**Tobacco Settlement Revenue Oversight Committee**
**2015 Interim Summary**

The Tobacco Litigation. In 1994, the attorney general of the State of Mississippi filed suit against major tobacco companies for deceptive and fraudulent marketing, targeting children and conspiracy to conceal the health effects of smoking, arguing that Mississippi should not be forced to pay the costs of treating smoking-related diseases and conditions such as lung cancer, heart disease, emphysema and low-birth-weight babies. Eventually, 45 other states, including New Mexico, filed similar lawsuits against the same defendants, seeking recovery of Medicaid and other public health expenses incurred in the treatment of smoking-related diseases and conditions.

The Settlement. In 1997, four states settled individually with the tobacco company defendants, and on November 23, 1998, the attorneys general of 46 states, five U.S. territories and the District of Columbia (the "settling states") resolved all of the remaining pending cases when they entered into a Master Settlement Agreement (MSA) with the largest tobacco companies in the United States. The original participating manufacturers were Philip Morris, Inc.; R.J. Reynolds Tobacco Co.; Brown & Williamson Tobacco Corp.; and Lorillard Tobacco Co. Since 1998, approximately 50 other tobacco companies (collectively, the "participating manufacturers") have also signed the agreement. (The MSA only settled state and local government lawsuits and does not apply to private suits such as class action lawsuits and claims brought by individuals, labor unions and private health care insurers.)

Under the terms of the MSA, the participating manufacturers agreed to prohibitions and restrictions on the marketing and advertising of their tobacco products, particularly marketing tobacco products to youth. The tobacco companies also agreed to make annual payments to the settling states in perpetuity based on the companies' shares of national cigarette sales and shipments to compensate the settling states for taxpayer money spent for health care costs connected to tobacco-related illness; the agreement does not limit the settling states' discretion in spending the money. In return, the settling states gave up any future legal claims they might have based on the tobacco companies' actions at issue in the settled lawsuits.

The participating manufacturers were the largest tobacco companies in the country, but there are smaller tobacco companies that did not participate in the settlement (NPMs or "non-participating manufacturers"). The participating manufacturers were concerned that, because of the payments they were obliged to make to the settling states, the NPMs would gain an unfair advantage, leading to an increased market share (and therefore a loss of market share to the participating manufacturers) as an unintended result of the settlement.

To avoid that result, the MSA provided that the annual payment amounts could be reduced if it could be shown that the participating manufacturers had lost market share to NPMs as a result of the settlement ("NPM adjustments"). The MSA allowed settling states to avoid NPM adjustments by: (1) passing model legislation ("model escrow statutes") "that effectively and fully neutralizes the cost disadvantages that the participating manufacturers experience" by requiring NPMs operating in the settling states to either join the MSA and comply with its terms, or to establish an escrow account and make regular payments into that account; and (2) "diligently [enforcing]" the escrow legislation. In 1999, the legislature enacted the model escrow statutes, Sections 6-4-12 and 6-4-13 NMSA 1978, followed in 2003 by the complementary Tobacco Escrow Fund Act (Sections 6-4-14 through 6-4-24 NMSA 1978).

Each year, an independent auditor calculates the settlement payment to be made by each participating manufacturer and the amount to be received by each settling state, including any NPM adjustments. The calculation is very complex, the parties can dispute them and tobacco product sales have been decreasing nationwide; so the amounts vary every year.

Disputes between the participating manufacturers and the states regarding calculation of the payments, including the NPM adjustments, may be resolved by arbitration; the arbitration decisions may be challenged in state court. The Attorney General's Office (AGO) manages enforcement of and compliance with the MSA and represents the state in any disputes with participating manufacturers or NPMs.

Litigation Against the State by Participating Manufacturers. The AGO regularly reports to the Tobacco Settlement Revenue Oversight Committee (TSROC) regarding enforcement of and compliance with the MSA. An arbitration proceeding filed in 2009 by the participating manufacturers challenging the state's diligent enforcement efforts of the model escrow statutes and the Tobacco Escrow Fund Act for calendar year 2003 was concluded in September 2013 with a ruling against the state. A summary of the issues and findings can be found in the 2014 TSROC Interim Committee Report Summary. The state appealed the arbitration ruling to district court, where it is still pending. The adjustment resulting from the arbitration award in September 2013 was deducted from the annual MSA payment to the state in fiscal year (FY) 2014 (July 1, 2014 through June 30, 2014).

The AGO has informed the TSROC that the participating manufacturers are pursuing diligent enforcement challenges against New Mexico for succeeding years. While it is possible that the state could be facing future adverse diligent enforcement determinations, the AGO does not expect a resulting reduction in future annual MSA payments to occur every year.

Accounting for the Distributions. In 1999, the legislature devised the accounting scheme to receive and use the annual distributions from the tobacco companies.

The Tobacco Settlement Permanent Fund (permanent fund) was created by Section 6-4-9 NMSA 1978 to receive the money distributed to the state pursuant to the MSA. The permanent fund statute has been amended over the years to direct the distributions from the permanent fund to the Tobacco Settlement Program Fund (program fund) and for other state purposes. In 2003, it was amended to make the permanent fund a reserve fund of the state that could be expended, under certain circumstances, to avoid an unconstitutional deficit. At various times since, amendments have allowed for distributions from the permanent fund to the general fund.

The program fund, consisting of distributions from the permanent fund, was established by Section 6-4-10 NMSA 1978. The program fund statute allows money in the program fund to be appropriated for health and educational purposes, including:

- support of additional public school programs, including extracurricular and after-school programs designed to involve students in athletic, academic, musical, cultural, civic, mentoring and similar types of activities;
- any health or health care program or service for prevention or treatment of disease or illness;
- basic and applied research conducted by higher educational institutions or state agencies addressing the impact of smoking or other behavior on health and disease;
- public health programs and needs; and
- tobacco use cessation and prevention programs, including statewide public information, education and media campaigns.

Each year that the settlement money is received in the permanent fund, a certain amount is transferred to the program fund, and appropriations are made from the program fund for health and education purposes. In most of the fiscal years since the creation of the permanent fund, amounts equal to the total annual MSA settlement payment have been appropriated, with no increase to the corpus of the permanent fund. In June 2015, however, the permanent fund received a $35 million payment and distributed $19.3 million from the permanent fund to the program fund; this was the first time since FY 2008 that 100% or more of the annual payment was not appropriated. As of September 2015, the balance in the permanent fund was $205.1 million.

<u>TSROC</u>. The TSROC was created in 2000 by Section 2-19-1 NMSA 1978 as a joint interim legislative committee to:

"(1) monitor the use of tobacco settlement revenue and meet on a regular basis to receive and review evaluations of programs receiving funding from tobacco settlement revenues;

(2) prepare recommendations [to the legislature] based on its program evaluation process, of program funding levels for the next fiscal year...; and

(3) make recommendations as necessary for changes in legislation regarding use of the tobacco settlement revenue."

The Department of Health (DOH), the Human Services Department (HSD) Medicaid program and the University of New Mexico (UNM) Health Sciences Center have historically been the primary recipients of appropriations from the tobacco settlement funds.

<u>FY 2016 Appropriations</u>. In FY 2016 (July 1, 2015 through June 30, 2016), tobacco settlement funds were appropriated to:

- the Indian Affairs Department for tobacco cessation and prevention programs;
- the HSD for breast and cervical cancer treatment and other Medicaid programs;
- the DOH for tobacco-use cessation and prevention programs; a diabetes prevention

and control program; HIV/AIDS prevention, services and medicine; breast and cervical cancer screening programs; and the Family Infant Toddler Program;
- the Children, Youth and Families Department for early childhood programs;
- the Higher Education Department to support Lottery Tuition Fund scholarships; and
- UNM for instruction and general purposes; research in genomics and environmental health; the poison control center; the pediatric oncology program; and specialty education in trauma and pediatrics.

TSROC Meetings in the 2015 Interim. The TSROC held five meetings in the 2015 interim to fulfill its oversight duties. The agendas, minutes and handouts provided by presenters are available on the legislature's website and in the Legislative Council Service library. The meetings are briefly summarized below.

At the initial meeting, on June 24 in the State Capitol in Santa Fe, the committee heard a summary of the tobacco litigation, settlement, enforcement and related litigation, and it approved the work plan for the interim.

On July 8, the committee met in Santa Fe again and heard reports from the DOH on the various DOH programs that receive funds from the tobacco settlement.

The committee met in Las Cruces at New Mexico State University (NMSU) on September 18, where it heard reports about research on tobacco-use trends and the impact on public health costs and about tobacco-use cessation and prevention programs in the Las Cruces area. The committee also heard a report on integrated health care and delivery of health care services in rural New Mexico and an overview of health programs at NMSU, including an update on cancer research, and it toured the nearly completed Burrell College of Osteopathic Medicine.

On October 21, the committee met in Albuquerque at the UNM Health Sciences Center, where it heard reports on the various UNM programs that receive tobacco settlement funds, toured the UNM Comprehensive Cancer Center and heard reports on tobacco-use cessation and prevention efforts in Indian country.

The last meeting of the 2015 interim was in the State Capitol in Santa Fe on November 2. The committee heard reports on the permanent fund asset allocation and the arbitration proceedings, on use of tobacco settlement funds in the Medicaid program and on cigarette tax revenue distributions and bonding; a request for funding for a 3-D mammography machine; a panel on the latest health effects of e-cigarettes; and a panel on nicotine taxation.

Recommendations for FY 2017 Appropriations. The committee did not make formal recommendations regarding FY 2017, but a majority of the committee signed a letter to the Legislative Finance Committee supporting continuation of the distribution of the program fund in the same amounts as in FY 2016.

Endorsed Legislation. The TSROC did not endorse any legislation for the 2016 regular session.