



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #525

### Tobacco Settlement Agreement Legal Expenses (Justice -- Legal Services)

[LFB 2023-25 Budget Summary: Page 376, #2]

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#### CURRENT LAW

On November 23, 1998, Wisconsin and 45 other states, Puerto Rico, the U.S. Virgin Islands, American Samoa, the Northern Mariana Islands, Guam and the District of Columbia (collectively referred to as the "settling states") entered into the Master Settlement Agreement (MSA) with Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Commonwealth Tobacco, and Liggett & Myers. These companies are known as the participating manufactures (PMs). The MSA followed earlier tobacco industry settlements with Mississippi, Florida, Texas, and Minnesota.

**Annual Payments.** A schedule of annual payments that the other participating manufacturers (OPMs) will pay to the settling states was established under the MSA, which will be made in perpetuity. The settling states are not guaranteed to receive the full amount of the annual payments provided for under the schedule. The annual payments made by the OPMs are subject to an inflation adjustment, a volume adjustment, a previously settled states reduction, a non-settling states reduction, a non-participating manufacturer adjustment, the offset for miscalculated or disputed payments, a federal tobacco legislation offset, a litigating releasing parties offset, and an offset for claims-over.

Since 1999, Wisconsin has received a total of \$3.2 billion in tobacco settlement funds. Under the 2007 Act 226 repurchase transaction, described in Chapter 2 of this paper, beginning in the 2009-11 biennium, \$50 million annually in unrestricted MSA settlement payments was deposited to the permanent endowment fund for transfer to the medical assistance trust fund. The remaining amount of unrestricted MSA settlement payments was deposited to the general fund. Under the 2021 Act 58, the annual unrestricted MSA settlement payments to Wisconsin are deposited to the permanent endowment fund for transfer to the medical assistance trust fund.

**Non-Participating Manufacturer Adjustment.** The annual and strategic contribution payments are subject to a non-participating manufacturer (NPM) adjustment. The MSA provides for a "model statute" to be enacted by the settling states. The model statute provides for the creation of an escrow fund, requiring non-settling tobacco manufacturers, known as non-participating manufacturers (NPMs), to pay money into the escrow fund as a reserve for future claims. The required escrow fund payments by the NPMs under the model statute is designed to eliminate any financial advantage between settling tobacco manufacturers and NPMs by requiring that both make similar payments regardless of settlement status under the MSA. A state statute is considered a model statute if it is enacted exactly as drafted in the MSA, except for particularized state procedural or technical requirements, as a stand-alone piece of legislation. A state statute is considered a "qualifying statute" if it effectively and fully neutralizes the cost disadvantages that the participating manufacturers experience when compared to NPMs as a result of the MSA, but is not considered a model statute. If a state does not pass the model statute or a qualifying statute, the state is subject to a reduction in its share of annual and strategic contribution payments. This reduction is known as the NPM adjustment. If a state passes a model statute, but it is subsequently overturned or invalidated by court action, under the MSA a state will risk losing no more than 65% of its payment as a result of the NPM adjustment. If a qualifying statute is enacted by a state but the qualifying statute is subsequently overturned or invalidated by court action, a state's payments would be subject to the complete NPM adjustment. A state that passes the model statute or a qualifying statute must also diligently enforce its provisions or that state may still be subject to the NPM adjustment. All settling states passed either a model or qualifying statute. The Wisconsin model statute (1999 Wisconsin Act 122) became effective on May 23, 2000.

States annually remain subject to an evaluation of these model or qualifying statutes, and diligent enforcement. For those states that become subject to the NPM adjustment, it is applied as follows: if in any year the total aggregate market share of the OPMs (settling tobacco manufacturers) decreases more than 2% from their total aggregate 1997 market share, and an economic consulting firm determines that the provisions of the MSA were a significant factor contributing to their market share loss, payments to states may be reduced based on that loss.

## **DISCUSSION POINTS**

1. **Diligent Enforcement of Wisconsin's Model Statute.** In order to avoid an NPM adjustment under the MSA which would reduce the settlement payments owed to Wisconsin, the state must, on a continuing basis, diligently enforce its model statute (s. 995.10 of the statutes). Under the model statute, any tobacco manufacturer selling cigarettes or "roll-your-own" tobacco products to consumers in Wisconsin, either directly or indirectly, after May 23, 2000, must either: (a) become a participating manufacturer under the MSA and, thus, become obligated to make settlement payments under the MSA; or (b) deposit into a qualified escrow fund, by April 15th of every year, the following amounts of money for prior calendar year sales as adjusted for inflation: (1) for 2003 through 2006, \$0.0167539 per cigarette sold; and (2) for each year after 2006, \$0.0188482 per cigarette sold.

2. A non-participating manufacturer depositing money in escrow receives the interest earned on the escrowed funds. These escrowed funds may only be released to either: (a) pay a court judgment or legal settlement on any released claim (as defined under the MSA) brought against the

NPM by the state; or (b) refund the NPM for escrow payments that were greater than legally required. (As a result, these escrowed funds cannot be accessed by the state barring successful legal action). To the extent that escrowed funds are not released under the above provisions, the escrowed funds revert to the relevant NPM 25 years after the date on which the money was placed in escrow.

3. Under s. 995.12 of the statutes, every tobacco product manufacturer whose cigarettes are sold directly or indirectly in Wisconsin must certify to the Department of Revenue and to the Attorney General, by April 30<sup>th</sup> of each year, that as of that date the tobacco manufacturer is either a participating manufacturer under the MSA, or is fully compliant with Wisconsin's model statute and annually escrowing required funds. A tobacco product manufacturer must include in its certification a list of its brand families. [A "brand family" means all styles of cigarettes sold under the same trademark and differentiated from one another by means of additional modifiers or descriptors, such as "menthol", "lights", or "kings".] An NPM must include a list of all of its brand families, and, in addition, the number of units sold for each brand family that were sold in the state during the preceding calendar year.

4. In accordance with s. 995.12 of the statutes, beginning March 1, 2004, the Attorney General was required to develop and make available for public inspection a directory listing all tobacco product manufacturers that have provided current and accurate certifications as required by the Act. The directory was required to also contain a listing of the brand families for these tobacco product manufacturers. It is unlawful to sell any cigarette of a brand family that is not included in the directory.

5. From 2000 through 2022, participating manufacturers under the MSA have withheld or paid into a disputed payments account \$303 million in settlement payments (excluding some interest and earnings), alleging that these amounts are not owed to Wisconsin, primarily as a result of the NPM adjustment. The state's Department of Justice (DOJ) represents the state. It is the position of DOJ that the state has diligently enforced its model statute and that most, if not all, of these funds will eventually be released to the state. Assuming that the tobacco companies continue to contend that several states (not including Wisconsin) are non-diligent in their enforcement of the model statute, withheld funds released to Wisconsin will largely come from reduced MSA payments made to the states deemed non-diligent in their enforcement of their model statute. Through 2022, \$46.9 million in withheld settlement payments have been released to Wisconsin.

6. The majority of the funds that have been released from the disputed payments account were released as a result of a disposition surrounding the 2003 NPM adjustment and the 2005 NPM adjustment. With the 2009 payment, \$11 million in principal payments were released to Wisconsin due to an agreement between the settling states and the participating manufacturers over the 2005 NPM adjustment. In 2014, \$15 million in principal payments were released from the disputed payments account after the participating manufacturers announced that they no longer contested Wisconsin's diligent enforcement of the model statute in 2003. In September, 2021, it was announced that Wisconsin would receive \$14 million in principal payments associated with the 2004 NPM adjustment.

7. Litigation is still pending with regards to Wisconsin's diligent enforcement of the model statute after 2005. As a result, final release of disputed and withheld funds for time periods after 2005 may take several more years.

8. In 2019, DOJ expended \$249,600 of tobacco settlement monies associated with the demands of ongoing arbitration. This amount was the highest annual expenditure for that purpose that DOJ had since 2016-17. Average annual expenditures from the appropriation have been \$91,800 from 2016-17 through 2021-22. The Department indicates that the costs of tobacco arbitration ebb and flow between fiscal years. Expenses include the hourly rates of each of the three arbitrators, the arbitrators' clerk, the space where the arbitration is held, transcripts, and other costs. These expenditures do not pay for any DOJ resources like salary or rent.

9. The Department expects the historically slow pace of arbitration to pick up within the next biennium. With the increase in arbitration pace will come an increase in arbitration costs that DOJ estimates will exceed available revenues from tobacco settlement funds.

10. Typically, DOJ has agreements with state agencies to provide legal services above what is required under statute. There are ongoing agreements covered by memorandums of understanding (MOU). Under these agreements, DOJ invoices agencies for the services provided on a quarterly basis unless a different arrangement is made. The costs associated with the work and the revenue are accounted for in the Legal Services Interagency and Intra-agency Assistance appropriation under s. 20.455 (1)(km). These are continuing all moneys received appropriations that allow DOJ to adjust budget authority based on expected costs and revenues. The Department is currently negotiating an MOU with the Department of Administration (DOA) for arbitration costs.

11. In order to support ongoing expenses related to the tobacco settlement arbitration, the Committee could provide \$250,000 GPR annually in the 2023-25 biennium in a new, continuing appropriation in DOJ for legal expenses related to participation in arbitration on the state's behalf arising from payments under the Master Tobacco Settlement Agreement for the 2023-25 biennium only. Further, it could be specified that, no later than September 1, DOJ submit an annual report to the Legislature and the Governor on the Department's legal expenses for arbitration or other alternative dispute resolution processes related to payments under the agreement. [Alternative 1]

12. The Committee may wish to provide support, but at a lower amount. [Alternative 2] This alternative would be similar to Alternative 1, but provide \$125,000 GPR annually on a one-time basis in a new, continuing appropriation in DOJ for legal expenses related to participation in arbitration on the state's behalf arising from payments under the Master Tobacco Settlement Agreement.

13. If no funding is provided, DOJ would continue to use revenue from the tobacco settlement and continue to negotiate an MOU with DOA. [Alternative 3]

## **ALTERNATIVES**

1. Provide \$250,000 GPR annually in a new, continuing appropriation in DOJ for legal expenses related to participation in arbitration on the state's behalf arising from payments under the Master Tobacco Settlement Agreement. Specify that, no later than September 1, DOJ submit an annual report to the Legislature and the Governor on the Department's legal expenses for arbitration or other alternative dispute resolution processes related to payments under the agreement. Funding

would be provided for the 2023-25 biennium on a one-time basis.

| <b>ALT 1</b> | <b>Change to Base</b> |
|--------------|-----------------------|
| GPR          | \$500,000             |

2. Provide \$125,000 GPR annually in a new, continuing appropriation in DOJ for legal expenses related to participation in arbitration on the state's behalf arising from payments under the Master Tobacco Settlement Agreement. Specify that, no later than September 1, DOJ submit an annual report to the Legislature and the Governor on the Department's legal expenses for arbitration or other alternative dispute resolution processes related to payments under the agreement. Funding would be provided on a one-time basis.

| <b>ALT 2</b> | <b>Change to Base</b> |
|--------------|-----------------------|
| GPR          | \$250,000             |

3. Take no action.

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