

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: CS/CS/SB 2214

SPONSOR: Finance and Taxation Committee and Judiciary Committee and Senator Burt

SUBJECT: Tobacco Settlement Agreements

DATE: April 24, 2001

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Matthews</u>	<u>Johnson</u>	<u>JU</u>	<u>Favorable/CS</u>
2.	<u>Johansen</u>	<u>Johansen</u>	<u>FT</u>	<u>Favorable/CS</u>
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

This bill imposes a supplemental permit fee on cigarettes produced by manufacturers in order to support the state's campaign to reduce tobacco product consumption and related health care costs and to correct economic market disparities among tobacco product manufacturers inadvertently created by the tobacco settlement agreements. Exemptions from the supplemental fee are provided to participating manufacturers who are defined as those tobacco product manufacturers: 1) who enter into an agreement with the state to assist the state in the reduction of tobacco use by making annual payments to the state and by complying with advertising restrictions, 2) who were signatories of the 1997 Tobacco Settlement Agreement and continue to comply with the economic and non-economic terms and conditions of that agreement, 3) who certify to the Attorney General specified information and sell specialty type of tobacco, and 4) who were dismissed from the 1997 Tobacco Settlement Agreement and certify specified information and action. It directs that funds received from the participating manufacturers be deposited in the Department of Banking and Finance Tobacco Settlement Clearing Trust Fund and that funds received from the assessments be deposited into the Lawton Chiles Endowment Fund. It also provides for an appropriation to The Lawton Chiles Endowment fund of the greater of \$40 million or 10% of payments made into the Tobacco Settlement Clearing Trust Fund.

This bill substantially amends the following sections of the Florida Statutes: 17.41, 20.435, 210.15, 210.20, 215.5601, and 215.5602.

II. Present Situation:

A. *Tobacco Settlement Background*

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, and U.S. Tobacco Company 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 approximately 94% of the tobacco market share in the U.S. The remaining 6% of the market share is held by various, smaller producers who were not named in the State’s suit as defendants and therefore, are not a part of the settlement.

Under the settlement agreement (as subsequently amended by a Stipulation of Amendment)¹, 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 \$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:

Year	1999	2000	2001	2002	2003	Thereafter
Dollar Amount	\$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.

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

¹Florida negotiated 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.

their products to young people. The unadjusted cost of the state settlements ranges between \$212 billion to \$246 billion over the next 25 years, subject to numerous adjustments ranging from inflation to fluctuations in cigarette consumption and market share.² 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 domestic sales of cigarettes by the participating tobacco manufacturers. The Task Force recommended several options for protecting the tobacco settlement revenue³ including the imposition of a licensing fee or equitable assessment on non-participating tobacco product manufacturers.

One of the continuing concerns has been the unintended consequences of the tobacco settlements whereby diversionary marketing events or other circumstances supplant domestic tobacco product sales or divert market share to nonsettling tobacco product manufacturers. For example, legislation was enacted last year to address the unlawful importation of "gray market" or diverted tobacco products in which sellers or other third parties obtain cigarettes for domestic sale at reduced prices via the international market. (See ch. 2000-251, L.O.F.) According to the Department of Legal Affairs, the first is Aexport label@product, which is manufactured domestically for export and is marked AU.S. Tax Exempt For Sale Outside the U.S.@The second type is Aforeign source@product, which is manufactured outside the United States for sale abroad

²According 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.

³The Task Force also recommended: 1) A constitutional amendment to limit expenditure of the principal from the Lawton Chiles Endowment Fund, 2) An annual minimum deposit of payments into Fund, 3) Securitization, and 4) Insurance against default payments, and 5) Verification of underlying financial data from tobacco companies as the basis for calculating payment amounts.

and may bear a variety of marks or legends that distinguish it from product made for the domestic market. Therefore, non-settling tobacco product manufacturers without the additional economic and non-economic responsibilities of settling tobacco product manufacturers have been able to expand their market share due to pricing advantages and non-restrictive advertising flexibility. As reported to the Task Force, these types of market events can and have impacted negatively on the states' settlement payment amounts.

B. Lawton Chiles Endowment Fund

The Lawton Chiles Endowment Fund was created by the Legislature in 1999. (*See* ch. 99-167, L.O.F.; s. 215.5601, F.S.) This fund provides a mechanism for generating a recurring revenue stream from the non-recurring portions of the settlement receipts. 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.⁴ The Lawton Chiles Endowment Fund serves as a clearing trust fund and is not subject to automatic 4-year termination by the Constitution as happens with other trust funds if not re-enacted. Funds from the endowment are disbursed to tobacco trust funds in various departments depending on legislative appropriations. Funds from the endowment first became available for disbursement to state agencies after July 1, 2000. The state agencies use these funds to enhance and support increases in clients served or in program costs for children's health care, child welfare, community-based health and human services, and biomedical research activities. The endowment principal can consist of all moneys received from the sale of the state's right, title and interest in the settlement agreement and amounts transferred from the Tobacco Settlement Clearing Trust Fund.

C. Tobacco Settlement Clearing Trust Fund

The Department of Banking and Finance Tobacco Settlement Clearing Trust Fund, also created in 1999, is credited with all the annual payments received by the state from the settlement. (*See* ch. 99-167, L.O.F., s. 17.41, F.S.) Funds are subsequently disbursed by a nonoperating transfer from the clearing trust fund to the tobacco settlement trust funds of the various agencies in amounts equal to the annual appropriations made from those trust funds in the General Appropriations Act. Additionally, the Department of Banking and Finance disburses funds from the clearing trust fund to the Lawton Chiles Endowment Fund in amounts specified by law. The current schedule of annual appropriations to the endowment does not provide for funding after the fiscal year 2003. In addition, any unencumbered balance in the various agency tobacco settlement trust funds at the end of any fiscal year and any encumbered balance remaining undisbursed on December 31 of the same calendar year reverts to the Lawton Chiles Endowment Fund.

D. Cigarette Tax Revenue

The Division of Alcoholic Beverages and Tobacco in the Department of Business and Professional Regulation oversees the collection of excise taxes from the sale of cigarettes and other tobacco products. Section 210.15, F.S., requires every person, firm or corporation desiring to deal in cigarettes in Florida as a distributing agent, wholesale dealer, or exporter to apply for a cigarette permit. A distributing agent is any person, firm, or corporation who receives cigarettes and distributes them to wholesalers or other distributing agents inside or outside the state. A

⁴Section 215.5601, F.S.

wholesale dealer is one who sells cigarettes to retail dealers for purposes of resale only, or who operates cigarette vending machines in more than one place of business. An exporter is a person who transports tax-exempt cigarettes into Florida under bond for delivery beyond state borders

Sections 210.02 and 210.04, F.S., provide that excise taxes be paid by the wholesale dealer upon the first sale or transaction within this state whether or not such sale or transfer is to the ultimate purchaser or consumer. Since wholesalers may purchase cigarettes from other wholesalers, only the first sale is taxed. Distributing agents, acting as agents to the manufacturers, are not required to pay taxes for the distribution of cigarettes to wholesalers. Collected tax is paid to the Division of Alcoholic Beverages and Tobacco. Stamps representing various denominations of tax are purchased in bulk by wholesale dealers and affixed to packages as proof of payment. Cigarettes that are not properly stamped may not be sold in Florida. The amount of the tax then becomes a part of the price of the cigarettes to be paid by the purchaser or consumer.

Section 210.15, F.S., describes the procedures required for application or renewal of a cigarette permit. Among the requirements are that annual wholesale dealer permits be renewed on or before July 1 and that fingerprints be submitted with an application. Section 210.151, F.S., provides that a temporary permit issued by the division is valid for 90 days while the division is conducting its background investigation. If the application is denied, there is no specific provision to terminate the temporary permit.

III. Effect of Proposed Changes:

The bill establishes a mechanism to make cigarette companies contribute on a fair basis to mitigate the harmful effects of cigarette smoking on citizens and for securing the long-term benefits of the Lawton Chiles Endowment.

Beginning July 1, 2002, a supplemental permit fee will be imposed on all cigarettes shipped into Florida by tobacco product manufacturers. The supplemental fee shall be 36 cents for each package of cigarettes delivered to wholesale dealers for sale in this. A tobacco product manufacturer's cigarettes may be exempted from this fee, provided the manufacturer or importer qualifies as a "participating manufacturer" under one of four classes of tobacco product manufacturers. The manufacturer or importer may qualify if it:

- 1) Was a signatory to the 1997 Florida tobacco settlement agreement and other specified tobacco settlement agreements so long as the manufacturer remains in compliance with the terms of the settlement agreements,
- 2) Enters into an agreement voluntarily with the Attorney General and agrees:
 - a. To phase out outdoor and transit advertising by the end of any existing contract term or at the end of 4 months from the date a list is submitted to the Attorney General regarding the location of existing advertisements,
 - b. To support legislative initiatives to curb sale of cigarettes to minors⁵,

⁵ Prior to the 1997 Florida Tobacco Settlement Agreement, the Florida Legislature enacted law in 1997 strengthening civil penalties for tobacco product sales to and possession of tobacco products by minors. *See* ch. 97-162, L.O.F.

- c. To refrain from cigarette promotion in motion pictures,
 - d. To cease marketing and licensing in Florida⁶
 - e. To make annual payments based on the number of cigarette packages delivered to Florida wholesale dealers for the previous calendar year at the rate of 36 cents per package,
- 3) Certifies to the Attorney General that it was not manufacturing or selling cigarettes in this state before January 1, 1994, that it was not engaging in outdoor or transit advertising, and that it will terminate its cigarette sales by January 1, 2008, undertakes to sell cigarettes that contain less toxin, and files a copy of its annual security exchange commission form with the Attorney General, or
 - 4) Was a dismissed party from the case of *The State of Florida et. al. v. American Tobacco Company, et. al.*, and certifies that it will comply with the noneconomic provisions of the 1997 Tobacco Settlement Agreement

Failure to remain in compliance with these provisions subjects the cigarettes of the participating manufacturer to the assessment of the supplemental permit fee for all the 12-month periods from inception of the fee. In addition, interest and a penalty equal to the amount of the fee will be assessed.

The bill provides that funds received from participating manufacturers will be deposited into the Department of Banking and Finance Tobacco Settlement Clearing Trust Fund. The unappropriated balance of the annual tobacco revenue stream is to be deposited in the Lawton Chiles Endowment Fund. The bill amends the schedule of annual appropriations to be made to the Lawton Chiles Endowment Fund from the Department of Banking and Finance Tobacco Settlement Clearing Trust Fund. The greater of \$40 million or 10% of the payment amounts must be deposited into the clearing trust fund for all fiscal years subsequent to the fiscal year 2002-2003.

The bill requires the division to certify monthly to the Comptroller, the amount derived from the supplemental permit fee and that amount must be transferred from the Cigarette Tax Collection Trust Fund and credited to the Department of Banking and Finance Tobacco Settlement Clearing Trust Fund.

This act takes effect upon becoming law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

⁶The restrictions under paragraphs a)-d) are patterned after the advertising restrictions in the 1997 Florida Tobacco Settlement Agreement.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

The bill raises constitutional concerns as follows:

- The regulatory measures may discriminate in purpose or in effect against cigarettes produced by certain manufacturers in violation of the Commerce Clause. *See Oregon Waste Systems, Inc. v. Department of Environmental Quality of Ore.*, 511 U.S. 93, 114 S.Ct. 1345, 128 L.Ed.2d 13 (1994)(discrimination in the contest of commerce means differential treatment such that in-state interests are benefited at the expense of burdening out-of-state interests). Under the Commerce Clause, Congress has the power to regulate commerce among the states. See art. I, s. 8, *U.S. Constitution*. Though phrased as a grant of regulatory power to Congress, the clause has long been understood to have a **A**negative@or **A**dormant@aspect that denies the states the power to unjustifiably discriminate against or burden the interstate flow of articles of commerce. *Id.* In its negative aspect, the Commerce Clause prohibits economic protectionism, that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors. *See Fulton Corp. v. Faulkner*, 516 U.S. 325, 116 S.Ct. 848, 133 L.Ed.2d 796 (1996); *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 110 S.Ct. 2238, 946 U.S. 18 (Fla. 1990).

Assuming the supplemental permit fee is nondiscriminatory, the standard for evaluating such regulations on commerce is whether the effects of the regulation on interstate commerce are only incidental and the burden imposed is not excess to the public benefit. *See Pike v. Bruce, Inc.* 397 U.S. 137, 142, 90 S.Ct. 844, 25 L.Ed. 2d 174 (1970).

- Equal protection issues may be also be implicated by the “supplemental permit fee” dependent on whether this fee is construed as an excise tax or license tax. It is the state’s inherent power to tax a specified class and to grant exemptions, if any. *See Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 509 (1937). However, the differential treatment of classes of persons or entities must be rationally related to furthering a legitimate state interest. *See Smith v. Florida Dept. of Revenue*, 512 So.2d 1008 (Fla. 1st DCA 1987). As noted earlier, the proposed supplemental permit fee is initially to be collected by all Florida wholesalers for cigarettes produced by manufacturers in- and out-of-state. There are, however, exemptions for cigarettes produced by tobacco manufacturers, the operative effect of which might be to benefit one Florida tobacco manufacturer over another because the manufacturer’s cigarettes would not be subject to the supplemental permit fee. The issue becomes whether the classifications under the supplemental permit fee scheme are reasonably related to the

state's interest in mitigating tobacco consumption and not arbitrarily or discriminatorily imposed.

- The advertising restrictions of this bill may also be construed as requiring an entity to waive its First Amendment right to commercial speech. Under current law, restrictions on commercial speech are analyzed under an intermediate scrutiny standard. The U.S. Supreme Court has offered a four-prong test to determine whether a restriction on commercial speech is violative of a commercial entity's First Amendment right of speech: 1) whether the activity constitutes lawful activity that is not misleading, 2) whether a substantial governmental interest is asserted, 3) whether the regulation directly advances the governmental interest, and 4) whether the regulation is more extensive than necessary to alleviate the real harm. *See Central Hudson Gas & Elec. Corp. v. Public Service Commission of New York*, 447 U.S. 557, 566, 100 S. Ct. 2343, 65 L.Ed. 2d 341 (1980). Under this bill, the cigarette manufacturers are not required to waive their right to advertise unless they seek relief from the assessment of the supplemental permit fee collected by the wholesale dealer on their cigarettes. In such case, they may voluntarily enter into an agreement with the state and comply with specified advertising restrictions. The appropriate scope of advertising restrictions is an issue⁷ that will be addressed by the U.S. Supreme Court in the 2001 term as the Court recently granted certiorari to hear a case involving a ban on tobacco product billboards placed near school grounds and playgrounds. *See Consolidated Cigar Corp, et al. v. Reilly* (1st Cir. Mass. 2000), cert. granted.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

The willingness of manufacturers to voluntarily enter into agreements with the state of Florida as contemplated by this bill is indeterminate. However, wholesalers selling the products of manufacturers which do not voluntarily enter into agreements will be required to collect and remit supplemental permit fees. Based on the assumption that 6 % of the Florida market is held by nonparticipating manufacturers, the combined voluntary payments and supplemental permit fees anticipated in this bill would total \$26.8 million in FY 2002-03 and \$26.7 million in FY 2003-04. These estimates do not take into consideration the exemptions created in s. 215.5601(d) & (e).

Section 215.5601(e) of this bill creates an exemption for any manufacturer which was a defendant in *The State of Florida et. al. v. American Tobacco Company, et. al.*, but was dismissed from that case and which is not a signatory to the August 25, 1997, settlement agreement. There were initially 18 manufacturer defendants in that case, all but four of which were dismissed prior to the August 25, 1997, settlement agreement. Cigarette manufacturers which potentially qualify for the exemption created by s. 215.5601(e) include the Liggett Group, the Brooke Group, Loews Corporation, Miami based Dosal Tobacco

⁷Other issues potentially involve whether advertising regulation of tobacco has been pre-empted by federal law such as the Federal Cigarette Labeling and Advertising Act (FCLAA). The expressed Congressional intent of the Act is to establish a comprehensive Federal Program to deal with cigarette labeling and advertising with respect to any relationship between smoking and health. *See* 15 U.S.C. ss.1331-1341).

Corporation, and European based British American Tobacco Corporation, which is reportedly larger than Philip Morris in terms of the world tobacco market.

The Florida settlement agreement contains no prohibition on the sale of a brand from one manufacturer to another. Therefore, a manufacturer exempted by the provisions of s. 215.5601(e), F.S., could acquire a popular brand from a non-exempt manufacturer and in so doing bestow the exemption on that brand. This is true even if the brand was previously owned by one of the original settling manufacturers.

The exemptions contained in s. 215.5601(d) and (e), F.S., are expected to significantly reduce the number of manufacturers expected to make voluntary payments or required to pay the supplemental permit fee.

B. Private Sector Impact:

The impact is indeterminate. The bill imposes a supplemental permit fee that will apply to cigarettes shipped into Florida by manufacturers other than those able to claim the fee exemption as a participating manufacturer. As a result, manufacturers other than those currently paying the state pursuant to the settlement agreement will either pay as a participating manufacturer or pay the supplemental fee, except for manufacturers which become participating manufacturers under the provisions of s. 215.5601(d) or (e), F.S.

C. Government Sector Impact:

The fiscal impact of this bill is indeterminate. The bill, however, would be expected to result in the collection of additional revenues.

VI. Technical Deficiencies:

VII. Related Issues:

None.

VIII. Amendments:

None.