No. 10-622

In The
Supreme Court of the United States

S&M BRANDS, INC., TOBACCO DISCOUNT HOUSE # 1, and MARK HEACOCK,
Petitioners,

v.

JAMES D. "BUDDY" CALDWELL, in his official capacity as Attorney General of the State of Louisiana,
Respondent.

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

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

MICHAEL MCCONNELL
559 Nathan Abbott Way
Stanford, CA 94305

HANS F. BADER
SAM KAZMAN
COMPETITIVE ENTERPRISE INSTITUTE
1899 L Street, NW
Washington, D.C. 20036

ERIK S. JAFFE
(Counsel of Record)
ERIK S. JAFFE, P.C.
5101 34th Street, NW
Washington, DC 20008
(202) 237-8165
jaffe@esjpc.com

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

REASONS FOR GRANTING THE WRIT

Despite respondent's protests, the MSA is a horizontal collective agreement among competing tobacco companies and among sister States that, by its express terms, restrains trade, invades state sovereignty, and encroaches upon federal authority. Respondent's and the Fifth Circuit's approach in rejecting the antitrust and Compact Clause challenges in this case effectively eliminate *Parker*'s limits on antitrust immunity and render the Compact Clause a redundant nullity.

This case is an appropriate and well-framed vehicle for addressing those issues. It correctly frames the antitrust issue in terms of the *MSA*'s legality as a contract in restraint of trade rather than as a challenge to the Escrow Statute alone. And it allows this Court to consider the essential interplay between the antitrust and Compact Clause issues, which both involve fundamental federalism concerns.

That the Fifth Circuit rejected petitioners' *Parker*-based antitrust challenge by relying on irrelevant cases addressing whether the Escrow Statute and the MSA mandated further or subsequent anticompetitive conduct is not a vehicle problem. Rather, it is an inadequacy in the court's reasoning that enhances, rather than diminishes, the justification for certiorari. Likewise, the Fifth Circuit's bare repetition of the flawed Compact Clause analysis in *Star Scientific* shows that such reasoning has become entrenched and is unlikely to benefit from further percolation. Given the tremendous economic, political, and constitutional importance of these issues, it is now time for

this Court to weigh in regardless whether there is a circuit split.

I. Agreements Among Multiple States and Private Companies in Restraint of Nationwide Commerce Are Not Immune from the Antitrust Laws.

Unlike the challenges in most other MSA cases, which focused on the effects of the Escrow Statutes on subsequent competitive behavior and did not directly challenge the MSA itself, the gravamen of the antitrust claim here is that the MSA itself and by its terms is a "contract * * * in restraint of trade" that is not immunized by the fact that States are parties to that contract. *Parker* v. *Brown*, 317 U.S. 341, 350-52 (1943). That is how the claim was presented to the Fifth Circuit, and state-action immunity was respondent's virtually exclusive defense. *See* Opening Brief of Appellants at 35-40 (discussing *Parker*); Reply Brief of Appellants at 15-18 (same); Brief of Appellee at 26-30 (citing *Parker* and its progeny to argue that the MSA and its implementing statutes are entitled to state-action immunity).[1]

---

[1] Notwithstanding respondent's assertion, at 20, the antitrust claim was more than adequately pled and litigated below. Complaint ¶¶ 7, 34-35, 61-62 [R24, R32, R42]; Plaintiffs' Opp. to Motion to Dismiss 16-21 [R335-40]; Plaintiffs' Mem. in Support of Sum. Judgment 23-27 [R2094-98]; Plaintiffs Opp. to Motion for Sum. Judgment 17-22 [R1518-23]. The Fifth Circuit declined to endorse respondent's contrary argument on appeal, and proceeded to rule, albeit erroneously, on the merits of the claim. The antitrust claim thus is properly before this Court, both as a stand-alone issue and as a component of the Compact Clause analysis.

The Fifth Circuit acknowledged the nature of that challenge but rejected it with the non-sequitur that the Escrow Statute, either alone or in combination with the MSA, did not mandate any *subsequent* conduct in violation of the antitrust laws "in all cases." Pet. App. A8-A9 (citation and internal quotation marks omitted). But the court of appeals never disputed that the MSA itself would be an illegal contract if entered into solely among private parties. And the court offered no response to *Parker*'s proviso that States may not join as "participant[s] in a private agreement or combination by others for restraint of trade" and thereby immunize it. *Parker*, 317 U.S. at 351-52.

Respondent seeks to turn this deficiency into a virtue by arguing, at 19-22, that the court never reached the *Parker* question but ruled only that there was no preemption in the absence of further compelled violations in all cases. Like the Fifth Circuit, however, respondent misconceives the *Parker* issue presented in this case. Petitioners' challenge to the MSA itself is unlike facial challenges to state statutes that are not themselves contracts or combinations subject to the Sherman Act. Such challenges must first demonstrate that the statutes mandate third parties to engage in subsequent *per se* violations "in all cases." *Rice* v. *Norman Williams Co.*, 458 U.S. 654, 661 (1982). But where the state action and the illegal contract are one and the same, the two-part immunity analysis for statutes that are separate from the alleged violations collapses into the single question whether direct state involvement in an otherwise il-

legal contract among private parties thereby immunizes that contract.

The Fifth Circuit's misplaced discussion of whether the tobacco companies are compelled to engage in subsequent antitrust violations thus did not resolve any questions "antecedent" to the *Parker* issue in *this* case; only questions from other MSA cases that were neither relevant nor responsive to the different aspect of *Parker* that was before it.[2] Notwithstanding that analytic failure the Fifth Circuit upheld the MSA as valid state action, and thus necessarily ruled on and rejected petitioners' *Parker*-based challenge. The issue of state-action immunity is properly before this Court.

On the central question whether the participation of the States in the MSA immunizes it from the Sherman Act, respondent, at 24-25, argues (1) that *Parker* allowed immunity even in the face of interstate effects, and (2) that States are not "person[s]" to whom the Sherman Act applies.

Parker, however, involved the regulation by California of raisin growers in California. That regulation may have had interstate *effects*, but it did not involve regulation across state lines, let alone a massive agreement among States and private industry to restrain trade in all fifty States. Nothing in *Parker*'s

---

[2] That the Sixth Circuit in *Tritent International Corp.* v. *Kentucky*, 467 F.3d 547, 557-58 (CA6 2006), viewed its state-action analysis as distinct "preemption" and *Parker*-immunity issues is irrelevant to this case. Such a distinction is more of nomenclature than substance – *Parker* itself was effectively a preemption case – and where the illegal contract and alleged state action are the same, any such distinction collapses and is meaningless.

language or federalism-based rationale supports extending immunity to such an agreement. Pet. 17-22. And the relevant portion of the Sherman Act at issue here does not purport to apply to "persons" at all, but rather declares that "[e]very contract * * * in restraint of trade" is "illegal," without limitation on the identities contracting parties. 15 U.S.C. § 1.[3]

In its factual discussion, respondent also raises irrelevant factual disputes regarding the competitive effects of the MSA. BIO 9-13, The antitrust claim in this case, however, does not depend on the eventual *effects* of the MSA, but rather on the direct terms of that agreement, which expressly require price stabilization by imposing offsetting costs on competing NPMs, expressly divide markets by imposing fees on grandfathered SPMs that exceed their allotted market share, restrict competitive advertising, and tie payment obligations to future market share. Pet. 4-7. Every one of those actions, if contained in an agreement solely among private parties, would constitute a *per se* violation of the Sherman Act, wholly apart from whether they were actually successful in suppressing competition. Pet. 16-17; *see National Electrical Contractors Ass'n* v. *National Constructors Ass'n*, 678 F.2d 492, 497 (CA4 1982) (agreement imposing offsetting costs on competitors is a *per se* illegal attempt to "stabilize prices").

---

[3] Other references to "persons" in the penalty clauses of the Sherman Act, 15 U.S.C. § 1, are irrelevant given that petitioners are not seeking such penalties; merely a declaration and an injunction.

Even were the ultimate competitive effects of the MSA relevant to the question presented, respondent is still mistaken in disputing such effects now. There is ample evidence in the record that the MSA has enabled the Majors to charge supra-competitive profits and suppressed competition from NPMs. *See* Pet. 7 nn. 2 & 3 (MSA allowed OPMs to raise prices by far more than necessary to pass through MSA costs; OPM profits increased dramatically); *Report of Plaintiffs' Expert Jeremy Bulow* at 33-34 (Aug. 13, 2008) (NPM market share in Louisiana declined by 92 percent to 0.12 percent of the market immediately following amendment to Escrow Statute); *Amicus* Brief of Freedom Holdings, at 6-7 (following amendment to Escrow Statutes, NPM market share in MSA States declined well below NPM market share in non-MSA states). Because this case was decided by summary judgment on purely legal grounds without addressing any factual disputes regarding the effects of the MSA, such disputes must be viewed in favor of the non-moving party.[4]

II. The Decision Below Strips the Compact Clause of All Independent Meaning.

On the Compact Clause question, respondent largely ignores the arguments in the Petition, and simply endorses the rationale of the Fourth Circuit in *Star Scientific* and the Fifth Circuit below. BIO 27-

---

[4] In any event, evaluating the economic and policy effects of the MSA is more appropriately done by Congress. The existence of disputes over such effects is a further reason for applying the Compact Clause to the MSA and requiring that it be presented to Congress for approval.

28. Respondent does not deny that its reading of the Compact Clause would render that clause redundant with the Supremacy Clause. Indeed, according to respondent, it seems, if there is no *actual* violation of some other statutory or constitutional provision there can be no potential encroachment under the Compact Clause. BIO 33.[5] Respondent does not attempt to reconcile its construction with basic principles of constitutional interpretation. *Marbury* v. *Madison*, 5 U.S. 137, 174 (1803) ("It cannot be presumed that any clause in the constitution is intended to be without effect").

Respondent's approach is also inconsistent with this Court's cases addressing the function and purpose of the Compact Clause and its role in protecting the federal system and the prerogatives of both the federal government and the States. Pet. 22-26.

In seeking to expunge this Court's emphasis in *MTC* on evaluating state agreements for their "potential" encroachment of federal authority, respondent argues, at 32, that the mere existence of a "federal interest" in the subject matter of a compact is insufficient to trigger the Compact Clause. Respondent fails, however, to address the far more persuasive interpretation of *MTC* by the Office of Legal Counsel, which sets out factors establishing when a compact goes beyond merely touching federal interests and

---

[5] Although respondent takes issue with petitioners' earlier FCLAA preemption claim, not now before this Court, BIO 31, it effectively ignores the MSA's extraterritorial imposition of fees and restrictions on speech and petitioning, which, at a minimum, encroach upon state sovereignty and federal commerce authority. Pet. 7-10, 33-34.

rises to the level of potential encroachment. *See* Applicability of Compact Clause to Use of Multiple State Entities Under the Water Resources Planning Act, 4B Op. Off. Legal Counsel 828, 830-31 (1980); *see also* Amicus Brief of Constitutional Law Scholars, at 10-11 (discussing OLC standards and how MSA meets every one). Here, the MSA's anticompetitive and extraterritorial provisions, and its restrictions upon the member States themselves, more than satisfy the criteria the OLC describes as triggering the States' submission obligation and Congress's consent authority under the Compact Clause.

Respondent's suggestion, at 28, that the MSA is not an agreement among the States because it operates vertically between States and companies, rather than horizontally, simply ignores the plain terms of the agreement. The States have agreed among themselves: to pool and divide revenues from the MSA; to diligently enforce their escrow statutes in order to reduce competition from NPMs; and to incur severe financial penalties should any State fail to meet those obligations. Pet. 7-9. They have likewise collectively granted the Firm unreviewable enforcement authority over States that fail to diligently enforce their escrow statutes bound future state officials, and restricted those officials' MSA-related speech and lobbying. *Id.* None of that could be adopted and enforced by States acting individually without the collective obligations and penalties under the MSA.

Finally, respondent, at 33-35, claims that the MSA was approved by Congress as a compact, and hence satisfies the Compact Clause. Although the district

court accepted that argument, it was not adopted by the court of appeals.

The passing reference in the Medicaid Amendment does not remotely qualify as consent to an interstate compact. The Medicaid Amendment had as its sole purpose eliminating the uncertainty over whether the States had to remit to the federal government a portion of the funds collected under several different tobacco settlements as compensation for Medicaid expenditures. The amendment declared only that Medicaid's claw-back rules "shall not apply" to moneys from the MSA and other tobacco settlements. 42 U.S.C. § 1396b(d)(3)(B)(i)-(ii).[6] It made no broader pronouncements regarding the MSA or any of the other potential legal issues surrounding that agreement, and certainly did not purport to ratify it in total, either as a compact or otherwise.[7]

Implied approval of compacts should be "necessar[y]" and "clear and satisfactory." *Virginia v. West Virginia*, 78 U.S. 39, 60 (1871). That the implied approval asserted by respondent came in an appropria-

---

[6] Defendant's reliance, at 48-49, on the Conference Report discussing the amendment is misplaced. The only litigation uncertainty the conferees sought to avoid was that "absent Congressional action, the issue of the Federal share of funds recovered under such settlements or judgments would be subject to litigation over the next several years." H.R. CONF. REP. 106-143, 1999 WL 303282, *55 (May 14, 1999).

[7] In fact, respondent implicitly conceded the point at oral argument below. Oral Arg. Recording, No. 09-30985, July 7, 2010, at 30:42 to 31:34 (Respondent's counsel conceding that Medicaid Amendment's reference to MSA did not approve of every aspect of the MSA or supersede other federal statutes) (available at www.ca5.uscourts.gov/OralArgumentRecordings.aspx).

tions bill further demonstrates that it is neither and did not ratify the MSA as a whole. In *TVA* v. *Hill*, 437 U.S. 153, 189-92 (1978), for example, the Court resoundingly rejected implied ratification from appropriations provisions, notwithstanding that the Committee Reports there expressly referred to the potential illegal agency conduct that was supposedly ratified. The Medicaid Amendment, by contrast, makes no mention of the Compact Clause or other legal challenges to the MSA. *See also In re Endo*, 323 U.S. 283, 303 n.24 (1944) (Congressional funding of detentions did not constitute "Congressional ratification"; "appropriation must plainly show a purpose to bestow the precise authority which is claimed"); *Greene v. McElroy*, 360 U.S. 474, 506-07 (1959) (Congressional funding of Defense Department security procedures did not constitute "implied ratification").

As this Court has observed, Congress does not "hide elephants in mouse holes," *Whitman* v. *American Trucking Ass'n*, 531 U.S. 457, 468 (2001).

III. This Petition Presents Important Issues Having a Tremendous Impact on the National Economy and Our Federal System.

Offering little to rebut the tremendous economic, political, and constitutional consequences of MSA and the reasoning of the decision below, respondent instead emphasizes the absence of a split and previous denials of certiorari to discourage certiorari here. But given the national importance of the MSA and the antitrust and Compact Clause questions presented, certiorari is warranted even absent a split. Indeed, the particularly thin analysis of the decision

below demonstrates that the lower courts' approach to MSA challenges is becoming entrenched, further time is unlikely to add to the analysis of the issues, and it is time for this Court to consider the issues itself.[8] The many billions of dollars at stake, the unwarranted extension of state action immunity, and the effective elimination of the Compact Clause from the Constitution are all sufficiently important for this Court to have the final say on full briefing, and not leave such matters to the lower courts.

As for respondent's further suggestion, at 24, that the issues presented by the MSA are unlikely to arise in other contexts, that is incorrect. The grave danger is that the MSA will be the model for future agreements between States and private industry, in which state attorneys general secure revenues, the industries receive protection from competition, and consumers and taxpayers suffer the consequences. *See* Seth M. Wood, *The Master Settlement Agreement as*

---

[8] That the Fifth Circuit merely quoted the Fourth Circuit's erroneous Compact Clause reasoning without addressing petitioners' arguments concerning the flaws in that reasoning is not a reason to deny certiorari. BIO 25-26. Rather, it shows the lack of considered attention the issue is receiving in the lower courts. This Court's previous denial of certiorari in *Star Scientific Inc.* v. *Beales,* 278 F.3d 339, 359 (CA4), *cert. denied*, 537 U.S. 818 (2002), likewise does not call for the same result here. *Star Scientific* was the first case to address the Compact Clause issue, there have been nearly ten unproductive years of percolation since, and the consequences of the MSA have gotten progressively worse in the wake of the 2003 amendment to the Escrow Statutes, which virtually purged NPMs from the market in MSA States. *Supra* at 6. Such changed legal and factual circumstances call for a grant of certiorari now, notwithstanding this Court's willingness to let the issue lie in 2002.

Class Action: An Evaluative Framework for Settlements of Publicly Initiated Litigation, 89 VA. L. REV. 597, 600-01 (2003) (noting current and likely future use of the MSA model against other industries).

Even if the MSA itself were unlikely to be replicated, however, it is damaging enough in its own right, extracts billions of dollars annually from consumers, and will continue in perpetuity. Moreover, the expansion of *Parker* immunity and the effective elimination of the Compact Clause have application beyond agreements modeled on the MSA, and open the door for tremendous state mischief involving the environment, energy, and other areas previously dealt with via federally approved compacts. *See* Pet. 25. This case and the issues herein are thus of exceptional national importance and should be reviewed and resolved by this Court.

CONCLUSION

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

Respectfully submitted,

ERIK S. JAFFE
(Counsel of Record)
ERIK S. JAFFE, P.C.
5101 34th Street, N.W.
Washington, D.C. 20008
(202) 237-8165

MICHAEL MCCONNELL
559 Nathan Abbott Way
Stanford, CA 94305

HANS F. BADER
SAM KAZMAN
COMPETITIVE ENTERPRISE
INSTITUTE
1899 L Street, NW
Washington, D.C. 20036

Counsel for Petitioners

Dated: February 9, 2011