

MINUTES
of the
TOBACCO SETTLEMENT REVENUE OVERSIGHT COMMITTEE
October 6, 2006
Santa Fe

The third meeting of the Tobacco Settlement Revenue Oversight Committee (TSROC) was called to order on October 6, 2006 at 9:00 a.m. in Room 311, State Capitol, by Representative Gail Chasey, co-chair.

Present

Rep. Gail Chasey, co-chair
Sen. Mary Jane M. Garcia, co-chair
Rep. Danice Picraux
Sen. John C. Ryan
Rep. Gloria C. Vaughn

Absent

Sen. John T.L. Grubestic

Advisory Members

Sen. Rod Adair
Sen. Joseph J. Carraro
Sen. Dede Feldman
Sen. Linda M. Lopez

Rep. Ray Begaye
Sen. James G. Taylor
Rep. Teresa A. Zanetti

Staff

Ramona Schmidt
Cristina Martinez

Friday, October 6

Representative Chasey welcomed all attendees to the TSROC meeting and asked the members of the committee and support staff to introduce themselves.

Tobacco Settlement Agreement Update

David Thomson, assistant attorney general, and Claudia Ravanelli, chief paralegal, presented a brief summary on the fiscal year funding. Mr. Thomson stated that in 2005, through enforcement under the Master Settlement Agreement (MSA), there were seven manufacturers that were noncompliant and notified by letter to be brought into compliance. As a result, ZigZag has escrowed an additional \$49,000 and it is continuing to pursue outliers. He noted the Attorney General's Office has been working with the Taxation and Revenue Department (TRD) staff closely to continue to meet the due diligence requirements by the state under the MSA. The Attorney General's Office appreciates the funding for a designated attorney to handle the reporting requirements laid out in the MSA and suggested that designation of an identified person in TRD to handle the MSA due diligence requirements would be highly advisable to ensure compliance.

Mr. Thomson stated that while the Attorney General's Office is unable to track foreign companies, it is now able to identify the distributor in the state to enforce compliance. He noted the tobacco industry is attempting to force states into arbitration as to whether the MSA is a significant factor in market loss and whether each participating state is compliant in its due diligence requirements. Mr. Thomson stated there continues to be ongoing conversation regarding this issue and growing frustration with regard to the way the MSA is operating.

In response to a question involving an additional \$6.4 million being paid to New Mexico in April/May 2006 for this fiscal year, Mr. Thomson stated he had not seen a letter involving notification of payment of an award for the state of New Mexico's effort in suing tobacco manufacturers resulting in the MSA but will work with committee staff to clarify this additional revenue. He reminded committee members that in 1997, when the state engaged the industry in litigation and was awarded about \$85 million over 10 years, the amount continues to be subject to adjustments.

Mr. Thomson stated there are continued conversations regarding behavioral issues within the industry and he will notify the committee if and when this is addressed. He does not think the dispute over the MSA will continue year after year, as the legal issues will be decided as to what the state's obligations are under diligent enforcement and what the deciding factors are. He noted it is costly for both the manufacturers and the states to address these issues.

Committee issues raised included how to track all the different types of cigarettes on the market, the fluidity of the industry, the importance of tracking through TRD, MSA requirements and how other states use the MSA revenue. It was noted the MSA does provide certain restrictions on what the funds can be spent on, but it is the legislature of each state that sets the policy. Clarification was made that New Mexico statute addresses how the revenue should be spent and that the settlement amounts are tied to domestic revenues, which are declining, and not international revenues, which are increasing. Mr. Thomson stated that another wrinkle may be tribal and internet sales and the Attorney General's Office continues to work on national attorney generals to address the possible impact.

Tobacco Permanent Fund Investment/Balance

Bob Jacksha, State Investment Council, stated the Tobacco Permanent Fund has grown through contributions and investment returns. He reviewed the historical allocations, total fund benchmarks and portfolio returns and risks. He stated an initial deposit of \$49 million was made to create this fund in May 2000. Mr. Jacksha clarified that there are funds the Tobacco Settlement Permanent Fund cannot participate in due to their being too small. He noted the Tobacco Permanent Fund is invested the same as other funds with investments in all pools.

Tobacco Settlement Revenue Estimates — Update on Tobacco Permanent Fund

Laird Graeser, Department of Finance and Administration, noted the incidence of lowering smoking is not just a national issue but is international as well. Mr. Graeser informed the committee that as a result of information presented during the previous presentations, he will need to revise the figures. He noted to date the state has received \$284 million, which is part of an estimated \$1.25 billion to be received by the year 2025. He stated the revenue for FY07 is flat

due in part to the previous sequestration. Mr. Graeser noted that for the purpose of this presentation, he used an adjustment of -2.6 percent.

Committee discussion occurred on the impact of the number of cigarettes sold in Indian smoke shops and the market share and volume adjustment.

MSA and Tobacco Control Program Funding National Overview

Eric Lindblom, assistant general counsel, director of policy research, The Campaign for Tobacco-Free Kids, spoke on the original reason for the MSA. He noted it is a contract between the states and the tobacco companies and the enforcement of the MSA can only be addressed between those entities. Mr. Lindblom stated that New Mexico is doing better than the average state in the money received. He reviewed information on tobacco money in New Mexico, which includes total state tobacco revenue, Centers for Disease Control and Prevention (CDC) minimum prevention spending, actual state tobacco prevention spending, tobacco company marketing- and smoking-caused direct costs, and noted that there are related indirect costs not tracked. Mr. Lindblom noted while the state is improving smoking prevention spending, the tobacco industry is increasing its marketing expenditures.

He stated that the CDC reviews the most cost-effective manner to address smoking prevention, including oversight and the amount spent to be cost-effective and have measurable results. He noted that it is important to have sustained funding and gave the state of Massachusetts as an example of a state that did not sustain and has seen an increase in smoking. He stated that conservatively speaking, if New Mexico invests in CDC recommendations, the state could see about a one percent decline average in smoking.

Committee discussion included limiting tobacco industry marketing expenditures, the rise of small manufacturers and the difficulty addressing regulatory issues with the increase in manufacturers. Mr. Lindblom will provide information to the committee on CDC recommendations for what should be spent for varying programs. He made suggestions of various legal approaches to encourage tobacco manufacturers to honor the MSA and noted the national attorney generals have not come out as a national organization to seek legal action other than the current arbitration. He stated he is unaware of any provision in the MSA limiting legal action.

In response to a question as to whether, comparatively speaking, if raising the price or tax of cigarettes or spending more on prevention has more impact on consumption, Mr. Lindblom stated that if the tax is raised and money is spent on prevention, the most impact occurs, and evidence of doing both gives a synergistic impact. The point was made that if cigarette taxes are raised, it is only fair to adequately fund tobacco cessation assistance. Mr. Lindblom stated that to have impact, an increase in tax needs to be large enough and \$.50 is a good amount to raise a tax. It was noted that the difficulty in tracking youth smoking is that high school students are counted, but dropouts are not, and there is a higher percentage of high school dropouts who smoke.

Lovelace Respiratory Research Institute (LRRRI)/University of New Mexico (UNM) Funding Issue Update

Arly Williams, Legislative Finance Committee, shared the history of the funding request by UNM and the result of the recommended \$1 million appropriated annually to LRRRI through UNM being moved out of the line item for research and placed into ING for UNM by the Senate Finance Committee. Ms. Williams did not have further information as to a possible supplemental appropriation being made to LRRRI during the current fiscal year and no further information has been received from Representative Varela regarding the funding issue.

Implementation of House Bill 617 (Cigarette Tax Bill) and Related Issues

Libby Gonzales and Linda Palmer, TRD, presented before the committee summarizing HB 617, passed during the past session, which introduced sweeping changes.

Ms. Gonzales reviewed changes and implementation concerning Cigarette Tax Act definitions, requirements for affixing stamps, licensing requirements, retail sales of cigarettes, record retention requirements, shipment of unstamped cigarettes in New Mexico, new reporting requirements, tax exemption provisions, intergovernmental agreements and civil penalties. She shared the status and description of proposed regulations and stated a proposed regulation hearing was held on August 31, 2006. She noted a number of industry and tribal representatives were present and provided written and oral comments on the proposal. Ms. Gonzales stated Secretary of Taxation and Revenue Goodwin is considering these comments and plans to file regulations by the end of the year.

TRD is in the process of developing legislative proposals to clarify some of the changes that were made in HB 617, which include the definition of cigar, exemption for sales by Indian entities, stamping and packaging requirements, labeling/contraband requirements, redemption of unstamped cigarettes protest procedures and application of fraud penalties. Ms. Gonzales stated there was concern raised during a presentation before the Revenue Stabilization and Tax Policy Committee regarding the 20-stick stamp being used on packages with small cigars with fewer than 20.

Discussion occurred as to the change involving tracking of cigarettes sold on and off reservation and the penalties in place for offenses. Representative Chasey stated that if TRD would like to have endorsement by the TSROC on the proposed bill amending HB 617, committee staff could work with TRD staff to draft legislation.

Bob Barberousse raised concern with some technical problems involved with the definition of small cigars involving the cigar being wrapped in 100 percent tobacco and suggested adopting the cigarette definition language in the MSA.

Detection of Lung Cancer Testing

John Cousins, president, Biomoda, Inc., thanked the committee for the opportunity to share his progress and the possible impact of his work on cancer treatment, particularly early lung cancer detection and treatment. He requested that the committee consider funding a clinical study in cooperation with the Veterans' Administration to help New Mexico veterans and others

afflicted by lung cancer to detect their disease at its early stages when survival rates are significantly improved. He reviewed the procedures used in the test. Mr. Cousins stated the Mayo Clinic in Rochester, Minnesota, has agreed to jointly conduct a study to validate its internal results and the study is ongoing with the first phase of results expected later this year. Mr. Cousins said it is his intent to conduct a long-term clinical study with the Veterans' Administration that would provide at least 2,600 veterans with screening and subsequent treatment if cancer is found. He stated it is his intent to conduct this study in New Mexico as well as to keep Biomoda in New Mexico. Mr. Cousins invited committee members to visit Biomoda's lab in Albuquerque.

Committee discussion included what federal participation might be involved, the technologies involved, the possibility of partnership with other similar entities, various avenues of funding and who would be a candidate for the test.

It was recommended that Mr. Cousins speak with the secretaries from the Human Services Department, the Veterans' Services Department and the Economic Development Department as to what would be the appropriate fiscal agent for funding.

Smokeless Tobacco Discussion

A panel discussion occurred addressing smokeless tobacco. Phillip Larragoite gave a history on the taxation on "moist" tobacco. Jim O'Neill, representing United States Tobacco (UST), reviewed HB 673, which was introduced last year by Speaker Lujan. Eric Donaldson, UST representative, stated the differences among the three tobacco products UST produces are based on size. Mr. O'Neill stated UST is looking at changing the current taxation on "moist" tobacco, which is currently paid by the first purchaser, to a weight-based tax. He noted that if a weight-based tax is implemented, the tobacco revenue estimates would increase.

The committee clarified that UST is attempting to increase profits and the committee is trying to stop the use of tobacco products. Mr. Donaldson stated that UST is trying to create equity to make a level playing field.

Nathan Bush, government relations director, American Cancer Society, offered policy options for the committee based on public health issues. He reviewed why UST would want to change New Mexico's tax code on spit tobacco. He shared some business opportunism at the expense of public health driven by issues such as smokefree environment laws and maintaining nicotine-dependent user markets, which is in contrast to the public health community wanting to help users successfully quit tobacco altogether. Mr. Bush stated that most of New Mexico's neighbors have resisted this change. He said the strongest concern is that youth strongly prefer UST products and reducing UST's taxes makes UST products more accessible. Mr. Bush related the taxation of smokeless tobacco products to current taxation on beer, wine and spirits, which are all taxed differently, assumptively based on higher alcohol content. He noted that the largest tobacco companies, R. J. Reynolds and Philip Morris, have come out with new smokeless tobacco product lines.

Discussion occurred on the concern with increase in the use of smokeless tobacco. Mr. Bush encouraged the committee to look at model legislation to make competition in the smokeless tobacco market more equitable. He reviewed three options: (1) expanding the statutory definitions of smokeless tobacco to make sure they reach all of the new and experimental smokeless products being introduced to the market, including many via the internet; (2) encouraging all other smokeless tobacco companies to sign on so that they will be subject to the same marketing restrictions and other provisions as UST is; and (3) in an effort to assist people trying to quit, increasing and protecting state tobacco tax revenues over time and reducing state harms and cost. Mr. Lindblom reminded the committee that with weight-based tax, the weight can be manipulated through different products.

Smokefree Environment Discussion

A video on secondhand smoke was viewed by committee members.

Representative Al Park and Steve Brockett, Alamogordo city commissioner, presented before the committee on the smokefree environment. Representative Park addressed policy changes since 2005 and stated he will introduce legislation in the upcoming session that would include bars being required as smoke-free environments. Commissioner Brockett was welcomed by the committee. He stated he was elected to the city commission this past year and has been in the restaurant business for many years. He noted that, until 2004, his restaurant had allowed smoking but had changed to a nonsmoking environment in January 2005. He noted that this change resulted in a 17 percent increase in sales and the benefits felt from turning into a nonsmoking environment included the ability to pay staff more due to the increase in sales and have a cleaner environment.

Representative Park stated that places that have instituted a smoking ban have seen an increase in sales and he is unaware of any business closing due to the ban. Mr. Bush stated that when Roswell revenues were reviewed after the enactment of a smoking ban in public spaces, the revenues had increased despite the complete ban. It was noted the nonsmoking ban is the trend and states all around New Mexico are passing smoking bans.

Committee discussion included whether the arguments in the past against the nonsmoking ban are still relevant, including: a business owner's right versus the right of the individual employee or patron, the effect secondhand smoke has on health, property rights versus health rights and if cigar bars are under different recommendations.

Representative Picraux moved that Representative Park's bill be endorsed in concept, seconded and adopted. Mr. Lindblom clarified the difference between cigars and what is defined as a small cigar is based on weight.

Public Comment

Cynthia Serna stated that the smokefree environment is the most significant issue and she stood in support of Representative Park's concept for legislation. Mr. Lindblom shared a few other ideas that might fit in the cigarette tax bill discussed earlier. He stated that California has implemented a higher tax stamp and, along with enforcement, cigarette revenues went up \$120

million by stopping counterfeit tax stamps. Mr. Lindblom said there is even higher technology available and will provide a fact sheet for the committee's review. He noted a simple measure, when changing enforcement statutes as to the collection of fines obtained by agencies or offices, to distribute half to general revenues and the other half back to those agencies or offices that did the enforcement, which resulted in the penalty.

Committee Discussion on FY08 Program Funding Recommendations

Ms. Schmidt reviewed the FY07 recommendations and proposed recommendations for FY08. Committee members discussed the need for further information before making final recommendations, including proposed Biomoda funding and clarification of LRRI/UNM funding. The committee members recommended that an additional TSROC meeting be requested and that a subcommittee meet composed of Senator Ryan, Senator Carraro and chaired by Representative Picraux to review and bring recommendations back before the committee regarding the two issues.

A motion was made to approve the minutes from the September 8, 2006 meeting, as amended. The motion was seconded and the minutes were adopted, as amended.

Having no further business, the committee adjourned at 4:50 p.m.

Materials distributed at the meeting are in the meeting file in the Legislative Council Service Library.