

July 28, 2017

To: Economic Revenue Forecast Council
From: State Budget Outlook Work Group
Subject: Enacted 2017-19 Budget Outlook

The State Budget Outlook Work Group poses the following question for the Economic Revenue Forecast Council to finalize the Outlook for Enacted 2017-19 Biennial Budget (SSB 5883, Chapter 1, Laws of 2017, 3rd Special Session PV).

1. TOBACCO ARBITRATION SETTLEMENT

The legislature assumed that the state would receive an additional tobacco arbitration award amount of \$15 million by the end of the 2017-19 fiscal biennium. By way of background, some tobacco companies that are part of the 1998 settlement have disputed the lack of a down-ward adjustment related to non-participating manufacturers and have not been fully paying the amounts they owe going back to 2003. The argument for the manufacturers is that Washington and other states are failing to diligently enforce provisions related to non-manufacturers and therefore the downward adjustment should be applied.

In 2013, Washington was one of a number of states that prevailed in an arbitration related to with-held payments for the year 2003. Washington received approximately \$15 million upon conclusion of the arbitration for with-held 2003 funds. There were a few states that were found to have failed to diligently enforce the agreement and as a result suffered significant adverse fiscal impacts from the arbitration.

Staff from the attorney general's office have indicated that the process for hearings related to the amounts withheld from 2004 have begun and a decision is expected in 2018. While there is no guarantee Washington will prevail in the arbitration related to 2004 payments that were with-held, staff from the attorney general's office have indicated that Washington continues to maintain strong enforcement related to non-participating manufacturers which is the basis for not applying the downward adjustment.

For this item, there is not a specific budget directive or implementation funding from normal operations.

For additional background, the legislature assumed \$34 million in the Outlook for anticipated audit payments in FY 2016. Large audit assessments are generally reflected as non-economic changes in the revenue forecast. For this item, there is not a specific budget directive or implementation funding as it is from the normal DOR operations. Prior adopted Outlooks have not reflected anticipated non-economic changes, such as DOR audit payments, prior to incorporation into the official forecast.

At its April 26, 2016 meeting, discussion ensued regarding the timing of how monthly collection variances are factored into the revenue forecast as well as concerns about the uncertainty of timing of audit payments and refunds. The ERFC agreed not to include the anticipated audit payments in the final enacted outlook.

There are some differences between the assumed audits in 2016 and the anticipated tobacco arbitration award. The hearing process related to the arbitration has begun and the process is expected to be concluded in 2018. While there is no certainty that Washington will prevail, the prior arbitration established that Washington's prior enforcement activities were adequate to justify not including the downward adjustment in 2003.

Should the Outlook for the enacted budget include the anticipated \$15 million tobacco arbitration award?