CASE NO. 09-30985

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

S&M BRANDS, INC., MARK HEACOCK, and TOBACCO DISCOUNT HOUSE #1, INC.,
PLAINTIFFS-APPELLANTS
V.
JAMES "Buddy" CALDWELL, in his official capacity as Attorney General of Louisiana
DEFENDANT - APPELLEE

APPEAL FROM THE U.S. DISTRICT COURT
FOR THE WESTERN DISTRICT OF LOUISIANA
CIVIL ACTION NO. 05-1372

OPENING BRIEF OF APPELLANTS

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CERTIFICATE OF INTERESTED PARTIES

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

1. S&M Brands, Inc.; Mark Heacock; and Tobacco Discount House #1, Inc., Plaintiffs-appellants.

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3. The following additional persons or entities also may be financially interested in the outcome of this litigation: (a) all States and U.S. territories that receive payments under the tobacco Master Settlement Agreement (MSA), including all States other than Texas, Mississippi, Florida, and Minnesota; the territories of Puerto Rico, the U.S. Virgin Islands, American Samoa, the Northern Mariana Islands, Guam; and the District of Columbia; (b) all tobacco companies whose cigarettes are sold in the United States; (c) all cigarette wholesalers, retailers, and purchasers; (d) the National Association of Attorneys General; (e) all attorneys or law firms entitled to receive attorneys fees under the MSA; and (f) all persons and entities that possess any securities backed by or secured by MSA payments or attorneys fees.

None of the plaintiffs-appellants have parent companies, and no publicly-traded company owns more than 10 percent of the shares of any of the plaintiff companies.

s/ Hans F. Bader
Hans F. Bader
Attorney of record for plaintiffs/appellants

STATEMENT REGARDING ORAL ARGUMENT

Plaintiff-Appellants believe that because the primary issues raised in this appeal are matters of first impression for this Circuit, oral argument will be helpful. Moreover, the importance of this case – a challenge to a multibillion dollar multistate agreement and related state laws similar to those found in many other States – also weighs in favor of holding oral argument.

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JURISDICTIONAL STATEMENT

This Court has jurisdiction over this appeal of the district court's September 24, 2009 final judgment pursuant to 28 U.S.C. § 1291. The district court had federal-question jurisdiction under 28 U.S.C. §§ 1331, 1343(a), 1367 & 2201, and 42 U.S.C. § 1983.

ISSUES PRESENTED

The Master Settlement Agreement ("MSA") is a collective agreement among numerous States and various tobacco companies that imposes billions of dollars in fees on national cigarette sales, restricts national tobacco marketing, advertising, lobbying, and litigation, and forces signatory States to adopt an Escrow Statute and related legislation imposing severe burdens on competing tobacco companies that do not join the MSA. The issues presented by this case are:

1. Whether the MSA and Louisiana's Escrow Statute, LA. R.S. §§ 13:5061, *et seq.*, violate the First Amendment by imposing the unconstitutional conditions of escrow payments and related burdens on companies that seek to avoid the MSA's restrictions on lobbying, petitioning, and advertising?

2. Whether the MSA and the Escrow Statute violate the Federal Cigarette Labeling and Advertising Act, 15 U.S.C. § 1334?

3. Whether the MSA and the Escrow Statute violate federal antitrust laws by creating an interstate combination and conspiracy to raise prices and protect participating tobacco companies' market share?

4. Whether the MSA and the Escrow Statute violate the Commerce and Due Process Clauses by imposing extraterritorial national fees and regulations?

5. Whether the MSA violates the Compact Clause?

STATEMENT OF THE CASE

This case stems from an interstate agreement, the MSA, in which 46 States and various territories conspired and agreed among themselves and with the four largest tobacco manufacturers (the "Majors") to give the States a share of ongoing tobacco revenues; to protect the national market share of the Majors and other participating manufacturers; to regulate national advertising and political speech regarding tobacco; and to penalize any companies that refused to join the conspiracy.

Plaintiffs – a cigarette manufacturer that did not join the MSA, a cigarette dealer, and a smoker – challenge the legality and constitutionality of the MSA and the Louisiana laws that enforce it. On cross-motions the district court granted summary judgment in favor of the State and dismissed

all of plaintiffs' claims. Memorandum Ruling (Sept. 24, 2009) ("Mem."), at 18. [R2296]

STATEMENT OF FACTS

During the 1990s, Attorneys General in many States, including Louisiana, sued the Majors alleging decades of fraud that supposedly cost the States billions of dollars in increased Medicaid expenses. In 1998, 46 Attorneys General and the Majors settled those suits by collectively entering into the MSA. Cplt. ¶¶1-8 [R21-24]; Answer ¶6 [R728].

A. The Terms and Structure of the MSA.

The MSA obligates the Majors and certain other manufacturers who join the MSA (collectively "Participating Manufacturers" or "PMs") to pay more than $200 billion over 25 years, plus other payments in perpetuity. MSA § IX.[1] That money is paid each year by PMs in proportion to their *current* national market share of cigarette sales, including sales in States that have not joined the MSA, and is then distributed in fixed shares to the Settling States. MSA § IX(c)(1); Cplt. ¶8 [R24]; Answer ¶8 [R728]. The percentage of MSA payments by each of the four Majors, or original participating manufacturers ("OPMs"), thus rises or falls in relation to their

[1] The MSA is attached to the Complaint as Exhibit 1, and included in the record as a manual attachment, but not paginated as part of the record. It is available in PDF form at http://www.naag.org/backpages/naag/tobacco/msa/msa-pdf.

annual national market share. As for subsequent participating manufacturers ("SPMs"), their MSA payments, if any, depend on when they joined the MSA. SPMs that joined the MSA within 90 days after it was executed make no MSA payments at all on sales at or below the "grandfathered" amount of the higher of their 1998 sales, or 125% of their 1997 sales. MSA § IX(i). SPMs joining after the 90 day window are not eligible for the grandfather clause and make MSA payments according to their annual market share.

All PMs are eligible for substantial reductions in their MSA payments should they lose market share to non-participating manufacturers ("NPMs"). MSA §§ II(ff), IX(d) (NPM Adjustment). OPMs receive an approximately 12% reduction in their payments due to the amounts they pay to the Previously Settled States, MSA § II(kk), IX(c) (PSS Reduction).

In addition to imposing payment obligations, the MSA prohibits PMs from certain tobacco- or MSA-related lobbying of the state and federal governments, any litigation adverse to the MSA or its implementing statutes, and various forms of cigarette advertising. MSA §§ III(m)-(p), III(b)-(i), XVIII(*l*). Many of those restrictions apply nationwide, not merely within the MSA States. *Id*. §§ II(rr), III(b)-(c).

Regarding the Settling States, the MSA releases all past and most future health and smoking claims they might have against PMs, including

against SPMs that were never sued by the States. MSA § XII. In addition, in order to allow PMs to pass on the cost of their settlement payments to consumers without losing market share to competitors who did not have such settlement costs, the MSA requires each Settling State to enact a "qualifying" or "Escrow" statute that selectively imposes substantial costs on NPMs. MSA § IX(d)(2)(E); MSA Exh. T.[2] Such statutes offset the competitive consequences to PMs from having settled hundreds of billions of dollars of liability to the States.

The MSA is binding on "present and future" state officials, and States may not withdraw from or "directly or indirectly" challenge the MSA. MSA §§ XVIII(g), (*l*).

B. The Escrow Statute and Related Enforcement Statutes.

Understanding the operation of the Escrow Statute and its relation to the MSA is essential to understanding the MSA scheme. Because smaller tobacco companies, unlike the Majors, had not engaged in or been sued for fraud, and hence had no liabilities to settle, their per-cigarette cost of production would have been substantially lower than that of companies having to make MSA payments. The Majors thus faced a competitive

[2] The MSA also empowers "the Firm," a non-public entity, to make "conclusive and binding," "final and non-appealable" determinations on various issues, including penalties against States failing to enforce the MSA. MSA § IX(d).

dilemma: If they raised prices to pass MSA costs on to consumers they risked losing market share to NPMs without such costs; but if they kept their prices competitive their MSA payments would eat into their profits.

To protect both the Majors' market share and profitability and the Settling States' interest in the Majors' tobacco revenue, the MSA undermines potential NPM price competition by selectively raising the costs and burdens on NPMs. LA. R.S. § 13:5061(6) (Escrow Statute designed to prevent NPMs from having a "resulting cost advantage"); MSA Exhibit T (same). The MSA effectively requires each settling State to adopt an identical Escrow Statute requiring NPMs to pay into escrow an amount per cigarette roughly equal to the amount paid by an SPM not eligible for the grandfather clause exemption. MSA Exh. T.[3] Any Settling State that fails to adopt such a statute would still have its citizens pay passed-through MSA costs, but risk losing its share of hundreds of billions in MSA payments. Such penalties thus imposed "coercive" pressure on the Settling States to

[3] The costs under the Escrow Statute were originally lower in many cases due to a provision that refunded all but the amount of an individual State's "allocable share" of what an NPM would have paid under the MSA for its sales nationwide. *See Initial Submission of Jonathan Gruber & Robert S. Pindyck*, at 15-18 (Oct. 10, 2005) ("*Gruber & Pindyck Initial Sub.*") (due to allocable share refunds (ASR), escrow payments were 9.8 cents rather than 39 cents per pack in 2003) [Sealed Doc. 96, attach. 6]. More recently, Louisiana and other States abolished such "allocable share" refunds. *See* LA. R.S. § 13:5063(C)(2)(b), amended by Acts 2003, No. 925 (HB 731), § 1, eff. July 1, 2003. NPMs must now escrow in each State the equivalent of a full MSA payment for cigarettes sold in that State, regardless of the State's allocable share.

adopt the Escrow Statute, and all did. *Star Scientific Inc. v. Beales*, 278 F.3d 339, 359 (4th Cir.) ("Because Virginia could face a substantial financial burden if it were not to enact a qualifying statute, the [MSA] is coercive in requiring the states to pass such a statute"), *cert. denied*, 537 U.S. 818 (2002).[4] Louisiana state legislators cited such penalties and pressure to justify passing the State's Escrow Statute. LA. R.S. §§ 5061-63.[5]

In addition to escrow fees, NPMs are obliged to keep detailed records and file numerous reports showing compliance with their escrow obligations. Any NPM failing to make payments or satisfy such other requirements would be prohibited from selling cigarettes within the State, and the NPM and its dealers could face criminal liability for violation of that prohibition. LA. R.S. §§ 13:5071-77, 47:843D.

As a result of the cost increases imposed on NPMs by the Escrow statute, the Majors were able to pass on the costs of the MSA to consumers –

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[4] *Report of Plaintiffs' Expert Jeremy Bulow* at 14-15 (Aug. 13, 2008) ("*Bulow Rep.*") (quoting Washington State legislative report on the Escrow Statute, which explained that " 'This [escrow] legislation is necessary for the state to receive the full amount of the tobacco settlement due Washington. … The MSA sets up an incentive for every state to pass the legislation because states that do not will be left "holding the bag" because those are the states from which the non-participating adjustment will come first.' ") [R1092-93].

[5] *Stipulated transcript of portions of hearing in Louisiana House of Representatives* (April 8, 1999), at 6, and of *Chamber Proceedings in Louisiana House of Representatives* (April 15, 1999), at 7-9 & 12-13 (statements of Louisiana legislators and Louisiana's Attorney General noting that the State had no choice but to enact the MSA's Qualifying Statute word-for-word). [R1072, R1077-79, R1082-83]

the purported victims of decades of fraud by the Majors – without fear of price competition from NPMs.[6] In the years since the MSA, the big tobacco companies have made record profits, while trial lawyers hired by the States have reaped at least $15 billion in attorney fees.[7]

C. The Burdens Imposed on NPMs.

Overwhelming evidence on summary judgment demonstrated that NPMs face heavy and punitive expenses and administrative burdens under the MSA-required Escrow Statute and are worse off than participating manufacturers, and especially than grandfathered SPMs.

1. States Impose a Monetary Penalty on NPMs for Not Joining the MSA.

Contrary to the fiction that escrow payments merely "level the playing field," NPMs actually pay more under the Escrow Statute than is paid by MSA participants.[8] First, MSA payments by OPMs are reduced by 12% to

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[6] *See Declaration of Defendant's Expert Jonathan Gruber* at 8 (Sept. 24, 2008) ("*Gruber Decl.*") (MSA payments "largely passed on in the form of higher prices to consumers") [R1109]; *Deposition of Defendant's Expert Jonathan Gruber* at 139 (Oct. 28, 2008) ("*GruberDep.*") (same) [R1593].

[7] Mark Curriden, *Up In Smoke*, ABA JOURNAL (March 2007) at 27, 30 ("$15.4 billion" from the MSA is "the largest attorney fee award in history"; Philip Morris profits "were $4.5 billion in 2005—up 36 percent from 1997," while its stock price doubled).

[8] Although escrow payments theoretically may be returned after 20 years, the present value of such future payments is limited given the functionally negative interest on escrow monies earned by NPMs. *See Response by the Settling States to the Firm's Initial Written Questions* at 63 ("given the high borrowing costs faced by NPMs and the low interest rates earned on escrow deposits, a reasonable minimum estimate of the difference in these rates is 8 percentage points.") [Sealed Doc. 96, attach. 7]. A standard present value calculation using that minimum 8% spread as the discount rate and compounding

offset payments under previously negotiated settlements with the four non-MSA States. MSA §§ II(kk), IX(j).[9] NPM escrow payments, in contrast, are tied to the unreduced MSA amounts payable by non-grandfathered SPMs. LA. R.S. § 13:5063(C)(2)(b) (escrow payments linked to MSA § IX(i)).[10] NPMs thus are forced to pay not only the per-cigarette equivalent of what OPMs pay under the MSA, but also the per-cigarette equivalent of what OPMs pay for their settlements with *non*-MSA States. They are thus penalized by the MSA States to offset *pre-existing* costs to the Majors that were not even imposed by the MSA.

Second, many SPMs receive an exemption under the "grandfather clause" from any MSA payments on the amount of cigarettes sold up to their 1998 market share or 125% of their 1997 market share. Sales above that level are subject to ordinary MSA per-cigarette charges. Grandfathered

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monthly ($100/(1 + (0.08/12)^{240}) = $20.30) demonstrates that even if the Escrow were certain to be returned, its reversionary value would be worth at most 20% of the amount deposited. Of course, only the credulous would imagine that 20 years of accumulated monies will actually be returned. Rather, it will pose an irresistible temptation for States and their contingency-attorneys to generate any claim, however meritless, or alter its law, if only to coerce a settlement. *Id*. (due to potential litigation and other contingencies, there is a "non-trivial probability that an NPM will not receive its deposit back.").

[9] *Gruber & Pindyck Initial Submission* at 15 n. 18 ("SPM marginal costs exceed the OPM marginal cost because the OPMs receive a PSS [Previously Settling States] reduction that does not apply to SPM payments") [Sealed Doc. 96, attach. 6].

[10] *See also Freedom Holdings v. Spitzer*, 447 F.Supp.2d 230, 237-238 (S.D.N.Y. 2004) (NPM escrow payments are "very close to those of SPMs who did not have the benefit of the grandfather clause"), *aff'd*, 408 F.3d 112 (2d Cir. 2005); *supra* at 6 n.3 (escrow payments increases after repeal of allocable share refund provision).

SPMs thus pay nothing if they adhere to the MSA's market division rules, and still pay vastly lower average costs even if they exceed their assigned market share. NPMs receive no such exemptions.[11] That puts them at a severe cost disadvantage compared to grandfathered SPMs.[12] As a result, the vast majority of non-OPM cigarettes are now sold by grandfathered SPMs.[13]

Third, MSA payments are further reduced under the so-called "NPM Adjustment." MSA § II(ff). In effect, to the extent NPMs manage to compete with PMs despite the burdens imposed upon them, PMs are compensated for any competitive losses with a still further reduction in their MSA payments. Settlements regarding such adjustments have been reached

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[11] Plaintiff S&M was in business and selling cigarettes before the MSA was adopted, and thus would have been eligible for an exemption under the grandfather clause had it joined promptly. *See Defendant's Response to Plaintiffs' Statement of Undisputed Facts* at 14, ¶54 (admitting S&M manufactured cigarettes since 1994). [R. 1827]

[12] *Bulow Rep.* at 51 ("grandfathered SPMs already have an enormous advantage over the NPMs") [R1102]; *id.* at 52 ("The NPMs have much higher average and marginal payments ... than do PMs") [R1103]; Rule 30(b)(6) *Deposition of Peter J. Levin* representing National Association of Attorneys General at 62-63 (July 1, 2008) ("*Levin Dep.*") (grandfathered SPMs now "have a lower cost" than NPMs) [R1115]; *Gruber Decl.* at 11 (defendant's expert admitting that grandfathered SPMs have a "very large competitive advantage" as a result of their exemption). [R1110].

[13] *Bulow Rep.* at 49 ("MSA-compliant non-grandfathered SPMs sell almost no cigarettes") [R1100]; *id.* at 33-34 ("In Louisiana the passage of ASR led to an immediate 92 percent decline in the market share of NPMs, to .12 percent") [Sealed Doc. 96, attach. 3].

for 1999 to 2002 and are being negotiated for subsequent years.[14] NPM escrow payments, of course, are not reduced accordingly.[15]

Finally, NPMs face far harsher penalties than do PMs for late payment or underpayment. "Failure to comply with the escrow law can result in significant penalties up to 300% of any past due obligation and a prohibition on the same of cigarette or tobacco products for up to two years." NAAG, *Why Join the Tobacco Master Settlement Agreement*, at 3 (Dec. 15, 2003) [R1057]; *see* LA. R.S. § 5063(C)(3)(a)-(b). By contrast, PMs face little penalty for late payment, only the accrual of modest interest, and have little incentive to pay off their MSA debts, which are, in effect, below-market-rate loans.[16] For many SPMs, payment defaults have been excused, their MSA payments deferred, and, unlike non-compliant NPMs, such SPMs have been allowed to continue selling cigarettes.[17]

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[14] *See, e.g.*, Bear Stearns Municipal Research, *MSA Update: NPM Adjustment Process in Works for 2008 MSA Payment* (May 11, 2007) (discussing NPM Adjustment claims for the years 1998 to 2002 and requests for adjustments for later years) [R1190]; *Levin Dep.* at 182-85, 191 (past NPM adjustment settlements and negotiations for further adjustments) [Sealed Doc. 96, attach. 4].

[15] *Deposition of Everett W. Gee III* (June 9, 2008) ("*Gee Dep.*") at 116-18 [R1153-54]; *Levin Dep.* at 185 [Sealed Doc. 96, attach. 4].

[16] MSA § IX(h) (interest on "any payment due hereunder and not paid when due" is "Prime Rate plus" 3%); *id.* at §IX(i)(1)(A) (interest on "underpayments" is "Prime Rate"); *Bulow Rep.* at 4 ("virtually all non-grandfathered SPMs (by volume) have large debts to the MSA that will probably never be paid.") [R1088].

[17] *Rule 30(b)(6) Deposition of Thomas L. Enright* (June 20, 2008) ("*Enright Dep.*") at 142 (Assistant AG Enright admitting that General Tobacco was "not required to make a full back payment at the time they became an SPM") [R1145]; *Levin Dep.* at 100 (despite

2. States Threaten NPMs and their Customers with Litigation and Potential Liability for Not Joining the MSA.

In addition to the greater financial burdens imposed on NPMs for refusing to join the MSA, the Settling States impose competitive burdens on NPMs by threatening them and their distributors with future litigation and potential liability. While companies joining the MSA are released from all past and much future potential liability, the Settling States continuously threaten expensive litigation against NPMs to scare off their distributors.

The National Association of Attorneys General ("NAAG"), Louisiana's agent for MSA purposes,[18] not only admits but affirmatively touts the litigation threat as a potent reason for joining the MSA. According to NAAG, "[s]uch suits would be extremely expensive to defend. Joining the MSA settles a tobacco product manufacturer's liability to the states of essentially all tobacco-related claims that states might have against a company." NAAG, *Why Join the MSA*, at 2. [R1056] NAAG adds that the

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failure to make even deferred required payments, General Tobacco was not deemed to be "in default" of its MSA obligations, and was permitted to continue selling cigarettes.) [R1121]; *id*. at 98-99 (citing court ruling that PMs can't be delisted for delay in payment) [R1121]; *Bulow Rep.* at 48-49 (discussing failure to take action against an SPM's default on $47 million in MSA payments in 1999-2001, and deferral of back-payments) [R1099-1100].

[18] *Defendant's Resp. to Plaintiff's Supp. Mem. In Support of Motion to Compel* (Mar. 20, 2007) in *Xcaliber International LLC v. Foti*, at 12-13 (asserting that NAAG is Louisiana's "agent" and claiming an "attorney-client relationship") [R1166-67]; *Levin Dep.* at 40-41 (NAAG representative and defendant's counsel asserting attorney-client privilege because NAAG represents the States in connection with the MSA) [R1113].

litigation threat provides SPMs with "a marketing advantage over NPMs" because even "[c]ompanies *buying from* NPMs run the risk of being sued by the States." *Id*. at 3 (emphasis added). Consequently, "[s]ome wholesalers and distributors have advised that they do not wish to deal with NPMs due to compliance concerns and potential risk involved." *Id*. at 2. Joining the MSA, in contrast, releases not just the SPM from liability, but its customers as well. *Id*. at 3. "[B]ecause the customers of PMs cannot be sued while the customers of NPMs can be, NPMs are excluded from 69 percent of the retail outlets in the country, including all the big chains." *Bulow Rep.* at 46. [R1097] [19]

3. States Impose Greater Administrative Burdens on NPMs for Not Joining the MSA.

NPMs also face greater administrative burdens under the Escrow Statutes than PMs face under the MSA. NAAG again boasts of this differential burden in trying to pressure companies to join the MSA. NAAG, *Why Join the MSA*, at 2-3 (NPMs must separately comply with Escrow Statutes in each State, must establish separate state escrow accounts, calculate separate state payments, file separate quarterly or annual reports

[19] *See also Final Submission of the Settling States: Expert Report of Jonathan Gruber & Robert S. Pindyck* at 17 (Jan. 30, 2006) ("*Gruber & Pindyck Final Sub*.") ("NPM cigarettes are not as widely available in retail outlets such as supermarkets, drugstores, and convenience stores. . . the transaction cost associated with buying them is high compared to that for OPM products"). [Sealed Doc. 96, attach. 5]

and certifications, and bear the administrative costs of such duplication). [R1056-57] SPMs, by contrast, "face significantly fewer administrative burdens." *Id*. (single annual sales report, single payment covering all States calculated for SPMs by MSA's Auditor).

4. The Greater Burdens on NPMs Are Confirmed by the Many Companies that Have Opted To Become SPMs.

Not surprisingly, the burdens imposed on NPMs have coerced numerous companies that were never sued to nonetheless join the MSA. The Settling States, including Louisiana, recognize as much, affirmatively claiming that the existence of higher NPM costs and their "net disadvantages compared to PMs" have led "many manufacturers [to join] the MSA, even without the benefit of having grandfathered shares," and even prior to "higher NPM costs imposed by the [Allocable Share refund] repeals." *Response by the Settling States to the Firm's Initial Written Questions* at 62 (Dec. 16, 2005) (brief filed on behalf of Louisiana and the other MSA States) [Sealed Doc. 96, attach. 7]; *See* Plaintiffs' Exhibit 1 [Dkt. No. 122] (chart showing many more SPM than NPM companies and brands in Louisiana). Indeed, the increasing burdens on NPMs as a result of changes in the Escrow Statutes have all but eliminated competing NPMs from the Louisiana market. *See supra* at 6 & n.3; *Bulow Rep*. at 33-34 ("In Louisiana

the passage of ASR led to an immediate 92 percent decline in the market share of NPMs, to .12 percent") [Sealed Doc. 96, attach. 3]

D. Plaintiffs' Claims and the Decision Below.

Plaintiffs alleged that the MSA, in conjunction with its implementing statutes, violates the Compact Clause because it is an interstate agreement, unapproved by Congress, that potentially and actually encroaches upon federal ajthority and upon the independent sovereign interests of the States. In particular, plaintiffs alleged that the MSA and its implementing legislation (1) impose burdensome unconstitutional conditions on political and commercial speech, in violation of the First Amendment; (2) impose burdensome and unlawful conditions on cigarette advertising, in violation of the Federal Cigarette Labeling and Advertising Act ("FCLAA"), 15 U.S.C. § 1334; (3) create a national cartel to divide markets, suppress competition, and raise prices, in violation of federal antitrust laws; and (4) impose interstate speech restrictions and a surcharge on nationwide cigarette sales, including those made in non-participating States, in violation of the Commerce and Due Process Clauses. Furthermore, the fact that the MSA and its implementing statutes even raise a meaningful question regarding such violations demonstrates that, even absent a finding of individual

violations, they *potentially* encroach upon federal authority and state interests and thus require congressional consent under the Compact Clause.

Regarding the Compact Clause, the district court held that the MSA does not result in any actual or potential encroachment on federal supremacy; that the States do not exercise any powers under the MSA they could not exercise in its absence; and that therefore the MSA was not subject to congressional approval under the Compact Clause. Mem. at 10-11. [R2288-89] Alternatively, the court held that Congress had impliedly consented to the MSA when, in 1999, it disclaimed any federal entitlement, under the Medicaid statute, to any MSA or other settlement money received by the States. *Id*. at 11-12 (citing 42 U.S.C. § 1396b(d)(3)(B)(i-ii)). [R2289-90]

Regarding the First Amendment, the court noted the claim raised by plaintiffs, but offered no analysis of its merits other than a passing string cite to cases addressing various challenges to MSA-related statutes. Mem. at 5, 9 n.7 [R2283, R2287] The court did not analyze or opine upon the merits of those cases.

Regarding the FCLAA, the court held that the Escrow Statute is not preempted because it "does not in any way concern cigarette packaging, advertising, or promotion," and that plaintiffs lacked standing to object to

any "voluntary" advertising restrictions imposed upon MSA signatories. *Id*. at 13-14. [R2291-92]

Regarding the antitrust laws, the court again noted plaintiffs' claims of antitrust violations, but again offered no analysis of the merits beyond a string cite of cases on which it failed to comment. *Id*. at 5, 9 n.7. [R2283, R2287]

Regarding the Commerce and Due Process Clause implications of the extraterritorial reach of the MSA and the Escrow Statutes, the court held that the fees charged under the Escrow Statute make no distinction based upon the state of origin of any cigarettes sold in Louisiana, regardless whether escrow payments are tied to certain MSA payments, which in turn are tied to national market share (including sales in non-MSA States). *Id*. at 16. [R2294] As for any indirect burden on commerce, the court held that the state interest in requiring NPMs to maintain a source of funds to pay hypothetical future health-related claims outweighed the minimal burden on commerce from NPMs worried about escrow liability for cigarettes sold outside the State and imported into Louisiana by third parties. *Id* at 16-17. [R2294-95] The court similarly found no due process violation because there was little likelihood that cigarettes sold out-of-state would trigger escrow payments in Louisiana. *Id*. at 18. [R2296] The court did not

address the extraterritorial price increases and advertising restrictions imposed and enforced by the MSA and the Escrow Statutes.

As a result of those holdings, the court granted defendant summary judgment and dismissed all of plaintiffs' claims. *Id.*

In nearly every respect, the district court misconceived the violations alleged in this case, ignored critical and largely undisputed facts, and erroneously relied upon earlier cases rejecting claims against various Escrow Statutes. In contrast to virtually all earlier cases, the facts and arguments developed in this case demonstrate that the MSA and its implementing legislation impose severe burdens and penalties on NPMs for not joining the MSA. Those burdens seek to coerce tobacco companies into acceding to the MSA's extraterritorial regulations, anticompetitive price fixing and market division scheme, and speech restrictions. Such an interstate agreement encroaches upon both federal supremacy and state sovereignty.

SUMMARY OF ARGUMENT

The MSA and its implementing statutes regulate the national cigarette market in a manner that potentially and actually encroaches upon numerous areas of federal authority in violation of the Constitution and federal law. Because it is an agreement among, *inter alia*, numerous States, even the mere *potential* for encroachment into areas of federal authority or state

sovereignty would render it an interstate "compact" requiring affirmative congressional approval regardless of any *actual* conflict with existing federal law, state sovereignty, or the Constitution. With the MSA, however, there is *both* potential and actual encroachment upon federal authority and state interests and violations of federal law and the Constitution.

First, the Louisiana Escrow Statute, by imposing punitive payment obligations and administrative burdens upon manufacturers refusing to subject themselves to the MSA, imposes an unconstitutional condition on the exercise of First Amendment rights by NPMs. Louisiana and other States have forced tobacco companies to choose between joining the MSA, thereby forfeiting their ability to engage in certain political and commercial speech, or being subjected to escrow payments and administrative burdens substantially in excess of what is required of PMs. Plaintiff S&M Brands, which was never sued by the States, declined to "settle" non-existent claims and forfeit its speech rights. It has been paying dearly for that choice ever since.

Second, the Escrow Statute, in conjunction with the MSA, burdens the lawful advertising of cigarettes. It thus seeks to regulate such advertising in violation of the FCLAA, 15 U.S.C. § 1334. The FCLAA expressly preempts state regulation of cigarette advertising based on smoking and

health. *Id*. § 1334(b). Complying with the Escrow Statute is an NPM's only alternative to joining the MSA, which itself quite brazenly restricts cigarette advertising for the stated purpose of promoting public health. The Escrow Statute, in penalizing an NPM's refusal to join the MSA and comply with such advertising restrictions, is no less an improper regulation of cigarette advertising than a state law levying fines for failure to comply with such restrictions. Thus, the Escrow Statute and the MSA impose an unlawful condition restricting or penalizing cigarette advertising that the FCLAA expressly places beyond the authority of the States.

Third, the MSA, as supported by the Escrow Statute, violates the Sherman Act by creating a national tobacco cartel. It enables the Majors to raise prices and pass on its cost (and more) to tobacco consumers. If the MSA were a purely private contract, the parties involved "would long ago have" been jailed. *Freedom Holdings v. Spitzer*, 357 F.3d 205, 226 (2d Cir. 2004). This cartel's national scope takes it outside antitrust immunities such as the *Parker* state-action doctrine.

Fourth, the MSA restricts advertising and speech and imposes fees on cigarettes sold even outside of MSA States. It thus violates the ban on extraterritorial regulation rooted in the Constitution's Commerce and Due Process Clauses.

Finally, the MSA and its implementing statutes violate the Compact Clause. The MSA is an agreement among, *inter alia*, numerous states, and the Escrow Statutes were adopted pursuant to the coercive terms of that agreement. The Compact Clause requires that such an agreement receive affirmative congressional approval if it has even the *potential* to encroach upon areas of federal interest and authority or state sovereignty. *U.S. Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452, 472 (1978) ("*MTC*"); *Rhode Island v. Massachusetts*, 37 U.S. 657, 726 (1838). The MSA encroaches upon areas of federal authority and state sovereignty both potentially and actually, as described in connection with the claims discussed above. That Congress has disclaimed an interest in MSA payments for purposes of Medicaid reimbursement falls far short of the approval required by the Compact Clause. The court below erred in holding otherwise.

ARGUMENT

The District Court's ruling on motions for summary judgment is reviewed *de novo. Scottsdale Ins. Co. v. Knox Park Constr., Inc*., 488 F.3d 680, 683 (5th Cir. 2007).

I. THE MSA AND ITS IMPLEMENTING STATUTES VIOLATE THE FIRST AMENDMENT.

Governments are forbidden from infringing the freedoms of speech and to petition either directly, by prohibiting protected speech, or indirectly, by exacting a penalty or imposing an unconstitutional condition upon the exercise of such freedoms. *Dollan v. City of Tigard*, 512 U.S. 374, 385 (1994) ("Under the well-settled doctrine of 'unconstitutional conditions,'" the government generally may not require a person to give up a constitutional right "in exchange for a discretionary benefit conferred by the government."). In this case, the MSA and its implementing statutes do both.

The MSA – an NPM's sole alternative for avoiding the burdens of the Escrow Statute – *directly* restricts the speech of PMs by forbidding various forms of lobbying and petitioning activity concerning tobacco or the MSA itself. *See, e.g.*, MSA, §§ III(m-p), XV (prohibiting membership in trade association that might oppose the MSA and prohibiting lobbying, litigation, or other advocacy adverse to the MSA or State receipts thereunder). The MSA also prohibits numerous forms of cigarette advertising. MSA § III.

Lobbying and petitioning the government are core political expression protected by the First Amendment. *See Eastern Railroad Presidents Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961) (lobbying protected by First Amendment); *Pfizer, Inc. v. Giles*, 46 F.3d 1284, 1286-88, 1290 (3d Cir. 1994) (trade association membership and lobbying protected). Cigarette advertising is commercial speech likewise protected, albeit to a lesser degree, by the First Amendment. *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 565 (2001) (ban on "outdoor advertising" of tobacco products violates First Amendment). The MSA, implemented via multiple consent decrees, is state action restricting such speech.[20] There is no meaningful suggestion that such restrictions could survive either strict or intermediate scrutiny.

The MSA and the Escrow Statute together *indirectly* abridge the First Amendment rights of NPMs by imposing an unconstitutional condition upon exercise of their rights and penalizing their refusal to join the MSA and its direct restrictions on speech. Companies can avoid the multiple burdens imposed by the Escrow Statute, *supra* at 8-14, only by joining the MSA and thereby agreeing, *inter alia*, to give up their First Amendment rights. Regardless how one views Louisiana's baseline discretion to impose or

[20] Edward Correia & Patricia Davidson, *The State Attorney Generals' Tobacco Suits: Equitable Remedies*, 7 CORNELL J. L. & PUB POL'Y 843, 849 n. 33 (1998) ("Actions by the state embodied in a consent decree are state action subject to the Fourteenth Amendment.").

remove the burdens of the Escrow Statute, conditioning those burdens on the refusal to waive First Amendment rights is an unconstitutional condition. *Dollan*, 512 U.S. at 385; *see also Thompson v. Western Medical Center*, 535 U.S. 357 (2002) (refusal to approve drugs absent agreement to restrict advertising is unconstitutional condition); *Simon & Schuster v. Members of New York State Crime Victims Bd.*, 502 U.S. 105, 116-17 (1991) (conditioning speech on escrow deposit unconstitutional); *Pacific Frontier v. Pleasant Grove City*, 414 F.3d 1221, 1232-33 (10th Cir. 2005) (bond requirement for commercial speech unconstitutional).

The court below rejected plaintiffs' First Amendment claim without analysis, notwithstanding its earlier holding that such claim was sufficient to withstand a motion to dismiss.[21] The court's passing reference, Mem. at 9 n.7 [R2287], to prior MSA-related cases, only two of which addressed First Amendment challenges, and those only to the repeal of the Allocable Share refund, adds nothing to the lack of analysis of the claim in this case.

Unlike the litigants in *Xcaliber International Ltd. v. Caldwell*, 2009 WL 1324042 (E.D. La. May 7, 2009), and *Grand River Enterprises Six Nations Ltd. v. Beebe*, 418 F.Supp.2d 1082 (W.D. Ark. 2006), *aff'd*, 574

[21] *See* Mem. Ruling at 3 (Nov. 9, 2006) (denying defendant's "motion to dismiss plaintiffs' claims pursuant to the [FCLAA], Commerce Clause, Due Process Clause, and First Amendment"). [R724]

F.3d 929 (8th Cir. 2009), plaintiffs in this case challenge both the MSA and the Escrow Statute as a whole. The limited scope of the challenge in those other cases – essentially asking for a return to a kinder, gentler Escrow Statute – was ultimately fatal because plaintiffs there failed to make the case that life under the Escrow Statute was worse than under the MSA, rather than merely worse than under the previous Escrow Statute. *Xcaliber*, 2009 WL 1324042, at *9-*10 (where plaintiff "has provided no evidence that is it being coerced to join the MSA and makes no argument to that effect, the first amendment is not implicated"; recognizing unconstitutional conditions doctrine but holding that the benefit of the allocable share amendment was not conditioned on joining the MSA); *Grand River*, 418 F.Supp.2d at 1092-93 (noting that plaintiffs' claim regarding the allocable share amendment is "not an allegation that the regulatory scheme is so structured that it costs a tobacco manufacturer more to be an NPM than a PM"). In this case, plaintiff S&M Brands raises the very different claim that it is worse off under the Escrow Statute than if it had joined the MSA. It is that burden that demonstrates the unconstitutional condition.

II. THE MSA AND ITS IMPLEMENTING STATUTES CONFLICT WITH THE FEDERAL CIGARETTE LABELING AND ADVERTISING ACT.

The FCLAA regulates, *inter alia*, the advertising of cigarettes and expressly provides that States may impose "[n]o requirement or prohibition based on smoking and health … with respect to the advertising, or promotion of any cigarettes the packages of which are labeled in conformity with" its provisions. 15 U.S.C. § 1334(b). The FCLAA broadly "preempts state regulations targeting cigarette advertising." *Lorillard*, 533 U.S. at 550; *Jones v. Vilsack*, 272 F.3d 1030, 1035 (8th Cir. 2001) (same). Congress, in the FCLAA, made a legislative choice as to the amount and type of advertising requirements and restrictions that would best serve the public health. Having struck its legislative balance, it then prohibited States from altering that policy choice by imposing additional restrictions targeted at cigarette advertising. The MSA and the Escrow Statute supplant Congress' decision regarding cigarette advertising, conflict with the FCLAA's prohibition, and hence are preempted.

As noted, *supra* at 4, the MSA, with the express intent to promote public health, directly regulates and prohibits certain forms of cigarette advertising. And the MSA and the Escrow Statute together indirectly attempt to serve the same ends by imposing an unlawful condition on such advertising, penalizing NPMs who decline to join the MSA and accept its

advertising restrictions.[22] Such targeted restrictions and conditional penalties on cigarette advertising are preempted by the FCLAA. *Lorillard*, 533 U.S. at 550.

Failing to conduct a straight-forward preemption analysis, the district court rejected plaintiffs' preemption claim. It suggested that the Escrow Statute "does not in any way concern cigarette packaging, advertising, or promotion," and that the MSA's advertising restrictions are "voluntary," "not legislatively required," and hence not a preempted requirement or prohibition. Mem. at 13-14. [R2291-92] The district court was incorrect on both counts.

The district court's suggestion that the Escrow Statute does not "concern" advertising wholly ignores the Escrow Statute's direct reference to the MSA as the only means by which a manufacturer may avoid the burdens imposed by statute. The Escrow Statute and the MSA must be viewed and reviewed together, not separately. Indeed, Louisiana has readily conceded that the "Escrow Statute was designed to address" the "prospect

[22] It makes no difference that the MSA is incorporated into a series of nominally "voluntary" consent decrees. Because the States themselves are parties and courts have added their imprimatur, the MSA is state action for purposes of preemption. *See Ridgway v. Ridgway*, 454 U.S. 46, 47, 53 (1981) (federal law preempted settlement "imposed both by voluntary agreement" and "state court decree"); *A.D. Bedell Wholesale Co. v. Philip Morris*, 263 F.3d 239, 261 (3d Cir. 2001) (states enforce MSA via consent decrees), *cert. denied*, 534 U.S. 1081 (2002); *cf. Cipollone v. Liggett Group*, 505 U.S. 504, 521 (1992) (FCLAA restricts state suits).

that NPMs which ... had assumed none of [the MSA's] public health and anti-promotional restrictions, would take advantage of their ... commercial freedom" at the expense of PMs who had agreed to such restrictions. *Defendant's Mem. In Support of Motion for Summary Judgment* at 9-10. [R1216-17] That the Escrow Statute does not itself affirmatively restrict cigarette advertising, but merely punishes the failure to agree, *inter alia*, to such restrictions hardly removes it from the ambit of FCLAA preemption. Preemption bars not only overt regulations, but indirect regulation as well.[23]

The court's added suggestion that the MSA's advertising restrictions are the result of a "voluntary" choice by companies rather than a state-imposed prohibition ignores the punitive alternative imposed by the Escrow Statute. Even if the MSA can be characterized as a voluntary agreement by the Majors who negotiated it, it is hardly "voluntary" as to other manufacturers who subsequently had to decide whether or not to join the MSA. A choice between "agreeing" to advertising restrictions or being subject to punitive statutory consequences is not meaningfully different from a choice between obeying a direct restriction or facing the consequences of disobedience. Forcing such a choice by statute thus is a regulatory act, even

[23] *See Ingersoll-Rand v. McClendon*, 498 U.S. 133, 139 (1990) (ERISA preempted state law "even if the law is not specifically designed to affect such [benefit] plans, or the effect is only indirect").

if participants ultimately must "agree" to the MSA's restrictions. *South-Central Timber Dev. Co. v. Wunnicke*, 467 U.S. 87, 97-98 & n.10 (1984) (States may not regulate interstate commerce through contractual conditions any more than through statute or regulation); *Automated Salvage Transport, Inc. v. Wheelabrator Ent'l Sys., Inc.*, 155 F.3d 59, 78 (2d Cir. 1998) (fact that a state agency and a business "have entered into an agreement does not necessarily insulate it from scrutiny under the Commerce Clause").[24] The "choice" compelled by the Escrow Statute between "agreeing" to advertising restrictions and punitive burdens violates the prohibition contained in the FCLAA.

As for the district court's reliance on *PTI, Inc. v. Philip Morris, Inc.*, 100 F.Supp.2d 1189 (C.D. Cal. 2000), and two other district court cases rejecting FCLAA challenges, Mem. at 13 [R2291], the vanishingly thin discussions of the FCLAA in those cases say nothing more than the decision below, offer no support for their assertions, and are wrong for the reasons just discussed. *PTI*, 100 F.Supp.2d at 1205 (bare paragraph on FCLAA making same two arguments as the court here); *Grand River Enterprises Six Nations, Ltd. v. Pryor*, 2003 WL 22232974, at *16-*17 (S.D.N.Y. 2000)

[24] *Cf. Grand River Enterprises Six Nations Ltd. v. Pryor*, 425 F.3d 158, 173 (2d Cir. 2005) (reviving Commerce Clause challenge to MSA and Escrow Statute); *Bedell*, 263 F.3d at 265 n.55 (MSA is "regulatory" for purposes of Commerce Clause).

(same, citing *PTI*), *aff'd in part*, 425 F.3d 158 (2d Cir. 2005); *Omaha Tribe of Nebraska v. Miller*, 311 F.Supp.2d 816, 823 (S.D. Iowa 2004) (merely citing *Grand River*). In this Court, a daisy-chain of district court decisions, each citing the previous and none with meaningful analysis, is neither actual nor persuasive authority.

III. THE MSA AND ITS IMPLEMENTING STATUTES VIOLATE THE ANTITRUST LAWS.

The Sherman Act states that "[e]very contract, combination …, or conspiracy, in restraint of trade or commerce among the several States … is declared to be illegal." 15 U.S.C. § 1. It is well-established that combinations and conspiracies establishing cartels, dividing markets, and fixing prices are quintessential *per se* antitrust violations. *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 406-07 (1978) (cartels); *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 647-49 (1980) ("combination formed for the purpose of raising . . . or stabilizing the price of a commodity"); *United States v. Topco Assocs.*, 405 U.S. 596 (1972) (horizontal market division). The MSA and its implementing statutes violate this bedrock principle and antitrust law. And the only potentially relevant exception to those *per se* prohibitions is the implied state-action exception, *see Parker v. Brown*, 317 U.S. 341 (1943), which does not apply here.

A. The MSA and Its Implementing Statutes Establish a National Cigarette Cartel to Divide Markets and Fix Prices, in *Per Se* Violation of the Antitrust Laws.

The MSA constitutes an "agreement" among the PMs, as well as with the Settling States. In both intent and effect, the agreement serves to protect the market dominance and market share of the Majors, limit competition among them and from SPMs, and protect all PMs from price competition by NPMs. One of the underlying purposes of this agreement, openly acknowledged by its participants, is to facilitate coordinated price increases by the Majors so that they may pass along the costs of their MSA payments to consumers rather than eat into their profits. *See supra*, at 5-6, 8. In fact, the scheme is so effective at suppressing competition that it has allowed the Majors to increase prices and to earn supra-competitive profits well above recouping the costs of their own wrongdoing.[25] In structure, function, and intent, the MSA thus establishes a national cigarette cartel.

First, the MSA's structure and operation demonstrate that it is a cartel, not an innocuous tort settlement. For example, despite having the nominal purpose of settling claims for wrongdoing and damages by the Majors, MSA

[25] *Gruber & Pindyck Final Sub.* at 2-3 ("Between 1997 and 2003, OPM premium and discount retail prices increased by much more than MSA marginal costs") [Sealed Doc. 96, attach. 5]; *Bulow Rep.* at 3 ("Since the passing of the MSA, the major companies have raised the price of cigarettes by considerably more than the cost of the MSA, or by the amount of any cost increases. Experts for the major companies have acknowledged that the MSA created incentives to raise prices by more than costs increased") [R1087].

payments are entirely forward-looking, with payments from individual manufacturers based on their yearly market share. MSA § IX. Were the MSA truly compensatory in nature, it would presumably have been based on past market share or some other approximation of the injuries inflicted by different manufacturers. That the MSA concerns itself only with current and future market share strongly suggests that it is intended to preserve such market share and provide a financial disincentive for price competition between the Majors that might lead to gains in market share – and thus a higher share of the relatively fixed MSA burden. As the Third Circuit has recognized, such market-share-based incentives are anticompetitive in purpose and effect:

> [A]ny signatory who increases production beyond historic levels automatically will increase its proportionate share of payments to the [MSA]. Normally, a company which lowers prices would be expected to increase market share. But the penalty of higher settlement payments for increased market share would discourage reducing prices here. For this reason, signatories have an incentive to raise prices to match increases by competitors. It appears this incentive structure has proven true.

Bedell, 263 F.3d at 248.[26]

Defendant here does not meaningfully dispute that the MSA is designed to facilitate price increases by the participants, and provides an

[26] The MSA's agreement to eliminate many kinds of advertising likewise is contrary to federal antitrust laws. *See Blackburn v. Sweeney*, 53 F.3d 825, 828 (7th Cir. 1995) .

effective incentive to do so in unison. Thus, defendant concedes that the MSA's costs are "'internalized' in the cost of the cigarettes and largely if not entirely passed on to consumers in the form of higher prices," and that the MSA has "led those companies [the Majors] to increase the prices they charge for their cigarettes." *Def. Sum. Judgment Mem.* at 8. [R1215][27]

Second, regarding SPMs, the MSA's market division scheme is explicit. It grandfathers many SPMs' past market share from MSA payments entirely, but imposes an MSA-payment penalty on sales above such market share. While the market division is not airtight (the grandfathered sales reduce average cost even when sales exceed prior market share), it nonetheless decreases the profitability of sales above the limit and provides a strong incentive to limit sales and raise prices in unison with other manufacturers in order to reap still-greater supra-competitive profits.

Third, the MSA protects the market share of all PMs by imposing costs on NPMs that are effectively greater than those imposed on parties to the MSA. *See supra*, at 8-14. And even if escrow payments merely offset the cost disadvantage of the Majors from having settled their potential

[27] *Gruber Dep.* at 139 (defendant's expert admitting that cost of the MSA is "largely passed on in higher prices to smokers") [R1593]; *Gruber Decl.* at 8 (same) [R1109]; *Bulow Dep.* at 26-27 (the MSA authorizes price increases and is a "collusive cost-sharing agreement" that leads "directly to higher prices.") [R1125].

liability to the States – rather than providing PMs an affirmative cost *advantage* over NPMs – that purpose would still be distinctly improper under the antitrust laws. *See National Electrical Contractors Ass'n v. National Constructors Ass'n*, 678 F.2d 492, 497, 500-01 (4th Cir. 1982) (agreement between union and contractors to impose costs on some competitors to compensate for costs voluntarily assumed by other competitors is a *per se* illegal attempt to "stabilize prices"). MSA payments by the Majors to settle their liability to the States are nothing more than the legal and market consequences of their own past wrongful business practices. The lack of such an expense for NPMs who did not engage in such practices, were not sued, and hence did not have any liability to settle, is not an improper advantage that must be offset, but rather the direct consequence of not having made unlawful choices in the past. Interfering with such perfectly ordinary competitive differences is price fixing. *Id*. at 500 ("To be guilty of price-fixing, conspirators do not have to adopt a rigid price . . . interference with market forces freely setting the price of goods is sufficient").

B. Implied State-Action Immunity Does Not Insulate the MSA and Its Implementing Statutes.

Although the district court recognized plaintiffs' allegations and arguments of antitrust law violations, it offered no analysis of the issue and

made only passing reference to cases that had rejected various antitrust challenges to various Escrow Statutes.[28] Antitrust cases relating to the Escrow Statutes address a variety of arguments and defenses, but the most pertinent potential defense is that of implied state-action immunity, as established in *Parker v. Brown*, 317 U.S. 341 (1943).

In *Parker*, the Supreme Court, relying on principles of federalism and state sovereignty, declined to "lightly" attribute to Congress, in enacting the Sherman Act, an intention to "restrain a state or its officers or agents from activities directed by its legislature." *Id*. at 350-51. Finding no specifically expressed intention in the Sherman Act to limit state legislative activity, and finding that the State "as sovereign" had "imposed the restraint as an act of government" rather than by making an "agreement or contract" or by entering into a "conspiracy in restraint of trade," the Court held that the state program at issue was not prohibited by the Sherman Act. *Id*. at 352. The Court in *Parker* included the proviso, however, that even state action will not avoid the prohibitions of the Sherman Act if the State acts as a "participant in a private agreement or combination by others for restraint of trade," or seeks to "give immunity to those who violate the Sherman Act by

[28] Mem. at 9 n.7 (recognizing that plaintiffs accuse the State, *inter alia*, of "patently violating the federal antitrust laws" and only offering a "but see" string cite). [R2287]

authorizing them to violate it, or by declaring that their action is lawful." *Id.* at 351-52.[29]

The *Parker* doctrine does not apply to this case, which involves multiple States, including Louisiana, entering into a contract, agreement, and conspiracy with private parties and each other in restraint of trade, binding on its member States, and reaching beyond the borders of those States.

First, because "state action immunity is disfavored, much as are repeals by implication," *F.T.C. v. Ticor Title Ins. Co.*, 504 U.S. 621, 636 (1992), it should not be radically extended to cover extraterritorial regulation of national scope, like the MSA. *Cf. Aetna Health Ins. v. Davila*, 542 U.S. 200, 217 (2004) ("overpowering federal policy" reflected in statute may preempt state law that would otherwise fall within one of its exceptions).

Second, the *Parker* doctrine only shields intrastate regulations by individual States, not national cartels like the MSA. *See Northern Securities Co. v. United States*, 193 U.S. 197, 346 (1904) (State may not "give a corporation ... authority to restrain interstate or international commerce"). Indeed, the very premise of *Parker* was that federalism and

[29] Had the States merely agreed to individual settlement amounts from each OPM, who thereafter agreed among themselves to the market-share division of those combined costs, there is no question such a private agreement would violate the Sherman Act. Having incorporated that second agreement into an agreement with the States does not immunize it as state action.

state sovereignty provided some presumptive protection to State conduct within a State's limited spheres of sovereignty – and required an express statement of congressional intent to regulate the States within their presumptive sphere of sovereignty. *Parker*, 317 U.S. at 350; *cf. id*. at 359-60 (emphasizing, in discussing the related Commerce Clause challenge, that "states are sovereign within their territory save only as they are subject to the prohibitions of the Constitution," or conflict with national powers or legislation).

In this case, however, *Parker*'s premises and presumptions are turned on their heads. Rather than making individual and independent choices regarding matters wholly "within their territory," the MSA States have acted collectively (albeit subject to severe coercion) in order to divide markets, raise prices, and restrict advertising nationwide, even in the four non-MSA States. *See supra* at 4. Such collective, coercive, and extraterritorial regulation flies in the face of the federalism interests animating *Parker*. *See Lafayette*, 435 U.S. at 406-07 (conduct's extraterritorial reach, involving buyers outside the defendant city, militated against granting immunity).

Furthermore, many States felt they had no choice but to join the MSA and, having joined may not withdraw from it, have no recourse regarding the decisions of the Firm, and are forbidden from challenging the MSA in

virtually any way. *Supra* at 4-5. The MSA thus wholly undermines the federalism principle of local control and political accountability as both a constitutional value and a check against abuse. *See Hallie v. Eau Claire*, 471 U.S. 34, 45 n.9 (1985) (distinguishing municipal from private anticompetitive conduct permitted by State because "public scrutiny" of municipalities and being "checked to some degree through the electoral process" may provide some greater protection against antitrust abuses than exists for private parties"). Given the MSA's restrictions, individual States are now subject to the collective authority of the group, have no further meaningful discretion regarding the anticompetitive effects of their decision, and their citizens have no means of holding them accountable through the "electoral process" or "public scrutiny." *Hallie*, 471 U.S. at 45 n.9. And, of course, the four non-MSA States and their citizens have no say whatsoever over the behavior of the MSA States. *See Lafayette*, 435 U.S. at 406 ("consumers living outside the municipality . . . have no recourse at the municipal level").

Indeed, because the MSA is the product of an *agreement* among the States (and private parties), the federalism concerns it implicates are not those of the Tenth Amendment, but rather those of the Compact Clause,

which imposes the precise *opposite* presumption concerning the scope of state authority than does the Tenth Amendment. *See infra* at 44-46.

Finally, *Parker* immunity does not apply where the anti-competitive conduct facilitated by the State is not "actively supervised by the State itself." *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980). The MSA enables and encourages PMs to raise prices at their discretion under their cartel's umbrella, above and beyond any amount needed to make their MSA payments. *Freedom Holdings*, 357 F.3d at 231-32. And the States readily admit that they have no control over such pricing decisions.[30]

The cases cited by the district court in passing have little bearing on the claim at issue here. The appellate decisions cited generally did not address the state-action issue because they dealt with rather different claims subject to different defenses not applicable here. *See KT&G Corp. v. Attorney General of the State of Oklahoma*, 535 F.3d 1114, 1126-30 (10th Cir. 2008) (finding no conflict between Allocable Share Amendments alone and Sherman Act, hence no *Parker* issue; distinguishing claims from other cases because "Plaintiffs are expressly not challenging the MSA and the original escrow statutes"); *Tritent Int'l Corp.* v. *Kentucky*, 467 F.3d 547,

[30] *Levin Dep* at 103 (NAAG representative admitting that "neither NAAG nor the States controls the pricing of these companies [the PMs]"). [R. 1122]

555-58 (CA6 2006) (Escrow Statute alone did not require an antitrust violation hence no conflict and no need to reach *Parker* issue).

In this case, however, plaintiffs have not limited their challenge to the Escrow Statutes or the Allocable Share Amendments alone. Rather, they also challenge the MSA itself; an agreement to which Louisiana is a party and which is plainly a *per se* violation of the Sherman Act absent some immunity. The Escrow Statute and the MSA together are part of a single combination and conspiracy, with the Escrow Statute performing a specific role, pursuant to express agreement, within the larger combination. The Third Circuit treated the MSA as a hybrid restraint, analyzed it under *Midcal*, and held that the lack of active supervision precluded *Parker* immunity (although the court accepted a *Noerr-Pennington* defense for the Majors who petitioned for the MSA). *Bedell*, 263 F.3d at 259-65. The Second Circuit likewise found *Parker* immunity unlikely in light of *Midcal*. *Freedom Holdings*, 357 F.3d at 226-32 (applying *Midcal* test, reversing dismissal, and remanding). In this case challenging the MSA in addition to the Escrow Statute, *Parker* is inapplicable for the same reasons, as well as for the broader federalism reasons discussed above.

IV. THE MSA AND ITS IMPLEMENTING STATUTES REGULATE EXTRATERRITORIAL ACTIVITY AND THUS VIOLATE THE COMMERCE AND DUE PROCESS CLAUSES.

The "Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State." *Healy v. Beer Institute*, 491 U.S. 324, 336 (1989). And under the Due Process Clause, "no principle is better settled than that the power of a State … in respect to property, is limited to such as is within its jurisdiction." *Miller Bros. v. Maryland*, 347 U.S. 340, 342 (1954). Yet the MSA restricts political and commercial speech throughout the nation and imposes assessments on cigarette sales even outside the MSA States. *See supra* at 3-4. Given such extraterritorial charges and regulation, the MSA violates the Commerce and Due Process Clauses. *See* Ian Ayres, *Symposium: Using Tort Settlements to Cartelize*, 34 VAL. U. L. REV. 595, 603 (2000) (MSA is "extraterritorial due process" violation).

The trial court rejected plaintiffs' Commerce and Due Process Clause claims. Mem. at 18. [R2296] The court focused on whether the Escrow Statute discriminated against cigarettes originating in other States, or charged NPMs for cigarettes they sold in other States but that were resold in Louisiana by others. But it completely ignored the direct extraterritorial

price increases and advertising restrictions of the MSA itself and the role the Escrow Statute plays in coercing and enforcing such extraterritorial conduct. Indeed, nothing in the court's opinion has anything whatsoever to do with this aspect of the Commerce and Due Process Clause violations. By contrast, in *Grand River Enterprises v. Pryor*, 425 F.3d 158, 170-173 (2d Cir. 2005), *cert. denied*, 549 U.S. 951 (2006), the Second Circuit expressly recognized the extraterritorial pricing effects of the MSA and reversed a dismissal of a Commerce Clause challenge based on the nationwide price increases caused by the MSA and Escrow Statutes. Having failed to even address this important aspect of plaintiffs' Commerce Clause and Due Process Claims, the district court's decision must be reversed.

V. THE MSA VIOLATES THE COMPACT CLAUSE.

Plaintiffs contend that the MSA violates the Compact Clause of the U.S. Constitution, Art. I, § 10, cl. 3. As interpreted by the Supreme Court, the Clause requires the consent of Congress for any state agreement that tends "to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States," *Virginia v. Tennessee*, 148 U.S. 503, 519 (1883), or that "might affect injuriously the interest of the other[]" States, *Florida v. Georgia*, 58 U.S. 478, 494 (1855). *See also MTC*, 434 U.S. at 471 (endorsing *Virginia v. Tennessee*

formulation). Plaintiffs argued that the MSA (1) plainly "encroaches" on federal authority and state interests and therefore (2) requires, but failed to receive, the approval of Congress. The court below rejected plaintiffs' Compact Clause claim based on the purported "absence of any actual or potential encroachment or interference." Mem. at 11. [R2289] In the alternative, the court held that Congress had consented to the MSA through its "express reference to the MSA" in a 1999 Medicaid amendment that "disclaimed any federal interest in the moneys received" under the Agreement. *Id*. at 11-12. [R2289-90] Both contentions are in error.

A. The MSA Is Subject to the Compact Clause.

The Compact Clause provides that "[n]o state shall, without the Consent of Congress, ... enter into any Agreement or Compact with another State, or with a foreign power." U.S. CONST., Art. I, § 10, cl. 3. By its terms, the Clause prohibits *any* agreement or compact among States that has not been approved by Congress. Despite the broad language of the Clause, the Supreme Court has narrowed its application to agreements "tending to" or that "might" encroach upon the rights and interests of the federal government and sister States. *Virginia v. Tennessee*, 148 U.S. at 519; *Florida v. Georgia*, 58 U.S. at 494.

This narrowing construction, however, cannot be understood to deprive the Compact Clause of *all* constitutional meaning and force. Accordingly, the Clause applies to all state agreements that even potentially encroach upon federal authority and state interests. As the Supreme Court has consistently emphasized, the "pertinent inquiry is one of *potential*, rather than actual, impact upon federal supremacy." *MTC*, 434 U.S. at 472 (emphasis added); *see also Virginia v. Tennessee*, 148 U.S. 519 (agreements "*tending* to" increase state power or that "*may* encroach" on just federal supremacy); *Florida v. Georgia*, 58 U.S. at 494 (agreements that "*might* affect" state interests) (emphasis added); *Rhode Island v. Massachusetts*, 37 U.S. 657, 726 (1838) (intended purpose of the Compact Clause "to guard against the derangement of [compacting States'] federal relations with other States of the Union, and the federal government; which *might* be injuriously affected") (emphasis added). Such focus on potential, rather than actual, encroachment ensures that the approval requirement remains the constitutional rule and exempt agreements the judicially inferred exception.

This consistent interpretation focusing on "potential" encroachment is dictated by both the constitutional text and structure. Actual encroachments upon federal supremacy and sister-States' constitutional interests are already unlawful under an ordinary analysis of the Supremacy Clause and federalism

constraints. "It cannot be presumed," however, "that any clause in the constitution is intended to be without effect." *Marbury* v. *Madison*, 5 U.S. 137, 174 (1803). For the Compact Clause to retain independent force and meaning, it must be understood to cover more than only agreements that involve actual encroachments.

Put differently, the Compact Clause inverts, in the context of interstate "agreements," the usual constitutional default rule, which presumes the authority of any individual State to adopt laws of its own choosing absent affirmative congressional or constitutional preemption. The judiciary presumes that laws adopted by individual States are valid absent proof of a constitutional violation or a clear and express intention by Congress to preempt such laws. But such preemption analysis under the Supremacy Clause or implied or "dormant" constitutional limits "will produce a number of 'false negatives' – that is, unaddressed offenses against national rights and prerogatives," with Congress bearing the burden to correct such results. Michael Greve, *Compacts, Cartels, and Congressional Consent*, 68 MO. L. REV. 285, 317 (2003) . For state compacts, in contrast, the Constitution mandates the opposite, *prophylactic* rule: interstate agreements are presumed *un*constitutional unless and until Congress gives its affirmative consent. The

burden of correcting any "false positives" from that opposite rule – by persuading Congress to grant consent – rests with the States.

The Constitution reserves such prophylactic approval requirements for classes of state activities that the Framers deemed to pose substantial threats to the union, and to sister States, by their very nature: imposts or duties on imports and exports; duties of tonnage; the maintenance of armies in time of peace, *compacts*, and (for good measure) warfare. U.S. CONST., Art. I §10 cl. 2-3. These provisions are generally understood to require approval not merely for the direct objects of their concern, but for any indirect substitutes as well. *See, e.g., Polar Tankers, Inc. v. City of Valdez*, 129 S.Ct. 2277, 2282 (2009) (Tonnage Clause designed to prevent States from taking advantage of a favorable geographic position, and also forbids "a State to 'do that indirectly which she is forbidden … to do directly.'") (citation omitted). The Supreme Court's construction of the Compact Clause cannot be pushed to the point of inverting the carefully crafted constitutional arrangement.

Just that result, however, is embodied in the district court's holding in this case and in the rulings and perfunctory Compact Clause analysis in the MSA cases cited by the court. To find an "absence of any actual or potential encroachment or interference" with federal supremacy or non-member state interests in this case, Mem. at 11 [R2289], is to empty the Compact Clause

of all meaning and force. As shown in the preceding sections, the MSA, in conjunction with the Escrow Statute, presents numerous actual violations of federal supremacy and sister-state interests. It thus violates the Compact Clause: States may not do jointly what none of them may do individually. As explained, however, the reach of the Compact Clause is broader. Even assuming, *arguendo,* that plaintiffs have failed to demonstrate any *actual* violation, the *potential* encroachment is simply beyond reasonable dispute.

Consider, for starters, the MSA's viewpoint-based restrictions on political speech and petitioning: regardless what one makes of any putative defense as to whether such restraints are nominally voluntary or coerced by the Escrow Statute, there is no doubt that the MSA at least has the *potential* of interfering with constitutionally protected speech, including speech *directed toward Congress*. MSA § III; *cf. United States v. Cruikshank*, 92 U.S. 542, 552-53 (1876) (Even prior to 14th Amendment, "petitioning Congress . . .[wa]s an attribute of national citizenship," a right "within the scope of the sovereignty of the United States"); *Crandall v. Nevada*, 73 U.S. 35, 43-44 (1867) (invalidating a state transit tax in part on the ground that it interferes with a citizen's right to "come to the seat of government to assert any claim he may have upon that government" notwithstanding that Congress had the "authority to pass laws" that would preempt Nevada's tax,

but had not done so to the Court's knowledge); *Davies v. Grossmont Union High School*, 930 F.2d 1390, 1394 (9th Cir.) (settlement agreement limiting political participation was contrary to public policy "of the highest order"), *cert. denied*, 501 U.S. 1252 (1991).[31]

A similar analysis applies to the MSA and its implementing statutes' violation of the FCLAA. Ordinary preemption analysis asks whether a state law presents a conflict with, or obstacle to the policy embodied in, a federal law. While the scope of preemption has often divided the Supreme Court, *see e.g. Lorillard*, 533 U.S. at 551-52 FCLAA preempts outdoor advertising ban); *id*. at 591-98 (Stevens, J., dissenting on preemption issue), no such difficulty is present in this case. Apart from the fact that defendant essentially admits that the MSA's advertising restrictions, enforced pursuant to the Escrow Statute, are "based on smoking and health," a *potential* encroachment on federal supremacy arises even from state laws that might eventually survive judicial preemption analysis due to the favorable presumptions applied under such analysis (*i.e.*, the false negatives discussed *supra*, at 45). Viewed differently, while direct federal preemption of an entire field is not to be presumed, the Compact Clause effectively creates

[31] Furthermore, the fact that the First Amendment claim, and others, survived a motion to dismiss is itself some evidence supporting at least the *potential* for encroachment on federal interests.

federal "field preemption" with respect to state *agreements* even absent affirmative congressional occupation of a specific substantive field. Compacts are preempted unless Congress affirmatively approves them, not merely when Congress affirmatively displaces them. The Compact Clause instructs courts to realign their presumptions, emphasizing the reserved congressional power to *withhold* consent, not any presumed state power to act collectively.

The MSA's antitrust violations likewise illustrate the important role played by the Compact Clause in our federal system and the MSA's patent unconstitutionality. As noted *supra* at 39-40, while some appellate courts have questioned whether the Escrow Statutes conflict with the antitrust laws, there is little serious question that the MSA itself would do so absent some affirmative defense. *Freedom Holdings*, 357 F.3d at 226; *Bedell*, 263 F.3d at 248-49. And while the Supreme Court has declined to *affirmatively* enforce federal antitrust law against individual States due to presumptions concerning state sovereignty and federalism, that posture regarding individual state action does not even remotely suggest that *concerted* state

action contrary to the letter of the antitrust laws and the policy therein does not *encroach* upon federal policy and supremacy. [32]

Parker's presumption that an individual State may, absent clearly expressed congressional intent to the contrary, adopt anticompetitive laws does not warrant an inference that States may *combine* to *create* cartels. The Compact Clause commands just the opposite inference: By its terms it reverses the federalism presumptions when two or more States act in concert.[33] Regardless whether such different federalism presumptions are sufficient to limit *Parker* immunity itself to the single-State context, as argued *supra* at 35-39, they certainly clear the far lower hurdle of showing a potential encroachment for Compact Clause purposes. [34]

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[32] Congress' own action in limiting the scope of its approval for anticompetitive compacts that might not otherwise *violate* federal law is telling. It demonstrates that Congress views conflict with federal *policy* interests to have a sufficient potential for concern to come within its Compact Clause authority to grant or withhold consent. *See, e.g.*, 73 Stat. 290 (1959) (requiring periodic resubmission of the Oil & Gas Compact, forbidding state cartels or price stabilization (Art. V), and ordering attorney general to investigate whether it promotes monopoly); Greve, 68 MO. L. REV. at 326-27 (discussing how resubmission requirement checked exploitation by the compacting States).

[33] Failure to enforce the consent requirement forces Congress to take further affirmative action to prevent anticompetitive interstate conduct rather than leaving the burden on compacting States to obtain congressional consent for such conduct. Given that the Constitution purposefully imposes numerous hurdles to final congressional action, shifting the burden of action to Congress *encroaches* on federal supremacy where there is insufficient support *either* to approve or forbid a proposed activity. *See* Greve, 68 MO. L. REV. at 318-19 (explaining constitutional logic and purpose of congressional consent requirement under the Compact Clause).

[34] Any concern for judicial restraint is likewise inapplicable given that the Compact Clause merely requires the permissibility of the agreement to be addressed by Congress, and thus can be viewed as a means of avoiding ultimate resolution of the constitutional

State-action immunity under *Parker* is a judicially inferred exemption from a federal statute that broadly applies to all conduct. The exemption, and hence the *Parker* defense, cannot conceivably apply to compacts among States: *by its terms*, the Compact Clause applies to state action, and nothing but state action. The judicially inferred statutory *Parker* exemption is one thing. A judicial dispensation, inferred from *Parker*, for state conduct that is explicitly disfavored by the Constitution, is a different thing altogether.

Finally, as noted *supra* at 3-4, 41-42, the MSA and its implementing statutes impose a surcharge on *national* cigarette sales and restrict speech and advertising on a *national* basis, including in States that are not parties to the MSA. Even if, *arguendo*, those interferences with the non-MSA States' interests pass Commerce and Due Process Clause muster, the Compact Clause requires congressional approval for such potential encroachments upon sister-state interests. Because the protection of States against sister-state discrimination and aggression is a national concern of the highest order, those interests have always been viewed as a central Compact Clause objective. *See supra* at 43-44; *Port Authority Trans-Hudson Corp. v.*

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and statutory issues presented. *Cf. Bartlett v. Strickland*, 129 S.Ct. 1231, 1247 (2009) (applying "canon of constitutional avoidance" to avoid "serious constitutional concerns under the Equal Protection Clause"). A decision finding the MSA subject to the Compact Clause merely shifts the forum of substantive debate regarding the legal and policy implication of the MSA back to Congress, where it belongs, and allows this Court to avoid a rigid resolution of at least some of the questions discussed above.

Feeney, 495 U.S. 299, 315 (1990) (purpose of Compact Clause is to "ensure that whatever sovereignty a State possesses within its own sphere of authority ends at its political border"). The Compact Clause accomplishes this objective by mandating the examination and approval of the collective designs of *some* States by the only body where *all* States are represented – the United States Congress. To eviscerate that requirement is to eviscerate an important political safeguard of federalism.

In holding that the MSA did not even potentially encroach upon federal authority, the district court relied on the Fourth Circuit's decision in *Star Scientific*, 278 F.3d at 360, which in turn relied upon the Supreme Court's decision in *MTC*, upholding an interstate compact aimed at coordinating state taxation of multistate businesses. Mem. at 10-11.

Star Scientific is untenable.[35] Its brief discussion of the Compact Clause failed to recognize that the issue was one of potential rather than actual encroachment, and treated the fact that Congress could preempt the agreement with future legislation as sufficient to resolve the issue. 278 F.3d at 360. As noted, however, that gets things backwards and places the burden

[35] The two district court decisions cited below add nothing beyond what has already been discussed in connection with *Star Scientific* and *MTC*. *See Mariana v. Fisher*, 226 F.Supp.2d 575, 586-87 (M.D. Penn. 2002) (simply repeating the arguments and errors of *Star Scientific*), *aff'd on other grounds*, 338 F.3d 189, 198 (3d Cir. 2003), *cert denied*, 540 U.S. 1179 (2004); *PTI*, 100 F.Supp.2d at 1198 (MSA gives no powers States could not exercise individually).

on Congress to affirmatively preempt compacts, rather than on States to seek approval. If the mere possibility of congressional preemption eliminated even the *potential* for encroachment, no agreement would *ever* be subject to the Compact Clause.

In addition, *Star Scientific* failed to recognize, let alone discuss, the salient differences between the MSA and the compact at issue in *MTC*. The MSA constitutes a far greater potential encroachment on both federal and state interests. The Supreme Court's decision in *MTC* rested centrally on the loose, non-coercive nature of the multi-state agreement at issue. States could (and did) withdraw unilaterally at any time. *MTC*, 434 U.S. at 454 n.1, 457. Given the exit threat, coordination remained voluntary: each participating State "retain[ed] complete freedom to adopt the rules and regulations" of the MTC or any other procedures it desired, "just as it could if the compact did not exist." *Id*. at 473, 477-78.[36] The MSA is the polar opposite in this constitutionally critical dimension. It effectively coerced States into joining, compels them to "diligently" enforce its terms, continues in perpetuity, and prohibits withdrawal or any challenge to its terms and various decisions made thereunder. *Supra* at 5-7.

[36] Additionally, the MTC provided voluntary coordination in *furtherance* of constitutional and federal concerns regarding multiple taxation of interstate businesses. *MTC*, 434 U.S. at 455-56.

The suggestion in *Star Scientific* and by the court below, 278 F.3d at 260; Mem. at 10 [R2288], that the MSA, like the MTC, enabled nothing the individual States could not do on their own is simply wrong. Individual States could not possibly exercise the type of coercive power the MSA provides with respect to sister States. Similarly, absent the MSA, the market regulation aspects and market-share protection would be impossible to enforce. Further, an individual State on its own could not eliminate subsequent political changes or lobbying by others state participants without the interstate obligations contained in the MSA.

The MSA thus plainly enables a group of States to enhance their power vis-à-vis each other, non-MSA States, and the federal government in ways they could not hope to accomplish without such an enforceable agreement.

B. The MSA Did Not Receive Congressional Approval.

There is no dispute that the MSA was never submitted to Congress as an interstate compact, evaluated by Congress as such, or approved as such. Indeed, the only thing ever submitted to Congress was a proposed precursor to, and close cousin of, the MSA, which raised serious antitrust concerns and died on the Senate floor without ever reaching the House. *See* 143 CONG. REC. S12003 (Nov. 7, 1997) ("[T]he bill we are introducing today [S. 1415]

is the legislative version of the Universal Tobacco Settlement agreed upon by the attorneys general and the tobacco companies"); 144 CONG. REC. S6479-S6481 (June 17, 1998) (resistance to bill, which dies in Senate); FTC, *Competition and the Financial Impact of the Proposed Tobacco Industry Settlement* (Sept. 1997) at ii, v-vi (antitrust objections that proposal would have allowed the Majors to raise their prices to monopoly levels).

Contrary to the district court's alternative holding, Congress did not implicitly consent to the MSA through its "express reference to the MSA" in an obscure 1999 Medicaid amendment that "disclaimed any federal interest in the moneys received" from "any individual state settlement or judgment" or any of the multistate tobacco agreements entered into in "November 1998," which includes the MSA. Mem. at 11-12 [R2289-90]; 42 U.S.C. § 1396b(d)(3)(B)(i)&(ii) (1999). That Amendment merely exempted such settlement money – which supposedly compensated the States for their Medicaid payments for smoking-related illnesses – from the federal government's right to recoup from the States its share of any reimbursed Medicaid payments. Such a passing reference only to the disposition under the Medicaid rules of monies received from the MSA is wholly inadequate to constitute congressional "consent" to the MSA itself.

First, the Medicaid amendment was buried in an obscure appropriations rider amending a similarly obscure subsection of the Medicaid law. It addressed only the treatment of MSA receipts under such law, never mentioned any of the other questionable and intrusive portions of the MSA, and never employed the language of approval. Indeed, the amendment was introduced before the MSA was adopted and was not originally addressed to the MSA at all, but rather to individual state settlements. *See* H.R. 2938, 105th Cong., 1st Sess. (Nov. 8, 1997) (Medicaid amendment introduced by 6 representatives from Florida, which had entered into its own earlier tobacco settlement). There is no evidence that Congress even considered the substance of the MSA or the Compact Clause implications of its actions. *Cf. Baber v. First Republic Group*, 2008 WL 2356868, *22 (N.D. Iowa 2008) (ratification requires clear and convincing evidence of intent and full knowledge of material facts). As the Supreme Court has observed, Congress does not "hide elephants in mouse holes," *Whitman v. American Trucking Ass'n*, 531 U.S. 457, 468 (2001).

That the amendment was put in the particular mouse hole of a rider to an appropriations bill further confirms that courts should not draw any broad inferences from its passage. *See TVA v. Hill*, 437 U.S. 153, 189-93 (1978) (appropriations bills are presumed not to enact substantive changes to the

law); *In re Endo*, 323 U.S. 283, 303 n.24 (1944) (Congressional funding of detentions did not constitute "Congressional ratification"); *Greene v. McElroy*, 360 U.S. 474, 506-07 (1959) (Congressional funding of Defense Department security procedures did not constitute "implied ratification" of them); *Buck Hill Falls v. Gant*, 537 F.2d 29, 35 n.12 (2d Cir. 1976) ("appropriations acts generally cannot" constitute "ratification of prior agency acts").

And, just as congressional funding of an activity does not imply "ratification" of the activity itself, so too, congressional forbearance in collecting revenue from an activity does not condone or consent to the activity itself. For example, while Congress allows taxpayers to take a deduction for expenses associated with certain illegal activity, it plainly does not thereby consent to or approve the underlying activity.[37]

Second, given the state sovereignty consequences of congressional compact approval, approval must not be implied absent clear evidence of intent to do so. For example, congressional approval of a compact significantly diminishes States' sovereignty by partially abrogating their

[37] *See Lilly v. Commissioner*, 343 U.S. 90 (1952) (unethical rebates were deductible); *Jerry Rossman Corp. v. Commissioner*, 175 F.2d 711, 715 (2d Cir. 1949) (civil penalty was tax-deductible); *Commissioner v. LaRosa*, 2003 FCAFC 125 (Fed. Ct. Aus. 2003) (taxpayer could deduct costs of earning income through illegal activity).

immunity from suit and curbing their lawmaking powers.[38] Such abrogation or surrender of sovereignty may not be lightly implied and may only be found from clear and unmistakable congressional intent.[39]

Third, any implication of consent is countered by the existence, in 1999, of the Tobacco Control Act ("TCA"), a provision of which expressly disavowed consent to "any compact for regulating or controlling the production of, or commerce in, tobacco for the purpose of fixing the price thereof, or to create or perpetuate monopoly, or to promote regimentation." 7 U.S.C. § 515.[40] The FCLAA likewise expressly prohibited state restrictions on cigarette advertising, again countering any inference of consent. Repeal of existing legislation, like abrogation or surrender of sovereignty, is not to be found by implication.

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[38] *See Hess v. Port Authority Trans-Hudson Corp.*, 513 U.S. 30, 40-42 (1994) (Congressionally-approved compacts lose their Eleventh Amendment sovereign immunity); *West Virginia ex rel. Dyer v. Sims*, 341 U.S. 22, 28 (1951) (federally-approved compacts override contrary state law).

[39] *Dellmuth v. Muth*, 491 U.S. 223, 227-28 (1989) (because "abrogation of sovereign immunity upsets 'the fundamental constitutional balance between the Federal Government and the States,' " Congress's "intention" to "abrogate the States' immunity" must be " 'unmistakably clear' ") (citation omitted); *International Union, Local 542 v. Delaware River Joint Toll Bridge Comm'n*, 311 F.3d 273, 276 (3d Cir. 2002) ("By compacting together," states have "surrendered a portion of their sovereignty": "the Supreme Court has stated that courts should not find a surrender unless it has been 'expressed in terms to plain to be mistaken'") (citation omitted).

[40] In 2004, long after the MSA's execution, Congress repealed the TCA as a whole as part of its repeal of tobacco price supports. PUB. L. 108-357, Title VI, § 611(c), Oct. 22, 2004, 118 STAT. 1522. Nothing in the legislative history of the so-called tobacco-buyout bill suggests the repeal was enacted with the MSA in mind.

Fourth, the suggestion that the MSA constitutes a federally-approved interstate compact is at odds with the position of MSA signatories and the consistent holding by courts that the MSA's interpretation is a matter of *state* law.[41] Congressional ratification of a compact "transforms the State's agreement into federal law," making its "interpretation" a "question of federal law." *Cuyler v. Adams*, 449 U.S. 433, 440, 442 & n.10 (1981).[42] The treatment of the MSA as a creature of state law rebuts any suggestion that it has been ratified by Congress, by implication or otherwise.

The cases cited by the court below are not to the contrary, and do not permit a finding of Congressional after-the-fact ratification based on such meager indicia of consent. *Cuyler* did not involve after-the-fact ratification at all, since it upheld a 1956 anti-crime compact based on Congress's *prior* express consent in 1934 to anti-crime compacts. 449 U.S. at 441. *Virginia v. Tennessee* involved a boundary compact that did not potentially encroach on federal sovereignty and had been used by Congress itself for more than a century for the very purpose of drawing district boundaries. 148 U.S. at 521-22. *Green v. Biddle*, 21 U.S. 1, 87 (1823), involved the carving of

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[41] *See, e.g., State v. Philip Morris*, 217 P.3d 475, 480 (Mont. 2009) (construing MSA under Montana law); *Ieyoub v. Philip Morris, Inc.*, 982 So.2d 296, 299-300 (La. App. 3 Cir. 1998) (applying Louisiana law).

[42] *Accord New York v. Hill*, 528 U.S. 110, 111 (2000) ("a congressionally sanctioned interstate compact ... is a federal law subject to federal construction.").

Kentucky out of Virginia, which Congress necessarily ratified by admitting Kentucky to the Union, showing consent "not by a mere tacit acquiescence, but by an express declaration of the legislative mind." The supposed consent found by the district court here is a far cry from the explicit, if anticipatory, consent in *Cuyler*, or the absolutely unavoidable implications in *Virginia* and *Green*.

Because the MSA and its implementing legislation involve, at a minimum, such clear *potential* for encroachment on federal authority and state interests and lack the express or necessarily implied approval of Congress, they violate the Compact Clause. Indeed, if the MSA's interstate scheme does not violate the Compact Clause, nothing does.

CONCLUSION

For the reasons set forth above, plaintiffs ask this Court to reverse the order below, grant summary judgment for plaintiffs, and enjoin the MSA and Louisiana's Escrow Statute. In the alternative, plaintiffs ask the Court to remand this case for trial.

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CERTIFICATE OF COMPLIANCE

Undersigned counsel certifies that this original appellants' brief complies with the type-volume limitation of Rule 32 of the Federal Rules of Appellate Procedures. This brief, excluding those portions specified in the Rule, contains 13,996 words in proportionally spaced font.

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ECF CERTIFICATIONS

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Undersigned counsel of record does hereby certify that on the 25th day of January, 2010, he served, electronically a copy of the foregoing Opening Brief of Appellants on:

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