STATE OF MAINE
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BRUCE L. POLIQUIN
Treasurer of State

To: Members, Joint Standing Committee on Appropriations and Financial Affairs
Members, Joint Standing Committee on Health and Human Services
Fr: State Treasurer Bruce L. Poliquin
On: December 1, 2012
Re: 2012 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: The total annual settlement payments are driven by two key annual adjustments, 1) the inflation adjustment and the 2) the volume of cigarettes sold nationwide. Under the Inflation Adjustment, the base annual payments will increase by the greater of 3% or the CPI value (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 year are less or greater than 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 Office of the State Treasurer 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 each Revenue Forecasting Committee meeting in order to reach consensus on the tobacco settlement 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 payment stream of any disputes pending under the MSA. These disputes, and the timing and direction of their outcomes, present significant volatility to the tobacco settlement 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 things are determined in its favor: First, an economics 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). 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.

Beginning in sales year 2003 and continuing through sales year 2010, the PMs have claimed that they are entitled to the NPM adjustment, which, if accepted by the Arbitration Panel presiding over this matter (currently hearing the dispute over the NPM Adjustment for sales year 2003 only), would result in a decrease in the amount the PMs owe under the MSA for those years. Maine asserts that it has had a qualifying statute in place for all relevant sales years and that it has diligently enforced that statute. If Maine prevails in the MSA arbitration proceeding, Maine will not experience a reduction in its payment amount due to the NPM Adjustment for the sales year at issue. If, however, Maine is found not to have diligently enforced, the State's liability could be equal or less than its entire annual payment amount for that sales year.

If the PMs dispute the calculated tobacco settlement amount they owe by claiming entitlement to the NPM Adjustment, they have three options under the MSA. One, the PMs can pay the contested amount to the State, as Phillip Morris did for sales years 2003-09; or, two, the PMs can place the contested amount in a disputed payment account, which R.J. Reynolds did for sales years 2003-10 except for 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 payment account for the NPM Adjustment for those sales years); and three, the PMs can simply withhold the entire amount they dispute from their annual payments, and many PMs have done this.

If Maine is found to have diligently enforced its qualifying NPM escrow statute, the State will be entitled to the amounts still owed by R.J. Reynolds and other PMs.

TOBACCO SETTLEMENT PAYMENTS AND INVESTMENT EARNINGS,

The State of Maine has received $689,001,118 to date from the 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
(DECEMBER, 2012 RECOMMENDATION TO STATE'S REVENUE FORECASTING COMMITTEE)

	FY 12 (actual)	FY 13	FY 14	FY 15	FY 16	FY 17
Base Payments	$42,306,831	$41,024,383	$40,587,014	$40,154,309	$39,726,216	$39,302,688
Strategic Contribution Payments	8,702,217	8,450,202	8,359,943	8,270,648	8,182,307	8,094,910
Racino Revenue	4,500,000	0	4,946,587	5,001,109	5,051,120	5,101,631
Income from Investments	7,858	5,067	5,768	8,764	15,299	15,776
TOTAL FHM Revenue	**$55,516,906**	**$49,479,652**	**$53,899,312**	**$53,434,830**	**$52,974,942**	**$52,515,005**

* Racino Revenue reflects that portion of the State's share of proceeds from slot machines at commercial race tracks designated for the Fund for a Healthy Maine. For fiscal years 2009-10, 2010-11, and 2011-12, PL 2009, c. 462, Pt. H. caps the proceeds transferred to the Fund for a Healthy Maine at $4.5 million per year, with the balance transferred to the General Fund. PL 2011 c. 380, Part II extended the $4.5 million cap through 2012-13. PL 2011 c. 477 re-directed $2 million of the 2012-13 transfer to the General Fund and PL 2011, c. 657 re-directed the remaining $2.5 million of the 2012-13 transfer to the General Fund.

** Beginning in FY10, this category reflects revenue transfers from the Fund for a Healthy Maine to General Fund undedicated revenue to offset revenue reductions from the implementation of PL 2007, c. 467, which limited the sale of certain flavored cigars and cigarettes beginning July 1, 2009. PL 2011 c. 380, Part II eliminated this transfer effective July 1, 2011.