

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

**June 23, 2011
Room 311, State Capitol
Santa Fe**

The first meeting of the Tobacco Settlement Revenue Oversight Committee (TSROC) was called to order by Representative Gail Chasey, co-chair, on June 23, 2011 at 10:20 a.m. in Room 311 of the State Capitol in Santa Fe. The co-chair announced that the meeting was being webcast.

Present

Rep. Gail Chasey, Co-Chair
Sen. Mary Jane M. Garcia, Co-Chair
Sen. Dede Feldman
Rep. Jim W. Hall
Rep. Danice Picraux

Absent

Sen. John C. Ryan

Advisory Members

Sen. Sue Wilson Beffort
Sen. Linda M. Lopez
Sen. Mary Kay Papen

Rep. Ray Begaye

Staff

Alise Rudio
Roxanne Knight
Zelda Abeita

Guests

The guest list is in the meeting file.

Handouts

Handouts are in the meeting file.

Thursday, June 23

Introductions

By suggestion of Representative Chasey, members of the committee, staff and audience introduced themselves.

Interim Committee Protocols

Doris Faust, assistant director for drafting services, Legislative Council Service (LCS), briefed the committee on interim committee protocols and said that, due to budget constraints, the New Mexico Legislative Council requested interim committees to keep the number of meetings the same as in 2010.

2011 Committee-Related Legislation and Fiscal Year 2011 Funding Levels

Ms. Rudio, staff attorney, LCS, provided a summary of legislation enacted since the committee last met in 2010. During the regular session, the legislature enacted House Bill 79 (Laws 2011, Chapter 3), which provides that, for fiscal years 2012 and 2013, 100 percent of the tobacco settlement payments into the Tobacco Settlement Permanent Fund be distributed to the Tobacco Settlement Program Fund for appropriations to state agencies and higher education institutions. Normally, only 50 percent of the payments are distributed to the program fund, with the remaining 50 percent going into the permanent fund. This will be the fourth fiscal year in a row that payments will be diverted from the permanent fund. The additional 50 percent (estimated at \$19.8 million) was appropriated to the Human Services Department (HSD) for Medicaid programs in the General Appropriation Act of 2011.

The legislature also enacted House Bill 52 (Laws 2011, Chapter 167), which changes the standard for investment for the Tobacco Settlement Permanent Fund to that "in accordance with limitations in Article 12, Section 7 of the constitution of New Mexico". This change requires that the permanent fund be invested with the same statutory limitations that currently exist on the investment of the land grant permanent funds under the Uniform Prudent Investor Act, but it does not require the Tobacco Settlement Permanent Fund to be invested in a mirror image of the land grant permanent funds. The change in investment standards may result in more conservative investments because certain types of long-term investments, such as private equity, hedge funds or real estate, may not be prudent for the Tobacco Settlement Permanent Fund, which is a reserve fund and is smaller than the land grant permanent funds.

Ms. Rudio told the committee that the appropriations made in the General Appropriation Act of 2011 for fiscal year 2012 from the Tobacco Settlement Program Fund would be presented later in a spreadsheet. The General Appropriation Act of 2011 also includes an appropriation of \$300,000 to the legal services program of the attorney general for tobacco litigation and arbitration costs. In addition, the act authorizes the legal services program of the attorney general to request budget increases up to \$150,000 for discovery costs for tobacco arbitration, provided that the revenue expended shall be solely from settlements that authorize consumer issues. This money does not come out of the Tobacco Settlement Program Fund.

In addition, Ms. Rudio informed the committee that the General Appropriation Act of 2011 contains language that authorizes a transfer of up to \$30 million during fiscal year 2012 from the Tobacco Settlement Permanent Fund to the benefit account of the Unemployment Compensation Fund, which is contingent upon certification by the secretary of workforce solutions that there will be insufficient amounts to pay benefits and that the loan can be repaid by

June 30, 2012. The transfer is also contingent on review by the Legislative Finance Committee (LFC) and approval by the State Board of Finance.

Ms. Rudio also discussed Senate Bill 397, which was vetoed by the governor. Senate Bill 397 proposed to amend the definition of "units sold" to include both "tax-exempt" and "tax-credit" stamps for the purposes of determining escrow payments of cigarette manufacturers that are not participating in the Master Settlement Agreement (MSA). The purpose of the bill was to remove ambiguity under current law about which sales are subject to escrow payment and to equalize treatment of participating and nonparticipating manufacturers. Ms. Rudio told the committee that Nan Erdman from the Attorney General's Office (AGO) would be discussing the vetoed bill during her presentation.

Ms. Rudio and Ms. Knight, researcher, LCS, provided the committee with a spreadsheet showing the appropriations made for fiscal year 2012 from the Tobacco Settlement Program Fund. All of the appropriations in fiscal year 2012 are lower than the committee's recommendations, and lower than the appropriations for fiscal year 2011, except for the appropriations to the HSD for Medicaid.

The total amount appropriated for recurring programs for fiscal year 2012 is \$19,775,800. The discrepancy between the total amount appropriated for recurring programs and the amount recommended for appropriation by the TSROC is the balance in the program fund that was appropriated to supplement the HSD's Medicaid budget. The total solvency funding is an additional \$19,776,000, bringing the total amount appropriated from the Tobacco Settlement Program Fund to \$39,551,800.

Ms. Knight informed the committee that the Department of Finance and Administration (DFA) advised agencies in April 2011 of reduced allotments based on the 2011 actual tobacco settlement payment, which resulted in a revised operating budget for 2012. According to the revised operating budget, the final amount allocated to recurring programs is \$19,111,500, and the final amount allocated to Medicaid solvency for the HSD is \$19,453,900, bringing the total amount allocated from the Tobacco Settlement Program Fund to \$38,565,400. Ms. Knight told the committee that the spreadsheet also showed the 2012 program allocations by the University of New Mexico (UNM) Health Sciences Center. Ms. Knight explained that while the allotments for other programs funded by the Tobacco Settlement Program Fund were reduced proportionately, UNM has been allowed more flexibility in allocating its budget. Ms. Knight pointed out that numbers provided by UNM indicate that two programs, the Area Health Education Center and Los Pasos, which were both appropriated \$36,300, were allocated no money by UNM. Committee members asked Ms. Knight numerous questions about the spreadsheet and UNM's authority to reallocate money, including where the money went that was reallocated. Ms. Knight informed the committee that staff will continue to research the budget issues by consulting with the LFC, the DFA and UNM.

Committee members expressed concern about recidivism rates in cessation programs, teen smoking and the importance of ensuring that funds go to the most effective programs.

MSA and Litigation Update

—**Nan Erdman, Assistant Attorney General, AGO**

—**Claudia Ravanelli, Special Projects Coordinator, AGO**

Ms. Erdman presented a detailed summary of the history of the tobacco MSA. Ms. Erdman explained that in 1994, the states began to sue the major tobacco companies over the health care costs associated with tobacco sales. In 1998, 46 states and five territories entered into a joint settlement that resulted in the MSA. The tobacco companies that joined the MSA are called participating manufacturers (PMs). The PMs agreed to limit advertising and marketing and to make payments to the states in perpetuity commensurate with the products sold in each state to reimburse the state for the health care costs that result from the sale of tobacco products. In exchange, the states agreed to enact model legislation or a similar qualifying statute that would allow the states to charge an escrow payment from nonparticipating manufacturers (NPMs) and to enforce the statute diligently.

Ms. Erdman said that the payments to the states are about 50 cents per pack. She noted that the \$30 million to \$40 million that New Mexico receives per year in tobacco settlement payments does not account for the \$200 million or more that New Mexico incurs for the costs of health care related to smoking.

Ms. Erdman explained that a crucial part of the MSA allows for PMs to receive a refund of their payments if the state does not meet its obligations under the MSA. The PMs are entitled to an adjustment if:

- (1) the PMs lose more than two percent in market share compared to their 1998 market share;
- (2) an independent economics firm determines, in a non-appealable proceeding, that the MSA was a "significant factor" in the PMs' market share loss;
- (3) the state does not have a qualifying statute; and
- (4) the state has not diligently enforced the statute, which is measured by verifying escrow payments from the NPMs selling in the state. This NPM adjustment is directed at preventing NPMs from gaining an unfair price advantage because of the MSA.

Ms. Erdman explained that the MSA states are in arbitration over the question of diligent enforcement. As a consequence of the diligent enforcement claims, PMs are withholding a percentage of revenues and placing money into a disputed payment account. The amount in escrow for New Mexico in the disputed payment account currently is between \$10 million and \$15 million. The PMs claim that they are entitled to an adjustment of NPM for every year from 2003 to the present based on the failure of the MSA states to enforce their statutes diligently. Ms. Erdman said that the PMs have already prevailed in demonstrating that they lost market share and that the MSA was a significant factor for every year up to 2008. New Mexico now must show that it diligently enforced its statute. Ms. Erdman said that the AGO expects the 2003 arbitration to cost \$500,000 in litigation expenses. According to charts provided by the AGO, if New Mexico loses the arbitration, the state risks losing \$350 million in payments. This money

would be withheld from future payments, so the state would not receive annual tobacco settlement revenue for several years.

Ms. Erdman said that one possible change for New Mexico in the future would be to collect escrow on every cigarette sold in New Mexico. She said that Senate Bill 397 would have taken a big step toward that goal, but it was vetoed by the governor. She also discussed a potential settlement agreement that was recently reported in *The Wall Street Journal*. One element of the settlement would be to pass legislation that has similar language to Senate Bill 397. The rest of the settlement would impose stricter regulations associated with tribal sales. Failure to pass the proposed legislation or to add substantial diligent enforcement resources would result in significant reductions in MSA payments. Ms. Erdman said that the settlement agreement needs the agreement of the critical mass of states, but some states are not likely to agree. A response to the settlement proposal is due July 1, 2011.

Ms. Erdman informed the committee that the PMs are also challenging New Mexico's qualifying statute. The PMs contend that New Mexico has not had a qualifying statute since 2006. Ms. Erdman explained that New Mexico's statute, enacted as Sections 6-4-12 and 6-4-13 NMSA 1978, includes the exact language of the model statute proposed in 1998. However, the PMs are claiming that changes to the Cigarette Tax Act (Chapter 7, Article 12 NMSA 1978) made in 2006 to provide for exempt stamps had an impact on what New Mexico could collect escrow on. The AGO believes that New Mexico has a qualifying statute, but it will have to fend off the challenge. She said that New Mexico is one of only two states that the PMs claim do not have qualifying statutes. If New Mexico is found not to have a qualifying statute, the state is at much greater risk for losing its MSA payment for 2006 through the present, until the state has a full calendar year with a qualifying statute. Ms. Erdman provided the committee with charts to demonstrate the history of payments to New Mexico pursuant to the MSA (which payments amount to almost half a billion dollars since 1999), the payments at risk in arbitration, the payments at risk for failure to have a qualifying statute (about \$240 million) and the projected payments to New Mexico from 2003 through 2012 (which are zero for 2012).

Ms. Erdman discussed the importance of passing legislation similar to Senate Bill 397. She said that Senate Bill 397 would have made the possibility of any challenge to the qualifying statute unlikely to succeed and more likely that the state could prevail in NPM adjustment proceedings. She said that the bill would have clearly established the state's ability to collect escrow on all sales that have a tribal stamp, an excise stamp or an exempt stamp.

Ms. Erdman and Ms. Ravanelli briefly discussed enforcement issues and lawsuits against the state over the escrow issue.

The committee asked numerous questions about the vetoed legislation, the challenge to the qualifying statute and the amount of money at risk due to the challenge. Upon inquiry from the committee about how New Mexico's enforcement efforts compare to other states, Ms. Erdman explained that it all comes down to the definition of "units sold" in Senate Bill 397. She explained that for 2003 to the present, the PMs are contending that New Mexico should have

been collecting escrow on all tribal sales, which is 90 percent of all sales. She said that in 2009, New Mexico passed a law to collect escrow on all sales. She said that New Mexico has always done a good job of collecting escrow on excise tax cigarettes.

Ms. Erdman said that the AGO is not sure whether the provision authorizing the \$30 million transfer from the Tobacco Settlement Permanent Fund to the Unemployment Compensation Fund is constitutional and noted that a committee member could ask the attorney general for a formal opinion. Representative Picraux said that she would write a letter asking for a formal opinion.

The committee asked for an update from the AGO in October. Ms. Erdman said that Attorney General Gary King is writing an opinion piece on the vetoed legislation for *Round the Roundhouse*. The committee requested that the AGO send the article to staff for distribution to committee members.

The committee discussed the costs to the state for any health care costs resulting from smoking and noted that the American Cancer Society could provide that data at a future meeting.

2011 Interim Work Plan and Meeting Schedule Development

The committee reviewed the proposed work plan. Representative Chasey requested that an item concerning a review of how allotments are made from the Tobacco Settlement Program Fund be deleted from the 2011 proposed work plan. On a motion by Senator Garcia, seconded by Representative Hall, the committee unanimously approved the revised work plan.

The committee also discussed the possibility of changing the July meeting to the week in September following Labor Day if the special session for redistricting is not planned for that time.

Adjournment

The committee adjourned at 12:35 p.m.