CALIFORNIA
▪ BUDGET PROJECT ▪

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WHAT WILL THE TOBACCO SETTLEMENT MEAN FOR CALIFORNIA?

On November 16, 1998, the National Association of Attorneys General (NAAG) announced a settlement to more than 40 lawsuits filed by states and localities against the tobacco industry. Forty-six states, the District of Columbia, and several territories are signatories to the agreement along with the major US tobacco companies. Under the terms of the agreement, the tobacco industry will make annual payments to states (and, in California, to localities) in perpetuity. The payments are expected to total $206 billion over the next 25 years. California's share of the payments over the next 25 years could exceed $25 billion. In addition to cash payments, the settlement agreement:

- ✓ Restricts certain types of tobacco marketing and advertising, including limits on advertising at sports events, bans on the use of cartoon characters, and bans on promotional payments for placement of tobacco products in movies and other media.
- ✓ Requires tobacco companies to adopt measures designed to restrict youth access to tobacco.
- ✓ Establishes a foundation to study programs to reduce teen smoking and research smoking related diseases. This foundation will receive $25 million per year for ten years and will be controlled by the NAAG. In addition, a national public education fund will receive payments of $1.45 billion over the next five years to conduct a campaign aimed at reducing youth smoking.
- ✓ Prohibits the tobacco industry from opposing certain types of state legislation designed to restrict youth access to tobacco products and limit tobacco industry lobbying activities.
- ✓ Prohibits the tobacco industry from initiating new challenges to tobacco control ordinances enacted prior to June 1, 1998.
- ✓ Allows public access to documents obtained by attorneys engaged in tobacco litigation.
- ✓ Requires companies to pay $861 million per year into a "strategic contribution fund" each year from 2008 through 2017. This fund will be distributed among the states using a formula reflecting each state's contribution to the resolution of the settlement as determined by the NAAG.

How Much? Where Will It Go?

California’s share of the payments will be divided between the state, counties, and four cities whose lawsuits were included as part of the settlement. A memorandum of understanding (MOU)signed by attorneys for the plaintiffs in the affected lawsuits outlines the allocation of the payments. The state will receive 50 percent of the funds; the Cities of San Francisco, Los Angeles, San Diego, and San Jose will each receive 1.25 percent of the total amount; and the remaining 45 percent will be divided among counties based on population. If any jurisdiction(s) chooses not to participate in the settlement, their share of the funds will be divided among participating entities based on the formula outlined above. Any payments made by the industry toward the plaintiffs' attorneys fees will be in additional to the specified payments in the settlement agreement.

The Governor's budget deposits the 1998 and 2000 settlement payments in the state's General Fund in order to help close an anticipated 1999-00 budget gap. Proceeds of the settlement funds will not increase the state's school spending guarantee, which depends on tax revenues. However, the payments could trigger additional reductions in the Vehicle License Fee beginning in 2000-01 under the trigger adopted in last summer's tax package. The agreement includes a number of offsets and adjustments that could reduce payments to states and localities. Offsets and adjustments include:

How Much Will California Receive From The Tobacco Settlement? (Dollars in Millions)

	State	Counties	Four Cities
1998	$153	$138	$15
2000	$409	$368	$41
2001	$442	$398	$44
2002	$531	$478	$53
2003	$536	$482	$54
2004-2007 (each year)	$447	$402	$45
2008-2017 (each year)	$456	$410	$46
2018-2025 (each year)	$511	$460	$51
TOTAL	**$12,507**	**$11,252**	**$1,255**

Payments represent maximum amount before any offsets and reductions and prior to required inflation adjustments. Payments continue through 2025. San Francisco receives payments as a city and as a county. City payments are shared equally between Los Angeles, San Francisco, San Diego, and San Jose. County payments are allocated on a per capita basis.
Source: Memorandum of agreement between participating attorneys

- ✓ **Inflation adjustment percentage.** Beginning in 2000, payments will be increased annually by the greater of three percent or the increase in the Consumer Price Index.
- ✓ **Volume adjustment**. This factor adjusts payments to reflect increases or decreases in tobacco manufacturers' income from the sale of tobacco products in the US.
- ✓ **Non-settling states adjustment.** This factor reduces the amount due to states that do not approve the settlement, but does not affect states that approve the settlement.
- ✓ **Non-participating manufactures adjustment.** This factor reduces payment amounts if participating manufacturers lose market share to firms that are not subject to the agreement.
- ✓ **Federal legislation offset**. Settlement payments to states could be reduced on a dollar for dollar basis if the federal government increases tobacco taxes or requires the tobacco industry to make payments of any form on or before November 30, 2002 and any portion of the amounts raised is sent to the states either in unrestricted funds or in grants restricted to health care or tobacco related health care.
- ✓ **Litigation releasing parties offset.** This factor reduces payments in an amount equal to any settlement obtained by an agent of any state or jurisdiction (including local government entities) seeking a judgement to recover tobacco related public health costs.

Finally, unlike the tobacco agreement considered by Congress, this agreement only applies to US manufacturing subsidiaries. Thus, the parent companies are not liable for payments if a US subsidiary declares bankruptcy. In previous deliberations, the federal government reserved the right to claim the portion of the funds allocated to the states on behalf of Medicaid clients. In an attempt to prevent such a federal claim, the settlement agreement explicitly states that the payments authorized are not made as reimbursement for Medicaid expenditures. President Clinton recently announced plans to pursue federal litigation against the tobacco industry. At this point, it is unclear how federal actions will affect the industry's settlement with the states. The MOU outlining distribution of payments to California states that any reduction in payments due to claims by the federal government will be borne proportionately by participating jurisdictions.

Can The Distribution Formula Be Changed?

To the extent the payments are made as part of a settlement of outstanding litigation, it is not clear whether the state has the authority to reallocate proceeds of the payment. The MOU specifically states that the distribution of funds "is not subject to alternation by legislative, judicial, or executive action at any level."

What Happens Next?

In order for the state to receive funds, a California court must approve the agreement and a consent decree implementing the terms of the settlement. The time clock for any appeals of the settlement must have expired prior to a state's receipt of funds. On December 9, 1998, the San Diego Superior Court approved the agreement. This decision will become final if no appeals are made within sixty days of the court's decision. In order for California to receive the full allocation of funds allowed under the agreement, the state must also enact a model statute included as part of the agreement. This statute, which must be enacted without changes, is designed to level the playing field between the tobacco companies that are participating in the agreement and those that are not. Annual payments will be reduced by 65 percent to states that do not approve the model legislation.

When Will The Money Arrive?

The initial distribution date for the funds depends on the date by which a specified number of states approve the terms of the settlement agreement. Funds will be made available on the earlier of June 30, 2000, or the date that 80 percent of the involved states approve the agreement and states receiving 80 percent of the authorized payments approve the settlement. If 80 percent of the states do not approve the agreement, payments will be made to approving states after June 30, 2000.

Key Policy Questions

The Governor's budget uses the first payments from the tobacco settlement to help fill the gap in the 1999-00 budget. While the payments are meant to reimburse states for amounts paid by public health programs for treating smoking related diseases, there is no requirement that the moneys be used for health related programs. The settlement and related funding raises a number of important policy questions for the 1999-00 budget and beyond:

- ✓ Should payments from the settlement go into the state's General Fund or be set aside for specific programs?
- ✓ If the funds are set aside for specific purposes, how should they be spent?
- ✓ Should the Legislature attempt to coordinate the use of state and county funds to obtain economies of scale or address needs that exceed the amount that the state will receive?
- ✓ Should the state enact additional tobacco control legislation during the period when the "will not oppose" agreement is in effect?