

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: SB 1580

SPONSOR: Senator Burt

SUBJECT: Tobacco Settlement Proceeds

DATE: April 3, 2001                      REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Matthews	Johnson	JU	Favorable
2.	_____	_____	FT	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**I. Summary:**

This bill requires the Comptroller, in consultation with the Attorney General and the Governor’s Office to verify ‘representations’ to be submitted by the tobacco industry upon which the industry is relying to calculate its annual tobacco-settlement payments pursuant to a 1997 settlement agreement between the State of Florida and major tobacco companies. As a check, the Auditor General must review the Comptroller’s verification of those representations.

This bill substantially amends the following section of the Florida Statutes: 569.21.

**II. Present Situation:**

In February, 1995, the State of Florida sued a number of tobacco manufacturers and other defendants, asserting various claims for monetary and injunctive relief on behalf of the state of Florida. In March, 1997, the State settled all of its claims against the Liggett Tobacco Company. In August, 1997, the “Big Four” tobacco companies: Phillip Morris, Reynolds Tobacco, B&W American Brands, and Lorillard<sup>1</sup>, entered into a landmark settlement with the State for all past, present and future claims by the State including reimbursement of Medicaid expenses, fraud, RICO and punitive damages. *See State v. American Tobacco Co. et al., Case # 95-1466AH, Palm Beach County.* These cigarette producers hold 93% of the tobacco market share in the U.S. The remaining 7% of the market share is held by various, smaller producers who were not named in the State’s suit as defendants and therefore, not a part of the settlement.

<sup>1</sup> U.S. Tobacco Company is also a signatory to the agreement but is only subject to the non-economic provisions.

Under the settlement agreement (as subsequently amended by a Stipulation of Amendment)<sup>2</sup>, there are non-monetary and monetary sanctions imposed on the tobacco manufacturers. The non-monetary provisions involve restrictions or limitations on billboard and transit advertisements, merchandise promotions, product placement, and lobbying, relating to all *tobacco products*.

Florida is to receive approximately \$11.3 billion over the next 25 years and an additional \$1.7 billion over the next 5 years as a result of a most favored nation clause in the settlement agreement as amended. The amounts of these tobacco settlement receipts (or payments) are based on a consideration of volume of U.S. *cigarette* sales, share of market, net operating profits (undefined in the agreement), consumer price indices, and other factors as to each year payment is made. Any adjustment to those payments are based on a formula set forth in an appendix to the settlement agreement and involve a ratio of volume of U.S. cigarette sales as existed in 1997 and volume of such sales in the applicable year. Apart from other first year payments, Florida is to receive 5.5 percent of the following unadjusted amounts, in perpetuity:

<b>Year</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Thereafter</b>
<b>Dollar Amount</b>	\$4.5 Billion	\$5 Billion	\$6.5 Billion	\$6.5 Billion	\$8 Billion	\$8 Billion

Statutory guidelines were established to govern the expenditure of the tobacco settlement proceeds. *See* ch. 98-63, L.O.F. As authorized by the Act, the Comptroller is responsible for the enforcement of the Tobacco Settlement Receipts (“payments”) from the depository institution to which the tobacco companies submit their payments in Electronic Fund Transfer form. Currently, tobacco payments are placed in the Lawton Chiles Endowment Fund, which was created by the Legislature in 1999. *See* ch. 99-167, L.O.F. Portions of the non-recurring moneys received pursuant to the settlement are required to be deposited into this fund, and monies are subsequently disbursed to tobacco funds in various departments depending on appropriations made by law. The State Board of Administration administers the funds and invests monies in the endowment in order to maximize the rate of return earned by the State.<sup>3</sup> Funds from the endowment became available for disbursement to state agencies after July 1, 2000.

Subsequent to Florida’s settlement, the major tobacco companies, Phillip Morris, Reynolds Tobacco, B & W American Brands, and Lorillard and other smaller tobacco producers settled with 46 states and 5 U.S. territories in November, 1998. This Master Settlement Agreement (MSA) provided states with funding to prevent smoking and control tobacco sales. The agreement required tobacco companies to take down all billboard advertising and advertising in sports arenas, to stop using cartoon characters to sell cigarettes and to make available to the public specified documentation. The tobacco companies also agreed to not market or promote their products to young people. The unadjusted cost of the state settlements ranges between \$212

<sup>2</sup>Florida negotiated a A Most Favored Nations clause in the settlement which provided the state with additional monies for a period of time after Minnesota settled with the defendants on terms more favorable than Florida’s.

<sup>3</sup>Section 215.5601, F.S.

billion to \$246 billion over the next 25 years, subject to numerous adjustments ranging from inflation to fluctuations in cigarette consumption and market share.<sup>4</sup> What the tobacco companies and the settling state governments cannot factor at this time is the estimated cost of dozens of individual suits and one certified class action which has been appealed (*Engle v. R.J. Reynolds, et. al.*, in Dade County, Florida).

In light of the uncertainty in the marketplace, the threat of bankruptcy and pending litigation which may impact the tobacco companies' obligations under the settlement agreements, some states have resorted to securitization of the tobacco settlement proceeds by issuing bonds through non-profit corporations. The Legislature established the Task Force on Tobacco-Settlement Revenue Protection to determine the need for and evaluate methods for protecting the state's settlement revenue from diminution or significant loss. See ch. 2000-128, L.O.F. The Task Force submitted its findings and recommendations in March, 2001. The Task Force found that Florida has received annual payments totaling \$2.4 billion since September, 1997. However, the annual payments have been subject to adjustments for inflation, changes in the volume of cigarette shipments and profitability of the tobacco companies. There has also been concern surrounding the tobacco companies' willingness and ability to continue to make payment based on declining payments which have already necessitated revenue adjustments.

The Task Force identified two major categories of uncertainty underlying these payments: 1) No payments due to bankruptcy or some other catastrophic financial event as may be caused by a huge judgment, and 2) Reduced payments owing to adjustments allowed under the settlement agreement. Florida's payments under the settlement agreement are based on its share of total national settlement payments, prorated among participating tobacco manufacturers. The Task Force recommended several options for protecting the tobacco settlement revenue<sup>5</sup>, including verification of underlying financial data from tobacco companies as the basis for calculating payment amounts.

As reported to the Task Force, Florida has no formal process for verifying that payments received are in accordance with the terms of the settlement agreement. However, according to the Attorney General, the settlement agreement originally contemplated verification of the annual payments through review of "publicly available and verifiable volume figures reported to federal authorities" (such as the comprehensive filings submitted to the Securities Exchange Commission or shipping records) within the context of Florida's public records law in existence at the time of the settlement agreement.<sup>6</sup> This process is allegedly the same method of verification adopted by the states of Mississippi, Texas, and Minnesota in their settlement agreements. The Attorney General adopted this process for verification as one that is

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<sup>4</sup>According to a report prepared by WEFA, Inc., an international econometric and consulting firm, on behalf of the Westchester Tobacco Asset Securitization Corporation, dated December 15, 1999, adult consumption of cigarettes declined 0.65% annually for the period 1965 to 1981, 3.31% for the period 1981 to 1990, and 2.47% for the period 1991 to 1998. According to these trends, consumption could decline from the roughly 539 million cigarettes consumed in 1990 to under 200 million cigarettes for the year 2040.

<sup>5</sup>The Task Force also recommended: 1) Constitutional amendment to limit expenditure of the principal from the Lawton Chiles Endowment Fund, 2) Licensing fee or equitable assessment on non-participating tobacco manufacturers, 3) Annual minimum deposit of payments into Fund, 4) Securitization, and 5) Insurance against default payments.

<sup>6</sup>February 27, 2001 Letter from Florida Attorney General to Auditor General.

economical, reliable, and redressible if accurate based on available federal and state actions for misrepresentations. Other than the Comptroller receives the annual payments for transfer and disbursement later, the Florida tobacco settlement agreement is otherwise silent as to whom is responsible for the submission, accounting, verification and updating of such tobacco settlement payment amounts.

### **III. Effect of Proposed Changes:**

The bill directs the Comptroller, in consultation with the Attorney General and the Governor's Office of Planning and Budgeting to verify the representations received from the tobacco industry underlying the tobacco settlement receipts. The Comptroller may contract with a service provider to verify the representations for purposes of accountability and resolution of any inconsistencies in the industry's representations. In turn, the Auditor General is directed to conduct annual review of the Comptroller's verification of the tobacco industry representations.

The bill also redesignates the Comptroller as Chief Financial Officer effective January 7, 2003, to conform with a recent constitutional amendment which changes the title of the position.

The act takes effect upon becoming law.

### **IV. Constitutional Issues:**

#### **A. Municipality/County Mandates Restrictions:**

None.

#### **B. Public Records/Open Meetings Issues:**

None.

#### **C. Trust Funds Restrictions:**

None.

### **V. Economic Impact and Fiscal Note:**

#### **A. Tax/Fee Issues:**

None.

#### **B. Private Sector Impact:**

None.

**C. Government Sector Impact:**

The bill will benefit the State of Florida to the extent that it ensures that the state receives tobacco settlement payments in accordance with the settlement agreement based on an accurate accounting.

It is indeterminate the extent of the fiscal impact the requirements of this bill will have on the offices of the Comptroller, Attorney General and Auditor General as they develop an accounting methodology for what will be a complex, substantial and time-intensive financial accounting.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

The bill does not define what is meant by verification although it implies an accounting. The bill does not require or address what accounting principles must be used, and what qualifications the private service provider must have to conduct the verification.

The term “representations” is not defined so as to give the tobacco companies or the Comptroller’s office notice as to what will constitute sufficient documentation or information for verification. No time frame is provided as to when such “representations” should be submitted or how long such verification must take. Tobacco companies are under no obligation to submit any documentation with the payment. A public records exemption is necessary if the tobacco companies oblige and provide confidential documentation which contain trade secrets, privileged market information or other proprietary information which might otherwise be subject to Florida’s public records law. *See* SB 1562 (provides an exemption from public records for information submitted by members of the tobacco industry for purposes of verifying calculation of annual tobacco-settlement payments).

**VIII. Amendments:**

None.