Issue Brief – Tobacco Funds

DEPARTMENT OF HEALTH NUMBER DOH IB 07-34

SUMMARY

FY 2006 marks the seventh year of the State receiving funds from the Master Settlement Agreement with tobacco manufacturers. In those seven years, the state will have received over $200 million. Legislation in 2000 established the Permanent Trust Fund and the Tobacco Settlement Account.

Due to pending litigation, the estimates for FY 2006 and beyond may be uncertain.

OBJECTIVE

The objective of this Issue Brief is to help legislators understand the revenue and distribution of the Tobacco Master Settlement Agreement.

DISCUSSION AND ANALYSIS

The tobacco funding for the fiscal year is received by the State each April. These funds are then distributed according to their statutory allocations. The table below details the revenue and distribution. The FY 2006 and FY 2007 columns are the estimates established by the Governor's Office of Planning and budget.

Tobacco Settlement Payments:
Current Funding for Existing Programs

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Estimated Tobacco Payment	**$27,736,600**	**$27,898,400**	**$32,551,700**	**$32,642,900**	**$27,936,000**	**$28,353,400**	**$29,541,000**	**$30,390,400**
Statutory Split of Payment	**50/50**	**50/50**	**50/50**	**50/50**	**20/80**	**30/70**	**25/75**	**25/75**
Share to Trust Fund	13,868,300	13,949,200	16,275,900	16,321,500	5,587,200	8,506,000	7,385,300	7,597,600
Share to Restricted Account	13,868,300	13,949,200	16,275,900	16,321,500	22,348,800	19,847,400	22,155,800	22,792,800
Trust Fund	**FY 2000**	**FY 2001**	**FY 2002**	**FY 2003**	**FY 2004**	**FY 2005**	**FY 2006**	**FY 2007**
Account Balance as of July 1	***$ -***	***$ 13,788,300***	***$ 27,521,200***	***$ 41,530,800***	***$12,177,400***	***$17,759,200***	***$18,108,900***	***$25,675,300***
Tobacco Payments	13,868,300	13,949,200	16,275,900	16,321,500	5,587,200	8,506,000	7,385,300	7,597,600
Interest/Market Valuation/Other	(80,000)	(216,300)	(2,266,300)	(1,239,900)	(5,400)	349,700	181,100	256,800
Transfer to General Fund/ Rainy Day Fund	0	0	0	(44,435,000)	0	(8,506,000)	0	0
Account Balance as of June 30	***$13,788,300***	***$27,521,200***	***$41,530,800***	***$12,177,400***	***$17,759,200***	***$18,108,900***	***$25,675,300***	***$33,529,700***
Restricted Account	**FY 2000**	**FY 2001**	**FY 2002**	**FY 2003**	**FY 2004**	**FY 2005**	**FY 2006**	**FY 2007**
Account Balance as of July 1	***$ -***	***$ 13,788,300***	***$ 13,608,800***	***$ 12,338,000***	***$ 11,232,400***	***$ 5,246,800***	***$6,101,900***	***$9,153,800***
Tobacco Payments	13,868,300	13,949,200	16,275,900	16,321,500	22,348,800	19,847,400	22,155,800	22,792,800
Interest/Market Valuation/Other	(80,000)	1,471,300	53,300	231,400	73,700	75,500	61,000	91,500
Distributions to Agencies								
CHIP	$0	($5,500,000)	($5,500,000)	($5,496,800)	($6,424,900)	($6,818,800)	($7,003,200)	($7,003,200)
Tobacco Prevention	0	(4,000,000)	(4,000,000)	(4,062,100)	(4,062,100)	(4,076,000)	(4,062,100)	(4,062,100)
Drug Courts	0	(1,490,000)	(1,490,000)	(1,490,000)	(1,490,000)	(1,490,000)	(1,490,000)	(1,490,000)
Drug Board	0	(510,000)	(510,000)	(510,000)	(510,000)	(510,000)	(510,000)	(510,000)
U of U Health Sciences Center	0	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)
Additional Dept. of Health Funding	0	0	(2,000,000)	(1,999,600)	(1,999,600)	(2,073,000)	(1,999,600)	(1,999,600)
Attorney General's Office	0	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)
SB 3 (2003) to General Fund	0	0	0	0	(9,821,500)	0	0	0
Total Account Distributions	**$0**	**($15,600,000)**	**($17,600,000)**	**($17,658,500)**	**($28,408,100)**	**($19,067,800)**	**($19,164,900)**	**($19,164,900)**
Account Balance as of June 30	***$13,788,300***	***$13,608,800***	***$12,338,000***	***$11,232,400***	***$5,246,800***	***$6,101,900***	***$9,153,800***	***$12,873,200***
Shortfall	$ -	$ -	$ -	$ -	$ -	$ -	*$ -*	*$ 97,100*

FY 2000 to FY 2005 = Actual revenues and expenditures
FY 2006 to FY 2007 = GOPB estimates of revenues and expenditures

Pending Litigation

The tobacco settlement has provisions that both the tobacco companies and the states must fulfill. Some audit results may be in dispute and may result in litigation. The Attorney General's Office has issued the following statement on January 4, 2006 to keep the citizens of Utah informed of the situation. It is reproduced on the next page.

Utah's Tobacco Money – Utah Attorney General Statement – January 4, 2006

Landmark litigation against tobacco companies, stemming from decades of allegedly deceitful advertising and illegal marketing of tobacco products aimed at children was brought by a number of states in the mid-1990's, including Utah. The litigation was settled in 1998 when the four largest and several smaller tobacco companies agreed to change their marketing practices and pay $206 billion over 25 years to 46 states, the District of Columbia and five U.S. territories (the "Settling States"). This settlement is known as the Master Settlement Agreement (MSA). Utah's share of the settlement is $836 million. Tobacco product manufacturers (TPM) that signed the MSA pay the Settling States on an annual basis.

In recognition of the obligations assumed by the TPM under the terms of the MSA, and the possibility that the obligations could result in a loss of the TPM market share of tobacco products sold in the United States, the MSA includes a provision for a potential adjustment to the TPM annual payment to the states. Whether or not that adjustment is applied is subject to a three step analysis, which is set out in detail in the MSA.

First, the TPM are required to give notice that they intend to seek an NPM Adjustment in their annual payment due to a market share loss during a specific year. An independent auditor then takes the information submitted by the TPM and makes a determination if, in fact, the TPM have suffered a market share loss in the sale of tobacco products in the United States. For 2003, the potential national NPM adjustment due to the TPM market share loss is approximately $1.4 billion.

The next step is for an independent auditor to determine if the MSA was a "significant factor" causing that market share loss to the TPM. The independent auditor is currently in the process of reviewing evidence from both the TPM and the Settling States in order to make the "significant factor" determination. It is anticipated that the independent auditor's findings and conclusion will be issued in March of 2006.

If the independent auditor concludes that the MSA was a significant factor in the market share loss suffered by the TPM, the NPM adjustment may be applied to the Settling States; however, its application is not automatic. The MSA states that the NPM adjustment will not be applied to an individual state's payment if that state "diligently enforced" its NPM laws. If a state diligently enforced those laws, the NPM adjustment is reallocated to the Settling States that did not "diligently enforce" its NPM legislation.

The conclusion is that if the independent auditor determines the MSA was a "significant factor" in the market share loss experienced by the TPM in 2003, there will be legal action to determine whether the NPM adjustment applies to Utah, and the extent to which it applies. At this point in the process, it is not possible to determine whether Utah will be receiving the entire TPM payment that is anticipated on April 15, 2006 (approximately $28 million), or just a portion thereof. If the tobacco companies fail to make the scheduled payment, the state will take appropriate legal action to enforce its rights under the MSA.

LEGISLATIVE ACTION

The Analyst recommends that the Subcommittee draft a letter to Executive Appropriations to make them aware of the situation.

No other legislative action is required at this time.