Cigarette Restitution Fund
Fiscal 2008 Budget Overview

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Cigarette Restitution Fund Overview

History of the Cigarette Restitution Fund

On November 23, 1998, the 4 (now 3) major tobacco companies agreed to settle all outstanding litigation with 46 states, 5 territories, and the District of Columbia. Four states including Florida, Minnesota, Texas, and Mississippi had earlier settled lawsuits against the major tobacco companies. Under the Master Settlement Agreement (MSA), the settling manufacturers will pay the litigating parties approximately $206 billion over the next 25 years and beyond, as well as conform to a number of restrictions on marketing to youth and the general public.

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

In anticipation of receiving tobacco settlement revenue, the State established the Cigarette Restitution Fund (CRF) in Chapter 173 of 1999 as a special nonlapsing fund to be used for a variety of programs and initiatives. The Act specified eight health- and tobacco-related priorities, listed in **Exhibit 1**, to which no less than 50% of funds must be appropriated annually. To support this goal, the General Assembly created the Tobacco Use Prevention and Cessation Program and the Cancer Prevention, Education, Screening, and Treatment Program as programs within the Family Health Administration to address both the causes and effects of tobacco use. The fund also supports existing health programs such as substance abuse treatment and Medicaid. In addition to the above funding requirement, State law also requires the following mandatory appropriations.

- ***Statewide Academic Health Centers:*** The Governor must include $15.4 million for the University of Maryland Medical Group and Johns Hopkins Institutions (JHI) for tobacco-related disease research ($2.0 million), cancer research ($10.4 million), and the Statewide Health Network ($3.0 million). The two statewide academic health centers must also receive at least 9.5% of total local health funds in the cancer program. These funds are used to provide cancer prevention, education, screening, and treatment services to low-income Baltimore City residents; these services are provided by local health departments in all other jurisdictions.

- ***Tobacco Use and Prevention Activities:*** The Governor must include in the State budget at least $21.0 million for tobacco use and prevention activities. Historically, the Governor has included funds in the CRF and Family Health Administration budget to meet this requirement.

Exhibit 1
Spending Priorities in the Cigarette Restitution Act

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

Source: Chapter 173 of 1999

- ***Medicaid:*** At least 30% of the CRF appropriation must be dedicated to Medicaid.
- ***Office of the Attorney General:*** 0.15% of the fund is dedicated to enforcement of Title 16, Subtitle 5 of the Business Regulation Article (Escrow Requirements for Nonparticipating Tobacco Product Manufacturers).
- ***Administrative Costs:*** Administrative expenses are limited to 7% of program cost.

Performance Analysis: Managing for Results

The CRF program is charged with reducing cancer mortality and tobacco use and reducing health disparities among ethnic minorities. The program accomplishes these goals through two programs – the Cancer, Prevention, Education, Screening, and Treatment Program and the Tobacco Use Prevention and Cessation Program. Over the last seven years, Maryland had dedicated approximately $206.0 million from the CRF to the cancer program and approximately $96.0 million to the tobacco prevention program. Over the past decade, Maryland has been successful in reducing both the incidence and mortality rates related to tobacco use and cancer. Significant findings related to cancer incidence and mortality, tobacco use, and minority health disparities are discussed below.

Cancer Mortality and Incidence Rates

The cancers targeted under the CRF program include lung and bronchus, colorectal, female breast, prostate, oral, melanoma of the skin, and cervical. These cancers were selected due to the ability to prevent, detect early, and effectively treat these cancers, and due to their impact on incidence and mortality. In fiscal 2007, 22 jurisdictions screened for colorectal cancer, 6 jurisdictions screened for prostate cancer, 4 jurisdictions screened for breast and cervical cancer, 3 jurisdictions screened for oral

cancer, and 2 jurisdictions screened for skin cancer. All jurisdictions directly target lung cancer incidence and mortality through the tobacco use and prevention program. The fiscal 2008 budget dedicates $27.9 million to the cancer program and $18.6 million to the tobacco program. Overall, cancer mortality in Maryland and nationally has decreased steadily since 1991 as shown in **Exhibit 2**. A number of observations may be made about the data presented in Exhibit 2.

- Cancer is the second leading cause of death in Maryland, responsible for nearly 24% of all deaths in 2003.

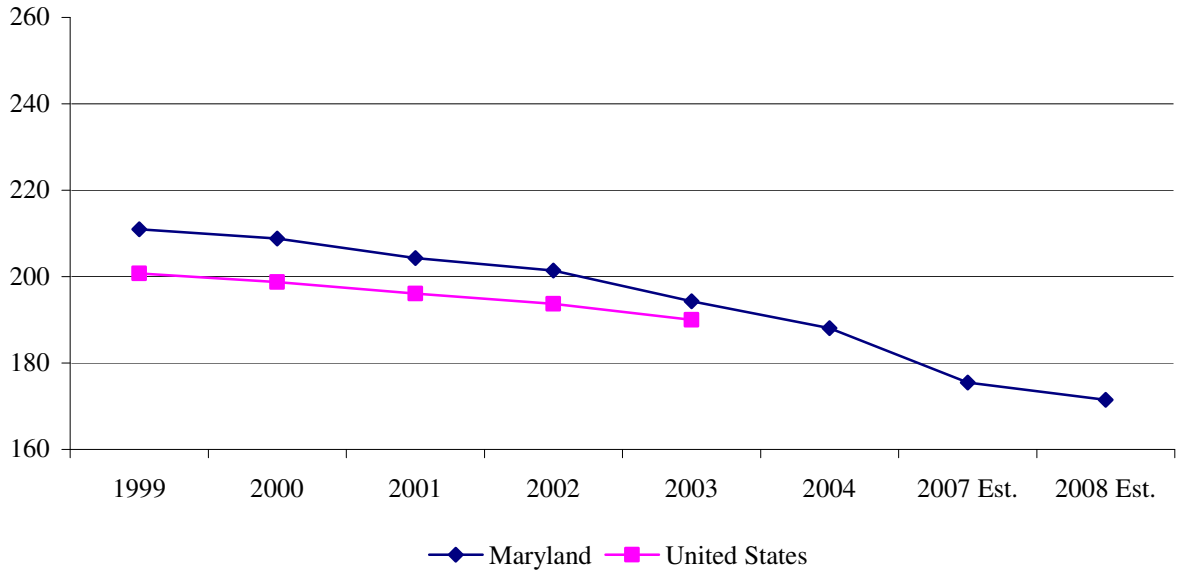
- While Maryland's mortality rate is still higher than the national average, the gap has closed substantially since 1990. Almost 242 cancer-related deaths per 100,000 individuals were reported in 1990 compared to 199 in 2003. A similar but more modest decline is observed nationally.

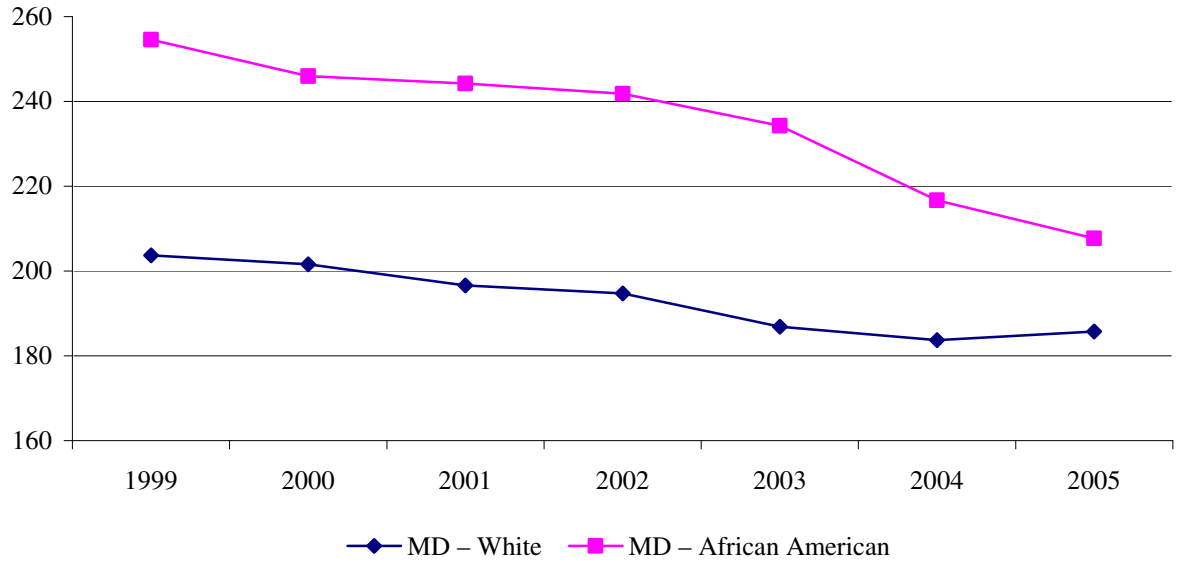
- Advances in cancer treatment options as well as an increase in screening programs and a reduction in both adult and teenage smoking rates have contributed significantly to the reduction in cancer mortality rates since 1990.

- Despite significant progress in closing the mortality gap, considerable disparities remain in Maryland between African Americans and Whites.

- Healthy People (HP) 2010 goal is to reduce cancer mortality to 159.9 per 100,000 people. In 2003, Maryland's overall cancer mortality rate was 194.3 per 100,000 people – significantly higher than the HP 2010 goal.

Exhibit 2
Age Adjusted Overall Cancer Mortality Rates
Cases Per 100,000 Population
Calendar 1999-2008





Note: Healthy People 2010 Goal: 159.9 per 100,000 population.

Source: Department of Health and Mental Hygiene Vital Statistics Administration, National Cancer Institute

One of the main goals of the CRF program is to reduce cancer mortality and disparities among ethnic minorities. The local health departments undertake a number of activities to increase minority participation in their cancer screening and tobacco cessation programs such as working with local minority churches, community-based organizations, and other entities that serve low-income and uninsured individuals. Additionally, the Minority Outreach and Technical Assistance (MOTA) program distributes competitive grants to minority community-based organizations throughout the State to increase minority participation in cancer screening and tobacco cessation programs. In fiscal 2006, MOTA grantees performed a number of activities, including developing and distributing cancer and tobacco related health promotion and prevention messages to over 24,059 people through newsletters and health pledges and organizing and administering 45 health awareness events. These events were attended by approximately 5,107 minority individuals. The 2008 allowance includes $1.2 million to support MOTA activities.

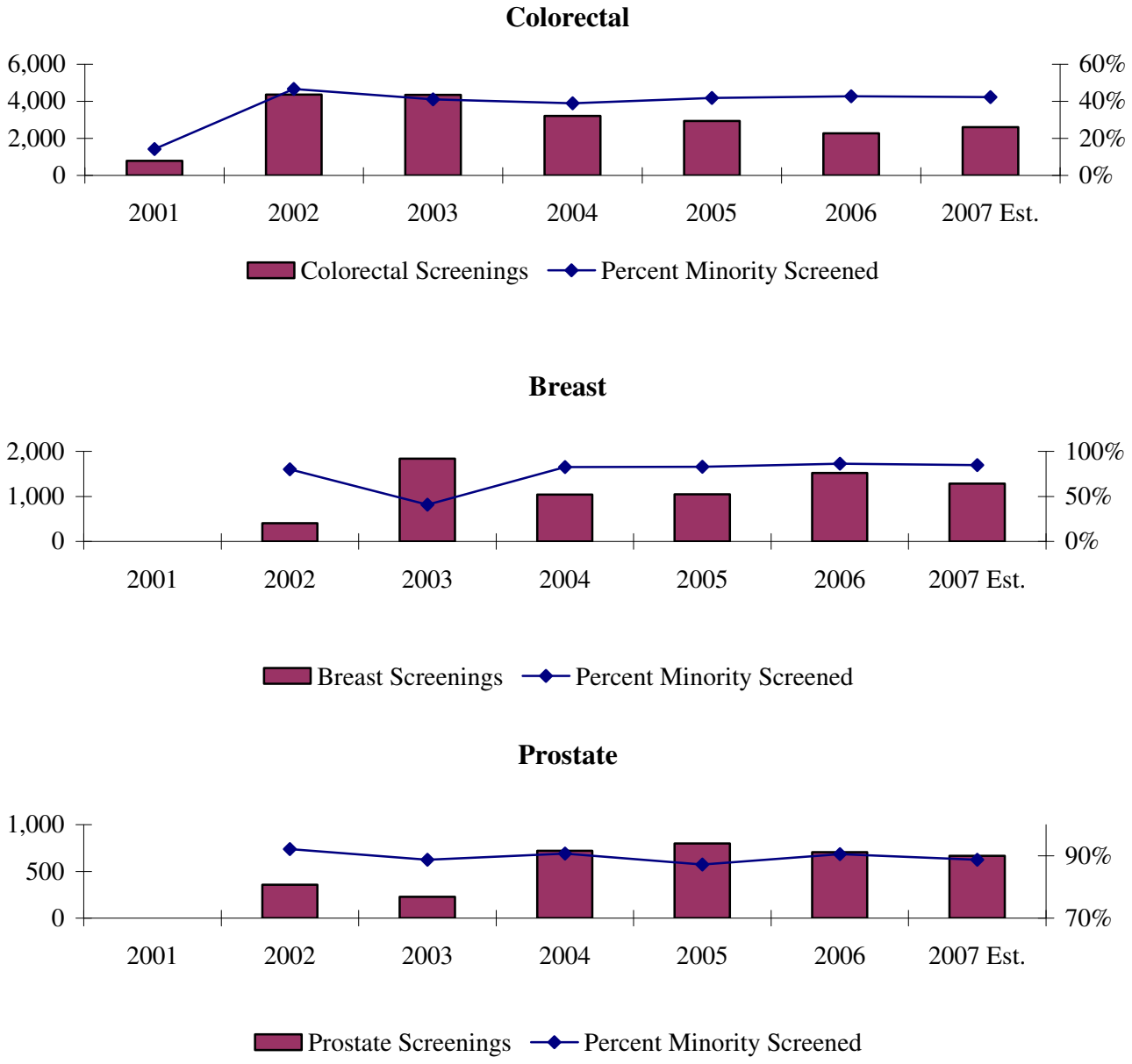
Lung, colorectal, breast, and prostate cancer are the four most common cancers nationally and in Maryland. **Exhibit 3** presents the number of individuals screened in the CRF program for colorectal, breast, and prostate cancer and the percent minority participation. Jurisdictions do not directly screen for lung cancer. A number of observations may be made about the prevalence of these cancers in Maryland and of the data presented in Exhibit 3.

- Colorectal cancer is the third most common cancer in both men and women. Between fiscal 2003 and 2006, the number of individuals screened decreased as a result of reduced funding levels and a change in the screening method. The newer method only requires screening every 10 years as opposed to every 5 years as previously recommended. Since 2003, the percent minority screened has increased slightly; however, less than 45% of individuals screened are minorities.

- Breast cancer is the leading cancer among women of all races in Maryland and nationally, followed by lung cancer in White women and colorectal cancer in African American women. Over the past three years, the number of women screened has increased 46% from 1,043 in fiscal 2004 to 1,522 in fiscal 2006. Additionally, the screening program has an 86% minority participation rate. The fiscal 2003 numbers are skewed due to Garrett County's participation in the screening program in 2003 only. Garrett County screened over 400 women in 2003, yet only a small number of those women were minorities.

- Prostate cancer is the leading cancer among men of all races in Maryland and nationally, followed by lung cancer and colorectal cancer. Incidence rates have increased on average 1.2% per year from 1998 to 2002. African American men have a significantly higher incidence and mortality rate than White men. Beginning in fiscal 2004, Johns Hopkins Institutions more than doubled the number of men screened. The percent minority screened has remained at about 90% since fiscal 2004.

Exhibit 3
Number of Individuals Screened with CRF Funds
Fiscal 2001-2007



Source: Department of Health and Mental Hygiene

Tobacco Use Prevention and Cessation

Adult Smoking

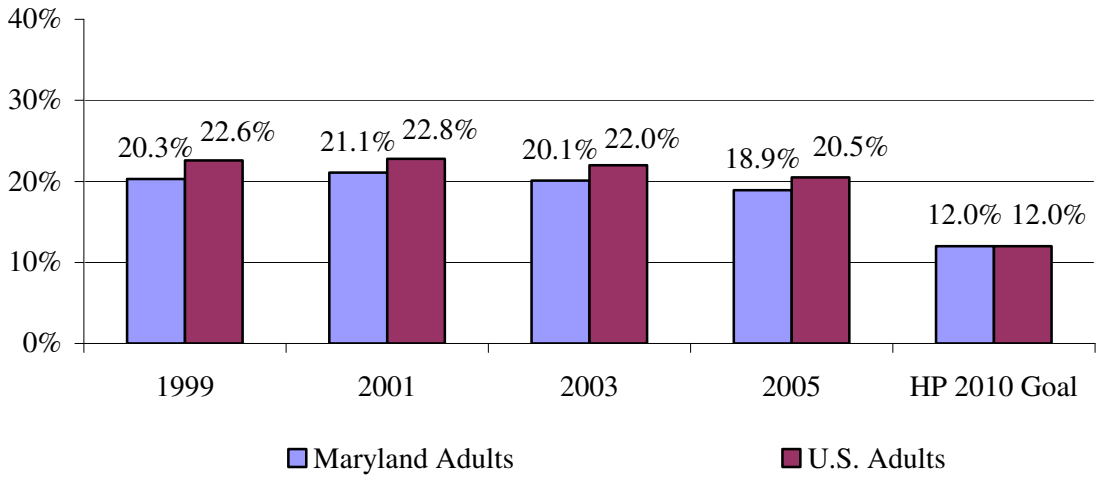
As part of Maryland's Tobacco Use and Prevention Program, the Maryland General Assembly established the surveillance and evaluation component. The purpose of this component is to monitor Maryland's progress in reducing the use of tobacco through conducting a Baseline Tobacco Study in 2000 and then annual tobacco studies thereafter. During the 2003 session, the General Assembly required biennial studies, rather than annual studies, beginning in fiscal 2005. However, due to the State's fiscal condition, the fiscal 2005 tobacco study was further delayed until fiscal 2007. The results of the 2007 tobacco study will not be available until September 2007. Consequently, the most recent CRF tobacco surveillance data available is fiscal 2002.

Given the lack of CRF tobacco performance data, the analysis relies on data from the Centers for Disease Control Behavior Risk Factor Surveillance System, the National Cancer Institute, and the Maryland Adolescent Survey (MAS). MAS, which is administered by the Maryland State Department of Education is a biennial survey designed to parallel the National Institute of Drug Abuse's annual national survey "Monitoring the Future." The most recent MAS survey is fiscal 2004.

According to the 2005 Cancer Trends Progress Report, published by the National Cancer Institute, cigarette smoking causes approximately 30% of all U.S. cancer deaths each year. Quitting tobacco use reduces a person's risk of developing not just cancer but also heart disease, respiratory disease, and reproductive problems. CRF tobacco prevention funds primarily support efforts at the local level to educate the community including school children on the dangers of tobacco use. Funds are also used to enforce existing tobacco laws, to provide smoking cessation classes, and to prescribe treatment for nicotine addiction. The fiscal 2008 budget dedicates $18.6 million of CRF funds for tobacco use prevention and cessation activities. Nationally, tobacco use has declined steadily since the 1960s. **Exhibit 4** shows this decline in Maryland and nationally from 1999 through 2005. Although adult smoking prevalence is lower in Maryland than nationally, the rate is still significantly higher than the HP 2010 goal of 12%.

While the overall smoking rate for Maryland has shown improvement since 1999, the rate of smoking for racial and ethnic minorities is increasing. Between 2000 and 2005, **Exhibit 5** shows a 17% decline in the White smoking rate but an 8.8 and 16.3% increase in the African American and Hispanic smoking rates, respectively. In 2005, the prevalence of cigarette smoking is highest among African Americans, followed by Hispanics and Whites. The higher smoking rate among minorities may be linked to higher rates of mortality and morbidity from smoking-related cancers.

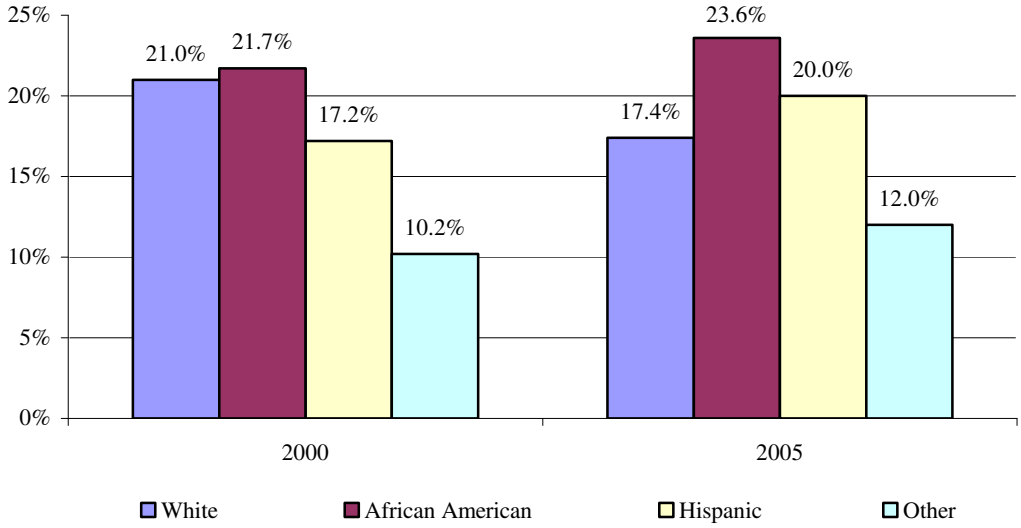
Exhibit 4
Adult Smoking Prevalence in Maryland and Nationally
Calendar 1999-2005



Note: The Behavioral Risk Factor Surveillance System is an ongoing, State-based telephone surveillance system supported by the Centers for Disease Control and Prevention. Through a series of telephone interviews, states uniformly collect data on behaviors and conditions that affect adult health.

Source: Centers for Disease Control Behavioral Risk Factor Surveillance System

Exhibit 5
Adult Smoking Prevalence by Race and Ethnicity, Maryland
Calendar 2000 and 2005



Source: Centers of Disease Control Behavioral Risk Factor Surveillance System Survey Data, 2000 and 2005

Teenage Smoking

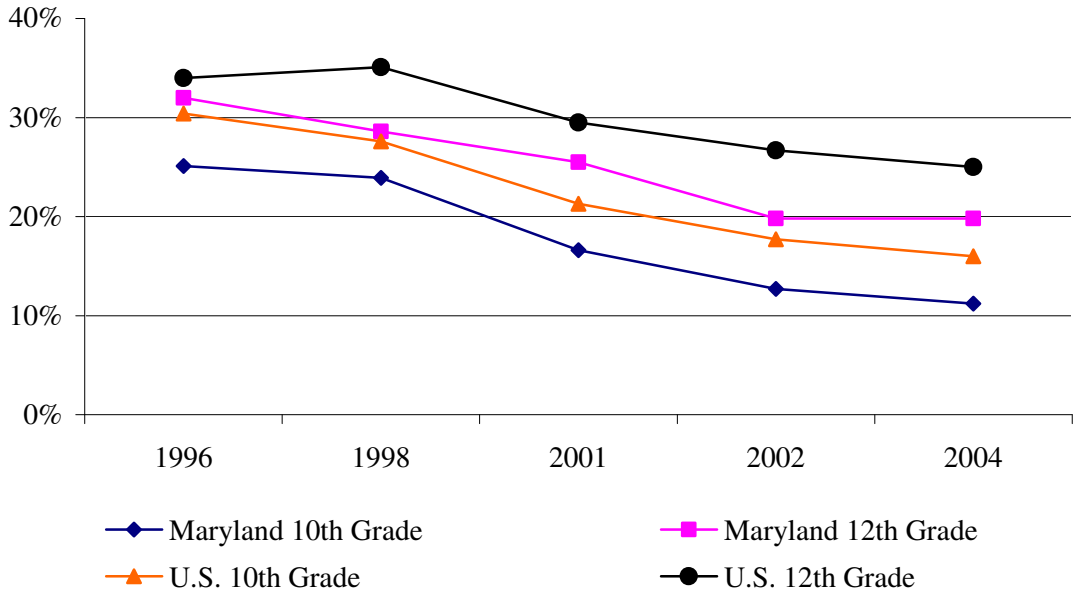
According the 2004 MAS, cigarettes are the third most used substance, behind alcohol and marijuana by Maryland's youth. As shown in **Exhibit 6**, tobacco use among tenth and twelfth graders has declined steadily since 1996. A number of observations may be made about the data presented in Exhibit 6.

- Eighth, tenth, and twelfth grade students responding to the Maryland Adolescent Survey were less likely to report having used a cigarette within the last 30 days in the 2004 survey than in prior years. Unfortunately, more sixth grade students reported smoking a cigarette in the last 30 days in 2004 (1.5%) than in 2002 (1.3%).

- The decline in reported cigarette use in Maryland mirrors the national trend. However, Maryland students are less likely than students nationally to report smoking a cigarette.

- 42% of twelfth grade smokers in Maryland reported that they were not asked to show proof of age.

Exhibit 6
Percent of Students Reporting Cigarette Use in the Last 30 Days
Calendar 1996-2004



Source: Maryland Adolescent Survey; National Institute on Drug Abuse "Monitoring the Future" 2005

The department should comment on the contributions the cancer and tobacco programs are making toward reducing cancer mortality and tobacco use.

Governor's Proposed Budget

CRF revenue is expected to increase $28.0 million in fiscal 2008 from $152.6 million to $180.6 million as a result of the start of the strategic contribution payments. These payments, which represent Maryland's contribution toward the resolution of the tobacco settlement, are expected to increase revenues by $28.0 million annually between fiscal 2008 and 2017. In fiscal 2008, total available revenue is anticipated to total $197.6 million. Of this amount, $17.0 million is prior year unexpended fund balance.

Legal actions taken by the tobacco manufacturers in April 2005 reduced Maryland's 2006 MSA payment by $17.7 million. As a result of this litigation, language was added during the 2006 session restricting $26.0 million of the fiscal 2007 Medicaid appropriation until conclusion of the proceedings. Similar litigation was again initiated by the tobacco manufacturers in April 2006. The more recent litigation is threatening to reduce Maryland's 2007 payment by approximately $26.5 million. Additionally, the tobacco manufacturers have indicated that they intend on filing similar litigation in April 2007 that will affect the 2008 MSA payment. The ultimate disposition of these cases is likely years away, creating uncertainty regarding the amount of available CRF tobacco revenues.

The fiscal 2008 allowance provides $193.9 million for programs supported by the CRF, an increase of $27.8 million, or 16.8% over the fiscal 2007 working appropriation. Although revenues increased substantially in fiscal 2008, the majority of programs are funded at the fiscal 2007 level or have a small change in funding. The only substantial increase in funding is for the Medicaid program, which grows from $89.7 million to $116.0 million in fiscal 2008. **Exhibits 7** and **8** detail changes in CRF revenue and expenditures since fiscal 2005.

Exhibit 7
Cigarette Restitution Fund Revenue
Fiscal 2005-2008
($ in Millions)

	Actual 2005	Actual 2006	Working Appropriation 2007	Allowance 2008
Beginning Fund Balance	$10.5	$15.4	$4.5	$17.0
Settlement Payments	152.0	140.5	152.6	180.6
Available Revenue	**$162.5**	**$155.9**	**$157.1**	**$197.6**
Payment to Law Offices	-30.0	-29.9		
Prior Year Recoveries	1.5	1.1		
Total Available Revenue	**$134.0**	**$127.1**	**$157.1**	**$197.6**
Total Expenditures	**$118.6**	**$122.6**	**$166.1**	**$193.9**
Restricted Medicaid Appropriation			26.0	
Ending Balance	**$15.4**	**$4.5**	**$17.0**	**$3.7**

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

Source: Department of Budget and Management

Exhibit 8
Cigarette Restitution Fund Expenditures
Fiscal 2005-2008
($ in Millions)

	Actual Spending 2005	Actual Spending 2006	Working Appropriation 2007	Allowance 2008	$ Change
Health					
Management	$0.4	$0.3	$0.6	$1.0	$0.3
Tobacco	9.9	9.3	18.7	18.6	-0.1
Cancer	30.9	20.1	28.1	27.9	-0.3
Substance Abuse	17.1	17.1	17.1	17.1	0.0
Medicaid	51.5	66.8	89.7	116.0	26.3
Restricted Medicaid Appropriation			-26.0		26.0
Subtotal	**$109.8**	**$113.5**	**$128.3**	**$180.6**	**$52.3**
Education					
Aid to Nonpublic Schools	3.0	2.9	4.0	3.9	-0.1
Subtotal	**$3.0**	**$2.9**	**$4.0**	**$3.9**	**-$0.1**
Crop Conversion	**$5.7**	**$6.0**	**$7.6**	**$9.0**	**$1.5**
Attorney General	**$0.2**	**$0.2**	**$0.2**	**$0.4**	**$0.2**
Total Expenses	**$118.6**	**$122.6**	**$140.1**	**$193.9**	**$53.9**

Numbers may not sum to total due to rounding.

Source: Governor's Budget Books, Fiscal 2008

Tobacco Use Prevention and Cessation

Funding for the Tobacco Use Prevention and Cessation Program decreases $0.1 million in the fiscal 2008 allowance. This program – established by Chapter 17 of 2000 – is charged with developing initiatives to reduce tobacco use in Maryland and otherwise benefit public health. This program and the Cancer Prevention, Education, Screening, and Treatment Program are the basis of the State's CRF Program. Program funding, detailed in **Exhibit 9**, is highlighted below.

Exhibit 9
Tobacco Use Prevention and Cessation
Fiscal 2005-2008
($ in Millions)

	Actual 2005	Actual 2006	Working Approp. 2007	Allowance 2008	$ Changes
Surveillance and Evaluation	$0.5	$0.0	$1.9	$1.9	$0.0
Local Public Health	6.9	7.0	12.1	12.1	0.0
Statewide Public Health					
Minority Outreach and Technical Assistance	0.7	0.8	1.2	1.2	0.0
Telephone Quit Line	0.0	0.0	1.5	1.5	0.0
Tobacco Use Cessation Resource and Coordination Center	0.0	0.0	0.2	0.2	0.0
University of Maryland School of Law	0.3	0.3	0.5	0.5	0.0
Tobacco Prevention and Cessation[(1)]	0.0	0.4	0.0	0.0	0.0
Subtotal	**$1.0**	**$1.5**	**$3.5**	**$3.5**	**$0.0**
Countermarketing	1.0	0.5	0.5	0.5	0.0
Administration	0.4	0.3	0.8	0.7	-0.1
Total	**$9.9**	**$9.3**	**$18.7**	**$18.6**	**-$0.1**

[(1)] In fiscal 2006, $0.4 million of CRF funds supported tobacco prevention activities typically funded with general funds.

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

Source: Governor's Budget Books, Fiscal 2008; Department of Health and Mental Hygiene

All of the programs are funded at the fiscal 2007 level except for administrative expenses. In fiscal 2008, $87,211 in administrative costs are transferred to the CRF DHMH management support program offsetting the decrease in the tobacco program.

- ***Surveillance and Evaluation:*** This project has the responsibility to maintain surveillance of current tobacco use among underage youth, adults, pregnant women, and minority populations through administration of biennial tobacco studies conducted in each county and Baltimore City. The program also supports analysis and evaluation of CRF cessation, countermarketing, and media projects. The allowance includes $1.9 million for surveillance and evaluation activities in fiscal 2008.

- ***Local Public Health:*** Local health departments in each of the 24 jurisdictions provide prevention and cessation programming in 4 areas: community education, school-based programs, cessation, and enforcement. The allowance provides $12.1 million to continue local tobacco use prevention and cessation grants in fiscal 2008.

- ***Statewide Public Health:*** This component was developed to ensure that the tobacco program was implemented in a coordinated and integrated manner and to ensure participation by minority and underrepresented populations. This component of the tobacco program includes five subprograms – listed in Exhibit 9 – most notably, the telephone quit line and the minority outreach and technical assistance (MOTA) program.

  The Centers for Disease Control and Prevention (CDC) awarded the department a supplemental grant in federal fiscal 2005 and 2006 to establish the framework for a telephone-based quit line in Maryland. The grant was part of a nationwide effort by CDC to establish toll-free quit lines in every state. The $1.5 million in funding will be used to maintain the quit line and to provide access to cessation services for callers. In fiscal 2008, MOTA will award $1.2 million in competitive grants to local community-based minority serving organizations for the purposes of reducing health disparities related to the use of tobacco products and cancer. Maryland jurisdictions with 15% or 13,000 minorities are eligible to apply. The allowance also includes $0.2 million for a Tobacco Use Cessation Resource and Coordination Center. The center promotes best practices for tobacco cessation and provides regional training and motivational counseling to professionals addressing the issue of tobacco.

- ***Countermarketing:*** This component of the Tobacco Use Prevention and Cessation Program supports development of media campaigns to counteract tobacco industry advertising and to promote the tobacco quit line. In addition to program development, funds provide for the purchase of print space and air time. The fiscal 2008 allowance provides $0.5 million for this program.

CRF funding for the Tobacco Use Prevention and Cessation Program totals $18.6 million in fiscal 2008. The Governor's allowance also includes an additional $2.4 million in general funds in the Family Health Administration budget for tobacco use and prevention activities. Together, this funding meets the requirement that the Governor include $21.0 million in the budget for this purpose. This amount is less than the CDC recommendation of a minimum spending amount of $5.98 per capita for tobacco prevention activities, which is equivalent to approximately $30.3 million in Maryland. Proposed State funding for tobacco prevention provides 70% of the total amount of CDC-recommended funding in fiscal 2008.

Cancer Prevention, Education, Screening, and Treatment Program

Funding for the Cancer Prevention, Education, Screening and Treatment Program decreases $0.3 million in the fiscal 2008 allowance. This program – established by Chapter 17 of 2000 – is charged with developing initiatives to reduce morbidity and mortality rates for cancer- and tobacco-related diseases and otherwise benefit public health. This and the Tobacco Use Prevention and Cessation program are the basis of the State's CRF program. Program funding, detailed in **Exhibit 10**, is highlighted below.

Exhibit 10
Cancer Prevention, Education, Screening, and Treatment
Fiscal 2005-2008
($ in Millions)

	Actual 2005	Actual 2006	Working Approp. 2007	Allowance 2008	$ Change
Surveillance and evaluation	$1.6	$1.2	$1.3	$1.3	$0.0
Local public health	7.5	7.5	7.5	7.5	0.0
Statewide academic health centers					
University of Maryland Medical Group					
Cancer research	8.0	4.0	7.9	7.9	0.0
Statewide network	2.9	1.5	3.0	3.0	0.0
Tobacco-related disease research	2.0	1.0	2.0	2.0	0.0
Baltimore City public health	1.2	1.2	1.2	1.2	0.0
General Fund Deficiency Appropriation		3.2			
Subtotal	**$14.2**	**$10.9**	**$14.2**	**$14.2**	**$0.0**
The Johns Hopkins Institutions					
Cancer research	2.4	1.2	2.5	2.5	0.0
Baltimore City public health	1.2	1.2	1.2	1.2	0.0
General Fund Deficiency Appropriation		0.6			
Subtotal	**$3.6**	**$3.0**	**$3.7**	**$3.7**	**$0.0**
Administration	1.0	0.8	1.0	0.7	-0.3
Statewide skin cancer project	0.4	0.4	0.4	0.4	0.0
Cancer screening database	0.1	0.1	0.1	0.1	0.0
Total	**$28.4**	**$23.9**	**$28.1**	**$27.9**	**$-0.3**

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

All of the programs are funded at the fiscal 2007 level except for administrative expenses. In fiscal 2008, $262,763 in administrative costs are transferred to the CRF DHMH management support program offsetting the decrease in the cancer program.

- ***University of Maryland Medical Group (UMMG):*** The UMMG's research grant supports recruitment and retention of cancer researchers. In fiscal 2008, the university will continue to recruit six to eight new faculty members. The new faculty will include clinical practitioners for patient care and clinical trials as well as faculty for basic research. The university will also use the funds to purchase cancer treatment equipment and to finance the renovation of laboratory and clinical space. To date, four inventions initiated under the CRF program have been disclosed and are moving toward development into products useful to consumers.

  The UMMG tobacco-related disease grant, like the cancer research grant, supports individual research projects as well as faculty recruitment and retention. The 2008 funding will enable the university to continue with recruitment and seed funding for faculty positions. Additionally, the grant will support one or two studies on culturally competent recruitment strategies for clinical trials. This initiative is aimed at reducing the health impact of tobacco-related diseases including asthma, cardiovascular disease, emphysema, infant mortality, or other illnesses.

  Funds from the CRF also provide for the Statewide Health Network administered by UMMG. The network supports community-based health partnerships that increase awareness of and access to prevention and education related to cancer and other tobacco-related diseases. Efforts include expanding participation in clinical trials, educating health providers on best practices, and increasing access to University of Maryland education and outreach and clinical experts through 32 telemedicine and video sites. Efforts are currently underway to expand telemedicine to at least three additional sites in rural and/or underserved areas in the State. The network operates through a central office located in Baltimore City and three regional offices.

- ***JHI:*** Between fiscal 2001 and 2007, JHI received a total of $17.5 million for translational research, faculty recruitment, and faculty retention. JHI awards its cancer research funds under a grant process to its faculty members each year. In the past two years, grants have been made in priority areas recommended by internal or external advisory committees. The fiscal 2008 allowance provides $2.5 million for this program. To date, seven inventions initiated under the CRF program have been disclosed and are moving toward development into products useful to consumers.

- ***Baltimore City Public Health Grants:*** State law establishes UMMG and JHI as recipients of CRF funding to provide cancer prevention, education, screening, and treatment services to low-income Baltimore City residents; these programs are provided by local health departments in all other jurisdictions. The Governor's proposed budget for the two statewide academic health center grants includes $1.2 million for each institution, exceeding the funding formula by 2.5 percentage points.

Comprehensive Evaluation

The legislation establishing the tobacco and cancer programs included a provision for a comprehensive evaluation of the programs at the end of fiscal 2004. The evaluation was to include an analysis of the administration and effectiveness of the programs, including an assessment of whether the short- and long-term goals of the program had been met, with results due to the Governor and the General Assembly by November 2004. Budget reconciliation legislation enacted in 2004 delayed the comprehensive evaluation to the end of fiscal 2005, with a final report due by November 2005. The 2005 budget reconciliation legislation authorized $1.0 million in CRF funding in fiscal 2005 by budget amendment for the comprehensive evaluation. Accordingly, in fiscal 2005, $1.0 million was appropriated by budget amendment to conduct the comprehensive evaluation. The final report is expected to be completed in March 2007. **The department should comment on the status of the comprehensive evaluation or on the findings of the evaluation, if available.**

Other Cigarette Restitution Fund Initiatives

In addition to the tobacco and cancer programs, CRF provides support for other health- and tobacco-related priorities. In fiscal 2008, funding for Medicaid increases $26.3 million to a total of $116.0 million, reducing the need for that amount of general funds for the program. State law requires the Medicaid program to receive at least 30% of the CRF appropriation. The Governor's proposed budget provides 58.7%, exceeding the mandate.

In addition, funding for the Maryland Department of Agriculture's (MDA) Tobacco Transition program increases by $1.5 million to $9.0 million (5% of total CRF appropriations), allowing for expansion of noncapital grants for infrastructure and agricultural development programs. Funding to purchase textbooks and technology for nonpublic schools decreases $0.1 million in fiscal 2008.

Future Tobacco Settlement Revenue

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

- **Initial payments** were scheduled from fiscal 1999 through 2003. Maryland received initial payments of approximately $60 million annually for each of five years.

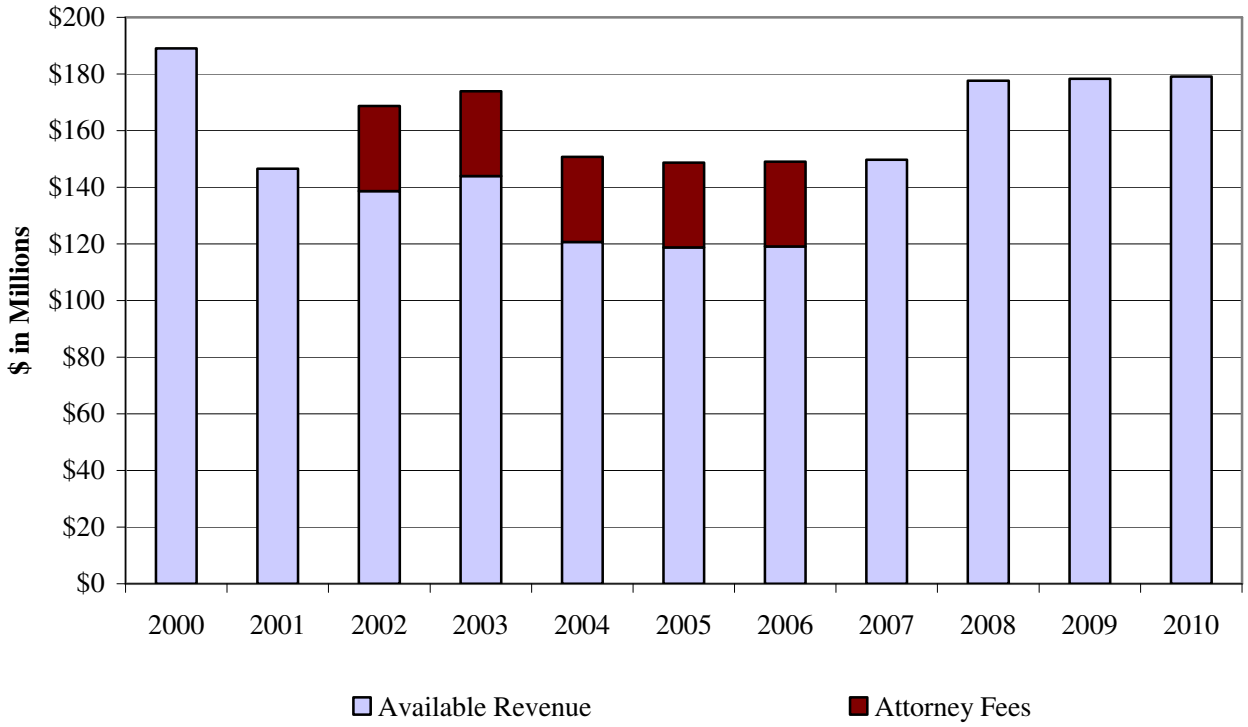
- **Annual payments** began in fiscal 2000 and will continue as long as the settling manufacturers continue to ship tobacco products domestically. These payments are adjusted annually based on domestic consumption of tobacco products and inflation. Maryland's annual payment is expected to vary from $140 million to $150 million in the near future.

- **Strategic contribution payments**, beginning in fiscal 2008 and continuing through fiscal 2017, reflect states' legal contributions to the tobacco settlement. Maryland's share of these payments is estimated at $28 million annually.

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

As detailed in **Exhibit 11**, beginning in 2008, the strategic contribution payments will add an additional $28 million to CRF revenues.

Exhibit 11
Net Revenue to the Cigarette Restitution Fund
Fiscal 2000-2010



Source: Department of Budget and Management

Legal Challenges to the Master Settlement Agreement

Tobacco Settlement Revenue

On November 23, 1998, 4 (now 3) major tobacco companies agreed to settle all outstanding litigation with 46 states, 5 territories, and the District of Columbia. Under the Master Settlement Agreement (MSA), these original participating manufacturers agreed to compensate the states for smoking-related medical costs and conform to certain marketing restrictions. Since 1998, several additional tobacco companies have also entered into the agreement. These companies, known as subsequent participating manufacturers, have brought additional revenue to the states.

Recent Legal Actions Threaten Cigarette Restitution Fund Revenues

Legal actions by manufacturers participating in the MSA threaten to reduce the amount of tobacco settlement revenues available to the states. These manufacturers contend that manufacturers not participating in the agreement have increased their share of the market by exploiting legal loopholes to reduce their escrow payments to the states, giving those manufacturers a competitive advantage in the pricing of their products. Chapter 169 of 1999, subsequently amended in 2001 and 2004, established Maryland's qualifying statute to level the playing field with respect to price between participating and nonparticipating tobacco manufacturers. The statute requires nonparticipating manufacturers (NPM) to either join the MSA or make refundable deposits into an escrow account based on the number of cigarettes they sell in the State. The agreement authorizes participating manufacturers that lose a certain share of the market to withhold three times the amount of their losses. This withholding is known as a nonparticipating manufacturer adjustment. The agreement allows participating manufacturers to pursue this adjustment on an annual basis. In April 2005, the participating manufacturers gave notice to State Attorneys General that they were pursuing an NPM adjustment with respect to a loss of market share in sales year 2003.

In March 2006, an arbitrator ruled that the MSA was a significant factor contributing to the participating manufacturers' 2003 loss of market share thus allowing a 2003 NPM adjustment. The ruling entitled the tobacco manufacturers to reduce their 2006 Master Settlement payment by approximately $1.1 billion, or 18%, of which Maryland's share is approximately $26.0 million. The agreement provides that the adjustment will apply to all states unless a state has enacted and is diligently enforcing its qualifying statute. Diligent enforcement of the statute will be determined on a state-by-state basis through either a court proceeding or arbitration. If one state wins diligent enforcement, that state's share of the NPM adjustment will be deducted from those states that are found not to have diligently enforced. Consequently, it is possible that Maryland's share of the 2003 adjustment could exceed $26.0 million.

Pending resolution of the diligent enforcement proceedings, the participating manufacturers placed $781.8 million into a disputed payments account, reducing Maryland's 2006 payment by $17.7 million. The initial adjustment of $26.0 million was not fully deducted because Phillip Morris, the country's largest tobacco manufacturer, and several other participating manufacturers elected to make their full 2006 payments, reducing the initial adjustment by approximately $8.3 million. If the tobacco manufacturers win

the diligent enforcement proceedings, the manufacturers who elected to make their full 2006 payment would have the option to offset future payments by the amount of their 2003 NPM adjustment.

Once the legal proceedings are concluded and if Maryland is found to have diligently enforced its qualifying statute, the $17.7 million in the disputed payments account will be released to the State. If it is determined that Maryland has not diligently enforced its qualifying statute, the State's Cigarette Restitution Fund revenues could be reduced by between $26.0 million and the State's full 2006 Master Settlement payment, approximately $158.2 million. The actual amount would depend on how many other states are found not to have diligently enforced their qualifying statute. The fiscal 2007 State budget restricted $26.0 million in the Medicaid appropriation, pending conclusion of the proceedings.

In May 2006, Maryland filed two motions in Baltimore City Circuit Court for a declaratory judgment. The first motion sought a court ruling on whether the dispute would be decided by the courts or by arbitration, and the second motion argued that the State has diligently enforced its qualifying statute. In January 2007, the judge ruled that the language in the MSA was clear in its directive that the dispute should be decided by arbitration. Maryland is in the process of appealing the decision. The ruling was ambiguous on whether the arbitration should be decided by a state-specific or national arbitration panel. The appeals process could take anywhere from nine months to two years.

In April 2006, the participating manufacturers again gave notice to the State Attorneys General that they were pursuing an NPM adjustment with respect to a loss of market share in sales year 2004. In January 2007, an arbitrator ruled that the MSA was a significant factor contributing to the participating manufacturers' 2004 loss in market share, thus allowing a 2004 NPM adjustment. The amount of the 2004 adjustment will be about the same as the 2003 adjustment, approximately $1.1 billion, of which Maryland's share is approximately $26.5 million. The reduction will be applied to the fiscal 2007 payment due April 15, 2007. The course of litigation will be similar to the process used for the 2003 challenge. Additionally, the participating manufacturers have indicated that they intend to initiate a significant factor determination for sales year 2005.

Aside from the 2003 and 2004 NPM adjustment litigations, several nonparticipating manufacturers are also challenging the legality of the model statute provision in the MSA in New York Federal District Court. The model statute provision requires settling states to establish and enforce qualifying statutes that require nonparticipating manufacturers to make refundable deposits into escrow accounts. The provision is a nonseverable provision, and therefore, if found to be unlawful or unenforceable, will have to be substituted by a provision agreed to by the participating manufacturers or the MSA will be terminated. The likely conclusion of this litigation is several years away.

Conclusion

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

Tobacco Transition Program (Statewide)

In 1999, the General Assembly created the Cigarette Restitution Fund (CRF). Part of this fund is to be earmarked to end tobacco growing in Maryland. Under the legislation, the CRF is to fund the "…implementation of the Southern Maryland Regional Strategy Action Plan for Agriculture adopted by the Tri-County Council for Southern Maryland (TCC) with an emphasis on alternative crop uses for agricultural land now used for growing tobacco." Funds are appropriated to the Maryland Department of Agriculture, which then issues grants to TCC. TCC is a nonprofit, quasi-governmental body that works with the Southern Maryland Agricultural Development Commission to develop programs to stabilize the region's agricultural economy as Maryland growers' transition away from tobacco production.

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

- The tobacco buyout component is a voluntary program that provides funds to (a) support all eligible Maryland tobacco growers who choose to give up tobacco production forever while remaining in agricultural production, and (b) restrict the land from tobacco production for 10 years should the land transfer to new ownership. A total of 854 farmers and 7.65 million pounds of tobacco are enrolled in the program and out of production.

- The infrastructure/agricultural development program seeks to foster profitable natural resource-based economic development for Southern Maryland by helping farmers and related businesses to diversify and develop and/or expand market-driven agricultural enterprises in the region through economic development and education.

- The agricultural land preservation component seeks to provide an incentive to tobacco farmers to place land in agricultural preservation, enhance participation in existing preservation programs, and assist in the acquisition of land for farmers' markets.

Tobacco Transition Programs Fiscal 2008 Funding

The fiscal 2008 allowance includes a total of $12.0 million in operating and capital funds for the Tobacco Transition Program. Funds are spread among three different areas of the Maryland Department of Agriculture's allowance:

- $2,149,000 in CRF special funds in the operating budget for administrative expenses ($440,000) and noncapital grants for infrastructure/agricultural development programs ($1,709,000);

- $6,880,000 in CRF special funds in the PAYGO budget for the tobacco buyout program; and

- $3,000,000 in general obligation (GO) bonds in the capital budget for the tobacco buyout ($770,000) and agricultural land conservation programs ($2,230,000).

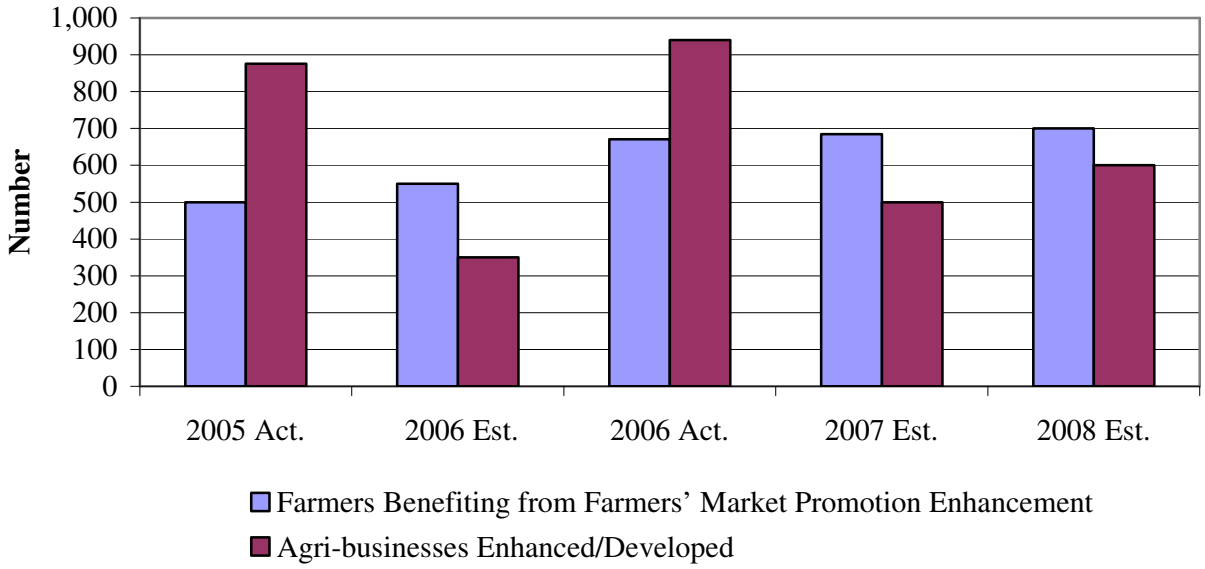
This allocation assumes that a total of $7,650,000 will be dedicated to buyout payments and $2,230,000 to agricultural land conservation.

The 2007 *Capital Improvement Program* (CIP) reflects several adjustments that were made last year to the program's preauthorized GO bond funding in fiscal 2008 through 2011. Specifically, the bond authorization period extends to fiscal 2010 and new pre-authorized appropriation amounts are reflected in fiscal 2008 ($3.0 million), fiscal 2009 ($3.0 million), and fiscal 2010 ($5.0 million).

Participation in the Budget Program

The performance data associated with TCC's efforts to help farmers transition to other agricultural opportunities continues to suggest some success. As shown in **Exhibit 12**, the number of farmers and agri-businesses benefiting from TCC's marketing efforts increased slightly in 2006. However, agri-business enhancement and development efforts are expected to be far less successful in fiscal 2007 and 2008. **TCC should be prepared to discuss why there was a sharp increase in agri-businesses enhance/developed in fiscal 2006, and why it expects significantly less success in fiscal 2007 and 2008.**

Exhibit 12
Tobacco Transition Program Performance Measurements
Fiscal 2005-2008



Source: Governor's Budget Books, Fiscal 2007-2008

Language and Reductions for Consideration

- ***Consider Language Prohibiting the Expenditure of $26.5 Million in Special Funds from the Cigarette Restitution Fund Budget:*** Ongoing legal actions by participating manufacturers threaten to reduce the amount of revenue available to the states. These manufacturers contend that nonparticipating manufacturers have exploited legal loopholes to reduce their payments to the states, giving those manufacturers a competitive advantage in the pricing of their products. The MSA authorizes manufacturers that lose a certain share of the market to withhold three times the amount of their losses. This withholding is known as a nonparticipating manufactures adjustment. Based on preliminary estimates, an action of this sort has the potential to reduce the 2007 payment under the MSA by $1.1 billion, or 18%, of which Maryland's share is approximately $26.5 million. **The Department of Legislative Services recommends prohibiting the expenditure of $26.5 million in special funds from the CRF until the Department of Budget and Management and the Attorney General submit a letter to the budget committees certifying that the legal proceedings related to the 2007 MSA payment will not result in net revenues received by the CRF during 2007 falling below $152.5 million. Funds shall be withheld proportionally from each program receiving a Cigarette Restitution Fund appropriation in fiscal 2008. The amount withheld reduces the appropriation for each program by 13.7% as follows:**

L00A1210	Agriculture – Marketing and Development	$293,388
L00A1213	Agriculture – Tobacco Transition Program	939,278
M00F0306	Cancer Prevention/Screening/Treatment and Heart/Lung	3,805,427
M00F0306	Tobacco Use Prevention and Cessation Program	2,545,175
M00F0306	Department of Health and Mental Hygiene Management – Prevention and Disease Control	131,034
M00K0201	Alcohol and Drug Abuse	2,336,306
R00A0304	Maryland State Department of Education – Aid to Nonpublic Schools	533,805
C81C0014	Office of the Attorney General – Civil Litigation Division	57,476
M00Q0103	Medical Provider Reimbursement	15,836,786
Total Funds Withheld		**$26,478,675**

- ***Reduce Funding for the Nonpublic Textbook Program:*** The reduction still leaves $3.5 million in funding for the program. In fiscal 2006, when the program received $2.9 million in funding, 119 schools did not spend the funds that were allocated to them, and $94,000 reverted to the general fund. It is unlikely that the $3.9 million provided in the allowance will be spent by eligible schools. **The Department of Legislative Services recommends reducing funding for the Nonpublic Textbook Program by $391,000.**