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## Tobacco Master Settlement Agreement (1998): Overview, Implementation by States, and Congressional Issues

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## **ABSTRACT**

This report summarizes the provisions in the November 1998 Master Settlement Agreement (MSA) between the states and the cigarette companies. State activities to implement the MSA, and congressional issues raised, directly and indirectly, by the agreement are discussed. The report also provides a side-by-side comparison of the MSA with the 1997 proposed national settlement and the McCain tobacco bill (S. 1415). The report will be updated on a regular basis. For more information on tobacco issues, including additional CRS tobacco reports, see the CRS Tobacco Electronic Briefing Book [<http://www.congress.gov/brbk/html/ebtobtop.html>].

# Tobacco Master Settlement Agreement (1998): Overview, Implementation by States, and Congressional Issues

## Summary

On November 23, 1998, attorneys general representing 46 states, the District of Columbia, and the five U.S. territories signed an agreement with the major cigarette companies to settle all the state lawsuits seeking to recover the Medicaid costs of treating smokers. The Master Settlement Agreement, or MSA, contractually imposes some restrictions on tobacco advertising, marketing, and promotion and requires the manufacturers to make annual payments totaling about \$206 billion through 2025. It follows earlier individual settlements with four states—Mississippi, Florida, Texas, and Minnesota—totaling more than \$40 billion over the first 25 years. Cigarette price increases have passed on those settlement costs to smokers.

The MSA is narrower in scope than the June 1997 proposed national tobacco settlement, which would have required federal legislation in order to take effect. Efforts in the 105<sup>th</sup> Congress to pass comprehensive tobacco-control legislation ended on June 17, 1998, when the Senate rejected the McCain tobacco bill (S. 1415).

A trial court judge in each state must approve the MSA in order for the state to receive its share of the MSA payments. The funds are allocated based on estimated tobacco-related Medicaid expenditures and the number of smokers in each state. The MSA does not earmark or restrict how states spend the money. The agreement also requires states to enact a model statute regarding the treatment of nonparticipating tobacco companies. A national anti-tobacco advertising campaign, funded by the MSA is expected to begin in January 2000.

In addition to the MSA payments, the cigarette companies will pay \$5.15 billion over 12 years into a trust fund to compensate tobacco farmers and quota holders for anticipated financial losses resulting from the implementation of the MSA. The states also signed a separate agreement with the leading smokeless tobacco company, United States Tobacco, which contains many of same public health provisions as the MSA.

Under the Medicaid statute, states are required to return to the federal government its share of any recoveries of Medicaid expenditures. On May 21, however, the President signed the FY1999 Emergency Supplemental Appropriations Act (P.L. 106-31), which waived any federal claim to the MSA funds and allowed states to keep all the money without any restrictions on spending. State Governors and attorneys general had strongly opposed federal recoupment of a portion of the MSA funds, as well as proposals to allow the states to keep all the funds but with restrictions on how the money is spent.

Unlike the 1997 proposed settlement, the MSA does not incorporate the Food and Drug Administration's (FDA) tobacco regulation. The U.S. Supreme Court is expected to issue a ruling next year on whether the FDA has statutory authority to regulate tobacco products. On September 22, the Department of Justice sued the tobacco companies to recover billions of dollars spent by federal health care programs, such as Medicare, to treat smoking-related diseases.

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# Tobacco Master Settlement Agreement (1998): Overview, Implementation by States, and Congressional Issues

## Overview

On November 23, 1998, attorneys general from 46 states, the District of Columbia (DC), and the five U.S. territories signed a contractual agreement—the Master Settlement Agreement, or MSA—with the cigarette companies to settle all the state lawsuits seeking to recover the public health costs of treating smokers.<sup>1</sup> The MSA imposes some agreed upon restrictions on tobacco advertising, marketing, and promotion and binds the companies to make annual payments totaling about \$206 billion through 2025. It follows earlier individual settlements with four states—Mississippi (7/3/97), Florida (8/25/97), Texas (1/16/98), and Minnesota (5/8/98)—in which the industry will make annual payments totaling more than \$40 billion over the first 25 years.

The MSA is a scaled-down version of the June 1997 proposed national settlement, which required federal legislation in order to take effect. After a year of intense debate, efforts by advocates in the 105<sup>th</sup> Congress to pass comprehensive tobacco-control legislation that embodied the 1997 settlement ended on June 17, 1998, when the Senate rejected the McCain tobacco bill (S. 1415).

President Clinton praised the MSA as an “important step” towards a comprehensive national tobacco-control policy. State officials also applauded the agreement as the best opportunity to secure billions of dollars for anti-tobacco and other public health programs, rather than risk protracted legal battles with uncertain consequences. They predict that the MSA will significantly reduce underage tobacco use. Skeptics have criticized the deal as accomplishing little but a very large transfer of wealth from smokers (through the tobacco companies) to state treasuries. On the day the settlement was signed, the major cigarette companies raised prices by 45 cents a pack to cover the cost of the annual payments.<sup>2</sup>

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<sup>1</sup> The MSA was negotiated by the nation’s four largest cigarette companies: Philip Morris, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, and Lorillard Inc. Liggett & Myers, the fifth and smallest cigarette maker, agreed at the last minute to sign the MSA. Liggett was the first manufacturer to acknowledge a link between smoking and cancer and began settling with individual states in 1996. By signing the MSA, Liggett replaced the terms of those earlier agreements with the terms of the MSA. Liggett does not have to contribute financially to the MSA unless its sales rise 25% above current levels.

<sup>2</sup> Since early 1997, Philip Morris and R.J. Reynolds have increased wholesale prices by a total  
(continued...)

The MSA bears a superficial resemblance to the 1997 proposed settlement, but there are several key differences between the two documents. First, the MSA represents a private contract between the industry and the states and does not require congressional action for implementation. The National Association of Attorneys General (NAAG) will manage the MSA on behalf of the states. By contrast, the 1997 proposal was a blueprint for a comprehensive national tobacco-control policy, including federal regulation and oversight. Second, the MSA settles only the state and local government lawsuits. The industry gains no protection from class-action lawsuits and claims brought by individuals, labor unions, and private health care insurers. Finally, the MSA lacks many of the tobacco-control initiatives that were included in the McCain bill.

ENACT, a coalition of leading national health and medical associations organized to lobby for comprehensive tobacco-control legislation, strongly criticized the settlement as a victory for the industry that will do little to reduce tobacco use. The MSA places some limits on tobacco-product advertising, marketing, and promotion, but fails to address most of the public health provisions included in the McCain bill and other tobacco legislation introduced in the 105<sup>th</sup> Congress. For example, the MSA bans outdoor billboard advertising (with the exception of poster-sized advertising outside tobacco retailers) and limits companies to one brand-name sponsorship of sporting and cultural events each year. But, unlike the McCain bill, it does not restrict print advertising, Internet advertising, or marketing and advertising inside retail stores. The MSA does not include any provisions limiting youth access to tobacco products (e.g., restrictions on vending machines, self-service displays, and mail order sales), nor does it provide for the enforcement of federal and state minimum age-of-sale laws through retailer licensing and inspection. Finally, the MSA fails to address FDA regulation of tobacco products, indoor smoking restrictions, and smoking cessation, all of which were included in the McCain bill.

Table 1, which begins on page 12, provides a more detailed comparison of the MSA's provisions and the corresponding sections of the June 1997 proposal and the McCain bill. Whereas the McCain bill would have provided billions of dollars annually for federal tobacco-control programs, the MSA creates a national foundation to combat underage tobacco use and substance abuse. Manufacturers will pay a total of \$1.7 billion to the foundation to fund research, surveillance, and public education.

## **MSA Implementation by States**

A trial court judge in each state must approve the MSA, as well as a consent decree containing many of the provisions of the agreement, in order for the state to receive its share of the MSA payments. Court approval becomes final once all opportunities for appeal have expired. To date, 38 states, DC, and the five territories have received final approval. The remaining eight states either have pending legal challenges to the MSA or, facing no legal challenges, are waiting for the appeals'

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<sup>2</sup> (...continued)

of 93.5 cents a pack. Analysts estimate the cost of settling with all 50 states to be about 45 cents a pack, assuming an 8–10% decline in consumption.

deadline to pass (see Table 2). MSA funds will be released when 80% of the states obtain final approval (referred to as State Specific Finality) and those states represent 80% of the total annual payments.<sup>3</sup> That will occur when the next state achieves finality because the 38 states approved so far account for 79.7% of the funds.

The MSA funds will be allocated to the states and territories according to a formula developed by the attorneys general (see Table 2). The formula is based on estimated tobacco-related Medicaid expenditures and the number of smokers in each state. The annual payments are subject to a number of adjustments, reductions, and offsets, of which the most important is likely to be the volume-of-sales adjustment. That adjustment ties payments to nationwide cigarette sales, much like a sales tax. If, as anticipated by public health officials, cigarette consumption declines as a result of higher prices, the annual payments will be reduced proportionately.

### **Funding for Tobacco Control Programs**

The MSA does not address the question of state legislative appropriation of the settlement funds, nor does it earmark or in any way restrict how states spend the funds. With billions of dollars at stake, state legislators have come under intense pressure from lobbyists over MSA spending priorities. More than 500 MSA-related bills have been introduced in 49 states this year.<sup>4</sup> As of October 1, 1999, 195 bills had passed at least one house of the legislature, and 103 bills had been signed into law. Many of the tobacco-settlement bills that have been introduced deal with establishing a trust fund or funds, from which money may be allocated to specific areas such as children's health, smoking cessation, education, or highway construction. Some of the bills directly earmark the settlement funds for health care access, tobacco control, S-CHIP (State Children's Health Insurance Program), and children's health programs. Others propose using the settlement funds to compensate tobacco farmers and their communities, or pay for long-term care, tax cuts, and other miscellaneous proposals.<sup>5</sup>

Public health officials are pressuring state lawmakers to allocate MSA funds for tobacco control programs. Experts believe that the public health provisions in the settlement are unlikely, by themselves, to have much impact on reducing underage tobacco use. But if states commit a substantial portion of the annual payments to comprehensive tobacco control programs, and if those efforts are tied to a national strategy, then public health officials are confident that the agreement will lead to significant reductions in tobacco use.

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<sup>3</sup> If the requisite number of states have not reached State Specific Finality by June 30, 2000, MSA funds become available to all the states that have obtained final approval by that date.

<sup>4</sup> The Kentucky state legislature is not in session this year, but it did pass tobacco settlement-related legislation in 1998.

<sup>5</sup> The Health Policy Tracking Service at the National Conference of State Legislatures is monitoring state tobacco-settlement legislation. Details and analysis of all the bills, state by state, are available on their web site [<http://www.hpts.org>].

In a recent guidance document, the Centers for Disease Control and Prevention (CDC) recommended that comprehensive tobacco control programs include each of the following nine components:<sup>6</sup>

- community programs that engage youth and local officials;
- school-based programs;
- enforcement of restrictions on minors' access to tobacco and on smoking in public places;
- statewide programs that provide assistance to local programs;
- anti-tobacco advertising and marketing;
- cessation programs;
- public health programs to reduce the residual burden of tobacco-related disease among former users (e.g., cancer, heart disease, asthma);
- surveillance and evaluation of statewide and local programs; and
- administration and management.

Those recommendations are based on CDC's analysis of the large-scale tobacco control programs funded by state excise taxes in California and Massachusetts, and on the agency's involvement in providing technical assistance to other states that are developing comprehensive programs using excise taxes (Oregon and Arizona) or settlement funds (Florida, Minnesota, Mississippi, and Texas). For each state, CDC has estimated the funding required to establish a comprehensive tobacco control program. Annual costs to implement all nine program components range from \$7–\$20 per capita in less populated states, and \$5–\$16 per capita in more heavily populated states.

Table 3 summarizes the decisions taken by state legislatures so far this year on whether to allocate a portion of their MSA funds for tobacco control programs. Because some state legislatures are still in session and others have deferred funding decisions until next year, it is not yet possible to draw any overall conclusions about how much of their MSA payments states will use for tobacco control in the immediate future.

## **Other Legislation**

The MSA contractually obligates state legislatures to enact a model statute that would include a per-pack fee on nonparticipating cigarette manufacturers, to be placed in an escrow fund, in order to protect the market share of the companies that participated in the agreement. Failure to enact such a statute will result in a reduction in the state's allocation of no more than 65%.

State legislatures may consider other legislative actions aside from determining funding priorities and enacting a model statute. The settlement's provision banning the sale of cigarettes in packs containing fewer than 20 cigarettes sunsets on December 31, 2001. Public health officials consider the ban to be a key provision to

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<sup>6</sup> U.S. Dept. of Health and Human Services, Centers for Disease Control and Prevention, *Best Practices for Comprehensive Tobacco Control Programs*, August 1999. Available online at [<http://www.cdc.gov/tobacco>].

discourage youth smoking. Legislation would be required if states wish to continue the ban. Some of the public health issues included in the 1997 proposed settlement but not addressed in the MSA (e.g., lookback penalties, print advertising) may also be the subject of state legislative initiatives. The MSA contractually bars tobacco companies from lobbying against certain kinds of state legislation and regulation that is intended to reduce underage tobacco use.<sup>7</sup> However, it allows companies to oppose legislative efforts to raise excise taxes and restrict smoking in public places.

## **American Legacy Foundation**

The MSA created a non-profit national foundation in Washington DC, named the American Legacy Foundation (ALF), to support research on effective tobacco-control programs and fund an anti-smoking advertising campaign. Manufacturers agreed to pay the ALF a total of \$1.45 billion over 5 years to fund the advertising campaign and provide \$250 million over 10 years to fund research and surveillance. The ALF Board of Directors recently selected Arnold Communications of Boston, MA, to head a team of marketing communications firms that will create a coast-to-coast advertising, marketing and public relations anti-smoking campaign. The campaign will include TV, radio, print and Internet advertising with a particular focus on discouraging teenagers from smoking. The ALF plans to spend \$150–255 million a year on the campaign, making it one of the largest advertising accounts in the country. The campaign is expected to begin in January 2000.

The ALF Board has asked Research Triangle Institute, NC, in partnership with the Rand Corporation and Prospect Associates of Silver Spring, MD, to coordinate and manage the Foundation's research and surveillance activities. Information about ALF may be found online [<http://www.americanlegacy.org>].

## **National Tobacco Growers' Settlement Trust Fund**

The four cigarette manufacturers that signed the MSA also agreed to negotiate with the tobacco-growing states to establish a growers' trust fund. The purpose of the fund is to compensate tobacco farmers and quota holders for financial losses as a result of the anticipated MSA-driven decline in cigarette consumption.<sup>8</sup>

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<sup>7</sup> Protected legislation or regulation includes limiting vending machine access, enforcing youth access through penalties for underage possession or use, and supporting technology to increase the effectiveness of age-of-purchase laws (e.g., ID scanners).

<sup>8</sup> The U.S. Department of Agriculture (USDA) supports tobacco prices through a combination of marketing quotas and nonrecourse loans. Information on the USDA's tobacco price support program may be found on the CRS Tobacco Electronic Briefing Book [<http://www.congress.gov/brbk/html/ebtobtop.html>].

In August, both sides agreed to establish the National Tobacco Growers' Settlement Trust Fund.<sup>9</sup> Under the agreement, the four companies will pay into the trust fund a total of \$5.15 billion over 12 years. Each company will make payments in proportion to its share of the domestic market, and the payments will be subject to adjustments for inflation and volume-of-sales. Chase Manhattan Bank is the designated trustee.

Only those states that grow flue-cured and burley tobacco used to manufacture cigarettes will be eligible to receive payments from the trust fund. The fourteen eligible states are Alabama, Florida, Georgia, Indiana, Kentucky, Maryland, Missouri, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Virginia, and West Virginia. Funds will be allocated to the states based on their 1998 tobacco production.<sup>10</sup> In order to receive funds, each state is required to establish a certification board to develop a spending plan and submit it to the trustee for approval. Board members must include the state Governor and Attorney General, state legislators, members of the state's congressional delegation, and representatives of the tobacco growers and quota holders.

## **Smokeless Tobacco Master Settlement Agreement**

In addition to the MSA, the states also signed a separate agreement with the United States Tobacco Company (UST), the nation's largest smokeless tobacco company. UST manufactures Skoal and Copenhagen, the two most popular brands of moist snuff, and has about a 55% share of the smokeless tobacco market (based on the number of units sold).

The Smokeless Tobacco Master Settlement Agreement (STMSA) contains many of the same components as the MSA. The public health provisions in the STMSA are very similar to those in the MSA, except that they also include a ban on free samples to sports teams. Under the terms of the agreement, UST will pay a total of \$100 million over 10 years.<sup>11</sup> Unlike the MSA, the states do not receive any STMSA funds directly. The payments go to the American Legacy Foundation. If the other five smokeless tobacco companies sign the STMSA, the 10-year total will increase to \$400 million, with UST's share rising to more than \$200 million (in proportion to the company's overall market share).<sup>12</sup> So far, however, only UST has signed the agreement.

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<sup>9</sup> Also referred to as the Phase II settlement fund.

<sup>10</sup> The five leading tobacco-growing states, which account for 89% of total production, will receive approximately the following amounts: North Carolina - \$1.97 billion; Kentucky - \$1.5 billion; Tennessee - \$394 million; South Carolina - \$361 million; Virginia - \$342 million.

<sup>11</sup> The STMSA payments are subject to the same kinds of adjustments and offsets as the MSA payments (see Table 1).

<sup>12</sup> The five companies are Conwood Company, Pinkerton Tobacco Company, Swisher International, National Tobacco Company, and Brown & Williamson Tobacco Corporation.

UST has already made its initial payment, in addition to a one-time \$4 million payment to the NAAG, which will oversee implementation of the STMSA. The company has also agreed to make two payments totaling \$5 million to cover attorneys fees. Unlike the cigarette companies, UST has not raised its prices to pay for the STMSA. Finally, the company has agreed to make certain legal documents available to the NAAG.

## Congressional Issues

### Federal Medicaid Recoupment

By far the most controversial issue is whether the states should be required to return a portion of the MSA payments to the federal government. Under the Medicaid statute, states are required to return to the federal government its share of any Medicaid expenditures that states recover from liable third parties.<sup>13</sup> Medicaid is a joint federal-state health insurance program that pays for medical assistance for low-income persons. The federal Health Care Financing Administration (HCFA) matches state Medicaid benefit spending at anywhere from 50%, the minimum federal matching rate, to 77%, the matching rate for Mississippi. Overall, HCFA pays 57% of total Medicaid benefit costs. The President's FY2000 budget included a 5-year projection of HCFA recoupment of MSA funds, starting at \$4.6 billion in FY2001 and increasing to \$4.8 billion in FY2004.<sup>14</sup>

On May 21, President Clinton signed the FY1999 Emergency Supplemental Appropriations Act (P.L. 106-31, H.R. 1141), which included a provision that waives any federal claim to a portion of the MSA funds and allows the states to keep all the money without any restrictions on how it is spent.

Public health officials expressed concern that without federal involvement the states will not make a long-term commitment to use MSA funds to pay for anti-tobacco programs. State governors and attorneys general strongly opposed efforts by some anti-tobacco lawmakers to allow HCFA to recover a portion of the MSA payments for the following reasons:

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<sup>13</sup> The Medicaid statute establishes that it is the state's responsibility "to ascertain the legal liability of third parties...to pay for care and services available under the [state's Medicaid] plan." Under the statute, states are authorized to pursue through the courts third party recoveries and provide the federal government with its share of any recovered funds (Sections 1902(a)(25) and 1903(d) of the Social Security Act). The Justice Department has concluded that the federal government is not authorized by the Medicaid statute to sue third parties directly.

<sup>14</sup> Determining the specific portion of each state's MSA payment that reflects Medicaid recovery for treating smoking-related illnesses might be extremely difficult because of the variety of legal approaches taken. Non-Medicaid recoveries (e.g., damages and penalties for violations of state antitrust and consumer protection laws) would not be subject to any federal share requirements under the Medicaid statute.

- The state lawsuits included a variety of claims in addition to Medicaid recovery, including consumer protection, racketeering, antitrust, and civil penalties for violations of state laws. Medicaid was not mentioned in a number of state lawsuits and was one of several claims in many others. In California and Iowa, state courts dismissed the Medicaid portion of the lawsuit.
- The federal government was invited to participate in the state lawsuits but declined. As a result, the states bore all the risk and financial burden of taking on such a powerful industry.
- Congress never intended the third-party recovery provisions of the Medicaid statute to apply to the types of lawsuits brought by the states against the tobacco industry.
- Following the demise of federal legislation to enact the June 1997 proposed national settlement, states were forced to pursue their share of tobacco-related medical costs and negotiate a settlement based on nonfederal claims.

The Administration countered that the federal government is entitled to a share of the settlement payments under the Medicaid statute because the states sued the industry primarily to recover the costs of treating tobacco-related illnesses, and the Medicaid program bears the lion's share of those costs. Moreover, the MSA and the individual state settlements prohibit the states from making any future claims for tobacco-related Medicaid expenditures. Under the existing Medicaid statute, which allows only the states to sue third parties directly, that effectively precludes the federal government from recovering its share of Medicaid claims in the future. Federal recoupment of settlement funds therefore represented the only opportunity to recover a portion of the money that federal taxpayers have paid to treat tobacco-related illnesses under the Medicaid program.

State officials also opposed legislation that would have waived the federal claim to a share of the MSA funds in exchange for a commitment by the states to use a portion of the money for anti-tobacco and public health programs. They argued that the federal government had no business telling the states how to spend the money, and that earmarking a fixed percentage of MSA funds for particular programs failed to recognize ongoing efforts and new initiatives already implemented in the states.

## **FDA Regulation**

Unlike the 1997 proposed settlement, the MSA does not incorporate the Food and Drug Administration's (FDA) 1996 tobacco regulation, which includes restrictions on youth access to tobacco products, new labeling requirements for packages and advertisement, and restrictions on tobacco product advertising and promotion.<sup>15</sup> Only two of the rule's provisions—prohibiting tobacco sales to minors and requiring photo ID for persons under age 27—have gone into effect, pending the

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<sup>15</sup> On August 28, 1996, the FDA issued a final regulation to reduce underage tobacco use (Federal Register, v. 61, no. 168, p. 44396–45318), based on its conclusion that cigarettes and smokeless tobacco products are delivery devices for nicotine, an addictive drug.

final outcome of the industry's lawsuit against the agency. On August 14, 1998, the U.S. Fourth Circuit Court of Appeals ruled that the FDA does not have statutory authority to regulate tobacco products. Following the full appellate court's refusal to reconsider the ruling, the Administration appealed to the U.S. Supreme Court, which has agreed to hear the case this fall.

The Administration and public health groups have urged Congress to pass legislation to give FDA the authority to regulate the manufacture, sale, advertising, and promotion of tobacco products. If the Supreme Court upholds the appellate court's ruling, anti-tobacco lawmakers may revive last year's legislative efforts to grant FDA broad regulatory authority over tobacco products.

## **Economic and Tax Issues**

The industry's 45-cents price increase to cover the cost of the state settlements falls well short of the \$1.50 a pack increase sought by public health officials as the single most effective means of reducing underage smoking.<sup>16</sup> The President's FY2000 budget called for a 55 cents-a-pack increase in the federal cigarette excise tax to help offset tobacco-related health care costs. Under the Balanced Budget Act of 1997 (P.L. 105-33), the current federal excise tax of 24 cents per pack is already set to increase by 10 cents on January 1, 2000, and an additional 5 cents on January 1, 2002. The FY2000 budget proposed that the full 15-cents increase take effect on January 1, 2000.<sup>17</sup>

Some economists have criticized proposals to raise cigarette taxes because they are highly regressive. Lower-income families consume more tobacco, unlike most commodities, than do higher-income families. According to a 1998 analysis by the Joint Committee on Taxation, individuals with annual incomes of up to \$30,000 account for about 47% of the federal cigarette taxes collected. States may also oppose a significant increase in federal tobacco tax because of provisions in the MSA. For example, if cigarette sales decline due to higher prices, the volume-of-sales adjustment would reduce proportionately the annual payments. Further, under the provisions of the settlement, if the federal government raises tobacco taxes and gives a portion of the money to states either as unrestricted funds or earmarked for health care programs, these funds would be subtracted from the annual settlement payments on a dollar-for-dollar basis.

## **Federal Tobacco Lawsuit**

On September 22, the Department of Justice (DOJ) sued the tobacco industry to recover billions of dollars spent by federal health care programs to treat smoking-related illnesses. The government alleges that the cigarette companies have conspired

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<sup>16</sup> Nationwide, the average retail price of a pack of cigarettes is about \$2.90. However, prices vary considerably from state to state because of the large differences in state tax.

<sup>17</sup> The tobacco excise tax proposals in the FY2000 budget would generate estimated receipts of \$8 billion in FY2000, decreasing to \$6.4 billion in FY2004.

since the 1950s to “deceive the American public about the health effects of smoking.” The allegation of a decades-long campaign of fraud and deception is based largely on an analysis of millions of industry documents that were uncovered by the states. Specifically, the DOJ’s lawsuit alleges that the companies:

- made false and misleading statements about the health risks of smoking;
- supported biased research that was used in defending lawsuits brought by smokers against the companies;
- suppressed research that suggested smoking caused disease;
- lied about the addictive nature of nicotine;
- refrained from developing, testing and marketing potentially less hazardous products; and
- denied marketing products to teenagers, while seeking to capture the youth market.

The civil lawsuit, filed in the U.S. District Court for the District of Columbia, names nine defendants: Philip Morris Inc., R.J. Reynolds Tobacco Co., Brown & Williamson Tobacco Corp., American Tobacco Co., British American Tobacco PLC, Lorillard Tobacco Co. Inc., Liggett Group Inc., the Council for Tobacco Research, and the Tobacco Institute. The DOJ claims that federal health care programs, excluding Medicaid, spend more than \$20 billion a year to treat illnesses attributable to smoking. Those programs include Medicare, the Federal Employees Health Benefits Program, and health care services provided by the Department of Defense, the Department of Veterans’ Affairs, and the Indian Health Service.

The DOJ based its lawsuit on three federal statutes: the Medical Care Recovery Act (42 U.S.C. §§2651 *et seq.*), the Medicare Secondary Payer provisions of the Social Security Act (42 U.S.C. §1395y(b)(2)(B)(ii) and (iii)), and the civil provisions of the Racketeer Influenced and Corrupt Organizations Act (18 U.S.C. §§1961–1968). Under the first two statutes, the government is seeking to recover some of the medical costs of treating smokers, whereas under the federal racketeering statute it is seeking a portion of the industry’s profits over the past 45 years. In addition to monetary damages, the government is seeking fundamental changes in the way the industry advertises and markets its products.

The federal lawsuit has strong support from the public health community. Tobacco opponents predict that it may have an even greater financial impact on the industry than the MSA. The companies have criticized the federal lawsuit as hypocritical and politically motivated and vowed to fight it in court rather than negotiate a settlement. Critics of the lawsuit argue that the federal government suffers no net financial loss from smoking. Smokers pay billions of dollars in excise taxes, and government health and welfare programs save on the costs of old-age medical care, pensions, and nursing home care because of smokers’ reduced life expectancy.<sup>18</sup> The lawsuit’s critics also point out that for decades the federal government has recognized the health risks of smoking, subsidized tobacco farming, and encouraged

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<sup>18</sup> See CRS Report 97-1053, *The Proposed Tobacco Settlement: Who Pays for the Health Care Costs of Smoking?* by Jane Gravelle.

smoking in the military through subsidized cigarette sales and free cigarette packs in field rations.

For more information on the federal tobacco lawsuit, see CRS report RS20091, *The Federal Lawsuit Against Tobacco Companies to Recover Health Care Costs*, by Henry Cohen.

## **Additional Information**

Additional information and analysis on the issues discussed in this report, as well as other tobacco-related topics, may be found on the CRS Tobacco Electronic Briefing Book [<http://www.congress.gov/brbk/html/ebtobtop.html>]. The full text of the MSA is available on the National Association of Attorneys General home page [<http://www.naag.org>]. Further analysis and information pertaining to the settlement, including state-by-state tobacco-control activities, may be found on the National Governors Association web site [<http://www.nga.org>].

**Table 1. Comparison of Master Settlement Agreement (MSA) with the June 1997 Proposal and the McCain Bill**

Topic	MSA	June 1997 Proposed Settlement	McCain Bill <sup>a</sup>
<b>Advertising, Marketing, and Promotion</b>	Prohibits targeting youth. Bans use of cartoons. Permits corporate sponsorship of sporting and cultural events. Limits companies to one brand-name sponsorship a year (may not include team sports, events with a significant youth audience, or events with underage contestants). Bans public transit advertising. Bans billboard advertising in arena, stadiums, malls, and arcades. Allows billboard advertising for brand-name sponsored events. Limits advertising outside retail stores to signs no bigger than 14 sq. ft. Bans payments to promote tobacco products in various media. Bans non-tobacco merchandise with brand-name logos except at brand-name sponsored events. Bans gifts of non-tobacco items to youth in exchange for tobacco products. Restricts use of non-tobacco brand names for tobacco products.	Includes the following additional prohibitions and restrictions: Bans use of human images. Bans all outdoor advertising and brand-name sponsorship. Bans Internet advertising. Restricts point-of-sale advertising. Restricts permissible tobacco advertising to black text on a white background except in adult-only facilities and adult publications. Bans non-tobacco merchandise with brand-name logos. Bans non-tobacco items, gifts, and services. Restricts self-service displays to adult-only facilities. Requires all tobacco products be placed out of reach of customers except in adult-only facilities.	Similar provisions to the June 1997 settlement.
<b>Youth Access</b>	Limits free samples to adult-only facilities. Bans sale of cigarettes in packs of less than 20 through December 2001.	Bans free samples and vending machines. Sets minimum age of 18 (verified with photo ID) to purchase tobacco. Face-to-face sales only. Mandates minimum pack size of 20 cigarettes.	Similar provisions to June 1997 settlement.
<b>Corporate Culture</b>	Requires corporate commitments to reducing youth access and consumption. Prohibits manufacturers from suppressing health research. Disbands existing tobacco trade associations and provides regulation and oversight of new trade organizations.	Requires corporate commitments to reducing youth access and consumption. Protects industry whistleblowers. Disbands existing tobacco trade associations. Prohibits manufacturers from suppressing health research.	Requires companies to submit annually to DHHS a report reviewing their compliance with the Act and efforts to reduce youth smoking. Provides for suspending the annual cap on legal liability if manufacturers impede progress in reducing youth smoking. Protects industry whistleblowers.
<b>Industry Lobbying Restrictions</b>	Companies agree not to lobby against certain specified kinds of state anti-tobacco legislation and regulation, but permits them to oppose efforts to raise excise taxes, create lookback penalties, or restrict ETS exposure. Requires lobbyists to seek company authorization for their activities.	Requires lobbyists to seek company authorization for their activities.	Similar provisions to June 1997 settlement.

Topic	MSA	June 1997 Proposed Settlement	McCain Bill <sup>a</sup>
<b>Tobacco Document Disclosure</b>	Industry agrees to release, and create a website for, all documents under protective orders in specified state lawsuits, except those for which companies assert privilege or trade-secret protection.	Establishes a public depository of industry documents. Industry must provide a detailed log of documents determined to be privileged against disclosure. Establishes an arbitration panel to settle disputes over making privileged documents public.	Similar provisions to June 1997 settlement. Requires industry to submit all privileged documents (and accompanying detailed log) to arbitration panel to settle disputes over making such documents public.
<b>Annual Payments</b>	Mandates up-front and annual payments to the states totaling \$204.5 billion through 2025 (see table 2). Payments subject to inflation adjustment, volume-of-sales adjustment, and a federal legislation adjustment. No restrictions on how the states spend the funds.	Mandates up-front and annual payments totaling \$368.5 billion over the first 25 years, allocated as follows: \$193.5 billion in unrestricted funds to states; \$36 billion for cessation; \$25 billion for research; \$37 billion for tobacco control; \$77 billion (if required) to settle lawsuits. Payments subject to inflation and volume-of-sales adjustment.	Mandates up-front and annual payments totaling \$516 billion over the first 25 years, allocated as follows: 40% (i.e., \$206.4 billion) to states, half of which is unrestricted; 22% for tobacco control; 22% for research; 16% for tobacco farmers and Medicare. Payments subject to inflation and volume-of-sales adjustment.
<b>Anti-Tobacco Research and Education</b>	Creates a national foundation to reduce underage tobacco use and substance abuse. Requires industry to pay the foundation \$250 million over 10 years to fund research and surveillance, and \$1.45 billion (subject to inflation and volume-of-sales adjustment) over 5 years to pay for a national anti-tobacco education program.	Provides \$25 billion over 8 years (see above) to create a public health trust to fund biomedical and behavioral tobacco-related research. Provides \$37 billion (see above) over first 25 years to fund tobacco-control programs, including anti-tobacco advertising (\$0.5 billion/yr), FDA regulation, and local community activities.	Provides \$113.5 billion (see above) over first 25 years to fund research and extend Medicare coverage to cancer clinical trials. Provides \$113.5 billion (see above) over first 25 years to fund tobacco-control programs, including anti-tobacco advertising, FDA regulation, cessations programs, international tobacco control, and local community activities.
<b>Enforcement, Consent Decrees</b>	Requires companies and states to sign legally enforceable consent decrees that include key provisions of the agreement. Only the tobacco divisions and not the parent companies are liable. Mandates the Nat. Assoc. Attorneys General to coordinate implementation and enforcement of the agreement. Directs industry to pay \$52 million for that purpose.	Requires companies and states to sign legally enforceable consent decrees that include key provisions of the agreement. Establishes civil and criminal penalties for violations of the agreement.	Requires companies, states, and the federal government to sign legally enforceable consent decrees that include many of the provisions of the Act. Excludes from annual liability cap any company that violates the provisions of the Act.
<b>Attorneys' Fees</b>	Companies agree to pay all fees and expenses of attorneys general, subject to a \$150 million annual cap. Requires companies to pay outside attorneys retained by states: either (i) all fees paid from a \$1.25 billion pool, or (ii) fees determined by arbitration panel and paid subject to a \$500 annual cap.	Requires companies to pay all fees and expenses of outside attorneys retained by states. Establishes an arbitration panel to determine and award attorneys' fees and expenses.	Requires companies to pay all fees and expenses of outside attorneys retained by states. Establishes an arbitration panel to determine and award attorneys' fees and expenses. Limits attorneys' fees to \$4,000/hr for lawsuits filed prior to 1995, and limits fees in future lawsuits to \$500/hr.

Topic	MSA	June 1997 Proposed Settlement	McCain Bill <sup>a</sup>
<b>Civil Liability</b>	Settles state and local medical-cost reimbursement lawsuits and protects industry (including retailers and distributors) from future state and local tobacco-related lawsuits. Allows dollar-for-dollar reduction in state's recoveries should the industry be found liable in a local government lawsuit.	Settles state medical-cost reimbursement and class-action lawsuits. Prohibits future class actions. Prohibits punitive damage awards in individual lawsuits arising from past industry conduct. Caps total annual liability at \$5 billion.	Allows states to settle their medical-cost reimbursement lawsuits in return for a share of the payments, or opt to continue with their lawsuits and forgo those funds. Settles Castano class-action lawsuits and prohibits addiction claims. Caps total annual liability at \$8 billion.

**Sources:** Full text of settlement [<http://www.naag.org/tob2.htm>]; CRS Report 98-6, *Tobacco Legislation in the 105<sup>th</sup> Congress*.

<sup>a</sup> Refers to the modified committee substitute bill (S. 1415) that was debated on the Senate floor (May 18–June 17, 1998), as amended.

**Table 2. Aggregate MSA Payments (\$ in millions) to the States and Territories through 2025<sup>a</sup>**

<b>Alabama<sup>b</sup></b>	3,166	Georgia	4,809	Maine	1,507	<b>New Jersey</b>	7,576	Rhode Island	1,408	Wisconsin	4,060
Alaska	669	Hawaii	1,179	Maryland	4,429	New Mexico	1,168	South Carolina	2,305	Wyoming	487
<b>Arizona</b>	2,888	Idaho	712	Massachusetts	7,913	New York	25,003	South Dakota	684	American Samoa	30
<b>Arkansas</b>	1,622	Illinois	9,119	Michigan	8,526	North Carolina	4,569	<b>Tennessee</b>	4,782	Guam	43
California	25,007	Indiana	3,996	<b>Missouri</b>	4,456	North Dakota	717	Utah	872	N. Marianas	17
Colorado	2,686	Iowa	1,704	Montana	832	Ohio	9,869	Vermont	806	U.S. Virgin Islands	34
Connecticut	3,637	Kansas	1,633	Nebraska	1,166	Oklahoma	2,030	<b>Virginia</b>	4,006	Puerto Rico	2,197
Delaware	775	Kentucky	3,450	Nevada	1,195	Oregon	2,248	Washington	4,023		
DC	1,189	Louisiana	4,419	New Hampshire	1,305	<b>Pennsylvania</b>	11,259	West Virginia	1,737		
<b>Total = 195,919</b>											

**Source:** National Association of Attorneys General [<http://www.naag.org>]. Payment allocation is based on each state's Medicaid expenditures and the number of smokers in each state.

**Note:** The table does not include the 4 states that settled individually with the tobacco companies (i.e., Florida, Minnesota, Mississippi, Texas).

<sup>a</sup> Payments include the up-front payment (paid in 5 installments through 2003) and the annual payments through 2025. The annual payments do not reflect any of the adjustments and reductions set out in the MSA (e.g., inflation adjustment, volume-of-sales adjustment, federal legislation adjustment). The table *does not* include an additional \$8.61 billion, which will be paid in 10 annual installments (2008–2017) to the strategic contribution fund and allocated to states to reflect their contribution toward resolution of the state lawsuits against the tobacco companies.

<sup>b</sup> As of the end of September, the 8 states listed in boldface had yet to receive final court approval.

**Table 3. Allocating MSA Funds for Tobacco Control:  
Summary of State Actions (1999 Legislative Session)<sup>a</sup>**

<b>Committed At Least 20% of MSA Funds for Tobacco Control</b>	Hawaii — 25% of MSA funds (\$3.6 million in FY2000, \$10-12 million a year thereafter) Maryland — \$21 million New Jersey — \$18.6 million Vermont — \$19.2 million Washington — \$100 million (unclear for how many years) Wisconsin — \$26 million (FY2000-01)
<b>Committed Limited (i.e., less than 20%) MSA Funds for Tobacco Control</b>	Alaska — \$1.4 million Connecticut — \$5 million Louisiana — \$4.1 million Montana — \$7 million (FY2000-01) Nevada — 10% of MSA funds (\$120 million over 25 years) New Hampshire — \$3 million Rhode Island — \$1 million Virginia — 10% of MSA funds for tobacco control and other health programs (\$400 million over 25 years)
<b>May Commit MSA Funds for Tobacco Control</b>	Ohio
<b>Outcome Unpredictable</b>	Arkansas, Illinois, New York, Pennsylvania
<b>Committed MSA Funds for Health Programs Which May Include Tobacco Control</b>	Delaware, Kansas, Nebraska, North Carolina, North Dakota, Wyoming
<b>Deferred Funding Decisions Until Next Year</b>	Colorado, District of Columbia, Indiana, Iowa, Kentucky, New Mexico, Oklahoma, South Dakota, Utah
<b>Did Not Allocate Any MSA Funds for Tobacco Control</b>	Alabama, Georgia, Idaho, Maine, Michigan, Missouri, South Carolina, Tennessee, West Virginia
<b>States With Existing Tobacco Control Programs Funded by Cigarette Excise Taxes</b>	Arizona — Tobacco Education and Prevention Program (TEPP) received \$29.3 million in 1998. No allocation decisions for MSA funds were made during 1999. California — state tobacco control program received \$126 million in 1998. MSA funds have been placed in the state's general fund. Massachusetts — Tobacco Control Program (MTCP) received \$31 million in 1999. Allocation of MSA funds is still under consideration. Oregon — state tobacco control program received \$17 million in 1998. Voters will consider MSA allocations in a ballot initiative in the November 2000 election.
<b>Non-MSA States (i.e., Settled Individually): Settlement Funding for Tobacco Control</b>	Florida — \$44 million Minnesota — \$489 million into endowments for tobacco control, with about \$35 million available in 2000 Mississippi — \$62 million (1999-2000) Texas — \$200 million into endowment, with about \$10 million available for tobacco control in 2000

**Sources:** National Campaign for Tobacco-Free Kids [<http://www.tobaccofreekids.org>], The Center for Social Gerontology [<http://www.tcs.org/tobacco.htm>].

a. The funding figures are for FY2000 unless indicated otherwise.

