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HOUSE OF REPRESENTATIVES
COMMITTEE ON
FISCAL POLICY & RESOURCES
ANALYSIS

BILL #: HB 1079

RELATING TO: Tobacco Settlement

SPONSOR(S): Representative(s) Atwater

TIED BILL(S): None

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:
(1) FISCAL POLICY & RESOURCES
(2) FISCAL RESPONSIBILITY COUNCIL
(3)
(4)
(5)

I. SUMMARY:

The bill deletes the requirement of prior legislative approval for the sale of all or part of the state’s right, title to and interest in the tobacco settlement agreement and for the issuance of bonds by the Tobacco Settlement Financing Corporation which are payable from and secured by tobacco settlement proceeds. The bill also changes the amount transferred from the Tobacco Settlement Clearing Trust Fund to the Lawton Chiles Endowment Fund.

SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

1.	Less Government	Yes []	No []	N/A [X]
2.	Lower Taxes	Yes []	No []	N/A [X]
3.	Individual Freedom	Yes []	No []	N/A [X]
4.	Personal Responsibility	Yes []	No []	N/A [X]
5.	Family Empowerment	Yes []	No []	N/A [X]

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

B. 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 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.

Under the settlement agreement (as subsequently amended by a Stipulation of 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*.

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 inflation to fluctuations in cigarette consumption and market share.[1] 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[2] 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

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[1]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.

[2]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.

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 export label product, which is manufactured domestically for export and is marked U.S. Tax Exempt For Sale Outside the U.S. The second type is foreign 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 products 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. 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

Section 210.02, F.S., provides for a tax on cigarettes which has been collected since 1943. The tax is paid by the wholesale dealer to the Division of Alcoholic Beverages and Tobacco upon the first sale or transaction within the state, whether or not such sale or transfer is to the ultimate purchaser or consumer. 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. Cigarette tax revenue are disposed of as follows: 7.3 percent of total collections is deducted for the General Revenue service charge under s. 215.20, F.S.; and an additional 0.9 percent of total collections is deducted to fund the administrative costs of the Division of Alcoholic Beverages and Tobacco within the Department of Business and Professional Regulation. Of the remaining cigarette tax revenue, distributions are made as follows: 2.9 percent to County Revenue Sharing; 29.3 percent to the Public Medical Assistance Trust Fund to fund indigent health care; 2.59 percent to the Board of Directors of the H. Lee Moffitt Cancer Center and Research Institute; and the remainder to the General Revenue Fund. Chapter 2000-355, Laws of Florida, eliminated the distribution from the Cigarette Tax to the Municipal Revenue Sharing Trust Fund and the Municipal Financial Assistance Trust Fund, thereby increasing the distribution to the General Revenue Fund.

C. EFFECT OF PROPOSED CHANGES:

The bill deletes the requirement of prior legislative approval for the sale of all or part of the state's right, title to and interest in the tobacco settlement agreement and for the issuance of bonds by the Tobacco Settlement Financing Corporation which are payable from and secured by tobacco settlement proceeds. The bill also changes the amount transferred from the Tobacco Settlement Clearing Trust Fund to the Lawton Chiles Endowment Fund for fiscal years 2001-2002 and 2002-2003.

D. SECTION-BY-SECTION ANALYSIS:

This section need be completed only in the discretion of the Committee.

II. <u>FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT</u>:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. <u>Revenues</u>:

None.

2. <u>Expenditures</u>:

The bill provides that for FY 2001-2002 the amount transferred from the Tobacco Settlement Clearing Trust Fund to the Lawton Chiles Endowment Fund may be increased from $200 million to $247 million, but may be decreased in FY 2002-2003 from $200 million to $125 million. This will not result in any increased expenditure by the state.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. <u>Revenues</u>:

N/A

2. <u>Expenditures</u>:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

N/A

D. FISCAL COMMENTS:

N/A

III. <u>CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION</u>:

A. APPLICABILITY OF THE MANDATES PROVISION:

N/A

B. REDUCTION OF REVENUE RAISING AUTHORITY:

N/A

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

N/A

IV. <u>COMMENTS</u>:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

N/A

V. <u>AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES</u>:

N/A

VI. <u>SIGNATURES</u>:

COMMITTEE ON FISCAL POLICY & RESOURCES:

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