

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SJR 1008

SPONSOR: Governmental Oversight and Productivity Committee and Senator Kirkpatrick

SUBJECT: Lawton Chiles Endowment Fund

DATE: April 25, 2000 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Harkey</u>	<u>O'Farrell</u>	<u>ED</u>	<u>Fav/1 amendment</u>
2.	<u>Rhea</u>	<u>Wilson</u>	<u>GO</u>	<u>Favorable/CS</u>
3.	_____	_____	<u>RC</u>	<u>Withdrawn</u>
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____

I. Summary:

This joint resolution would place on the ballot a proposed amendment to the State Constitution. The amendment would limit any use of the principal of the Lawton Chiles Endowment Fund to emergency situations. Even in an emergency, the Legislature would be limited to appropriating no more than 10 per cent of the principal for any fiscal year. An appropriation would require a two-thirds vote of the membership of each house of the Legislature.

This Joint Resolution would amend Article X of the State Constitution.

II. Present Situation:

A. Constitutional Amendment Process

Article XI of the Florida Constitution sets forth various methods for proposing amendments to the State Constitution, along with the methods for approval or rejection of proposals. One method by which constitutional amendments may be proposed is by joint resolution agreed to by three-fifths of the membership of each house of the Legislature.¹ Any such proposal must be submitted to the electors, either at the next general election held more than 90 days after the joint resolution is filed with the Secretary of State, or, if pursuant to law enacted by the affirmative vote of three-fourths of the membership of each house of the Legislature and limited to a single amendment or revision, at an earlier special election held more than 90 days after such filing.² If the proposed amendment is approved by a vote of the electors, it becomes effective as an amendment to the State Constitution on the first Tuesday after the first Monday in January following the election, or on such other date as may be specified in the amendment. *Id.*

¹Article XI, s. 1 of the State Constitution.

²Article XI, s. 5 of the State Constitution.

B. Tobacco Settlement

The State of Florida commenced legal action against a number of tobacco manufacturers and other defendants, asserting various claims for monetary and injunctive relief on behalf of the state in February of 1995. The state entered into a settlement agreement on August 25, 1997, with Phillip Morris, Reynolds Tobacco, B & W American Brands, and Lorillard. This settlement agreement was subsequently amended.³ These four cigarette producers hold an estimated market share of 93 percent in the United States. The remaining percentage is shared by smaller producers who were not named in the state’s suit as defendants and, as a result, were not parties to the settlement.

Under the agreement as amended, 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

Currently, tobacco proceeds are placed in the Lawton Chiles Endowment Fund, which was created by the Legislature in 1999. The fund is administered by the State Board of Administration. Portions of the non-recurring moneys received pursuant to the settlement are required to be deposited into this fund, and monies are disbursed to tobacco funds in various departments depending on appropriations made by law. The State Board of Administration invests monies in the endowment in order to maximize the rate of return earned by the State.⁴ Funds from the endowment are not available for disbursement to state agencies until after July 1, 2000.

After Florida’s settlement, Phillip Morris, Reynolds Tobacco, B & W American Brands, and Lorillard, settled lawsuits with Texas, Mississippi, and Minnesota. These corporations, as well as the other smaller producers, have settled with the remaining states in what has been termed the “Master Settlement Agreement” (MSA). The unadjusted cost of the state settlements ranges between \$212 billion to \$246 billion over the next 25 years. The range is broad because these amounts are subject to numerous adjustments, from inflation to fluctuations in cigarette consumption and market share. As a result, the amount may increase due to inflation but may decrease if cigarette consumption decreases markedly. Other factors that may affect cigarette consumption includes general population growth, cigarette price increases, changes in disposable income, youth consumption, health warnings, smoking bans in public places, nicotine dependence, advertising restrictions, and smoking trends over time.⁵

³Florida 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.

⁴Section 215.5601, F.S.

⁵According 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.

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 (*Engle v. R.J. Reynolds, et.al.*, in Dade County, Florida). While the tobacco settlement payments are to be made in perpetuity, it is possible that the tobacco companies may someday declare bankruptcy and default on their obligations.

In a story dated March 26, 2000, the Associated Press reported that the National Association of Attorneys General retained a Los Angeles bankruptcy law firm to insure states receive a combined \$246 billion in tobacco settlements. According to the story, the nation's five biggest cigarette makers owe about \$10 billion this year, and also face a potentially record-setting punitive damages award in *Engle*. The tobacco industry fears an estimated 500,000 sick Florida smokers may be awarded \$300 billion.

According to Salomon Smith Barney, tobacco industry credit fundamentals make bankruptcy of a major manufacturer unlikely due to the significant domestic demand, the profitability of the industry, and the ability of the industry to pass additional costs to consumers in the form of high prices.⁶ In a series of scenarios presented by WEFA included within the Salomon Smith Barney materials projected an industry settlement three times the size of the MSA (approximately \$700 billion) resulting in a cigarette price increase of more than 50 percent causing a consumption decline of more than 14 percent. WEFA concluded that even in those "extreme and unlikely conditions" consumption is still projected to generate sufficient tobacco settlement revenues to meet the planned principal amortization schedule. While it appears that the industry could survive payments that are amortized and made over time, it is unknown how the industry would react to a \$300 billion jury award that was upheld on appeal and immediately payable.

III. Effect of Proposed Changes:

The bill would place on the ballot a proposed constitutional amendment to Article X of the State Constitution. The amendment would prohibit use of the Lawton Chiles Endowment Fund, except as authorized by the provision. The provision authorizes use of the annual capital gains and investment income to be appropriated, in accordance with general law pursuant to the appropriations act, but prohibits use of the principal of the fund except in an emergency. In an emergency, no more than ten percent of the principal of the endowment fund may be appropriated in any fiscal year for:

- state children's health programs;
- child welfare programs;
- community-based health and human services; and
- biomedical research activities related to the diagnosis and treatment of diseases related to tobacco use, including cancer, cardiovascular diseases, stroke, and pulmonary diseases.

Appropriation for these uses requires a two-thirds vote of the membership of each house of the Legislature.

⁶Opinions in Tobacco Settlement Securitization, dated February 29, 2000, page 19.

The resolution defines the term “emergency” to mean a set of conditions which was unforeseen and which must be corrected in order to continue an operation of government, or a set of conditions which constitutes an imminent threat to public health, safety, or welfare. The resolution provides that the emergency must relate to one of the following areas:

- state children’s health programs;
- child welfare programs;
- community-based health and human services;
- or biomedical research activities related to the diagnosis and treatment of diseases related to tobacco use, including cancer, cardiovascular disease, stroke, and pulmonary diseases.

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:

Section 1, Article XI of the State Constitution requires a three-fifths vote of the membership of each house of the Legislature for passage of a joint resolution.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

Each constitutional amendment is required to be published in a newspaper of general circulation in each county, once in the sixth week and once in the tenth week preceding the general election. Costs for advertising vary depending on the length of the amendment; however, it is estimated that the cost per amendment averages about \$46,000.

VI. Technical Deficiencies:

None.

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.
