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MEMORANDUM

DATE: May 25, 2017

TO: Honorable Jennifer Williamson, Chair of the House Committee on Rules

FROM: Aaron D Knott, Legislative Director

SUBJECT: HB 3461 – Master Settlement Agreement Maintenance

This testimony is presented in support of HB 3461.

Background: In the late 1990's, Oregon joined a number of states in suing the largest tobacco product manufacturers in the United States in an effort to curtail the growing medical care costs the states faced in caring for citizens dealing with the health effects of tobacco usage. Oregon's suit included a number of claims including unlawful and deceptive trade practices, fraud and unjust enrichment. On November 23, 1998, Oregon joined 46 states that settled this litigation by entering into the Tobacco Master Settlement Agreement ("MSA"). The MSA requires tobacco manufacturers who joined the agreement ("Participating Manufacturers" or "PMs") to make significant annual payments to the settling states in perpetuity and to cease marketing practices that target youth. Since 1998, Oregon has received $60-$80 million per year ($120-$160 million per biennium) in settlement payments. These payments help fund a number of General Fund programs, including medical assistance programs and smoking cessation programs.

The MSA requires joining states to enact and diligently enforce a "Qualifying Statute." In 1999, Oregon enacted its Qualifying Statute, which is now codified at ORS 323.800 to 323.806. The Qualifying Statute requires tobacco product manufactures who have not joined the MSA (known as "nonparticipating manufacturers" or "NPMs") to pay a sum into an escrow account each year based on sales in Oregon. In addition, in 2003 Oregon enacted additional statutes known as "Complementary Legislation" (codified at ORS 180.400 to 180.455) to assist with enforcement of the Qualifying Statute. Under this Complementary Legislation, tobacco companies wishing to sell their cigarettes and roll-your-own tobacco in Oregon must file a certification with the Oregon Department of Justice ("DOJ") each year. If approved, a tobacco product manufacturer's products will be included in Oregon's Directory of Cigarette Brands Approved for Stamping and Sale, which is maintained by DOJ and enforced in conjunction with the Department of Revenue ("DOR").

Litigation and Settlement: The MSA includes a number of complicated payment adjustment mechanisms that can increase or decrease a state's annual payment. One of these adjustments is commonly referred to as the NPM Adjustment. Under the NPM Adjustment, if a nationwide arbitration panel determines that a state did not "diligently enforce" its Qualifying Statute in a given year, that state can lose up to the full amount of its MSA payment for the year at issue ($60-80 million for Oregon). In addition, while a dispute is pending, the tobacco companies can withhold a portion of their annual payment based on this adjustment. As a result, the tobacco companies had historically withheld $9-$10 million from Oregon's MSA payment each year since 2007 (which payment related to enforcement in 2003).

In 2013, an arbitration panel determined that Oregon diligently enforced its Qualifying Statue in calendar year 2003. As a result, the disputed funds for 2003 were returned to Oregon in April 2014. Unfortunately, the determination of whether a state is subject to the NPM Adjustment is made on a year-by-year basis and Oregon faced protracted litigation regarding enforcement in 2004 and all subsequent years.

Because of the length of time required for each arbitration, the significant litigation costs associated with continuing the dispute, and the constant uncertainty to Oregon's budget, Oregon recently joined a multistate settlement of the NPM Adjustment. This settlement, known as the NPM Adjustment Settlement, ends the costly and time-consuming litigation, eliminates the risk of Oregon losing its entire MSA payment for the 2004-2014 sales years, reduces the risk of MSA payment loss from 2015 going forward, and resulted in the return of approximately $60 million in withheld funds to Oregon. As part of the settlement, Oregon agreed to work to broaden its enforcement responsibilities regarding illegal contraband cigarette sales. This legislative proposal is offered in furtherance of that objective.

Concept: HB 3461 provides DOJ with additional enforcement tools to assist with implementing the NPM Adjustment Settlement. These additional tools include:

Importer Liability. The bill makes an importer jointly and severally liable with the manufacturer for escrow fund deposits and any penalties imposed for violating the escrow requirements. The definition includes both legally and illegally imported cigarettes.

Surety Bond. The bill requires an NPM to post a bond to secure its escrow obligations. The bond will give the state a source of recovery if the NPM files bankruptcy or otherwise defaults on its escrow obligation. The bill allows the Attorney General to execute on the bond to recover delinquent escrow payments, civil penalties, and costs. Any outstanding amounts above the amount recovered on the bond remain due from the NPM and its importers.

Additional Certification Requirements. The law requires all manufacturers whose cigarettes are directly or indirectly sold in Oregon to submit certification applications to the Attorney General annually. The bill requires the following additional annual disclosures on an NPM certification:

- That the NPMs' importer is registered to do business in Oregon or has appointed a registered agent.
- That the NPM has posted a bond;
- That all of the NPMs' sales into Oregon are made to an Oregon-licensed distributor; and
- The names and addresses of the NPMs' importers and distributors.

Information Sharing. The bill allows information sharing between DOJ, DOR, other state and federal enforcement partners, and a data clearinghouse, which will improve enforcement coordination and efficiency

Ban on Internet Sales of Cigarettes and Smokeless Tobacco Products. Remote sales of cigarettes and smokeless tobacco products circumvent several Oregon laws, such as age verification and payment of taxes. Remote sales also put Oregon businesses at a competitive disadvantage. The bill addresses those issues by restricting shipment and transport of cigarettes and smokeless tobacco products to tobacco distributors and retailers. The bill also prohibits retailers from selling cigarettes and smokeless tobacco products unless the retailer makes the sale to the purchaser in person as part of a face-to-face exchange. The Attorney General may bring a civil action to enforce these provisions.

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