers. Current estimate is $9.51, per employee, and will be due from employers in June 2011.

- If balance of loans is not paid by January 2012, federal law will begin lowering employer's federal credit by 0.3% per year until the balance is paid in full.

WHERE ARE WE NOW?

State Unemployment Tax Rate Information					
	2009	**2010 (prior to HB 7033)**	**2010**	**2011**	**2012**
Tax Base	$7,000	$8,500	$7,000	$7,000	$8,500
Trust Fund Trigger	Off	On	Off	Off	On
Minimum Tax	$8.40	$100.30	$25.20	$72.10	*$148.75
New Employer Tax	$189	$229.50	$189	$189	$229.50
Maximum Tax	$378	$459	$378	$378	$459

*The minimum tax rate listed for 2012 is from a legislative estimate performed in August 2010. This estimate may change due to recent and upcoming developments.

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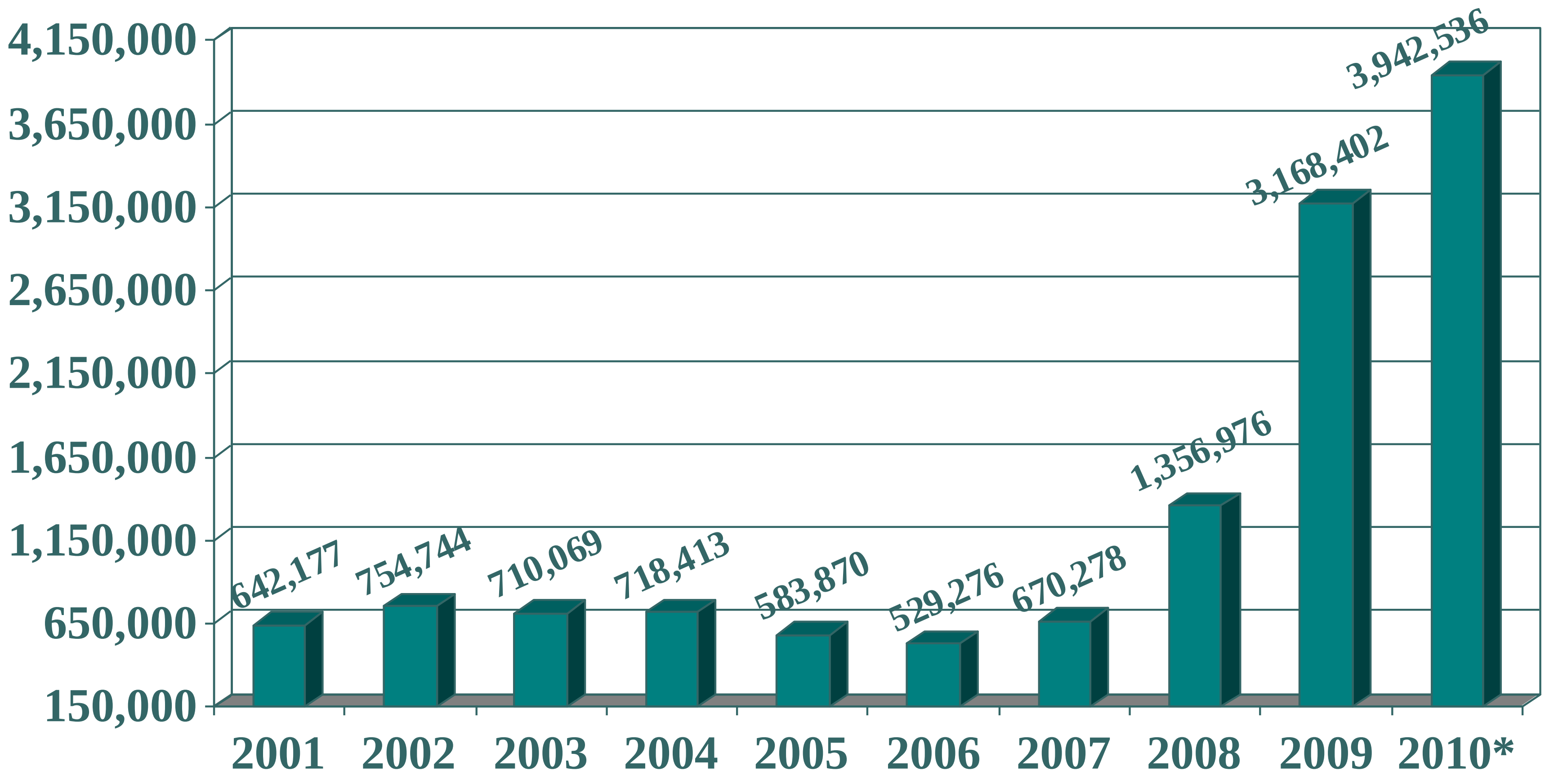
Unemployment Compensation

December 7, 2010

Total UC Claims



*Through November 30, 2010

UC – Then and Now

	2007	Now
Unemployment rate	4.7% (Dec 2007)	11.9% (Oct 2010)
Customers	587,956	1.3 million (YTD Nov 2010)
Benefits paid	$1.1 billion	$6.7 billion (YTD Nov 2010)
Calls to Call Center	137,000	543,000
Total employees	535	1,630
Total phone lines	736	2,093
Call Center hrs/wk	40 hours	75.5 hours

Agency Response

- **Added overflow call center**
  - Orlando-based
  - Assists 10,000+ customers daily for a total of 25,000 customers assisted daily
- **Extended hours**
  - Added 28 hours per week to toll-free UC Hotline operations
  - 6:30 AM – 7:30 PM Monday through Friday and 8 AM – 4 PM on Saturday
- **Added Customer Support Unit**
  - Assists up to 1000 customers daily with specific UC concerns
- **Additional enhancements**
  - Internet applications
  - Automated phone system
  - Debit card

Federal & State Extensions

Emergency Unemployment Compensation (EUC)

- Adds additional federally-funded weeks of benefits
- Extended 6 times since July 2008
- Only Congress can extend program

Extended Benefits (EB)

- Adds up to 20 weeks of benefits for those who exhaust EUC
- EB period ended December 4, 2010 due to federal funding limitations

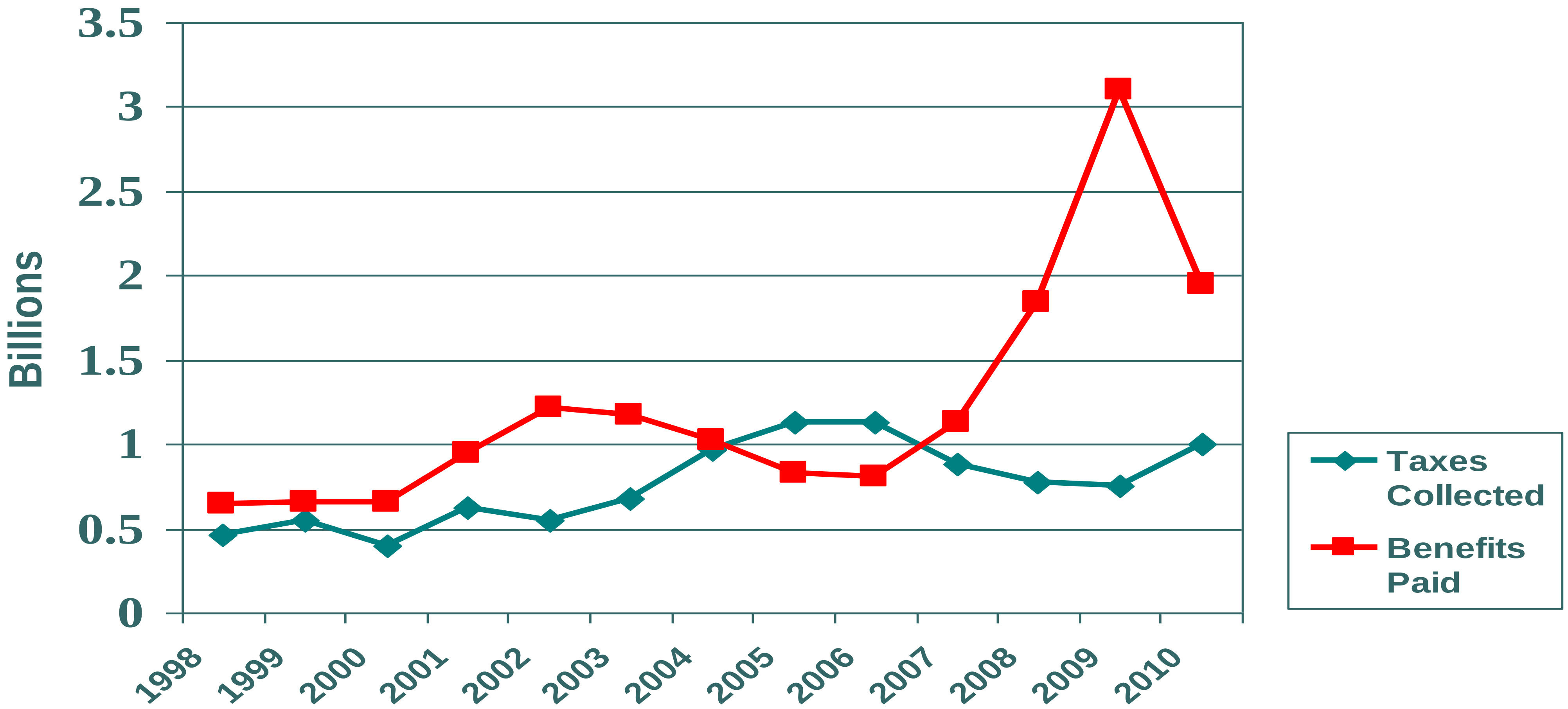
Federal Additional Compensation (FAC)

- Additional $25 weekly in Recovery Act-funded UC benefits
- FAC ends December 11, 2010

UC Trust Fund

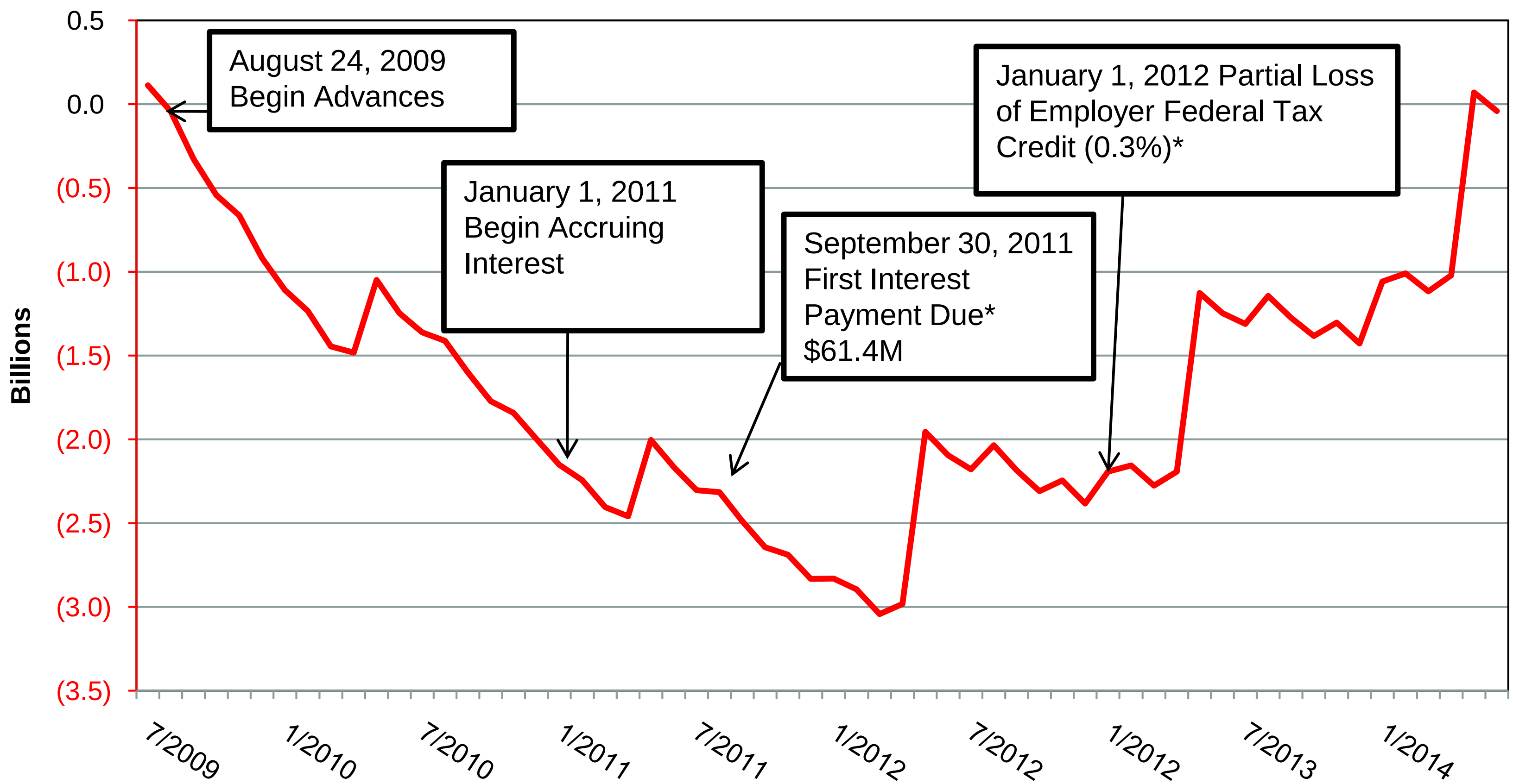
- **Florida UC Trust Fund Balance**
  - UC trust fund depleted
  - Began receiving advances from USDOL in August 2009
- **Total Florida Advances to Date**
  - $1.8 billion received from Federal Unemployment Account
- **National Picture**
  - 36 states have requested advances for total of $41.2 billion

UC Trust Fund



Through October 31, 2010, there were $1.953 billion in State Benefits Paid and $997.4 million in Taxes Collected.

UC Trust Fund Projections



Source: Office of Economic & Demographic Research
***Based on Federal Law**

UC System Replacement

- **To expedite claims processing/benefits payments**
  - Current system developed more than 30 years ago
  - $26.6 million federal funds appropriated in FY 2010-11 for design and implementation
  - Anticipated completion in 2013
  - $43.1 million annual projected savings

UC Debit Card

- UC customers receive payments faster with additional safety and security measures.
- Debit cards may be used at no cost to the customer at more than 1,800 ATMs statewide.
- Statewide implementation planned for January 2011.
- UC customers may continue to receive payments via EFT or paper check if they prefer.

Unemployment Compensation

Tom Clendenning, Assistant Director

850-245-7499

Unemployment Compensation Tax Rate

Senate Budget Subcommittee on Finance and Tax

December 7, 2010

FLORIDA DEPARTMENT OF REVENUE

Lisa Vickers

Executive Director

Department of Revenue

Unemployment Compensation

- The unemployment compensation program is a federal/state partnership based upon federal law.
  - administered by state employees under state law.
  - designed to provide a temporary partial wage replacement to those employees who lose their jobs through no fault of their own.
  - financed by separate state and federal payroll taxes.
  - states electing to administer unemployment compensation must follow certain federal requirements.

Unemployment Compensation

- The federal tax rate is 6.2% with a credit of 5.4% to employers in good standing if their state has a federally compliant unemployment tax program and carries no delinquent federal UT loans.
- This credit reduces the amount employers pay directly to the federal unemployment compensation trust fund to .8% of taxable payroll.
- The .8% is imposed on the first $7,000 of wages and equates to $56 per employee.

Unemployment Compensation

- The .8% that employers pay to the federal UC fund supports:
  - Unemployment compensation administrative expenses of the state
  - Federal share of extended benefits
  - Loans or advances to state trust funds
  - Benefits under supplemental/emergency programs

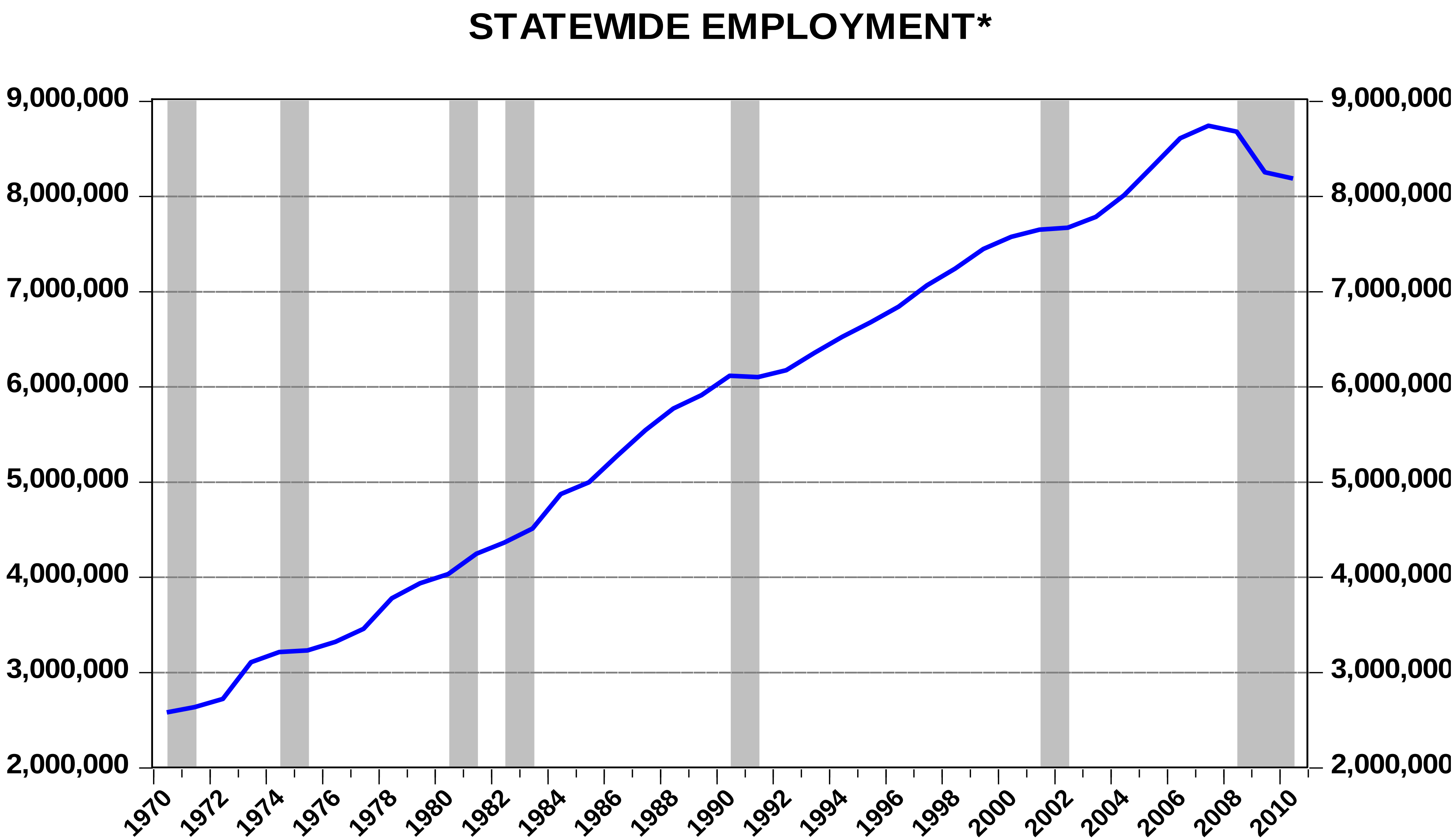
Unemployment Compensation

- The two types of employers are contributing and reimbursable.
  - Governmental entities, Non-profits and Indian Tribes can choose whether they are contributing or reimbursable.
- States take different approaches for taxing contributing employers.
- Florida imposes a system of four categories of rates:
  - <u>New business</u> or initial rate of 2.7% (first 10 quarters of payroll)
  - <u>Minimum</u> rate set each year through calculations imposed by statute
  - <u>Experience</u> or earned rates between the minimum and maximum rates set each year through calculations imposed by statute and dependent on the employer's actual benefit charge experience
  - <u>Maximum</u> rate of 5.4% (which also serves as the standard rate and the penalty rate)

Unemployment Compensation

- Initial rate employers will pay $189 per employee.
- Employers at the minimum rate will see an increase from $25.20 to $72.10 per employee.
- Employers already at the maximum tax rate will see no increase, but continue to pay $378 per employee.
- About 11.7% of employers will have a rate somewhere between the minimum and maximum rate based on their actual experience.

What's Happening in Florida?



*June

Note: Shaded areas represent recessions

Unemployment Compensation

- Florida has been facing high unemployment for the past three years.

	Unemployment rate
2007-08	4.9%
2008-09	8.4%
2009-10	11.6%
October 2010	11.9%

Recent Employer and Employee Changes

	FY 2007-08	FY 2008-09	FY 2009-10
# of Employers Filing UT Returns	506,597	491,684	472,812
# of Wage Items	9,019,682	8,421,665	7,764,093

Unemployment Compensation

- High unemployment and extended benefits have depleted the state’s unemployment tax reserves.
- The state resorted to borrowing funds from the federal government in 2010 to meet Florida’s benefit payment obligation.

Unemployment Tax Collections vs. State Benefits

Year	Unemployment Tax Collections	State Unemployment Benefits	Fund Balance
2005-06	$1.24 B	$750 M	$1.812 B
2006-07	$1.034 B	$1.1 B	$2.332 B
2007-08	$886 M	$1.5 B	$2.534 B
2008-09	$901 M	$2.5 B	$2.099 B
2009-10	$1.13 B	$2.7 B	$449 M
2010-11	$1.48 B	$2.1 B	$118 M

Federal Advances began August 2009

Cumulative Federal Advances - $1.86 B as of November 2010

Unemployment Compensation

- Last year the Legislature enacted a number of measures to prevent a large unemployment tax increase in 2010.
- The minimum rate for 2010 was scheduled to go from $8.40 to $100.30*.
- Through legislative efforts, the minimum rate in 2010 was $25.20.

Unemployment Compensation

- These measures included:
  - Suppressing the trust fund balance trigger
    - Delaying changes until 2012 to
      - The fund size trigger
      - Fund recoupment period
  - Delaying the wage base increase from $7,000 to $8,500 until 2012
  - Providing an installment payment option

Trust Fund Balances

	Trust Fund Balance	Trigger Status
June 2005	$1,812,803,500	Trigger On
June 2006	$2,332,069,916	Trigger Off
June 2007	$2,534,318,249	Trigger Off
June 2008	$2,099,552,017	Trigger Off
June 2009	$449,475,280	Trigger Disengaged
August 29, 2009	$0	
September 30, 2010	$118,941,270.18	Trigger Disengaged

Unemployment Compensation

- Last year the main driver of the rate increase was the insolvency of the trust fund engaging the fund size trigger provision, but even with the trigger suppressed again for 2011, other factors are continuing to drive rate increases.

Unemployment Compensation

- Excess Payments and Noncharge Benefits that are spread to employers through the Variable Adjustment Factor and the Constant (Final) Adjustment Factor.   These factors reassign obligation for
  - benefits paid to eligible claimants who worked for employers whose taxes were less than the benefits that were paid
  - and benefit payments which are nonchargeable to any employer's account.

Unemployment Compensation

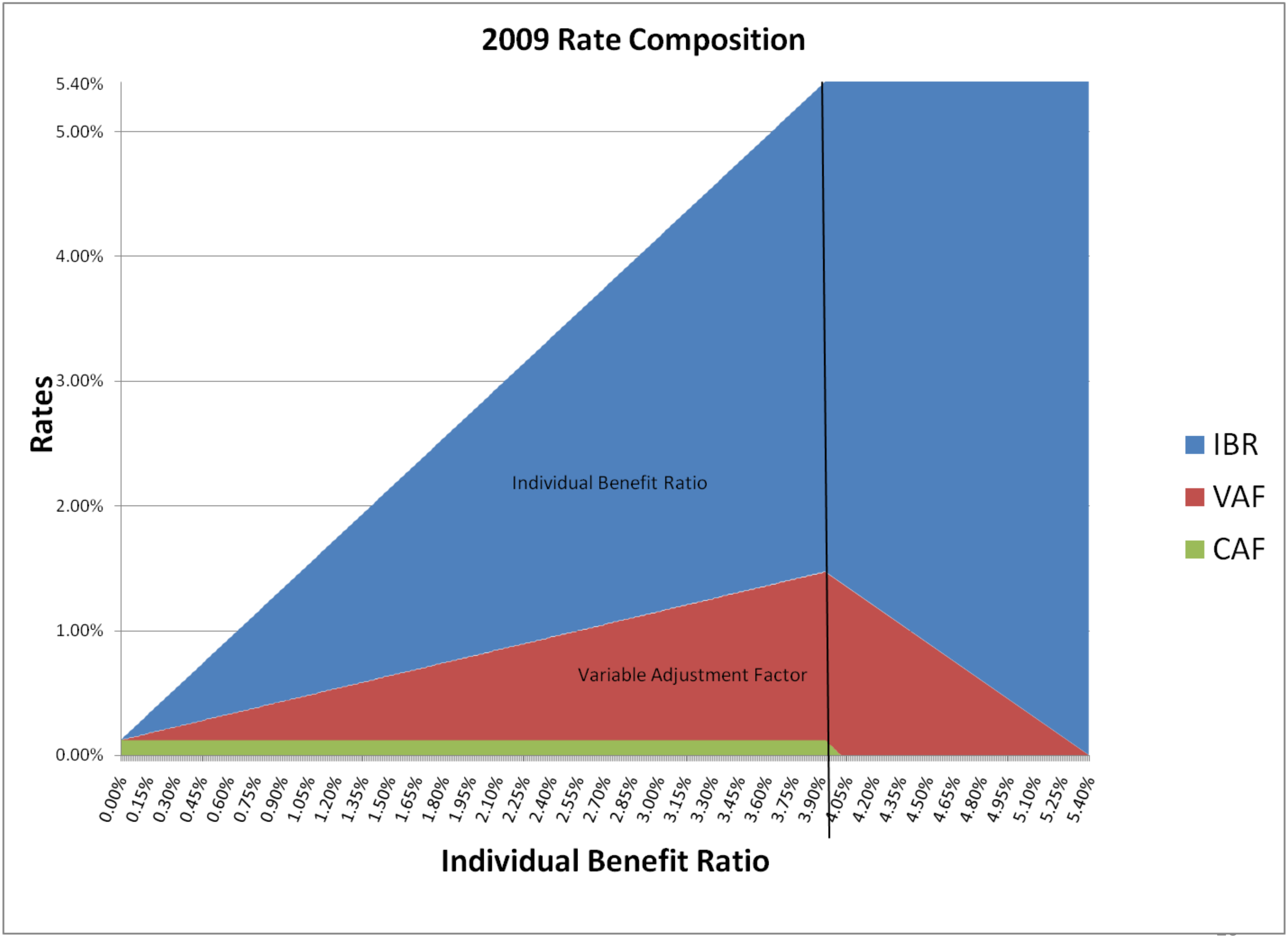
- This happens when:
  - Most employers paying at the 5.4% maximum incur more benefit charges against the trust fund than their tax rate will cover. This imbalance is known as Excess Payments.
  - Due to meeting certain statutory criteria, the benefit charge is not charged back to any employer. These are known as Noncharge Benefits.

Unemployment Compensation

- When economic conditions result in abnormally high unemployment accompanied by high benefit charges, there is a drain on the trust fund.
- The effect is an increase in these two adjustment factors, which in turn increases tax rates for employers whose own experience would otherwise allow them to have rates below the maximum rate.

Unemployment Compensation

- The Variable Adjustment Factor and the Constant Adjustment Factor have a greater impact on employers with better experience ratings.
- Employers whose own benefit experience already places them at the maximum tax rate are not impacted by these factors.


2009 Rate Composition
Rates
5.40%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
Individual Benefit Ratio
Variable Adjustment Factor
IBR
VAF
CAF
0.00%
0.15%
0.30%
0.45%
0.60%
0.75%
0.90%
1.05%
1.20%
1.35%
1.50%
1.65%
1.80%
1.95%
2.10%
2.25%
2.40%
2.55%
2.70%
2.85%
3.00%
3.15%
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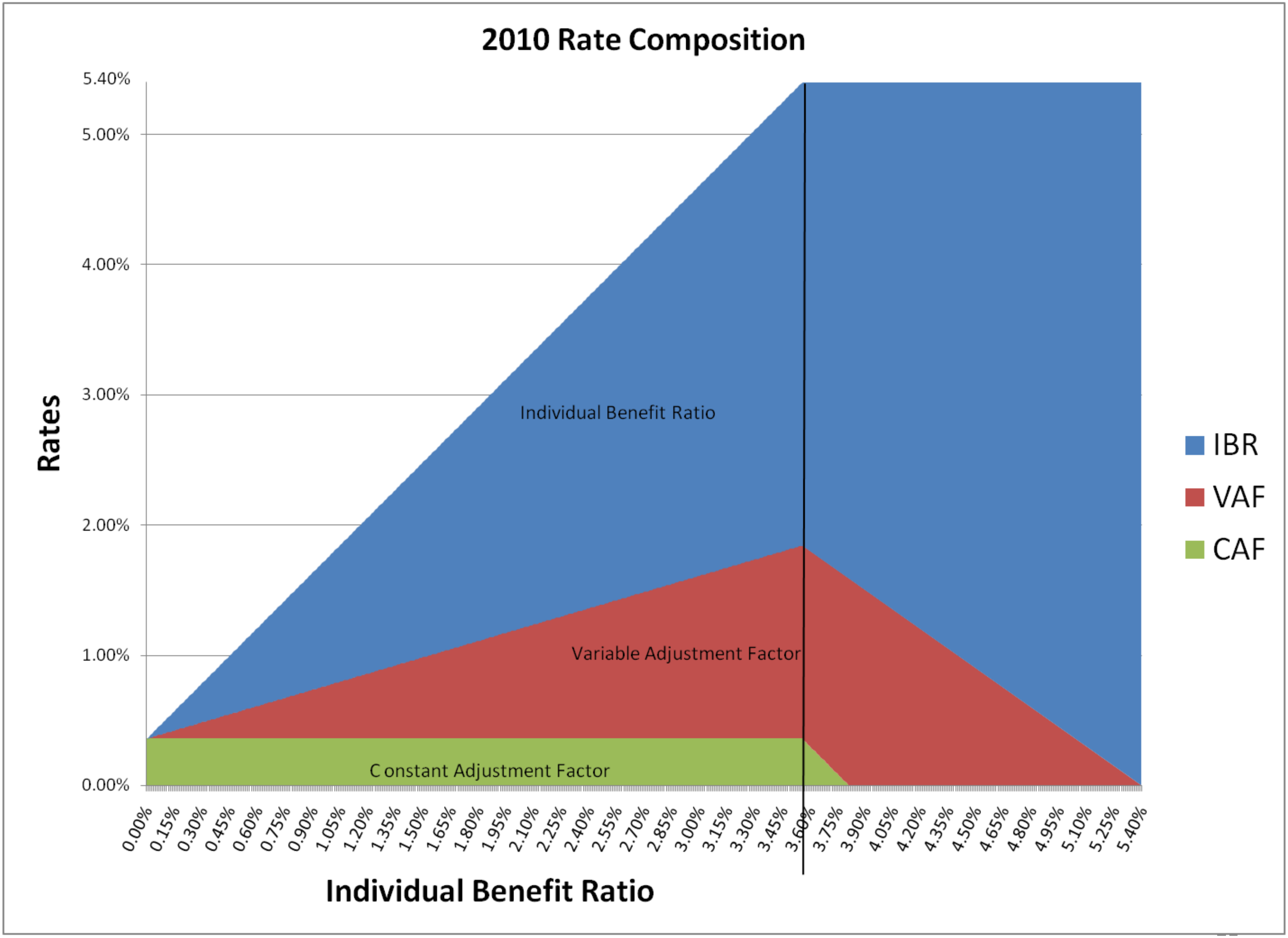
Individual Benefit Ratio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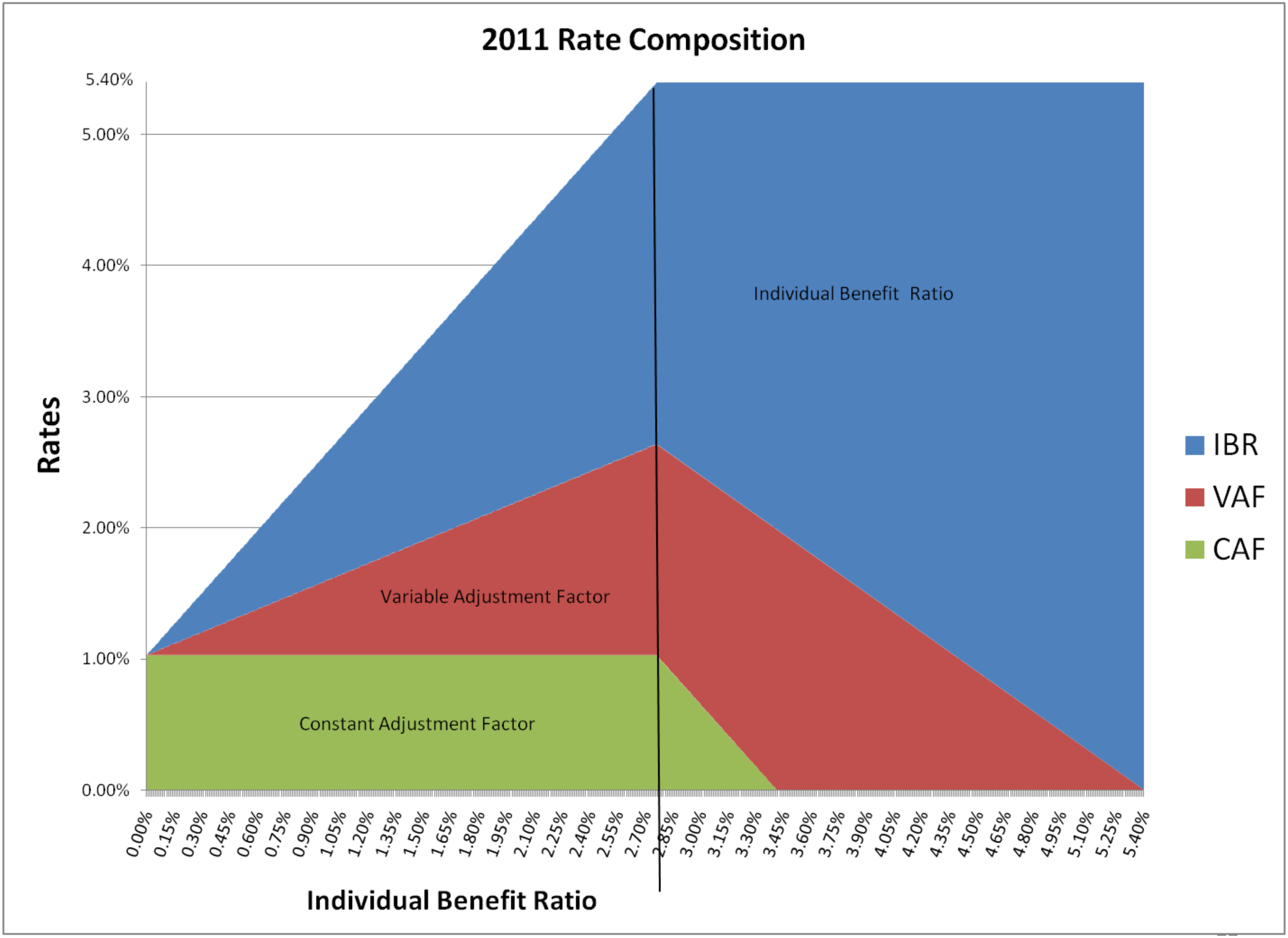
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Individual Benefit Ratio

Individual Benefit Ratio

- The portion of an employer's tax rate that is specific to the employer is called the Individual Benefit Ratio. It is derived by dividing the previous three years of benefit charges for that employer by the taxable payroll reported for the same three-year period by that employer.

Individual Benefit Ratio

- Individual Benefits Ratio (IBR) for Firm *i* -

$$IBR(i) = \frac{\sum_{t-14}^{t-2} ChargeableBenefits(i)}{\sum_{t-14}^{t-2} TaxableWages(i)}$$

Where t (time) = the first quarter of the year for which the rate is calculated. The t-2 to t-14 time frame represents 12 quarters of experience.

(i) is the set of employers eligible for experience based rates.

Variable Adjustment Factor

- The Variable Adjustment Factor is calculated by taking the last three years of benefits that were not attributable to any employer (Noncharge Benefits), payments that were made that cannot be recovered from employers due to the maximum tax rate (Excess Payments) and the Fund Size Factor (which for Florida is zero since the trigger is off) and spreading it across employers based on the employers Individual Benefit Ratio.
- This factor is only spread against employers who had benefit charges

Variable Adjustment Factor

Noncharge Benefit Factor

$$\frac{\sum_{t-14}^{t-2} NonchargeBenefits(i)}{\sum_{j=1}^{n}\sum_{t-14}^{t-2} TaxableWages(j)}$$

Excess Payment Factor

$$\frac{\sum_{i=1}^{n} Excess\,Payments(i)}{\sum_{j=1}^{n}\sum_{t-14}^{t-2} TaxableWages(j)}$$

Where Excess Payments=

$$\sum_{i=1}^{n}\left(\sum_{t-14}^{t-2} ChargeableBenefits(i) - \left(5.4\% \times \sum_{t-14}^{t-2} TaxableWages(i)\right)\right)$$

and (i) is the set of all employers eligible for an earned rate and (j) is the set of all employers eligible for an earned rate and whose Individual Benefit Ratio is less than 5.4%

Variable Adjustment Factor

- Fund Size Factor – application delayed until 2012
- Gross Benefit Ratio (GBR)

$$GBR = \frac{\sum_{i=1}^{n} \sum_{t-14}^{t-2} Benefits(i) - \sum_{i=1}^{n} \sum_{t-14}^{t-2} ExcessPayments(i)}{\sum_{i=1}^{n} \sum_{t-14}^{t-2} TaxableWages(i)}$$

where Excess Payments has the same calculation as in the Excess Payments Factor.

Variable Adjustment Factor

- Calculation of the Variable Adjustment Factor

$$VAF(i) = \boxed{\frac{NC + EP + FF}{GBR}} \times IBR(i)$$

This term is known as the "Multiplier"

Where:

NC= Noncharge Factor

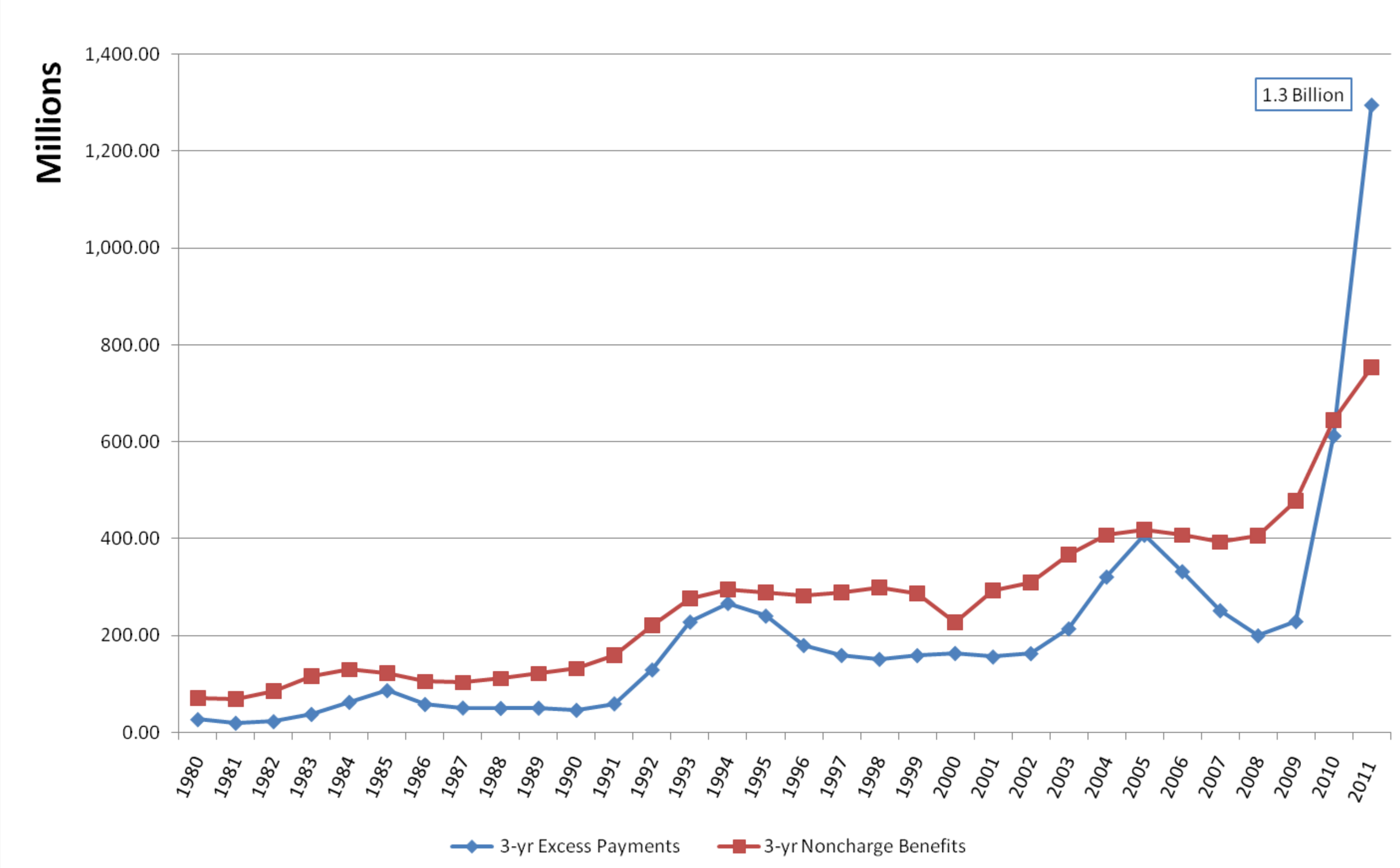
EP= Excess Payment Factor

FF = Fund Size Factor (does not apply until 2012)

And GBR = Gross Benefit Ratio

Historic Excess Payments and Noncharge Benefits

Shared Costs spread across employers through the Variable Adjustment Factor and the Constant Adjustment Factor



Constant Adjustment Factor

- After spreading the Noncharge Benefits and the Excess Payments across employers according to their Individual Benefit Ratio, any additional unassigned benefits are spread through the Constant Adjustment Factor across all employers except:
  - Initial Rate employers
  - Those employers at the maximum rate from either the Individual Benefit Ratio alone or the combination of the Individual Benefit Ratio and the Variable Adjustment Factor

Unemployment Compensation

Calculation of Constant Adjustment Factor

$$CAF = (NC + EP + FF) - \frac{\boxed{\sum_{j=1}^{n} \left(CAF(j) \times \sum_{t-14}^{t-2} TaxableWages(j) \right)}}{\sum_{i=1}^{n} \sum_{t-14}^{t-2} TaxableWages(i)}$$

This term is known as the "Sum of the Products"

Where:

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EP= Excess Payment Factor

FF = Fund Size Factor (does not apply until 2012)

and (i) is the set of all employers eligible for an earned rate and (j) is the set of all employers eligible for an earned rate and whose Individual Benefit Ratio is less than 5.4%

2011 UT Rates

- The Multiplier used in the variable adjustment factor for 2011 is .5833 compared to the Multiplier for 2010 of .4171
- The Constant Adjustment Factor for 2011 is .0103 compared to the factor for 2010 of .0036

2011 UT Rates

- If I am an employer with no benefit charges, I am not impacted by the Variable Adjustment Factor but will receive the full effect of the Constant Adjustment Factor in my final rate.
  - Individual Benefit Ratio: .0000
  - Variable Adjustment Factor: + .0000
  - Constant Adjustment Factor: + .0103
  - Tax Rate: .0103

2011 UT Rates

- If I am an employer with some benefit charges, I will receive the full effect of the two adjustment factors in my final rate if the combination of the three factors is less than the maximum tax rate.
  - Individual Benefit Ratio: .0266

    (IBR times Multiplier equals VAF: .0266 X .5833 = .0155)
  - Variable Adjustment Factor: + .0155
  - Constant Adjustment Factor: + .0103
  - Tax Rate: .0524

2011 UT Rates

- If I am an employer with more benefit charges, I will receive the effect of only some portion of the two adjustment factors in my final tax rate due to the maximum tax rate.
  - Individual Benefit Ratio: .0420

(IBR times Multiplier equals VAF: .0420 X .5833 = .0245; Max rate limits VAF to .0120)

  - Variable Adjustment Factor: + .0120
  - Constant Adjustment Factor: + .0000
  - Tax Rate: .0540

2011 UT Rates

- If I am an employer whose own benefit charges alone result in the maximum tax rate, these two factors will have no effect on my final rate and I do not contribute towards the shared costs.
  - Individual Benefit Ratio: .0730
  - Variable Adjustment Factor: + .0000
  - Constant Adjustment Factor: + .0000
  - Tax Rate: .0540

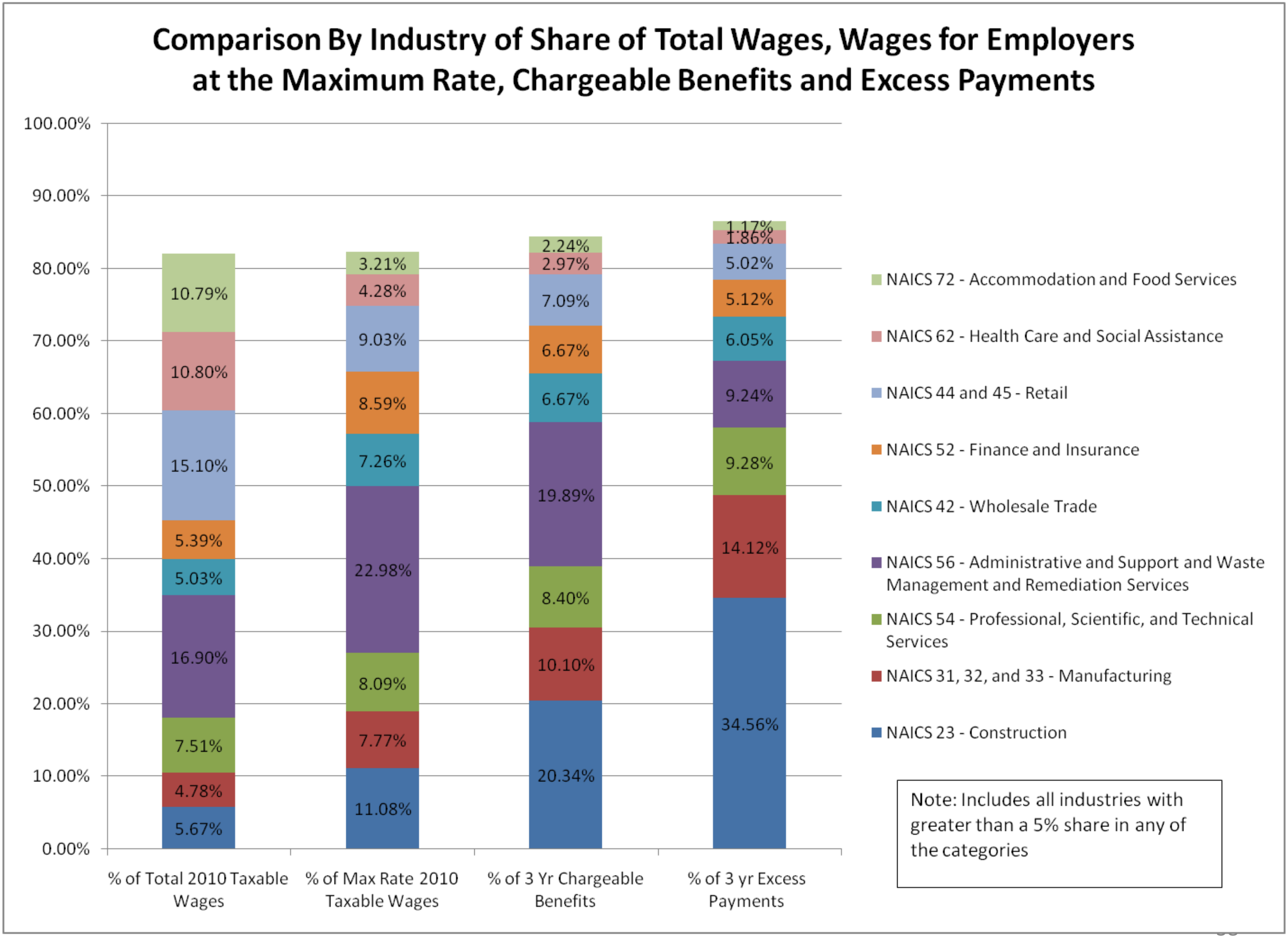
2011 UT Rates

	Employers	Taxes	IBR	VAF	CAF		ER Benefit Charges
Minimum rate employers (ER)	219,935	$45,635,636			$45,635,636		-$649,841
Employers above minimum and below maximum (ER)	54,281	$707,607,947	$291,948,023	$170,293,282	$245,366,642		$446,612,530
Maximum - IBR < 5.4% (ER)	26,760	$469,601,951	$335,267,254	$116,380,623	$17,954,074		512,826,048
Maximum - IBR >= 5.4% (ER)	51,681	$314,010,335	$314,010,335				$961,233,108
Penalty	9,296	$20,572,603					$25,920,564
STC (ER)	490	$53,378,833	$43,649,231	$8,804,777	$924,825		$80,552,587
Other	136	$1,881,720					$1,379,219
Unrated	101,958	$79,839,764					$17,930,197
Total - All Employers	464,537	$1,692,528,788	$984,874,843	$295,478,682	$309,881,177		$2,045,804,412
Total - All Employers at Maximum Rate	78,441	$783,672,634	$649,277,589	$116,380,623	$17,954,074		$1,474,059,028
Total - All Experience Rated Employers	353,147	$1,590,295,050	$984,874,843	$295,478,682	$309,881,177		$2,000,574,304

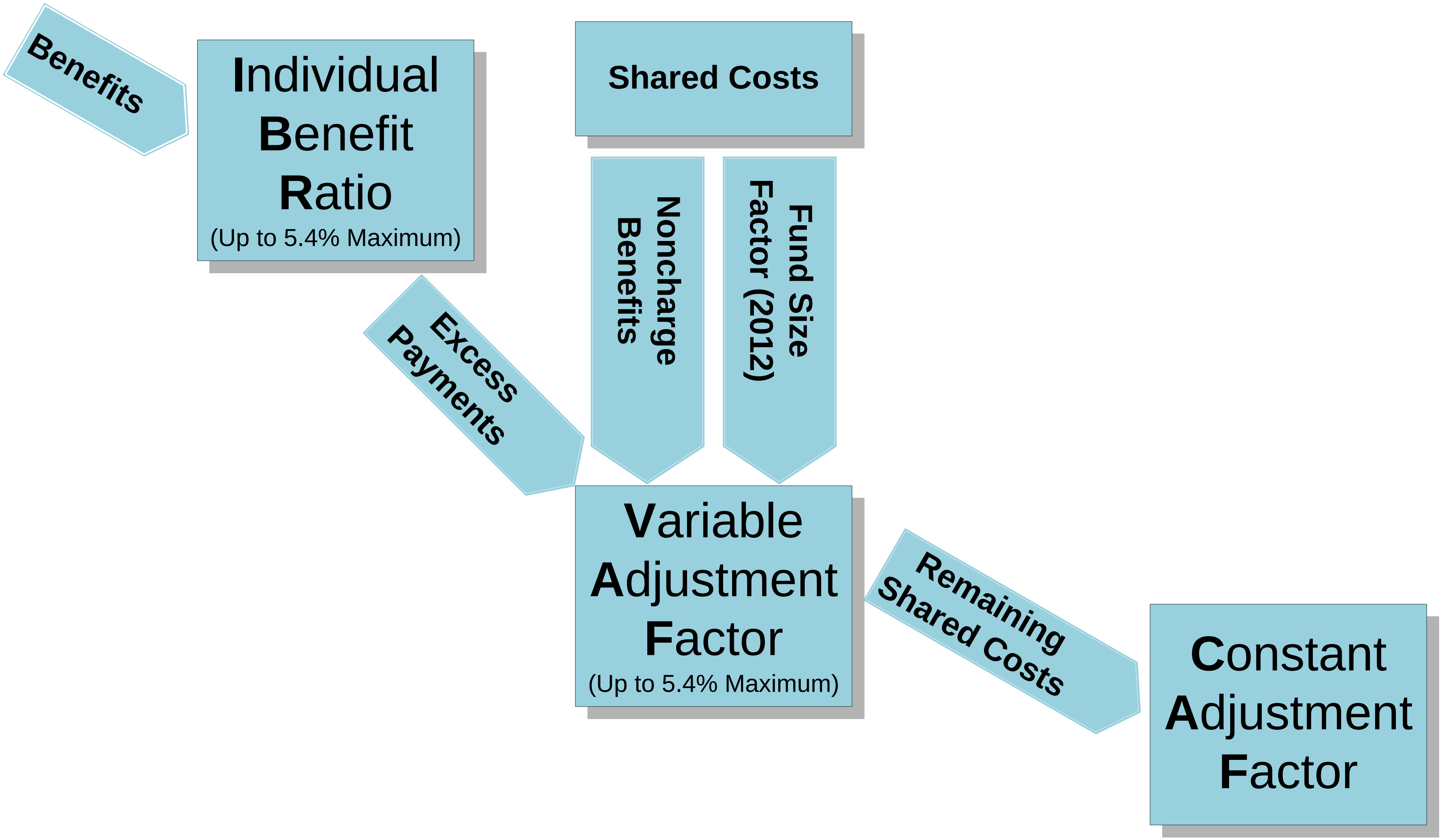
Note 1 : Taxes calculated using this year rate and last year wages

Note 2 - Additional analysis necessary to determine what amount of tax for Maximum rate employers are attributable to IBR, VAF, or CAF

Note 3: (ER) indicates Experience Rated Employers


Comparison By Industry of Share of Total Wages, Wages for Employers at the Maximum Rate, Chargeable Benefits and Excess Payments
100.00%
90.00%
80.00%
70.00%
60.00%
50.00%
40.00%
30.00%
20.00%
10.00%
0.00%
% of Total 2010 Taxable Wages
5.67%
4.78%
7.51%
16.90%
5.03%
5.39%
15.10%
10.80%
10.79%
% of Max Rate 2010 Taxable Wages
11.08%
7.77%
8.09%
22.98%
7.26%
8.59%
9.03%
4.28%
3.21%
% of 3 Yr Chargeable Benefits
20.34%
10.10%
8.40%
19.89%
6.67%
6.67%
7.09%
2.97%
2.24%
% of 3 yr Excess Payments
34.56%
14.12%
9.28%
9.24%
6.05%
5.12%
5.02%
1.86%
1.17%
NAICS 72 - Accommodation and Food Services
NAICS 62 - Health Care and Social Assistance
NAICS 44 and 45 - Retail
NAICS 52 - Finance and Insurance
NAICS 42 - Wholesale Trade
NAICS 56 - Administrative and Support and Waste Management and Remediation Services
NAICS 54 - Professional, Scientific, and Technical Services
NAICS 31, 32, and 33 - Manufacturing
NAICS 23 - Construction
Note: Includes all industries with greater than a 5% share in any of the categories

Experience Based Rate Setting Process
Florida Unemployment Tax



Additional Rate for Interest on Federal Advances

- In addition to the tax rates this year, Florida employers will also be subject to an additional rate which will be assessed to pay the interest that has accrued on the federal advances.

Additional Rate for Interest on Federal Advances

The rate is determined by dividing the estimated amount of interest by 95% of taxable wages for the previous fiscal year.

- Estimated Federal Interest Payment Due: $ 61,400,000
- One year taxable payroll ending 06/30/2010: $47,792,311,830

$61,400,000 interest / 95% ($47,792,311,830) = .0014 rate applied to each employer's one-year taxable payroll

- Estimated calculation at the employee level:

  $7,000 taxable wages X .0014 = $9.51 per employee

Repayment of Federal Advances

- If Florida does not pay back the federal loans as of November 2011, employers will be subject to a loss of .3 of their federal credit for each year the loans remain unpaid.
- This would result in the amount of federal tax due to increase from .8% to 1.1% of taxable payroll.

Unemployment Tax

- States can pay interest on federal loans for employers but not from the Unemployment Compensation Trust Fund
- Some states choose to spread more of the shared costs on the employers who are at the maximum rates by:
  - increasing taxable wages
  - Increasing maximum rates
- Some states use an array system that is designed to generate a specific amount of funding needed across groups of employers (South Carolina)
  - Eliminates Excess Payments by allowing for a floating maximum rate dependent upon the funding needs
  - Distributes funding burden fully on the basis of experience
- Other states require Employee contributions in addition to Employer contributions (Alaska, New Jersey, Pennsylvania)

Notifications to Employers

Timeline

December 14, 2010	Begin mailing Individual Tax Rate Notices
February 1, 2011	Mail Additional Rate Notice for Interest on Federal Advances
March 2011	Begin mailing Individual Tax Returns

Questions???

The Florida Senate

Issue Brief 2011-218 *October 2010*

Committee on Finance and Tax

TOBACCO SETTLEMENT AND NON-PARTICIPATING MANUFACTURERS ISSUE DESCRIPTION AND BACKGROUND

Statement of the Issue

In 1995 the State of Florida sued several tobacco companies, asserting claims for, among other things, expenses allegedly arising from tobacco-related matters and injunctive relief concerning sales of cigarettes to minors. In 1996 Florida and four other states[1] entered into a settlement agreement with the Liggett and Brooke Group.[2] In 1997 the State of Florida settled its lawsuit with the "Big Four" tobacco companies: Phillip Morris, Inc. R.J. Reynolds Tobacco Company, Brown and Williamson Tobacco Corp., and Lorillard Tobacco Company. These companies agreed to make annual payments to the state in perpetuity, adjusted annually for inflation. The amount of the annual payments was based on Florida's share (5.5 percent) of the total volume of U.S. cigarette sales at the time of the settlement, and the national market share of the settling manufacturers, which was calculated at 98.18 percent of U.S. volume in 1997.[3] (As provided by the settlement agreement, the annual payment is based on U.S. sales by the signatories to the agreement; not their sales in Florida.) The settlement also included a "most favored nation" provision, which provided the state with additional monies for a period of time if another state settled with the defendants on terms more favorable than Florida's. Cigarette manufacturers other than the "Big Four" were not named in the state's suit as defendants, or, in the case of Dosal Tobacco Corp., were subsequently dismissed from the lawsuit without prejudice.

In the years since the settlement agreement, the U.S. market share of the original participating cigarette manufacturers (OPMs) has fallen to 83.62 percent, significantly reducing Florida's annual settlement payments. At the same time, Florida's cigarette market has shifted toward non-participating manufacturers' (NPMs) cigarettes, which have a competitive price advantage over those whose manufacturers make tobacco settlement payments.

Discussion

In November 1998, the "Big Four" tobacco companies settled with 46 states, the District of Columbia, and five U.S. territories by entering into the Master Settlement Agreement (MSA). (The states of Mississippi, Minnesota, and Texas, like Florida, entered into individual settlements before the MSA.) Some but not all other cigarette manufacturers subsequently joined the MSA but have not settled with the State of Florida. These manufacturers are known as Subsequent Participating Manufacturers (SPMs). Manufacturers that have not joined the MSA or otherwise settled with a given state are known as Non-Participating Manufacturers (NPMs).

Treatment of Non-Participating Manufacturers in the Master Settlement Agreement

The Master Settlement Agreement between the "Big Four " tobacco companies and the states, and the individual settlements they made with Mississippi, Minnesota, Florida, and Texas, could have created significant competitive disadvantages for these companies compared to other cigarette manufacturers. Incentives were provided for small manufacturers to participate in the MSA—they were protected from lawsuits by the MSA states and early signatories' payments are based on the amount by which their market share exceeds their 1998

[1] West Virginia, Mississippi, Massachusetts, and Louisiana

[2] "The Liggett and Brooke Group" or "Liggett" refers collectively to Liggett Group, Inc., Brooke Group, Ltd., and Liggett & Myers, Inc.

[3] Revenue Estimating Conference "Tobacco settlements Payments Forecast," March 1, 2010

market share or 125 percent of their 1997 market share—and 58 manufacturers have subsequently joined the master settlement agreement. There are presently 51 active SPMs.[4] Unlike the states that joined the MSA, Florida never settled with any tobacco companies except the Big Four and Liggett. Florida does not receive a share of the payments made by the SPMs, even though the SPM payments are based on their total United States market share, including Florida sales.

Escrow Statutes and NPMs

To offset the competitive advantage that would otherwise inure to NPMs, and recognizing that all cigarettes impose health care costs on the states, the 46 MSA states enacted escrow statutes as prescribed by the MSA.[5] The statutes require each NPM to make payments of 53 cents per pack sold into an escrow account.[6] These accounts earn interest that is payable to the NPMs, and they can recover their payments if there is no state judgment against the manufacturers within 25 years of deposit. (Virginia and North Carolina have enacted legislation that allows NPMs to choose to release escrow money to the state.)

Liggett's Role in the Tobacco Settlement

On March 15, 1996, the states of Florida, West Virginia, Mississippi, Massachusetts, and Louisiana entered into a settlement (the "Initial Settlement") with Liggett and Brooke Group, pursuant to which Liggett agreed to make certain payments, comply with certain proposed regulations restricting the marketing and sale of cigarettes to minors and to offer certain cooperation in connection with the prosecution of such actions against other defendants, all according to the terms of the Initial Settlement.

On March 20th, 1997, eighteen states and Liggett and Brooke Group entered into a settlement (the "New Settlement"), pursuant to which Liggett agreed, among other things, to extend additional cooperation in connection with the prosecution of Attorneys General actions against other cigarette companies and the other states agreed to exercise their best efforts to ensure that the financial terms of any global settlement, legislative or otherwise, would be no more onerous on, or less favorable to, Liggett and Brooke Group than those set forth in any new agreement. The initial settling states and Liggett and Brooke Group decided to expand upon the Initial Settlement, through an Addendum to Settlement Agreement, to provide for additional cooperation by Liggett with the initial settling states and to provide Liggett with assurances that the initial settling states would seek to ensure that any global settlement provide for financial terms for Liggett that reflect appropriate recognition of Liggett's cooperative efforts.[7]

Because of these settlements, and the cooperation provided by Liggett in the states' subsequent negotiations and settlements with the "Big Four" cigarette companies, Liggett is not required to make payments under Florida's settlement with the "Big Four."

Florida's Tobacco Settlement and the Cigarette Market Today

According to the Department of Professional Regulation's Division of Alcoholic Beverages and Tobacco, there were 46 licensed cigarette manufacturers or importers doing business in Florida in FY 2009-2010.[8] There are four Settling Manufacturers—Liggett Group, Lorrilard Tobacco Company, Philip Morris, and RJ Reynolds Tobacco Company—whose shipments make up 78.6 percent of cigarette sales by volume. Of the non-settling manufacturers, 12 SPMs contribute 2.2 percent of total cigarette shipments while 30 NPMs make up 19.2 percent. One NPM—Dosal Tobacco Company of Miami, FL—accounts for 15.9 percent of Florida shipments, making it the 3rd-largest source of cigarettes manufactured in or shipped to Florida.

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[4] http://www.naag.org/backpages/naag/tobacco/msa/participating_manu/2010-07-27_PM_List.pdf/file_view

[5] http://www.naag.org/backpages/naag/tobacco/msa/exhbits/Exhibit%20T.pdf/file_view

[6] This is the 2009 payment year rate as adjusted for inflation, based on Exhibit C of the Master Settlement Agreement and information provided by Rob Wilkey, Senior Legal Counsel, Commonwealth Brands, Inc. on November 2, 2010.

[7] http://stic.neu.edu August 30, 2010.

[8] http://www.myfloridalicense.com/dbpr/abt/auditing/Wholesale/2010/June/documents/CigaretteShipmentstoFloridaforFY0910-JuneYearEnd.pdf

The 3 remaining "Big Four" cigarette manufacturers (OPMs)—Lorrilard Tobacco Company, Philip Morris, and RJ Reynolds Tobacco Company—that were parties to the 1997 settlement with the state make annual payments to the Tobacco Settlement Trust Fund. The FY 2009-10 payment was $355.1 million, and in that year these manufacturers shipped 679,525,553 packs of cigarettes into the state. The average payment per pack is 52.3 cents. The total amount of the payment for any year is based on, among other factors, the national sales volume of the settling manufacturers. As these manufacturers' market share decreases Florida's payment also falls.

Cigarette manufacturers (SPMs) that were not in the group of original signatories but subsequently joined the master settlement agreement (MSA) with the 46 states, the District of Columbia, and 5 territories also make annual payments to the MSA based on national sales, including sales in Florida and other non-MSA states. According to Commonwealth Brands, Inc., that company's MSA payment is approximately $5 per carton on all U.S. sales, including those in non-MSA states. These manufacturers do not make payments to Florida, and there is no provision in their settlement agreement for a credit for payments to Florida or other non-MSA states. These manufacturers are making payments to Minnesota and Mississippi[9] although they receive no credit for these payments against their MSA payments.

According to representatives of Commonwealth Brands, Inc., the SPMs have been negotiating with the MSA states over the issue of providing a credit for payments by these companies to previously settled states, including Florida. A conceptual agreement was reached in 2008 for an amendment to the MSA to allow these credits, but the agreement is not effective until all states execute an amendment to the MSA. A possible impediment to such an amendment is that 21 states and territories and the District of Columbia have securitized some of their MSA payments, and 8 of the states believe that the three bond rating agencies must confirm that their bonds would not be downgraded if they sign off on an amendment to provide credits. Two agencies—Fitch and Standard & Poor's—confirmed for one state (California) that such an amendment is not materially adverse to bondholder rights, but have not expressly approved an amendment to allow a credit for the previously settled states. Moody's has not concurred on the position with respect to California.

Many cigarette manufacturers have not joined the MSA or otherwise entered into settlements with the non-MSA states. These non-participating manufacturers (NPMs) are subject to escrow statutes (as described above) in the MSA states and must pay fees in lieu of settlement payments in Minnesota and Mississippi, but are not subject to any compensating fee in Florida (or Texas). These manufacturers are also exempt from marketing restrictions that are part of the settlement agreement.

Potential Revenue Impact of a Fee in Lieu of Settlement Payments

In 2004 bills were introduced in the Florida House of Representatives and Senate that would have imposed a fee of 2.5 cents per cigarette on each nonsettling manufacturer. SB 2112 was passed by the Senate (at a lower fee level) but its companion bill in the House, HB 405, was reported unfavorably by the House Committee on Business Regulation and the bill died. In 2009 the Senate Finance and Tax Committee held a workshop on the issue of NPM cigarettes but legislation was not introduced.

A fee that is imposed in lieu of settlement payments would provide additional revenue directly and indirectly. The direct revenue would come from fees collected from non-settling manufacturers for their Florida cigarette sales. The indirect revenue would come from higher settlement payments under the state's settlement agreement as the market share of the OPMs increased, because NPM cigarettes would no longer have such a large price advantage.

[9] Of the 4 states that are not signatories to the MSA—Florida, Mississippi, Minnesota, and Texas—Florida and Texas have not imposed a fee on the sale of cigarettes by NPMs. Minnesota imposed a fee of 1.75 cents per nonsettlement cigarette in 2003. Industry interests challenged this and other cigarette fees on various grounds. The Minnesota Supreme Court rejected these challenges, upholding the state's power to impose the fees, and the United States Supreme Court declined to hear the cases. In 2009 Mississippi imposed a 1.25 cent per cigarette fee on nonsettling-manufacturer cigarettes that are sold, purchased or otherwise distributed in the state, including those sold, purchased, or otherwise distributed for sale outside the state.

Whether or not to include SPM cigarettes will be an important question in any discussion considering fee legislation. SPM representatives explain that since they make payments to the MSA based on all their U.S. sales, including Florida sales, they do not have a competitive price advantage and would be unfairly penalized by an additional fee imposed on these sales. On the other hand, SPM settlement payments do not benefit Florida and their sales do cause Florida's settlement payments to be reduced to the extent they reduce sales by the settling manufacturers.

Potential Revenue from a Fee in Lieu of Settlement Payments (assuming no decrease in sales of non-settling cigarettes)			
	Fee per pack	NPM & SPM	NPM only
Mississippi rate	$0.25	$45,375,212	$39,233,536
Minnesota rate	$0.35	$63,525,297	$54,926,950
Escrow Statute Rate	$0.53	$96,195,450	$83,175,096
Effective OPM rate	$0.52	$94,641,753	$81,831,697

The actual revenue impact of a fee that is imposed in lieu of settlement payments would differ from the potential revenue because NPM cigarette sales will decrease due to the increase in their price. This loss would be offset to some extent by the additional settlement payments from the state's settlement agreement. The Revenue Estimating Conference would determine the magnitude of these offsetting effects in its analysis of any proposed fee.

Tobacco Settlement and Non-Participating Manufacturers

Issue Description and Background

The Issues: Disparate Treatment of Cigarette Manufacturers and Eroding Tobacco Settlement Payments

Florida receives annual settlement payments from 3 cigarette manufacturers that settled a lawsuit by the state in 1997.

- Other cigarette manufacturers do not make payments to the state. Because of this, some of these have a competitive advantage compared to the settling manufacturers.
- The increased U.S. market share of non-settling manufacturers has reduced Florida’s settlement payments by roughly 16 percent.

Who Are the Players?

- **Original Participating Manufacturers** (OPMs) or Big Four are tobacco companies that settled with Florida in 1997 and entered the Master Settlement Agreement (MSA) with 46 states in 1998.
- **Subsequent Participating Manufacturers** (SPMs) are 58 additional tobacco manufacturers that have since joined the MSA but do not make payments to Florida.
- **Non-Participating Manufacturers** (NPMs) have not joined the MSA and do not make payments to Florida.

Historic Context

- 1996 and 1997: Florida settled with Liggett and "Big Four" tobacco companies
  - Annual settlement payment from Big Four is $440 million, adjusted for total U.S. volume, U.S. market share of "Big Four" and inflation index
- 1998: Big Four tobacco companies (the OPMs) entered into the Master Settlement Agreement (MSA)
- Post-1998: 58 more cigarette manufacturers (the SPMs) have joined the MSA

More Context

- Credit Against Payments to Florida and Other non-MSA States
- Mandatory Escrow Statutes in MSA States
- Fees in Lieu of Settlement Payments

Disparate Treatment of Cigarette Manufacturers

	Payments to FL	Payments to MSA States	Credit for FL Payments
Original Participating Manufacturers	Yes, based on FL share of total US sales	Yes, based on total US sales, including FL	Yes
Subsequent Participating Manufacturers	No	Yes, based on total US sales, including FL	No
Non-Participating Manufacturers	No	Payments into escrow funds based on state sales	NA

Eroding Settlement Payments

- Falling sales and market share for the Big Four cigarette manufacturers have reduced payments under the Florida settlement.
- The market share of manufacturers that do not make payments to FL has increased from less than 2 percent in 1999-2000 to 16.4 percent in 2009-10.

Potential Revenue from a Fee in Lieu of Settlement

(assuming no decrease in sales of non-settling cigarettes)

	Fee per pack	NPM & SPM	NPM only
Mississippi rate	$0.25	$45,375,212	$39,233,536
Minnesota rate	$0.35	$63,525,297	$54,926,950
Escrow Statute Rate	$0.53	$96,195,450	$83,175,096
Effective OPM rate	$0.52	$94,641,753	$81,831,697

- Actual revenue would likely be smaller because an increase in price would cause consumers to reduce their purchases of NPM cigarettes.
- Settlement payments would increase slightly as smokers shifted their purchases to OPM cigarettes.