NO. 03-13-00753-CV

IN THE COURT OF APPEALS FOR THE
THIRD JUDICIAL DISTRICT OF TEXAS AT AUSTIN

****

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 JUDICIAL DISTRICT COURT,
TRAVIS COUNTY, TEXAS

****

AMICUS CURIAE BRIEF OF McLANE COMPANY, INC. IN SUPPORT OF APPELLANTS

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ORAL ARGUMENT REQUESTED

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AMICUS CURIAE BRIEF

TO THE HONORABLE JUDGES OF THIS COURT:

Amicus, McLane Company, Inc. ("McLane") respectfully submits this amicus curiae brief pursuant to Texas Rule of Appellate Procedure 11 in support of Appellants, Susan Combs, Texas Comptroller, and Greg Abbott, Texas Attorney General, and urges this Court to reverse the Travis County District Court's granting of Appellees' motion for summary judgment and issuance of an injunction preventing the collection of the cigarette fees in issue.

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STATEMENT OF INTEREST – McLANE COMPANY, INC.

The tobacco litigation resolved in the State in the late 1990s effectively creates two classes of cigarette manufacturers in Texas—those that pay additional fees to help the State afford increased medical and regulatory costs associated with smoking and those that do not. In 2013 the Texas Legislature enacted a new fee in House Bill 3536 (codified at Texas Health and Safety Code §§ 161.601 *et seq.*)[1] that is levied against only the second category of manufacturers, the so-called "non-settling manufacturers."

McLane is a "distributor" of cigarettes as such term is defined in Texas Tax Code § 154.001 and Texas Health and Safety Code § 161.601. As a distributor, McLane bears the responsibilities of purchasing and affixing cigarette tax stamps to packages of cigarettes, which constitutes payment of the cigarette tax, and filing various reports with respect to purchases and sales of cigarettes. McLane has a strong interest in the outcome of this case because the State's ability to exercise its police powers uniformly against settling and non-settling cigarette manufacturers greatly affects McLane's operations in the marketplace. As the largest distributor and participant in the State's system of regulating and taxing cigarettes, McLane

[1] Act of June 14, 2013, 83d Leg., R.S at § 1 (eff. Sept. 1, 2013) (codified at Tex. Health & Safety Code § 161.601 *et seq.*) ("House Bill 3536"). When citing to specific provisions in House Bill 3536, this brief will reference provisions by their codified section number in the Texas Health and Safety Code.

has a vested interest in the evenhanded application of the State's tobacco jurisprudence.

McLane will pay all attorneys' fees incurred in the preparation of this amicus brief.

ISSUES PRESENTED

1. House Bill 3536 describes the new assessment against non-settling cigarette manufacturers as a "fee." Is the assessment made by the statute a fee or a tax under Texas law? If House Bill 3536's assessment is a fee, then the fee is entitled to a presumption of constitutional validity, and it may be held unconstitutional only if it is so excessive as to have no reasonable relationship to the State's regulation of cigarettes and cigarette sales.
2. If House Bill 3536's assessment is a tax under Texas law, it is entitled to a presumption of constitutional validity. It may be held unconstitutional if it creates a tax classification that lacks a reasonable basis. Is there a reasonable basis for enacting a tax against only the non-settling cigarette manufacturers?

SUMMARY OF THE ARGUMENT

McLane fully supports Appellants' submission that House Bill 3536 is a constitutional enactment by the State of Texas. As McLane sets forth later in this brief, House Bill 3536 is sustainable as a constitutional tax. McLane submits, however, that House Bill 3536 should be sustained as a regulatory fee. McLane files as amicus because neither the district court, Appellants, nor Appellees have addressed with specificity whether the assessment made by House Bill 3536 is properly characterized as a fee or a tax under Texas law, and such a determination is vital to this litigation. As an active participant in the State's various systems and mechanisms of regulating and taxing cigarettes and other tobacco products, McLane has a vested interest in ensuring fair and equitable application of the State's tobacco laws.

Although the parties have filed briefs based on the assumption that House Bill 3536 exacts a tax, as compared to the statutory description of a fee, McLane submits that further analysis is warranted. Appellants have correctly identified that House Bill 3536 has "non-revenue" purposes and is an exercise of the police power,[2] which McLane urges leads to a conclusion that the provisions of House Bill 3536 may be considered as regulatory. As the Texas Supreme Court has

[2] *See* Reply Br. of Appellants at 10.

written, "[i]t is sometimes difficult to determine whether a given statute should be classified as a regulatory measure or as a tax measure." *See Hurt v. Cooper*, 110 S.W.2d 896, 899 (Tex. 1937). The Texas Supreme Court has come down on both sides of this analysis in various cases. *Compare Hurt*, 110 S.W.2d at 899-90 (holding that an assessment against chain stores by a state statute was an occupation tax), *with City of Fort Worth v. Gulf Refining Co.*, 83 S.W.2d 610, 620 (Tex. 1935) (holding that Fort Worth's ordinance making an assessment against gasoline filling stations was a fee and not a tax). Fees are enacted pursuant to the legislature's police powers under the state constitution; taxes are levied under the taxing power. The difference between a tax and a fee is that the primary purpose of a tax statute is to raise revenue while the primary purpose of a fee statute is to regulate.

All cigarettes are taxed—for the purpose of raising revenue—under Chapter 154 of the Texas Tax Code, the "cigarette tax." The products of both settling and non-settling manufacturers are taxed the same under the cigarette tax statutes. The cigarette tax is not in issue in this case, and it is incorrect to construe House Bill 3536 as a new or additional cigarette tax.

There is no dispute that cigarettes are highly regulated products in Texas. It is also a fact that the use of cigarettes increases the State's public health

expenditures. Both Appellants and Appellees have made extensive reference in their briefs to the Texas tobacco litigation of the late 1990s in which the State sued the five largest cigarette manufacturers doing business in Texas.[3] That case was dismissed pursuant to a Comprehensive Settlement Agreement and Release in 1998. The settlement agreement between the State of Texas and the five settling manufacturers provides for, among other things, the "unprecedented and comprehensive regulation of the tobacco industry."[4] The Texas Settlement Agreement requires the settling manufacturers to make payments to the State for various stated purposes, many of which are regulatory in nature.

House Bill 3536 serves as a statutory bridge to require non-settling manufacturers to share the burden of funding the regulatory scheme described in the Texas Settlement Agreement as well as other public health measures related to cigarettes. The stated legislative purpose of the bill is to place non-settling manufacturers in the same position as settling manufacturers vis-à-vis the Texas Settlement Agreement. As such, the passage of House Bill 3536 stands as an

[3] The five defendants in the lawsuit were Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, and United States Tobacco Company. The case was styled *State of Texas v. The American Tobacco Company, et al.* and was Cause No. 5.96cv91 in the United States District Court, Eastern District of Texas.

[4] *See* Comprehensive Settlement Agreement and Release (the "Texas Settlement Agreement") at the 4th WHEREAS para.

exercise of the legislature's police powers, not its taxing power, and the financial obligations in the bill are regulatory fees, not revenue-raising taxes. In order for House Bill 3536's fee to be held unconstitutional, Appellees must show that it is so excessive as to have no reasonable relationship to the State's regulation of cigarettes and cigarette sales or that it violates the equal protection clause. Because Appellees have not carried that burden, this case should, at a minimum, be remanded for a trial on the merits.

Alternatively, if House Bill 3536 is deemed to have enacted a tax and not a fee, McLane agrees with Appellant that the trial court erred by holding that requiring payment by only non-settling manufacturers creates a tax classification without a reasonable basis. Under Texas law, businesses of the same nature with the same operations can be taxed differently if there is a reasonable basis for the different treatment. Choices made by the non-settling manufacturers, the greater risk and burden borne by the settling manufacturers, and the settling manufacturers' internalizing of costs associated with the State's regulation of cigarettes all provide reasonable bases for the different tax treatment under Texas law.

ARGUMENT

I. THE TRIAL COURT ERRED WHEN IT GRANTED SUMMARY JUDGMENT FOR APPELLEES BECAUSE IT APPLIED CONSTITUTIONAL STANDARDS APPLICABLE ONLY TO TAX STATUTES. THE ASSESSMENTS MADE IN HOUSE BILL 3536 ARE FEES, NOT TAXES, AND THE FEES ASSESSED IN HOUSE BILL 3536 ARE CONSTITUTIONAL.

The trial court took a wrong turn at the outset of this case when it construed House Bill 3536 as a tax statute without consideration of whether it enacts a tax or assesses a fee. Different constitutional standards apply to tax statutes and regulatory measures that assess fees. The trial court's judgment should be reversed, and this Court should render judgment for Appellants or remand the case for a trial on the merits with instructions that House Bill 3536 is a regulatory fee statute and not a tax statute.

A. The overriding characteristic of a statute imposing a fee is that the purpose of the statute, when construed as a whole, is regulatory in nature.

The Texas Supreme Court's decisions in *Hurt v. Cooper* and *City of Fort Worth v. Gulf Refining* reach opposite conclusions in the fee/tax analysis, but the cases agree on the rules of law to be applied. Whether a statute imposes a fee or a tax is a question of fact. *See City of Houston v. Harris County Outdoor Advertising Ass'n*, 879 S.W.2d 322, 326 (Tex. App.—Houston [14th Dist.] 1994, writ denied). In answering the question, the trier of fact must consider the statute

as a whole and determine what is the primary purpose of the statute's assessments. *See Hurt*, 110 S.W.2d at 899; *see also Lowenberg v. City of Dallas*, 261 S.W.3d 54, 57-58 (Tex. 2008) (citing *Hurt v. Cooper*). If the primary purpose of the statute is to raise revenue, then it is a tax statute. *See Hurt*, 110 S.W.2d at 899; *City of Fort Worth*, 83 S.W.2d at 617. If the primary purpose of the statute is to regulate an activity or an object, then it is imposing fees not taxes. *See Hurt*, 110 S.W.2d at 899. When the legislature enacts a fee statute, it is exercising its police powers, and the State's police powers are broader in permissible scope than its taxing powers. *See City of Houston*, 879 S.W.2d at 326.

The holdings in *Hurt v. Cooper* and *City of Fort Worth v. Gulf Refining Co.* demonstrate that a close analysis of the law in issue is required when making the fee/tax determination. In *Hurt*, the Court considered a state statute that imposed an assessment on owners of mercantile establishments. *See Hurt*, 110 S.W.2d at 898-99. The Court analyzed each of the twelve sections of the act, including Section 9, which provided that the Texas Comptroller's expenses in enforcing the statute would not exceed the revenue received, and Section 12, which described the State's generalized need for additional revenue. *See id.* The Court also noted that the act required two different payments: Section 2 required a payment be submitted with a license application while Section 5 required a per-store annual fee on a

graduated scale. *See id.* Finally, the Court highlighted the fact that Section 9 of the act apportioned all collected revenue between the general fund and the school fund. *Id.* Based on its analysis and the rule of law emphasizing that the purpose of a law determines whether it is a tax or a fee, the Court concluded, "we experience no difficulty in reaching the conclusion that the so-called license fees levied [by the act] are primarily occupation taxes." *Id.* at 899.

The Court reached the opposite conclusion in *City of Fort Worth v. Gulf Refining Co.* This case concerned a challenge to an ordinance passed by the City of Fort Worth that assessed an annual fee on the operation of gasoline filling stations. *See City of Fort Worth*, 83 S.W.2d at 611-13. The challenged ordinance was a single-issue ordinance pertaining only to the fee. *Id.* The Court, however, considered it important to review other measures enacted by the city to address gasoline filling stations. *Id.* A second ordinance addressed matters related to the location of filling stations, and a third "comprehensive ordinance" regulated the storage and handling of gasoline. *Id.* at 613. In addition to the ordinances themselves, the Court noted the extensive testimony by various witnesses at trial about the importance of the city's regulation of gasoline. *Id.* at 615-17. Ultimately, the Court concluded that the assessments in the city ordinance were fees. *Id.* at 617.

The Court's methodology in *City of Fort Worth* provides a roadmap for the Court of Appeals in this case. The Court's first important holding in *City of Fort Worth* was that, when determining if the assessment was a tax or a fee, the three gasoline ordinances in issue may be construed together as one regulatory scheme. *See id.* If the single-issue ordinance imposing the fee was considered on its own, it would appear to be solely a revenue-raising measure, but the ordinance's role in the "machinery of the entire city" was significant to the Court. *See City of Fort Worth*, 83 S.W.2d at 617. In the language of the Court:

> The fact that this ordinance does not contain all the regulatory features it might appropriately have contained, of which it was contemplated filling stations should be subjected to, does not in the least mitigate against its validity or demonstrate that its purpose was solely to raise revenue. *Id.* at 619.

When construing House Bill 3536, this Court may consider the bill on its own or, along with the Texas Settlement Agreement and other cigarette laws, as part of the State's comprehensive policy toward cigarettes.[5] This brief construes House Bill 3536 both as a standalone measure and as part of the State's broader regulatory framework. In either case, the bill is properly characterized as a regulatory measure, and its exactions are fees.

[5] For an example of other laws that play a part in regulating cigarettes in Texas, see Texas Health and Safety Code, chapter 161, subchapter H, regarding sales to minors.

Second, the Court in *City of Fort Worth* emphasized that the government has a duty to ensure that its regulations are "continuously obeyed" and that the collection of a fee to support enforcement is permitted so long as the fee is not excessive or clearly unreasonable. *Id.* at 617-18. Financial exactions are necessary to the enforcement of government regulation. The Court noted the extensive reviews and studies that were required before a filling station could be constructed on a particular site, the numerous city officials who played roles in the safe construction and operation of filling stations, the city's role in ensuring that the public was protected from deceptive operators, and the city's efforts to prepare for foreseeable accidents related to filling stations. *See id.* at 618-19. Similar to the City of Fort Worth's duty to the public concerning filling stations, the State of Texas must ensure that the State's cigarette laws are followed. The continuous enforcement of cigarette laws requires financial support separate and apart from the government's need to simply raise revenue under the cigarette tax—which revenue can be used for all kinds of purposes. House Bill 3536 was enacted to ensure that all cigarette manufacturers participated in carrying this regulatory burden.

Finally, the Court explicitly held that the mere fact that a law raises revenue does not mean that it is a tax. The Court opined, "[t]he fact, however, that the

effect of a licensing ordinance does incidentally raise revenue does not militate against its validity." *See id.* at 617. Although raising revenue may be a hallmark of a tax statute and not a fee statute, sometimes raising revenue is only ancillary to the larger purpose of a law. The Court recognized this axiom in *City of Fort Worth*. The filling station annual fee may have raised revenue for the city—and perhaps that revenue was greater than what was necessary to regulate filling stations—but the primary purpose of the ordinance was to support a larger regulatory scheme while the revenue aspect was "incidental." For this reason, the Court determined that the exaction was a fee, not a tax. McLane, as amicus, urges the Court that a similar holding is warranted in this case.

In conclusion, the fee/tax analysis hinges on what the Court considers to be House Bill 3536's primary purpose. When there is a doubt as to whether a statute's purpose is for revenue or regulation, courts should err on the side of considering the statute to be a regulatory measure. In *Hanzal v. City of San Antonio*, barbers attacked a city ordinance that levied fees on all persons operating in the city as barbers. *See Hanzal*, 221 S.W. 237, 238 (Tex. Civ. App.—San Antonio 1920, writ denied). The court ultimately upheld the constitutionality of the assessment as a fee. *See id.* at 242. In making its holding, the court opined:

> Though reasonable doubts may exist as to the power of the Legislature to pass a law, or as to whether the law is calculated

> or adapted to promote the health, safety, or comfort of the people, or to secure good order, or promote the general welfare, we must resolve them in favor of the right of that department of the government. *See id.* at 239 (quoting *Holden v. Hardy*, 169 U.S. 366, 397 (1897)).

If this Court has doubts, it should follow *Hanzal* and resolve any doubts about House Bill 3536 in favor of the bill being considered an exercise of police powers as defined by the legislature and not a tax bill. But McLane believes that reliance on *Hanzal*, while useful, is not necessary because an analysis of the Texas Settlement Agreement and House Bill 3536 demonstrate that the bill is a regulatory measure.

B. When construed on its own, House Bill 3536 is an administrative reporting statute that assesses a fee to recover the costs inherent in its application.

In order to determine whether the exactions made by House Bill 3536 are fees or taxes, the Court must conduct a review of the statute similar to the reviews conducted in *Hurt* and *City of Fort Worth*. The first exercise that the Court should employ is to construe the meaning and purpose of House Bill 3536 standing on its own. When analyzed on its own, the statute contains two major components—it imposes two new reporting requirements and it exacts a new fee. Enacting new reporting requirements on cigarette distributors and non-settling manufacturers

represents the legislature's exercise of its police powers, and the imposition of the fee supports the enforcement of the new reporting regulations.

House Bill 3536 implements two new reporting requirements. Section 161.606 requires all non-settling manufacturers entering into the Texas market after September 1, 2013, to provide a report, on a prescribed form, to the Office of the Texas Attorney General.[6] House Bill 3536 describes the information that should be disclosed on the new report form.[7] In addition, § 161.605 mandates a second type of new report. The second report must be filed monthly by all distributors, such as McLane, and this report will inform the State of the following specific information: (1) the number of tax stamps affixed to non-settling manufacturers' cigarettes, (2) the amount of non-settling manufacturers' cigarettes subject to the cigarette tax, (3) the amount of non-settling manufacturers' cigarettes not subject to the cigarette tax but otherwise sold or distributed in Texas, (4) the calculation of the fee owed under House Bill 3536, and (5) any other "necessary or appropriate" information requested by the Texas Comptroller.[8] Non-settling manufacturers are not required to file this second report *or pay the assessed fee*;

[6] Tex. Health & Safety Code § 161.606.

[7] Tex. Health & Safety Code § 161.606.

[8] Tex. Health & Safety Code § 161.605.

that burden falls on the distributors. This second report provides important information to the State for the continued regulation of cigarettes.

The Texas Supreme Court's opinion in *City of Fort Worth* specifically identifies the gathering of information by the government as an element of a regulatory law. In its opinion in *City of Fort Worth*, the Court notes at least two occasions where reports must be made to the City. The first involves a report that must be prepared by a city employee when a new site is proposed for a gas station, and the second relates to reports that are made upon inspections by City employees. *See City of Fort Worth*, 83 S.W.2d at 615, 617-18. The Court highlights the importance of government inspections and information gathering in ensuring that the laws of the City are continuously obeyed. *See id.* at 617. Although House Bill 3536 does not exclusively utilize government employees to gather information—mandating and reimbursing distributors for certain reporting—government employees nonetheless are statutorily required to publish and maintain data sources and work within the information derived from the statute's reporting requirements as part of a comprehensive scheme regulating the sale of cigarettes. In this respect, House Bill 3536's reporting requirements are similar to the reports and inspections required by the ordinances in *City of Fort Worth* that supported the regulation of gas stations.

In enacting House Bill 3536, the legislature identified five purposes for the law, and four of these are directly supported by the law's mandate for new reports. Section 161.601 notes the following five purposes behind the law: (1) recovering health care costs, (2) preventing non-settling manufacturers from undermining the State's goal of reducing underage smoking, (3) protecting the Texas Settlement Agreement and its funding, (4) ensuring the evenhanded treatment of settling and non-settling manufacturers, and (5) obtaining funding.[9] The first, second, third, and fourth purposes of House Bill 3536 could not be achieved without the new mandated reports. The new reports are essential to ensuring the continuous enforcement of House Bill 3536 and the State's cigarette laws.

One innate characteristic of regulation is that it often increases administrative burdens, and new or increased fees are required to offset the costs associated with those administrative burdens. House Bill 3536 is no different in that it has mandated two new reports that must be prepared and processed. The legislature, recognizing the new burden it has placed on distributors to prepare the reports required by § 161.605, allows distributors who sell cigarettes of non-settling manufacturers an additional "stamping allowance."[10] The stamping

[9] Tex. Health & Safety Code § 161.601.

[10] Tex. Health & Safety Code § 161.605(e).

allowance permitted under Tax Code chapter 154 acts as a credit against tax stamp purchases. The credit is retained by distributors as consideration for playing their role in the State's cigarette tax and regulatory system, including for affixing cigarette tax stamps to packages of cigarettes.[11] Because House Bill 3536 places a new administrative burden on distributors selling cigarettes of non-settling manufacturers, the legislature has permitted an additional stamping allowance, but only to those who report and remit the fee assessed by House Bill 3536. The fee assessed by House Bill 3536 offsets these additional stamping allowances reimbursing distributors like McLane. The fee also recognizes the new burden on state agencies to process the reports required by §§ 161.605 and 161.606. Because House Bill 3536's assessment relates to the new costs associated with administrative and regulatory burdens, it is properly characterized as a fee and not a tax.

House Bill 3536 stands on its own as an administrative reporting law. Information gathering by the government is an exercise of police powers to support and aid in enforcing state laws. House Bill 3536 supports the enforcement of cigarette laws by requiring the submission of information from non-settling manufacturers and about the movement of non-settling manufacturers' products in

[11] Tex. Tax Code § 154.052.

Texas. The Texas Settlement Agreement requires the periodic submission of information by settling manufacturers, and House Bill 3536 fills the void for manufacturers not covered by the agreement. Gathering the information required by House Bill 3536 imposes new costs on the government and on distributors, and the law attempts to recover some or all of these costs by exacting a new assessment. The purposes of House Bill 3536 and its assessment are rooted in the tracking, monitoring, and regulation of cigarettes. House Bill 3536 allows the state to further investigate and track for regulatory purposes the manufacturing, promotion, and sale of cigarettes manufactured by those entities who are not subject to the restrictions imposed on settling manufacturers.[12] Therefore, the assessment is properly deemed a fee.

[12] Appellees, in their Motion for Review of Supersedeas Order filed before this Court, provided affidavits stating that sales of cigarettes by certain of their members who are non-settling manufacturers have dropped more than 50% after they raised their prices in advance of implementation of House Bill 3536. Since House Bill 3536 imposes its fees at the distributor level, it is not clear how a manufacturer's price increase would be caused by the statute's fees. McLane, which is very selective of the brands of cigarettes it sells that are produced by non-settling/subsequent-participating manufacturers, has not observed any significant decrease in the House Bill 3536 fees it remits monthly to the state, which would seem to question the impact of the fee itself on sales and indicate that other factors may be at issue.

C. When construed as part of a larger regulatory framework, House Bill 3536 has a common purpose with the Texas Settlement Agreement—the regulation of the sale and marketing of cigarettes in Texas and the funding of health and safety measures related to cigarette use.

The Supreme Court's opinion in *City of Fort Worth* directs that when conducting the fee/tax analysis, a statute may also be construed as part of the government's larger regulatory framework. House Bill 3536 can be viewed as just one small part of the State's response to the problems and costs related to cigarette use.

Tax Code chapter 154 has enacted a tax on cigarettes for the purpose of raising revenue for the State. But the State has also crafted a comprehensive plan for regulating cigarettes separate and apart from the cigarette tax. Whether under a settlement agreement or as a fee statute, the State is not restricted to a sole method of enforcing its cigarette laws or of regulating cigarettes. The State has a duty to ensure that all cigarette manufacturers continuously obey its laws, and the settling manufacturers have agreed to pay, separate from any allegations of past activity, amounts dedicated to this continuing, going-forward purpose. The principal purpose of House Bill 3536 is to require non-settling manufacturers to participate in funding the State's regulatory scheme.

1. The Texas Settlement Agreement incorporates a regulatory framework for the sale and use of cigarettes.

The Texas Settlement Agreement culminated years of litigation against the five largest tobacco companies doing business in Texas. In the litigation, the State made allegations of wrongdoing against the tobacco companies and argued that the alleged bad acts caused the State to suffer losses in the form of increased health costs. Cigarette use often resulted in medical problems, and for many patients, the State was required to pay the bill. In this respect, it is easy to view the Texas Settlement Agreement as merely the settling manufacturer's agreement to make recompense for misdeeds, as Appellees have argued.[13]

Appellees' view of the Texas Settlement Agreement, however, is far too narrow. Although it cannot be denied that the State alleged wrongdoing and damages, one principal function of the agreement was to support the State's desire to regulate the marketing, sale, and use of cigarettes. The settling manufacturers did pay billions over the settlement's first five years, but the settlement agreement also contains forward-looking regulatory provisions designed to change the industry. In addition to the upfront payments, the settling manufacturers agreed to

[13] *See* Br. of Appellees at 22.

make billions of dollars in "Annual Payments" to Texas forever into the future.[14] The settling manufacturers also agreed to various marketing and advertising restrictions, which required removal of advertising for their tobacco products from billboards, buses, taxies, trains, and transit locations. These aspects of the Texas Settlement Agreement belie a regulatory purpose that extends beyond just the conclusion of the initial litigation.

A closer reading of the Texas Settlement Agreement reveals its regulatory purpose. The fourth WHEREAS paragraph in the recitals of the agreement hails the agreement and the underlying Memorandum of Understanding as having "been agreed to by members of the tobacco industry, state attorneys general, private litigants, and representatives of public health groups . . . for unprecedented and comprehensive regulation of the tobacco industry . . . ."[15] The settling manufacturers and the State entered into the Texas Settlement Agreement in order to permit Texas to receive the benefits it would have received under the Memorandum of Understanding.[16]

Key provisions of the Texas Settlement Agreement indicate that it has a regulatory purpose. Section 5 of the agreement mandates uses for some of the

[14] *See* Texas Settlement Agreement at §10.

[15] *See* Texas Settlement Agreement at WHEREAS para. 4.

[16] *See* Texas Settlement Agreement at WHEREAS para. 6.

amounts to be paid by the settling manufacturers. Under section 5 some of the funds will be used for the Children's Health Insurance Program, the Texas Children's Cancer Institute, the Texas Foundation for Children and Public Health, smoking cessation programs, enforcement of juvenile smoking laws, counter-marketing efforts directed toward youth, anti-tobacco education programs, and other public health measures.[17] The usage of funds required by the Texas Settlement Agreement supports the conclusion that the agreement was not merely a mechanism for settling litigation; it was also an integral part of the State's strategy for regulating tobacco use and improving public health.

In addition to the funds usage provisions in section 5, the Texas Settlement Agreement contains provisions that directly regulate cigarette sales. Section 6 of the agreement eliminates billboard and transit advertisements and incorporates an administrative process for locating such advertisements throughout the state.[18] Section 7 requires cooperation in efforts to curb underage smoking, including limitations on vending machine sales.[19] And section 9 compels participation in and support of a pilot program aimed at the "meaningful and immediate reduction of

[17] *See* Texas Settlement Agreement at §5.

[18] *See* Texas Settlement Agreement at §6.

[19] *See* Texas Settlement Agreement at §7.

the use of Tobacco Products by children under the age of 18 years."[20] As a final matter, section 12 contemplates that some or all of the regulatory provisions of the settlement agreement may ultimately be incorporated into future legislation—but this step is not required by the agreement in order for the regulatory measures to be enforceable against the settling manufacturers.[21] In other words, the parties agreed that the regulation of cigarettes could be carried out under the auspices of the Texas Settlement Agreement itself, thus making the agreement a source of regulation.

Although the Texas Settlement Agreement was borne out of litigation between the State and the five largest tobacco manufacturers, the role played by the agreement is much larger than merely settling the State's claims. The Texas Settlement Agreement provides a unified response and a framework for regulating cigarette sales in Texas and an avenue for funding that framework. In 2013 the Texas Legislature was faced with the issue of whether the settling manufacturers should bear the burden of funding the State's regulatory scheme alone or whether the non-settling manufacturers should bear a portion of this burden. The

[20] *See* Texas Settlement Agreement at §9.

[21] *See* Texas Settlement Agreement at §12.

legislature indicated its desire that the non-settling manufacturers participate by enacting House Bill 3536 as a regulatory measure under its police powers.

2. One primary purpose of House Bill 3536 is to require non-settling manufacturers to share the cost of the State's framework for regulating cigarettes.

McLane argued in part I-B of this brief above that House Bill 3536 could be construed on its own as a regulatory measure. The statute can also be interpreted as part of a larger regulatory scheme, including the Texas Settlement Agreement, employed by the State as a response to the financial and social costs relating to cigarette use. Although the codification of a statute does not necessarily determine its purpose, the legislature codified House Bill 3536 in subtitle H, "Public Health Provisions," of the Health and Safety Code—the bill was not codified in the Tax Code along with the cigarette tax.[22] The Public Health and Safety Code deals with regulatory measures related to a variety of topics such as health programs, infectious diseases, tanning and tattoo facilities, air quality, and dangerous drugs. The legislature's choice to include House Bill 3536 in the Public Health and Safety Code indicates a regulatory purpose.

The legislature also included an express "Purpose" section in the bill, and the purpose statements illustrate the law's regulatory nature. The first and third

[22] *See* Tex. Health & Safety Code § 161.601 *et seq.*

purpose statements, when read together, illustrate the legislature's goal of preserving funding for the State's framework for regulating cigarettes. Purpose statement number one references the recovery of health care costs expended by the State as a result of cigarette use, and statement number three identifies the need to "protect the tobacco settlement agreement and funding."[23] Because one of the primary objectives of the Texas Settlement Agreement was to implement a state-wide framework for the regulation of cigarette sales, including securing adequate funding for implementing the framework, House Bill 3536's stated goal of "protect[ing] the tobacco settlement agreement and funding" is directly related to regulation, not raising revenue. The Bill Analysis (Engrossed) for House Bill 3536 highlights this purpose in the "Author's/Sponsor's Statement of Intent" by arguing that the bill is necessary to "protect the programs funded by the tobacco settlement agreement."[24] As the Texas Supreme Court reasoned in *City of Houston*, the government has a duty, through obtaining proper funding, to ensure that its regulations are "continuously obeyed." *See City of Fort Worth*, 83 S.W.2d at 617.

The second purpose statement included in House Bill 3536 also reveals its regulatory purpose. Purpose statement number two indicates that the legislature

[23] Tex. Health & Safety Code § 161.601(1), (3).

[24] "Author's/Sponsor's Statement of Intent," Bill Analysis (Engrossed) for House Bill 3536, available at Texas Legislature Online.

continues to be motivated by a desire to reduce underage smoking. The legislature viewed House Bill 3536 as necessary to "prevent non-settling manufacturers from undermining this State's policy of reducing underage smoking by offering cigarettes and cigarette tobacco products at prices that are substantially below the prices of cigarettes and cigarette tobacco products of other manufacturers."[25] With this statement, the legislature is addressing its belief that the cigarettes of settling manufacturers have a higher sales price to the consumer because the settling manufacturers are internalizing their burden of funding the State's regulatory scheme through the Texas Settlement Agreement. Appellants and Appellees have briefed, debated, and disagreed on the existence and extent of this practice.

McLane submits that whether the practice is actually carried out, and to what extent it is carried out, is irrelevant to the legal question of whether House Bill 3536 imposes a fee or a tax. The fee/tax question is determined by purpose—and the legislature's stated purposes were to ensure the viability of a regulatory framework and support a public health goal of discouraging underage smoking. Whether or not the amount assessed is excessive or unrelated to the act's purpose, an inquiry that has not taken place, does not play a role in adjudicating whether the assessment is a fee or a tax under Texas law. The purpose statements included in

[25] Tex. Health & Safety Code § 161.601(2).

House Bill 3536—which was ultimately codified as a public health measure—show that the statute is assessing a fee.

The Court may view purpose statement number five as irrefutable evidence that House Bill 3536 is a tax measure, but this conclusion will be incorrect. Purpose statement number five allows that the bill may "provide funding for any purpose the legislature determines."[26] McLane recognizes that such a statement could lend support to a conclusion that the purpose of the statute is to raise revenue, but the Appellees have not established that the legislature has determined any non-regulatory purpose of the funding. Unless and until there are facts establishing there is substantial excess revenue raised and subsequently expended in a manner wholly unrelated to regulation of cigarettes, this is nothing but speculation. Moreover, the Texas Supreme Court has rejected this line of reasoning before. In *City of Fort Worth*, the gas station annual fee statute contained a provision that the fees would be received into the city's general funds, but the Court did not hold that this made the assessment into a tax: "The fact that the revenue derived from the license fees here involved is paid into the general funds of the city does not show that it is a revenue measure . . . ." *See City of Fort Worth*, 83 S.W.2d at 619. The same opinion also provides that the mere fact that

[26] Tex. Health & Safety Code § 161.601(5).

the ordinance raised more revenue than was necessary to carry out the regulations did not make it a revenue measure. *See id.* at 617, 618 ("The fact that the exaction may result in producing a revenue in excess of that required for regulation, does not in itself destroy the regulatory character of a police measure."). Purpose statement number five in House Bill 3536 is less indicative of the statute's overall purpose than the other purpose statements that show the statute to be a regulatory measure.

House Bill 3536 was enacted to require all cigarette manufacturers to participate in how the State has chosen to regulate cigarettes. Some of the State's regulatory measures are statutory, and some are contained in the Texas Settlement Agreement. The Texas Settlement Agreement provides the funding mechanism for the State's regulatory scheme, but this arrangement has become problematic because only the settling manufacturers are burdened with the expense. House Bill 3536 assesses a fee against the non-settling manufacturers to protect the State's regulatory efforts and to further support the State's goals in the area of smoking prevention.

3. The fact that the State has not sued non-settling manufacturers should not absolve them from participating in the State's promotion of public health through the Texas Settlement Agreement.

Appellees have urged that the Court should give great weight to the fact that the Texas Settlement Agreement was the result of litigation in which the State made significant allegations against the settling manufacturers. Appellees' brief poses the following rhetorical question on this point: "If the State sued Small Tobacco for the same legal infractions as Big Tobacco, and Small Tobacco was cleared of any wrongdoing, could the State nonetheless impose a tax on the Small Tobacco companies to recover amounts it would have recovered had it succeeded in the litigation?".[27] Appellees miss the point of House Bill 3536's reference to the Texas Settlement Agreement. The act is not attempting to legislate a tax as a substitute for recovering a judgment for illegal acts; it is assessing a fee necessary to regulate cigarettes as a public health concern.

The Texas Supreme Court highlighted this issue in *City of Fort Worth*. In analyzing the city's ordinances regulating filling stations, the Court noted:

> Moreover, the filling station business is a hazardous one, requiring the utmost care in the handling of oils and high explosives. Potential destruction of life and property by blast and fire exists in every station. Not only do we know these

[27] *See* Br. of Appellees at 22.

> facts from the record, but we take judicial knowledge of them as well . . . . *City of Fort Worth*, 83 S.W.2d at 612.

In *Independent Tobacco Manufacturers v. State*, the Minnesota case involving a fee similar to the fee in House Bill 3536 which both Appellants and Appellees have addressed in their briefs to the Court, the Minnesota Supreme Court made a similar important pronouncement about cigarettes:

> Whether appellants have engaged in any wrongdoing is irrelevant to the inquiry: it is the harmful nature of their products that triggers the payment [of the fee], and that their products are harmful is not disputed. 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. *Indep. Tobacco Mfrs. v. Minn.*, 713 N.W.2d 300, 311 (Minn. 2006).

This Court should take a similar approach to the fee assessed by House Bill 3536.

The Court can and should take judicial notice of the fact that non-settling manufacturers' cigarettes are just as dangerous, pose the same risks, and expose the State to the same costs and regulatory issues as cigarettes sold by settling manufacturers. Just because settling manufacturers were subjected to litigation, and the funding for the State's regulatory response to cigarettes was wrought from that litigation, does not mean that non-settling manufacturers are immune from participating in funding the regulatory scheme as a public health measure. Further,

the State should not have to sue every cigarette manufacturer after it enters into the Texas market to force participation in funding the regulatory scheme. As the court reasoned in *Hanzal*, "Among all the objects sought to be secured by the governing power, none is more vital and important than the preservation of public health." *See Hanzal*, 221 S.W. at 238. House Bill 3536 is a measured step to ensure that (i) all cigarette manufacturers are similarly regulated and (ii) all cigarette manufacturers bear the financial responsibility of regulating cigarettes. As a regulatory measure, its exactions are fees and not taxes under Texas law.

D. Appellees have presented no evidence that the fees assessed in House Bill 3536 are unconstitutionally excessive or lack a reasonable basis.

Appellants and Appellees have provided extensive briefing on the constitutional standards that apply to the equal and uniform taxation clause of the Texas Constitution. But the equal and uniform taxation clause applies only to taxes; it does not apply to fees. Appellees must meet a higher standard in order to demonstrate the House Bill 3536's fees are unconstitutional.

The Court in *City of Forth Worth* described the high bar a complainant must reach in order to show that a fee is unconstitutional. In its opinion, the Court makes the following holdings concerning fees:

- Laws imposing fees "under the power to regulate are prima facie valid, and the unreasonableness of the exactions must be made clearly to appear . . . ." *City of Fort Worth*, 83 S.W.2d at 618.
- "As to the reasonableness of a license fee, the rule is that the sum levied cannot be excessive nor more than reasonably necessary to cover the costs of granting the license and exercising proper police regulation." *Id.*
- "The nature of the business sought to be controlled and the necessity and character of police regulations are the dominating elements in determining the reasonableness of the sum to be imposed. *Id.*
- The burden was on the [fee payers] to show that the exaction bore no reasonable relationship to the duties to be performed by the city and its officers with reference to the gasoline station business. *Id.* at 619.

These rules of law concerning the constitutionality of fees are clear. The party contesting the fee must show the unreasonableness or excessiveness of the fee as related to its regulatory purpose. The trial record does not contain any evidence that House Bill 3536's imposition of a fee is excessively more than necessary for the State to continuously enforce its cigarette regulations.

A fee statute must also not violate the equal protection clauses of the Texas and United States constitutions. Appellants' and Appellees' briefs in this case agree on the standard to be applied in an equal protection analysis—*any rational basis* for a tax classification will permit the statute to survive equal protection scrutiny, and classifications will stand unless they are arbitrary and capricious.[28] Appellees' brief agrees that even if its argument is correct that the application of the Texas Constitution's equal and uniform taxation clause carries higher constitutional standards, these higher standards do not apply in the equal protection clause analysis.[29] Because only the rational basis test applies to regulatory fees, House Bill 3536 survives an equal protection challenge. When construed on its own, House Bill 3536 assesses regulatory fees on only those parties that are affected by its new reporting and regulatory requirements. When construed along with the Texas Settlement Agreement as part of a larger regulatory scheme, House Bill 3536 assesses regulatory fees on non-settling manufacturers because the settlement agreement already assesses similarly purposed amounts on the settling

[28] *See* Br. of Appellants' at headings I & II; *see* Br. of Appellees' at heading II.

[29] *See* Br. of Appellees' at 18 ("In conducting an Equal and Uniform inquiry, courts first employ a test similar to the Equal Protection Clause's 'rational basis' test, which permits a statute to survive constitutional challenge when a rational basis is articulated by the legislature or implied by the reviewing court. [Citation omitted.] *But while the Equal Protection analysis ends there*, courts must ***additionally*** consider whether the ***nature and operations*** of the businesses are so different as to warrant unequal treatment." [Underlined italics added; bolded italics in original.]

manufacturers. Such an act by the legislature is not irrational, arbitrary, or capricious.

Appellees argue—and Appellants and McLane dispute—that House Bill 3536's classification between settling and non-settling manufacturers cannot survive scrutiny under the equal and uniform taxation clause's constitutional test. But the mere fact that settling manufacturers pay amounts toward the regulation of cigarettes while non-settling manufacturers do not is enough to pass constitutional muster under the reasonable basis and "arbitrary and capricious" tests applied to the legislature's exercise of its police powers.[30] When the Court properly views House Bill 3536 as a fee statute, the fact that only non-settling manufacturers pay the fee does not render the statute unconstitutional.

In this case, the trial court analyzed and construed House Bill 3536 as a tax statute, and McLane, as amicus, argues that this is an error. The Texas Settlement Agreement is an important part of the State's regulation of the sale, marketing, and use of cigarettes. The agreement is especially important in light of the fact that it secures perpetual funding for the State's regulatory efforts. As set out in *City of Fort Worth*, the fee/tax analysis may be conducted by construing House Bill 3536 on its own or by viewing it in light of the government's entire regulatory scheme.

[30] For a discussion of the Minnesota Supreme Court's opinion concerning Minnesota law on this point, see *Independent Tobacco Manufacturers*, 713 N.W.2d at 310-311.

In either case, House Bill 3536's primary purpose is regulatory. Thus its assessments are fees, not taxes. This Court should reverse the trial court's grant of the Appellees' motion for summary judgment because it analyzed House Bill 3536 as a tax statute. The Court should additionally either remand the case with instructions that constitutionality of the statute be construed as a fee statute or render judgment that the statute is constitutional.

II. IN THE ALTERNATIVE, IF HOUSE BILL 3536 IS A TAX STATUTE, THERE IS A REASONABLE BASIS FOR REQUIRING ONLY NON-SETTLING MANUFACTURERS TO PAY THE TAX.

If the Court holds that House Bill 3536 is a tax statute, the Court must decide whether the tax violates the equal and uniform taxation clause of the Texas constitution. Under the equal and uniform clause, the legislature may treat taxpayers differently so long as it has a "reasonable basis" for doing so. As the Texas Supreme Court recently (and unanimously) observed, "deciding who is taxed . . . is best left to legislators, not courts." *Tracfone Wireless, Inc. v. Comm'n on State Emergency Communications*, 397 S.W.3d 173, 176 (Tex. 2013). Economic classifications among taxpayers enjoy a "strong presumption of constitutional validity" under the equal and uniform clause and will be upheld unless there is "no rational basis" to support them. *Upjohn Co. v. Rylander*, 38 S.W.3d 600, 609 (Tex. App.—Austin 2000, pet. denied). Only "an extreme and a

clear case" of discrimination against a particular group of taxpayers "would justify an interference by the courts." *Hurt*, 110 S.W.2d at 901 (Tex. 1937).

Moreover, the legislature's basis for distinguishing between taxpayers need not be significant or profound to survive scrutiny under the equal and uniform taxation clause. The Third Court of Appeals has held that even "a *slight difference* in the subject matter taxed justifies a separate classification." *American Home Assur. v. Texas Dep't of Ins.*, 907 S.W.2d 90, 98 (Tex. App.— Austin 1995, writ denied) (emphasis added); *see also Fairmont Dallas Restaurants, Inc. v. McBeath*, 618 S.W.2d 931, 933 (Tex. App.—Waco 1981, no writ) ("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").

Appellants and Appellees have both argued the applicability of the constitutional test for equal and uniform taxation in their briefs. Both parties have agreed that classifications made by tax statutes are constitutional under the equal and uniform taxation clause so long as the classifications have a reasonable basis when viewed in light of the nature and operations of the businesses being taxed.[31] Appellees' brief, however, takes the constitutional test one step too far when it argues that, "[w]hen the nature and operations of businesses are the same, the

[31] *See* Br. of Appellants at 12-13, Br. of Appellees at 17-19.

Legislature's attempt to apply different classifications for taxing purposes must be rejected . . . ."[32] In three cases described in this brief, the courts permitted tax classifications where the nature and operations of businesses were the same but where other factors—different choices made by the taxpayers, different risks, or different internalized costs—justified the tax classes.

In 1963 the Texas Supreme Court upheld a tax classification based on the sales prices of similarly situated taxpayers' products. In *Calvert v. Canteen Company*, the Court considered a two percent state sales tax on tangible personal property sold in vending machines. *See Calvert v. Canteen Co.*, 371 S.W.2d 556 (Tex. 1963). Because of the impossibility of assessing an exact two percent tax on vending machine sales, the statute in issue adopted a bracket system. *See id.* at 557. Under the bracket system, sales of products costing 24 cents or less were not assessed tax. *See id.* The plaintiff in the case argued that the tax was not equal and uniform because, depending on the items' sales prices, the actual rate of tax would be different from taxpayer to taxpayer. *See id.* at 558-59. The taxpayer argued that this result violated the equal and uniform taxation clause. The Court disagreed.

[32] *See* Br. of Appellees at 19.

The Court's ultimate holding was based on the fact that the taxpayer could choose the sales price of its products. In the words of the Court, the complaining taxpayers were "required to absorb the tax only because *they have elected* to sell items at a retail price less than the price provided for collectibility *[sic]* from the consumer." *See id* (emphasis added). In summary, even though the nature and operations of vending machine sellers were identical, a tax classification based on the sales price of items was constitutional because the taxpayers had choices, with full knowledge of the effected results, when they set prices for their products.

In *American Home Assurance v. Texas Department of Insurance*, the Third Court of Appeals upheld a tax classification that was based solely on the risks associated with a particular business. In *American Home Assurance*, the plaintiffs alleged that a statute that granted the Texas Workers' Compensation Insurance Fund (the "Fund"), a chief competitor in the workers' compensation insurance industry, a tax credit in the amount of two percent credit of its gross premiums was unconstitutional. *See American Home Assurance*, 907 S.W.2d 90, 97 (Tex. App.—Austin 1995, no writ).[33] The plaintiffs complained that the Fund participated in the same industry as they did and would have an unfair advantage because of the tax credit. *See id.* The court disagreed and held that the legislature could create a tax

[33] This was only one of the equal and uniform taxation violations alleged by Appellees in this case.

classification that granted the credit only to the Fund because the Fund insured a greater proportion of high-risk employers and was the "insurer of last resort." *See id.* The court opined that 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.*" *See id* (emphasis added). Ultimately, *American Home Assurance* stands for the proposition that businesses with an identical nature and identical operations may be taxed differently when they are subjected to different risks and external factors.

The Third Court of Appeals also upheld a tax classification based on the ability of a business to internalize and recover its costs. In *Central Power and Light Company v. Sharp*, the court considered whether the method of calculating a company's taxable surplus under the Texas franchise tax statute was unconstitutional when regulated utility companies were required to capitalize AFUDC-equity[34] but similarly situated private companies were not. *Central Power & Light Co. v. Sharp*, 919 S.W.2d 485, 488-89 (Tex. App.—Austin 1996, writ denied). The nature and operations of the businesses did not drive the tax classification in this case; the classification was driven by an external factor, namely the fact that government regulations required a specific accounting method

[34] "AFUDC" stands for "Allowance for Funds Used During Construction." *See Central Power & Light Co.*, 919 S.W.2d at 487.

for regulated utilities. The requirement to capitalize AFUDC-equity resulted in Central Power and Light Company paying higher franchise taxes than those paid by non-regulated companies. The plaintiff alleged no reasonable basis existed for this disparate treatment, and therefore, the Comptroller rule that required capitalization violated the equal and uniform taxation clause. *See id.* at 488.

Once again, the court upheld the tax classification. The court reasoned that the plaintiff, as a regulated utility, had a greater assurance of recovering its AFUDC-equity because it could internalize the cost and recover it through its utility rates set during the ratemaking process. *See id.* at 489. Even though there was nothing significantly different between the nature and operations of Central Power and Light Company and private companies that paid franchise taxes, the classification made by the Comptroller's administrative rules was constitutional because the plaintiff's ability to recover and internalize costs set it apart from other taxpayers.

Based on the opinions in *Calvert v. Canteen Company*, *American Home Assurance*, and *Central Power and Light Company*, tax classifications that treat companies with the same "nature and operations" differently can still pass constitutional muster when they are supported by a reasonable basis. In these three cases, the reasonable basis for the tax classification had nothing to do with

taxpayers' operations—the real differences were based on external factors or intangible aspects of the businesses at issue. For this reason, Appellees' assertion that "[w]hen the nature and operations of businesses are the same, the Legislature's attempt to apply different classifications for taxing purposes must be rejected . . . ." should be disregarded by the Court.

The classifications upheld in the three cases discussed above are similar to the classification created by House Bill 3536. Non-settling cigarette manufacturers have made business choices, similar to Canteen Company, that affect their taxation. Non-settling manufacturers might be able to avoid the assessment in House Bill 3536 by seeking an agreement with the State to become a settling manufacturer directly subject to the go-forward provisions of the Texas Settlement Agreement, but they have not chosen to do this. Their choice to avoid inclusion in the agreement creates a reasonable basis for different taxation. As in *American Home Assurance*, the settling manufacturers have been subjected to greater risk and difficulty in realizing profits because of the amounts they owe under the Texas Settlement Agreement. The Third Court of Appeals held that the two percent credit allowed the Fund was constitutional because of its higher-risk insureds; the same rationale can be used to validate House Bill 3536's exclusion of settling manufactures from the statute's assessment. Finally, the opinion in *Central Power*

and Light Company upheld a classification solely because of how external regulations allowed certain taxpayers to internalize and recover costs. This holding applies directly to this case where both Appellants and Appellees have agreed that the primary difference between settling and non-settling manufacturers lies in the fact that settling manufacturers are required to pay additional amounts to the State under the Texas Settlement Agreement.

Texas was not the first—but the 49th—state in the country to enact a law that makes the commonsense distinction between settling and non-settling cigarette manufacturers. Appellees are not able to cite a single court in the country that has struck down a distinction between settling and non-settling manufacturers as unreasonable. There is good reason for this universal consensus—and McLane believes that this Court should rule in the same manner.

McLane argues that the assessment in House Bill 3536 is a fee not a tax. But if the Court disagrees, the tax does not violate the equal and uniform taxation clause because its classification has a reasonable basis. Businesses with the same nature and operations can still be taxed differently under the equal and uniform taxation clause, and the case of settling and non-settling cigarette manufacturers presents a good example of a reasonable classification. In the *Independent Tobacco Manufacturers* case, the Minnesota Supreme Court highlighted the

differences between settling and non-settling manufacturers operating in Minnesota as follows:

> There are substantial differences between settling and nonsettling manufacturers. Settling manufacturers make payment to the state to cover the social costs of smoking; nonsettling manufacturers make no such payments. Settling 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; nonsettling 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 nonsettling manufacturers' products. Settling manufacturers have agreed to discourage underage smokers from buying their cigarettes; nonsettling manufacturers have made no such agreement and, in fact, have taken advantage of the settling manufacturers' price increases to increase their own sales. *See Indep. Tobacco Mfrs.*, 713 N.W.2d at 311.

Whether Texas's and Minnesota's constitutional standards for equal and uniform taxation are the same or not, Appellees cannot deny that the differences between settling and non-settling manufacturers outlined by the Minnesota court are valid in Texas as well. Under the Texas Settlement Agreement, settling manufacturers must pay amounts to the State—in addition to the cigarette tax—to support the State's regulation of cigarettes. The fact that settling manufacturers must pay these amounts forms a reasonable basis for the legislature's choice to assess only non-settling manufacturers in House Bill 3536. The existence of a reasonable basis precludes a violation of the equal and uniform taxation clause.

PRAYER

WHEREFORE, PREMISES CONSIDERED, McLane prays that the Court reverse the trial court's granting of the Appellees' motion for summary judgment and granting of injunction against the collection of the fees in House Bill 3536 and either remand the case with instructions that the constitutionality of House Bill 3536 be weighed under the rules of law applicable to fee statutes or render judgment that the statute is constitutional.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Amicus Curiae Brief was served by ProDoc E-Filing on May 9, 2014, to the following counsel:

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CERTIFICATE OF COMPLIANCE

In compliance with Texas Rule of Appellate Procedure 9.4(i)(2), this Response contains 9,490 words, excluding the portions of the brief exempted by Rule 9.4(i)(1)

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May 9, 2014

By e-Filing
The Honorable Jeffrey D. Kyle,
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Price Daniel Sr. Bldg.
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Re: **No. 03-13-00753-CV, *Susan Combs, In Her Official Capacity as Texas Comptroller, and Greg Abbott, In His Official Capacity as Texas Attorney General v. Texas Small Tobacco Coalition and Global Tobacco, Inc.*; Amicus Curiae Brief of McLane Company, Inc. in Support of Appellants**

Dear Mr. Kyle:

Enclosed by e-filing is the Amicus Curiae Brief of McLane Company, Inc. in Support of Appellants in the above-referenced appeal. Thank you for your courtesies and attention to this matter.

Sincerely,

STAHL, BERNAL, DAVIES,
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