March 2, 2000

SSA1 to Senate Bill 122 (Rosenzweig/Bock)

Agreement Between the State and Tobacco Manufacturers

Summary of Bill --

This is a follow-up to the tobacco settlement. As part of the deal, states are supposed to enact legislation to make sure that the companies that were not part of the settlement are also bound by the terms of the agreement. States are required to enact a "qualifying statute." This bill is intended to fulfill that requirement. DOJ says the sub does the job.

The bill requires companies that are not part of the settlement to either join in on the agreement or put money into an escrow account. The assumption is that the state will then sue any company that does not join the settlement. The escrow account would assure that money is available to settle the suit.

Passing this bill is intended to prevent a possible reduction in payments under the original settlement.

Staff Comments --

Expect several technical amendments. No substantial changes, especially concerning funding, can be approved without blowing up the qualifying statute aspect of the deal.

DOR apparently has proposed an untenable funding source. You can't create a new tax on the tobacco companies under the terms of the agreement. Their cost estimates appear to be wildly inflated and not at all in line with practice in other states. Chances are, their efforts might have to be funded by GPR, but it shouldn't take as much as they suggest.

Standing Committee Action --

SSA1 to SB 122 was recommended for passage on a 5-0 vote by the Senate Committee on Human Services and Aging on Sept. 28, 1999.

Recommended JFC Action --

Adoption of SSA1 to SB 122.
Introduction and adoption of any simple technical amendments.
Passage of SB 122 as amended.

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March 2, 2000

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Substitute Amendment 1 to Senate Bill 122: An Agreement Between the State and Tobacco Product Manufacturers

On September 28, 1999, Senate Substitute Amendment (SSA) 1 to Senate Bill 122 was recommended for passage by the Senate Committee on Human Services and Aging, by a vote of 5 to 0.

BACKGROUND

The Master Settlement Agreement (MSA) from the multi-state lawsuit against certain tobacco manufacturers contains a provision to protect the tobacco manufacturers that participated in the lawsuit ("participating manufacturers") from losing market share. Under the provision, the settling states may pass into legislation a "qualifying statute" that would prevent the tobacco manufacturers that did not participate in the agreement ("nonparticipating manufacturers") from increasing their share of the tobacco market as a result of the agreement's provisions. The MSA includes a model statute, which if enacted without substantive changes, would serve as a qualifying statute.

If the combined market share of the participating manufacturers in a calendar year is less than it was in the base year, states that have failed to enact a qualifying statute which was in effect during the last six months of the calendar year in which the market share loss occurred could lose their entire tobacco settlement payment for the succeeding year. In states that have enacted a qualifying statute but a court of competent jurisdiction invalidates the statute, the state could lose up to 65% of its tobacco settlement payment in the year succeeding a market share loss. Under the MSA, "base year" is defined as 1997 market share minus 2%. A reduction in tobacco settlement payments would not occur unless a nationally recognized firm ("the firm") of economic consultants (to be selected by the participating manufacturers and a majority of the attorneys general from the lawsuit) determines that the provisions of the MSA significantly contributed to the participating manufacturers' market share loss.

According to the Department of Justice (DOJ), as of February 3, 2000, 38 of the 46 settling states have passed a qualifying statute. The Department of Justice has stated that Senate Substitute Amendment 1 to Senate Bill 122 would serve as a qualifying statute. The substitute amendment is worded to more closely match the language in the model statute than SB 122, to better assure that it would be deemed a qualifying statute.

SUMMARY OF SENATE SUBSTITUTE AMENDMENT 1 TO SENATE BILL 122

Senate Substitute Amendment 1 to SB 122 would require any tobacco product manufacturer selling cigarettes to consumers within the state, whether directly or through a distributor, retailer or similar intermediary, after the effective date of the bill, to do one of the following: (a) become a participating manufacturer and generally perform its financial obligations under the MSA; or (b) place into a qualified escrow fund by April 15 of the year following the listed year the following amounts, as those amounts are adjusted for inflation: (i) for 1999, \$0.0094241 per unit sold after the effective date of the bill; (ii) for 2000, \$0.0104712 per unit sold; (iii) for each of 2001 and 2002, \$0.0136125 per unit sold; (iv) for each of 2003 to 2006, \$0.0167539 per unit sold; and (v) for each year after 2006, \$0.0188482 per unit sold.

The substitute amendment would require that tobacco product manufacturers that place money into the escrow fund receive the earned interest or other appreciation on that money. The substitute amendment would release money from escrow to the respective tobacco product manufacturers only under the following circumstances: (a) to pay a judgment or settlement on any released claim brought against that tobacco product manufacturer by the state or any releasing party located or residing in the state (the substitute amendment would require monies to be released from escrow in the order in which they were placed into escrow and only to the extent and at the time necessary to make payments required under the judgment or settlement); (b) when there are excess monies because the amount the tobacco product manufacturer was required to place into escrow in a particular year was greater than the state's allocable share of the total payments that the manufacturer would have been required to make in that year under the MSA had it been a participating manufacturer (as those payments are determined in the MSA); and (c) 25 years after the date on which the tobacco product manufacturer placed the money into escrow, any monies that remained after releases under the above circumstances would revert to the tobacco product manufacturer.

The substitute amendment would require tobacco product manufacturers that elect to place money into escrow to annually certify to the Attorney General by April 15 that the tobacco product manufacturer is in compliance with the escrow procedure described above. The substitute amendment would allow the Attorney General to bring a civil action on behalf of the state against any tobacco product manufacturer that fails to place into escrow the required monies. If the Attorney General is the prevailing party in an action under these provisions, SSA 1 would require the court to award the Attorney General costs and reasonable attorney fees.

If tobacco product manufacturers fail in any year to place the required monies into escrow, SSA 1 would require those manufacturers to place, within 15 days, the amount of money into escrow that would bring the tobacco product manufacturer into compliance. If the tobacco product manufacturer fails to meet the 15-day deadline, SSA 1 would allow the court to impose a civil penalty in an amount not to exceed 5% of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100% of the original amount improperly withheld from escrow. However, if a court finds that the tobacco product manufacturer knowingly violated this 15-day deadline, SSA 1 would allow the court to impose a civil penalty in an amount not to exceed 15% of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300% of the original amount improperly withheld from escrow. In the case of a second or subsequent knowing violation of the escrow requirements, SSA 1 would prohibit the tobacco product manufacturer from selling cigarettes to consumers within the state directly or through a distributor, retailer or similar intermediary for a period not to exceed two years. The substitute amendment would require that each failure in making the required annual deposit be considered a separate violation.

Under SSA 1, the following terms would be defined: (a) adjusted for inflation; (b) affiliate; (c) allocable share; (d) cigarette; (e) master settlement agreement; (f) qualified escrow fund; (g) released claims; (h) releasing parties; (i) tobacco product manufacturer; and (j) units sold.

The substitute amendment would require the Department of Revenue (DOR) to promulgate rules necessary to ascertain the amount of Wisconsin excise tax paid on the cigarettes of each tobacco product manufacturer for each year. In promulgating these rules, SSA 1 would require DOR to use the emergency rule procedures to submit those rules in proposed form to the Legislative Council no later than the first day of the fourth month beginning after the effective date of the bill. In addition, SSA 1 would allow DOR to submit temporary rules, which would be in effect before the effective date of the rules which would be submitted by the fourth month. The substitute amendment would exempt DOR from providing evidence that promulgating the rules as emergency rules is necessary for the preservation of the public peace, health, safety or welfare.

Finally, SSA 1 would require the Department of Administration to provide a copy of the MSA to each public library system, and would require the Revisor of Statutes, within 60 days after the effective date of the bill, to publish a copy of the MSA in the Wisconsin Administrative Register.

It should be noted that since the provision concerning 1999 escrow payments would no longer apply, an amendment to the substitute amendment is needed to: (a) delete the 1999 reference; and (b) specify that the amounts to be deposited in 2000 would be $0.0104712 per unit sold after the effective date of the bill. An incorrect reference should also be corrected.

FISCAL EFFECT

The substitute amendment does not appropriate any funds for the administration of the program.

Fiscal estimates were received for SB 122 from the following agencies: (a) the Department of Health and Family Services (DHFS); (b) the Department of Administration (DOA); (c) DOJ; and (d) DOR (revised). The provisions in the substitute amendment are similar to SB 122, with the following additions: (a) the requirement that a court award the Attorney General costs and reasonable attorney fees if the Attorney General is the prevailing party in an action; and (b) the requirement that DOR promulgate rules to ascertain the amount of Wisconsin excise tax paid on the cigarettes of each tobacco manufacturer each year. In its fiscal estimate, DHFS indicated that the bill would not have a fiscal effect on the Department. According to the DOA fiscal estimate, the bill requires DOA to distribute copies of the tobacco settlement to 17 library systems in Wisconsin. DOA's estimate states that copying and mailing cost would be several hundred dollars, which could be absorbed by the Department. The bill allows DOJ to bring a civil action against tobacco product manufacturers that fail to place money into the escrow fund. DOJ's fiscal estimate indicates that the Department would be able to absorb the costs of such action through its current budget appropriations.

Administration of Cigarette Enforcement Program. The substitute amendment does not provide DOR with any additional resources to monitor escrow accounts of nonparticipating tobacco manufacturers. However, DOR indicates that it would need $155,600 in 1999-00 and $338,100 in 2000-01 and 2.5 positions, beginning in 2000-01, to meet the administrative requirements of monitoring escrow payments. DOR would be required to obtain more detailed sales information than is currently collected. Consequently, the Department would develop a new automated cigarette tax administration and enforcement system. A contractor would be hired to develop a new computer tracking system over a two-year period. The costs for the contractor would be paid through a masterlease over a seven-year time period. A total of $154,200 in 1999-00 and $162,500 in 2000-01 would be required for these masterlease payments. (The estimated masterlease costs assume a contractor could start by April 1, 2000. Otherwise, the costs could increase.) Supporting costs of $1,400 in 1999-00 and $34,400 in 2000-01 would be incurred for computer equipment (masterleased), furniture, telephone service, office supplies and InfoTech charges. In addition, DOR requests $131,200 and 2.5 positions beginning in 2000-01 to administer the cigarette enforcement program. Of the total, 1.5 positions would provide data, network and business support while the other 1.0 position would conduct audit and enforcement activities. The following table shows a breakdown of the estimated administrative costs over the term of the masterlease.

Estimated Costs of Development and Support of the Cigarette Enforcement Program

Expenses	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Salaries & Fringe Benefits	$0	$131,200	$131,200	$131,200	$131,200	$131,200	$131,200	$131,200	$131,200
Contract Programming Masterlease Allocations	154,200	162,500	147,200	155,800	155,800	155,800	155,800	131,500	61,100
Server/4PC Masterlease	1,400	31,100	31,100	15,500	1,400	31,100	31,100	15,500	1,400
Furniture	0	10,000	0	0	0	0	0	0	0
Infotech Charges, Telephone Service & Office Supplies	0	3,300	3,300	3,300	3,300	3,300	3,300	3,300	3,300
Total	$155,600	$338,100	$312,800	$305,800	$291,700	$321,400	$321,400	$281,500	$197,000

DOR recommends that these costs be funded with fees charged to cigarette distributors and manufacturers. Under the Department's recommendation, it would impose an administrative fee, per cigarette sold, on distributors and manufacturers. The fee would be determined by DOR by July 1 of each year based on the estimated annual administrative costs. Fee collections would be placed in a newly-created program revenue appropriation that would be used to fund the Department's computer, audit and other related costs. At the end of each fiscal year, the unencumbered balance in the appropriation that was in excess of 10% of current year expenditures and encumbrances would lapse to the general fund. Based on current projections of administrative costs and cigarette sales, DOR estimates that a per cigarette fee of 0.061 mills (0.122 cents per pack) would be required in 2000-01. This per cigarette fee would decrease to 0.023 mills (0.046 cents per pack) as start-up and masterlease costs were paid off.

Prepared by: Barbara Zabawa and Ron Shanovich