Office of the Legislative Fiscal Analyst
Presentation to the Executive Appropriations Committee
November 16, 1999
Summary of Tobacco Settlement

Background

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 the payment of approximately $206 billion over the next 25 years 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. Funds from the settlement will be deposited into the restricted General Fund account, as explained below (Senate Bill 173).

Important Dates

The various non-monetary points of the settlement take effect on dates relative to the "master settlement execution date" (November 23, 1998). The dates dealing with the monetary points are the "state specific finality date",(the date when the state court gives final approval to the state's settlement and consent decree) and the final approval date for the Master Settlement Agreement (M.A.). The date of Utah's consent decree was **January 6, 1999**, the initial step of trial court approval. The state specific finality date was approved in **February 1999**, following the 30-day appeal time period required under state law. The final approval date is the earlier of **June 30, 2000**, or whenever 80 percent of the states reach their state specific finality date and those states represent 80 percent of the payments. While most people were resigned to the June 30, 2000 date, it now appears that the 80/80 milestone could be reached prior to the end of 1999. To date, 44 states have attained state-specific finality, representing 79.7 percent on the settlement payment amount. Virginia appears to be very close to attaining state-specific finality. If this occurs, final approval would occur in this month or next, after which the first initial payment would be received by the State.

Utah-specific Information

In December of 1998, the tobacco companies made the first Initial Payment of $2.4 billion. These funds have been held in an escrow account, drawing interest, until the final approval is reached. Utah's share of this first Initial Payment is expected to be approximately $10.5-11.0 million and could be made by the end of this year. Assuming the final approval is reached by the end of 1999, the ensuing payments would be made as outlined in the following table:

Date	Applicable Year	Initial Payment	Annual Payment
12/31/99	1998	$10,700,000	
1/10/00	2000	$11,000,000	
4/15/00	2000		$17,500,000
1/10/01	2001	$11,300,000	
4/15/01	2001		$19,500,000
1/10/02	2002	$11,700,000	
4/15/02	2002		$25,300,000
1/10/03	2003	$12,000,000	
4/15/03	2003		$25,300,000
4/15/04	2004		$31,200,000
4/15/05	2005		$31,200,000
4/15/06	2006		$31,200,000
4/15/07	2007		$31,200,000
		subject to Volume adjustments	subject to Volume adjustments, inflation adjustments

Specific Legislation

During the 1999 Legislative Session, the following bills were passed to facilitate the settlement and resulting inflow of money:

House Bill 132 — enacted the Model Tobacco Settlement Statute, which requires tobacco manufacturers selling cigarettes in the state to either comply with the Master Settlement Agreement or place sufficient funds in an escrow account to pay its costs of the agreement

House Bill 375 — clarified the wording in the Master Settlement Agreement and defined additional terms

Senate Bill 173 — established a restricted account within the General Fund known as the Tobacco Settlement Account, consisting of all funds received by the State from the settlement, and requiring a Legislative appropriation for the use of any of those funds

Potential Losses to the State Allocation

Although the total settlement is estimated at $206 billion over the next 25 years, with Utah's share estimated at $836 million, there are potential reductions to that amount. Efforts by the federal government to recoup a significant portion of the funds would impact the net amount received by the states. Other lawsuits against the tobacco companies could also affect their ability to make the payments called for in the Master Settlement Agreement. In addition, the settlement is written to allow reductions in the amount paid out by the tobacco companies, based on the volume of cigarettes sold. Since the State's revenue source from tobacco taxes is based on the volume sold, this could also be indirectly affected by the terms of the settlement.

Federal Medicaid Recoupment	Early in the settlement process, the federal government asserted that the settlement money is reimbursement for funds expended under the Medicaid program for costs related to smoking, and as a result, it has a legal right to a portion of the funds. While Congress has taken steps to avert this, the possibility should not be totally discounted. The federal government could simply reduce its Medicaid payments to the state. If this occurs, then the states would likely use a corresponding portion of the settlement funds to cover this reduction. It is likely that such a reduction would be made to the individual states' Federal Medicaid Assistance Percentage (FMAP) rate. For FY 2000, Utah's FMAP rate is 71.64 percent, meaning that federal funds pay for 71.64 percent of Utah's Medicaid program. The FMAP rate has been decreasing slightly for a number of years. If the federal government succeeds in its claim on a portion of the settlement funds, and it uses the FMAP rate, <u>Utah could stand to lose 70 to 75 percent of the settlement amount attributed to Medicaid expenditures.</u>
Other Legal Action	The Master Settlement Agreement precludes states from any further legal action against the tobacco companies. However, it does not preclude the Federal government or individuals from pursuing legal action against them. A class-action lawsuit has been filed in Florida and could have significant implications for the tobacco companies involved. The case is rapidly approaching the penalty phase, where it is expected that an award of $200-300 billion could be made. If this occurs, or if the tobacco companies agree to settle with the litigants, it could open the door to further lawsuits brought on by other individuals or groups. This case alone, and certainly if there were other substantial awards or agreements, could seriously impact the tobacco companies' financial ability to make the required payments.
Volume Adjustment	The settlement provides that decreases in cigarette sales volume can be offset by reduced payment to the states. For example, if the increased prices and the ban on advertising, combined with any favorable outcomes from cessation programs (a suggested use of the funds) result in a decrease in the volume of cigarettes sold by 10 percent, payments under the settlement can be reduced by eight percent. <u>The desired result of decreasing tobacco consumption will have a negative impact on the financial aspects of the settlement for the states</u>.

It should be noted that the settlement funds from the tobacco companies will come from the profits from future cigarette sales, yet one of the main objectives of the states is to reduce tobacco consumption. If that objective is achieved, there would be no profits from which to pay the settlement.

The number and severity of these potential losses to the state's allocation indicates that any funds received from the Master Settlement Agreement should be considered one-time in nature and probably should not be used toward funding on-going programs or projects.

Other Potential Losses to the State

Tobacco companies have increased their prices recently by about 35 cents per pack. This increase, plus any further increases levied to finance the settlement will likely reduce consumption, which would decrease the tax collected on tobacco sales. The state should bear in mind that the settlement is not a firm source of new funding and the existing funding source from tobacco taxes will likely be negatively impacted. As a point of reference, FY 2000 revenue projections included $46.8 million from cigarette sales. This represents approximately 2.9 percent of the General Fund budget.

Potential Increases to the State Allocation

The settlement provides for an annual inflation adjustment of the greater of three percent or the value of the consumer price index.