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/SB 2140

SPONSOR: Regulated Industries Committee and Senator Mitchell

SUBJECT: Sale of Tobacco Products

DATE: February 26, 2002 REVISED: ________ ________ ________ ________

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wiehle	Caldwell	RI	Favorable/CS
2.			JU	
3.			CM	
4.			AGG	
5.			AP	
6.				

I. Summary:

The bill: creates the Tobacco Settlement Protection Act; provides a statement of legislative purpose; requires the Division of Alcoholic Beverages and Tobacco in the Department of Business and Professional Regulation to prepare a list of approved cigarette brand families, including each manufacturer that certifies that it is a participating manufacturer and each nonparticipating manufacturer that certifies that it will make all escrow payments required by the MSA Statute of each MSA state; provides that a manufacturer may bring an action to challenge the division's determination to exclude the manufacturer's products, or remove them, from the approved list; prohibits any permittee or licensee from shipping, selling, or delivering cigarettes not on the approved list to any person in this or another state, or from possessing such cigarettes for sale, shipment, or delivery; requires each permittee or licensee to file a quarterly report of shipments of cigarettes in this state and other states, listed by nonparticipating manufacturer; and provides penalties.

The bill creates the following sections of the Florida Statutes: 210.81, 210.82, 210.83, 210.84, 210.85, 210.86, 210.87, 210.88, 210.89, 210.90, and 210.91.

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 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

[1]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.

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 Florida 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 that 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 revenue[3] 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 non-settling tobacco product manufacturers. For example, legislation was enacted 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 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

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[2] 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 fewer than 200 million cigarettes for the year 2040.

[3] The 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.

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. MSA States' Subsequent Non-settling/Non-participating Manufacturer Escrow Legislation

According to proponents of the bill, the 46 states that entered into the MSA all passed model legislation requiring non-participating cigarette manufacturers to make payments into escrow accounts. New York's statute is New York Consolidated Laws, Public Health, Article 13-G, sections 1399-nn.-1399-pp. In its findings and purpose, the statute states that it is state policy that financial burdens imposed on the state by cigarette smoking be borne by tobacco product manufacturers rather than by the state to the extent that such manufacturers either determine to enter into a settlement with the state or are found culpable by the courts. The statute refers to the MSA, then states:

> 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.

The statute requires any tobacco product manufacturer selling cigarettes to consumers within the state, whether directly or through a distributor, retailer, or similar intermediary, to either:

- become a participating manufacturer (as that term is defined in the master settlement agreement) and generally perform its financial obligations under the master settlement agreement; or
- place into a qualified escrow fund by April fifteenth of the year following the year in question the following amounts (as such amounts are adjusted for inflation):
  - 1999: $.0094241 per unit sold;
  - 2000: $.0104712 per unit sold;
  - for each of 2001 and 2002: $.0136125 per unit sold;
  - for each of 2003 through 2006: $.0167539 per unit sold;
  - for each of 2007 and each year thereafter: $.0188482 per unit sold.

A tobacco product manufacturer that places funds into escrow is to receive the interest or other appreciation as earned. The escrowed funds themselves will be released from escrow only under the following circumstances:

- to pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the state or any releasing party located or residing in the state. The funds will be released:
  - in the order in which they were placed into escrow and
  - only to the extent and at the time necessary to make payments required under such judgment or settlement;

- to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the state's allocable share of the total payments that such manufacturer would have been required to make in that year under the master settlement agreement, had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or
- to the extent not released from escrow under the above provisions, funds will be released from escrow and revert back to such tobacco product manufacturer twenty-five years after the date on which they were placed into escrow.

Any tobacco product manufacturer that fails in any year to place the required funds into escrow is:

- to be required within fifteen days to place such funds into escrow. The court, upon a finding of a violation of this provision, may impose a civil penalty to be paid to the general fund of the state in an amount not to exceed five percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed one hundred percent of the original amount improperly withheld from escrow;
- in the case of a knowing violation, to be required within fifteen days to place such funds into escrow. The court, upon a finding of a knowing violation of this provision, may impose a civil penalty to be paid to the general fund of the state in an amount not to exceed fifteen percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed three hundred percent of the original amount improperly withheld from escrow; and
- in the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the state, whether directly or through a distributor, retailer, or similar intermediary, for a period not to exceed two years.

Each failure to make a required annual deposit constitutes a separate violation. The tobacco product manufacturer is to be required to pay the state's costs and attorney's fees incurred during a successful prosecution under this subdivision.

III. Effect of Proposed Changes:

Section 1 creates the Tobacco Settlement Protection Act, Part III of chapter 210, F.S., ss. 210.81–210.91, F.S.

Section 210.82, F.S., and provides that the legislative purpose is to protect Florida's payments under its settlements with various cigarette manufacturers.

Section 210.83, F.S., provides definitions.

Section 210.85, F.S., requires the Division of Alcoholic Beverages and Tobacco in the Department of Business and Professional Regulation (the division) to annually prepare a list of all brand families manufactured for sale to consumers within the United States by each tobacco product manufacturer that by May 1 of such year has provided the division the certification that it is a participating manufacturer, and each tobacco product manufacturer as to which the division has made the determination described in s. 210.86, F.S.

Section 210.86, F.S., provides that for a nonparticipating manufacturer to make the approved list, it must certify that it will make all escrow payments required by the MSA Statute of each MSA state for sales of its cigarettes during the current calendar year; and that it has in good faith made all escrow payments required by the MSA Statute of each MSA state for sales of its cigarettes during the prior calendar year. The nonparticipating manufacturer must also provide any information required by the division to determine whether such certification is true and correct. A manufacturer is considered to have made all escrow payments in good faith if the escrow payments made accord with:

- The MSA state's finding of the number of units sold in the state during the year in question as measured by excise taxes collected;
- An agreement between the manufacturer and the MSA state with respect to the manufacturer's obligations.
- A court order regarding the manufacturer's escrow payment obligations.

The division is to approve the certification of a manufacturer if each MSA state confirms in writing the validity of the manufacturer's certification. The division must promptly notify the manufacturer and the Attorney General of its approval or rejection of a manufacturer's certification. Before either party files an action in court, and before the manufacturer's products are excluded or removed from the list, the parties must work in good faith for 15 business days to resolve any issues causing rejection of the certification.

Section 210.84, F.S., makes it unlawful for any permittee or licensee to ship, sell, or deliver to any person in this or another state cigarettes belonging to a brand family not on the division's list of approved cigarettes, or to possess such cigarettes for shipment, sale, or delivery.

Section 210.87, F.S., requires each permittee and licensee to file a quarterly report listing all shipments, deliveries, and sales of cigarettes in this state and other states, listing them by manufacturer and brand family the quantity of cigarettes shipped, delivered, or sold to each state.

Section 210.88, F.S., provides that upon a violation of the prohibition against sale or shipping of non-approved cigarettes, the division may impose upon the permittee or licensee a civil penalty in an amount not to exceed the greater of 500 percent of the retail value of the cigarettes shipped or $5,000. Upon a finding of a second or subsequent violation, the division may suspend or revoke the license or permit. The Attorney General, on behalf of the division, may seek an injunction to restrain a permittee or licensee from unlawfully shipping cigarettes or to compel the filing of the quarterly report. Based on credible information provided by authorities in an MSA state or other credible information, the Attorney General is to bring an action in circuit court against a nonparticipating manufacturer for filing a false certification. Upon a finding that the nonparticipating manufacturer has filed a false certification, the court is to issue a permanent injunction prohibiting the manufacturer from selling cigarettes, directly or indirectly, to permittees and licensees within the state for a period not to exceed 2 years.

Section 210.89, F.S., provides that before the division may exclude or remove a manufacturer's brand families from the approved list, it must comply with the requirement to work in good faith to resolve any issues causing rejection of the certification. After expiration of this period, the

manufacturer may bring an action to challenge the determination in the appellate district where the division maintains its headquarters, where a party resides, or as otherwise provided by law. Upon the filing of such an action, the division's determination is to be stayed for 10 days. The court may extend the stay upon a showing by the manufacturer that it has a substantial probability of success and would suffer irreparable injury in the absence of a stay.

Section 210.90, F.S., requires the division to update the approved cigarettes list no less often than monthly to correct mistakes and to remove or add brand families.

The bill takes effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

If the bill becomes law, it may be challenged as violating constitutional provisions on due process, access to courts, equal protection, and the commerce clause. However, when Virginia's Non-participating Manufacturer Escrow statute was challenged on these bases, the challenges were rejected. *Star Scientific, Incorporated, v. Beales*, 278 F.3d 339 (4th Cir. 2002).

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Nonparticipating manufacturers that are not now making the required escrow payments in MSA states will not be able to sell cigarettes into other states from Florida. This may decrease their income and increase that of participating manufacturers.

C. Government Sector Impact:

Indeterminate. One of the proponents estimates that 8 percent of the decrease in FSA payments over the last five years has been due to nonparticipating manufacturers taking

sales from participating manufacturers. This is an estimated $6-7 million. To the extent that this erosion in market share is attributable to nonparticipating manufacturers selling cigarettes into MSA states from Florida, the bill should decrease similar future erosion in market share.

The bill requires the division to compile a list of brands of cigarettes approved for sale in this state, which requires the division to certify that all nonparticipating manufacturers have made all required escrow payments in other states and report this certification determination to the nonparticipating manufacturer and the Attorney General. The bill also assigns enforcement authority to the division. The division estimates that performance of these duties will require creation of one Auditor II position in the main office and at least one additional Tax Auditor I position in each of the eight district offices. The division estimates that this will cost $381,325 in Fiscal Year 2002-03, $390,914 in Fiscal Year 2003-04, and $400,791 in Fiscal Year 2004-05.

VI. Technical Deficiencies:

The bill provides that the division is to review manufacturers' certifications of compliance with MSA states' escrow statutes and approve or reject the certification. However, at page 5, line 17, it refers to the Attorney General rejecting the certification.

VII. Related Issues:

None.

VIII. Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.