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# **Cigarette Restitution Fund Fiscal 2007 Budget Overview**

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**Department of Legislative Services  
Office of Policy Analysis  
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*Analysis of the FY 2007 Maryland Executive Budget, 2006*

## ***Cigarette Restitution Fund Overview***

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### **History of the Cigarette Restitution Fund**

On November 23, 1998, the four (now three) major tobacco companies agreed to settle all outstanding litigation with 46 states, five territories, and the District of Columbia. Four states including Florida, Minnesota, Texas, and Mississippi had earlier settled lawsuits against the major tobacco companies. Under the Master Settlement Agreement (MSA), the settling manufacturers will pay the litigating parties approximately \$206 billion over the next 25 years and beyond, as well as conform to a number of restrictions on marketing to youth and the general public.

The distribution of funds among the states was determined using a formula that assigned equal weight to the Medicaid and non-Medicaid smoking-related costs of each state; subsequent adjustments to this formula were made to allow smaller states to achieve economies of scale in providing tobacco prevention programs. According to this formula, Maryland will receive 2.26% of MSA monies. In addition, the State will collect 3.3% of monies from the Strategic Contribution Fund, distributed according to each state's contribution toward resolution of the state lawsuits against the major tobacco manufacturers. Funds from these revenue streams, in addition to smaller payments related to the settlement, are estimated to result in variable annual payments of \$150 million to \$200 million.

In anticipation of receiving tobacco settlement revenue, the State established the Cigarette Restitution Fund (CRF) in Chapter 173, Acts of 1999 as a special nonlapsing fund to be used for a variety of programs and initiatives. The Act specified nine health- and tobacco-related priorities, listed in **Exhibit 1**, to which no less than 50% of funds must be appropriated annually. To support this goal, the General Assembly created the Tobacco Use Prevention and Cessation Program and the Cancer Prevention, Education, Screening, and Treatment Program as programs within the Family Health Administration to address both the causes and effects of tobacco use. As these programs have grown, emphasis has shifted to these programs from other CRF recipients, such as primary and secondary education enhancements. The fund also supports existing health programs such as substance abuse treatment and Medicaid.

### **Governor's Proposed Budget**

The fiscal 2007 allowance provides \$166.1 million for programs supported by the CRF, an increase of \$43.3 million, or 35.3% over the fiscal 2006 working appropriation. Although the amount of revenue is roughly equal to the amount of revenue in fiscal 2006, the State completed its last payment to the Law Offices of Peter Angelos in fiscal 2006, allowing for increased appropriations from the fund in fiscal 2007. Overall, the allowance provides across-the-board increases for most major programs with the exception of the Alcohol and Drug Abuse Program which is level funded at \$17.1 million. The largest single increase in funds is for the Medicaid program, which increases from \$67 million to \$90 million in fiscal 2007. **Exhibits 2** and **3** detail changes in CRF revenue and expenditures since fiscal 2004.

*Cigarette Restitution Fund – Fiscal 2007 Budget Overview*

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**Exhibit 1**  
**Spending Priorities in the Cigarette Restitution Act**

1. Reduction in tobacco use by youth
2. Tobacco control campaigns in schools
3. Smoking cessation programs
4. Enforcement of tobacco sales restrictions
5. Primary health care in rural areas
6. Programs concerning cancer, heart disease, lung disease, and tobacco control
7. Substance abuse treatment and prevention
8. Maryland Health Care Foundation
9. Crop conversion

Source: Chapter 173, Acts of 1999

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**Exhibit 2**  
**Cigarette Restitution Fund Revenue**  
**Fiscal 2004 – 2007**  
**(\$ in Millions)**

	<b>FY 04</b>	<b>FY 05</b>	<b>FY 06</b>	<b>FY 07</b>
	<b><u>Actual</u></b>	<b><u>Actual</u></b>	<b><u>Working</u></b>	<b><u>Allowance</u></b>
			<b><u>Appropriation</u></b>	
Beginning Fund Balance	\$51.0	\$10.5	\$15.4	\$16.3
Settlement Payments	150.7	152.0	153.5	152.3
<b>Available Revenue</b>	<b>\$201.7</b>	<b>\$162.5</b>	<b>\$168.9</b>	<b>\$168.6</b>
Payment to Law Offices	-\$30.0	-\$30.0	-\$29.9	
Prior Year Recoveries	4.3	1.5		
To/From Special Reserve Fund	13.5			
<b>Total Available Revenue</b>	<b>\$189.4</b>	<b>\$134.0</b>	<b>\$139.0</b>	<b>\$168.6</b>
<b>Total Expenditures</b>	<b>\$178.9</b>	<b>\$118.6</b>	<b>\$122.8</b>	<b>\$166.1</b>
<b>Ending Balance</b>	<b>\$10.5</b>	<b>\$15.4</b>	<b>\$16.3</b>	<b>\$2.5</b>

Source: Department of Budget and Management

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*Cigarette Restitution Fund – Fiscal 2007 Budget Overview*

**Exhibit 3  
Cigarette Restitution Fund  
Fiscal 2004– 2007  
(\$ in Millions)**

	<u>FY 04 Actual Spending</u>	<u>FY 05 Actual Spending</u>	<u>FY 06 Working Appropriation</u>	<u>FY 07 Allowance</u>	<u>\$ Change</u>
<b>Health</b>					
Management	\$0.5	\$0.4	\$0.3	\$0.6	\$0.3
Tobacco	13.8	9.9	9.3	18.7	9.4
Cancer	31.0	30.9	20.1	28.1	8.1
Substance Abuse	17.1	17.1	17.1	17.1	0.0
Medicaid	108.3	51.5	66.8	89.7	22.9
<b>Subtotal</b>	<b>\$170.7</b>	<b>\$109.8</b>	<b>\$113.6</b>	<b>\$154.3</b>	<b>\$40.7</b>
<b>Education</b>					
Aid to Nonpublic Schools	3.0	3.0	3.0	4.0	1.0
<b>Subtotal</b>	<b>\$3.0</b>	<b>\$3.0</b>	<b>\$3.0</b>	<b>\$4.0</b>	<b>\$1.0</b>
<b>Crop Conversion</b>	<b>\$5.1</b>	<b>\$5.7</b>	<b>\$6.0</b>	<b>\$7.6</b>	<b>\$1.6</b>
<b>Attorney General</b>	<b>\$0.0</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.0</b>
<b>Total Expenses</b>	<b>\$178.9</b>	<b>\$118.6</b>	<b>\$122.8</b>	<b>\$166.1</b>	<b>\$43.3</b>

Source: Maryland Operating Budget

### **Tobacco Use Prevention and Cessation**

Funding for the Tobacco Use Prevention and Cessation Program increases \$9.4 million in the fiscal 2007 allowance. This program – established by Chapter 17, Acts of 2000 – is charged with developing initiatives to reduce tobacco use in Maryland and otherwise benefit public health. This program and the Cancer Prevention, Education, Screening, and Treatment Program are the basis of the State’s CRF Program. Changes to program funding, detailed in **Exhibit 4**, include the following:

- **Surveillance and Evaluation:** Section 13-1004 of the Health-General Article requires the department to conduct a biennial tobacco study to determine the number of individuals using tobacco products, with the intent that this information would be compared to the department’s

**Exhibit 4**  
**Tobacco Use Prevention and Cessation**  
**Fiscal 2004 – 2007**  
**(\$ in Millions)**

	<u>FY 04</u> <u>Actual</u>	<u>FY 05</u> <u>Actual</u>	<u>FY 06</u> <u>Working</u> <u>Approp.</u>	<u>FY 07</u> <u>Allowance</u>	<u>\$</u> <u>Changes</u>
Surveillance and Evaluation	\$0.0	\$0.5	\$0.0	\$1.9	\$1.9
Local Public Health	8.0	6.9	7.0	12.1	5.1
Statewide Public Health					
Minority Outreach and Technical Assistance	0.9	0.7	0.9	1.2	0.3
Telephone Quit Line	0.0	0.0	0.0	1.5	1.5
Tobacco Use Cessation Resource and Coordination Center	0.0	0.0	0.0	0.2	0.2
University of Maryland School of Law	0.3	0.2	0.2	0.5	0.3
Tobacco Prevention and Cessation <sup>(1)</sup>	0.0	0.0	0.4	0.0	-0.4
<b>Subtotal</b>	<b>\$1.2</b>	<b>\$1.1</b>	<b>\$1.5</b>	<b>\$3.4</b>	<b>\$1.9</b>
Countermarketing	4.0	1.0	0.5	0.5	0.0
Administration	0.6	0.4	0.3	0.8	0.4
<b>Total</b>	<b>\$13.8</b>	<b>\$9.9</b>	<b>\$9.3</b>	<b>\$18.7</b>	<b>\$9.4</b>

<sup>(1)</sup> In fiscal 2006, \$0.4 million of CRF funds supported tobacco prevention activities typically funded with general funds. In fiscal 2006, these tobacco prevention activities are again solely supported with general funds.

Note: Numbers may not sum to total due to rounding.

Source: Maryland Operating Budget; Department of Health and Mental Hygiene

baseline study to determine the State’s progress in reducing tobacco use. The General Assembly required biennial studies, rather than annual studies, beginning in 2003, to reduce the administrative burden on the department. At the same time, the General Assembly also required biennial, rather than annual, cancer incidence studies.

The last tobacco study was conducted in fiscal 2003. The General Assembly adopted a provision in the 2004 budget reconciliation legislation delaying the scheduled fiscal 2005 tobacco study for one year. A similar provision adopted in the 2005 budget reconciliation legislation further

## *Cigarette Restitution Fund – Fiscal 2007 Budget Overview*

delayed the tobacco study until fiscal 2007. The allowance includes \$1.9 million to conduct the tobacco study.

- ***Local Public Health:*** Local health departments in each of the 24 jurisdictions provide prevention and cessation programming in each of four areas: community education, school-based programs, cessation, and enforcement. Funding for local tobacco use prevention and cessation grants increases from \$7.0 million in fiscal 2006 to \$12.1 million in fiscal 2007.
- ***Statewide Public Health:*** This component was developed to ensure that the tobacco program was implemented in a coordinated and integrated manner and to ensure participation by minority and underrepresented populations. This component of the tobacco program includes five subprograms – listed in Exhibit 4 – most notably, the telephone quit line and the minority outreach and technical assistance program. The Centers for Disease Control and Prevention (CDC) awarded the department a supplemental grant in federal fiscal 2005 and 2006 to establish the framework for a telephone-based quit line in Maryland. The grant was part of a nationwide effort by the CDC to establish quit lines in every state. Funding for the Statewide Public Health program increases from \$1.5 million in fiscal 2006 to \$3.5 million in fiscal 2007, as additional funding is provided for several new programs including \$1.5 million for the quit line. The quit line funding will be used to provide access to cessation services for callers. Approximately \$0.4 million of the proposed quit line appropriation will be dedicated to providing cessation services to high-risk populations. The allowance also includes \$0.2 million for a Tobacco Use Cessation Resource and Coordination Center. The center will promote best practices for cessation and provide regional training and motivational counseling. The center will also collect and analyze data on cessation programs, including the quit line, and provide feedback with respect to programmatic effectiveness.
- ***Administration:*** In fiscal 2006, administration of the tobacco program was supported with a combination of CRF and general funds to comply with the law limiting administration expenditures to 5% of allocations from CRF. The 2005 budget reconciliation legislation included a provision increasing the amount the department can spend on administrative expenses from 5 to 7%. Accordingly, in fiscal 2007, tobacco administrative expenses increase \$0.4 million and are supported solely with CRF funds. This increase is offset by a \$0.1 million decrease in general funds for this purpose.

CRF funding for the Tobacco Use Prevention and Cessation Program totals \$18.7 million in fiscal 2007, less than the amount recommended by the CDC. The CDC recommends a minimum amount of spending of \$5.98 per capita for tobacco prevention activities, which is equivalent to \$30.7 million in Maryland. Proposed CRF tobacco program funding provides nearly 60% of the total amount of CDC-recommended funding in fiscal 2007.

The Governor's allowance also includes \$2.3 million in the Community and Family Health Administration budget for tobacco use and prevention activities. This amount, combined with the CRF tobacco use and prevention funding, meets the requirement that the Governor include \$21 million in budget for tobacco use and prevention activities.

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## **Cancer Prevention, Education, Screening, and Treatment Program**

Funding for the Cancer Prevention, Education, Screening and Treatment Program increases \$8.1 million in the fiscal 2007 allowance. This program – established by Chapter 17, Acts of 2000 – is charged with developing initiatives to reduce morbidity and mortality rates for cancer- and tobacco-related diseases and otherwise benefit public health. This and the Tobacco Use Prevention and Cessation program are the basis of the State’s CRF program.

The largest component of this program provides grants to the statewide academic health centers for cancer- and tobacco-related disease research and services. The 2005 budget reconciliation legislation included a provision mandating minimum spending of \$15.4 million to support the statewide academic health centers beginning in fiscal 2007. This level of funding is consistent with the level of funding provided in fiscal 2005. As shown in **Exhibit 5**, the Governor’s proposed budget includes \$15.4 million as required by State law.

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**Exhibit 5**  
**Statewide Academic Health Center Grants and**  
**Fiscal 2006 Deficiency Appropriation**  
**Fiscal 2005 – 2007**  
**(\$ in Millions)**

	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>
<b>Statewide Academic Health Centers</b>			
University of Maryland Medical Group (UMMG)	\$12.9	\$6.5	\$12.9
Johns Hopkins Institutions (JHI)	2.4	1.2	2.5
<b>Subtotal</b>	<b>\$15.3</b>	<b>\$7.7</b>	<b>\$15.4</b>
<b>Deficiency Appropriation</b>			
UMMG		\$3.2	
JHI		0.6	
<b>Subtotal</b>		<b>\$3.8</b>	
<b>Total</b>	<b>\$15.3</b>	<b>\$11.5</b>	<b>\$15.4</b>

Source: Maryland Operating Budget; Department of Health and Mental Hygiene

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The budget reconciliation legislation authorized additional CRF funds of \$6.7 million to provide the academic health centers with a level of funding close to the fiscal 2005 appropriation of \$15.3 million. The proposed fiscal 2007 Community and Family Health Administration budget includes a fiscal 2006 general fund deficiency appropriation of \$3.8 million for the centers, resulting in a total fiscal 2006 appropriation \$2.9 million below the authorized level. Including the deficiency appropriation, the fiscal 2007 allowance for the centers increases \$3.9 million, or 34% over the

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fiscal 2006 working appropriation. The deficiency appropriation provides \$3.2 million to the University of Maryland Medical Group (UMMG) and \$0.6 million to the Johns Hopkins Institutions (JHI). The increased funding will allow UMMG to support recently recruited research faculty members, maintain the telemedicine infrastructure, and reinstate the pilot faculty research program. JHI will use the deficiency appropriation to award additional grants in fiscal 2006.

Including the 2006 deficiency appropriation, overall funding for cancer prevention, education, screening, and treatment increases \$4.2 million, or 17.6%. Changes to fiscal 2007 program funding, detailed in **Exhibit 6**, include the following:

- **UMMG:** Funding increases from \$7.7 million in fiscal 2006 to \$14.2 million in fiscal 2007, enhancing the amount of funds available for cancer research. Including the 2006 deficiency appropriation, funding increases \$3.3 million, or 30.3% over the fiscal 2006 working appropriation. There are four research and program grants from the cancer program to UMMG. The largest increase in funding occurs in the UMMG research grant, which supports recruitment and retention of cancer researchers. Increased funding will allow the university to continue to invest in cancer research, including support for clinical faculty recruitments, research activities, and capital investments in facilities and equipment. The university also notes that increased funding will enhance its capacity to compete for funds from external sources such as the National Cancer Institute and the National Institutes of Health.

Funds from the CRF also provide for the Statewide Health Network administered by UMMG. The network supports community-based health partnerships that increase awareness of and access to prevention and education related to cancer and other tobacco-related disease. Efforts include expanding participation in clinical trials, educating health providers on best practices, and increasing access to University of Maryland education and outreach and clinical experts through 31 telemedicine and video sites. The network operates through a central office located in Baltimore City and three regional offices. A funding increase of \$1.5 million will allow UMMG to continue to implement community-based education and outreach activities in 24 local jurisdictions and to support the programmatic aspects of the telemedicine infrastructure.

Funding for the UMMG tobacco-related disease grant increases \$1 million in fiscal 2007. This grant, like the cancer research grant, supports individual research projects as well as faculty recruitment and retention. Increased funding will enable the university to continue with recruitment and seed funding for faculty positions and to fund the pilot research grant program.

- **JHI:** Funding for JHI increases \$1.3 million in fiscal 2007. Including the 2006 deficiency appropriation, funding increases \$0.7 million, or 23.3% over the fiscal 2006 working appropriation. Increased funding for the cancer grant, which supports recruitment and retention of cancer researchers, will likely double the number of grant awards in fiscal 2007. JHI anticipates awarding four new recruitment, four new retention, and seven new translational grants. In addition, the university estimates it will award seven continuation grants. (Continuation grants are made based on investigator progress and the promise that more research in the area will have high yield.)

**Exhibit 6  
Cancer Prevention, Education, Screening, and Treatment  
Fiscal 2004 – 2007  
(\$ in Millions)**

	<u>FY 04</u>	<u>FY 05</u>	<u>FY 06</u> <u>Working</u>	<u>FY 07</u>	<u>\$</u>
	<u>Actual</u>	<u>Actual</u>	<u>Approp.</u>	<u>Allowance</u>	<u>Change</u>
Surveillance and evaluation	\$1.4	\$1.6	\$1.2	\$1.3	\$0.0
Local public health	8.6	7.5	7.5	7.5	0.0
Statewide academic health centers					
<b>University of Maryland Medical Group</b>					
Tobacco-related disease research	2.3	2.0	1.0	2.0	1.0
Cancer research	8.6	8.0	4.0	7.9	3.9
Statewide network	3.2	2.9	1.5	3.0	1.5
Baltimore City public health	1.4	1.2	1.2	1.2	0.0
<b>Subtotal</b>	<b>\$15.5</b>	<b>\$14.2</b>	<b>\$7.7</b>	<b>\$14.2</b>	<b>\$6.5</b>
<b>The Johns Hopkins Institutions</b>					
Cancer research	2.6	2.4	1.2	2.5	1.3
Baltimore City public health	1.4	1.2	1.2	1.2	0.0
<b>Subtotal</b>	<b>\$4.0</b>	<b>\$3.6</b>	<b>\$2.4</b>	<b>\$3.7</b>	<b>\$1.3</b>
Administration	1.0	1.0	0.7	1.0	0.3
Statewide skin cancer project	0.0	0.1	0.1	0.1	0.0
Cancer screening database	0.4	0.4	0.4	0.4	0.0
<b>2007 Allowance Subtotal</b>	<b>\$30.8</b>	<b>\$28.4</b>	<b>\$20.1</b>	<b>\$28.1</b>	<b>\$8.1</b>
Deficiency appropriation			3.8		
<b>Total</b>	<b>\$30.8</b>	<b>\$28.4</b>	<b>\$23.9</b>	<b>\$28.1</b>	<b>\$4.3</b>

Source: Maryland Operating Budget; Department of Health and Mental Hygiene

- Administration:** In fiscal 2006, administration of the cancer program was supported with a combination of CRF and general funds to comply with the law limiting administrative expenditures to 5% of allocations from CRF. The 2005 budget reconciliation legislation included a provision increasing the amount the department can spend on administrative expenses from 5 to 7%. As a result, fiscal 2007 cancer administrative expenses increase \$0.3 million and are supported solely with CRF funds. This increase is offset by a \$0.1 million decrease in general funds for this purpose.

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- **Baltimore City Public Health Grants:** Health-General Section 13-1115 establishes statewide academic health center public health grants to UMMG and JHI. The statute establishes the two institutions as recipients of CRF funding to provide cancer prevention, education, screening, and treatment services to low-income Baltimore City residents; these programs are provided by local health departments in all other jurisdictions.

The 2005 budget reconciliation legislation included a provision modifying the Statewide Academic Health Center Public Health grant distribution formula beginning in fiscal 2007. Under current law, the two statewide academic health centers must receive at least 9.5% of total local health funds. The Governor’s proposed budget for the two statewide academic health center grants includes \$1.2 million for each institution, exceeding the funding formula by 2.5 percentage points as shown in **Exhibit 7**.

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**Exhibit 7**  
**Baltimore City Public Health Grant**  
**Fiscal 2005 – 2007**  
**(\$ in Millions)**

	<u>FY 05</u> <u>Actual</u>	<u>FY 06 Wk.</u> <u>Approp.</u>	<u>FY 07</u> <u>Allowance</u>	<u>% of Total</u>
Local Public Department	\$7.5	\$7.5	\$7.5	75%
UMMG	1.2	1.2	1.2	12%
JHI	1.2	1.2	1.2	12%
<b>Total</b>	<b>\$9.9</b>	<b>\$9.9</b>	<b>\$9.9</b>	<b>100%</b>

Source: Maryland Operating Budget

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### **Comprehensive Evaluation**

The legislation establishing the tobacco and cancer programs included a provision for a comprehensive evaluation of the programs at the end of fiscal 2004. The evaluation was to include an analysis of the administration and effectiveness of the programs, including an assessment of whether the short- and long-term goals of the program had been met, with results due to the Governor and the General Assembly by November 2004. Budget reconciliation legislation enacted in 2004 delayed the comprehensive evaluation to the end of fiscal 2005, with a final report due by November 2005. The 2005 budget reconciliation legislation authorized \$1.0 million in CRF funding in fiscal 2005 by budget amendment for the comprehensive evaluation. Accordingly, in fiscal 2005, \$1.0 million was appropriated by budget amendment to conduct the comprehensive evaluation. **The department should comment on the status of the comprehensive evaluation.**

## **Other Cigarette Restitution Fund Initiatives**

In addition to the tobacco and cancer programs, CRF provides support for other health- and tobacco-related priorities. In fiscal 2007, funding for Medicaid increases \$23 million to a total of \$90 million, reducing the need for that amount of general funds for the program. The 2005 budget reconciliation legislation included a provision modifying the mandated funding requirement for Medicaid beginning in fiscal 2007. The legislation required the Medicaid program to receive at least 30% of the CRF appropriation. The Governor's proposed budget provides 54%, exceeding the mandate.

In addition, funding for the Maryland Department of Agriculture's (MDA) tobacco transition program increases to \$7.6 million, allowing for expansion of noncapital grants for infrastructure and agricultural development programs. The budget also increases \$1.0 million to purchase textbooks and technology for Nonpublic Schools.

## **Future Tobacco Settlement Revenue**

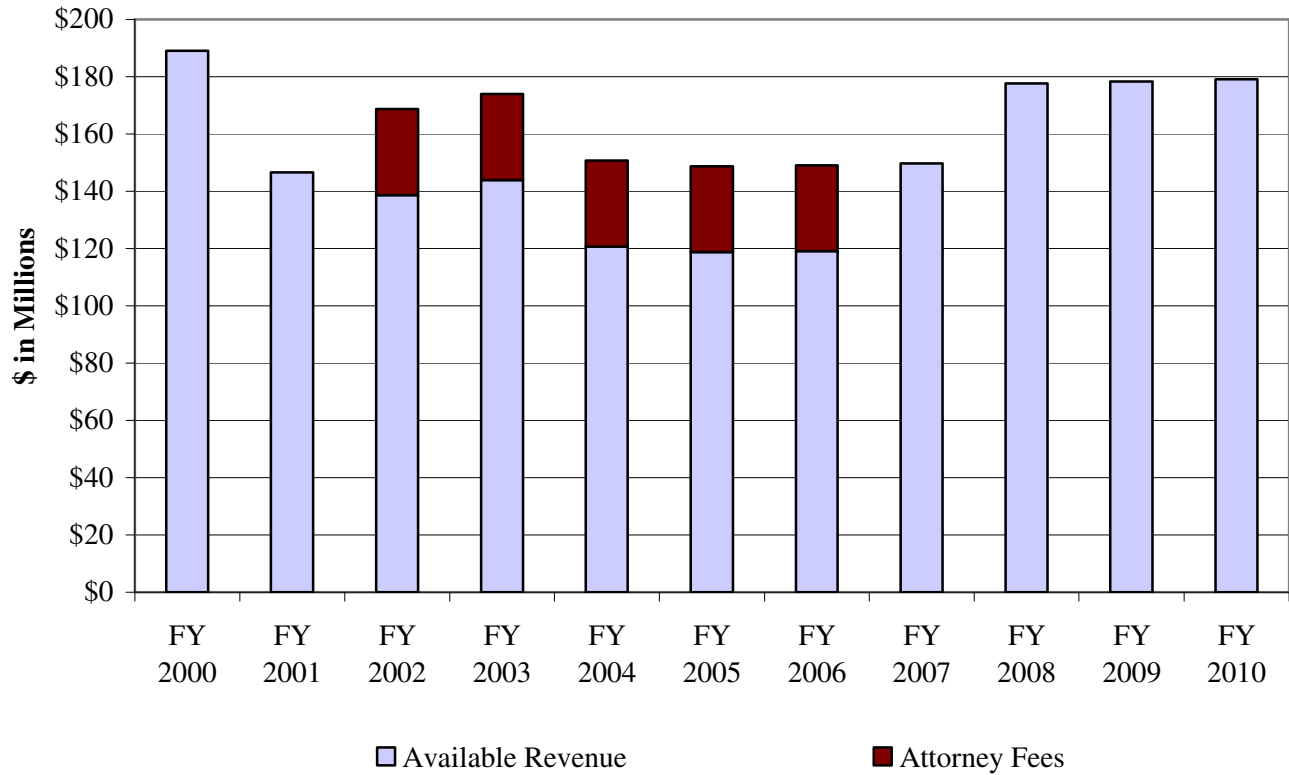
The MSA established three types of payments: initial, annual, and strategic contribution payments.

- **Initial payments** were scheduled from fiscal 1999 through 2003. Maryland received initial payments of approximately \$60 million annually for each of five years.
- **Annual payments** began in fiscal 2000 and will continue as long as the settling manufacturers continue to ship tobacco products domestically. These payments are adjusted annually based on domestic consumption of tobacco products and inflation. Maryland's annual payment is expected to vary from \$140 million to \$150 million in the near future.
- **Strategic contribution payments**, beginning in fiscal 2008 and continuing through fiscal 2017, reflect states' legal contributions to the tobacco settlement. Maryland's share of these payments is estimated at \$28 million annually.

In addition to these three payment streams, the national arbitration panel established by the MSA to compensate states for their legal costs awarded the State approximately \$132 million for the State's contribution to the legal settlement. Annual award payments, which began in fiscal 2003, are estimated between \$5 million and \$7 million over the next 20 years.

As detailed in **Exhibit 8**, the State's tobacco settlement revenue is at a low from the end of the initial payment stream in fiscal 2003 to the beginning of the strategic contribution payment stream in fiscal 2008. Although the amount of revenue in fiscal 2007 is roughly equal to the amount of revenue available to the fund since fiscal 2004, the State completed its last payment to the Law Offices of Peter Angelos in fiscal 2006, allowing for increased appropriations in fiscal 2007. Beginning in 2008, the strategic contribution payments will make an additional \$28 million available to the CRF.

**Exhibit 8**  
**Net Revenue to the Cigarette Restitution Fund**  
**Fiscal 2000 – 2010**



Source: Department of Budget and Management

## ***Legal Challenges to the Master Settlement Agreement***

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### **Tobacco Settlement Revenue**

On November 23, 1998, the four (now three) major tobacco companies agreed to settle all outstanding litigation with 46 states, five territories, and the District of Columbia. Under the MSA, these original participating manufacturers agreed to compensate the states for smoking-related medical costs and conform to certain marketing restrictions. Since 1998, several additional tobacco companies have also entered into the agreement. These companies, known as subsequent participating manufacturers, have brought additional revenue to the states.

### **Non-participating Manufacturers and the Qualifying Statute**

Tobacco companies not participating in the MSA are referred to non-participating manufacturers (NPM) and are not bound by the marketing or other restrictions contained in the tobacco settlement agreement nor are they required to make MSA payments to the states. Therefore, the opportunity exists for NPMs to have a cost advantage over the participating manufacturers in the pricing of their products.

Chapter 169, Acts of 1999 as amended by Chapter 141, Acts of 2001 and Chapter 348, Acts of 2004 enacted the MSA qualifying statute to level the playing field with respect to price between participating and non-participating tobacco manufactures. The qualifying statute requires tobacco manufacturers to either join the MSA or make refundable deposits into an escrow account based on the number of cigarettes they sell in the State. The escrow account serves two purposes. First, it provides a fund source should the State bring a law suit against the NPMs, and second, it limits the NPM's competitive pricing advantage. Funds may only be released from escrow if an NPM enters into a settlement or there is a judgment against the company for health related damages for its cigarette sales in the state, or after the funds have been sitting in the escrow account for 25 years.

### **Recent Legal Actions Threaten CRF Revenues**

Recent legal actions by the participating manufacturers threaten to reduce the amount of revenue available to the states. These manufacturers contend that NPMs have exploited legal loopholes to reduce their payments to the states, giving those manufacturers a competitive advantage in the pricing of their products. The MSA authorizes manufacturers that lose a certain share of the market to withhold three times the amount of their losses. This withholding is known as an NPM adjustment. Based on preliminary estimates, an action of this sort has the potential to reduce the 2006 payment under the MSA by up to \$1.1 billion, or 18% of which Maryland's share is approximately \$26 million.

In April 2005 the original participating manufacturers initiated a "Significant Factor Determination" which is currently being litigated. The proceeding will determine whether the MSA was a significant factor contributing to the loss of market share. A final decision, by arbitration is due on March 27, 2006. If the arbitrator finds that the MSA was not a significant factor, there will be no NPM adjustment, and Maryland's 2006 MSA payment will not be affected. If the firm finds that the MSA was

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a significant factor, up to \$1.1 billion may be withheld from the April 2006 MSA payment. The MSA provides that the NPM adjustment will apply to all states unless a state has enacted and is diligently enforcing its Qualifying Statute.

### **Diligent Enforcement of Qualifying Statute**

Diligent enforcement of the qualifying statute will be determined on a state-by-state basis through a court proceeding. If Maryland is found to have diligently enforced its qualifying statute, there will be no NPM adjustment, and Maryland's 2006 MSA Payment will not be affected; however if it is determined that Maryland has not diligently enforced its qualifying statute, the State will be allocated a portion of the entire NPM adjustment. If one state wins on diligent enforcement, that state's share of the NPM adjustment will be reallocated to those states that are found not to have diligently enforced. Consequently, it is possible that Maryland's share of the NPM adjustment could exceed \$26 million. Furthermore, these legal challenges have the potential to reduce revenues in subsequent years.

### **Possible Scenarios**

- Significant Factor Determination is not decided before April 15, 2006.
  - Participating manufacturers are not permitted to withhold the NPM adjustment from the 2006 payment. However, once the decision is made, the NPM adjustment may or may not be applied.
- States win the Significant Factor Determination.
  - Maryland's April 2006 payment is unaffected.
- States lose the Significant Factor Determination.
  - There will be a diligent enforcement proceeding in Baltimore City Circuit Court.
  - If the courts rule before April 15, 2006, and Maryland is found to have "diligently enforced" its Qualifying Statute, Maryland will be entitled to the full 2006 MSA payment.
  - If the court has not decided by April 15, 2006, the participating manufactures may withhold the NPM adjustment, reducing Maryland's 2006 MSA payment by approximately \$26 million.

## **Conclusion**

It is difficult to anticipate at this time the magnitude or timing of challenges to payments under the MSA. The nature of these disputes will vary based on state laws, the level of enforcement, and the amount of competition from non-participating manufacturers; likewise, the timeline and ultimate disposition of these cases will likely vary by state.

## ***2005 Budget Reconciliation Legislation***

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After submission of the Governor's 2006 budget, estimates of fiscal 2005 and 2006 tobacco settlement revenue were increased, prompting the General Assembly to authorize additional CRF spending of \$13.4 million in the 2005 budget reconciliation legislation. The Governor did not use this authorization, but as shown in **Exhibit 9**, some of the initiatives identified by the General Assembly were funded.

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### **Exhibit 9 Additional Fiscal 2006 Uses of Cigarette Restitution Funds as Authorized in 2005 Budget Reconciliation Legislation**

<b><u>In Priority Order</u></b>	<b><u>Authorized Use of CRF</u></b>	<b><u>Governor Funded<sup>(1)</sup> with General Funds</u></b>	<b><u>Difference</u></b>
Challenge Grants	\$3.5	\$0.0	-\$3.5
Academic Health Centers	6.7	3.8	-2.9
Adult Literacy	1.2	1.0	-0.2
Summer Youth Connection Program	0.2	0.2	0.0
Family Support Centers	0.8	0.8	0.0
Aid to Nonpublic Schools	1.0	0.0	-1.0
<b>Total</b>	<b>\$13.4</b>	<b>\$5.8</b>	<b>-\$7.6</b>
Cigarette Restitution Funds	\$13.4	\$0.0	\$-13.4
General Funds	0.0	5.8	5.8

<sup>(1)</sup> The Governor is requesting the \$3.8 million for the academic health centers through a deficiency appropriation. The other items are funded through excess dollars in the fiscal 2006 Aid to Education Budget.

Source: Department of Budget and Management; Department of Legislative Services

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Using excess general funds in the Aid to Education budget, the Governor funded \$2.0 million of the \$2.2 million authorized for the Adult Literacy, Summer Youth Connection, and Family Support programs through budget amendment. The budget reconciliation legislation also authorized \$3.5 million in CRF funding for challenge grants and \$1.0 million in CRF funding for nonpublic text books, but these initiatives have not been funded.

The budget reconciliation legislation authorized additional CRF funds of \$6.7 million to provide the academic health centers with a level of funding close to the fiscal 2005 appropriation of \$15.3 million. The proposed fiscal 2007 Community and Family Health Administration budget includes

*Cigarette Restitution Fund – Fiscal 2007 Budget Overview*

a fiscal 2006 general fund deficiency appropriation of \$3.8 million for the centers, resulting in a total fiscal 2006 appropriation \$2.9 million below the authorized level.

Recent legal actions by participating manufacturers threaten to reduce the 2006 MSA payment by approximately \$26.0 million. Additionally, these legal challenges also have the potential to reduce revenues in subsequent years. Despite not using the authorization for additional fiscal 2006 CRF spending, the fiscal 2007 allowance of \$166.1 million exhausts all but \$2.5 million of the total available revenues, including the projected fiscal 2006 ending balance of \$16.3 million.

## ***Future Uses of Funds***

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Beginning in 2008, the strategic contribution payments will make an additional \$28 million available to the CRF. All appropriations from the fund must meet certain minimum requirements established in law; specifically, the Governor must include the lesser of \$100 million, or 90% of available funds in the annual budget bill, with at least 50% of appropriations made for established health- and tobacco-related priorities. In addition, a minimum of 0.15% of appropriations must be made to the Office of the Attorney General for enforcement of provisions in the MSA. During the 2006 session, several pieces of legislation have been introduced to address to the projected increase in CRF funds in fiscal 2008; including bills that would divert CRF funds for stem cell research, the Office of Minority Health and Health Disparities, and the Healthy Maryland Initiative Fund.

Other possibilities include increasing the amount of CRF dedicated to the Medicaid program, further reducing the need for that amount of general funds for the program; and increasing tobacco prevention funding to the CDC recommended level. Another possibility includes providing additional funding for the Alcohol and Drug Abuse Program. This program has been level funded at \$17.1 million since fiscal 2004.

## ***Tobacco Transition Program***

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One of the established priorities for CRF dollars is the implementation of the Southern Maryland Regional Strategy Action Plan for Agriculture, adopted by the Tri-County Council for Southern Maryland (TCC), with emphasis placed on alternative crop uses for agricultural land now used for growing tobacco. Funds are appropriated to MDA, which then issues grants to TCC. TCC is a nonprofit, quasi-governmental body that works with the Southern Maryland Agricultural Development Commission to develop programs to stabilize the region's agricultural economy as Maryland growers transition away from tobacco production.

TCC's Strategy Action Plan has three main components: the tobacco buyout, infrastructure/agricultural development, and agricultural land preservation.

- The tobacco buyout component is a voluntary program that provides funds to (a) support all eligible Maryland tobacco growers who choose to give up tobacco production forever while remaining in agricultural production; and (b) restrict the land from tobacco production for 10 years should the land transfer to new ownership.
- The infrastructure/agricultural development program seeks to foster profitable natural resource based economic development for Southern Maryland by helping farmers and related businesses to diversify and develop and/or expand market-driven agricultural enterprises in the region through economic development and education.
- The agricultural land preservation component seeks to provide an incentive to tobacco farmers to place land in agricultural preservation, enhance participation in existing preservation programs, and assist in the acquisition of land for farmers' markets.

### **Tobacco Transition Program Fiscal 2006 Funding**

The fiscal 2007 allowance includes a total of \$11.6 million in operating and capital funds for the Tobacco Transition Program. Funds are spread among three different areas of the allowance:

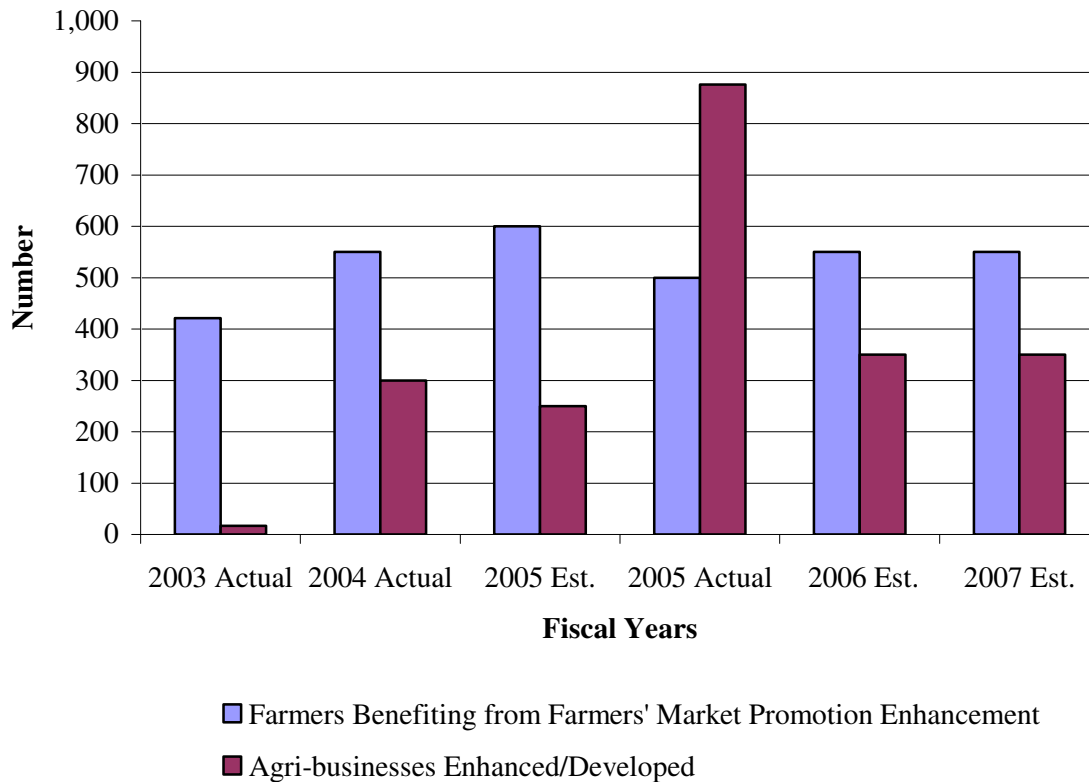
- \$1,500,000 in CRF special funds in the operating budget for administrative expenses (\$400,000) and noncapital grants for infrastructure/agricultural development programs (\$1,100,000);
- \$6,065,000 in CRF special funds in the PAYGO budget for the tobacco buyout program; and
- \$4,000,000 in general obligation bonds in the capital budget for the tobacco buyout (\$1,585,000) and land preservation programs (\$2,415,000).

This allocation assumes that a total of \$7,650,000 will be dedicated to buyout payments and \$2,415,000 to agricultural land preservation.

## **Participation in the Buyout Program**

Participation in the tobacco buyout program has been higher than anticipated, and the performance data associated with TCC’s efforts to help farmers transition to other agricultural opportunities suggests some success as well. As shown in **Exhibit 10**, the number of farmers and agri-businesses benefiting from TCC’s marketing efforts declined slightly in 2005. However, agri-business enhancement and development efforts more than doubled between fiscal 2004 and 2005, but a return to close to the fiscal 2004 level is anticipated in fiscal 2006 and 2007.

**Exhibit 10**  
**Tobacco Transition Program Performance Measurements**  
**Fiscal 2003 – 2007**



Source: Tri-County Council Fiscal Year 2005 End of Year Report

## **How Are Tobacco Buyout Participants Staying in Agriculture?**

### **Background**

Tobacco buyout participants are required to give up tobacco production forever while remaining in agricultural production for the 10-year buyout payment period. To help participants develop new or expanded agricultural enterprises to replace tobacco, TCC is implementing a variety of infrastructure and agricultural development programs. Recent development programs include the following:

- **Marketing Southern Maryland:** *So. Maryland, So Good* marketing campaign directories, web site, and promotional materials and advertising;
- **Agritourism:** Southern Maryland Agritourism brochure; agritourism field day event, including field trip to successful programs, workshops on living heritage trail development; research on grape and wine production potential;
- **Leadership and Entrepreneurial Development:** Southern Maryland farm Viability Enhancement Grant program business planning assistance; farmer seminars and workshops on marketing and agriculture alternatives; and
- **Education:** *Kids Cook* farm visits for elementary and high school students and development of a documentary video on Southern Maryland agriculture and natural resources.

To garner a better understanding of buyout participants' transition to alternative agricultural enterprises, TCC sent a voluntary survey to approximately 800 buyout participants in October 2005. Approximately 589 surveys, or 74% of the surveys sent, were completed and returned in response to the information request. The survey results indicate the following trends:

- nearly 50% of the respondents were over 60 years old;
- 30% of the respondents no longer farm full-time and more participants are becoming part-time farmers with part-time off-farm jobs;
- many respondents are growing and/or raising grain and soybeans (56.8%), hay (37.6%), vegetables (29.8%), and livestock (22.8%);
- since the buyout began, respondent's farming operations have been downsized (46.5%), maintained (40%), and expanded (13.5%);
- in 5 to 10 years, most respondents believe that their business will remain the same (41.8%), decrease (5.5%), or they will be retired (10%); and
- respondents would like assistance with identifying the best farming alternatives to tobacco, financial/retirement issues, and specific farming enterprises.

## ***Language and Reductions for Consideration***

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- ***Consider Language Prohibiting the Expenditure of \$26.0 Million in the Medicaid Budget:*** Recent actions by participating manufacturers threaten to reduce the amount of revenue available to the states. These manufacturers contend that non-participating manufacturer's have exploited legal loopholes to reduce their payments to the states, giving those manufacturers a competitive advantage in the pricing of their products. The MSA authorizes manufacturers that lose a certain share of the market to withhold three times the amount of their losses. This withholding is known as an NPM adjustment. Based on preliminary estimates, an action of this sort has the potential to reduce the 2006 payment under the MSA by \$1.1 billion, or 18%, of which Maryland's share is approximately \$26 million. **The Department of Legislative Services recommends prohibiting the expenditure of \$26.0 million in special funds for M00Q01.03 from the CRF until the Department of Budget and Management and the Attorney General submit a letter to the budget committees certifying that the legal proceedings related to the 2006 MSA payment will not result in net revenues received by the CRF during 2006 falling below \$153.5 million.**
- ***Reduce Funding for the Nonpublic Textbook Program:*** The amount of funding available from the CRF fund in fiscal 2007 is uncertain due to arbitration proceedings at this time. **In light of that uncertainty, continuing funding at the fiscal 2006 level is recommended.**