HB 102

1-GH1036\A.1
Ford✓
3/25/99

AMENDMENT

OFFERED IN THE HOUSE BY REPRESENTATIVE DAVIES

TO: HB 102

Page 3, line 27:

Delete "Such money itself"

Insert "Money placed into escrow and interest earned on money in escrow"

HOUSE COMMITTEE REPORT

(11)

Date Referred to Committee: March 16, 1999 **FURTHER REFERRALS:**

Date of Committee Action: 3/26/99

The FINANCE Committee considered: **HB 102**

HOUSE BILL NO. 102 **CIGARETTE SALES: AGREEMENT/ESCROW**

"An Act imposing certain requirements relating to cigarette sales in this state by tobacco product manufacturers, including requirements for escrow, payment, and reporting of money from cigarette sales in this state; providing penalties for noncompliance with those requirements; and providing for an effective date."

recommends it be replaced with the following committee substitute _____ [ ] the same title [ ] a new title

[ ] additional referral to _____ Committee
[ ] attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(s): (Dept) APPROVES PREVIOUS: (Dept/Date)

[ ] fiscal note(s) _____ [ ] fiscal note(s) _____

[ ] zero fiscal note(s) _____ 2 [4] zero fiscal note(s) ~~Law, DOR 3/19/99~~

SIGNING WITH RECOMMENDATIONS	DP	DNP	NR	AM
Therriault			X	
Mulder	✓			
Bunde			✓	
DAVIES (In principal...)	X			
(Generally) Grussendorf			✓	
Moses			X	
DAVIES			X	
Foster			X	

CHAIR'S SIGNATURE Therriault Mulder

CO-

FISCAL NOTE

(S) Version: HB 102
(H) Publish Date: 2/19/99

STATE OF ALASKA
1999 LEGISLATIVE SESSION

Revision Date/Time (Note if correction)
Dept. Affected Law
Title "... to a settlement agreement between certain tobacco product manufacturers and the state ..."
BRU Civil Division
Component Fair Business Practices
Sponsor Rules Committee
Requester Governor
Component Serial No. 2206

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below

OPERATING EXPENDITURES	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY99) cost:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This legislation implements a provision of the Master Settlement Agreement (MSA) between 46 states, including Alaska, and certain United States tobacco product manufacturers. That agreement, which was a final settlement of the states' litigation with the major tobacco manufacturers, was signed on November 23, 1998. Under the terms of the settlement, Alaska will receive $670 million over the next 25 years to help offset the financial burdens imposed on the state by cigarette smoking. In addition to the monetary provisions, the settlement requires fundamental and far-ranging changes in the tobacco industry's business practices, advertising, and marketing.

This legislation, referred to in the MSA as the "model (or qualifying) statute," creates a reserve fund for nonparticipating manufacturers to pay future claims and is intended to level the playing field between the manufacturers who participated in the MSA (or sign on to it in the future) and those who did not. It is intended to neutralize the cost

Prepared by Joan M. Kasson
Division Attorney General's Office
Phone 465-5370
Date/Time 2/8/99, 8:37 AM

Approved by Commissioner Bruce M. Botelho, Attorney General
Agency for Department of Law
Date 2/8/99

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FISCAL NOTE

ANALYSIS CONTINUATION

disadvantages that the participating manufacturers experience (relative to the nonparticipating manufacturers) as a result of the MSA. It requires the nonparticipating manufacturers that sell tobacco products in the state and are not signators of the MSA to establish escrow accounts to pay for qualified claims for health-related concerns tied to their sales of tobacco products in the state.

Alaska does not need to pass the model/qualifying statute in order to receive payments under the Master Settlement Agreement, but failure to enact it could result in a significant reduction (as much as 65 percent) in the state's allotment under the agreement in the future. If a state does not pass the model statute, the MSA provides for an adjustment to that state's payments if the participating manufacturers, as a result of the marketing restrictions, payments, and other restrictions in the settlement, experience a disadvantage and lose market share for sales of their tobacco products to nonparticipating manufacturers. However, under the terms of the MSA, if a state passes the model statute and enforces it, it will be exempt from any payment reductions, even if the settlement was a significant factor contributing to the participating manufacturers' loss of market share.

Under terms of the legislation, a tobacco product manufacturer selling cigarettes in the state must either become a participating manufacturer or place a set amount into an escrow account for each unit sold in the state. The Commissioner of Revenue will be responsible for receiving certification that the manufacturer is in compliance with the terms of the legislation, and the Attorney General will be responsible for bringing a civil action against a non-complying manufacturer. It is impossible to predict whether nonparticipating manufacturers will enter the Alaska market and whether there will be a need for the Attorney General to take legal action against companies that do not comply with the terms of the statute. At this time, however, we do not anticipate additional costs related to enforcing the legislation.

FISCAL NOTE

L... Version: HB 102
(H) Publish Date: 2/19/99

STATE OF ALASKA
1999 LEGISLATIVE SESSION

Revision Date/Time (Note if correction) _____ Dept. Affected Revenue
Title Federal Government Tobacco Settlement BRU Revenue Operations
Component Income and Excise Audit
Sponsor RLS
Requester Governor Component Serial No. 113

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES ( )	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of current year (FY99) cost: 0.0

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

See attachment.

Prepared by Tim Cottongim, Appeals Officer I Phone 465-3695
Division Income and Excise Audit Date/Time February 5, 1999
Approved by Commissioner Wilson L. Condon Date February 8, 1999
Agency Department of Revenue

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Cig99 - 2 5 1999

BILL ANALYSIS

Section 1 describes the health consequences from smoking cigarettes, and the state's obligation to provide and pay for medical assistance to and for persons with health conditions associated with cigarette smoking. This section holds the tobacco product manufacturers responsible for the financial burdens imposed on the state by cigarette smoking, describes the Master Settlement Agreement reached with the leading tobacco product manufacturers, and discusses the intent of this legislation, which is to prevent non-signatory manufacturers from deriving short-term profits and from becoming judgement-proof before liability arises.

Section 2 requires non-signatory manufacturers selling cigarettes in the state to either participate in the Master Settlement Agreement or place into a qualified escrow account by April 15 of each year an established amount for each cigarette sold in the state in the prior year. Funds in escrow will only be released: 1) to pay judgements or settlements from claims brought against the non-signatory manufacturer, 2) to the non-signatory manufacturer if payments placed in escrow exceed what would have been paid if the non-signatory manufacturer participated in the Master Settlement Agreement, or 3) to the non-signatory manufacturer after 25 years from the date of deposit. This section directs non-signatory manufacturers selling cigarettes in the state to certify that they are in compliance with the escrow requirements, and provides for civil actions if they fail to comply.

Section 3 establishes an immediate effective date.

OPERATING EXPENDITURES

This bill will require the Department of Revenue to revise its tax forms to allow verification of the name of each manufacturer whose cigarettes are being sold in the state. We believe the costs of new forms and the accompanying data capture and computer program modifications can be absorbed into the existing budget.

REVENUE

This Act provides no new revenue to the state.

TONY KNOWLES
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HB 102

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STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

February 19, 1999

The Honorable Brian Porter
Speaker of the House
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

Dear Speaker Porter: Brian

Cigarette smoking presents serious pu[illegible] health concerns to the state and its citizens. Recently, this Administration, along with virtually every other state, reached a monumental master settlement agreement with the leading tobacco producers. That agreement was approved by the Alaska Superior Court on February 9, 1999. Under the terms of the settlement, it is anticipated the State of Alaska will receive $670 million over the next 25 years and will benefit from important restrictions on advertising and other matters to addr[illegible]s public health concerns.

While this is an important step forward in addressing this significant health problem, the states that are parties to the agreement wanted to be sure the problem was more comprehensively addressed. This bill I transmit today would help do that by placing some requireme[illegible]ts on tobacco product manufacturers who sell cigarettes in the state but do not sign the settlement agreement.

Under this bill, the non-participating tobacco manufacturers will take responsibility for their share of the financial burden caused by their products by setting up escrow accounts to cover qualified claims for health-related concerns. The availability of the escrow money will better ensure a source of compensation for Alaskans while preventing those manufacturers from deriving large, short-term profits from sales in this state and then becoming judgment-proof before liability may arise. This bill is fair and puts all tobacco product manufacturers on an equal footing regarding cigarette sales in Alaska.

I urge your prompt and favorable action on this bill, as part of an overall solution to address this major public health concern.

Sincerely,

Tony Knowles
Governor

LEGISLATION TO ACCOMPANY TOBACCO SETTLEMENT

"MODEL STATUTE" – HB 102/SB 84

The Tobacco Settlement: The tobacco manufacturers that participated in the November 23, 1998, settlement with the states represent over 98 percent of the tobacco manufacturing industry. The participating manufacturers agreed to make payments to the state for their violations of state law and to restrict their marketing practices. Alaska's payments over 25 years will total nearly $670 million. No legislation to approve the terms of the settlement is required. However, the Master Settlement Agreement (MSA) contemplates important legislation, referred to as the "Model Statute," to assure that all manufacturers of tobacco products are accountable to Alaskans for potential future costs associated with their tobacco sales in the state.

Overview of the Model Statute Legislation: The settlement contemplates that all states will pass a model statute, with the goal being to provide assurances that all companies that sell tobacco products, including those that did not participate in the settlement, are financially capable of fulfilling their economic obligations, if any, to citizens and to the states. The model statute will give all tobacco manufacturers that sell their products in a state the option to either 1) sign on to the settlement agreement or 2) establish an escrow account and pay into that account at a stated rate per unit of tobacco sold in the state. The rates are proportional to the payments to be made by the participating manufacturers under the settlement. In other words, a tobacco manufacturer that did not participate in the settlement agreement could not get around the restrictions in the settlement and sell its products in Alaska with impunity, leaving either individual Alaskans, or the state, to pay the costs of treating resulting illnesses.

In addition, passage of the model statue legislation will protect the state's annual payments from a potential, but unlikely, Non-Participating Manufacturer Adjustment (see explanation below).

This statute was the subject of extensive and difficult negotiations, including discussions on whether the statute would survive legal challenges. The statute was reviewed by a number of antitrust and constitutional law experts who opined that this statute would survive legal challenge.
Except for a few minor procedural changes, SB 84 and HB 102 are identical to the Model Statute provided in Exhibit T of the MSA.

Importance of Model Statute: Alaska is not required to pass the model statute to receive payments under the terms of the settlement. However, if Alaska does not pass the model statute, it will risk a reduction in payments under the Non-Participating Manufacturer (NPM) Adjustment formula of the settlement. Passing and enforcing the model statute will protect against such a reduction.

The settlement provides for an adjustment to a state's payments if the participating manufacturers experience a disadvantage and lose in-state market share for sales of their tobacco products to non-participating manufacturers as a result of the marketing restrictions, payments, and other provisions in the settlement agreement. However, each state has a safe haven from the application of the reduction formula: if it passes the model statute and enforces it, the state will be exempt from any payment reductions even if the settlement was a significant factor contributing to the participating manufacturers' loss of market share. Indeed, even if a court were to find the statute unconstitutional, the maximum NPM Adjustment Alaska would have to bear is 65% of the payment in any particular year. Without the passage of the statute, the maximum NPM Adjustment would be 100%.

Sectional Analysis

Section One: Section One is the findings and purpose section of the model statute legislation. Section One identifies tobacco as a serious public health problem in Alaska and discusses the burden that treating tobacco-related illnesses places on the State of Alaska. This section also establishes that it is the policy of the State of Alaska that tobacco product manufacturers—not the state or its citizens—bear the financial costs of treating smoking-related illnesses. Section One establishes the need to prevent other non-participating manufacturers from reaping short-term profits in Alaska, while leaving the state and its citizens without any financial protection from the known harms related to cigarette smoking. Finally, Section One identifies the purpose of the model statute legislation as the implementation of the November 23, 1998, MSA

Section Two: Section Two amends Alaska Statutes, Title 45, by adding Chapter 53, which is entitled "Cigarette Sales."

Sec. 45.53.010 recognizes the MSA entered into between the State of Alaska, and the Participating Manufacturers in *State v. Philip Morris*, 1JU-97-915 CI.

Sec. 45.53.020 requires that all tobacco product manufacturers do one of two things: (1) participate in the MSA, or (2) establish an escrow account and place dollars into that account at a stated rate per unit sold in this state. The rates are calculated to be equivalent to the rates paid by the Subsequent Participating Manufacturers (tobacco companies that signed the MSA after it was signed by the four original participating manufacturers) pursuant to the MSA. The changes in the rates also mirror the changes in the MSA annual payments on a per unit basis.

A manufacturer who places funds in escrow is entitled to withdraw interest or other earnings from the account as they are earned. The principal deposited in escrow can be released from escrow only:

1. to pay a judgment or settlement on any claim brought by the State or a party located in or residing in Alaska;
2. if the manufacturer establishes that the amount it would have paid the State had it participated in the MSA is less than the amount the manufacturer is required to place in escrow. In this case the manufacturer is allowed to withdraw the excess from the escrow; or
3. if the funds have remained in escrow for a period of 25 years from the date of payment.

Sec. AS 45.53.030 requires the commissioner of revenue to adopt regulations under the Administrative Procedure Act necessary to determine the volume of cigarettes manufactured by a tobacco product manufacturer that enter Alaska for sale in the state based on the amount of excise taxes paid. This will allow the commissioner of revenue to determine whether a tobacco manufacturer that does not sign the Master Settlement Agreement is making the appropriate deposits into the escrow account provided under AS 45.53.020.

Sec. AS 45.53.040 provides for auditing by the Alaska Department of Revenue of payments into escrow required by a tobacco manufacturer and enforcement by the Alaska Department of Law. This section provides for different levels of penalties against a tobacco manufacturer that fails to make the required deposits into escrow. If enforcement by the department of law is required and

the state prevails in an action brought under this section, the court may award the department full reasonable attorney's fees.

Sec. AS 45.53.990 sets forth the definitions. Many of the bill's definitions incorporate by reference the definitions in the MSA. This was done to avoid any confusion between the two documents, and to prevent this legislation from being overly lengthy. The MSA is a public document approved by the Juneau Superior Court on February 9, 1999, in the case of *State of Alaska v. Philip Morris*, 1JU-97-915 CI. A complete copy of the MSA can be found at www.naag.org on the Internet.

Consequences If the Legislature Does Not Pass the Model Statute

It is important to note that the State of Alaska is **not** required to pass the model statute legislation. The MSA and the Consent Decree will remain in force and effect regardless of legislative action on this bill. However passage of this statute will help protect public health and will protect the state settlement payments from a possible draconian and dramatic reduction. The MSA provides for an adjustment to state payments if the disadvantages experienced as a result of the MSA are a significant factor contributing to the participating manufacturers' loss of market share, i.e., the "Non-Participating Manufacturer Adjustment" (NPM Adjustment) found on page 58, at Section IX (d), of the MSA

To illustrate the potential impact of the NPM Adjustment, assume the following hypothetical situation:

1. In 2003 the Original Participating Manufacturers' (as defined at Section II (hh) of the MSA) (OPMs) market share was reduced from 97.5% in 1997 to 93.5%;
2. The OPMs shipped fewer cigarettes into the United States and Puerto Rico in 2003 than they shipped in 1997;
3. The MSA was a "significant factor" contributing to the market share loss;
4. All states except Alaska , California, Colorado, and Wyoming have adopted a Model Statute; and
5. The year for which payments are being calculated is 2004.

Alaska's payments based on the above hypothetical would be calculated as follows if the state had not passed the model statute:

> **Step One**: Calculate the total dollars to be adjusted. In this hypothetical the loss of market share for which an adjustment is required is 2%. That 2% is calculated by subtracting the 2003 market share of 93.5% from the 1997 market share of 97.5% for a total market share loss of 4%; however, the first 2% of the total market share loss is not counted as part of the NPM Adjustment calculations. Then multiply the 2% market share loss times 3, resulting in a total percentage adjustment of 6%. (Note: under the MSA each 1% loss in market share results in a 3% reduction until the loss in market share reaches 16 2/3%, at which time the percentage reduction is calculated at a variable ratio.)
>
> The 2004 total annual payment of $7,004,000,000.00 to all of the states is reduced by an NPM adjustment of 6%, or $420,240,000.00.

Step Two: Allocate the $420,240,000.00 among the four states that did not pass the Model Statute. The following illustrates the allocation method:

States	Allocation % Established in Exhibit A to the MSA	2004 payment without NPM adjustment	% share of NPM Adjustment	Total NPM Adjustment $420,240,000.00	2004 adjusted Payments
CALIFORNIA	0.127639554	$893,987,436.22	0.866846800	$364,283,699.20	$529,703,737.01
COLORADO	0.013708614	$ 96,015,132.46	0.093100201	$ 39,124428.61	$ 56,890,703.84
ALASKA	0.003414187	$ 23,912,965.75	0.023186990	$ 9,744,100.72	$ 14,168,865.03
WYOMING	0.002483449	$ 17,394,076.80	0.016866009	$ 7,087,771.46	$ 10,306,305.33
Totals	0.147245804	$1,031,309,611.22	1.000000000	$420,240,000.00	$611,069,611.22

The "% share of NPM Adjustment" (fourth column above) is calculated pro rata based on the states' relative allocations given in Exhibit A to the MSA. For example, Alaska's allocation established in Exhibit A is .03414187% of the total allocation of the four states whose payments will be adjusted by the NPM Adjustment because they did not pass a Model Statute.

The NPM Adjustment is calculated each year. For instance, if the Participating Manufacturers continued to lose market share and the market share in 2005 remained at 93.5%, these four states would continue to experience an NPM Adjustment.

OVERVIEW OF TOBACCO ISSUES

prepared by Alaska Department of Law

March 7, 1999

INTRODUCTION

During the past two years, the Knowles administration, with the help of the Alaska Legislature, has addressed the problems caused by tobacco and the challenge of limiting access on a number of fronts. Our joint efforts have included legislation to increase taxes on tobacco products, measures to limit youth access to tobacco, stepped-up enforcement activities, and, of course, litigation and participation in the national settlement with the industry. The Department of Law's efforts have been closely coordinated with the Alaska Departments of Health and Social Services and Revenue, local tobacco control groups, and other state attorneys general

ENFORCEMENT OF TOBACCO VENDOR AND TAX LAWS

- **TOBACCO VENDOR ENFORCMENT (STING OPERATIONS):** During 1997 and 1998, the Department of Law ("Law") worked closely with the Anchorage and Juneau Police Departments to coordinate enforcement and prosecution of tobacco vendors that sold tobacco products to persons under 19. Law plans to work with the Fairbanks Department of Public Safety and Fairbanks City Attorney's Office during the early spring to emphasize enforcement of state tobacco laws.

    - Last month Law announced a settlement related to tobacco business licensing litigation with 9 vendors operating a total of 11 stores (5 in Anchorage and 6 in Juneau). The vendors agreed to a settlement that required: (1) a three-day suspension of their tobacco licenses, (2) that they re-train all of their tobacco sales clerks in stores where violations occurred, and (3) that vendors make contributions totaling more than $50,000 to a statewide youth tobacco prevention television campaign. This television campaign will air statewide for a month this spring.

- **STATE SALES TAX ENFORCEMENT:** State law requires any person who causes cigarettes to be brought into the state for personal consumption or resale to obtain a license from the Alaska Department of Revenue and pay the appropriate taxes. A federal law known as the "Jenkins Act" requires persons shipping cigarettes into Alaska to provide the state with a list identifying the recipients. With the growth of Internet sales, the Alaska Departments of Law and Revenue have worked closely with the federal Alcohol, Tobacco and

Firearms investigators and U.S. Attorney's Office to vigorously pursue illegal cigarette shipments. Investigations are currently underway, and additional investigations are likely.

- **EFFECTS OF TOBACCO TAX INCREASE:** In 1997 the Alaska Legislature adopted the nation's highest tax on tobacco products, $1 per pack on cigarettes and 75 percent of the wholesale price on other tobacco products. According to a recent study released by the Departments of Health and Social Services and Revenue, taxable consumption of cigarettes has declined 17 percent since the tax went into effect. Although it will take several years to collect enough data to complete an analysis of the impact of the tax increase on tobacco consumption by youth and adults, the decline in consumption is viewed as a positive result of the increase in taxes. In addition, the monthly revenue from tobacco taxes has risen from $1.5 million to $4.3 million, a 190 percent increase, since the tax was raised.

LITIGATION AND THE NATIONAL SETTLEMENT

- **ALASKA'S LITIGATION:** In April 1997, Alaska filed suit against the major tobacco manufacturers based on state consumer protection and antitrust laws. The suit was scheduled to go to trial in February 2000.

- **NATIONAL SETTLEMENT:** On November 23, 1998, after extended negotiations, the State of Alaska and 45 other states reached a final settlement of litigation with the tobacco industry – Mississippi, Texas, Florida, and Minnesota had already settled their lawsuits. The settlement, which was approved by the Juneau Superior Court on February 9, 1999, ends the State's litigation with the industry. The settlement will mean payments of nearly $670 million to Alaska over the next 25 years, starting in FY 2000.

- **PUBLIC HEALTH TERMS:** The significant public health terms of the settlement require: bans on marketing to youth; changes in corporate culture; disbanding trade associations; lobbying restrictions; opening industry research; and creation of a national teen smoking foundation and public education fund. The full settlement agreement is available at www.naag.org on the Internet.

- **THE PAYMENT STREAM:** The State of Alaska **does not** need to pass any legislation to receive payments under the settlement. However, legislation is required to protect Alaska's payments from the rather remote possibility of a nonparticipating manufacturer reduction, which is discussed in more detail below. The State also needs protection against attempts by HCFA (the federal Health Care Finance Administration) to recoup a portion of the state's funds, as will also be discussed below.

Under terms of the settlement agreement, Alaska will receive the following payments:

PAYMENTS TO ALASKA
under
SETTLEMENT OF TOBACCO LITIGATION

	Date of Payment		Amount of Payment
Up-front Payment	between April 1999 and June 2000 (depending on actions of other states)		$8,194,049.54
Annual Payments	between April and June	2000	$21,890,915.46
	April	2001	$23,638,672.09
	April	2002	$28,383,145.58
	April	2003	$23,651,761.36
	April	2004	$23,912,967.90
	April	2005	$23,912,967.90
	April	2006	$23,912,967.90
	April	2007	$23,912,967.90
	April	2008	$24,387,539.93
	April	2009	$24,387,539.93
	April	2010	$24,387,539.93
	April	2011	$24,387,539.93
	April	2012	$24,387,539.93
	April	2013	$24,387,539.93
	April	2014	$24,387,539.93
	April	2015	$24,387,539.93
	April	2016	$24,387,539.93
	April	2017	$24,387,539.93
	April	2018	$27,327,155.20
	April	2019	$27,327,155.20
	April	2020	$27,327,155.20
	April	2021	$27,327,155.20
	April	2022	$27,327,155.20
	April	2023	$27,327,155.20
	April	2024	$27,327,155.20
	April	2025	$27,327,155.20
		TOTAL	$668,903,056.53

- **TIMING OF UP-FRONT PAYMENT:** On December 28, 1998, the tobacco companies paid an up-front payment into escrow as part of the agreement. No legislation is required for Alaska to receive its up-front payment, which will be disbursed to Alaska only when 80 percent of the states' lawsuits are dismissed without any appeal, or on June 30, 2000, whichever comes first. Right now, there are appeals in California and New York, so the anticipated receipt of the up-front payment will probably come closer to June 30, 2000.

- **TIMING OF ANNUAL PAYMENTS:** The first annual payment will be available no later than June 30, 2000. No legislation is required for Alaska to receive its annual payments. Alaska's first annual payment could come as early as April 2000, if 80 percent of the states' lawsuits are dismissed without any appeal, but in any case will be made no later than June 30, 2000. Beginning in 2001, the annual payments will be made to the state on April 15 each year.

- **ATTORNEYS' FEES:** The State of Alaska was represented in the tobacco litigation by the law firm of Hagens & Berman, which represented all the Northwest states. The settlement agreement allows the state's outside counsel to seek payment from the tobacco companies without affecting Alaska's share of the settlement. Hagens & Berman requested reimbursement directly from the tobacco companies, which agreed to pay $10 million as full payment for the firm's representation of Alaska. This payment did not affect Alaska's share of the settlement. However, when compared to the state's settlement of $668,903,056.53, the Hagens & Berman fee is approximately 1.5 percent.

THREAT TO SETTLEMENT FROM HCFA

- **FEDERAL RECOUPMENT:** The U.S. Health Care Finance Administration (HCFA) has taken the position that as much as half of the funds recovered through the national settlement are subject to the agency's right of recoupment. HCFA apparently bases its position on an interpretation of §1903(d)(2)(A-B) of the Social Security Act, which states that reimbursements to a state by a third party are "overpayments" from which HCFA may claim a pro-rata share.

  - The agency's position is based on the assumption that the state was specifically suing to collect state and federal dollars under a Medicaid reimbursement theory. One estimate shows that HCFA's interpretation of §1903(d) could result in a loss to the State of Alaska of $400 million over 25 years. The Department of Law is working through Alaska's congressional delegation and other states to solve this problem, and it will defend the state's right to settlement funds in court if necessary. HCFA has represented

that it will assert its claim against annual state payments beginning after the Year 2000 payment.

- **ALASKA'S RESPONSE TO THREAT: Alaska's Objectives** - The State had four primary objectives when it brought suit against the tobacco industry: (1) to end the industry's targeting of Alaska's children as new consumers for its products; (2) to force the industry to disclose the harmful effects of smoking and decades of research demonstrating that tobacco kills; (3) to thwart the industry's apparent efforts to prevent the development of a safer product; and (4) to require the industry to pay for the harm it already has caused and, in the future, fund public health programs directed at alleviating the related public health concerns.

  - **Alaska Sued to Protect Alaskans:** Alaska brought suit to protect Alaskans and to protect the fiscal integrity of the state's Medicaid program against future smoking-related treatment costs. Unlike other states, Alaska did not specifically plead a federal Medicaid recoupment claim in state superior court. Collecting federal dollars is the responsibility of HCFA and the U.S. Department of Justice. The U.S. Department of Justice declined to sue the tobacco industry on behalf of HCFA, and HCFA provided no support to the states during the litigation.

  - **First Proposed Settlement and Congress vs. State Settlement:** The first settlement was signed by the states and tobacco industry on June 20, 1997. It called for the tobacco industry to make payments to the states and fund federal enforcement programs totaling $368.5 billion over 25 years. This settlement also required congressional approval, which did not occur. Accordingly, the states returned to litigation and resumed negotiations with the industry on their own. The litigation and resumed negotiations resulted in the second state settlement of November 23, 1998. HCFA could have acted along with the states to protect its rights during the second settlement process, but chose not to.

  - **Use of Settlement Funds:** A key provision of the McCain Bill in the 105th Congress provided that if states directed 50 percent of the settlement money (of the proposed 1997 settlement) to supplement but not supplant existing health care programs, HCFA could not assert its claim for recoupment. Although the McCain Bill did not pass and the states take the position that all settlement dollars are state funds, many states are abiding by the provisions of the McCain Bill (spending no less than 50 percent to supplement health care-related programs) to protect against recoupment by the federal government. Governor Knowles' proposal for spending tobacco settlement proceeds on annualized payments for Head Start, Healthy Families, and tobacco prevention programs will provide a strong argument against recoupment by HCFA.

- **Recent Development: SB 346:** On February 3, 1999, U.S. Senator Frank Murkowski and U.S. Senator Kay Bailey Hutchinson co-sponsored SB 346. SB 346 would protect all the states' settlement dollars from HCFA's attempted recoupment.

LEGISLATION

➢ **MODEL STATUTE:** The state is not required to pass the model statute included in the settlement to receive settlement payments. However, if the state does not pass the model statute, the state will risk a possible reduction in payments under the nonparticipating manufacturers' payment (NPM) reduction formula of the settlement. The settlement provides for an adjustment to the state's payments if the participating manufacturers experience a disadvantage and lose market share for sales of their tobacco products to other nonparticipating manufacturers as a result of the marketing restrictions, payments, and other restrictions in the settlement agreement.

- **NPM Risk Low In Alaska** - At this point, the risk to Alaska of a non-participating manufacturer reduction is minimal, given that many of the very small tobacco product manufacturers have decided to sign on to the settlement, which reduces the risk that they will take market share away from the largest companies. The risk is further lowered by the fact that the small tobacco products manufacturers only represent 1-2 percent of the U.S. market, making it unlikely that sales of their products will trigger the nonparticipating manufacturer reductions.

- **NPM Risk Can Be Eliminated** - The risk of nonparticipating manufacturer reductions can be eliminated by passage of the model statute (SB 84/HB 102). Under the terms of the settlement agreement, if the state passes the model statute and enforces it, the state will be exempt from any payment reductions even if the settlement was a significant factor contributing to the participating manufacturers' loss of market share.

CONCLUSION

In the upcoming months, Law will be working closely with the Alaska Departments of Revenue and Health and Social Services, and the federal Alcohol, Tobacco and Firearms investigators to assure full compliance with state tax laws. Law is also working closely at the direction of the governor with members of Alaska's congressional delegation to protect the state settlement from HCFA.

Prepared by Alaska Department of Law
March 7, 1999

MASTER SETTLEMENT AGREEMENT

Participating Manufacturers pursuant to this subsection (c)(2) shall be subject to the Inflation Adjustment, the Volume Adjustment, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8). Such payments shall also be subject to the Non-Settling States Reduction; provided, however, that for purposes of payments due pursuant to this subsection (c)(2) (and corresponding payments by Subsequent Participating Manufacturers under subsection IX(i)), the Non-Settling States Reduction shall be derived as follows: (A) the payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be allocated among the Settling States on a percentage basis to be determined by the Settling States pursuant to the procedures set forth in Exhibit U, and the resulting allocation percentages disclosed to the Escrow Agent, the Independent Auditor and the Original Participating Manufacturers not later than June 30, 1999; and (B) the Non-Settling States Reduction shall be based on the sum of the Allocable Shares so established pursuant to subsection (c)(2)(A) for those States that were Settling States as of the MSA Execution Date and as to which this Agreement has terminated as of the date 15 days before the payment in question is due.

(d) Non-Participating Manufacturer Adjustment.

(1) Calculation of NPM Adjustment for Original Participating Manufacturers. To protect the public health gains achieved by this Agreement, certain payments made pursuant to this Agreement shall be subject to an NPM

Adjustment. Payments by the Original Participating Manufacturers to which the NPM Adjustment applies shall be adjusted as provided below:

(A) Subject to the provisions of subsections (d)(1)(C), (d)(1)(D) and (d)(2) below, each Allocated Payment shall be adjusted by subtracting from such Allocated Payment the product of such Allocated Payment amount multiplied by the NPM Adjustment Percentage. The "NPM Adjustment Percentage" shall be calculated as follows:

(i) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is less than or equal to 0 (zero), then the NPM Adjustment Percentage shall equal zero.

(ii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 0 (zero) and less than or equal to 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the product of (x) such Market Share Loss and (y) 3 (three).

(iii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the sum of (x) 50 percentage points and (y) the product of (*1*) the Variable Multiplier and (*2*) the result of such Market Share Loss minus 16 2/3 percentage points.

(B) Definitions:

(i) "Base Aggregate Participating Manufacturer Market Share" means the result of (x) the sum of the applicable Market Shares (the applicable Market Share to be that for 1997) of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due minus (y) 2 (two) percentage points.

(ii) "Actual Aggregate Participating Manufacturer Market Share" means the sum of the applicable Market Shares of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question is due).

(iii) "Market Share Loss" means the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) the Actual Aggregate Participating Manufacturer Market Share.

(iv) "Variable Multiplier" equals 50 percentage points divided by the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) 16 2/3 percentage points.

(C) On or before February 2 of each year following a year in which there was a Market Share Loss greater than zero, a nationally recognized firm of economic consultants (the "Firm") shall determine whether the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall apply. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were not a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall not apply. The Original Participating Manufacturers, the Settling States, and the Attorneys General for the Settling States shall cooperate to ensure that the determination described in this subsection (1)(C) is timely made. The Firm shall be acceptable to (and the principals responsible for this assignment shall be acceptable to) both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question (or in the event no such firm or no such principals shall be acceptable to such parties, National Economic Research Associates, Inc., or its successors by merger, acquisition or otherwise ("NERA"), acting

through a principal or principals acceptable to such parties, if such a person can be identified and, if not, acting through a principal or principals identified by NERA, or a successor firm selected by the CPR Institute for Dispute Resolution). As soon as practicable after the MSA Execution Date, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of making the foregoing determination, and the Firm shall provide written notice to each Settling State, to NAAG, to the Independent Auditor and to each Participating Manufacturer of such determination. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable. The reasonable fees and expenses of the Firm shall be paid by the Original Participating Manufacturers according to their Relative Market Shares. Only the Participating Manufacturers and the Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (1)(C).

(D) No NPM Adjustment shall be made with respect to a payment if the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico in the year immediately preceding the year in which the payment in question is due by those Participating Manufacturers that had become Participating Manufacturers prior to 14 days after the MSA Execution Date is greater than the aggregate number of Cigarettes shipped in or to the fifty United States, the

District of Columbia, and Puerto Rico in 1997 by such Participating Manufacturers (and any of their Affiliates that made such shipments in 1997, as demonstrated by certified audited statements of such Affiliates' shipments, and that do not continue to make such shipments after the MSA Execution Date because the responsibility for such shipments has been transferred to one of such Participating Manufacturers). Measurements of shipments for purposes of this subsection (D) shall be made in the manner prescribed in subsection II(mm); in the event that such shipment data is unavailable for any Participating Manufacturer for 1997, such Participating Manufacturer's shipment volume for such year shall be measured in the manner prescribed in subsection II(z).

(2) Allocation among Settling States of NPM Adjustment for Original Participating Manufacturers.

(A) The NPM Adjustment set forth in subsection (d)(1) shall apply to the Allocated Payments of all Settling States, except as set forth below.

(B) A Settling State's Allocated Payment shall not be subject to an NPM Adjustment: (i) if such Settling State continuously had a Qualifying Statute (as defined in subsection (2)(E) below) in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year; or (ii) if such Settling State enacted the Model Statute (as defined in subsection (2)(E) below) for the first time during the calendar year immediately preceding the year in

which the payment in question is due, continuously had the Model Statute in full force and effect during the last six months of such calendar year, and diligently enforced the provisions of such statute during the period in which it was in full force and effect.

(C) The aggregate amount of the NPM Adjustments that would have applied to the Allocated Payments of those Settling States that are not subject to an NPM Adjustment pursuant to subsection (2)(B) shall be reallocated among all other Settling States pro rata in proportion to their respective Allocable Shares (the applicable Allocable Shares being those listed in Exhibit A), and such other Settling States' Allocated Payments shall be further reduced accordingly.

(D) This subsection (2)(D) shall apply if the amount of the NPM Adjustment applied pursuant to subsection (2)(A) to any Settling State plus the amount of the NPM Adjustments reallocated to such Settling State pursuant to subsection (2)(C) in any individual year would either (i) exceed such Settling State's Allocated Payment in that year, or (ii) if subsection (2)(F) applies to the Settling State in question, exceed 65% of such Settling State's Allocated Payment in that year. For each Settling State that has an excess as described in the preceding sentence, the excess amount of NPM Adjustment shall be further reallocated among all other Settling States whose Allocated Payments are subject to an NPM Adjustment and that do not have such an excess, pro rata in proportion to their respective Allocable Shares, and such other Settling States' Allocated

Payments shall be further reduced accordingly. The provisions of this subsection (2)(D) shall be repeatedly applied in any individual year until either (i) the aggregate amount of NPM Adjustments has been fully reallocated or (ii) the full amount of the NPM Adjustments subject to reallocation under subsection (2)(C) or (2)(D) cannot be fully reallocated in any individual year as described in those subsections because (x) the Allocated Payment in that year of each Settling State that is subject to an NPM Adjustment and to which subsection (2)(F) does not apply has been reduced to zero, and (y) the Allocated Payment in that year of each Settling State to which subsection (2)(F) applies has been reduced to 35% of such Allocated Payment.

(E) A "Qualifying Statute" means a Settling State's statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement. Each Participating Manufacturer and each Settling State agree that the model statute in the form set forth in Exhibit T (the "Model Statute"), if enacted without modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, shall constitute a Qualifying Statute. Each Participating Manufacturer agrees to support the enactment of such Model

Statute if such Model Statute is introduced or proposed (i) without modification or addition (except for particularized procedural or technical requirements), and (ii) not in conjunction with any other legislative proposal.

(F) If a Settling State (i) enacts the Model Statute without any modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, (ii) uses its best efforts to keep the Model Statute in full force and effect by, among other things, defending the Model Statute fully in any litigation brought in state or federal court within such Settling State (including litigating all available appeals that may affect the effectiveness of the Model Statute), and (iii) otherwise complies with subsection (2)(B), but a court of competent jurisdiction nevertheless invalidates or renders unenforceable the Model Statute with respect to such Settling State, and but for such ruling the Settling State would have been exempt from an NPM Adjustment under subsection (2)(B), then the NPM Adjustment (including reallocations pursuant to subsections (2)(C) and (2)(D)) shall still apply to such Settling State's Allocated Payments but in any individual year shall not exceed 65% of the amount of such Allocated Payments.

(G) In the event a Settling State proposes and/or enacts a statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that is not the Model Statute and asserts that such

statute, regulation, law and/or rule is a Qualifying Statute, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of determining whether or not such statute, regulation, law and/or rule constitutes a Qualifying Statute. The Firm shall make the foregoing determination within 90 days of a written request to it from the relevant Settling State (copies of which request the Settling State shall also provide to all Participating Manufacturers and the Independent Auditor), and the Firm shall promptly thereafter provide written notice of such determination to the relevant Settling State, NAAG, all Participating Manufacturers and the Independent Auditor. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable; provided, however, (i) that such determination shall be of no force and effect with respect to a proposed statute, regulation, law and/or rule that is thereafter enacted with any modification or addition; and (ii) that the Settling State in which the Qualifying Statute was enacted and any Participating Manufacturer may at any time request that the Firm reconsider its determination as to this issue in light of subsequent events (including, without limitation, subsequent judicial review, interpretation, modification and/or disapproval of a Settling State's Qualifying Statute, and the manner and/or the effect of enforcement of such Qualifying Statute). The Original Participating Manufacturers shall severally pay their Relative Market Shares of the reasonable fees and expenses of the Firm. Only the

Participating Manufacturers and Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (2)(G).

(H) Except as provided in subsection (2)(F), in the event a Qualifying Statute is enacted within a Settling State and is thereafter invalidated or declared unenforceable by a court of competent jurisdiction, otherwise rendered not in full force and effect, or, upon reconsideration by the Firm pursuant to subsection (2)(G) determined not to constitute a Qualifying Statute, then such Settling State's Allocated Payments shall be fully subject to an NPM Adjustment unless and until the requirements of subsection (2)(B) have been once again satisfied.

(3) Allocation of NPM Adjustment among Original Participating Manufacturers. The portion of the total amount of the NPM Adjustment to which the Original Participating Manufacturers are entitled in any year that can be applied in such year consistent with subsection IX(d)(2) (the "Available NPM Adjustment") shall be allocated among them as provided in this subsection IX(d)(3).

(A) The "Base NPM Adjustment" shall be determined for each Original Participating Manufacturer in such year as follows:

(i) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied exceed or are

equal to their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal 0 (zero).

(ii) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied are less than their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal the result of (x) the difference between such Original Participating Manufacturer's Relative Market Share in such preceding year and its 1997 Relative Market Share multiplied by both (y) the number of individual Cigarettes (expressed in thousands of units) shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such preceding year (determined in accordance with subsection II(mm)) and (z) $20 per each thousand units of Cigarettes (as this number is adjusted pursuant to subsection IX(d)(3)(C) below).

(iii) For those Original Participating Manufacturers whose Base NPM Adjustment, if calculated pursuant to subsection (ii) above, would exceed $300 million (as this number is adjusted pursuant to subsection IX(d)(3)(C) below), the Base NPM Adjustment shall equal $300 million (or such adjusted number, as provided in subsection IX(d)(3)(C) below).

(B) The share of the Available NPM Adjustment each Original Participating Manufacturer is entitled to shall be calculated as follows:

(i) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year is less than or equal to the sum of the Base NPM Adjustments of all Original Participating Manufacturers in such year, then such Available NPM Adjustment shall be allocated among those Original Participating Manufacturers whose Base NPM Adjustment is not equal to 0 (zero) pro rata in proportion to their respective Base NPM Adjustments.

(ii) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year exceeds the sum of the Base NPM Adjustments of all Original Participating Manufacturers in such year, then (x) the difference between such Available NPM Adjustment and such sum of the Base NPM Adjustments shall be allocated among the Original Participating Manufacturers pro rata in proportion to their Relative Market Shares (the applicable Relative Market Shares to be those in the year immediately preceding such year), and (y) each Original Participating Manufacturer's share of such Available NPM Adjustment shall equal the sum of *(1)* its Base NPM Adjustment for such year, and *(2)* the amount allocated to such Original Participating Manufacturer pursuant to clause (x).

(iii) If an Original Participating Manufacturer's share of the Available NPM Adjustment calculated pursuant to subsection IX(d)(3)(B)(i) or IX(d)(3)(B)(ii) exceeds such Original Participating Manufacturer's payment amount to which such NPM Adjustment applies (as such payment amount has been determined pursuant to step B of clause "Seventh" of subsection IX(j)), then *(1)* such Original Participating Manufacturer's share of the Available NPM Adjustment shall equal such payment amount, and *(2)* such excess shall be reallocated among the other Original Participating Manufacturers pro rata in proportion to their Relative Market Shares.

(C) Adjustments:

(i) For calculations made pursuant to this subsection IX(d)(3) (if any) with respect to payments due in the year 2000, the number used in subsection IX(d)(3)(A)(ii)(z) shall be $20 and the number used in subsection IX(d)(3)(A)(iii) shall be $300 million. Each year thereafter, both these numbers shall be adjusted upward or downward by multiplying each of them by the quotient produced by dividing (x) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such year, by (y) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such immediately preceding year.

(ii) For purposes of this subsection, the average revenue per Cigarette of all the Original Participating Manufacturers in any year shall equal (x) the aggregate revenues of all the Original Participating Manufacturers from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico after Federal excise taxes and after payments pursuant to this Agreement and the tobacco litigation Settlement Agreements with the States of Florida, Mississippi, Minnesota and Texas (as such revenues are reported to the United States Securities and Exchange Commission ("SEC") for such year (either independently by the Original Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of the Original Participating Manufacturers) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with United States generally accepted accounting principles and audited by a nationally recognized accounting firm), divided by (y) the aggregate number of the individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such year (determined in accordance with subsection II(mm)).

(D) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied both (x) the Relative

Market Share of Lorillard Tobacco Company (or of its successor) ("Lorillard") was less than or equal to 20.0000000%, and (y) the number of individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by Lorillard (determined in accordance with subsection II(mm)) (for purposes of this subsection (D), "Volume") was less than or equal to 70 billion, Lorillard's and Philip Morris Incorporated's (or its successor's) ("Philip Morris") shares of the Available NPM Adjustment calculated pursuant to subsections (3)(A)-(C) above shall be further reallocated between Lorillard and Philip Morris as follows (this subsection (3)(D) shall not apply in the year in which either of the two conditions specified in this sentence is not satisfied):

(i) Notwithstanding subsections (A)-(C) of this subsection (d)(3), but subject to further adjustment pursuant to subsections (D)(ii) and (D)(iii) below, Lorillard's share of the Available NPM Adjustment shall equal its Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding the year in which such NPM Adjustment is applied). The dollar amount of the difference between the share of the Available NPM Adjustment Lorillard is entitled to pursuant to the preceding sentence and the share of the Available NPM Adjustment it would be entitled to in the same year pursuant to subsections (d)(3)(A)-(C) shall be reallocated to Philip Morris and used to decrease or increase, as the case may be,

Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C).

(ii) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied either (x) Lorillard's Relative Market Share was greater than 15.0000000% (but did not exceed 20.0000000%), or (y) Lorillard's Volume was greater than 50 billion (but did not exceed 70 billion), or both, Lorillard's share of the Available NPM Adjustment calculated pursuant to subsection (d)(3)(D)(i) shall be reduced by a percentage equal to the greater of (*1*) 10.0000000% for each percentage point (or fraction thereof) of excess of such Relative Market Share over 15.0000000% (if any), or (*2*) 2.5000000% for each billion (or fraction thereof) of excess of such Volume over 50 billion (if any). The dollar amount by which Lorillard's share of the Available NPM Adjustment is reduced in any year pursuant to this subsection (D)(ii) shall be reallocated to Philip Morris and used to increase Philip Morris's share of the Available NPM Adjustment in such year.

(iii) In the event that in any year a reallocation of the shares of the Available NPM Adjustment between Lorillard and Philip Morris pursuant to this subsection (d)(3)(D) results in Philip Morris's share of the Available NPM Adjustment in such year exceeding the greater of (x) Philip Morris's Relative Market Share

of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding such year), or (y) Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C), Philip Morris's share of the Available NPM Adjustment in such year shall be reduced to equal the greater of (x) or (y) above. In such instance, the dollar amount by which Philip Morris's share of the Available NPM Adjustment is reduced pursuant to the preceding sentence shall be reallocated to Lorillard and used to increase Lorillard's share of the Available NPM Adjustment in such year.

(iv) In the event that either Philip Morris or Lorillard is treated as a Non-Participating Manufacturer for purposes of this subsection IX(d)(3) pursuant to subsection XVIII(w)(2)(A), this subsection (3)(D) shall not be applied, and the Original Participating Manufacturers' shares of the Available NPM Adjustment shall be determined solely as described in subsections (3)(A)-(C).

(4) NPM Adjustment for Subsequent Participating Manufacturers. Subject to the provisions of subsection IX(i)(3), a Subsequent Participating Manufacturer shall be entitled to an NPM Adjustment with respect to payments due from such Subsequent Participating Manufacturer in any year during which an NPM Adjustment is applicable under subsection (d)(1) above to payments due