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ADOPT TOBACCO SETTLEMENT MODEL STATUTE

House Bill 5088 (Substitute H-1)
First Analysis (11-9-99)

Sponsor: Rep. Charles LaSata
Committee: Appropriations

THE APPARENT PROBLEM:

Michigan is one of the 46 states that is party to the Tobacco Master Settlement Agreement (MSA) reached between states' attorneys general and the five major tobacco companies on November 23, 1998. (Four other states reached separate agreements.) According to information from the National Governors' Association, this agreement should result in payments by tobacco companies totaling $206 billion over 26 years in exchange for the states releasing past, present, and certain future claims against the participating tobacco manufacturers. Michigan's share is estimated at $8.2 billion. (There are a number of adjustments, including those based on inflation and cigarette sales volume, that will affect the final amount of tobacco settlement money.)

One element of the master settlement agreement is the non-participating manufacturer (NPM) adjustment, which allows the original participating manufacturers to reduce their payments if their combined market share drops two percent or more from the 1997 level and if an independent research firm determines that the settlement agreement was a significant contributor to the loss of market share. Underlying this provision is the concern that the original participating manufacturers could lose market share to non-participating manufacturers as a result of having to raise prices to meet their payment obligations under the MSA. (The original participating companies represented about 97.5 percent of the tobacco industry, according to the National Governors' Association. Since the agreement was reached, reportedly, several other manufacturers have become participating manufacturers, which means they have agreed to make payments in exchange for a release from claims.)

The MSA provides, generally speaking, that states adopting and enforcing "qualifying statutes" will be protected against the loss of funds if the NPM adjustment is triggered. A state can draft its own qualifying statute following the terms of the MSA and submit it for approval to the independent economic research firm or it can adopt the model statute contained in the MSA (as "Exhibit T"). The point of such a statute, according to the MSA, is to neutralize the cost disadvantages the original participating manufacturers face versus the non-participating manufacturers under the settlement agreement. The model statute would do this, in part, by requiring non-participating manufacturers to put money based on cigarette sales volume into escrow. Legislation has been introduced under which Michigan would adopt the MSA model statute.

THE CONTENT OF THE BILL:

The bill would create a new act that follows the model statute found in the multistate settlement with the tobacco industry reached by states' attorneys general. (The bill specifically refers to the settlement agreement and related documents entered into on November 23, 1998, and incorporated into a consent decree and final judgment entered into on December 7, 1998, in Kelley Ex Rel. Michigan v Philip Morris Incorporated, et al., in Ingham County Circuit Court.)

Under the bill, any tobacco manufacturer selling cigarettes to consumers within the state (whether directly or through a distributor, retailer, or similar intermediary) would have to do one of the following:

1) become a participating manufacturer and generally perform its financial obligations under the master settlement agreement; or

2) place into a qualified escrow fund certain amounts as specified in the bill based on the number of cigarettes sold.

Escrow Funds. Interest or other appreciation on funds in escrow would go to the tobacco product manufacturer. Funds themselves could only be released from escrow under one or more of the following circumstances.

– – Funds could be released to pay a judgment or settlement on any released claim brought against the manufacturer by the state or any releasing party located or residing in the state. Funds would have to be released in the order in which they were placed in escrow and only to the extent and at the time necessary to make payments required under the judgment or settlement.

– – To the extent that a manufacturer established that it had put in escrow in a particular year an amount greater than the state's allocable share of the total payments that the manufacturer would have had to make under the master settlement agreement had it been a participating manufacturer, the excess would be released from escrow and revert to the manufacturer.

– – Funds would otherwise be released from escrow and revert to the manufacturer 25 years after the date they were placed into escrow.

A "qualified escrow fund" would be defined as an escrow arrangement with a federally or state chartered financial institution having no affiliation with any tobacco manufacturer and having assets of at least $1 billion, where the arrangement required the financial institution to hold the escrowed funds' principal for the benefit of releasing parties and prohibits the manufacturer from using, accessing, or directing the use of the funds' principal except as permitted in the act.

<u>Enforcement.</u> Each manufacturer that elected to put funds into escrow would annually certify to the attorney general that it was in compliance with the bill. The attorney general could bring a civil action on behalf of the state against any manufacturer that failed to place the required funds into escrow. A manufacturer that failed in any year to escrow the required funds would be subject to the following when applicable. (Each failure to make an annual deposit would constitute a separate violation.)

– – A manufacturer would be required within 15 days to put sufficient funds into escrow to bring it into compliance. The court could impose a civil penalty payable to the general fund 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 100 percent of the original amount improperly withheld.

– – In the case of a knowing violation, a manufacturer would be required within 15 days to comply and a court could impose a civil penalty not to exceed 15 percent of the amount improperly withheld per day of the violation, up to a total of 300 percent of the amount improperly withheld.

– – In the case of a second knowing violation, the manufacturer would be prohibited from selling cigarettes in the state for a period not to exceed two years.

<u>Escrow formula.</u> The bill specifies the amount a manufacturer would have to put into escrow based on cigarette sales volume. For 1999, the amount would be $.009421 per unit (i.e., per cigarette) sold after the date of enactment of the bill. For 2000, the amount would be $.0104712 per unit sold; for 2001 and 2002, $.0136125 per unit; for each of 2003 through 2006, $.0167539 per unit; and for 2007 and each year thereafter, $.0188482 per unit. Funds would have to be placed in escrow by April 15 of the year following the year in question. Amounts would also be adjusted for inflation. The number of cigarettes sold would be measured by excise taxes collected by the state on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the state. The Department of Treasury would be required to promulgate such regulations as necessary to ascertain the amount of state excise tax paid on the cigarettes of a manufacturer for each year.

BACKGROUND INFORMATION:

Several web sites have information on the tobacco settlement and the model act contained within it. These include the National Governors' Association site (http://nga.org/Health/TobaccoQ&A.asp); the National Association of Attorneys General site (www.naag.org); and the Tobacco Control Resource Center at Northeastern University School of Law (www.tobacco.neu.edu).

FISCAL IMPLICATIONS:

The House Fiscal Agency had indicated that the bill would have no state or local cost or revenue impact. The agency points out that the bill protects the state from potential reductions in tobacco settlement payments due to adjustments that participating tobacco manufacturers can make in their payments if they lose market share to non-participating manufacturers. (Fiscal Note dated 11-2-99)

ARGUMENTS:

For:

The adoption of this bill would safeguard Michigan's payments from tobacco companies under the Tobacco Master Settlement Agreement (MSA) reached between states' attorneys general and the five major tobacco companies. The agreement specifies that if a state adopts a qualifying statute, it is protected against reductions in tobacco company payments under the non-participating manufacturer (NPM) adjustment, which aims to protect participating companies from the loss of market share that could result from increased prices caused by the payment obligations under the MSA. While a state need not adopt the model statute contained in the MSA, it is advantageous to do so. States that adopt the model statute rather than an independently drafted qualifying statute reportedly receive greater protection under the MSA against the potential loss of settlement payments in the event the statute was struck down by a court.

The bill requires that non-participating manufacturers either become a participating manufacturer (and meet the financial obligations of the MSA) or put funds into escrow based on a per cigarette formula to cover any smoking-related claims against them. The interest on the funds would be available to the manufacturers but the principal would remain in escrow for 25 years (except under special circumstances).

Against:

The model act provided in the multistate settlement agreement contains a statement of findings and purpose. House Bill 5088 does not contain this and some persons have recommended that the statement be added. That section would essentially lay out the rationale for the bill; it specifies that cigarette smoking presents public health concerns to the state and results in health care costs to states, and it makes a policy statement that the financial burdens imposed on the state by smoking should be borne by tobacco manufacturers through settlement payments or court actions. It also would make the case for the escrow provisions of the bill by stating that manufacturers who do not enter the settlement agreement should not be able to use their cost advantage to derive large, short-term profits in the years before any recovery is made from them if they are proven to have acted culpably.

Response:

The model statute specifically provides that a state "may elect to delete the 'findings and purposes' section in its entirety." Drafters say it is not the usual practice in Michigan for statutes to contain a section of findings or a statement of intent or purpose; they are not considered binding and tend to make statutes longer and statute books thicker.

POSITIONS:

The attorney general's office supports the bill. (11-3-99)

The Department of Management and Budget supports the bill. (11-4-99)

Analyst: C. Couch

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.