

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

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Prepared By: Regulated Industries Committee

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BILL: SB 1988

SPONSOR: Senator Bennett

SUBJECT: Cigarettes/Transportation & Sale

DATE: March 19, 2006

REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Oxamendi</u>	<u>Imhof</u>	<u>RI</u>	<u>Pre-meeting</u>
2.	_____	_____	<u>CM</u>	_____
3.	_____	_____	<u>WM</u>	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

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## I. Summary:

This bill imposes a fee of two cents per cigarette, 40 cents per package of 20 cigarettes, or \$4.00 a carton on the sale of cigarettes from manufacturers who are not parties to any of the Tobacco Settlement agreements (nonsettling manufacturers, or NSMs) in which Florida and other states have participated. This fee is increased annually by the greater of three percent or the Consumer Price Index.

The bill also:

- Provides the purposes for imposing the fee, including, but not limited to:
  - Preventing underage smoking due to the availability of cigarettes at discounted prices; and
  - Protecting the state's tobacco settlement from the growth of NSM sales of tobacco;
- Imposes new reporting requirements on NSMs as well as penalties for non-compliance;
- Requires the Division of Alcoholic Beverages and Tobacco within the Department of Business and Professional Regulation to provide notice to NSMs when their payments are due and to post on the Internet a list of complying manufacturers;
- Exempts subsequent participating manufacturers (SPMs), which are tobacco companies that have joined the Master Settlement Agreement (MSA), from the fee until the effective date of a credit amendment to the MSA, and it outlines requirements for such a credit;
- Requires that tax stamps not be placed on cigarette packages from nonsettling manufacturers who have not paid the fee or who do not appear on the division's Internet listing of complying manufacturers;
- Provides criminal and civil penalties for sale or possession of counterfeit cigarettes;

- Requires the seizure, confiscation and forfeiture, and destruction of counterfeit cigarettes;
- Appropriates \$16 million to the Department of Health (DOH) for anti-smoking programs; and
- Appropriates \$2 million to DOH to address health care disparities in minority communities.

The bill provides that the Attorney General may demand from the administrator of the MSA that payments that are based upon the sale of cigarettes in this state be paid annually to Florida, or that the affected companies pay Florida directly and receive an MSA credit. The bill requires that the Attorney General report to the President of the Senate and the Speaker of the House of Representatives regarding the status of these activities by January 1, 2007.

The bill provides an effective date of July 1, 2006.

This bill creates section 210.0205, Florida Statutes. This bill substantially amends the following sections of the Florida Statutes: 17.41, 210.01, and 210.18. This bill reenacts sections 772.102(1)(a) and 895.02(1)(a), Florida Statutes. This bill creates unnumbered sections of the Florida Statutes.

## II. Present Situation:

### Florida's Tobacco Settlements Background

In February 1995, Florida sued several tobacco companies to recover smoking-related health care costs. In March 1996, the state entered into a settlement agreement with Liggett Group, Inc., Brooke Group, Ltd., and Liggett & Myers, Inc. This settlement is known as the Attorneys General Settlement Agreement.

In August 1997, the "Big Four" tobacco companies (Phillip Morris, Inc., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corp.,<sup>1</sup> and Lorillard Tobacco Company) entered into the landmark tobacco settlement agreement with Florida for all past, present and future claims by the state, including reimbursement of Medicaid expenses, fraud, RICO and punitive damages.<sup>2</sup> These cigarette producers held over 97 percent of the tobacco market share in the U.S.<sup>3</sup> The remaining market share was, and remains, held by various, smaller producers who were not named in the state's suit as defendants and therefore, are not a part of the settlement.

### Master Settlement Agreement

Two years after Florida entered into the tobacco settlement with the Big Four Tobacco Companies, those companies, along with Commonwealth Tobacco and Liggett & Myers, settled with 46 states, the District of Columbia, and five U.S. territories in November 1998, by entering

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<sup>1</sup> In 2003, R.J. Reynolds Tobacco Company and Brown & Williamson Tobacco Corp. merged to form R.J. Reynolds Tobacco Company as a wholly owned subsidiary of Reynolds American, Inc.

<sup>2</sup> See, s. 215.56005(1)(f), F.S., which defines the tobacco settlement agreement to mean *State v. American Tobacco Co. et al.*, Case no. 95-1466AH (Fla. 15th Cir. Ct. 1996).

<sup>3</sup> The Council of State Governments, *Tobacco Settlement and Declining State Revenues*, Trends Alert (March, 2002), page 5.

into the Master Settlement Agreement (MSA).<sup>4</sup> These settling manufacturers are known as the Original Participating Manufacturers or OPMs. Tobacco companies that did not enter into a settlement with any state are known as nonsettling-manufacturers (NSMs), and they make no direct payments to any state.

The MSA<sup>5</sup> provided states with funding to prevent smoking and control tobacco sales while imposing restrictions on OPMs such as, for example, requiring the removal of billboard advertising, prohibiting the use of cartoon characters to sell cigarettes, limiting product placement in movies and television, and limiting cigarette sampling. Under the MSA, each state receives payments based on a formula contained in the agreement that takes into account inflation, and volume of cigarette sales in the states. OPM payments under the MSA are also subject to a “previously settled states reduction” based on their payments to the four states, including Florida, which settled prior to 1998 under the Attorneys General Settlement Agreement.

According to a list of participating manufacturers on the National Association of Attorneys General (NAAG) website, over 40 subsequent participating manufacturers (SPMs) have signed the MSA since the 1998 settlement with the OPMs.<sup>6</sup> SPMs are subject to the same restrictions as OPMs, but make lower up-front payments than do OPMs.<sup>7</sup> However, SPMs, which have settled with the MSA states but not with Florida, are not subject to a comparable reduction in their payments under the MSA. OPMs and SPMs are required to make their annual payments into a national escrow account by April 15<sup>th</sup> of each year. The funds are later distributed to the states pursuant to an MSA allocation formula.<sup>8</sup>

### **Reduction in Cigarette Sales Attributed to the MSA Settlement**

On March 8, 2006, the Tobacco Committee of the NAAG announced that the number of cigarettes sold in the United States during the previous year had dropped to historic levels. Based on data compiled by the Tobacco Tax Bureau of the United States Department of the Treasury, NAAG announced that cigarette sales in 2005 had declined by 4.2 percent from 2004 levels, and that this decline marked the largest one-year percentage decrease in cigarette sales since 1999.<sup>9</sup> NAAG stated that the 2005 sales figures continue the unprecedented long-term decline in cigarette smoking that began with the settlement of lawsuits brought by state Attorneys General against the major tobacco companies.

According to NAAG, cigarette sales in the United States have fallen by 21.1 percent since the state Attorneys General negotiated the 1998 tobacco MSA, which imposed public health restrictions on the advertising, promotion and marketing of cigarettes by tobacco companies.

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<sup>4</sup> Florida, Minnesota, Mississippi, and Texas were not parties to the Master Settlement Agreement, having previously settled with those companies.

<sup>5</sup> *Master Settlement Agreement* (Nov. 1998), available at National Association of Attorneys General, [http://www.naag.org/upload/1032468605\\_cigmsa.pdf](http://www.naag.org/upload/1032468605_cigmsa.pdf). (Last visited March 21, 2006).

<sup>6</sup> *Participating Manufacturers and Brand Name List Under MSA*, 9 March 2005. <http://www.naag.org>. (Last visited March 21, 2006.)

<sup>7</sup> *See, MSA: Five Years Later*, State Government News, November/December 2003, page 14.

<sup>8</sup> The Council of State Governments, *Tobacco Settlement and Declining State Revenues*, Trends Alert (March, 2002), p. 3.

<sup>9</sup> News Release, National Association of Attorneys General, dated March 8, 2006. A copy of this document may be found at <http://www.naag.org/news/pdf/pr-20060308-cig-decrease.pdf>. (Last visited March 19, 2006.)

NAAG stated that the 378 billion cigarettes sold in the United States in 2005 represented the lowest number of cigarettes sold in the United States since 1951. NAAG noted that this decline is even more impressive because the United States population has more than doubled since that time.<sup>10</sup>

### **Escrow Statutes**

Settlement payments under Florida's tobacco settlement and the MSA are based, in part, on the tobacco companies' respective market shares and the number of cigarettes sold.

In order to receive its full share of the settlement payments, each state that is a party to the MSA is required by the MSA to enact a law addressing the potential competitive advantage of tobacco companies that were not parties to the settlement. The Florida agreements have no comparable provision. The MSA specified that individual states can avoid a downward adjustment—known as the “non-participating manufacturers” adjustment—to their payments by enacting and enforcing an escrow statute intended to prevent a competitive disadvantage for the participating manufacturers. The MSA included a model law that, if enacted and enforced by a state, would protect that state from any adjustment for market share loss, although states were permitted to enact and enforce any law that achieved the same result.<sup>11</sup>

According to representatives for the National Association of Attorneys General, which negotiates the MSA on behalf of the participating states, all MSA participating states have adopted some form of the model escrow statute. The model escrow statute requires that every tobacco company in the state must either participate in the settlement and pay its respective share of the settlement payments to the states based on the manufacturer's market share of cigarette sales in the United States or remain a NSM. Under the model escrow statute, a NSM must pay funds into an escrow account equivalent to the amount the manufacturer would have paid to the state if it had been sued by the state and became a participating manufacturer under the MSA. Because Florida is not a party to the MSA, a NSM may sell cigarettes in this state without making either MSA payments or escrow payments.<sup>12</sup>

Escrow payments are collected from the manufacturers who then transfer the cost to the consumers. Escrow payments are intended to limit the cost advantage of the nonsettling manufacturers and thereby potentially discourage underage tobacco use. Escrow payments are held for 25 years, after which time, if the state has not sued to recover Medicaid or other costs associated with cigarette consumption, the state must return the moneys collected. Escrow statutes have the disadvantage that the funds placed in escrow cannot be used to address the health costs associated with tobacco consumption or to address other state revenue needs.

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<sup>10</sup> *Id.*

<sup>11</sup> *Exhibit T of the Master Settlement Agreement, supra* note at 279 (page number of the PDF file).

<sup>12</sup> New York and Virginia courts have heard challenges to their NPM statutes. In *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205 (2d Cir. 2004), NPM's challenged an escrow statute on Commerce Clause, Equal Protection and Anti-Sherman Act grounds and a contraband statute based on affixing the stamp tax to cigarette packs. The New York court held that NPMs had a cause of action to challenge the statutes on the basis that the escrow and contraband statutes may, based on the facts alleged in the complaint, violate the Sherman Anti-Trust Act because they effectively relieved the settling manufacturers from price competition. The court did not find a commerce clause or equal protection basis for the NPMs claims. In *Star Scientific, Inc. v. Beals*, 278 F.3d 339 (4<sup>th</sup> Cir. 2002), a U.S. District Court of Appeals upheld Virginia's escrow statute against a constitutional challenge by an NPM on due process, commerce clause and equal protection grounds.

## **Task Force on Tobacco-Settlement Revenue Protection**

In 2000, Florida's Legislature established the Task Force on Tobacco-Settlement Revenue Protection (task force) to determine the need for and evaluate methods for protecting the state's settlement revenue from diminution or significant loss.<sup>13</sup> The task force submitted its findings and recommendations in March, 2001, and found that Florida had received annual payments totaling \$2.4 billion since September 1997. The task force expressed concern about the tobacco companies' willingness and ability to continue to make payment based on declining payments due to a decrease in the number of smokers and a shift in market share among cigarette manufacturers which had already necessitated revenue adjustments.

The Task Force identified two major categories of uncertainty underlying these payments:

1. No payments due to bankruptcy or some other catastrophic financial event as may be caused by a huge judgment; and
2. Reduced payments owing to adjustments allowed under the settlement agreement.

Florida's payments under the settlement agreement are based on domestic sales of cigarettes by the participating tobacco manufacturers. The task force recommended several options for protecting the tobacco settlement revenues, including the imposition of a licensing fee or equitable assessment on non-participating tobacco product manufacturers or NSMs.

### **NonSettling Manufacturers (also known as Non-Participating Manufacturers, or NPMs)**

Nonsettling manufacturers (NSMs), are mostly small, domestic tobacco companies and foreign tobacco manufacturers that market their products state by state or regionally. Because they are not parties to the MSA or have not otherwise settled with any state, including Florida, they are not required to make the annual payments required of the settling-manufacturers. They are also not subject to the advertising and marketing restrictions that the settling-manufacturers are subject to. Florida's Division of Alcoholic Beverages and Tobacco (the division) within the Department of Business and Professional Regulation (DBPR) estimates that there are approximately 40 NSMs selling cigarettes in Florida with estimated sales to various distributors in Florida in excess of 209,362,000 packs of cigarettes.

The states that entered into settlement agreements with the major tobacco companies are concerned about the effect on payments under the agreements of the sale of deep-discounted cigarettes from nonsettling-manufacturers. Florida's settlement agreements and the MSA consider OPMs and SPMs market share in determining payments; lower prices of NSM products allow for a reduction in the total payments that states receive under the agreements. A reduction in market share has been observed in the 46 states that are a party to the MSA.<sup>14</sup> In response to these concerns, for instance, Minnesota, a non-MSA state like Florida, imposed a fee of \$.35 per

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<sup>13</sup> See, ch. 2000-128, s.5, L.O.F

<sup>14</sup> According to the U.S. General Accounting Office, adjustments of settlement payments based, in part, on market share led to a \$1.6 billion reduction in the payments from projections between 1999 and 2001. See U.S. General Accounting Office, *Tobacco Settlement: States' Use of Master Settlement Agreement Payment* 8 (GAO-01-851, June 2001). See also *Issues Affecting MSA Payment, Issue Brief Summary* from the National Conference of State Legislatures, dated October 1, 2003, at 11 (page number of the PDF file).

pack of 20 cigarettes in 2003 on NSM cigarettes.<sup>15</sup> When the fee was challenged by NSMs, a Minnesota appellate court upheld the fee as constitutional finding the distinction between settling and nonsettling manufacturers tied to the legitimate state interests of subsidizing costs of smoking to the state and raising cigarette prices to discourage youth smoking.

### **Equitable Assessment Fees**

Other states have considered enacting a fee on the cigarettes of nonsettling manufacturer as a means to eliminate any cost advantage they may have in the market place and thereby avoid any downward adjustments in tobacco payments.<sup>16</sup> These fees are often termed “equitable assessment fees.”

NSMs argue such fees are inequitable for several reasons including, but not limited to, the following:

- Payments made by settling manufacturers are the consequence of their alleged denial and concealment of the deadly and addictive nature of cigarettes. Nonsettling manufacturers were never sued for similar acts and, therefore, they should not be obligated to pay the same penalty as the settling manufacturers and settling manufacturers should not have to escape the associated penalty of higher prices for their products.
- NSMs should not be required to pay a fee or tax for their refusal to enter into a settlement with Florida.
- If a fee were imposed, it would not equalize the market because the settling manufacturers receive a credit in their MSA payments for their Florida settlement payments.
- NSMs that have entered the MSA assert that a Florida fee or tax would disproportionately increase their price-per-carton because the prices for their products already reflect either MSA payments or escrow payments to the other states.

Vibo Corporation, doing business as General Tobacco, a Miami based importer, became an SPM in August 2004 under the MSA. General Tobacco’s settlement provides a \$.73 credit for each dollar it pays to the MSA. Representatives for NAAG represented that the MSA states are prepared to give the same credit to any tobacco company that has settled under the MSA or wishes to enter into the agreement. There is no intent to provide a similar credit to NPMs for their escrow payments to the MSA-states. However, according to the SPM, the credit that the

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<sup>15</sup> Section 297F.24, Minnesota Statutes (2003). A trial court decision in Minnesota held that this statute is not unconstitutional in an analysis that analogized the state’s tax to Virginia’s escrow statute. *See, Council of Independent Tobacco Manufacturers v. Minnesota*, Minn. 2<sup>nd</sup> Jud. Dist., File No. C1-03-7120, Nov. 18, 2001. (Unreported decision.)

<sup>16</sup> In 2003, the State of Michigan imposed an equitable assessment of 17.5 mills (or 1.75 cents) per cigarette on NPM cigarettes sold in the state. *See* Section 205.426d, Mich. Comp. Laws (2003). In 2004, the State of Utah imposed a 17.5 mills (or 1.75 cent) per cigarette equitable assessment fee on NPM cigarettes. *See* Section 59-14-214, Utah Code Ann. (2004). Legislation to establish equitable assessment fees has failed in other states. Legislation in the State of Tennessee to establish a 25 mills (or 2.5 cent) per cigarettes fee failed in the state’s General Assembly during its 2004 regular session. *See* SB 3183 by Senator Kurita and HB 3350 by Representative Bowers, General Assembly for the State of Tennessee. Tennessee’s legislative documents may be accessed at [www.legislature.state.tn.us](http://www.legislature.state.tn.us).

NAAG offered the SPM's was not equitable and would have required a greater MSA payment than if there were no credit.

Representatives for the settling manufacturers have indicated that, in order to be equitable, a fee imposed on NSM cigarettes would have to approximate the settling manufacturers' per-cigarette settlement costs. The settling manufacturers' projected adjusted tobacco settlement payment to Florida for 2004 was \$372.9 billion. This translates to a Florida settlement cost of approximately two cents (or 20 mills) per cigarette or 40 cents per cigarette package sold in this state.<sup>17</sup> Accordingly, if the Legislature opts to enact a fee or tax on NSM cigarettes, a similar per cigarette fee is suggested.

National Association of Attorneys General representatives have recommended that Florida collect the fee at the wholesale level as is done with excise taxes. However, representatives for wholesalers have indicated that requiring them to collect the fee would impose additional regulation and administrative costs for the wholesalers that would increase their work and expenses. For example, currently s. 210.05(3), F.S., authorizes stamping agents and wholesalers to collect two percent of the par value of the amount of stamps purchased during the fiscal year; but, the discount is calculated on 24 cents per pack of cigarettes, which is less than the 33.9 cent excise tax rate for a standard 20-cigarette pack. Wholesalers indicate that this compensation is insufficient for collecting the tax and that an additional requirement for collection and administration of a fee on NSM cigarettes would impose an additional uncompensated expense on the industry.

### **The OPM's MSA Credit for Florida Tobacco Settlement Payments**

The OPMs receive a credit under the MSA for their payments to the four previous settled states, including Florida, that are not a part of the MSA settlement. The amount of the OPMs' credit is based, in part, is the OPMs' assumed national market share at the time of the settlement.

Under the MSA, the OPMs' assumed market share for the four previously settled states is 17 percent. According to the NAAG, during negotiations, the MSA states did not want to give such a large credit, so the parties settled at a credit of 12.45 percent. The assumed market share for Florida is 5.5 percent. Consequently, the OPM's do not get a dollar for dollar credit for their MSA settlement payments to the previously settled states.<sup>18</sup> The difference between the presumed market share and the actual credit is 4.55 percentage points.

According to NAAG, the SPMs should also not get a dollar for dollar credit for any fee they may pay Florida or any other previously settled state. Instead, to earn the credit, an SPM should pay an extra MSA payment of 4.55 percent because that is the difference between the OPMs' market share and the credit that they receive. This is the "credit" that the NAAG has offered the SPMs for the purpose of joining the MSA. According to NAAG, this extra payment is equitable because the SPMs' currently have a 4.55 percent advantage over the OPMs for the cigarettes

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<sup>17</sup> Based on the estimates of the Revenue Estimating Conference, Tobacco Settlement Payments Forecast, February 12, 2004. These estimates do not include payments by Liggett because it made no settlement payments during that year.

<sup>18</sup> Florida, Minnesota, Mississippi, and Texas, using MSA nomenclature, are know as the previously settled states. These four states that are not parties to the MSA, but have reached independent tobacco settlements with the OPMs.

they sell nationwide. The 4.55 percent reflects the amount of the OPMs' uncredited market share-based payments to the nonsettling states.

According to representatives for the NPMs who have expressed an interest in joining the MSA, the NAAG is looking at the difference in terms of percentage points instead of the actual differential. They argue that the difference between a credit of 12.45 percent and 17 percent is 27 percent. In other words, if a 17 percent credit were equal to 100 percent of their payments to the nonsettling states, a 12.45 percent credit would equal 73 percent of those payments, i.e., 12.45 percent is 27 percent less than 17 percent in the way that 10 percent is 50 percent less than 20 percent. Consequently, the SPMs assert that an equitable MSA credit for any equitable fee payments to the nonsettling states should be in the amount of approximately 73 percent.

### **Cigarette Excise Tax Revenue**

The Division of Alcoholic Beverages and Tobacco (division) in the Department of Business and Professional Regulation (department) oversees the collection of excise taxes from the sale of cigarettes and other tobacco products. Section 210.15, F.S., requires every person, firm or corporation desiring to deal in cigarettes in Florida as a distributing agent, wholesale dealer, or exporter to apply for a cigarette permit. The current excise tax in Florida ranges from 16.9 cents per package to 67.8 cents per package, depending on the number of cigarettes per package.<sup>19</sup> The current excise tax is 33.9 cents per standard 20-cigarette pack cigarettes.<sup>20</sup>

A "distributing agent" is any person, firm, or corporation who receives cigarettes and distributes them to wholesalers or other distributing agents inside or outside the state.<sup>21</sup> An "agent" is any person authorized by the division to purchase and affix adhesive or meter stamps under part I of ch. 510, F.S.<sup>22</sup> A "wholesale dealer" sells cigarettes to retail dealers for resale only, or operates cigarette vending machines in more than one place of business.<sup>23</sup> An "exporter" is a person who transports tax-exempt cigarettes into Florida under bond for delivery beyond state borders.<sup>24</sup>

Section 210.06, F.S., requires that every dealer affix a tax stamp as evidence that the excise tax has been paid before the cigarettes can be offered for sale in this state. Sections 210.02 and 210.04, F.S., provide that excise taxes must be paid by the wholesale dealer upon the first sale or transaction within this state whether or not such sale or transfer is to the ultimate purchaser or consumer. Because wholesalers may purchase cigarettes from other wholesalers, only the first sale is taxed. Distributing agents, acting as agents to the manufacturers, are not required to pay taxes for the distribution of cigarettes to wholesalers. Collected excise taxes are paid to the division. Stamps representing various denominations of tax are purchased in bulk by wholesale dealers and are affixed to packages as proof of payment. Cigarettes that are not properly stamped may not be sold in Florida. The amount of the tax then becomes a part of the price of the cigarettes to be paid by the purchaser or consumer.

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<sup>19</sup> Section 210.02(3) and (4), F.S.

<sup>20</sup> Section 210.02(3)(b), F.S.

<sup>21</sup> Section 210.01(14), F.S.

<sup>22</sup> Section 210.01(9), F.S.

<sup>23</sup> Section 210.01(6), F.S.

<sup>24</sup> Section 210.01(17), F.S.

## **Cigarette Reporting Requirements**

### ***A. Manufacturers***

Under current law, cigarette manufacturers report information pertaining to the tobacco settlement agreement to the Attorney General's Office rather than to the division. Section 210.09(2), F.S., requires a monthly report by "any distributing agent, wholesale dealer, retail dealer, common carrier, or any other person handling, transporting or possessing cigarettes for sale or distribution within the state." All manufacturers must report to the division the amount of cigarettes, by invoice total, shipped to Florida cigarette stamping wholesalers, i.e., distributors. However, according to the division, not all manufacturers submit these reports.

Although most out-of-state manufacturers report their deliveries in Florida voluntarily, Florida law does not require that manufacturers report their in-state sales to the division. According to the division, a requirement that manufacturers must report monthly to the division all cigarettes sold in Florida, would permit the division to know that unlicensed or non-reporting entities are selling cigarettes to the retailers in Florida and not reporting to the division. According to the division, this information would allow the division to cross-reference and identify distributors who are not licensed or who do not report and pay taxes to the state. The untaxed cigarette sales, i.e., less expensive cigarettes, may adversely affect the market share of the settling manufacturers and, thereby, adversely affect Florida's share of the tobacco settlement.

### ***B. Importers***

Florida law does not provide for the licensure of cigarette importers nor defines the term "importer" in the context of cigarettes or other tobacco products importers. The division relies on the definition for importers in s. 561.14(4), F.S., which establishes a license classification for importers of alcoholic beverages. Section 210.185, F.S., regulates the importation of cigarettes into this state by prohibiting the acquiring, holding, owning, possessing, transporting or the importation, for sale or distribution in this state of cigarettes that the manufacturer did not intend to sell or distribute in the United States. This section prohibits the importation of "gray market" cigarettes or diverted tobacco products which are cigarettes that are domestically manufactured then obtained at reduced prices from international markets and imported for domestic sale.

Like cigarette manufacturers, the division relies on s. 210.09(2), F.S., to report the amount of cigarettes shipped to Florida cigarette stamping agents. The division indicates that all importers may not be reporting to the division.

### ***C. Wholesalers and Distributing Agents***

Cigarette distributing agents file a monthly report with the division detailing the number of cigarettes shipped through their warehouse for the preceding month, including all cigarettes received from manufacturers and delivered to each stamping agent. Stamping agents file a monthly report listing all stamp purchases and usage for the preceding month, including ending and beginning inventories. Wholesale distributors that are not stamping agents file a similar report of all purchases and sales inside and outside the state for the preceding month, including ending and beginning inventories. Sales of cigarettes out-of-state are reported on a wholesale

dealer's monthly report as exempt from the excise tax because the tax applies only to sales in Florida. The monthly report details the number of cigarette packages, but does not include any information about the quantity of each brand. There are no reporting requirements for retailers.

### **Contraband Cigarettes**

The sale of contraband cigarettes, which includes untaxed and counterfeit cigarettes, deprives the state of excise and sales tax revenues, and it may supplant legal sales, thereby reducing the state's tobacco settlement payments. The scope of counterfeit or untaxed cigarette sales in Florida is also unknown. The Florida Department of Law Enforcement (FDLE) and the division do not maintain records of counterfeit cigarette seizures or related arrests. Section 210.18(7), F.S., requires law enforcement officers to report to the division the seizure of any unstamped cigarettes in order to keep the state informed about the size and magnitude of the illicit cigarette business. Section 10 of ch. 2005-228, L.O.F., amended s. 210.18, F.S., to require the division to keep records showing the number of seizures and seized cigarettes reported to, or seized by, the division.

### **Senate Interim Project Report No. 2005-157: Florida Tobacco Settlement and Nonsettling Manufacturers**

The Florida Senate issued a report authored by the Committee on Regulated Industries regarding the tobacco settlement agreements.<sup>25</sup> It detailed the history of Florida's tobacco settlements, and discussed how the market share of the settling manufacturers has been decreasing relative to the market share of the cigarette manufacturers that have not settled with Florida or the MSA states. The report also discussed several equity issues that have arisen as a result of the tobacco settlements including escrow statutes as well as payments made under the MSA versus those of the four states not part of the MSA. The report made recommendations to the Legislature, including, but not limited to, the following:

- The Legislature should impose a tax or fee on the cigarettes sold in Florida that are manufactured by cigarette manufacturers that are not making tobacco settlement payments to Florida, if the Legislature believes that the nonsettling-manufacturers are not paying their equitable share of the costs associated with tobacco use and are causing an erosion of the market share for Florida's settling manufacturers to the detriment of Florida's tobacco settlement payments. In order to offset any cost advantage by cigarette manufacturers that are not making tobacco settlement payments to Florida, the fee or tax would have to reflect the settling manufacturers per cigarette cost under the Florida tobacco settlement. The MSA-states' willingness to provide the SPMs with a credit for any fee or tax paid in Florida on nonsettling manufacturers' cigarettes may negate concerns regarding inequitable treatment of the SPMs.
- If the Legislature chooses to enact the fee or tax, it should also provide that the purpose of the fee or tax is to recoup the state's health costs associated with the use of nonsettling manufacturer cigarettes and to discourage under-aged smokers by reducing the cost advantage of lower-priced cigarettes.

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<sup>25</sup> See *Florida Tobacco Settlement and Nonsettling Manufacturers*, Report No. 2005-157, Florida Senate Committee on Regulated Industries, November 2004.

- If the Legislature chooses to enact the fee or tax, it should provide for collection of the fee or tax from wholesalers or stamping agents in the same manner that the cigarette excise tax is collected. The Legislature should also permit the wholesalers or stamping agents to reserve from the amount collected an amount sufficient to compensate the wholesalers or stamping agents for their expenses in collecting and administering the fee or tax.
- Require that manufacturers and importers identify the quantity of cigarettes shipped or sold, or cause to be shipped or sold, and to whom the cigarettes were shipped or sold, or cause to be shipped or sold.
- Require that all manufacturers and importers file a monthly report to the division if they ship or sell, or cause to be shipped or sold, cigarettes into Florida for sale to consumers in this state.

### III. Effect of Proposed Changes:

**Section 1** amends s. 210.01, F.S., to define the term “brand family” as:

all styles of cigarettes sold under the same trademark and differentiated from one another by means of additional modifiers or descriptors, including, but not limited to, "menthol," "lights," "kings," and "100s," and includes any brand name used alone or in conjunction with any other word, trademark, logo, symbol, motto, selling message, recognizable pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, a previously known brand of cigarettes.

**Section 2** creates s. 210.0205, F.S., to impose a fee on cigarettes produced by nonsettling-manufacturers.

Subsection (1) defines a nonsettling manufacturer to mean:

any tobacco product manufacturer that has not entered into the tobacco settlement agreement defined in s. 215.56005(1)(f) or the Attorneys General Settlement Agreement dated March 15, 1996, in the State of Florida, et al. v. American Tobacco Company, et al., Fifteenth Judicial Circuit, Case No. 95-1466.

The bill also defines the terms “Consumer Price Index,” and “nonsettling-manufacturer cigarettes.”

It defines the term “manufacturer” to mean:

a person or entity holding a valid permit under 26 U.S.C. s. 5712 that manufactures, fabricates, or assembles cigarettes. The term includes an entity that is the first importer into the United States of cigarettes manufactured abroad.

Subsection (2) imposes an additional fee of 20 mills per cigarette on the sale, receipt, purchase, possession, consumption, handling, distribution, and use in this state of cigarettes from a nonsettling-manufacturer. One mill equals one-tenth of a cent; therefore, the fee imposed by this

subsection is \$.02 per cigarette, \$.40 per package of 20 cigarettes, or \$4.00 a carton. This fee is in addition to any other fee or tax imposed on cigarettes. The fee amount must be adjusted upward annually by the division each January 1 by the greater of three percent or the Consumer Price Index.

Subsection (3) provides the procedure for collecting the fee. The amount of fee collected would be based on the information collected under the reporting requirements in subsection (6). This subsection requires that, no later than the 15th day of each month, the division must mail to each nonsettling-manufacturer a notice of the fee due based on sales in the preceding month. The nonsettling-manufacturer is required to ensure that the division has received the required fee no later than the last day of the month in which the notice is mailed. This subsection provides that, except as provided in this section, the fee shall be imposed, collected, paid, administered, and enforced in the same manner as the tax on cigarettes imposed by s. 210.02, F.S. Unless otherwise provided in this section, proceeds from the fee must be deposited into the Tobacco Settlement Clearing Trust Fund.

Subsection (4) of s. 210.0205, F.S., requires a nonsettling-manufacturer that is selling cigarettes in Florida on July 1, 2006, to provide the information described in subsections (7) and (8) of this section, and to pay the fee imposed by August 1, 2005. If the nonsettling-manufacturer is not selling cigarettes in this state on the effective date of this bill, the nonsettling-manufacturer must prepay the required fee before commencing any sales in this state. This subsection provides that the prepayment amount shall be determined by 20 mills multiplied by the number of cigarettes the division reasonably projects that the nonsettling-manufacturer will sell in this state in the first calendar month or \$50,000, whichever is greater. This subsection authorizes the division to require a nonsettling-manufacturer to provide whatever information necessary to make this determination. It also requires that the division establish procedures for reimbursing a nonsettling-manufacturer if the actual sales are less than the sales projected. Moreover, this subsection provides that the term "cigarettes" as used in that section only refers to nonsettling manufacturer cigarettes.

Subsection (5) of s. 210.0205, F.S., states the legislative purposes of the fee, including:

- Preventing nonsettling-manufacturers from undermining the state policy of reducing underage smoking by offering substantially lower priced cigarettes;
- Protecting the tobacco settlement agreement as defined in s. 215.56005(1)(f), F.S., and funding for state programs supported by money derived from the settlement agreement;
- Recouping settlement revenue lost to the state as a result of nonsettling-manufacturers cigarette sales;
- Funding enforcement and administration of nonsettling-manufacturer legislation and the fee imposed by this section; and
- Funding such other purposes as the Legislature deems necessary.

This subsection requires that \$16 million of the fee proceeds must be provided annually in quarterly disbursements to the Department of Health (DOH) to allow that agency to implement statewide anti-smoking marketing, educational and advertising campaigns to reduce tobacco use. DOH must evaluate the performance of its program and may contract out for any of the activities specified in this legislation.

Subsection (6) requires each agent and wholesaler to make monthly reports to the division. The reports must state the number and denominations of tax stamps or insignia affixed to individual packages of nonsettling-manufacturer cigarettes sold or purchased in this state. The reports must also state the number of individual packages of nonsettling-manufacturer cigarettes handled or distributed in this state for sale in another state, commonwealth, or territory of the United States, and must state, by manufacturer and brand family, the number sold for each place of business in the month preceding the month in which the report is made.

This subsection authorizes the division to adopt rules to require any agent or wholesaler, wholesale dealer or nonsettling-manufacturer to provide any information necessary to determine the required fee in its monthly report.

Subsection (7) requires a nonsettling-manufacturer to provide the following information on a form prescribed by the division before selling cigarettes in Florida, or if selling cigarettes in Florida on the effective date of this bill, within 30 days of the effective date:

- Its name, address and telephone number;
- The date it began, or intends to begin, selling, cigarettes in Florida;
- The name of cigarette brand families it is selling or will be selling in Florida;
- A statement of intention to comply with this legislation; and
- The name, address, telephone number, and signature of an officer of the nonsettling-manufacturer attesting to the information provided pursuant to this subsection.

Subsection (8) requires that each nonsettling-manufacturer certify to the division on the first day of each month that it is in compliance with this section and has paid the required fee. This section requires the division to develop, maintain, and publish on its Internet website a directory listing all nonsettling-manufacturers that have provided current, accurate, and complete certifications. A copy of this list must be provided to any person upon request.

Subsection (9) provides that the cigarettes of a nonsettling-manufacturer that has not paid the required fee or not complied with the reporting requirement section shall be treated as cigarettes for which the tax imposed by s. 210.02, F.S., has not been paid. If a person receives notice that the nonsettling-manufacturer of such cigarettes has not paid the fee required by this section in full or, if the nonsettling-manufacturer is not listed in the division's internet directory described in subsection (8), a person may not affix stamps to the subject cigarettes or otherwise purchase or sell such cigarettes.

Subsection (10) excludes subsequent participating manufactures (SPM) from the imposition of the fee described in subsection (4) until the effective date of a credit amendment to the MSA. This section provides that an amendment to the MSA is considered a "credit amendment" if it makes available to each SPM, other than one that has an agreement as of July 1, 2006, each year a credit against its payment obligations under the MSA which is equal to or greater than the product of the total number of individual cigarettes sold by an SPM during the year in question multiplied by at least 73.2 percent of the per-cigarette fee provided in section (4). The credit described is not conditioned on that SPM forfeiting in whole or in part any other benefits or credits provided for in the MSA.

**Section 3** amends s. 210.18(6)(a), F.S., to delete the second degree misdemeanor penalty provision for any person, firm or corporation that “possesses, removes, deposits, conceals or aids in the possessing, removing, depositing, or concealing” any unstamped cigarettes.” This bill would make any such violation a third degree felony as provided under the current s. 210.18(6)(b), F.S.

The bill provides the following penalties for the sale or possession for sale of counterfeit cigarettes:

- Quantity of less than two cartons of cigarettes or an equal amount of other cigarettes:
  - First violation: Punishable by a fine not to exceed \$1,000 or five times the retail value of the cigarettes involved, whichever is greater, or imprisonment not to exceed five years, or both;
  - Subsequent violation: A fine not to exceed \$5,000 or five times the retail value of the cigarettes involved, whichever is greater, or imprisonment not to exceed five years, or both, as well as the revocation of the perpetrator’s permit.
- Quantity of more than two cartons of cigarettes or an equal amount of other cigarettes:
  - First violation: Punishable by a fine not to exceed \$2000 or five times the retail value of the cigarettes involved, whichever is greater, or imprisonment not to exceed five years, or both;
  - Subsequent violation: A fine not to exceed \$50,000 or five times the retail value of the cigarettes involved, whichever is greater, or imprisonment not to exceed five years, or both, as well as the revocation of the perpetrator’s permit.

The bill requires seizure of the counterfeit cigarettes and the related machinery, and requires that cigarettes seized under this provision must be destroyed.

**Section 4** republishes s. 772.102, F.S., which outlines definitions of terms related to civil remedies for criminal practices to incorporate the amendment made to s. 210.18, F.S., which is also included under the definition of “criminal activity” in ch. 772, F.S.

**Section 5** republishes s. 895.02, F.S., providing definitions under Florida’s Racketeering Influence and Corrupt Organizations Act (RICO) to incorporate the amendment made to s. 210.18, F.S., which is included under the definitions of racketeering activity.

**Section 6** appropriates \$480,028 from the Alcoholic Beverage and Tobacco Trust Fund for FY 2006-07 and authorizes the creation of four full-time equivalent positions to be established by DBPR for the purpose of conducting regulatory activities relates to the transportation and sale of cigarettes.

**Section 7** appropriates \$2 million to Department of Health to address health care disparities in the minority community.

**Section 8** of the bill amends s. 17.41, F.S., relating to the Department of Financial Services Tobacco Settlement Clearing Trust Fund, to provide the depositing of the fees collected from nonsettling-manufacturers under this bill to the trust fund.

**Section 9** provides that the Attorney General may demand from the administrator of the MSA that the payments currently being made to the 46 MSA states by the tobacco companies which are based, in part, upon the sale of cigarettes in Florida be paid annually to Florida. Alternatively, the Attorney General may demand that the affected companies pay Florida directly and receive an MSA credit. The bill gives the Attorney General the authority to negotiate with the MSA so as not to violate any contractual agreements that have been made between Florida and the affected companies.

The bill requires that the Attorney General report to the Present of the Senate and the Speaker of the House of Representatives regarding the status of these activities by January 1, 2007.

**Section 10** provides this act will take effect July 1, 2006.

#### **IV. Constitutional Issues:**

##### **A. Municipality/County Mandates Restrictions:**

None.

##### **B. Public Records/Open Meetings Issues:**

None.

##### **C. Trust Funds Restrictions:**

None.

##### **D. Other Constitutional Issues:**

Congress derives its power to regulate commerce among the states from the Commerce Clause.<sup>26</sup> The clause has a dormant aspect that denies the states the power to unjustifiably discriminate against or burden the interstate flow of articles of commerce.<sup>27</sup> The Dormant Commerce Clause prohibits economic protectionism, i.e., state regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.<sup>28</sup>

<sup>26</sup> See, Art. I, s. 8, cl. 3, U.S. Constitution.

<sup>27</sup> See, *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Ore.*, 511 U.S. 93 (1994).

<sup>28</sup> See, *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996); and *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 946 U.S. 18 (Fla. 1990).

The standard for evaluating whether a state action is an unconstitutional burden on interstate commerce is whether the effects of the regulation on interstate commerce are only incidental and the burden imposed does not exceed the public benefit.<sup>29</sup>

This constitutional provision may be violated if courts determine that the bill discriminates in purpose or in effect against cigarettes produced by nonsettling manufacturers.

The bill also raises equal protection concerns.<sup>30</sup> The equal protection clause of the U.S. Constitution requires that all persons and entities be treated similarly under similar circumstances and conditions. Florida's Supreme Court has stated, in reviewing a taxing statute: "A statute that discriminates in favor of a certain class is not arbitrary if the discrimination is founded upon a reasonable distinction or difference in state policy."<sup>31</sup> Differential treatment of classes of persons or entities must be rationally related to furthering a legitimate state interest.<sup>32</sup> Therefore, the relevant inquiry is whether the classifications under the fee scheme, i.e., nonsettling manufacturers and settling-manufacturers, are reasonably related to the state's interest in decreasing tobacco consumption.

Federal court decisions relating to the constitutionality of state escrow statutes and the related regulations for MSA-states, which may be analogous to the fee and regulatory scheme in this bill, have held that such statutes are not unconstitutional on equal protection and commerce clause grounds.<sup>33</sup> In 2003, Minnesota, which is not an MSA state, imposed a fee of \$.35 per pack of 20 cigarettes on cigarettes produced from manufacturers that have not entered into a settlement agreement with the state.<sup>34</sup> In August 2004, the Court of Appeals of Minnesota upheld a trial court decision that this fee is constitutional.<sup>35</sup> In *Council of Independent Tobacco Manufacturers*, the court held that the classifications in the statute between settling and nonsettling manufacturers create a genuine and substantial distinction tied to a legitimate state interest, i.e., to subsidize the costs of smoking to the state and to raise cigarette prices to discourage youthful smokers.<sup>36</sup>

## V. Economic Impact and Fiscal Note:

### A. Tax/Fee Issues:

The Department of Business and Professional Regulation projects revenues from the fee to be \$101,397,389 in FY 2006-2007, \$104,439,310, in FY 2007-08, and \$107,572,490 in FY 2008-09.

<sup>29</sup> See, *Pike v. Bruce, Inc.* 397 U.S. 137 (1970).

<sup>30</sup> U.S. Constitution, Amendment XIV: "No State...shall deny to any person within its jurisdiction the equal protection of any laws."

<sup>31</sup> See, *Eastern Air Lines v. Dept. of Revenue*, 455 So.2d 311 (Fla. 1984).

<sup>32</sup> See, *Smith v. Florida Dept. of Revenue*, 512 So.2d 1008 (Fla. 1st DCA 1987).

<sup>33</sup> See, *Star Scientific, Inc. and Freedom Holdings, Inc.*, note 11, *supra*.

<sup>34</sup> See Section 297F.24, Minnesota Statutes (2003).

<sup>35</sup> See *Council of Independent Tobacco Manufacturers v. Minnesota*, 685 N.W.2d 467 (Minn. 2004).

<sup>36</sup> *Id.*

**B. Private Sector Impact:**

This bill would cause the nonsettling-manufacturers to pay the additional fee imposed by this bill of \$.40 per package of twenty cigarettes, and the cost of this fee may be passed on to the consumer.

**C. Government Sector Impact:**

The department estimates that the bill would increase the workload within the Division of Alcoholic Beverages and Tobacco and the Division of Technology.

It estimates that the Division of Alcoholic Beverages and Tobacco will need three additional positions to handle the workload associated with these new duties. The Division of Technology will need one position to provide maintenance and support of a new computer application, and \$200,000 in nonrecurring funds to develop, test and implement the new computer application.

The bill appropriates four positions and \$480,028 from the Alcoholic Beverages and Tobacco Trust Fund (AB&T TF) for the purpose of conducting these regulatory activities. According to the department's Schedule I for the AB&T TF, the department projects a transfer of \$2,345,931 in surplus cash to General Revenue in FY 2006-07. The appropriation in the bill would reduce this transfer to \$1,865,903.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.



## **VIII. Summary of Amendments:**

None.

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This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.

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