INITIAL STATEMENT OF REASONS

I. General Purpose of Proposed Regulations

The Department of Justice (“Department”) proposes to make permanent the emergency repeal of sections 999.12 and 999.13 of chapter 16, division 1, of title 11 of the California Code of Regulations, including the form escrow agreement incorporated therein, and the emergency adoption of section 999.12, including the Approved Tobacco Escrow Agreement, JUS-TOB6 (Rev. 5/2019), which is incorporated by reference therein, after considering all comments, objections, and recommendations regarding the proposed action.

II. Problem Intended to Address

In 1998, 46 states entered into a Tobacco Master Settlement Agreement (“MSA”) with the largest tobacco manufacturing companies in the United States to settle certain claims against manufacturers arising out of the sale, advertising, and consumption of certain tobacco products. (Health & Saf. Code, § 104555, subd. (e).) Tobacco manufacturers that elect not to join the MSA are Non-Participating Manufacturers

Non-Participating Manufacturers (“NPMs”) must deposit funds into qualified escrow funds governed by state law based upon their sales of cigarettes and roll-your-own tobacco (“RYO”) in California. Unless specific conditions are satisfied, NPMs are statutorily prohibited from accessing or using the principal on deposit in the tobacco escrow accounts for twenty-five years. (Health & Saf. Code, § 104557, subd. (b).) NPMs and their escrow banks must execute a California Attorney General approved escrow agreement and ensure the funds are held and monitored in compliance with California law. (Rev. & Tax. Code, § 30165.1, subd. (c)(2)(a).)

The Office of the Attorney General is responsible for establishing and updating California’s tobacco escrow agreement. (Rev. & Tax. Code, § 30165.1, subd. (b)(3)(D) and (o).) Title 11 of the California Code of Regulations, Chapter 16, section 999.12 govern tobacco escrow accounts and the Approved Tobacco Escrow Agreement.

Since the Department’s most recent revision to the regulation and the escrow agreement in 2004, some NPMs prematurely accessed escrow principal in violation of Health and Safety Code section 104557. Furthermore, some NPMs abandoned their reversionary interest in the escrow accounts without resolving the status of the funds with California or the escrow bank.

This rulemaking action protects the public health and welfare by providing clear guidance to NPMs and escrow banks to ensure successful compliance with the law. The revised definitions of principal and interest will prevent NPMs from prematurely accessing escrow funds. The agreement clarifies and improves provisions regarding the procedures for account ledgers, NPMs that fail to appoint successor agents after their escrow bank resigns, and reports to California. Furthermore, the terms and conditions in Approved Tobacco Escrow Agreement were reorganized, consolidated, and edited to make it much easier to interpret, understand, and reference.

III. Economic Impact Assessment (EIA)

The Department concludes it is unlikely the proposed regulation will affect: (1) the creation or elimination of any jobs within California; (2) the creation of new businesses or the elimination of existing businesses within California; and (3) the expansion of businesses currently doing business within California.

The Department has determined that the proposed regulation will not have a significant, statewide, adverse impact affecting business. All of the tobacco companies and escrow banks addressed by these revisions currently have tobacco escrow accounts and tobacco escrow agreements. The Department anticipates that the regulation will require approximately fifty NPMs to each spend approximately $1,500 reviewing the revised regulation and executing the Approved Tobacco Escrow Agreement. Moreover, the Department anticipates that approximately eight to ten escrow banks will each spend approximately $2,500 reviewing and executing several Approved Tobacco Escrow Agreements with NPMs.

The regulation will benefit the public by ensuring that NPMs and escrow banks properly hold, track, and monitor tobacco escrow funds on deposit for the benefit of California.

IV. Technical, Theoretical, and/or Empirical Studies, Reports or Documents

The Department relied upon Department's staff understanding of tobacco escrow accounts in determining that the proposed emergency revision is necessary to have the effect and accomplish the objective of ensuring that NPM escrow deposits remain in qualified escrow accounts for the requisite time period pursuant to California law. The Department did not rely upon any technical, theoretical, or empirical study, report or similar document in making that determination.

V. Reasonable Alternatives to the Proposed Regulatory Action That Would Lessen Any Adverse Impact On Small Business.

No other reasonable alternatives were presented to or considered by the Department that would be either more effective in carrying out the purpose for which the action is proposed or as effective and less burdensome.

VI. Proposed Regulations

1. Proposed Permanent Repeal of Section 999.12

As last revised in 2004, Section 999.12 was a restatement of the definition of "qualified escrow fund" in Health and Safety Code section 104557. Repeal of this section is a non-substantive change.

2. Proposed Permanent Repeal of Section 999.13

The provisions of Section 999.13 have been updated and moved to Section 999.12 and the Approved Tobacco Escrow Agreement JUS-TOB6 (Rev. 5/2019). Section 5 of the JUS-TOB6 extends the time for the Attorney General to reject to a release of funds to pay a judgment or settlement from 30 days to 45 days. This change is necessary to give the Attorney General adequate time to review each request for a release of funds.

3. Proposed Permanent Adoption of Section 999.12

Subdivision (a) establishes the scope of the entities subject to the regulation. This regulation applies to NPMs that must maintain escrow principal for the benefit of California and other releasing parties under the MSA pursuant to Health and Safety Code sections 104555 through 104557, and the financial institutions that serve as escrow agents for NPMs with tobacco escrow accounts for the benefit of California. Subdivision (a) also incorporates an updated form of the escrow agreement that will govern the escrow accounts.

Subdivision (b) implements Health and Safety Code section 104557 by requiring NPMs to establish, fund, and continue to maintain an escrow fund in compliance with the new Approved Tobacco Escrow Agreement JUS-TOB6 (Rev. 5/2019) and all applicable state law. The new escrow agreement will ensure that NPMs and escrow banks properly hold, track, and monitor tobacco escrow funds on deposit for the benefit of California.

Subdivision (c) requires all NPMs and their escrow agents to sign the new Approved Tobacco Escrow Agreement JUS-TOB6 (Rev. 5/2019). Subdivision (c) also provides that other than filling blank spaces and checking boxes, no deviation, amendments, or other changes to the escrow agreement shall be permitted without the prior written approval of the Attorney General. This change is necessary to ensure that going forward all NPMs and their escrow agents comply with the terms and conditions of the new escrow agreement.

The new escrow agreement addresses several issues that that have emerged since California’s most recent revision. The revised definitions of “principal” and “interest” will prevent NPMs from prematurely accessing escrow principal. The new form clarifies provisions regarding account ledgers, NPMs that fail to appoint successor agents after their escrow bank resigns, and reports from NPMs to California.

Subdivision (c) also clarifies that under certain conditions an escrow agent may service an abandoned escrow account under the terms and conditions of a prior escrow agreement. This provision is necessary because if an account is abandoned, it may not be possible for a bank to enter into the new escrow agreement with the NPM that has abandoned the account.

Subdivision (d) requires NPMs to irrevocably assign funds in the escrow account to the state in the event the escrow agent resigns and the NPM fails to appoint a successor escrow agent subject to certain conditions in the escrow agreement. This change is necessary to address the uncertainties created when an NPM abandons an escrow account and the escrow agent resigns.

Subdivision (e) clarifies the resolution process for disputes in which the state is a party. This provision is necessary to distinguish the dispute resolution process described in the escrow agreement.