



December 5, 2013

NOTICE TO TOBACCO PRODUCT MANUFACTURERS AND FIRST IMPORTERS

RE: Amendment to the California Reserve Fund Statute Definition of "Units Sold"

Please be advised that California has enacted a new law, Senate Bill 680, which affects escrow due for cigarette and roll-your-own tobacco ("RYO") sales in California. This law becomes effective on January 1, 2014. Senate Bill 680 (ch. 168) amends the definition of "units sold" in the California Reserve Fund Statute (Cal. Health & Saf. Code, §§ 104555-104558). An updated copy of the Reserve Fund Statute is enclosed for your review and consideration.

All tobacco product manufactures whose cigarettes and RYO (as defined in subdivision (d) of section 104556 of the Health and Safety Code) are sold to consumers within California, whether directly or through any distributor, retailer, or similar intermediary, are required to either: (1) become a Participating Manufacturer (PM) under the Master Settlement Agreement (MSA) and comply with their obligations as a PM; or (2) place specified funds into a qualified escrow account as a Non-Participating Manufacturer (NPM) under the Reserve Fund Statute. **The new law revises the definition of "units sold" (upon which the escrow due is calculated) to be the number of cigarettes or RYO sold to consumers in California, regardless of whether or not the state excise tax was collected on the sale. NPMs must make escrow deposits based on the new "units sold" definition.** The new "units sold" definition is as follows:

"Units sold" means the number of individual cigarettes sold to a consumer in the state by the applicable tobacco product manufacturer, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, during the year in question, regardless of whether the state excise tax was due or collected. "Units sold" shall not include cigarettes sold on federal military installations, sold by a Native American tribe to a member of that tribe on that tribe's land, or that are otherwise exempt from state excise tax pursuant to federal law. The State Board of Equalization shall adopt any regulations as are necessary to ascertain the amount of state excise tax paid on the cigarettes of the tobacco product manufacturer for each year.

Failure to comply with the Reserve Fund Statute, including its amended "units sold" definition, will result in exclusion from the California Tobacco Directory, as well as any legal action authorized by statute. (See Cal. Rev. & Tax. Code, §§ 30165.1, subs. (b) & (e); Cal. Health & Saf. Code, § 104557.)

Questions About This Notice

Thank you for your cooperation. Please send inquiries to:

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Enclosure: Senate Bill 680 (Cal. Health & Saf. Code, § 104555-104558.)

California Health and Safety Code Sections 104555-104558

Section 104555. The Legislature finds and declares all of the following:

(a) Cigarette smoking presents serious public health concerns to the state and to the citizens of the state. The Surgeon General has determined that smoking causes lung cancer, heart disease, and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

(b) Cigarette smoking also presents serious financial concerns for the state. Under certain health care programs, the state may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

(c) Under these programs, the state pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

(d) It is the policy of the state that financial burdens imposed on the state by cigarette smoking be borne by tobacco product manufacturers rather than by the state to the extent that those manufacturers either determine to enter into a settlement with the state or are found culpable by the courts.

(e) On November 23, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the Master Settlement Agreement, with the state. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present, and certain future claims against them as described therein, to pay substantial sums to the state (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.

(f) 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 without ensuring that the state will have an eventual source of recovery from them if they are proved to have acted culpably. It is thus in the interest of the state to require that these manufacturers establish a reserve fund to guarantee a source of compensation and to prevent those manufacturers from deriving large, short-term profits and then becoming judgment proof before liability may arise.

Section 104556. The definitions contained in this section shall govern the construction of this article.

(a) “Adjusted for inflation” means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

(b) “Affiliate” means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for

purposes of this definition, the terms “owns,” “is owned,” and “ownership” mean ownership of an equity interest, or the equivalent thereof, of 10 percent or more, and the term “person” means an individual, partnership, committee, association, corporation, or any other organization or group of persons.

(c) “Allocable share” means allocable share as that term is defined in the Master Settlement Agreement.

(d) “Cigarette” means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; (2) tobacco, in any form, that is functional in the product, which because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in this section. “Cigarette” also includes “roll-your-own” tobacco, meaning any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes. For purposes of this definition of “cigarette,” 0.09 ounces of “roll-your-own” tobacco shall constitute one individual “cigarette.”

(e) “Master Settlement Agreement” means the settlement agreement and related documents entered into on November 23, 1998, by the state and leading United States tobacco product manufacturers.

(f) “Qualified escrow fund” means an escrow arrangement with a federally or state chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least one billion dollars (\$1,000,000,000) where the arrangement requires that the financial institution hold the escrowed funds’ principal for the benefit of releasing parties and prohibits the tobacco product manufacturer placing the funds into escrow from using, accessing, or directing the use of the funds’ principal except as consistent with subdivision (b) of Section 104557.

(g) “Released claims” means released claims as that term is defined in the Master Settlement Agreement.

(h) “Releasing parties” means releasing parties as that term is defined in the Master Settlement Agreement.

(i) “Tobacco product manufacturer” means an entity that after the date of enactment of this article directly, and not exclusively through any affiliate:

(1) Manufactures cigarettes anywhere that the manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where the importer is an original participating manufacturer as that term is defined in the Master Settlement Agreement, that will be responsible for the payments under the Master Settlement Agreement with

- respect to such cigarettes as a result of the provisions of subsection II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States); or
- (2) Is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or
 - (3) Becomes a successor of an entity described in paragraph (1) or (2).

The term “tobacco product manufacturer” shall not include an affiliate of a tobacco product manufacturer unless the affiliate itself falls within any of paragraphs (1) to (3) of this subdivision.

(j) “Units sold” means the number of individual cigarettes sold to a consumer in the state by the applicable tobacco product manufacturer, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, during the year in question, regardless of whether the state excise tax was due or collected. “Units sold” shall not include cigarettes sold on federal military installations, sold by a Native American tribe to a member of that tribe on that tribe’s land, or that are otherwise exempt from state excise tax pursuant to federal law. The State Board of Equalization shall adopt any regulations as are necessary to ascertain the amount of state excise tax paid on the cigarettes of the tobacco product manufacturer for each year.

Section 104557.

(a) Any tobacco product manufacturer selling cigarettes to consumers within the state, whether directly or through a distributor, retailer or similar intermediary or intermediaries, after the date of enactment of this article shall do one of the following:

- (1) Become a participating manufacturer as that term is defined in Section II(jj) of the Master Settlement Agreement and generally perform its financial obligations under the Master Settlement Agreement; or
- (2) Place into a qualified escrow fund by April 15 of the year following the year in question the following amounts, as such amounts are adjusted for inflation:
 - (A) For 1999: \$0.0094241 per unit sold during that year, after the date of the enactment of this article.
 - (B) For 2000: \$0.0104712 per unit sold during that year.
 - (C) For each of 2001 and 2002: \$0.0136125 per unit sold during the year in question.
 - (D) For each of 2003 through 2006: \$0.0167539 per unit sold during the year in question.
 - (E) For each of 2007 and each year thereafter: \$0.0188482 per unit sold during the year in question.

(b) Any tobacco product manufacturer that places funds into escrow pursuant to paragraph (2) of subdivision (a) shall receive the interest or other appreciation on the funds as earned. The funds, other than the interest or other appreciation, shall be released from escrow only under the following circumstances:

- (1) To pay a judgment or settlement on any released claim brought against that tobacco product manufacturer by the state or any releasing party located or residing in the state. Funds shall be released from escrow under this subdivision

(i) in the order in which they were placed into escrow and (ii) only to the extent and at the time necessary to make payments required under that judgment or settlement.

(2) To the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow on account of units sold in this state in a particular year was greater than the Master Settlement Agreement payments, as determined pursuant to section IX(i) of the agreement including after the final determination of all adjustments, that the manufacturer would have been required to make on account of the units sold had it been a participating manufacturer, the excess shall be released from escrow and revert back to that tobacco product manufacturer; or

(3) To the extent not released from escrow under paragraph (1) or (2) of subdivision (b), funds shall be released from escrow and revert back to the tobacco product manufacturer 25 years after the date on which they were placed into escrow.

(c) Each tobacco product manufacturer that elects to place funds into escrow pursuant to paragraph (2) of subdivision (a) shall annually certify to the Attorney General that it is in compliance with paragraph (2) of subdivision (a), and subdivision (b). The Attorney General may bring a civil action on behalf of the state against any tobacco product manufacturer that fails to place into escrow the funds required under this section. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under this section shall:

(1) Be required within 15 days to place the funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a violation of paragraph (2) of subdivision (a), or subdivision (b), may impose a civil penalty to be paid to the General Fund of the state in an amount not to exceed 5 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100 percent of the original amount improperly withheld from escrow.

(2) In the case of a knowing violation, be required within 15 days to place the funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a knowing violation of paragraph (2) of subdivision (a), or subdivision (b), may impose a civil penalty to be paid to the General Fund in an amount not to exceed 15 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300 percent of the original amount improperly withheld from escrow.

(3) In the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the state, whether directly or through a distributor, retailer, or similar intermediary, for a period not to exceed two years.

(d) Each failure to make an annual deposit required under this section shall constitute a separate violation.

Section 104557.1

(a) Notwithstanding subdivision (b) of Section 104557, a tobacco product manufacturer that elects to place funds into escrow pursuant to paragraph (2) of subdivision (a) of Section 104557 may make an irrevocable assignment of its interest in the funds to the

benefit of the State of California. Such assignment shall be permanent and apply to all funds in the subject escrow account or that may subsequently come into the account, including those deposited into the escrow account prior to the assignment being executed, those deposited into the escrow account after the assignment is executed, and interest or other appreciation on the funds. The tobacco product manufacturer, the Attorney General, and the financial institution where the escrow amount is maintained may make such amendments to the qualified escrow account agreement as may be necessary to effectuate an assignment of rights executed pursuant to this subdivision or a withdrawal of funds from the escrow amount pursuant to subdivision (b). An assignment of rights executed pursuant to this section shall be in writing, signed by a duly authorized representative of the tobacco products manufacturer making the assignment, and shall become effective upon delivery of the assignment to the Attorney General and the financial institution where the escrow account is maintained.

(b) Notwithstanding subdivision (b) of Section 104557, any escrow funds assigned to the state pursuant to subdivision (a) shall be withdrawn by the state upon the request by the Treasurer and approval of the Attorney General. Any funds withdrawn pursuant to this subdivision shall be deposited into the General Fund and shall be calculated on a dollar-for-dollar basis as a credit against any judgment or settlement described in subdivision (b) of Section 104557 which may be obtained against the tobacco product manufacturer who has assigned the funds in the subject escrow account. Nothing in this section shall be construed to relieve a tobacco product manufacturer from any past, current, or future obligations the manufacturer may have pursuant to this chapter.

Section 104558.

(a) In order to secure and protect the moneys to be received as a result of the Master Settlement Agreement, as defined in subdivision (e) of Section 104556, in civil litigation under any legal theory involving a signatory, successor of a signatory, or an affiliate of a signatory to the Master Settlement Agreement that has not been brought to trial as of the effective date of this section, the amount of the required undertaking, bond, or equivalent surety to be furnished during the pendency of an appeal or any discretionary appellate review of any judgment granting legal, equitable, or any other form of relief in order to stay the execution thereon during the entire course of the appellate review shall be set in accordance with applicable laws and rules of the court, except that the total undertaking, bond, or equivalent surety that is required per case, whether individual, aggregate, or otherwise, of all appellants, collectively, may not exceed 100 percent of the verdict or one hundred fifty million dollars (\$150,000,000) whichever is less, regardless of the value of the judgment.

(b) Nothing in this section or any other provision of law shall be construed to eliminate the discretion of the court, for good cause shown, to set the undertaking or bond on appeal in an amount lower than that otherwise established by law.

(c) If the appellee proves by a preponderance of the evidence that a party bringing an appeal or seeking a stay of execution of judgment and for whom the undertaking has been limited under this section, is intentionally dissipating or diverting assets outside the ordinary course of its business for the purpose of avoiding ultimate payment of the judgment, any limitation under subdivision (a) may be rescinded and the court may order any actions necessary to prevent dissipation or diversion of the assets.