Issue Brief – Tobacco Settlement Account

TOBACCO SETTLEMENT GENERAL FUND RESTRICTED ACCOUNT

The Tobacco Settlement Restricted Account was created as a result of a settlement agreement between states and tobacco companies (UCA 63-97-201). The settlement agreement requires tobacco companies to make annual payments to states. The Tobacco Settlement General Fund Restricted Account payments have been declining as companies continue to withhold their Non-participating Manufacturers (NPM) adjustment and place them in a disputed payment account.

OBJECTIVE

The objective of this issue brief is to make the Subcommittee aware of the potential fiscal impact for the Departments of Health and Human Services if the tobacco settlement payments are reduced.

DISCUSSION AND ANALYSIS

In 1998, litigation between the tobacco companies and states was settled in a Master Settlement Agreement (MSA). The agreement requires participating tobacco companies to pay approximately $206 billion over the next 25 years with $12.7 million being paid within five years and $182.5 billion in payments each April through 2025. Distribution of payments is based on percentages agreed upon by the states' attorney generals as listed in the MSA. Utah's allocation is 0.4448869 or $836 million.

Each state's annual payments are subject to three adjustments:

1. An inflationary adjustment equal to the greater of 3% or the Consumer Price Index (CPI) percent change;
2. A volume adjustment based on increases or decreases in the manufacturers' total sales; and
3. A Non-participating Manufacturers (NPM) adjustment if participating manufacturers have suffered a market share loss as a result of the MSA, and states have not enforced their tobacco statutes.

A Non-participating Manufacturer (NPM) adjustment may be applied to the payments to states because of the following three reasons:

1. The participating manufacturers experience a market share loss;
2. An independent economic consultant determines that the Master Settlement Agreement (MSA) was a significant factor in the market share loss; and
3. The state fails to "diligently enforce" statute requiring non-participating manufacturers to contribute to an escrow account.

An independent consultant determined that the MSA was a significant factor in the national market share loss experienced by participating manufacturers in 2003 and 2004. Because of this, most participating companies withheld their NPM adjustments for 2003 and 2004 which reduced their total payments for 2006 and 2007. The withheld monies were placed in a disputed payments account. Utah's share of the disputed payments funding was $3.5 million for 2006 and $3.3 million for 2007. According to the Utah Attorney General, this trend will continue.

The following table shows the history of tobacco settlement payments and distribution of funds since FY 2006:

Tobacco Settlement Restricted Account Payments and Appropriations

	Statutory Ranking	Actual FY 2006	Actual FY 2007	Estimate FY 2008	Estimate FY 2009
Account Balance as of July 1		$6,101,800	$3,190,300	$954,100	$418,200
Tobacco Payments		$19,521,500	$20,493,500	$24,300,000	$24,300,000
Interest/Other		$158,700	$170,000	$150,000	$150,000
Total Payments		**$25,782,000**	**$23,853,800**	**$25,404,100**	**$24,868,200**
Appropriations:					
CHIP	$10,300,000	$10,272,400	$10,321,000	$12,333,100	$10,333,100
Tobacco/Alcohol/Drug Prev	$4,000,000	$4,000,000	$4,000,000	$4,000,000	$4,000,000
Drug Courts	$1,490,000	$1,489,700	$1,490,000	$1,490,000	$1,490,000
Drug Board	$510,000	$510,000	$510,000	$510,000	$510,000
U of U Health Sciences Center	$4,000,000	$4,000,000	$4,000,000	$4,000,000	$4,000,000
Remaining Funds Discretionary					
Department of Health		$2,219,600	$2,303,500	$2,377,600	$2,377,600
Attorney General's Office		$100,000	$275,200	$275,200	$275,200
Total Appropriations	**$20,300,000**	**$22,591,700**	**$22,899,700**	**$24,985,900**	**$22,985,900**
Account Balance as of June 30		**$3,190,300**	**$954,100**	**$418,200**	**$1,882,300**

Utah's Allocation of per Statute

Section 63-97-2 of the Utah Code requires funds from the Tobacco Settlement Restricted Account to be appropriated in the following order based on available funds:

1. $10,300,000 to the Department of Health for the Children's Health Insurance Program (CHIP);
2. $4,000,000 to the Department of Health for alcohol, tobacco and drug prevention programs;
3. $193,700 to the Administrative Office of the Courts (13%) and $1,296,300 to the Department of Human Services (87%) for the drug court program;
4. $77,400 to the Board of Pardons, $350,900 to the Department of Human Services and $81,700 to the Department of Corrections for a drug board pilot program; and
5. $4,000,000 to the University of Utah Health Sciences Center for health education, research and treatment.

In addition, the Legislature may appropriate any additional funds.

Options for Consideration

It will not be known until April of 2008 after the Legislature convenes whether the participating manufacturers withhold an NPM adjustment for FY 2008. There are several options which the Legislature may wish to address:

1. If a shortfall does occur, the Legislature can address the issue in the 2009 General Session with a supplemental appropriation;
2. The Legislature may wish to replace the Tobacco Settlement Restricted Account funding with General Funds for all or part of the allocations in Section 63-97-2 of the Utah Code. This would require a change in statute; or
3. By default, reduce the funding of one or more programs with Tobacco Settlement Restricted funds if there is a shortfall.

RECOMMENDATIONS

It is the recommendation of the Analyst that the Legislature wait until the 2009 General Session to address any shortfalls in the Tobacco Settlement General Fund Restricted Account.