TOBACCO SETTLEMENT FUNDS

EXECUTIVE APPROPRIATIONS COMMITTEE
STAFF: RUSSELL FRANDSEN

ISSUE BRIEF

SUMMARY

The State received $26.5 million more from tobacco settlement funds in FY 2018 as compared to FY 2017. These funds increased the deposits into the Tobacco Settlement Restricted Account by $15.9 million and the General Fund by $10.6 million. Current appropriations from the Tobacco Settlement Restricted Account are in conflict with two Utah laws. The Legislature may want to act on one or more of the following four options to respond to this situation.

LEGISLATIVE ACTION (OPTIONS)

1. **Do nothing and leave the $24.5 million balance** – the Tobacco Settlement Restricted Account should end FY 2018 with a balance of $24.5 million. The fund balance would only be used to the extent ongoing revenues are lower than the ongoing expenditures of $15.7 million. Current forecasts from the attorney general project sufficient ongoing revenue to cover ongoing expenditures through at least FY 2021.
2. **Use the $24.5 million fund balance** – there are no statutory restrictions on the uses of the $24.5 million fund balance in the Tobacco Settlement Restricted Account. Based on the average shortfall of (2.5%) over the seven most recent years with shortfalls, the Analyst recommends leaving $400,000 in the fund as a one-year buffer based on current appropriations.
3. **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 2018 for FY 2018). If the Legislature left $15.7 million in the account to replace all the account distributions for one year, then the Legislature could know how much revenue would be available in April for the following fiscal year (i.e. - April 2018 for FY 2019). This may help avoid unanticipated program reductions at the end of the year as has happened in seven of the past nine fiscal years.
4. **Update statutory distributions** – current appropriations from the Tobacco Settlement Restricted Account are lower than the statutorily-required minimum in statute (UCA 51-9-201) by $5.2 million. Further, the split for funding for drug courts (Human Services vs Courts) does not match the statutorily-required 87/13 split required in UCA 78A-5-201.

DISCUSSION AND ANALYSIS

What is the Master Settlement Agreement (MSA)?

On November 23, 1998, the attorneys general from 46 states (all but Florida, Minnesota, Mississippi, and Texas), the District of Columbia, and four territories agreed to a settlement with the five major tobacco companies. The significant points of the settlement involve annual payment to the states, the elimination of marketing geared toward young people, the limitation of corporate sponsorships, and the prohibition of the companies' lobbying state and local governments. The amount each state receives from the total settlement is based on a formula agreed upon by the attorneys general. In return, the tobacco companies now have the assurance that all pending lawsuits against them will be dropped and no new suits will be filed. The settlement contains no requirements on how the funds must be used. Distribution of payments is based on percentages agreed upon by the states' attorney generals as listed in the MSA. Utah's allocation is 0.44%.

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 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.

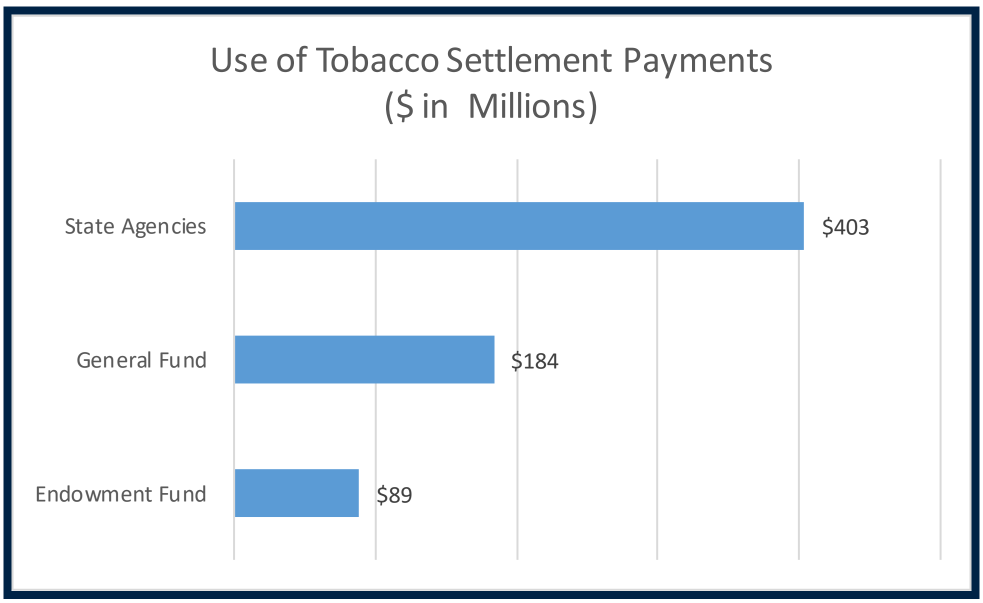
A Non-participating Manufacturer (NPM) adjustment may be applied to the payments to states because of the following three reasons:

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. Since that time, the states have conceded the issue. This allows the participating manufacturers to withhold a portion of each state's allocation of the NPM adjustment. The withheld monies were placed in a disputed payments account.

How Will the State Have Used Its $676 Million in Tobacco Settlement Payments?

The State of Utah has received a total of $676 million through FY 2018 in total tobacco settlement payments since they began in FY 2000. The State will have used the $676 million in the following three ways as shown in the table below: (1) $403 million in payments to state agencies, (2) $184 million in deposits to the General Fund, and (3) $89 million of deposits into the State Endowment Fund.



Currently, statute directs the following two purposes for the annual tobacco payments:

1) 60% goes into the Tobacco Settlement Restricted Account as per UCA 51-9-201.
2) 40% goes into the General Fund as per UCA 51-9-202.

Why Was the State of Utah FY 2018 Tobacco Settlement Payment $26.5 Million Higher Than FY 2017?

Since FY 2006 tobacco companies have been withholding part of their payments and putting them into a disputed payments account. The tobacco companies claimed that states were not adequately enforcing as required by the terms of the tobacco settlement against the tobacco companies who were not a part of the settlement. Further, the tobacco companies claimed that participating tobacco companies had suffered a market loss due to the Master Settlement Agreement. Since that time, the states have conceded the issue.

This allows the participating manufacturers to withhold a portion of each state's allocation of the NPM adjustment. The one-time increase in funds is from the release of the majority of funds put into the disputed payments account plus earnings from FY 2007 through FY 2018. Additionally, as part of the agreement Utah will have expanded enforcement obligations over contraband cigarettes, internet sales, and some tribal sales.

Why a $24.5 Million Ending Balance in FY 2018 for the Tobacco Settlement Restricted Account?

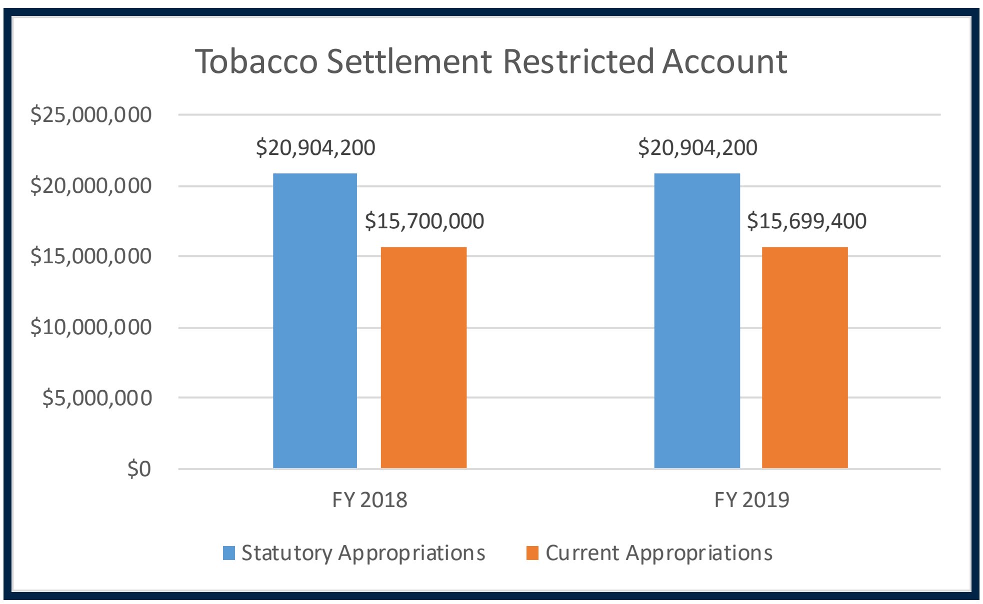
The State received a total of $63.0 million from tobacco settlement funds in FY 2018. The Tobacco Settlement Restricted Account will end FY 2018 with a $24.5 million ending balance for two reasons:

1) $22.1 million – of the $63.0 million received by the state 60% or $37.8 million goes into the Tobacco Settlement Restricted Account (the other 40% goes into the General Fund). The $37.8 million in revenues for the account is $22.1 million higher than the appropriations of $15.7 million in FY 2018.
2) $2.4 million – the Tobacco Settlement Restricted Account ended FY 2017 with a fund balance of $2.4 million because revenues were higher than appropriations.

End of About $12 Million Ongoing From Strategic Contribution Payments Starting in FY 2018

The State of Utah lost all annual Strategic Contribution Payments of about $12 million in tobacco settlement funds beginning in FY 2018. Of the $12 million loss about $7.2 million would be lost for the Tobacco Settlement Restricted Account. As can be seen in the first table on page seven, these payments began in FY 2008. Strategic Contribution Payments go to states that invested resources into pursuing litigation against tobacco companies. The State addressed this ongoing loss and reduced appropriations from the Tobacco Settlement Restricted Account a total of $8.0 million from FY 2016 to FY 2018. Based on the attorney general's low range estimate of future tobacco settlement payments there should be enough ongoing revenues through at least FY 2021 to support ongoing appropriations of $15.7 million.

Statutory Funding Requirements Are Higher Than Current Appropriations From the Account



[UCA 51-9-201](#) directs that fixed dollar amounts totaling $20.9 million be used for seven purposes and that remaining settlement funds can be appropriated for any discretionary purposes. Currently, appropriations are $5.2 million lower than the level required in statute as show in the table above. The Division of Finance indicates that it plans to follow appropriations for the amount to distribute from the Tobacco Settlement Restricted Account based on the statutory direction of "To the extent that funds will be available for appropriation in a given fiscal year, those funds shall be appropriated from the account in the following order" in UCA 51-9-201(4). *The Legislature may want to open a bill file to change the statutorily-required appropriations in statute to match appropriations.*

Current Appropriations Are Out of Compliance With Statute

UCA 78A-5-201(3)(a) requires state funds disbursed to a drug court program be allocated 87% to the Department of Human Services for testing, treatment, and case management and 13% to the Administrative Office of the Courts for increased judicial and court support costs. The state funds spent or appropriated from FY 2017 through FY 2019 do not match this 87/13 split as shown in the table below. The Legislature may want to amend either the 87/13 split statute or the appropriations to Courts and/or Human Services. *The Legislature may want to open a bill file to fix the current conflict with statute or provide direction to the two affected appropriations subcommittees to fix the issue via appropriations changes.*

Drug Courts - State Funds	FY 2017		FY 2018 (est.)		FY 2019 (est.)	
	Human Services	Courts	Human Services	Courts	Human Services	Courts
General Fund	$ 1,597,200	$ 226,800	$ 2,331,400	$ 502,600	$ 2,682,200	$ 502,600
Tobacco Settlement Restricted Account	$ 2,311,600	$ 369,000	$ 1,121,200	$ 193,700	$ 1,121,200	$ 193,400
State Asset Forfeiture Grant (Transfers)	$ 425,000		$ 375,000		$ 250,000	
Total	$ 4,333,800	$ 595,800	$ 3,827,600	$ 696,300	$ 4,053,400	$ 696,000
Percentage Split	88%	12%	85%	15%	85%	15%
Change Required to Obtain 87%/13% Split	**$ (45,000)**	**$ 45,000**	**$ 108,200**	**$(108,200)**	**$ 78,600**	**$ (78,600)**

Tobacco Settlement Restricted Account				
Fiscal Year	Appropriations	Expenditures	(Shortfall)	% Difference
2002	$17,830,500	$ 17,830,400	$ (100)	0%
2003	$ 17,658,500	$ 17,658,500	$ -	0%
2004	$ 28,408,100	$ 28,408,100	$ -	0%
2005	$ 19,067,900	$ 19,067,800	$ (100)	0%
2006	$ 22,591,700	$ 22,591,700	$ -	0%
2007	$ 22,729,700	$ 22,729,700	$ -	0%
2008	$ 24,985,600	$ 24,985,600	$ -	0%
2009	$ 23,120,000	$ 23,120,000	$ -	0%
2010	$ 26,278,000	$ 26,050,400	$ (227,600)	-1%
2011	$ 24,260,700	$ 23,627,400	$ (633,300)	-3%
2012	$ 22,264,200	$ 21,838,400	$ (425,800)	-2%
2013	$ 22,140,400	$ 21,874,000	$ (266,400)	-1%
2014	$ 22,173,000	$ 22,173,000	$ -	0%
2015	$ 23,704,300	$ 22,737,900	$ (966,400)	-4%
2016	$ 23,719,400	$ 22,162,100	$ (1,557,300)	-7%
2017	$ 19,607,900	$ 19,553,200	$ (54,700)	0%
2018	$ 15,700,000	$ 15,700,000	$ -	0%

How Often Has the Tobacco Settlement Restricted Account Had Shortfalls in the Past?

The Tobacco Settlement Restricted Account has had shortfalls in seven of the past nine years. The size of the shortfall has ranged from less than 1% or $(54,700) in FY 2017 to (7%) to $(1,557,300) in FY 2016. The table on the bottom of the previous page compares the appropriations and expenditures by year for the account from FY 2002 through FY 2018.

How is the Tobacco Settlement Restricted Account Money Used?

1. **Attorney General**: uses this money for ongoing defense and enforcement of the settlement agreement.
2. **Tax Commission**: used for part of an FTE to ensure businesses' compliance with the settlement agreement.
3. **Health - Children's Health Insurance Program/Medicaid**:
    a. Children's Health Insurance Program (CHIP) - provides health insurance coverage to about 19,000 previously uninsured children up to age 19 living in families with incomes less than 200% of the Federal Poverty Levels (FPL) on an annual basis. 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.
    b. Medicaid - provides health insurance coverage to about 193,700 children under the age of 19 with family incomes less than 185% of the FPL each month. These children must be U.S. citizens or legal residents to receive full coverage through Medicaid, but can receive emergency only services otherwise. There is not an asset test for most children.
4. **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.
5. **Courts - drug court**: 5/3/2018 email from Jacey Skinner, State Court Administrator:
    a. "Juvenile Court Drug Courts: Drug court funds are used to provide probation officers and judicial assistants in drug courts. Probation officers monitor and facilitate necessary testing of juvenile drug court participants.
    b. District Courts: Drug Court funds are used to provide judicial assistants in district courts to support and provide staff to drug courts. The support includes, among other things, scheduling, coordinating, issuing warrants, and arranging jail transport."
6. **Human Services - drug court**: Drug courts provide eligible participants intensive court-supervised drug treatment as an alternative to jail or prison. The local area substance abuse authorities provide treatment services. Currently, 47 of the 50 drug courts operating in the state (excluding mental health and veterans drug courts) receive funding from the Department of Human Services. Eligibility for Drug Court requires that an individual be identified as high risk for recidivism and in high need of substance abuse treatment services. 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 three times a week. The drug court judge reviews compliance with the treatment plan during weekly court reviews. In most programs, participants must be drug-free 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 that receive funding from the Department of Human Services: 1) Adult Drug Courts, 2) Juvenile Drug Courts, 3) Misdemeanor Drug Courts, and 4) Dependency Drug Courts.

What is the State Endowment Fund?

Article XXII, Section 4 of the Utah Constitution explains the purpose of the State Endowment Fund: "the state treasurer shall, as provided by statute, hold all trust funds and assets in trust and invest them for the benefit of the people of the state in perpetuity." Additionally, Article XXII, Section 4 of the Utah Constitution directs that money currently in the fund can only be accessed by a ¾ vote of each house of the Legislature and the approval of the Governor. There are no regular expenditures approved for this trust fund. UCA 51-7b outlines the restrictions on investments for the State Endowment Fund. The State Endowment Fund ended FY 2017 with a balance of $196.2 million.

Additionally, UCA 51-9-202 directs that the fund keep half of its interest earnings from the tobacco payments and the other half be deposited into the General Fund. This fund also receives excess severance tax revenues over statutory limits at the end of each year as per UCA 51-9-305. The first table on page seven details the annual changes to the ending balance of the State Endowment Fund.

APPENDIX

Uses of Tobacco Settlement Restricted Account				
Agency	**Program/Purpose (From Statute)**	**Statute UCA 51-9-201**	**FY 2018 Appropriations Higher/(Lower) vs Statute**	**FY 2019 Appropriations Higher/(Lower) vs Statute**
Attorney General	enforcement and defense of the Tobacco Settlement Agreement	$66,600	$0	($600)
Tax Commission	enforcement of business compliance	$18,500	$0	$0
Health	Children's Health Insurance Program/Medicaid	$10,452,900	$0	$0
Health	alcohol, tobacco and drug prevention programs	$3,847,100	$0	$0
Courts	drug court	$193,700	$0	$0
Human Services	drug court	$2,325,400	($1,204,200)	($1,204,200)
University of Utah	in-state research, treatment, and educational activities	$4,000,000	($4,000,000)	($4,000,000)
Total		**$20,904,200**	**($5,204,200)**	**($5,204,800)**

Fiscal Year	Tobacco Settlement Payments	Account Deposits for Payments to State Agencies	Payments to General Fund	Payments to Endowment Fund
2000	$ 27,736,600	$ 13,868,300	$ -	$ 13,868,300
2001	$ 27,898,400	$ 13,949,200	$ -	$ 13,949,200
2002	$ 32,551,700	$ 16,275,800	$ -	$ 16,275,900
2003	$ 32,642,900	$ 16,321,500	$ 44,435,000	$ (28,113,600)
2004	$ 27,936,000	$ 18,348,800	$ 4,000,000	$ 5,587,200
2005	$ 28,353,400	$ 19,847,400	$ 8,506,000	$ -
2006	$ 26,028,600	$ 19,521,400	$ -	$ 6,507,200
2007	$ 27,244,100	$ 20,433,100	$ -	$ 6,811,000
2008	$ 42,059,200	$ 25,235,500	$ -	$ 16,823,700
2009	$ 45,249,700	$ 27,149,800	$ -	$ 18,099,900
2010	$ 38,191,000	$ 22,084,000	$ 830,600	$ 15,276,400
2011	$ 35,734,700	$ 21,440,800	$ 11,350,900	$ 2,943,000
2012	$ 36,426,700	$ 21,006,000	$ 15,420,700	$ -
2013	$ 36,419,900	$ 21,851,900	$ 14,568,000	$ -
2014	$ 39,426,500	$ 23,655,900	$ 15,770,600	$ -
2015	$ 35,412,200	$ 21,247,300	$ 14,164,900	$ -
2016	$ 36,931,900	$ 21,493,900	$ 14,772,800	$ 665,200
2017	$ 36,547,300	$ 21,928,400	$ 14,618,900	$ -
2018	$ 63,038,800	$ 37,823,300	$ 25,215,500	$ -
Total	**$ 675,829,600**	**$ 403,482,300**	**$183,653,900**	**$ 88,693,400**

Fiscal Year	Tobacco Settlement Payments	Interest and Fair Market Adjustments	Severance Taxes	Endowment Fund Ending Balance
2000	$ 13,868,300	$ (80,000)	$ -	$ 13,788,300
2001	$ 13,949,200	$ (216,300)	$ -	$ 27,521,200
2002	$ 16,275,900	$ (2,266,300)	$ -	$ 41,530,800
2003	$ (28,113,500)	$ (1,239,900)	$ -	$ 12,177,400
2004	$ 5,587,200	$ (5,400)	$ -	$ 17,759,200
2005	$ -	$ 349,700	$ -	$ 18,108,900
2006	$ 6,507,200	$ 54,700	$ -	$ 24,670,800
2007	$ 6,811,000	$ 1,739,400	$ -	$ 33,221,200
2008	$ 16,823,700	$ (4,210,500)	$ -	$ 45,834,400
2009	$ 18,099,900	$ (7,471,100)	$ 23,016,800	$ 79,480,000
2010	$ 15,276,400	$ 4,776,800	$ 7,193,200	$ 106,726,400
2011	$ 2,943,000	$ 11,289,300	$ -	$ 120,958,700
2012	$ -	$ 2,579,700	$ -	$ 123,538,400
2013	$ -	$ (2,848,600)	$ -	$ 120,689,800
2014	$ -	$ 22,259,100	$ 16,559,500	$ 159,508,400
2015	$ -	$ 8,582,400	$ 975,500	$ 169,066,300
2016	$ 665,200	$ 1,637,200	$ -	$ 171,368,800
2017	$ -	$ 19,422,800	$ 5,380,000	$ 196,171,500
Total	**$ 88,693,500**	**$ 54,353,000**	**$ 53,125,000**	