

SENATE BILL REPORT

SHB 2038

As Reported By Senate Committee On:
Ways & Means, April 16, 2003

Title: An act relating to refunds from escrow for certain tobacco manufacturers.

Brief Description: Modifying tobacco escrow refund provisions.

Sponsors: House Committee on Finance (originally sponsored by Representatives Gombosky and McIntire; by request of Attorney General).

Brief History:

Committee Activity: Ways & Means: 4/16/03 [DP].

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: Do pass.

Signed by Senators Rossi, Chair; Hewitt, Vice Chair; Brown, Doumit, Fairley, Fraser, Hale, Parlette, Poulsen, Regala, Roach, Sheahan and B. Sheldon.

Staff: Steve Jones (786-7440)

Background: In 1996, the state of Washington brought suit against the major tobacco companies, seeking reimbursement for costs incurred in treating tobacco-related illnesses, as well as damages for violations of consumer protection and anti-trust laws. On November 23, 1998, the Attorneys General and other representatives of 46 states announced a national settlement with the five largest tobacco manufacturers. The settlement of Washington's case was approved by the King County Superior Court and the decision became final on December 24, 1998.

The national master settlement agreement requires annual payments by the companies to the participating states; up to \$206 billion will be received during the first 25 years of the agreement. The state of Washington is scheduled to receive approximately \$4.0 billion during the first 25 years.

The master settlement agreement is an agreement between two groups known as the "settling states" and the "participating manufacturers." The settling states consist of 46 states, the District of Columbia, and six territories. The participating manufacturers include the major tobacco companies and several smaller manufacturers. The tobacco manufacturers that did not sign the agreement are known as non-participating manufacturers.

Under the agreement, participating manufacturers make specified payments to the settling states and agree to abide by restrictions on the advertising, promotion, and marketing of cigarettes. In exchange, the states agreed to release the participating manufacturers from claims by the states. Non-participating manufacturers were not released from potential state claims and did not undertake any of the payment obligations or agree to abide by the

marketing restrictions. The agreement included a proposed escrow statute (known as the "model statute") for states to adopt. The model statute requires non-participating manufacturers to make annual payments into an escrow fund based on the number of cigarettes sold in that state. The payment is approximately 30 cents per pack of cigarettes. The model statute is intended to prevent non-participating manufacturers from taking competitive advantage of the fact that they do not make payments under the settlement agreement and are not bound by the marketing restrictions under the settlement agreement. It is also intended to provide a fund from which a state that successfully sues a non-participating manufacturer in the future can recover any judgment or settlement moneys. All settling states, including Washington, enacted the model statute.

Money deposited in a state's escrow account is refunded to the non-participating manufacturer after 25 years if no judgment or claim is made against the funds. In addition, the model statute permits a non-participating manufacturer to obtain an annual refund of money to the extent that its escrow payments are greater than the state's share of the total payments that manufacturer would have paid if the manufacturer had signed the settlement agreement. It appears that if a non-participating manufacturer concentrates its sales in a single state or a few states, the annual refund formula in the model statute could result in refunds of the vast majority of the manufacturer's escrow deposits. A non-participating manufacturer who is able to obtain these refunds could lower the price of its cigarettes in comparison to manufacturers who are making full payments under the settlement agreement, thereby obtaining a competitive advantage. In addition, the reduced escrow funds might be insufficient for a state to recover judgments or settlement moneys against a non-participating manufacturer. This depletion of escrow funds by certain non-participating manufacturers was not anticipated when the model statute was enacted.

Summary of Bill: The formula for refund of escrow funds to a non-participating tobacco manufacturer is altered so that the amount remaining in escrow is not less than the amount the manufacturer would have been required to pay under the master settlement agreement for those cigarettes sold in Washington State.

If a court finds this revision of the escrow refund provisions is unconstitutional, the annual refund provisions shall be eliminated entirely. If a court finds that elimination of the annual refund provisions is also unconstitutional, the refund provisions shall be restored as if no amendments had been made.

Appropriation: None.

Fiscal Note: Available.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Testimony For: The goal of the bill is to maintain a reasonably level playing field among tobacco manufacturers. The model statute contains an unintended loophole, allowing inadvertent refunds and creating a huge competitive advantage for some manufacturers. Ultimately, this competitive advantage will affect payments to the state under the national master settlement agreement. The bill eliminates the unintended price advantage by basing the escrow payments on actual sales in Washington State.

Testimony Against: This bill affects independent companies that have less than 3 percent of the market. Many factors affect a company's market share, including marketing advantages and economies of scale. The refunds from the escrow payments are unlikely to materially affect a company's market share. The large tobacco companies are trying to squeeze out the small companies. The bill will not produce any additional revenue to the state.

Testified: Dave Horn, Office of the Attorney General (pro); Nick Federici, American Lung Assoc. (pro); T.K. Bentler, RJR Co.(pro); Joe Daniels, Phillip Morris Co. (pro); Mark Triplett, Council of Independent Tobacco Manufacturers (con).