HB 870 (FAV)

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TO:	Hon. Del. Joseline A. Pena-Melnyk, Chair House Health and Government Operations Committee
FROM:	Aravind Muthukrishnan Assistant Attorney General, Office of the Attorney General 200 St. Paul Place, 20th Floor Baltimore, MD 21202
RE:	House Bill 870 –Tobacco Product Manufacturers – Escrow Act – Alterations.

The Office of Attorney General urges this Committee to report favorably on House Bill 870 – Tobacco Product Manufacturers – Escrow Act – Alterations.

House Bill 870 brings fairness and equity to Maryland's cigarette market. It amends Maryland's Tobacco Product Manufacturers Escrow Act ("Escrow Act"), Bus. Reg. §§ 16-401–403, by requiring cigarette manufacturers that did not join the Tobacco Master Settlement Agreement ("MSA") to pay a fee based on the number of cigarettes manufactured by that company that are sold in the State during a given year. The bill remedies a situation that currently allows those manufacturers to use statutorily required escrow accounts to subsidize low cigarette prices and undersell their competitors. House Bill 870 will thus fulfill the legislature's intention when it enacted the Escrow Act by creating a level playing field for all cigarette manufacturers that compete in Maryland's market.

Maryland enacted the Escrow Act in 1999, the year after it signed the MSA. Cigarette manufacturers that join the MSA, called Participating Manufacturers ("PMs"), are restricted from engaging in many types of cigarette advertising and pay Maryland and other States billions of dollars every year. These payments compensate the State for the past and future medical expenses incurred from treating their residents for the diseases caused by cigarettes. PMs raised their prices to finance their settlement payments. This created a market opportunity for other manufacturers, called Nonparticipating Manufacturers ("NPMs"), which did not join the MSA and were thus not obligated to make settlement payments, to undersell the PMs.

Intending to level the playing field between PMs and NPMs, the MSA incentivized Maryland and other States to enact the Escrow Act, which requires all cigarette manufacturers to make a choice if they wish to sell cigarettes in the State. They must either become a PM by joining the MSA and complying with their financial obligations *or* deposit funds into a qualified escrow account roughly equivalent to the settlement payments and leave the payments in the escrow account for 25 years.

Over the past 25 years, NPMs have collectively deposited more than $11 million in escrow accounts for the cigarettes they have sold in Maryland. NPM cigarettes are just as dangerous, make Marylanders just as sick, and strain Maryland's health care system just as much as the cigarettes manufactured by PMs. However, while PMs make annual payments to the State which are used to pay for various public health and smoking cessation programs and help defray the health costs imposed on the State due to smoking related disease, NPMs' escrow deposits remain in an account held and controlled by the companies, and from which they are entitled to collect interest and earnings. As one NPM recently boasted, they simply use the interest earned "to offset business expenses." Moreover, NPMs can expect to receive back every penny they put in escrow 25 years after the date of deposit. Rather than compensating the State for the costs imposed by their products, NPMs can use the escrow funds to underwrite their business and sell cigarettes at lower prices than the PMs can.

Both PM and NPM packs of cigarettes are subject to the same amount of Federal Excise Tax and Maryland State Excise Tax. Where their costs differ is in MSA payments versus escrow deposits. PMs pay the States about 93 cents per pack pursuant to the MSA. Maryland's MSA payments are deposited in Maryland's Cigarette Restitution Fund, which funds tobacco use prevention and cessation programs, cancer research, and other health and education programs. Under the Escrow Act, NPMs are required to deposit about 89 cents per pack into an escrow account; however, that figure understates the disparity in costs borne by PMs and NPMs. This is because NPM escrow deposits do not go to the State; rather, NPMs deposit funds into their own trust accounts. NPMs are able to withdraw the interest earned on the accounts, which can be used to subsidize lowering the price of their cigarettes. Beginning this year, NPMs can also withdraw funds that have been on deposit for 25 years, further allowing NPMs to reduce the cost of cigarettes they sell to Marylanders. Those cheaper cigarettes make it easier for youth to purchase them, drive up Maryland's smoking rate, and cost Maryland's taxpayers money treating the additional people who are sickened and killed from smoking NPM cigarettes.

A situation that was not foreseen a quarter century ago is now the NPMs' business plan; the escrow accounts- which were intended to internalize the costs of cigarettes on NPMs and to make funds available if NPMs were to engage in fraud and deceptive marketing- can be used to subsidize low-priced cigarettes. This leaves current and future Maryland taxpayers to foot the bill for the costs associated with the NPMs' products.

HB 870 will achieve the goal the General Assembly set for itself 25 years ago and bring equity cigarette marketplace that is now out of balance. Instead of requiring NPMs to deposit funds into what is effectively a deferred savings account, HB 870 will require that NPMs pay that amount as an Equity Fee to compensate the State for the health costs imposed by their cigarettes. This fee would be deposited into the Cigarette Restitution Fund, just as MSA payments are today.

HB 870 is also carefully drafted to avoid any risk to the State's future MSA settlement payments. If any future court or tribunal determines that the amendments contained in HB 870 are unconstitutional or otherwise invalid, it provides that the current law immediately snaps back in place as if it had not been amended.

By enacting this legislation, Maryland can restore equity in Maryland's cigarette by creating the level playing field that the legislature intended when it enacted Maryland's Escrow Act a quarter of a century ago. The Office of the Attorney General strongly urges a favorable report on House Bill 870.