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March 6, 2024

HEALTH AND GOVERNMENT OPERATIONS
COMMITTEE

241 Taylor House Office Building
6 Bladen Street
Annapolis, Maryland 21401

Re: House Bill 1173

Dear Chair Melnyk and Members of the Committee:

My name is Dustin McDaniel. I am an attorney in Little Rock, Arkansas. I have a national law practice representing various sectors of American businesses in their dealings with state Attorneys General. I served in the Arkansas House of Representatives before I was elected to serve two terms as Arkansas's 55th Attorney general. I was the youngest AG in the United States at the time.

I served as Co-Chair of the Democratic Attorneys General Association for three years, as the Southern Regional Chair of the National Association of Attorneys General (NAAG) for 3 years, and as the NAAG Tobacco Project Co-Chair for four years. I have served as the Democratic Co-Chair of the Society of Attorneys General Emeritus (SAGE) for the last three years.

As NAAG Tobacco Chair, I worked to protect the interests of every state, including Maryland, to secure their rights and settlement funds under the Master Settlement Agreement ("MSA"), which was executed between the states and "big tobacco" in 1998.

Since leaving office, in my private practice, I still work to ensure compliance with the MSA for my sole Tobacco client, Xcaliber International, Ltd., L.L.C. ("Xcaliber"), whose general counsel, Eric B. Estes, is one of the nation's foremost experts on the MSA and tobacco policy. Mr. Estes will be one of two representatives of the company testifying against House Bill 1173 ("HB1173" or "bill").

HB1173 proposes to establish an "equity fee," on some, but not all, sellers of tobacco products in Maryland. Under this bill, Non-Participating Manufacturers ("NPMs") operating in Maryland would be required to pay a new tax directly to the State instead of into escrow as required by the Master Settlement Agreement ("MSA").

In short, this bill does not benefit public health, as it generates very little revenue for the state. It does not deter smoking, since it does not apply at all to 99.3% of tobacco sales in Maryland. It requires written consent from big tobacco manufacturers (the 99.3% of the Maryland market that will be exempt under the bill) to avoid endangering the state's annual MSA payments. This

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bill is NOT equitable as it does not give NPMs a liability release, which PMs enjoy forever, requires a bond to be paid by NPMs, but not required for PM's, and requires NPMs make payments quarterly, while PMs get to hold their money and pay at the end of each year.

This bill unfairly changes the rules that NPMs have been strictly following. Below you will find additional testimony to further support my respectful opposition to this bill.

I. The Maryland Model Escrow Statute is the recognized system for regulating NPMs under the MSA.

In 1998, the nation's major cigarette companies, known as the Participating Manufacturers ("PMs"), entered into the Master Settlement Agreement ("MSA") with 46 states – including Maryland – to pay annual damages as a remedy related to prior litigation over an alleged 40-year conspiracy by tobacco companies to suppress information about the hazards of smoking and the addictive character of nicotine and for deceptive marketing practices. Most NPMs, including Xcaliber, were not involved in the litigation resulting in the MSA; Xcaliber was not only not on the market at that time, but it did not even enter into business until years later. Regardless of the NPMs non-existence at the time of the settlement, they have been regulated, since inception, by states via the MSA and subsequently related legislation.

Under the MSA, to ensure that NPMs did not have a competitive market advantage, and to provide for future potential litigation, NPMs pay a per cigarette fee into escrow accounts on an annual basis. The amount deposited into escrow by NPMs is also done so without any liability waiver unlike the exemption provided to the PMs. This money is held in trust in the event the funds are necessary to pay out damages from litigation brought forth by the state. *No such lawsuit against an NPM has succeeded since the adoption of the MSA in 1998.*

Specifically, under the Maryland Model Escrow Statute:

- NPMs deposit sums into a qualified escrow account for sales in Maryland during the preceding year. MD. CODE ANN. BUS. REG. § 16-403(a).
- Escrow is held for a period of 25 years. The escrowed funds may only be obtained by the State through legal processes to satisfy certain health-related claims relating to an NPM's conduct. MD. CODE ANN. BUS. REG. § 16-403(b)(2).
- During the 25-year escrow period, the NPMs are permitted to obtain and use the interest on the escrow funds for purposes such as offsetting business expenses. MD. CODE ANN. BUS. REG. § 26-403(b)(1).

The Model Escrow Statute has been upheld by courts and justified by policymakers. HB1173, however, would replace the court approved, gold standard, nationally accepted escrow system with a new, discriminatorily applied tax. HB1173 is contrary to two of the fundamental premises of the Model Escrow Statute:

(1) No money is taken from the NPM. It remains the NPM's property in an interest-bearing account, and

(2) the statute is designed to ensure that the NPMs pay no more than the PMs.

HB1173 undermines both of the above well-established principles. First, by requiring NPMs to pay a tax to the state instead of escrow, NPMs would no longer have access to the interest of the escrow accounts to offset business expenses, and further, would be unable to have those held funds released after satisfying the 25-year obligations. Additionally, this tax is levied only against the NPMs that are contributing to 0.7% of cigarette sales in Maryland, while the PMs that brought about the need for MSA in the first place, receive cost-advantages. This provides for further protection of their market shares.

Further, the bill converts the NPMs' escrow payments into a tax thereby resulting in a taking without due process or litigation. It represents a breach of a more than two-decade old understanding between the NPMs and the model statute despite zero instances of legal wrongdoing by NPMs. Under the bill, NPMs would be able to contest payment amounts within only a one-year period. However, PMs can withhold payments under dispute and obtain credits for years after their deposit. The one-year cutoff for NPM refund claims guarantees that NPMs would pay more than their larger competitors - the actual parties to the prior tobacco litigation. In addition, many PMs have substantial payment exemptions, meaning that they would also pay less to the State than the NPMs.

II. The superior bill, House Bill 1073, is equitable across all tobacco product manufacturers and better advances public health by imposing state excise taxes on all manufacturers.

This Committee has the ability to advance legislation under HB1073 that would raise considerably more revenue in the interest of public health. By taxing all tobacco product manufacturers in a uniform manner, not only is more money made available, but it is applied equitably among all tobacco product manufacturers. This eliminates the constitutional concerns of HB1173 and provides a non-discriminatory opportunity to advance public health in Maryland.

By uniformly raising tobacco taxes by \$0.75 per pack, HB1073 would raise revenue of \$54,000,000.00 in its first year, per the Maryland Department of Legislative Services' Fiscal and Policy Note. That is *nearly one hundred times* the amount provided by HB1173 which for 2023 would have resulted in less than \$550,000.00 from three NPMs with only 0.7% of Maryland's total cigarette sales. The discriminatory application of HB1173 needlessly supports larger PMs at the expense of smaller NPMs and raises constitutional issues as presented by Xcaliber and other NPMs.

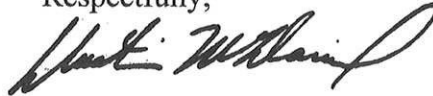
In closing, it is my opinion that HB1173 is not only unnecessary, but its passage would lead to significant litigation between Maryland and those NPMs operating lawfully in the state. There is no justification for this risk, especially given that the inequities and ineffectiveness of this bill, as presented here and in written testimony by effected NPMs, are resolved through HB1073. Advancement of that legislation can have an immediate impact on Maryland public health and funding to support those initiatives.

March 6, 2024

Page 4 of 4

Thank you for your service to your state and for your consideration of my testimony on this complicated matter.

Respectfully,

A handwritten signature in black ink, appearing to read "Dustin McDaniel". The signature is fluid and cursive, with a large, sweeping flourish at the end.

Dustin McDaniel

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