Master Settlement Agreement
Attorney General - Department of Law
Program Summary

Program Overview
In the 1990s, states began suing cigarette companies for public health costs related to tobacco consumption. These lawsuits resulted in the Master Settlement Agreement (MSA), a contract between the 4 largest cigarette manufacturers and 46 states, including Arizona, the District of Columbia, and 6 territories. The MSA was signed by all parties in November of 1998.

As part of the settlement, states agreed to dismiss their lawsuits against manufacturers in exchange for perpetual annual payments and restrictions on cigarette marketing practices, such as the explicit targeting of youth. The annual payments have resulted in approximately $2.18 billion in revenue for Arizona since 1998. The amount Arizona receives each year varies due to adjustments of several variables.

The MSA permits other tobacco companies, beyond the Original Participating Manufacturers (OPMs), to join the settlement as a Subsequent Participating Manufacturer (SPM). Firms that choose not to join the MSA, known as Non-Participating Manufacturers (NPMs), must deposit about $0.037 per cigarette sold into a Qualified Escrow Account. This amount is adjusted according to annual inflation. Both MSA and escrow deposits are due on April 15th of the following year.

Prior to FY 2006, a portion of the annual payment was appropriated to the Department of Health Services (DHS). 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; therefore, their portion of the annual payment was appropriated to the Arizona Health Care Cost Containment System (AHCCCS) and replaced with General Fund dollars in the DHS budget. AHCCCS uses the funds, which are deposited into the Tobacco Litigation Settlement Fund, to meet Proposition 204 requirements, including expanding eligibility to those up to 100% of the Federal Poverty Level.

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. The purpose of the unit is to enforce the provisions of the MSA and the accompanying statutes to ensure that the state receives its full annual payments. The unit received 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 PMs' recent challenges to it, but the amounts were reduced to $100,000 and 1 FTE Position during the economic downturn.

Table 1
MSA Transfers from AHCCCS

Fiscal Year	AHCCCS Transfer Limit	Actual Transfer
FY 2012	$1,364,300	$ 900,000
FY 2013	1,200,000	1,200,000
FY 2014	1,200,000	800,000
FY 2015	1,200,000	900,000
FY 2016	1,200,000	1,200,000
FY 2017	1,200,000	1,200,000
FY 2018	1,200,000	1,200,000
FY 2019	1,200,000	1,200,000
FY 2020	1,200,000	1,130,000

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 Protection-Consumer Fraud (CPCF) Revolving Fund for operating costs in FY 2009, including costs of the MSA arbitration. Laws 2010, 7th Special Session, Chapter 6 permanently allowed the AG to use available monies in the CPCF Revolving Fund for these purposes.

Since 2012, AHCCCS has been required to transfer money to the AG for use in the MSA litigation. *Table 1* shows the transfer limit and actual transferred amount for each year.

In addition, Laws 2016, Chapter 117 also required AHCCCS to transfer $436,000 to the Department of Revenue (DOR) to fund 6 positions for perform luxury tax enforcement and audit duties. These monies provided to DOR allow the state to comply with the terms of the amended agreement through enhanced auditing capabilities and an automated accounting system.

For FY 2021, the AG was appropriated $88,300 from the General Fund and $745,900 from the CPCF Revolving Fund to defend and implement a multi-year settlement reached in December 2012 between tobacco companies and the state over the MSA. *(Please see Annual Payments to the State for more information.)* These funds brought the total monies appropriated to the AG for MSA enforcement in FY 2021 to $2,034,200.

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 are based on the total number of cigarettes sold by participating manufacturers; and
3) An NPM adjustment for gain of market share by Non-Participating Manufacturers.

The NPM adjustment is to correct for a possible market advantage for companies not participating in 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 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 if 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 ongoing MSA 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. The formula is slightly different if the market share loss exceeds 16 and 2/3 percentage points. No NPM adjustment is made if market share increases.

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. To receive the amount that had been withheld from the state, the AG's office sued the tobacco manufacturers that chose to make the NPM adjustments and prove that Arizona has diligently enforced the model statutes. If Arizona had been found as non-diligent in enforcing the model statutes, then the state would not have received the previously withheld NPM adjustments and could have lost a portion or all the annual MSA payment.

In December 2012, Arizona along with 23 other states, the District of Columbia, and Puerto Rico reached a settlement for disputed payments from 2003-2014. Settling states and manufacturers agreed to split the monies representing the NPM adjustments for the years in question, with the states receiving 54%. Arizona received its share of the NPM adjustment through a one-time payment of $48,090,600 in FY 2013. The manufacturers will receive their share of the settlement monies through credits against the settling states' portion of annual MSA payments for 5 years. In July 2018, Arizona along with 33 states, the District of Columbia, and Puerto Rico reached a settlement that extended the receipt of disputed payments to 2015-2017.

Several states opposed the settlement and sought to invalidate it. None of these legal challenges succeeded. However, the non-settling states are currently litigating the 2004 NPM adjustment. The multi-year NPM adjustment settlement that Arizona joined contains a provision that, if triggered, requires Arizona to assist in this arbitration in a limited manner. If the arbitration panel decides that it needs to determine the diligence of the settling states, then Arizona and the other settling states will have to provide relevant documents and witnesses for the purposes of this determination. Arizona is not at risk of losing any money. Instead, this would be done only to determine the amount of money that the manufacturers can recover from the non-settling states.

Since FY 1999, the state has received a total of $2.18 billion. Because Arizona was one of the lead states in the litigation and negotiation that led to the MSA, the state received additional "strategic contribution payments" from FY 2008 to FY 2017. Although all strategic payment dollars were reallocated to the Annual Payments total after FY 2017, Arizona's share was negatively affected because the state received a higher proportion (3.1%) of strategic contribution payments than it does from the general pot (1.5%). This difference reduced Arizona's payments by about $7 million in FY 2018. This was offset by a backfill of FY 2015 payments that resulted from a settlement over NPM adjustments. *Table 2* lists the payments received by the state in FY 1999 through FY 2020.

Table 2

Received Payments

Fiscal Year	**MSA Payment**	**Strategic Contribution Payment**	**Total Payments Received**
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
FY 2007	92,004,100		92,004,100
FY 2008	91,342,555	$24,244,269	115,586,824
FY 2009	100,728,675	24,842,186	125,570,861
FY 2010	83,826,497	21,567,586	105,394,083
FY 2011	79,474,407	19,655,567	99,129,974
FY 2012	78,489,981	22,577,432	101,067,413
FY 2013 [1/]	122,925,501	26,199,893	149,125,394
FY 2014	79,872,741	20,598,428	100,471,169
FY 2015	79,293,353	20,681,785	99,975,138
FY 2016	78,609,954	20,296,944	98,906,898
FY 2017	80,823,410	20,698,337	101,521,747
FY 2018 [2/3/]	101,761,000		101,761,000
FY 2019	98,938,461		98,938,461
FY 2020	94,283,057		94,283,057
Total	**$1,926,104,235**	**$221,362,427**	**$2,183,466,662**

1/ Includes $48.1 million the state received as a one-time payment for its share of the NPM adjustment settlement reached in 2012.

2/ Strategic contribution payments ended with FY 2017, and the money was reallocated to the annual payments total. This caused a decrease in Arizona's total payment as the state received a larger share of strategic contribution monies (3.1%) than it does annual payment monies (1.5%).

3/ Includes $6.2 million the state received as a one-time payment for the addition of 2015 to the NPM adjustment settlement.

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