

# MAINE STATE LEGISLATURE

The following document is provided by the  
**LAW AND LEGISLATIVE DIGITAL LIBRARY**  
at the Maine State Law and Legislative Reference Library  
<http://legislature.maine.gov/lawlib>



Reproduced from scanned originals with text recognition applied  
(searchable text may contain some errors and/or omissions)



**State of Maine**  
**Office of the Treasurer of State**

39 State House Station  
Augusta ME 04333-0039  
207.624-7477 (voice) 207.287-2367 (fax)

December 13, 2002

Dear Members of the Joint Standing Committee on Appropriations and Financial Affairs and Members of the Joint Standing Committee on Health and Human Services:

Each year, by the second Friday of December, I report to both Committees on the status of Maine's Tobacco Settlement Payments. My report includes:

- Tobacco Settlement Payments received to date
- Deposits, Transfers, Earnings, and Available Balances in the Fund for a Healthy Maine
- Estimated Tobacco Settlement Payments for the current Fiscal Year and for the 2004/2005 and 2006/2007 biennium

In addition to what is required by Statute, I have reviewed the basic history of the Master Settlement Agreement in the Executive Summary, included a section on the determining factors of Maine's Tobacco Settlement Payments, discussed how my office projects future payments, and outlined what is happening elsewhere in the tobacco industry.

The State of Maine has received over \$167.3 million to date from the Tobacco Settlement. Each payment is deposited into the Fund for a Healthy Maine where it is invested in the Treasurer's Cash Pool. All earnings are deposited into the Fund. 2001 Public Law Chapter 358 repealed the Trust Fund and redirected all future revenues to the Fund for a Healthy Maine.

I hope you will feel free to call or stop by my office with any questions or comments at any time. My door is always open.

Sincerely,

A handwritten signature in black ink that reads "Dale McCormick". The signature is written in a cursive, flowing style.

Dale McCormick

C: Governor Angus S. King Jr., Governor-elect John E. Baldacci, Legislative Leadership, Jane Lincoln, Attorney General G. Steven Rowe, Grant Pennoyer, Tim Leet, Dr. Dora Mills



## TABLE OF CONTENTS

	<u>Page</u>
Executive Summary	3
Payments and Balances in the Fund for a Healthy Maine	4
Estimated Future Tobacco Settlement Payments	5
Factors Affecting the Amount of Maine's Tobacco Settlement Payments	6
Revenue Forecasting and Tracking	6
Elsewhere in the Tobacco Industry	7
Securitizations Around the Country	8
Tobacco Industry Litigation	11



## Executive Summary

- ◆ In 1998 Maine and the other states became creditors of the Participating Manufacturers: the Participating Manufacturers owe Maine money and our interests are linked by the Master Settlement Agreement.
  - The predominant determinant of Tobacco Settlement Payments to be received by Maine each year is the number of cigarettes sold nationwide during the previous calendar year.
- ◆ Tobacco Settlement Payments are a revenue stream that should be monitored and treated like a tax revenue.
- ◆ The Master Settlement Agreement presents the states with conflicting objectives:
  1. States want to maximize the Tobacco Settlement Payments to accomplish important policy goals.
  2. States want to reduce smoking, which will decrease the number of cigarettes smoked, which will in turn decrease the Tobacco Settlement Payment dollars received.
- ◆ Credit analysis of the Tobacco Settlement Payment revenue stream hinges on two key issues:
  1. The continuing enforceability of the manufacturer's obligation under the Master Settlement Agreement to make settlement payments and
  2. Total cigarette sales within the United States by Participating Manufacturers (94% of the market share). More tobacco companies have signed onto the Master Settlement Agreement (accounting for 4.5% of the market) as Subsequent Participating Manufacturers to protect their financial interests. The total market share included under the Master Settlement Agreement is 98.5%.
- ◆ Rating agencies have focused on two primary risks to the Master Settlement Agreement:
  1. A Participating Manufacturer enters bankruptcy and does not meet its obligation under the Master Settlement Agreement.
  2. Non-Participating Manufacturers gain market share at the expense of Participating Manufacturers.

---

### Key

MSA	= Master Settlement Agreement
TSP	= Tobacco Settlement Payment
PM	= Participating Manufacturer
OPM	= Original Participating Manufacturer
SPM	= Subsequent Participating Manufacturer
NPM	= Non-Participating Manufacturer

---



PAYMENTS AND BALANCES

Tobacco Settlement Payments Received

	<u>Date of Payment</u>	<u>Amount of Payment</u>
	FY 00 Total	\$63,176,643.10
FY 01	07/25/00	\$ 53,225.99 <sup>1</sup>
	12/29/00	\$16,839,538.70
	02/15/01	\$3,165.22 <sup>2</sup>
	04/16/01	\$30,878,625.32
	06/14/01	\$ 44,724.44 <sup>2</sup>
FY 02	11/16/01	\$ 381,637.14 <sup>3</sup>
	12/31/01	\$14,955,645.56
	01/03/02	\$ 25,475.00 <sup>4</sup>
	01/16/02	\$ 4,351.93 <sup>5</sup>
	04/16/02	\$39,669,653.89 <sup>6</sup>
	04/23/02	\$1,280,998.36 <sup>7</sup>

Fund for a Healthy Maine (FHM) Balance

Total Principal Deposits:	\$167,313,684.65	
Transfers:	(\$11,099,592.27)	To Trust in FY 01 <sup>8</sup>
	(\$61,213,828.05)	FY 01 Transfers out of the FHM <sup>9</sup>
	(\$61,081,185.34)	FY 02 Transfers out of the FHM <sup>9</sup>
	(\$24,899,098.44)	FY 03 Transfers out of the FHM <sup>9</sup>
Earnings:	\$6,444,225.54	FY 00, 01, & 02
	\$291,920.27	FY 03 to date
Fund Balance:	\$15,756,126.36	(as of 12/13/2002)

<sup>1</sup> The July 25, 2000 payment of \$53,225.99 was a reimbursement for legal expenses. This was combined with a FY 2000 payment and deposited into the Fund for a Healthy Maine. PL 1999, C.731, §HHHH-3 provided for an allocation of \$260,000 to the Attorney General's Office.

<sup>2</sup> The February 15, 2001 and the June 14, 2001 payments were amounts originally withheld because of a dispute with a manufacturer. Once resolved, the payments were released to the states.

<sup>3</sup> The November 16, 2001 payment of \$381,637.14 was the result of an IRS refund for 1999. This refund comes after an IRS decision that State Tobacco Settlement Payments are not taxable.

<sup>4</sup> The January 3, 2002 payment of \$25,475.00 represents in-house attorneys fees paid by the National Association of Attorneys General to the State of Maine.

<sup>5</sup> The January 16, 2002 payment of \$4,351.93 is an adjustment to payments made to the State of Maine in Fiscal Year 2001.

<sup>6</sup> The April 16, 2002 payment includes \$3,010.49, which is the IRS refund for 1998, plus interest due to the delay in releasing these funds to the States.

<sup>7</sup> This payment is the release of Brown & Williamson funds (plus interest) from the disputed escrow account, where they were held since January 2002.

<sup>8</sup> The balance of the Trust Fund was transferred to the General Fund Unappropriated Surplus at the end of FY 2001 in accordance with 2001 PL Chapter 358 Section Q-8.

<sup>9</sup> Transfers out of the FHM include transfers to Departments for expenditures and transfers to the General Fund.



**ESTIMATED FUTURE TOBACCO SETTLEMENT PAYMENTS**

	<u>Original Estimates</u>	<u>Changes</u>	<u>Revised Estimates</u>	<u>FY TOTALS</u>
1/10/2003	\$16,278,619	\$355,391	<b>\$16,634,010</b>	} \$56,885,250
4/15/2003	\$39,391,260	\$859,980	<b>\$40,251,240</b>	
4/15/2004	\$49,042,116	\$612,383	<b>\$49,654,499</b>	\$49,654,499
4/15/2005	\$49,586,323	\$721,044	<b>\$50,307,367</b>	\$50,307,367
4/15/2006			<b>\$51,215,374</b>	\$51,215,374
4/15/2007			<b>\$52,075,923</b>	\$52,075,923

---

- The Office of the Treasurer of State's original Tobacco Settlement Payment (TSP) Projections shown above were estimated in August 2002 using the then current WEFA base case scenario econometric model.
- The revised estimates, in bold above, include the most recent information from DRI•WEFA. Adjustments to the econometric model were made as a result of the newest data. The revised forecast was presented to the Revenue Forecasting Committee on November 21, 2002.



## MAINE'S TOBACCO SETTLEMENT PAYMENTS

The Tobacco Settlement Payment that Maine will receive each year is driven by two key adjustments, the **inflation** factor and the **volume** of cigarettes sold nationwide.

### Inflation Factor

- ◆ The base annual payments will increase annually by the *greater* of 3% or CPI (the Consumer Price Index).

### National Sales Volume

- ◆ Maine's Tobacco Settlement Payments are directly related to the consumption of cigarettes nationwide.
- ◆ Even if Maine experiences a decline in cigarette consumption, its Tobacco Settlement Payments will not decrease as long as total national sales remain the same or increase.
- ◆ Conversely, if Maine's cigarette sales increase in any given year, the Tobacco Settlement Payments may remain the same or decline based upon the level of total national sales.

### Revenue Forecasting and Tracking

- ◆ As a creditor of Participating Manufacturers, the State must track, forecast and reforecast Tobacco Settlement Payments as it would a tax revenue stream.
  - Maine will need to follow tobacco industry trends, including the financial health of the Participating Manufacturers as well as any federal, private or third-party litigation and/or settlements.
- ◆ The Independent Auditor, as specified in the Master Settlement Agreement, will verify the volume of cigarettes sold in a particular year to ensure that the states receive the correct Tobacco Settlement Payment amounts.
- ◆ Some industry observers predict that demand for cigarettes is likely to continue to decline as a result of price increases as well as behavioral changes reducing both the Tobacco Settlement Payments and Maine's cigarette sales tax receipts.
- ◆ Conversely, other industry observers believe that current industry consumption is sustainable based on factors such as:
  - The presence of a core group of smokers and
  - The recent rise in smoking among certain population classes.

### How the Treasurer of State Estimates Tobacco Settlement Payments

- ◆ The Treasurer of State's Office estimates future Tobacco Settlement Payments using the econometric model developed by DRI•WEFA. This model was developed for the purpose of projecting payments to states using the most current information available.



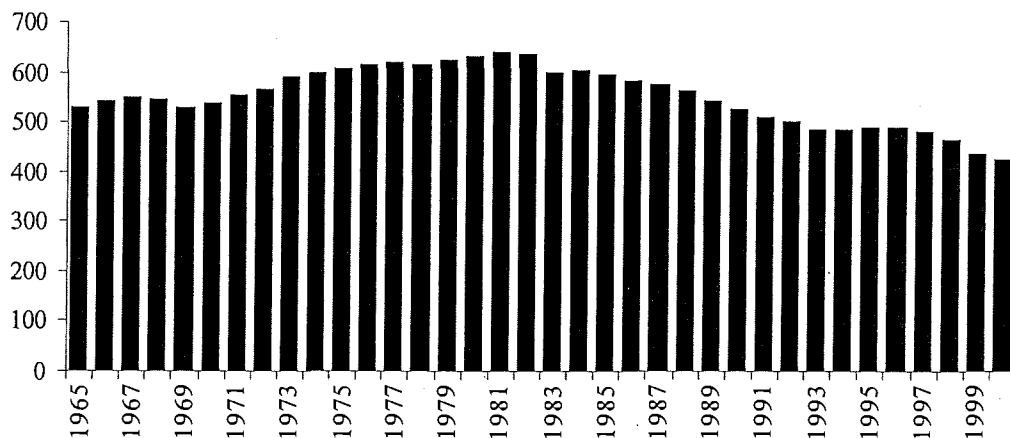
- ◆ The Treasurer of State’s projections of November 2002 were based on the current DRI•WEFA base case scenario econometric model, which was developed to study U.S. Cigarette Consumption and addressed the volume adjustment – the adjustment with the greatest effect on Maine’s Tobacco Settlement Payments.
- ◆ Since then, WEFA has become DRI•WEFA and is now Global Insight.
- ◆ The DRI•WEFA base case scenario econometric model is still the most advanced study on which to base our projections.<sup>10</sup> There are 2 reasons for this:
  - The newly revised study analyzes the reaction of the cigarette market in 1999 and 2000 to price and tax increases due to the Master Settlement Agreement, and uses this as a base for future assumptions.
  - The model in this study is based on economics and its primary purpose is for forecasting.
- ◆ The revised estimates, shown earlier in this report, include the most recent information from DRI•WEFA. The use of this model is substantiated by its inclusion in Official Statements for Tobacco Securitization deals. DRI•WEFA continues to make advancements and continues to keep the public up to date.

### ELSEWHERE IN THE TOBACCO INDUSTRY

- ◆ The historical trend continues to be a modest, steady decline in domestic cigarette consumption since 1981. Between 1981 and 1990, consumption declined at an average annual rate of 2.18%, and from 1990 to 1998, the average annual rate of decline was 1.51%. For 1998 the decline increased to 3.13% and then the decline for 1999 accelerated to 6.45%. These sharp recent declines are correlated with the large price increases in 1998 and 1999.

#### Domestic Cigarette Consumption, 1965 – 2000 est.

(billions)



Source: DRI•WEFA Report, October 10, 2002.

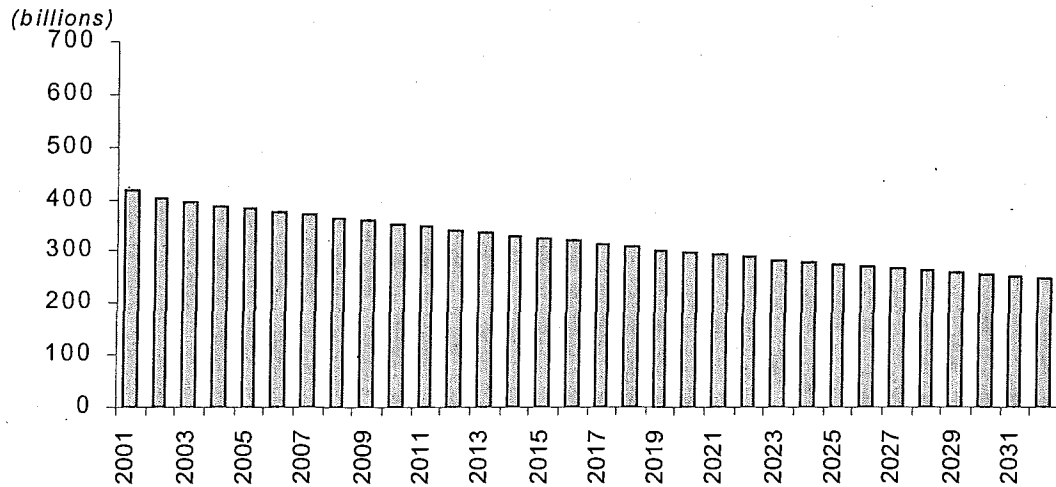
<sup>10</sup> The econometric modeling is based on estimates and assumptions and cannot guarantee or predict all movements in the cigarette marketplace.





- ◆ DRI•WEFA, an econometrics consultant, has published the Base Case forecast of cigarette consumption shown below.

**Projected Domestic Cigarette Consumption, 2001 - 2032**



Source: DRI•WEFA Report, October 10, 2002.

- ◆ DRI•WEFA estimated that for the year 2000, the average price per pack was \$3.20, representing a nominal growth in the price of cigarettes of 11.0% from 1999. For 2001, we estimate that the average price was \$3.45.
- ◆ As published in the DRI•WEFA Report, in the year 2000, lower than expected prices increased consumption and, after examining manufacturer's shipment data for the year, DRI•WEFA now estimates a consumption level for year 2000 of 423 billion, 7 billion more than its 2001 forecast. DRI•WEFA has also revised its year 2001 consumption projection upwards, to 419 billion from 408 billion.

**Securitization of Tobacco Settlement Payments**

- ◆ The tobacco companies are currently obligated to make payments to a national escrow account and the escrow account pays the respective proportional amount annually to the State.
- ◆ The State could sell or transfer to a dedicated trust fund, an independent authority, or a special purpose entity ("SPE") its right to receive the Settlement Payments.
- ◆ A governmental issuer or the SPE would sell bonds, the interest and principal of which are paid by the Settlement Payments.
- ◆ A portion of the overcollateralization amounts not used for debt service may transfer to the State free and clear of the financing transaction.
- ◆ The SPE would be a non-operating, bankruptcy-remote entity.
- ◆ 48 tobacco-backed bond issues have been sold as of November 20, 2002 totaling \$14.7 billion. An additional 5 issues for approximately \$8 billion are expected to be sold through the first half of 2003.



**Office of Maine State Treasurer Dale McCormick**

**Completed Tobacco Settlement Payment Bond Issues as of November 20, 2002.**

State/County	Issuer	Sale Date	Par Amount (000)
Alabama	Alabama 21 <sup>st</sup> Century Authority Tobacco Settlement Revenue Bonds, Series 2000	9/00 & 12/01	\$ 153,760
Alaska	Northern Tobacco Securitization Corporation Tobacco Settlement Asset-Backed Bonds, Series 2000 & 2001	10/00 & 8/01	242,840
Arkansas	Arkansas Development Finance Authority Tobacco Settlement Revenue Bonds, Series 2001	09/99	60,000
California/Alameda County	California County Tobacco Securitization Agency Tobacco Settlement Asset-Backed Bonds, Series 2002	10/02	220,525
California/Fresno County	California County Tobacco Securitization Agency Tobacco Settlement Asset-Backed Bonds, Series 2002	07/02	92,955
California/Kern County	California County Tobacco Securitization Agency Tobacco Settlement Bonds, Series 2002A-C	04/02 & 05/02	105,245
California/Litigation Attorneys	Legal Settlement Trust, 2002-A	06/02	53,750
California/Marin County	California County Tobacco Securitization Agency Tobacco Settlement Asset-Backed Bonds, Series 2002A & B	06/02	34,345
California/Merced County	California County Tobacco Securitization Agency Tobacco Settlement Bonds, Series 2002A & B	03/02	30,515
California/Placer County	California County Tobacco Securitization Agency Tobacco Settlement Asset-Backed Bonds, Series 2002	06/02	41,590
California/Pooled Program	California Statewide Financing Authority Tobacco Settlement Asset-Backed Bonds, Series 2002A&B	06/02 & 07/02	196,545
California, Sacramento County	The Northern California Tobacco Securitization Authority Tobacco Settlement Bonds, Series 2001	08/01	199,620
California/San Diego County	Southern California Tobacco Securitization Authority Tobacco Settlement Bonds, Series 2001A & B	12/01	466,840
California/Sonoma County	California County Tobacco Securitization Agency Tobacco Settlement Bonds, Series 2002A	04/02	67,410
California/Stanislaus County	California County Tobacco Securitization Agency Tobacco Settlement Bonds, Series 2002A & B	03/02	67,305
California, Tulare County	Tulare County Public Financing Authority Variable Rate Demand Bonds, Series 1999	12/99	45,000
District of Columbia	District of Columbia Tobacco Settlement Financing Corp. Tobacco Settlement Asset-Backed Bonds, Series 2001	03/01	521,105
Guam	Guam Economic Development Authority Tobacco Settlement Asset-Backed Bonds, Series 2001 A & B	05/01 06/01	25,477
Hawaii	Board of Regents of the University of Hawaii University Bonds, Series 2002A	06/02	150,000
Iowa	Iowa Tobacco Settlement Authority Tobacco Settlement Bonds, Series 2001 A & B	10/01	644,245
Louisiana	Louisiana Tobacco Settlement Finance Corporation Tobacco Settlement Bonds, Series 2001 A & B	11/01	1,202,770
Mississippi-Litigation Attorneys	Legal Settlement Trust	5/01	50,500
New Jersey	Tobacco Settlement Financing Corporation Tobacco Settlement Asset-Backed Bonds, Series 2002	08/02	1,801,455



## Office of Maine State Treasurer Dale McCormick

New York City	New York City TSASC, Inc. Tobacco Flexible Amortization Bonds, Series 1999-1 & 2002-1	11/99 & 08/02	1,209,280
New York, Chautauqua County	Chautauqua Tobacco Asset Securitization Corporation Tobacco Settlement Revenue Bonds, Series 2000	09/00	30,115
New York, Erie County	Erie Tobacco Asset Securitization Corporation Tobacco Settlement Asset-Backed Bonds, Series 2000A/B	09/00	246,325
New York/Monroe County	Monroe Tobacco Asset Securitization Corporation Tobacco Settlement Asset-Backed Bonds, Series 2000	08/00	163,400
New York/Nassau County	Nassau County Tobacco Settlement Corporation Tobacco Settlement Asset-Backed Bonds, Series A	11/99	294,500
New York/Niagara County	Niagara Tobacco Asset Securitization Corporation Tobacco Settlement Asset-Backed Bonds, Series 2000	10/00	47,920
New York/NYCTTI	New York Counties Tobacco Trust I Tobacco Settlement Pass-Through Bonds, Series 2000	11/00	227,130
New York/NYCTTII	New York Counties Tobacco Trust II Tobacco Settlement Pass-Through Bonds, Series 2001	7/01	215,220
New York/Rensselaer County	Rensselaer Tobacco Asset Securitization Corporation Tobacco Settlement Asset-Backed Bonds, Series A	12/01	34,555
New York/Rockland County	Rockland Tobacco Asset Securitization Corporation Tobacco Settlement Asset-Backed Bonds, Series 2001	12/01	47,750
New York/Ulster County	Ulster Tobacco Asset Securitization Corp. Tobacco Settlement Asset-Backed Bonds, Series 2001	01/01	28,352
New York/Westchester County	Westchester Tobacco Asset Securitization Corporation Tobacco Settlement Asset-Backed Bonds, Series 1999	12/99	103,505
Puerto Rico	The Children's Trust Fund (of Puerto Rico) Tobacco Settlement Asset-Backed Bonds, Series 2000 & 2002	10/00 & 10/02	1,568,205
Rhode Island	Tobacco Settlement Financing Corporation Tobacco Settlement Asset-Backed Bonds, Series 2002A & B	06/02	685,390
South Carolina	South Carolina Tobacco Settlement Management Authority Tobacco Settlement Asset-Backed Bonds, Series 2001A & B	03/01	934,530
South Dakota	Educational Enhancement Funding Corporation Tobacco Settlement Asset-Backed Bonds, Series 2002A & B	09/02	278,045
Virgin Islands	Virgin Islands Tobacco Settlement Corporation Tobacco Settlement Bonds, Series 2001	11/01	21,710
Washington	Tobacco Settlement Authority Tobacco Settlement Asset-Backed Bonds, Series 2002	10/02	517,905
Wisconsin	Badger Tobacco Asset Securitization Corp. Tobacco Settlement Bonds	05/02	1,591,095
<b>TOTAL</b>			<b><u>\$ 14,718,729</u></b>



### Tobacco Industry Litigation

- ◆ One OPM reported that as of August 1, 2002, there were approximately 1,500 smoking and health cases filed and served on behalf of individual plaintiffs in the United States against it and other tobacco industry defendants.
- ◆ One OPM reports that as of August 1, 2002, there were approximately 21 smoking and health cases pending as purported class actions in the United States against cigarette manufacturers and other defendants.
- ◆ The jury in a class-action suit in Florida against R.J. Reynolds (the "Engle Case") awarded \$12.7 million in compensatory damages to the three named plaintiffs on April 7, 2000 and awarded approximately \$145 billion as punitive damages to the entire class of plaintiffs on July 14, 2000. Philip Morris appealed the verdict to the Florida State Circuit Court, which then upheld the verdict. Other appeals remain outstanding.
- ◆ On May 7, 2001, Phillip Morris, Lorillard and Liggett reached a settlement agreement with the *Engle* plaintiffs whereby the three companies will forfeit a total of approximately \$709 million even if they are successful on appeal. The agreement provides that the three firms will post a \$2 billion bond and approximately \$1.3 billion will be refunded if the appeal is successful. Reynolds Tobacco and B&W are considering joining the agreement. The *Engle* plaintiffs have agreed not to challenge Florida's legislation which caps the appeal bond.
- ◆ Some industry analysts believe that this judgement could materially adversely affect the ability of tobacco companies to make payments under the Master Settlement Agreement.
- ◆ The European Community ("EC") brought suit against Reynolds Tobacco and Philip Morris alleging that the defendants engaged in a conspiracy to smuggle cigarettes into EC member states in an effort to evade taxes. On July 18, 2001, a US court found that the EC claims were without merit and dismissed the case. On August 6, 2001, the EC and 10 member states filed a second complaint against Reynolds Tobacco, Philip Morris and related companies. The EC's second complaint is essentially a resubmission of the first complaint. It seeks unspecified damages including compensatory damages, injunctive relief, and treble damages under RICO.
- ◆ Several lawsuits are also being filed to recover health care costs. In June 2001, a federal jury in the Eastern District of New York awarded Empire Blue Cross \$17.8 million in compensatory damages for violations of consumer protection statutes and \$11.8 million in separate but overlapping claims.

### Federal Litigation

- ◆ A verdict is currently expected to be completed in July 2003 in a case brought before a federal district court by a group of farmers from Alabama, Florida, Georgia, North Carolina, South Carolina and Tennessee accusing cigarette manufacturers of conspiring to set prices offered for tobacco.
- ◆ A trial date has been set for July 2003 for a civil lawsuit the Justice Department filed September 22, 1999 against major tobacco companies to recoup health-related expenses paid to veterans, military personnel, federal employees and the elderly through Medicare payments.
- ◆ The suit also alleges industry collusion to conceal risks to consumers using the federal civil racketeering statute (RICO).



- ◆ The district court has granted the tobacco companies' motion to dismiss the Medical Care Recovery Act and the Medicare Secondary Payer Act claims. This motion has been upheld through two sets of appeals. The RICO claims portion of the suit remains.
- ◆ Maine's TSPs could be reduced if the Justice Department succeeds in its lawsuit or reaches a settlement requiring payment by the manufacturers. The reduction could occur under several circumstances:
  1. The Original Participating Manufacturers are required to make settlement payments to the federal government or to return "ill-gotten gains" as determined by a federal judge under RICO and subsequently must increase prices to afford the payments, initiating a decline in consumption; or
  2. The federal government gives amounts received from the OPMs to the Settling States either:
    - (a) unrestricted or
    - (b) "restricted to any form of health care or to any use related to tobacco" if certain other conditions are met.

In this case, Maine's TSP would be reduced dollar-for-dollar by the amount received from the federal government.