

MAINE STATE LEGISLATURE

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STATE OF MAINE
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NERIA R. DOUGLASS
State Treasurer

KRISTI L. CARLOW
Deputy State Treasurer

To: Members, Joint Standing Committee on Appropriations and Financial Affairs
Members, Joint Standing Committee on Health and Human Services
Fr: State Treasurer Neria R. Douglass
On: December 1, 2014
Re: 2014 Tobacco Settlement Payments Report

Mandated Report: The State Treasurer is required to report the status of Maine's Tobacco Settlement Payments each December to the Joint Standing Committees on Appropriations and Financial Affairs and Health and Human Services. The report must summarize the activity in any funds or accounts directly related to the Fund for a Healthy Maine. *See 22 M.R.S.A s. 1511(8).*

EXECUTIVE REVIEW

In 1998, Maine, along with 45 other states and 6 U.S. Territories became creditors of Participating Cigarette Manufacturers (PMs) pursuant to a Master Settlement Agreement (MSA) made between the states and many cigarette manufacturers settling lawsuits brought by these states and territories. Florida, Minnesota, Texas and Mississippi had already reached individual agreements with the tobacco industry. The MSA exempted participating cigarette manufacturers from liability to the state governments arising from the claims alleged in the states' lawsuits, and provided those state governments with compensation for smoking related medical costs and the states' other monetary claims, and with funding to help reduce smoking in the United States through a national foundation. The MSA also limited the marketing and advertising practices of the cigarette manufacturers to further protect public health.

Maine's continuing receipt of Tobacco Settlement Payments hinges on three (3) key factors:

1. Enforceability: The continuing enforceability of the manufacturers' Master Settlement Agreement payment obligations.
2. Financial Capacity: The continuing financial capacity of the OPMs and SPMs to make timely Master Settlement Agreement payments.
3. Legal Actions: Legal actions which delay or alter Master Settlement Agreement Payment obligations.

PAYMENTS FORMULA AND REVENUE PROJECTION PROCESS

ELIGIBILITY: Maine has the right to always receive 0.7693050% of the Annual Payments that are expected to be paid in perpetuity pursuant to the MSA. In addition, Maine will also receive 1.3281978% of the Strategic Contribution Payments during the years 2008 through 2017. Maine is eligible for these supplemental payments as a result of its early involvement in the work which resulted in the MSA. Payments are due in April each year.

PAYMENTS FORMULA: Annual settlement payments are driven by two key annual adjustments, the 1) inflation adjustment and the 2) volume of cigarettes sold nationwide. Under the Inflation Adjustment, the base annual payments will increase annually by the greatest of 3% or CPI, (Consumer Price Index). Under the Volume Adjustment, the MSA tobacco payments due from the manufacturers are either reduced or increased depending on whether the Original Participating Manufacturers' national sales volumes for a given sales year are less than or greater than, respectively, the national cigarette sales volumes for 1997. Maine's Tobacco Settlement Payments are directly related to the shipments of cigarettes nationwide, without regard to increases or decreases in Maine cigarette sales.

REVENUE PROJECTION PROCESS: The Treasurer's Office organizes a meeting of the Maine Attorney General's Office, the State Budget Office and the Legislature's Office of Fiscal and Program Review in advance of the Spring Revenue Forecasting Committee meeting in order to reach consensus on the revenue forecast. That meeting agenda includes a review of an econometric model available from the National Association of Attorneys General that projects domestic consumption of cigarettes. Each meeting also discusses the likely impacts on Maine's payments stream of any disputes pending under the MSA. These disputes, and the timing and direction of their outcomes, present significant volatility to the revenue stream projection process.

Under the MSA, a participating tobacco company may be entitled to a reduction in its annual payment obligation for the Non-participating Manufacturer Adjustment if two (2) things are determined in its favor: First, an economic firm determines that the disadvantages imposed upon it by the MSA were a significant contributing factor in its loss of market share to non-participating manufacturers (NPMs), and; Second, recovery of this NPM Adjustment amount from an individual state is dependent on a) whether the state had a qualifying statute governing NPM escrow deposits in place during the relevant sales year and b) whether the individual state diligently enforced that qualifying statute.

Once the PMs dispute the calculated amount they owe by claiming entitlement to the NPM Adjustment, they have three options under the MSA. They may pay the contested amount to the State anyway, as Phillip Morris did for sales years 2003-2009, or the PM may place the amount in a disputed payment account, which R.J. Reynolds did for sales years 2003-2010 (excepting sales year 2006, for which it withheld the NPM Adjustment amount), and which Phillip Morris did for the first time with its April 2011 payment. To date R.J. Reynolds has escrowed more than \$2.1 billion into the disputed payments account for the NPM Adjustment for those sales years. Finally, the PMs may simply withhold the entire amount they dispute from their annual payments, and many PMs have done this.

Beginning in sales year 2003 (and expected for every sales year thereafter), the PMs have claimed that they are entitled to an NPM Adjustment, which would result in a decrease in the amount the PMs owe under the MSA for any year in which the PMs' argument succeeds. The 2003 NPM Adjustment dispute as it pertains to Maine went to a final arbitration hearing in September 2012, and on September 11, 2013 the Panel issued its ruling finding in Maine's favor. Specifically, the Panel found that Maine diligently enforced its qualifying statute during sales year 2003 and that Maine's payment is thus not subject to the NPM Adjustment for that year. As a result of that favorable decision, the State determined that it was entitled to an additional payment of \$5,569,153. The State's 2014 payment included these additional funds, as well as a potential overpayment as calculated by the Independent Auditor, PwC. PwC is continuing to work with the States and the PMs in an effort to identify and correct any errors. It is not known when PwC will finalize its work. If errors are identified, PwC may make adjustments to States' payments in future years.

TOBACCO SETTLEMENT PAYMENTS AND INVESTMENT EARNINGS

The State of Maine has received \$796,380,678 to date in Tobacco Settlement payments. Each payment is deposited into the Fund for a Healthy Maine (FHM) where it is held in the Treasurer's Cash Pool. All investment earnings on these funds are deposited back into the FHM.

ESTIMATED FUTURE TOBACCO SETTLEMENT PAYMENTS

(FY15-17 BASED ON MARCH 2014 REVENUE FORECASTING COMMITTEE REPORT)

	FY14 (Actual*)	FY15	FY16	FY17
Base Payments	47,833,255	47,585,948	41,624,080	41,235,036
Strategic Contribution Payments	8,559,647	8,662,513	8,581,751	8,501,742
Racino Revenue	4,158,208	4,430,980	4,475,290	4,520,043
Income from Investments	7,823	5,090	13,485	17,949
Offset	0	0	0	0
TOTAL FHM Revenue	60,558,935	60,684,531	54,694,606	54,274,770

**Payments for FY14 include funds released to Maine as a result of an arbitration panel's September 2013 determination that Maine diligently enforced its Qualifying Statute in 2003 and that its payment for that year should not have been reduced by the NPM adjustment. In addition, the Independent Auditor is continuing to review its 2014 calculations. If it identifies errors, adjustments may be made to Maine's payment in a future year.*