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

May 29, 2018
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 May 29, 2018 at 9:43 a.m. in Room 311 of the State Capitol in Santa Fe.

Present	**Absent**
Sen. Cisco McSorley, Co-Chair	Rep. Monica Youngblood
Rep. Elizabeth "Liz" Thomson, Co-Chair	
Rep. Joanne J. Ferrary	
Sen. Sander Rue	
Sen. John Arthur Smith	

Advisory Members	
Sen. Candace Gould	Rep. Gail Chasey
	Sen. Linda M. Lopez
	Sen. Mary Kay Papen
	Rep. Jim R. Trujillo

Guest Legislator
Sen. Nancy Rodriguez

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 website and in the meeting file.

Tuesday, May 29

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 brought against five major tobacco companies for, among other things, concealing the detrimental health effects of tobacco use. The states successfully argued that the companies should share the burden of treating diseases and conditions related to using the tobacco companies' products. The resulting MSA requires that the tobacco companies — referred to in the settlement as "participating manufacturers" or PMs — cease all deceptive marketing of cigarettes, especially to children, and make compensatory payments to the states in perpetuity. In return, the states gave up the right to make future claims against the PMs for the same behaviors that led to the lawsuit.

Under the MSA, New Mexico receives an annual settlement payment — generally between $30 million and $40 million — from the PMs based on their revenue from cigarette sales in the previous year and the state's population. This payment is deposited into the Tobacco Settlement Permanent Fund (permanent fund), with one-half of the payment further transferred to the Tobacco Settlement Program Fund (program fund) for expenditure. The permanent fund, however, was also designated as a "reserve" fund, which allows the legislature to make transfers from the fund to the General Fund when necessary to avoid unconstitutional deficit spending. In 2015 and 2016, the permanent fund was used for this purpose.

While the MSA does not prescribe or limit the use of the settlement funds, the legislature enacted statutes to limit their use to "health and educational purposes". The funds are primarily used for public health programs; research and teaching at the University of New Mexico (UNM) Health Sciences Center; supporting public health programs; and various tobacco use prevention and cessation programs. In 2014, some of the settlement money was used for early childhood care and education programs administered by the Children, Youth and Families Department, and some was used for legislative lottery scholarships. For the last few years, the bulk of the tobacco settlement funds have been used for the Medicaid program.

The PMs were the largest tobacco companies in the country, but there are smaller tobacco companies that did not participate in the lawsuit or the settlement. These companies are referred to as "nonparticipating manufacturers", or 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 compensate for 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 allowed a state to avoid NPM adjustments by passing model escrow statutes that require NPMs operating in the state to either join the MSA and comply with its terms or to establish an escrow account and make regular payments into that account. An NPM that does not join the MSA must make annual payments into escrow accounts in perpetuity. The payments for a given year will be returned to the NPM after 25 years if no judgments are made against the NPM in that time period.

The New Mexico Legislature enacted the model escrow statutes that would allow it to avoid NPM adjustments (Sections 6-4-12 and 6-4-13 NMSA 1978) along with the permanent fund and program fund statutes, in the 1999 legislative session after the MSA was signed in November 1998. In 2003, the complementary Tobacco Escrow Fund Act (Sections 6-4-14 through 6-14-24 NMSA 1978) was enacted. As a result, New Mexico immediately met the first requirement for avoiding NPM adjustments.

States must also "diligently" enforce the escrow legislation by keeping complete and accurate records of NPMs operating in the state and making sure that an NPM either joins the MSA or makes escrow payments.

The MSA allows PMs to challenge the required annual payments and seek to have them reduced. Payment disputes are settled through arbitration, with appeals to those decisions heard in court. The first payment challenge brought by the PMs against New Mexico concerned the 2003 settlement payment and the state's "diligent enforcement" of its escrow statutes as required under the MSA. The challenge was filed in 2009, and New Mexico has been involved in arbitration and litigation with the PMs ever since. The PMs have declared that they intend to challenge the enforcement of the escrow statutes in every year.

Post-Session Update: Tobacco Settlement Permanent and Program Funds

RubyAnn Esquibel, principal fiscal analyst, Legislative Finance Committee, gave a summary of appropriations made in the General Appropriation Act of 2018 from tobacco settlement funds. In addition to the Human Services Department, which administers the Medicaid program, entities that received appropriations include:

- 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 Health Sciences Center, for instruction and general purposes; genomics and environmental health research; the poison control center; pediatric oncology; trauma specialty education; and pediatric specialty education.

New Mexico's tobacco settlement payment for fiscal year (FY) 2018 totaled $35.7 million. Because this payment was $3.3 million less than had been projected, all of the programs that receive funding saw their allotments proportionally adjusted, with the exception of the Medicaid program, which absorbed most of the overall reduction. In making the adjustments, the

Department of Finance and Administration gave the receiving entities leeway in how to apply the reductions.

State revenues were robust enough leading into the 2018 legislative session that the legislature did not need to dip into the permanent fund to avoid deficit spending in the FY 2019 budget. The current permanent fund balance is approximately $184.5 million.

On questioning, Ms. Esquibel and committee members addressed the following topics.

Program allotment reductions. Because the reduced FY 2018 tobacco settlement payment arrived in April, cuts to program spending must be absorbed entirely from program budgets for the last two months of the fiscal year. Programs cannot spend at a deficit and may have to reduce program functions. If an administering agency has other funds available, it might submit a budget adjustment request to cover program costs.

Permanent fund. Since 2009, $384 million has been taken from the permanent fund. A member spoke in favor of dedicating some of the state's revenue from the oil and gas industry to rebuilding the fund and eliminating statutory language that allows the fund to be used as a reserve fund so that it will be a true permanent fund.

Update on MSA Litigation

Ari Biernoff, assistant attorney general, Attorney General's Office (AGO), gave an update on the state's efforts to comply with the MSA and litigation to recover the money to which the state is entitled.

The MSA requirement for diligent enforcement includes not only ensuring that NPMs make escrow deposits, but also making sure that cigarettes sold in New Mexico bear appropriate tax or tax-exempt stamps. Through this effort, the AGO follows through on the state's diligent enforcement obligations while the Taxation and Revenue Department collects taxes due to the state. One joint action under way concerns a cigarette seller in Las Cruces that has been selling unstamped cigarettes.

In addition to its enforcement duties, the AGO is engaged in ongoing arbitration and litigation concerning the tobacco settlement payments made to the state. Last year, New Mexico received a one-time payment adjustment of approximately $14.5 million following settlement of a dispute initially filed in 2009. The membership of the arbitration panel has recently been revised; while it previously consisted of one member chosen by the tobacco companies, one chosen by the states and one chosen by the two other panelists, it now includes two members chosen by the tobacco companies. New Mexico disputed this change; after losing in district court, the state filed an appeal and the court issued a stay. Mr. Biernoff noted that the matter may not be decided for a few years.

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

Arbitration and litigation. In the single arbitration cycle that has been completed, New Mexico incurred costs of contracting with an economist and a tribal law expert, transaction costs, travel costs and lost-opportunity costs. The MSA does not provide for states or tobacco companies to recover their costs in arbitration and litigation.

Diligent enforcement. Based on their assertion that all states have failed in their duty to diligently enforce the MSA's escrow requirements, tobacco companies have begun to withhold approximately 10 percent of the payments to the states. If payments that are withheld by the tobacco companies are later found to be due to the states, the companies must pay interest on the withheld amounts.

New York signed an agreement for a permanent reduction of approximately 11 percent in exchange for not having to engage in future arbitration or litigation on the matter of escrow payment enforcement. In another, less beneficial, settlement, approximately 30 states signed a settlement that provides a claims split between the states and the tobacco companies; unlike New York's settlement, this "term sheet" settlement does not provide the states with immunity from further arbitration or litigation. New Mexico is not a party to the term sheet settlement.

It is possible that the U.S. tobacco companies will assert that states must enforce the MSA's escrow payment obligations, not only on domestic tobacco manufacturers but on overseas manufacturers as well, which would be very costly for the states.

Tribal cigarette sales currently do not trigger the requirement for escrow payments; however, tobacco companies contend that such sales do require escrow payments.

Tobacco sales at military commissaries. Tobacco sales at military commissaries are tax exempt.

Permanent fund. The permanent fund is invested through the State Investment Council. The fund is also used to calculate the state's reserve percentage.

E-cigarettes. E-cigarettes are not covered by the MSA because of the agreement's definition of "cigarette"; nor are they regulated or subject to any excise tax. The major tobacco companies have invested heavily in the e-cigarette, or "vaping", industry and own the majority of the market share in the U.S. Vaping liquids are manufactured overseas, and their contents, including nicotine content, are not verified.

One study shows that 24 percent of American youth use e-cigarettes. The governor vetoed a bill that would have increased the age for purchasing e-cigarettes to 21.

Mr. Biernoff will provide:

(1) information on the volume and percentage of tobacco sales in New Mexico that are attributable to overseas tobacco companies; and
(2) the percentage of the e-cigarette industry that is owned by the PMs.

Ms. Esquibel will provide information at a future date on how the permanent fund is invested.

Review and Adoption of 2018 Interim Work Plan and Meeting Schedule

Ms. Ludi presented a work plan and schedule for the committee's interim work. In discussion, members requested that the following be included in the plan:

(1) a focus on e-cigarettes, with information on what other states are doing on the matter;
(2) a presentation on federal changes regarding nicotine and its recent designation as a narcotic, which qualifies it for federal regulation; and
(3) legislation to change the permanent fund so it cannot be used as a reserve fund.

Members discussed the need to protect the programs that rely on tobacco settlement funding.

Adjournment

There being no further business before the committee, the first meeting of the TSROC for the 2018 interim adjourned at 11:43 a.m.