Legislative Council Staff
Nonpartisan Services for Colorado's Legislature

Memorandum

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TO: Interested Persons

FROM: Emily Dohrman, Economist, 303-866-3687

SUBJECT: 2024 Tobacco MSA Payment Forecast

Summary

Colorado receives annual payments from tobacco manufacturers as part of the Tobacco Master Settlement Agreement (MSA). In April 2023, the state received $93.1 million, which was used to determine distributions to MSA-funded programs for the current FY 2023-24.

This document presents a forecast for annual receipts from the Tobacco MSA through 2026. The state is expected to receive $86.7 million in 2024; the actual amount received in 2024 will determine disbursements to MSA-funded programs in FY 2024-25. Payments are expected to be $83.0 million in 2025 and $80.6 million in 2026.

Tobacco Master Settlement Agreement

The Tobacco MSA was reached in 1998 between tobacco manufacturers that chose to participate and the governments of 46 states (including Colorado), the District of Columbia, and five U.S. territories. Under the MSA, these governments consented to release participating manufacturers from health-related claims associated with the use, manufacture, and marketing of tobacco products in exchange for perpetual annual payments from these manufacturers. Governments are required to diligently enforce the terms of the MSA within their jurisdictions.

Participating manufacturers' annual payments to states. The national MSA payments are determined by a formula established in the MSA. The total payment from all manufacturers is adjusted upwards each year by either year-over-year inflation in the prior year or 3.0 percent, whichever is greater. The payment is then adjusted based on the volume of cigarettes and roll-your-own tobacco sold in the U.S. in the prior year, which tends to decline over time. Other, smaller adjustments are made to the base payment as well, including a potential upward adjustment if manufacturers' income exceeds a certain threshold. The total base payment is then allocated to states based on a fixed percentage, where Colorado receives about 1.37 percent of the total payment. Revenue from the Tobacco MSA is exempt from TABOR as a damage award.

Withholding of payments. Beginning in 2003, participating manufacturers claimed that they had lost market share resulting from governments' failure to diligently enforce the requirements of the MSA. A participating manufacturer is allowed to reduce its payments if all of the following conditions are met:

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

In order for manufacturers to reduce their payments, they must dispute the amount owed at the time of payment. Each dispute triggers an arbitration proceeding to determine whether all of the conditions listed above were met. Beginning in 2006, some manufacturers withheld a portion of their annual payments either by reducing the amount paid or by depositing the disputed amounts in an escrow account ("Disputed Payments Account") pending resolution of the arbitration proceedings. Payments were withheld from governments while arbitration was pending.

Arbitration proceedings often take years to resolve. Arbitration concerning disputed payments for 2003, which were withheld in 2006, was resolved in 2014. Colorado was found to have complied with the NPM agreement and received $11.4 million in NPM adjustment arbitration money, of which $2.2 million was paid from the Disputed Payments Account and $9.2 million was reallocated to Colorado from the annual payments of states that did not comply.

Nonparticipating Manufacturers Adjustment Settlement Agreement

To expedite resolution of payment disputes, participating manufacturers and states negotiated the NPM Adjustment Settlement Agreement (NPM Settlement), a supplementary legal agreement within the MSA framework. Colorado signed the NPM Settlement in March 2018.

Prior to the NPM Settlement, disputed payments had either been withheld by manufacturers or paid to an escrow account where they were meant to be held until arbitration was resolved. Under the NPM Settlement, however, Colorado immediately received a percentage of the payments that had been withheld between 2004 and 2017, and a share of the amounts that would otherwise be withheld in future years, rather than waiting for the arbitration process.

Settlements for 2004 through 2019. In 2018, Colorado received an additional roughly $113 million as part of the NPM settlement, representing 100 percent of the amounts withheld by manufacturers between 2004 and 2017, and a share of the amounts that would otherwise be withheld in future years. However, the state was only authorized to retain 54 percent of the disputed amounts for 2004 through 2012, 66 percent of the disputed amounts for 2013 and 2014, and 75 percent for 2015 through 2017.

Therefore, the state was required to credit a portion of the lump sum amount back to manufacturers. The excess was credited back to manufacturers as a subtraction from the state's annual payments between 2018 and 2022. Credits to the manufacturers were frontloaded in 2018 to maintain relatively constant annual payment amounts in later years.

In 2019, Colorado received 100 percent of what otherwise would have been withheld from its 2018, 2019, and 2020 payments. Approximately 25 percent of the amounts received were credited back to manufacturers as subtractions from the annual payments received in 2022 and 2023.

Payments in later years. Disputed payments for future years are not settled. Beginning with the 2024 payment, participating manufacturers are expected to pay states about 72 percent of the amount that they would have otherwise withheld from their annual payments while waiting for arbitration. Had Colorado not joined the NPM Settlement, the state would not receive any portion of the withheld payments until after arbitration was resolved. Therefore, participation in the NPM Settlement is expected to increase annual receipts relative to what would be expected if the state had not joined the NPM Settlement.

Revenue Forecast

Table 1 presents the actual Tobacco MSA payment received in 2023 and estimated payments for 2024 through 2026. Payments are received in April each year.

Table 1
Tobacco MSA Payment Forecast
Dollars in Millions

Payment	2023 Actual	2024 Estimate	2025 Estimate	2026 Estimate
Annual MSA Payment	$93.1	$86.7	$83.0	$80.6

Source: Department of Law, Department of the Treasury, and Legislative Council Staff Forecast.

Determinants of payment amounts. The size of the annual MSA base payment is largely determined by U.S. inflation, U.S. cigarette and roll-your-own tobacco consumption, and cigarette manufacturers' income. Inflation has a positive impact on the size of payments, while the volume of cigarette sales tends to decline year over year, putting downward pressure on payments. Lastly, if the income collected by cigarette manufacturers in a given year exceeds a certain inflation-adjusted threshold, then the payments will be increased.

Some fluctuation in annual payments is also attributable to a schedule of payments and credits that was established by the NPM Settlement. The NPM Settlement governs the share that the state receives from the amount that manufacturers would have withheld had Colorado not joined the NPM Settlement.

Recent payments and expectations. The payments received in 2022 and 2023 came in higher than recent years due to high inflation combined with a slower than normal decline in cigarette and tobacco sales. Additionally, manufacturers began moving toward higher-priced premium products and non-cigarette tobacco products, and away from lower-cost products, resulting in higher incomes, and therefore an upward adjustment in the base payment.

Payments are expected to decline through the forecast period as inflation moderates and cigarette sales return to their pre-pandemic trend of steady decline. National cigarette consumption is estimated to have fallen by 7.4 percent in 2023, which impacts the 2024 payment, and is expected to fall by another 6.2 percent in 2024. Inflation is expected to be below 3 percent through the forecast period beginning in 2024, which means that the inflation adjustment will be equal to 3 percent.

Risks to the forecast. Annual payments are sensitive to cigarette consumption, U.S. inflation, and manufacturers' income. To the extent that actual cigarette consumption is higher or lower than is forecast, Colorado's base payment will be impacted accordingly. The inflation adjustment increases by a minimum of 3 percent each year, so payments will not be impacted if inflation is lower than expected, but could increase by more than 3 percent if inflation exceeds expectations. Payments will also be impacted by the amount that manufacturers choose to withhold as part of a disputed payment.

Additionally, the Tobacco MSA remains an area of ongoing legal uncertainty. Any changes to the legal landscape resulting from government or manufacturer legal strategy, arbitration proceedings, or court orders will have an effect on the amounts received. Colorado's arbitration proceedings for the 2004 through 2022 NPM disputes have been settled; however, resolution of these disputes will not be concluded entirely until arbitration proceedings for all states have been closed. Receipts will also fall if participating manufacturers cease operations, file bankruptcy, or otherwise fail to pay what is due each year.

Distribution of MSA Payments

Total allocations to MSA-funded programs each year correspond to the MSA payment that was received in April of the preceding fiscal year.

Distribution formula. Funds are distributed based on a statutory formula enacted in House Bill 16-1408. The formula directs the distribution of 96.5 percent of the annual MSA payment as shown in Table 2. Starting in FY 2023-24, the 2.0 percent that was previously allocated to the Autism Treatment Fund, which was eliminated under Senate Bill 23-289, is unallocated under current law. The unallocated portion is reserved each year to reduce the amount of the annual accelerated payment, described below.

Table 2
Distribution of Tobacco MSA Payment[1]

Program	Distribution
Department of Law	
Tobacco Settlement Defense Account	2.5%
Department of Human Services	
Nurse Home Visitors	26.7%
Tony Grampsas Youth Services	7.5%
Department of Health Care Policy and Financing	
Children's Basic Health Plan Trust	18.0%
Department of Higher Education	
CU Health Sciences Center[1]	17.5%
Department of Public Health and Environment	
AIDS Drug Assistance	5.0%
HIV Prevention	3.5%
Immunizations	2.5%
Health Services Corps	1.0%
Dental Loan Repayment	1.0%
Capital Construction	
Fitzsimons Trust Fund	8.0%
Department of Personnel and Administration	
Supplement State Employee Insurance Plans	2.3%
Department of Military and Veterans Affairs	
Veterans Trust Fund	1.0%
Total Funds Distributed	**96.5%**

[1]Of this share, 2.0 percent must be expended for tobacco-related in-state cancer research.

Accelerated payments. Due to a budget-balancing measure enacted in 2009 following the Great Recession, the annual payment received each April funds programs in both the fiscal year in which it is received and the following fiscal year.[2] This creates an annual General Fund obligation for a bridge loan, or "accelerated payment," made to fund MSA programs between the date when the prior year's payment is exhausted and the date when the current year's payment arrives.

Prior to the COVID-19 pandemic, the General Assembly had taken steps to gradually reduce the size of this obligation on the General Fund. However, the General Assembly increased the accelerated payment in House Bill 20-1380 as a budget-balancing measure during the pandemic-induced recession. This bill transferred $20 million from the state's 2020 MSA

[1] Section 24-75-1104.5 (1.7), C.R.S.
[2]Senate Bill 09-269.

payment to the General Fund. To compensate, an additional $20 million from the state's 2021 MSA payment was allocated to programs in FY 2020-21, thereby increasing the accelerated payment by $20 million.

To decrease the amount advanced annually from the General Fund, any unallocated amount remaining in the Tobacco Litigation Settlement Cash Fund after programs are funded is retained in the fund and used to reduce the following year's accelerated payment. This amount is currently 3.5 percent of the annual payment received.

For programs funded in FY 2023-24, $35.7 million was paid from the state's April 2023 payment, and the remaining $57.4 million is expected to be paid from the April 2024 payment.

Distribution forecast. Table 3 shows the amount that each MSA-funded program is projected to receive through FY 2026-27 under the payment forecast estimates presented in Table 1. The unallocated amount is presented at the bottom of the table.

Table 3
Tobacco MSA Distribution Forecast
Dollars in Millions

Program	FY 2023-24 Preliminary	FY 2024-25 Estimate	FY 2025-26 Estimate	FY 2026-27 Estimate
Department of Law				
Tobacco Settlement Defense Account	$2.3	$2.2	$2.1	$2.0
Department of Human Services				
Nurse Home Visitors	$24.9	$23.2	$22.2	$21.5
Tony Grampsas Youth Services	$7.0	$6.5	$6.2	$6.0
Department of Health Care Policy and Financing				
Children's Basic Health Plan Trust	$16.8	$15.6	$14.9	$14.5
Department of Higher Education				
CU Health Sciences Center[1]	$16.3	$15.2	$14.5	$14.1
Department of Public Health and Environment				
AIDS Drug Assistance	$4.7	$4.3	$4.2	$4.0
HIV Prevention	$3.3	$3.0	$2.9	$2.8
Immunizations	$2.3	$2.2	$2.1	$2.0
Health Services Corps	$0.9	$0.9	$0.8	$0.8
Dental Loan Repayment	$0.9	$0.9	$0.8	$0.8
Capital Construction				
Fitzsimons Trust Fund	$7.4	$6.9	$6.6	$6.4
Department of Personnel and Administration				
Supplement State Employee Insurance Plans	$2.1	$2.0	$1.9	$1.9
Department of Military and Veterans Affairs				
Veterans Trust Fund	$0.9	$0.9	$0.8	$0.8
Total Funds Distributed	**$89.8**	**$83.7**	**$80.1**	**$77.8**
Unallocated Funds	**$3.3**	**$3.0**	**$2.9**	**$2.8**

Source: Department of the Treasury and Legislative Council Staff Forecast.
[1]For FY 2016-17 and subsequent years, a share of this amount is required to be spent for tobacco-related in-state cancer research.