

**MINUTES
of the
FIRST MEETING
of the
TOBACCO SETTLEMENT REVENUE OVERSIGHT COMMITTEE**

**June 19, 2017
State Capitol, Room 311
Santa Fe**

The first meeting of the Tobacco Settlement Revenue Oversight Committee (TSROC) was called to order by Representative Elizabeth "Liz" Thomson, co-chair, on June 19, 2017 at 1:35 p.m. in Room 311 of the State Capitol in Santa Fe.

Present

Sen. Cisco McSorley, Co-Chair
Rep. Elizabeth "Liz" Thomson, Co-Chair
Sen. Sander Rue
Rep. Monica Youngblood

Absent

Rep. Joanne J. Ferrary
Sen. John Arthur Smith

Advisory Members

Sen. Linda M. Lopez

Rep. Gail Chasey
Sen. Candace Gould
Sen. Mary Kay Papen
Rep. Jim R. Trujillo

Staff

Celia Ludi, Staff Attorney, Legislative Council Service (LCS)
Kathleen Dexter, Researcher, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are on the New Mexico Legislature website and in the meeting file.

Monday, June 19

Brief History of the Master Settlement Agreement in New Mexico

Ms. Ludi provided the committee with a history of the settlement between tobacco companies and states, known as the Master Settlement Agreement (MSA).

In 1998, New Mexico and 45 other states settled a lawsuit they initiated four years earlier against five major tobacco companies for, among other things, concealing the detrimental health

effects of tobacco use. The states argued that the companies should share with the states' Medicaid programs the cost of treating smoking-related diseases and conditions. The resulting MSA requires that the tobacco companies — referred to in the settlement as "participating manufacturers" (PMs) — cease all deceptive marketing of cigarettes, especially to children, and make compensatory payments to the states in perpetuity. The MSA also prohibits those states from making future claims against the PMs on the same issues. Four states are not part of the MSA but instead reached their own separate settlements with the PMs.

Under the MSA, New Mexico receives an annual settlement payment from the PMs based on their revenue from cigarette sales in the previous year. This payment is generally \$30 million to \$40 million per year and is deposited into the state's Tobacco Settlement Permanent Fund (permanent fund), which was created in 1999 along with the Tobacco Settlement Program Fund (program fund) and other statutes addressing the use and management of the revenues from the payments.

While the MSA does not prescribe or restrict the use of settlement funds, the legislature imposed a broadly worded statutory limit that directs these funds to "health and educational purposes". Each annual payment is deposited into the permanent fund, and then one-half is distributed to the program fund to be appropriated for health and educational purposes. The settlement funds have been used primarily for public health programs, research and teaching at the University of New Mexico (UNM) Health Sciences Center (HSC) and tobacco use prevention and cessation programs. In 2014, some of the settlement money went to the Children, Youth and Families Department for early childhood care and education programs, and some was used for legislative lottery tuition scholarships.

Because the permanent fund is also designated as a reserve fund, the money in it may be used to avoid unconstitutional deficit spending if the balance in the General Fund is not sufficient to meet appropriations authorized for a given fiscal year. The permanent fund has been used in this manner for seven of the past 10 fiscal years, including the current fiscal year.

Post-Session Update: Tobacco Settlement Permanent and Program Funds

Ruby Ann Esquibel, principal fiscal analyst, Legislative Finance Committee (LFC), gave a presentation on revenue to and appropriations from the permanent fund and the program fund in the past three fiscal years.

Senate Bill 154 from the 2017 regular session, which was passed by both chambers and signed into law, appropriated the entire fiscal year (FY) 2018 tobacco settlement payment to the program fund instead of retaining one-half of the payment in the permanent fund. The ending balance of the permanent fund for FY 2018 is projected to be \$12 million, down from more than \$110 million two years earlier.

Total program fund appropriations for FY 2018 are \$39 million, an increase of \$2 million over FY 2017. Medicaid was the single largest recipient of tobacco settlement money, receiving

a total of \$29.3 million, including the entire \$2 million increase. Other entities that receive program fund appropriations are:

- the Indian Affairs Department, for tobacco use prevention and cessation programs;
- the Department of Health, for tobacco use prevention and cessation programs; diabetes prevention and control; human immunodeficiency virus and acquired immune deficiency syndrome, or HIV/AIDS, services; and breast and cervical cancer screening; and
- the UNM HSC, for instruction and general purposes; genomics and environmental health research; the New Mexico Poison and Drug Information Center; pediatric oncology; trauma specialty education; and pediatric specialty education.

On questioning, Ms. Esquibel and committee members addressed the following topics. They were joined by David Abbey, director, LFC, and Dawn Iglesias, economist, LFC, both of whom spoke from the audience on invitation of the chair.

Permanent fund. The balance in the permanent fund was more than \$200 million four years ago, but the fund was swept in FY 2016 and legislation is in place to allow it to be swept again in FY 2017 and FY 2018 if necessary. While its status as a reserve fund means it is available for use to avoid deficit spending, it is considered a "fund of last resort". The current positive revenue outlook might mean there will be no need to use the permanent fund to shore up the General Fund in FY 2017 or FY 2018. An updated revenue projection will be released in August.

FY 2017 MSA payments. The \$15 million increase in the settlement payment in FY 2017 over FY 2016 is due to additional money the state received as a result of a court decision on a challenge of an arbitration decision regarding the amount of the 2003 payment.

Update on MSA Litigation

Ari Biernoff, assistant attorney general, gave a review and update on litigation since the MSA went into effect.

Mr. Biernoff explained that the PMs are the largest tobacco companies in the country, but there are smaller tobacco companies that do not participate in the settlement. These companies are referred to as "nonparticipating manufacturers" (NPMs).

The PMs were concerned that, because of the payments they had to make to the settling states, the NPMs would gain an unfair advantage in sales, leading to an increased market share for the NPMs and therefore a loss of market share to the PMs, as an unintended result of the settlement. To address that, the MSA provided that the annual payment amounts to a state could be reduced if it could be shown that the PMs had lost market share to NPMs as a result of the settlement. These payment reductions are called "NPM adjustments".

The MSA also allowed states to avoid NPM adjustments by passing model escrow statutes that require NPMs operating in the settling states to either join the MSA and comply with its terms or establish an escrow account and make regular payments into that account, and by diligently enforcing the escrow legislation.

The legislature enacted the model escrow statutes at the same time that it created the permanent fund and program fund. NPMs must make annual payments into escrow accounts in perpetuity; the payments for a given year will be returned to those NPMs after 25 years if no judgments are made against them in that time period.

The annual calculation of the settlement payment to be made by each PM and the amount to be received by each settling state, including any NPM adjustments, is very complex, and the parties can dispute the calculations, as well as whether the state has diligently enforced the escrow statutes. Those types of dispute are resolved by arbitration, and the arbitration decisions may be challenged in state court.

In connection with the 2003 payment to the states, the PMs disputed whether New Mexico and all of the other MSA states had diligently enforced their escrow statutes. New Mexico participated in an arbitration hearing to resolve that issue, a process that took many years. The PMs also challenged the state's recordkeeping regarding NPMs. In 2013, the arbitration panel issued a ruling against New Mexico. The state appealed the ruling in district court. The district court did not entirely reverse the arbitration panel's decision but ruled that the arbitrators had overstepped their authority by using their own formula for determining by how much New Mexico's payment should have been reduced, rather than applying the MSA. As a result of the district court's order, New Mexico received a one-time \$14.5 million payment in FY 2017 in addition to the state's annual MSA payment. The state has improved its sales recordkeeping since the issue was first raised.

The PMs notified the states that they intend to challenge the enforcement of the escrow statutes every year, including the 2004 payment. Some other states have entered into a "term sheet" agreement with the PMs to resolve their dispute for a fixed number of years in exchange for adopting significantly more burdensome enforcement obligations. Some of the remaining states voluntarily entered into a multiparty arbitration with the PMs to resolve that dispute, which is presently active. In the view of the Office of the Attorney General, New Mexico is entitled to a stand-alone arbitration and should not be required to resolve its dispute with the PMs in the multiparty arbitration. That matter is presently before the New Mexico Court of Appeals.

Arbitration is conducted by an arbitration panel. Under the MSA, an arbitration panel must consist of one member chosen by "each of the two sides" and a third member chosen by the other arbitrators. The panel considering the 2004 multiparty dispute includes four members, two of whom were chosen by the tobacco companies. New Mexico has appealed the membership of this panel as being contrary to the terms of the MSA and giving an unfair advantage to the companies. The 2004 matter is still in process and probably will not be resolved until after the

state receives its April 2018 settlement payment. The 2018 payment should be intact because adjudication of the 2004 dispute will not be completed by then; if the state loses and is required to absorb an NPM adjustment for 2004, that deduction will be reflected in the payment cycle immediately following that decision.

On questioning, Mr. Biernoff and committee members addressed the following topics.

Cigarette sales on tribal lands. Responding to a committee member's question, Mr. Biernoff said that tobacco companies have argued that cigarette sales on tribal lands should be included in the enforcement of the escrow statutes. New Mexico's position is that it is not obligated to regulate sales on tribal lands because the MSA only requires escrow deposits for sales subject to state excise tax, and, under New Mexico law, tribal sales are not subject to state excise tax.

Arbitration proceedings and costs. Mr. Biernoff related that while there is a three-person team within the Office of the Attorney General assigned to represent the state in all MSA litigation and arbitration, those staff also work on other matters. There is no provision in the MSA for the prevailing party to recover arbitration and litigation costs, so states shoulder those costs themselves. In addition to the salaries of tobacco project team members, states must pay for expert witnesses and contract attorneys when necessary. The Office of the Attorney General includes the cost of the tobacco project team in its budget, and its members are not solely engaged in tobacco settlement litigation. He noted that tobacco companies are in a much better position to bear the cost of drawn-out arbitration and litigation proceedings than the states and have, in some cases, made frivolous arguments against states in an effort to exhaust states' resources.

Appeals of arbitration decisions. Mr. Biernoff explained that the MSA vests jurisdiction over enforcement of the MSA, including review of arbitration decisions, in the state court systems. A state supreme court decision may be appealed to the U.S. Supreme Court. Four of the six states to receive an adverse arbitration decision in 2013 regarding NPMs were successful on appeal to state courts and recovered some of the MSA payments they lost through that ruling. The successful appeals came from New Mexico, Maryland, Pennsylvania and Missouri. Two other states that received adverse decisions from the 2003 panel, Kentucky and Indiana, have since joined some other states in a term sheet agreement resolving the NPM adjustment dispute for a limited period of time in exchange for heightened regulation of the NPM market from those states. New Mexico, Missouri, Pennsylvania and Maryland have recovered significant additional revenue on appeals. The U.S. Supreme Court, without stating its reasons, declined to hear appeals by the PMs of the Maryland and Pennsylvania state court decisions in those states' favor. A committee member commented that the companies have a lot more money than the states to fund litigation, and all they need is one win in the U.S. Supreme Court to get a precedential ruling that will favor them in future litigation. The member observed that the makeup of the court has changed since it declined to review the Maryland and Pennsylvania decisions.

Tobacco-related health costs. A member commented that a recent estimate puts New Mexico's annual cost for tobacco-related health issues and treatment at \$850 million, and the annual payment comes nowhere near this amount. A member observed that the litigation leading to the MSA was based on health care impacts resulting from the use of the tobacco companies' products, the companies' denial of causation and the deceptive claims that companies were making in their advertising and commented that other industries such as the cannabis industry can learn from the tobacco companies' experience in this regard.

Mr. Biernoff said he will provide:

(1) five years of data on the Office of the Attorney General's expenses for and time spent on litigation related to the MSA; and

(2) an estimate of how much money is at stake in the 2004 arbitration proceedings.

Review and Adoption of 2017 Interim Work Plan and Meeting Schedule

Ms. Ludi presented a proposed work plan and meeting schedule for the 2017 interim, which may be found in the meeting folder.

In discussion, members noted the importance of the committee's oversight work, even in years of scarce money.

The members agreed:

(1) to change the meeting proposed for Monday, August 21, to Tuesday, September 5;
and

(2) that one meeting would be in Albuquerque at the UNM Comprehensive Cancer Center and that the other would be at a cancer center in Gallup if possible or alternatively in Santa Fe at the State Capitol.

On a motion duly made, seconded and unanimously adopted, the committee approved the proposed work plan and meeting schedule.

Adjournment

There being no further business before the committee, the first meeting of the TSROC for the 2017 interim adjourned at 3:10 p.m.