Tobacco Settlement, Securitization and Tobacco Control Board

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History of the Master Settlement Agreement Between Certain States and Tobacco Manufacturers

On February 5, 1997, the State of Wisconsin filed suit in Dane County Circuit Court against certain tobacco manufacturers. The State of Wisconsin retained three private law firms (Habush, Habush, Davis & Rottier, S.C.; Brennan, Steil, Basting & MacDougall, S.C.; and Whyte, Hirschboeck & Dudek, S.C.) as special counsel to work with and under the direction of the Department of Justice (DOJ) in prosecuting the litigation against the tobacco manufacturers.

In its lawsuit, Wisconsin alleged that:

- Tobacco companies engaged in a conspiracy to mislead, deceive and confuse the public regarding the evidence that the use of tobacco products causes debilitating and fatal disease and that the nicotine in tobacco is a powerfully addictive substance;

- Tobacco companies concealed material information and waged an aggressive campaign of disinformation about the health consequences of their products, despite the fact that they had known, based on their own research, that their products often injured or killed consumers when used exactly as intended;

- Certain tobacco companies manipulated the amount of nicotine delivered by their products to create and sustain addiction;

- The defendants engaged in this conduct, despite their knowledge that the vast majority of new tobacco product users are children and adolescents. In addition, the defendants spent millions of dollars marketing to attract children and adolescents to use their products (despite the fact that minors cannot/could not legally purchase tobacco products);

- The state spent millions on medical and related services for Wisconsin residents for tobacco-related diseases and thousands of residents died each year from the products, while tobacco manufacturers reaped huge profits from sales to residents;

- It was a long-standing policy of the state to prevent children from using tobacco products, and to prevent facilitating children's access to, or desire for, such products; and

- The state had a policy of paying health care costs for its residents who could not afford to pay those costs themselves. In addition, the state also had a policy of recovering the costs from those who should have paid for them.

On March 21, 1997, the Joint Committee on Finance approved 8.0 program revenue (PR), two-year project positions to provide DOJ additional personnel to coordinate the litigation efforts of special counsel and to oversee the tobacco litigation generally. Funding for the positions came from private, non-profit, anti-tobacco groups (such as the American Cancer Society, the American Heart Association and the Wisconsin Medical Society).

When the positions were approved in March, 1997, the Wisconsin Division of the American Cancer Society had pledged $150,000 and the American Cancer Society had pledged to generate as much as $500,000 annually from other organizations to support the state's tobacco litigation effort. Under the agreement, if the state was successful in its litigation against the tobacco industry, the state would reimburse the private, non-profit, anti-tobacco groups the sums they had advanced to support the state's tobacco litigation effort. The state ultimately reimbursed these groups $230,000.

In the state's amended complaint filed in Dane County Circuit Court on May 29, 1997, the state sued the defendants for deceptive advertising/fraudulent representations, intentional misrepresentations, negligent misrepresentations, strict responsibility for misrepresentations, conspiracy in restraint of trade, undertaking of and failure to perform a special duty, unjust enrichment, restitution, public nuisance, conspiracy and concert of action, and for violations of Wisconsin's Organized Crime Control Act. The state sought monetary damages, civil penalties, declaratory and injunctive relief, restitution for the alleged conduct of the defendants and punitive damages. The requested injunction sought to require the defendants to cease marketing tobacco products to children, to disclose their research on smoking, addiction and health and to fund a remedial public education campaign of the health consequences of smoking and smoking cessation programs.

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. The MSA followed earlier tobacco industry settlements with Mississippi, Florida, Texas and Minnesota. As a result of the agreement, Wisconsin's pending lawsuit was dismissed.

Significant Non-Payment Terms of the Master Settlement Agreement

While the MSA is primarily known for the payments it requires the settling tobacco manufacturers to make to the settling states, the agreement also places many new contractual restrictions on the settling tobacco manufacturers, including new restrictions on their marketing efforts.

Restrictions on Brand Name Sponsorships. With limited exception, the MSA prohibits settling tobacco manufacturers from using their product brand names to sponsor concerts, events with a significant youth audience, or team sports (football, basketball, baseball, hockey or soccer). The MSA also prohibits settling tobacco manufacturers from sponsoring events where the paid participants or contestants are underage.

General Advertising and Marketing Restrictions. The MSA bans the use of cartoon characters (such as Joe Camel), but not human subjects, in the advertising, promotion, packaging or labeling of tobacco products, effective May 22, 1999. The MSA also prohibits settling tobacco manufacturers from naming future cigarette brands after recognized non-tobacco brand or trade names (such as Cartier) or nationally recognized individual celebrities, entertainment groups or sports teams.

Restrictions on Outdoor Advertising. With the exception of billboards, signs and placards no larger than a poster in arenas, stadiums, shopping malls, and video game arcades, the MSA bans all transit and outdoor advertising of tobacco products. The settling tobacco manufacturers may not use the permitted poster-sized signs and placards to target children.

Corporate Culture and Compliance. Settling tobacco manufacturers are required to make a corporate commitment to reduce youth access to and consumption of tobacco products. The settling tobacco manufacturers are prohibited from entering into agreements to suppress tobacco research and are prohibited from making material misrepresentations of fact regarding the health consequences of using any tobacco product.

Trade Associations and Lobbying. The MSA requires that the Council for Tobacco Research, the Tobacco Institute, and the Council for Indoor Air Research be disbanded. The MSA also requires that the records of these organizations that relate to any lawsuit be preserved.

Under the MSA, the settling tobacco manufacturers also contractually obligate themselves not to oppose any of the following:

1. Limitations on youth access to vending machines;

2. Inclusion of cigars within the definition of tobacco products;

3. Enhancement of enforcement efforts to identify and prosecute violations of laws prohibiting retail sales to youth;

4. Encouraging or supporting the use of technology to increase the effectiveness of age-of-purchase laws, such as, without limitation, the use of programmable scanners, scanners to read drivers' licenses, or use of other age/ID databanks;

5. Limitations on promotional programs for non-tobacco goods using tobacco products as prizes or give-aways;

6. Enforcement of access restrictions through penalties on youth for possession or use;

7. Limitations on tobacco product advertising in or on school facilities, or wearing of tobacco logo merchandise in or on school property;

8. Limitations on non-tobacco products which are designed to look like tobacco products, such as bubble gum cigars and candy cigarettes; and

9. Legislation banning the manufacture and sale of cigarette packs containing fewer than 20 cigarettes.

Youth Access Restrictions. Under the MSA, settling tobacco manufacturers can no longer distribute free samples in a facility unless the operator of the facility ensures that no underage individuals are present. Gifts can no longer be offered to minors in exchange for the purchase of tobacco products, coupons or proofs of purchase. Gifts can also no longer be distributed through the mail without proof of age.

Public Disclosure. Finally, the MSA requires the settling tobacco manufacturers to establish a user-friendly website that includes all documents produced in state and other smoking and health-related lawsuits. These manufacturers must maintain the website through June 30, 2010, and must add to the website all documents produced in future civil actions involving smoking and health cases.

Payments to the States under the Master Settlement Agreement

Subsequent Participating Manufacturers

The MSA allows for tobacco product manufacturers, in addition to the Original Participating Manufacturers (OPMs), to join the MSA. Such tobacco product manufacturers are known as Subsequent Participating Manufacturers (SPMs). (The definition of OPMs and SPMs under the MSA can be found in the Appendix.) SPMs generally share the liability of OPMs under the MSA in the event that their individual market shares in any calendar year exceed 125 percent of their 1997 individual market shares. For purposes of the MSA, however, the 1997 market share (and 125 percent of that market share) equals zero for those SPMs that either: (a) became a signatory to the MSA more than 60 days after the MSA execution date; or (b) had no market share in 1997.

A number of tobacco manufacturers have joined the MSA as SPMs and have met the criteria for making payments under the MSA. As a result, annual payments to states, described below, include SPM payments.

Unrestricted Settlement Payments to the States

Unrestricted settlement payments to the settling states under the MSA are made up of initial payments, annual payments and strategic contribution payments. The MSA does not specify or restrict how the states may use these payments under the agreement.

Initial Payments. The MSA contains a schedule of five initial payments, through 2003, that the OPMs must pay to the settling states. The schedule of initial payments under the MSA is detailed in Table 1.

Table 1: Initial Payments to Settling States

Payment Date	Amount
1998*	$2,400,000,000
January 10, 2000	2,472,000,000
January 10, 2001	2,546,160,000
January 10, 2002	2,622,544,800
January 10, 2003	2,701,221,100

* Held in escrow and released in December, 2000.

The settling states, however, are not guaranteed to receive these sums under the MSA. The initial payments made by the OPMs are subject to a volume adjustment, a non-settling states reduction and an offset for miscalculated or disputed payments. These variables affecting payment amounts are discussed below.

Annual Payments. As with initial payments, a schedule of annual payments that the OPMs will pay to the settling states was established under the MSA. Unlike the initial payments that are made only until 2003, the annual payments will be made in perpetuity. The schedule of annual payments under the MSA is detailed in Table 2.

Table 2: Annual Payments to Settling States

Date	Amount
April 15, 2000	$4,500,000,000
April 15, 2001	5,000,000,000
April 15, 2002	6,500,000,000
April 15, 2003	6,500,000,000
April 15, 2004	8,000,000,000
April 15, 2005	8,000,000,000
April 15, 2006	8,000,000,000
April 15, 2007	8,000,000,000
April 15, 2008	8,139,000,000
April 15, 2009	8,139,000,000
April 15, 2010	8,139,000,000
April 15, 2011	8,139,000,000
April 15, 2012	8,139,000,000
April 15, 2013	8,139,000,000
April 15, 2014	8,139,000,000
April 15, 2015	8,139,000,000
April 15, 2016	8,139,000,000
April 15, 2017	8,139,000,000
2018 and thereafter	9,000,000,000

As with initial payments, 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. These variables affecting payment amounts are discussed below.

Strategic Contribution Payments. Finally, the MSA also provides for a series of strategic contribution payments that the OPMs will pay to the settling states. Beginning April 15, 2008, and on April 15th of each year thereafter through 2017, the OPMs are to make a yearly strategic contribution payment totaling $861,000,000. The strategic contribution payments are subject to an inflation adjustment, a volume adjustment, the non-participating manufacturer adjustment, the offset for miscalculated or disputed payments, the federal tobacco legislation offset, the litigating releasing parties offset, and the offset for claims-over. These variables affecting payment amounts are discussed below.

Adjustments, Reductions and Offsets to Unrestricted Settlement Payments

The MSA calls for the following adjustments, reductions and offsets to the unrestricted payments to the settling states. Generally, these are applied in the order listed below.

Inflation Adjustment. The annual and strategic contribution payments are subject to an inflation adjustment. The inflation adjustment percentage applicable to payments due in the year 2000 was equal to the greater of 3% or the "Consumer Price Index Percentage" (CPI%). The CPI% is the actual total percent change in the Consumer Price Index during the calendar year immediately preceding the year in which the payment in question is due. As the year 2000 CPI% was equal to 2.68456%, payments under the MSA for that year were subject to an inflation adjustment percentage of 3%.

The inflation adjustment percentage applicable to payments due in any year after 2000 is calculated by applying each year the greater of 3% or the CPI% to the inflation adjusted percentage applicable to payments due in the prior year. For example, the inflation adjustment percentage in 2000 was 3% and the CPI% for payments due in 2001 was 3.38681%. Thus, the inflation adjustment percentage applicable in 2001 was 6.48841% (the product of the 3.38681% inflation adjustment applied to the 3% inflation adjustment percentage applicable in 2000).

Volume Adjustment. The initial, annual and strategic contribution payments are all subject to a volume adjustment. The volume adjustment is primarily based on the aggregate number of cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico by the OPMs in a given year compared to the base year of 1997. Depending on the change in the aggregate number of cigarettes shipped in or to these jurisdictions by the OPMs, the volume adjustment may either increase or decrease the initial, annual and strategic contribution payments. The 2002 annual payment to the states was reduced by 18.837021% as the result of a volume reduction of 19.22145% adjusted by a multiplier of 0.98 imposed by the MSA.

Previously Settled States Reduction. Only annual payments are subject to a previously settled states reduction. Florida, Texas, Mississippi and Minnesota settled with the major tobacco manufacturers prior to the MSA. The previously settled states reduction is determined by multiplying the applicable settlement payment by 12.45%, in the case of payments due in or prior to 2007; by 12.2373756%, in the case of payments due after 2007 but before 2018; and by 11.0666667% in the case of payments due in or after 2018.

Non-Settling States Reduction. The initial and annual payments are subject to a non-settling states reduction. If any state that settled with the OPMs under the MSA was to become a non-settling state through a failure to have the settlement approved in state court, any given initial or annual payment due to the states would be reduced by the subtotal of the payment that would have gone to the non-settling state if it had remained a settling state. This reduction may reduce the overall value of a given initial or annual payment, but does not reduce payments to individual settling states in any way.

Non-Participating Manufacturer Adjustment. The annual and strategic contribution payments are subject to a non-participating manufacturer 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 level the playing field 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 standalone 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 vis-à-vis non-participating manufacturers as a result of the MSA, but is not 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 non-participating manufacturer 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 non-participating manufacturer 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 non-participating manufacturer adjustment.

A state that passes the model statute or a qualifying statute must diligently enforce its provisions to exempt itself from the NPM adjustment.

For those states subject to the non-participating manufacturer 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.

The Wisconsin model statute (1999 Wisconsin Act 122) became effective on May 23, 2000. As a result, Wisconsin is not expected to be subject to an NPM adjustment on its 2001 annual payment, and future annual payments should not be impacted. However, diligent enforcement of the statute (by the Department of Revenue) is still necessary to avoid NPM adjustments.

Offset for Miscalculated or Disputed Payments. The initial, annual and strategic contribution payments are all subject to an offset for miscalculated or disputed payments. If the independent auditor is notified within four years of a payment due date that an OPM has made an underpayment or overpayment, the independent auditor is to promptly determine what payment is due the OPM in the case of an overpayment or what payment is owed the escrow account in the case of an underpayment. There is a separate account within the escrow account for disputed payments. When resolution has been reached regarding a disputed payment, the independent auditor directs the funds be deposited in the appropriate account.

Since the independent auditor must calculate payments before all final data is received, offsets for previous payments can be expected. Both the 2000 annual and the 2001 initial payments included offsets under this provision.

Federal Tobacco Legislation Offset. The annual and strategic contribution payments are subject to a federal tobacco legislation offset. Under the MSA, if federal tobacco-related legislation is enacted on or before November 30, 2002, and if such legislation requires settlement payments, taxes or any other payments to be paid by the OPMs, all or a part of which payments are actually made available to settling states, each OPM shall receive a continuing dollar-for-dollar offset for any and all amounts paid by the OPM under the legislation and actually made available to the settling states. If the federal tobacco legislation offset to which an OPM is entitled exceeds the annual and strategic contribution payments owed by an OPM in a given year, the OPM may carry forward any unused federal tobacco legislation offset, and offset future annual and strategic contribution payments with the unused federal tobacco legislation offset balance.

The federal tobacco legislation offset only applies to that portion of federal funds received from OPMs and going to the settling states that are either unrestricted as to their use, or restricted to any form of health care or to any use related to tobacco (including, but not limited to, tobacco education, cessation, control or enforcement). The federal tobacco legislation offset would not apply if: (1) the funds were earmarked for assistance to tobacco growers or impacted communities; or (2) grant conditions that would require states to take some significant actions or to provide matching funds were placed on the federal funds and a state chose not to participate in the grant program.

This offset will not impact any past or future payments under the MSA as no federal tobacco-related legislation was enacted on or before November 30, 2002.

Litigating Releasing Parties Offset. The annual and strategic contribution payments are subject to a litigating releasing parties offset. Under the MSA, if a releasing party (such as the state, a county or municipality, or a taxpayer) files suit on a released claim and wins a judgment or a settlement against an OPM, the judgment or settlement amount shall give rise to a litigating releasing parties offset that may be used dollar-for-dollar to offset the annual and strategic contribution payments that the OPM would otherwise owe. If the litigating releasing parties offset to which an OPM is entitled exceeds the annual and strategic contribution payments owed by an OPM in a given year, the OPM may carry forward any unused litigating releasing parties offset, and offset future annual and strategic contribution payments with the unused litigating releasing parties offset balance. (The definitions of releasing parties and released claims are included in the Appendix.)

Offset for Claims-Over. The annual and strategic contribution payments are subject to an offset for claims-over. If a releasing party wins a judgment or settlement on a released claim against a non-settling party under the MSA, and the non-settling party has a claim-over against an OPM in regards to the judgment or settlement on the released claim, the OPM shall receive a dollar-for-dollar offset for any amounts paid by the OPM to the non-settling party. If the offset for claims-over to which an OPM is entitled exceeds the annual and strategic contribution payments owed by an OPM in a given year, the OPM may carry forward any unused offset for claims-over, and offset future annual and strategic contribution payments with the unused offset for claims-over balance.

Dedicated Payments

In addition to the unrestricted payments to the states described above, the MSA also provides settlement money for a series of specific purposes.

American Legacy Foundation. The MSA provides for the creation of a non-profit national foundation, which has since been created and called the American Legacy Foundation. The purposes of the American Legacy Foundation are to support: (a) the study of and programs to reduce youth tobacco product usage and youth substance abuse in the states; and (b) the study of and educational programs to prevent diseases associated with the use of tobacco products in the states. The MSA provides base foundation payments of $250 million over 10 years to support the foundation. The base foundation payments are not subject to any adjustments, reductions, or offsets.

The MSA also provides for the following national public education fund payments to support the work of the foundation: (a) $250 million on March 31, 1999; and (b) $300 million annually on each successive March 31, from 2000 through 2003.

The March 31, 1999, payment is not subject to adjustment, while subsequent payments are subject to the inflation adjustment, the volume adjustment and the offset for miscalculated or disputed payments, as described above.

Finally, beginning on April 15, 2004, and on April 15th of each year thereafter, if the sum of the market shares of the participating manufacturers during the entire calendar year immediately preceding the year in which the payment would be due equals or exceeds 99.05%, the OPMs shall make a supplemental payment of $300 million to fund the national public education functions of the American Legacy Foundation. These supplemental payments are subject to the inflation adjustment, the volume adjustment, the non-settling states reduction and the offset for miscalculated or disputed payments. (The definition of participating manufacturer is included in the Appendix.)

States' Antitrust/Consumer Protection Tobacco Enforcement Fund. The MSA provides for the creation of a States' Antitrust/Consumer Protection Tobacco Enforcement Fund, which is to be established and maintained by the Attorneys General of the settling states, acting through the National Association of Attorneys General (NAAG). Under the MSA, the purpose of the fund is to supplement the settling states': (a) enforcement and implementation of the terms of the MSA and the associated consent decrees; and (b) investigation and litigation of potential violations of laws with respect to tobacco products. The MSA provides for a one-time payment of $50 million on March 31, 1999 from the OPMs to support this fund.

Annual Payments to the National Association of Attorneys General. The MSA provides that, beginning on December 31, 1998, and on December 31st of each year thereafter, through December 31, 2007, the OPMs must pay $150,000 to NAAG to support its efforts to coordinate and facilitate the implementation and enforcement of the MSA.

Attorneys' Fees. The MSA provides that the OPMs reimburse for reasonable costs and expenses, as well as the time reasonably expended by internal government attorneys and paralegals in connection with the MSA litigation for the following governmental entities: (a) the Office of the Attorney General of each settling state; (b) the office of the governmental prosecuting authority for any political subdivision of a settling state with a lawsuit pending against any participating manufacturer as of July 1, 1998; and (c) other appropriate agencies of a settling state and such litigating political subdivision. The MSA provides an aggregate cap of $150 million for such payments made to the settling states and their political subdivisions and provides that the payments are separate and apart from any other amounts due pursuant to the MSA.

In 1999-00, Wisconsin received $2,715,700 in one-time reimbursement of government costs and expenses in connection with the MSA litigation. Of this amount, $230,000 reimbursed the private, nonprofit groups that advanced moneys to support the state's tobacco litigation effort. Of the $2,485,700 remainder, 90% ($2,237,100) was deposited to the general fund and 10% ($248,600) was retained by the Department of Justice to offset the costs of prosecution.

Finally, the MSA also provides that the OPMs reimburse reasonable attorneys' fees paid to private outside counsel, if any, retained by settling states in connection with the MSA litigation. These payments to outside counsel are not subject to the $150 million cap that applies to reimbursement of internal government costs and attorney and paralegal time associated with the MSA litigation. The OPMs and the private firms retained as special counsel in Wisconsin reached independent settlements as to the reimbursement of private counsels' costs and attorneys' fees incurred in connection with the MSA litigation.

Ongoing Enforcement and Implementation Issues Under the Master Settlement Agreement

National Association of Attorneys General. The National Association of Attorneys General (NAAG) has an ongoing responsibility to oversee the implementation and enforcement of the MSA. Under the MSA, NAAG will also convene at least two meetings per year and one major national conference every three years for the purpose of evaluating the success of the MSA, and coordinating efforts by the Attorneys General and the participating tobacco manufacturers to reduce youth smoking.

Independent Auditor. The MSA also provides that beginning with payments due in the year 2000, an independent auditor will calculate and determine the amount of all payments owed pursuant to the MSA, the adjustments, reductions and offsets thereto (and all resulting carry-forwards, if any), the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the participating tobacco manufacturers and among the settling states. Pricewaterhouse Coopers has been selected as the independent auditor.

Payments to Wisconsin Under the Master Settlement Agreement

Through June 30, 2002, Wisconsin has received $447,966,900 in unrestricted settlement payments. These monies have generally been deposited to the general fund as general fund revenues. Table 3 details the payments received by type of payment and fiscal year.

Table 3: Payments to Wisconsin 1999-02

Type of Payment	Fiscal Year	Amount
1998 Initial	1999-00	$51,159,300
2000 Initial	1999-00	44,562,100
2000 Initial Overpayment Offset	1999-00	-364,600
2000 Annual	1999-00	72,005,300
1999-00 Payments		$167,362,100
2000 Annual Overpayment Offset	2000-01	-$5,040,300
2001 Initial	2000-01	45,185,800
2001 Annual	2000-01	83,120,900
2001 Payment Adjustments	2000-01	1,123,100
2000-01 Payments		$124,389,500
2002 Initial	2001-02	$40,278,900
2002 Annual	2001-02	110,130,500
2002 Payment Adjustments	2001-02	5,805,900
2001-02 Payments		$156,215,300
Total		$447,966,900

The 1998 initial payment was held in escrow until certain specified conditions were met for release of the funds, and the payment amount finally credited in 1999-00 reflects interest received on the escrow account minus tax withholding and investment management fees.

Tobacco Securitization

Under 2001 Act 16 (the 2001-03 budget), the Secretary of the Department of Administration (DOA) was authorized to securitize the state's rights to its tobacco settlement payments. The Secretary can sell, transfer or assign the rights to the Wisconsin Health and Educational Facilities Authority (WHEFA) or to a nonstock, nonprofit corporation formed by WHEFA or the state. After receiving the rights to the state's tobacco settlement payments, the corporation would use the newly-acquired revenue stream to back the issuance of revenue bonds. In return for the tobacco settlement payment revenue, the corporation would provide the state with the proceeds from those bonds. The DOA Secretary was provided the authority to structure the tobacco securitization transaction, including the type of bonds to be issued, the maturity of the bonds and the timing of the bond issue.

Under Act 16, the securitization transaction was to result in $450 million in bond proceeds being deposited to the state's general fund in 2001-02. During legislative deliberations on Act 16, it was indicated that the remaining available bond proceeds (estimated at $570 million at that time) would be deposited to a permanent endowment fund created under the act. Act 16 would have required that annually 8.5% of the value of the permanent endowment fund, including investment earnings, would be transferred to the general fund. These provisions were modified by 2001 Act 109 (the 2001-03 budget adjustment act), to fully expend in the 2001-03 biennium all of the proceeds of the securitization transaction.

Wisconsin's Securitization Transaction

Using its authority under Act 16, DOA carried out a securitization transaction that involves only tax exempt bonds. On April 18, 2002, DOA formed a nonstock, nonprofit corporation called the Badger Tobacco Asset Securitization Corporation. The Corporation is governed by a Board of Directors made up of the three individuals appointed by the DOA Secretary. On May 1, 2002, the Corporation priced the tobacco securitization bonds backed by the newly-assigned rights to the state's tobacco settlement payments. Based on that pricing, the state received $1.567 billion in total bond proceeds with $1.275 billion of these proceeds available to the state after establishing required reserves and consideration of capitalized interest and issuance costs. The transaction was finalized on May 23, 2002. Under the securitization transaction, the true cost of financing is expected to be 6.5% on the $1.567 billion in revenue bonds issued. Table 4 indicates use of the bond proceeds under the transaction.

Under the securitization transaction, the state has assigned the rights to the next 30 years of its tobacco settlement payments to the Badger Tobacco Asset Securitization Corporation. While 30 years of tobacco settlement payments are pledged to support the bonds issued by the Corporation, fewer years of payments will actually be needed. Under the securitization undertaken by the state and the Badger Tobacco Asset Securitization Corporation, it is estimated that the bonds could be repaid by as early as 2017, at which time the state would regain the rights to its annual tobacco settlement payments.

Table 4: Uses of Tobacco Securitization Bond Proceeds (Under 2001 Act 109)

Purpose	Amount (In Millions)
Proceeds Available to the State	$1,275
Debt Service and Other Reserves	137
Capitalized Interest and Expenses	140
Costs of Issuance	15
Total	$1,567

Under the provisions of Act 109, $681.0 million of the bond proceeds available to the state were transferred to the general fund in 2001-02. The remaining $594.0 million in bond proceeds, which were initially deposited in the permanent endowment fund, as well as $4.3 million in interest earnings, were used to make a portion of the November, 2002, state shared revenue payments to counties and municipalities across the state in lieu of using GPR to make these payments.

Tobacco Securitization Transaction Cash Flows

In securitizing its tobacco settlement payments, the state is pledging an estimated $5.4 billion in tobacco payments over the next 30 years. However, it is likely that the state will actually forego only $2.5 billion of those payments because 30 years of tobacco payments will not be needed to retire the bonds issued under securitization. Table 5 indicates the flow of tobacco settlement payments through 2017-18. The $140.5 million in securitization proceeds shown for 2017-18 indicates the release of the debt reserve funds and related interest earnings required to be held until the bonds are repaid. These amounts could be used instead to make the last debt service payments on the bonds. As indicated Table 5, tobacco payment revenues would not be available to the state until 2017-18, at which time it is estimated that the bonds will be repaid, or 2016-17, if the debt service reserve funds are used to make the final principal and interest payments on the bonds.

In analyzing the tobacco securitization transaction, a comparison of the total cash flows available to the state under the tobacco settlement and the securitization transaction is useful. In addition, a comparison of the present value of cash flow streams under the settlement payments and securitization is also relevant. Present value is the value in today's dollars assigned to an amount of money or stream of payments to be received in the future at a specified discount rate. Table 6 compares the cash flows to the state and the present value of those cash flows under the tobacco settlement payments and under securitization. For the purposes of calculating the present value of the cash flow streams under each scenario, an annual discount rate of 6.5% is applied.

As indicated in Table 6, under the tobacco securitization transaction carried out by the state, total cash flows to the state will be reduced by $996.4 million compared to just receiving its tobacco settlement revenues through 2018, the year in which the tobacco securitization bonds are estimated to be repaid. Based on the these estimated cash flows, under securitization, the state will receive approximately 60.5 cents back for every $1 of tobacco payments it would have otherwise received if securitization had not taken place. On a present value basis, which compares the discounted value to the state of the cash flows under each transaction and is believed to be the better measure for determining whether such a transaction is beneficial to the state, the tobacco securitization transaction will cost the state $41.2 million in value compared to not securitizing its tobacco settlement payments.

Table 5: Flow of Tobacco Payment Funds Under Tobacco Securitization ($ in Millions)

	Tobacco Payments	Securitization Proceeds	Net Debt Service Costs	Funds Available to State
2001-02	$0	$681.0	$0.0	$681.0
2002-03	0	594.0	0.0	594.0
2003-04	135.6	0	135.6	0.0
2004-05	137.1	0	137.1	0.0
2005-06	138.9	0	138.9	0.0
2006-07	140.7	0	140.7	0.0
2007-08	167.6	0	167.6	0.0
2008-09	170.0	0	170.0	0.0
2009-10	172.2	0	172.2	0.0
2010-11	174.7	0	174.7	0.0
2011-12	177.2	0	177.2	0.0
2012-13	179.5	0	179.5	0.0
2013-14	181.8	0	181.8	0.0
2014-15	184.0	0	184.0	0.0
2015-16	186.6	0	186.6	0.0
2016-17	189.2	0	189.2	0.0
2017-18	186.5	140.5	76.6	250.4

Table 6: Comparison of Cash Flows and Present Value Through 2017-18 Payoff of Tobacco Bonds ($ in Millions)

	Total Cash Flow	Present Value
No Securitization		
Tobacco Payments*	$2,521.8	$1,404.7
Tobacco Securitization		
Proceeds Expended in Biennium	$1,275.0	$1,275.0
Reserves and Residual Amounts	250.4	88.5
Total	$1,525.4	$1,363.5
Impact of the Securitization		
Securitization	$1,525.4	$1,363.5
Less No Securitization	-2,521.8	- 1,404.7
Difference in Value	-$996.4	-$41.2

*Indicates only the tobacco payments from 2003-04 through 2017-18 that are estimated to be needed to retire the tobacco securitization bonds. Total payments through 2031-32, the period for which the payments are pledged for the repayment of the bonds, are $5.4 billion.

Wisconsin Tobacco Control Board

1999 Wisconsin Act 9 (the 1999-01 biennial budget act) created a segregated, nonlapsible trust fund, the tobacco control fund, and a new state agency, the Tobacco Control Board, to support activities related to a statewide, comprehensive tobacco control program. Act 9 specified that, in 1999-00, the tobacco control fund would consist of the first $23.5 million of the moneys received under the MSA.

The Board. The Tobacco Control Board is an independent state agency that is attached to the Department of Health and Family Services (DHFS) for limited administrative purposes. Current law does not specify the number of persons who serve on the Board or the length of Board members' terms, nor does it require that specific interests be represented on the Board. Instead, the Governor determines the size of the Board and makes all appointments to it. All Board members serve at the pleasure of the Governor.

As of January 1, 2003, there were 17 Board members, which included legislators, public health advocates, health care providers, county officials, youth members, the State Superintendent of Public Instruction, and representatives of the business community.

The statutes require the Board to:

- Appoint an executive director and employ staff with appropriate programmatic and technical expertise;
- Administer the Board's grant program;
- Promulgate rules establishing criteria for receipt of the Board's grants, including performance-based standards for grant recipients that propose to use grants for media efforts and ensure that programs or projects conducted under the grants are culturally sensitive;
- Provide a forum for the discussion, development and recommendation of public policy alternatives in the field of smoking cessation and prevention;
- Provide a clearinghouse of information on matters relating to tobacco issues and how they are being met in different places throughout the nation; and
- Develop and prepare an annual plan regarding the allocation of funding for a statewide tobacco control program.

Grants. Under the statutes, the Board may allocate funding for grants for any of the following:

- Community-based programs to reduce tobacco use;
- Community-based programs to reduce the burden of tobacco-related diseases;
- School-based programs relating to tobacco use cessation and prevention;
- Enforcement of local laws aimed at reducing exposure to secondhand smoke and restricting underage access to tobacco;
- Grants for partnerships among statewide organizations and businesses that support activities related to tobacco use cessation and prevention;
- Marketing activities that promote tobacco use cessation and prevention;
- Projects designed to reduce tobacco use among minorities and pregnant women;
- Other tobacco use cessation programs;
- Surveillance of indicators of tobacco use and evaluation of the activities funded by the Board; and
- Development of policies that restrict access

to tobacco products and reduce exposure to environmental tobacco smoke.

Grant recipients may not expend more than 10% of grant funds to support administrative costs.

The Board has promulgated rules that further specify how it distributes grant funding. For example, the rules specify that a grant applicant must be: (a) a public agency; (b) a legally-formed organization; (c) a coalition of organizations under the auspices of a public agency or a legally-formed organization; or (d) a tribal governing body of a federally recognized tribe or band of Indians, or an American Indian organization appointed by the tribal governing body. These rules include requirements relating to project eligibility, the application and review process, reporting of project expenses, and prohibitions on supplanting existing anti-tobacco resources and activities.

Strategic Plan. The Board must develop and prepare an annual plan regarding the allocation of funding for a statewide tobacco control program. In September, 2000, the Board adopted its strategic plan, which outlines the Board's vision, mission, goals, and an allocation of the Board's funds. In its plan, the Board indicates that its mission is "to aggressively pursue the elimination of tobacco use by partnering with communities to prevent tobacco use among youth, promote cessation, and eliminate second-hand smoke. This mission will be achieved through comprehensive state and local efforts that utilize best practices and address the needs of diverse populations most adversely impacted by tobacco use."

The plan identifies the following goals for the state to achieve by 2005:

- Tobacco use among middle and high school-age youth will decline by 20 percent;

- Tobacco use among adults will decline by 20 percent;

- Tobacco consumption will decline by 20 percent;

- 100 Wisconsin municipalities will establish smoke-free restaurant ordinances;

- 100 percent of municipal governments will have smoke-free government-owned buildings;

- 90 percent of workplaces will establish smoke-free environments; and

- 70 percent of homes will voluntarily establish smoke-free environments.

Media and Countermarketing Campaign. The Board selected BVK McDonald to oversee an integrated statewide media campaign that focuses on three messages -- the role of the tobacco industry in encouraging addiction to tobacco, the dangers of secondhand smoke, and the addictive quality of nicotine and tobacco. The Board has established a media advisory group to monitor and approve campaign initiatives. The youth-led movement and ethnic networks will work with the media agency to develop campaign components specific to youth and minorities. The Board will also coordinate with local coalitions to maximize the use of campaign messages in local anti-tobacco initiatives.

Community Coalitions. The Board distributes funding to support local anti-tobacco coalitions that will work with community leaders to develop plans for reducing the negative impacts of tobacco at the community level. Coalition activities will include cessation support, school-based and school-linked programs, data collection, evaluation of programs, and community-based education on the health impacts of tobacco use. These coalitions will also work with community leaders to emphasize the health consequences of secondhand smoke and promote smoke-free environments through voluntary and locally determined anti-tobacco policies, enforcement activities, and ordinances. Coalitions must include, at a minimum, representatives from schools, health care profession, organizations that serve youth, local public health departments, and law enforcement. Coalitions are awarded contracts based upon performance. Regional technical assistance and training will be provided for all local coalitions, and attendance will be a requirement of funding in order to assure the use of research-based strategies and programs.

Funding for community coalitions will be distributed to local coalitions by the DHFS Division of Public Health. In addition, a competitive grant for school programs was offered in early 2001-02. These grants support research-based curricula, programs and strategies that prevent tobacco initiation and addiction. The Board contracted with the Department of Public Instruction to administer the grant process for school-based programs. In order for a school-based program to receive a grant, it must be an active partner in a community coalition.

Statewide Programs. The Board distributes funding on a competitive basis to organizations to support statewide strategies to prevent and stop tobacco use in populations most adversely impacted by tobacco, including communities of color, young adults between the ages of 18 and 24 years, and pregnant women.

Monitoring and Evaluation. The Board allocates funding to the University of Wisconsin Comprehensive Cancer Center to support a monitoring and evaluation system that tracks tobacco use and assesses the effectiveness of programs and efforts supported by the Board. The Cancer Center evaluates the Board's statewide activities and provides technical assistance and training for community-based programs to evaluate their programs and activities. The results of these evaluations will be used to determine the effectiveness of the resources and activities funded by the Board.

Youth-Led Movement. The Board facilitates the development of a statewide, youth-led movement against tobacco use. This movement engages youth in peer education, adult education, local and statewide advocacy, development of youth-targeted media and other meaningful leadership roles in anti-tobacco activities. The Board will fund a statewide organization with the following responsibilities; (a) organize a statewide conference on youth-led strategies for reducing tobacco use; (b) facilitate a statewide youth coalition; and (c) distribute grants for youth-led activities.

Cessation Support Programs. The Board allocates funding to the University of Wisconsin Center for Tobacco Research and Intervention to support several cessation initiatives, including a statewide hotline to support individuals trying to stop using tobacco, the promotion of the use of clinical cessation strategies by health care professionals, and the promotion of cessation in underserved populations, primarily women and communities of color.

Resource Clearinghouse. The Board allocates funding to the University of Wisconsin Clearinghouse for Prevention to establish a clearinghouse of resources available to all Wisconsin residents. The clearinghouse will distribute anti-tobacco resources through the Internet, mailings, and information catalogues.

These activities are funded on a calendar-year basis. Table 7 summarizes the funding amounts allocated for these activities in calendar year 2002.

Statutory Funding Allocations. In addition to the programs described above, the Board is required, by statute, to distribute funding for the following activities.

Center for Tobacco Research and Intervention. The Board is required to distribute $1.0 million annually to the Center for Tobacco Research and Intervention at the University of Wisconsin. The Center uses this funding to support:

- A biennial survey tracking tobacco use in Wisconsin;

- In 2001, a one-year statewide partnership

Table 7: Tobacco Control Board Contract Expenditures (Calendar Year 2002)

Program	Amount
Media and Countermarketing Campaign	$2,600,000
Community Coalition	2,800,000
School Grants	625,000
Ethnic Network	418,000
Spit Tobacco	92,000
Young Adult Pilot Studies-UW Oshkosh	140,000
Young Adult Pilot Studies-UW Pharmacy	50,000
Pregnant Smokers Pilot Studies	178,646
Youth Cessation Pilot Studies	163,179
Monitoring & Evaluation	1,115,000
Youth-Led Movement	661,520
Wisconsin Quit Line	1,000,000
Resource Center	200,000
Technical Assistance and Training	300,000
Total	$10,343,345

with the Wisconsin Women's Health Foundation to foster communication between adolescent girls and their mothers about tobacco use and other high-risk behaviors;

- Statewide education and outreach on prevention and cessation strategies to schools, clinics, and communities; and

- Mini-grants for local tobacco prevention and cessation research.

Thomas T. Melvin Youth Tobacco Prevention and Education Program. The Board is required to distribute $2.0 million annually to DHFS to provide funding for the Thomas T. Melvin youth tobacco prevention and education program. The Thomas T. Melvin youth tobacco prevention and education program uses the funds to prevent youth initiation of tobacco use among middle school students. The funding supports:

- A statewide multimedia campaign;

- Community interventions in 10 areas across the state;

- School-based or school-linked activities;

- Statewide evaluation and surveillance through the youth tobacco survey; and

- Research regarding the best methods to prevent youth initiation of tobacco use among middle school students.

Youth Smokeless Tobacco Cessation and Prevention. The Board was required to distribute $92,000 in 1999-00 for a youth smokeless tobacco cessation and prevention campaign developed by the DHFS Division of Public Health. Working with the Wisconsin Dental Association and the Milwaukee Brewers, the program supports a modular curriculum for the prevention and cessation of the use of smokeless tobacco among youth. Funded activities include the development of a comic book featuring Brewer players emphasizing the importance of staying away from smokeless tobacco and taking care of their teeth. Contributions from the Milwaukee Brewers, the Wisconsin Dental Association, the Department of Public Instruction, and the Department of Health and Family Services support a related marketing campaign and a dentist speakers program.

Medical College of Wisconsin. The Board is required to distribute $500,000 annually, beginning in 2000-01, to the Medical College of Wisconsin for activities directly related to preventing individuals from smoking and assisting smokers to quit smoking. The tobacco prevention research and education project at the Medical College will use the funding to support activities in four areas -- education, community outreach, tobacco cessation resources, and clinical research.

Accomplishments. In its 2002 Annual Report, the Board reports the following as its key accomplishments thus far:

- The rate of smoking among University of Wisconsin Oshkosh students has dropped 29% since the University began its campus campaign to market tobacco-free living.

• The Wisconsin Tobacco Quit Line received over 20,000 calls in its first 10 months. Over three out of four callers reported the Quit Line was helpful in the quit attempt.

• The City of Onalaska and the Village of Holmen became the 10th and 11th Wisconsin municipalities to ensure smoke-free environments in restaurants; the City of Madison enacted Wisconsin's first policy to guarantee a smoke-free environment in most workplaces

• An independent evaluation of the Board's media campaign found that 92% of Wisconsin youth understand that secondhand smoke is deadly. This is an 11% increase since the media campaign began.

• Through workplace-based cessation counseling, 45% of participants in UW School of Pharmacy's young adult pilot study have quit smoking. The cold turkey quit rate is only about 5%.

• Since the Wisconsin Ethnic Networks Collaborative began, the tribal governments of the St. Croix Chippewa and Menomonee Tribes approved policies making government buildings smoke-free

• 45% of the pregnant smokers participating in the First Breath pilot study have quit or reduced their smoking.

• Over 4,000 youth have signed up to join the FACT youth movement against tobacco.

• Large health systems, including Aurora Health Care, ThedaCare Health Systems, and Dean Health Plan, are strengthening cessation services and institutionalizing Public Health Service cessation guideline recommendations.

Summary of Program Funding. Table 8 identifies the amount of funding that has been budgeted for the Tobacco Control Board in each year since its creation. Under current law, the annual amount of funding that will be transferred to the segregated tobacco control fund to support the Board's activities will be $25,000,000, beginning in the 2003-04 fiscal year.

Table 8: Tobacco Control Board Authorized Funding Levels (Fiscal Years 1999-00 thru 2002-03)

	1999-00	2000-01	2001-02	2002-03
Earmarked Grants				
Thomas T. Melvin Youth Prevention and Education Program	$1,000,000	$1,000,000	$2,000,000	$2,000,000
University of Wisconsin-Madison Tobacco Research and Intervention Center	1,000,000	1,000,000	1,000,000	1,000,000
Medical College of Wisconsin	0	500,000	500,000	500,000
Youth Smokeless Tobacco Campaign	92,000	0	0	0
Competitive Grants*	0	18,308,000	11,500,000	11,500,000
Subtotal Grant Funding	$2,092,000	$20,808,000	$15,000,000	$15,000,000
Program Support/Administration	200,000	400,000	336,300	345,100
Total Funding	$2,292,000	$21,208,000	$15,336,300	$15,345,100

*Funding for competitive grants for 2001-02 includes $9,154,000 that was carried forward from the amount budgeted for 2000-01 competitive grants.

APPENDIX

Selected Definitions Under the Master Settlement Agreement

"**Participating manufacturer**" means a tobacco product manufacturer that is or becomes a signatory to this agreement, provided that (1) in the case of a tobacco product manufacturer that is not an original participating manufacturer, such tobacco product manufacturer is bound by the MSA and the consent decree carrying out the MSA (or, in any settling state that does not permit amendment of the original consent decree, a consent decree containing terms identical to those set forth in the original consent decree) in all settling states in which the MSA and the consent decree binds original participating manufacturers (provided, however, that such tobacco product manufacturer need only become bound by the consent decree in those settling states in which the settling state has file a released claim against it), and (2) in the case of a tobacco product manufacturer that signs the MSA after the MSA execution date, such tobacco product manufacturer, within a reasonable period of time after signing the MSA, makes any payments (including interest thereon at the prime rate) that it would have been obligated to make in the intervening period had it been a signatory as of the MSA execution date. "Participating manufacturer" shall also include the successor of a "participating manufacturer".

"**Original participating manufacturers**" means the following: Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated and R.J. Reynolds Tobacco Company, and the respective successors of each of the foregoing.

"**Subsequent participating manufacturer**" means a tobacco product manufacturer (other than an "original participating manufacturer") that: (1) is a "participating manufacturer", and (2) is a signatory to this agreement, regardless of when such tobacco product manufacturer became a signatory to the MSA. "Subsequent participating manufacturer" shall also include the successors of a "subsequent participating manufacturer".

"**Releasing parties**" means each settling state and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions. "Releasing parties" also means, to the full extent of the power of the settling states to release past, present and future claims, the following: (1) any settling state's subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (2) persons or entities acting in a parens patriae, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participated in the MSA, (a) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such settling state or the people of the state, as opposed solely to private or individual relief for separate and distinct injuries, or (b) to the extent that any such entity (as opposed to an individual) is seeking recovery of health-care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a settling state.

"**Released claims**" means either of the following:

For past conduct, acts or omissions (including any damages incurred in the future arising from such past conduct, acts or omissions), they refer to those claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to

(1) the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, (2) the exposure to, or (3) research, statements, or warnings regarding, Tobacco Products (including, but not limited to, the claims asserted in the actions brought by the settling states and settled by the MSA, or any comparable claims that were, could be or could have been asserted now or in the future in those actions or in any comparable action in federal, state or local court brought be a settling state or a releasing party (whether or not such settling state or releasing party has brought such action)), except for claims not asserted in the settling states actions settled by the MSA for outstanding liability under existing licensing (or similar) fee laws or existing tax laws (but not excepting claims for any tax liability of the tobacco-related organizations or of any released party with respect to such tobacco-related organizations, which claims are covered by the release and covenants set forth in the MSA);

For future conduct, acts or omissions, they refer only to those monetary claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to tobacco products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement of health care costs allegedly associated with the use of or exposure to tobacco products.