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Testimony in Support of Senate Bills 484 and 485
An Act Concerning Tribal-State Compacts

Presented to the Senate Committee on Federal and State Affairs
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Chairman Ostmeyer and Members of the Committee:

The Office of the Attorney General respectfully submits the following testimony to the Committee in support of Senate Bills 484 and 485, Acts Concerning Tribal-State Compacts.

Under the Master Settlement Agreement ("MSA"), the State of Kansas is tasked with "diligently enforcing" its "qualifying statute." In 2012, Kansas settled a 2003 dispute regarding "diligent enforcement" of the MSA (the "2003 NPM Adjustment Settlement") and avoided the potential of having to repay hundreds of millions of dollars received from the MSA. By virtue of this settlement, Kansas agreed to make certain changes regarding "diligent enforcement" of the MSA. Several of these changes were made by this Legislature during the 2015 session in passing Senate Substitute for House Bill 2124, including amending the definition of "units sold" to include all federal excise tax paid cigarettes (expanded from the previous standard of state excise tax paid), the basis for which Kansas must account for and collect escrow payments from manufacturers that are not a party to the MSA, known as Non-Participating Manufacturers ("NPM"). In particular, and relevant to Senate Bills 484 and 485, Kansas must account for ***all*** cigarette sales on "qualified tribal lands," regardless of whether state-excise tax is paid. The purpose of these compacts is to help provide Kansas with the information necessary to "diligently enforce" the MSA statutes.

"Qualified tribal lands," as defined in K.S.A. 2015 Supp. § 50-6a07(o), include the reservations and trust lands of the Iowa Tribe of Kansas and Nebraska and the Prairie Band Potawatomi Nation as well as those of the Kickapoo Tribe and the Sac and Fox Nation of Missouri in Kansas and Nebraska. Compact negotiations continue with both the Kickapoo and Sac and Fox.

Kansas, along with 51 other states and territories, have entered into the MSA with certain tobacco manufacturers, known as Participating Manufacturers ("PM"), in part due to the fact that the states were incurring costs derived from the use and sale of cigarettes (healthcare costs among others) by the PMs and the taxpayers were bearing those costs. The MSA settled disputes regarding these past and future costs with the PMs, however, absent a different obligation, NPMs would have been able to sell in the states without any potential compensation for similar costs incurred on the states and taxpayers. Thus the MSA escrow statutes require the NPMs to place money in escrow so that it is available for the states if they elect to pursue a claim for damages. The term "escrow" for purposes of the MSA refers to a bank account held by the NPM to hold the money for satisfaction of a damage (costs) lawsuit if Kansas chooses to pursue such an action, otherwise the money is released back to the NPM after 25 years. The escrow amount owed is based on the calculation per individual cigarette and is approximately equal to what the PMs annually pay into the MSA per cigarette. The problem for Kansas and other states is the fact that NPMs have been hiding behind the veil of tribal sales to avoid paying escrow. These compacts would remove that veil and allow for proper escrow collection. **Failing to collect all required escrow puts Kansas at risk of being subject to a downward adjustment in its annual MSA payment**.

When negotiating both compacts, Kansas focused on several basic needs for enforcement: (1) **the collection of sales data to be used for escrow assessment**, (2) **the ability to audit/inspect/verify the reliability and accuracy of such data** and (3) **the ability to prevent manufacturers that are violating the MSA escrow statutes from selling in Kansas.**

Currently in Kansas, brand-specific sales data is received through monthly tax reports supplied by state-licensed wholesalers and distributors to the Department of Revenue ("KDOR"). The Office of the Attorney General ("OAG") reports the sales data to the manufacturers for MSA purposes and, regarding NPMs, quarterly escrow collection. If an NPM fails to comply with its escrow obligation (or other statutory obligations), it is removed from the directory, a lawsuit is filed and its cigarettes are no longer legal for sale in Kansas. If non-compliant cigarettes are found offered for sale in Kansas, they are seized as contraband. All manufacturers are required to maintain annual certification with the OAG including the submission of statutorily required documentation.

Without the compacts, Kansas is unable to calculate and assess the exact amount of escrow required by NPMs on tribal sales because the necessary sales data is not provided to the KDOR. *With* the compacts, KDOR will collect the data, track the sales (through stamping) and allow the OAG to properly collect escrow owed by NPMs and maintain certifications and the directories.

The nuts and bolts of the Prairie Band compact referenced in Senate Bill 484 provide Kansas with the information necessary to enforce the escrow requirements, the ability to verify sales data and provide documentation to the PMs, and the ability to require continued certification and compliance of the Kansas MSA statutes by manufacturers all while considering the sovereign status of the Prairie Band. The following are highlights of sections of the Prairie Band compact and how this compact will aide Kansas in "diligent enforcement."

- <u>Article I Definitions</u>. Most of the stated definitions are pulled directly from Kansas MSA statutes and the Kansas Cigarettes and Tobacco Products Act, K.S.A. § 79-3301. Others are specifically tailored to meet the requirements of the compact. In particular, "Approved Manufacturer" maintains OAG authority to regulate what manufacturers are legal for sale in Kansas. "Compact Lands" sets forth the Prairie Band lands for which this compact is applicable, namely the reservation and a specific parcel of trust land.

- <u>Article III Effective Date; Term. Section 3.02 Term</u>. The term of the compact is ten (10) years, subject to renewal or termination as provided. Subsection "b" provides for termination if Kansas is deemed non-compliant in a MSA arbitration due to this compact and the parties are unable to renegotiate an agreement.

- <u>Article IV Master Settlement Agreement Provisions. Section 4.01 Nation Obligations</u>. Prairie Band is obligated to control (through licensing) who sells cigarettes and where retailers purchase cigarettes, verify and account for all sales of cigarettes on "Compact Lands," ensure that tax stamps are affixed to every pack of cigarettes offered for sale, collect brand specific sales data and remit such data to KDOR on a monthly basis (as required by every state-licensed wholesaler/distributer) and seize/prevent the sale of contraband (unstamped and off the OAG directory) cigarettes.

- Article IV. Section 4.02 State Obligations. In return for compliance by the Prairie Band, Kansas is obligated to provide an annual payment to Prairie Band based on the proportion of MSA payments received by Kansas that are attributed to Participating Manufacturer ("PM") sales on "Compact Lands." For example, if Kansas received $60,000,000 in MSA money for a particular year in which 2 billion PM cigarettes were sold state-wide and 700,000 of those cigarettes were sold by Prairie Band on "Compact Lands," Kansas would owe Prairie Band their proportional amount, .00035 of (700,000/ 2 billion = .00035) the $60,000,000, or approximately $21,000.

- Article V Tax provisions. Section 5.01 Exercise of Tax Jurisdiction. Prairie Band will have exclusive tax jurisdiction over cigarette and tobacco products excise taxes and sales taxes upon such sales. Given the options available, the cigarette excise tax rate would be $0.17 per pack: the same as other compacting tribes and Missouri (currently). The tobacco products excise tax rate for roll-your-own tobacco would be at least 1% of the wholesale price.

- Article V. Section 5.02 Indicia of Tax; Distribution and Transport. Kansas requires all packs of cigarettes to be stamped. This allows for verification of legally sold cigarettes and, most importantly, the ability to track the numbers of sales through corresponding tax reports. For sales by Prairie Band, a unique state-tribal stamp will be created. To compensate for costs, Prairie Band will provide an annual payment to Kansas of $150,000 so long as sales do not fall below a threshold amount. Contraband is defined and in order to provide for the ability to receive shipments of cigarettes yet be stamped, certain exceptions to contraband are set forth.

- Article VI Audits and Inspections. Important to Kansas is the ability to obtain accurate brand-specific sales data. Kansas will be allowed to inspect retail, wholesale and distributor locations on "Compact Lands" to verify brands being sold, proper stamping and other evidence of compact compliance as provided. Additionally, an independent auditor will conduct an annual audit of all cigarette and tobacco products records, documentation and processes used by Prairie Band and its retailers and distributors and issue a report. This report can be used in order to help demonstrate diligent enforcement.

- Article VII. Dispute Resolution. This Article provides for arbitration for disputes arising under the compact and provides limited waivers of sovereign immunity for each party.

- Article VIII Miscellaneous. Section 8.02 Confidentiality. Like tax reports supplied to Kansas by state-licensed wholesalers/distributors, all reports provided by Prairie Band will be confidential. Kansas is permitted to provide this information for purposes of MSA compliance.

The Iowa compact as referenced in Senate Bill 485, while slightly different, also provides Kansas with the information necessary to enforce the escrow requirements, the ability to verify sales data and provide documentation to the PMs, and the ability to require continued certification and compliance of the Kansas MSA statutes by manufacturers. The following are highlights of different sections of the Iowa compact and how this compact will aide Kansas in "diligent enforcement."

- Article II Terms and Conditions. Section 3. The Iowa will not purchase cigarettes that are not on the OAG directories of approved manufacturers.

- Article II. Sections 4 and 5. The Iowa will license and regulate cigarette retailers on the reservation.

- <u>Article II. Section 6 and 7</u>. All cigarettes sold on the Iowa reservation will be listed on the OAG directories of approved manufacturers and affixed with a unique state-tribal tax stamp.
- <u>Article II. Section 8</u>. The Iowa will report brand-specific sales data to KDOR on a monthly basis, similar to state-licensed wholesalers/distributors. Kansas is permitted to provide this information for purposes of MSA compliance (see Article III, Section 17).
- <u>Article II. Section 9</u>. This section is provides for the auditing mechanism to verify the accuracy of data reported to KDOR. The auditor will examine the records of the Iowa and retailers and issue a report. This report can be used for purposes of demonstrating diligent enforcement. Additionally, subsection "g" allows Kansas the right to inspect retail locations on the reservation.
- <u>Article II. Sections 10, 11, 12 and 13</u>. The Iowa have the right to tax cigarettes and tobacco products sold by retailers on the reservation, exempting sales to members of the Iowa. The minimum excise tax rate is $0.17 per pack (same as Prairie Band and Missouri).
- <u>Article II. Section 14</u>. In return for costs incurred by the Iowa for assisting Kansas with enforcement, Kansas will pay $120,000 per year to the Iowa during the term of the compact, subject to increase for subsequent terms.
- <u>Article II. Section 15</u>. As additional consideration, Kansas will exempt the Iowa from sales tax for specific purchases.
- <u>Article III General Provisions. Sections 1, 2 and 3</u>. These sections provide for negotiations and arbitration for dispute resolutions as well as limited waivers of sovereign immunity for each party.
- <u>Article III. Section 7</u>. The term of the compact is five (5) years subject to renewal or termination.
- <u>Article III. Section 17 Confidentiality</u>. Like tax reports supplied to Kansas by state-licensed wholesalers/distributors, all reports provided by Iowa will be confidential. Kansas is permitted to provide this information for purposes of MSA compliance.

In recent years, Kansas has received approximately $60,000,000 per year from the MSA, although that figure is expected to trend slightly lower due to decreased tobacco sales and other factors. In order to help ensure that Kansas continues to receive its annual payment under the MSA, Kansas needs to continue to "diligently enforce" its "qualifying statutes." These compacts allow the KDOR to account for all cigarette sales on "qualified tribal lands," provide accurate brand-specific sales data, and preserve the OAG's ability to prevent non-compliant cigarette sales.

As we work with the Iowa and Prairie Band under the terms of the respective compacts, we will continue to further strengthen MSA "diligent enforcement" efforts in Kansas. Other states, including Oklahoma, have taken a similar approach with resident tribes to ensure the state continues to receive reliable and necessary sales data. The sovereign status of both Iowa and Prairie Band place them in unique situations as compared to state-licensed wholesalers and distributors. Therefore, a different approach to collecting the data is required. I believe these compacts, if put into proper use, will benefit all parties involved and help Kansas achieve what it needs for MSA compliance and protect the receipt of annual MSA payments going forward.

Thank you for the opportunity to present this testimony on behalf of the Office of the Attorney General.

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