



# TOBACCO SETTLEMENT RESTRICTED ACCOUNT

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ISSUE BRIEF

**SUMMARY**

Receipts to the Tobacco Settlement Restricted Account will likely be \$944,000 or 4% lower than anticipated in FY 2011 and \$7,078,500 or 25% short in FY 2012. A 4% reduction in FY 2011 total receipts translates into a 25% reduction in discretionary appropriations. A 25% reduction in FY 2012 total receipts translates into a 95% reduction in discretionary appropriations. The Legislature has at least five options to respond to this situation, ranging from “do nothing” to hold-harmless with other revenue.

**DISCUSSION AND ANALYSIS**

***What is the Tobacco Settlement Restricted Account?***

In April of each year, the Tobacco Settlement Restricted Account receives 60% of annual payments from tobacco companies under the 1998 Master Settlement Agreement (UCA 51-9-201). Beginning July 1, 2011, the other 40% goes to the General Fund as per changes made in HB 454 “*Tobacco Settlement Funds Amendment*” (Litvack). UCA 51-9-201 has specific dollar amounts in statute for five purposes and an option of appropriating the settlement account for discretionary purposes. Discretionary appropriations by the Legislature appear last in statute and are the lowest legal priority when there are revenue shortfalls. These discretionary appropriations are reduced first before any of the fixed dollar amounts in statute and are indicated in the “discretionary appropriations” column in the two tables below.

***What is the current status of the account?***

For FY 2011, the Legislature appropriated \$24,569,300 from the account. For FY 2011 we expect a shortfall of \$944,000 or 4%. One method to reduce appropriations in accordance with statute is to proportionally reduce all of the “discretionary appropriations” not specifically detailed in statute, as was done in FY 2010. Because discretionary appropriations would be the first thing to go under this scenario, a 4% reduction in overall Tobacco Settlement funds means a 25% reduction in discretionary appropriations. The Department of Finance, under the direction of the Governor’s Office of Planning and Budget, has indicated that it will implement the reductions across the board for the discretionary appropriations. The table below shows the final appropriations as well as how a proportional allocation to the “discretionary appropriations” impacts those appropriations:

FY 2011 - Adjustments to Original Appropriations					
Agency	Program/Purpose (From Statute)	Statute UCA 51-9-201	Discretionary Appropriations	Potential Reductions	Net Available
Health	Children’s Health Insurance Program	\$ 10,452,900	\$ 1,227,800	\$ (309,100)	\$ 11,371,600
Health	alcohol, tobacco and drug prevention programs	\$ 3,847,100	\$ 2,011,000	\$ (506,200)	\$ 5,351,900
Courts <sup>1</sup>	drug court	\$ 193,700	\$ 159,100	\$ (40,000)	\$ 312,800
Human Services <sup>1</sup>	drug court	\$ 2,325,400	\$ -	\$ -	\$ 2,325,400
University of Utah	in-state research, treatment, and educational activities	\$ 4,000,000	\$ -	\$ -	\$ 4,000,000
Attorney General		\$ -	\$ 276,100	\$ (69,500)	\$ 206,600
Tax Commission		\$ -	\$ 76,200	\$ (19,200)	\$ 57,000
<b>Total</b>		<b>\$ 20,819,100</b>	<b>\$ 3,750,200</b>	<b>\$ (944,000)</b>	<b>\$ 23,625,300</b>

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For FY 2012, the Legislature appropriated \$28,236,300 from the account. The Analyst estimates a shortfall of \$7,078,500 or 25% in FY 2012. As with FY 2011, one way to address the shortfall is to proportionally reduce all of the “discretionary appropriations” not specifically detailed in statute. Because discretionary appropriations would be the first thing to go under this scenario, a 25% reduction in overall Tobacco Settlement revenue means a 95% reduction in discretionary appropriations for FY 2012. The table below shows the original appropriations as well as how a proportional allocation to the “discretionary appropriations” would impact those appropriations:

<b>FY 2012 - Adjustments to Original Appropriations</b>					
<b>Agency</b>	<b>Program/Purpose (From Statute)</b>	<b>Statute UCA 51-9-201</b>	<b>Discretionary Appropriations</b>	<b>Potential Reductions</b>	<b>Net Available</b>
Health	Children’s Health Insurance Program	\$ 10,452,900	\$ 3,644,300	\$ (3,477,900)	\$ 10,619,300
Health	alcohol, tobacco and drug prevention programs	\$ 3,847,100	\$ 2,410,700	\$ (2,300,600)	\$ 3,957,200
Courts <sup>1</sup>	drug court	\$ 193,700	\$ 159,100	\$ (151,800)	\$ 201,000
Human Services <sup>1</sup>	drug court	\$ 2,325,400	\$ -	\$ -	\$ 2,325,400
University of Utah	in-state research, treatment, and educational activities	\$ 4,000,000	\$ -	\$ -	\$ 4,000,000
General Fund	one-time deposit		\$ 850,000	\$ (811,200)	\$ 38,800
Attorney General		\$ -	\$ 276,300	\$ (263,700)	\$ 12,600
Tax Commission		\$ -	\$ 76,800	\$ (73,300)	\$ 3,500
<b>Total</b>		<b>\$ 20,819,100</b>	<b>\$ 7,417,200</b>	<b>\$ (7,078,500)</b>	<b>\$ 21,157,800</b>

***How did the shortfall situation occur?***

The year 2011 marks the first time that Philip Morris, Inc. withheld part of its payment to the State. Philip Morris withheld a total of \$1,905,300, of which \$1,143,200 or 60% would have gone to the Tobacco Settlement Restricted Account. Additionally, other companies did not pay or increased withholdings over 2010 by \$543,700 of which \$326,200 or 60% would have gone to the Tobacco Settlement Restricted Account.

***In General, Why are Revenues Going Down?***

The amount paid by tobacco companies to the states participating in the Master Settlement Agreement is largely based on a company’s sales volume as well as an annual adjustment for inflation. The following issues affected the FY 2011 and FY 2012 tobacco company payments to the Tobacco Settlement Restricted Account:

- 1. Increased federal cigarette tax** – The cost of cigarettes increased about 25% nationwide effective March 31, 2009 from the federal government’s increased tax of \$1 per pack. This reduced consumption by about 10%.
- 2. Economic downturn** – As personal incomes have decreased, the purchasing of cigarettes also decreased.
- 3. Timing of the payment** – Currently the revenue for a fiscal year comes in the last quarter of that fiscal year (i.e. – April 2011 for FY 2011). When shortfalls do occur, this means that programs have about 60 days to make up for the reduced revenues in the current fiscal year.

***Is there any hope of revenues coming in higher than current projections?***

Based on the current economic outlook for FY 2012, revenues may go up or down, but probably not significantly. Since 2000 tobacco companies have not paid Utah tens of millions of dollars in scheduled payments. Tobacco companies either withhold or pay into a disputed payments account. It is unknown when or if the State will prevail in obtaining these disputed payments. Individual cases by states to obtain

withholdings from 2003 may start as early as 2012; however, none of the money from the accounts may be released until a majority of the states nationwide suing for the money complete the arbitration process.

### **LEGISLATIVE ACTION**

1. **Do nothing and allow each agency to address the shortfalls** – the ongoing estimated shortfall beginning in FY 2013 is \$6.2 million. This amount may be reduced if payments from tobacco companies increase because consumers chose to buy more tobacco products. If no action is taken, then in FY 2012 affected programs will have to meet the (\$7,078,500) in reductions as shown in the table above.
2. **Prioritize the payments from tobacco companies for the Tobacco Settlement Restricted Account** – instead of the current 60%/40% split in statute, change statute to have all funds first go the restricted account and then the remainder to the General Fund. The use of this mechanism will decrease revenues going to the General Fund in years with shortfalls.
3. **Change the appropriations from the account** – in FY 2012 the money from this account goes to help fund seven programs and one revenue exchange. The Legislature could make changes to the amounts appropriated and/or remove recipients altogether.
4. **Base appropriations on prior year receipts** – currently the revenue for a fiscal year arrives in the last quarter of that fiscal year (i.e. - April 2011 for FY 2011). If the Legislature found a one-time source to replace all the money for one year, then the Legislature could know how much revenue would be available in April for the following fiscal year (i.e. - April 2011 for FY 2012). This may help avoid unanticipated program reductions at the end of the year.
5. **Find another funding source to address the shortfall** – the Legislature may be interested in identifying a source to fund some or all of the shortfall of \$7.1 million in FY 2012. Of the \$7.1 million FY 2012 shortfall, \$6.2 million is an ongoing problem. A one-time funding source would only solve the problem for a year.

***How is the Tobacco Settlement Restricted Account Money Used?***

1. **Health - Children's Health Insurance Program:** provides health insurance coverage to about 38,300 uninsured children up to age 19 living in families with incomes less than 200 percent of the Federal Poverty Levels (FPL). Additionally, eligible children must: (1) not be currently covered by health insurance, (2) not have voluntarily terminated private health insurance within the last 90 days, and (3) be U.S. citizens or legal residents. There is no asset test for CHIP eligibility.
2. **Health - alcohol, tobacco and drug prevention programs:** The Tobacco Prevention and Control Program (TPCP) provides technical expertise and coordination at State and community levels to prevent and reduce tobacco use in Utah. The goals of the TPCP are to promote quitting among young people and adults, prevent initiation of tobacco use among young people, eliminate nonsmokers' exposure to secondhand smoke, and identify and eliminate disparities in tobacco use among populations groups.
3. **Courts - drug court:** "probation officers in juvenile drug courts (for monitoring and testing participants), and for clerks in district courts, who have to handle much of the drug court workload - scheduling, coordinating, issuing warrants, arranging jail transport, etc." 3/1/2011 email from Richard Schwermer, Assistant State Court Administrator
4. **Human Services - drug court:** Drug Courts is a judicial process that offers nonviolent drug abusing offenders intensive court-supervised drug treatment as an alternative to jail or prison. The local area substance abuse authorities and private contractors provide treatment services. Currently, 29 of the 35 drug courts operating in the state receive funding from the Department of Human Services. Each drug court has its own eligibility criteria. However, most look at both a potential participant's legal history as well as the clinical severity of the addiction. In most drug courts, offenders enter a guilty plea which is then held in abeyance for the duration of the program. The charges are then dismissed upon successful completion of the program. Drug court participants are enrolled in the program for approximately 73 weeks. Treatment counselors develop individualized treatment plans. The participants are randomly tested for drug use from one to four times a week. The drug court judge reviews compliance with the treatment plan during weekly court reviews. In most programs, participants must be clean for at least six months to graduate. Failure to comply with any element of the program or having a positive drug test may result in immediate court action such as being taken to jail. Compliance and progress in the program are rewarded with praise from the court and a gradual decrease in supervision. Utah has four distinct drug court models: 1) Adult Felony Drug Courts, 2) Juvenile Drug Courts, 3) Misdemeanor Drug Courts, and 4) Dependency Drug Courts.
5. **University of Utah - in-state research, treatment, and educational activities:** In 2011 President Machen received approval from the Capital Facilities committees to use some of the Tobacco Settlement funds to pay the University's portion of the bond on the cancer clinical research hospital. Since then \$2 million has been allocated to the bond payment and \$2 million to cancer research. When that payment is complete, the full \$4 million will be invested in research as described in the statute.
6. **Attorney General:** uses this money for ongoing defense and enforcement of the settlement agreement.
7. **Tax Commission:** used for an FTE to ensure businesses' compliance with the settlement agreement.

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<sup>1</sup> UCA 78A-5-201(3)(a) requires funds disbursed to a drug court program be allocated 87 percent to the Department of Human Services for testing, treatment, and case management and 13 percent to the Administrative Office of the Courts for increased judicial and court support costs. After the FY 2011 and FY 2012 proportional Tobacco Settlement reductions, allocations will not match this 87/13 split. The Legislature may amend either the 87/13 split statute, or make Courts' discretionary appropriation statutory instead.