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**HOUSE OF REPRESENTATIVES
COMMITTEE ON
BUSINESS REGULATION
ANALYSIS**

BILL #: HB 1459
RELATING TO: The Florida Cigarette Anti-Conduit Act
SPONSOR(S): Representative(s) Henriquez and Others

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:

- (1) BUSINESS REGULATION
 - (2) FISCAL POLICY & RESOURCES
 - (3) COUNCIL FOR SMARTER GOVERNMENT
 - (4)
 - (5)
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I. SUMMARY:

THIS DOCUMENT IS NOT INTENDED TO BE USED FOR THE PURPOSE OF CONSTRUING STATUTES, OR TO BE CONSTRUED AS AFFECTING, DEFINING, LIMITING, CONTROLLING, SPECIFYING, CLARIFYING, OR MODIFYING ANY LEGISLATION OR STATUTE.

In August 1997, the State of Florida entered into a settlement agreement with the four leading U. S. cigarette manufacturers. Thereafter, three states entered into individual settlements and the 46 remaining states, that did not have individual settlement agreements, entered into a Master Settlement Agreement with the cigarette manufacturers. Under terms of the Master Settlement Agreement, any cigarette manufacturer that is not a party to the agreement must make annual payments into an escrow account in each of the participating states where their product is sold. The terms of Florida's settlement require cigarette manufacturers to make annual payments to the state that are based, in part, on the manufacturers national market share of product sold.

This bill creates the Cigarette Anti-Conduit Act and prohibits Florida cigarette wholesalers from shipping or selling cigarettes from manufacturers that have not made all escrow payments required by the Master Settlement Agreement.

The bill implements reporting and audit requirements and imposes penalties for violations.

The fiscal impact of this legislation is indeterminate.

The bill requires that the Act will take effect upon becoming a law.

SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | |
|-----------------------------------|------------------------------|--|---|
| 1. <u>Less Government</u> | Yes <input type="checkbox"/> | No <input checked="" type="checkbox"/> | N/A <input type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input type="checkbox"/> | No <input checked="" type="checkbox"/> | N/A <input type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

The bill establishes new reporting and audit requirements and establishes prohibitions and penalties for violations for cigarette manufacturers and wholesalers.

B. PRESENT SITUATION:

Chapters 210, 386 and 569, Florida Statutes, provide the regulatory and tax structure for Florida's tobacco laws. Part I of chapter 210 addresses cigarettes and Part II addresses other tobacco products [OTP]. Chapter 386 provides the guidelines for Florida's Clean Indoor Air Act and chapter 569 requires licensing of persons selling tobacco products at retail and the enforcement and penalty provisions for violations. The Division of Alcoholic Beverages and Tobacco [division] within the Department of Business and Professional Regulation is charged with enforcing the tobacco laws of the state.

Section 210.15, F.S., requires every person or business desiring to deal in cigarettes to obtain a cigarette permit. Wholesalers with potential tax liabilities are required to post a surety bond in an amount acceptable to the division. At the present time, there are over 29,000 cigarette and OTP retail dealers in the state and over 800 cigarette and other tobacco products [OTP] wholesalers. Cigarette and OTP importers are licensed as wholesaler dealers if they offer their product for sale in Florida.

Distributing agents receive cigarettes in interstate or intrastate commerce and typically warehouse the product while awaiting distribution instructions from the manufacturer. Exporters receive or transport tax-exempt cigarettes for delivery beyond the borders of the state and store the product in bonded warehouses prior to shipment into foreign commerce.

Cigarettes and OTP, with the exception of cigars, are subject to a state excise tax. Taxes are required to be paid by the wholesaler dealer at the time of first sale within the state. According to the division, in FY 2000-01, state excise taxes on cigarettes generated \$418,806,304 in revenue and the excise tax on OTP generated \$23,528,834.

Tobacco Settlement

In February 1995, the State of Florida sued a number of tobacco manufacturers asserting various claims for monetary and injunctive relief on behalf of the state of Florida. In March 1997, the State

settled¹ all of its claims against the Liggett Tobacco Company. In August 1997, the “Big Four” tobacco companies [Phillip Morris, R.J. Reynolds, Brown and Williamson, and Lorillard] 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.² At the time of this settlement, these cigarette producers held 93% of the tobacco market share in the U. S. The remaining 7% market share was held by various smaller producers who were not named in the State’s suit as defendants and, therefore, were not part of the settlement agreement.

Under the terms of the settlement agreement, as subsequently amended by a Stipulation Amendment, 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.

With regard to the monetary settlement, Florida is scheduled to receive approximately \$11.3 billion over the 25-year term of agreement and an additional \$1.7 billion over a 5-year period as a result of a most favored nation clause in the settlement agreement, as amended.³ Apart from other first year payments, Florida is also scheduled to receive 5.5% of established amounts in perpetuity: in 1999 - \$4.5 billion; in 2000 - \$5 billion; 2001 - \$6.5 billion; in 2002 - \$6.5 billion; in 2003 - \$8 billion; and, \$8 billion per year thereafter.

The amount of the tobacco settlement payments is based on a consideration of volume of U. S. cigarette sales, share of market, net operating profits, consumer price indices, and other factors as to each year payment is made. Any adjustment to those payments is based on a formula set forth in an appendix to the settlement agreement and involves a ratio of volume of U. S. cigarette sales as existed in 1997 and volume of sales in the applicable year. If the market share of these manufacturers declines, their payments to Florida under the settlement agreement will, likewise, decline.

Subsequent to Florida’s settlement, the major tobacco companies, Phillip Morris, R. J. Reynolds, Brown and Williamson, and Lorillard and some other smaller tobacco producers⁴ settled with 46 states and five U. S. territories [November 1998]. This Master Settlement Agreement [MSA] provided over \$200 billion to the participating states over a 25-year period and contained terms similar to those of the Florida agreement which tie their payments, in part, to the company’s market share sales.

Terms of the MSA require each participating state to enact legislation that ensures the participating manufacturers are not placed at a competitive disadvantage due to their participation in the MSA with regard to the nonparticipating manufacturers.⁵ The model legislation, attached as Exhibit T of the MSA, reads, in part:

¹ See State v. American Tobacco Co., et al., Case 95-1466AH, Palm Beach County. [U.S. Tobacco Company is also a signatory to the agreement but is only subject to the non-economic provisions of the settlement agreement.]

² The states of Texas, Minnesota and Mississippi also entered into individual settlement agreements.

³ Florida negotiated a “Most Favored Nations” clause in the settlement that provided the state with additional monies for a period of time after Minnesota settled with the defendants on terms more favorable than Florida’s.

⁴ Approximately 30 to 35 of the smaller manufacturers are now participating in the MSA.

⁵ Section IX (d)(E) of MSA reads in part: “A ‘qualifying Statute’ means a Settling State’s statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis -à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement.”

“(f) It would be contrary to the policy of the State if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise without ensuring that the State will have an eventual source of recovery from them if they are proven to have acted culpably. It is thus in the interest of the State to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment proof before liability may arise.”

To that end, the model legislation requires nonparticipating manufacturers [NPM] to pay funds into an escrow account in an amount equal to the NPM's allocable share of the payments that the manufacturer would have been required to pay in a specific year under the MSA, adjusted for inflation. The principal from these funds is held in escrow for a period of 25-years, after which it is released from escrow and returned to the manufacturer if no liability has been attributed to that manufacturer.

It is generally understood that each state participating in the MSA has enacted the model legislation, established the necessary escrow accounts, and require escrow payments by NPM. Efforts to verify this information were unsuccessful.

According to industry statistics, prior to 1996 there were 28 smaller cigarette manufacturers in existence in the United States; there are presently over 100 smaller companies. In addition there are numerous foreign manufacturers that either routinely or occasionally ship cigarettes into the United States. Some industry statistics indicate that the smaller cigarette manufacturers have increased their market share of cigarette sales to as much as 21% of total sales. The increase in market share may be attributed, in part, to the increased cost of products sold by MSA participating manufacturers.

C. EFFECT OF PROPOSED CHANGES:

The State of Florida entered into a settlement with the four leading U. S. cigarette manufacturers in August 1997. Thereafter, 46 other states entered into a Master Settlement Agreement [MSA] with the major cigarette manufacturers. Under terms of the MSA, any cigarette manufacturer that has not joined the MSA must make annual payments based on a formula established in the MSA into an escrow account in each of the MSA states where their product is sold.

This bill creates “The Cigarette Anti-Conduit Act.”

This bill establishes new reporting requirements for cigarette manufacturers and wholesalers in an attempt to prevent the sale or pass-through of tobacco products that are produced by manufacturers who are not participating in the Master Settlement Agreement [MSA] nor contributing into the escrow funds required by the MSA in the states which are a party to the agreement.

Before their products can be sold in Florida, the bill requires non-participating manufacturers to provide to the Division of Alcoholic Beverages and Tobacco of the Department of Business and Professional Regulation, a certification, under penalty of perjury, that the manufacturer has made all escrow payments required by each MSA state in the preceding year and that the manufacturer will continue to make all such required payments for the year in which the certification is provided. The

bill tracks language in the MSA in establishing a formula to determine if the non-participating manufacturer has made the requisite escrow payments.⁶

Manufacturers must submit quarterly reports to the division of all shipments of cigarettes, by brand family and quantity, during the preceding calendar year.

When the division has determined that the manufacturer has made a true and correct certification, the Division is required to compile, from information submitted by the manufacturer, a list of the brand families the manufacturer wishes to sell in Florida. The Division is then required to transmit the list of all cigarettes approved [both from MSA participating and non-participating manufacturers] for shipment and sale in the state to all permitholders and post the list on the division's website.

The bill makes it unlawful for a cigarette wholesale dealer or exporter or distributor of other tobacco products to ship, sell, or possess for sale or resale any brand of cigarettes not included on the approved list of products issued by the division. The division and the Attorney General are authorized to audit, or engage others to audit, the information supplied by nonparticipating manufacturers and the division is authorized to audit the information supplied by licensed permitholders.

The bill authorizes the Division to impose graduated penalties on permitholders, including license suspension or revocation, for selling brand families that are not on the approved product list and for failing to submit the quarterly reports of all shipments of cigarettes.

To capture imported products, a nonparticipating manufacturer is deemed to be the manufacturer of all cigarettes to which it is the first purchaser, for resale in the United States, of cigarettes manufactured for sale outside of the United States.

The bill authorizes the Attorney General to seek injunctions to require permitholders to comply with the statute and to bring an action against a nonparticipating manufacturer for filing a false certification. This section permits the court to award permanent injunctions prohibiting the nonparticipating manufacturer from selling cigarettes to permitholders and consumers in Florida for up to two years. The bill also enables a nonparticipating manufacturer to seek review of an adverse determination by the division in the appellate court.

D. SECTION-BY-SECTION ANALYSIS:

Section 1. Creates a new Part III, chapter 210, consisting of ss. 210.81, 210.82, 210.83, 210.84, 210.85, 210.86, 210.87, 210.88, 210.89, 210.90, 210.91, and 210.92.

Section 210.81, F.S., designates Part III as "The Cigarette Anti-Conduit Act."

Section 210.82, F.S., articulates the findings and purposes of the act.

Section 210.83, F.S., establishes definitions for common terms used within Part III.

Section 210.84, F.S., specifies that it is unlawful for a cigarette wholesale dealer or exporter or distributor of other tobacco products to ship, sell, or possess for sale or resale any brand of cigarettes not included on an approved list of products issued by the division.

⁶ The escrow payment that must be made by each nonparticipating manufacturer is 0.94 cents per cigarette sold in each state in 1999, increasing to 1.88 cents per cigarette sold in each state by the year 2007.

Section 210.85, F.S., requires the division to compile, transmit to permitholders and post on the division's website a list of cigarettes approved for shipment and sale in the state.

Section 210.86, F.S., requires the list to include the brand families of participating manufacturers and the brand families of non-participating manufacturers that the division has determined to have made a true and correct certification. This section also specifies that a nonparticipating manufacturer is deemed to be the manufacturer of all cigarettes to which it is the first purchaser anywhere for resale in the United States of cigarettes manufactured for sale outside of the United States.

Section 210.87, F.S., requires each non-participating manufacturer that wishes its brand families to be included on the approved list to provide the division a certification, under penalty of perjury, that the manufacturer has made all escrow payments required by each Master Settlement Agreement [MSA] state in the preceding year and that the manufacturer will make all such required payments for the year in which the certification is provided. The non-participating manufacturer is required to submit such information as the division determines is necessary to ensure the certification is true and correct.

In addition, this section specifies that a nonparticipating manufacturer will be determined to have made a true and correct certification if the division determines that the nonparticipating manufacturer's total amount of escrow payments in all MSA states in the preceding year is equal to the product of:

- The per-unit amount specified in the MSA states' escrow payment statutes; and
- The number of the nonparticipating manufacturer's cigarettes sold to consumers within all MSA states for such year.

For purposes of this section, the bill provides that references to cigarettes sold to consumers within a state include cigarettes whether sold by the manufacturer directly or by a distributor, retailer or other intermediary.

The division is required to promptly notify the Attorney General and the nonparticipating manufacturer of any determination under this section.

Section 210.88, F.S., requires quarterly reports from permitholders to the division of all shipments of cigarettes, by brand family and quantity, during the preceding calendar year.

Section 210.89, F.S., authorizes the division to impose graduated penalties on permitholders, including license suspension or revocation, for selling brand families in violation of s. 210.84 and for failing to submit the reports required by s. 210.88.

Moreover, this section authorizes the Attorney General to seek injunctions to require permitholders to comply with the statute and to bring an action against a nonparticipating manufacturer for filing a false certification. This section permits the court to award permanent injunctions prohibiting the nonparticipating manufacturer from selling cigarettes to permitholders and consumers in Florida for up to two years.

Section 210.90, F.S., enables a nonparticipating manufacturer to seek review of an adverse determination by the division in the appellate court. Upon filing such an action for review the division's determination is stayed for 20 days or longer as determined by the court.

Section 210.91, F.S., requires the division to revise the list monthly to correct mistakes and add or remove brand families. The division and the Attorney General are authorized to share information with each other, with other authorities in this state, and with authorities in other states for purposes of analysis and enforcement.

The division and the Attorney General are authorized to audit, or engage others to audit, the information supplied by nonparticipating manufacturers and the division is authorized to audit the information supplied by licensed permitholders.

Section 210.92, F.S., requires applicants for permits to certify, under penalty of perjury, that such person will comply fully with this act.

Section 2. Specifies timelines for compliance with the reporting requirements of Section 1.

Section 3. Provides that the act will take effect upon becoming a law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

Indeterminate.

2. Expenditures:

The Division of Alcoholic Beverages and Tobacco, Department of Business and Professional Regulation indicates the need for additional personnel to comply with the increased audit functions required by this legislation.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Indeterminate.

D. FISCAL COMMENTS:

None.

III. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that counties or municipalities have to raise revenues.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

IV. COMMENTS:

A. CONSTITUTIONAL ISSUES:

None noted.

B. RULE-MAKING AUTHORITY:

None.

C. OTHER COMMENTS:

None.

V. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

N/A

VI. SIGNATURES:

COMMITTEE ON BUSINESS REGULATION:

Prepared by:

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