H.B. 362

123rd General Assembly
(As Reported by H. Finance & Appropriations)

Reps. Coughlin, Thomas, Van Vyven, Vesper, Mottley, Jones, Carey, Wilson, O'Brien, Metzger, Womer Benjamin, Boyd, Perry, Barrett, D. Miller, Roberts, Damschroder, Goodman, Hoops, Mead, Opfer

BILL SUMMARY

- Requires that any tobacco product manufacturer selling cigarettes in Ohio must either participate in the national tobacco master settlement agreement or pay specified amounts into an escrow fund.

- Provides that the amount that must be escrowed by nonparticipating manufacturers increases from approximately 19¢ per pack of cigarettes sold in the state in 1999 to 38¢ per pack in 2007 and thereafter.

- Provides that funds paid into an escrow account generally can be released only to pay a judgment or settlement on a claim brought against the manufacturer by the state, but that any escrowed amounts not used for such a claim revert to the manufacturer after 25 years.

CONTENT AND OPERATION

Background: Master Tobacco Settlement Agreement

In November, 1998, the Attorney General, along with the attorneys general or other representatives of 46 other states, entered into an agreement with the major American tobacco manufacturers to settle state lawsuits against the industry. Manufacturers that participate in the agreement must curtail many advertising and marketing practices, commit to reducing youth access to and consumption of tobacco, and restrict state lobbying activities. The manufacturers also must pay to create a foundation to implement a sustained, nationwide program of advertising, research, and public education against youth tobacco use, and must contribute in perpetuity to a settlement fund from which participating states will receive payments. Payments to states are estimated to exceed $206 billion over the next 25

years. The agreement lists Ohio's share at more than $9.8 billion during this period.

To be eligible to participate to the fullest extent in the financial benefits of the agreement, a state must enact a law (or adopt a rule) that "effectively and fully neutralizes the cost disadvantages that the participating manufacturers experience vis-à-vis non-participating manufacturers" as a result of the terms of the agreement. Master Settlement Agreement, Sec. IX(d)(2)(E). The settlement proposes a model statute that qualifies as such a law, as long as it is enacted "without modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal." H.B. 362 proposes to enact the model statute without modification.

The manufacturers that originally agreed to the settlement are Philip Morris, R.J. Reynolds, Brown & Williamson, and Lorillard. According to information obtained from the National Association of Attorneys General, 17 other tobacco manufacturers (including the Liggett Group, Japan Tobacco, and Commonwealth Brands) have subsequently agreed to participate. The bill does not apply to any of these original or subsequent participating manufacturers.

Escrow requirements on nonparticipating manufacturers

(secs. 1346.01 and 1346.02)

The bill requires a tobacco product manufacturer that sells cigarettes to consumers in Ohio either to become a participating manufacturer under the master settlement agreement, or to pay amounts based on its sales in the state into an escrow fund.[1] The requirement applies whether the sales are made directly by the manufacturer or through a distributor, retailer, or similar intermediary. The payment amounts are set forth in the following table. The first column of the table shows the year for which payments must be made, the second column shows the dollar amount that must be paid per cigarette sold in the state that year, and the

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[1] *"Cigarette" is defined as any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in a substance not containing tobacco, (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette, or (3) any roll of tobacco wrapped in a substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in (1) above.*

third column restates the dollar amount as a cents-per-pack rate for a 20-cigarette pack.

Year	Amount per cigarette	Cents-per-pack equivalent
1999 (sales after the bill's effective date)	$0.0094241	18.8482¢
2000	$0.0104712	20.9424¢
2001 and 2002	$0.0136125	27.225¢
2003 through 2006	$0.0167539	33.5078¢
2007 and thereafter	$0.0188482	37.6964¢

The per-cigarette payment amounts are stated in current dollars, but are to be increased in accordance with the formula for inflation adjustment set forth in the master settlement agreement. In general, the inflation adjustment for a year is found by increasing the preceding year's adjustment by the greater of 3% or the percentage increase in the consumer price index that year.

The nonparticipating manufacturer must pay the amount due for a year by April 15 of the following year. Escrow payments must be made for sales of roll-your-own tobacco in addition to cigarettes. The bill states that for the purposes of making the payments, 0.09 ounces of roll-your-own tobacco constitutes one cigarette. ("Roll-your-own" is defined as any tobacco that, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes.)

The number of cigarettes sold in a year by a manufacturer is to be measured by excise taxes collected by the state on packs (or roll-your-own tobacco containers) bearing the state's tax stamp. The Department of Taxation is required to promulgate regulations as are necessary to ascertain the amount of excise tax paid on the manufacturer's cigarettes each year.

The manufacturer's escrow account must be established with a federally or state-chartered financial institution that has assets of at least $1 billion and is not affiliated with a tobacco manufacturer. The escrow arrangement between the financial institution and manufacturer is to specify that the institution holds the funds for the benefit of the state, and to prohibit the manufacturer from using, accessing, or directing the use of the funds.

Release of escrow funds

Funds paid into an escrow account by a tobacco product manufacturer can be released under three circumstances. First, funds can by used to pay a judgment or settlement on a claim brought against the manufacturer by the state, a political subdivision or instrumentality of the state, or a person located or residing in the state and acting on behalf of the state. The funds must be released 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.

Second, funds can be released to the manufacturer to the extent it establishes that the amount it was required to place into escrow in a particular year was greater than the state's share of the total payments the manufacturer would have been required to make that year if it had been a participating manufacturer under the settlement (as adjusted for inflation, but prior to any other adjustments allowed to participating manufacturers).

Third, funds not released for either of the other two purposes revert back to the manufacturer 25 years after the date on which they were placed into escrow. The manufacturer also is to receive any interest or other appreciation on the escrow account as it is earned.

Enforcement of the escrow requirement

A tobacco product manufacturer that elects to place funds into escrow under the bill must annually certify to the Attorney General that it is in compliance with the requirement. The bill authorizes the Attorney General to bring a civil action on behalf of the state against any manufacturer that fails to escrow the proper amount of funds. A manufacturer that fails in any year to place the proper amount into escrow is required within 15 days to escrow an amount that will bring it into compliance. Upon a finding of a violation of the escrow requirement, a court can impose a civil penalty of up to 5% of the amount improperly withheld from escrow per day of violation. But the total penalty cannot exceed the original amount improperly withheld. Penalty payments must be credited to the state General Revenue Fund.

For a knowing violation of the requirement, the court can increase the civil penalty to up to 15% of the amount improperly withheld from escrow per day of violation, not to exceed a total of 300% of the original amount improperly withheld. For a second knowing violation, the manufacturer would be prohibited from selling cigarettes to consumers in the state for a period not to exceed two years (either directly or through a distributor, retailer, or similar intermediary).

Definition of a tobacco product manufacturer

For the bill's purposes, a "tobacco product manufacturer" is an entity that directly (and not exclusively through an affiliate):

--Manufactures cigarettes that it intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer that is not one of the original participating manufacturers under the master settlement agreement. The bill does not apply to a manufacturer that uses an original participating manufacturer as its importer, as long as the participating manufacturer meets its payment obligations under the agreement, and provided the manufacturer of the cigarettes does not market or advertise them in the United States.

--Is the first purchaser for resale in the United States of cigarettes that the manufacturer does not intend to be sold in the United States.

--Becomes a successor to an entity to which either of the above definitions applies.

An affiliate of a manufacturer is not subject to the bill, unless the affiliate itself falls within the definition of a tobacco product manufacturer. The bill defines an affiliate as a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person (where ownership is indicated by an equity interest of at least 10%).

COMMENT

The master settlement agreement contemplates the possibility that a nonparticipating manufacturer or other party could successfully challenge the legality of the model statute. Under the agreement, states that do not have in force a statute that "levels out" the competitive disadvantage of participating manufacturers relative to nonparticipating manufactures can have their share of the settlement funds reduced to zero if the participating manufacturers lose market share because of the terms of the settlement. But if a state has no such statute because it was invalidated or rendered unenforceable by a court of competent jurisdiction despite the state's efforts to defend it, the state's share for any year cannot be reduced below 35% of the amount otherwise called for in the agreement. Master Settlement Agreement, Sec. IX(d)(2)(F).

HISTORY

ACTION	DATE	JOURNAL ENTRY	
Introduced	05-26-99	p.	728
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