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BILL ANALYSIS

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Senate Bills 472 and 473 (as enacted) **PUBLIC ACTS 42 & 43 of 2016**
Sponsor: Senator Wayne Schmidt (S.B. 472)
Senator Peter MacGregor (S.B. 473)
Senate Committee: Commerce
House Committee: Appropriations

Date Completed: 3-20-17

CONTENT

Senate Bill 472 amended Public Act 244 of 1999, which requires certain tobacco product manufacturers to deposit funds in escrow accounts, to do the following:

- **Require the deposits to be made quarterly, rather than annually, according to a specific schedule.**
- **Require the quarterly deposits to be based upon units sold in that quarter plus an estimated inflation adjustment, and require an annual reconciliation deposit to be made.**
- **Require the manufacturers to certify their compliance quarterly, as well as annually.**
- **Allow a manufacturer to irrevocably assign to the State the manufacturer's interest in the escrow funds, and provide that the assignment applies to all funds in the account and those subsequently deposited.**
- **Provide for assigned escrow funds to be withdrawn by the State and deposited into the General Fund as a credit against a judgment or settlement on a released claim brought against the manufacturer by the State or a releasing party.**
- **Modify the definition of "units sold".**

Senate Bill 473 amended the Tobacco Products Tax Act to require the Department of Treasury, upon request, to disclose to the Attorney General information relevant to the enforcement of Public Act 244 of 1999; and permit the Department and the Attorney General to disclose otherwise-confidential information under certain circumstances.

Each bill took effect on June 13, 2016.

Senate Bill 472

Escrow Account Deposits

Public Act 244 of 1999 requires a tobacco product manufacturer selling cigarettes to consumers within the State to either 1) become a participating manufacturer and generally perform its financial obligations under the master settlement agreement; or 2) place into a qualified escrow account an amount based on units (individual cigarettes) sold. ("Participating manufacturer" means that term as defined in the master settlement agreement, which Michigan and 45 other states entered into with the U.S. tobacco industry in 1998.)

The bill deleted a requirement that the escrow fund deposits be made by April 15 of the year following the year in question. Instead, the deposits must be made in quarterly installments following the quarter in which sales took place. For this purpose, the calendar year is divided into quarters beginning on the first of January, April, July, and October.

Quarterly deposits must be made, and a certification of the deposits must be filed with the Department of Treasury, according to the following schedule:

-- For sales occurring in the first quarter, deposits are due April 30, and a certification must be filed by May 15, of the same year.
-- For sales occurring in the second quarter, deposits are due July 31, and a certification must be filed by August 15, of the same year.
-- For sales occurring in the third quarter, deposits are due October 31, and a certification must be filed by November 15, of the same year.
-- For sales occurring in the fourth quarter, deposits are due January 31, and a certification must be filed by February 15, of the following year.

For each of the quarters, the deposit must be based upon units sold in that quarter together with an estimated inflation adjustment provided by the Department. An annual reconciliation deposit must be made by April 15 of the year following the year in which the cigarettes were sold to account for the actual annual inflation adjustment. A statement of the reconciliation deposit and the final reconciled deposit figures must be included with the annual certification, due by April 30 of the year following the year in which the cigarettes were sold. An annual certification required under the Tobacco Products Tax Act also must include the final reconciled deposit figures.

Under the bill, each tobacco product manufacturer that elects to deposit funds into escrow must certify quarterly and annually to the Department that it is in compliance with those requirements. Formerly, Public Act 244 required this certification on an annual basis.

The Act prescribes civil penalties for a manufacturer that fails to deposit funds into escrow as required. Under the bill, each failure to make a quarterly deposit or (as previously provided) an annual deposit is a separate violation.

The Act previously defined "units sold" as the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer during the year in question, as measured by excise taxes collected by the State on packs (or "roll-your-own" tobacco containers) bearing the State's excise tax stamp. Under the bill, "units sold" also includes the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer during the year in question, as to which the State had power under Federal law to impose or collect an excise tax but did not.

The Act formerly required the Department of Treasury to promulgate regulations necessary to ascertain the amount of State excise tax paid on the cigarettes of the tobacco product manufacturer for each year. The bill, instead, allows the Department to promulgate rules necessary to ascertain the number of units sold by the manufacturer for each year.

<u>Assignment of Interest in Escrow Funds</u>

Under the bill, if a tobacco product manufacturer elects to place funds into an escrow account, the manufacturer may make an irrevocable assignment of its interest in the funds to the benefit of the State. An assignment must be permanent and apply to all funds that are in the account or subsequently come into it, including funds deposited before the assignment is executed, funds deposited after the assignment is executed, and interest or other appreciation on the funds.

The tobacco product manufacturer, the Department of Treasury, and the financial institution where the account is maintained may amend the qualified escrow account agreement as necessary to effectuate an assignment of rights executed under these provisions or a withdrawal of funds from the account. An assignment must be made in writing and signed by a duly authorized representative of the manufacturer. It becomes effective upon delivery to the Department and the financial institution.

The State must withdraw any escrow funds assigned to it upon the request of the Treasurer and approval of the Attorney General. Any funds withdrawn must be deposited into the General Fund and be calculated on a dollar-for-dollar basis as a credit against any judgment or settlement that may be obtained against the manufacturer. (Under the Act, funds may be released from an escrow account to pay a judgment or settlement on any released claim brought against the manufacturer by the State or a releasing party located or residing in the State. "Released claim" and "releasing parties" mean those terms as defined in the master settlement agreement. Very generally, released claims are claims related to the use, sale, distribution, manufacture, marketing, or side effects of, or exposure to, tobacco products, that are covered by the release set forth in the master settlement agreement. Releasing parties include states entering into the agreement and people or entities seeking relief on behalf of the public.)

Nothing in these provisions may be construed to relieve a tobacco product manufacturer from any past, current, or future obligations it may have under the Act.

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Notwithstanding any law to the contrary, the bill requires the Department of Treasury, upon request, to disclose to the Attorney General, or his or her designee, information obtained by the Department that is relevant to the enforcement of Public Act 244 of 1999. However, with regard to information received pursuant to any tax agreement entered into between the State and any Indian tribe that includes limitations on disclosure of such information in addition to, or instead of, those contained in statute, the information must be consolidated to include all information received under those agreements with Indian tribes so a person cannot ascertain any one tribe's information.

The Department and the Attorney General, or his or her designee, may disclose information under these provisions that may otherwise be confidential, under one or more of the following circumstances:

-- In the discharge of the duty to enforce or defend the Tobacco Products Tax Act or Public Act 244 of 1999.
-- In the course of any litigation, arbitration, or proceeding related to Public Act 244, the master settlement agreement, or the NPM (nonparticipating manufacturer) adjustment settlement agreement.
-- In compliance with provisions in the NPM adjustment settlement agreement related to a data clearinghouse.

Tobacco product sales data provided by another state, a manufacturer, or another person or entity to a data clearinghouse under the NMP adjustment settlement agreement that also are provided to the Department under that agreement must be treated as confidential tax information subject to Section 28 of the revenue Act. This provision applies only to information the Department receives as a result of the NPM adjustment settlement agreement. (Except as otherwise provided, Section 28 of the revenue Act prohibits a current or former employee or authorized representative of the Treasury Department, or anyone connected with the

Department, from divulging any facts or information obtained in connection with the administration of a tax administered by the Department.)

MCL 445.2051 & 445.2052 (S.B. 472)
205.426e (S.B. 473)

BACKGROUND

In the mid-1990s, a number of states filed civil lawsuits against four major tobacco companies (Lorillard, Philip Morris, RJ Reynolds, and Brown & Williamson). Those states alleged that tobacco products produced and marketed by the defendant tobacco companies contributed to health issues, which increased those states' costs of providing public health services to their respective populations. In 1998, the Master Settlement Agreement (MSA) was reached between 46 states and the defendant tobacco companies ("original participating manufacturers" or "OPMs"), although smaller companies have since joined the agreement. (Companies that chose to join the settlement later are referred to as "subsequent participating manufacturers" (SPMs). The OPMs and SPMs are referred to collectively as "participating manufacturers" (PMs).)

Under the settlement, the settling states were required to drop their suits and preclude subsequent lawsuits for a range of future conduct by the tobacco companies. In exchange, the PMs agreed to abide by restrictions pertaining to marketing, advertising, and promotion of cigarettes. The PMs also agreed to deposit funds into an escrow account for annual distribution to the states based on the number of cigarettes sold nationwide. Beginning in 2000, these payments are guaranteed to reach a minimum of $206 billion through 2025, and are due in perpetuity.

The obligation to pay did not apply to tobacco companies that did not sign the MSA; those companies are referred to as "nonparticipating manufacturers". When the settlement was executed, it was understood that the OPMs held over 97% of the market share for cigarettes and that an NPM might have a competitive advantage for not signing the MSA. The settlement includes two provisions that address the possibility that an NPM might increase its market share because of nonparticipation in the settlement and, as a result, decrease revenue to the settling states.

The first was an NPM adjustment, which allows PMs to reduce their contributions for a particular year if: 1) their market share drops 2% or more, and 2) a "nationally recognized firm of economic consultants" determines that participation in the MSA was a significant factor in the loss in market share. The second provision provides protection if the adjustment is triggered on condition that the state adopts a "qualifying statute". A "qualifying statute" requires a tobacco manufacturer that sells cigarettes to consumers in a settling state to either become a PM and comply with the settlement or put into escrow a certain amount of money based on the number of cigarettes it sells to cover smoking-related claims. Michigan adopted a qualifying statute by enacting Public Act 244 of 1999.

Under the MSA, a settling state is subject to a continuing obligation to "diligently enforce" the qualifying statute. A state's failure to do so may trigger the NPM adjustment provision for a particular year's contribution to the escrow account, provided a PM can satisfy the two-part test described above. The meaning of the phrase "diligently enforce" was at issue in a dispute between PMs that sought to invoke the adjustment provisions against a number of states for their market losses to NPMs in the early 2000s. The dispute was resolved by arbitration in September 2013.

Legislative Analyst: Jeff Mann

FISCAL IMPACT

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The bill will result in a small amount of costs to the Department of Treasury and will have no impact on escrow funds. Moving to quarterly deposits into the escrow accounts will not have an impact in the long run; however, it will allow accounts to increase more rapidly for withdrawals needed to be made by the State. The Department will have minor costs to ensure quarterly deposits and reconciliation deposits. These costs will not require additional appropriations to the Department.

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The bill will have no fiscal impact on State or local government.

Fiscal Analyst: Cory Savino

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