701 South Battleground Avenue
Grover, North Carolina 28073

704.937.7200 704.937.7250
www.cheyenneintl.com

March 4, 2024

Honorable Delegate Joseline A. Pena-Melnyk
Maryland General Assembly
Health and Government Operations Committee
Room 241
House Office Building
Annapolis, MD 21401

Re: House Bill 1173

Dear Honorable Delegate Pena-Melnyk,

Please find below a brief outline of legal arguments in opposition to Maryland House Bill 1173 for your consideration by Cheyenne International, L.L.C., ("Cheyenne"), a small business that is a Non-Participating Manufacturer ("NPM"), located in Grover, North Carolina,. This letter is intended to clarify the position of Cheyenne with respect to this bill.

HOUSE BILL 1173 DOES NOT ACCOMPLISH ITS STATED PURPOSES

In its preamble to House Bill 1173, the State asserts that all manufacturers should be required to provide compensation for the harm caused by their cigarette products. Despite this, the State fails to acknowledge that the Model Escrow Statute, which House Bill 1173 seeks to amend, has provided an effective remedy to achieve the stated goal of the legislative proposal for almost 25 years. Pursuant to the Model Escrow Statute, NPMs are required to place funds into escrow for every cigarette sold in Maryland. The funds exist "[t]o pay a judgment or settlement on any released claim brough against such tobacco product manufacturer by the State of Maryland[.]" Thus, to the extent that an NPM, such as Cheyenne, has committed a violation of law that meets the definition of a "released claim," it can be sued and the monies deposited for each sale in the State would be forfeited.

Knowing that, to date, NPMs have not committed any actions that would give rise to a "released claim" . Maryland now wishes to simply take the deposited escrow funds for non-legal claims, ignoring its own statutes, without the need for either due process or the other legal protections that are provided to the Participating Manufacturers ("PMs"), whose bad acts and practices brought forth both the need for the MSA and the Model Escrow Statute itself.

In its preamble to House Bill 1173, Maryland lists a number of justifications for the amendments to the Model Escrow Statute. For instance, the State seems to argue that the measures will "prevent the manufacturers from deriving large, short-term profits and then becoming judgment-proof." These justifications provided the basis for the Model Escrow Statute and subsequent legislation that was enacted almost 25 years ago, but fail to apply in this circumstance. By requiring NPMs to deposit money for each sale that they make in Maryland, the Model Escrow

Statute creates a fund against which the State may collect a judgment or settlement related to a released claim. The tax obligations imposed on NPMs by House Bill 1173 do not change the sum owed by NPMs; it only converts the escrow obligation to a tax obligation. The State has already assured that the NPMs cannot enter and exit the market without incurring costs.

The State also seemingly asserts that the measure would prevent youth initiation of cigarette products. If that is the goal, the State should target the PMs, rather than NPMs. As outlined by the Centers for Disease Control ("CDC") as recently as 2018, youth do not smoke brands manufactured by NPMs. Rather, "the top three brands usually smoked among cigarette smokers in all middle school grades combined were Marlboro (38.3%), Newport (21.4%), and Camel (13.4%). In 2017, the CDC more fully outlined the remaining cigarette brands used by youth. In order, these were Pall Mall, Maverick, Santa Fe, Winston, and Kool. All of these brands are manufactured by PMs. House Bill 1173 does not correct youth initiation of NPM brands, as the evidence establishes there is none.

HOUSE BILL 1173 WOULD VIOLATE THE EQUAL PROTECTION CLAUSE.

Maryland cannot effectively argue that PMs and NPMs are not similarly situated, as House Bill 1173 seeks to treat both types of manufacturers the same in terms of payment obligations to the State. Despite this, House Bill 1173 results in disproportionate obligations and legal protections, in direct violation of the Equal Protection Clause. As part of their litigation against the states (constituting due process within the legal requirements of law that will not be afforded to NPMs under House Bill 1173), PMs were given the ability to craft a settlement. This settlement provided the PMs with several protections that would not be reciprocated to NPMs under House Bill 1173, to wit:

(1) Under the MSA, PMs make payment obligations on an annual basis. In contrast, NPMs would be required to pay quarterly. This gives the PMs the use of the monies throughout the year, including the ability to invest and make money from the funds pending payment.

(2) Under the MSA, the PMs received a liability release. The NPMs receive no such consideration.

(3) Under House Bill 1173, NPMs would be given one year to dispute payments. Under the MSA, however, PMs are given a near infinite amount of time to dispute the payments, including the ability to forego payment during a dispute, while reserving their ability to sell product. If an NPM were to fail to make payments, its products would be removed from the State's list of approved brands and the products would be considered contraband.

(4) Under the MSA, courts and arbitration panels are given the ability to resolve payment disputes. Under House Bill 1173, the Attorney General alone is seemingly provided that ability.

(5) Under the MSA, the PMs were afforded most favored nations terms, assuring that no party would secure settlement rights better than they received. NPMs would receive no such protections under House Bill 1173.

HOUSE BILL 1173 FAILS TO REQUIRE ALL MANUFACTURERS TO PAY EQUALLY.

House Bill 1173 purportedly seeks to assure that all manufacturers internalize the harm caused by their products. In reality, however, the statute fails to achieve this goal. The MSA allowed for two different types of PMs: the Original Participating Manufacturers that signed the MSA at the time of its execution and Subsequent Participating Manufacturers ("SPMs") that signed the agreement after its execution. Of those SPMs, a subset is neither required to make payment on its full sales either by the MSA or, perhaps most notably, by the terms of House Bill 1173.

Under the MSA, SPMs that signed within a certain amount of time are not obligated to make payment to the Settling States unless their market share "exceeds the greater of (1) its 1998 market share or (2) 125 percent of its 1997 market share." This permits the so-called "grandfathered SPMs" to avoid payment on a portion of their sales. House Bill 1173 does not correct this market share advantage, despite its lofty goals of wanting all tobacco product manufacturers to pay for the alleged harm caused to the State and its citizens.

Additionally, the MSA provides PMs with a reduction in their MSA payments in the form of an "NPM Adjustment." The PMs and several states have been in arbitration for years over the correct amount of the NPM Adjustment. In House Bill 1173, you intend to make NPM products sold into your state pay at the same rate as the OPMs and SPMs. However, there is nothing in the bill that would adjust the new NPM tax for any NPM Adjustment that the PMs might benefit from. Consequently , the NPMs are not receiving the same treatment as OPMs and SPMs under this bill..

In closing, I appreciate the opportunity to present my company's objections to House Bill 1173 and if you have any questions regarding my arguments against House Bill 1173, please do not hesitate to contact me.

Best regards,

David Scott
CEO
Cheyenne International, LLC