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Council
Staff**

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MEMORANDUM

January 28, 2016

TO: Interested Persons
FROM: Greg Sobetski, Economist, 303-866-4105
SUBJECT: 2016 Tobacco MSA Payment Forecast

Summary

Colorado receives annual payments from tobacco manufacturers as part of the Tobacco Master Settlement Agreement. In April 2015, the state received \$88.1 million. This memorandum presents the distribution of the received payment from 2015 and forecasts payments and distributions through FY 2017-18. Most of this money will be used to fund health care programs across the state.

A tobacco manufacturer participating in the settlement can withhold a portion of its required payment if its market share decreases. The amount withheld is paid into an escrow account until an arbitration panel can rule on the cause of the decrease in market share. Most manufacturers have withheld a portion of their payments since 2006; this forecast assumes that withholding will continue. Payments withheld in 2007 and subsequent years remain a subject of legal dispute and are not expected to affect payments during the forecast period.

Tobacco Master Settlement Agreement

The Tobacco Master Settlement Agreement (MSA) was signed in 1998 by 46 states, including Colorado, the District of Columbia, and five U.S. territories. As part of the agreement, states consented to release participating tobacco manufacturers from health-related claims associated with the use, manufacture, and marketing of tobacco products in return for perpetual annual payments from the manufacturers. Colorado receives a fixed portion of the national MSA payment each year. As a damage award, MSA revenue is exempt from TABOR.

The states and tobacco manufacturers have to meet certain requirements to maintain the present level of payments. An arbitration process was established in the MSA to hear any disputes between the participating states and tobacco manufacturers. Since 2003, a portion of the MSA payment has been disputed each year.

MSA Payment History and Forecast

Colorado began receiving MSA payments in 1999. The payments are calculated from a base amount that was agreed to in the MSA and is adjusted annually for inflation and changes in cigarette consumption. Consumption has fallen faster than the rate of inflation, so the nominal base payment has decreased over time. In addition to the inflation and consumption adjustments, receipts have been reduced because tobacco manufacturers have disputed a portion of the payment each year. The payments are due each April.

MSA dispute and withholding of payments. The MSA allows a participating manufacturer to reduce its payments to a state if the following conditions are met:

- the manufacturer is found to have lost market share to manufacturers that do not participate in the MSA;
- the MSA is determined to have been a significant contributing factor in the manufacturer's market share loss; and
- the state in which the market share loss occurred has not upheld its legal obligations to participating manufacturers under the MSA.

This is called the "nonparticipating manufacturers adjustment" (NPM). In order for manufacturers to lower their obligations under the framework of the NPM, they must dispute the amount owed at the time of the payment.

Since 2003, tobacco manufacturers have been claiming losses in market share resulting from states' failure to comply with the MSA. Some manufacturers began withholding a portion of their annual payments in 2006. Payments have been withheld despite the fact that the full legal process that must occur for the manufacturers to lower their payments has not run its course. Withheld payments either have not been paid by manufacturers or have been deposited into a separate disputed payments account. Since 2011, all of the largest manufacturers and most of the smaller manufacturers have annually withheld disputed payment amounts. This forecast assumes all tobacco manufacturers will continue to withhold disputed payments in 2016 and future years.

Litigation concerning disputed payments for 2003, which were withheld in 2006, was resolved in 2014. Colorado was found to have complied with the NPM agreement and received \$11.4 million in NPM adjustment arbitration money, of which \$2.2 million was paid from the disputed payments account and \$9.2 million was reallocated to Colorado from the annual payments of states determined not to have complied.

At some future date, Colorado's MSA payment will increase or decrease when the arbitration panel rules on the state's compliance in 2004 and subsequent years. Colorado's share of the nationwide payment withheld by manufacturers based on alleged 2004 noncompliance is \$9.7 million. An arbitration panel may adjudicate the 2004 dispute as early as February 2016; however, given the slow pace of legal proceedings, a quick resolution is unlikely. Given the likelier scenario of a protracted legal battle, the 2004 dispute is not expected to impact payments during the current forecast period.

Table 1 shows MSA payments since 2008 and the estimated payments for 2016 through 2018. The increase in disputed payments in 2011 is a result of withholding by the three largest tobacco manufacturers. Between 2008 and 2010, only two of the three largest manufacturers disputed payment amounts.

Table 1
Colorado Tobacco Master Settlement Agreement Payments
and Disputed Payments
2008 to 2018

Year	Colorado Annual Payment After Withholdings	Disputed Amount Withheld	Release of Prior Withholdings
2008	\$103,640,385	(\$7,711,843)	
2009	105,419,647	(7,062,223)	\$7,411,531
2010	95,709,303	(8,714,641)	
2011	89,065,763	(13,614,015)	
2012	90,809,964	(11,574,809)	
2013	90,769,997	(12,362,477)	
2014	89,037,053	(11,756,684)	11,367,403
2015	88,079,225	(12,500,634)	
Forecast			
2016	\$87.6 million	(\$12.4 million)	
2017	87.0 million	(12.3 million)	
2018	71.6 million	(10.2 million)	

Source: Department of Law and Legislative Council Staff.

Forecast. In 2015, Colorado received an MSA payment totaling \$88.1 million after withholdings, 0.6 percent less than the \$88.6 million expected in the 2015 Tobacco MSA Payment Forecast. Expected MSA receipts have been revised downward by about \$500,000 in each of 2016 and 2017, based on increased expectations for withholdings in these years.

The MSA payment is expected to fall to \$71.6 million in 2018, a one-time drop owing to the termination of payments from the Strategic Contribution Fund (SCF). Through 2017, this secondary payment from tobacco manufacturers each year is distributed to states based on their level of contribution toward final resolution of state lawsuits against tobacco companies. After withholdings, Colorado received about \$15.1 million from the SCF in April 2015, a similar amount to what the state has received since 2010. Beginning in 2018, this payment will cease.

Risks to the MSA forecast. In addition to the NPM dispute, several factors could alter the amount the state receives from future payments, resulting in either larger or smaller amounts than forecast. These are described below:

- MSA base payments are adjusted depending on the volume of cigarettes consumed nationwide and on inflation rates, which are difficult to predict. The forecast for the base payment reflects projected decreases in cigarette sales and inflation rates below 3 percent.
- Manufacturers may change their pattern of withholding payments. Consistent with the 2011 and subsequent payments, it is assumed that the largest cigarette manufacturers

will withhold payments through the forecast period. If this pattern changes, annual payments received could be higher than forecast.

- Additional smaller adjustments occur when manufacturers withhold payments in disputes unrelated to the NPM, or when manufacturers release payments withheld in prior disputes of this type. These are difficult to forecast.
- Some manufacturers may go out of business or file bankruptcy, and some manufacturers may not pay what is due each year.

Distribution of MSA Payments

Table 2 shows the state's actual MSA receipts in FY 2012-13 through FY 2014-15 and the Legislative Council Staff forecast of the state's receipts for FY 2015-16 through FY 2017-18. Table 2 also summarizes how money is distributed among the Tobacco Litigation Settlement Fund, MSA-funded programs, and reduction of the accelerated payments discussed below. Table 3 shows the amount that each MSA-funded program is projected to receive through FY 2018-19. The table includes a summary of the cash funds that receive MSA revenue and the funding formula used to allocate those funds. State law distinguishes between two tiers of programs, which is why that distinction is made in Tables 2 and 3.

Currently, most of the payments fund programs in the Department of Health Care Policy and Financing, the Department of Human Services, the Department of Higher Education, and the Department of Public Health and Environment, though other departments receive payments as well. Each annual MSA payment funds programs in both the fiscal year the payment is received and the following fiscal year.

Accelerated payments. Senate Bill 09-269 transferred \$65.0 million in tobacco MSA payments to the state General Fund in FY 2009-10. These funds would have been appropriated to healthcare programs in FY 2010-11. To make up for this transfer, \$65.0 million in tobacco MSA payments received in April 2011 were used to fund healthcare programs in FY 2010-11. This accelerated payment has occurred each year since FY 2010-11, as a portion of MSA payments are used to fund programs in the fiscal year they are received.

Because the state fiscal year begins in July but MSA payments do not arrive until April, expenditures to programs funded by MSA revenue are paid out of the General Fund between the date when the previous fiscal year's MSA revenue is exhausted, usually in August, and the arrival of the current fiscal year's MSA payment in April. In order to decrease the amount advanced annually from the General Fund, House Bill 12-1247 prevents the size of the accelerated payment from increasing in any fiscal year after FY 2012-13.

During the 2014 legislative session, the General Assembly adopted Senate Bill 14-104 and House Bill 14-1394, requiring that any disputed payments released in FY 2013-14 and subsequent years be used to reduce the share of payments disbursed to fund programs in the fiscal year they are received. The \$11.4 million disputed payment received in 2014 was used for this purpose.

Spending on MSA-funded programs, tobacco litigation, and reduction of accelerated payments totaled \$89.0 million in FY 2014-15, based on the MSA payment Colorado received in April 2014. According to the State Treasurer's Office, \$25.6 million, or 28.7 percent of this amount, was paid out of the 2014 MSA payment, while the remaining \$63.5 million, or

71.3 percent, was accelerated from the 2015 payment.¹ Over time, the former share should grow as the latter share shrinks.

Legislative adjustments to allocations of MSA payments. Laws passed in recent legislative sessions adjusted the allocation of MSA payments to certain programs. Table 4 shows a summary of bills passed in the 2012 through 2015 sessions and their effects on the distribution of MSA payments.

¹“Tobacco Master Settlement Agreement (MSA) Moneys.” Department of the Treasury memorandum to the Joint Budget Committee, October 1, 2015.

Table 2
Tobacco Master Settlement Agreement Payments
(In Millions)
Fiscal Years 2012-13 to 2014-15 Reflect Actual Payments

Received from Tobacco MSA Settlement		2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Annual MSA Payment Received <small>(Payments provide funding for programs both in the fiscal year received and in the following year)</small>		\$90.8	\$89.0	\$88.1	\$87.6	\$87.0	\$71.6
Reduction of Accelerated Payment		2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
General Fund	Release of disputed payments from prior years (not included in the Annual MSA Payment Received) ¹	\$0.0	\$11.4	\$0.0	\$0.0	\$0.0	\$0.0
	Diversion of reduced transfers to tobacco programs (HB 12-1247) ²	\$1.3	\$1.3	\$1.2	\$1.2	\$1.2	\$0.9
Attorney General		2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Tobacco Litigation Settlement Fund	\$1 million annually between FY 2013-14 and FY 2015-16; 2 percent of MSA payment beginning FY 2016-17 ³	\$1.0	\$1.0	\$1.0	\$1.8	\$1.7	\$1.4
State Agencies		2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Allocations to MSA-Funded Programs	Tier 1 Programs (pursuant to 24-75-1104.5 (1), C.R.S.)	\$60.6	\$61.5	\$61.7	\$60.6	\$60.2	\$49.9
	Tier 2 Programs (pursuant to 24-75-1104.5 (1.5), C.R.S.)	\$27.5	\$25.3	\$24.2	\$24.0	\$23.9	\$19.5
	Total; See Table 3	\$88.1	\$86.8	\$85.9	\$84.6	\$84.1	\$69.3

¹SB 14-104 and HB 14-1394 require that disputed payments received beginning in FY 2013-14 be used to reduce "accelerated payments," which fund settlement programs in the fiscal year that the annual payment is received. Disputed payments are not a part of the sum distributed according to the formula in statute.

²HB 12-1247 eliminated the Short-term Innovative Health Programs Grant Fund and used the 6% of second tier MSA revenue that had been allocated to that fund to offset a portion of the annual General Fund loans used to make accelerated payments to tobacco programs. General Fund savings from HB 12-1247 is reported as General Fund revenue in this table.

³SB 15-188 allocates 2% of the annual MSA payment to the TLSF beginning FY 2016-17.

Table 3
Tobacco Master Settlement Agreement Distribution
(In Millions)

Fiscal Years 2013-14 and 2014-15 Reflect Actual Distribution; Pursuant to Section 24-75-1104.5, C.R.S.

Total MSA Payment Distributed <i>(Excluding Tobacco Litigation Settlement Fund and Reduction of Accelerated Payments)</i>			\$88.1	\$86.8	\$85.9	\$84.6	\$84.1	\$69.3
First Tier Program Allocations			2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Health Care Policy and Financing	Children's Basic Health Plan Trust	27% of MSA payment through FY 2015-16; then 25% ¹	\$24.0	\$24.0	\$23.8	\$21.9	\$21.7	\$17.9
	Children with Autism	\$1 million annually	\$1.0	\$1.0	\$1.0	\$1.0	\$1.0	\$1.0
Public Health and Environment	Dental Loan Repayment	\$200,000 annually	\$0.2	\$0.2	\$0.2	\$0.2	\$0.2	\$0.2
	HIV Prevention	2% of MSA payment up to \$2 million	\$1.8	\$1.8	\$1.8	\$1.8	\$1.7	\$1.4
	AIDS Drug Assistance	3.5% of MSA payment up to \$5 million	\$2.5	\$3.1	\$3.1	\$3.1	\$3.0	\$2.5
Human Services ²	Nurse Home Visitors	Varies; see footnote ³	\$14.4	\$15.0	\$15.7	\$16.6	\$16.5	\$13.6
	Tony Grampas Youth Services	4% of MSA payment up to \$5 million	\$3.6	\$3.6	\$3.5	\$3.5	\$3.5	\$2.9
	Children's Mental Health Treatment	\$300,000 annually	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3
Capital Construction	Fitzsimons Trust Fund	8% of MSA payment up to \$8 million, or Fitzsimons debt service requirement under HB 03-1256 if less	\$7.3	\$7.1	\$7.0	\$7.0	\$7.0	\$5.7
Military Affairs and Veterans	Veterans Trust Fund	1% of MSA payment up to \$1 million	\$0.9	\$0.9	\$0.9	\$0.9	\$0.9	\$0.7
Education	Early Literacy Fund	5% of MSA payment up to \$8 million	\$4.5	\$4.5	\$4.4	\$4.4	\$4.3	\$3.6
Second Tier Program Allocations			2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Health Care Policy and Financing	Children's Basic Health Plan Trust	14.5% of MSA payment remaining after first tier	\$4.9	\$3.8	\$3.7	\$3.7	\$3.6	\$3.0
Higher Education	CU Health Sciences Center	49% of MSA payment remaining after first tier	\$13.7	\$13.0	\$12.4	\$12.4	\$12.3	\$10.0
Human Services	Offender Mental Health Services	12% of MSA payment remaining after first tier	\$3.4	\$3.2	\$3.0	\$3.0	\$3.0	\$2.4
	Alcohol and Drug Abuse Programs	3% of MSA payment remaining after first tier	\$0.8	\$0.8	\$0.8	\$0.8	\$0.8	\$0.6
Personnel and Administration	Supplement State Employee Insurance Plans	4.5% of MSA payment remaining after first tier	\$1.3	\$1.2	\$1.1	\$1.1	\$1.1	\$0.9
Public Health and Environment	Public Health Services	7% of MSA payment remaining after first tier	\$2.0	\$1.9	\$1.8	\$1.8	\$1.8	\$1.4
	Immunizations	4% of MSA payment remaining after first tier	\$1.1	\$1.1	\$1.0	\$1.0	\$1.0	\$0.8
	Health Services Corps	\$250,000 annually	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3
Office of the State Auditor	Reviews of Tobacco Settlement Programs	\$89,000 annually beginning in FY 2012-13 ⁴	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1

¹Beginning in FY 2016-17, SB 15-188 reduces the first tier allocation to the Children's Basic Health Plan Trust from 27% to 25%, and transfers 2% to the Tobacco Litigation Settlement Fund (see Table 2).

²SB 10-175 relocated the Children's Mental Health Treatment program from the Department of Health Care Policy and Financing to the Department of Human Services. HB 13-1117 relocated the Nurse Home Visitors fund and Tony Grampas Youth Services Fund from the Department of Public Health and Environment to the Department of Human Services.

³HB 13-1180 made substantial changes to the funding formula for the Nurse Home Visitors Program. In FY 2011-12 and FY 2012-13, the fund received the greater of 14% of the MSA payment and \$12,727,350; in FY 2013-14, 2014-15, and 2015-16, it receives 17%, 18%, and 19% of the MSA payment, respectively, less \$1 million annual transfer to the Tobacco Litigation Settlement Fund; beginning FY 2016-17, it receives 19% of the MSA payment.

⁴HB 12-1249 requires the Office of the State Auditor to review the performance of programs receiving MSA funding. It appropriated \$89,000 from the 6% of unallocated second tier revenue, the balance of which is transferred to the General Fund.

Table 4
Recent Bills Affecting MSA Distributions

2012 Session	
HB 12-1238	Eliminated the Read-to-Achieve program and transferred its funding to the Early Literacy Fund.
HB 12-1247	Eliminated the Short-term Innovative Health Programs Grant Fund and used the savings to offset General Fund accelerated payments to MSA-funded programs.
HB 12-1249	Requires the Office of the State Auditor to review MSA programs and allocates \$89,000 in Tier 2 monies annually for this purpose.
2013 Session	
HB 13-1180	Redirected MSA funds from the General Fund to the Nurse Home Visitor program and to the Defense Account of the Tobacco Litigation Settlement Cash Fund.
HB 13-1305	Allows the Governor to transfer General Fund money into the Tobacco Litigation Settlement Cash Fund if the General Assembly is not in session and an arbitration panel rules that Colorado is not entitled to its share of disputed payments.
2014 Session	
SB 14-104	Diverts all disputed payments received in 2014 and subsequent years to reduce the annual amount of accelerated payments to MSA-funded programs.
HB 14-1394	Clarified SB 14-104 to stipulate that disputed payments are not to be included in the calculation of MSA receipts distributed to MSA-funded programs.
2015 Session	
SB 15-188	Reduces the Tier 1 allocation to the Children's Basic Health Plan Trust and transfers additional money to the Tobacco Litigation Settlement Cash Fund. Allows money in this fund to be appropriated to the Department of Revenue in addition to the Department of Law to promote coordination between the two agencies.
SB 15-189	Repealed the requirement that the State Board of Health prepare a tobacco MSA programs annual report each year.
SB 15-247	Expanded the scope of the MSA-funded AIDS drug assistance program without changing the MSA distribution.