

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

**June 14, 2012
Room 311, State Capitol**

The first meeting of the Tobacco Settlement Revenue Oversight Committee (TSROC) was called to order by Representative Gail Chasey, co-chair, on Thursday, June 14, 2012, at 9:46 a.m. in Room 311 of the State Capitol in Santa Fe.

Present

Rep. Gail Chasey, Co-Chair
Sen. Mary Jane M. Garcia, Co-Chair
Sen. Dede Feldman
Rep. Jim W. Hall
Sen. John C. Ryan

Absent

Rep. Danice Picraux

Advisory Members

Sen. Linda M. Lopez

Sen. Sue Wilson Beffort

Rep. Ray Begaye

Sen. Mary Kay Papen

Staff

Roxanne Knight, Legislative Council Service (LCS)
Shawn Mathis, LCS
Sean Sullivan, LCS

Guests

The guest list is in the archived meeting file.

Handouts

Copies of all handouts are in the archived meeting file.

Thursday, June 14

Introductions

Representative Chasey welcomed the committee and members of the audience to the meeting. She reviewed the webcasting announcement, informing everyone that meetings are webcast and that members and presenters need to use the microphones. The committee members and staff introduced themselves.

2012 Committee-Related Legislation and Update; Review Handouts

Ms. Knight introduced herself to the committee. She provided the members with an update of 2012 tobacco-related legislation. (See handout.) Ms. Knight reviewed the contents of SB 225, noting that the purpose of the bill was to remove ambiguity regarding which cigarette sales are subject to escrow. The bill would also redefine "units sold" and give the secretary of taxation and revenue the authority to adopt rules regarding the amount of state excise tax to be paid. Ms. Knight noted that this bill was passed by the legislature but vetoed by the governor. She asked to defer questions on the bill to the assistant attorney general during her presentation.

Ms. Knight spoke briefly about HB 2, the General Appropriation Act of 2012, noting that in addition to normal Tobacco Settlement Program Fund (program fund) appropriations to the various state agencies for health and research programs, the bill contains additional budget adjustment authority from other state funds for the attorney general to request up to \$150,000 increases in both fiscal year (FY) 2012 and FY 2013 to fund discovery costs for the tobacco arbitration.

Ms. Knight finished the legislative update by detailing HB 315, which appropriates \$1 million from the program fund to the University of New Mexico Health Sciences Center (UNM HSC) for FY 2013 to conduct the Speaker Ben Lujan Lung Cancer Research Project. She pointed out that the \$1 million appropriation pushes beyond the projected revenues, and she indicated that she would discuss this jointly with Greg Geisler, an analyst with the Legislative Finance Committee (LFC).

Ms. Knight pointed out a packet of handouts in the members' folders. She explained that the handouts contain some of the most current tobacco-related information pertaining to New Mexico, including recent tobacco tax articles and statistics from the American Lung Association, the federal Centers for Disease Control and Prevention (CDC), the Campaign for Tobacco-Free Kids and others.

FY 2013 Funding Levels

Ms. Knight reviewed an LCS information memorandum pertaining to miscellaneous interim committee items and to SM 33. Mr. Geisler introduced himself to the committee.

Ms. Knight began by stating that tobacco settlement revenue in April 2011 was lower than expected, and the Department of Finance and Administration (DFA) required agencies to reduce their FY 2011 operating budgets last year. A committee member explained that these reductions are frequently required because of the funding cycle. The member pointed out that the appropriations from the program fund are made each legislative session for the start of the following fiscal year; however, the actual revenue is not received until the following April. This causes those agencies relying on that revenue to adjust their budgets during the last few months of the FY. Ms. Knight presented a spreadsheet to the committee denoting the final budget for agencies receiving tobacco settlement revenue for FY 2012. She added that for FY 2013, the legislature adopted the committee's funding recommendations, which were the same as the original recommendations for FY 2012.

Ms. Knight explained that tobacco settlement revenue goes into the Tobacco Settlement Permanent Fund (permanent fund) and that 50% of that money is then distributed into the program fund to fund various tobacco cessation and prevention programs. She added, however, that in years when additional money has been needed for the state budget, the remaining 50% of revenue normally dedicated to the permanent fund has been distributed to the program fund for appropriation, primarily to Medicaid. Ms. Knight stated that this second 50% distribution, roughly \$19.4 million this FY, will cease after FY 2013 unless legislation is enacted to extend the distribution.

Mr. Geisler reported that the LFC recommendation is to appropriate \$19.4 million from the general fund to offset the money that has usually been allocated to Medicaid through the second distribution. He emphasized the need to make up this \$19.4 million during the FY 2014 budget process, and he noted that the LFC had made a similar recommendation for FY 2013.

Mr. Geisler went on to discuss the fiscal impact of HB 315, noting that there was no tobacco settlement revenue available beyond the projected \$38.5 million to fund the Speaker Ben Lujan Lung Cancer Research Project. He noted that upon passage of HB 315, the LFC met with the DFA to discuss funding possibilities and recommended a pro rata reduction (in accordance with Section 6-4-9(C) NMSA 1978) to all the appropriations (now totaling \$39.4 million) by including the HB 2 appropriations. Ms. Knight read from the governor's message to the house of representatives regarding HB 315, which outlined the administration's desire to work with the UNM HSC to find an appropriate way to fund the program. Ms. Knight also referred to correspondence from Dr. Paul Roth of the UNM HSC to Secretary of Finance and Administration Tom Clifford, explaining that the UNM HSC is planning to seek a \$600,000 supplemental appropriation in FY 2013 to take the place of the \$1 million appropriation from the program fund and for the \$600,000 appropriation to be recurring starting in FY 2014.

Mr. Geisler concluded by explaining that in order to compensate for the \$19.4 million Medicaid distribution, plus the \$600,000 appropriation for the Speaker Ben Lujan Lung Cancer Research Project, a general fund appropriation of around \$20 million would be required to maintain the same level of funding.

Questions

A committee member asked whether the UNM HSC is expecting the \$600,000 appropriation to be recurring. Mr. Geisler reported that the UNM HSC is proposing a recurring appropriation.

Another committee member inquired into the current balance of the permanent fund. Ms. Knight stated that she estimates a balance of between \$120 million and \$130 million. The legislator questioned what the balance would have been if the permanent fund had not been "raided" in the previous years. A committee member noted that the State Investment Council would be testifying regarding these issues at the end of the FY. The legislator explained that the rationale is to grow the permanent fund over time, and as tobacco company payments are anticipated to diminish, the interest earned on the permanent fund is to be used annually to fund

the tobacco cessation programs. Mr. Geisler referred to a recent fiscal impact report, which stated that the permanent fund is projected to be around \$132 million at the end of FY 2012.

The committee member acknowledged that predicting the balance of the permanent fund would be speculative because of market fluctuations. The committee member asked whether the LFC kept its promise to continue funding programs through the general fund when revenues were distributed into Medicaid. Ms. Knight mentioned that Department of Health tobacco cessation appropriations peaked in FY 2008 and FY 2009 and have since been reduced. Ms. Knight reported that prior to FY 2008, some of the first distributions of the program fund were appropriated for nonrecurring budget items and supplementary funding for Medicaid expansion.

Another committee member expressed satisfaction that the settlement revenue has been used for tobacco prevention and cessation programs, rather than for infrastructure and other projects as has been done nationwide. The legislator asked the presenters to clarify the funding situation for the Speaker Ben Lujan Lung Cancer Research Project. Ms. Knight explained that the \$1 million appropriation in HB 315 addresses the discontinued funding in HB 2 for UNM's contract with Lovelace Respiratory Research Institute.

A committee member recounted that during the floor debate on HB 315, he did not recall any discussion that it was to be a recurring expenditure. The member went on to express his concern about the failure to put money into the permanent fund, and he noted that smoking rates are still high, suggesting that the committee prune any non-smoking-related programs from the appropriations. After a discussion between members regarding the effectiveness of cigarette taxes to reduce cigarette sales to youths, the member stated that he is interested in seeing a presentation comparing the smoking rates of states that have raised cigarette taxes versus those states that have not.

Another committee member inquired into the target goal for the permanent fund. Mr. Geisler stated his understanding that the goal is to have a permanent fund of \$661 million by 2021. A committee member further noted that the goal is to draw upon the permanent fund at a rate similar to that of the state's Permanent School Fund as provided in Article 12, Section 7 of the Constitution of New Mexico.

Master Settlement Agreement (MSA) Status Update

Nan Erdman, assistant attorney general, Office of the Attorney General (OAG), and Claudia Ravanelli, paralegal, OAG, introduced themselves to the committee. Ms. Erdman presented to the committee a brief overview of the MSA primer, noting that she would focus on the MSA risk analysis spreadsheet and chart.

Ms. Erdman stated that New Mexico is at risk of losing MSA money due to challenges to the state's diligent enforcement and qualifying statute issues. Ms. Erdman went on to outline the factors under which there could be a nonparticipating manufacturer (NPM) adjustment, by which the participating manufacturers (PMs) could get a refund of their MSA payments. Ms. Erdman explained that the PMs could obtain a refund if they lost over 2% in market share from 1997 and

an economics firm determined that the MSA was a significant factor in this market share loss. She added that while payments prior to 2003 have been settled, there are still 34 states in arbitration regarding the 2003 payments. Ms. Erdman explained that the satisfaction of these conditions would result in an NPM adjustment, unless the state has a qualifying statute and diligently enforced that statute. Ms. Erdman indicated that while New Mexico passed an MSA model qualifying statute verbatim in 1999, New Mexico's statute is still at issue in the arbitration. In addition, she summarized the disputes over New Mexico's diligent enforcement of this statute as it relates to cigarette sales on tribal property. Ms. Erdman informed the committee that as part of the arbitration for 2003 adjustments, the arbitration panel is attempting to develop a list of what states must do to "diligently enforce" their escrow statutes and will consider the steps that other states have taken in their enforcement to see where New Mexico ranks comparatively.

Ms. Erdman advised the committee that an unfavorable ruling for New Mexico could result in a loss of the entire MSA payment, and she noted that if the state is required to pay back all of the 2003 payment, the state would not receive the FY 2014 payment. In addition, New Mexico could be forced to forgo MSA payments for each year in which a finding of "no diligent enforcement" is made. Ms. Erdman detailed the argument by the PMs that the original model statute left room for states to collect escrow on tribal sales but that New Mexico has created an uneven playing field by refusing to do so. She explained that New Mexico has avoided charging excise taxes on cigarette sales on tribal lands to nontribal members because smoke shops are a significant source of income to tribes. Ms. Erdman further noted that although SB 225 would have clarified the definition of which sales are subject to escrow payment, it was vetoed by Governor Susana Martinez. In addition, the PMs are arguing that New Mexico no longer has a qualifying statute because an exempt stamp was created in 2006 that altered the cigarette tax code. The PMs suggest that this language removes the possibility of the state collecting excise taxes. Ms. Erdman reminded the committee that an unfavorable decision regarding a qualifying statute, combined with a loss of 2% market share for the PMs, could deprive the state of MSA payments.

Ms. Erdman recounted the challenges that New Mexico faces in keeping this MSA funding. She reiterated that an adverse diligent enforcement finding could result in the state losing MSA money from 2003 through 2009, and an adverse qualifying statute finding could result in the state losing MSA money from 2006 until whenever a qualifying statute is passed. Ms. Erdman stressed that the total amount of MSA money at risk during these 10 to 11 years totals \$389 million.

Ms. Erdman went on to discuss the possible legislative fixes and to update the committee on arbitration proceedings. Ms. Erdman stated that the OAG will advance another bill to resolve these issues, although the legislation would need a new sponsor. She explained that similar bills have been vetoed in the past because the governor was concerned that the escrow is a tax and because, according to the governor, amending the statute was tantamount to admitting that New Mexico's original statute was not a qualifying statute. Ms. Erdman noted her disagreement with the latter argument. She suggested that the OAG may request direct funding for enforcement

from the MSA money to address the PMs' allegations that enforcement is insufficient without a dedicated funding source. Ms. Erdman finished by informing the committee that state-specific arbitration hearings have begun, with the panel not expected to rule until 2014.

Ms. Ravanelli detailed the OAG enforcement efforts, noting that New Mexico collected 100% of the escrow that was due in 2011, based on the NPMs' argument that the statute does not require escrow payments for sales on tribal property. She added that there are 13 NPMs active in the state, all of which are compliant. Ms. Ravanelli also summarized the increased reporting requirement for PMs and NPMs and the enforcement of roll-your-own tobacco laws. She finished by discussing concerns relating to NPM sales of unstamped cigarettes to prisons and military bases.

Questions

A committee member asked why PMs can go back and challenge New Mexico's qualifying statute, especially considering that the statute is based on the MSA template. Ms. Erdman stated that PMs have challenged the state's qualifying statute every year since 2006 and that this is permissible under the four-year statute-of-limitation provision. She added that this type of statute of limitation is standard procedure and New Mexico is contractually bound by it. The legislator also inquired into whether there is a provision under which the PMs would have to prove their market share loss. Ms. Erdman explained that the states can challenge the market share argument, but she pointed out that market share loss is determined nationally rather than by state by PricewaterhouseCoopers and that all challenges to the determination to date have been unsuccessful.

Another committee member inquired into the OAG qualified statute argument. Ms. Erdman noted that the issue is interpreted by an economics firm, but reiterated that the AG believes that New Mexico has a qualifying statute in place. The committee member then asked about how tribal sovereignty fits into these issues. Ms. Erdman explained that the state can collect excise taxes on sales that take place on tribal property to nontribal members, but it cannot impose a tax on a sale from a tribe to a tribal member. She pointed out that the escrow issue is analyzed by comparing the state interest to the tribal interest. Ms. Erdman asserted that the state interest is huge because tribal members take advantage of the tobacco prevention and cessation programs and they may be enrolled in Medicaid. Ms. Erdman went on to explain that if a tribe has a qualifying tribal tax, which 22 of 24 tribes do, it may be imposed, but if it does not have a qualifying tribal tax, the tribe must pay excise tax on cigarettes sold to nontribal members. The legislator concluded by asking about the number of NPMs making escrow payments. Ms. Erdman stated that only three of the 13 NPMs are making full escrow payments for all state taxes. She noted that a declaratory judgment action was recently filed by these NPMs against the OAG and a New Mexico court will determine whether the state can collect escrow on tribal sales.

A committee member asked for an explanation about Native Trading Associates. Ms. Erdman stated that Native Trading Associates is the largest NPM selling in New Mexico and its

sales are targeted at tribal property. She added that roughly 98% of NPM sales are on tribal property.

Another committee member asked about the status of the state's qualifying statute if a bill is not passed in the next session. Ms. Erdman stated that the current version might be upheld, but if it is not, the state could be at risk of losing roughly \$400 million in MSA payments over the next 10 years if the state is unable to prevail in this challenge.

A committee member inquired into what type of immunity government actors enjoy. Ms. Erdman explained that immunity applies only to individual actors, not to the state's contractual obligations.

Another committee member initiated a discussion regarding tribal involvement in challenging the state's attempts to collect from NPMs. Ms. Erdman noted that tribes have always agreed to stand down from any opposition as long as the state does not impose a state excise tax on any of their sales. She added that while imposing escrow on sales may reduce sales, the tribes have agreed to do this to protect the MSA. The legislator then asked about when tribes can claim sovereign immunity. Ms. Erdman noted that once tribal products enter the state's commerce stream, there is no longer sovereign immunity. The committee member concluded by asking whether tribes have challenged excise taxes on sovereign immunity grounds, if the incidence of the tax is properly assessed on sales to nontribal consumers and, if not, why the state does not impose an excise tax on all sales. Ms. Erdman replied that states have the authority to tax sales to nontribal members. Another legislator added that tribal leaders prefer to deal with the executive branch, government to government.

A committee member opined that if the state loses in the arbitration, the only recourse would be for the legislature to pass a heavy state excise tax. Ms. Erdman stated that a statute that keeps escrow sales even between nontribal and tribal sales should be sufficient. The legislator reiterated that state excise tax would be the likely result.

Public Comment

Maxine Velasquez, general counsel for the Pueblo of Tesuque, stated that tribes are supportive of the state and are taking the MSA issue seriously. She noted that tribes will continue to do what is right for the state while ensuring the preservation of tribal tax agreements. Ms. Erdman remarked that Ms. Velasquez is one of the many liaisons to whom the OAG reaches out whenever cigarette tax legislation is offered. Ms. Erdman again cited the need for a member to sponsor another version of SB 225 in the next legislative session.

TSROC 2012 Work Plan and Meeting Locations

Ms. Knight reviewed the work plan item by item. A committee member reiterated that, given the financial situation and high levels of smoking, the committee should "prune" appropriations that are not related to smoking prevention and cessation.

Upon a motion by Senator Feldman, seconded by Representative Hall, the committee voted without objection to approve the work plan.

Discussion then turned to the committee's meeting locations. Ms. Knight noted that the preliminary budget allowed for one meeting in Albuquerque to visit the UNM HSC. A committee member requested consideration of the oncologist shortage in Las Cruces. There was discussion among the committee members about having an epidemiologist present an overview of oncologist distribution throughout the state. Another committee member remarked that the American Cancer Society and the CDC should be brought before the committee to give an update about necessary levels of tobacco prevention and cessation funding. Another legislator wondered whether tobacco companies are living up to the advertising restrictions in the MSA. Staff was asked to look at tobacco sales to youths and potential correlations to cigarette sales and taxes.

Suggestions were made for additional research on the subject of marketing to youths, the related prohibitions and what enforcement role the state has, as well as what the current trends are with regard to tobacco and how they may be meeting the goals of the MSA.

Vanessa Hawker, associate budget director, UNM HSC, stated that the UNM HSC would be available for the TSROC meeting in August.

Adjournment

There being no further business before the committee, the first meeting of the TSROC adjourned at 11:56 a.m.