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**VIRGINIA TOBACCO INDEMNIFICATION  
AND COMMUNITY REVITALIZATION COMMISSION**

701 East Franklin Street, Suite 501  
Richmond, Virginia 23219

**Full Commission Meeting**  
Tuesday, January 11, 2005

Re: Executive Director's Report  
Allocable Share Legislation  
Philip Morris  
S & M Brands

1 MR. CURRIN: Mr. Chairman, back to the Allocable  
2 Share Legislation. John Rainey, with the Philip Morris group, and there are  
3 various individuals that are going to make a presentation.

4 MR. RAINEY: Mr. Chairman.

5 SENATOR HAWKINS: Yes, sir.

6 MR. RAINEY: This is John Rainey with Philip Morris,  
7 and thank you for having us here today, and members of the Commission.  
8 I'm pleased to have my colleague, Jeff Wintner, Mr. Chairman, here today to  
9 discuss the Allocable Share Legislation and the need to have it passed in  
10 Virginia to protect Virginia's Master Settlement payments and the great work  
11 that this Commission is doing.

12 If I may introduce, Mr. Chairman, Jeff Wintner.

13 SENATOR HAWKINS: You certainly may. Welcome, sir.

14 MR. WINTNER: Thank you, Mr. Chairman, and members  
15 of the Commission. My name is Jeff Wintner, and I serve as counsel to  
16 Philip Morris USA. On behalf of PM USA, I'd like to thank you, Mr.  
17 Chairman, and members of the Commission for the opportunity to speak  
18 with you here today.

19 Because the Commission is already familiar with a lot of the  
20 background behind the Allocable Share issue, and because I realize the time  
21 is tight, my thought was just to go over that background very briefly and  
22 then to answer any questions that members of the Commission may have.

23 I believe the Commission is fully familiar with the problem that  
24 exists with the Commonwealth's existing escrow deposit law, that that  
25 escrow law as written contained a loophole, that this loophole allows non-

1 participating companies or companies that haven't signed yet to avoid up to  
2 98 percent of the escrow payments that the statute intends for them to make,  
3 and that as a result of this, every year the Commonwealth is losing a large  
4 and ever-increasing amount of its MSA payments. And so, like I said, I don't  
5 think there's an issue about whether there is a problem; the issue for us  
6 today, how best to fix that problem, how best to safeguard the MSA  
7 payments. PM USA believes that the best, in fact, the only way to fix this  
8 problem would be the Allocable Share Amendment. That's what the  
9 National Association of Attorneys General concluded in endorsing the  
10 Allocable Share Amendment as the way to fix this problem. That's what  
11 forty MSA states have concluded themselves in a national --

12 DELEGATE HOGAN: Let me interrupt you. Is it forty  
13 states, does that also include the territories?

14 MR. WINTNER: Yes, it does.

15 DELEGATE HOGAN: It's not forty states.

16 MR. WINTNER: It's thirty-seven states, as we would  
17 normally define states. The MSA defines states to include territories.

18 SENATOR HAWKINS: We are talking about things other  
19 than the states?

20 MR. WINTNER: Yes, it's thirty-seven states out of forty-  
21 six states, as we would normally define states, that are joined in the MSA  
22 that have enacted Allocable Share, and three of the six territories, and that's  
23 where I got my forty number from. And they've come to the conclusion that  
24 the Allocable Share Amendment is the best, in fact, the only way to fix this  
25 problem. The reason is that it fixes the problem the simplest way possible,

1 through a small change in the language of the existing escrow law to close  
2 the loophole. By addressing the problem through a simple linguistic change  
3 in the existing law, it preserves the basic structure of the escrow statute,  
4 preserves the basic structure of the MSA, and for that reason it doesn't do  
5 any damage or violence to the MSA or create any threat, potential threat to  
6 the MSA's continuation of the economy.

7 Now, the same can't be said for the alternative tax proposal that was  
8 made before the General Assembly sub-committee on the issue back on  
9 December 9, and may be discussed here today. In fact, the opposite is true  
10 with respect to that proposal. The reason is that proposal doesn't fix the  
11 problem or do anything within the structure of the existing MSA and the  
12 existing statutory structure. Rather, that proposal is to create an entirely new  
13 cigarette tax applicable to all companies, including those that have signed  
14 the MSA, and then to overlay that tax on top of the MSA and the escrow law.  
15 As a result of this, that tax would be violating the MSA structure and would  
16 create a serious risk of the MSA's termination from the Commonwealth.

17 I'll explain why in a moment, but at the outset I'd like to underscore  
18 that I'm not the only person saying this. Attorney General Kilgore has  
19 directly opined on the issue of alternative proposals to Allocable Share, such  
20 as this proposal. In a letter dated December 8 to Delegate Albro, here's what  
21 he said on the subject, and I quote: "Any alternative proposals, such as  
22 assessment fees against cigarettes sold in the Commonwealth, could lead to  
23 legal action that could threaten the loss of Virginia's annual payments under  
24 the MSA." Now the reason he came to this conclusion, we believe that he's  
25 right on the subject, is that the tax would purport to override or abrogate

1 central contractual provisions of the MSA. And I'll give you a few examples  
2 of that.

3           First of all, it would abrogate a series of payment adjustments and  
4 credits that the MSA provides for all existing companies, including Philip  
5 Morris USA. An example of this is that if a participating company is  
6 required to pay certain money to cities or counties or municipalities for  
7 certain specified reasons, we would get a credit against our MSA payments.  
8 So that we don't have to pay the same money twice, we don't have a double  
9 payment. The way the tax works, however, we would just have to make up  
10 that adjusted payment in the form of additional tax payments, so we would  
11 have to pay that. It would abrogate that adjustment and increase our  
12 payment obligations. That's number one.

13           Number two, it would work a further increase in PM USA payment  
14 obligations by calculating payments in an entirely different way and  
15 overriding the manner in which payments are calculated under the MSA.  
16 Under the MSA we make a single nationwide payment, all participating  
17 companies make a single nationwide payment, and each state gets a  
18 stipulated share of that, it's called Allocable Share Assessment, is where it  
19 came from. Virginia's share is approximately two percent or a little higher.  
20 The tax, however, would be calculated on the basis of in-state volume, and  
21 so a credit against the tax, as I understand, was proposed back on December  
22 9th in the amount of the MSA payment that you make to the state, the  
23 Commonwealth, for any company such as Philip Morris USA that sells more  
24 than two percent of its nationwide volume in the Commonwealth of Virginia,  
25 the credit does not fully defray the tax, we owe them additional money.

1           The third way that this abrogates provisions under the MSA, it  
2 doesn't directly concern PM USA, is that it would abrogate a grandfather  
3 share provision under which those smaller companies who signed the MSA  
4 immediately, in the first 90 days, got their existing market share  
5 grandfathered. This proposed tax proposed on December 9th would override  
6 that, abrogate that as well.

7           So why does this matter? Why does this create a threat to the  
8 MSA?

9           The MSA is a contract, and like any contract it lists its material  
10 terms. The MSA specifically provides that every one of the adjustment and  
11 payment terms that I just described is a, quote, non-severable term of the  
12 MSA, the term it uses, and the MSA goes on to provide that if a non-  
13 severable term is abrogated in a state, that gives rise to a claim that the MSA  
14 should be terminated in the state. And that's what the Attorney General was  
15 talking about in his letter when he said that if alternative proposals along  
16 these lines, and again I quote, "could lead to legal action that could threaten  
17 the loss of Virginia's annual payments under the MSA." We agree with that  
18 analysis, we want to avoid that result, we are committed to the MSA, and for  
19 that reason we support the Allocable Share Amendment as a way to fix the  
20 problem and to safeguard the Commonwealth's MSA payments.

21           SENATOR HAWKINS: Any questions? Mr. Day.

22           MR. DAY: Thank you, Mr. Chairman. Sir, what is your  
23 advocacy to raise the retail prices of your competitors' products?

24           MR. WINTNER: I think that would be up to them, but  
25 what we're dealing with right here is a situation where they can avoid up to

1 98 percent of the escrow deposits that the Legislature, in enacting the escrow  
2 statute in the first place, intended for them to make. So I think it's fair to say  
3 that if they are now not avoiding those escrow deposits, that may have an  
4 impact on retail prices.

5 SENATOR PUCKETT: You made reference earlier to the  
6 escrow payment and the loophole, and you made a statement that because of  
7 that loophole we're losing a large portion of the MSA payments. Are you  
8 attributing what we're losing solely to the loophole, or are there other  
9 factors?

10 MR. WINTNER: There are other factors as well.

11 SENATOR PUCKETT: What would those other factors  
12 be?

13 MR. WINTNER: Well, there are other factors, including  
14 the general decline in the amount, total volume of smoking is down in this  
15 country, and the fact that even with the Allocable Share Amendment, that  
16 would narrow the price gap, that would narrow the gap between what the  
17 largest companies have paid and what smaller companies have paid. There  
18 are other elements, but this is a substantial contributing factor to what has  
19 been a very large and ever-increasing annual loss of MSA payments.

20 SENATOR PUCKETT: Are you saying that the loophole  
21 is the single most significant factor in the loss of payments from the MSA?

22 MR. WINTNER: It's difficult to quantify that, sir, but I  
23 am saying it is a very significant component of it.

24 SENATOR PUCKETT: But you're not saying that it is the  
25 most significant?

1 MR. WINTNER: I can't quantify that, sir.

2 SENATOR PUCKETT: One other question, Mr.

3 Chairman. You made reference also to the other tax plan, and I assume we're  
4 going to hear something about that later, but you indicated that something  
5 that might give rise to a complete change in the MSA agreement, if I heard  
6 you right, you used non-severable term. Could you elaborate on what's out  
7 there that might cause the MSA, if we chose to do something with the tax  
8 plan, what's out there that might cause, is there a legal opinion, or is there a  
9 court case, or is there something on record, or is this just someone's opinion?

10 MR. WINTNER: Well, it's Attorney Kilgore's opinion.

11 SENATOR PUCKETT: Is that in writing? I heard you  
12 refer to the letter, but is that the Attorney General's opinion?

13 MR. WINTNER: It's in the form of a letter. The reason  
14 there haven't been any court cases is nobody has tried to abrogate a non-  
15 severable term with the MSA, and that's why forty MSA states, or thirty-  
16 seven states I should say, have fixed the problem through the Allocable  
17 Share Amendment, and none of the MSA states have tried to adopt some tax  
18 proposal or alternative measure that would abrogate an MSA term and create  
19 this risk to their state that the MSA would be terminated.

20 SENATOR PUCKETT: I don't need to see the letter, but I  
21 would like for you to answer the question. Is that an official legal opinion,  
22 or is that just a letter from the Attorney General?

23 MR. WINTNER: It's just a letter on his letterhead.

24 SENATOR PUCKETT: It's not an official legal opinion?

25 SENATOR HAWKINS: Now you're getting into a

1 running debate that we probably need to avoid.

2 SECRETARY SCHEWEL: I take it, sir, that what you  
3 anticipate if this contract is abrogated the way the issue would arise would  
4 be a participant, a party to the contract, would sue for breach of contract,  
5 saying the contract had been breached and therefore was void.

6 MR. WINTNER: Yes, that's correct. In fact, the MSA  
7 specifically provides for that mechanism in what's called its severability and  
8 termination clause, provides a mechanism you think a non-severable term  
9 and identifies at great length what are non-severable terms has been  
10 abrogated then you can seek termination of the contract in the state. There  
11 are a host of parties to this contract, dozens of companies that are parties to  
12 it, and it only takes one of them to make that claim.

13 DELEGATE KILGORE: I guess the thing that I'm having  
14 the most trouble with would be the subsequent participating manufacturers.  
15 Now they would pay less, they would be paying less than others that would  
16 come in under this Allocable Share Agreement, this Allocable Share  
17 Amendment if we pass it?

18 MR. WINTNER: Certainly that's not true with respect to  
19 all of them. There are dozens of subsequent participating manufacturers. I  
20 think the number that I heard is somewhere between forty-five and fifty of  
21 them.

22 DELEGATE KILGORE: Right.

23 MR. WINTNER: Now a sub-set of them, a minority of  
24 them, joined the MSA right away, between ten and fifteen of them joined the  
25 MSA within the first ninety days. They got a grandfather share as an

1 incentive for joining immediately to make payments to the state, which they  
2 have been making from the get-go, for the last six years.

3 DELEGATE KILGORE: So that was the deal that was  
4 worked out?

5 MR. WINTNER: Yes, it was a deal we offered to all  
6 companies at the outset. If you want to come under the MSA at the  
7 beginning, make payments from the get-go, yes, you would get your existing  
8 market share grandfathered.

9 DELEGATE HOGAN: You spoke about the intent of the  
10 escrow statute; it would be people making full payments because of what  
11 you define as a loophole, they are not making those full payments, that was  
12 not the intent of the statute. My understanding is that Virginia receives  
13 about two percent of the Master Settlement Agreement from the participating  
14 manufacturers, and the escrow payment as defined is exactly identical to the  
15 two percent that Virginia receives, and that's based on market share and other  
16 things like that. So the statute pretty clearly says, from my understanding,  
17 you're going to make an escrow payment equivalent to the Master Settlement  
18 payment to the State of Virginia. On what basis do you make the comment  
19 that was not the intent of the statute as it was originally written?

20 MR. WINTNER: What I believe the intent of the statute  
21 was, the intent of the provision that gives rise to what I term, is that there is a  
22 provision in there that is designed to say that this statute can't be construed  
23 as saying that you should make more in the way of escrow deposits than you  
24 would if you were a participant in the MSA and paying nationwide. The  
25 problem is the way that provision is drafted. Instead of comparing your

1 escrow deposits on a per-pack basis to what you would pay nationwide  
2 under the MSA, if you were a party of the MSA, you would be making a  
3 single nationwide payment on a nationwide volume. Instead of making that  
4 comparison, which was a comparison intended, it makes a comparison  
5 between what the state receives under the MSA, and that creates a  
6 disconnect, and that is what allows a company to withdraw immediately up  
7 to 98 percent of the money that it is supposed to put into escrow. It is a  
8 strange statute indeed that says on the one hand we're going to create this  
9 requirement, but on the other hand we're going to allow you to take out 98  
10 percent of what you're supposed to put in, and that's why I say it was a  
11 loophole.

12 DELEGATE HOGAN: Just make a statement, make a  
13 comment to you. You all don't write that statute to start with. It's my  
14 understanding, it's a little hard for me to understand how you wrote  
15 something that's different from what you intended to do, but the statute does  
16 say that, the escrow statute says make a payment equivalent to the state's  
17 receipts, very clearly the statute, that's what it says, how can the intent of  
18 that be different from what it says?

19 MR. WINTNER: I think we're all familiar with situations  
20 where a statute is enacted by a legislature and is based on, and something  
21 comes up in the aftermath of that statute nobody contemplated when the  
22 statute was written. Now, I'm not saying that it doesn't comply with the  
23 statute, to take out up to 98 percent of the escrow, it does. The problem is  
24 not that there has been a violation of the statute there, the problem is the way  
25 the statute is written.

1 SENATOR HAWKINS: Mr. Owen

2 MR. OWEN: In response to Senator Puckett's question,  
3 you spoke first about the decline of the overall MSA payment, but that  
4 doesn't speak to its adjustment for Virginia. Are there any other factors  
5 other than this escrow account that cause Virginia's share to be adjusted off  
6 this more or less two percent?

7 MR. WINTNER: I think there are additional other  
8 potential factors. I think this is the most direct one and tangible in that it's  
9 going to happen.

10 MR. OWEN: And it's happening today?

11 MR. WINTNER: It is happening today.

12 MR. OWEN: How much has Virginia's MSA's payment  
13 been reduced in this period by this effect?

14 MR. WINTNER: I have to break that down into a couple  
15 of components. The growth of market share of non-participating  
16 manufacturers has gone from, in 1998 when the MSA was signed, a small  
17 fraction of one percent to approximately ten percent nationwide now, and it's  
18 continued to grow, is greater than Virginia's, is my understanding. That  
19 produces a direct impact on MSA payments, because the MSA payments are  
20 tied to participating companies' volumes. So a shift from a participating  
21 company to a non-participating company takes money straight out of the  
22 pockets of the states.

23 MR. OWEN: Volume overall, I think that's right.

24 MR. WINTNER: Well, that's part of the overall picture.  
25 Another way that MSA payments decline, to give you the whole thing in

1 context of the overall picture, is the overall value, everybody's. Then there's  
2 the diminution. This shift to NPM, which is what I'm trying to quantify for  
3 you to try and answer your question, I believe the number that I have seen  
4 from last year was that this shift in market share from the NPM's profit, the  
5 Commonwealth, I think it was twelve million dollars, and as that number  
6 continues, as that shift continues, that number will continue to grow.

7 SENATOR HAWKINS: Okay. Now, I'm not trying to be  
8 impolite, we're going to run out of time today, we've got another viewpoint  
9 that has to be presented today. I'm going to take two more questions from  
10 Senator Puckett and Delegate Wright, and then we'll go to the next group.

11 Senator Puckett?

12 SENATOR PUCKETT: Jeff, I don't want to put words in  
13 your mouth. If I'm saying something wrong or asking the wrong question  
14 you can tell me real quick. Did I understand you to say that in your opinion  
15 the only way to fix this problem is through the Allocable Share Legislation?

16 MR. WINTNER: The only way to fix the problem and to  
17 safeguard the MSA and the MSA payments without doing violence to the  
18 MSA, and creating this risk that I talked about, yes.

19 SENATOR PUCKETT: Key word there, risk. You don't  
20 know that, though, do you?

21 MR. WINTNER: I know there will be a risk.

22 SENATOR PUCKETT: You know there is a possibility  
23 there?

24 MR. WINTNER: I think that there would be a very  
25 serious risk to the continuation of the MSA.

1                   SENATOR PUCKETT: Do you not have any opinion that  
2 there might be another way to fix this without the Allocable Share?

3                   MR. WINTNER: I can point you again to Attorney  
4 General Kilgore's letter in which he says --

5                   SENATOR PUCKETT: -- Thank you --

6                   MR. WINTNER: -- in which he says any alternative  
7 provision might create that risk.

8                   SENATOR HAWKINS: Delegate Wright?

9                   DELEGATE WRIGHT: Mr. Chairman, I have one  
10 question, please. If a way was found to have a tax rather than an MSA  
11 payment is it true that the State of Virginia would be better off, for instance,  
12 if the tobacco companies had a way including bankruptcy to avoid MSA  
13 payments, would they still be liable for the tax payments? So would the  
14 state actually be better off, and the Tobacco Commission, if the money was  
15 still coming in, rather than not getting any?

16                  MR. WINTNER: Everything is premised on the if, that  
17 was the beginning, that was the premise of your question. And all the other  
18 states that have enacted Allocable Share, they've considered other  
19 approaches. Like this tax proposal, the concept of it is not new, other forms  
20 of it were discussed and potentially even introduced in a bunch of these  
21 other states, and they all came to the conclusion that it created too large of a  
22 risk to the continuation of the MSA, all of the dollars that that means to the  
23 state and all the public health benefits and they went the route of the  
24 Allocable Share, and we urge you to do the same thing.

25                  DELEGATE WRIGHT: Is the answer to my question yes

1 or no? If the answer is yes, if there was a risk-free way to do it, isn't it true  
2 that there would be less risk to the state by getting the tax rather than  
3 depending on the MSA payment, which could be jeopardized by bankruptcy;  
4 is that not a true statement?

5 MR. WINTNER: If there is a risk-free way that does not  
6 present any threat to the MSA, I think the answer to your question is yes, it  
7 would address certain other issues.

8 SENATOR HAWKINS: Thank you, and we'll have  
9 obviously many opportunities to continue this conversation as the session  
10 progresses.

11 MR. JOHNSON: Thank you, Mr. Chairman. Some of you  
12 I know, some of you I have met, and some of you I have never had the  
13 pleasure of meeting. I'm Scott Johnson, I live out in Hanover County. Don't  
14 hold it against me, but I'm one of the lawyers, too. I'm going to try to  
15 introduce who we're here for. You've heard from a well-respected corporate  
16 citizen, but I want you to hear on behalf of a very small business in  
17 Keysville, Virginia, and that's who I have the privilege of representing with  
18 Mr. Ernie Gellhorn, and we're going to talk a little bit about that. Permit me  
19 if I can, not to trespass on your time, because I know your hips are as sore as  
20 mine from sitting.

21 Let me take you through a roadmap of where we're going. Number  
22 one, we're going to tell you about S&M Brands, and who S&M Brands is.  
23 Number two, we're going to give you a solution that we firmly believe  
24 works. It differs from a proposal that you just heard about. Delegate Wright  
25 asked the question over there a second ago about a steady revenue stream to

1 Virginia. Our solution gives to Virginia that steady stream, a protected  
2 stream and a stream that we will show you can result in Virginia getting in  
3 your hands one hundred million dollars.

4 Now first let me tell you about S&M Brands. You see the pictures  
5 up here, some of them have got a little bit of age on them, but this began as  
6 Bailey's Tobacco, and you see Mack Bailey there on the left who I'll  
7 introduce in a second; some of his relatives started in Southside. Let's tell  
8 you where they are. Starting in Keysville, Virginia out in Lunenburg  
9 County, five generations of tobacco farmers employs two hundred and  
10 twenty-five people at their facilities now. One of the proudest things that we  
11 have to bring to you is that they are true Virginians. They buy one hundred  
12 percent U.S. flue cured and burley tobacco. If I may, Mr. Chairman, I'd like  
13 Mr. Bailey to please stand at this point in time so you can see who Mr.  
14 Bailey is, and one of the things you may have heard if you read any of the  
15 newspapers or seen any of the announcements, as of Friday S&M Brands  
16 announced that their plans this year is to buy ten million pounds of Virginia  
17 flue-cured and burley tobacco.

18 SENATOR HAWKINS: Scott, how does this apply to the  
19 import market, cigarettes made offshore? That's a question I just haven't had  
20 a good answer to.

21 MR. JOHNSON: One thing about it, Mr. Chairman, with  
22 the solution that we have before you it will allow S&M Brands to continue  
23 to buy Virginia grown tobacco; without a solution like this, then the  
24 alternative is not to buy Virginia tobacco and to have buy Brazilian tobacco,  
25 which would save S&M Brands approximately five million dollars, and

1 that's not something they want to do. They want to stay in business to  
2 support Virginians.

3 The second answer to your question is the foreign tobacco that  
4 comes in, we're creating a level playing field with the foreign companies, so  
5 we're trying to make sure the foreign companies would owe Virginia the  
6 same thing that S&M Brands would, and owe Virginia the same thing that  
7 the larger companies would.

8 SENATOR HAWKINS: It's not so much tobacco, it's the  
9 offshore manufacturing, too, that we begin to see more and more of, and I  
10 just wonder how they fit in the mix; I know you don't represent any of those  
11 companies.

12 MR. JOHNSON: Yes, sir.

13 SENATOR HAWKINS: It's part of the overall mix.

14 MR. JOHNSON: Yes, sir. They would have the same  
15 excise tax applied to them as would the local growers and the larger  
16 companies in Virginia. Mr. Chairman, if I could introduce at this point in  
17 time Mr. Ernie Gellhorn, and while I'm just a local guy, for any of you that  
18 like Blue Devil basketball, Mr. Gellhorn was Dean of the Law School down  
19 at Duke. He's been dean at three schools, he teaches Constitutional law.  
20 He's an expert in this area, and it's my pleasure to introduce my friend, Ernie  
21 Gellhorn.

22 SENATOR HAWKINS: Welcome, sir.

23 MR. GELLHORN: Thank you very much, Mr.  
24 Chairman. Before I go into our presentation I'd like to answer some of the  
25 specific questions that were presented to you, because I think they can be

1 answered quite pictorially. First of all, the Allocable Share Amendment  
2 proposed by NAG increasing the cigarette price, the answer is yes. The  
3 average price paid by the NPM in terms of the escrow is a dollar per carton.  
4 Under the Allocable Share Amendment it will go to four dollars, so that will  
5 be an increase of cost of three dollars per carton, and unless you're willing to  
6 take a loss you're going to have to pass that on to the consumers.

7 The second point I would make is --

8 SENATOR HAWKINS: -- Is that an overall increase, or  
9 just that particular market that we're talking about, which are the brands that  
10 are not members of the MSA?

11 MR. GELLHORN: It will be for the non-participating  
12 manufacturers and for the grandfathers; excuse me, it'll just be for the non-  
13 participants, but remember they are the ones who produce the low cost  
14 products that's primarily bought by the poorest citizens of this  
15 Commonwealth and every other state. They are the ones that are going to be  
16 most affected.

17 Second, they're suggesting that you cannot do anything else that  
18 might have any impact on the MSA. But oh, yes, you can change the escrow  
19 deposit part of the statute. It seems to me a deal is a deal. If you created the  
20 deal that says there's a limit on the escrow statute, to change that is a  
21 modification. We happen to think that, and that's not going to stand, it's  
22 legally vulnerable. It has been challenged in the State of Oklahoma. And  
23 last week, the 5th of January, the district court issued a temporary restraining  
24 order. It has been passed in New York, and on September 18th, earlier last  
25 year, the district court in New York enjoined that statute, and yesterday a

1 representative told you that that statute is not going to survive review, or that  
2 that injunction is not going to survive review in the court of appeals, and let  
3 me tell you they got it wrong, because it will survive. Why? Because the  
4 state didn't appeal it. There has been an appeal on other parts of the court's  
5 order, but not on the injunction of the Allocable Share Amendment.

6 Likewise, the State of Louisiana has an Allocable Share Amendment that is  
7 currently in litigation in the district court. It has been challenged, the court  
8 is taking that challenge under advisement; we're waiting for a decision.

9           With that background let me move specifically to the points we  
10 were wishing to make. What I'm going to present today is first of all what is  
11 the legislative proposal related to? It's not complex, but I think it is fair. I  
12 want to explain how it works, and I want to identify, in contrast to the  
13 Allocable Share Amendment, that this produces additional revenue for the  
14 state, we're going to suggest at least a hundred million dollars annually.  
15 Now the benchmarks that we use for this is to make sure that what we do is  
16 fair to every manufacturer. You'll see that our proposal applies the very  
17 same amount for every manufacturer. We don't distinguish between  
18 subsequent participating manufacturers, original participating manufacturers  
19 or non-participating manufacturers. Second, we seek to assure through this  
20 mechanism that there will be continued payments to Virginia because, as was  
21 properly noted, we're proposing an excise tax, which is not voidable in  
22 bankruptcy. And third, we're proposing, in contrast to what was presented to  
23 you a moment ago, no change to the MSA. Ours is a separate proposal for  
24 change in the Virginia statute, which takes into account the MSA, but does  
25 not itself change the MSA. And therefore I think it is not vulnerable to

1 Constitutional challenge, or in fact any contractual challenge.

2 Okay. What's our solution? Well, first of all it is that the State of  
3 Virginia would adopt an excise tax of four dollars per carton on all  
4 manufacturers. Everybody would be obliged to make that payment. There's  
5 nothing hidden about, there's nothing complex, essentially one sentence to  
6 the Virginia Statute. Okay. Then second, how do we blend this with the  
7 MSA to make sure that nobody's paying twice and nobody is caught in an  
8 unfair situation. Well, we think that in this bill credit shall be given for any  
9 payment made under the Master Settlement Agreement. In other words, if  
10 you're paying, as Philip Morris claims, four dollars per carton on its cigarette  
11 tax, it will get a credit for that four dollars and end up paying no more. If on  
12 the other hand you're making a payment on your escrow payment, you'll get  
13 a credit for that, but everybody pays the same amount. The final  
14 thing is that we want to make no modifications but we want to create  
15 additional revenue for Virginia. Okay. That's, I'm sorry, I skipped over one,  
16 I apologize, and that is we suggest that this money that comes into Virginia  
17 which would be approximately fifty million dollars a year, be allocated to  
18 the Virginia Healthcare Fund for medical assistance so that it can be matched  
19 by federal Medicaid. That would obviously be up to the legislature's  
20 discretion, but that could produce a total of one hundred million dollars for  
21 the Commonwealth.

22 Okay. Let's look at the payment structure. It is basically very  
23 simple. The original participating manufacturers, Philip Morris, RJR,  
24 Lorillard, they owe four dollars, under the Master Settlement Agreement,  
25 they get credit for four dollars, and they owe Virginia no more as a result of

1 this proposal. Second, we have the subsequent participating manufacturers.  
2 They would also owe four dollars. Now, the grandfathered market gets an  
3 exemption for all of the cigarettes that they sold in 1998, or a hundred  
4 twenty-five percent of what they sold in 1997, which means that they pay  
5 actually considerably different amounts, Victory pays fifty-four cents,  
6 Liggett pays ninety, Wind River pays three nineteen. On the average we  
7 figure about a dollar. So they get the credit for what they pay. They would  
8 owe Virginia three dollars per carton. And then there's the group, Bailey's  
9 included, would also be subject to the four dollars per carton.

10 SENATOR HAWKINS: Where does the consumer fit into  
11 this?

12 MR. GELLHORN: The consumer, they're currently  
13 paying, basically, the premium manufacturers, about twenty-eight to thirty-  
14 five dollars a carton. The non-participating manufacturers, low cost  
15 producers, they're selling at from eight to fifteen dollars a carton. They  
16 would see along with, they would see an increase in their payments. We're  
17 proposing a tax on ourselves. Why? Because we want a level playing field.  
18 Currently, we're playing up against the subsequent participating  
19 manufacturers who pay very much less, and they have most of the low cost  
20 sales, in fact, they're the ones who would welcome this. Does that answer  
21 your question?

22 SENATOR HAWKINS: Just that the consumer is going to  
23 pay the burden of what we're doing and I don't want to get into a debate on  
24 this today, but the problem if we're trying to work with the MSA payments  
25 based on the sale of domestic cigarettes and we keep prices going up that

1 more and more people would just walk away and you'd have less  
2 consumption, and you'd have a little problem, in my mind.

3 MR. GELLHORN: Under the Allocable Share  
4 Amendment proposal, the consumer also has to pay more. There's no  
5 difference on this. The difference is that the local smaller manufacturer such  
6 as the Baileys in contrast to the Liggetts and the, are going to be put at a  
7 severe competitive disadvantage, because the grandfathered subsequent  
8 participating manufacturers under the Allocable Share Amendment cannot  
9 more.

10 SECRETARY SCHEWEL: Mr. Chairman.

11 SENATOR HAWKINS: Yes, sir.

12 SECRETARY SCHEWEL: Mr. Gellhorn, I'm sorry, I  
13 didn't understand what you just said there. You said it would be the same  
14 thing under the Allocable Share Amendment in terms of, the way I would  
15 understand it, correct me if I'm wrong, under the Allocable Share  
16 Amendment cigarettes made by the non-participating members would, those  
17 manufacturers would have to pay more.

18 MR. GELLHORN: Yes, sir.

19 SECRETARY SCHEWEL: But the whole rest of the  
20 universe of manufacturers would not have to pay more, so that in the tax  
21 proposal, the tax goes up on all cigarettes sold by all manufacturers, that's  
22 your proposal. Under the Allocable Share Amendment proposal the price of  
23 a sub-set of cigarettes, a small sub-set of cigarettes would go up, but they  
24 wouldn't go up for the rest of them.

25 MR. GELLHORN: No, that's incorrect. Let me explain,

1 and I apologize for not being clear on that. For the original participating  
2 manufacturers who already pay, they pay four dollars per carton, they don't  
3 pay any more under our proposal.

4 SECRETARY SCHEWEL: I'm sorry, you misunderstood  
5 me. I didn't say that they paid more, I said the consumer paid more.

6 MR. GELLHORN: The consumer wouldn't pay more,  
7 because they're not paying more unless they're choosing to use that as an  
8 excuse to raise their prices. So there wouldn't be any change. The original  
9 participating manufacturer faces absolutely no change.

10 SECRETARY SCHEWEL: How can that be so if they  
11 have to pay four dollars in tax?

12 MR. GELLHORN: Because they get a credit, a full credit  
13 for their MSA payment against their Virginia tax on their bills from the  
14 Department of Revenue would be zero. Now, let me suggest this, I wasn't  
15 complete in my descriptions. And that is that under the Allocable share  
16 Amendment the non-participating manufacturer has to pay now four dollars  
17 and does not get a tax deduction. The tax deduction on four dollars a carton  
18 is a dollar sixty, but their costs are going to go up by sixty under the  
19 Allocable Share Amendment. That's what's behind it. This isn't an attempt  
20 to create a level playing field, this is an attempt to wipe out the non-  
21 participating manufacturers, and that's exactly what the New York court  
22 found in Freedom Holding. They said that those states that had the  
23 Allocable Share Amendment did not have, quote, a legitimate reason other  
24 than to do, quote, at the behest of the original participating manufacturers.  
25 So what we're really trying to do is stop something that is just grossly unfair

1 and will not benefit the consumer.

2 SENATOR HAWKINS: Okay. Let me interrupt. Cell  
3 phones, if anyone has them, please turn them off . Mr. Bryant.

4 MR. BRYANT: Sir, you are disputing the testimony that  
5 we just heard from the attorney from Philip Morris stating that their  
6 payments go into a national fund, they're not just paying on the basis of two  
7 percent that Virginia has. I don't understand you saying it's going to create a  
8 level playing field and everyone is going to pay the same. You're in direct  
9 conflict with what has just been testified by the participating manufacturers.

10 MR. GELLHORN: I'm suggesting that it was a  
11 misleading aspect, I assume unintentionally, to that statement. Yes, they're  
12 making a payment in of approximately four dollars on all of their cigarettes,  
13 and they get as a consequence all sorts of protections, no immunities, no  
14 liabilities, immunity from lawsuits, et cetera. What we're suggesting here is  
15 they will get a credit under the proposal that we're making for their payments  
16 to the MSA on their sales in Virginia. What we're suggesting is that the very  
17 same amount would put them at a zero change level where under our  
18 proposal the cost to the subsequent participating manufacturers that are  
19 currently protected and grandfathered and pay a lot less as well as the non-  
20 participating manufacturers would be obliged to make the same four-dollars-  
21 per-carton price. And it would be a tax; that's a consequence, it's a tax, it  
22 would be a steady stream to Virginia. It would not be subject to bankruptcy  
23 exception, it could not be voided in bankruptcy and that frankly is a real  
24 threat.

25 SENATOR HAWKINS: One more question.

1                   MR. BRYANT: Was Bailey's allowed to join as an SPM at  
2 the very beginning of the MSA?

3                   MR. GELLHORN: Yes, and they were told what the terms  
4 would be and under the terms they specified to. We're a tiny company,  
5 we're not going to be allowed to promote our product under this scheme,  
6 we'll be frozen in basically to our tiny ship, and they were told that if they  
7 would not become a participant they would pay an escrow amount which  
8 would release that money, the 98 percent to the State of Virginia, and it is  
9 that term of the deal that is being changed unilaterally, contrary to the  
10 statements made by Philip Morris' then attorney, a man by the name of Mr.  
11 Wright, as stated in an affidavit in the Freedom Holding Case. So yes, they  
12 were given a chance, they understood the terms, they accepted those terms,  
13 and now an effort is being made to say we want to change those terms  
14 unilaterally.

15                   SENATOR HAWKINS: Mr. Walker.

16                   MR. WALKER: Mr. Chairman, my concern is how this  
17 proposal would affect this particular Commission. As you know we're  
18 funded through the MSA payments, and I'm wondering how your proposal  
19 would flow money into this Commission so we could continue to help  
20 Southside and Southwest Virginia?

21                   MR. GELLHBORN: First of all you would be getting,  
22 you would continue to get your MSA payments from the OPM and the  
23 subsequent participating manufacturers to the extent that it has been in place.  
24 Those funds would come in. We were proposing that the fifty million  
25 dollars that would be generated be doubled under the Medicaid proposal, but

1 that, obviously, is up to you. You can allocate additional funds for the  
2 Commission. The money that we are proposing in excise tax produces  
3 revenue for Virginia. Note the process the Allocable Share Amendment  
4 being proposed by Philip Morris is producing only for the escrow account  
5 the Commonwealth gets only if there is subsequent liability. Whereas what  
6 we're proposing is an excise tax that raises and is matched by and  
7 produces an additional total of a hundred million dollars for the  
8 Commonwealth.

9 SENATOR HAWKINS: I'm not trying to cut off the  
10 debate, but it's ten minutes to twelve, and we need to be out of here at twelve  
11 o'clock. Can you wrap this up fairly quickly, sir, or not?

12 MR. GELLHORN: Yes. Let me go to two final points.  
13 One is the claim that was just made this produces additional revenue for the  
14 state. It does it on a basis on which each manufacturer would pay the same  
15 amount. It eliminates a dollar sixty tax disadvantage currently suffered  
16 under the Allocable Share Amendment proposal by the non-participating  
17 manufacturers, such as Bailey's. It would protect the revenue to the state  
18 because this would be tax not subject to be voided in bankruptcy, and finally  
19 it would not be subject to legal challenge. The Allocable Share Amendment,  
20 I would suggest to you, is highly vulnerable, and we expect, frankly, some  
21 decisions out of district court saying that this does not pass Constitutional  
22 muster.

23 SENATOR HAWKINS: How does this all tie into the  
24 offshore manufacturing? I go back to that. This discussion has to be  
25 expanded beyond what we're talking about, and we're talking about

1 competition in the market place, and you've got the offshore people that are  
2 coming in with cheaper manufacturing. How does that fit into this?

3 MR. GELLHORN: Our proposal applies equally to the  
4 offshore manufacturer as well as the on-shore manufacturer. Every cigarette  
5 sold in the Commonwealth of Virginia would be subject to the excise tax.

6 SENATOR HAWKINS: But your first comment was that  
7 you could not bankrupt this whole tax situation, but in fact if you're an off-  
8 shore corporation what control do we have over that?

9 MR. GELLHORN: Zero. And the offshore corporation  
10 can of course come into the state, make a sale for the year, disappear and not  
11 make a payment the following year. That's not uncommon, unfortunately,  
12 and it's not limited to offshore producers. Whereas, under the proposal we're  
13 making that excise tax is collected like all other income taxes on a much  
14 more immediate and certain basis.

15 SECRETARY SCHEWEL: Mr. Chairman?

16 SENATOR HAWKINS: Yes, sir. Mr. Secretary.

17 SECRETARY SCHEWEL: Mr. Gellhorn, you said that  
18 the excise tax wouldn't be subject to legal challenge on the tax bill, et cetera.  
19 You're certainly not arguing, are you, that the MSA wouldn't be subject to  
20 legal challenge because of it, you may be saying that you think that's a losing  
21 argument, but you certainly must think, don't you, that it's likely to generate  
22 a challenge to the MSA arising out of these kinds of things?

23 MR. GELLHORN: I don't think there's any legislation  
24 that I could draft today that would be immune from legal challenge.

25 SECRETARY SCHEWEL: Well, you said it wasn't

1 subject to legal challenge, it seems to me you mean immune from?

2 MR. GELLHORN: I don't think it's subject to legal  
3 challenge, because an excise tax, which applies equally, and which provides  
4 credit for existing conditions, is well recognized. Look at the tax laws today.  
5 We have mortgage deductions, mortgage payment deductions. Some people  
6 have a mortgage, others don't. Some get the deductions, others don't. A well-  
7 recognized mechanism of tax revenue, that's all we've done.

8 SENATOR HAWKINS: Mr. Secretary.

9 SECRETARY SCHEWEL: I would argue it's a gross  
10 oversimplification, and so your conclusion is that the Attorney General's  
11 conclusion on this point is wrong?

12 MR. GELLHORN: The Attorney General didn't provide a  
13 legal opinion here. He gave a first-hand view of this, we had discussions  
14 with Mr. Ferguson in his office on it and raised some of the same questions.  
15 We talked about them directly, and we both walked away acknowledging  
16 that there are some issues that can be discussed. I don't read that letter, if  
17 you read all of the letter, it makes a statement at the very end of it that  
18 suggests that this is going to have to be subject to further scrutiny and  
19 evaluation before we can reach a conclusion. So I think it's wordy at this  
20 time.

21 SENATOR HAWKINS: Mr. Secretary.

22 SECRETARY SCHEWEL: One last question, I'm sort of  
23 troubled here in addition by sort of a risk-to-reward ratio. I'm willing to  
24 accept the fact that the question of whether the MSA is applicable is at least  
25 a litigatable issue and one on which there is going to be strong argument on

1 either side. We at least potentially run the risk, if that were abrogated, of  
2 losing all the MSA payments; in exchange we get what you claim are the  
3 benefits of this. Why is that the right risk-to-reward ratio for us to  
4 undertake?

5 MR. GELLHORN: I don't think you have a complete  
6 understanding. First of all, the Master Settlement Agreement itself has been  
7 challenged in the State of Florida's litigation as a violation of the anti-trust  
8 laws and equal protection, and in the Second Circuit, in a major opinion by  
9 Chief Judge Quinn, ruled in connection with a motion to get rid of this case,  
10 saying no, this is a very valid lawsuit. Indeed, he goes so far as to say, but  
11 for the fact that the states joined in this, the various tobacco companies  
12 would have already had the pressing conversations with the U. S.  
13 Department of Justice for violation of the anti-trust. So he says, look, if you  
14 look at MSA Settlement it has serious legal problems. That issue is now in  
15 the process of being addressed, and there will be arguments during the week  
16 of January 17th, next week, in the Second Circuit on that issue. That court  
17 also has said that the Allocable Share Amendment itself is, looks to be in  
18 violation of the federal anti-trust laws, and the district court enjoined it, as  
19 has now one other federal district court judge. I think we're going to see an  
20 avalanche on this. So I would say first of all the MSA itself is not totally  
21 immune from challenge. Second, the Allocable Share Amendment is at a  
22 high rate of risk, third, the excise tax proposal provides, not only provides  
23 additional revenue, but is itself very difficult to challenge.

24 SENATOR HAWKINS: Anybody else?

25 MR. MAYHEW: Mr. Gellhorn, is it true that the SPM's

1 have also entered into agreement early on and thought the SPM's were going  
2 to follow through, would they may be harmed by this tax increase?

3 MR. GELLHORN: Yes. No question about it, and they  
4 may have a claim against the MSA. I don't think they have a claim against  
5 the Commonwealth, for adopting an excise tax, because every one of the  
6 cases has said that a state can go ahead and adopt an excise tax. The only  
7 thing they'd really be complaining about is these other people are getting  
8 more credit for payments they're making to the MSA. But how can the  
9 SPM's be hurt or make any complaint that Virginia won't give them a credit  
10 for a payment that their not making?

11 SENATOR HAWKINS: Delegate Hogan.

12 DELEGATE HOGAN: Mr. Gellhorn, I'd like to just go  
13 back to something that Senator Hawkins asked you about. In terms of  
14 dealing with some of the offshore manufacturers and how they're affected,  
15 my understanding is there's a significant number of the grandfathered SPM's,  
16 people that get a discount on their payments are offshore, and if you were to  
17 pass Allocable Share the effect of that could be that we would be passing a  
18 tremendous price advantage for offshore manufacturers and taking away  
19 from our domestic manufacturers and I think the point that Senator Hawkins  
20 was maybe asking about, and I wondered if you might speak to that.

21 MR. GELLHORN: To the extent to which there are  
22 offshore manufacturers that are grandfathered under the Master Settlement  
23 Agreement, that certainly would apply. Personally, I don't know anything  
24 about the specifics of that. I do know that the two majors, Liggett and  
25 Com -- have primarily U.S manufacturing facilities.

1                   SENATOR HAWKINS: Thank you, sir. I'm not trying to  
2 rush you, but we've got some others. Thank you. We all have a better  
3 understanding and a fuller grasp of the problems, and I'm sure we all have a  
4 solution to this, and I look forward to seeing how this will be done. We  
5 appreciate your time.

6                   DELEGATE WRIGHT: I have one comment.

7                   SENATOR HAWKINS: Yes, sir.

8                   DELEGATE WRIGHT: Earlier you spoke about the  
9 situation in Charlotte County and how it affected them. I want to make it  
10 clear that S & M Brands is located in my home county of Lunenburg and  
11 employs two hundred twenty-five people. We could make the same  
12 comment about Lunenburg and how to replace those jobs if a rush to  
13 judgment is made on this Allocable Share Amendment, so I strongly hope  
14 that we'll take a real strong look at any other options that are risk-free that  
15 are out there.

16                   SENATOR HAWKINS: Well, that's what we're here for, is  
17 to do that. What I would strongly suggest is that although we will not make  
18 a recommendation today, all the participants in this get together and come up  
19 with something that works and we need to get this thing finished.

20                   MR. BRYANT: Mr. Ferguson, I'd like to ask you one  
21 question. Yesterday the question was asked by Delegate Hogan about the  
22 position of the Attorney General, and we heard one answer from a  
23 representative from that office, and we heard you speak about the letter that  
24 we heard today. Is that the official position of the Attorney General? I want  
25 this body to hear that.

1                   MR. FERGUSON: I think the best thing to do is read this  
2 letter, it's very short, it'll take about thirty seconds. As I recall, this letter  
3 was written to Delegate Albro, and copies to Chairman of the Senate and  
4 House Courts Committee.

5                   SENATOR HAWKINS: It will be made part of the record.

6                   MR. FERGUSON: This is a letter dated December 8th,  
7 addressed to Delegate Albro. "Dear Delegate Albro: Currently tobacco  
8 companies known as non-participating manufacturers or NPM's which are  
9 not party to the Master Settlement Agreement, MSA, sometimes obtain their  
10 immediate relief of over 90 percent of their required escrow deposits, which  
11 results in a loss of millions of dollars in MSA payments that would  
12 otherwise flow to the Commonwealth. One way to address and correct this  
13 problem is to enact the Allocable Share Model Legislation that is the  
14 endorsement of the National Association of Attorneys General. The  
15 Association adopted the Allocable Share as a policy position at a meeting  
16 held in Williamsburg in December of 2003. To date forty states out of forty-  
17 six states that are part of the MSA have enacted the Allocable Share  
18 Legislation. Any alternative approach, such as assessment fees against  
19 cigarettes sold in the Commonwealth could lead to legal action that would  
20 threaten the loss of Virginia's annual payments under the MSA. Therefore,  
21 Allocable Share appears to be a viable course for the Commonwealth to  
22 take. Finally, I support and I encourage the General Assembly to enact  
23 legislation that mitigates any adverse economic impact to employers  
24 operating in Virginia as a result of the proposed Allocable Share  
25 Amendment. Very truly yours, Jerry W. Kilgore."

1           To clear up any question I would note that this is not an official  
2 opinion of the Attorney General in the way we view those. This is a letter  
3 expressing the Attorney General's opinion about it, but is not an official  
4 opinion that would have any precedential value in a legal proceeding. I  
5 would take a moment, Mr. Chairman, I think that you heard the advocacy  
6 position of both parties here today. I think that some of the things Secretary  
7 Schewel has said, some of the things that other members have commented  
8 on are accurate. I think that whichever, all advocacy positions there is some  
9 oversimplification. There are statements, I think, from both parties, but I  
10 think that at the end day there is a large loss of MSA payments to the state.  
11 Under the current system, I don't use the term loophole, because like  
12 Delegate Hogan I believe that the statute was written the way it was intended  
13 to be written at the time. We've had consequences that may have been  
14 unforeseen, but I don't believe that is a loophole the way we traditionally  
15 think about it. I would say it is a significant risk of litigation if the proposal  
16 from the NPM's goes forward. But I think there's also significant risk of  
17 litigation if the Allocable Share passes. I think we would likely face  
18 litigation if any change if any change is made whatsoever. I would not stand  
19 here and predict the outcome of any of that litigation. Just to clarify one  
20 point on that, though, I would say that the MSA itself, while it is subject to  
21 challenge in New York, it has been challenged in the Fourth Circuit here in  
22 Virginia and the escrow statute itself, not the Allocable Share Amendment,  
23 both have been subject to challenge in federal courts here in Virginia and in  
24 the Fourth Circuit, and it has withstood those challenges.

25                           SENATOR HAWKINS: Thank you, sir. One final

1 question.

2 DELEGATE HOGAN: I think the point that you made at  
3 the end is maybe worth focusing on. I think we've been sued, we're being  
4 sued now under the existing law, so if you make the Allocable Share change  
5 we're going to get sued, if you make this other change we're going to get  
6 sued. So would you agree with the statement, or maybe comment on the  
7 statement, that the notion that these proposals are not legitimate because the  
8 State of Virginia is going to get sued would apply equally to every single one  
9 of them?

10 MR. FERGUSON: Well, I don't want to go quite that far,  
11 because I think it probably would handicap the likelihood of success of a  
12 particular legal challenge is something any lawyer who values his license  
13 wouldn't do. What I would say is this. I think that, the reason I say I'm  
14 confident we would have potential litigations is because I have been told that  
15 by both parties, not just both parties, there are multiple parties involved.  
16 SPM's haven't really spoken directly, heard by deposition. But there are  
17 more than just two, at least three, four or five. What I'm trying to do is give  
18 you an objective comment about things without, hyperbole, without the  
19 advocacy role and without trying to necessarily persuade you one way or the  
20 other at this point. What I'm trying to say is I think there is a risk of  
21 litigation in any event. I think there are claims to be made probably in any  
22 of that litigation. I can't tell you that any one of them would prevail.  
23 Certainly our office would be in a position of defending whatever change  
24 might be made. I think there are strong defenses for any of the changes that  
25 might be made. Understand also, though, that the issue of whether or not the

1 MSA might be subject to attack is somewhat separate from the issue of  
2 whether or not a tax itself is legitimate. The tax may be perfectly legally  
3 okay, but that still may give a basis, arguably, as refers to Philip Morris for  
4 attacking or claiming that the MSA has been abrogated. So again it's not  
5 just one legal issue, it's just not a matter of whether or not a bill that is  
6 passed is constitutional or not. It could be constitutional but have  
7 repercussions beyond that.

8                   SENATOR HAWKINS: Thank you, that's one of the  
9 advantages that Virginia has, we have some of the finest law schools in the  
10 country. Any other comments? Anyone from the audience like to make  
11 some comments? Going once?

12                   Yes, sir. Would you mind identifying yourself for the record?

13                   MR. LEVIN: My name is Peter Levin, and I'm with the  
14 National Association of Attorneys General. I know the time is late and, Mr.  
15 Chairman and members of the Commission, I just wanted to make a point or  
16 two, if I could. One is that we've heard, because we've heard that the state,  
17 as I heard it, has a deal with S&M Brands that they shouldn't renege on. I'm  
18 not aware of any deal between any state and S&M Brands. I am aware that  
19 there is a written agreement with participating manufacturers, subsequent  
20 participating manufacturers, and as you've heard the proposal for this tax  
21 certainly does engender a potential risk to the Master Settlement Agreement.

22                   You've also asked about offshore manufacturing, and if the status  
23 quo continues then there is no question the rise in the NPM market has been  
24 largely foreign manufacturers, and Virginia will be simply a magnet for  
25 foreign manufacturers who want to take advantage of basically the Allocable

1 Share release as originally enacted and that will mean you've got cigarettes  
2 coming in not subject to the public health provisions, not subject to full  
3 escrow payments, and that are most attractive to your youngest smokers, the  
4 youth, and that seems to me to be a point that has not been addressed. Thank  
5 you.

6 SENATOR HAWKINS: Thank you. As I said, this is  
7 something that will be an ongoing conversation for the next few days, and I  
8 look forward to that. Any further comments?

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10 PROCEEDINGS CONCLUDED.

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