

**ATTORNEY GENERAL REGULATIONS
NON-PARTICIPATING TOBACCO MANUFACTURER’S RESERVE FUND
FOR SMOKING-RELATED ILLNESS AND OTHER LIABILITIES**

Chapter 16 is added to Title 11 of the California Code of Regulations

Chapter 16.

**Attorney General Regulations Under Master Settlement Agreement with
Tobacco Product Manufacturers and Non-Participating Tobacco Product
Manufacturer Law (Health & Safety Code sections 104555 - 104557)**

**999.10 Scope and Purpose, Definitions, and Written Confirmation of Compliance with Reserve
Fund Requirements by Non-Participating Tobacco Product Manufacturers**

a. Scope and Purpose

The purpose of these regulations is to implement Health and Safety Code sections 104555, 104556 and 104557 by providing tobacco product manufacturers clear definitions, instructions, guidance and forms to comply with the requirement to establish a reserve fund for tobacco-related illness and other potential liabilities. The Legislature imposed the reserve fund requirements to ensure a source of compensation for the financial burdens imposed upon the State by cigarette-smoking related illness and other health conditions. Health and Safety Code sections 104555-104557 essentially require tobacco product manufacturers to provide a “surety bond” against future liability for cigarette-smoking related healthcare costs. This “surety bond” is imposed upon manufacturers which choose to avoid the conduct restrictions that apply if they sign the MSA. Government Code sections 11110-11113 require the Attorney General to adopt regulations to provide forms for “surety bonds,” which are approved by the Attorney General as conforming with applicable law.

The Legislature also intended to prevent the unfair competition that would occur if tobacco product manufacturers who did not sign the Master Settlement Agreement (“MSA”) and did not incur the financial obligation under the MSA were allowed to derive large short-term profits to the disadvantage of those manufacturers participating in the MSA. These regulations are also intended to protect tobacco distributors and wholesalers from the financial risk of accepting orders for tobacco products or purchasing tobacco products that may be banned from sale by a court because the tobacco product manufacturer failed to make the required deposits or otherwise comply with the reserve fund requirements.

Through the definitions, instructions, guidance and forms provided, these regulations also make available to the public and local and state government officials the Attorney General’s enforcement policy and interpretation of how tobacco product

manufacturers should comply with the reserve fund requirements to avoid unfair and unlawful business conduct and activity. Toward that end, these regulations are intended to describe the meaning of compliance with the reserve fund requirements, the proper interpretation of the statutory requirements and the enforcement policy designed to protect those manufacturers which do comply from unfair competition by those manufacturers which might otherwise fail to comply with the reserve fund requirements without the definitions, instructions, guidance and forms provided.

b. Definitions

The definitions contained in this subdivision shall govern the construction of this chapter.

- (1) “Cigarette” shall have the same meaning as in Health and Safety Code section 104556 (d).
- (2) “Distributor” shall have the same meaning as in Revenue and Taxation Code section 30011.
- (3) “Non-participating tobacco product manufacturer (NPM)” means any tobacco product manufacturer selling cigarettes to consumers within the state, whether directly or through a distributor, retailer or similar intermediary or intermediaries, which has not become a participating manufacturer as that term is defined in section II(jj) of the Master Settlement Agreement (MSA) or has become a participating manufacturer but does not generally does not perform its financial obligations under the MSA.
- (4) “Original Participating Manufacturer (OPM)” mean the companies specified in section II(hh) of the MSA which are generally performing their obligations under the MSA.
- (5) “Units sold” means the number of individual cigarettes, including the amount of “roll-your-own” tobacco (.09 ounces of “roll-your own” constitutes one cigarette) sold in California by a non-participating tobacco product manufacturer, whether directly or through a distributor, retailer or similar intermediary or intermediaries, during the year in question, as measured by excise taxes collected by the State Board of Equalization on cigarette packs or “roll-your-own” tobacco containers.
- (6) “Wholesaler” shall have the same meaning as in Revenue and Taxation Code section 30016.
- (7) All other terms used in this chapter shall have the same meaning as in Health and Safety Code sections 104555 - 104557, unless otherwise indicated.

c. Confirmation of Compliance with Reserve Fund Requirements

- (1) Before an NPM sells or ships cigarettes or roll-your-own tobacco to a distributor or wholesaler for sale in California, the NPM shall provide written confirmation to the distributor or wholesaler that said manufacturer has either become a participating manufacturer under the MSA and is generally performing its financial obligations under the MSA, or has made the requisite escrow deposits and certification of compliance required of NPMs by Health and Safety Code section 104557 and these regulations. A copy of the Certificate of Compliance (Form TOB.CC-1) filed with the Attorney General by an NPM or an equivalent notarized statement which has been approved by the Attorney General pursuant to section 999.11 is adequate written confirmation for the purposes of this section.

- (2) An NPM which has not sold tobacco products in California before these regulations become effective shall not sell or ship cigarettes or roll-your-own tobacco to a distributor or wholesaler purchasing or accepting orders for any cigarettes or roll-your-own tobacco for sale in California, unless the NPM has provided written confirmation to the distributor or wholesaler that the NPM has received and reviewed a copy of Health and Safety Code sections 104555-104557 and these implementing regulations. During the first year of sales in California, an NPM must provide written confirmation of compliance either by producing a copy of the “Acknowledgment of Receipt and Review of NPM Statute, Implementing Regulations, Forms, Calculation Method and Reporting Responsibilities for Depositing Reserve Funds into Escrow” Form (Acknowledgment of Receipt and Review form) (Form TOB.AOR-1), or an equivalent notarized statement which has been approved by the Attorney General, filed with the Attorney General. The Acknowledgment of Receipt and Review form (Form TOB.AOR-1) shall be listed as an approved form in subchapter 2 of chapter 1 of Title 11 of the California Code of Regulations as Article 3, section 28.4.

An NPM shall complete and file the Acknowledgment of Receipt and Review form with the Attorney General within 30 days of receipt. Thereafter, the NPM shall provide copies of the form, as filed with the Attorney General, to wholesalers and distributors before the NPM sells or ships its tobacco products to a wholesaler or distributor until April 15 of the year after the first calendar year in which the NPM began selling in California, when it must file its first Certificate of Compliance. The filed Acknowledgment of Receipt and Review form shall constitute adequate written confirmation of compliance only until April 15 of the year after the calendar year in which the NPM began selling tobacco products in California. No deviation from the Acknowledgment of Receipt and Review form (Form TOB.AOR-1) shall be permitted without the prior written approval of the Attorney General.

- (3) If an NPM fails to provide the requisite written confirmation of compliance, the wholesaler or distributor shall request the NPM to provide written confirmation of compliance prior to the manufacturer selling or shipping its tobacco products to the wholesaler or distributor. If the distributor or wholesaler does not receive any written confirmation prior to the NPM shipping or offering to sell its tobacco products, or receives inadequate confirmation, the distributor or wholesaler shall report the lack of prior confirmation or inadequate confirmation to the Attorney General (attention: Tobacco Litigation & Enforcement Section) within 14 business days after the failure to provide confirmation or the provision of inadequate confirmation. The report shall be in writing and include the name, address and telephone number of the NPM and details of the request for confirmation pursuant to this section and the inadequacies in the confirmation, or the details of the failure to provide the requested written confirmation. The report shall also specify whether the failure to provide confirmation or inadequate confirmation may be because the NPM has not sold tobacco products in California.
- (4) Upon request of the Attorney General, the distributor or wholesaler shall provide such further information as may be required by the Attorney General to confirm compliance by the tobacco product manufacturer or to seek a court order barring the NPM from further sales of tobacco products pending proof of compliance or other enforcement action by the Attorney General.
- (5) Tobacco product manufacturers shall provide such information as required by the Board of Equalization, or requested by distributors, wholesalers, retailers or other intermediaries required to report to the Board, when the reports required by the Board are to assist the Board to determine the number of units sold in California. NPMs shall also provide such information as required by the Attorney General or requested by distributors or wholesalers, as required by this section, to confirm and enforce compliance with the requirements of Health and Safety Code sections 104555 - 104557 and prevent the unfair competition resulting from non-compliance. The information required by the Board of Equalization and the Attorney General includes, but is not limited to:
 - (A) Brand names;
 - (B) Unit sales of each brand;
 - (C) Corporate or business name, and address of importer;
 - (D) Corporate or business name, and address of manufacturer;
 - (E) Whether the seller was the manufacturer, and;
 - (F) Whether the seller was the first importer for resale in the United States.

For the purposes of information reports required by the Board of Equalization or the Attorney General, distributors and wholesalers shall deem any brand, which is not on the list of brands of participating manufacturers provided by

the Board for use with Cigarette Schedule F (Form BOE-501-CFS) and Tobacco Schedule T (Form BOE-501-CTT), to be the brand of an NPM and provide the information and reports required of such brands.

999.11 Certificate of Compliance Form

The certification required of NPMs by Health and Safety Code section 104557(c) shall be on the Certificate of Compliance (Form TOB.CC-1), which shall be listed as an approved form in subchapter 2 of chapter 1 of Title 11 of the California Code of Regulations as Article 3, section 28.5. The completed form shall be signed under oath before a notary public and include the following information:

- (1) The escrow account number and the amount held in the account;
- (2) A copy of the receipt or other proof of escrow deposit from the financial institution;
- (3) A copy of the escrow agreement; and
- (4) Date and signature of a notary public.

No deviation from the Certificate of Compliance (Form TOB.CC-1) shall be permitted without the prior written approval of the Attorney General. The completed Certificate of Compliance must be received by the Attorney General on or before April 30 of the year following the sales year that is the subject of the certificate. A Cigarette Brand Unit Sales Schedule (Form TOB.SCHEDULE-1) must be completed and attached to the completed Certificate of Compliance. The Cigarette Brand Unit Sales Schedule shall be listed as an approved form in subchapter 2 of chapter 1 of Title 11 of the California Code of Regulations as Article 3, section 28.6.

999.12 Escrow Agreement for Non-Participating Manufacturer

Health and Safety Code section 104556(f) establishes the following conditions for the escrow accounts to be established by a NPM:

- (1) The financial institution may not be affiliated with any Tobacco Product Manufacturer and must have assets of at least \$1,000,000,000.
- (2) The escrow agreement must require that the financial institution hold the escrowed funds' principal for the benefit of the State of California and other releasing parties under the MSA; and,
- (3) The escrow agreement must also state that the company is prohibited from accessing or directing the use of the funds' principal inconsistent with Health and Safety Code section 104557.

These provisions shall be included in the escrow agreement even when the Attorney General

approves an escrow agreement that deviates from Escrow Agreement Form TOB.EA-1.

999.13. Escrow Agreement Form

The escrow agreement required by Health and Safety Code sections 104556(f) and 104557 shall be on Escrow Agreement (Form TOB.EA-1), which shall be listed as an approved form in subchapter 2 of chapter 1 of Title 11 of the California Code of Regulations as Article 3, section 28.7. The escrow agreement shall include each of the following provisions:

- (1) The escrow agent shall provide 30 days' written notice to the Attorney General prior to any release of funds from the escrow to pay a judgment or settlement and allow the Attorney General to object to the release.
- (2) The objection of the Attorney General must be resolved under applicable state law, procedures, and remedies before any funds are released.
- (3) Requests for refund of "excess" deposits by the NPMs pursuant to Health and Safety Code section 104557(b)(2), if disputed by the State, are to be determined by a court of competent jurisdiction. Section 104557(b)(2) allows a refund if the NPM demonstrates that the escrow deposits exceed what the manufacturer would have been required to make had it been a participating manufacturer under the MSA.
- (4) The escrow agent shall notify the Attorney General of the first deposit, provide a copy of the escrow agreement, all relevant instructions from the NPM and the amount of deposit made.
- (5) Each year after the initial year, the escrow agent shall notify the Attorney General of the amount of deposit made by the NPM.

No deviation from the Escrow Agreement Form TOB.EA-1 shall be permitted without the prior written approval of the Attorney General.

999.14 Guidelines for Escrow Release Requests

a. Introduction; grounds

The NPM Statute (codified at Health & Saf. Code §§ 104555-104557) authorizes the release of funds from escrow only under certain circumstances. Section 104557(b) authorizes the release of funds from escrow to the extent that an NPM "establishes that the amount it was required to place into escrow in a particular year was greater than the state's allocable share of the total payments that the manufacturer would have been required to make in that year under the Master Settlement Agreement had it been a participating manufacturer." (Health & Saf. Code, § 104557(b)(2).) To establish entitlement to an escrow adjustment on this ground, an NPM must calculate first the total payments that it would have made as a participating manufacturer during a particular year absent certain adjustments, offsets and

reductions and then the State's allocable share of that total.

Adjustments to escrow accounts deposited pursuant to Health & Safety Code sections 104555-104557, including balances due for deposit, may occur upon a showing that the adjustment is authorized pursuant to Health & Safety Code section 104557(b)(2) in response to requests for adjustments (i) by the tobacco manufacturer or (ii) by the State Board of Equalization ("BOE") or the Attorney General as a result of additional information not known to the Attorney General when the initial, or most recent, deposit was deemed sufficient or when a release from escrow was authorized and implemented.

b. Time for filing request

Requests for adjustments must be filed in a timely manner and no later than three years after the initial deposit was due for the relevant year of sales or. (See Code Civ. Proc., §338(a)(c).)

c. Form and contents of request

To be eligible for consideration, a request for an adjustment by an NPM must be made in writing and must be accompanied by supporting documentation which establishes compliance with all other aspects of the reserve fund requirements and the basis for the escrow release request. The supporting documentation, at a minimum, must include:

- (1) A timely filed Certification of Compliance form (Form TOB.CC-1) or timely filed Acknowledgment of Receipt and Review form (Form TOB.AOR-1), a timely filed Cigarette Brand Unit Sales Schedule (Form TOB.SCHEDULE-1), and an Escrow Agreement (Form TOB.ea-1) and an affidavit identifying all current officers, owners and agents for service of process for the manufacturer and all cigarette brands owned or made by the manufacturer; When a manufacturer does not own the cigarette brand that it makes or imports or sells, the affidavit shall identify the owner of the cigarette brand sufficiently to enable regular contact and communication with the brand owner by the State. These forms must be completed and timely filed in compliance with Health & Safety Code sections 104555-104557.
- (2) An affidavit, signed by the executive officer of the manufacturer responsible for escrow compliance, setting forth the officer's authority to bind and act on behalf of the manufacturer and demonstrating the facts which support the adjustment requested;
- (3) All records and/or other documentation demonstrating the facts offered in support of the requested adjustment, as well as documentation evidencing the timely deposit of payments into escrow; and any legal argument or analysis in support of the requested adjustment. The NPM shall submit a proposed calculation of the annual deposit due, a proposed calculation of the refund

amount and a draft letter of instructions to the Escrow Agent concerning the proposed refund. To document its national unit sales, the NPM shall include copies of the NPM's bi-monthly Excise Tax Returns filed with the U.S. Treasury, Bureau of Alcohol, Tobacco & Firearms. To document its unit sales in California (as measured by excises taxes paid), the NPM shall include copies of filed California excise tax returns for its tobacco products or arrange for equivalent excise tax payment documentation from the State of California.

The State may request such further information as is required in light of the specific facts, including, but not limited to, information on compliance with reserve fund requirements and the basis for any adjustment requested.

d. Formulae for calculating the State's allocable share

STEP ONE in calculating the State's allocable share is to determine the "corresponding base amount." The formula for calculating the corresponding base amount is as follows:

corresponding base amount = (total payment due from OPMs) - (volume adjustments)

Original Participating Manufacturers (OPM) is defined in 999.10(b)(4).

As indicated in the above formula, to calculate the State's "corresponding base amount," determine the "volume adjustments" for "the total payment due from the OPMs" and subtract the "volume adjustments" from the total payment due from the OPMs. The total payment due from the OPMs is the sum of the section VI(c) and the section IX(c)(1) payments under the MSA. The volume adjustments are the total of the section VI(c) volume adjustment and the section IX(c)(1) volume adjustment under the MSA. The formula for calculating volume adjustments is set forth in Exhibit E to the MSA.

STEP TWO in calculating the State's allocable share is to insert the "corresponding base amount" into the following formula, as A, and make the following calculation:

California's Allocable Share = $[(A \times B) \div C] \div D \times E \times F$

A = Corresponding Base Amount (calculated in step 1)

B = the number of cigarettes sold by the NPM

C = the total number of cigarettes sold in the U.S.

D = OPM aggregate percentage of the total U.S. market

E = Inflation Adjustment

F = California's allocation percentage, which is 12.7639554%.

e. Data to Be Used

Requests for adjustments to escrow must use the most recent data available for the OPMs' aggregate percentage of the total market and total payment due from the OPMs. The only data which will be accepted in such submittals is the data provided to the State from the Independent Auditor under the MSA. An NPM submitting a request for an adjustment to escrow may obtain this information from the State.

f. Preliminary requests for review

Preliminary requests for releases from escrow may be submitted for review and consideration by the BOE and the Attorney General. Preliminary requests for release must satisfy all the requirements for requests for adjustments to escrow, including but not limited to the timeliness, forms, content, formulae, data and documentation requirements in these guidelines. The NPM is responsible for ensuring that all information and documentation necessary for a determination is provided. If all the foregoing requirements are satisfied and all the required information and documentation is provided, and the Attorney General makes a determination on a preliminary request for release from escrow before the initial escrow payment is made, the Attorney General shall authorize an adjustment to escrow consistent with that determination as soon as practicable within 30 days of the receipt of confirmation of the escrow deposit to the BOE and the Attorney General. The Attorney General shall notify the submitting manufacturer by April 1st if the determination of a preliminary request for release from escrow will not be made by April 15th.

g. Independent review

The BOE and the Attorney General may initiate an adjustment to escrow or to a release therefrom should additional facts become available during the three-year period after the initial deposit was due for the relevant year of sales showing that the escrow amount paid or escrow amount released was incorrect. Bases for adjustment include, but are not limited to, new information showing inaccurate reporting of the number of units or a change in the OPM market share or any other failure by the NPM to comply with these regulations or Health and Safety Code sections 104555, 104556 and 104557.

h. Notice of decision

Except as provided in subsection f of this section, a request for an adjustment of escrow account will be decided within sixty (60) days of the submission of all of the information necessary for its determination. The Attorney General will send a copy

of the release determination to the manufacturer and, if the release request has been allowed in whole or in part, to the financial institution holding the funds in escrow.

Decisions to deny escrow release requests in whole or in part must contain (1) a statement of reasons for the denial; and (2) a statement of the means and deadline by which review of the decision may be obtained.
