Program Summary
Attorney General – Department of Law
Master Settlement Agreement

Program Overview

In the 1990's, Tobacco manufacturers were sued for damages related to cigarette smoking. As a result, the 4 largest cigarette manufacturers, known as the Original Participating Manufacturers (OPMs), entered into a Master Settlement Agreement (MSA) in November 1998 with 46 states, including Arizona, the District of Columbia, and 6 territories to pay damages for the cost of treating smoking-related illnesses. According to the MSA, state lawsuits against manufacturers would be dismissed in exchange for annual settlement payments to be received on April 15 of each year, as well as restrictions on cigarette marketing and advertising practices. Since 1998, additional cigarette manufacturers, known as Subsequent Participating Manufacturers (SPMs), have signed into the MSA. Cigarette manufacturers that have not signed the MSA are known as Non-Participating Manufacturers (NPMs).

In FY 2002, the Tobacco Enforcement Unit was created in the Attorney General's (AG) office. The sole purpose of the Tobacco Enforcement Unit is to enforce the provisions of the Master Settlement Agreement and the accompanying statutes, and ensure that the state receives its annual payments.

Since FY 2006, the annual payments received by the state have been deposited into the Tobacco Litigation Settlement Fund, which provides funding to expand the AHCCCS program to 100% of the Federal Poverty Level and for 6 public health programs as required by Proposition 204 in the 2000 General Election. Prior to FY 2006, a portion of the annual payment had been appropriated to the Department of Health Services (DHS) for DHS-related Proposition 204 expenditures. Because the annual payments are not received until April of each year, DHS had difficulty in identifying state match monies to draw down federal dollars; and, therefore, their portion of the annual payment was appropriated to AHCCCS and replaced with General Fund dollars in the DHS budget.

Program Funding

In FY 2002, the AG's office received $300,000 from the General Fund for the creation of the Tobacco Enforcement Unit with 4 FTE Positions. Funding was added to the unit only for standard statewide adjustments in FY 2003 through FY 2007. In FY 2008, the AG's office received an additional $223,000 and 3 FTE Positions, to defend the MSA against the PM's recent challenges to it, which have remained in the program's budget through FY 2012, adjusted for statewide adjustments.

The AG estimated the need of an additional $1.7 million for arbitration costs in FY 2009. Laws 2008, Chapter 286 allowed the AG to use available monies in the Consumer Fraud Fund for operating costs in FY 2009, including costs of the MSA arbitration. Laws 2008, Chapter 285 appropriated $1.7 million from the Consumer Fraud Fund for any expenditures including those related to the MSA litigation in FY 2009. Laws 2010, 7th Special Session, Chapter 6 permanently allows the AG to use available movies in the Consumer Fraud Fund for operating costs, including costs of the MSA arbitration.

Annual Payments to the State

The state's annual payment is based on a formula contained in the settlement agreement, which is subject to 3 primary adjustments annually:

1) An inflation adjustment that accounts for the change in the value of a dollar from year to year;
2) A volume adjustment that ensures payments to the states is based on the total number of cigarettes sold by participating manufacturers; and
3) A NPM adjustment for gain of market share by Non-Participating Manufacturers.

The intent of the NPM adjustment is to correct for a possible NPM market advantage resulting from the MSA. At the time the MSA was negotiated, the OPMs raised concerns that the annual payment to the states would require them to raise prices in order to remain profitable, while the NPMs would not be faced with the same requirement and could, therefore, avoid a similar adjustment in prices. As a result, the MSA contains provisions known as model statutes that all 46 states and 6 territories have adopted in an attempt to compensate for market changes. These statutes require NPMs to make deposits into an escrow account proportional to the number of cigarettes sold in that state each year. This money is not available for state use and can only be obtained in the event that the state files suit against the manufacturer and prevails. If the state does not file suit successfully within 25 years of the deposit date, the money in the escrow account is returned to the manufacturer.

Any state that has not enacted or properly enforced the model statutes for a given year has its payment decreased according to a NPM adjustment. Both OPMs and SPMs can make the NPM adjustment to their annual payment. The NPM adjustment is calculated by multiplying the market share loss for the OPMs from the previous year in a given state by 3. In other words, a 2% loss of market share by OPMs would result in a 6% reduction in the allocated payment to the respective state.

Table 1 lists the annual payments received by the state in FY 1999 through FY 2011. Since FY 1999, the state has received a total of $1.14 billion.

In April 2006, the state was entitled to an annual payment of $97.0 million, but only received $86.3 million due to the March 2006 ruling of an independent arbiter that the MSA contributed to a loss in market share for the OPMs in sales year 2003. In subsequent years, the state also received less than the entitled annual payment for further OPM market share losses based on previous sales years. In order to receive the amount that has been withheld from the state, the AG's office needs to sue the tobacco manufacturers that chose to make the NPM withholdings and prove that Arizona has diligently enforced the model statutes. These proceedings could take anywhere from 1 to 2 years and the AG cannot predict if the state will be successful, or if the withheld funds would be settled for a reduced amount. If it is ruled that Arizona did not diligently enforce the model statutes, Arizona would not receive the previously withheld payments and could lose a portion or all of the MSA payment. Proceedings to address the withholding from FY 2006, which is based on market share from sales year 2003, may begin in summer 2011. The AG's office does not have an estimate as to when it will reach a resolution and predicts that the tobacco manufacturers will continue to attempt to make similar withholdings on an annual basis.

There are other reasons funds could be withheld from the state, including companies refusing to make payments and companies having insufficient funding to make payments. In some cases, companies decide not to deposit disputed funds in the disputed payments escrow account, and these monies would also be identified as withheld funds.

As Arizona was one of the states that initiated the lawsuit, the court order states that Arizona is entitled to additional monies beginning in FY 2008 because of these additional efforts. These "strategic contribution payments" will continue until FY 2017 and are noted in *Table 1*.

Table 1

	Received Payments			**Withheld Payments**		
Fiscal Year	**MSA Payment** [1/]	**Strategic Contribution Payment**	**Total Payments Received**	**NPM Deposits to Disputed Payments Account**	**Withheld and Unpaid Amount**	**Total Payments Withheld**
FY 1999 – FY 2001	$207,966,000		$ 207,966,000			
FY 2002	111,955,069		111,955,069			
FY 2003	106,926,757		106,926,757			
FY 2004	92,648,165		92,648,165			
FY 2005	93,933,400		93,933,400			
FY 2006	86,301,152		86,301,152	$10,640,248		$10,640,248
FY 2007	92,004,100		92,004,100	7,632,600		7,632,600
FY 2008	91,342,555	$24,244,269	115,586,824	350,641	$ 164,925	515,566
FY 2009	100,728,675	24,842,186	125,570,861	1,568,252	6,544,986	8,113,238
FY 2010	83,826,497	21,567,586	105,394,083	7,892,997	1,486,157	9,379,154
FY 2011	79,474,407	19,655,567	99,129,973	14,517,407	728,645	15,246,052
Total	**$1,147,106,777**	**$90,309,608**	**$1,237,416,384**	**$42,602,145**	**$8,924,713**	**$51,526,858**

1/ May include funds that were withheld in previous years and/or disputed funding that could be subject to future arbitration.