

SENATE INDUSTRY, BUSINESS AND LABOR COMMITTEE  
MARCH 6, 2023

TESTIMONY OF ANDREW MORAGHAN  
OFFICE OF ATTORNEY GENERAL  
HOUSE BILL NO. 1274

Mr. Chairman, members of the Committee, my name is Andrew Moraghan, I am an Assistant Attorney General in the Civil Litigation Division in the Attorney General's Office, and I appear on behalf of the Attorney General in connection with HB 1274. Before I describe the different sections of the bill I would like to provide some background and context for the bill.

**MASTER SETTLEMENT AGREEMENT**

In November 1998, the attorneys general of forty-six states, including North Dakota and six territories, entered into the global agreement, known as the Master Settlement Agreement or MSA, with certain tobacco manufacturers. The MSA settled litigation against the tobacco industry for recovery of the settling states' tobacco-related health-care costs. These original tobacco manufacturers (OPMS), and manufacturers who subsequently joined the settlement (SPMS), are commonly referred to as the Participating Manufacturers or PMs. The Nonparticipating Manufacturers, those tobacco manufacturers who did not join the MSA, are referred to as the NPMS.

Pursuant to the MSA, the PMs agreed to make annual payments to the settling states, including North Dakota, through an independent auditor in perpetuity in a base amount that totals billions of dollars each year in exchange for release of civil liability. From 1999 through 2022, the aggregate payment made just to North Dakota under the MSA was \$563,434,363.77. The PMs also agreed in the MSA to extensive restrictions in the manner in which they market and advertise tobacco products.

Under the MSA, the annual MSA payment of the PMs is subject to a downward adjustment known as the NPM Adjustment if it is determined the PMs lost market share to the NPMs as a result of the PMs' compliance with the terms of the MSA. The Settling States may avoid the NPM

Adjustment if, during the year at issue, they “diligently enforced” a “Qualifying Statute,” which “effectively and fully neutralizes the cost disadvantages that [PMs] experience vis-à-vis [NPMs] within such Settling State as a result of the provisions of [the MSA].”

#### **QUALIFYING STATUTE AT N.D.C.C. CH. 51-25**

Each Settling State enacted a Qualifying Statute in the aftermath of the MSA. North Dakota’s Qualifying Statute at N.D.C.C. ch. 51-25 became law in 1999. It included language accommodating the particularities of North Dakota’s existing law, including removing from the model qualifying statute any reference to tax stamps on cigarettes, which have not been required in North Dakota since 1991.

Our Qualifying Statute requires all NPMs selling cigarettes in the state to deposit annually into escrow with a financial institution a fixed sum for every NPM cigarette sold in the state on which excise tax is collected, which is defined as “units sold” in our Qualifying Statute. Under the Qualifying Statute, escrow funds may be used by the state to satisfy any judgment the state has against an NPM. Otherwise, unless the NPM were to assign its escrow deposits to the state, for example to avoid payment of annual fees to the financial institution holding the escrow funds, the state would be required, twenty-five years after the NPM made an annual escrow deposit, to release the deposit for that year to the NPM.

Under our Qualifying Statute, escrow deposits for the sale of NPM cigarettes in North Dakota have been required on an annual basis since the year 2000. Hence, escrow deposits made by NPMs in year 2000 would be subject to release to those NPMs beginning in 2025. The current total aggregate balance of all escrow deposits made by all NPMs in connection with the sale of NPM cigarettes in North Dakota since 2000 is approximately \$4MM.

#### **COMPLEMENTARY STATUTE AT N.D.C.C. CH. 51-25.1**

North Dakota became a signatory to an additional settlement agreement related to the MSA in 2018, known as the NPM Adjustment Settlement Agreement. Among other things, the NPM Adjustment Settlement Agreement settled North Dakota’s potential disputes with the PMs over the NPM Adjustment – the possible downward adjustments to the state’s share of the PMs’ annual

MSA payments – from 2004 through 2017. The settlement subsequently was extended through the 2022 sales year. A total of 37 states, including the District of Columbia and Puerto Rico, are signatories to the NPM Adjustment Settlement Agreement.

When North Dakota became a signatory in 2018, it agreed, subject to a contingency, to introduce legislation with procedural enhancements to complement and aid in the enforcement of our Qualifying Statute. After the contingency was met in 2020, SB 2259 was introduced during the Sixty-Seventh Legislative Assembly in 2021. The bill was enacted and became effective on August 1, 2021.

The Complementary Statute that is codified at N.D.C.C. ch. 51-25.1 includes requirements for PMs, NPMs, and distributors of cigarettes. Among other thing, our Complementary Statute requires both PMs and NPMs to submit annual certifications to the attorney general for approval to lawfully sell cigarettes in this state. Additionally, the law requires the attorney general to publish on the attorney general’s website a directory listing all PMs and NPMs whose cigarettes are approved for sale in North Dakota.

#### **SUMMARY OF SECTIONS IN HB 1274**

Section 1 of the bill is proposed as an amendment to the definition of the term “units sold” in the Qualifying Statute at ch. 51-25. The amendment proposed in section 1 goes hand in hand with the other proposed amendment to the state’s Qualifying Statute in section 8. The impetus for these proposed amendments is language contained in the NPM Adjustment Settlement Agreement the state signed onto in 2018. The intent of the amendments in section 1 is to authorize the collection of escrow from NPMs on cigarettes sold into the state on which state excise tax is not collected, notwithstanding that there may be precedent under federal law to collect state excise tax on the sale.

The intent of the amendment in Section 8 of the bill would be to provide a process under the amended definition of “units sold” for the collection of escrow from NPMs. Under the process described in section 8, the burden would be on the NPM to establish a sale of cigarettes falls outside the “units sold” definition, in other words, to establish the sale is exempt from state excise tax

under federal law such that an escrow deposit for the sale would not be required. The impetus in section 10 for proposing sections 1 and 8 as an emergency measure is to permit the diligent enforcement of the provisions proposed in sections 1 and 8 beginning on the date the governor would sign the bill rather than not until August 1, 2023.

Section 2 of the bill would provide a process for an NPM to make an irrevocable assignment of its escrow funds to the state. Following an irrevocable assignment by an NPM, the state would not be required to release an NPM's escrow funds back to the NPM. The amendment is proposed because of interest expressed in recent years by some NPMs or their transferees to release low balance escrow funds to states rather than being required to continue to pay bank fees. The impetus of the proposed amendment also is to provide a clear statutory framework how the state would handle an irrevocable assignment from an NPM.

Section 3 of the bill proposes an amendment to the state's Complementary Statute that would make inclusion of a PM or NPM on the state's approved-for-sale directory contingent on the cigarettes of the PM or NPM being imported into the state only by distributors licensed under the Tobacco Products Tax Law, N.D.C.C. ch. 57-36. Further, section 3 proposes an amendment that would make inclusion of an NPM on the state's directory contingent on the NPM providing the attorney general and tax commissioner with the monthly reports that are required under federal law. The impetus for the amendments proposed in section 3 is based on experience in diligently enforcing the state's Qualifying Statute since the Complementary Statute went into effect in August of 2021.

The amendments proposed in sections 4 and 5 of the bill go hand in hand. Section 5 is intended to provide guidance to distributors and retailers selling cigarettes in the state by providing in-state distributors and retailers with a "sell-through period" to sell their existing inventory of cigarettes in the event a PM or NPM, or a brand family thereof, is removed from the approved-for-sale tobacco directory. The intent of the amendment proposed in section 4, is to establish that, under the "sell-through" provisions in section 5, it would be lawful for in-state distributors and

retailers to sell or possess for sale the cigarettes of a tobacco product manufacturer or brand family for a period of time after the manufacturer or brand family been removed from the directory.

Section 6 proposes amendments to the state's Complementary Statute that would provide enforcement mechanisms to seek compliance from distributors and retailers with the sell-through-related provisions proposed in section 5 of the bill, and from distributors with respect to existing requirements in the Complementary Statute to disclose records to the attorney general.

The amendment in section 7 is proposed to clarify that, for purposes of the state's Complementary Law, a distributor licensed to sell cigarettes in the state also must comply with requirements for those distributors set forth in the Tobacco Products Tax Law, N.D.C.C. ch. 57-36. Finally, the amendment to the Tobacco Products Tax Law in section 9 is proposed to clarify that distributors and retailers licensed to sell cigarettes in the state also must comply with relevant provisions in the Complementary Statute. Sections 7 and 9 are proposed to further assist in the state's diligent enforcement of our Qualifying Statute.