

**Office of the Legislative Fiscal Analyst
Presentation to the Executive Appropriations Committee
June 13, 2000
Update of Tobacco Settlement**

The State received the first two initial payments from the tobacco manufacturers via the Master Settlement Agreement at the end of 1999. On April 17, 2000, the State received its first annual payment. (There will be a total of five initial payments to be received each December 31st through 2002. The annual payments are to be paid to the State indefinitely.) The annual payment reflects an inflationary adjustment of three percent to the base payment, which increased the amount by approximately \$600,000. Also included in the payment is a downward adjustment of 13.2 percent to reflect the reduction in sales volume. This 13.2 percent reduced the payment by \$2.6 million. The total amount received by the State from the April 17, 2000 annual payment is \$11.9 million. The total from the two initial payments and the annual payment is \$27.3 million. This amount is the net amount, after the 25 percent being held out by the federal court for claims for attorney fees. The total amount being held is \$9.1 million. The Attorney General is working on the State's claim on those funds being held. It is anticipated that the case will go to arbitration later this year, at which point it is possible that negotiations will free up some of those funds. (See Appendix I)

Senate Bill 15, "Use of Tobacco Settlement Revenues"

The 2000 Legislature passed Senate Bill 15, "Use of Tobacco Settlement Revenues," which created the Tobacco Settlement Restricted Account and the Tobacco Settlement Endowment.

Tobacco Settlement Restricted Account:

Until July 1, 2003, 50 percent of the tobacco settlement funds will go into the restricted account. After July 1, 2003, the amount is reduced to 40 percent. Appropriations from the restricted account will be made in the following order, as funds are available:

\$5.5 million to cover the State's share of the Children's Health Insurance Program (CHIP);
\$4.0 million to the Department of Health for alcohol, tobacco, and other drug prevention, reduction, cessation, and control programs, with a preference given to tobacco-related programs (up to an additional \$2.0 million may be made available if the funds being held by the federal courts are freed up);

\$2.0 million for drug courts and a drug board pilot program;

\$4.0 million for the University of Utah Health Sciences

Tobacco Settlement Endowment:

Until July 1, 2003, 50 percent of the tobacco settlement funds will go into the endowment fund. After July 1, 2003, the amount is increased to 60 percent. The endowment funds will be invested in common investment instruments by the treasurer, within specific statutory guidelines.

Appropriations from the endowment fund are limited to 50 percent of the endowment's earnings. The other 50 percent will remain in the endowment fund. A proposed permanent trust fund will be established to replace the endowment fund, if approved by the voters in the next general election.

Volume Adjustment

As detailed in previous reports, the settlement provides that decreases in cigarette volume can be offset by reduced payments to the states. The desired result of decreasing tobacco consumption will have a negative impact on the financial aspects of the settlement for the states.

The first annual payment shows the effect of the volume adjustment, where the payment was reduced by over \$2.6 million. This effect is expected to increase as cigarette prices increase and cessation and prevention programs see some results.

Future of the Tobacco Industry

With so much at stake, state governments are keeping close watch on the health of the very industry at the core of the health-related problems to begin with.¹

An unintended consequence of the settlement (or perhaps not) was that all states, not just those in tobacco-growing regions, gained a vested interest in the viability of the tobacco industry. If American tobacco goes bankrupt, states will have to get in line with other creditors to recover what they can of their promised settlement.

A class action lawsuit in Florida has shed some light on the complex realities that the settlement has introduced into the relationship between the states and the tobacco industry. A Florida jury in April awarded three smokers \$12.7 million. The class action portion of the lawsuit, which could extend damages to as many as 500,000 Floridians, was scheduled to resume on May 15. A total damage award of between \$100 billion and \$300 billion could convince many of the major tobacco companies to declare bankruptcy.²

¹ Deseret News, "Tobacco woes costing states", 27 April 2000, pg. A12

² State Budget and Tax News, Volume 19, No. 8, pg. 12

APPENDIX I

TOBACCO SETTLEMENT UPDATE

		<u>Gross Payment</u>	<u>Inflation Adj.</u>	<u>Volume Adj.</u>	<u>Previously Settled States Reduction</u>	<u>Other Adjustments</u>	<u>Net Payment</u>	<u>25% Allocation held in Federal Court</u>	<u>Final</u>
Dec. 14, 1999	1st Initial Pmt.						10,984,387	(2,746,097)	8,238,290
Dec. 31, 1999	2nd Initial Pmt.						9,567,916	(2,391,979)	7,175,937
April 15, 2000	1st Annual Pmt.	20,019,910	600,597	(2,649,591)	(2,237,379)	123,754	15,857,291	(3,964,323)	11,892,968
TOTALS							36,409,593	(9,102,398)	27,307,195