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: SB 2192

SPONSOR: Senator Dockery and others

SUBJECT: Stamping of Cigarettes in Interstate Commerce

DATE: March 31, 2003 REVISED: ________ ________ ________ ________

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Gillespie	Maclure	CM	Favorable
2.			FT	
3.			AGG	
4.			AP	
5.				
6.				

I. Summary:

Senate Bill 2192 prohibits a person from transporting from Florida, or causing to be transported, cigarettes for sale in another state without complying with the other state's laws relating to the affixation of stamps to, the payment of excise taxes on, or the sale of the cigarettes. The bill also requires the person transporting, or causing to be transported, those cigarettes to submit a monthly report identifying the quantity of each brand style and the recipient of the cigarettes to the Division of Alcoholic Beverages and Tobacco of the Department of Business and Professional Regulation and authorizes the division to adopt rules for the administration of these requirements.

This bill substantially amends section 210.06, Florida Statutes.

II. Present Situation:

Tobacco Settlement Agreements

Beginning in the mid 1990s, more than 40 states and some local governments brought suit against tobacco companies, alleging the industry violated antitrust and consumer protection laws, withheld information about the adverse health effects of tobacco, manipulated nicotine levels to keep smokers addicted, and conspired to hold back less risky and less addictive tobacco products from the market.[1] In February 1995, the State of Florida brought its suit in Palm Beach County against a number of tobacco companies, seeking monetary damages and injunctive relief on

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[1] *See, e.g.,* U.S. General Accounting Office, *Tobacco Settlement: States' Use of Master Settlement Agreement Payment* 8 (GAO-01-851, June 2001).

behalf of the state.[2] In March 1996, Florida settled its claims with two of those tobacco companies (Brooke and Liggett) as part of a five-state settlement agreement.[3]

In 1997 and 1998, four states (Florida, Minnesota, Mississippi, and Texas) settled their lawsuits by negotiating independent agreements with the tobacco industry. In August 1997, the State of Florida entered into its settlement agreement with the four largest tobacco companies in the United States (Philip Morris, R. J. Reynolds, Brown & Williamson, and Lorillard). As part of the settlement, the companies agreed to make annual payments to the state, based on each company's respective market share of sales of cigarettes for consumption in the United States, among other non-monetary provisions, in exchange for release from past, present, and future claims brought by the state. According to the Council of State Governments, it is estimated that Florida would receive approximately $13.4 billion in settlement payments through 2025.[4]

In November 1998, after Florida's settlement, the nation's four largest tobacco companies (cited as the "original participating manufacturers" or "OPMs") negotiated an agreement with the attorneys general of the remaining 46 states, thereby settling the lawsuits brought by these states against the tobacco companies. This multi-state agreement (cited as the "Master Settlement Agreement" or "MSA"), like the Florida agreement, released the tobacco companies participating in the settlement from past, present, and future claims brought by the settling states in exchange for annual payments to the states and reimbursement of attorneys fees.[5] Under the Master Settlement Agreement, the tobacco industry was projected to pay the settling states in excess of $200 billion over a 25-year period.[6]

The MSA also imposed restrictions on the marketing and advertising practices of the settling tobacco companies. In addition, to receive its full share of the settlement payments, unlike the Florida agreement, each state was required by the MSA to enact a law that addressed the potential competitive advantage that tobacco companies that were not parties to the settlement might experience. Under the MSA, if the aggregate market share of the tobacco companies that were parties to the agreement fell more than 2 percent below their base level in 1997 and the loss was caused in significant part by the MSA, the MSA payments might be reduced based on a formula that corrects for this loss in market share.

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[2] *Complaint, State of Florida v. American Tobacco Co. et al.,* No. 95-1466AO (Fla. 15th Cir. Ct. filed Feb. 21, 1995), *available at* University of California San Francisco, http://www.library.ucsf.edu/tobacco/litigation/fl/1florida.pdf (last visited Mar. 30, 2003).

[3] *Attorneys General Settlement Agreement with Brooke Group Ltd. and Liggett Group, Inc.* (Mar. 15, 1996), *available at* University of California San Francisco, http://www.library.ucsf.edu/tobacco/litigation/fl/agsettlement.pdf (last visited Mar. 30, 2003). (Florida, Louisiana, Massachusetts, Mississippi, and West Virginia were the states that entered into the settlement agreement with Liggett.)

[4] James B. Carroll & David A. Moss, Council of State Governments, *Tobacco Settlement and Declining State Revenues, TrendsAlert* 4 (Mar. 2002).

[5] *Master Settlement Agreement* (Nov. 1998), *available at* National Association of Attorneys General, http://www.naag.org/upload/1032468605_cigmsa.pdf (last visited Mar. 30, 2003).

[6] National Association of Attorneys General, *at* http://www.naag.org/issues/issue-tobacco.php (last visited Mar. 30, 2003).

The MSA specified that individual states can avoid this downward adjustment—known as the "non-participating manufacturers" adjustment—to their payments by enacting and enforcing a law intended to prevent a competitive disadvantage for the participating manufacturers.[7] The MSA included a model law that, if enacted and enforced by a state, would protect that state from any adjustment for market share loss, although states were permitted to enact and enforce any law that achieved the same result.[8] The model law includes legislative findings and purpose, which provide, in part:

> 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.[9]

To achieve these legislative findings and purpose, the model law requires that every tobacco company in the state must either become a participating manufacturer who pays its respective share of the settlement payments to the states based on the manufacturer's market share of cigarette sales in the United States or remain a nonparticipating manufacturer ("NPM"). Under the model law, a NPM must pay funds into an escrow account equivalent to the amount the manufacturer would have paid to the state if it became a participating manufacturer under the MSA. As of December 2002, approximately 37 tobacco companies had joined the MSA.[10]

Because Florida is not a party to the MSA, a NPM may sell cigarettes in this state without making either MSA payments or escrow payments. The tobacco industry claims that, since the MSA was signed in 1998, there has been an increase in the interstate transportation of cigarettes by NPMs from the four states that are not parties to the MSA (Florida, Minnesota, Mississippi, and Texas) into states that are parties to the MSA, in order to avoid making payments in compliance with the laws in those states which implement the MSA's model law.

Florida's Excise Tax on Cigarettes and Reporting Requirements

Under current law, each person, firm, or corporation dealing in cigarettes as a distributing agent, wholesale dealer, or exporter within this state must apply for and obtain a cigarette permit from

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[7] The Master Settlement Agreement provides that 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." *MSA, supra* note 5, at 60 (page number of the PDF file).

[8] *Exhibit T of the Master Settlement Agreement*, *supra* note 5, at 279 (page number of the PDF file).

[9] *Id.* at 279-80 (page numbers of the PDF file).

[10] David J. Adelman et al., Morgan Stanley & Co., Inc., *State of the US Cigarette Industry: Not a Pretty Picture* 2 (Dec. 20, 2002). These tobacco companies are cited as "subsequent participating manufacturers" or "SPMs," which distinguishes these companies from OPMs (original participating manufacturers).

the Division of Alcoholic Beverages and Tobacco of the Department of Business and Professional Regulation (s. 210.15(1), F.S.). A person, firm, corporation, or business entity dealing in, selling, storing, or operating as a wholesale dealer in cigarettes, or acting as a cigarette distributing agent or exporter, without a cigarette permit commits a misdemeanor of the first degree, publishable by no more than 1 year in jail and a $1,000 fine (s. 210.15(8), F.S.). In addition, the division may suspend or revoke the permit of any wholesale dealer for violations relating to the tax on cigarettes (s. 210.16, F.S.).

The State of Florida imposes an excise tax on cigarettes and requires each wholesale dealer, regardless of whether the dealer is located in the state, to affix to each package or container or cause to be affixed, a stamp evidencing the payment of the excise tax before the cigarettes may be offered for sale or use, consumed, or otherwise disposed of in this state (ss. 210.02 and 210.06(1), F.S.). Current law does not include provisions concerning the affixation of another state's tax stamps on cigarettes for sale in the other state.

Wholesale dealers are required to submit to the Division of Alcoholic Beverages and Tobacco by the 10th day of each month a monthly report of its purchases and sales of cigarettes within or without the state for the preceding month (rule 61A-10.011, F.A.C; s. 210.09(2), F.S.). Sales of cigarettes out-of-state are reported on a wholesale dealer's monthly report as exempt from the excise tax because the tax applies only to sales in Florida. The monthly report details the number of cigarette packages, but does not include any information about the quantity of each brand style.[11]

Decline of Tobacco Settlement Payments

In 1997, according to industry estimates, the original participating manufacturers (Philip Morris, R. J. Reynolds, Brown & Williamson, and Lorillard) controlled approximately 97.4 percent of the United States cigarette market, with the remaining smaller companies representing about 2.6 percent of the market.[12] By 2000, the market share of the OPMs had fallen to about 94.5 percent, according to industry estimates.[13]

One of the causes for the OPMs' declining market share, according to industry market analysts, is the interstate sale of cigarettes from one of the four states that are not parties to the Master Settlement Agreement (Florida, Minnesota, Mississippi, and Texas) into states that are parties of the MSA. Because Florida's settlement agreement does not require the state to enact legislation requiring nonparticipating manufacturers to become subsequent participating manufacturers (responsible for payments under the MSA) or make payments into a state escrow account, NPMs have a competitive advantage over the OPMs when transporting cigarettes from Florida for sale into other states that are parties to the MSA. Nonparticipating manufacturers may accordingly

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[11] Florida Dept. of Bus. and Prof'l Regulation, *Taxable Cigarette Wholesale Dealer's Monthly Report, Form AB&T 4000A-205* (Nov. 1998), *available at* http://www.state.fl.us/dbpr/abt/forms/auditing/acrobat_auditing/cigformsstamping.pdf (last visited Mar. 30, 2003).

[12] *See* Carroll, *supra* note 4, at 5.

[13] *Id.*

sell cigarettes for substantially reduced prices than the OPMs in these other states, thereby causing shifts in market share.

Because payments by the OPMs under both Florida's settlement agreement and the MSA are based on each company's respective market share, a reduction in the OPMs' market share vis-à-vis the NPMs may consequently cause a reduction in Florida's settlement payments. A reduction in settlement payments has been observed in the 46 states that are party to the MSA.[14]

III. Effect of Proposed Changes:

The bill prohibits a person from transporting from Florida, or causing to be transported, cigarettes for sale in another state without first affixing the stamp and paying any other excise tax required by that state to be affixed or paid. The bill also prohibits a person from affixing a stamp, or paying any other excise tax, required on cigarettes by another state, if the other state prohibits the stamp from being affixed or the excise tax from being paid, or if the other state prohibits the sale of the cigarettes.

Collectively, these provisions effectively prohibit a person from transporting from Florida, or causing to be transported, cigarettes for sale in another state without complying with the other state's laws relating to the affixation of stamps to, the payment of excise taxes on, or the sale of the cigarettes.

The bill also requires a person transporting from Florida, or causing to be transported, cigarettes for sale in another state to submit a monthly report to the Division of Alcoholic Beverages and Tobacco of the Department of Business and Professional Regulation. The report must be submitted by the 10th day of each month and must identify, from the preceding calendar month, the quantity of each brand style of the cigarettes and the name and address of each recipient of the cigarettes.

The bill requires the Division of Alcoholic Beverages and Tobacco to adopt rules necessary to administer these provisions.

The bill takes effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

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[14] According to the U.S. General Accounting Office, adjustments of settlement payments based, in part, on market share led to a $1.6 billion reduction in the payments from projections between 1999 and 2001. GAO, *supra* note 1, at 11.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

In addition to current reporting requirements, the bill requires wholesale dealers of cigarettes to detail the quantity of each brand style of cigarettes sold out-of-state. The bill also requires nonparticipating manufacturers (tobacco companies that are not parties to the Master Settlement Agreement), which transport cigarettes from Florida for sale in another state, to comply with the laws of other state. Compliance with other state laws will most likely require the nonparticipating manufacturers to become subsequent participating manufacturers (and make payments under the Master Settlement Agreement) or make payments into escrow accounts in other states, thereby reducing the competitive advantage and market share of these companies. A reduction in the market share of nonparticipating manufacturers will most likely benefit the original participating manufacturers (Philip Morris, R. J. Reynolds, Brown & Williamson, and Lorillard) and other subsequent participating manufacturers.

C. Government Sector Impact:

Department of Business and Professional Regulation

The Department of Business and Professional Regulation estimates the bill would impose no significant additional costs on the department's operations. Although the department cites that the Division of Alcoholic Beverages and Tobacco would need to update its computer programs to capture additional information (i.e., quantity of each brand style of cigarettes) from wholesale dealers as part of their monthly reports and would need to verify license and excise tax information from other states as part of routine audits, the department estimates the workload increase would be minimal.

Tobacco Settlement Trust Funds

If the bill causes an increase in the market share of the original participating manufacturers (Philip Morris, R. J. Reynolds, Brown & Williamson, and Lorillard) by reducing the market share of nonparticipating manufacturers through requiring compliance with the laws of other states, the bill would likely increase the amounts of settlement payments made by the original participating manufacturers to Florida under the state's settlement agreement.

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.