X C A L I B E R
INTERNATIONAL LTD., LLC.

Eric Barkley Estes
General Counsel

Direct Dial: (918) 824-6641
Email: e.estes@xcaliberinternational.com

February 13, 2023

HOUSE COMMITTEE ON JUDICIARY
Oregon State Capitol
900 Court Street, N.E.
Salem, Oregon 97301

Re: House Bill 2128

Dear Madam Chair and Representatives:

On behalf of Xcaliber International, Ltd., L.L.C. ("Xcaliber"), I wish to thank the House Committee on Judiciary for the opportunity to submit written testimony in opposition to House Bill 2128 ("legislation" or "bill"). Xcaliber, an Oklahoma Limited Liability Company, manufactures cigarettes and other tobacco products as a Non-Participating Manufacturer ("NPM") under the terms of the 1998 tobacco Master Settlement Agreement ("MSA").

By this letter, I intend to address the following issues: (1) the structure of the bill, (2) background related to the MSA, to which the bill relates, (3) the comparative and disparate treatment between various types of tobacco product manufacturers permitted by the bill, (4) whether the proposed legislation effectuates a tax on a subset of tobacco product manufacturers, (5) the stated legislative justifications for the bill, and (6) the adverse effects that the bill could have on ongoing MSA payment disputes involving the State.

1. THE BILL COMPLETELY UPENDS THE REGULATORY STRUCTURE UNDER WHICH XCALIBER AND OTHER NPMs OPERATE.

The vast majority of NPMs, including Xcaliber, commenced business after the execution of the MSA in 1998. As such, the companies committed none of the tortious activities that brought about the need for the agreement. The companies have, nonetheless, been regulated by Oregon and other Settling States pursuant to the terms of the MSA and legislation passed pursuant thereto. Per the terms of Model Escrow Statute, one such piece of legislation, NPMs deposit sums into a qualified escrow account for sales in Oregon during the preceding year. OR. REV. STAT. § 323.806(1)(b)(A). Under the terms of the existing law, those moneys are held for a period of 25 years. OR. REV. STAT. § 323.806(1)(b)(B)(iii). In the interim period, the NPMs are permitted to obtain and use the interest on the escrowed funds. OR. REV. STAT. § 323.806(1)(b)(B). The escrowed funds may only be obtained by the State through legal processes to satisfy certain health-related claims relating to an NPM's conduct. OR. REV. STAT. § 323.806(1)(b)(B)(i). To date, no such claims have been made.

Under the terms of the legislation being considered by the Oregon Legislature, however, beginning in 2023, NPMs operating in Oregon would no longer deposit funds into escrow. Instead, the legislation would require those companies to pay the State an amount, in the form of a new tax, that is ostensibly equivalent to the current escrow obligation.[1] In other words, the money would no longer be deposited into escrow, would no longer generate interest to be used by NPMs to offset business expenses, and the companies would no longer have the right to obtain a release of the escrowed funds after a 25-year period. The new obligations would amount to a tax imposed only on NPMs, as the Participating Manufacturers ("PMs"), those that committed the tortious activities that brought about the MSA, remain unaffected by the legislation.

Even more problematically, the legislation would also require NPMs, such as Xcaliber, to forfeit funds deposited into escrow since 1999. Under current law, these funds belong to NPMs. By this legislation, however, the funds would be taken by the State without any due process and by legislative fiat. As of August 2016, the last date on which publicly available information could be found related to sales in Oregon by NPMs, approximately "39 NPMs have deposited $15.6 million into escrow for the benefit of Oregon." LEGISLATIVE FISCAL OFFICE, BUDGET INFORMATION REPORT: TOBACCO MASTER SETTLEMENT AGREEMENT 2 (2016).[2] Undoubtedly, that number has only increased since that time. Xcaliber asserts that the forfeiture of millions of dollars of funds previously deposited by it and other NPMs would violate the takings and contract clauses of both the Constitutions of the United States and Oregon.

2. NPMs, SUCH AS XCALIBER, COMMITTED NONE OF THE ACTS AND PRACTICES THAT BROUGHT ABOUT THE NEED FOR THE 1998 TOBACCO MASTER SETTLEMENT AGREEMENT.

As outlined by Oregon's Legislative Fiscal Office, "[t]he MSA settled state claims against the [PMs under the MSA] to recover state healthcare costs associated with treating smoking-related illnesses and settled all unlawful trade practices, antitrust, consumer protection, common law, and other relief alleged by the Settling States." LEGISLATIVE FISCAL OFFICE, BUDGET INFORMATION REPORT: TOBACCO MASTER SETTLEMENT

---

[1] As outlined more fully *supra*, both the requirement for a tax payment and the amount of that payment are constitutionally suspect. The Model Escrow Statute, including OR. REV. STAT. § 323.800, *et seq.*, has been justified by policymakers and upheld by courts on two fundamental premises: (1) no money is taken from the NPM; it remains the NPM's property in an interest-bearing account; and (2) the statute is designed to ensure that NPMs pay no more than Participating Manufacturers ("PMs"). By mandating a tax payment to the state in lieu of escrow, the first of these justifications is eliminated. Indeed, the PMs were sued in the courts and had the opportunity to contest and eventually settle those claims made against them. In contrast, NPMs would be found guilty by legislative fiat and deprived of fundamental due process rights. As drafted, the second justification for the Model Escrow Statute would also be eliminated by the bill. NPMs would be able to contest payment amounts within only a yearlong period. PMs, on the other hand, can withhold payments under dispute and obtain credits for years after their deposit. The one-year cutoff for NPM refund claims guarantees that NPMs would pay more than their larger competitors that brought about the need for the MSA. In addition, many PMs have substantial payment exemptions, meaning that they would also pay less to the State than their NPM competitors. Simply stated, these payment exemptions are not afforded to the NPMs either by the terms of the MSA or the legislation. Additional constitutional issues also exist under the proposed legislation.

[2] A copy of this document is attached as Attachment 1.

AGREEMENT 1 (2016). The bad acts that brought about both the litigation against the PMs and the MSA were numerous. For instance, PM advertisements were littered with false health claims. The PMs asserted the following within their media campaigns: "More doctors smoke Camels than any other cigarette," "20,679 physicians say Luckies are less irritating," "As your dentist, I would recommend Viceroys," and "Chesterfield is best for you." Perhaps most egregiously, another advertisement boldly stated: "Chesterfield cigarettes are just as pure as the water you drink." Other print advertisements used celebrity endorsements from such people as Ronald Reagan, Lucille Ball, Monte Irvin, Willie Mays, and even Santa Claus. Advertisements further targeted mothers, women, and African Americans. Another harmful subset of advertisements took the form of cartoons, including the figure of Joe Camel, that were undoubtedly intended to lure children and teens into smoking specific cigarette brands.[3]

The acts and practices in which the PMs engaged were also intended to convince the American public that cigarette smoking was not injurious to health and that nicotine was non-addictive. For instance, in 1954, certain PMs took out advertisements in newspapers throughout the United States to specifically cast doubt on scientific studies linking smoking to cancer and other dangerous health effects. In the advertisement, titled "A Frank Statement to Cigarette Smokers," the companies asserted, "[w]e believe the products we make are not injurious to health."[4] These false statements did not end in the 1950s; they continued well into the 1990s. In 1994, a number of tobacco executives testified before the United States Congress. In their testimony, the executives argued, almost mimicking each other's statements word-for-word, that nicotine was a non-addictive substance. Asked pointblank whether the products manufactured by his company were addictive, one executive stated, "I do not believe that nicotine or our products are addictive." UNIVERSITY OF CALIFORNIA SAN FRANCISCO: TOBACCO CEOS STATEMENT TO CONGRESS 1994 NEWS CLIP "NICOTINE IS NOT ADDICTIVE" 2 (1994).[5]

While these acts were bad enough, documents later recovered from the PMs showed that their marketing was intended to attract and addict youth smokers. As outlined by the Campaign for Tobacco-Free Kids, these documents disclosed the following statements:

1975 Marlboro's phenomenal growth rate in the past has been attributable in large part to our high market penetration among young smokers ... 15 to 19 years old ... my own data, which includes younger teenagers, shows even high Marlboro penetration amount 15-17 year-olds.

1981 Because of our high share of market among the youngest smokers, Philip Morris will suffer more than other companies from the decline in the number of teenage smokers.

1981 [T]he success of Marlboro Red during its most rapid growth period was because it became the brand of choice among teenagers who then stuck with it as they grew older.

---

[3] A sampling of these advertisements by the PMs are attached as Attachment 2. One the advertisements boasts the use of a micronite filter. The filters contained asbestos.

[4] A copy of this document is attached as Attachment 3.

[5] A copy of this document is attached as Attachment 4.

1985 [Marlboro must] continue growth among new, young smokers ... While Marlboro continues to attract increasing shares of young smokers, expected declines in the number of young people restrict future volume gains from this source.

1992 Thus, the ability to attract new smokers and develop them into a young adult franchise is key to brand development.

CAMPAIGN FOR TOBACCO FREE KIDS: PHILIP MORRIS: A LONG HISTORY OF DOUBLE TALK 2 (2006).[6]

In contrast, there is no evidence that Xcaliber, which started business in 2001, three years after the MSA, committed any of these acts and practices. The same is true of the other NPMs targeted by the legislation at hand. Xcaliber's advertisements include no health claims, have no celebrity endorsements, do not target specific demographics, and certainly are not in cartoon form with the intent to reach children. Rather, the advertisements, which take the form of point-of-sale signage, have the name of the various cigarette products manufactured by the company, a price, and the U.S. Surgeon General's Warning, which informs the smoking public of the harms associated with the products.[7]

3. THE PMs, DESPITE THEIR LONG HISTORY OF BAD ACTS AND PRACTICES, RECEIVE FAR MORE FAVORABLE TREATMENT THAN PROVIDED TO NON-OFFENDING NPMs UNDER THE BILL.

Despite their long history of bad acts and practices, the MSA and the proposed legislation afford the PMs disproportionate legal protections as compared to NPMs. Examples are as follows:

- PMs were sued in court and given the opportunity to litigate the claims made against them by Oregon and the other Settling States. This constitutes due process within the meaning of the law. To end that litigation, the PMs were able to negotiate the MSA with the Settling States and craft a settlement that permitted them to remain viable, ongoing entities. In contrast, legislative protections within OR. REV. STAT. § 323.806(1)(b)(B)(i) that were intended to provide NPMs with due process if they committed acts and practices leading to legal liability are eliminated by the legislation. Instead, by mere legislative fiat, NPMs would be deemed legally liable for potential harm and a tax would be imposed against them alone.

- Pursuant to § IX(c) of the MSA, PMs are permitted to make their MSA payments on an annual basis. This gives the companies the use of their monies through the year, including the right and ability to invest and make money from funds that will ultimately be paid to the State. In contrast, NPMs are expected by the legislation to make their tax payments on a quarterly basis, depriving them of the use of the funds over a longer period. Further, unlike the PMs, NPMs are expected to secure a bond to assure that necessary tax payments are made. This is done even though

[6] A copy of this document is attached at Attachment 5.

[7] A sample point-of-sale advertisement by Xcaliber is attached as Attachment 6.

MSA payments from the PMs dwarf the financial obligations of NPMs in terms of payment amounts.

- Pursuant to § XI(c) of the MSA, PMs are given an almost infinite period of time to dispute their payment obligations to the Settling States. In contrast, under the legislation proposed by the Attorney General, NPMs would be given only one year to dispute payments. In some cases, this would completely deny NPMs of a remedy, as certain payment disputes occur outside of this one-year limitation.

- Pursuant to § IX(h) of the MSA, if a PM refuses to make a payment due to the Settling States, such payment only accrues interest until paid. In the interim period, the PMs may continue to sell their product, without interruption. In contrast, if an NPM were to fail to make a tax payment under the legislation, the NPM would be fined under the legislation in an amount not to exceed 100% of the amount owed. In the case of a knowing violation, that amount would increase to 300% of the amount owed. Further, the brands manufactured by the NPM would be removed from the list of approved cigarette products maintained by the Attorney General, meaning that the products would be contraband, subject to seizure.

- Pursuant to § VII of the MSA, any disputes between PMs and the Settling States are to be adjudicated by either courts of competent jurisdiction or an arbitration panel. In contrast, the bill provides no forum for the adjudication of payment-related disputes by NPMs, and instead permits the Attorney General, with whom the dispute would relate, the sole ability to resolve the matter.

- Pursuant to § XII of the MSA, the PMs secured a liability release for all past, current, and future legal claims that could be made against them by the Settling States. In contrast, the legislation before this Committee provides no liability release to NPMs, despite the fact that it seeks to permanently secure funds for the State. In fact, the bill states that nothing within the measure is intended to "[w]aive the right of the state to bring a claim against a tobacco product manufacturer, except that any funds paid to the state ... shall be credited on a dollar-for-dollar basis against any such judgment or settlement."

All of these protections, per the explicit terms of the MSA, are intended to "effectively and fully neutralize[] the cost disadvantages that the [PMs] experience vis-à-vis [NPMs]." 1998 TOBACCO MASTER SETTLEMENT AGREEMENT, § IX(d)(2)(E). In other words, the measures adopted by the Model Escrow Statutes – and by extension the legislation under consideration – are intended to protect the market share of the PMs whose own acts and practices brought about the need for the MSA. Not only does this constitute a gross miscarriage of justice, it also raises a number of due process and equal protection violations that will undoubtedly result in litigation against the State.

4. THE LEGISLATION IS A TAX (AGAINST NPMs ALONE) WHICH REQUIRES A THREE-FIFTHS MAJORITY VOTE OF BOTH CHAMBERS OF THE OREGON LEGISLATURE.

The legislation at issue is a tax requiring a three-fifths majority vote by both chambers of the Oregon Legislature. *See* OR. CONST., ART. IV, §§ 18, 25. As outlined within the bill, "[a]mounts recovered under this section shall be deposited in the Tobacco Settlement Funds Account established under ORS 293.57." The Tobacco Settlement Funds Account, in turn, is "an account in [Oregon's] General Fund." OR. REV. STAT. § 293.537(1). Put more simply, the payments collected from NPMs would be in the form of a tax that would be deposited within the General Fund of the State, from which the Legislature is free to draw, and historically has drawn, as it sees fit. As outlined more fully *infra*, NPMs receive nothing in exchange for this tax payment and certainly none of the protections afforded to PMs under the MSA. To further complicate matters, the tax imposed by the bill is imposed on a specific subset of tobacco product manufacturers, *to wit:* NPMs alone. This disparate tax treatment between PMs and NPMs provides additional grounds for a constitutional challenge against the State.

5. THE BILL FAILS TO ADVANCE THE GOALS OUTLINED WITHIN THE PREAMBLE TO THE LEGISLATION.

In its preamble, the legislation sets forth several justifications for the tax measure to be imposed on NPMs. Upon review, however, the bill fails to advance the stated goals in any significant way.

First, the bill asserts the State's "public health obligations" are owed to all persons, "regardless of the brand of cigarette smoked or the status of the tobacco product manufacturer under the [MSA]." Despite this lofty goal, not all tobacco manufacturers would actually be required to make full payment, whether in the form of an MSA payment or a tax under the legislation, to the State. The MSA, by design, allowed for different types of PMs: the Original Participating Manufacturers that signed the MSA at the time of its execution and Subsequent Participating Manufacturers ("SPMs") that signed the agreement after its execution. Of those SPMs, a subset is neither required to make payment on its full sales by the MSA nor, perhaps most notably, by the terms of the legislation under consideration. Under the MSA, SPMs that signed the settlement within a certain amount of time are not obligated to make payment to the Settling States unless their market share "exceeds the greater of (1) its 1998 market share or (2) 125 percent of its 1997 market share." 1998 TOBACCO MASTER SETTLEMENT AGREEMENT, § IX(i). This permits the so-called "grandfathered SPMs" to avoid payment on a portion of their sales. The bill does not correct this market share advantage, despite its goal of wanting all manufacturers, regardless of status, to pay for the alleged harm caused to the State and its citizens. Rather, grandfathered SPMs would continue to avoid full payment to Oregon, thereby rendering the goal of making all manufacturers pay a falsity.

Further, the bill states that the legislation is required to "[p]revent the manufacturers from deriving large, short-term profits and then becoming judgment-proof." Somewhat ironically, this same justification was also used for the passage of the Model Escrow Statute, codified as OR. REV. STAT. §§ 323.800, *et seq.* As originally passed

(and still in operative effect), the language of the Model Escrow Statute passed by the Oregon Legislature stated:

> It would be contrary to the policy of the State of Oregon if those tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive short-term profits in the years before liability may arise without ensuring that this state will have an eventual source of recovery from them if they are proven to have acted culpably. It is thus in the interests of the State of Oregon to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from *deriving large, short-term profits and becoming judgment proof* before liability may arise.

OR. REV. STAT. § 323.803(6) (emphasis added). By requiring NPMs to deposit monies that may later serve as a source for judicially contemplated judgments or settlements by Oregon, NPMs have, per the legislative policy of the State, been prevented from "deriving large, short-term profits and then becoming judgment proof." Nothing within the current bill changes that. The tax obligations contemplated by the legislation does not change the sum owed by NPMs; the measure only converts the escrow obligation to a tax obligation, which the Legislature is free to spend for purposes *other* than satisfying future judgments contemplated in the statute above. The State has already assured that NPMs cannot enter and exit the market without incurring costs.

Finally, the legislation asserts that the measures contained therein would prevent youth access to tobacco. If that is indeed the goal, the State should target the PMs, rather than the NPMs. As outlined by the Centers for Disease Control and Prevention ("CDC") as recently as 2018, youth do not smoke brands manufactured by NPMs. Rather, "the top three brands usually smoked among cigarette smokers in all middle school grades combined were Marlboro (38.3%), Newport (21.4%), and Camel (13.4%)." CENTERS FOR DISEASE CONTROL AND PREVENTION: CIGARETTE BRAND PREFERENCE AND PRO-TOBACCO ADVERTISING AMONG MIDDLE AND HIGH SCHOOL STUDENTS – UNITED STATES, 2012-2016 2 (2018).[8] The CDC more fully outlined the remaining cigarette brands used by youth in subsequent publications. In order, these were Pall Mall, Maverick, Santa Fe, Winston, and Kool. CENTERS FOR DISEASE CONTROL AND PREVENTION: TOBACCO BRAND PREFERENCES 1 (2021).[9] All of these brands are manufactured by PMs. The proposed bill does nothing to correct youth initiation of NPM brands, as the evidence establishes that there is none. Further, statistics maintained by State also indicate that the legislation is a remedy in search of a problem. As of 2020, only a small fraction of youth used any type of cigarette product at all, regardless of manufacturer. Those numbers equated to 0.4% of sixth graders, 1.2% of eighth graders, and 2.9% of eleventh graders. OREGON HEALTH AUTHORITY: TOBACCO PREVENTION 13 (2021).[10] The far more prevalent tobacco product by use was e-cigarettes, at 1.7%, 5.1%, and 11.9% respectively. *Id.* These statistics – produced by Oregon – degrade an already weak argument that youth somehow initiate smoking on NPM products. If the Attorney General and Oregon Legislature truly want to

[8] A copy of this document is attached at Attachment 7.
[9] A copy of this document is attached at Attachment 8.
[10] A copy of this document is attached at Attachment 9.

better outcomes for youth, they should focus their efforts on the products that youth actually use.

6. THE PASSAGE OF THE BILL MAY ADVERSELY IMPACT ONGOING PAYMENT DISPUTES INVOLVING THE STATE.

One of the largest downward adjustments to annual MSA payments received by the Settling States, including Oregon, is the so-called "NPM Adjustment." A Settling State, however, can avoid this adjustment if it "continuously had a Qualifying Statute ... in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of the statute during such entire calendar year[.]" 1998 TOBACCO MASTER SETTLEMENT AGREEMENT, § IX(d)(2). The Model Escrow Statute, passed by the Oregon Legislature as OR. REV. STAT. §§ 323.800, *et seq.*, is considered a "Qualifying Statute" only "if enacted without modification or addition (except for particularized state procedural or technical requirements) ...." *Id.* at § IX(d)(2)(E). Needless to say, the amendments to the Model Escrow Statute are substantial and would undoubtedly constitute a "modification or addition" within the meaning of the MSA. This would negatively impair tens of millions of dollars received by the State each year from the PMs.

While the PMs could undoubtedly waive this term of the MSA and allow the bill, as drafted, to continue to serve as a "Qualifying Statute" within the meaning of the MSA, such a development would be quite troublesome. *First,* it would mean that the Attorney General discussed the terms of the legislation with the PMs prior to filing, while affording NPMs no such review or consideration. *Further*, it would mean that the PMs believed that they were receiving something of value within the bill, which is undoubtedly the case. By this bill, the PMs would be assuring the market share advantage contemplated within § IX(d)(2)(E) of the MSA vis-à-vis NPMs continues well into the future. Indeed, the legislation would require NPMs to pay the State an amount, in the form of a new tax, that is ostensibly equivalent to the current escrow obligation. Monies from the NPMs would no longer be deposited into escrow, would no longer generate interest to be used by NPMs to offset business expenses, and the companies would no longer have the right to obtain a release of the escrowed funds after a 25-year period, as the funds would no longer be deposited into escrow, as currently contemplated under the Oregon law being amended.

Based on the foregoing, it is the belief of Xcaliber that this legislation serves a single purpose: to support larger PMs at the expense of smaller NPMs. Xcaliber has steadfastly satisfied all escrow obligations imposed by Oregon and other Settling States. Now that it has survived the system intended to impede its success, the State apparently wants to change the game and further protect the market share of those companies that brought about the need for the MSA and the statutes passed in contemplation thereof.

If you have any questions, or need anything further, please do not hesitate to contact me.

Warmest Regards,

Eric B. Estes
General Counsel

attachments