No. 07-995

In The
Supreme Court of the United States

STEVE SANDERS,
individually and as class representative
Petitioner,

v.

EDMUND G. BROWN, in his official capacity as Attorney General of the State of California, PHILIP MORRIS USA, INC., R.J. REYNOLDS TOBACCO CO., BROWN & WILLIAMSON TOBACCO CORP., and LORILLARD TOBACCO CO.,
Respondents.

On Petition for Writ of Certiorari
To the United States Court of Appeals for the Ninth Circuit

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF THE CASE

Respondents do not deny that under the MSA the Original Participating Manufacturers ("OPMs") have increased prices well beyond that necessary to fund their MSA payment obligations. Nor do they deny that price increases have occurred in lockstep among the OPMs. The nevertheless offer the distinctly factual claim that the MSA merely imposes a uniform charge per cigarette sold on each OPM independent of market share or volume and that the OPMs are merely complying with independent obligations to pay such fees.

But the MSA's complex payment allocation scheme show those assertions to be incorrect or, at best, subject to ample factual dispute.[1] For example, the per-cigarette charge on the OPMs is not fixed or uniform except in the first instance. Increases in price by one OPM, if not met by the others, would both reduce the relative market share of that manufacturer, reduce the total volume of the aggregate OPM market share to some degree (and shift volume to the other OPMs in part as well), and thus *disproportionately* change the relative market share among the OPMs. That disproportionate change in market share would result

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[1] The MSA's complex and interdependent allocation scheme itself, spanning dozens of pages of the agreement, tends to belie the notion of a fixed charge per cigarette, which could have been provided for in a few sentences as with the escrow charges applied to NPMs. The Second Circuit recognized as much in describing the MSA payment scheme and distinguishing it from a fixed charge per cigarette. *See Freedom Holdings Inc.* v. *Spitzer,* 357 F.3d 205, 228-29 (CA2 2004) ("*Freedom Holdings I*").

in the lower-priced manufacturers paying a greater per-cigarette cost than would the higher-priced manufacturer.

In any event, the complex interaction of the MSA's dozens of pages of allocation rules is not an issue this Court needs to or can resolve at this stage of the litigation. It is sufficient that the complaint reasonably alleges an interdependency between the OPMs that affects and can change the per-cigarette charge and that encourages each OPM to match price rises by the others in order to maintain the balance of the MSA payments and not be subjected to higher relative payments. Far from imposing *independent* obligations on individual manufacturers, the MSA institutionalizes a *dependency among* the OPMs whereby the pricing decisions of one OPM drives parallel pricing decisions by the others.

REASONS FOR GRANTING THE WRIT

As Respondents acknowledge, the MSA is "perhaps the most far-reaching and important" settlement in history, affecting hundreds of billions of dollars and the national market in cigarettes. Mfrs. BIO at 1; AG BIO at 21. The sheer scope and effect of the settlement is precisely what makes the application of uniform legal rules regarding antitrust immunity a matter of national importance and worthy of this Court's attention.

I. There Is an Extended Split on the Questions Presented.

Denying the splits expressly acknowledged by the Ninth Circuit below, Respondents claim that there is no split because no court has entered final judgment

against them. Mfrs. BIO at 18-19, 22-23, 26; AG BIO at 12-14. But, as the Ninth Circuit itself recognized, the circuits have split – genuinely so – on certain essential legal questions governing the eventual resolution of much of the litigation involving the MSA. Pet. 16, 18-19; App. A13, A21, A24. That the rulings have occurred at the motion to dismiss stage rather than after trial does not demonstrate a mere "procedural" dispute – as the Manufacturers would have it – but in fact demonstrates that the differences are based on clean disputes as to the substance of antitrust law based on comparable allegations regarding the MSA and its consequences. *Cf.* Mfrs. BIO at 2 (current suit offers "no new allegations or legal theories" than other suits).

The wholly separate question whether such allegations will prove out at trial are not relevant at the motion to dismiss stage, and Respondents' bold assertions that the eventual facts will support the same *result* are particularly inappropriate given that Petitioner here and plaintiffs elsewhere generally have not been given the opportunity to prove their facts and put on expert economic testimony concerning the effects of complex allocation scheme under the MSA.

A. The Decision Below Expands the Split on Preemption.

The Second and Ninth Circuits, both evaluating the allegations of comparable complaints, as well as the MSA provisions referenced therein, have reached opposite conclusions regarding whether the MSA and its related statutes would be preempted based on such allegations. Pet. 16, 20-21. Contrary to Respondents' suggestions, Mfrs. BIO at 21, the Second Cir-

cuit did not blithely ignore the provisions of the MSA, but instead carefully examined those provisions as well as the allegations regarding their effect, and found them sufficient to state a *per se* antitrust violation. *Freedom Holdings I*, 357 F.3d at 226. While Respondents are, of course, correct that the Second Circuit's preemption holding was based on alleged facts that would eventually be tested at trial, that does not change the fact that the case squarely splits with the present Ninth Circuit decision, which similarly ruled on the allegations, not the eventual facts of a trial.[2] On comparable alleged facts, therefore, the two circuits reached opposite holdings as a matter of law – the quintessential description of a split.

Respondents try to pass off the difference in the circuit rulings as attributable to the Second Circuit's supposed inattention to the terms of the MSA and its acceptance of supposedly incorrect allegations. Mfrs. BIO at 20-21; AG BIO at 12-13. But the Second Circuit discussed the terms and operation of the MSA in detail and explained how they were reasonably alleged to have anticompetitive effects and how they differed from a fixed per-cigarette charge. *Freedom Holdings I*, 357 F.3d at 210-11, 225-26, 228-29. The

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[2] Petitioner, of course, does not claim that the Second Circuit rendered a final decision on the ultimate merits of the preemption claim, merely that it found the allegations sufficient to demonstrate preemption, as the quotes of the Second Circuit in the Petition indicated. Pet. 25-26. Petitioner does not mean to suggest otherwise any more than did the Ninth Circuit in describing the holdings of the Second and Third Circuits. *See* Mfrs. BIO at 23 n. 2; App. A28-A29. The split identified goes not to the ultimate outcomes of the cases, but rather to the conflicting *legal holdings* on virtually identical alleged facts.

Second Circuit thus gave precisely the type of attention to the allegations and the MSA that this Court described in its recent decision in *Bell Atlantic Corp.* v. *Twombly*, 127 S. Ct. 1955 (2007), and found the alleged anticompetitive injury sufficiently persuasive to defeat a motion to dismiss.

That later proceedings in the Southern District of New York and the Second Circuit denied a preliminary injunction hardly undermines the existence of a split on the underlying legal question. *Freedom Holdings, Inc.* v. *Spitzer*, 447 F. Supp.2d 230 (S.D.N.Y. 2004), *aff'd*, 408 F.3d 112 (CA2 2005). The problems of proof noted by the Southern District of New York were evaluated under a heightened standard applied to requests for preliminary injunctions that would change the status quo, 447 F. Supp.2d at 247, and, in relevant part, went largely to the issue of whether the MSA injured *NPMs* relative to OPMs, not whether it reduced competition among OPMs and injured *consumers*. 447 F. Supp.2d at 254-59. The Second Circuit's affirmance of that denial of a preliminary injunction was based upon the lack of irreparable harm to the NPMs, 408 F.3d at 114-15, not on that court's agreement with the district court regarding the effects of the MSA. And, of course, neither of those courts questioned the earlier legal rulings in *Freedom Holdings I*.[3]

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[3] Furthermore, the district court's determination that the escrow obligations on *NPMs* were essentially a flat tax that did not preclude price competition *above* the newly imposed price floor hardly negates the anti-competitiveness of creating such an artificially higher floor for NPMs in the first place. And, in any event, the district court recognized the difference between the

B. *The Decision Below Expands A Split on the Application of the* Noerr-Pennington *Doctrine.*

Regarding the *Noerr-Pennington* doctrine, the conflict identified in the Petition was on whether *Noerr-Pennington* immunized the "results" of petitioning activity rather than merely the petitioning itself. Pet. 23. Contrary to Respondents' suggestion, Mfrs. BIO at 24, whether the results being considered are the government action itself as in *Freedom Holdings I*, or the private conduct facilitated by such government action, as here, does not change the question or the correct answer. The results of petitioning – both the government action and the private conduct thereunder – must be evaluated under *Parker* (and *Midcal* in the case of a hybrid restraint), not under *Noerr-Pennington*. The Ninth Circuit, however, refused to apply *Parker* to the resulting conduct by the OPMs, misconceiving the legal scope of *Noerr-Pennington* immunity. That the Second Circuit correctly limited *Noerr-Pennington* and instead applied *Parker* and *Midcal* to the *governmental* results of petitioning, as opposed to the subsequent private conduct thereunder, still presents a split on the relevant legal question. The two situations both turn on the same issue of the scope of *Noerr-Pennington* and whether it extends beyond petitioning activity itself.[4]

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flat per-cigarette charge imposed on NPMs and the complex charges to OPMs resulting from the MSA's allocation scheme. 447 F. Supp.2d at 238.

[4] Contrary to Respondents' suggestion, Mfrs. BIO at 25, Petitioner certainly does allege that the OPMs' conduct *following* the MSA, not merely entry into the MSA itself, is illegal. *See* Pet. at 8-9, 17-18. And, and as the Second Circuit has recognized, there is no need to allege a further agreement among the

C. *The Decision Below Expands the Split Regarding the Application of the* Midcal *Test.*

The essential dispute among the circuits regarding *Midcal* turns on what constitutes a hybrid restraint that would be subject to the *Midcal* analysis. Pet. 25-26. Respondents' and the Ninth Circuit's denials that the MSA enables or facilitates private anticompetitive conduct, Mfrs. BIO at 22, App. A28, simply state one side of that split based on improperly restrictive criteria for finding hybrid restraints. The Second and Third Circuits, however, both viewed the MSA, as alleged, to be a hybrid restraint.[5] It is on the legal standards for finding a hybrid restraint that he courts diverge, not on any difference in the alleged facts.

OPMs where the MSA itself was an agreement among the OPMs, not merely with the state AGs, and the MSA established the market conditions that facilitated and drove interdependent and coordinated conduct. *Freedom Holdings I*, 357 F.3d at 223-24.

[5] The suggestion, Mfrs. BIO at 23-24, that the Third Circuit's *Parker/Midcal* holding is merely *dicta* is contrary to how the Third Circuit itself treats that holding, notwithstanding the misgivings of particular judges. *See Mariana* v. *Fisher*, 338 F.3d 189, 202, 203 (CA3 2003) ("Because this court in *Bedell* examined precisely the same facts and the same documents and concluded that we must apply the *Midcal* test, we believe we are not free to decide to the contrary."; "Nonetheless, even though the case before us differs from *Bedell* in that the parties are different, we feel bound by *Bedell* to abstain from reaching a different conclusion on *Parker* immunity. We cannot in conscience characterize the discussion on *Parker* immunity in *Bedell* as dicta."), *cert. denied*, 540 U.S. 1179 (2004).

II. The Circuit Split Implicates Recurring Questions of National Importance.

1. As the Petition explained, at 28-29, the disparate rules applied by the circuits have created uncertainty regarding the MSA and its state statutes, particularly where the Second Circuit has asserted jurisdiction over state AGs from around the country. Respondents' claimed confidence as to the eventual outcomes of any cases that might reach trial, Mfrs. BIO at 26; AG BIO at 21-22, seems more like puffery than a genuine lack of uncertainty. Indeed, while Respondent Attorney General now denies any uncertainty from the current conflict between the circuits, AG BIO at 23, the Petition of the State AGs in *Grand River* is quite to the contrary. Petition for Writ of Certiorari of State Attorneys General, No. 05-1343, 2006 WL 1049019, at *14-*15 (Apr. 18, 2008), seeking review of *Grand River Enterprises Six Nations, Ltd.* v. *Pryor*, 425 F.3d 158 (CA2 2005), *cert. denied*, 17 S. Ct. 379 (2006). That petition decried the loss of "certainty and finality" for decisions favorable to the States in other jurisdictions, thus necessarily recognizing that Second Circuit jurisdiction – coupled with the different legal standards applied in that circuit – threatens to undermine favorable rulings elsewhere. Uniform standards, for whatever legal rule this Court endorses, would at least provide legal certainty and consistency as to the test to be applied, whether favorable or unfavorable to the MSA.

Respondents suggest, Mfrs. BIO at 27, that other pending cases would make better vehicles if and when this Court decides to take up the issues here. But there is no need to await further percolation – or

to wait for cases involving summary judgment – where the legal issues and disagreements are directly addressed by the Ninth Circuit. Waiting only prolongs the time when challenges to the MSA receive the full factual development they deserve (or prolongs litigation in the Second Circuit if this Court eventually agrees with the Ninth Circuit).[6] Furthermore, cases arising from summary judgment raise the risk that they will turn on factual matters or case-specific failures of proof rather than on purely legal questions. Cases arising from motions to dismiss – based on complaints that are not meaningfully different – thus present cleaner vehicles through which this Court can address the legal issues in dispute.

2. Regarding the importance of this case to antitrust law in general, Respondents claim that the court below was faithful to *Midcal* and thus there is no confusion in the legal principles involved. Mfrs. BIO at 27; AG BIO at 24-25. But that once again ignores the different standards applied by the circuits for finding a hybrid restraint – the essential prerequisite to the *Midcal* analysis. Furthermore, regarding the relationship between *Midcal* and *Hoover*, while Respondents decry the absence of a string-cite in the Petition, it was in fact the Ninth Circuit that identified the confusion and the cases reflecting the prob-

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[6] That this Court has, over the past eight years, denied petitions for certiorari on similar issues likely reflected the need for at least some percolation of the issues, but is no reason to deny the current petition now that the issues have indeed percolated even since the last petition denied by this Court in 2004. *See Mariana* v. *Fisher*, 338 F.3d 189 (CA3 2003), *cert. denied*, 540 U.S. 1179 (2004). Further percolation is unnecessary given the Ninth Circuit's direct confrontation of contrary circuit decisions.

lem. App. A24. The Petition's citation, at 30-31, to the opinion below thus is more than sufficient to support the existence of a problem warranting this Court's resolution. And, as explained in the Petition, at 30, the Ninth Circuit's excessive willingness to find unilateral action subject to *Hoover*, as opposed to a hybrid restraint subject to *Midcal*, severely diminishes the scope of *Midcal* both in MSA cases and elsewhere.

3. Finally, the extension of the federalism-based *Parker* doctrine to cover an agreement among numerous States that regulates a national market in cigarettes turns federalism on its head. That Congress was asked to approve such a plan and declined – hearing testimony regarding the anticompetitive nature of the then-proposed plan – speaks loudly to the federal interests involved and infringed upon by the subsequent agreement adopted without federal approval. *Freedom Holdings I*, 357 F.3d at 229 n. 23, 230 (quoting objections from FTC Chairman Robert Pitofsky). It is thus Respondents, not Petitioner, who have it "exactly backwards," Mfrs. BIO at 28-29, regarding the application of federalism principles to this case.[7]

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[7] That plaintiff did not bring a separate Compact Clause challenge is of little moment given that such a challenge would have to demonstrate infringement upon federal interests – here the interests embodied in the antirust laws – and consequently the Compact Clause is more readily viewed as one consideration in evaluating the federalism-based *Parker* defense in the context of the primary antitrust claim itself. That the Compact Clause could have formed, but was not raised as, the basis of its own claim does not denigrate it as an independently material and relevant consideration in the antitrust context.

III. The Decision Below Improperly Expands Antitrust Immunity Contrary to the Decisions of this Court.

As the Petition explained, at 32-33, the Ninth Ciruit departed from a variety of this Court's precedents, including in its incorrect application of the more rigorous standard of review in *Rice* v. *Norman Williams Co.*, 458 U.S. 654 (1982). Regardless whether this case is viewed as a facial or an as-applied challenge, it remains true that this case is brought post-implementation, with eventual access to the facts regarding the actual operation of the MSA, not merely "abstract" speculation on how the scheme might operate in the future. 458 U.S. at 661. The Ninth Circuit thus erroneously applied the stricter *Rice* standard contrary to this Court's express rationale for that standard.

And, as also explained previously, Pet. 33-34, the Ninth Circuit was indeed unfaithful to *Midcal* and its progeny by narrowing the scope of what constitutes a hybrid restraint to the point that it would seem to exclude even the restraint in *Midcal* itself. As the Second and Third Circuits recognized and the Petition explains, Pet. 25-27, the MSA scheme as alleged indeed constitutes a hybrid restraint just as readily as the restraint in *Midcal*.

Finally, as for *Noerr-Pennington*, the Petition amply explains the error in extending *Noerr-Pennington* to the results of petitioning rather than limiting it to the petitioning activity itself. Pet. 22-25, 34. The Ninth Circuit's express refusal, App. A30 n. 11, even to consider *Parker*'s application to the claims against

the OPMs thus is inconsistent with the limited scope of *Noerr-Pennington* immunity.

CONCLUSION

For the reasons above, this Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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