

SB

162

# STATE OF ALASKA

*Frank H. Murkowski, Governor*

## DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

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April 30, 2003

Senator Ralph Seekins  
Senate Judiciary Committee  
Alaska State Legislature  
State Capitol  
Juneau, AK 99801

Re: SB 162 – “An act relating to a tobacco product manufacturer's compliance with certain statutory requirements regarding cigarette sales”

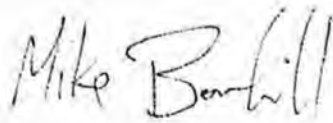
Dear Senator Seekins:

I am writing this letter to request that you schedule the above bill for a hearing at your earliest convenience.

If you have any questions, please feel free to contact me.

Sincerely,

GREGG D. RENKES  
Attorney General

By:   
Michael Barnhill  
Assistant Attorney General

MB:lb

Cc: Mike Tibbles, Legislative Director, Office of the Governor  
Deborah Behr, Legislation and Regulations Attorney, Department of Law

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### SB 162

#### Background and Sectional Analysis

#### I. BACKGROUND

On November 23, 1998, Alaska and 45 other states (plus the District of Columbia and 5 territories) entered into the Tobacco Master Settlement Agreement ("MSA") with certain Tobacco Product Manufacturers (known as "Participating Manufacturers" or "PMs"). The MSA provides that in exchange for the PMs' agreement to make specified payments to the Settling States -- estimated to exceed \$200 billion through 2025 -- and their agreement to abide by extensive public health restrictions on the advertising, promotion and marketing of cigarettes, the Settling States agreed to release the PMs from claims by the States.<sup>1</sup>

Those non-participating Tobacco Product Manufacturers that did not sign the MSA ("Non-Participating Manufacturers" or "NPMs") were not released from potential State claims and did not undertake any of the payment obligations or agree to abide by the public health restrictions. In order to ensure that Settling States that successfully sue NPMs in the future will have a fund against which they can recover any judgment or settlement moneys, the MSA includes a proposed "Model Statute" that, if enacted by a Settling State, requires NPMs to make annual payments into a qualified escrow fund based on the number of that NPM's cigarettes sold in the State.<sup>2</sup> The Model Statute is also intended to prevent NPMs from reaping a windfall benefit by selling cigarettes in a Settling State without bearing the costs that cigarette smoking imposes on the State.

The Model Statute declares:

It would be contrary to the policy of the state if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise

<sup>1</sup> The released claims generally include claims arising out of or in any way related to (a) the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, (b) the exposure to, or (c) research, statements, or warnings regarding, tobacco products. MSA §II(m).

<sup>2</sup> Alaska's "model statute" was enacted in 1999 (ch. 46, SLA 1999) and is found at AS 45.53.

without ensuring that the state will have an eventual source of recovery from them if they are proven to have acted culpably; it is thus in the interests of the state to require that such manufacturers establish an escrow fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment-proof before liability may arise.

§ 1, ch. 46, SLA 1999.

The MSA encouraged States to enact the Model Statute by creating a significant financial incentive: Settling States that enact and 'diligently enforce' a Model Statute are not subject to certain potential downward adjustments in receiving their annual MSA payments. All Settling States have enacted Model Statutes.

A Settling State through its attorney general or other official may bring a civil action on behalf of the State against any Tobacco Product Manufacturer that fails to place into escrow the funds required by the Model Statute. While the Settling States have been aggressively enforcing the provisions of the Model Statutes, enforcement has proved costly and cumbersome. Among other things, the Model Statute enables NPMs to sell cigarettes for up to 16 months in a State before the State can bring an action to enforce the Model Statute. In addition, many NPMs are located in foreign countries and it has proved difficult and expensive to obtain service of process or to effect judgments. And, as the Settling States have moved forward with numerous actions against non-compliant NPMs, many NPMs have devised ingenious schemes to evade compliance. The purpose of this "complementary legislation" is to make State enforcement of Model Statutes more effective and thereby promote the purposes for which the Model Statutes were enacted.

Approximately fifteen states, including Alaska, have enacted complementary legislation. Alaska's existing complimentary legislation is AS 43.50.145, which simply provides that NPM cigarettes for which escrow payments have not been made are contraband and subject to confiscation. Other states' complimentary legislation have taken different forms but is largely similar from state to state. Generally, these statutes: prohibit tax-stamping of tobacco products that are not in compliance with a Settling State's Model Statute; require certification that a Tobacco Product Manufacturer is either a Participating Manufacturer under the MSA or, if an NPM, is in full compliance with a State's Model Statute; require an attorney general or revenue department to maintain a list of Tobacco Product Manufacturers that are in compliance with a Settling State's laws; and subject violators to civil and criminal penalties and license revocation/suspension.

Complementary legislation has been effective in promoting compliance with the Model Statutes. This positive experience led the Tobacco Committee to create a Complementary Legislation Working Group, a multi-State staff-level group coordinated by the NAAG Tobacco Project. The Working Group was charged with developing draft complementary legislation that could be recommended as a model to all of the Settling

States. After extensive deliberations, the Working Group has now recommended model legislation to the Tobacco Committee, and the Committee has recommended that the Attorneys General of the Settling States give serious consideration to the legislation and designate its enactment a priority. The Committee believes that enactment of such legislation by all Settling States will promote the purposes the Model Statutes were designed to serve and safeguard payments to the Settling States that might otherwise be imperiled.

## II. COMPLEMENTARY LEGISLATION SUMMARY

The proposed model complementary legislation would require a state to maintain a directory of cigarette products that are permitted to be sold instate. The proposed legislation would prohibit the sale of products that are not listed in the directory. While all Tobacco Product Manufacturers would be required to make specific certifications *before* a brand could be listed in the directory, a Non-Participating Manufacturer would be further required to certify that: a) it is registered to do business in the state or has appointed an agent for service of process; b) it maintains a Qualified Escrow Fund with an executed qualified escrow agreement that has been reviewed and approved by the State; c) it is in full compliance with the escrow statute; and d) it identifies the financial institution where it has established such Qualified Escrow Fund and identifies all deposits and withdrawals to/from said fund. In addition, neither an NPM nor its brands will be listed in the directory unless all escrow payments for any period have been fully paid and all outstanding final judgments for violations of the Model Statutes fully satisfied.

The proposed model complementary legislation will also allow the Settling State through its attorney general or other official to request information to verify the accuracy of reported information and will further permit disclosure of information to other state agencies to facilitate investigation. Civil penalties, including injunctive relief and designation of product as contraband subject to seizure, forfeiture and destruction are among the penalties imposed.

The proposed requirements will ensure that a Tobacco Product Manufacturer has met certain obligations before being permitted to sell its products instate. This will help prevent significant periods of non-compliance and will reduce the expense and difficulty of enforcement actions against NPMs.

The proposed model complementary legislation is intended to complement Alaska's Model Statute (AS 45.53), but it does not replace or amend Alaska's Model Statute.

### III. SECTION REVIEW

#### *Section 1. Findings and Purpose*

Several Settling States emphasized that in order to assist with passage of a proposed model bill, it would be helpful, and in some cases, necessary to have a legislative declaration regarding the relationship between complementary legislation, fiscal soundness of the State and advancement of public health issues.

#### *Section 2.*

##### **AS 43.50.500**

- (a) Requires PMs to annually certify that they are a participating manufacturer. Requires NPMs to annually certify that they are in compliance with the model statute, AS 45.43.
- (b) Requires PMs to attach a list of its brands to its certification.
- (c) Requires NPMs to attach a list of its brands to its certification and provide information about its instate sales.
- (d) Requires NPMs to register to do business instate or appoint an instate agent for service of process. Requires NPMs to set up a "qualified escrow fund."
- (e) Requires NPMs to provide information about its qualified escrow fund.
- (f) Requires tobacco product manufacturers to affirm the identity of the brands it manufactures. This provision is intended to prevent a manufacturer from identifying a particular brand and then attempting to assert that another party, such as an importer or distributor, is responsible for escrow, other payment or certification obligations.
- (g) Requires tobacco product manufacturers to maintain sales records for five years.

##### **AS 43.50.510**

This section establishes the requirements for the directory to be maintained by the Department of Revenue for brands of tobacco products that may be sold in the state. The provisions of this section provide a means by which a cigarette seller will be able to ascertain if a particular brand of tobacco product may be permissibly sold in the State. In addition, this section requires that the Department of Revenue shall update the directory as necessary to keep it current. Notices provided by this section may be provided by electronic mail in order to reduce the cost and expense for disseminating any notices.

##### **AS 43.50.520**

- (a) This subsection establishes that it is unlawful to sell a product that is not included in the directory.

(b) This subsection provides for a cigarette tax credit for licensees that permissibly import directory-listed cigarettes that are later de-listed prior to retail sale.

#### **AS 43.50.530**

This section requires any non-resident or foreign NPM to establish an agent for service of process before its brands may be included on the directory established in AS 43.50.510. The appointment of such an agent would be limited to actions arising out of the enforcement of the complementary legislation or the Model Statute, AS 45.53. Subsection (c) provides for service on the commissioner of the Department of Commerce and Economic Development for failure to appoint an agent.

#### **AS 43.50.540**

This section establishes the reporting requirements for licensees. This provision will allow monitoring of the sales activity of NPM product and provides an ongoing method to evaluate compliance. This section also provides the authority to share information obtained pursuant to the complementary legislation or Model Statute with the attorney general or other state agencies. The section also grants authority to request additional information as may be necessary to verify the accuracy of information reported and to provide actual product or label samples as may be necessary to effect the purpose of the statute. Finally, subsection (e) permits the adoption of regulations to require escrow deposits on a quarterly basis.

#### **AS 43.50.550**

This section provides for penalties for noncompliance. Penalties include:

- Revocation or suspension of a licensee's license and civil penalty.
- Designation of non-compliant NPM tobacco products as contraband, seizure and forfeiture of unlawful product.
- Injunctive relief against a licensee

#### **AS 43.50.560**

Subsection (a) establishes review procedures in accordance with a AS 44.62 (Administrative Procedure Act) for determinations regarding removal or non-listing of a tobacco product brand. Subsection (b) requires licensees to certify compliance with this law. Subsection (c) provides authority to promulgate regulations. Subsection (d) provides for disgorgement of any profits upon a finding of a violation by a court.

#### **AS 43.50.590**

Most of the definitions mirror those from the MSA or the Model Statute, AS 45.53.

*Brand Family* is intended to cover all variations of a brand of tobacco products that are sold instate. It is further intended to include the brand names of tobacco products that undergo slight modification as a means of evading liability under a Settling State's Model Statute. For example, in order to avoid an ongoing violation or potential injunction against a particular brand, some manufacturers have attempted to modify the name of a brand while maintaining the product the same, i.e., changing the brand name from Distinction to Distinctive or from Bloomberg to Blumburg.

**Section 3.** Conforming amendment to Administrative Procedures Act, AS 44.62.

**Section 4.** Repeal of existing complimentary legislation.

**Section 5.** Transition—initial compliance deadlines.

**Section 6.** Effective date.

#### **IV. ASSURANCES BY PARTICIPATING MANUFACTURERS**

After constructive deliberation with several Participating Manufacturers, Settling States and the PMs agreed upon certain assurances that the PMs would provide to the States. The assurances are intended to facilitate introduction and passage of Complementary Legislation in those States where there may be concerns that the proposed.

Complementary Legislation may be construed as amending the Model Statute or MSA. The language agreed upon States in relevant part that:

the Settling States shall have no duty or obligation to enact the proposed Complementary Legislation or any similar bill, and failure to enact such legislation shall not be used against any State in any proceeding to determine whether that State has diligently enforced its escrow statute.... Additionally, enactment of the proposed Model Complementary Legislation (or similar bill containing no deviation of substance from the Model Complementary Legislation) shall not be construed as an amendment to the Model Statute or to the MSA and shall not constitute any breach of the MSA....

The NAAG Tobacco Project has secured assurances from the following Participating Manufacturers: Philip Morris, RJ Reynolds, Brown & Williamson, Lorillard, Caribbean-America Tobacco, Dharanj Imports, Japan Tobacco Int'l, King Maker, Konci G&D, Liggett, Lignum-2, Nat Sherman, Planta, PT Djarum, Santa Fe Natural Tobacco, Top Tobacco, Vector Tobacco, Virginia Carolina, and Wind River.

## V. CONCLUSION

The enactment of Complementary Legislation will streamline enforcement of the NPM Model Escrow Statutes, safeguard annual MSA payments and help combat the proliferation of youth smoking. The Attorneys General regard this legislation as extremely important and recommend that the proposed model Complementary Legislation be given legislative priority. Attorneys from the Alaska Department of Law as well as the NAAG Tobacco Project and the Complementary Legislation Working Group are available to answer additional questions on this issue of critical importance.

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SB 162

Senate State Affairs Committee

April 15, 2003

9:00am

Testimony of Michael A. Barnhill, Asst. Attorney General

Thank you Mr. Chair. My name is Mike Barnhill. I am employed by the Alaska Dep't of Law as an Assist. Attorney General in the Commercial Section. I am pleased to testify on behalf of the administration in support of SB 162, the bill before you.

In your bill packets you should have a copy of the background and sectional analysis I prepared. I don't intend to read the entire document for you, but I will touch the salient points for your consideration.

By way of background, as you all know, the State of Alaska, along with 45 other states settled its tobacco litigation with the major tobacco manufacturers in 1998, in exchange for a stream of payments that would last indefinitely. One of the terms of this "Master Settlement Agreement" is that the payments can be reduced by what's called a "non-participating manufacturer adjustment" or "NPM adjustment." The MSA provides, however, that states can avoid an NPM adjustment by doing two things: (1) enact the model NPM statute and (2) diligently enforce that statute.

The model NPM statute is basically a statute that levels the playing field between tobacco manufacturers that participated in the settlement agreement and those that did not—it requires the non-participating manufacturers to deposit certain amounts of money into an escrow account for every cigarette sold in the state. In 2001, for instance, an NPM was required to deposit approximately 1.5 cents into escrow for every cigarette sold.

Alaska enacted the model NPM statute in 1999 (AS 45.53) and has been diligently enforcing it since its enactment.

Since the enactment of the NPM statute, however, Alaska and many other states have found that enforcing the NPM statute is unnecessarily difficult in some situations. Usually these situations involve cases where the tobacco manufacturer is located in a far-flung jurisdiction like India or the Phillipines. While it is possible to seek enforcement of Alaska laws on companies in foreign countries it is not necessarily easy.

As a solution, states began looking for ways to enhance their ability to enforce the NPM statutes. In 2001, Alaska and Maine became the first states to enact "complimentary legislation". Alaska's complimentary legislation is found at AS 43.50.145 and basically creates a list of companies that have failed to comply with our NPM laws and declares their cigarettes to be contraband and subject to seizure.

Other states followed suit and enacted their own versions of complimentary legislation. By 2002, there were various versions of complimentary legislation around the country and it became clear that there was a need for uniformity.

The National Association of Attorneys General formed a working group in 2002 with the goal of drafting a model complimentary legislation statute. SB 162 is the product of that working group and NAAG has urged all states to enact this legislation as a high priority.

Simply put, SB 162 enhances our ability to enforce Alaska's NPM statute by creating a "directory" of cigarettes that are permitted to be sold in Alaska. A company can be added to the directory simply by annually certifying to the Dep't of Revenue that they are either (a) a participating manufacturer under the MSA or (b) a non-participating manufacturer that has complied with AS 45.53 by depositing all required amounts into escrow.

SB 162 requires tobacco manufacturers to provide information about their products to the Dep't of Revenue to aid in enforcement efforts. It provides penalties for failure to comply. It provides for service of process upon the Dep't of Community and Econ. Development for companies that refuse to comply with our law and fail to appoint an in-state agent for service of process. Lastly, it provides a tax credit for cigarette distributors that import cigarettes that are listed on the directory and that are subsequently de-listed—this ensures that distributors will not be left "holding the bag" on cigarette taxes for a tobacco manufacturer that fails to comply with Alaska law.

I'm delighted that the administration supports this bill and I urge your support of it. I'd be happy to answer any questions the committee might have.