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IN THE PROCEEDINGS BEFORE THE ARBITRATION PANEL CONCERNING THE 2005 TO 2007 NPM ADJUSTMENT PURSUANT TO SECTION XI(c) OF THE MASTER SETTLEMENT AGREEMENT

COMMON CASE FINDINGS, STATE-SPECIFIC FINDINGS FOR THE STATE OF MARYLAND, AND INTERIM AWARD FOR THE STATE OF MARYLAND

These arbitration proceedings, known as the 2005-2007 NPM Adjustment Proceedings, arise pursuant to the 1998 Master Settlement Agreement ("MSA") executed by forty-six states[1], the District of Columbia, and five U.S. territories to settle years of litigation with four major U.S. tobacco companies to recover healthcare costs associated with the treatment of tobacco-related illnesses. Common Case Hearing Transcript (hereinafter "CCH Tr.") at 215:18-23; *see generally* Common Case Hearing Exhibit (hereinafter "CCH Ex.") 2, MSA. In exchange for the release of past and future claims by the settling States, the MSA, among other things, imposed on the signatory tobacco companies (referred to as the "Original Participating Manufacturers" or "OPMs") the obligation to make annual payments totaling billions of dollars in perpetuity to the States and Territories based upon the quantity of tobacco cigarettes and roll-your-own ("RYO") tobacco sold in each state by the settling tobacco companies. CCH Tr. at 215:3-11, 219:4-16; CCH Ex. 2, MSA § IX(c)(1).

Since the execution of the MSA, more than fifty other tobacco companies have joined the MSA. These later-joining companies are the "Subsequent Participating Manufacturers" or

[1] The States of Florida, Minnesota, Mississippi, and Texas have separate settlement agreements with the PMs and are not parties to the MSA. These four states are commonly referred to as the "Previously Settled States." CCHT at 216:5-12.

"SPMs." CCH Tr. at 219:21-25. Together, the OPMs and SPMs are referred to as the "Participating Manufacturers" or "PMs." CCH Tr. at 220:11-15. Under the MSA, the PMs' make Annual Payments in April of each year. CCH Ex. 2, MSA § IX (c)(1). The Annual Payments are not static; they are subject to an Inflation Adjustment, a Volume Adjustment, a Previously Settled States Reduction, a Non-Settling States Reduction, and an NPM Reduction. CCH Ex. 2, MSA § IX (c)(1).

The PMs do not remit payments directly to the individual States. Instead, they make payments into an escrow account administered by an Independent Auditor. CCH Ex. 2, MSA § IX (a). Under Section XI of the MSA, the Independent Auditor calculates the various adjustments, including the "NPM Adjustment," and determines the Annual Payments to be distributed to the various States. CCH Ex. 2, MSA § XI (a)(1). In accord with MSA Section XI(c), disputes arising out of determinations made by the Independent Auditor are to be submitted to binding arbitration before a panel of three former Article III federal judges. CCH Ex. 2, MSA § XI (c). This proceeding, like the NPM Adjustment Proceedings for 2003 and 2004, is such a dispute arising under Section XI (c).

Pursuant to the *Amended Case Management and Scheduling Order*, this arbitration is divided into two parts. *See generally Amended Case Management and Scheduling Order* (hereinafter "CMO") (Lexis ID 66872748). First, all parties participated in a Common Case Hearing to present testimony and evidence regarding issues common to all of the States and PMs. CMO at 14, § 11. Second, each Arbitrating State has or will present evidence regarding their diligence at an individual state-specific hearing. CMO at 14-18, § 12. Part One of this *Common Case Findings, State-Specific Findings for the State of Maryland, and Interim Award for the State*

of Maryland ("Award")[2] sets forth the findings from the Common Case Hearing which apply generally to these 2005-2007 NPM Adjustment Proceedings. Part Two sets forth the Panel's State-Specific Findings for the State at issue and Part Three provides the Panel's Interim Award regarding the State designated.

PART ONE – COMMON CASE FINDINGS

I. PARTIES

The parties in the 2005-2007 NPM Adjustment Proceedings are comprised of two collective groups. The first group is the manufacturers of tobacco products that joined the MSA and agreed to be bound by its terms. The MSA refers to such manufacturers as Participating Manufacturers ("PMs"). CCH Ex. 2, MSA § II (jj). As noted above, the PMs fall into two categories: Original Participating Manufacturers and Subsequent Participating Manufacturers. CCH Tr. at 219:7 through 220:10.

The Original Participating Manufacturers ("OPMs") are the four manufacturers that were the original parties to the MSA, now consisting of only Philip Morris USA, Inc. ("Philip Morris") and R.J. Reynolds Tobacco Company ("R.J. Reynolds"). CCH Tr. at 219:8-16; CCH Ex. 2, MSA § II (hh). Since the execution of the MSA in 1998, two of the former OPMs have merged with R.J. Reynolds: Brown & Williamson Tobacco Corporation in 2004, and Lorillard Tobacco Company in 2015. CCH Tr. at 219:17-20.

The Subsequent Participating Manufacturers ("SPMs") are smaller manufacturers that joined the MSA following its execution in 1998. CCH Ex. 2, MSA § II (tt). The following SPMs

[2] In an effort to maintain a level of consistency throughout the NPM Proceedings over time, much of the background information in this Award is adopted from the 2003 and 2004 Awards.

claim entitlement to an NPM Adjustment for years 2005 through 2007 and are petitioners in these proceedings: Commonwealth Brands, Inc., Compania Industrial de Tabacos Monte Paz, S.A., Daughters & Ryan, Inc., Farmer's Tobacco Company of Cynthiana, Inc., House of Prince A/S, ITG Brands, LLC (formerly Lignum-2, LLC), Japan Tobacco International U.S.A., Inc., King Maker Marketing, Inc., Kretek International, Inc., Liggett Group LLC, Peter Stokkebye Tobaksfabrik A/S, Premier Manufacturing, Inc., P.T. Djarum, Reemtsma Cigarettenfacbriken Gmbh (Germany), Santa Fe Natural Tobacco Company, Scandinavian Tobacco Group Lane Ltd (formerly Lane Limited), Sherman 1400 Broadway N.Y.C., LLC, Tabacalera del Este S.A. ("TABESA"), Top Tobacco, L.P., US Flue-Cured Tobacco Growers, Inc., Vector Tobacco Inc., Von Eicken Group, and Wind River Tobacco Company, LLC. *See* CMO at 2, fn. 2.

The other collective of parties grouped together in this proceeding are the states of Idaho, Maryland, Massachusetts, Missouri[3], New Mexico, Ohio, Washington, and Wisconsin.[4] *See* CMO at 2, fn. 2. These states are often referred to as the "Arbitrating States." Many issues addressed in the common case hearing, as more fully set forth below, will be applicable to all remaining parties. However, the Panel will also issue separate state-specific findings and awards for each Arbitrating State.

[3] In accordance with the Panel Formation Agreement, with respect to the State of Missouri, any decision of this Panel shall only apply to the arbitration for 2005. In all instances in which this Award references the arbitration for 2005 through 2007, as to Missouri, each reference shall be limited to Missouri's 2005 arbitration. Disputes regarding Missouri's 2006 and 2007 enforcement will be arbitrated in future proceedings before a different panel or panels. CMO at 1, n.1.

[4] Illinois and Iowa were originally parties to this Arbitration but have since settled with the PMs.

Although they are not parties to the 2005-2007 NPM Adjustment Proceedings, two other entities will be mentioned in this Award. The first of these entities is the National Association of Attorneys General ("NAAG"). NAAG is defined in the in the MSA as "the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement." CCH Ex. 2, MSA § II (bb). NAAG served as an advisor and legal resource to the Settling States, including interpreting the MSA and opining on potential requirements for diligent enforcement. CCH Tr. at 408:4-9; CCH Ex. 2, MSA § VIII (a).

These Findings may also refer to a determination made by the MSA's "Independent Auditor," which since 1998 has been PricewaterhouseCoopers LLP. CCH Tr. at 224:13-23. The MSA provides that the Independent Auditor is responsible for "calculat[ing] and determin[ing] all payments" under the MSA, applying the MSA's various "adjustments, reductions and offsets" (including the NPM Adjustment) to those payments, and determining "the allocation of such payments, reductions, offsets . . . among the Settling States." CCH Ex. 2, MSA § XI (a)(1). Although the Independent Auditor plays a major role in the implementation of the MSA, it is not a party to this Arbitration Proceeding, and the Panel has no jurisdiction over its actions or determinations.

II. BACKGROUND

A. Master Settlement Agreement

Both the Supreme Court and the Settling States have characterized the MSA as a "landmark" public health agreement. *Lorillard Tobacco Co. v. Reilly,* 533 U.S. 525, 533 (2001); NAAG March 8, 2006, News Release. The MSA settled and released past and future claims by

the Settling States for, among other things, recovery of health-care costs attributed to tobacco-related illnesses. CCH Tr. at 255:3-17; CCH Ex. 2, MSA § II (nn). In exchange, the PMs agreed to make substantial annual payments in perpetuity based upon their annual nationwide cigarette sales and to be subject to an array of advertising, marketing, and other restrictions. CCH Tr. at 221:20 through 222:15. After the MSA was initially executed in November 1998, more than fifty additional tobacco companies have agreed to be bound by its terms. As noted above, these companies are referred to as SPMs. CCH Tr. at 219:21-25; CCH Ex. 2, MSA at § II (tt). Tobacco product manufacturers that have not joined the MSA or agreed to its terms are referred to as Non-Participating Manufacturers ("NPMs"). CCH Tr. at 220:16-24; CCH Ex. 2, MSA at § II (cc).

Pursuant to the MSA, each OPM makes a single annual payment based on its nationwide cigarette and RYO sales volume during each calendar year. CCH Ex. 2, MSA § IX (c)(1). The annual payment on a year's volume is due on April 15 of the following year. *Id.* Thus, for example, the annual payment for 2005 was due on April 15, 2006. These annual payments total in the billions of dollars each year. CCH Ex. 2, MSA §§ IX (c)(1)-(2). The SPMs also make separate annual payments based on their sales volume during the year. CCH Ex. 2, MSA IX (i). The PMs' annual payments are calculated by the Independent Auditor. CCH Tr. at 256:14-18; CCH Ex. 2, MSA § XI (a)(1). The MSA's annual base payment amounts are subject to various adjustments, including an Inflation Adjustment and a Volume Adjustment (under which the base payments are increased or decreased in proportion to changes in the PMs' nationwide volume of sales). CCH Tr. at 256:23 through 258:8; CCH Ex. 2, MSA §§ IX (c), XI (a).

The PMs do not make these payments directly to individual States. CCH Ex. 2, MSA § IX (a). Instead, each PM makes a single, nationwide payment into an escrow account in the

overall amount calculated and determined by the Independent Auditor. CCH Tr. at 259:16 through 260:8; CCH Ex. 2, MSA § IX (c)(1). The Independent Auditor then allocates those nationwide payments among the States according to each State's "Allocable Share" percentage expressed as a fraction of the total payments (and as set forth in Exhibit A to the MSA). CCH Tr. at 260:13-25; CCH Ex. 2, MSA §§ II (f)-(g), IX (b)-(e), IX (j); CCH Ex. 2, MSA Ex. A.

The MSA's payment obligations impose substantial costs on the PMs. CCH Tr. at 85:17-25.[5] The NPMs, by contrast, do not bear MSA costs and need not reflect those costs in their pricing. CCH Tr. at 87:4 through 88:4. In recognition of this fact, the MSA gives the States an incentive to enact and diligently enforce a Qualifying Statute that requires NPMs to deposit escrow on cigarettes and RYO the NPMs sell within their borders. CCH Tr. at 94:1 through 95:10. The NPM deposit burden is similar, but not necessarily identical, to a PM's MSA burden. CCH Tr. at 95:10-12. NPM deposits remain in escrow (earning interest) for 25 years after which they are returned to the NPM unless used to pay a judgment in favor of the State against the NPM, or a settlement between the NPM and the State, based on claims similar to those the Settling States settled against the PMs in the MSA. CCH Ex. 2, MSA Ex. T, Sec. [3](6)(2)(A)-(C), Requirements.

Absent enforcement of statutes imposing escrow obligations on NPMs, the cost differential they would otherwise enjoy could give them "a resulting cost advantage to derive large, short-term profits in the years before liability may arise without ensuring that the State will have an eventual source of recovery from them if they are proven to have acted culpably."

[5] Several citations in the Common Case Findings reference the opening statements by counsel during the Common Case Hearing. Even though such statements are not evidence, the statements did provide important background information which is not disputed by either party.

CCH Ex 2, MSA Ex. T, § [l](f), Findings and Purpose. This outcome would be harmful to the PMs, the States, and the public, by undermining the goals of the MSA. CCH Tr. at 88:1-4.

B. NPM Adjustment

Accordingly, to "protect the public health gains achieved by" the MSA and neutralize the cost disadvantages of the PMs vis-a-vis NPMs, the MSA included a further adjustment known as the "NPM Adjustment," that provides for a potential reduction in the PMs' settlement payments in the event of an MSA-related market share shift to NPMs above a specified threshold. CCH Ex. 2, MSA § IX (d)(1). If the two conditions set forth in Section IX (d)(l) are met, then under Section IX (d)(2) the Adjustment "shall apply to the Allocated Payments of all Settling States."

The first condition is that the PMs must have suffered a "Market Share Loss," which is defined to mean that the PMs' collective market share during the year at issue decreased by more than two percentage points compared to their collective market share in 1997, the last full year before the MSA was signed. CCH Ex. 2, MSA §§ IX (d)(1)(A), IX (d)(1)(B).

Second, a nationally recognized firm of economic consultants jointly selected and retained by the OPMs and the States (the "Firm") must have determined that the disadvantages experienced by the PMs as a result of the provisions of the MSA were a "significant factor" contributing to the Market Share Loss for the year in question. CCH Ex. 2, MSA § IX (d)(1)(C).

When both conditions are satisfied, the NPM Adjustment applies "to the Allocated Payments of all Settling States," with one exception. CCH Ex. 2, MSA § IX (d)(2)(A). The only exception occurs when a Settling State demonstrates that 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 such statute during such

entire calendar year." CCH Ex. 2, MSA § IX (d)(2)(B).

"A 'Qualifying Statute' means a Settling State's statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-a-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement." CCH Ex. 2, MSA § IX(d)(2)(E). Both the Settling States and the PMs agreed that the Model Statute set forth as Exhibit T to the MSA, discussed further below, "shall constitute a Qualifying Statute." *Id.*

If an individual Settling State diligently enforced the provisions of its Qualifying Statute during the year in question, the NPM Adjustment still applies to the PMs' collective MSA payments for that year, but no part of the NPM Adjustment is allocated to that Settling State's share of those payments. CCH Ex. 2, MSA § IX (d)(2)(B). This diligent enforcement exception thus operates as an incentive to the Settling States to enact and enforce the provisions of their Qualifying Statutes. CCH Tr. at 93:16 through 94:7. The MSA and its supporting exhibits, however, do not define "diligent enforcement." *See generally* CCH Ex. 2, MSA; CCH Tr. at 275:21 through 276:2.

When a Settling State qualifies for this diligent enforcement exception, the MSA provides that the "aggregate amount of the NPM Adjustments that would have applied" to Settling States that prove they fall within the diligent enforcement exception "shall be reallocated among all other Settling States pro rata in proportion to their respective [payment shares]," and that those States' MSA payments "shall be further reduced" up to the full amount of their MSA payments for that year. CCH Ex. 2, MSA §§ IX (d)(2)(B), IX (d)(2)(D). As a result of this reallocation provision,

the greater the number of Settling States that do not establish that they diligently enforced the provisions of their Qualifying Statutes, the more widely the NPM Adjustment is spread thereby reducing the share of the Adjustment that each such State bears. CCH Tr. 274:9 through 275:17.

Conversely, if only a few Settling States have failed to diligently enforce their Qualifying Statutes for a given year, those Settling States face a more concentrated application of the NPM Adjustment – and hence a greater reduction of their payments for that year, subject only to the limitation that the Adjustment applied to a Settling State can be no greater than the total MSA payment it received for that year. *Id.* The diligent enforcement and reallocation provisions are thus designed to create dual incentives for a Settling State to enact and enforce a Qualifying Statute.

The MSA provides that Exhibit T to the MSA constitutes a "Qualifying Statute" for the purposes of Section IX and the NPM Adjustment. CCH Ex. 2, MSA § IX (d)(2)(E). The MSA further provides that this "model" Statute, if enacted with those modifications necessary to reflect "particularized state procedural or technical requirements, will "constitute a Qualifying Statute." *Id.*

The Model Statute, commonly referred to throughout these Proceedings as the "Model T," requires each NPM to make escrow deposits "per unit sold" in the respective Settling State in the year in question. CCH Ex. 2, MSA Ex. T, § [3](b)(l), Requirements. The escrow deposits are made by April 15 of the following year into a "[q]ualified escrow fund," which is defined as an escrow arrangement with a qualifying financial institution in which the deposits are held for the benefit of the State. CCH Ex. 2, MSA Ex. T, § [2](f), Definitions. "Units sold" is defined in the MSA as "the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or

intermediaries) during the year in question, as measured by excise taxes collected by the state on packs (or 'roll-your-own' tobacco containers) bearing the excise tax stamp of the State." CCH Ex. 2, MSA Ex. T, § [2](f), Definitions.

By remaining in escrow for a quarter century, deposits are intended to guarantee the State a source of recovery should it subsequently sue or settle with that NPM on claims similar to those the State settled against the PMs in the MSA. CCH Tr. at 475:21 through 476:7. Additionally, escrow deposits avoid the risk that NPMs would otherwise use their MSA-related "cost advantage to derive large, short-term profits . . . and then becom[e] judgment-proof before liability [to the State] may arise." CCH Ex. 2, MSA Ex. T, § [l](f), Findings and Purpose. Absent a judgment or settlement, the escrow deposit is released to the NPM twenty-five (25) years after it was made. CCH Tr. 385:9-12.

Following execution of the MSA, all Settling States enacted the Model Statute, subject to their respective particularized statutory, procedural, or technical requirements, as agreed to by the PMs. CCH Tr. at 272:23 through 273:1. Despite the Settling States' universal enactment of Qualifying Statutes imposing escrow obligations on NPMs, the NPMs' market share has increased at significant rates. CCH Tr. at 101:2-9. This shift of market share from PMs to NPMs has triggered the NPM Adjustment provision of the MSA for multiple years, including the years at issue in this proceeding. CCH Tr. at 103:9-15.

C. Allocable Share Release Repeal and Complementary Legislation

Not long after enactment, several flaws in the Model Statute soon became apparent to the States and the PMs. CCH Tr. at 328:19 through 329:1. To cite one example, an NPM could sell product in a State for as long as 15 months before its obligation to deposit escrow accrued. CCH

Tr. 241:3-17. This time lag enabled an NPM to concentrate sales in a given State, reap short-term profits through its large price advantage over the PMs, stop selling in the State when escrow was due, then repeat the process in another State. CCH Tr. at 45:6-14. Exacerbating this problem, the Model Statute requires an NPM to commit "two knowing violations" before it is subject to an injunction. CCH Tr. at 634:18-23. This meant that an NPM could not be enjoined from selling within the State unless it had failed to deposit escrow for two years. CCH Tr. at 47:5-11.

The principal enforcement tool that the Model Statute affords a State is litigation. CCH Tr. at 480:5-19. As the evidence at the Common Case Hearing demonstrated, litigation against noncompliant NPMs often proved a cumbersome, ineffective tool. In the first place, it was sometimes difficult for the State to identify the manufacturer. CCH Tr. at 704:7-11. Many manufacturers were not only foreign but located in countries with weak judicial systems, making it difficult, or impossible, to effect service or collect a judgment. CCH Tr. at 632:19-24, 703:11-19. Foreign service and collection were also expensive. CCH Tr. at 46:7-12, 333:9-22. Once served, some NPMs successfully defended on the ground that they lacked the necessary minimum contacts with the State to assert personal jurisdiction over them, or that they were protected from suit by sovereign immunity. CCH Tr. at 334:2-7, 335:16-22.

Another flaw of the Model Statute was the Allocable Share Release. CCH Tr. at 385:13 through 388:22. Under this provision, an NPM that deposits escrow for sales in a State can request return of its entire deposit save for the small fraction allocable to that State. CCH Tr. at 386:4-12. By concentrating sales in a single State, or a few States, the NPM could get back most of its escrow deposits and circumvent the purpose of the Qualifying Statute. CCH Tr. at 386:18-25.

In an effort to close the ASR loophole and create a more effective enforcement mechanism under the Model Statute, the States, in consultation with the PMs, began working on amendments to the Qualifying Statutes that would repeal the ASR provision and also create Model Complementary Legislation. CCH Tr. at 370:2-21, 664:21 through 665:3. Under the Model Complementary Legislation, a State could: (1) require all tobacco products to be listed on a directory before they could be legally sold in the State; (2) remove non-compliant NPMs from the directory; and (3) take action against wholesalers and retailers selling or possessing for sale products not listed on that State's directory. CCH Tr. at 329:19 through 330:24, 336:21 through 337:12, 360:14 through 361:2, 362:6-19, 364:20 through 365:12. These were very valuable tools to help the States enforce the Qualifying Statute. CCH Tr. at 420:1-5.

By 2005, most States had passed the ASR repeal and Model Complementary Legislation. CCH Tr. 421:11-16 (noting that all Arbitrating States except Missouri had adopted Complementary Legislation by 2005). However, before doing so, the States acquired assurance letters from the PMs wherein the manufacturers agreed that the ASR Repeal would not disqualify the States' existing Qualifying Statutes. CCH Tr. at 664:24 through 665:12. The PMs also agreed that failure to enact Complementary Legislation could not be used against a State in an NPM Adjustment Proceeding and that the diligent enforcement obligation of MSA Section IX(d)(2)(b) would not apply to the new Complementary Legislation. CCH Tr. at 370:23 through 372:1; CCH Ex. 12 (example assurance letter from RJ Reyolds Tobacco Company).

D. Enforcement Against Noncompliant PMs

As mentioned above, many manufacturers joined the MSA as SPMs in the years following its initial execution. However, some of these manufacturers failed to make their MSA payments

in accordance with the terms of the MSA. Some of these SPMs included Alliance, Bekenton, M/S Dhanraj, Liberty Brands, and Virginia Carolina. CCH Tr. at 764:15-21, 818:4-5, 1026:3-12.

The States, often in a collectively manner, pursued these SPMs through litigation to ensure proper payment. *See, e.g.*, CCH Tr. at 763:23 through 764:3, 820:7-8. However, collection was rarely easy. For example, the manufacturers would regularly declare bankruptcy and the States would have to pursue them through the bankruptcy court. CCH Tr. at 406:1-5, 797:4-9. Usually, attorneys from NAAG would serve as bankruptcy counsel for the States. CCH Tr. at 406:6-9.

In another example of difficult collection, the State of Iowa attempted to require Bekenton to deposit escrow pursuant to its Qualifying Statute or be removed from the State's directory. CCH Tr. at 787:20 through 788:10. However, the court rejected this argument and enjoined Iowa from seeking escrow payments from Bekenton or delisting the company from the State's directory. CCH Tr. at 791:5-9, 793:24 through 794:3; CCH Ex. 56. The MSA court ruled that the MSA governs claims against the PMs for failure to make their MSA payments, not Iowa's Escrow Statute. CCH Tr. at 792:10-18; CCH Ex. 56.

Another illustration of a noncompliant SPM is General Tobacco. General Tobacco was an NPM that joined the MSA in July of 2004. CCH Tr. at 840:2-4. When it joined the MSA, General Tobacco was the largest NPM holding a twenty-five percent (25%) market share. CCH Tr. at 838:6-8.

Notably, at the time that General Tobacco joined the MSA, it was compliant with its escrow obligations. CCH Tr. at 841:17-21. However, upon joining the MSA, General Tobacco was also responsible for making additional back payments under MSA Section II (jj). CCH Tr. at 844:6-7; CCH Ex. 2, MSA § II (jj). The back payments were an obligation for an NPM becoming a PM

to make payments equivalent to MSA payments for its cigarette sales after 1998 up to the date of joinder, as if the NPM had a been a PM since 1998. CCH Tr. 842:9 through 843:12.

The Adherence Agreement executed by General Tobacco gave the company twelve (12) years to make the payments. CCH Tr. at 844:22 through 845:2; CCH Ex. 45. General Tobacco made the required back payment in 2005. CCH Tr. at 849:14-17. However, the company failed to make its full back payment in 2006, at which time 42 states entered into forbearance agreements with the SPM. CCH Tr. at 850:9-21. Under the forbearance agreement, the States agreed they would not (1) remove General Tobacco from approved-to-sell directories, (2) list General Tobacco as noncompliant on directories, or (3) otherwise bar General Tobacco from continuing to import or sell cigarettes. CCH Tr. at 947:3-14; CCH Ex. 505. However, the SPM failed to make its ongoing back payments and eventually the States took action against General Tobacco. CCH Tr. at 856:23 through 857:18; CCH Ex. 84.

E. 2005 – 2007 NPM Adjustment Proceedings

It is undisputed that both conditions triggering application of the NPM Adjustment were met for 2005, 2006 and 2007 – i.e., the PMs suffered a Market Share Loss to the NPMs above a defined threshold and the MSA was a significant factor in that loss. CCH Tr. at 36:12-23. Therefore, the primary issue in this arbitration whether the eight Arbitrating States can be exempt from the NPM Adjustment for any of those years because they diligently enforced the provisions of their respective Qualifying Statutes for each year in question. CCH Tr. at 103:16-19.

These 2005-2007 NPM Adjustment Proceedings are conducted by a Panel comprised of Judge William F. Downes (Ret.), Justice Carlos Moreno (Ret.) and Judge Lawrence F. Stengel (Ret.). All three panelists are former federal Article III judges as required by the MSA arbitration

clause, which states the following:

> Resolution of Disputes. Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge. Each of the two sides to the dispute shall select one arbitrator. The two arbitrators so selected shall select the third arbitrator. The arbitration shall be governed by the United States Federal Arbitration Act.

CCH Ex. 2, MSA § XI (c).

III. PROCEDURAL HISTORY

In late 2020, the Parties began discussions with the Panel on developing a case management order for these proceedings. Although the parties agreed on the majority of the ground rules for this Arbitration, there were a few items that required a decision by the Panel. The issues were briefed and a virtual hearing was held on March 23, 2021. Following the hearing, the Panel issued its decision on the disputed items and a Case Management Order ("CMO") was entered on May 17, 2021. *Case Management and Scheduling Order* (Lexis ID 66607836). The CMO, after additional briefing and argument by the Parties, was amended on August 23, 2021. *Amended Case Management and Scheduling Order* (Lexis ID 66872748).

Following the adoption of the CMO, the Parties filed many pre-hearing motions and letter requests. Many of the filings pertained to discovery disputes between the PMs and the Arbitrating States. The filings and the Panel's rulings are posted on an electronic docket maintained by a private company, File&ServeXpress. This database is available to authorized users.

Pursuant to the CMO, the Panel held a Common Case Hearing on July 5-12, 2022, in Chicago, Illinois. During the hearing, the Parties addressed the background of the dispute and the

enforcement issues common to all of the Arbitrating States.

Following the Common Case Hearing, the Arbitrating States filed four dispositive motions: (1) *Motion for Declaratory Ruling Concerning "Units Sold"* (Lexis ID 68009992); (2) *Motion for a Declaratory Ruling that to Avoid the NPM Adjustment, a State Must Enact and Diligently Enforce Only the Provisions of its Qualifying Statute* (Lexis ID 68009679); (3) *Motion for Judgment as a Matter of Law that the States Have No Obligation to Enforce Their Qualifying Statute Against Participating Manufacturers* (Lexis ID 68009587); and (4) *The State of Idaho's Motion for Partial Summary Judgment Regarding Units Sold* (Lexis ID 68077373). A hearing regarding those motions was held in person in Denver, Colorado on December 5, 2022. The Panel denied all of the dispositive motions and noted that the issues should be heard and decided on a state-by-state basis following the State-specific hearings.

On June 6, 2023, the PMs and Arbitrating States each submitted proposed common case findings of fact and conclusions of law. *See Participating Manufacturers' Proposed Common Legal Standards and Findings* (Lexis ID 70152544); *States' Proposed Findings of Fact and Conclusions of Law* (Lexis ID 70152266). These filings set forth the Parties' respective arguments regarding the common case issues.

IV. CONTENTIONS OF THE PARTIES

The Parties agree that the predominant issue before this Panel is whether each of the Arbitrating States can demonstrate that they diligently enforced their Qualifying Statute during each year at issue in this Proceeding. The Parties disagree, however, on what is required to prove diligent enforcement. The Parties also differ on their proposed definition of "units sold."

A. PMs' Contentions

The PMs contend that the diligent enforcement inquiry requires analysis of common enforcement mechanisms available to the states such as reporting requirements, data collection, data verification, inspections of distributors and retailers, implementation and enforcement of directories, and penalties and lawsuits for noncompliance. The PMs also argue that coordination between a state's Department of Revenue and Attorney General Office is necessary for diligent enforcement. Finally, the manufacturers aver that detecting and preventing escrow fraud schemes is crucial to diligent enforcement.

More specifically, the PMs make two claims regarding diligent enforcement requirements that are adamantly opposed by the Arbitrating States. First, the PMs state that the Arbitrating States were required to take enforcement actions against noncompliant SPMs. For example, the PMs argue that the States should have required any SPM that was delinquent in its MSA payment to deposit escrow.

Secondly, the PMs posit that the Arbitrating States were required to enforce Complementary Legislation in order to meet the definition of diligent enforcement. According to the PMs, the States must show that they used all tools available to them to ensure compliance with the Qualifying Statute and Complementary Legislation is one such tool.

Finally, the PMs also claim that the definition of "units sold" is much broader than the textual language set forth in the MSA. The PMs argue that the diligent enforcement determination must focus on more than just stamped NPM cigarettes.

B. States' Contentions

The States propose that diligent enforcement should be defined as "the conscious consideration by the State of the provisions of its Qualifying Statute to monitor, detect, and compel compliance with those provisions, in light of the circumstances of the State's cigarette market and in light of the State's competing laws and policies during the time at issue." In putting forth this definition, the Arbitrating States contend that the diligent enforcement obligations of the state are limited solely to the Qualifying Statute. In other words, the enactment or use of complementary legislation is not relevant to the diligent enforcement discussion.

Additionally, the States contend that diligent enforcement does not require the States to enforce the Qualifying Statute against noncompliant SPMs. According to the States, SPMs, even if they are not performing their financial obligations, do not change their stripes and become NPMs for the purpose of escrow.

Finally, as to the units sold issue, the Arbitrating States claim that the definition for purposes of diligent enforcement is limited to language in the MSA. Accordingly, pursuant to their argument, States have no obligation to obtain escrow on deposits for unstamped contraband, or any other product not meeting a particular State's definition of "units sold."

V. FINDINGS AND CONCLUSIONS ON COMMON ISSUES

As noted above, the Parties have very different opinions on the meaning of the terms "diligent enforcement" and "units sold." The Parties also disagree on whether the States should have required escrow from noncompliant SPMs and whether Complementary Legislation can be considered during the diligent enforcement analysis. During the Common Case Hearing, the PMs

and States spent a great deal of time educating the Panel on these issues. They also presented arguments supporting their varying interpretations of the terms and pertinent contractual and statutory language. As mentioned above, the States also filed dispositive motions regarding several of these issues. The Panel denied the motions finding that they should be decided on a state-by-state basis. Notwithstanding those rulings, the Panel does find that certain determinations can be made on a more global level. Those determinations are contained below.

A. Diligent Enforcement

As has already been noted, the preeminent issue in this Arbitration is whether each of the Arbitrating States "diligently" enforced its Qualifying Statute. Section IX(d)(2)(B) of the MSA provides that a "Settling States Allocated Payment shall not be subject to an NPM Adjustment" if it 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 such statute during the entire calendar year." However, the MSA does not define "diligent enforcement" and the Parties do not agree on a definition.

Therefore, this Panel, like the 2003 and 2004 Panels, must define "diligent enforcement" for itself. The 2003 Panel defined "diligent enforcement" as follows:

> Diligent Enforcement is an ongoing and intentional consideration of the requirements of a Settling State's Qualifying Statute, and a significant attempt by the Settling State to meet those requirements, taking into account a Settling State's competing laws and policies that may conflict with its MSA contractual obligations. Both the legislative and executive branches of a Settling State are bound by the MSA obligations.

2003 Panel Final Award, Common Findings/Conclusions at 13-14. The 2003 Panel noted that the definition is measured by an objective standard. It considered numerous factors in determining whether that standard had been met. For example, the 2003 Panel analyzed the collection rate of

a state, the lawsuits filed by a state, the gathering of reliable data by the state, and the resources allocated to enforcement by the state. *Id.*

The 2004 Panel took a different path. It found that "the words 'diligent enforcement' as used in the MSA are not amenable to a concise and inflexible definition." *2004 Panel Interim Award*, Common Case Findings at 28. The Panel continued with the following finding:

> "[I]t is impractical to fashion a list of uniform and concrete factors against which the diligence of a State in enforcing its Qualifying Statute could be measured. Instead, in evaluating each State's claim to have diligently enforced its Qualifying Statute the Panels will be guided by the evidence presented regarding each State's efforts to monitor compliance, its efforts to detect non-compliance, and its efforts to compel compliance in the contexts of the facts, law and circumstances existing in that State during the relevant 2004 time period.

Id.

After considering the Parties' contentions and reviewing the decisions of the previous Panels, this Panel also finds that the term "diligent enforcement" cannot be defined with specificity or measured against a precise metric. Rather, as the 2004 Panel found, "diligent enforcement" must be analyzed on as state-by-state basis in accordance with the circumstances existing in the State during the 2005, 2006, and 2007 time period.

Although a State's performance will not be measured against a precise metric, there are certain diligent enforcement efforts that will guide this Panel's decisions. Specifically, the Panel will consider a State's efforts in the following areas in making its State-Specific findings:

1. **Reporting Requirements – what reporting requirements did the State impose upon the cigarette manufacturers and distributors?**

2. **Data Collection – what efforts were made by the State to collect cigarette sales (units sold) data and escrow deposit data?**

3. **Data Verification – what efforts were taken by the State to verify the sales and escrow deposit data provided to the State by cigarette manufacturers and distributors?**

4. **Inspection Activities – did the State have a reasonable strategy to conduct distributor and retail inspections of inventory?**

5. **Implementation and Enforcement of Directories – did the State effectively use the directory as a tool to enforce the Qualifying Statute?**

6. **Penalties and Lawsuits for Noncompliance – did the State make reasonable efforts to address noncompliance with the assessment of penalties and the use of lawsuits?**

7. **Resources and Staffing Allocated to Enforcement – did the State allocate appropriate levels of staffing and resources to enforcement of the Qualifying Statute?**

8. **Coordination Between Agencies – did all State agencies involved with enforcement of the Qualifying Statute adequately coordinate and communicate with each other?**

9. **Effect on Market – did the State's actions have a positive effect on the NPM tobacco market?**

It should be noted that the enforcement activities listed above are not all encompassing. Other enforcement activities (or lack thereof) that are presented at State-Specific hearings may also factor into the Panel's diligent enforcement decision.

Finally, it is worth stating that diligent enforcement does not require perfection. Rather, it simply requires a showing of reasonable and deliberate efforts to enforce the terms of the Qualifying Statute based upon the circumstances in the state during the time frame at issue.

B. Noncompliant or Delinquent SPMs

As noted above, the Parties dispute whether "diligent enforcement" requires the States to enforce the terms of the Qualifying Statute against noncompliant or delinquent SPMs. The PMs contend that a State must collect escrow from any SPM that fails to make its MSA payment. The

States respond that "diligent enforcement" only requires them to collect escrow from NPMs and that enforcement against PMs falls strictly under the terms of the MSA.

The Panel previously addressed this issue in a prior order. *See Order on Motion for Judgment as a Matter of Law that the States Have No Obligation to Enforce Their Qualifying Statutes Against Participating Manufacturers* (Lexis ID 68963158). Therein, the Panel found that regardless of which option a tobacco manufacturer chose, the States had an obligation to ensure that the company was meeting its obligation under the Qualifying Statute. The Panel continues to believe this is the correct decision for the following reasons.

First, the MSA specifically requires the States to enforce the terms of the Qualifying Statute to avoid NPM Adjustment. Under the Qualifying Statute, a manufacturer either has to choose to (a) become a participating manufacturer and generally perform its financial obligations under the Master Settlement Agreement or (b) pay escrow in accordance with the terms of the Qualifying Statute. Consequently, under the terms of the Qualifying Statute, there are requirements for both SPMs and NPMs. The SPMs have to make their MSA payments and the NPMs have to deposit escrow. And, according to the MSA, the States must enforce all terms of the Qualifying Statute. The MSA does not express that a State can avoid the adjustment by simply enforcing the Qualifying Statute against NPMs – it is not that specific.

Second, the States' argument on this issue would allow the States to circumvent the purpose of the MSA. As noted in the order, if the States let a problematic manufacturer join the MSA and it failed to make payments under the MSA, the compliant PMs would suffer the same harm as if the non-compliant manufacturer had remained an NPM and failed to make escrow.

However, notwithstanding the foregoing, there is also no contractual or statutory language to support the PMs argument that a noncompliant SPM should be forced to pay escrow. Rather, once a manufacturer becomes a SPM it is bound by the terms of the MSA and is only required to make its payments thereunder.

Therefore, in conclusion, diligent enforcement does require the States to require compliance with the Qualifying Statute by both PMs and NPMs. However, it does not require the States to obtain escrow deposits from an SPM that fails to make its MSA payments.

C. Complementary Legislation

The PMs argue that enactment and enforcement of Complementary Legislation should be a factor considered in the diligent enforcement inquiry. According to the PMs, Complementary Legislation was a useful tool in ensuring compliance with the Qualifying Statute.

The States counter that they are only required to enforce the Qualifying Statute in order to avoid the NPM Adjustment. They argue that there is no contractual or statutory obligation to either pass or enforce the Complementary Legislation. The States point to the Assurance Letters issued by the PMs as support for their argument.

As with the noncompliant SPM issue, this subject was also considered and decided by the Panel following the dispositive motions hearing held in December of 2022. *See Order on Motion for a Declaratory Ruling that to Avoid the NPM Adjustment, a State must Enact and Diligently Enforce Only the Provisions of Its Qualifying Statute (Lexis ID 68963713).* In the order issued by the Panel, the Panel found that the diligent enforcement discussion should encompass all tools that were available to the States to ensure compliance with the Qualifying Statute. In certain circumstances, this could include the use of the tools provided by Complementary Legislation.

The Panel finds no reason to depart from its earlier decision. As appropriate in its State-Specific hearings, the Panel will consider a State's use of the tools available under Complementary Legislation when analyzing its enforcement efforts.

However, notwithstanding the foregoing, the States are correct that enactment or use of Complementary Legislation is not required for a finding of diligent enforcement. A State could have diligently enforced its Qualifying Statute without ever passing or enforcing Complementary Legislation.

D. Units Sold

As in previous Arbitrations, the Parties disagree on the meaning of the term "Units Sold." The PMs contend that "Units Sold" includes more product than that listed in the statutory definition. For example, the PMs argue that "Units Sold" should include all cigarettes, including contraband cigarettes in certain circumstances. The States counter that "Units Sold" is clearly defined by the MSA and is not subject to amendment or addition. In other words, the States are only required to collect escrow on stamped cigarettes (or RYO) for which excise taxes were collected.

Exhibit T to the MSA (commonly referred to in this Proceeding as the "Model T Statute" or "Qualifying Statute") defines as follows:

> "Units sold" means the number of individual cigarettes sold in the State by the Applicable tobacco product manufacturer (whether directly or through a Distributor, retailer or similar intermediary or intermediaries) during the year in Question, as measured by excise taxes collected by the State on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the State. The [fill in name of responsible state agency] shall promulgate such regulations as are necessary to ascertain the amount of State excise tax paid on the cigarettes of such tobacco product manufacturer for each year.

CCH Ex. 2, MSA Ex. T, T-3, Definitions (j).

In the 2003 Proceedings, the Panel found that the "Model Statute definition of 'units sold' is unambiguous and binding." *2003 Panel Final Award*, Common Findings/Conclusions at 14-15. Similarly, the 2004 Panel found the statutory definition of "Units Sold" to be clear and concise:

> The 2004 Panels find no ambiguity in the definition of "Units sold" set forth in the MSA. "Units sold" as the term is defined in the literal language of the MSA are confined to cigarettes or RYO containers that are both stamped and taxed. The first half of the definition is sweeping. "Units sold" means the number of individual cigarettes sold in the State by a tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary) during the year in question . . . ." The Model Statute broadly defines "cigarette' as anything commonly understood as a cigarette, including RYO. MSA exhibit T, T-2, Definitions. Hence, the first part of the definition could include every cigarette or RYO container sold by an NPM, including contraband, internet sales, tribal sales, and both stamped and unstamped sticks.
>
> The definition does not stop there, however. It continues, "as measured by excise taxes collected by the State on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the State." Thus, the Model Statute identifies a subset of "cigarettes" that are subject to the escrow requirement. The phrase, "as measured by" could, perhaps, be made clearer, but it is not ambiguous. To qualify as a "Unit sold," the cigarette, or RYO container, must be both stamped and taxed. This meaning is reinforced by the last sentence of the definition. The responsible State agency "shall promulgate such regulations as are necessary to ascertain the amount of state excise tax paid on the cigarettes of such tobacco manufacturer for each year."

2004 Panel Interim Award, Common Case Findings at 24.

This Panel has previously agreed with the ultimate findings of the other Panels. In the *Order on Motion for a Declaratory Ruling Concerning "Units Sold"*, this Panel found the definition of "units sold" within the Qualifying Statute to be clear and unambiguous. *Order on Motion for a Declaratory Ruling Concerning "Units Sold"* at 2 (Lexis ID 68964589). However, the Panel also found that evidence regarding contraband cigarettes, tribal sales, and intentional manipulation of the escrow system by NPMs would be relevant to the any State-Specific inquiry.

To that end, the Panel denied the motion filed by the States. However, this Panel, like the previous Panels does find that escrow is only required to be paid on "Units Sold" as that is defined in the Qualifying Statute.

PART TWO – STATE SPECIFIC FINDINGS FOR THE STATE OF MARYLAND

I. INTRODUCTION

The Common Case Findings set forth above in Part One set forth the general background and history of the MSA and the Diligent Enforcement proceedings as they apply to all states. The Common Case Findings also set forth the general framework used by the Panel in evaluating the evidence presented at the state-specific hearings to determine whether a particular state diligently enforced the provisions of its Qualifying Statute during the relevant time frame.

This portion of the Award, Part Two – State Specific Findings, focuses on the evidence presented during the Maryland state-specific hearing. The facts presented at the hearing are applied to the general framework established in the Common Case Findings to determine if Maryland met its burden of proving by a preponderance of the evidence that it diligently enforced its Qualifying Statute in 2005, 2006, and 2007.

II. MARYLAND HEARING

The Maryland hearing was held on March 21, 2023 through March 28, 2023, in Washington, D.C. During the hearing, the State of Maryland was represented by John M. Leovy and Anna MacCormack of the Tobacco and Enforcement Unit of the Office of the Attorney General for the State of Maryland. The Participating Manufacturers were represented by Alexander Shaknes, Manvin Mayell, Daniel Bernstein, Evelina Norwinski, and Kerry Dziubek of the law firm Arnold & Porter.

During the Maryland hearing, the Parties advanced a large number of legal and factual submissions, as well as oral opening statements. However, not every such piece of evidence or argument is referred to in this Award. Nonetheless, such selection should not be interpreted as a

consideration of only some of the evidence and arguments relied upon. On the contrary, the Panel has carefully considered all relevant facts, evidence, legal authorities and arguments put before it in this proceeding. To the extent that the facts found and the legal conclusions reached by the Panel in this Award differ from any party's position, those conclusions are the result of determinations as to credibility, relevance, burden of proof considerations, and the weighing of the evidence, both oral and written.

As noted above, both parties presented opening statements to the Panel at the beginning of the hearing. Maryland Hearing Transcript at 8:5 through 99:3 (hereinafter "MDH Tr."). Following the openings, the State of Maryland presented testimony from several witnesses. The names of the witnesses called by the State and a general summary of their respective testimony is set forth below.

David Lapp was an Assistant Attorney General during the years 2005-2007 and was primarily responsible for enforcing Maryland's qualifying statute during that time. MDH Tr. at 101:11-16. During his testimony, he explained all of the steps the State took during the relevant time period to keep NPMs compliant or keep them out of the Maryland market. MDH Tr. at 109:18-22. Many of these activities were actions that Maryland had been taking prior to 2005. For example, Mr. Lapp testified about the use of the directory, quarterly escrow deposits, and the use of lawsuits to maintain compliance with the qualifying statute.

However, there were also new actions taken by Maryland to improve their tobacco enforcement regime during the years 2005-2007. For example, Maryland amended two reporting forms to more accurately capture the NPM RYO market. MDH Tr. at 218:9 through 225:3. Maryland also retained an outside accounting firm, Maryland First Financial, to help the State set

up better procedures for gathering and verifying wholesalers' reports. MDH Tr. at 260:22 through 263:19. The Maryland Attorney General's office also hired additional legal staff in 2007 to help with the tobacco enforcement work.

Maryland presented the videotaped deposition testimony of **Jonathan Beeker** and **Jennifer Straus**. Mr. Beeker was a Rule 30(b)(6) witness for Philip Morris. He specifically testified that the OPM market share before the MSA was approximately 99.6%. MDH Tr. at 767:15-20. Likewise, Mr. Straus was called as a Rule 30(b)(6) witness for Farmers Tobacco. She provided testimony regarding late back payments made by Farmers Tobacco when it joined the MSA as an SPM. MDH Tr. at 768:20 through 774:5.

Denise Davis was a long-time employee of the Maryland Office of the Comptroller. During 2005-2007, she served as the manager of the alcohol and tobacco regulatory unit. MDH Tr. at 775:18-20, 779:12-16. She generally testified about the processes used by the Office of the Comptroller to monitor and review the tobacco reports and returns that were filed with the State. MDH Tr. at 780:18-22. She also provided detailed testimony about changes made to reporting forms during 2005 and actions taken by her office when licensees did not comply with the existing rules. MDH Tr. at 825:2-15 (discussing the new Schedule A to Form 609); 830:3-8 (discussing new Scheule A to Form 610); 842:19 through 843:21 (discussing actions taken by revenue administration office).

Christopher Byrd was called by the State to testify about his work as an auditor in the Maryland Office of the Comptroller during the 2005-2007 time frame. During this time, he worked in the alcohol and tobacco tax unit of the compliance division where he did audits of tobacco wholesalers. MDH Tr. at 953:21 through 955:1. He testified regarding the general field audit

procedures used by the compliance division at that time. *See generally* MDH Tr. at 948:8 through 1137:16. He also stated that beginning in 2005 the field auditors began checking for compliance with the directory. MDH Tr. at 1009:18 through 1011:21, 1013:4 through 1015:6.

William George was a field enforcement agent within the Maryland Office of the Comptroller during 2005-2007. MDH Tr. at 1142:15-18. He testified that his duties ranged from retail inspections to investigation and interdiction of contraband trafficking. MDH Tr. at 1155:11 through 1157:13. He also testified that sometime in late 2004 he began checking for off-directory brands during his retail inspections. MDH Tr. at 1195:15 through 1196:9; MDH Ex. 168.

Aravind Muthukrishnan was hired as a staff attorney in the tobacco enforcement unit of the Maryland Attorney General's Office in 2007. MDH Tr. at 1251:9-14, 1252:11-14. Mr. Muthukrishnan testified in detail about his job duties at the tobacco enforcement unit. For example, he described how he reviewed the wholesaler sales reports for NPM product and verified the escrow deposits made by the NPMs. MDH Tr. at 1255:11 through 1258:9.

The videotaped testimony of **Suresh Subramanian** and **James Pisciotta** was also presented by the State of Maryland. MDH Tr. at 1393:14 through 1394:3. Mr. Subramanian was a Rule 30(b)(6) witness for Philip Morris. MDH Tr. at 1395:12-15. He testified regarding the STARs data system and Philip Morris' procedures for collecting and verifying the data. *See generally* MDH Tr. at 1395:10 through 1418:11. Similarly, Mr. Pisciotta was a Rule 30(b)(6) witness for R.J. Reynolds. MDH Tr. at 1420:21 through 1421:5. He testified about the STR data system and R.J. Reynolds' processes for obtaining and auditing the STR data. *See generally* MDH Tr. at 1420:12 through 1445:15.

Victor Lipnitsky is a certified public accountant and has been involved with Maryland's diligent enforcement activities since 2005. MDH Tr. at 1454:1-3, 1455:3-8. Originally, he worked for Maryland First Financial and helped set up the processes used by the Maryland Attorney General's Office to verify NPM sales data. MDH Tr. at 1472:9 through 1473:13. However, for the purposes of this proceeding, he was called by the State as a Rule 1006 summary witness. MDH Tr. at 1461:20-22. To that end, he provided summaries regarding: (1) the NPM escrow deposit rate for the years in question; (2) communications with wholesalers and NPMs regarding NPM sales; (3) tobacco directory; (4) tobacco enforcement lawsuits filed by the State; (5) RYO sales; and (6) NPM market share in Maryland during 2004-2007. *See generally* MDH Tr. at 1475:12 through 1496:8.

Michael Kahaian provided expert testimony regarding Maryland's data collection procedures and the effectiveness of Maryland's tobacco enforcement program. MDH Tr. at 1521:19 through 1522:16. Specifically, he testified that Maryland's procedures for collecting information on NPM Units Sold met the professional standards for reliability and sufficiency. MDH Tr. at 1547:11-17. He also opined that Maryland's enforcement efforts for 2005-2007 were effective in increasing compliance with the Qualifying Statute. MDH Tr. at 1547:21 through 1548:2.

To rebut the testimony provided by the State of Maryland, the PMs called two witnesses. Both of the PMs' witnesses provided expert testimony regarding the perceived shortfalls of the Maryland NPM enforcement procedures.

Specifically, **Susan Wynne**, Ph.D., provided expert testimony as a government performance auditor and fraud investigator. MDH Tr. at 1746:14-15. She testified that Maryland

did not ensure the accuracy of the NPM sales data it relied upon to enforce the qualifying statute and that the state took only limited efforts to detect and address off-directory sales. MDH Tr. at 1761:16 through 1762:1. Dr. Wynne provided several facts which she concluded supported her opinions. For example, she testified that Maryland did not verify NPM sales data reported by licensed wholesalers through either desk or field audits. MDH Tr. at 1770:14-17. She also asserted that Maryland didn't adequately investigate discrepancies between NPM certifications and wholesaler reports. MDH Tr. at 1771:9-12.

Karen Engstrom is a certified public accountant and a certified fraud examiner. She testified that Maryland failed to confirm the accuracy and the completeness of reported NPM sales. MDH Tr. at 2122:14-16. To support her opinion, she noted that the State failed to verify the Form 608-3 with the underlying source documentation. MDH Tr. at 2127:11-13. In her opinion, the State should have audited the Form 608-3. MDH Tr. at 2127:15-18. She also criticized Maryland for failing to conduct effective cross-checks of the different forms or resolve the reporting discrepancies discovered by the State. MDH Tr. at 2128:1 through 2131:15.

III. CONTENTIONS OF THE PARTIES

Based upon the evidence provided at the Maryland hearing, the State contends that it diligently enforced its Qualifying Statute for the reasons set forth below. Conversely, the PMs argue that the State clearly failed to prove diligent enforcement for years 2005, 2006, and 2007. The PMs' argument is described in detail below.

A. Maryland's Contentions[6]

The State of Maryland argues that the hearing evidence clearly shows that it diligently enforced its qualifying statute in 2005-2007. To support this contention, Maryland first points to the fact that it already had an effective enforcement regime in place prior to the years in question. For example, Maryland argues that it implemented it complementary legislation in 2003 and 2004 and was putting it to use as of January 2005. Maryland also argues that it had sufficient personnel prior to 2005 to enforce its qualifying statute. Finally, Maryland claims that the market share and escrow deposit rates as proof of its regime's success.

Maryland next argues that the evidence shows that the State only improved upon its prior efforts in 2005-2007. For example, the State contends that it amended tax forms to capture more of the RYO market. Maryland also argues that it dedicated more resources to enforcement by hiring more staff and contracting with Maryland First Financial to improve its data gathering procedures. The State also claims that it improved it enforcement processes when it began to involve the Compliance Division of the Office of the Comptroller in directory enforcement.

The State also avers that it adequately put its enforcement tools to use. As examples to bolster this argument, the State points out that it filed twelve (12) lawsuits against NPMs during 2005-2007. It also notes that it sued SPM Cutting Edge to enforce the terms of the MSA. As further support for its claim, Maryland argues that it actively used the directory to bar noncompliant NPMs from selling in its cigarette market.

Finally, the State contends that the market share data from 2005-2007 conclusively shows

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[6] *See generally The State of Maryland's Post-Hearing Brief* (Lexis ID 70132026) and *The State of Maryland's Post-Hearing Reply Brief* (Lexis ID 70871499).

that Maryland's enforcement efforts were effective. According to the data provided by the State, the PM market share increased during the years at issue. It also shows that the NPMs sales volume decreased during that time.

B. PMs' Contentions[7]

The PMs respond to Maryland's contentions by arguing that Maryland failed to diligently enforce its qualifying statute for several distinct reasons. Each of those reasons is described below.

First, the PMs allege that Maryland generally failed to ensure the accuracy and completeness of the NPM sales data due to a variety of factors. Those factors include the following: (1) that the State failed to audit wholesalers NPM sales reports even though it knew it should be doing so; (2) that Maryland excise tax audits revealed reporting problems that were not investigated for escrow purposes; (3) that Maryland's practice of giving NPMs sales numbers to the manufacturers prevented the State from cross-checking wholesaler reports against NPM reports; (4) that Maryland failed to cross-check wholesalers' Form 608-3 reports with other information it had about NPM sales; (5) that Maryland's process of cross-checking total sales reported on the Form 608 with Form 608-3 was not a useful verification of NPM sales and (6) that the State failed to resolve significant reporting discrepancies for NPM wholesalers Triple C and George J. Falter Co.

In its second contention, the PMs claim that the enforcement statistics used by Maryland to demonstrate diligent enforcement are not reliable. The PMs support this claim with the argument that the underlying data used by the State cannot be verified. The PMs also argue that

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[7] *See generally Participating Manufacturers' Post-Hearing Brief for the State of Maryland Hearing* (Lexis ID 70540220) ("PMs' Maryland Brief").

the industry data compiled in STARS and STR cannot be used to verify the accuracy of the State's numbers.

In its next argument, the PMs contend that Maryland failed to take enforcement actions against SPMs that failed to make MSA payments. The PMs point to Maryland's actions in regard to General Tobacco as support for this argument.

Finally, the PMs claim that the State took only limited steps to detect and address off-directory NPM sales. According to the PMs, the State should have taken more direct enforcement actions to address the sale of off-directory product.

IV. FINDINGS AND CONCLUSIONS AS TO THE STATE OF MARYLAND

Based upon the evidence presented at the Maryland Hearing, this Panel is tasked with determining whether the State of Maryland diligently enforced its Qualifying Statute in the years 2005, 2006, and 2007. As noted above, the term "diligent enforcement" cannot be defined with specificity or measured against a precise metric. Rather, it must be analyzed on a state-by-state basis in accordance with the circumstances existing in the State. Diligent enforcement does not require perfection. Instead, it requires a showing of reasonable and deliberate efforts to enforce the terms of the Qualifying Statute based upon the circumstances in the state during the time frame at issue.

A. Discussion of Enforcement Considerations

In Part One, this Panel set forth several enforcement considerations that it would review in making its state-specific decisions on diligent enforcement. Accordingly, Maryland's actual enforcement efforts during 2005, 2006, and 2007 are analyzed in relation to each of those areas below.

1. **Reporting Requirements – what reporting requirements did the State impose upon the cigarette manufacturers and distributors?**

The evidence produced at the Maryland hearing indicated that the State of Maryland had many reporting requirements during the 2005-2007 time frame. For example, the State required all licensed tobacco distributors to file a Form 608 report each month. MDH Tr. at 168:19-22. This report was used by the Office of the Comptroller to determine the amount of excise tax owed by a licensed distributor. MDH Tr. at 226:17-19. There were also several schedules that could be attached to Form 608. Schedule A, also known as Form 605, was one such attachment. MDH Tr. at 836:4-6; MDH Ex. 208. This schedule was filed by all in-state wholesalers to identify product purchased from out of state. MDH Tr. at 837:8-11, 1390:7-22.

Another required report was Form 608-3. MDH Ex. 118. This form required the distributors to identify the manufacturer and brand of all cigarettes. MDH Tr. at 165:4-8. The form was to be filed quarterly and allowed the State to determine an NPM's escrow deposit obligation. MDH Tr. at 1255:8 through 1256:3.

The State also required the other tobacco product ("OTP") wholesalers to file Form 609 and OTP retailers and consumers to file a Form 610. MDH Tr. at 220:4-7, 224:3-7. Both of these forms contained a Schedule A which required the reporting party to identify the manufacturer of any RYO contained on the forms. MDH Tr. at 221:5-7, 224:14-18.

The hearing evidence also demonstrated that the State was consistently trying to improve its reporting requirements. For example, a Schedule A for Forms 609 and 610 was created during 2005. MDH Tr. at 218:9 through 225:3, 824:15 through 830:16. Similarly, the State amended Form 608-3 during 2005 to require that wholesalers report individual manufacturers on separate pages. MDH Tr. at 170:2 through 171:1, 816:4 through 817:14.

2. Data Collection – what efforts were made by the State to collect cigarette sales (units sold) data and escrow deposit data?

As noted above, tobacco wholesalers were required to file several different forms with the Office of the Comptroller on either a monthly or quarterly basis. Ms. Davis described in detail the steps her office took to make sure the correct forms were filed and were filed on time. MDH Tr. at 801:5 through 803:22. As part of this testimony, Ms. Davis also explained the penalties available to the State if a distributor failed to properly report. *Id.*

She also testified about the actions the office took if mistakes were found in the reporting forms:

> Q. Okay, so did you – if you saw something incorrect on the 608-3 form that you reviewed, what would you do?
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> A. Well, it would depend on the error. If it was a mathematical error, because back then a lot of the returns were still handwritten. So we would add all their figures down the columns to be sure that the math was added correctly.
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> If it was a mathematical error, we would then contact, probably by phone, e-mail back then, and tell them what we found, and then ask for an amended report.
>
> If it was an illegal brand, we would contact the attorney-general's office right away and ask them – tell them what we found, and to be sure that they weren't in the middle of updating a directory that these people had certified, or whatever.

MDH Tr. at 818:13 through 819:9.

Mr. Muthukrishnan also testified about gathering the escrow deposit data. He noted that he would communicate with the NPMs directly to make sure the State had the proper escrow deposit information. MDH Tr. at 1261:2-15; MDH Ex. 270 (phone log of all calls made by Mr. Muthukrishnan). He also required the NPM to provide to the State an official document from a bank confirming the escrow had been deposited. MDH Tr. at 1262:13-17.

All of the efforts described by the State during the state-specific hearing demonstrate that Maryland took sufficient steps to collect sales and escrow data. The State also made efforts to ensure that the reported data was correct and reliable.

3. Data Verification – what efforts were taken by the State to verify the sales and escrow deposit data provided to the State by cigarette manufacturers and distributors?

Data verification is one of the largest points of contention in this proceeding. The State argues that it did an adequate job of verifying the data submitted by the wholesalers and NPMs. The PMs contend that the State could have and should have done a great deal more to confirm the reported data. There are facts in the record to support both parties' contentions.

For example, both Mr. Lapp and Mr. Muthukrishnan testified about the process used to cross-check the Form 608-3 against the Form 608. Mr. Lapp provided general background on the process. MDH Tr. at 244:4 through 246:1. Mr. Muthukrishnan testified as to the specifics of the process:

> Q. I want to talk about some of the regular work that you had done on escrow enforcement. You said that you would review the 608-3s that OAG received from the comptroller. Did you do anything else to verify the information contained on the 608-3s?
>
> A. Yes. I would confirm – I would compare the information reported on the 608-3 against the cigarette sales that were being reported on the Form 608.
>
> * * * *
>
> Q. Okay. And what would you do when you received these forms and were working on this spreadsheet you just described?
>
> A. So I would go to the Form 608-3, the one that had all of the sales broken out by brand and manufacturer and I would add up all of the sales by manufacturer to come up with a sum total of sales for the quarter on the 608-3.

> And I would enter that number into the appropriate line in the spreadsheet, and the I would go to the Form 608 for the corresponding calendar quarter. So first quarter of January, February, March, and then take the number of cigarette packs sold from each of those three reports and put those onto corresponding lines.
>
> And that way I could obtain a total of the cigarettes sales for the quarter reported on the 608 and compare that to the total of cigarettes sales that were reported on the 608-3.

MDH Tr. at 1275:14 through 1276:2, 1278:11 through 1279:10; MDH Ex. 277.

The PMs forward several arguments claiming that the cross-check used by the Attorney General's Office was an insufficient verification process. A couple of these arguments do identify minor deficiencies in the Maryland enforcement regime. For example, the PMs point to evidence that Maryland did not audit NPM sales reports during 2005-2007 even though it could have used its existing audit system to do so. MDH Tr. at 1104:11-16, 1877:11-15; *see also* PMs' Maryland Brief at 8 (noting that Maryland began auditing Form 608-3 reports in 2015). Second, the State's practice of providing numbers from the 608-3s to the manufacturers in advance of the NPM certifications did prevent the State from conducting another level of cross-checking. MDH Tr. at 656:8-14.

However, despite the deficiencies identified by the PMs, the Panel finds that the State of Maryland did an adequate job of verifying the reported data. There was no credible evidence in the record indicating that Maryland failed to account for significant NPM sales. In fact, the evidence presented regarding the PMs' own sales numbers (STARS and STR) strongly corroborates the State's argument that it had accurate data regarding sales of NPM product. MDH Tr. at 1615:5-8 (Mr. Kahaian noting that STARS and STR data was very similar to Maryland's data for 2004, 2005, 2006, and 2007).

4. Inspection Activities – did the State have a reasonable strategy to conduct distributor and retail inspections of inventory?

As noted above, two Maryland witnesses testified extensively about the audit and inspection activities of the State. This testimony exhibited that Maryland had a reasonable strategy to inspect tobacco wholesalers and retailers in the State during the 2005-2007 time frame.

Mr. Byrd generally testified regarding the compliance division audits. He stated that there were about six (6) auditors during 2005-2007 and that the auditors conducted field audits for all wholesalers located with Maryland on an annual basis. MDH Tr. at 955:6-9, 1048:13-17. Although the main focus of the audits was compliance with excise tax laws, the auditors also checked for off-directory product during their audits beginning in 2005. MDH Tr. at 957:18-21, 1009:18 through 1014:15. During an audit, the division auditors would do a joint physical inventory with the distributor. MDH Tr. at 985:22 through 986:5. The auditors also looked at various distributor business records such as stamp purchase records, shipping documentation, and sales summaries. MDH Tr. at 960:14-20, 964:8-10, 971:22 through 972:7.

Mr. George provided testimony regarding the inspection activities taken by the field enforcement division in the Office of Comptroller. He stated that the division inspected half of all licensed tobacco retailers each year. MDH Tr. at 1172:5-12. During the inspection, the agent would review the retailer's license, purchase invoices, and the prices of the product. MDH Tr. at 1188:3 through 1192:18. They also made sure the packs were stamped and that the brands were listed on the directory. MDH Tr. at 1189:11 through 1190:6, 1195:15 through 1201:19. If non-compliant product was found, it was seized by the agents. MDH Tr. at 1196:14 through 1197:3.

5. Implementation and Enforcement of Directories – did the State effectively use the directory as a tool to enforce the Qualifying Statute?

The hearing transcript is replete with evidence regarding the State's use of the directory as a tool to enforce the Qualifying Statute. Both Mr. Lapp and Mr. Muthukrishnan testified at length about their use and management to the directory in the Attorney General's Office. For example, Mr. Lapp testified that any tobacco manufacturer not listed on the directory was strictly prohibited from selling product in Maryland under the Complementary Legislation. MDH Tr. at 139:1 through 140:1. He also testified to specific examples where he removed manufacturers from the directory for failing to deposit escrow. MDH Tr. at 344:17 through 348:20 (discussing his removal of Tabacalera Honnington and Tabacalera Nazionale from the directory for failing to pay escrow).

In his testimony, Mr. Muthukrishnan detailed the process for adding a manufacturer to the directory. The first step in this process occurred when a manufacturer filed a brand certification form, which Mr. Muthukrishnan described as follows:

> Q. You spoke about the brand certification form. Can you tell us some more details about what the brand certification form is?
>
> A. The certification form was about – when I started in 2007, I believe six or eight pages long, and it requested basic corporate information such as name, address, phone number, website, point of contact, that sort of thing. That would be Page 1.
>
> Then manufacturers would indicate whether they were participating or nonparticipating manufacturer. And they would have to provide a list of their brands that they were seeking to certify in the state.
>
> And then it also asked for various supplemental documentation.

MDH Tr. at 1318:7 through 1319:1. After the form was submitted, Mr. Muthukrishnan would then begin the work of reviewing the form and verifying the submitted information. MDH Tr. at 1319:2 through 1338:16. For example, he would check websites and phone numbers. MDH Tr.

at 1321: 1-10. He also would check the company's escrow deposit history before allowing them to be listed on the directory. MDH Tr. at 1327:2-14.

Other state employees also testified that they commonly referred to the directory as part of their job duties. Denise Davis testified that the revenue administration division within the Office of the Comptroller reviewed the Form 608-3 for directory compliance. MDH Tr. at 814:17 through 815:1-5. The compliance division also was checking inventory against the product authorized by the directory during 2005-2007. MDH Tr. at 1009:18 through 1011:21. Similarly, field enforcement agent Mr. George testified that he also checked for off-directory brands during his retail inspections. MDH Tr. at 1195:15 through 1196:9; MDH Ex. 168.

The collective action of the agencies to enforce the directory produced results for the State of Maryland. During the 2005-2007 time period, the Maryland Attorney General's Office removed fourteen (14) NPMs from directory and prevented them from selling tobacco in the State. MDH Ex. 188. As a result, the number of NPMs on the State's directory was reduced from nineteen (19) in 2005 to six (6) by the end of 2007. MDH Tr. at 512:21 through 513:10.

6. Penalties and Lawsuits for Noncompliance – did the State make reasonable efforts to address noncompliance with the assessment of penalties and the use of lawsuits?

The evidence provided at the Maryland hearing clearly demonstrated the State's willingness to sue noncompliant manufacturers and assess penalties. During the 2005-2007 time period, the Attorney General's Office filed twelve lawsuits against NPMs that failed to deposit escrow. MDH Ex. 190. Eleven of these cases resulted in judgements and the remaining case ended with NPM Seneca-Cayuga agreeing to pay the full amount of escrow plus penalties. MDH Tr. at 329:13 through 331:20; MDH Ex. 190. Although the State acquired judgments against the

NPMs, the judgments rarely resulted in collection. MDH Tr. at 307:14-22. Yet, Mr. Lapp thought it was important for the Attorney General's Office to continue to file lawsuits against the NPMs:

> Q. Let me ask this: You sued anyway, even though you had a sense that they were not terribly effective of getting escrow deposits, right? Is there a reason why?
>
> A. Yes. Especially, you know, this is still relatively early in time, an so we thought that maybe there is a chance that we would be able to collect on a judgment. There was, you know, there was possibility of attaching assets if they had any in the United States. There was the possibility, you know, some of these NPMs, again, most of noncompliance was pre-directory, but there is a possibility of states working together to go after judgments.
>
> Most of the money involved with these foreign manufacturers, it wasn't all that cost effective necessarily to go to Korea and try and collect 200,000 or whatever in escrow, or sometimes much less than that. But there was the possibility that the states might work out something together.
>
> I wanted to, you know, do everything that I could do and so I filed the lawsuits and we got the judgments.

MDH Tr. at 308:1 through 309:3.

During the relevant time frame, the State also sued an SPM named Cutting Edge to enforce the provisions of the MSA and revoke its corporate status for trying to sell NPM brands under its SPM status. MDH Tr. at 405:19 through 406:3. Ultimately, the State succeeded on the suit and prevented Cutting Edge from selling product in Maryland and other states. MDH Tr. at 415:6-11, 417:21 through 418:2.

7. Resources and Staffing Allocated to Enforcement – did the State allocate appropriate levels of staffing and resources to enforcement of the Qualifying Statute?

The State spent a large amount of hearing time addressing the resources and staffing allocated to its enforcement activities during 2005-2007. A review of this testimony illustrates that the State took its diligent enforcement efforts very seriously and devoted adequate resources

and staff to those efforts. For example, prior to 2005, the State had an experienced team at the Attorney General's Office and the Office of the Comptroller working on tobacco enforcement issues. MDH Tr. at 111:12 through 112:9, 780:11 through 782:19. This included staff such as David Lapp, Denise Davies, Roberta Hastey, and Christie Mattox. MDH Tr. at 111:12-21.

In 2005, the State devoted additional resources to its enforcement efforts when it retained the firm of Maryland First Financial to help it determine whether the procedures it was using to verify and investigate sales figures for NPM was accurate or not. MDH Tr. at 262:1-9. Similarly, in 2007, the Attorney General's Office again bolstered its staffing when it created a separate unit for tobacco enforcement and hired an additional attorney to focus on diligent enforcement issues. MDH Tr. at 243:13-16.

8. Coordination Between Agencies – did all State agencies involved with enforcement of the Qualifying Statute adequately coordinate and communicate with each other?

The hearing transcript reflects evidence illustrating coordination and communication between the Attorney General's Office and the Office of the Comptroller in regard to enforcement of the qualifying statute. For example, multiple witnesses testified about the standard reporting system used by the State and how it required near constant communication between the agencies. However, the testimony of Mr. Muthukrishnan best described the process:

> Q. And where did those reports initially go?
>
> A. They were submitted to the office of the comptroller as part of the cigarette tax forms that all wholesalers have to submit.
>
> Q. And I know we've heard from Ms. Davis, but what would the comptroller's office do once they received the 608-3 reports?
>
> A. The would take the 608-3s and review the cigarettes that were reported. They would tabulate those cigarettes by manufacturer into a spreadsheet, they

would e-mail that spreadsheet to the office of the attorney general.

Q. Did the office of the attorney general also receive the 608-3 reports that were submitted initially to the comptroller?

A. Yes. After the comptroller had finished tabulating the reports, they would [sic] them to the office of the attorney general via courier, so we'd get a physical copy of the reports.

MDH Tr. at 1256:4 through 1257:3.

There was also testimony regarding occasions where the agencies worked together to improve the existing enforcement regime. For instance, the Attorney General's Office worked with the Office of the Comptroller to amend certain reporting forms to close a reporting loophole for NPM RYO. MDH Tr. at 213:4 through 225:20. The agencies also worked together with Maryland First Financial to help the State set up better procedures for gathering and verifying wholesalers' reports. MDH Tr. at 262:1-9.

Finally, there was also evidence indicating that the agencies worked together to enforce the directory. For example, in late 2004, Mr. Lapp asked the Field Enforcement Division to begin checking for directory compliance during their routine retail inspections. MDH Tr. at 248:7-10. These directory checks continued through 2005, 2006, and 2007. MDH Tr. at 248:11-13. Mr. Lapp even provided training to the field enforcement agents regarding complementary legislation and the use of the directory. MDH Tr. at 247:11 through 248:6. The Compliance Division was also working in concert with the Attorney General's office to enforce the directory. Mr. Byrd testified that his office checked for off-directory product during each audit in the 2005-2007 time frame. MDH Tr. at 1010:13-20.

9. Effect on Market – did the State's actions have a positive effect on the NPM tobacco market?

Maryland produced two witnesses to discuss the NPM market in the State during the time in question – Mr. Lipnitsky and Mr. Kahaian. As mentioned above, Mr. Lipnitsky testified as a Rule 1006 summary witness. The summaries he provided contained statistics pertaining to Maryland's enforcement efforts and the effect such efforts had on the Maryland NPM tobacco market. *See* MDH Exs. 180, 182, 183, 185, 186, 187, 188, 189, 190, 195 and 196.

Many of the data summaries complied by Mr. Lipnitsky were also used by Mr. Kahaian in formulating his expert opinion. MDH Tr. at 1654:22 through 1664:22. For example, Mr. Kahaian testified regarding the escrow deposit rate and provided an exhibit showing the actual numbers. MDH Tr. at 1571:10 through 1577:1; MDH Ex 185. According to the exhibit, the deposit rate increased every year between 2004 and 2007 with one exception in 2005. MDH Ex. 185. Ultimately, in 2007, the escrow deposit rate was one hundred percent (100%). *Id.* Mr. Kahaian also explained why the rate decreased in 2005, citing to the issues surrounding Tabacalera Nazionale and Tabacalera Regionale. MDH Tr. at 1574:9 through 1576:1.

Second, Mr. Kahaian testified that the Maryland enforcement efforts yielded a smaller NPM market share:

> A. Well, it shows us – on the top it shows us the NPM market share based on that calculation. The red represents the NPM percentage of the total Maryland market, and the – the number inside the – the pie, we'll call it, represents the – the NPM market share for the entire Maryland market each one of years: 2004, 2005, 2006, and 2007.
>
> Q. And what's happening to the market share over this time?
>
> A. Well, it shows that the market share of NPM is declining from 0.63 in 2004 to 0.5 in 2005 to 0.34 in 2006 to 0.30 in 2007.

MDH Tr. at 1590:6-13.

Finally, Mr. Kahaian testified about a statistic he called the "enforcement rate," which he described as follows:

> Q. What is the enforcement rate?
>
> A. So enforcement rate is very similar to deposit rate. Yet, I wanted to use a quantifiable way to determine how much of the sales of NPM units sold were either compelled escrow paid, or that there was enforcement upon it. And I added the escrow paid the NPM units sold on which lawsuits were filed and judgments were obtained. So when I added those two together, and then divided it by the total NPM units sold on which escrow was due. That was how I calculate the enforcement rate.
>
> * * * *
>
> Q. And so tell me, the enforcement rate was units sold plus judgments actually obtained, right?
>
> A. Actual judgments obtained, yes.

MDH Tr. at 1577:18 through 1578:7; 1578:12-15. According to Mr. Kahaian's testimony and his demonstrative exhibit, Maryland's enforcement rate was 99.4% in 2004, 99.9% in 2005, 97.8% in 2006, and 100.0% in 2007. *See generally* MDH Tr. at 1578:8 through 1588:9. Mr. Kahaian also explained that a later payment made by an NPM would have raised the enforcement rate for 2006 to 99.9%. MDH Tr. at 1580:14 through 1581:5. However, due to the timing of the payment he did not consider it in his calculations. MDH Tr. at 1581:6-14.

The data detailed by the State's witnesses shows that Maryland's efforts did affect the NPM tobacco market in the State. The PMs argue these statistics are of limited relevance. *See* PMs' Maryland Brief at 27. However, the Panel disagrees. Evidence that a State significantly and consistently reduced the NPM tobacco market is indicative of diligent enforcement efforts.

B. Conclusion

After comparing Maryland's 2005-2007 enforcement actions against the areas set forth by the Panel, the Panel finds that Maryland carried its burden of establishing diligent enforcement in years 2005, 2006, and 2007. The evidence demonstrates that Maryland had a comprehensive and well-coordinated program and that the State used its best efforts to successfully eradicate noncompliant NPM manufacturers, collect NPM escrow deposits, sufficiently monitor wholesalers and retailers, and level the playing field between the PMs and NPMs.

PART THREE – INTERIM AWARD FOR THE STATE OF MARYLAND

Based upon the evidence presented at the Maryland arbitration hearing, and for the reasons set forth above in the State-Specific Findings, the Panel unanimously finds that Maryland diligently enforced its Qualifying Statute during calendar years 2005, 2006, and 2007. Therefore, Maryland is not subject to an NPM Adjustment pursuant to Section IX(d)(2)(B) of the Master Settlement Agreement. Any other claims not specifically addressed in this Award are hereby DENIED.

DATED this 17th day of November, 2023.

Hon. Carlos R. Moreno (Ret.)

Hon. William F. Downes (Ret.) Chair

Hon. Lawrence F. Stengel (Ret.)