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

SUR-REPLY OF RESPONDENTS/CROSS-APPELLANTS R.J. REYNOLDS TOBACCO COMPANY AND PHILIP MORRIS USA INC.

Jeffery T. McPherson #42825
ARMSTRONG TEASDALE LLP
7700 Forsyth Blvd., Suite 1800
St. Louis, MO 63105
(314) 621-5070
jmcpherson@armstrongteasdale.com

Peter J. Biersteker, *pro hac vice*
Hashim M. Mooppan, *pro hac vice*
JONES DAY
51 Louisiana Ave., NW
Washington, DC 20001
(202) 879-3939
pbiersteker@jonesday.com
hmmooppan@jonesday.com

Attorneys for R.J. Reynolds Tobacco Company,
for itself and as successor-by-merger to Lorillard Tobacco Company,
and, with permission, also on behalf of Philip Morris USA Inc.

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Although Missouri's extra-record arguments in its Reply Brief involve several errors or material omissions of fact, which Respondents/Cross-Appellants R.J. Reynolds Tobacco Company and Philip Morris USA Inc. ("OPMs") detail below, the arguments have a common, fundamental flaw: They ignore that, for 2004, "as in 2003," "the dispute" that "arose when the Independent Auditor refused to apply the NPM Adjustment at the request of" Missouri and the other MSA States is "a multistate concern," for which "multistate arbitration is the only reasonable interpretation" of the MSA's text and structure. *Commonwealth ex rel. Kane v. Philip Morris, Inc.*, 128 A.3d 334, 350–51, 355 (Pa. Commw. Ct. 2015). That text and structure control under the contract law governing arbitration agreements. *E.g.*, *id.* at 349, 355; *Dunn Indus. Grp., Inc. v. City of Sugar Creek*, 112 S.W.3d 421, 428 (Mo. 2003) (en banc) (per curiam).

And because any question "[w]hether a particular State diligently enforced its qualifying statute" is "just one part" of that dispute, the MSA's text and structure require such questions to be committed to multistate arbitration. *Kane*, 128 A.3d at 351. That was the basis on which the courts, agreeing with the PMs, overwhelmingly ordered a multistate arbitration of the 2003 NPM Adjustment. *See* OPM Resp. 5–6, 36–41. And that has been the basis on which every trial and appellate court (except the Court of Appeals below), agreeing with the PMs, has ordered a multistate arbitration of the 2004 NPM Adjustment. *See id.* at 14–16.

Thus, as a matter of law, the particular extra-record facts said by Missouri in its Reply to bear on the nascent 2004 arbitration proceeding could not override the MSA's text and structure. If, however, those facts have any relevance, they *confirm* the PMs' position on what the MSA's text and structure require. As detailed below, the PMs, joined by a large majority of the MSA States that continue to dispute the PMs' entitlement to a 2004 NPM Adjustment, are now carrying out a multistate arbitration proceeding to resolve that dispute.

I. Missouri's Extra-Record Factual Arguments Are Irrelevant.

In its Opening Brief, Missouri opposed a multistate arbitration for the 2004 NPM Adjustment by alleging that it suffered "inequities" and "prejudice" in the 2003 arbitration and would again in a multistate 2004 arbitration. The OPMs' Response showed that those allegations were not only wrong but also, more fundamentally, irrelevant, because they could not override the MSA's terms and structure. OPM Resp. 45–46. It established this under both the Federal Arbitration Act (which requires courts to rigorously enforce arbitration agreements according to their terms) and decisions of this Court (which apply "'[t]he usual rules and canons of contract interpretation'"). *Id.* at 46 (quoting *Dunn*, 112 S.W.3d at 428).

The State in its Reply ignores this showing. Instead, it adds more irrelevancies. This is most pronounced in its Argument I.A. That is where the State most heavily relies on the extra-record facts (the supposed "current record")

in its additional Appendix. The State in those five pages (11–16) also cites not one case. Missouri thus does not attempt to show why these extra-record factual allegations are legally relevant, nor could it. In any event, as explained below, its new factual arguments also are wrong on their own terms.

II. Missouri's New Factual Arguments Regarding The States That *Have Settled* The 2004 NPM Adjustment Dispute With The PMs Are Wrong.

Twenty-five MSA States have settled the 2004 NPM Adjustment dispute (among others) with the PMs. Twenty-four of them settled by signing or joining a "Term Sheet." *See* OPM Resp. 9–10, 46; A-22, A-30, A-32.[1] Missouri too became a "Signatory State" to the Term Sheet, but its joinder was conditioned on enacting certain legislation, which the State failed to do. *See* A-26, A-32.

The OPMs' Response showed that, notwithstanding Missouri's contentions, this Term Sheet settlement has no bearing on whether those MSA States that have *not* settled the 2004 NPM Adjustment dispute must join a multistate arbitration. *See* OPM Resp. 46–50. In particular, under the Term Sheet and the MSA, there will not be "any *separate* arbitration with the Signatory States for 2004." *Id.* at 48. Indeed, every court that has held, unequivocally, that the MSA requires a

[1] "A-_" citations, unless otherwise noted, are from the State's Appendix to Substitute Reply Brief.

multistate arbitration of the 2004 dispute knew of and mentioned the Term Sheet settlement. *E.g.*, *Kane*, 128 A.3d at 348 (noting settlements); *id.* at 351 ("All of the [MSA] States that did not settle . . . share the same interest in upholding the Independent Auditor's refusal to apply the 2004 NPM Adjustment."); *id.* ("[T]he non-settling [MSA] States are squarely aligned on the same side of the dispute."); *Maryland v. Philip Morris, Inc.*, 123 A.3d 660, 668–70, 683–86 (Md. Ct. Spec. App. 2015) (detailing Term Sheet before denying motion for single-state arbitration), *cert. denied*, 446 Md. 293 (2016).

Rather than responding, Missouri just reiterates its prior assertions (MO Reply 6, 20) and adds what appear to be two new factual arguments. Both rest on misstatements and therefore fail.

First, Missouri now attempts, at length, to argue for a single-state arbitration for itself based on the PMs' settlement with the State of New York a year ago, in October 2015. *Id.* at 1, 4, 12–14. A copy of that Settlement Agreement is the first item in Missouri's extra-record, additional Appendix. *See* A-1 – A-20. Yet Missouri is wrong, repeatedly, about what that document says.

Missouri primarily asserts that "any future NPM Adjustment disputes will be arbitrated in a single-state proceeding solely between New York and the PMs." MO Reply 1. But the sub-section of the Settlement Agreement from which Missouri selectively quotes for this assertion just says that "disputes *under this*

Agreement shall be resolved through binding arbitration between the interested PMs (as a side) and New York (as a side)." *Cf.* A-13 (emphasis added), *with* MO Reply 14. It thus does not concern disputes *under the MSA*, such as "any future NPM Adjustment disputes."

Two other provisions, both of which Missouri ignores, do address that subject, and they confirm the State's error: With respect to the NPM Adjustment at issue in this appeal, 2004 (as well as further Adjustments through 2014), the PMs and New York have *unconditionally settled*. *See* A-11 (§ IV.A, "Release by the PMs"). There is nothing to arbitrate between them. With respect to the NPM Adjustment for much later years (2015 and beyond), the PMs and New York also have settled. They did include a condition, under which the PMs might in some years receive an option to seek an NPM Adjustment from that State. *See* A-7 – A-8 (§ III.B.10). But if that condition is met, and if the PMs exercise that option, "the PMs' claim to apply the NPM Adjustment to New York will be *subject to all procedures, standards and exemptions under the MSA*" (together with agreements settling three issues for all years). *Id.* (emphasis added).

Missouri also asserts, without quoting the Settlement Agreement, that the PMs and New York have agreed "that 2004-2014 NPM Adjustment liability will be calculated" using an "*all non-diligent*" rule. MO Reply 13 n.8. But the provision to which Missouri refers simply defines a term, "Potential Maximum

NPM Adjustment," that New York and the PMs have agreed to use in calculating certain *settlement payments*. *See* A-2. It is therefore irrelevant here.

Second, Missouri asserts that the 2003 arbitration Panel, in issuing its Settlement Award regarding the Term Sheet, gave direction that the Auditor "will no doubt consult" in "calculating the 2004 NPM Adjustment," which Missouri claims will somehow undermine the ability to have "a 'single decision maker' or a 'nationwide arbitration' regarding the 2004 NPM Adjustment." MO Reply 12. Missouri's premise, however, is false: The language that the State now quotes for the first time from the Settlement Award concerns the 2003 Panel's jurisdiction to direct the Auditor to release certain disputed payments from an escrow account, which the Auditor did years ago and Missouri is not challenging. *Cf.* LF 244–45 (Settlement Award § I.5–I.6, addressing jurisdiction) & MO Reply 12 (quoting this), *with* LF 250 (§ IV.1, addressing allocation of "the 2003 NPM Adjustment"). Missouri is again making new arguments inaccurately from irrelevant facts.

III. Missouri's New Factual Arguments Regarding The Arbitration Proceeding Between The PMs And The States That *Have Not Settled* The 2004 NPM Adjustment Dispute Are Wrong.

Beyond its irrelevant and inaccurate factual arguments based on the PMs' settlements of the 2004 NPM Adjustment dispute, Missouri also argues that that dispute will be resolved in several "separate proceedings." MO Reply 4; *see id.* at

2–5, 9, 12–16, 18, 22. This argument is irrelevant, for the reasons summarized above in Part I. It also involves factual errors or omissions, and thus fails on its own terms, for the reasons explained below. Most fundamentally, whether the Auditor was correct to refuse to apply the 2004 NPM Adjustment, including any question whether a particular State diligently enforced its escrow statute, is now being decided in an integrated, multistate arbitration. No *other* arbitration of those questions exists or is contemplated; on the contrary, the MSA parties who initiated the pending proceeding provided for other States to join, as they have done.

Initially, the 2003 Panel is not a "decision maker[ ]" for the 2004 NPM Adjustment. MO Reply 9, 12; *see supra* at 6. Nor, similarly, does the Auditor's reliance on judicial rulings on motions to vacate or modify the 2003 Panel's awards bear on whether the MSA requires a multistate arbitration for the 2004 NPM Adjustment. *See* MO Reply 22–23. That is the process the MSA's arbitration clause contemplates. *See, e.g.*, *Kane*, 128 A.3d at 354–55.[2]

[2] As the OPMs show in their briefing regarding the Settlement Award, the highly deferential standard for reviewing arbitration awards serves under the MSA to reduce the risk of inconsistent decisions that otherwise would result from the ability of many state courts to review an arbitration award. By invoking the complications from multiple court decisions, Missouri confirms the reasons for faithfully following the MSA and FAA.

Second, Missouri is wrong to assert in its Reply that there are "two separate arbitrations" of the 2004 NPM Adjustment dispute. MO Reply 3; *see id.* at 2. Rather, an integrated, multistate proceeding is underway. *See* OPM Resp. 49 n.9. All parties to that proceeding have agreed that, as ordered by all courts to have addressed the issue in the context of the 2004 NPM Adjustment other than the Court of Appeals below, there should be one nationwide arbitration including all questions regarding diligence. *See id.*

That the proceeding has two arbitration panels, under a Stipulation resolving litigation over the composition and scope of authority of the arbitration panel, does not transform the single, integrated proceeding into two "separate" ones. Indeed, the facts in Missouri's additional Appendix confirm this: The two panels "have two arbitrators in common." A-26. Given that a panel has only three arbitrators, a *majority* of arbitrators are common to each panel. *Cf.* MO Reply 24 (contending that having "any arbitrator" in common works a "*de facto* consolidation"). In addition, a common "case management order governing the arbitration" provides for common "discovery" and "a hearing on common issues." A-31. And the Stipulation itself, which the common Chair of the proceeding entered on May 13, 2016, adds that all four arbitrators will attend not only the "common case hearing" but also "all hearings on pre-hearing motions, discovery disputes, and any other disputed issues, to the extent that such hearings involve issues common to all or

several States"; and that, as in the 2003 arbitration, they will issue all decisions on diligent enforcement "simultaneously." OPM Supp. Appx. A-1 – A-2.

The Stipulation also provides for "other Settling States [to] join the Arbitration." *Id.*, Appx. A-2. Two have done so since the original parties signed: Maryland and Pennsylvania. *See* A-26. Both had failed in seeking, as Missouri does, a judicial exemption from the multistate arbitration.

Third, Missouri misunderstands the relevance and relationship of the absent non-settling MSA States to the arbitration proceeding. With respect to Montana, the only State whose courts excused it from arbitrating the 2003 NPM Adjustment, the legal situation for 2004 is the same as for 2003 (when the PMs ultimately did not initiate a judicial proceeding to contest that State's diligence). *See* A-36 – A-37. So it is not clear why Missouri suggests that Montana's unique situation has now acquired relevance for a multistate arbitration by other States. MO Reply 15, 19 n.10. The Montana Supreme Court itself recognized that, if diligence were to be arbitrated—as Missouri now concedes it must be—then that arbitration would need to be multistate. *See* OPM Resp. 6 n.2. And Montana's situation did not matter to the courts of Pennsylvania and Maryland in reaching the same holding regarding the MSA's requirements for the 2004 arbitration as did the trial court below. *E.g.*, *Kane*, 128 A.3d at 340, 351 n.8 (noting Montana's absence from 2003 arbitration); *see also id.* at 352 (noting need for intervention in "separate"

proceedings, and that even intervention would not eliminate the "risk of inconsistent results"); *Maryland*, 123 A.3d at 685 (similar).

With respect to the only other absent, non-settling MSA "States" (besides Missouri), Missouri again has its facts wrong, as its additional Appendix again shows. Although the State claims ignorance regarding New Mexico and four small island territories, and speculates about separate proceedings (MO Reply 2, 14), the Reynolds 10-Q explained that "New Mexico and the four U.S. territories have been asked to join the 2004 NPM Adjustment Arbitration but have not yet done so." A-32. Again, there is no separate proceeding for any of them. In fact, several PMs (including the OPMs) moved in September to compel New Mexico to join the multistate arbitration. *See* OPM Supp. Appx. A-12 – A-17. And in their letters to the territories, requesting them "to participate in the arbitration," the PMs "reserve[d] all rights, including but not limited to the right to argue that the results of the arbitration are binding on" each territory. *Id.*, Appx. A-18 – A-25.

Finally, Missouri contends it is significant that the OPMs have agreed to separately arbitrate, between themselves, disagreements over allocating certain amounts between themselves. MO Reply 3, 22. Apparently related, Missouri also invokes a purported admission in Pennsylvania trial court, albeit without quoting or even citing any statement. *Id.* at 3, 18.

In making this charge, Missouri actually confirms the irrelevance of these inter-PM questions to the question in this appeal. Regardless of what may have been said in the Pennsylvania trial court, the *appeals* court had no difficulty in ordering multistate arbitration between the PMs and the States—holding that "[t]he nature of the dispute is whether PMs are entitled to an NPM Adjustment for 2004"; that any question of "one State's diligent enforcement defense for that year" is part of that dispute; and that the trial court was correct to order that "all issues related to the 2004 NPM Adjustment dispute must be decided in one multistate arbitration proceeding." *Kane*, 128 A.3d at 340, 355; *see id.* at 353 ("[T]he same arbitration panel selected to determine the parties' NPM Adjustment dispute will determine all issues related thereto, including the [MSA] States' diligent enforcement."); *id.* at 348 (recounting PMs' position on "subsidiary issues"). The Commonwealth Court saw no inconsistency by the PMs.

Kane thus confirms that, regardless of the correct answer on the specific question of the manner of resolving the inter-PM allocation questions, there is no question of what the MSA's arbitration provision requires for disputes over the Auditor's denial of an NPM Adjustment. *See also* OPM Resp. 26; *cf.* MO Op. Br. 56–57. The former question is distinct from the straightforward and settled question whether each State's diligence defense may be severed.

In any event, but consistent with this understanding, the agreement on arbitrating the inter-PM issues is part of the stipulation under which the 2004 NPM Adjustment arbitration will be arbitrated. The Stipulation itself explains this context: The PMs and joining States recognized that "there have been disputes among the parties over the composition and scope of authority of the arbitration panel for the 2004 NPM Adjustment arbitration," leading to litigation in seventeen States; that "certain of these courts have issued conflicting orders regarding the composition of the Arbitration panel, which complicated the parties' ability to move forward with the Arbitration," and appeals were pending; and that the parties wanted "to avoid further protracted litigation and to allow the Arbitration to proceed promptly." OPM Supp. Appx. A-1; *see also* A-26.

In sum, and contrary to Missouri's claims in its Reply, the NPM Adjustment for 2004 is being arbitrated in a single proceeding, under a stipulation worked out by the numerous PMs and arbitrating States. And that proceeding remains far more workable than the vision that Missouri offers this Court, which would, every year, allow for 27 completely separate proceedings to decide diligence and thereby make it possible to determine the 2004 NPM Adjustment. Missouri thus still "fails to explain how the myriad proceedings necessary to determine diligence of each of the other 26 States would function more equitably than a nationwide arbitration." OPM Resp. 53–54.

* * *

This Court should affirm the order below denying Missouri's Motion to Compel a Single-State Arbitration of the dispute over the 2004 NPM Adjustment.

Dated: November 4, 2016

Respectfully submitted,

/s/ Jeffery T. McPherson

Peter J. Biersteker, *pro hac vice*
Hashim M. Mooppan, *pro hac vice*
JONES DAY
51 Louisiana Ave., NW
Washington, DC 20001
(202) 879-3939
pbiersteker@jonesday.com
hmmooppan@jonesday.com

Jeffery T. McPherson #42825
ARMSTRONG TEASDALE LLP
7700 Forsyth Blvd., Suite 1800
St. Louis, MO 63105
(314) 621-5070
jmcpherson@armstrongteasdale.com

Attorneys for R.J. Reynolds Tobacco Company, for itself and as successor-by-merger to Lorillard Tobacco Company, and, with permission, also on behalf of Philip Morris USA Inc.

CERTIFICATE OF SERVICE AND COMPLIANCE

The undersigned hereby certifies that on November 4, 2016, this brief was filed with the Clerk of the Court, and may be accessed by parties and their counsel, via the Missouri Case.net electronic filing system. Notice of this filing will also be sent to counsel of record for all parties by operation of the Court's electronic filing system.

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