No. 03-13-00753-CV

In the Court of Appeals
for the Third Judicial District
Austin, Texas

SUSAN COMBS, IN HER OFFICIAL CAPACITY AS TEXAS COMPTROLLER, AND GREG ABBOTT, IN HIS OFFICIAL CAPACITY AS TEXAS ATTORNEY GENERAL,
Appellants,

V.

TEXAS SMALL TOBACCO COALITION AND GLOBAL TOBACCO, INC.,
Appellees.

On Appeal from the 98th District Court, Travis County

Brief of Missouri, South Dakota, Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Mississippi, Montana, Nebraska, Nevada, New Mexico, Oklahoma, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Washington, and Wyoming as Amici Curiae Supporting Appellants

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STATEMENT OF AMICI CURIAE

Amici curiae are the attorneys general of Missouri, South Dakota, Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Mississippi, Montana, Nebraska, Nevada, New Mexico, Oklahoma, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Washington, and Wyoming, all but one[1] of which are signatories to the Master Settlement Agreement (MSA) with nearly 60 Participating Manufacturers (PMs) of cigarettes. Each year, the PMs pay billions of dollars to the 46 states, the District of Columbia, and the 5 U.S. territories that signed the MSA to partially offset the significant costs the MSA States absorb providing health care to individuals with smoking-related health problems. The PMs' annual payments also drive up the price of cigarettes, which tends to discourage smoking in the first place.

The MSA's annual payment obligation creates a significant market advantage for cigarette makers that did not sign the settlement (Non-Participating Manufacturers or NPMs), which are able to sell

[1] Mississippi is a "Previously Settled State" and not a signatory to the MSA.

their brands at much lower prices absent legislation imposing similar costs on manufacturers that did not join the MSA. Accordingly, all of our states have adopted legislation requiring NPMs to internalize the public health costs of their products by escrowing monies each year—roughly equal to the PMs' annual MSA payments—to pay for future judgments. These escrow statutes increase the cost of all cigarettes sold in our states, promote the public health goals of the MSA by reducing smoking rates, and preserve future payments from the PMs.

The equity fee legislation enacted by H.B. 3536 (and invalidated by the district court under the Equal and Uniform Clause of the Texas Constitution) serves the same purpose as our states' NPM escrow statutes. Like H.B. 3536, our escrow statutes have been challenged on constitutional grounds by non-settling manufacturers. Both state and federal courts have universally rejected those challenges. Amici submit this brief to urge the Texas Court of Appeals to follow the courts in every other jurisdiction considering similar legislation and reverse the district court's ruling as to the constitutionality of H.B. 3536. Amici take no position with regard to any other issues raised in the parties' briefing.

BACKGROUND

By the late 1990s, more than 40 state attorneys general had initiated suits against tobacco companies to recover costs incurred in treating smoking-related illnesses. Early attempts to resolve these claims envisioned a comprehensive national settlement under which participating tobacco companies would accept federal regulation of their marketing and advertising, fund national tobacco control programs, and make substantial payments to the states. In exchange, those companies' substantial litigation exposure would be reduced to a fixed, predictable annual payment. J. Bulow & P. Klemperer, "The Tobacco Deal," Brookings Papers on Economic Activity, at 323 (1998).

When concerns about seeking congressional approval scuttled the idea of a national settlement, however, Mississippi, Florida, Texas, and Minnesota (the "Previously Settled States" or "PSS") entered into separate agreements. In exchange for broad liability releases, the settling manufacturers agreed to make annual payments to the PSS to offset past and future government-paid health care costs. *See, e.g.*, Comprehensive Settlement Agreement & Release, § 5, *Texas v. American Tobacco Co.*, 5-96-cv-91 (Jan. 16, 1998) (characterizing annual

payments as satisfying future claims, including "for reimbursement of Medicaid expenditures"); Settlement Agreement and Stipulation for Entry of Consent Judgment, *Minnesota v. Philip Morris, Inc., et al.*, at 2, C1-94-8565 (Minn. 2 Dist. May 19, 1998) (settlement provides "significant funding for the advancement of public health").

Eventually, the remaining states reached a modified settlement that did not require congressional action. On November 23, 1998, 46 states and 6 other U.S. jurisdictions signed the MSA with representatives from Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated, and R.J. Reynolds Tobacco Company (whom the MSA refers to collectively as Original Participating Manufacturers or "OPMs" and the Texas Small Tobacco Coalition "Coalition" calls "Big Tobacco"). Since 1998, fifty-six additional manufacturers have joined the MSA as Subsequent Participating Manufacturers or "SPMs". *See* MSA § II(tt).

Based in part on the payment schedule proposed in the unsuccessful national settlement and partially implemented in the PSS' individual settlement agreements, the MSA requires all PMs to compensate states for past health care costs and internalize *future* costs

for their ongoing sales by making annual payments to the MSA States in perpetuity. *See, e.g.*, MSA § IX(c) (reporting annual base payment schedule, with 2014 base payment to the MSA States of $8.139 billion). Estimates put the combined value of these payments over the first 25 years at roughly $206 billion. *See Grand River Enterprises Six Nations, Ltd. v. Pryor*, 481 F.3d 60, 63 (2d Cir. 2007). The MSA has been characterized by the U.S. Supreme Court as a "landmark" public health achievement addressing "one of the most troubling public health problems facing our Nation today." *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125 (2000).

The parties to the MSA realized that requiring PMs to incorporate government-paid health care costs into their prices while permitting NPMs to avoid those costs would give the NPMs a market advantage. "[T]o protect the public health gains achieved" by the settlement, the MSA proposed model legislation requiring NPMs to escrow funds each year roughly the same as what the PMs pay the states under the MSA. *See* MSA Ex. T-1 (d) ("It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State"); T-1 (f) ("It would be contrary

to the policy of the State if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise"). All 52 MSA States have adopted the model legislation, which also has the effect of narrowing the NPM's cost advantage over the PMs.[2]

Contrary to the Coalition's argument in this case (*see* Appellee Br. at 1), tilting the marketplace away from PMs and towards companies without similar restrictions on their sales was never a goal of the settlements between the states and the tobacco companies. On the

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[2] *See* Ala. Code § 6-12-3; Alaska Stat. § 45.53.020; Ariz. Rev. Stat. Ann. § 44-7101; A.C.A. § 26-57-260; Cal. Health & Safety Code § 104557; Colo. Rev. Stat. Ann. § 39-28-201; Conn. Gen. Stat. Ann., Ch. 47, § 4-28i; DC Off. Code § 7-1801.02; Del. Code Ann. Title 29, § 6080; Ga. Code Ann. § 10-13-1; Hawaii Rev. Stat. § 675-1; Idaho Code Ann. § 39-7801; 30 Ill. Stat. 168/5; Ind. Code § 24-3-3-1; Iowa Code § 453C.2; Kan. Stat. Ann. § 50-6a03; La. Rev. Stat. Ann. § 13:5063; Me. Rev. Stat. Ann. Title 22, § 1580-G; Md. Code Ann. Bus. Reg. § 16-401; Mass. Gen. Laws Ann. ch. 94E, § 2; Mich. Comp. Laws § 445.2052; Mo. Rev. Stat. § 196.1003; Mont. Code Ann. § 16-11-403; Neb. Rev. Stat. § 69-2703; N.J. Stat. Ann. 52:42-1; N.M. Stat. Ann. 1978 § 6-4-12; N.Y. Pub. Health Law § 1399-nn; N.C. Gen. Stat. § 66-291; NDCC § 51-25-01; Ohio Rev. Code Ann. § 1346.02; Okla. Stat. Ann. § 600.21; Or. Rev. Stat. 323.806; R.I. Gen. Laws Ann. § 23-71-1; S.C. Code Ann. § 11-47-30; S.D. Codified Laws § 10-50B-7; Tenn. Code Ann. § 47-31-103; Utah Stat. Ann. § 59-22-201; Vt. Stat. Ann. tit. 33, §§ 1912-1914; Wash. Rev. Code Ann. § 70.157.020; W. Va. Code § 16-9B-1; Wis. Stat. § 994.10; Wyo. Stat. Ann. § 9-4-1202.

contrary, the MSA States have been implementing legislation (including the model statute) to rebalance the market ever since. NPMs have challenged many of these statutes, arguing that "discriminating against" their products (by forcing them to internalize the same costs as their competitors) is unconstitutional. *All of these challenges have failed*. Courts across the country have universally concluded that PMs and NPMs operate under different business models and that states need not treat them the same.[3] NPMs have no constitutional entitlement to a cost advantage over their PM competitors.

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[3] *See, e.g., Grand River Enterprises Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 175 (2d Cir. 2005) ("the Escrow statutes are rationally-related to a legitimate state interest: promoting public health and recovering the costs of tobacco-related illnesses."); *Star Scientific, Inc. v. Beales*, 278 F.3d 339, 354 (4th Cir. 2002) (the "decision to require nonparticipating manufacturers to place funds in escrow is not 'invidious discrimination' or a 'wholly arbitrary act.' Rather, it is a rational system for assessing tobacco manufacturers for the costs of cigarette smoking as well as regulating their conduct to the extent that they were sued and agreed to resolve that suit through settlement."); *PTI, Inc. v. Philip Morris, Inc.*, 100 F.Supp.2d 1179, 1208 (C.D. Cal. 2000) (California's statute "is a necessary adjunct to the MSA, 'effectively closing what the state believes to be a loophole in the MSA,' and the MSA is rationally related to permissible health and safety goals."). For cases upholding other statutes treating PM and NPMs differently, *see Xcaliber Int'l Ltd. v. Attorney General of La.*, 612 F.3d 368, 381 (5th Cir. 2010) ("We agree with the other circuits who have addressed this issue," holding that Louisiana's distinctions between settling and non-settling manufacturers are "easily sufficient to uphold [the law] under rational basis review."); *Grand River Enterprises Six Nations Ltd. v. Beebe*, 574 F.3d 929, 944 (8th Cir. 2009) ("This difference in treatment is rationally related to the

Previously Settled States Minnesota and Mississippi took a different approach. Rather than implement an escrow regime to deal with non-settling manufacturers, both states passed "equity fee" statutes that collect a tax for the difference in health care contributions made by settling and non-settling manufacturers. Minn. Stat. sec. 297F.24 (2013); Miss. Code Ann. sec. 27-70-3 *et seq*. (2012). Efforts are underway to pass similar legislation in the Florida Legislature. *See* Florida S.B. 252 (2013).

Like H.B. 3536, Minnesota's equity fee statute imposes a per-stick fee on cigarettes made by non-settling manufacturers to "ensure that manufacturers of non-settlement cigarettes pay fees to the state that are comparable to costs attributable to the use of the cigarettes," as well as other purposes. Minn. Stat. § 297F.24(1)(b)(1). A group of non-

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state's legitimate interest in collecting future medical costs related to tobacco use."); *KT & G Corp. v. Attorney General of Okla.*, 535 F.3d 1114, 1139 (10th Cir. 2008) ("the distinctions are rationally related to the states' legitimate purpose of ensuring a source of recovery from *all* manufacturers for the states' future costs related to smoking") (citation omitted); *S & M Brands, Inc. v. Summers*, 393 F.Supp.2d 604, 636 (M.D. Tenn. 2005) (amendment "is rationally related to Tennessee's legitimate purpose of ensuring a source of recovery from *all* manufacturers for Tennessee's potential future costs related to cigarette smoking."), aff'd *S & M Brands, Inc. v. Summers*, 05-5148, 2007 WL 1175630 (6th Cir. Apr. 19, 2007).

settling manufacturers challenged Minnesota's equity fee statute under both the Uniformity Clause of the Minnesota Constitution and the Equal Protection Clause of the U.S. Constitution. The plaintiffs in that case advanced the same argument the Coalition does in this case, that the equity fee unfairly discriminated against their products. The Minnesota Supreme Court disagreed, concluding that the state had a rational basis "to impose an additional charge on the cigarettes of those manufacturers who are not otherwise contributing" to the health costs associated with their sales "through either the tobacco settlement or individual voluntary settlements." *Id.* at 310. "The state need not, and should not be required to, allege wrongdoing against nonsettling manufacturers who admit the health effects of their products are no different from manufacturers who are already making payments to the state to cover those health costs." *Council of Indep. Tobacco Mfrs. of America v. Minnesota*, 713 N.W.2d 300, 311 (Minn. 2006).

The Minnesota court further found that the equity fee served to discourage underage smoking by "impos[ing] an additional cost on low-cost cigarettes to drive up their prices"; "leveled the playing field between settling and non-settling manufacturers"; and allowed the

state to "recapture revenue lost by the state as the major manufacturers lose market share." *Id.* at 310. Rejecting the non-settling manufacturers claims of disparate treatment, the Minnesota court noted that "[s]ettling manufacturers have agreed to changes in their behavior and marketing practices that are designed to reduce the health effects of their products in the future; non-settling manufacturers have agreed to no such changes and, as a result, the state can expect to incur increasing costs in the future attributable to the use of non-settling manufacturers' products." *Id.* at 311. The Minnesota Supreme Court thus declined to "second-guess a legislative tax classification that is not arbitrary and that has a reasonable basis in fact." *Id.* at 312-313.

By concluding that H.B. 3536's distinction between settling and non-settling manufacturers "does not relate at all to the nature of the [respective] businesses," *see* Letter Ruling at 3, *Texas Small Tobacco Coalition v. Combs*, D-1-GN-13-002414 (Tex. 98th Dist. Nov. 1, 2013), the district court in this case stands apart from every other court to consider the constitutionality of similar statutes, including nearly identical legislation in Minnesota as well as the NPM escrow statutes in 52 MSA jurisdictions. That decision is incorrect as a matter of state and

federal constitutional law and should be reversed.

ARGUMENT

I. The Act Survives Rational Basis Review.

The Coalition challenges H.B. 3536 under the Equal and Uniform Clause of the Texas Constitution because the law taxes their "identical" cigarettes differently from settling manufacturers' cigarettes. *See* Appellee Br. at 17. But they have failed to overcome the presumption of constitutionality enjoyed by statutes generally and tax statutes in particular.

Because the Legislature "understands and correctly appreciates the needs of its own people, that its laws are directed to problems made manifest by experience, and that its discriminations are based on adequate grounds," *Enron Corp. v. Spring Independent School Dist.*, 922 S.W.2d 931, 934 (Tex. 1996) (citations omitted), Texas courts generally presume legislation is constitutional, *In re Nestle USA, Inc.*, 387 S.W.3d 610, 623 (Tex. 2012). This presumption is "especially strong in respect to statutes relating to taxation" because the legislature's taxing authority is broad and its competence at reconciling complex, evolving,

and disparate interests is superior to that of the judiciary. *Nestle*, 387 S.W.3d at 623 (quoting *Vinson v. Burgess*, 773 S.W.2d 263, 266 (Tex. 1989)). Tax policy, the Supreme Court has noted, "is peculiarly a legislative function, involving political give-and-take and an awareness of local conditions." *San Antonio Ind. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 40 (1973).

Markets are dynamic and price-sensitive, so legislatures regularly use exemptions and "mixed-motive" taxes to shape consumer and business behavior in positive ways. *See Dept. of Revenue of Montana v. Kurth Ranch*, 511 U.S. 767, 782 (1994) (discussing "mixed-motive taxes," like cigarette taxes, that "governments impose to deter a disfavored activity and to raise money"); *see also Hurt v. Cooper*, 110 S.W.2d 896, 899 (Tex. 1937) (noting that "[i]t is sometimes difficult to determine whether a given statute should be classed as a regulatory measure or as a tax measure."). To do so, the Legislature must draw sometimes-narrow distinctions, and these distinctions are generally to be upheld. *Enron*, 922 S.W.2d at 936 (gathering cases).

The requirements for uniformity and equality under the Texas Constitution "are similar" to those for equal protection or due process

under the U.S. Constitution. *Enron*, 922 S.W.2d at 937; *see also Combs v. STP Nuclear Operating Co.*, 239 S.W.3d 264, 275 (Tex. App.-Austin 2007, pet. denied) (the requirements are "substantially the same."); *Upjohn Co. v. Rylander*, 38 S.W.3d 600, 609 (Tex. App.-Austin 2000, pet. denied); *RR Comm'n of Tex. v. Channel Indus. Gas Co.*, 775 S.W.2d 503, 507 (Tex. App.-Austin 1989, writ denied); *see also* Appellee Br. at 18 ("In conducting an Equal and Uniform inquiry, courts first employ a test similar to the Equal Protection Clause's 'rational basis' test"). "Each recognizes the power of the Legislature to make classifications, and each requires that such classifications, when made, must not be unreasonable, arbitrary, or capricious." *Hurt v. Cooper*, 110 S.W.2d at 441.

The requirement that a tax classification have a rational basis is extremely deferential. A challenging party carries a heavy burden to "negative every conceivable basis which might support it, whether or not the basis has a foundation in the record," and courts must accept "a legislature's generalizations even where there is an imperfect fit between means and ends." *Heller v. Doe by Doe*, 509 U.S. 312, 320-21 (1993). Applying the standard to challenges under the Equal and

Uniform Clause and Equal Protection Clause, Texas courts have upheld taxes segregating store owners by the number of stores they own, *Hurt v. Cooper*, 110 S.W.2d at 903; insurers by the type of insurance they offer, *Am. Home Assur. v. Texas Dept. of Ins.*, 907 S.W.2d 90, 98 (Tex. App.-Austin 1995); and cell phone customers by how they pay their bills, *Tracfone Wireless, Inc. v. Com'n on State Emergency Communications*, 397 S.W.3d 173 (Tex. 2013). "The difference between the subjects taxed need not be great, and if any reasonable distinction can be found, the duty of the court is to sustain the classification." *Fairmont Dallas Restaurants, Inc. v. McBeath*, 618 S.W.2d 931, 933 (Tex. App.-Waco 1981, no writ).

Contrary to the Coalition's assertion, Texas courts have never imposed any requirement that a tax "must operate equally on subjects within the same line of business." *See* Appellee Br. at 18. On the contrary, "[t]he legislature may create separate tax classifications which treat differently those engaged in the same business so long as a reasonable basis justifies the disparate treatment." *Am. Home Assur.*, 907 S.W.2d at 97 (citing *Texas Co. v. Stephens*, 103 S.W. 481, 485 (Tex. 1907)); *see also Puget Sound Power & Light Co. v. City of Seattle, Wash.*,

291 U.S. 619, 625 (1934) ("The state may tax different types of taxpayers differently even though they compete."). Similar products may compete in the same market and still be distinguishable from one another. An old 100-watt incandescent light bulb and a new 10.5 watt light-emitting diode bulb both screw into the same fixture and emit light. But to group them together for all purposes ignores their differences: their retail costs are significantly different, as are their component materials and their power use. For some purposes, a "light bulb" tax may be appropriate; for others, it may make no sense. That is why constitutional review of tax programs "imposes no iron rule of equality, prohibiting flexibility and variety that are appropriate to reasonable schemes of state taxation. . . . It is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value." *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 526-27 (1959).

As the Coalition acknowledges, settling manufacturers make a payment to Texas every year to offset future health costs while its members do not. *See* Appellee Br. at 9 (conceding that "Big Tobacco agreed to pay Texas billions of dollars through a multi-year payout

structure"). One of the stated purposes of H.B. 3536 is to "recover health care costs to the state imposed by non-settling manufacturers" that do not already make health care-related payments. Tex. Health & Safety Code, sec. 161.601(1). The Coalition acknowledges that state tobacco settlement payments placed settling manufacturers at a "competitive disadvantage" and that non-settling manufacturers have increased their market share at the settling manufacturers' expense. Appellee Br. at 1; *see also id.* at 13 (complaining that the Act "protect[s]" the settling manufacturers' market share). Another of the stated purposes of the Act is to "protect the tobacco settlement agreement and funding, which has been reduced because of the growth of sales of non-settling manufacturer cigarettes." Tex. Health & Safety Code, sec. 161.601(2). And the Coalition acknowledges that the targeted tax *actually works*. Absent the Act, its members' costs would be structurally lower than those of the settling manufacturers. But the Act "coerced" them to raise prices, eliminating that cost advantage. Appellee Br. at 1. This is consistent with another of the Act's purposes, to "ensure evenhanded treatment of manufacturers." Tex. Health & Safety Code, sec. 161.601(4). Finally, the Coalition acknowledges that the state tobacco

settlements have resolved issues of future liability between the states and the settling manufacturers, while those issues remain live with respect to the non-settling manufacturers. Appellee Br. at 12. That difference, which makes non-settling manufacturers a different sort of enforcement risk than settling manufacturers, justifies their disparate treatment as well.

The Coalition's own concessions demonstrate that the equity fee imposed by H.B. 3536 satisfies rational basis review. The distinction between non-settling manufacturers and their settling manufacturer competitors does not exist only as a legislative construct. It is real and observable outside of the taxing classification. The distinction has real consequences on the cigarette market inside Texas, interfering with the settlement's health objectives by providing an avenue for cheaper cigarettes to reach consumers and discouraging the sale of cigarettes that help defray the state's costs. The tax put in place by the Legislature directly addresses several of the negative consequences arising from the settling/non-settling manufacturer distinction (and the attendant exploitation of the cost loophole), netting revenue while narrowing the structural cost gap. The Coalition bears the burden of

"negativ[ing] every conceivable basis which might support" the Act. Instead, it has effectively agreed that the Legislature's stated bases for the Act are true in fact and effective in practice. The Coalition therefore cannot succeed on this part of its claim. *Cf. Walters v. City of St. Louis*, 347 U.S. 231, 236 (1954) (rejecting challenge because "There is not so much similarity between [taxed and untaxed persons] that they must be placed in precisely the same classification for tax purposes.").

II. The "More Strict" Analysis of *Nestle* Also Sustains the Constitutionality of H.B. 3536.

The Coalition is correct in stating that Equal and Uniform Clause analysis is "more strict" than rational basis review in one respect. *See In re Nestle*, 387 S.W.3d 610, 624 (Tex. 2012) (equal protection merely "keeps government decision makers from treating differently persons who are in all relevant respects alike."). In addition to a rational basis for the legislation, the Equal and Uniform Clause also requires a connection between the classification scheme and the purpose of the tax. *See Tracfone Wireless,* 397 S.W.3d at 181 ("the Legislature's decision to treat different classes in different ways must still be related to the purpose of the tax."); *Nestle*, 387 S.W.3d at 621, 622 (franchise

taxes, which are a tax on "the privilege of carrying on a business," must "relate to differences in doing business that affect the value of the privilege."). But even under this "more strict" analysis, H.B. 3536 passes muster.

The Coalition assumes that there is only one acceptable policy objective for a sales or use tax: raising revenue. Appellee Br. at 24. Because the Legislature could raise *more* revenue by taxing all manufacturers than it does taxing only non-settling manufacturers, the Coalition claims that the Act's classification scheme is not adequately related to its purpose. *Id.* Yet, the mere existence of "sin" taxes——taxes designed in part to discourage consumption—proves that claim false.[4]

In its brief, the Coalition quotes *Nestle* for the proposition that "the Legislature may pursue goals through tax legislation, but only goals related to taxation." Appellee Br. at 24. It interprets this to mean that revenue is the only valid goal for H.B. 3536. But the actual quote from *Nestle* says nearly the opposite: "the Legislature may pursue

[4] Such taxes have always been premised, in part, on the positive health effects that result from increased market prices. *See, e.g.*, T. Hu, *The Liquor Tax in the United States*, p. 13 (1950) (Treasury Secretary Hamilton proposed the tax leading to the Whisky Rebellion in 1791, arguing in part that it would have a desirable impact "from the standpoint of health and morals.")

policy goals through tax legislation, but only goals related to ***the*** taxation." *Nestle*, 387 S.W.3d at 622 (emphasis added). Thus, franchise taxes (which key off the privilege of doing business in the state) may advance policies related to how (or which) companies do business in the state. *Id.* at 622. By extension, sales taxes (which key off the sale, use or consumption of goods in the state) may advance policies related to how (or which) products are sold, used, or consumed in the state.

The Coalition's assertion that Texas "has never used taxation as a means of discouraging smoking or the use of tobacco products" (Appellee Br. at 24) is patently incorrect. *See, e.g.*, Bill Analysis, H.B. 5 (2006)[5] ("By increasing taxes on cigarettes and other tobacco products, H.B. 5 would provide a reliable revenue stream while helping to reduce tobacco use, thereby saving lives and lowering health care costs."); Bill Analysis, H.B. 6 (1990)[6] ("Alcohol and tobacco taxes provide a stable source of revenue, and these 'sin' taxes also help discourage activities that incur enormous social costs. . . . All Texans bear the costs of drinking and smoking through higher costs for medical insurance, law

[5] http://www.lrl.state.tx.us/scanned/hroBillAnalyses/79-3/HB5.PDF
[6] http://www.lrl.state.tx.us/scanned/hroBillAnalyses/71-6/HB6.pdf

enforcement and human services. The higher tax rates not only would discourage use but would more than compensate for the revenue loss from any decrease in consumption."). It is also irrelevant. The Legislature need not actually articulate the link between its classification scheme and the policy promoted to survive scrutiny. The presumption that all legislation is constitutional necessarily presumes *some* policy must have been promoted through the legislation, and the Coalition has certainly not established otherwise.

III. Statutes like H.B. 3536 have been consistently upheld against similar challenges in part because the distinction between settling and non-settling manufacturers is readily apparent.

The Coalition acknowledges that every other jurisdiction to consider a similar statute has upheld the statute as constitutional, but it attempts to distinguish those statutes as imposing escrow obligations rather than taxes. Both federal and state courts have concluded that the escrow/tax distinction is irrelevant. *See, e.g.*, *Star Scientific, Inc. v. Beales*, 278 F.3d 339, 350 (4th Cir. 2002) ("we note that the State surely could properly accomplish the same end by enacting" a tax instead of an escrow requirement); *KT & G Corp.*, 535 F.3d at 1134 n. 2 (the same

analysis would apply whether the challenged law imposes an "escrow" obligation or a "tax"); *see also Council of Indep. Tobacco Mfrs. of America v. Minnesota*, 713 N.W.2d at 311 (focus on the difference between the Minnesota fee and the escrow statutes is "misplaced").

The Coalition also argues these earlier cases "provide no persuasive authority" because they were decided under rational basis, rather than the test articulated by the Texas Supreme Court in *Nestle*. *See* Appellee Br. at 26 (escrow statutes); *see also id.* at 28 (Minnesota equity fee). The fact that every other court to compare statutory treatment of settling and non-settling manufacturers has found the distinctions to be "meaningful,"[7] "rational,"[8] and "relevant and logical,"[9] is at least *persuasive* authority that their operations are not the same. *Cf. Hurt v. Cooper*, 110 S.W.2d at 903 (in upholding a chain store tax, the court reasoned "Courts generally over the country, including the highest court in the land, hold that reasonable differences justifying the classification exist. It cannot be demonstrated that they do not exist.

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[7] *Star Scientific, Inc. v. Beales*, 278 F.3d at 361.

[8] *Id.* at 353.

[9] *Council of Indep. Tobacco Mfrs. of America v. Minnesota*, 713 N.W.2d 300, 310 (Minn. 2006).

How, then, could we at this late day justify a holding that the classifications are arbitrary? Only by announcing that the differences seen by all those great courts are but the fruits of their imaginations. We are unwilling to assume such a critical attitude."). This argument also loses its power when the Coalition admits that much of the analysis under the Equal and Uniform Clause is the same as the rational basis approach required under the federal Equal Protection Clause. *See* Appellee Br. at 18.

The cases upholding the MSA's model escrow legislation have uniformly rejected the Coalition's premise that the state settlement agreements were intended only to "punish" the settling manufacturers while leaving non-settling manufacturers with a market advantage. *See, e.g.*, Appellee Br. at 1 (claiming settlement payments were "penalties against Big Tobacco" intended to place those manufacturers at a "competitive disadvantage"). Instead, courts have consistently recognized that the state settlement agreements are part of a broader solution to the myriad public health problems created by cigarette smoking. Statutes like H.B. 3536 are an integral part of the solution. *See, e.g., Council of Indep. Tobacco Mfrs. of America v. Minnesota*, 713

N.W.2d at 310 ("it is reasonable to impose additional costs on the cigarettes of non-settling manufacturers"); Final Award re State of Colorado, In the 2003 NPM Adjustment Proceedings, at 5 (Sept. 2013)[10] (observing that NPMs "do not bear [payment obligations] and thus do not reflect them in their pricing" and that "that differential cost between the PMs and the NPMs could be harmful to both the PMs and to the States, as well as to the public, by undermining the goals and purpose of the MSA.").

The many cases upholding MSA escrow statutes are more easily reconciled with the realities of cigarette sales and distribution than the district court's conclusion that H.B. 3536 is "taxing identical products sold by competitors." Letter Ruling at 2. The difference matters greatly to the 52 MSA States where a shift in market share from PMs to NPMs would lower our states' annual MSA payments even as our healthcare costs rise due to the prevalence of cheaper cigarettes. The presence of cost loopholes anywhere in the domestic market harms the public

[10] http://www.coloradoattorneygeneral.gov/sites/default/files/press_releases/2013/09/12/091213_tobacco_arbitration_colorado_final_award_2pd0f.pdf

health achievements of the state tobacco settlements by providing an avenue for low-cost cigarettes to enter the domestic distribution chain.

Finally, as the GAO has recognized, stable price variations between states "creat[e] opportunities and incentives for illicit trade." GAO, Illicit Tobacco: Various Schemes are used to Evade Taxes and Fees (March 2011). Escrow obligations imposed by the MSA States have encouraged bootlegging from the Previously Settled States into the MSA States in the past. *See* Information, *U.S. v. Burke*, 1-09-cr-00134-SA-DAS (Nov. 24, 2009); Information, *U.S. v. Benham*, 1-09-cr-00148-GHD-DAS (Nov. 24, 2009); *see also* GAO Report, at 22 (describing scheme). Absent the fee imposed by H.B. 3536, cigarettes sold by non-settling manufacturers in Texas can avoid the $6.18 per carton escrow charge imposed in neighboring New Mexico, Oklahoma, or Arkansas, creating a strong incentive for criminals to smuggle Texas cigarettes across state lines.

H.B. 3536 brings every state one step closer to the day when all cigarettes sold in the United States include a premium for the cost of providing healthcare to those who consume them. That future promises better health for our constituents and better savings for our states. We

strongly agree with the Texas Legislature's policy decision to close the non-settling manufacturer loophole with H.B. 3536. And we urge this Court to conclude, like every other court to consider the issue, that escrow and equity fee legislation is a rational and reasonable exercise of state power.

CONCLUSION

The position of the State of Texas is correct. The judgment of the district court should be reversed, and H.B. 3536 reinstated.

Respectfully submitted,

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CERTIFICATION OF AMICUS

In accordance with Texas Rule App. P. 11(c), undersigned, on behalf of Amicus Curiae, certifies that that no counsel for any party had any involvement whatsoever in the authoring of this brief, and no persons other than Amicus Curiae or their counsel made any monetary contribution to the preparation or submission of this brief.

CERTIFICATE OF COMPLIANCE

In accordance with Texas Rule App. P. 9.4(3), undersigned, on behalf of Amicus Curiae, certifies that this **Brief of Certain States as Amici Curiae Supporting Appellants** contains 4,845 words.

CERTIFICATE OF SERVICE

In accordance with Texas Rules App. P. 9.5(b), (e) and 11(d), undersigned certifies that this **Brief of Amici Curiae Supporting Appellants** has been served on the following counsel of record via express or electronic mail on May 16, 2014.

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