

# TOBACCO RECOUPMENT

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HEARING  
BEFORE A  
SUBCOMMITTEE OF THE  
COMMITTEE ON APPROPRIATIONS  
UNITED STATES SENATE  
ONE HUNDRED SIXTH CONGRESS  
FIRST SESSION  
—————  
**SPECIAL HEARING**  
—————

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# TOBACCO RECOUPMENT

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MONDAY, MARCH 15, 1999

U.S. SENATE,  
SUBCOMMITTEE ON LABOR, HEALTH AND HUMAN  
SERVICES, AND EDUCATION, AND RELATED AGENCIES,  
COMMITTEE ON APPROPRIATIONS,  
*Washington, DC.*

The subcommittee met at 11:36 a.m., in room SD-124, Dirksen Senate Office Building, Hon. Kay Bailey Hutchison presiding.  
Present: Senators Specter and Hutchison.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

HEALTH CARE FINANCING ADMINISTRATION

**STATEMENT OF HON. MICHAEL HASH, DEPUTY ADMINISTRATOR**

OPENING STATEMENT OF SENATOR HUTCHISON

Senator HUTCHISON. I think we are ready, and I apologize for our running a little late. I just came in from the airport and Senator Specter's train is late coming in from Pennsylvania this morning. So that is the hazard of a Monday morning hearing.

But I am very pleased to see the very first-rate witnesses that we have been able to put together, because this is an issue that is going to be coming to the floor very shortly and I think having the witnesses explain their various positions will be very important.

I would like to start with my own statement. I am on the subcommittee which Senator Specter chairs, but I also am the sponsor of S. 346, which is the vehicle that we are using to deal with the tobacco recoupment issue. Senator Bob Graham is my co-sponsor and we now have 43 co-sponsors of the bill. So I am very pleased that we are going to be able to talk about this.

In brief, my bill, along with Senator Graham, is to clarify existing Federal law to prevent what I believe to be an erroneous interpretation of that law by the Health Care Financing Administration. HCFA's stated position has been that every dollar of every State settlement is directly attributable to Medicaid and that the Federal Government is therefore entitled to 57 percent of those funds, which is the national average Federal share of the Medicaid program.

I think that position is not correct on the merits. I have looked at the law carefully and I just do not read into the law what HCFA is claiming that it says. So I will look forward to hearing from the HCFA representative to explain the point of view of HCFA.

But I and the supporters of the bill believe that it is wrong for the Federal Government to try to seize any of these State funds. It will lead to years of protracted litigation that would tie up the money. I would like for this to be clarified, which is why I have put this bill onto the supplemental appropriations bill. We definitely need to have clarification.

Many State legislatures are meeting right now. Many of these legislatures meet only once every 2 years, and they do not feel comfortable spending the money as long as the HCFA letter is out there saying that Medicaid is entitled to part of these funds.

The fallback position as stated by the President to the Governors recently is that, well, perhaps the Federal Government does not need to take the money from Medicaid, but they would like to have a 25 percent requirement that the States spend the money on tobacco cessation programs. Well, I have looked at the stated purposes for which many States are going to use their recoupment funds and some of them do have tobacco recoupment programs, some have them but not at the 25 percent level, and some big States especially, spending 25 percent of the money on tobacco recoupment for a State like—I am sorry—for the cessation of tobacco use by teenagers, 25 percent of the funds for Texas or California would create quite a few entrepreneurs for seminars in our State.

So I do not think that the Federal Government should try to do a one size fits all approach here, nor on the merits do I think that the Federal Government has any kind of rightful claim. The Federal Government was not part of these lawsuits and most certainly the fact that they have announced their intention, the Justice Department, to sue the tobacco companies shows that they have a separate cause of action, as I understand it, based on Medicare.

So I am glad that we have experts in this field. I think that we can clarify both the Federal Government position and the State government position, and now is the time to begin. Let me just lay out the ground rules quickly for you. Each witness will have 5 minutes to make a statement and then following that each Senator will have 5 minutes to ask questions.

So with that, I would like to call the first panel, which is Mr. Michael—which is represented by Mr. Michael Hash, the Deputy Administrator of the Health Care Financing Administration, fondly known as “HCFA.” Prior to joining HCFA in April of 1998, Mr. Hash was a principal with Health Policy Alternatives, a consulting firm specializing in health care financing.

So, Mr. Hash we certainly welcome you to the panel and would like to hear your interpretation of the law or whatever you would like to say. Thank you.

#### SUMMARY STATEMENT OF MICHAEL HASH

Mr. HASH. Thank you, Senator Hutchison. We appreciate you holding this hearing and inviting us to discuss our obligations under current law to recoup Federal taxpayers’ share of Medicaid funds from State tobacco settlements.

State Governors and their attorneys general have achieved an enormous victory. They have worked hard to hold tobacco firms accountable for the health care costs of smoking-related illnesses. We

are pleased that many States, like the President has suggested, want to use tobacco settlement money to fight teen smoking, to protect tobacco farmers, to assist children, and to promote the public health.

However, existing Federal law clearly requires States to share all Medicaid recoveries from liable third parties with Federal taxpayers, who pay more than half of all Medicaid costs. Nothing in the law as we read it creates an exception for tobacco settlements, regardless of their size. States routinely share Medicaid recoupments with Federal taxpayers. In fact, three States have already reported earlier tobacco settlements with the Liggett Corporation.

My written testimony outlines the current legal authorities and the history of this issue in some detail, so I will just simply summarize for now. Federal law specifically requires States to pursue Medicaid recoveries from third parties. The law does not authorize the Federal Government to bring or participate in these suits. States must return and report these recoveries to HCFA so that Federal taxpayers receive their fair share.

HCFA passes the savings from Medicaid recoupments back to Federal taxpayers by subtracting the Federal share of Medicaid recoupments, minus costs incurred by the States in obtaining these recoveries, from future Medicare payments to the State. Over the last 5 years Federal taxpayers have recouped more than \$1.5 billion from third party liability collections by the States.

The State tobacco settlements clearly include restitution for costs of Medicaid tobacco-related illnesses. In fact, the States' tobacco settlements prohibit States from making any future claims for Federal and State tobacco-related Medicaid expenditures. That means that Federal taxpayers are precluded from taking any action to recoup their fair share of Medicaid expenditures for tobacco-related illnesses. Federal taxpayers are, therefore, clearly entitled to a share of tobacco-related Medicaid expenditures.

However, as the President has said in his budget and otherwise, in lieu of exercising our claims under Federal law, the administration has proposed giving States flexibility and discretion over how these funds would be spent. Specifically, the President has proposed that States keep 100 percent of the tobacco settlement funds in exchange for a commitment to use a portion of the funds to reduce youth smoking, to improve the public health, to protect tobacco farmers, and to assist children.

#### PREPARED STATEMENT

The details of this arrangement would be worked out through negotiations with the Congress and the States. We want to work with you and the States to find a bipartisan resolution of Federal taxpayers' claims to tobacco settlements and one that we agree is fair to all Americans.

I want to thank you again for holding this hearing and I am happy to answer any questions that you might have.

[The statement follows:]

## PREPARED STATEMENT OF MICHAEL HASH

Chairman Specter, Senator Harkin, distinguished subcommittee members, thank you for inviting me to discuss the Health Care Financing Administration's obligation under current law to recoup Federal taxpayers' share of Medicaid funds from State tobacco settlements.

In November 1998, several State Attorneys General reached an historic settlement with the tobacco industry that provides reimbursement to the States for some of the health care costs associated with treating smoking-related illnesses. The Attorneys General deserve a great deal of praise for crafting this important agreement. The settlement follows and confirms an important principle established with the 1996 settlement with the Liggett tobacco corporation: tobacco companies must be held accountable for the damage their product does to our nation's health. Most importantly, the national agreement will help curb smoking among our nation's youth, a goal that the Administration and members of this Subcommittee share.

As the Subcommittee knows, the Administration began our tobacco efforts four years ago with the strong leadership of the President, Vice President, and the then Commissioner of the Food and Drug Administration (FDA). The FDA then put in place a strong crackdown on youth access to tobacco, the broadest and most significant effort to date to protect our children from the dangers of tobacco. Last year, the president sought comprehensive tobacco legislation and, while the 1998 State tobacco settlement was an important step in the right direction, more must be done to protect our children and hold the tobacco industry accountable.

We are here today to talk about Medicaid recoupment. Existing Federal law clearly requires States to share all Medicaid recoveries with Federal taxpayers. Nothing in the law creates an exception for tobacco settlements, regardless of their size. States routinely report and credit HCFA with the Federal share of third party liability collections. It is worth highlighting that three States—Massachusetts, Louisiana, and Florida—reported and credited to HCFA some of their tobacco collections as part of a settlement with the Liggett Corporation. Although the funds involved in the Liggett settlement are much smaller than those at stake in the comprehensive settlement, these initial payments indicate that the States understand their legal and fiduciary responsibility to credit the Federal government with its share of tobacco settlement proceeds.

Rather than having HCFA claim the full Federal share of the comprehensive settlement through current law procedures, the Administration has proposed an approach that gives States flexibility and discretion over how these funds will be spent. Specifically, the Administration proposes that States keep 100 percent of the tobacco settlement funds in exchange for a commitment to use a portion of the proceeds to reduce youth smoking, protect tobacco farmers, improve public health and assist children. The details of this arrangement would be worked out through negotiation with the States and Congress. Without such an arrangement, not a single penny of tobacco settlement funds would have to be used to reduce youth smoking.

## BACKGROUND

Medicaid is a joint Federal/State partnership, in which States run their own individual Medicaid programs within Federal guidelines, and the Federal government pays for, on average, 57 percent of State Medicaid costs. The Federal match rate is at least 50 percent in all States and as high as 77 percent. State administrative costs, including costs incurred in pursuit of Medicaid cost recoveries, qualify for Federal matching at a rate of 50 percent.

Federal law specifically requires States to pursue Medicaid recoveries from third parties. The law says States must report these recoveries to HCFA so that Federal taxpayers receive their fair share of such recoveries.

This dates back to the beginning of the Medicaid program. The Title XIX Medicaid chapter of the Social Security Act at section 1903(d)(2) specifically requires that Federal taxpayers be reimbursed for the Federal share of Medicaid expenditures that States recovered from liability cases involving third parties.

Section 1903(d) of the Social Security Act mandates that States allocate from the amount of any Medicaid-related recovery the pro-rata share to which the Federal Government is entitled. Specifically, this law states:

(2)(A) The Secretary shall then pay to the State, in such installments as he may determine, the amount so estimated, reduced or increased to the extent of any overpayment or underpayment which the Secretary determines was made under this section to such State for any prior quarter and with respect to which adjustment has not already been made under this subsection.

(2)(B) Expenditures for which payments were made to the State under subsection (a) shall be treated as an overpayment to the extent that the State or local agency administering such plan has been reimbursed for such expenditures by a third party pursuant to the provisions of its plan in compliance with section 1902(a)(25). . . .

(2)(3) The pro rata share to which the United States is equitably entitled, as determined by the Secretary, of the net amount recovered during any quarter by the State or any political subdivision thereof with respect to medical assistance furnished under the State plan shall be considered an overpayment to be adjusted under this subsection.

These statutory requirements have been in existence for 30 years. Furthermore, 42 U.S.C. §§ 1396a(a)(25)(A), which became effective March 31, 1968, establishes that it is the State's responsibility "to ascertain the legal liability of third parties . . . to pay for care and services available under the [State's Medicaid] plan." Regulations set forth in 42 CFR 433.136 define "third party" as "any individual, entity or program that is or may be liable to pay all or part of the expenditures for medical assistance furnished under a State plan." Also, 42 CFR 433.140(c) describes the State's obligation clearly: "If the State receives FFP [Federal financial participation] in Medicaid payments for which it receives third party reimbursement, the State must pay the Federal government a portion of the reimbursement determined in accordance with the FMAP [Federal medical assistance percentage] for the State." It is important to recognize that unlike the States, the Federal Government is not authorized by the Medicaid statute to sue third parties directly. This does not mean, however, that Congress intended to abdicate its claim to such recoveries. Rather, the Medicaid statute protects the Federal Government's interests by explicitly making the States responsible for both pursuing these recoveries, reporting them to HCFA, and ensuring that the Federal Government receives its share. Thus, the State cannot pursue only State claims; it is obligated to pursue both State and Federal claims at the same time.

States routinely comply with this law. Three States—Florida, Louisiana, and Massachusetts—reported recoupments of more than \$780,000 from tobacco settlements with the Liggett Corporation.

In fiscal 1998, States reported more than \$642 million in recoveries for medical costs for which another party was liable, often because a judge ruled that the other party was at fault. Federal taxpayers' share of third party liability Medicaid recoupments reported from fiscal year 1994 through fiscal year 1998 totaled \$1.5 billion.

HCFA passes savings from Medicaid recoupments back to Federal taxpayers by subtracting the Federal share of Medicaid recoupments, minus costs incurred by States in obtaining the recoveries, from future Medicaid disbursements to States.

Just like in the tobacco settlements, States routinely undertake Medicaid recoupment actions without any Federal involvement. In fact, Federal law authorizes only States, and not the Federal government, to file lawsuits under the Medicaid statute to recoup Medicaid funds. It says it is States' responsibility "to ascertain the legal liability of third parties . . . to pay for care and services" under State Medicaid plans.

#### DETERMINING FEDERAL TAXPAYERS' FAIR SHARE

The State tobacco settlements clearly include restitution for the costs to Medicaid of care for disease caused by tobacco. In fact, the Florida settlement specifically states that it in part covers Medicaid expenditures. In exchange for settlement funds, all the States gave up all present and future claims, including all Federal Medicaid claims. These settlements legally prohibit States from making any future claims for tobacco-related Medicaid expenditures, and the Social Security Act does not authorize the Federal government from bringing Medicaid recoupment suits.

That means Federal taxpayers are precluded from taking any other route for recouping their fair share of Medicaid expenditures for tobacco-related illnesses, and since their tax dollars went to States to cover these costs. Federal taxpayers are, therefore, clearly entitled to a share of the settlement for tobacco-related Medicaid expenditures.

#### CONCLUSION

We commend States for their historic achievement in obtaining settlements from tobacco companies. The Social Security Act does not authorize us to seek Medicaid restitutions from third parties, and only States could have done what they did. We are currently working with our colleagues at the Justice Department to secure a

similar recovery from tobacco companies for costs of treating tobacco-related diseases incurred by Medicare and other Federal health programs outside of Medicaid.

We want to work with you and States to find a resolution of Federal taxpayers' claim to tobacco settlements that we all agree is fair to all Americans. I thank you for holding this hearing, and I am happy to answer your questions.

#### FEDERAL TAXPAYERS

Senator HUTCHISON. Thank you, Mr. Hash.

I would like to first ask you about your statement that Federal taxpayers would be shut out. The Justice Department has given notice that it plans to sue the tobacco companies under Medicare. So I do think—I do not see that the Federal taxpayers are going to be shut out.

Mr. HASH. These are, Senator Hutchison, two distinctly separate matters, I believe. On the one hand, the suit that you refer to that the President announced in his State of the Union Address reflects the recovery of direct health care costs to Federal programs such as Medicare, the VA, the DOD, and other direct Federal health care programs.

The matter of Medicaid expenditures, 57 percent on average which are Federal, is the subject I think of our discussion this morning, and under the law we do not have any recourse to bring suits of our own. In fact, as a term of the settlements that the States have entered into with the tobacco companies, States have waived their rights to any future claims on Medicaid, which would effectively extinguish any claims that the Federal Government would have with respect to Medicaid.

Senator HUTCHISON. With respect to Medicaid, but would you not accede to the point that Medicare is much more general in coverage and perhaps is even a better Federal case as a first point? And then second, if the Federal Government felt that it had a fair claim under Medicaid, why did not the Federal Government sue under Medicaid in the first place?

Mr. HASH. Well, with respect to the first question, Senator, we believe that the Federal Government does have a right to make a claim for Federal expenditures associated with tobacco-related illnesses for Medicare beneficiaries.

With respect to your second question, regarding the ability of the Federal Government to pursue its own claims with Medicaid, as I indicated, our reading of the statute is that the Federal Government is precluded from being a party to suits under Medicaid. The statute specifically sets forth that States are to pursue third party liabilities under the Medicaid Program and then to in turn share those recoupments with the Federal Government on the basis of the Federal Government's share of the Medicaid Program.

Senator HUTCHISON. Does it bother you at all that many States sued not even mentioning Medicaid as a cause of action? Some of the causes of action were consumer protection, racketeering, anti-trust violations. Some States did assert direct health care costs, but others did not. In some cases Medicaid was thrown out, and in fact to my knowledge only Florida even mentioned Medicaid in the final settlement. There may have been one or two others, but the vast majority were on other causes of action.

Mr. HASH. Senator, I think the answer to that question is of course we would like to work with the States to identify any evi-

dence that they have that the settlements that they entered into, in fact, do not reflect any Medicaid-related costs. But as I mentioned earlier, the fact that they explicitly waived any future claim against the companies with respect to Medicaid expenditures suggests that the settlements are related to Medicaid expenditures.

The Justice Department has reviewed the initial State filings of the lawsuits and determined that they almost all were predicated on Medicaid costs. There have been a number of outside, independent studies that have found that smoking-related costs attributable to the Medicaid Program are on average about \$12.9 billion a year.

Senator HUTCHISON. How did HCFA come to the \$18.9 billion figure in the President's budget?

Mr. HASH. Actually, I think with respect to that I should respectfully refer you to the Office of Management and Budget. But I think the shorter answer on that is that it is an estimation of the portion of the 57 percent of the settlement amount due to the Federal Government spread over a 4-year period.

Senator HUTCHISON. I do not see how you can get to that point. As I understand it, Medicaid is annually about \$175 billion, so 57 percent would be much more than \$18.9 billion.

Mr. HASH. It is a portion of the 57 percent of the State settlements that is estimated to flow to the States over the next 5 years.

Senator HUTCHISON. But is that not the average that would go to the States of the Medicaid expenditures?

Mr. HASH. I believe that the \$18.9 billion is related to the 57 percent of the States' collective share of the settlements that they would receive over the next 5 years.

Senator HUTCHISON. So you just based it on what the States' take was, regardless of what the States alleged, what their causes of action were? You just picked that number?

Mr. HASH. Well, as I said, Senator, I think what the President intends here is that we work with the States to review all the evidence that they may have regarding the basis upon which their claims were made, in order that we can jointly arrive at an appropriate allocation of the funds between Medicaid and whatever other bases that the States may have made in terms of their settlement.

Senator HUTCHISON. Let me—my time is almost up, but let me just ask you: If you are taking the position that this is Medicaid costs, how do you arrive then at the compromise that the President proposed, which would be tobacco cessation programs to the tune of 25 percent in lieu of the Medicaid costs? Does that not seem a little far-fetched if Medicaid cost reimbursement is your goal?

Mr. HASH. Well, Senator, I think the President's intention is to work with the Congress and the States to arrive at a mutual agreement about an appropriate allocation of these funds. The President has suggested a number of what we believe are shared national and Federal priorities, including assisting children, reducing youth smoking, providing for the public health, and assisting farmers who are adversely affected.

Those kinds of priorities are somewhat similar to what the Congress and the administration worked on last year in the context of the McCain bill, which I am sure you will recall set forth a kind of menu of options. I think that is what the President has in mind

when he has taken the position of working with the Congress and the States to arrive at a mutual understanding and agreement about an appropriate allocation of these funds.

Senator HUTCHISON. I think from the way you describe it, respectfully, it is a Federal grab to say that, we are taking this position because we think that it is Medicaid funds, but if you just refuse to do that then let us give you a menu of options that would be acceptable to the Federal Government for you to spend the State-earned tobacco recoupment money.

I am not drawing the nexus there.

Mr. HASH. Well, I guess I would have to respectfully say that we do not agree that this is a Federal grab, Senator. We believe that under the law the Federal taxpayers are actually entitled to their fair share of these recoupments because they provided half of the funding, roughly, for the Medicaid program along with the States.

So I think we do not see it in the same context as a Federal grab. In the context of arriving at a mutual understanding about how these proceeds could be most effectively used, I think we are willing to look at a variety of ways in which the money might be applied.

But absent some agreement that is really memorialized in legislation, we would have no assurance that even one penny of these funds would be used for preventing tobacco use by young people or any other public health use. States could use them for whatever purpose they might want, having nothing to do with these pressing public health needs.

Senator HUTCHISON. Well, it just seems to me that if you believe that Medicaid is entitled to reimbursement, that you should pursue that option and not try to dictate to the States the range of things that would be acceptable to the big brother Federal Government, and perhaps you should pursue legislation in Congress. If you think that Medicaid is really being wronged, then perhaps the States did not have the right to bypass the Federal Government under Medicaid, and if you think that is a better cause of action why did you not just come to Congress and ask for legislation that would override the States?

Mr. HASH. Well, as I mentioned to you earlier, under current law, Federal law, we do not have any standing to be a plaintiff in a suit to recover third party liabilities from any party, including tobacco companies. So we do not have—

Senator HUTCHISON. But that is exactly the question that I am asking you: Why do you not pursue that if you really believe that it is HCFA's right to do so?

Mr. HASH. I think the President's view on this is that we should work together toward an acceptable agreement about the allocation of the money which has now been awarded to the States through their settlement agreements. That money is there. We should work to make sure that it is applied to pressing public health needs and to the prevention of youth smoking.

Senator HUTCHISON. Well, I guess I would just hopefully, respectfully, disagree that you could say it is Medicaid money, but you are not pursuing your Federal right to come to Congress and ask for the ability to sue, so the States are not wanting to give you Medicaid money because many of their lawsuits were not based on that,

so the Federal Government should be able to come in and say, well, if we are not going to have Medicaid money and if we are not going to pursue our right to Congress to file suit under Medicaid let us tell the States what they should be doing with the money.

I think there is not a nexus, and hopefully we can work with you or with the Justice Department on Medicare. I am glad the Federal Government is going to sue the tobacco companies, but I do not think that translates into taking the money that the States authorized through State leadership—very creatively, I might add.

They won and that money is theirs. Now let us go forward and pursue another remedy, either through Medicaid or Medicare or what this administration thinks is the proper way to go. I will be helpful to you in that. But I will not be helpful to you—in fact, I guess it is pretty clear I am going to try to keep you from dictating to the States what they do with money that I think they have earned fair and square and I hope they will spend in many of the ways that you have named. But I just do not think it is my place to tell them.

Mr. HASH. Well, Senator, I hope on behalf of the administration that we can work with you because we would like to have your help and the help of others in Congress and in the States to work out an agreement with respect to the use of these funds that is bipartisan and meets the priorities that all agree upon. I think we are optimistic that can be done and we hope you will be a part of that with us.

Senator HUTCHISON. Well, let us look for another funding source. Thank you, Mr. Hash.

Mr. HASH. Thank you, Senator.

Senator HUTCHISON. I do thank you for your courtesy, and we will continue to work to find your rightful share.

Mr. HASH. Thank you.



## NONDEPARTMENTAL WITNESSES

### STATEMENT OF HON. PAUL E. PATTON, GOVERNOR OF KENTUCKY AND EXECUTIVE COMMITTEE MEMBER, NATIONAL GOVERNORS ASSOCIATION

Senator HUTCHISON. Now let me call Hon. Paul Patton—this is panel two—the Governor of Kentucky; Hon. Michael Fisher, the Attorney General of the Commonwealth of Pennsylvania; Hon. John Cornyn, the Attorney General of Texas; and Hon. Tom Miller, the Attorney General of Iowa.

I want to thank all of you for coming. I want to say again that I think the States have been very creative in their approach to the tobacco issue. I have read many of the reported uses by the States and certainly they vary across the lot. Most are certainly using their money for health care, but some are not.

So I would welcome hearing from you your views on what you think the right approach should be here. I would like to start with Governor Patton.

Governor PATTON. Thank you, Madam Chairwoman, for the opportunity to talk with you this morning.

If I may, before I begin talking about the tobacco settlement, express my concerns and the Governors' about the proposal to take some of the TANIF funds, which I believe is a part of this proposed legislation. I cannot imagine a greater breach of faith between the Federal Government and the States, a breach of faith that would cost my State, Kentucky, \$5 million.

Three years ago we fully realized that if the economy turned down the amount of extra money we could receive would be very limited, certainly not adequate to handle an increased caseload. Prudence dictated that we plan for a slowed economy and most States have. I know in Kentucky we were cautious as we implemented our program.

As it became apparent that the rolls were actually dropping, we developed plans to spend our money on several different programs to eliminate dependency permanently, much of it on increased daycare services for working families.

Our 1998 fiscal balance of \$44 million, the basis for calculating the \$5 million loss, is expected to drop to \$14 million by the end of fiscal 1999. This year we will spend \$30 million more than we are allocated from the Federal Government, and I am sure that other States have similar stories.

I understand that had we reported our plans to spend differently we would have shown a zero balance, like several other States did. For Kentucky to lose \$5 million which we already have plans to spend and sorely need because of the way we reported our plans is surely unfair, and I beseech you to live up to the commitment made to the States and not change the rules in the middle of the game.

Now I would like to address the Governors' No. 1 legislative priority, the retention of all funds received as a result of the settlement reached with the major tobacco companies. The Governors' position is clear, it is longstanding, and was re-articulated in a policy resolution adopted at the 1999 meeting here in Washington on February 23.

That meeting was attended by all but two of the Governors, and I know of no Governor who does not agree with the resolution. This is truly a bipartisan position. Stated simply, our position is that the tobacco settlement funds belong to the States.

There is a fundamental difference between the settlement we reached and the proposals being promoted a year or so ago involving Federal legislation to enact a tax on tobacco and appropriate the proceeds for several different purposes. You have already mentioned the many different reasons that States used to claim damages. The State by State allotments were determined, not based on Medicaid expenditures, but on an overall picture of health care costs in a given State.

Speaking for Kentucky, I can assure you that I agreed to the settlement on behalf of all Kentuckians as an attempt to recover at least a small portion of the money they have or will spend on tobacco-related illnesses personally or through their government.

The master settlement agreement represents a global settlement approach that covers States what sued for Medicaid, States who had Medicaid claims thrown out of courts, and other States that simply did not sue at all. The Medicaid third party recovery provisions of the Social Security Act do not encompass, nor did Congress intend them to apply to, situations in which States initiated lawsuits on behalf of all of their residents against manufacturers of products asserting a variety of consumer protection and other causes of action. These Medicaid provisions were adopted to facilitate reimbursements from insurance companies for small claims and to provide a tool to fight provider fraud. No one envisioned the use of the provisions to take from the States payments received as a result of massive State-originated negotiations with the tobacco industry.

Let me summarize our position. Medicaid is not a major component of the settlement and therefore the Federal Government has no legitimate claim to the funds. Reduced tobacco consumption will significantly reduce State revenue and a part of these funds must be utilized to replace them.

By their words and actions, Governors and States are allocating these funds for the most part to the same areas as are being discussed in Washington. But the Governors, working closely with State legislatures and concerned parties, must have the flexibility to tailor the spending of these funds to meet the needs of individuals in their States. There is simply no reason to believe that the Federal Government's wisdom on this issue is superior to the wisdom of the individual States and territories.

#### PREPARED STATEMENT

Although States will spend significant amounts of money on programs that improve the health, education, and welfare of their citi-

zens, States do not need to be told how to spend any portion of their money.

Again, I thank you for the opportunity to be with the committee, and when the rest of the panel presents I will be glad to answer questions. Thank you very much.

[The statement follows:]

PREPARED STATEMENT OF GOV. PAUL E. PATTON

Mr. Chairman, thank you for the opportunity to appear before this subcommittee today to testify on the governors' number one legislative priority.

TOBACCO SETTLEMENT FUNDS BELONG TO THE STATES

The nation's governors agree that the funds obtained in the historic tobacco settlement agreement rightfully belong to the states. The retention of all funds received as a result of the settlement reached with the major tobacco companies of the nation. The governors' position is clear it was re-articulated in a policy resolution adopted at the 1999 winter meeting here in Washington on February 23rd. This meeting was attended by all but two of the governors and I know of no governor who does not agree with the resolution. This is truly a bipartisan position. Simply stated, our position is that the tobacco settlement funds belong to the states.

Without the states' leadership and years of commitment to initiating and undertaking state lawsuits, we would not have achieved this major goal—a comprehensive settlement of myriad claims against the tobacco industry. After bearing all the risks and expenses in the arduous negotiations and litigation in which the states have been engaged we are now fully entitled to all the funds awarded to us.

The nation's governors strongly endorse S. 346, the Hutchison/Graham tobacco recoupment protection bill, and applaud the support of the many bipartisan cosponsors. It is crucial that the passage of this legislation, without federal restrictions, take place this year.

There is a fundamental difference between the settlement we reached and the proposals being promoted a year or so ago involving federal legislation to enact a tax on tobacco and appropriate the proceeds for several purposes. For the federal government to take the position that the entire \$246 billion settlement amount represents the recovery of Medicaid-related expenditures and that therefore HCFA is entitled to recoupment of 57 percent of the entire settlement is clearly untenable for a number of reasons.

1. In the original state suits, states filed complaints that included a variety of claims, such as consumer protection, racketeering, antitrust, disgorgement of profits, and civil penalties for violations of state laws. Medicaid was not mentioned at all in a number of cases and was only one of a number of issues in many others. Further, the state-by-state allotments were determined, not based on Medicaid expenditures, but on an overall picture of health care costs in a given state.

Speaking for Kentucky, I can assure you that I agreed to the settlement on behalf of all Kentuckians as an attempt to recover at least a small portion of the money they have spent or will spend on tobacco-related illnesses, personally or through the federal government. As a consequence, I view the money that the Kentucky state government will receive as belonging to the people of Kentucky and therefore the decision about how it should be spent should be made by their representatives in the Kentucky General Assembly. Our legislature does not meet this year, however they have already expressed, in a joint resolution passed in our 1998 regular session, their intention to make that decision on behalf of our people. The fact is that I believe that we will devote these funds to the same kinds of activities as are generally being discussed around the country and here in Washington. But even if we do intend to spend the funds on programs that are similar to the ones Washington would place in legislation, as a matter of principle, the people of Kentucky, the legislature, and I would be opposed to it. For the federal government to use its power to cause us to have to involuntarily remit these funds to the federal treasury is offensive and totally unacceptable.

2. It is important to note that, ultimately, the master settlement agreement bears no direct relationship to any particular state lawsuit. The master settlement agreement represents a global settlement approach that represents states who sued for Medicaid, states who had Medicaid claims thrown out of court, and other states that simply didn't sue at all. The attorneys general were attempting to obtain a fair monetary recovery for all states considering the variety of claims and requests for relief and the common aims of the multistate settlement process.

3. The federal government was invited to participate in the lawsuits, but declined. States were forced to bear all of the risk initiating the suits and the entire fiscal burden of carrying forth the unprecedented lawsuits against a well-financed industry that had never lost such a case before. It wasn't until after state victory was ensured that the federal government began to pay renewed attention to state activities.

4. The Medicaid third-party recovery provisions of the Social Security Act do not encompass, nor did Congress intend them to apply to, situations in which states initiate lawsuits on behalf of all of their residents against manufacturers of products, asserting a variety of consumer protection and other causes of action. These Medicaid provisions were adopted to facilitate reimbursements from insurance companies for small claims and to provide a tool to fight provider fraud. No one envisioned the use of the provisions to take from the states payments received as the result of massive, state-originated negotiations with the tobacco industry.

5. As I have already stated, the master settlement agreement negotiated between the attorneys general and the tobacco companies is separate and distinct from the agreement that failed to pass in the 105th Congress. That failed proposal would have represented almost twice as much money, \$368 billion compared to the current settlement of \$246 billion. The failed agreement was much more comprehensive, representing both state and federal costs and requiring congressional approval. In the context of the negotiations over the \$368 billion amount, the federal government may have had a legitimate claim to a share of the settlement, but the proposal's failure in Congress fundamentally changed the debate. Without passage of supporting legislation, states were forced to proceed with their own lawsuits and negotiate settlements based on nonfederal claims.

#### GOVERNORS OPPOSE FEDERAL RESTRICTIONS

The nation's governors also are strongly opposed to any federal restrictions on how states spend their tobacco funds. Each state must be given the flexibility to tailor its spending to the unique needs of its citizens. For example, some states need to be able to assist farm communities while others may want to expand health coverage to the uninsured. For example, to force Kentucky or Virginia to spend all their funds on health insurance for children would represent flawed federal policy when they need to assist farm communities. Similarly, to force Vermont to spend all its funds on health insurance for children would be unwise, given the low percentage of uninsured children in that state.

Many governors, through state-of-the-state speeches or through proposed or finalized state legislation, have already publicly committed to spending these funds for the health and welfare needs of their citizens. The majority of governors have already made commitments to create trust funds and escrow accounts that will ensure that tobacco settlement funds are spent on health care, services for children, assistance for growers, education, and smoking cessation.

The nation's governors and state legislators are committed to spending the settlement funds on a wide variety of state programs that will reduce teen smoking and improve the health, education and public welfare of each state's citizens. Ensuring this requires the flexibility for states to spend the settlement funds on programs targeted to the specific needs of each state. States do not need the federal government to tell them when and how to spend the money.

Examples of spending commitments include the following.

- Governor Jane Dee Hull of Arizona has proposed: building medical facilities and permanently funding a variety of health care programs; forming a trust fund for research and education on smoking cessation; establishing an up-front payment for a new state mental hospital, new state health laboratory, and rural health clinics; and funding a county health care block grant.
- Governor Gary Locke of Washington has proposed: increasing funding for Washington's Basic Health Plan for working families; expanding Medicaid health coverage for children in low-income families; and establishing an endowment fund to help smokers quit and convince young people not to use tobacco.
- Governor Frank O'Bannon of Indiana has proposed: increasing funding for children's health, antismoking programs, other public health programs, and support of local health departments; expanding health insurance to low-income working families; and providing support to tobacco farmers to ease their transition to other crops.
- Governor James S. Gilmore III of Virginia has proposed: establishing a fund for economic and agricultural development targeted at assistance for farm communities hurt by the settlement; establishing a health fund for children, community-based treatment for mental illness, long-term care, and youth antismoking

programs; and establishing a fund that addresses other critical needs such as education infrastructure.

#### SET-ASIDES FOR SMOKING CESSATION PROGRAMS ARE BAD PUBLIC POLICY

One of the restrictions under consideration in the Senate is a proposal to require states to spend 25 percent of the funds on smoking cessation programs. Although the nation's governors agree with the goal of substantially reducing smoking, we are adamantly opposed to this restriction. It would represent very poor public policy. There are already four major initiatives that are going into effect to reduce smoking.

1. The price of tobacco has increased. The price of tobacco products has already increased between 40 cents and 50 cents per pack. Additional price increases may come over time as companies attempt to hold profit margins and make settlement payments. These price increases will substantially reduce smoking over time.

2. Two major programs in the settlement are dedicated to reducing teen smoking and educating the public about tobacco-related diseases. \$250 million will create a national charitable foundation to support the study of programs to reduce teen smoking and substance abuse and prevent diseases associated with tobacco use. An additional \$1.45 billion will create a National Public Education Fund to counter youth tobacco use and educate consumers about tobacco-related diseases.

3. The settlement agreement has a significant number of restrictions on advertising and promotion. The settlement prohibits targeting youth in tobacco advertising, including a ban on the use of cartoon or other advertising images that may appeal to children. The settlement also prohibits all outdoor tobacco advertising, tobacco product placement in entertainment or sporting events, and the distribution and sale of apparel and merchandise with tobacco company logos. Further, the settlement places restrictions on industry lobbying against local, state, and federal laws. Over time, these restrictions on tobacco companies' ability to market their products to children and young adults will have a major impact on smoking.

4. States are already spending state funds on smoking cessation and will substantially increase funding as the effectiveness of programs becomes established. Many states have already invested years in program design, modification, and evaluation to determine the best ways to prevent youth from taking up cigarette smoking and helping youth and adults quit smoking. Governors and states are highly motivated to implement effective programs. We see the human and economic burdens of tobacco use every day in lost lives, lost wages and worker productivity, and medical expenditures for tobacco-related illnesses. Thirteen states have already committed to creating a dedicated trust fund or devoting considerable settlement revenues to smoking cessation programs—Alabama, Alaska, Arizona, Delaware, Hawaii, Indiana, Maryland, Massachusetts, Missouri, New Jersey, North Dakota, Vermont, and Washington.

Given the fact that these four major initiatives to reduce smoking are now being implemented, it is critical that additional spending be well coordinated with these and other initiatives. Governors will commit additional funds as the effectiveness of new programs is proven. However, the funds must be well coordinated with these four new initiatives. States must have the flexibility to spend funds in a cost-effective way. They should not have to meet an artificial restriction that has no basis in sound public policy.

#### STATE REVENUE IMPACTS OF THE TOBACCO AGREEMENT

Although the tobacco agreement will create payments of \$246 billion to states over the next twenty-five years, the net revenue gain to states may be substantially below that total as state tobacco tax-revenues are substantially reduced. In 1996 state tobacco tax collections were about \$7.1 billion per year. Over the next twenty-five years, these revenues will fall substantially below what they would have been without a tobacco agreement.

There are three major reasons for this reduction in revenue. First, the tobacco agreement has already increased the price of tobacco products by from 40 cents to 50 cents per pack. This could reduce state tobacco tax collections by around \$700 million per year. However, over time there is the possibility that tobacco companies will be forced to increase prices more in order to maintain profit margins. If this were to lead to another increase of 50 cents per pack, the combination of the two price increases could lead to a reduction in state revenues of \$1.4 billion per year.

Second, in addition to the price effects, the tobacco agreement puts a number of restrictions on advertising that will further reduce smoking and thus state tax revenues.

Third, the foundation created in the agreement to fund national smoking cessation programs coupled with state programs for smoking cessation will further sub-

stantially reduce smoking and therefore state tobacco tax revenues. Although it is difficult to provide an accurate estimate of the reduction in tobacco revenues, the combination of significant price increases coupled with major new smoking cessation programs would likely reduce state tobacco tax revenues by tens of millions of dollars over the twenty-five year period. This would substantially reduce the net revenues from the tobacco agreement.

Further, there is another major potential offset to the settlement funds if the volume of cigarette sales is reduced. Specifically, there is a net revenue reduction for every percentage reduction more than 2 percent. For example, if the volume of cigarettes sold is reduced by 12 percent, state revenues from the agreement would be reduced by \$14 billion over twenty-five years. Similarly, if the volume went down by 22 percent, then revenues would be \$32 billion lower.

This reduction in overall tobacco use is one of the primary purposes of the tobacco settlement, and the governors will applaud such reductions. Although a worthy goal, such reductions will reduce net funds available to states, and thus must be taken into consideration.

#### CONCLUSION

The nation's governors feel strongly that the states are entitled to all of the funds awarded to them in the tobacco settlement agreement without federal seizure. The master settlement agreement is fundamentally different from the proposals recently considered by the Congress. It is a global settlement of myriad claims. Medicaid was not the major focus or force in the settlement, and there is therefore no legitimate federal claim to the funds. Reduced tobacco consumption will significantly reduce state revenue and a part of these funds must be utilized to replace them. By their words and actions, governors and states are allocating these funds, for the most part, to the same areas that are being discussed in Washington. But the governors, working closely with state legislators and concerned parties must have the flexibility to tailor the spending of these funds to meet the needs of individuals in their states. There is no reason to believe that the federal government's wisdom on this issue is superior to the wisdom of the individual states and territories. Although states will spend significant amounts of money on programs that improve the health, education, and welfare of their citizens, states do not need to be told how to spend any portion of their money.

I thank you again for the opportunity to appear before the committee, and I would be happy to answer any questions you may have.

#### TOBACCO SETTLEMENT

Senator SPECTER [presiding]. Thank you very much, Governor Patton.

I regret my somewhat late arrival. The trains are having a little problem, but not as much problem as Senator Harkin is having, because he is in bed with a bad back.

But we welcome you to this hearing on such short notice. I am sure you have gone over the history of the issue with the emergency supplemental appropriations bill coming to the floor perhaps later this week with a provision which Senator Hutchison introduced the week before last which would give the States the unfettered discretion to retain the money on the tobacco settlement.

I received a call from our distinguished attorney general in Pennsylvania bringing me up to date on the matter, and Senator Harkin and I thought that it would be useful for this subcommittee to have a hearing because we have the responsibility for funding the Department of Health and Human Services and HCFA. Both Senator Harkin and I had expressed ourselves at the Appropriations Committee hearing of concern as to allowing the States to retain all of the funds.

There is the existing provision of law which provides for the Federal Government to retain a proportionate share, pegged at some 57 percent, and it may be that we can reach an accommodation as to the concerns which a number have expressed about having an

allocation of the funds directed toward preventing youth smoking and the medical matters, which is the reason we felt we ought to have this hearing.

There is a conflict between the Finance Committee and Appropriations as to handling these matters. That is not a matter of your concern, but an objection was lodged to Senator Hutchison's amendment and an objection has been lodged to this hearing. But I think we can work out the Senate turf battles.

The more important issue for Americans is what is going to happen to the funds. The smoking issue is an overwhelming one. I was reviewing the statistics again this morning; 400,000 people die each year from tobacco-related illnesses. The projection is that some 5 million of those now under 18 will die from tobacco-related illnesses. Enormous costs are involved—\$572 billion in health care expenditures each year by the U.S. Government on tobacco-related illnesses, \$7.3 billion on Medicaid payments.

This morning I noted a news report that women who smoke heavily—and this seems to have a curious causal relationship—have children who have a higher incidence of being involved in criminal activity. So you really wonder where the smoking issue ends.

But we do appreciate the work of the attorneys general in getting this \$206 billion settlement. Not surprisingly, the Federal Government was not involved. I do not think that totally answers the question of the Federal Government's interests in proportionate share. If we only dealt with the Federal Government where they exercised diligence, we might not deal with the Federal Government much at all.

But we thank you for your prompt attendance. I understand that Governor Patton is the first of this panel to testify. So we now turn to the Honorable Mike Fisher, who brings to this hearing a very distinguished background as an Assistant District Attorney and a State Senator and a candidate for Governor, and a very distinguished Attorney General in Pennsylvania.

General Fisher, the floor is yours.

**STATEMENT OF HON. MIKE FISHER, ATTORNEY GENERAL OF PENNSYLVANIA**

Mr. FISHER. Thank you very much and good morning, Mr. Chairman, and we thank you for calling this hearing. Good morning, Senator Hutchison. We thank you for being here and for your leadership on this issue.

I am very pleased to have the opportunity to address this subcommittee today on behalf of the National Association of Attorneys General concerning the States' historic settlement with the tobacco industry. I have been asked to give a short overview of the States' litigation against the industry and the subsequent \$206 billion settlement.

In 1994, Attorney General Mike Moore filed the first State lawsuit against the tobacco industry on behalf of the State of Mississippi, claiming that the industry had engaged in a 40-year conspiracy to keep the truth from the public about the addictive nature of nicotine to cultivate a new generation of smokers.

By June 1997, more than 40 States had filed their own lawsuits. On June 20 1997, attorneys general and the industry announced a tentative settlement. The tobacco industry was prepared to pay \$368 billion, to acquiesce to FDA regulation, and change its way of doing business. Of that settlement, \$196 billion would have gone to the States and the balance would have largely gone to the Federal Government. This agreement was contingent on Congressional approval and, as you know, the required legislation was not enacted.

In the summer of 1998, with roughly 36 State cases still unresolved, the Congress having abandoned efforts to approve the June 20 resolution, a second effort towards a multistate settlement commenced. Between July and November 1998, a group of attorneys general engaged in intensive negotiations with the tobacco industry.

I was one of eight negotiators chosen by my colleagues to represent the coalition of States suing the industry. After months of negotiations, an agreement was signed on November 23, 1998, under which the industry agreed to pay the States \$206 billion over 25 years. In addition, the agreement required the industry to make major public health concessions on how it would conduct business in the future. My written testimony outlines those various provisions.

As we sit here today, State legislatures across the country are studying how best to use these proceeds. Without question, public health programs will be the principal recipient of settlement funds. In Pennsylvania, for example, I have provided to the Governor and our general assembly a blueprint for action. We have proposed spending the money to enhance our children's health insurance program and making more insurance funds to adults who do not otherwise have insurance, expanding funding for Pennsylvania's schools to offer comprehensive tobacco use and prevention programs, increased funding for medical research into tobacco-related diseases, and other proposals which are included in my written testimony, a copy of which is attached to my remarks.

Although Pennsylvania's plan is not yet final, Pennsylvania Governor Tom Ridge has also stated that he wants to use the money for public health purposes, including smoking prevention and education programs. I am confident that our legislature will support our goal to spend the \$11.3 billion we will receive on public health and tobacco cessation programs.

The information available to me indicates that almost all the States have initiated plans to use the settlement dollars on health-related programs.

I sued on behalf of the people of Pennsylvania, not for the Federal Government. The States fought the tobacco industry for more than 5 years, expended considerable time and resources, and assumed 100 percent of the risk. During this whole period of time the Federal Government sat on the sidelines. In fact, the Department of Justice specifically declined to become involved when it was asked. Therefore, it is wholly inappropriate for the Federal Government to now demand to share the States' proceeds.

Those who have advocated that the Federal Government is entitled to share the proceeds have relied on a provision of the Social Security Act. I believe that that provision does not apply because

the Federal Government does not have a valid claim to funds received by the States for settlement of purely State claims or for State share of Medicaid expenses.

Even more significantly, I want to emphasize that many of the States' causes of action sought relief completely independent—

Senator SPECTER. General Fisher, I must interrupt you for just a moment. There has been a black bag left on the coat stand in the corridor. So if anyone left it there, claim it now because it is about to be removed, for obvious reasons.

Go ahead, General.

Mr. FISHER. Thank you, Mr. Chairman, and it was not mine.

Even more significantly, I want to emphasize that many of the States' causes of action sought relief completely independent of Medicaid. In Pennsylvania, for example, our consumer protection claim brought about under the Commonwealth unfair trade practices would have entitled us to recover a penalty of \$1,000 for each pack of cigarettes sold in the Commonwealth and \$3,000 if the sale was to a senior citizen. Every State had claims which were separate and apart from Medicaid funding, and I have listed the various examples in my testimony.

The simple fact is that the States' lawsuits are not wholly comprised of Medicaid reimbursements. Each State's claim was based on violations of numerous State laws. For the Federal Government to seek to recover a share of the States' settlement of the \$206 billion would in the view of the State attorneys general be an attempt to take money from the States that legitimately belongs to the States and represents the settlement of purely States' claims.

Finally, let me address the proposal that a fixed percentage of the State settlement funds be restricted to smoking cessation and prevention efforts or, for that matter, any other specific category. The States should be permitted to use their money as they see fit. In fact, I firmly believe that a Federal mandate could be detrimental to the efforts of the Governors and the attorneys general to target most of the settlement funds to public health.

Based on my past experience, I believe that legislators could wind up viewing this funding mandate as a ceiling rather than a floor, therefore making it more difficult for the States to commit virtually all of their funds to public health.

#### PREPARED STATEMENT

Once again, Mr. Chairman, I would like to thank you for providing me this opportunity to address the committee. I believe the decisions which the Senate and the House of Representatives will make will have a significant impact on the health of Pennsylvania and our citizens throughout the United States.

Mr. Chairman, I stand available to answer any questions.

Senator SPECTER. Thank you very much, General Fisher.

[The statement follows:]

#### PREPARED STATEMENT OF MIKE FISHER

Good morning, Chairman Specter, Senator Harkin, and distinguished members of the Senate Appropriations Subcommittee on Labor, Health and Human Services, and Education. Thank you for the opportunity to address the Subcommittee today on behalf of the National Association of Attorneys General concerning the States' historic settlement with the Tobacco industry. I urge you to support Senator

Hutchison's legislation, which will allow the States to keep the money rightfully earned as a result of this litigation. As you are aware, Senator Hutchison's legislation, which now has 44 co-sponsors, has been amended into the fiscal year 1999 supplemental appropriations bill that the Senate will soon consider.

Before I begin my remarks, allow me to provide you with the following submission from the National Conference of State Legislatures, which also urges you to support legislation to protect the states' funds from federal interference.

I've been asked to give you a short overview of the states' litigation against the tobacco industry and the subsequent \$206 billion settlement. In 1994, Attorney General Mike Moore filed the first state lawsuit against the Tobacco industry on behalf of the State of Mississippi, claiming that the industry had engaged in a 40-year conspiracy to keep the truth from the public about the addictive nature of nicotine and to cultivate a new generation of smokers. Soon after I was elected Pennsylvania's Attorney General in January 1997, I filed suit against the tobacco industry and became the 23rd state to file. By June of 1997, more than 40 states had filed their own lawsuits.

On June 20, 1997, the Attorneys General and the industry announced a tentative settlement. The tobacco industry was prepared to pay \$368 billion, to acquiesce to FDA regulation and change its way of doing business. Of that settlement, \$196 billion would have gone to the states and the balance would largely have gone to the federal government. This agreement was contingent on Congressional approval and as you know the required legislation was not enacted. During the period of Congressional review, the states' litigation continued and, to the consternation of the industry, the states' cases began to go to trial. The industry agreed to settle individually the lawsuits brought by Mississippi, Florida and Texas and Minnesota.

In the summer of 1998, with roughly 36 state cases still unresolved and with Congress having abandoned efforts to approve the June 20 resolution, a second effort towards a multi-state settlement commenced. This time around, the negotiators focused only on settling the states' claims, and set aside those issues in the prior year's negotiation which required Congressional action.

Between July and November of 1998, a group of Attorneys General engaged in intensive negotiations with the tobacco industry. I was one of the eight negotiators chosen by my colleagues to represent the coalition of states suing the industry. After months of negotiations, an agreement was signed on November 23, 1998 under which the industry agreed to pay the states \$206 billion over 25 years to settle our claims. I can assure you the states were proceeding on the assumption that whatever settlement funds were received would belong 100 percent to the states. That is why we ultimately agreed to a total settlement figure of \$206 billion, an amount almost identical to what the states were to receive from the June 20th resolution, rather than the \$368 billion that the tobacco industry had originally agreed to in the proposed global settlement in June 1997.

In addition, the Agreement required the industry to make major public health concessions on how it would conduct business in the future. I want to emphasize, these were concessions which most likely would not have been obtainable in any state's individual lawsuit.

#### KEY PROVISIONS

While it would be impossible for me to discuss all the terms of this complex agreement in the time available, I want to point out the major provisions of the Agreement. These provisions include restrictions on the tobacco industry's business practices, advertising and marketing, especially as they relate to children. The Agreement:

- removes and bans all tobacco billboards.
- prohibits the direct or indirect targeting of minors in the advertising, promotion, or marketing of tobacco products.
- bans the use of cartoons in advertising, marketing, and packaging.
- restricts brand name sponsorships.
- removes and bans all transit tobacco advertisements.
- bans payment for product placement in movies as well as in television shows, theatrical performances, live theater, recorded performances, and video games.
- restricts distribution of free samples to adult-only facilities.
- requires proof of age for distribution of free gifts.
- restricts the use of brand names by third parties and requires tobacco companies to enforce their trademarks.

The Agreement also:

- establishes a minimum pack size of 20 cigarettes.

- requires corporate culture changes among the tobacco defendants, including commitment to assist in the reduction of youth smoking.
- dissolves the Tobacco Institute, The Council for Tobacco Research, and the Council for Indoor Air Research, and mandates that future trade associations do not act like those of the past.
- restricts lobbying against laws that limit non-tobacco products that look like tobacco products (e.g., bubble gum).
- establishes a user-friendly searchable web site of all industry produced documents.
- establishes a counter-advertising fund and education foundation of at least \$1.45 billion, which includes \$250 million to fund the study of youth smoking.
- establishes a \$50 million enforcement fund with the National Association of Attorneys General.

Upon full implementation of the settlement, these fundamental industry restrictions and reforms, in combination with the public health, youth smoking cessation, and medical research programs contemplated by this \$206 billion settlement, will by all accounts produce significant results in the saving of lives and reduction of teen smoking.

As we sit here today, State Legislatures across the country are studying how best to use these proceeds. Without question, public health programs will be the principal recipient of the settlement funds. In Pennsylvania, for example, I have provided to the Governor and our General Assembly the following blueprint for action:

- Supplement funding for Pennsylvania's children's health insurance program and make funding available for adults without insurance who have not reached the Medicare eligibility age.
- Expand funding for PA schools to offer comprehensive programs on tobacco use prevention.
- Increase funding for medical research into tobacco-related diseases.
- Increase funding for effective smoking cessation programs.
- Expand funding for increased enforcement of youth smoking laws.
- Increase support for community-based anti-smoking programs.

(A copy of my recommendations to the Governor is attached for your review.)

Although Pennsylvania's plan is not yet final, Pennsylvania Governor Tom Ridge has also stated that he wants to use the money for public health purposes, including smoking prevention and education programs. I am confident that our legislature will support our goal to spend the \$11.3 billion on public health and tobacco cessation programs.

The information available to me indicates that almost all the States have initiated plans to use settlement dollars on public health-related programs. These plans are jeopardized by the federal government's threat to recoup the money or restrict how it can be used.

I sued on behalf of the people of Pennsylvania, not for the federal government. The states fought the tobacco industry for more than five years, expended considerable time and resources, and assumed 100 percent of the risk. During this whole time period, the federal government sat on the sidelines. In fact, the Department of Justice specifically declined to become involved when asked. It is wholly inappropriate for the federal government to now demand a share of the states' proceeds.

Those who have advocated that the federal government is entitled to a share of the proceeds have relied on a provision in the Medicaid Act. I believe that provision does not apply because the federal government does not have a valid claim to funds received by the states for settlement of purely state claims or for the states' share of Medicaid expenses. The relevant provisions of the Medicaid Act, 42 U.S.C. § 1396a(a)(25) and § 1396b(d), do not justify, let alone require, the federal government's attempt to recover part of the states' settlement. Under § 1396b(d)(3), the United States can seek a "pro rata share [of reimbursements] to which the United States is equitably entitled, as determined by the Secretary," by way of reduction to federal payments to states. However, under the states' settlement agreement, the federal government is not "equitably entitled" to any portion of the settlement, because the settlement as to that portion which may be for Medicaid represents only the states' portion of tobacco-related Medicaid expenses. The federal government's equitable portion was only reflected in the proposed \$368 billion settlement of June 1997 that Congress failed to approve.

Even more significantly, I want to emphasize that many of the states' causes of action sought relief completely independent of Medicaid. In Pennsylvania, for example, our consumer protection claim brought under the Commonwealth's Unfair Trade Practices Act would have entitled us to recover a penalty of \$1,000 for each pack of cigarettes sold in the Commonwealth and \$3,000 if the sale was to a senior citizen. In addition, prevailing on this claim could have resulted in the court order-

ing the surrender of all corporate profits the tobacco industry had from its sales in Pennsylvania.<sup>1</sup>

Every state had claims which were separate and apart from Medicaid funding. For example:

- Many states, like Pennsylvania, had claims for violation of their consumer protection laws. Remedies included significant monetary penalties for each violation, and there were millions of potential violations.
- Many states, for example, Florida, Ohio and Texas had viable RICO claims. Available remedies included surrender of corporate profits and treble damages. Billions of dollars were at stake.
- Several states had public nuisance claims. In Iowa, for example, the remedy requested was the refund of the entire price of each cigarette pack sold.
- Numerous states, such as Connecticut, Minnesota, Vermont and Washington had state law antitrust claims. As in the case of the RICO claims, available remedies included surrender of corporate profits and treble damages.
- Vermont asserted a claim for violations of its Public Health Act. The remedy was a staggering penalty of \$10,000 per violation per day.
- Even where a state asserted a Medicaid related claim, it was never the sole avenue for relief. Hence, when the Iowa Supreme Court affirmed the dismissal of the Medicaid portion of Iowa's complaint, Iowa's case continued. Similarly, California's case continued even after the dismissal of its Medical claims.

The simple fact is that the states' lawsuits were not wholly comprised of Medicaid reimbursements. Each state's claim was based on violations of numerous state laws. For the federal government to seek to recover a share of the state settlement of \$206 billion would, in the view of the state Attorneys General, be an effort to take money from the states that legitimately belongs to the states and represents the settlement of purely state claims. I can assure you that any such effort would inevitably result in nationwide litigation between the federal government and the states. This would result in a diversion of monies which could otherwise be spent for public health.

Finally, let me address the proposal that a fixed percentage of the states' settlement funds be restricted to smoking cessation and prevention efforts or, for that matter, any other specific category. States should be permitted to use their money as they see fit to meet their particular state's needs. As a former state legislator of 22 years, I find offensive the notion that the states can't be trusted to spend their money wisely. In fact, I believe that the states are better situated to determine what level of spending on particular programs makes the most sense to the people in that state. These are decisions that need to be made at home and not handed down or monitored by a new federal bureaucracy.

In addition, I firmly believe that a federal mandate could be detrimental to efforts by Governors and Attorneys General to target most of the settlement funds to public health funding in the long term. Based upon my past experience, I believe that legislators could wind up viewing this funding mandate as a ceiling rather than a floor for public health spending. The State Legislatures may see the federal government's mandate as a maximum amount they need to dedicate to public health measures. This would undercut all we have attempted to gain. Give the states who did the work to attain this historic settlement the freedom to develop the public health spending plan that best meets the needs of their people over the next 25 years. We took the risk—allow us to do the job.

Once again, I would like to thank you for providing me with this opportunity to address this Committee. I believe that these decisions can have a significant impact on the health of Pennsylvanians and our citizens throughout the United States.

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<sup>1</sup> Pennsylvania's complaint had ten distinct counts: Count 1, Civil Conspiracy/Concert of Action; Count 2, Undertaking a Special Duty—willful and negligent breach; Count 3, Fraudulent Misrepresentation; Count 4, Fraudulent Concealment; Count 5, Negligent Design; Count 6, Strict Liability; Count 7, Unfair Trade Practices (consumer protection); Count 8, Public Nuisance; Count 9, Negligent and Intentional Entrustment; and Count 10, Unjust enrichment/Restitution.

LETTER FROM MIKE FISHER TO GOVERNOR THOMAS J. RIDGE

COMMONWEALTH OF PENNSYLVANIA,  
OFFICE OF ATTORNEY GENERAL,  
Harrisburg, PA, January 14, 1999.

Hon. THOMAS J. RIDGE,  
Governor, Commonwealth of Pennsylvania,  
Harrisburg, PA.

DEAR GOVERNOR RIDGE: I am very pleased to inform you that on January 13, 1999, Judge John Herron, Administrative Judge of the Court of Common Pleas of Philadelphia County, approved the Pennsylvania tobacco settlement and consent decree, which I helped to negotiate on behalf of the Commonwealth. By dismissing all objections to our \$11.3 billion tobacco settlement, Judge Herron has paved the way for the timely implementation of the significant health policies and monies which are due Pennsylvania under the settlement. Because this consent decree holds the participating state attorneys general responsible for enforcing its provisions, I can assure you that I will do everything in my power to ensure that the tobacco industry operates within the parameters of this agreement.

Decisions on how the settlement proceeds will be used need to be made in the near future by you and the General Assembly. I look forward to working with you in that process. As Pennsylvania's share of the 1998 payment may be received prior to the beginning of the next fiscal year, I would ask you to consider creating a restricted Tobacco Recovery Fund into which all of the tobacco dollars will first be deposited upon receipt from the escrow agent. Preservation of monies in this way will conserve the principal and result in earnings, actually increasing the amount of dollars available to the Commonwealth.

There are a number of initial recommendations on where these funds could best be directed that I would like to offer for your consideration:

1. Establishment of a Pennsylvania Tobacco Settlement Advisory Panel. The purpose of this oversight panel would be to advise the Governor and the General Assembly on the best use of the proceeds coming to the State as a result of the settlement. This panel's ongoing role would be to recommend, review and monitor those programs and initiatives chosen to receive funding from the settlement funds.

2. Supplement Funding for Pennsylvania's Children's Health Insurance Program. As you are aware, the General Assembly greatly expanded the scope of this program in 1998, making CHIP available to even more of Pennsylvania's children. Proceeds from the settlement could be used to ensure full funding of the program now, and in the future.

3. Encourage Pennsylvania's Schools to Offer Comprehensive School-Based Programs on Tobacco Use Prevention. The key to curtailing tobacco use is to educate our children about its deadly effects. Funds should be made available to our schools and education professionals in order to give them the resources to acquire and develop new, innovative educational programs designed to make children understand the perils of tobacco use.

4. Increase Funding for Medical Research to Improve the Diagnosis and Treatment of Tobacco-Related Illnesses. Pennsylvania is home to some of the pre-eminent research hospitals and cancer centers in the nation. Pennsylvania should substantially increase its commitment to these institutions, allowing them to strengthen and expand their efforts in diagnosing and treating cancer and other tobacco-related illnesses.

5. Increase Funding for Effective Smoking Cessation Programs. Effective and accessible cessation programs are integral to any comprehensive state tobacco control effort. Steps should be taken to provide direct cessation services to the medically uninsured and medical assistance recipients. Revenues could also be used to encourage private health plans to cover cessation programs.

6. Limit Youth Access to Tobacco Products. Funds should be used to develop and enhance retail education programs to ensure that store owners are aware of the law and are taking every necessary measure to limit youth access to tobacco products. In addition, state and local law enforcement agencies, including the Office of Attorney General, should receive funding to implement tougher enforcement initiatives.

7. Support Community-Based Anti-Smoking Programs. The Center for Disease Control and Prevention reports that some of the most effective anti-smoking initiatives are community-based programs. Local programs can effectively utilize individual community leaders, community businesses, ethnic and cultural groups, and school and youth organizations.

Directing the funds to be derived from this settlement to these kind of efforts, as well as other related proposals, will be important for Pennsylvania's future. The careful selection of where this money is spent, should help Pennsylvania to defeat

any claim that may be asserted by the Health Care Financing Administration seeking reimbursement for federal medical assistance funding.

I am truly grateful to have had the opportunity to help negotiate this historic settlement, and proud to represent Pennsylvania in this action, and I look forward to working with you to assure that the best decisions are made in utilizing these dollars.

Very truly yours,

MIKE FISHER,  
*Attorney General.*

**STATEMENT OF HON. JOHN CORNYN, ATTORNEY GENERAL OF TEXAS**

Senator SPECTER. Our next witness is the distinguished Attorney General from the State of Texas, John Cornyn—

Senator HUTCHISON. "CORR-nin."

Senator SPECTER. "CORR-nin." Always good to have a fellow Texan here.

Mr. CORNYN. You bet.

Senator SPECTER. Mr. Cornyn has been in the practice of law, a member of the State judiciary, a district judge, a presiding judge, and a member of the Texas Supreme Court. Welcome, Judge—General Cornyn. We look forward to your testimony.

Mr. CORNYN. Thank you, Chairman Specter. It is a pleasure for me to be here today before the committee and particularly to support the efforts of my Senator, Texas Senator Kaye Bailey Hutchison, by clarifying and attempt to clarify what I believe to be the current law, which is that the funds that have been recovered by the States through their individual tobacco lawsuits as well as the collective settlement of 46 States amounting to \$206 billion, that those are not recoverable by the Federal Government, but HCFA, based on the legal theories that were alleged in virtually every State, with maybe one or two exceptions.

I first would like to discuss the lawsuit that was brought by the State of Texas, which was settled separately, as you may recall, in January of 1998, and to address the various legal theories that were alleged in that case. I would also like to explain to you why any attempt on the part of the Federal Government to withhold Medicaid dollars which the State is legally authorized to receive is without legal justification.

Finally, I would like to provide you with some information about the various programs to which the Texas tobacco recovery already—will be dedicated under a memorandum of understanding between the leaders of our State Senate, our House appropriations committee, and my predecessor attorney general.

The Federal Government I believe has no legal right to withhold Federal Medicaid money, money that the State of Texas is legally authorized to receive, money that provides health care to children and poor people all over Texas, because the State of Texas did not bring a cause of action seeking recovery of Medicaid money under the Medicaid third party recovery program. In short, I do not believe there should be a Medicaid recoupment because no Medicaid recovery was either sought or obtained.

The Texas lawsuit was brought to recover money expended by the State to provide medical treatment to citizens suffering from smoking-related illnesses and to seek appropriate injunctive relief against the defendants' continued illegal conduct. The general categories of claims were four in number: first, the Federal Racketeer-

Influenced and Corrupt Organization Act, or RICO; secondly, Federal and State antitrust claims; third, equitable principles of Federal and State common law; and fourth, under products liability law.

The State of Texas made no claims seeking recovery of Medicaid money under the third party recovery program, and yet the Federal Government is now threatening to withhold Medicaid money which the State of Texas is authorized by law to receive.

I believe that if you look, in short, at the allegations contained in the Texas lawsuit and in the judgment that was actually, the settlement that was actually obtained awarding the State of Texas \$17.3 billion against the tobacco industry, in addition to \$3.3 billion in attorney's fees through a national arbitration award, that you will see that none of it relates in any way to the Medicaid program.

Now, I would like to mention to you that under the memorandum of understanding entered into by the chairman of the Senate finance committee of the State of Texas and the House appropriations committee and the attorney general at the time, my predecessor, there are funds dedicated to tobacco cessation programs. In fact, under the memorandum of understanding \$200 million would already go to a tobacco cessation funding program. I believe, based on the comments of the leadership in the State Senate and the State House, that in fact the vast majority of the funds will go to public health as well as tobacco cessation programs.

Now, if you will forgive me, when I learned a little bit more about the nature of Senator Hutchison's proposal and HCFA's claim to recoup up to 57 percent of what the States had recovered, I was reminded of a play that my daughter participated in when she was in elementary school called "The Little Red Hen."

You may recall that the little red hen asked the cat and the rat and the pig to help her plant wheat, harvest the wheat, grind it into flour, and finally bake it into bread. And even though each of them were unwilling to help with the hard work, once the fruits of her labor were plain they were more than willing to enjoy the fruits of the little red hen's labor.

Now, the little red hen in this instance is the States, who asked for and received no help from the Federal Government when it took on the tobacco industry. But now, after the risks have been taken, after the work has been done, the Federal Government is like the cat, the rat, and the pig in "The Little Red Hen," all of whom want to enjoy the benefits of the States' labor.

#### PREPARED STATEMENT

In summary, Mr. Chairman, members of the committee, the attempted recoupment by HCFA of the tobacco recoveries of the State of Texas and the other States is not fair, it is not the law, and this committee ought to reject it.

Thank you very much.

Senator SPECTER. Thank you very much, Attorney General Cornyn.

I very well remember the "Little Red Hen" story. I just have one question before we go on to the next witness, is the Federal Government the cat, the rat, or the pig, or a combination of rat and pig? [Laughter.]

Mr. CORNYN. I believe I will not comment on that, Senator.  
 Senator SPECTER. Well, we will press you for an answer when  
 the questions and answers comes.  
 [The statement follows:]

PREPARED STATEMENT OF JOHN CORNYN

Thank you for allowing me to offer my testimony on Senator Hutchison's proposal.  
 I would like briefly to address three issues:

- I would like to discuss the lawsuit brought by the State of Texas against the tobacco companies and to address the various causes of action and specific items of relief that we sought.
- I would like to explain to you why any attempt on the part of the federal government to withhold Medicaid dollars which the state is legally authorized to receive is without legal justification.
- And finally, I would like to provide you with information about the various programs on which the State of Texas is expending money that it has received in its tobacco settlement.

THE TEXAS LAWSUIT

Simply put, the federal government has no legal right to withhold federal Medicaid money—money that the State of Texas is legally authorized to receive—money that provides health care to children and poor people all over Texas—because the State of Texas did not bring a cause of action seeking recovery of Medicaid money under the Medicaid third-party liability program.

The lawsuit filed by Texas was brought to recover money expended by the State to provide medical treatment to citizens suffering from smoking-related illnesses and to seek appropriate injunctive relief and the defendants' continued illegal conduct.

The State alleged violations or causes of action in four broad areas of law: (1) Federal Racketeer Influenced and Corrupt Organizations Act (RICO); (2) Federal and state Antitrust Acts; (3) Equitable principles of Federal and State Common Law; and (4) Product Liability Law. The State of Texas made no claim seeking recovery of Medicaid money under the third-party liability program. And yet the federal government is threatening to withhold Medicaid money to which the State of Texas is authorized by law to receive—money that pays for health care treatment to children and the poor in the State of Texas—in an attempt to lay claim to money to which the federal government has no right.

THE MISAPPLICATION OF THE MEDICAID THIRD-PARTY LIABILITY PROVISIONS TO THE  
 LAWSUIT FILED BY THE STATE OF TEXAS

It is widely believed that the State of Texas—that, indeed, each of the fifty states—filed suit against the tobacco companies under each state's Medicaid third-party liability recovery statutory provisions that each state participating in the Medicaid program is required to enact. I have not examined the pleadings filed by each of the fifty states, so I cannot declare that no other state filed a cause of action and sought relief under that state's Medicaid third-party liability recovery statutory program. But I can declare that the State of Texas did not. Then why do so many assume that we did? The answer to that can be explained by any first year law student.

As every first year law student knows, proving up damages and proving liability are two very different things. Simply put, there are two components that an attorney bringing a lawsuit that seeks relief in the form of damages is required to prove. First, the attorney must prove a theory of liability—a theory, whether a violation of common law or statutory law, that imposes a duty to act or not act on the defendant sued. And second, the attorney must prove damages, however calculated.

In the tobacco lawsuit filed by the State of Texas, the State proved damages by estimating the amount of money that the State expends on health care costs involving tobacco-related illnesses. And what more logical place to seek information on the costs incurred by the State than by examining expenses incurred under the State's largest health care program—the Medicaid program. But that was not the only component in calculating the costs of health care incurred by the State. The State also examined costs incurred in providing health care to the indigent, to persons in jails and prisons, and to persons receiving care in public hospitals, none of which are part of the Medicaid program.

Moreover, in alleging liability, the State never claimed a violation of or sought recovery under the State's Medicaid third-party liability recovery program. As we have seen, the State of Texas alleged violations of or asserted claims under federal and state statutes and federal and state common law under 15 different causes of action and sought 20 specific items of relief—and not one cited or even mentioned state or federal Medicaid provisions.

Thus, as a matter of law, the federal government is not entitled to lay claim to any of the money received by the State of Texas under its settlement agreement with the tobacco companies.

THE USES TO WHICH THE MONEY RECEIVED BY THE STATE OF TEXAS WILL BE  
DEDICATED

I've addressed the legal issues involved. Now let me address the public policy issues. Any attempt by the federal government to dictate to the states how the tobacco money must be spent rests, in part, on the paternalistic notion that the federal government knows better than the state does what the health care needs of those states are. But each state's needs are different and each state should decide just how its money should be spent.

The State of Texas will receive an estimated \$17.3 billion during the next 25 years by virtue of its settlement with the tobacco companies and all of the money that the State has received so far has been earmarked for health-related expenditure, either in the form of direct reimbursements to political subdivision providing health care and to health education facilities or in the form of the creation of permanent trust funds, the income from which will be used for public health and health education, including:

\$2.3 billion was been directly set aside for counties and hospital districts to compensate them for unreimbursed health care costs. First, there will be direct disbursements of money—\$450,000,000 in total—during this year and the following two years to reimburse counties and hospital districts for unreimbursed health care costs they incur providing health care to indigents, to persons in jail, and to persons in prison. The remaining approximately \$1.8 billion will be placed in a permanent trust fund created by law, the earnings from which will, in perpetuity, be used to reimburse the counties and hospital districts.

During the next two years, the legislature proposes to disburse \$881 million to fund, in conjunction with the federal government, a children's health insurance program; a state-wide tobacco pilot program for anti-smoking program directed at children; and the creation of 11 different permanent endowments at 11 public institutions, the income from which will support research and other programs that benefit public health, the creation and operation of a children's cancer center, and the creation of an institute for border health. Specifically, the proposed expenditures include:

1. \$151 million or other such amounts as needed for the purpose of providing funding, in conjunction with the federal government, for the Children's Health Insurance Program pursuant to Title XXI of the Social Security Act;

2. \$200 million to fund tobacco pilot program for the purpose of supporting smoking cessation program, enforcement of juvenile smoking laws, counter-marketing promotional efforts directed toward youth, general anti-tobacco educational programs, and other similar activities;

3. \$200 million to create an endowment for the benefit of the University of Texas Health Science Center at San Antonio for the purpose of establishing, maintaining, and operating a children's cancer center;

4. \$100 million to the University of Texas M. D. Anderson Cancer Center in Houston to create an endowment fund for research and other programs that benefit public health;

5. \$50 million to the Texas Tech University Health Science Center and the University of Texas at El Paso to create an endowment fund for research and other programs, including the establishment and operation of an institute for border health;

6. \$50 million to the University of Texas Southwestern Medical Center at Dallas to create an endowment fund for research and other programs that benefit the public health;

7. \$25 million to the University of Texas Medical Branch at Galveston to create an endowment for research and other programs that benefit the public health;

8. \$25 million to the University of Texas Health Science Center at Houston to create an endowment fund for research and other programs that benefit the public health;

9. \$25 million to the University of Texas at Tyler to create an endowment fund for research and other programs to benefit the public health;

10. \$25 million to Texas A&M University Health Science Center to create an endowment fund for research and other programs that benefit the public health;

11. \$25 million to the University of North Texas Health Science Center at Fort Worth to create an endowment fund for research and other programs that benefit the public health;

12. \$5 million to the Regional Academic Health Center to create an endowment fund for research and other programs that benefit the public health.

And finally, the memorandum of understanding calls for the creation of four separate permanent trust funds, the earnings of which will be used for the following: 1. Tobacco education and enforcement; 2. Children and public health; 3. Emergency medical services and trauma care; and 4. Rural health facility capital improvements.

#### THE LITTLE RED HEN

The recoupment claims of the federal government, for funds that they played no role in obtaining, remind me of the children's story about the Little Red Hen. You remember: the little red hen asked the cat, the rat, and the pig, to help her plant the wheat, harvest it after it had grown, grind it into flour, and finally bake it into bread. But even though they were unwilling to help with the hard work, all of the little red hen's neighbors were willing to enjoy the fruits of her labor.

Now, the little red hen in this instance is the states, who asked for and received no help from the federal government when it took on the tobacco industry. But now, after the risks have been taken by the state, after the work has been done, the federal government is like the cat, the rat, and the pig—all of whom wanted to enjoy the benefits of someone else's labor.

In summary, Senators: Its not fair, it's not the law, and this committee ought to reject it.

#### STATEMENT OF HON. TOM MILLER, ATTORNEY GENERAL OF IOWA

Senator SPECTER. Our next witness is the Honorable Tom Miller, Attorney General of Iowa. He served in that position from 1979 to 1991 and again since 1995; former city attorney and private practitioner. Welcome, Attorney General Miller. We look forward to your testimony.

Mr. MILLER. Thank you, Senator Specter and Senator Hutchison, for having this hearing and for inviting me. What I want to do is briefly describe the Iowa hearings, briefly talk about first principles, talk about how we want to spend the money in Iowa, at least I hope we spend the money in Iowa, and then summarize.

In Iowa we brought a common law, a series of common law claims for the Medicaid money. We also brought a Consumer Fraud Act claim. We felt that the Consumer Fraud Act claim was the stronger one of the two, and indeed the court rulings bore that out.

I would mention, however, that to the extent we prevail on consumer fraud there is some obligation of one type or another to spend that money either returning it to individual smokers, which would be impossible, or spending it on tobacco prevention. So tobacco prevention really is tied to the consumer fraud claim.

We brought a State RICO claim. We brought a claim concerning nuisance. And we were looking for a series of fines. So we tried to hit a number of aspects in our lawsuit. The one that looked to be the most successful would have been consumer fraud.

Whenever we deal with these issues, particularly if they are complex or difficult or controversial, we always go back to the first principles of why we did this in the first place. We did it for two reasons, brought these lawsuits. The first reason for many of us, including myself, were the reasons that you alluded to a few minutes ago, Senator Specter: 400,000 Americans dying each year from tobacco-related disease, 5,000 Iowans, 3,000 kids starting every day, 1,000 of those will die from tobacco-related disease. That is the

main reason that we got in the lawsuits. That is the main reason I think we are here today.

We got in the lawsuits, too, for the money. The money was considerable and important to us, but in the whole scheme of things secondary.

In Iowa, what I have proposed and our Governor, Tom Vilsack, has agreed in principle to these proposals, although he has not signed onto the dollar amounts, we propose to spend each year \$17.7 million of the recovery on tobacco prevention type programs, about \$8.5 million on school-based programs, cessation, research, local and community programs, about \$6.5 million on public education, including TV and media ads, \$2 million on enforcement, and one-half million on evaluation, what is working and what is not working.

We are at the point where our legislature is coming down towards the end. Decisions have to be made. It is very, very important to our State that you all make the decision on what happens to this money that is claimed by the Federal Government.

Senator Hutchison, we are deeply indebted for you to take the leadership on this issue and, as we discussed this morning, bring about sort of a coup on the Senate Appropriations Committee to get us to where we are. We are deeply indebted to you.

I also took heart from the witness from the administration when he indicated that they are willing to compromise on this. They have had their set of priorities where they want the State money to be spent. As they indicate that there is movement to compromise on that, I would hope that there is some compromise resolution, because what I would hate to see happen is for the Congress and the administration to continue to fight on this issue and not reach resolution.

#### PREPARED STATEMENT

In that case, the Governor of Iowa, the Attorney General of Iowa, the legislature in Iowa, and all Iowans lose, because we cannot spend that money, and we would spend it, I think, in an intelligent way.

I just would encourage some sort of compromise to get this resolved and have us do our good works in the State. Thank you.

[The statement follows:]

#### PREPARED STATEMENT OF TOM MILLER

I appreciate the opportunity to testify before this subcommittee on an issue of great importance to my state and the nation.

My message today is simple. When leaders in Washington and in state capitols discuss tobacco issues (including today's issue of federal recoupment) the focus should always remain on the key public policy goal—reducing the death and suffering caused by tobacco usage. Tobacco is the number one preventable cause of death in the United States. The statistics are staggering—420,000 Americans, including 5000 Iowans, die yearly from smoking. In the relatively small state of Iowa, approximately 12,000 Iowa kids become new daily smokers each year and about 4,000 of these will die from tobacco caused disease.

The State of Iowa has been in the fight against the tobacco industry for some time. On November 27, 1996, Iowa became one of the earlier states to file a lawsuit against the tobacco companies. Our lawsuit contained several causes of action. Not only did it include a claim for reimbursement of Medicaid costs incurred as a result of tobacco related illnesses, but strong claims under the Iowa Consumer Fraud Act, common law nuisance and the new Iowa law concerning ongoing criminal conduct.

Since the settlement agreement was signed on November 23, 1998, attention in Iowa, like all states, has turned to how the settlement money should be expended. On February 18, 1999, I, along with Tobacco Free Iowa (a state-wide tobacco control coalition) proposed that \$17.7 million of the settlement money be spent on a Comprehensive Iowa Plan for Tobacco Prevention and Control. I was joined at the announcement by Governor Tom Vilsack who pledged to support an effective tobacco control program in our state. Leaders of both parties in the Iowa Legislature also have indicated a willingness to support efforts to reduce youth tobacco use.

The Comprehensive Iowa Plan for Tobacco Prevention and Control is based on recommendations of the Centers for Disease Control and input from tobacco control advocates in Iowa. The plan has five components: The first component will support state and local programs to reduce tobacco use, including school programs, cessation programs, research, local partnerships and community programs, and educational programs. The second component is sponsorship and support of public education through tobacco-free media messages on TV, radio, and other media, and special events and promotions. The third component is strengthening of enforcement of tobacco control laws by local law enforcement and creating a tobacco control unit in the Attorney General's Office. The fourth component is the ongoing monitoring, assessment, and evaluation of the plan.

Based on the experience of other states (notably California and Massachusetts, and more recently Oregon), I believe this plan can have a real impact in reducing the prevalence of teen smoking in Iowa.

The issue in front of this subcommittee today, of course, is whether the federal government should try to recoup part of settlement recovery. I strongly urge the Congress to allow states to keep all of money. This is a fair and just result. The states took the risks, invested the time, money, and talent, and brought these lawsuits to a successful resolution. The states should receive the rewards.

I also urge the Congress and the administration to act in an expeditious manner. Delay on this matter only adds uncertainty and confusion. This issue has been before the Congress and the Administration for over one and one-half years. There was an opportunity to resolve the Medicaid recoupment question as part of the budget bill last year—the Congress and the Administration failed to do so. In Iowa, the Governor and the Legislature want to appropriate the money in a responsible way that benefits our citizens. They cannot do so until you and the President act.

I thank you for the opportunity to testify today.

#### TOBACCO FUNDS

Senator SPECTER. Thank you very much, Attorney General Miller.

With only 2 of us here, I think we will set the clock at 10 minutes and see how that goes.

We have just received a letter from the Secretary of Health and Human Services, Donna Shalala—it actually arrived shortly after noon, 12:03—expressing the Secretary's strong opposition to the provisions approved by the Senate Appropriations Committee, a good bit tougher in tone—and we will make this available to you—than the testimony which was given earlier today by Deputy Administrator Hash, whereas I note the prepared text suggests that the States keep 100 percent of the tobacco funds in exchange for a commitment to use a portion of the proceeds to reduce youth smoking, protect tobacco farmers, improve public health, and assist children.

As I listen to the testimony, especially by Attorney General Cornyn and Attorney General Miller, and I think by Attorney General Fisher, too, that the Federal Government has no claim to the funds, so in a sense the legislation would be unnecessary, although there might be considerable controversy. So I think there is an interest, as General Miller expressed, to resolve it so that plans can be made and so that we do not get into litigation between the States and the Federal Government, which would be both unseemly and very, very costly and time-consuming.

Everyone has talked about using the funds for smoking prevention and for medical purposes. There have been a variety of percentages tossed around by a number of Senators as to how much ought to be allocated for those purposes. But from what I hear, all the money, at least under the memorandum of intent which Attorney General Miller talked about and the programs that General Fisher is talking about, Mr. Cornyn as well—and I would be interested in your views on this, too, Governor Patton, because I did not hear your testimony; I came in right at the tail end—if the money is all to be spent along those lines, what would the objection be to having that as a condition, that all the funds be spent in the lines which you gentlemen have testified to?

What do you think, Attorney General Miller?

Mr. MILLER. Well, like I said, I feel very strongly that you all should compromise on this and work it out. One possible area of compromise is to say that some of this money really was through the consumer remedy and that that money in effect should be spent on tobacco prevention. What that percentage is, I do not know what the magic percentage is.

But I think if there is some compromise the bulk of the money should be free and clear, that there should be no conditions on the money. Part of it perhaps should be on tobacco prevention to dovetail with the consumer remedy that was in most of our lawsuits and was very, very much part of ours.

I think that if there is any condition on part of the money, there should not be a lot of regulation. There has been some talk about States certifying that they have spent the money in the category. Maybe that should work. If there is a tobacco prevention category, States should have great freedom to use it in whatever ways that they want in tobacco prevention, consistent with the concept of laboratories of democracy.

But I view that as some sort of compromise that maybe you all could work towards at some point.

Senator SPECTER. Well, I think your point about the absence of regulation is a good point and one that I would subscribe to. I do not see having a limitation only to a portion of consumer fraud, which would then implicate tobacco prevention.

Attorney General Shalala thinks she has a claim to this on Medicaid. I do not know what the quality of the case is. I know it is one which ought not to be litigated. But if there is a claim on Medicaid, then that would support a conclusion that some of the funds ought to be used for health purposes.

Governor Patton, what is your thinking on this?

Governor PATTON. Well, there is a fundamental principle involved. As the attorneys general have stated and we the governors reiterate, this is the State funds that have been recovered for a broad variety of things like many other things that we may recover money for, and it really is a decision that should be made by the States.

I think getting down to micromanagement in the area of like smoker cessation just illustrates the lack of wisdom for the Federal Government to make these decisions. These gentlemen evidently paid a great deal of attention to smoker cessation programs in the negotiations. For one thing, the cost of the program, 45 cents a

pack, is in itself a vehicle of reducing consumption of cigarette products.

The prohibition against many, many forms of advertisement—another smoker cessation program. The allocation of almost \$2 billion specifically for smoker cessation programs illustrates that the attorneys general addressed this subject as a part of this settlement. On the one side they negotiated some smoker cessation programs and on the other side they negotiated some compensation for damages to various degrees.

So then for the Federal Government to come in and say, well, what the attorneys general negotiated is not adequate and we need to insist on a certain portion of the States' money going for this, I think is incorrect. So I think that—I think that as a practical matter most of the money will end up being spent in the areas that is generally being discussed both in the State and the Federal level, as my comments related.

But as a matter of principle, I think that the Federal Government should clarify the intent of the existing legislation because, as these gentlemen have said, we have a very strong position the Federal Government does not have this authority. If the administration is going to continue to insist, as they indicate that they have, the effect of Federal Government legislation will just eliminate protracted litigation, which will delay this money being effectively used for the benefit of the people of the country.

Senator SPECTER. Well, Governor Patton, I do not agree with you as a matter of principle that the States ought to have full sway to make the decision. Secretary Shalala in her letter points out that in 1998 States recovered some \$642 million from third party claims and the Federal share was some \$400 million.

You may articulate as a practical matter that the funds will be used for cessation and public health purposes, but they may not be. I am not talking about micromanagement, but, speaking only for myself, I am not prepared to turn over all the money *carte blanche* to the States.

There just simply needs to be assurance that the moneys will not be used for some other important State purpose. But I am not at all talking about micromanagement. Suppose the conditions were that there would be on tobacco prevention just as Attorney General Fisher outlines it, and school education and public education and insurance coverage for children who cannot afford it, but that will be given related to damages caused by tobacco, and without any regulations, and something along the certification line which would be minimally intrusive? Attorney General Fisher, what is your thought about a proposal like that?

Mr. FISHER. Mr. Chairman, I think the problem with a proposal like that is that not one shape does fit all. You have 50 States across this country and the District of Columbia and territories who have shared or will share in this settlement or their four individual State settlements.

I think you have to go back to the fundamental principle of whose moneys are we talking about. I believe these moneys are clearly moneys which were obtained by the States as a result of their State lawsuits. I am willing to admit, as I have in my testimony, that part of our suit did seek recovery of some Medicaid

funds. There is no question about that. But we did have other counts contained therein.

But there is a real difficult—I think it is going to be extremely difficult for the Congress and for the Federal Government to try to ascertain what that set percentage is across the board. When you try to put some categorical earmarking on the funds, I believe it presents some real difficulties in the various States shaping an appropriate program.

Senator SPECTER. Well, suppose there are no categorical amounts, that the whole fund is left to the States, but with the kind of broad outlines that you have articulated that it is your view the moneys ought to be spent for.

Mr. FISHER. The one point that I raised in my testimony, I am concerned that—let us say that the resolution was that 15 percent of the total dollars was to be spent on a laundry list of funds.

Senator SPECTER. I was thinking something more like 100 percent.

Mr. FISHER. Well, I would like to stay between 5 and 15 percent. But just so whatever the percentage was.

Senator SPECTER. Well, I am not going to go above 100 percent, no matter what you say. [Laughter.]

Mr. FISHER. And I will not go below zero, I promise.

But whatever the percentage is, I think the potential then is that when we are working and as the governor and I are working back in Pennsylvania to try to convince the legislature—and I think we have made real progress—that we should spend practically all of our funds on public health and tobacco cessation programs, that by earmarking one percentage for a specific category you may give many legislators a signal that then they can spend the rest of the moneys for such things as tax reduction and filling potholes and other projects which really were not the intent of what I filed my suit for and my colleagues filed suit for.

I think that is one of the real dangers in the Federal Government's stepping in and implementing a mandate that I do not believe is necessary for the States to carry out comprehensive programs.

Senator SPECTER. Well, my red light is on, Attorney General Cornyn. So I am going to leave you to Senator Hutchison, and I hope she does pursue whether the Federal Government is the cat, the rat, or the pig.

Senator Hutchison.

Senator HUTCHISON. I think General Cornyn and I would probably agree on the answer, but neither of us are going to probably share that with you today.

Let me say first I do thank the chairman for holding this hearing and for having this panel, because I think we are getting the views of the people who are out there on the front line dealing with this issue and many of the ones who were creative enough to go forward on this settlement.

I have a question first for General Cornyn, and that is on the 25 percent “set-aside” for tobacco cessation programs. You mentioned that you thought probably Texas would be spending maybe \$200 million out of the \$2 billion-some, which would not meet the 25 percent category probably. But regardless of that, it has been sug-

gested when you are talking about not having strings and trying to do it in a way that is not obtrusive on State authority that Secretary Shalala should have the ability to veto Medicaid money, the State's portion, if she finds that the State has failed to meet her definition of the 25 percent in the categories which she has mentioned—reduce youth smoking, protect tobacco farmers, assist children, and promote public health—and if she feels that that 25 percent does not meet those stated purposes, that she would withhold the money.

Now, I would like to ask you, what would that do to a State's budgeting process?

Mr. CORNYN. Well, of course the impact would be on the most vulnerable portion of our population, the beneficiaries of the Medicaid program. I think just the lack of wisdom of that I would like to think is obvious.

Also, under the Texas settlement, which totaled \$17.3 billion plus attorney's fees, that would be \$4.3 billion that is mandated by the Federal Government to be spent on smoking cessation programs. As you alluded to earlier—

Senator HUTCHISON. You would have a fancy program.

Mr. CORNYN [continuing]. It would be quite a cottage industry on providing smoking cessation programs in the State.

As I said, under the memorandum of understanding and I believe under the appropriation bill that has already been introduced in the Texas legislature there is a provision made for a substantial amount, \$200 million, for smoking cessation programs in Texas.

So I think you are a better expert than I am in terms of its budgetary impact, but I think it is fair to conclude it would have a disruptive impact on the State's ability to plan how to spend this money in the manner it deems most appropriate.

Senator HUTCHISON. Let me ask another question. In Donna Shalala's letter, which I just received this morning as well, it states that perhaps there could be legislation, Federal legislation that would resolve the Federal claim, the Medicaid claim, in exchange for a commitment by the States to use that portion of the settlement for shared priorities—reduce youth smoking, protect tobacco farmers, assist children, and promote public health.

My question to the attorneys general, any of whom would like to answer, is if we could pass a law that would require the 25 percent, why would we not be able to pass a law that would allow the Federal Government to make a claim under Medicaid and change the present statutory mechanism?

Mr. CORNYN. Well, the concern that jumps out at me, Senator, is a retroactivity problem under the United States Constitution. In the case of the Texas settlement, the settlement was consummated in January of 1998 and now to pass a law, which ordinarily should operate prospectively, to operate retroactively to pick up and dictate the terms of how that money is spent I think creates some very serious constitutional questions.

Senator HUTCHISON. I was really referring to the Federal Government's ability, the Congress, to pass a law saying, changing the statutory language that precludes the Federal Government from being part of a settlement or an overpayment. In fact, let me just go back to the point that, is not the language upon which HCFA

is relying that—is it not usually used for overpayments or mistakes in billing?

Is there a record of it having been used for other types of lawsuit results in the past? Or is this a new and creative interpretation? Then following that, if that is the case, could we not change the law?

Mr. CORNYN. I think this is a novel application of the third party recovery provisions under the Social Security Act, and I know of no precedent. In fact, my review of the law shows that this would be the first time that this type of thing has happened.

As to changing the law for future prospective lawsuits by the Federal Government against the tobacco industry to recover for their share of the Medicaid costs, I think that is certainly within the power of the Federal Government to do, which would authorize that kind of litigation.

Senator HUTCHISON. Yes, General Fisher?

Mr. FISHER. Senator Hutchison, I would agree with General Cornyn on that, that I think that Congress could change the law however they say fit in that regard.

But I also direct this subcommittee to the fact that there is currently a law on the books, which is the Federal Medical Care Recovery Act, which we believe—and our counsel has provided us a legal memorandum—which we believe if the Federal Government chose to exercise their rights to recover their Federal share of Medicaid, that they could pursue that remedy under that existing act.

But even if someone disagreed with this interpretation and felt that you needed additional Federal legislation, I believe you could change the Social Security Act to make it clear that the Federal Government did have a right to go after the industry for that balance that in essence was left on the table.

Remember, there is a difference between \$206 billion and \$368 billion, and that \$368 billion—that difference is the amount of money which otherwise would have gone to the Federal had the original June 20th resolution been enacted.

Senator HUTCHISON. Then you agree with General Cornyn's interpretation of the present HCFA statute, that it is usually used for overbilling and mistakes in billing?

Mr. FISHER. Yes, I do concur with that.

Senator HUTCHISON. General Miller?

Mr. MILLER. I would just, add one other category where it is commonly used is on personal injury actions, where someone is in an automobile accident, Medicaid has paid for the medical costs, and then routinely the States secure part of that, that judgment or settlement, for the Medicaid expenditures and then that is shared with the Federal Government. That is where it is commonly done.

Senator HUTCHISON. It is a cost related to that particular type of lawsuit.

Mr. MILLER. Right.

Senator HUTCHISON. Rather than a general sort of scattershot, which is what they are claiming now, from what I see.

Mr. MILLER. Yes; they are claiming that this is analogous to those kinds of accidents.

I would agree with my colleague from Texas, though, that to try and do it now sort of looking back would be difficult. The tobacco

companies would argue that it is unfair, perhaps unconstitutional, for them to pay the States and the Federal Government if you authorized a Federal action for the same sort of thing.

Senator HUTCHISON. You are saying Medicare is the better approach for the Federal Government than Medicaid?

Mr. MILLER. Very much so.

Senator HUTCHISON. Governor Patton, you probably could speak to the issue of what it does to a budgetary process if the Federal Government arbitrarily says 25 percent has to be spent on certain types of programs. What would that do to your budgeting capabilities in Kentucky?

Governor PATTON. Well, until this issue is settled I would not recommend the expenditure of any of the funds, because it would be irresponsible to do so. Our legislature does not meet until next year, so we are really not up against the plow like some of the other States are. But we do want to have this issue resolved in a way that will let us begin, very quickly to begin to think about the use of these funds.

Senator HUTCHISON. Would the other States like to talk about whether money is being withheld? I understood that some are putting it into escrow until this matter is settled. So it is clearly something that we need to address and clarify, from the things that I have heard.

Are any of you others having experiences of this type?

Mr. MILLER. Exactly. We are certainly in that situation. All of the legislative leaders and the governor and I think it would be irresponsible to spend the money with the Federal claim laying out there. So we are really paralyzed as to that amount. So it is extremely important that the Congress and the administration act as quickly as possible on this.

Senator HUTCHISON. Do you think you would have clarification if the Secretary of Health and Human Services were able to essentially withhold your Medicaid money in the future if her interpretation of your use of the funds and yours differed?

Mr. FISHER. Senator, I believe if that occurred, if there was no action by the Congress and there was even the threat of the withholding of the Medicaid funds, I would anticipate that there would probably be a lawsuit, which would be an unfortunate result because that would just be a further dissipation of the resources.

But I concur with Attorney General Miller that we believe that we need a resolution of this issue as quickly as possible.

Senator HUTCHISON. Thank you, all of you, for sharing your particular situation. I do hope we can act quickly in the supplemental appropriations bill. I hope the Federal Government will pursue its own avenues through Medicare. They have that option. It is a bigger, I think more appropriate, area of interest than Medicaid.

I most of all hope that we do not create another Federal string of regulations and bureaucracies that would cause the States to do as you have just suggested they might, and that is to have to wait or hold money in escrow or not have the freedom to spend it. I do trust in the States that, even if they do not meet the exact specific test—for instance, Kentucky is going to help tobacco farmers, but Texas is not; Texas is going to use it for health care; Michigan is going to use it for scholarships.

I do not think that we are going to get far afield here, but I do think that it is the States' money and I do not think they need to have strings that turn into regulations that turn into vetoes of Medicaid funds. We have seen this path before and I hope we can avoid it on this issue in the future.

Thank you, and thank you, Mr. Chairman.

Senator SPECTER. Thank you, Senator Hutchison.

I think there is agreement that—we do not need the lights. We are about to move on to the next panel, but just a few concluding comments. I think there is agreement that we ought to get it resolved so that you can have certainty as to how to proceed. I think that is plain.

The statute provides that the States do have the responsibility for initiating the litigation, States or local agency administering such plans shall take, et cetera, the legal action. So I think that in the States undertaking the matter it was, at least by the Federal statute, the States' obligation.

The statute further provides that "the pro rata share to which the United States is equitably entitled, as determined by the Secretary." So that, absent some change in law, the Secretary can make that determination.

I share the frustration of the States on mandates, unfunded mandates—we are trying to stop those—on the regulatory system, and on a lot of strings which are attached. I am not sure exactly what is going to happen on the floor of the U.S. Senate, but I have a sense that there will be a majority which will favor some sort of general guidance as to how the funds are going to be used. I do not know what that percentage is going to be.

When you talk about an action on behalf of consumers for consumer fraud, as Attorney General Miller outlines, there may be an obligation or there may be some claim of a class to enforce proceeds to go in a certain direction. I do not know, and I would like to see litigation avoided.

But if you talk about the broad categories and you talk about a simple certification, I do not think we are in an area where there is over-Federal intrusion. But what I would request that each of you gentlemen do is to provide us with a generalized set of standards that you think would be easiest for you to live with, without prejudice. Not that you agree to them, but instead of having us work out a delineation or an enumeration, to have you work it out, so that the funds are not used for some totally collateral purpose.

I do not want to become involved in an enumeration of some actions in some States, fortunately not Iowa, Kentucky, Pennsylvania, or Texas, where there has been a demonstrated need for some sort of general guidelines. But we do want to work with you. We do want to get it resolved.

We do want to thank you for what you have done, and this hearing is designed to shed some light on the subject, to have a better understanding by us of your points of view and to try to work it out.

We thank you very much for coming.

Senator HUTCHISON. Thank you.

Senator SPECTER. We move now to the third panel.

[Pause.]

**STATEMENT OF MATTHEW MYERS, EXECUTIVE VICE PRESIDENT, NATIONAL CENTER FOR TOBACCO-FREE KIDS**

Senator SPECTER. We now move to our third panel, Mr. Matthew Myers, executive vice president and general counsel of the National Center for Tobacco-Free Kids. The center is a privately funded organization established to focus attention on reducing tobacco use among children.

Welcome, Mr. Myers. We appreciate your coming and look forward to your testimony.

Mr. MYERS. Mr. Chairman, thank you for holding the hearing. I am delighted to be here. This hearing does address very important issues about what the Congress should do with regard to the Federal share of the funds the States are due to receive from the November 1998 settlement of the cases they brought against the tobacco industry.

I have four basic points and I would like to make them briefly. The first is the States and the State attorneys general deserve enormous credit. Without their efforts, we would not have the opportunity now before us today. If, but only if, we use the money wisely, we have the opportunity to make major advances in reducing the number of our children who become addicted to tobacco.

However, given the Government's Federal role in the Medicaid Program, the fact that the States took the lead in suing the tobacco companies does not alter the core legal premise that the Federal Government has a legitimate claim to a significant portion of the funds to be paid by the tobacco companies. At the heart of many of these cases and indeed the catalyst for the early cases was a claim that the State had spent millions and in some cases billions of dollars in Medicaid funds treating tobacco-caused disease. I do not need to tell this committee that the Medicaid Program is a Federal-State partnership in which the Federal Government pays over 50 percent of every dollar spent.

Even in those State-initiated cases—and I think this is very important—where less emphasis was placed on the recoupment of Medicaid dollars, those cases which did not cite the Medicaid statute at all, or in those very few cases where a Medicaid claim was made and was cut back by the courts, the Medicaid Program is implicated.

Now, why do I say that? In return for the tobacco industry's agreement to the terms of this particular settlement, the States agreed to accept the tobacco companies' payments as full payment for any claims which the State asserted or could have asserted for costs incurred in treating tobacco-caused disease. That includes the Medicaid claims. What that means is that by the terms of the settlements, even when they had not referred to Medicaid, the States accepted the payments in return for full payment of any possible Medicaid claim the States or the Federal Government might have had, past, present, or future.

Senator Hutchison talked about the possibility of passing a law giving the Federal Government the right to sue under Medicaid. Well, unfortunately, at least as it relates to tobacco it is too late, because the States in their settlement have already waived any Federal claim as well as their own claim to these dollars.

The hard reality is this State settlement is all of the money either the Federal Government or the State government is going to receive as a result of the billions of dollars of Medicaid payments that have been made or that in the future will be made. Thus, we reach the same conclusion that you do, Senator Specter: The Federal Government has a legitimate claim to a significant portion of the moneys.

However, having reached that claim, we also think that this should be an area in which we do not fight. We support the States' request to have the money go back, provided that a significant portion of the money is actually used for the purposes for which the cases were brought.

Senator SPECTER. Significant portion? Why not all of it?

Mr. MYERS. Well, to the extent that we could avoid getting into a fight with the States about how much of the money is Federal money versus State money, we would like to do so in the nature of a compromise. We believe that, based on the data supplied by the Centers for Disease Control and others, that you need at least 20 to 25 percent of the overall money, and it will vary somewhat from State to State of course, in order to fund comprehensive, effective tobacco control programs.

Indeed, during the negotiations——

Senator SPECTER. Tobacco control, but how about medical——

Mr. MYERS. Tobacco prevention programs. Well, let me limit it to that and then return to that question, because I think it is a very important point that you make.

Indeed, during the negotiations it has been widely reported that some of the smaller States, the Dakotas, argued that their State ought to receive an increased proportion of the moneys precisely because there was a minimum amount of money that was necessary to fund a meaningful tobacco prevention and control program. That is why they got the money.

Now, there are some States, as you heard today, that are proposing to spend the money on precisely the sort of programs about which we are talking about. Iowa, Washington, New Jersey are leaders in this. But unfortunately there are a substantial number of States that are talking about spending these dollars on everything but programs to reduce tobacco use or in some cases on public health.

We would of course share your desire to see that money that was paid by the tobacco companies as a result of the death and disease that they have caused, are causing, and will cause be used to improve the public health. So we do agree on that point, Senator Specter, 100 percent.

For us it is very important to realize that the decision that the Congress makes about whether to ensure that money is spent on public health and tobacco prevention will actually affect the amount of money that Congress and the Federal Government pays on Medicaid programs in the future. As a result of the leadership of some States, we now know that effective programs to prevent tobacco use and to help smokers quit—we can dramatically reduce the death toll and the disease and the Medicaid costs from tobacco prevention programs.

Let me cite you a few examples, because I think it is very important to understand. In 1996, Oregon initiated the type of comprehensive tobacco prevention program we are talking about. In a 2-year period they reduced tobacco use in their State by 11.3 percent, dramatically higher than the national average.

In 1993, Massachusetts initiated a comprehensive tobacco prevention program, and there are three facts about that program that are critical. One is during that period of time they reduced smoking in their State by over 30 percent, over 3 times the national average.

Second, while smoking rates skyrocketed among children elsewhere, they did not in Massachusetts and, indeed, they even went down among eighth graders.

Third, in the short term Massachusetts succeeded in cutting smoking among pregnant women by 50 percent. As a direct result of that, Massachusetts encountered a dramatically lower rate of premature births.

California saw the same thing after they initiated their tobacco prevention program, and California has estimated that in the 6 years their program has been in existence they have saved 10,800 women from suffering from a premature birth. If that data is correct, and there is every reason to believe that it is, California's tobacco prevention program has paid for itself already.

In other words, we think it is vitally important for Congress to step in and provide some guidance to the States, rather than for us all to fight about what proportion of this money is Medicaid money and what should be done with it. We know that if a significant percentage of the money is spent on programs to prevent tobacco use we can have a significant impact on the number of kids who become addicted, we can have over the long run a significant impact on disease rates of diseases like lung cancer, and in the short run we can have a dramatic impact on smoking and the health of pregnant women. We also know that over the long run we can save the Medicaid program, Federal and State, billions and billions of dollars.

#### PREPARED STATEMENT

We think this is an issue in which the Federal Government has a direct financial interest and a direct policy interest. We support the positions that you took earlier to ensure that guidance is given to the States. If the State cases that were brought, as General Miller said, with the primary goal of reducing tobacco use and the amount of money we spend on tobacco-caused disease is to be met, it is essential that Congress express its views and ensure that at least a significant portion of the money be used for these purposes.

Thank you.

[The statement follows:]

#### PREPARED STATEMENT OF MATTHEW MYERS

Good morning Mr. Chairman, and members of the committee. My name is Matthew Myers. I am the Executive Vice President and General Counsel of the National Center for Tobacco-Free Kids, a national organization created to protect children from tobacco by raising awareness that tobacco use is a pediatric disease, by changing public policies to limit the marketing and sales of tobacco to children, by altering the environment in which tobacco use and tobacco policy decisions are made,

and by actively countering the tobacco industry and the influence of its special interest. The National Center is a membership organization with over 125 members, including many of this nation's major public health organizations and other groups concerned about the health and welfare of our nation's children.

Mr. Chairman, I would like to thank you for holding this hearing to focus attention on what the Congress should do with regard to the federal share of the funds the states are due to receive from the November 1998 settlement of the cases they brought against the major tobacco companies. The answer to this important question will have an impact on federal Medicaid policy, the amount of money available to the federal government for Medicaid and other purposes, the amount of money the states retain as a result of the tobacco settlement, and whether the tobacco settlement actually results in the funding of programs in every state in the nation to reduce tobacco use, particularly among children.

#### MAJOR CONCLUSIONS

Before we go into more detail, I would like to summarize the National Center's key points:

(1) The state attorneys deserve enormous credit. Without their efforts we would not have the opportunity now facing us. They initiated litigation when no one thought they could win; they used the litigation to develop a national consensus about the responsibility of the tobacco companies to reimburse taxpayers for the billions of dollars being spent to treat tobacco caused disease; and they forced the tobacco companies to the table. If we use the money from their agreement wisely, we have an opportunity to make major advances, advances that would not have otherwise been possible.

(2) Given the federal government's role in the Medicaid program, the fact that state attorneys general took the lead in suing the tobacco companies does not alter the conclusion that the federal government has a legal entitlement to a significant portion of the funds to be paid by the tobacco companies in the settlement of these cases.

(3) Despite having reached the conclusion that the federal government is entitled to a portion of these funds, we support the states' request that the federal government waive its right to these funds, provided that the waiver is conditioned on the states spending a sufficient amount on programs to actually prevent and reduce tobacco use—at least twenty-five percent of the total the states receive. This condition is necessary in order to accomplish the purpose for which the cases were brought and to take the steps necessary to reduce the burden on the Medicaid system of tobacco caused disease. Without Congressional action it is now clear that some states will fund programs to prevent and reduce tobacco use with these funds, but many will not do so.

(4) We support the states' request because a number of states have already demonstrated what can be accomplished when a state takes the lead in the fight to reduce tobacco use. There now exists a sound scientific basis to demonstrate that a multifaceted tobacco prevention effort at the state and local level, if adequately funded and properly administered, does reduce tobacco use and can save a significant amount of money in health care dollars. While state programs do not replace the need for federal action in certain areas, funding state and local tobacco prevention and reduction efforts is good health policy and good fiscal policy.

#### MEDICAID AND THE STATE TOBACCO LAWSUITS

At the heart of many of the state tobacco cases was a claim that the state had spent millions, and in some cases billions, of dollars in Medicaid funds treating tobacco caused disease. As this committee is well aware, the Medicaid program is a federal/state partnership in which the federal government pays over fifty cents of every dollar spent. When a state joins the Medicaid program, it agrees that it will be the entity responsible for taking the steps to recover any funds paid out through the Medicaid program as the result of the wrong doing of a third party. The Medicaid program further provides that if a state succeeds in its efforts to recover these funds, the federal government is automatically entitled to the portion of the recovery that reflects the federal government's share of the original payment.

Even in those state initiated cases where less emphasis was put on the claim for recoupment of Medicaid dollars, those cases which did not specifically cite the Medicaid program, or those cases where the courts limited the state's ability to seek Medicaid recoupment, the federal Medicaid program is impacted by the settlement. Why do we reach this conclusion? In return for the tobacco industry agreeing to the terms of the settlement, the states agreed to accept the tobacco companies' payments as full payment for any claims which the state had asserted or could have

asserted for costs incurred in treating tobacco caused disease, including those related to the Medicaid program. They also released the tobacco companies from both the state's and the federal government's right to seek further recovery of money they will spend on tobacco caused disease. Since the federal government's Medicaid rights are dependent on the states, the state settlement cuts off the claims of the federal government.

The federal government has incurred billions of dollars in Medicaid costs due to tobacco and will continue to do so. Beyond its share of the settlement, these are funds it can not now recover. No matter how these cases are characterized, the settlement directly affects the federal government's ability to recover reimbursement for past, present or future payments of federal Medicaid dollars for tobacco caused disease. Thus, what the Congress does now has an impact on Medicaid policy and the amount of money that will be available to the federal treasury. It will also have an impact on whether federal Medicaid related expenditures for tobacco caused disease increase or decrease in the future.

If the federal government waives its share of the tobacco settlement funds, a significant portion of these funds should be dedicated to reducing tobacco use:

It has been estimated that annually the federal government spends as much as 7.4 billion dollars through the Medicaid program to pay for treating individuals with tobacco caused disease. Unless strong action is taken to reverse current trends these expenditures and the tobacco problem will only continue to grow. Smoking among high school seniors in the United States is near a 19-year high. Since 1991 past-month smoking has increased by 35 percent among 8th graders. Over the past 10 years the number of kids under 18 who become daily smokers each year has increased by over 70 percent. Nationwide, the Centers for Disease Control and Prevention has estimated that more than 3,000 kids become new daily smokers each and every day.

When the states brought these cases they said that they did so in order to reduce tobacco use, particularly among children. Virtually every public official involved in bringing and prosecuting these cases stated repeatedly that the goal of these cases was to fund programs designed to reduce the number of our children who become addicted to tobacco and to assist and encourage adults to quit using tobacco. It is clear that those who negotiated the November 1998 settlement intended for some of the funds to be used to fund programs to reduce tobacco use. For example, it has been widely reported that during the negotiations that led up to the November 1998 settlement, the representatives of the smaller states in those negotiations asked for additional funds as part of the settlement based upon the explicit premise that in a small state there is a minimal amount of money that is necessary to conduct an effective and meaningful tobacco prevention program.

The governors and state legislatures in a number of states have proposed to devote significant resources to protecting kids and reducing the terrible toll of tobacco. These states will have to do nothing different if our proposal is adopted. Yet, because the multi-state settlement makes no provision for how the money will be spent, in a number of other states there are plans to spend little or none of the money on programs to reduce tobacco use. In those states it now appears that funds obtained as the result of the toll of tobacco will be diverted to purposes which will do nothing to reduce the number of our children who become addicted to tobacco or to reduce the amount of money that the government will spend to treat tobacco caused disease in the future.

#### INVESTING IN TOBACCO PREVENTION WILL SAVE LIVES AND MONEY

Virtually everyone agrees upon the essential components of a state based comprehensive tobacco prevention program. They include: public education campaigns to deglamourize and discourage tobacco use; effective school based programs, community based programs, treatment for those who want to quit, adequate funding for enforcing existing laws, and funds to evaluate the effectiveness of programs on an ongoing basis.

There is now substantial scientific evidence to demonstrate that comprehensive state and local tobacco control programs work and independent studies from those states that have already initiated programs support this conclusion. For example, in 1996 Oregon passed an increase in its excise tax and initiated a comprehensive tobacco control program. The CDC has now reported that in the 2 years Oregon's program has been in existence, tobacco use in Oregon dropped by 11.3 percent, an increase far greater than the national average. Of that increase, the scientific evidence demonstrates that nearly one-half of the decline was directly related to the newly created tobacco prevention programs.

Massachusetts initiated a comprehensive tobacco control program in 1993 after the enactment of a statewide initiative that increased its tobacco excise tax. Between 1992 and 1998 consumption of tobacco products in Massachusetts declined by over 30 percent, three times the national average. In addition, Massachusetts did not experience the dramatic increase in teen smoking that occurred throughout the rest of the country during this period. Perhaps most critically, while smoking increased among 8th graders nationally, it actually decreased in Massachusetts.

The Massachusetts program produced results in another area that receives far too little focus. As a direct result of the Massachusetts program, smoking among pregnant women in Massachusetts declined by 47.8 percent during this period, the steepest decline in the nation. The decline in smoking among pregnant women produced immediate financial and health results. It resulted in a significant reduction in premature births and other pregnancy complications among Massachusetts' population, saving very substantial amounts of money.

In 1989 California increased its excise tax and used the funds to institute a comprehensive tobacco control program. Subsequently tobacco use in California dropped by 38 percent, more than twice the national average. As in Massachusetts, California has avoided the dramatic increase in teen smoking that has occurred nationally, and smoking among pregnant women dropped by nearly one half. It has been estimated that in California alone the tobacco prevention program resulted in over 10,800 fewer premature births.

As a result of the tobacco settlement in Florida in 1997, Florida has recently initiated a comprehensive tobacco prevention program. It is too early in Florida to see actual changes in consumption, but there has already been documented increased awareness by children of the health effects of tobacco and changed attitudes among children about tobacco.

In short the tobacco prevention programs which could be funded by using a portion of the money the states receive from the settlement of these lawsuits could save millions of lives and billions of healthcare dollars. It is about the most cost-effective investment Congress can make.

#### CONCLUSION

What the Congress decides to do with the federal portion of the money paid by the tobacco companies to the states will set a precedent for the Medicaid program and, as the Congressional Budget Office recognized, also affects the federal budget. Most importantly from our standpoint, what the Congress decides on this issue will also directly affect whether programs are put in place nationwide to reduce tobacco use among children.

We support the states' request to have the federal government waive its claims to these funds, but only if the waiver is conditioned on the states' spending at least 25 percent of the funds to accomplish the dual goals that prompted these cases—reduce tobacco use, particularly among children and reduce the burden on the Medicaid system by reducing tobacco caused disease.

Senator SPECTER. Mr. Myers, what do you recommend? You have talked about "significant" on a couple of occasions. I suggested at one point 100 percent and you did not take that figure. What figure would you insert in your amendment if you were filing one on the Senate floor?

Mr. MYERS. Mr. Chairman—

Senator SPECTER. I do not want to elevate you too fast here, but what do you think?

Mr. MYERS. I appreciate that.

Senator SPECTER. Or de-elevate you. I am not sure.

Mr. MYERS. Certainly an elevation.

I am here on behalf of an organization that works for the goal of reducing tobacco use, particularly among children. The ultimate policy I have expressed also represents the views of the ENACT coalition, which is a broadly based public health coalition of groups—

Senator SPECTER. Are you refusing to answer the question, Mr. Myers?

Mr. MYERS. No, I am about to give you the answer.

Like the American Cancer Society, the American Heart Association—

Senator SPECTER. Why do you not start there and then disclaim.

Mr. MYERS. OK. The only area in which I have precise expertise is the amount of money needed to be spent on programs to reduce tobacco use, and in that area we believe that at least 20 to 25 percent of the money must be spent. The additional amount of money that ought to be spent on programs for public health purposes is an area that is beyond our expertise, in which we would be delighted to work with you.

Senator SPECTER. You said that some States are talking about other programs for use of this money.

Mr. MYERS. Yes, sir.

Senator SPECTER. What specifically do you have in mind?

Mr. MYERS. Well, we can run a broad range of proposals, and very few States have reached a final conclusion at this juncture, many of the programs those that we would support and others are completely different. For example, in Rhode Island the Governor has proposed to use a substantial portion of the funds to reduce the car tax, which may or may not be a good idea, but it is certainly not why the lawsuit was brought.

In a number of other States their proposals are to spend the money on dealing with educational crises that have been in existence for a long period of time.

Senator SPECTER. Education unrelated to smoking?

Mr. MYERS. No; just education in general, financing the school systems.

Senator SPECTER. Which States are talking about that?

Mr. MYERS. In Ohio the Governor has raised that as a major issue, although there are also major proposals in the legislature to spend some, a substantial amount of money, on programs to reduce tobacco use. We do not yet know how that debate is going to come out.

Senator SPECTER. Any other purposes that you have heard about?

Mr. MYERS. Besides for education? Yes. The State of Louisiana, which does not yet have a formal proposal, at one point talked about using the funds—actually selling the entitlement to the settlement and then using the funds for debt reduction. The Governor of New York has also spoken about using the funds primarily for the purpose of debt reduction.

In at least one western State there has been talk about using the money to deal with the water crisis or water problems in that State.

I am not passing judgment on whether those are laudable goals or not laudable goals. They are simply not the reason these cases were brought, and if the money is diverted to those purposes what it means is that the continuing high tobacco use rates among children will only continue to rise and that we will have missed an historic opportunity to reduce tobacco use among children.

Senator SPECTER. Well, thank you very much, Mr. Myers, for your testimony. We are going to have to formulate a program for amendment, because I do intend to offer one. A number of Senators

have talked about it. Senator Harkin has talked about it, other Senators have talked about it.

But I share your concern about not giving carte blanche to the States. I do not think it ought to be used for a car tax or for general debt reduction. You have a very specific problem, you have a very specific recovery, and I believe that there may well be a legal right on the part of the citizens who have been damaged to have these funds used to alleviate the specific damage.

#### CONCLUSION OF HEARING

Thank you all very much for being here, that concludes our hearing. The subcommittee will stand in recess subject to the call of the Chair.

[Whereupon, at 1:08 p.m., Monday, March 15, the hearing was concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]



## MATERIAL SUBMITTED SUBSEQUENT TO CONCLUSION OF HEARING

[CLERK'S NOTE.—The following material was not presented at the hearing, but was submitted to the subcommittee for inclusion in the record subsequent to the hearing:]

### CONGRESSIONAL WITNESSES

#### PREPARED STATEMENT OF SENATOR THAD COCHRAN

Mr. Chairman, I applaud my colleague from Texas, Senator Kay Bailey Hutchison's, work to protect the state tobacco settlements from recoupment by the federal government.

The State of Mississippi was the first state in the nation to file suit and settle with the tobacco industry. The money our state will receive under its settlement agreement should be spent in accordance with the needs of our state as determined by our state's public officials—not by the federal government.

I am pleased to support Senator Hutchison's tobacco recoupment amendment to the fiscal year 1999 supplemental appropriations bill.

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#### PREPARED STATEMENT OF SENATOR LARRY E. CRAIG

Mr. Chairman, thank you for holding this critical hearing on the Clinton Administration's attempt to seize a large portion of the tobacco settlement from the states.

The full Committee has already spoken to this issue by adopting Senator Hutchison's legislation, which I was proud to cosponsor, as an amendment to the supplemental appropriations bill the Senate should be considering in the near future.

I am not a lawyer, and maybe that's why I'm not particularly impressed by all the legal hairsplitting we've been hearing from the government's lawyers about their claim to these funds. But you don't have to be a lawyer to recognize unfairness when you see it.

In fact, I think my little granddaughter would recognize the story that's unfolding in Washington today: it's called the "Little Red Hen." As my colleagues probably will recall, this story is about some people doing all the work and other people, who didn't lift a finger to help, wanting to share in the product of that work.

In this case, we have the states who initiated lawsuits against the tobacco industry, who took all the risks, who received no assistance from the federal government in making their claims, and who ultimately succeeded in negotiating the historic Master Settlement Agreement last November. Now that the work has been done by these 46 little red hens, and the other four who negotiated individual settlements, the federal government wants to sweep in and take away 57 percent of the funds.

Mr. Chairman, I do not think what we have here is an attempt to assert legal rights, but an attempt to assert control. Quite simply, the federal government wants to direct the spending of these funds by the states, despite the fact that this effort is likely to provoke more litigation, which in turn will only prevent the funds from benefiting the health or welfare of any state's residents. I do not think the federal government has the law on its side, and I know it doesn't have the equities or even common sense on its side.

At this point, I would ask unanimous consent to place in the record of the hearing a letter from Idaho Attorney General Al Lance, objecting to the Administration's attempted money grab. I wholeheartedly agree with Attorney General Lance's confidence that the Idaho state legislature is quite capable of properly determining how Idaho's share of the tobacco settlement should be spent.

It is my strong hope that the Administration will allow my state's legislature, and those of the other 49 states, to make these decisions without interference by aban-

doning its effort at recoupment. Failing that, I hope Congress will take action to protect the right of the states in this matter.

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LETTER FROM ALAN G. LANCE TO SENATOR LARRY CRAIG

STATE OF IDAHO,  
OFFICE OF THE ATTORNEY GENERAL,  
*January 13, 1999.*

Re Idaho tobacco settlement monies

Hon. LARRY CRAIG,  
*U.S. Senate,*  
*Washington, DC.*

DEAR SENATOR CRAIG: You are no doubt aware that Idaho settled its lawsuit against the tobacco defendants. Under the settlement agreement, Idaho is set to receive annual payments totaling \$711 million over the first 25 years of the settlement. Now that the settlement is complete, it is my understanding that the Clinton Administration intends to lay claim on a significant portion of settlement monies for its own use. This is wrong. I ask that you help Idaho protect itself from this money grab by supporting appropriate federal legislation.

Idaho was one of 40 states that filed suit against various tobacco defendants, alleging violations of various state statutes. In Idaho's complaint we sought reparation for damages incurred by the State, as well as civil penalties, costs, and fees as a result of the defendants' actions. We alleged as damages the increased Medicaid costs attributable to tobacco use, which Idaho has spent, as well as the increased insurance premiums attributable to smoking that the State has paid for its state employees. We sought civil penalties under our consumer protection laws.

Section 1903(d) of the Social Security Act provides that a State must allocate from the amount of any Medicaid-related recovery "the pro-rata share to which the United States is equitably entitled." Relying upon this statute, it is our understanding that the Health Care Financing Administration will be taking the position that Idaho's settlement payments represent a credit applicable to Idaho's Medicaid program, regardless of whether the monies are received directly by the State's Medicaid program. This should not be so.

It is not equitable for the federal government to take the fruits of the states' efforts. This is particularly true in this case. Idaho filed its suit, took significant risks, and fought for significant changes in how the tobacco industry will market its products. What did the Clinton Administration do in this regard with the federal government's vast resources? Nothing.

I have great confidence that Idaho's Legislature will properly determine how Idaho's tobacco proceeds should be spent. I am sure you share that trust as well. That will not happen, however, if the federal government is allowed to take that money and spend it as it pleases. I ask for your assistance in making sure that does not happen.

Sincerely,

ALAN G. LANCE,  
*Attorney General.*

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PREPARED STATEMENT OF SENATOR TOM HARKIN

Mr. Chairman, thank you for holding this hearing. As you know, I am strongly opposed to the amendment Senator Hutchison has attached to the supplemental which would turn over all of the Federal share of the tobacco settlement to the States without any requirement that a penny of the funds will be used to reduce teen smoking.

I know that some are saying that the federal government had no role in these lawsuits and therefore no right to these funds. They are wrong. The Federal taxpayer has every right to their share of the tobacco settlement. Medicaid is a federal-state partnership and the federal government pays an average of 57 percent of the costs of each state's Medicaid program.

Under the Social Security Act, it is the responsibility of the states to recover any costs caused by third parties. In fact, the law says that only the states can file such suits. Medicaid law then requires the states to turn back to the federal government its share of any money the state recovers.

While I understand that not all of the states based their cases entirely on lost Medicaid costs, when the states settled this case in November 1998, even those that

did not include a Medicaid claim in their suit waived their right (and therefore, the federal government's right) to recover tobacco-related Medicaid costs in the future.

The state suits began with the important goal of redressing the harms caused by tobacco; we owe it to our children and grandchildren to try to reduce that harm for future generations. Therefore, I will be offering an amendment on the Floor that will require States to devote some portion of the tobacco settlement proceeds to tobacco control programs.

Smoking among high school students has increased 32 percent from 1991 to 1997. Sadly, a number of States may not spend even a penny of the settlement dollars on preventing tobacco use among children. I feel very strongly that if we are going to allow the States to keep all of the proceeds of the tobacco settlement, the States must be required to commit some portion of those funds to reduce tobacco use, especially among kids.

I look forward to hearing from our witnesses today and I want to especially welcome, the Attorney General from my home State of Iowa, Mr. Tom Miller. I want to commend Attorney General Miller and our new Governor of Iowa, Governor Vilsack, who have announced their plans to direct next year over \$17 million of Iowa's tobacco settlement proceeds to tobacco prevention activities. I hope all States will follow Iowa's lead and use the tobacco dollars for what they were intended to be used for when all this tobacco litigation was started.

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#### PREPARED STATEMENT OF SENATOR RICHARD J. DURBIN

Mr. Chairman, I am pleased that you have called this hearing on a very important issue that has not received sufficient scrutiny in the Congress. The premature addition of the Hutchison amendment to the supplemental appropriations bill is an attempt to push the Congress into a hasty decision with billions of dollars and important public health issues at stake. This hearing will help shed light on those issues as we consider the conditions under which the federal government may relinquish its legitimate claim to its share of the Medicaid tobacco settlement funds.

#### MEDICAID LAW

The first point to emphasize is that the federal government is entitled to a share of the payments attributable to Medicaid costs from the settlement between the states and the tobacco companies.

The Medicaid program is a federal/state partnership with each paying a portion of the program's costs. On average, the federal share of the Medicaid program is 57 percent. The states are obligated under long-standing Medicaid law to recoup any costs caused by third parties. Indeed, the law says that only the states can file such suits even though part of what they recover belongs to the federal government. Medicaid law then requires each state to turn back to the federal government its share of any money the state recovers. Clearly, the federal government is entitled to a portion of the recovery from the tobacco companies.

#### FUTURE MEDICAID CLAIMS

Many people are not aware that the states agreed to relinquish future Medicaid claims against the tobacco companies, regardless of whether their current lawsuits involved Medicaid claims. The Master Settlement Agreement (MSA) includes provisions that settle all past and future Medicaid claims against the tobacco companies. This means the MSA settles federal claims, because current law requires the states to pursue third parties such as the tobacco companies on behalf of the states and federal government. Therefore, when the states waived their right to recover tobacco-related Medicaid costs in the future, they essentially waived the right of the federal government as well.

The federal government has paid, and will continue to pay, one-half or more of the Medicaid costs associated with treating tobacco-caused diseases, even though the states have now waived the federal government's right to any further tobacco related Medicaid recovery. This further underscores the federal right to a share of the settlement proceeds.

#### FEDERAL/STATE PARTNERSHIP

The states and the federal government share in both the costs and the recoveries under the Medicaid program. When states pursue third-party Medicaid claims, the federal government shares half the costs of these collection efforts. The federal government is legally required to reimburse states for such costs whether a state wins or loses its litigation.

States routinely follow the requirements of the Medicaid statute, which protects the federal government's interests by explicitly making the states responsible for pursuing these recoveries, reporting them to the Health Care Financing Administration (HCFA), and ensuring that the federal government receives the share to which it is entitled. In fiscal year 1997, the total collected by the states for third party liability Medicaid reimbursements was \$638 million, of which \$362 million was returned by the states to the federal government as the federal share of the recoupments.

There is even more direct evidence that the states were aware that they would have to reimburse the federal government after agreeing to settle their cases against the tobacco industry. In March 1996, five states (FL, LA, MA, MI, WV) settled with the Liggett tobacco company. That year three states (FL, LA, MA) credited HCFA with a portion of the \$200,000 payment they each received from Liggett. In 1997, two states (LA, MA) credited HCFA with a share of the \$91,000 payments they each received.

#### BUDGET IMPLICATIONS

Congressional action to change current law to waive the federal claim has federal budget implications. The Congressional Budget Office (CBO) has estimated that possible federal recoveries from the states total \$14 billion over five years and \$28 billion over 10 years. However, CBO has also assumed that there is a 25 percent probability that HCFA will successfully retrieve these funds and, therefore, estimates for scoring purposes that the federal recovery from the state tobacco suits will total \$2.9 billion over five years and \$6.8 billion over 10 years. Any legislation that allows the states to keep all of the funds requires an offset of this magnitude or a waiving of the federal Budget Act.

#### TOBACCO CONTROL PROGRAMS

Congress has an obligation to ensure that at least a significant portion of the federal money is used to reduce the tragedy of tobacco use, particularly among our nation's children. This does not require, and I am not advocating, that we physically take back the federal money. Instead, we could leave the money in the hands of the states with clear assurances that the money will be used for appropriate purposes and not just used to build a new state capitol building or for other purposes unrelated to tobacco, health care, and children.

Any Medicaid recoupment bill should give a mandatory share of the money to youth tobacco use prevention programs. Otherwise, many states will spend none of it on youth tobacco use, as several states have already proposed. The Centers for Disease Control estimates that each state will have to spend a minimum of an average of 25 percent of their settlement dollars to run an effective tobacco control program. A "lookback" program can assess the success of each state's effort to reduce underage tobacco use and whether this percentage can be raised or lowered.

#### GOVERNOR'S PRIORITIES

Where should we turn for guidance on how the federal share of the settlement money should be spent? I propose that we listen first to the priorities the National Governors Association (NGA) has already identified. According to the NGA Policy on Tobacco Settlement Funds adopted at their 1999 Winter meeting, "The nation's Governors are committed to spending a significant portion of the settlement funds on smoking cessation programs, health care, education, and programs benefiting children."

This range of programs is appropriate. But the first priority is that these settlements resulted from the harms caused by tobacco; at least a part of the funds should be spent to reduce that harm in the future. This will help protect kids and save both federal and state dollars in the long run.

#### PUBLIC SUPPORT

Finally, I would like to note that the public supports a large portion of the settlement money going to tobacco control programs. Polling conducted by the American Heart Association last November found that 74 percent of voters support dedicating at least half of these dollars to tobacco addiction treatment and efforts to educate teens about the dangers of tobacco.

Mr. Chairman, while we should not grant the dream wish of the governors and turn this money over to them without any guidance on how it should be spent, we should listen to the priorities outlined by the governors and the concerns of the

American public as we determine the terms under which we relinquish the federal share of this money.

I am less concerned with who is spending the money than I am with how it is being spent and whether the goal of reducing underage addiction to tobacco is being seriously addressed.

I thank you for the opportunity to share my thoughts with you today on this important issue.

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NONDEPARTMENTAL WITNESS

PREPARED STATEMENT OF CARL TUBBESING, DEPUTY EXECUTIVE DIRECTOR,  
NATIONAL CONFERENCE OF STATE LEGISLATURES

Since the Master Settlement Agreement (MSA) was signed last November, state legislators across the country have been studying the provisions of the agreement and determining what actions they need to take to implement the agreement in their respective states. As you know by now, this is a complicated legal proceeding. It presents particularly special challenges to short session states. States are taking many different approaches, but are unified on one issue. These funds are state funds and there is no room for intrusion of the federal government in the state budget and appropriation process.

Representative Robert Junell of Texas came to Washington, D.C. in January to participate in the press conference jointly sponsored by your colleagues, Senator Kay Bailey Hutchison and Senator Bob Graham regarding the introduction of S. 346, a bill NCSL vigorously supports. This bill, which is now part of S. 544, the fiscal year 1999 Supplemental Appropriations bill, is a top priority for NCSL and legislatures across the country. Representative Junell compared the states to the "Little Red Hen." For those of you unfamiliar with this story, I will briefly describe it here.

The Little Red Hen decided she wanted some fresh homemade bread and set about asking her friends and neighbors to help her with the process. Finding no takers, the Little Red Hen bought the seeds, planted the seeds, watered and weeded the plants, gathered the wheat, separated the grain, ground the grain into flour, made the dough, kneaded the dough and finally put the bread in the oven to bake. I may have missed a step or two along the way, but I hope you got the picture. All along the way the Little Red Hen asked for help, but received none. When the bread was finally ready, the Little Red Hen set a nice table and sat down to enjoy the fruits of her labor. Remember the Little Red Hen is representing the states. This is when the federal government steps in. As the Little Red Hen is slicing her loaf of bread, all the friends and neighbors who didn't have time, or the inclination to help show up with plates ready to join the feast. The Little Red Hen was not prepared to share. Neither are the states.

The Congress and the Administration failed in its efforts to enact tobacco legislation last year. States, through their attorneys general, continued to move forward and ultimately reached a compromise that was formalized in the Master Settlement Agreement on November 23, 1998. Four other states (Florida, Minnesota, Mississippi and Texas) independently reached agreements with the tobacco manufacturers. As a result, 50 states as well as the District of Columbia, American Samoa, the U.S. Virgin Islands, Puerto Rico, Guam and the Northern Mariana Islands have succeeded where the federal government failed. We firmly believe that these funds, recovered on behalf of the citizens of these states and jurisdictions, should be disbursed according to state law, with no interference or direction from Washington, D.C.

There has been considerable concern expressed about how states might spend these settlement dollars. NCSL, through its Health Policy Tracking Service (HPTS), is tracking all state tobacco settlement legislation. The information is published in an issue brief, "Tobacco Settlement Distribution," that is updated weekly to reflect the most recent legislative action. Most state legislatures are still in session, so it is not possible to predict what legislation will ultimately be adopted, but I can tell you what has been introduced and discuss some general trends. Below is a chart from the most recent issue brief. This issue brief has been submitted for the record by Attorney General Mike Fisher of Pennsylvania, who testified before the subcommittee during the hearing on March 15, 1999.

## STATE TOBACCO SETTLEMENT LEGISLATION 1999

[Updated March 12, 1999]

Category	Number of bills	Number of States with bills from column 1	Percent of States
Child development .....	11	7	14
CHIP/children's health .....	36	20	40
Smoking cessation, education, prevention .....	64	25	50
Access to health care for low income people .....	82	32	64
Tobacco growers/communities .....	29	9	18
Trust funds .....	126	37	74
Education .....	21	11	22
Graduate medical education .....	10	6	12
Long term care .....	10	8	16
Tax cuts/tax credits .....	13	9	18
Medicaid recoupment .....	34	25	50
Other <sup>1</sup> .....	81	30	60
<b>Total bills .....</b>	<b>517</b>		

<sup>1</sup>This category includes a number of health-related proposals including funding for: insurance risk pools, cancer research, women's health programs, HIV programs, prosthetic devices, veteran's homes, and medical equipment.

Three quarters of the states have proposed trust funds. This reflects, at least in part, the uncertainty surrounding the actual amount of funds that will become available to states. Part of the uncertainty is built into the Master Settlement Agreement, through the potential imposition of offsets and adjustments, but the most significant question for states is whether the Health Care Financing Administration (HCFA) will be permitted to seize as much as 80 percent of a state's allotment. It is clear by looking at the chart that a majority of states are inclined to spend these funds on health care and services for children and the indigent. Fifty percent of the states have proposed to fund smoking cessation, education and prevention programs.

Not reflected in the chart, but important to consider, is the fact that some states, Texas, New York and California come to mind, have agreed to allocate a significant amount, as much as 50 percent of their settlement funds, to local jurisdictions. Federally imposed mandated earmarking will certainly interfere with these carefully developed agreements and severely restrict state flexibility. Finally, national earmarking fails to account for actions already underway in the states. NCSL believes the federal system we have in place is working. The public is providing input and legislators across the country are responding. We do not believe Washington, DC, can do better.

For the convenience of the subcommittee members, I will quickly review what has been proposed in the states with members on the subcommittee (I have not included Pennsylvania, Iowa and Texas because they had representatives at the hearing): Mississippi (trust fund, health care); Washington (trust fund, health care); New Hampshire (education, smoking cessation); Idaho (trust fund); Alaska (health care, tobacco cessation); Arizona (mental health facility, localities for health care); South Carolina (tobacco growers); Hawaii (health care, youth tobacco cessation programs); Rhode Island (community health centers, mental health centers, trust fund, smoking cessation); Wisconsin (CHIP, youth tobacco cessation programs); and California (health care, women's health, children's health, smoking cessation, aid to cities and counties).

Finally, nine states are considering bills that would provide assistance to tobacco growers and to impacted communities. The importance of these bills should not be underestimated or disparaged. Agreements such as the one recently reached in the State of Virginia, where the state will spend funds to assist tobacco growers and to reduce the incidence of smoking among teenagers is just the kind of agreement that would be made more difficult to reach, if the federal government were to become involved.

NCSL urges the members of the Subcommittee to support the provision in S. 544 that would prohibit the Health Care Financing Administration from seizing state tobacco settlement funds. This action will permit states to move forward with all de-

liberate speed to complete implementation of the settlement agreement and to fund important health care and other initiatives that are to be funded through this effort.

I thank you for your kind consideration and hope that you will call upon NCSL if you have any questions or if we can be of additional assistance to you.

