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Victoria Newton
Executive Secretary
Executive Council
State Capitol
LOCAL

Re: Retention of Special Counsel

Dear Victoria:

Our office requests authorization pursuant to Iowa Code section 13.7 to retain special counsel to provide specialized legal services and representation to the State of Iowa with respect a dispute related to the administration of the Master Settlement Agreement (MSA) with Participating Tobacco Product Manufacturers (PMs). We also recommend pursuant to Iowa Code section 23B that the law firm be retained on a contingent-fee basis.

Iowa's annual MSA tobacco payment is subject to a number of contractual adjustments. One such adjustment is the NPM Adjustment. This adjustment is an attempt to offset market share losses of the MSA Participating Manufacturers ("PMs") to tobacco companies that have not joined the MSA, the Non-Participating Manufacturers ("NPMs"). The NPM Adjustment is calculated before every payment. However, the adjustment cannot be applied to Iowa's payment unless an arbitration panel determines that Iowa failed to "diligently enforce" its Qualifying Statute during the previous calendar year. To date, Iowa has arbitrated the diligent enforcement question for calendar years 2003 and 2004. In both cases, an arbitration panel of retired federal judges determined that Iowa had diligently enforced its Qualifying Statute for the year in question. The 2003 Panel found that "Iowa exemplified a Settling State where all the State actors worked together to enforce and improve its Qualifying Statute, from the Legislature to the Attorney General's Office to the Department of Revenue."

Notwithstanding Iowa's exemplary diligent enforcement record, the PMs have continued to withhold a portion of the State's MSA payment each April, alleging without support that Iowa did not diligently enforce its qualifying statute. The PMs currently are withholding over \$110 million from Iowa for the NPM adjustment. Iowa is in the process of arbitrating years 2005-2007, but it will take years to complete the process. Moreover, the arbitration process itself imposes significant costs upon Iowa. In the meantime, the PMs will continue to withhold funds from Iowa's payment each year and the cycle will repeat.

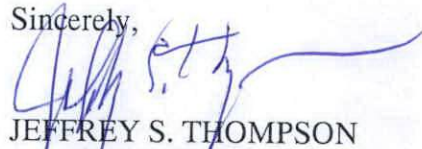
The Attorney General has determined that it is in the State's best interest to take action to break this cycle, recover the withheld funds, and stop future withholding of an NPM adjustment from Iowa's MSA payments. The Attorney General has identified two law firms, Paoli & Leisher PC, 257 W. Front Street, Missoula, Montana 59802, and Morgan & Morgan Complex Litigation Group PLLC, 76 S. Laura Street, Suite 1200, Jacksonville, Florida 32202, working jointly ("Special Counsel"), with the expertise and resources necessary to successfully challenge the contractual basis and lack of good faith by which the PMs have withheld Iowa's funds.

Special Counsel are uniquely qualified and equipped with specialized knowledge of the history and workings of the MSA having previously successfully represented the state of Montana in litigation involving the same issues. The proposed contingent fee arrangement would start at 15 percent of the actual recovery rather than the 25 percent permitted by law and otherwise track the provisions of Iowa Code Chapter 23B. In addition, Special Counsel will advance the costs of the litigation.

This office has determined that this proposed contingent representation is both cost effective and in the public interest. This office lacks sufficient resources – both in staffing and funding – to dedicate to this type of representation; the matter is both novel and complex; the matter would require legal work to be performed out of state; and Special Counsel has significant specialized experience in this area of the law and with this specific legal dispute. We have also determined that a procurement process is not feasible under these unique circumstances.

We therefore recommend approval of the law firms of Paoli & Leisher and Morgan & Morgan Complex Litigation Group, as Special Counsel. The engagement will be governed by a separate contingent fee agreement between this office and the firms which shall comply with the requirements of Iowa Code section 23B.3.

Sincerely,



JEFFREY S. THOMPSON
Solicitor General