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

REPLY BRIEF OF APPELLANTS

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ORAL ARGUMENT REQUESTED

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TO THE HONORABLE THIRD COURT OF APPEALS:

The Equal and Uniform Clause gives almost total deference to the Legislature's reasonable tax classifications. The tobacco companies' opening brief is empirical proof of that proposition: The State wins every single Equal and Uniform challenge cited in the tobacco companies' brief. This remarkable pattern exists because it is an extraordinary thing for a court to second guess the Legislature's considered judgment about tax classifications.

I. THE EQUAL AND UNIFORM CLAUSE DOES NOT INTERFERE WITH THE LEGISLATURE'S REASONABLE ATTEMPTS TO GROUP SIMILAR THINGS AND DIFFERENTIATE DISSIMILAR THINGS.

A. The State's opening brief says that courts must uphold taxes "where the tax operates equally within a *reasonable* tax classification." *See* State Br. at 13. The tobacco companies seem to agree with this statement in principle, but they understand it to announce a multi-part test that appears nowhere in the Supreme Court's Equal and Uniform Clause jurisprudence. *See* Tobacco Br. at 18.

Whatever the tobacco companies say, the only relevant question is whether a tax classification is "reasonable." The tobacco companies try to engraft onto this simple test several additional requirements, but upon close inspection, those appendages add nothing. First, as the tobacco companies correctly observe, the Supreme Court has explained that a tax must "attempt to group similar things and differentiate dissimilar things." Tobacco Br. at 19 (calling this phrase an "essential second requirement"). But that phrase is not a second hurdle for the Legislature to clear; it is the *very definition* of the word "classification." A "reasonable tax classification" is nothing more than "reasonable attempt to group similar things and differentiate similar things."

Second, the tobacco companies say that the Court should, *first*, ask whether the tax classification is reasonable and then, *next*, ask whether the tax operates uniformly

within the established class. That approach leads the Court in circles. If a tax fails the tobacco companies' "second prong" because it does not operate uniformly within a class, then it is apparent that the legislature has actually created two different classes, and the only relevant question still remains the same: Is the classification reasonable?

Finally, the tobacco companies say that "courts must additionally consider whether the nature and operations of the businesses are *so different* as to warrant unequal treatment." Tobacco Br. at 18 (emphasis added). Such strict language appears nowhere in the Equal and Uniform Clause or its implementing cases. *Compare* Tobacco Br. at 18 (must be "so different as to warrant unequal treatment"), *with Am. Home Assurance v. Tex. Dep't of Ins.*, 907 S.W.2d 90, 97-98 (Tex. Civ. App.—Austin 1995, writ denied) ("Only a *slight difference* in the subject matter taxed justifies a separate classification." (emphasis added)).

B. Because the parties apparently disagree on the proper standard, a brief review of what the Supreme Court has said on the subject may prove helpful to this Court. The unbroken rule for over one-hundred years has been that the Equal and Uniform Clause does not interfere with the Legislature's reasonable tax classifications — *i.e.* with the Legislature's reasonable attempts "to group similar things and to differentiate dissimilar things." *In re Nestle USA, Inc.*, 387 S.W.3d 610, 622 (Tex. 2012). The Texas Supreme Court announced this standard more than a century ago:

> The considerations upon which such classifications shall be based are primarily within the discretion of the Legislature. The courts, under the provisions relied on, can only interfere when it is made *clearly* to appear that an attempted classification has *no reasonable basis* in the nature of the businesses classified, and that the law operates unequally upon subjects between which there is no real difference to justify the separate treatment of them undertaken by the Legislature.

Tex. Co. v. Stephens, 100 Tex. 628, 640-41, 103 S.W. 481, 485 (1907) (cited favorably by *In re Nestle USA, Inc.*, 387 S.W.3d at 620)) (emphasis added). Thirty years later, the Texas Supreme Court reaffirmed that the Equal and Uniform Clause prohibits only tax classification that sink to the level of arbitrary:

> [T]he considerations upon which such classifications are based are primarily within the discretion of the Legislature; and that courts can interfere only when it is made clearly to appear that there is no reasonable basis for the attempted classification. *If there is a reasonable basis or, to express it differently, if it cannot be said that the Legislature acted arbitrarily, the courts will not interfere*. Mere differences in methods of conducting businesses have long been recognized in this state as sufficient to support the classification.

Hurt v. Cooper, 130 Tex. 433, 110 S.W.2d 896, 903 (1937) (cited favorably by *In re Nestle USA, Inc.*, 387 S.W.3d at 620)) (emphasis added). Likewise, the Supreme Court has explained that discrimination among taxpayers is permitted, so long as reasonable:

> The mere fact that discrimination is made proves nothing against a classification which is not, on its face, an arbitrary, unreasonable or unreal one.

Id. at 441. This Court has concluded the same:

> The 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. . . . Only a slight difference in the subject matter taxed justifies a separate classification.

Am. Home Assurance v. Tex. Dep't of Ins., 907 S.W.2d 90, 97-98 (Tex. Civ. App.—Austin 1995, writ denied); *see also Grayson County State Bank v. Calvert*, 357 S.W.2d 160, 162 (Tex. Civ. App.—Austin 1962, writ ref'd n.r.e.) ("The equal protection clause of the Fourteenth Amendment of the United States Constitution and the equal and uniformity requirements of the Texas Constitution upon the taxing powers of the State are substantially similar.").

The Supreme Court in *Nestle* did not purport to overrule or depart from this unbroken line of precedent. Indeed, many of these cases were favorably cited by the *Nestle* court. The Supreme Court did reject the State's argument that any franchise tax with merely *a rational basis* should survive. *See In re Nestle USA, Inc.*, 387 S.W.3d at 622 (explaining that the rational basis test, if adopted, might improperly "be used, for example, to circumvent the requirement that the ad valorem property tax be based strictly on property value"). *Nestle* holds that the Equal and Uniform Clause is more strict than rational basis because it prevents the Legislature from abusing its taxing authority to accomplish something otherwise forbidden. *Id.* But that narrow restraint

on the Legislature's power is of no use to the tobacco companies here. The tobacco tax's classifications are reasonable and should be upheld.

II. THE TOBACCO TAX REASONABLY DISTINGUISHES BETWEEN COMPANIES AND PRODUCTS THAT INTERNALIZE THE COSTS THEY IMPOSE ON TAXPAYERS AND THOSE WHICH DO NOT.

As the State explained in its opening brief, it is reasonable to grant a different tax treatment to companies and products that already pay the State for each cigarette sold. These companies and products already internalize their health-care externalities and already contribute their fair share to the State's coffers. The tobacco companies disagree, arguing that this differential tax treatment has no basis in "the nature and operations" of their business. But this is incorrect, even under the decisions cited by the tobacco companies.

A. Because some cigarette manufactures already pay the state for each cigarette sold, they face a real and permanent difference in internal cost structure from the manufacturers who do not pay. The cases cited by the tobacco companies recognize that such a difference in cost structure is a sufficient basis on which to classify taxpayers. *See Am. Home Assurance v. Tex. Dep't of Ins.*, 907 S.W.2d 90, 97-98 (Tex. Civ. App.—Austin 1995, writ denied) (holding that "although Appellants and the Fund perform the same business function" the Legislature could reasonably discriminate between them based on "difference in profits"); *Hurt v. Cooper*, 130 Tex.

433, 440, 110 S.W.2d 896, 901 (1937) ("Differences in the profits derived . . . could properly be taken into consideration by the Legislature in making classifications and determining the amount of the tax to be laid upon each; and it would be only an extreme and a clear case that would justify an interference by the courts with the legislative action."). Nestle endorsed a similar distinction only two years ago. *See In re Nestle*, 387 S.W.3d at 623 (upholding the franchise tax's exclusion of heavy construction equipment from the cost of goods sold because otherwise deductions for manufacturers who "do not sell goods and few employees" would be "unfairly low").

B. Next, the tobacco companies suggest that this case is unique because the settling manufactures' higher cost structure is entirely their own doing, since they (and not the small tobacco companies) are the ones who signed a settlement agreement with the State, compelling them to pay compensatory health-care costs for each cigarette sold. But there is nothing unusual about a sovereign crediting a taxpayer for money already paid to the State, or with a sovereign allowing a tax deduction for compensatory fines and penalties paid by a taxpayer. *See, e.g.*, *Fresenius Medical Care Holdings, Inc. v. United States*, No. 1:08-cv-12118-DPW (D. Mass. May 9, 2013) (allowing a tax deduction for over $300 million in compensatory fines and penalties paid by the taxpayer under a global settlement agreement of claims brought under the False Claims Act). As the Supreme Court observed in *Nestle*, the tax code

is shot through with such exemptions, credits, and deductions, and they do not undermine the equality and uniformity of the tax. *In re Nestle*, 387 S.W.3d at 620 ("[E]xemptions do not destroy equality and uniformity, nor do occupation tax classifications, and even an income tax, with its characteristic adjustments and deductions, can be equal and uniform."). In many ways, this is an easier case than *Fresenius*, which involved a penalty arising out of a *judgment of liability* under the FCA. The payments in this case arise out of a contractual settlement agreement.

C. Next, the tobacco companies argue that raising revenue is taxation's only lawful purpose. *See* Tobacco Br. at 24-25 ("Forcing Small Tobacco to internalize healthcare costs and deterring underage smoking are not legitimate policy goals to support tax legislation."). *Nestle* forecloses this extraordinary claim. *See In re Nestle*, 387 S.W.3d at 622 ("The Legislature may pursue policy goals through tax legislation . . . ."). To be sure, *Nestle* says that the Legislature's policy goals must be "related to the taxation," but whatever the bounds of that restriction, the Texas Supreme Court has plainly stated that the Legislature may use tax legislation to pursue "policy *goals*." *Id.* (emphasis added). The Texas Supreme Court would not have said "policy goals" if all it meant was "raise revenue," and it would not have used the plural form "goals," if all it meant was (1) raise revenue, (2) raise revenue, and (3) raise revenue.

In fact, taxation serves many legitimate policy goals. Governments tax to raise revenue, of course, but they also tax to discourage certain activities. Texans know this better than most, which is why we tax pollution, TEX. TAX CODE § 11.31, and consumption, *id.* 151.0028, but not work. TEX. CONST. art. 8, sec. 24 (prohibiting state income tax absent referendum). It is not clear what *Nestle* means by forbidding the Legislature to pursue policy goals "unrelated" to taxation. Perhaps the Court means only to restrict illegitimate attempts by the Legislature to circumvent a separate constitutional provision. That is our best guess, given the example that follows the Court's statement. *See In re Nestle*, 387 S.W.3d at 622 ("The Legislature may pursue policy goals through tax legislation, but only goals related to the taxation. The franchise tax may be used to advance policies relating to doing business in Texas, but it cannot be used, for example, to circumvent the requirement that the ad valorem property tax be based strictly on property value."). But whatever the Court means by the restriction, it cannot mean to exclude two longstanding purposes of taxation: to create disincentive structures and to force products or activities to internalize the costs they impose on the public.

D. Finally, the tobacco companies argue that tobacco taxes *in particular* are about revenue only. *See* Tobacco Br. at 24-25. The Supreme Court in *Calvert* did say that "the tax on gasoline, cigarettes and liquor are for revenue purposes only" and that

"[w]hile some other states have placed cigarettes in the category with liquor, racing and the like, Texas has not." *See House of Tobacco, Inc. v. Calvert*, 394 S.W.2d 654, 656 (Tex. 1965). But that is a statement of the Legislature's intent *at the time*, not a constitutional command. *See id.* (observing that the statute under review provided that "it was intended by the Legislature for [the tax on tobacco] to be an excise or use tax" as opposed to the liquor tax, which the Texas Liquor Control Act explicitly called "an exercise of the police power of the State for the protection of the welfare, health, peace, temperance and safety of the people of the State").

Where, as here, the constitution is silent, it is the Legislature, not the taxpayer, who gets to decide what purposes a tax will serve. It is apparent that the Legislature, like many Americans, has changed its mind about cigarettes since *Calvert* was decided in 1965. *See* TEX. HEALTH & SAFETY CODE § 161.601 (listing several purposes of the tobacco tax, including "(1) to recover health care costs to the state imposed by non-settling manufacturers; (2) prevent non-settling manufacturers from undermining this state's policy of reducing underage smoking; . . . and (5) provide funding for any purpose the legislature determines"). In any event, as the State said in its opening brief, if the State's "non-revenue" purposes mean that the tobacco tax is not a tax at all, but instead is an exercise of the police power, then this dispute is easily resolved, because the police power is unconstrained by the demands of equality and uniformity.

III. THE TOBACCO COMPANIES HAVE NO ANSWER FOR THE STATE'S OBSERVATION THAT, TO HOLD IN THE TOBACCO COMPANIES' FAVOR, THIS COURT MUST DECLARE UNREASONABLE THE JUDGMENT OF FIFTY FOUR OTHER LEGISLATURES AND ALSO MST REJECT THE HOLDINGS OF EVERY COURT OF APPEALS IN THE NATION TO CONSIDER THE QUESTION.

The State's opening brief observes that fifty four other legislatures have drawn the same distinction as the Texas Legislature, and that every court of appeals to consider a challenge to that distinction has found it reasonable. The tobacco companies respond that most of these statutes and subsequent challenges involve escrow accounts, not taxes paid. But that is a distinction without a difference when asking whether it is reasonable for the State to extract payments from non-settling tobacco companies.

It makes little difference whether a State extracts payments from non-settling tobacco companies under an escrow account or through taxes, for purpose of this case anyway, because such discrimination must be justified in either event as reasonable. Fifty four legislatures have determined that the distinction is reasonable, and every court to consider the question has agreed. For example, the United States Court of Appeals for the Fourth Circuit upheld Virginia's escrow account statute because the distinction between settling and non-settling manufacturers would have been reasonable for tax purposes:

> While we recognize the financial burden that [escrow contributions] might create for any given cigarette manufacturer . . . we note that the State surely could properly accomplish the same end by enacting a more financially burdensome form of legislation, such as an act imposing a tax on cigarette manufacturers but giving a tax credit to those who sign the Master Settlement Agreement.

Star Scientific v. Beales, 278 F.3d 339, 350 (4th Cir. 2002); *see also S&M Brands v. Summers*, 393 F. Supp.2d 604, 633 (M.D. Tenn. 2005) ("Tennessee could have enacted even more burdensome legislation, such as imposing a tax on [non-settling manufacturers] while allowing a tax credit to the [settling manufacturers].").

All of these escrow cases ask the same question presented to this Court: Is the classification reasonable? *See, e..g, Grand River Enters. v. Six Nations, Ltd. v. Beebe*, 74 F.3d 929, 944 (8th Cir. 2009) (holding that the Arkansas escrow statute "does treat [settling manufacturers] and [non settling manufacturers] differently" but that "[t]his difference in treatment is rationally related to the state's legitimate interest in collecting future medical costs related to tobacco use.") ; *KT & G Corp. v. Oklahoma*, 535 F.3d 1114, 1139-40 (10th Cir. 2008) ("[D]istinctions among tobacco manufacturers based on whether a manufacturer signs the Master Settlement Agreement . . . are rationally related to [the States'] legitimate purpose of ensuring a source of recovery from *all* manufacturers for [the States'] future costs related to cigarette smoking."); *Grand River Enters. Six Nations, Ltd. v. Pryor*, 425 F.3d 158,

175 (2d Cir. 2005) ("[T]he Escrow Statutes are rationally related to a legitimate state interest: promoting public health and recovering the costs of tobacco-related illnesses.").

IV. THE TOBACCO COMPANIES HAVE NO ANSWER FOR THE STATE'S OBSERVATION THAT SETTLING TOBACCO COMPANIES WOULD OWE TEXAS *NOTHING* IF THEY STOPPED SELLING CIGARETTES TOMORROW.

As the State's opening brief explained, the settling tobacco companies are paying to offset the State's future health care costs, not for past wrongdoing. One indisputable fact makes this plain: If the settling tobacco companies stopped selling cigarettes tomorrow, they would owe the State nothing. The tobacco companies have no answer to this observation.

A. Instead, the tobacco companies argue that, by imposing a fee only on them, the settling manufacturers are "effectively relieved of any economic sanctions for [their] unlawful conduct." Tobacco Br. at 13, 21, 34, 37. This factual inaccuracy rests on a misreading of the settlement agreement. The settlement agreement is comprised of two distinct parts: financial penalties for past misconduct, and compensatory payments to offset future health-care costs. The agreement is much more than what the tobacco companies describe as an agreement by Texas "not to pursue its claims of deceptive marketing, targeting children, and antitrust violations." *See* Tobacco Br. at 9. It includes, for example, claims of negligence and strict product liability. *See* Pl's

Fourth Amend. Compl. ¶¶ 230-51, *Texas v. Am. Tobacco Co*. (E.D. Tex. Oct. 3, 1997) ("Cigarettes are abnormally and unreasonably dangerous" and their sale "has caused the State to expend millions of dollars in order to provide necessary health care to [its] citizens, thereby damaging the State.").

The settling manufacturers paid billions for past misconduct during the first five years of the settlement agreement: a projected $3 billion in "Initial Payments" subject to adjustment, $264 million for youth access prevention programs, and millions more to cover the State's attorneys' fees. Settlement Agreement sec. 8 (Initial Payments); Amend. to Settlement sec. 5 (Supplemental Initial Payments); Agreement of Amend. Sec. 4.

But the settlement agreement also contains forward-looking provisions designed to force settling manufacturers to internalize the health-care costs that their products impose on the taxpaying public. In addition to up-front fines, the settling manufacturers agreed to pay billions of dollars in "Annual Payments" to Texas and the other states every year thereafter and forever into the future based on their annual sales. Amend. to Settlement sec. 7; MSA sec. IX(c). And they agreed to various marketing restrictions, including an agreement to stop and prevent marketing to children. Settlement sec. 6; MSA Sec. III.

These Annual Payments offset the State's health-care costs associated with the settling manufacturers' ongoing sale of cigarettes. The tobacco companies ignore these forward-looking payments because they arise in the same agreement that settles claims for past misconduct, *see* Tobacco Br. at 23, but separate agreements are not necessary to make the purpose of the payments clear. First, the Annual Payment obligations are triggered and measured *only* by post-settlement sales of cigarettes. Amend. to Settlement Agreement sec. 7 & App'x A. A settling manufacturer owes an Annual Payment in a given year only if it sells cigarettes that year, and the amount of the payment is based directly on the number of cigarettes sold. *Id.* Second, the settlement itself expressly provides that the Annual Payments cover "reimbursement of Medicaid expenditures" incurred as recently as "the year of the payment." Settlement sec. 5; Amend. to Settlement sec. 4. Third, the settlement's release covers not only claims based on past conduct but also those based on future cigarette sales. Settlement sec. 14.

The Texas tobacco tax reasonably imposes these same payments on non-settling manufacturers. As the Minnesota Supreme Court held when upholding a nearly identical law, "[t]he state need not, and should not be required to, allege wrongdoing against nonsettling manufacturers who admit the health effects of their productions are no different from manufacturers who are already making a payment to the state to

cover those health costs." *Indep. Tobacco Mfrs. v. Minn.*, 713 N.W. 2d 300, 311 (Minn. 2006).

B. The tobacco companies next argue that the Annual Payment obligations are set by "a sliding scale" and thus "bear no similarity to the 55-cent-per-pack tax imposed on [non-settling manufacturers]." *See* Tobacco Br. at 31. But the tobacco tax does mimic (as best as a flat-tax can) the Annual Payments obligations of the settling manufacturers. Indeed, in the trial court, the State reported that the settling manufacturers' Annual Payments amounted to roughly 64 cents per pack (9 cents *more* than paid by the non-settling manufacturers). CR. 1304. In rebuttal, the tobacco companies offered *no evidence* that the Annual Payments were anything different. The record, therefore, provides the tobacco companies with no basis to deny on appeal that the settling manufacturers' payment obligations, per cigarette, are less than those imposed on non-settling manufactures.

In any event, the Legislature's calculation accurately levels the playing field. Each year's Annual Payment obligations is stated as an "Applicable Base Payment" that is then multiplied by the ratio of (1) the actual aggregate number of cigarettes that the settling manufacturers sold in the United States that year to (2) a "Base Volume," which is the number of such sales in 1997. Amend. To Settlement Agreement sec. 7 & App'x A. This "Volume Adjustment" causes the Actual Payment obligation to rise

and fall each year in direct relation to sales volume and, therefore, to operate like a per-cigarette payment obligation for sales in the United States during the year when allocated among the manufacturers according to each manufacturer's pro rata share of such sales. The Annual Payment obligation is subject to other adjustments, such as for inflation, and settling manufacturers are then required to pay 7.25% of the total, which is Texas's agreed upon share of the settlement payments that are calculated on national sales volume. Amend. to Settlement sec. 7.

B. The tobacco companies lob other criticisms at the tobacco tax. First, they suggest there is something nefarious about the Texas Legislature's decision to credit "settlement payments to ***other states***." Tobacco Br. at 32. But sovereigns routinely credit taxpayers for taxes paid to other jurisdictions. *See, e.g., Burnet v. Chicago Portrait Co.*, 285 U.S. 1, 52 (1932) ("The Revenue Act of 1918, with its provisions for credits, against income taxes laid here, of taxes paid 'to any foreign country . . . ."); *Cornyn v. Universe Life Ins. Co.*, 988 S.W.2d 376, 377 (Tex. App.—Austin, 1999) ("Universe Life Insurance Company ("Universe Life") sought a credit against its Texas gross premiums tax for examination fees it paid to other states . . . ."). This is fundamental fairness at work, not unlawful discrimination. *In re Nestle USA, Inc.*, 387 S.W.3d at 623 ("What Nestle criticizes as a departure from uniformity is actually an attempt to treat like taxpayers alike.").

The tobacco companies also criticize the discount for Subsequent Participating Manufacturers (SPMs). Tobacco Br. at 31-32. This reduction, however, merely accounts for payments that SPMs already make for their cigarette sales in Texas. The SPMs joined the MSA and agreed to its ongoing Annual Payment obligations even though they had never been sued for past misconduct. Because the MSA, like the Texas settlement, uses national sales volume to calculate Annual Payment obligations, the reduction avoids burdening SPMs with overlapping payment obligations. The tobacco companies do not complain about the amount of the reduction. They simply suggest, without support, that Texas cannot continue cooperating with other states to use national sales volume to calculate settlement obligations that are then allocated to the states according to agreed upon shares.

V. THE TOBACCO COMPANIES' PENDING MOTION FOR SANCTIONS SHOULD BE DENIED.

The State's opening brief explains that the cigarette tax is motivated, in part, by the Legislature's concern that non-settling tobacco companies are marketing their products to minors. *See* TEX. HEALTH & SAFETY CODE § 161.601 (expressing the Legislature's desire to "prevent non-settling manufacturers from undermining this state's policy of reducing underage smoking . . ."). The Legislature's concern is well founded, we observed, noting that some members of the Small Tobacco Coalition sell

cigarettes and tobacco products in flavors such as wild cherry, grape, mango, strawberry, and peach. State Br. 2, 5–7.

The tobacco companies' sale of flavored cigarettes is not relevant to the elements of their claim, of course. It is the type of legislative fact of which courts of appeals routinely take judicial notice. *See, e.g.*, *Chen v. Hernandez*, No. 03-11-00222-CV, 2012 WL 3793294, at *13 (Tex. App.—Austin Aug. 28, 2012, pet. denied) (mem. op.). Nevertheless, the tobacco companies have accused the undersigned counsel of violating the Texas Disciplinary Rules. Sanctions Mot. at 4–5. They say that the State's opening brief falsely accuses them of violating a federal law banning the sale of flavored cigarettes. *Id*. at 2–5 (citing 21 U.S.C. § 387g). But the brief never said that the tobacco companies are federal lawbreakers. It said only that they sell flavored cigarettes, and indeed they do.[1] *See* Exhibit B.

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1. The relevant tobacco companies circumvent the federal ban on flavored cigarettes by adding some tobacco leaf to their cigarette wrappers (thereby turning their cigarettes a brownish color), which arguably permits them to label their cigarettes as "filtered mini cigars." Liz Szabo, *Tobacco Companies Profit from Loophole; Market Small Cigars*, USA Today, Aug. 3, 2012 ("They look like cigarettes . . . they smoke like cigarettes. They taste better than a cigarette because they have flavors . . . such as grape, vanilla, and chocolate."). I have delivered three packs of these grape cigarettes to the Clerk's Office, to be included as Exhibit B to this response. Tex. R. App. P. 10.2 (Evidence on Motions). But whatever plaintiffs label their tobacco products for purposes of avoiding federal law and local taxes, any reasonable observer would call them flavored cigarettes. The House Committee on Energy and Commerce, in which the federal ban on flavored cigarettes originated, agrees that few consumers would mistake these products for real cigars. *See, e.g.*, Letter from Congressman Henry A. Waxman to Bill Greiwe, President and CEO (Oct. 2, 2009) (Ex. A) ("We are investigating the allegations that Cheyenne's 'little cigars' . . . are no different than flavored cigarettes and are merely an attempt to circumvent the recent FDA regulatory action by continuing to market tobacco products that appeal to children."). Plaintiffs apparently have confused their own marketing for the truth. *Cf.* Consolidated and Further Continuing Appropriations Act, 2012, Pub. L. 112-55, sec. 743, 125 Stat. 551 (2012) (successful effort by Frozen pizza manufacturers to convince Congress to declare their

A former Justice of the Texas Supreme Court once argued that a motion for sanctions is "used to curb not frivolous arguments, but dangerous arguments." Craig T. Enoch, *Incivility in the Legal System? Maybe It's the Rules*, 47 SMU L. REV. 199 (1994). On this we stand shoulder to shoulder with Justice Enoch. The Court should deny the motion.

PRAYER

The Court should deny the motion for sanctions, reverse the judgment of the trial court, and render judgment dismissing plaintiffs' claims for lack of subject-matter jurisdiction.

product a vegetable).

Respectfully submitted.

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I certify that on May 5, 2014, this brief was served via File&ServeXpress to the following counsel for Appellees:

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CERTIFICATE OF COMPLIANCE

In compliance with Texas Rule of Appellate Procedure 9.4(i)(2), this brief contains 4,585 words, excluding the portions of the brief exempted by Rule 9.4(i)(1).

/s/ Arthur C. D'Andrea
ARTHUR C. D'ANDREA

No. 03-13-00753-CV

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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

APPENDIX

Ex. A — Letter from Congressman Henry A. Waxman to Bill Greiwe, President and CEO (Oct. 2, 2009)

Ex. B — One hard pack of Cheyenne 100's cigarettes (grape flavored)

Exhibit A

HENRY A. WAXMAN, CALIFORNIA
CHAIRMAN

JOE BARTON, TEXAS
RANKING MEMBER

ONE HUNDRED ELEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON ENERGY AND COMMERCE
2125 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6115

Majority (202) 225–2927
Minority (202) 225–3641

October 2, 2009

Mr. Bill Greiwe
President and CEO
Cheyenne International, LLC
701 South Battleground Avenue
Grover, NC 28073

Dear Mr. Greiwe:

The Committee on Energy and Commerce and its Subcommittee on Oversight and Investigations are investigating the marketing and sale of tobacco products to children. On September 22, 2009, the U.S. Food and Drug Administration banned the sale of flavored cigarettes. FDA took this action under the authority of the Family Smoking Prevention and Tobacco Control Act, a law that originated within this Committee.

According to public health groups, your company is attempting to circumvent this ban by repackaging your flavored cigarettes as "little cigars."[1] The "little cigars" you market include products with peach, vanilla, wild cherry, grape, and "xotic berry" flavors. In addition, Cheyenne also markets "Body Shot" cigars in various flavors including whiskey, mojito, and rum & cola.

The Family Smoking Prevention and Tobacco Control Act defines a cigarette as a product that:

> meets the definition of the term 'cigarette' in section 3(1) of the Federal Cigarette Labeling and Advertising Act; and includes tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette or as roll-you-own tobacco.[2]

---

[1] Letter from Matthew L. Myers, Campaign for Tobacco-Free Kids, et al, to FDA Docket Number FDA-2009-N-0294 (August 27, 2009).

[2] 21 U.S.C. § 387.

The Federal Cigarette Labeling and Advertising Act defines cigarettes as:

> (A) any roll of tobacco wrapped in paper or in any substance not containing tobacco, and (B) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in subparagraph (A).[3]

We are investigating the allegations that Cheyenne's "little cigars" and "Body Shot" cigars are no different than flavored cigarettes and are merely an attempt to circumvent the recent FDA regulatory action by continuing to market tobacco products that appeal to children. To assist us in our investigation, we ask that you provide the following documents and information to the Committee, from January 1, 2004 to the present:

1. Cheyenne's official corporate definition of flavored cigars, flavored little cigars, and flavored cigarettes and, if none exists, a written explanation of how Cheyenne's flavored little cigars and flavored cigars differ from flavored cigarettes;

2. A written explanation supporting Cheyenne's position that its flavored little cigars and flavored cigars cannot be regulated as cigarettes under federal law;

3. All internal and external communications related to Cheyenne's decision to market flavored little cigars and flavored cigars;

4. All marketing materials related to Cheyenne's flavored little cigars and flavored cigars, including (a) all advertisements and a schedule of publications in which they have appeared to date, and (b) the marketing budget for Cheyenne's flavored little cigars and flavored cigars for calendar 2009 to date;

5. All marketing or consumer research related to Cheyenne's flavored little cigars and flavored cigars, including, but not limited to, research related to the age of consumers of flavored tobacco;

6. All corporate policies and actions by Cheyenne to ensure that its flavored little cigars and flavored cigars are not consumed by minors. Please include a detailed description of all costs Cheyenne has incurred to implement these policies and actions.

7. A detailed break-down of all Cheyenne's sales of flavored little cigars and flavored cigars in comparison to your other non-flavored tobacco products, including total sales, monthly sales, sales per distributor, and sales per retailer.

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[3] 15 U.S.C. § 1332.

Please produce the requested information by October 16, 2009. In addition, please inform Committee staff by October 9, 2009, as to whether you will provide the requested information voluntarily.

An attachment to this letter provides additional information on how to respond to Committee requests. If you have questions regarding this request, please contact David Leviss or Paul Jung of the Committee staff at (202) 226-2424.

Sincerely,

Henry A. Waxman
Chairman

Bart Stupak
Chairman
Subcommittee on Oversight and Investigations

Enclosure

cc: The Honorable Joe Barton
Ranking Member

The Honorable Greg Walden
Ranking Member
Subcommittee on Oversight and Investigations

Exhibit B

[This physical exhibit is on file with the Clerk’s office.]