

X C A L I B E R

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KANSAS STATE SENATE
300 Southwest 10th Street
Topeka, Kansas 66612

Re: SB 273

Dear Senator:

Xcaliber International, Ltd., L.L.C. (“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”). This letter is written to voice opposition to SB 273 (“legislation” or “bill”), both in terms of the manner in which the legislation has thus far been heard and in the underlying content of the bill.

By way of background, 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 Kansas 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 Kansas during the preceding year. Under the terms of the existing law, those moneys are held for a period of 25 years. KAN. STAT. ANN. § 50-6a03(b)(2)(C). In the interim period, the NPMs are permitted to obtain and use the interest on the escrowed funds. KAN. STAT. ANN. § 50-6a03(b)(2). 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. KAN. STAT. ANN. § 50-6a03(b)(2)(A). To date, no such claims have been made.

Under the terms of the legislation being considered by the Kansas Legislature, however, beginning in 2022, NPMs operating in Kansas would no longer deposit funds into escrow. Instead, the legislation would require those companies to pay the State an amount that is ostensibly equivalent to the current escrow obligation.¹ In other words, the

¹ Both the requirement for a tax payment and the amount of that payment are constitutionally suspect. The Model Escrow Statute, including KAN. STAT. ANN. §§ 50-6a01, *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

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.

The manner in which the legislation has, at least to date, been heard by the Kansas Legislature has prevented Xcaliber and all other NPMs operating in the State from being able to speak with legislators about the issues raised in the bill and has further eliminated the ability of the companies to voice their concerns to elected officials by participating in the hearing process. In its March 25, 2021 written testimony, the Office of the Kansas Attorney General (“Attorney General”) candidly admitted that the bill was the product of “several years of discussions among many parties, including the Office of the Attorney General, other states, and participating manufacturers.” Notably absent from the list of those involved in the discussions that lead to the bill and the legislative language are those that are most directly impacted by the legislation: NPMs. Without being provided with a voice in the legislative process, the views of the NPMs will again be avoided. Simply stated, this is not good public policy, is an abuse of the legislative process, and will undoubtedly lead to litigation. With this in mind, the request in this letter is simple: Xcaliber respectfully requests the opportunity for legislative hearings so that it and other NPMs can educate the Kansas Legislature on issues related to MSA, diligent enforcement, the potential for settlement pursuant to the terms of the MSA, and the effects of the proposed legislation on small business interests.

The written testimony submitted by the Attorney General highlighted three distinct issues. Xcaliber disagrees with the enumerated “benefits” of the legislation, as outlined by the Attorney General. Each of these issues are addressed below.

First, the bill is not needed to improve the ability of Kansas to diligently enforce the obligations of NPMs. Through legislation passed by the Kansas Legislature, the ability of the Attorney General to diligently enforce against NPMs and avoid MSA payment disputes and payment offsets is already in place. In 2017, Kansas entered into an NPM Adjustment Settlement Agreement (“Settlement Agreement”) with the PMs and other states.² The document was predated by a Term Sheet from approximately 2012, which effectively settled diligent enforcement disputes for all years up to that point.³ Taken together, the settlement documents provide a roadmap for the avoidance of diligent enforcement disputes of the type discussed by the Attorney General. As outlined in IX.C.

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. Other constitutional issues, not addressed by this letter, also exist.

² The NPM Adjustment Settlement Agreement is publicly available and may be found at the following Internet link: <https://oag.ca.gov/sites/all/files/agweb/pdfs/tobacco/npm-adjustment-settlement-agreement.pdf>

³ The Term Sheet is publicly available and may be found at the following Internet link: https://oag.ca.gov/sites/all/files/agweb/pdfs/tobacco/term_sheet.pdf

of the Settlement Agreement, Kansas was required to have in place three pieces of legislation in order to take advantage of the settlement's benefits: (1) the Model Escrow Statute, (2) so-called "Complementary Legislation," and (3) the Allocable Share Repealer. Kansas has each of these legislative requirements in place, and has for over a decade. See *generally* KAN. STAT. ANN. §§ 50-6a01, *et seq.* Section IX.G. of the Settlement Agreement provided additional legislative means to avoid diligent enforcement liability, including: (1) a bonding requirement imposed on NPMs as a condition to being listed on an Approved-for-Sale directory in amount equal to the greater of the highest escrow liability deposited by the NPM in the prior 12-month period or \$25,000.00 and (2) a requirement that the importer of NPM products be jointly-and-severally liable for escrow on NPM products that they import. Notably, Kansas also has these legislative provisions in effect. See *generally* KAN. STAT. ANN. §§ 50-6a04(c)(3)(I) and 50-6a09(b). Despite assertions otherwise, nothing in the Settlement Agreement outlines a requirement that Kansas convert NPM escrow obligation into a tax payment obligation.

Second, the measure will not encourage settlement by NPMs. Simply stated, every NPM that has attempted settlement under the terms of the MSA has gone out of business due to the draconian terms imposed on them. For instance, in 2010, General Tobacco, formerly Vibo Corporation, went out of business because it was unable to meet its current MSA payment obligations and make so-called "backpayments" on all sales prior to becoming a PM, as required by § II(jj) of the MSA.⁴ Prior to joining the MSA in 2004, General Tobacco had been the sixth-largest tobacco product manufacturer in the United States.⁵ Further, in 2018, Xcaliber made a MSA settlement offer to Kansas and the other Settling States, the terms of which would have permitted both MSA settlement, ongoing payments to the Settling States, and the continued viability of the company. The settlement proposal did not even garner a response from those to which it was made. This leads the company to believe that the only MSA settlement that Kansas and others wish to entertain are those that would lead to the elimination of NPMs from the marketplace.

Next, despite assertions otherwise, it is completely unknown whether the legislation would generate revenue for Kansas due to the conversion from escrow into a tax. The fiscal impact statement accompanying the bill makes clear that "it is difficult to predict the fiscal effect of enactment of the bill, as some NPMs may choose to cease doing business in Kansas as a result." Additional annual revenue of \$9,000,000.00 is, therefore, speculative, at best. Further, the fiscal note fails to address the amount of anticipated litigation costs that the State would incur in defending the legislation.

The legislation is also deficient in other respects. For instance, some of the information contained in the stated purposes of the legislation is misleading. One stated purpose of the legislation, embodied within the bill's language, is that the measure will reduce "smoking rates, particularly among youth, consistent with the state's policy of discouraging underage smoking." A Kansas Youth Tobacco Survey unsurprisingly states that "[t]he three most heavily advertised cigarette brands continue to be the preferred brands of cigarettes smoked by youth. Camel, Marlboro, and Newport account for 71% of

⁴ David Kesmodel, *General Tobacco Plans to Shut Down*, WALL ST. J. (Sept. 3, 2010).

⁵ *Id.*

reported brand preferences by current Kansas high school smokers.”⁶ Each of the three cited brands is manufactured by a PM. Xcaliber, like most NPMs, does not advertise in media. Youth smoking is most often about status, not price.

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. This belief is supported by both the testimony submitted by the Attorney General and the very terms of the MSA. In its written testimony, the Attorney General stated that “escrow payments made by NPMs in the early years of the MSA will soon begin ‘rolling out’ escrow after 25 years and will be returned to the NPMs.” The State, on behalf of the PMs, is concerned that, with that money, NPMs will be able to build market share, taking it from the PMs. Although the PMs brought about the need for the MSA through their tortious activities, and the NPMs committed none of these acts, mostly coming into existence after the document was executed, the State, nonetheless, the legislation unfairly targets NPMs for the benefit of the much larger PMs. This assertion is buttressed by the very text of the MSA, which provides that a qualifying escrow statute, *i.e.*, the Model Escrow Statute, is one “that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers ... as a result of this Agreement.” *Master Settlement Agreement*, § IX(d)(2)(E). Xcaliber has steadfastly satisfied all escrow obligations imposed by Kansas and the other Settling States. Now that it has survived the system intended to impede its success, the State apparently wants to change the game.

Once again, Xcaliber respectfully requests that the legislation be the subject of legislative hearings and that the NPMs be given the opportunity to discuss the bill both publicly and individually with members of the Kansas Legislature.

Warmest Regards,



Eric B. Estes
General Counsel

⁶ The Kansas Youth Tobacco Survey is publicly available and may be found at the following Internet link: https://www.kdheks.gov/tobacco/download/YTS2010_FactSheet.pdf These trends are also reflected in national studies. *See, e.g.*, CENTERS FOR DISEASE CONTROL AND PREVENTION, CIGARETTE BRAND PREFERENCE AND PRO-TOBACCO ADVERTISING AMONG MIDDLE AND HIGH SCHOOL STUDENTS (2018). A copy of this report may be found at the following Internet link: <https://www.cdc.gov/mmwr/volumes/67/wr/mm6704a3.htm> The report confirms that Marlboro, Newport, and Camel are the most popular cigarette brands among youth, at 48.8%, 16.6%, and 13.3%, respectively. Other brands making the list included American Spirit, GPC, Basic, Doral, Kool, Lucky Strike, Parliament, and Virginia Slims, none of which are manufactured by NPMs.