

# THE TOBACCO MASTER SETTLEMENT AGREEMENT: PAYMENT ISSUES

Presented to the Task Force for  
the Fund for a Healthy Nevada  
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## MSA History

- 1994 Mississippi Attorney General Mike Moore sued the tobacco industry
- Numerous states followed suit, including Nevada
- Settlement: November, 1998
- Tobacco Master Settlement Agreement (MSA)

EXHIBIT C Healthy Nevada

Document consists of 13 pages.

☒ Entire document provided

A copy of the complete document is available through the  
Research Library (775/684-6827) or e-mail  
[library@lcb.state.nv.us](mailto:library@lcb.state.nv.us).

Meeting Date 7/13/06

## MSA: The Bargain

- Participating Manufacturers (PMs) Agree:
  - To limit substantially the advertising, promotion, marketing or packaging of cigarettes, including a ban on “targeting youth,” limitations on tobacco brand name sponsorships, ban on tobacco brand name merchandise, etc.
  - To make payments to the States in perpetuity with a present value of \$206 billion

## MSA: The Bargain (cont’d)

- Settling States Agree:
  - To release the PMs from specified claims that the States (but not individuals) had and might have in the future for costs arising out of tobacco related illnesses

# MSA PAYMENTS

- 3 Major Annual Payments Originally Required
  - “Initial Payment” due 1/10/99 through 1/10/03
  - Payment to American Legacy Foundation
  - Annual Payments due 4/15 – based on cigarette sales in the preceding year

## Adjustments to Annual Payments

- Annual Payments are base amounts subject to the following adjustments:
  - Inflation Adjustment
  - Volume Adjustment
  - Previously Settled States Adjustment
  - **NPM Adjustment**



## Payment Calculations

- Independent Auditor (PwC) calculates and determines all payments owed under MSA
- At least 40 days prior to April 15, IA issues Preliminary Calculations of (a) amount due from each PM, and (b) amount allocable to each State
- Nevada's allocable share is .6099351%

## Payment Calculations and Disbursements

- At least 30 days prior to April 15, any State or PM that disputes any aspect of Preliminary Calculations must notify other parties of dispute, including the "reasons and basis" for the dispute

## Payment Calculations and Disbursements (cont'd)

- At least 15 days prior to April 15, after receiving "dispute" notices, IA issues Final Calculations
- At least 5 days prior to April 15, each State or PM is to deliver to other parties a statement indicating whether it disputes IA's Final Calculations and, if so, disputed and undisputed amounts and basis for dispute

## Payment Calculations and Disbursements (cont'd)

- Each PM obligated to pay by April 15 the undisputed portion of its calculated payment
- Failure to pay subjects PM to interest at Prime + 3
- But – any disputed payment portion can be placed into Disputed Payments Account, so PM not liable for interest if it loses dispute

## Payment Calculations and Disbursements (cont'd)

- PM can alternatively **withhold** disputed payment portion
- If so, risks interest at Prime +3 if it loses
- No time limit on resolving disputes over payment calculations
- If dispute resolved in favor of PM, it gets credit against next payment due to the States

## Concept of Non-Participating Manufacturer (NPM) Adjustment

- NPMs have no obligations under the MSA
- MSA parties were concerned that NPMs could exploit their lower costs and commercial freedom to expand their markets which
  - Would undermine the MSA's public health goals
  - Would unfairly disadvantage PMs that had chosen to settle their claims with the States



## Concept of NPM Adjustment (cont'd)

- NPM Adjustment provides incentive to ameliorate these adverse effects
- If, because of the disadvantages imposed on them by the MSA, PMs lose "Market Share" to NPMs, PMs payments to the States can be reduced

## Applying the NPM Adjustment

- Step One:
  - Has there been a Market Share Loss for the year in question?
- Step Two:
  - If answer to Step One is "yes" calculate the NPM Adjustment Percentage for the year at issue

## Applying the NPM Adjustment (cont'd)

- Step Three:
  - To ascertain whether NPM Adjustment Percentage can be applied to any State's payment, determine if "the disadvantages experienced as result of the [MSA's] provisions [were] ... a significant factor contributing to the Market Share Loss for the year in question?"

## Applying the NPM Adjustment (cont'd)

- Step Four: If answer to Step Three is "yes" determine if State:
  - Continuously had a Qualifying (or Model or NPM) Statute in full force and effect during the calendar year preceding the payment year (NRS Chapter 370A); **and**
  - *Diligently enforced* the Model Statute's provisions during such calendar year



## Applying the NPM Adjustment (cont'd)

- Step Five:
  - If answer to both Step 4 questions = "Yes," NPM Adjustment cannot be applied to that particular State
  - If answer to either of the Step Four questions is "No," then the NPM Adjustment is applied to the State's annual payment

## Applying the NPM Adjustment (cont'd)

- A State's entire annual payment conceivably could be at risk depending on whether other MSA States annual payments are also subject to the NPM Adjustment – the "rollover" effect
- 2003 Settlement Agreement with PMs resolved disputes over 1999-2002 potential NPM Adjustments

# Applying the NPM Adjustment (cont'd)

- At issue now is the 2003 NPM Adjustment
  - Market Share Loss = Yes
  - Significant Factor Adverse Determination by the Brattle Group, and Independent Firm of Economic Consultants – March, 2006
  - Sole Issue- Diligent Enforcement

Participating Manufacturer	Amount Expected Per Notice 198	Amount Paid	Amount Paid into Dispute	Amount Withheld/ Not Paid	Disputed/Withheld Per 2005 NPM Adjustment Dispute	Disputed/Withheld Per 2003 NPM Adjustment Dispute	Disputed/Withheld for reduction of Grandfathered Share due to change to Net
Data from PwC Notice 202, Attachment 1c							
Lorillard	\$ 666,237,395.96	\$ 557,550,768.56	\$ 108,686,627.40			\$ 108,686,627.40	
Philip Morris	\$ 3,446,639,474.61	\$ 3,446,639,474.61					
RJ Reynolds	\$ 2,016,006,938.00	\$ 1,369,253,628.59	\$ 646,753,409.41			\$ 646,753,409.41	
Alliance							
Anderson							
Bekentlon, SA	\$10,013,439.70			\$10,013,439.70			
Canary Islands							
Caribbean-American							
Chancellor							
Commonwealth	\$225,385,179.93	\$ 201,094,729.30	\$ 24,290,450.63		\$ 24,290,450.63		
Compania Industrial de Tabacos Monte Paz							
Cutting Edge	\$95,906.12	\$ 95,906.12					
Daughters & Ryan	\$227,514.19	\$227,514.19					
Eastern							
Farmers	\$19,401,739.46	\$19,401,739.46					
General Tobacco	\$107,596,873.72	\$ 96,008,271.00		#####	\$ 11,588,602.72		
House of Prince	\$25,201.60	\$25,201.60					
Imperial Tobacco							
International Tobacco Group	\$74,171.87			\$74,171.87			
Japan Tobacco International	\$1,947,259.85	\$ 1,679,900.15	\$ 267,359.70		\$ 267,359.70		
King Maker Marketing	\$3,651,369.07	\$ 3,368,872.30	\$ 492,496.77		\$ 492,496.77		
Konci C&D Group	\$655,655.61	\$ 653,607.35	\$ 71,778.46		\$ 71,778.46		
Kretek	\$1,186,233.73	\$ 1,046,899.06	\$ 139,334.67		\$ 139,334.67		
Lane Limited	\$2,812,754.20	\$ 2,812,754.20					
Liberty Brands	\$5,701,164.21	\$ 5,094,722.29	\$ 606,441.96		\$ 606,441.96		
Liggett	\$14,847,948.55	\$ 10,636,816.70		\$ 4,211,029.85	\$ 1,559,181.99		\$ 2,611,847.89
Lignum-2	\$399,725.54	\$399,725.54					
M/s. Dhanraj	\$6,188,795.43	\$ 500,000.00		\$ 5,689,795.43			
Mac Bess	\$20,271.32	\$ 20,246.32		\$ 25.00			
NASCO							
Pacific Stanford	\$203,713.02	\$203,713.02					
Peter Stockdale	\$2,627,867.89	\$2,627,867.89					
Planta Tabak							
Poschi Tabak							
Premier							
PT Djavut	\$4,035,757.82	\$ 3,601,107.96	\$ 434,649.86	\$ (17.00)	\$ 434,666.86		
Sante Fe	\$14,358,347.66	\$14,358,347.66					
Sherman 1400 Broadway N.Y.C., Inc.	\$734,397.09	\$ 644,719.41	\$ 89,677.68		\$ 89,677.68		
SEITA							
TABESIA							
Top Tobacco	\$16,473,741.43	\$16,473,741.43					
U.S. Flue-Cured	\$365,423.34	\$365,423.34					
Vector							
VIP Tobacco							
Virginia Carolina	\$242,170.75			\$242,170.75			
Von Eicken Group	\$94,466.79	\$94,466.79					
Wood River	\$32,902.11	\$32,902.11					
ZNF International							
Totals	\$6,568,524,930.77	\$5,754,873,468.91	\$781,832,243.54	\$31,819,218.32	\$39,579,091.41	\$755,440,036.81	\$2,611,847.89

## Nevada Lawsuit

- On April 20, 2006, the Office of the Attorney General filed a complaint against the OPMs and SPMs seeking:
  - The Court's determination that Nevada diligently enforced Nevada's Model Escrow Statute during the entire calendar year of 2003, and therefore Nevada's Allocated Payments are not subject to a 2003 NPM Adjustment

## Model Escrow Statute NRS Chapter 370A

- Any tobacco product manufacturer selling cigarettes to consumers within the State shall do one of the following:
  - (a) Become a participating manufacturer under the MSA and generally perform its financial obligations under the MSA, or
  - (b) Place into a qualified escrow fund by April 15 of each year a specific sum (\$4.16/carton for 2005) for each of its tax-stamped cigarettes sold in Nevada during the preceding calendar year



## Model Escrow Statute NRS Chapter 370A

- Funds placed in escrow revert back to the NPM 25 years from the date deposited.  
*Unlike payments made by the PMs to the MSA, the NPM escrow payments do not belong to the State.*

## Purpose of the Model Escrow Statute (NRS Chapter 370A)

- At the time the MSA was negotiated, States were concerned that NPMs, which are not bound by the MSA's marketing restrictions and have no MSA payment obligations, would utilize this competitive advantage to increase cigarette sales, accumulate short-term profits, and disappear before the manifestation of the latent effects of their products

## Purpose of the Model Escrow Statute (NRS Chapter 370A)

- NPMs could sell dangerous products in the States without providing the security for future damages that the PMs provide through their per-cigarette payment under the MSA
- Realize a competitive advantage over PMs as a result of the NPMs decision not to join the MSA

## Purpose of the Model Escrow Statute (NRS Chapter 370A)

- Hence, the escrow requirement is designed to serve two purposes:
  - (1) To create a resource against which a State can recover in the event it files a lawsuit and wins a judgment against an NPM arising from an action for health related costs associated with the NPMs' product; and
  - (2) To create a financial obligation on the part of NPMs to make escrow deposits roughly equivalent, on a per-cigarette basis, to the MSA payments of the PMs to reduce the competitive advantage