MULTISTATE SETTLEMENT AGREEMENT

The Non-Participating Manufacturers Adjustment And The Model Statute

The multistate settlement agreement states that the participating tobacco companies' payments to the states will be reduced in any year that: 1) total U.S. cigarette sales go down; *and* 2) the cigarette manufacturers that are not part of the multistate settlement agreement have taken business away from the tobacco companies have signed onto the agreement. [Section IX.(d)] The amount of any such reductions depends on how much market share the non-participating manufacturers have taken away from the total 1997 market share of the all the participating manufacturers combined, and is calculated through a somewhat complicated non-participating manufacturer (NPM) adjustment formula. [Sec. IX.(d)(1)]

At the same time, the settlement agreement provides that the NPM adjustment will not apply at all to the tobacco payments made to any states that have passed into law a "Qualifying Statute" that "effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement." [Sec. IX.(d)(2)(B)]

The Qualifying Statute must either be in the exact form of the Model Statute in Exhibit T to the settlement agreement -- with no additions or modifications and with no supplementary legislative or regulatory proposals attached -- or must be judged to qualify as a Qualifying Statute by "the firm" (a nationally recognized firm of economic consultants). [Sec. IX.(d)(2)(E-G) and (d)(1)(C)] The Model Statute in Exhibit T gives non-participating manufacturers the option of either signing onto the settlement agreement or making annual payments into a special escrow account that are equal in amount to what they would pay the state each year if they did sign onto the multistate settlement agreement. The money a NPM pays into the escrow fund can be used only to pay a judgement or settlement brought against that specific NPM, and any not so used are given back to the NPM 25 years after they were paid into escrow. [Exhibit F]

To avoid any possible NPM adjustment to a scheduled settlement payment, the state must have had a Qualifying Statute in effect for at least the last six months of the preceding calendar year, and must have enforced the Qualifying Statute since its enactment. [Sec. IX.(d)(2)(B)]

Is the Model Statute a Good Deal for the States?

Passing the Model Statute, as is, or passing some other Qualifying Statute will protect a state against any possible reduction in payments caused by the application of the NPM Adjustment. Whether the states should go to the trouble of passing a Qualifying Statute depends on: a) the risk that the NPM Adjustment will be applied if they do not pass a Qualifying Statute; b) the probable size of any such NPM Adjustments; and c) whether passing a Qualifying Statute provides any other benefits or risks.

Chance that the NPM adjustment would otherwise come into play. The NPM adjustment is activated for states not passing a Qualifying Statute only when the three following conditions are met: 1) the total number of cigarettes shipped within the U.S. in the year preceding the scheduled payment by the four major tobacco companies who originally signed the agreement is less than the amount they shipped in 1997; *and* 2) the total *percentage* market share of *all* the participating manufacturers (i.e., the four major original signers plus other manufacturers who have subsequently signed onto the agreement) for the year preceding the payment is less than 98 percent of these same manufacturers' total percentage market share in 1997; *and* 3) "the firm" determines that the settlement agreement was a significant factor contributing to the market share loss.

We hope, and expect, that the first condition will be met every year because of continued reductions in U.S. tobacco use. But the second condition will not occur unless some non-participating manufacturers gain more than two percent of market share away from the participating manufacturers. Shifts in market share among the participating manufacturers (e.g., Philip Morris stealing sales from RJ Reynolds) will not activate the NPM adjustment and will not have any effect whatsoever on the amounts the states receive.

Although the "qualifying statute" provisions were put into the multistate settlement agreement because of the major tobacco companies fear of non-participating manufacturers, it seems highly unlikely that any non-participating manufacturers will gain any significant market share away from the participating manufacturers in the foreseeable future. Competing against Philip Morris and the other major tobacco companies, under any circumstances, is not easy given their enormous resources. In addition, many of the smaller tobacco manufacturers have already signed onto the settlement agreement (seventeen, as of March 31, 1999). There simply are not many non-participating manufacturers left to threaten the growing number of participating manufacturers. And even if Philip Morris and RJ Reynolds did somehow lose large amounts of their existing market share to other participating manufacturers (such as Japan Tobacco or the Santa Fe Natural Tobacco Company), it would have no impact on the settlement payments made to the states.

Whether the third condition might be met if non-participating manufacturers did take significant market share away from the participating manufacturers would probably depend on whether the NPM's success could be attributed to their being able to use forms of marketing that the participating manufacturers can no longer use because of the settlement agreement (e.g., billboards or certain sponsorships). Indeed, the Qualifying Statute provisions in the settlement agreement can be seen as an attempt to get states to force the non-participating manufacturers to become subject not only to the settlement's payment requirements but to its marketing restrictions. At this point, however, small tobacco firms seem to be relying much more on ads in publications or on the Internet or direct mail (none of which is prohibited by the settlement agreement) rather than on billboards, transit ads, or brand name sponsorships of entertainment or sporting events (which the agreement does prohibit).

Size of possible NPM adjustments. Following the formulas for the NPM Adjustment, the percentage reductions in payments to those states that do not pass the Model Statute or another Qualifying Statute would not be triggered unless the participating manufacturers lose more than two percent of their 1997 market share. Much beyond that, however, the percentage payment reductions applied to the states would be substantially larger than the percentage market share lost by the participating manufacturers. If, for example, non-participating manufacturers took away just five percent of the market share held by participating manufacturers, the reduction to the settlement payments to the states without a Qualifying Statute would be nine percent. A shift in market share from participating to non-participating manufacturers of 12 percent would reduce state settlement payments by 30 percent, and a 20 percent market shift would lead to state payment reductions of over 50 percent. [Sec. IX.(d)(1)(A)]

Possible side benefits from passing the Model Statute. Although it would eliminate the risk of payment reductions through the NPM adjustment, passing the Model Statute would not bring any new additional money directly to a state. If the NPMs chose to join the settlement agreement, they will simply pay their share of the total amounts already owed to the states. The total amounts owed would not be increased, but a larger number of manufacturers would be contributing to them. If the NPMs chose, instead, to pay funds into the special escrow accounts, the total amounts owed to the states still would not change -- the scheduled settlement payments would simply be paid by the existing participating manufacturers without any NPM contribution. In addition, the state would not get any of the monies paid into escrow (although the funds would be available to pay any judgements or settlements the state obtains through any state lawsuits against the NPMs).

Passing a Qualifying Statute could indirectly benefit the states, however, if it increased the number of manufacturers signing onto the agreement. Under the settlement agreement's terms, the participating manufacturers $300 million annual payments to the new national public education campaign to reduce tobacco use by youth will stop after 2003 unless the total market share of the participating manufacturers exceeds 99.05 percent. [Sec. IX.(e)] And the chance that the participating manufacturers’ total market share will exceed 99.05 percent in 2003 increases along with the total number of manufacturers actually participating.

Is There Any Benefit To Non-participating Manufacturers From Signing Onto The Agreement Rather Than Simply Paying The Amounts Required By The Model Statute ?

Although a non-participating manufacturer would pay the same amounts into escrow under the model statute as it would pay to the states if it signed onto the settlement agreement, each of its escrow payments would be returned to it 25 years after payment -- unless they were used to pay off a state settlement or judgment against the NPM. On the other hand, signing onto the agreement would protect the NPM against almost any lawsuits the state is likely to bring against it -- because the states have relinquished virtually all existing claims against any tobacco companies who sign onto the agreement and almost all future claims other than those for criminal acts or other misdeeds unassociated with people's use or exposure to tobacco products. It is probably because of this liability protection, that Japan Tobacco signed onto the multistate settlement agreement soon after it was announced, even though no Model Statute payment requirements yet applied to it, and sixteen other tobacco manufacturers quickly followed suit.

Can the Tobacco Companies Add Preemption Language or Other Undesirable Terms to the Model Statutes Passed By States?

The settlement agreement says that the Model Statute can serve as a Qualifying Statute that cancels the NPM adjustment only if 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." [Sec. IX.(d)(2)(E)] That means that any significant changes would stop the Model Statute from *automatically* serving as a Qualifying Statute. But it does not rule out the possibility that "the firm" could determine that Model Statutes passed with preemption language or other tobacco-company provisions added to them still qualify as Qualifying Statutes. In fact, the addition of preemption language should have no bearing one way or the other on whether a modified model statute could serve as a Qualifying Statute that "effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement." [Sec. IX.(d)(2)(B)]

The settlement agreement also states that "Each Participating Manufacturer agrees to support the enactment of such Model Statute if such Model Statute is introduced or proposed (i) without modification or addition (except for particularized procedural or technical requirements), and (ii) not in conjunction with any other legislative proposal." [Sec. IX.(d)(2)(E)] This language certainly means that the tobacco companies may choose to oppose any Model Statute that any states try to pass that are revised in any way or have additional provisions added to them. It also suggests that they cannot support any alternative to an unchanged Model Statute so long as that unchanged Model Statute is pending (since supporting an alternative is the same thing as opposing the unchanged Model Statute, which they cannot do). But it is not clear whether the language also blocks the tobacco companies from choosing to support Model Statutes that have already been revised in ways that they like if no unchanged Model Statute has not also been introduced or proposed. Given the stress the agreement language places on the Model Statutes not being changed, however, a decent argument could be made that the tobacco companies (and the state attorneys general) are forbidden from promoting any changes whatsoever to Model Statutes at any time. Another strategy might be to make sure an unchanged Model Statute is proposed so that the companies would have to support it exclusively.

Quite separately, the settlement agreement states that the tobacco companies "cannot oppose or cause to be opposed" any state or local proposals or administrative rules pertaining to certain measures listed in Exhibit F of the settlement agreement relating to reducing tobacco use by youth. [Sec. III.(m)1] Although the Exhibit F list of items is short and not very comprehensive, any tobacco company efforts to pass broad new preemption language that would block local governments from passing the Exhibit F measures -- e.g., by adding broad preemption language to any Model Statutes -- could be characterized as violating the lobbying restrictions of the settlement agreement.

Similarly, some of the more procedural lobbying restrictions in the settlement agreement might also interfere with tobacco company efforts to add undesirable terms to the Model Statutes. Applying these provisions, any tobacco company representative that supports such additional terms could be required to prove that they have previously certified in writing that they "will not support or oppose any state, local, or federal legislation, or seek or oppose any governmental action, on behalf of the Participating Manufacturer without the Participating Manufacturer's express authorization," and could be required to show that they have the participating manufacturers' express authorization for supporting the revisions or additions to the Model Statute. [Sec. III.(m)2]

Source of More Detailed Information

For the actual text of the Multistate Settlement Agreement, please go to the National Association of Attorneys General (NAAG) website: http://www.naag.org/tob2.htm.