

May 24, 1999

The Honorable Tony Knowles
Governor
State of Alaska
P.O. Box 110001
Juneau, AK 99811-0001

Re: House Bill 102 -- Imposing Certain Requirements Relating To Cigarette Sales In This State By Tobacco Product Manufacturers, Including Requirements For Escrow, Payment, And Reporting Of Money From Cigarette Sales In This State; Providing Penalties For Noncompliance With Those Requirements
A.G. file no: 883-99-0043

Dear Governor Knowles:

At the request of your legislative office, we have reviewed HB 102, which is the cigarette sales escrow agreement. The bill is based on the model statute in the November 23, 1998, settlement of *State of Alaska v. Philip Morris et al.*, 1JU-97-915 CI. It is our advice that there are no constitutional or other legal problems with this bill, and we recommend that you sign it. A more detailed analysis follows.

Overview of HB 102

Evidence from tobacco industry files discovered during litigation shows, and the legislature has acknowledged findings that tobacco causes cancer and a myriad of other serious health problems. *See* Section 1, Purposes and Findings, HB 102. Most of the cost of treating tobacco-related illnesses for low-income Alaskans is borne by the State of Alaska through the Alaska Medicaid program, and not by the companies that sell tobacco. While the November 23, 1998, Master Settlement Agreement ("MSA") was a substantial step taken to address those costs of treating smoking-related illnesses and changing the industry's marketing practices, some tobacco manufacturing companies did not become subsequent participating manufacturers and sign the MSA,

and continue to sell their products. In order to protect the health of Alaskans from sales and marketing practices of any non-participating manufacturer, the legislature passed HB 102. The bill will ensure that tobacco product manufacturers whose products make Alaskans sick will be able to pay for any damages attributed to their products by an Alaska court.

The bill provides that all tobacco manufacturers selling their products in Alaska the option to either (1) sign on to the settlement agreement or (2) establish an escrow account and pay into that account at a stated rate per unit of tobacco sold in the state. The rates are proportional to the payments that the participating manufacturers will make under the terms of the settlement. In other words, a tobacco manufacturer that did not participate in the settlement agreement could not get around the restrictions in the settlement and sell its products in Alaska with impunity, leaving individual Alaskans, or the state, to pay the costs of treating resulting illnesses. In addition, passage of the model statute legislation will protect the state's annual payments from a Non-Participating Manufacturer ("NPM") Adjustment. MSA § IX(d).

This statute was the subject of extensive and difficult negotiations, including discussions on whether the statute would survive legal challenges. The statute was reviewed by a number of antitrust and constitutional law experts who opined that this statute would survive legal challenge. Except for a few minor procedural changes approved by counsel for Philip Morris, and provided to the other Original Participating Manufacturers for review, the bill is identical to the Model Statute provided in Exhibit T of the MSA.

The settlement provides for an adjustment to a state's payments if the participating manufacturers experience a disadvantage and lose in-state market share for sales of their tobacco products to non-participating manufacturers as a result of the marketing restrictions, payments, and other provisions in the settlement agreement. However, Alaska has a safe haven from the application of the reduction formula by passing a bill like HB 102, which is identical to the model statute, and enforcing it after it becomes law. By enacting the bill into law, and subsequently enforcing the law, Alaska will be exempt from any payment reductions even if the settlement was a significant factor contributing to the participating manufacturers' loss of market share. Indeed, even if a court were to find the statute unconstitutional, the maximum NPM Adjustment Alaska would have to bear is 65 percent of the payment in any particular year. Without the passage of the statute, the maximum NPM Adjustment would be 100 percent.

Sectional Analysis

Section 1 of the bill is the findings and purpose section of the bill. Section 1 identifies tobacco as a serious public health problem in Alaska and discusses the burden that treating tobacco-related illnesses places on the State of Alaska. This section also establishes that it is the policy of the State of Alaska that tobacco product manufacturers — not the state or its citizens — bear the financial costs of treating smoking-related illnesses. Section 1 establishes the

need to prevent other non-participating manufacturers from reaping short-term profits in Alaska at the expense of public health, while leaving the state and its citizens without any financial protection from the known harms related to cigarette smoking. Finally, Section 1 identifies the purpose of the bill as the implementation of the November 23, 1998, MSA

Section 2 of the bill amends Alaska Statutes, Title 45, by adding Chapter 53, which is entitled "Cigarette Sales." Section Two adds the following sections:

Proposed AS 45.53.010 recognizes the MSA entered into between the State of Alaska and the Participating Manufacturers in *State v. Philip Morris*, 1JU-97-915 CI.

Proposed AS 45.53.020 requires that all tobacco product manufacturers do one of two things: (1) participate in the MSA, or (2) establish an escrow account and place dollars into that account at a stated rate per unit sold in this state. The rates are calculated to be equivalent to the rates paid by the Subsequent Participating Manufacturers (tobacco companies that signed the MSA after it was signed by the four original participating manufacturers) pursuant to the MSA. The changes in the rates also mirror the changes in the MSA annual payments on a per unit basis.

A manufacturer who places funds in escrow is entitled to withdraw interest or other earnings from the account as they are earned. The principal deposited in escrow can be released from escrow only:

to pay a judgment or settlement on any claim brought by the State or a party located in or residing in Alaska;

if the manufacturer establishes that the amount it would have paid the State had it participated in the MSA is less than the amount the manufacturer is required to place in escrow. In this case the manufacturer is allowed to withdraw the excess from the escrow; or

if the funds have remained in escrow for a period of 25 years from the date of payment.

Proposed AS 45.53.030 requires the commissioner of revenue to adopt regulations under the Administrative Procedure Act necessary to determine the volume of cigarettes manufactured by a tobacco product manufacturer that enter Alaska for sale in the state based on the amount of excise taxes paid. This will allow the commissioner of revenue to determine whether a tobacco manufacturer that does not sign the Master Settlement Agreement is making the appropriate deposits into the escrow account provided under AS 45.53.020.

Proposed AS 45.53.040 provides for auditing by the Alaska Department of Revenue of payments into escrow required by a tobacco manufacturer and enforcement by the Alaska Department of Law. This section provides for different levels of penalties against a tobacco manufacturer that fails to make the required deposits into escrow. If enforcement by the Department of Law is required and the state prevails in an action brought under this section, the court may award the Department of Law full reasonable attorney's fees.

Proposed AS 45.53.990 sets forth the definitions. Many of the bill's definitions incorporate by reference the definitions in the MSA. This was done to avoid any confusion between the two documents, and to prevent this legislation from being overly lengthy. The MSA is a public document approved by the Juneau Superior Court on February 9, 1999, in the case of *State of Alaska v. Philip Morris*, 1JU-97-915 CI. A complete copy of the MSA can be found at www.naag.org on the Internet.

Commerce Clause Analysis

The proposed addition of AS 45.53 may be challenged on grounds that the requirement of either signing the MSA as a Subsequent Participating Manufacturer or making escrow payments is overly burdensome on interstate commerce. Such a challenge is likely to fail.

Under our federalism, states retain authority to exercise police powers to control matters of local concern even though interstate commerce might be affected. *Maine v. Taylor*, 477 U.S. 131, 133 (1986). Courts apply a two-tiered analytical approach to Commerce Clause challenges. *Brown-Forman Distillers Corp. v. New York Liquor Authority*, 476 U.S. 573, 579 (1986); *Dayhoff v. Temsco Helicopters, Inc.*, 848 P.2d 1367, 1370-71 (Alaska 1993). If the practical effect of the statute is to discriminate or directly regulate interstate commerce, courts may strike down the statute as invalid on its face without further inquiry. However, if the statute only indirectly impacts on interstate commerce and does not discriminate, courts apply a balancing test to determine whether the statute effectuates a legitimate local interest, and whether the burden on interstate commerce clearly exceeds local benefit. *Brown-Forman*, 476 U.S. at 579. *See also Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

In the case of HB 102, local interests of protecting the health, safety, and welfare of Alaskan consumers from a flood of cancer – or other health-problem-causing tobacco products sent into the state by companies that may be judgment-proof far outweigh the minimal impact on interstate commerce. It is unlikely that a court would rule otherwise.

Conclusion

HB 102 furthers the important state interest of protecting consumers, and the State of Alaska, from a product that is known to cause cancer and other serious health problems, and the financial

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consequences tobacco-related illnesses impose on both the state and individual citizens. The bill protects the State of Alaska from reductions in payments under the MSA for Non-participating Manufacturers. Finally, the bill provides the regulatory authority to the Department of Revenue to monitor compliance, and enforcement by the attorney general. Based on the foregoing discussion and analysis, we recommend signing HB 102 into law.

Sincerely,

Bruce M. Botelho
Attorney General

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