IN THE SUPREME COURT OF MISSOURI

No. SC95422

STATE OF MISSOURI ex rel. JEREMIAH W. (JAY) NIXON,

Appellant/Cross-Respondent

v.

AMERICAN TOBACCO CO., et al.,

Respondents/Cross-Appellants

Appeal from the Circuit Court of the City of St. Louis
The Honorable Jimmie M. Edwards, Circuit Judge

SUBSTITUTE REPLY BRIEF OF RESPONDENTS/CROSS-APPELLANTS CERTAIN SUBSEQUENT PARTICIPATING MANUFACTURERS

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I. Missouri's New Collateral Estoppel Argument Is Without Merit

Missouri has raised a collateral estoppel argument for the first time in this appeal. It claims that because Pennsylvania and Maryland intermediate courts of appeals held that the pro rata method was irrational and erroneous under those States' standards for reviewing arbitration awards, this Court must follow those decisions. MO Br. 16-26.

However, as the OPMs' brief points out in detail, the issues that the Maryland and Pennsylvania courts addressed were different, rather than "identical" as required for collateral estoppel. *See Batson v. Shiflett*, 602 A.2d 1191, 1202 (Md. 1992); *Office of Disciplinary Counsel v. Duffield*, 644 A.2d 1186, 1189 (Pa. 1994); *accord State v. Rodden*, 728 S.W.2d 212, 220 (Mo. banc 1987).[1] Both Pennsylvania and Maryland applied their own more lenient state-law standards for whether trial courts may vacate arbitration awards, rather than the very narrow Federal Arbitration Act standard that Missouri concedes applies here. Mo Brief at 14, 29-34. Pennsylvania applied a state law standard permitting reversal if the award is "contrary to law," and vacated the panel's decision because the court

[1] The law of the state where the decision was entered governs whether collateral estoppel applies. *Strobehn v. Mason*, 397 S.W.3d 487, 494 (Mo. App. W.D. 2013).

believed it "departed from the MSA's clear and unambiguous language." *Pennsylvania v. Philip Morris USA, Inc.*, 114 A.3d 37, 57-58, 65 (Pa. Commw. Ct. 2015) (applying 42 Pa. Code § 7302(d)(2)). Maryland also applied its state law standard and vacated because the court believed the panel's decision "lacked rationality." *Maryland v. Philip Morris, Inc.*, 123 A.3d 660, 675-76, 680 (Md. Ct. Spec. App. 2015) (applying Md. Code § 3-224(b)(3)). Under the FAA standard applicable here, no such merits review is permitted. *See Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064 (2013).

Moreover, as the OPMs also point out, non-mutual collateral estoppel does not apply when the prior decisions are "inconsistent." Restatement (Second) of Judgments § 29(4), cmt. f; *Garrity v. Md. State Bd. of Plumbing*, 135 A.3d 452, 459-61 (Md. 2016); *Office of Disciplinary Counsel v. Kiesewetter*, 889 A.2d 47, 51-52 (Pa. 2005); *Bi-State Dev. Agency v. Whelan Sec. Co.*, 679 S.W.2d 332, 335-37 (Mo. App. E.D. 1984); *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 330-31 (1979). That is the case here, because the Colorado court reached the opposite result from the Pennsylvania and Maryland courts, refusing to vacate the panel's *pro rata* decision. *See Colorado v. R.J. Reynolds Tobacco Co.*, No. 1997CV3432 (Colo. Dist. Ct. Feb. 11, 2014) (final because Colorado did not appeal) (LF 1136-40). In addition, the Court of Appeals *in Missouri* reached the same inconsistent result as the Colorado court, reasoning that "it is clear from the Panel's Stipulated

Partial Settlement and Award that the Panel took its decision-making role seriously, reviewed the post-settlement judgment reduction law, and made its decision carefully," noting it was not suggesting that the panel's decision was incorrect, and holding that the award could not be vacated under the "very limited scope of review" required by *Oxford Health* and the FAA. OPM Appx. A28-A47. It would be an odd result indeed if this Court was required by two out-of-state intermediate appellate decisions to reach a result different than Missouri's own intermediate appellate court.

At a more general level, it would be fundamentally unfair for non-mutual collateral estoppel to apply to individual state court decisions under the MSA. That is because the MSA requires all litigation[2] – including disputes common to a number of States – to be conducted on a state-by-state basis in individual State MSA courts. MSA § VII (LF 993-94). *Accord* Mo. Brief at 4 ("Most disputes under the MSA are committed to the exclusive jurisdiction of a designated state court"). Accordingly, as here, the PMs will inevitably find themselves litigating the same issue with a number of different States in their State courts, with the possibility of different results in different courts. The PMs are parties to *all* those individual State court proceedings, while each State is party only to *its own* State court proceeding. Applying collateral estoppel to State court determinations in this

[2] Not including issues that the MSA requires to be arbitrated.

circumstance would give the States a massive and unfair structural advantage – the PMs would be bound in every State court by a single adverse State court ruling, while each State would remain free to litigate the issue afresh in its own State court. In other words, if collateral estoppel applies as Missouri suggests, the States would only have to win an issue once, in one forum, for that decision to bind the PMs in all State courts, while the PMs could never bind the States and would have to win the issue in all 52 MSA courts. In addition, all the other State courts would unable to interpret and apply the MSA themselves, contrary to the parties' bargain.

In light of this fundamental unfairness imposed by the MSA's structure, the Connecticut MSA court rejected application of collateral estoppel, noting the advantage it would give the States and the incentive for forum-shopping it would create. Applying collateral estoppel, the court held,

> would place an undesirable premium on finding a generally favorable forum, litigating all claims of nationwide significance before it, and then transporting the results across State lines to impose them elsewhere. That of course, would afford a considerable advantage to the Settling States, which could require all Participating Manufacturers to litigate any such issue in the court of one State without themselves being exposed to the requirement of litigating issues before any one tribunal with power over all the States.

Connecticut v. Philip Morris, Inc., 2005 WL 2081763, at *32 (Conn. Super. Ct. Aug. 3, 2005). *Accord* Restatement (Second) of Judgments § 28(3) (issue preclusion does not apply when a "new determination of the issue is warranted by … factors relating to the allocation of jurisdiction between" the forums); *id.* § 29 (non-mutual collateral estoppel does not apply when "[t]reating the issue as conclusively determined would be incompatible with an applicable scheme of administering the remedies in the actions involved;" or "compelling circumstances make it appropriate that the party be permitted to relitigate the issue.").

Indeed, the MSA itself expressly recognizes that the MSA courts likely will reach (and, indeed, often have reached, as discussed in the OPMs brief) inconsistent decisions, and directs the parties to attempt in good faith to work through such inconsistencies. MSA § VII(f) (LF 994). As the Connecticut court recognized, the fact that the MSA "expressly contemplates" the process of resolving inconsistencies among State courts confirms that the parties did not anticipate a "one strike you're out" rule applying against the PMs but not the States:

> [T]he application of collateral estoppel in the context of this multi-jurisdictional agreement would be inconsistent with the parties' reasonable expectations that the Courts of the individual Settling States would make different interpretations of the MSA which all parties would have to use

> "best efforts" to resolve by a common process of negotiation and compromise. Permitting the application of collateral estoppel as to such interpretive issues would prevent individual State Courts from considering such matters separately, effectively undermining their exclusive power to enforce and implement the MSA as to their own States.

Id.

The unfairness of applying non-mutual collateral estoppel to MSA cases is plainly illustrated here. Under Missouri's view, on the *pro rata* issue that the PMs have appealed, the PMs would be bound by the Maryland and Pennsylvania decisions even though the PMs won the issue in Missouri's intermediate appellate court and in Colorado. In contrast, Missouri would *not* be bound on the issue that the single-state arbitration issue that Missouri has appealed, even though other State courts have unanimously rejected State claims to single-state arbitrations.

II. Missouri Concedes That The Trial Court Could Not Modify The Settlement Award Based On Its View That The Award Was "Clearly Erroneous"

Missouri either concedes or entirely fails to address a number of points that doom its argument that the trial court correctly applied the Federal Arbitration Act ("FAA") to modify the arbitrators' settlement award:

- Missouri concedes that the FAA standard of review governed the trial court's review of Missouri's motion to vacate. Mo. Brief at 14, 29-31.

- Missouri concedes that the governing Supreme Court case on the FAA standard of review is *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064 (2013) Mo. Brief at 33-34.

- Missouri concedes that under *Oxford Health* and other Supreme Court authority, a trial court may not vacate an arbitration award if the arbitrators were "even arguably construing or applying" the contract before them. *Id.* at 34.

- *Oxford Health* further confirms, in a holding that Missouri does not question, that "convincing a court of an arbitrator's error – even [a] grave error – is not enough." 133 S.Ct. at 2068-71 (court may not "correct [arbitrators'] mistakes" but rather "the arbitrator's construction holds, however good, bad, or ugly").

- Missouri recognizes, as it must, that the basis of the trial court's modification of the panel ruling was its finding that the panel's decision was "clearly erroneous." Mo. Br. at 31, 32; Op. at 7 (LF 2399). In other words, the trial court "correct[ed]" the arbitrators' "mistakes" – a result expressly forbidden under the FAA and *Oxford Health*.

- Finally, Missouri does not even mention, much less dispute, that the MSA requires arbitrations to be "binding," further demonstrating that the parties

did not intend for any merits-based error review of the arbitrators' determinations. MSA § XI(c) (LF 332); SPM Opening Br. at 6-7 (citing definitions and cases).

Based on those concessions and undisputed principles, this Court should find that the trial court erred when it modified the award as "clearly erroneous."

III. Missouri's Arguments To The Contrary Have No Merit

This Court should reject Missouri's last-ditch argument that the trial court really didn't mean what it said when it modified the award as "clearly erroneous," but rather actually applied the correct FAA standard. There is no indication in the opinion that the trial court did not mean exactly what it said.

The Court should also reject the State's suggestion that the trial court reached its holding that the panel's determination was "clearly erroneous" solely on its conclusion that the panel "amended," rather than interpreted, the MSA. That argument ignores not only the panel's own careful and detailed explication of how it interpreted the MSA, but also the trial court's own characterization of the panel's determination. The trial court expressly recognized that the MSA did *not* address how reallocation would work upon a settlement, and explained further that the panel "concluded that the pro rata adjustment complied with the MSA and was the equitable way to determine the reallocation." Op. at 6-7 (LF 2398-99). This "effectively amended" MSA § IX(d)(2), the trial court held, "since the signatory

states are no longer subject to the NPM Adjustment and do not have to prove their diligent enforcement ." *Id.*

The States' attempt to parlay this into a holding in which the trial court did *not* in fact consider the merits of the panel's decision notwithstanding the trial court's own words is semantic gamesmanship. Every court or party that disagrees with an interpretation of a contract sees that interpretation as changing, or amending, the contract. Here, the panel concluded that MSA § IX(d)(2) did not require that all states "prove" their diligence (or have their diligence "determined"), but rather permitted the pro rata method of reallocation. The trial court believed instead that MSA § IX(d)(2) required the signatory states "to prove" their diligent enforcement, and concluded that the panel's "pro rata allocation method was clearly erroneous." And Missouri similarly now contends that MSA § IX(d)(2) required the diligence of the signatory states to be "determined," so the panel's determination should be vacated on that ground. This is absolutely merits review, which Missouri concedes is improper under *Oxford Health*.

This Court should also reject Missouri's related argument that what the trial court was trying to say when it held the panel's determination "clearly erroneous" was that the panel exceeded its jurisdiction by (allegedly) holding that it could amend the MSA without all parties' consent contrary to MSA § XVIII(j). This again ignores what the panel actually did. *The States* raised MSA § XVIII(g)

before the panel, as an objection to its consideration of the reallocation issues raised by the partial settlement. As it made perfectly plain, however, the panel did *not* rely on MSA § XVIII(g) to amend the MSA, but rather, in the face of the MSA's silence on the effect of a partial settlement, looked at the contract provision and generally-accepted background law and interpreted the contract, in light of its language, structure, and background law, to allow the *pro rata* method. It addressed the amendment issue under MSA § XVIII(g) only in the context of rejecting the States' objection. LF 252, 255. Missouri is now incorrectly trying to mischaracterize the panel's rejection of its own objection based on MSA § XVIII(g) – which the panel of course had to deal with – as an affirmative decision by the panel to amend the MSA under that section.

Here again, moreover, the State apparently rejects the trial court's reasoning, since the trial court held that "the issue is clearly within the scope of the arbitration agreement," reasoning that "[b]ecause the partial settlement related to the NPM Adjustment , any disputes regarding the partial settlement were themselves subject to arbitration. Op. at 6 (LF 2398); *id.* at 7 ("the panel had authority to determine the reallocation method") (LF 2399).

As the trial court correctly recognized, the MSA requires arbitration of all disputes "arising out of or related to" payment calculations under the MSA, including without limitation the "operation and application" of "adjustments" and

their "allocation[]." MSA § XI(c) (LF 1029, 764). Under this language, the arbitrators were *required* to address how the NPM Adjustment would be allocated, including in the circumstance of a partial settlement. Moreover, they were required to do so as a matter of practical necessity – the allocation determination was necessary for the MSA's Independent Auditor, which calculates MSA payments, to do its job and allocate the NPM Adjustment among States.[3]

IV. Missouri Never Asked The Panel to Determine The Signatory States' Diligence, and It Certainly Did Not "Refuse" to Do So

Missouri also places great weight on an argument that although it asked early in the proceedings to have the opportunity to contest the diligence of any State if the PMs stopped contesting it, it allegedly was never provided with the opportunity to do so in connection with the settlement. Even apart from the legal error in that argument – that the panel properly interpreted the MSA to provide for the *pro rata* judgment-reduction method rather than diligence determinations for the Signatory States – the argument is not factually accurate. The PMs themselves proposed an option to the panel that would have given Missouri exactly what it is now saying should have occurred, a determination as to the diligence of all the Signatory States. This option was the "proportionate fault" model, one of the recognized methods for addressing judgment reduction proposed by the PMs.

[3] The SPMs join in the arguments in the OPMs' reply brief filed today as well.

Under that model, the fact-finder assesses the actual potential liability of the settling parties and deducts that amount from the potential remaining liability of the rest. This would have given Missouri exactly what it says the MSA requires and it was deprived of.

However, Missouri and the other states refused to say which of the judgment reduction methods they preferred, and were at best extremely equivocal on whether they would actually dispute the diligence of the Signatory States if the panel gave them the opportunity. *See* OPM Reply Br. at 16. Their preference, then as now, was simply to assume the Signatory States were all not diligent – with no basis in fact – to obtain a windfall reduction. Notably, though it had every opportunity to do so, Missouri never affirmatively asked that the panel determine all the States' diligence, never said it would contest any other States' diligence, and never referred back to what it now characterizes as the panel's early promise to allow it to do so. It has, therefore, waived the right to now insist that the panel should have engaged in such determinations.

CONCLUSION

This Court should reverse the trial court order to the extent that it modifies the Settlement Award and reinstate the panel's *pro rata* judgment-reduction ruling.

Dated: August 31, 2016

Respectfully submitted,

/s/ Jonathan F. Dalton

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CERTIFICATE OF SERVICE AND COMPLIANCE

A copy of this document was served on counsel of record through the Court's electronic notice system on August 31, 2016.

This brief includes the information required by Rule 55.03 and complies with the requirements contained in Rule 84.06. Relying on the word count of the Microsoft Word program, the undersigned certifies that the total number of words contained in this brief is 3,005, excluding the cover, signature block, and this certificate.

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/s/ Jonathan F. Dalton