No. 03-13-00753-CV

In the Court of Appeals
Third District of Texas — Austin

GLENN HEGAR, IN HIS 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

SUPPLEMENTAL BRIEF OF TEXAS SMALL TOBACCO COALITION AND GLOBAL TOBACCO, INC.

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ISSUES PRESENTED

The tax imposed by Texas Health and Safety Code, Chapter 161, Subchapter V, violates the United States Constitution's Equal Protection Clause.

The tax imposed by Texas Health and Safety Code, Chapter 161, Subchapter V, violates the United States Constitution's Due Process Clause.

STATEMENT OF FACTS

During the 2013 legislative session, the Legislature enacted House Bill 3536, codified as Subchapter V, Chapter 161, Health and Safety Code ("Act"). The Act imposes a tax on small tobacco manufacturers that are not parties to the Liggett Settlement (the settlement agreement Texas and several other states entered into with Liggett Group in March 1997) or the Comprehensive Settlement Agreement and Release (the settlement agreement Texas subsequently entered into with the remaining large tobacco manufacturers) ("Texas Settlement"). *See* TEX. HEALTH & SAFETY CODE §§ 161.602(9), (13), (15); § 161.603. The Act expressly excludes settling manufacturers from paying any taxes under the Act. The Act also taxes at a greatly reduced rate subsequent participating manufacturers that joined a later Master Settlement Agreement that most settlement states (but not Texas) entered into in 1998. *See id.* § 161.602(8).[1]

Shortly after the Act was enacted, the Texas Small Tobacco Coalition ("Coalition"), which is comprised of Small Tobacco manufacturers that did not participate in the settlements, challenged the Act on grounds that it violates the Texas Constitution's Equal and Uniform Clause and the United States Constitution's Equal Protection and Due Process Clauses. The Coalition prevailed

[1] The Act does not include the Master Settlement Agreement in its definition of "Tobacco settlement agreement"—the definition includes only the Texas and Liggett Settlements. TEX. HEALTH & SAFETY CODE § 161.602(15).

in the trial court on summary judgment. The trial court's judgment stated that it granted the Coalition's motion for summary judgment in its entirety without stating its reasoning.

The State appealed to this Court, which affirmed the trial court's judgment on grounds that the Act violates the Equal and Uniform Clause, without reaching whether the Act also violates the Equal Protection and Due Process Clauses. *Combs v. Texas Small Tobacco Coalition*, 440 S.W.3d 304 (Tex. App.—Austin 2014), *rev'd* 496 S.W.3d 778 (Tex. 2016) (Appendix A). The State subsequently petitioned the Texas Supreme Court for review.

After granting review, the Supreme Court reversed this Court's judgment and held that the Act satisfies the Equal and Uniform Clause. *Hegar v. Texas Small Tobacco Coalition*, 496 S.W.3d 778 (Tex. 2016) (Appendix B). The Supreme Court observed that the test for whether a tax violates the Equal and Uniform Clause is whether a challenged tax classification is rational and reasonably related to the purpose of the tax. *Id.* at 787. The Court then concluded that the classification between settling manufacturers and Small Tobacco is rational and reasonably related to the tax's purpose because:

- settling manufacturers bear a financial burden and operating restrictions under the Texas and Liggett Settlements that Small Tobacco does not bear;

- the tax classification is reasonably related to the goals of recovering healthcare costs related to cigarette-use and reducing underage smoking; and

- the settlements "fundamentally transform[ed]" settling manufacturers' business operations and thus it is rational to consider the effect of the Texas and Liggett Settlements in imposing the tax classification.

Id. at 787-89, 791.

Because this Court did not reach the Coalition's equal protection and due process arguments, the Supreme Court reversed and remanded the case to this Court for consideration of those claims.[2] *Id.* at 793. This Court granted the Coalition's motion to allow supplemental briefing on its equal protection and due process claims.

ARGUMENT

I.

The tax violates the United States Constitution's Equal Protection Clause.

In its opinion, the Texas Supreme Court clarified that the standard of review for the Equal and Uniform Clause is similar to the rational basis test under the United States Constitution's Equal Protection Clause. Notably, though, in concluding that the settlement agreements' burdens on settling manufacturers

[2] When originally filed, Susan Combs was the Comptroller of Texas. Combs ceased to hold office before the appeal to the Texas Supreme Court was finally disposed of. Therefore, the Coalition has substituted Glenn Hegar for Susan Combs in this remand proceeding. *See* TEX. R. APP. P. 7.2(a).

justified imposing the Act's tax burden on Small Tobacco, the Supreme Court did not address:

- the unequal taxation on Small Tobacco and ***subsequent participating manufacturers*** who do not pay settlement payments to Texas under any agreement;
- the fact that settling manufacturers obtained the benefit of ***sweeping releases from past and future liability*** related to their products—while Small Tobacco is required to pay the tax while not receiving any of the liability-release benefits afforded to settling manufacturers; and
- the fundamental distinctions between the Act and the ***Texas and Liggett Settlements*** that render unconstitutional a tax that treats differently manufacturers that entered into those agreements and those that did not.

The Coalition explicitly argued these points to the Supreme Court. But having clarified the test under the Texas Constitution's Equal and Uniform clause, the Court chose not consider these specific points but rather remand them. As such, in remanding the case, the Supreme Court has given this Court the opportunity to determine whether, for these three reasons, the tax violates the Equal Protection Clause. Each of these three arbitrary distinctions renders irrational the classifications between settling manufacturers, subsequent participating manufacturers, and Small Tobacco. The Court should conclude that the Act violates the Equal Protection Clause.

A. A tax classification violates the Equal Protection Clause if it lacks a rational basis.

The United States Constitution's Equal Protection Clause provides that no state shall "deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV, § 1. Under the Equal Protection Clause, states may not treat differently persons who are in all relevant respects alike. *Nordlinger v. Hahn*, 505 U.S. 1, 10 (1992); *see also City of Cleburne v. Cleburne Living Ctr.*, 473 U.S. 432, 439 (1985) (the Equal Protection Clause directs that "all persons similarly situated should be treated alike"). Even if a law neither burdens a fundamental right nor targets a suspect class, the legislative classification still violates the Equal Protection Clause if it bears no rational relation to some legitimate end. *Romer v. Evans*, 517 U.S. 620, 630 (1996).

With regard to taxation, a state may vary the rate of excise on various products and "is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value." *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 527 (1959). But a state must proceed on a rational basis and may not resort to a classification that is palpably arbitrary. *Id.* A classification "must rest upon some ground of difference having a fair and substantial relation to the object of the legislation." *Id.* Only "[i]f the selection or classification is neither capricious nor arbitrary, and rests upon some reasonable

consideration of difference or policy, there is no denial of the equal protection of the law." *Id.*

B. The Act violates the Equal Protection Clause by granting subsequent participating manufacturers a substantial tax discount even though they pay nothing to Texas under any settlement.

The tax violates the Equal Protection Clause because of the different amounts of taxation imposed on Small Tobacco and subsequent participating manufacturers. Under the Act, subsequent participating manufacturers pay a fraction of what Small Tobacco must pay in taxes—Small Tobacco pays 2.75 cents per cigarette while subsequent participating manufacturers pay only .75 cents. TEX. HEALTH & SAFETY CODE § 161.604. Yet subsequent participating manufacturers have not entered into the Texas or Liggett Settlement—they have only entered into the Master Settlement Agreement with other states.[3] Because Texas is not a party to the Master Settlement Agreement, subsequent participating manufacturers do not pay Texas any funds under it— subsequent participating manufacturers only pay amounts to those states that have entered into the agreement.[4] Thus, Small Tobacco and subsequent participating manufacturers are similarly situated because neither pays funds to Texas under any settlement agreement, yet they are not

[3] Clerk's Record ("CR") 179, 345; *see also S&M Brands, Inc. v. Caldwell*, 614 F.3d 172, 174 (5th Cir. 2010).

[4] *Id.*

treated alike in the amount of taxes each group must pay to the State. *See Nordlinger*, 505 U.S. at 10; *City of Cleburne*, 473 U.S. at 439; TEX. HEALTH & SAFETY CODE § 161.604.

In its opinion, the Texas Supreme Court concluded that the tax satisfies the Equal and Uniform Clause because the Texas and Liggett Settlements impose financial and regulatory burdens on settling manufacturers and the State has an interest in recovering from Small Tobacco to recoup healthcare costs and deter underage smoking. But the Court focused solely on ***settling manufacturers*** that entered into the Texas and Liggett Settlements—not subsequent participating manufacturers that have never entered into either of those agreements. Subsequent participating manufacturers do not pay a penny to Texas to assist the State in recouping cigarette-related healthcare costs or deterring underage smoking, and they have no burdens, financial or otherwise, under the Texas or Liggett Settlement. No rational basis exists for taxing subsequent participating manufacturers and Small Tobacco differently. *See Allied Stores*, 358 U.S. at 527. The legislative distinction between the two similarly-situated groups is not rationally related to the Act's stated purposes and does not promote those purposes.

Because subsequent participating manufacturers pay nothing to the State under the Texas or Liggett Settlement and yet are assessed about a quarter of the taxes that Small Tobacco must pay under the Act, the tax classification between

subsequent participating manufacturers and Small Tobacco has no rational basis and violates the Equal Protection Clause.[5]

C. The tax violates the Equal Protection Clause by not affording Small Tobacco the benefits given settling manufacturers under the settlement agreements.

The Texas and Liggett Settlements afforded settling manufacturers many benefits in exchange for the settlements' burdens that the Act does not afford Small Tobacco. In the Texas Supreme Court's opinion, the Court put great focus on the operational and financial burdens imposed on settling manufacturers under the settlements that "establish[ed] sufficient differences in business operations to justify the non-settling manufacturer and settling-manufacturer classification." *Hegar* at 787. But the Court did not consider that the Texas settlement agreements also granted settling manufacturers wide-ranging benefits. These unequal benefits render the tax unconstitutional under the Equal Protection Clause.

The settlements were not wholly favorable to the State. Rather, the settlement agreements were designed to protect settling manufacturers' market share and granted settling manufacturers a sweeping release from liability for both past and future tort claims.[6] No citizen of Texas can now sue a settling manufacturer for any health injury caused by that manufacturer's products. These

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[5] CR 345-48, 358-86; TEX. HEALTH & SAFETY CODE § 161.604.

[6] CR 372-75; Supplemental ("Supp.") CR, Plaintiffs' Amended MSJ, Ex. 17, ¶¶ 7.1-7.3.

benefits counter-balance the financial and regulatory burdens settling manufacturers voluntarily assumed. Settling manufacturers can conduct their business without fear of future legal repercussions related to their cigarette products and enjoy the monopoly they enjoyed before the tobacco litigation.

The Act, on the other hand, does not grant Small Tobacco benefits of the same nature as those provided to the settling manufacturers under the settlements.[7] Indeed, the Act does not provide nonsettling manufacturers any benefits at all. Instead, it is a one-sided tax, under which Small Tobacco must undertake the operational burden of making payments to the State ad infinitum with no benefits offered by the State in return. There is no rational basis under the Equal Protection Clause for providing settling manufacturers the benefits of a release of liability and protected market share while denying these benefits to Small Tobacco under the Act. Recovering health care costs and preventing underage smoking may be legitimate governmental interests, but this disparity in benefits does not rationally relate to these interests.

The United States Supreme Court recently considered the lawfulness of a state statute that taxed diesel fuel purchases made by a rail carrier while exempting similar purchases made by its motor carrier competitors. *Alabama Dep't of*

[7] CR 341-54.

Revenue v. CSX Transp., Inc., 135 S.Ct. 1136, 1139 (2015). Though the Supreme Court evaluated the tax under a federal law that prohibits tax discrimination against rail carriers, the Court stated that the test for a violation of that law was whether the tax "treats groups that are similarly situated differently without sufficient justification for the difference in treatment." *Id.* at 1141 (internal quotations omitted). The Court noted similarities between the statutory and constitutional Equal Protection standards of review. *Id.* at 1142. Ultimately, the Court concluded that an "alternative, roughly equivalent tax" on rail carriers' competitors could render a tax disparity between the competitors lawful and remanded the case for the court of appeals to determine whether the tax on motor carriers was a rough equivalent to the tax on rail carriers. *Id.* at 1143-44.

The amounts Small Tobacco must pay the State under the Act are not the "rough equivalent" of what settling manufacturers pay, especially when considering the benefits afforded settling manufacturers under the settlement agreements. The Act violates the Equal Protection Clause.

D. The Act violates the Equal Protection Clause by failing to take into account differences between the Texas and Liggett Settlements.

The Act additionally improperly lumps the Texas and Liggett Settlements into the definition of "Texas Settlement Agreement"—even though the Texas and Liggett Settlements do not contain the same formula and Liggett and other settling manufacturers do not pay the State the same amounts. Thus, Liggett and other

settling manufacturers do not equally reimburse the State for cigarette-related healthcare costs or to deter underage smoking, yet enjoy an identical exemption from the tax while Small Tobacco is not exempt at all.

Liggett did not enter into the Texas Settlement. Instead, a year earlier, Liggett entered into its own settlement with Texas and several other states.[8] The formula for the Liggett Settlement differs from the formula for the Texas Settlement. Under the Liggett Settlement, Liggett was required to pay the states a total of 25 percent of its pretax income and cooperate with the states in their suits against the remaining manufacturers.[9] Conversely, under the Texas Settlement, settling manufacturers paid an initial sum followed by an annual payment of approximately $500 million, with the manufacturers paying their pro rata share based on national market share with the amount adjusted up or down based on sales.[10] Because of Liggett's financial struggles, it was known at the time of the Liggett Settlement that Liggett's payments would yield little revenue.[11] The Liggett Settlement also provided that in the event of a global settlement, Liggett would have the option to join that settlement and discontinue performance under

[8] Supp. CR, Plaintiffs' Amended MSJ, Ex. 17.

[9] *Id.*, ¶ 4.3.1-4.3.4, 6.3.2; Plaintiff's Amended MSJ, Exh. 15.

[10] CR 369-70.

[11] Plaintiff's Amended MSJ, Exh. 15.

the Liggett Settlement.[12] Liggett later entered into the Master Settlement Agreement as a subsequent participating manufacturer, but Liggett apparently did not enter into the Texas Settlement.[13]

Under the Act, Small Tobacco must pay the State 2.75 cents per cigarette, which amounts to 55 cents per pack. TEX. HEALTH & SAFETY CODE §§ 161.604(a)-(b). In its opinion, the Texas Supreme Court believed that under the ***Texas Settlement***, settling manufacturers pay the State approximately 64 cents per pack. *Hegar*, 496 S.W.3d at 782. But even assuming this is true, the Liggett Settlement's formula differs from the Texas Settlement's formula; thus, Liggett does not pay the State the same amounts as other settling manufacturers. The Act nonetheless affords Liggett the same exemption from the tax as other settling manufacturers. TEX. HEALTH & SAFETY CODE §§ 161.602(14), (15). There is no rational basis for assuming that the tax on Small Tobacco is roughly equivalent to the amounts Liggett pays under the Liggett Agreement.

In sum, because the tax violates the United States Constitution's Equal Protection Clause, the Court should affirm the trial court's judgment and conclude the tax is invalid.

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[12] *Id.*, Exh. 17, ¶ 5.2.

[13] *Id.*, General Liggett Replacement Agreement; *Id.*, Exh. 13 (Participating Manufacturers List as of June 28, 2013).

II.

The tax violates the United States Constitution's Due Process Clause.[14]

The United States Constitution's Due Process Clause commands that no person may be "deprived of life, liberty, or property without due process of law." U.S. CONST. amend. XIV, § 1. With regard to a state tax, the Due Process Clause "requires some definite link, some minimum connection, between a state, and the person, property, or transaction it seeks to tax." *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992). The test is whether the taxing power exerted by a state bears fiscal relation to protection, opportunities, and benefits given by the state. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940); *Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n*, 390 U.S. 317, 326 n.5 (1968).

The tax on the Small Tobacco bears no relation to the protection, opportunities, and benefits afforded those businesses by the State. It is simply an effort to improperly extract, through the State's taxing power, the same financial benefits from Small Tobacco competitors that were negotiated under private agreements with settling manufacturers—but without conveying any of the benefits to the Small Tobacco competitors that were granted by the State to settling manufacturers under the settlement agreements. The settlement agreements granted

[14] Small Tobacco relies on its due process argument raised in its Appellees' Brief filed in this Court on March 24, 2014. For ease of reference, Small Tobacco repeats that argument here.

immunity to and relieved settling manufacturers of liability from claims, while the Act provides neither benefit to Small Tobacco.

Because the tax violates the United States Constitution's Due Process Clause, the Court should affirm the trial court's judgment and conclude the tax is invalid.

PRAYER

Texas Small Tobacco Coalition and Global Tobacco, Inc. respectfully pray that this Court affirm the trial court's judgment on their equal protection and due process claims. Appellees further pray that this Court grant all other relief to which they may justly be entitled.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

The Coalition and Global Tobacco certify that this Supplemental Brief (when excluding the caption, table of contents, index of authorities, statement of issues presented, signature, proof of service, and certificate of compliance) contains 2,951 words.

/s/ Craig T. Enoch
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CERTIFICATE OF SERVICE

I hereby certify that this Supplemental Brief has been served on the following counsel of record via electronic filing on November 21, 2016:

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Appellants

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Appellees

APPENDIX

A. ***Combs v. Texas Small Tobacco Coalition*, 440 S.W.3d 304 (Tex. App.—Austin 2014), rev'd 496 S.W.3d 778 (Tex. 2016)**

B. ***Hegar v. Texas Small Tobacco Coalition*, 496 S.W.3d 778 (Tex. 2016)**

APPENDIX A

440 S.W.3d 304
Court of Appeals of Texas,
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.

No. 03–13–00753–CV.
|
Aug. 15, 2014.

Synopsis

Background: Tobacco manufacturers association filed a suit for declaratory and injunctive relief, alleging that cigarette tax imposed under Health and Safety Code was unconstitutional. The District Court, Travis County, 345th Judicial District, Stephen Yelenosky, J., found the tax unconstitutional. State appealed.

Holdings: The Court of Appeals, Puryear, J., held that:

[1] association had standing, and

[2] tax was unconstitutional as a violation of Texas's Equal and Uniform Clause.

Affirmed.

West Headnotes (14)

[1] Taxation
Remedies for wrongful enforcement
371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(I) Collection and Enforcement
371k3710 Remedies for wrongful enforcement
Because parties' actual arguments concerned the propriety of the trial court's finding that statutes assessing a "fee" on certain tobacco products were unconstitutional, Court of Appeals would not limit their discussion to the trial court's denial of State's plea to the jurisdiction. V.T.C.A., Health & Safety Code § 161.601 et seq.

Cases that cite this headnote

[2] Associations
Actions by or Against Associations
41 Associations
41k20 Actions by or Against Associations
41k20(1) In general
An association has standing to sue on behalf of its members if: the members themselves have standing to sue in their own right; the interests the association is seeking to protect are germane to its purpose; and participation of the individual members in the lawsuit is not necessary, meaning the pleadings and record show that neither the claim asserted nor the relief sought require the individual members to participate in the suit.

Cases that cite this headnote

[3] Associations
Actions by or Against Associations
Declaratory Judgment
Proper Parties
41 Associations
41k20 Actions by or Against Associations
41k20(1) In general
118A Declaratory Judgment
118AIII Proceedings
118AIII(C) Parties
118Ak299 Proper Parties
118Ak299.1 In general
For purposes of standing, when an association seeks injunctive or declaratory relief, as opposed to damages requiring a showing of individualized lost profits, the relief will inure to the benefit of the association's members and does not require the participation of each individual member.

Cases that cite this headnote

[4] States

Declaratory judgment

360 States
360VI Actions
360k191 Liability and Consent of State to Be Sued in General
360k191.9 Particular Actions
360k191.9(2) Declaratory judgment

A suit seeking a declaratory judgment that a state agent is acting pursuant to an unconstitutional law is not barred by sovereign immunity.

Cases that cite this headnote

[5] **Associations**
Actions by or Against Associations

Declaratory Judgment
Subjects of relief in general

Taxation
Remedies for wrongful enforcement

41 Associations
41k20 Actions by or Against Associations
41k20(1) In general
118A Declaratory Judgment
118AIII Proceedings
118AIII(C) Parties
118Ak299 Proper Parties
118Ak300 Subjects of relief in general
371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(I) Collection and Enforcement
371k3710 Remedies for wrongful enforcement

Tobacco manufacturers association had standing, on behalf of its members, to bring a lawsuit seeking injunctive and declaratory relief that cigarette tax imposed under Health and Safety Code was unconstitutional.

Cases that cite this headnote

[6] **Taxation**
Power to Impose

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(A) In General
371k3607 Power to Impose
371k3608 In general

Although the legislature may pursue policy goals through tax legislation, those goals must be related to the taxation.

Cases that cite this headnote

[7] **Constitutional Law**
Taxation and revenue legislation

Licenses
States

Taxation
Equality and uniformity in general

92 Constitutional Law
92VI Enforcement of Constitutional Provisions
92VI(C) Determination of Constitutional Questions
92VI(C)3 Presumptions and Construction as to Constitutionality
92k1006 Particular Issues and Applications
92k1012 Taxation and revenue legislation
238 Licenses
238I For Occupations and Privileges
238k2 Power to License or Tax
238k5 States
371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

The legislature has the discretion to make classifications in levying sales and occupation taxes, and there is a strong presumption in favor of a tax statute's constitutionality. Vernon's Ann.Texas Const. Art. 8, § 1.

Cases that cite this headnote

[8] **Taxation**
Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

Exact equality and uniformity in taxation is unattainable, and the uniformity that is required under Texas's Equal and Uniform

Clause is uniformity within classes. Vernon's Ann.Texas Const. Art. 8, § 1.

Cases that cite this headnote

[9] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

In reviewing tax classifications to ensure compliance with requirement of equal and uniform taxation, Court of Appeals will uphold a tax statute that treats differently those engaged in the same business so long as a reasonable basis justifies the disparate treatment. Vernon's Ann.Texas Const. Art. 8, § 1.

Cases that cite this headnote

[10] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

Court of Appeals looks to the nature of the business in evaluating a classification's reasonableness under requirement of uniform and equal taxation, and a slight difference in the subject matter taxed justifies a separate classification, thus, Court's focus must be on the subject of the tax, not the entity being taxed. Vernon's Ann.Texas Const. Art. 8, § 1.

Cases that cite this headnote

[11] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

Protecting one company's market share over another's does not justify the unequal treatment in taxation of identical products. Vernon's Ann.Texas Const. Art. 8, § 1.

Cases that cite this headnote

[12] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

Imposing a tax on only one class of identical products is not equal and uniform under Texas law and cannot be upheld. Vernon's Ann.Texas Const. Art. 8, § 1.

Cases that cite this headnote

[13] Taxation

Selective taxes in general

Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(A) In General
371k3601 Nature of Taxes
371k3605 Selective taxes in general
371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

Cigarette "fee," imposed under Health and Safety Code on tobacco manufacturers who had not participated in State's settlement with major tobacco companies in state's action for antitrust violations, deceptive advertising, and marketing campaigns aimed at children, was in fact a tax, and was not based on a reasonable distinction, and, therefore, was unconstitutional as a violation of Texas's Equal and Uniform Clause; non-settling

manufacturers obtained no release of past and future claims in exchange for taxes paid as settling manufacturers did, and unlike in states with escrow laws for such taxes, non-settling manufacturers did not earn interest and had no opportunity to regain any of the funds that were not used to satisfy claims leveled against the settling manufacturers by the State, instead, tax money went into State's general revenue coffers for use in whatever way the State saw fit. Vernon's Ann.Texas Const. Art. 8, § 1.

Cases that cite this headnote

[14] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

Tax classifications must not only be rational but must attempt to group similar things and differentiate dissimilar things to satisfy Texas constitutional requirement of uniform and equal taxation. Vernon's Ann.Texas Const. Art. 8, §§ 1, 2.

Cases that cite this headnote

West Codenotes

Held Unconstitutional

V.T.C.A., Health & Safety Code §§ 161.601, 161.602, 161.603, 161.604, 161.605, 161.606, 161.607, 161.608, 161.609, 161.610, 161.611, 161.612, 161.613, 161.614.

Recognized as Unconstitutional

V.T.C.A., Tax Code § 112.108.

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Before Justices PURYEAR, GOODWIN, and FIELD.

OPINION

DAVID PURYEAR, Justice.

After the legislature enacted subchapter V of the Texas Health & Safety Code, entitled, "Fee on Cigarettes and Cigarette Tobacco Products Manufactured by Certain Companies," appellees Texas Small Tobacco Coalition and Global Tobacco, Inc. (Small Tobacco) filed a suit for declaratory and injunctive relief, alleging that the tax imposed by subchapter V is unconstitutional. [1] Appellants Susan Combs, in her official ***307** capacity as Texas Comptroller, and Greg Abbott, in his official capacity as Texas Attorney General, (the State) filed a plea to the jurisdiction and a motion for summary judgment, and Small Tobacco filed its own motion for summary judgment. The trial court denied the State's plea to the jurisdiction and motion for summary judgment, granted Small Tobacco's motion for summary judgment, found that the tax is unconstitutional, and enjoined the State from assessing or collecting the tax. We affirm the trial court's order.

Factual Background

In 1996, the State sued four major tobacco companies (Big Tobacco) [2] for antitrust violations, deceptive advertising, and marketing campaigns aimed at children. In 1997 and 1998, Big Tobacco settled with the State, agreeing to change the way they advertised and marketed their products and to pay billions of dollars to the State in exchange for a settlement of the State's claims and a release from any future claims the State might have against Big Tobacco. [3]

The 1998 Comprehensive Settlement Agreement and Release (the 1998 Settlement) provided a schedule of payments to be made to various entities and stated that the payments were intended as "reimbursement for

public health expenditures of the State" and to satisfy the State's claims "for damages incurred by the State in the year of payment or earlier years," including Medicaid expenditures and punitive damages. The 1998 Settlement stated that payments made in 1998 "constitute reimbursement for public health expenditures" and that "[a]ll other payments ... are in satisfaction of all of the State of Texas's claims for damages incurred by the State in the year of payment or earlier years, including those for reimbursement of Medicaid expenditures and punitive damages." The agreement then listed seven specific payments, such as $351 million to be paid to the State's general revenue fund for funding the Children's Health Insurance Program and various anti-smoking programs, and stated that "[a]ll remaining amounts, including any amounts due to be paid by Settling Defendants after December 31, 1998, are to be allocated to the general revenue fund of the State of Texas to be used for such purposes as the State of Texas may determine." Big Tobacco agreed to make large yearly payments based on the companies' various market shares, and those payments were to increase or decrease "in accordance with decreases or increases in volume of domestic tobacco product volume sales."

In 2013, the legislature passed House Bill 3536 and enacted subchapter V of chapter 161 of the health and safety code. *See* Act of May 23, 2013, 83d Leg., R.S., ch. 1305, § 1, 2013 Tex. Gen. Laws 3331, 3331–36 (codified at Tex. Health & Safety Code §§ 161.601–.614 (effective September ***308** 1, 2013)). Subchapter V, entitled, "Fee on Cigarettes and Cigarette Tobacco Products Manufactured by Certain Companies," applies only to tobacco companies that did not sign the 1997 and 1998 settlement agreements ("non-settling manufacturers") and is intended to:

> (1) 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 by offering cigarettes and cigarette tobacco products at prices that are substantially below the prices of cigarettes and cigarette tobacco products of other manufacturers;
>
> (3) protect the tobacco settlement agreement and funding, which has been reduced because of the growth of sales of non-settling manufacturer cigarettes and cigarette tobacco products, for programs that are funded wholly or partly by payments to this state under the tobacco settlement agreement and recoup for this state settlement payment revenue lost because of sales of non-settling manufacturer cigarettes and cigarette tobacco products;
>
> (4) ensure evenhanded treatment of manufacturers and further protect the tobacco settlement agreement and funding by imposing a partial payment obligation on non-settling manufacturers that already make payments on Texas sales under the master settlement agreement until a credit amendment to that agreement that will provide those manufacturers with a credit for payments to Texas is effective; and
>
> (5) provide funding for any purpose the legislature determines.

Tex. Health & Safety Code § 161.601.

Under subchapter V, a 2.75 cent "fee" is imposed on each cigarette or 0.09 ounce of tobacco product made by a non-settling manufacturer, for a total of 55 cents added to the price of each 20–cigarette pack, with the fee to increase each year. *Id.* §§ 161.603, .604.[4] Subchapter V does not release non-settling manufacturers from liability, although it does provide that all fees paid by a manufacturer "shall apply on a dollar for dollar basis to reduce any judgment or settlement on a released claim brought against the manufacturer that made the payment." *Id.* § 161.612.

Small Tobacco sued for declaratory and injunctive relief, arguing that the fee imposed by subchapter V was in fact a tax that violated the Equal and Uniform Clause of the Texas Constitution and the Equal Protection Clause and the Due Process Clause of the United States Constitution. The State filed a plea to the jurisdiction asserting that the Texas Small Tobacco Coalition[5] lacked standing to bring a taxpayer suit under chapter 112 of the tax code, that section 112.108 of the tax code barred a suit under the Uniform Declaratory Judgments Act,[6] and that Small Tobacco had not pled a viable constitutional claim so as to overcome the State's sovereign immunity. Both Small ***309** Tobacco and the State filed motions for summary judgment. After a hearing, the trial court signed an order denying the State's plea to the jurisdiction and motion for summary judgment and granting Small Tobacco's motion for summary judgment. The trial court found

that subchapter V is unconstitutional "in its entirety" and permanently enjoined the State from assessing, collecting, or enforcing the tax. The State appealed.

Scope Of Our Review

[1] Initially, we note that in its statement of its arguments, the State contends only that the trial court erred in denying the State's plea to the jurisdiction, asserting (1) that Small Tobacco failed to plead valid claims that subchapter V violates the Equal and Uniform Clause of the Texas Constitution or the Equal Protection and Due Process Clauses of the federal constitution and (2) that the Texas Small Tobacco Coalition lacks standing to bring the suit. In its prayer, the State asks us to reverse the trial court's judgment and "render judgment dismissing plaintiffs' claims for lack of subject-matter jurisdiction." Although the State's statements of argument and prayer present a very limited question, the parties present detailed argument about the overall merits of Small Tobacco's underlying claims and the trial court's ruling of unconstitutionality. Because the parties' actual arguments concern the propriety of the trial court's finding that the statutes are unconstitutional, we will not limit our discussion to the trial court's denial of the State's plea to the jurisdiction. *See Majeed v. Hussain,* No. 03–08–00679–CV, 2010 WL 4137472, at *7–9 (Tex.App.-Austin Oct. 22, 2010, no pet.) (mem. op.) (omission of prayer for remand in brief did not waive appellant's entitlement to or court's power to award remand).

Standing

In its third issue, the State asserts that the Texas Small Tobacco Coalition lacks associational standing to bring the underlying suit on behalf of its members. We disagree.

[2] **[3]** **[4]** An association has standing to sue on behalf of its members if: the members themselves have standing to sue in their own right [7]; the interests the association is seeking to protect are germane to its purpose; and participation of the individual members in the lawsuit is not necessary, meaning the pleadings and record show that neither the claim asserted nor the relief sought require the individual members to participate in the suit. *Texas Ass'n of Bus. v. Texas Air Control Bd.,* 852 S.W.2d 440, 447–48 (Tex.1993) (quoting *Hunt v. Washington State Apple Adver. Comm'n,* 432 U.S. 333, 343, 97 S.Ct. 2434, 53 L.Ed.2d 383 (1977)). When, as here, an association seeks injunctive or declaratory relief, as opposed to damages requiring a ***310** showing of individualized lost profits, the relief will inure to the benefit of the association's members and does not require the participation of each individual member. *Id.* at 448 (quoting *Hunt,* 432 U.S. at 343, 97 S.Ct. 2434).

[5] The State contends that only an individual taxpayer has standing to sue under section 112.108 of the tax code and asserts that "lawsuits by associations of taxpayers ... are forbidden." [8] However, we have held that section 112.108 is unconstitutional, and that holding has not been overruled by the Texas Supreme Court. *See Richmont Aviation, Inc. v. Combs,* No. 03–11–00486–CV, 2013 WL 5272834, at *5–6 (Tex.App.-Austin Sept. 12, 2013, pet. filed) (mem. op.); *Rylander v. Bandag Licensing Corp.,* 18 S.W.3d 296, 304–05 (Tex.App.-Austin 2000, pet. denied). [9] Further, none of the statutes cited by the State forbids an association from bringing a lawsuit on behalf of its members to argue that a tax statute is unconstitutional, and we recently reaffirmed that a suit for declaratory relief challenging a tax statute's constitutionality can be brought by a trade association. *Texas Entm't Ass'n, Inc. v. Combs,* 431 S.W.3d 790, 795 & n. 3 (Tex.App.-Austin 2014, pet. filed). We overrule the State's third issue.

Equal and Uniform Clause

Although phrased in terms of whether Small Tobacco pled a valid constitutional claim, the State argues in its first issue that subchapter V's fee does not violate Texas's Equal and Uniform Clause because the legislature's decision to assess a fee against non-settling manufacturers and not against settling manufacturers was based on a reasonable distinction.

[6] **[7]** **[8]** **[9]** **[10]** In Texas, taxation must be equal and uniform. Tex. Const. art. VIII, §§ 1, 2. Although the legislature may "pursue policy goals through tax legislation," those goals must be "related to the taxation." *In re Nestle USA, Inc.,* 387 S.W.3d 610, 622 (Tex.2012) (orig. proceeding). The legislature has the discretion to make classifications in levying sales and occupation taxes, and there is a strong presumption in favor of a tax statute's constitutionality. *Id.* at 623 (quoting *Vinson v. Burgess,* 773 S.W.2d 263, 266 (Tex.1989), and citing 2

Wade Newhouse, *Constitutional Uniformity and Equality in State Taxation* 1723 (2d ed. 1984)). Exact ***311** equality and uniformity in taxation is unattainable, and the uniformity that is required is "uniformity within classes." *Id.* at 620 (quoting *Enron Corp. v. Spring Indep. Sch. Dist.,* 922 S.W.2d 931, 935 (Tex.1996)). In reviewing tax classifications, we will uphold a tax statute that "treat[s] differently those engaged in the same business so long as a reasonable basis justifies the disparate treatment." *American Home Assurance v. Texas Dep't of Ins.,* 907 S.W.2d 90, 97 (Tex.App.-Austin 1995, writ denied). We look to the nature of the business in evaluating a classification's reasonableness, and a "slight difference in the subject matter taxed justifies a separate classification." *Id.* at 97–98. [10] Thus, our focus must be on the subject of the tax, not the entity being taxed. *See id.; Prudential Health Care Plan, Inc. v. Commissioner of Ins.,* 626 S.W.2d 822, 830 (Tex.App.-Austin 1981, writ ref'd n.r.e.) (legislature may classify people, corporations, and organizations and may treat classes differently "merely because they are engaged in different businesses").

[11] **[12]** **[13]** Small Tobacco's members make cigarettes and other tobacco products, as do the Big Tobacco companies. There is no indication in this record that the taxed subject matter, cigarettes or "cigarette tobacco products," [11] *see* Tex. Health & Safety Code §§ 161.603, .604, differs even slightly when manufactured by Small Tobacco versus Big Tobacco. The only justification proffered by the legislature for making a distinction between the products is that Big Tobacco and, to a lesser degree, subsequent participating manufacturers, entered into the 1997 and 1998 settlement agreements. *See id.* § 161.601. Subchapter V was in part enacted to protect the settlement agreements and funding for the various programs that receive money from Big Tobacco and also is an apparent attempt to protect Big Tobacco from losing market share to Small Tobacco. *See id.* § 161.601(3) (subchapter V is intended to "protect the tobacco settlement agreement and funding, which has been reduced because of the growth of sales of non-settling manufacturer cigarettes and cigarette tobacco products"). Protecting one company's market share over another's does not justify the unequal treatment of identical products. Nor do the other, more laudable purposes of subchapter V. Few would take issue with goals of reducing underage smoking or recovering costs of medical care related to smoking. However, imposing a tax on only one class of identical products is not equal and uniform under Texas law and cannot be upheld. *See American Home Assurance,* 907 S.W.2d at 97–98; *Prudential Health Care Plan,* 626 S.W.2d at 830.

***312** Further, Big Tobacco, in entering into the settlement agreements, obtained a release of past and future claims, including claims of serious misconduct, claims that have not been leveled by the State at Small Tobacco. [12] Small Tobacco obtains no similar release in exchange for the taxes paid, although a non-participating manufacturer is to receive a dollar-for-dollar credit in the event it is found liable for claims brought against the manufacturer. And, unlike in states with escrow laws, an alternative to taxation discussed in more detail below, here, non-settling manufacturers like Small Tobacco's members do not earn interest and have no opportunity to regain any of the funds that are not used to satisfy claims leveled against the companies by the State. Instead, the tax money goes into the State's general revenue coffers for use in whatever way the State sees fit. *Id.* § 161.601(5) (tax intended to "provide funding for any purpose the legislature determines").

Finally, we address the State's assertion that, should we agree that subchapter V is unconstitutional, we "must also declare unreasonable the judgment of fifty[-]four other legislatures" and the "reasoning of every court of appeals in the nation to consider the question." We disagree. Only two other states, Minnesota and Mississippi, have assessed a per-cigarette tax on non-settling manufacturers. The other states established "escrow statutes" that require tobacco manufacturers other than Big Tobacco to either join the master settlement agreement as a subsequent participating manufacturer or remain a non-participating manufacturer. *See, e.g., Grand River Enter. Six Nations, Ltd. v. Pryor,* 481 F.3d 60, 63 (2nd Cir.2007). In escrow-statute states, non-participating manufacturers must make annual deposits into escrow accounts, creating "a pool of funds from which settling states may secure damage awards from [non-participating manufacturers] for any successful cigarette-related claims." *Id.* After twenty-five years, funds remaining in the escrow accounts, along with any earned interest, are returned to the non-participating manufacturers. *Id.; Commonwealth ex rel. Fisher v. Jash Int'l, Inc.,* 847 A.2d 125, 128 (Pa.Commw.Ct.2004); *see* Tenn.Code § 47–31–103(a)(2)(D) ("[a] tobacco product manufacturer that places funds into escrow ... shall receive the interest or other appreciation on such funds as earned"; escrow funds will

be released to pay "judgment or settlement on any released claim brought against such tobacco product manufacturer by the state or any releasing party located or residing in the state," if manufacturer can show it overpaid, or after twenty-five years). Such deposits have been upheld against constitutional challenges. *See, e.g., Star Scientific Inc. v. Beales,* 278 F.3d 339, 361–62 (4th Cir.2002), *cert. denied,* 537 U.S. 818, 123 S.Ct. 93, 154 L.Ed.2d 24 (2002). Due to the ***313** differences between the tax in question here and the escrow system established by the majority of the states, a finding that subchapter V is unconstitutional casts no shadow on the "judgment of fifty[-]four other legislatures" or the reasoning of every other "court of appeals in the nation."

[14] As for Mississippi and Minnesota, the constitutionality of Mississippi's tax statute has apparently not been challenged, and Minnesota applies a "rational basis" test to its tax statutes. *See Council of Indep. Tobacco Mfrs. of Am. v. Minnesota,* 713 N.W.2d 300, 308–11 (Minn.2006), *cert. denied,* 549 U.S. 1052, 127 S.Ct. 666, 166 L.Ed.2d 514 (2006) (quoting *Miller Brewing Co. v. Minnesota,* 284 N.W.2d 353, 356 (Minn.1979)) (reviewing state "Uniformity Clause challenge under the rational basis standard," stating that "*any* legitimate purpose can support the classifications created by the statute," and asking whether "the differences between the taxpayers distinguished by the statute provide a 'natural and reasonable basis' for separate classifications"). Texas's constitutional standard is more stringent. *See* Tex. Const. art. VIII, §§ 1, 2 (taxation must be equal and uniform). As the supreme court has stated, "tax classifications must not only be rational but must attempt to group similar things and differentiate dissimilar things." *In re Nestle USA,* 387 S.W.3d at 622. Thus, the Texas Constitution requires more than that a tax classification be merely rational, and Minnesota's rational-basis analysis is not applicable here.

We hold that the trial court did not err in determining that subchapter V's tax violates Texas's Equal and Uniform Clause. We overrule the State's first issue.

Conclusion

Having determined that subchapter V violates the Texas Constitution, we need not examine whether it also violates the federal constitution. We affirm the trial court's judgment.

As for Small Tobacco's motion and supplemental motion for sanctions, the State provided this Court with packs of grape-flavored "cigars" while representing them to be "cigarettes," and certain of its assertions and allegations in its briefing were unsupported by factual references. However, we do not believe those actions rose to a level that would justify our imposing sanctions in the form of requiring the State to pay Small Tobacco's appellate attorney's fees.[13] We therefore deny Small Tobacco's motions for sanctions.

All Citations

440 S.W.3d 304

Footnotes

1 Subchapter V states that it assesses a "fee" on certain tobacco products. The parties approach the case as raising taxation issues, and we will follow suit, viewing the assessment as a tax and not a fee. *See TracFone Wireless, Inc. v. Commission on State Emergency Commc'ns,* 397 S.W.3d 173, 175 n. 3 (Tex.2013) (legislature's decision to label assessment as fee not tax is not binding on courts; "A charge is a fee rather than a tax when the primary purpose of the fee is to support a regulatory regime governing those who pay the fee."); *Lowenberg v. City of Dallas,* 261 S.W.3d 54, 57–58 (Tex.2008) (quoting *Hurt v. Cooper,* 130 Tex. 433, 110 S.W.2d 896, 899 (1937)) (whether assessment is tax depends not on label given by legislature but on whether primary purpose is to raise revenue).

2 The companies sued were Phillip Morris Companies; RJR Nabisco Holdings, the parent company for R.J. Reynolds Tobacco; BAT Industries PLC, the parent company of Brown & Williamson Tobacco; and the Loews Corporation, parent company of Lorillard Tobacco. At the time, those four companies were responsible for more than ninety-five percent of the cigarettes sold in this country.

3 More than forty states filed suit, and most of them joined a master settlement agreement. Texas and several others negotiated their own separate agreements.

4 Tobacco companies who joined the multi-state master agreement, other than original signatories to that agreement or parties to the State's 1997 or 1998 settlements, pay a lower rate of 0.75 cents per cigarette or tobacco product. Tex. Health & Safety Code § 161.604(c).

5 The Texas Small Tobacco Coalition is a trade association made up of smaller tobacco manufacturers, distributors, and retailers. Most of the coalition's members came into existence after 1998, although Global Tobacco, Inc. has been in existence since before the settlement agreements were negotiated.

6 *See* Tex. Civ. Prac. & Rem.Code §§ 37.001–.011.

7 "[I]t is well-recognized that a suit seeking a declaratory judgment that a state agent is acting pursuant to an unconstitutional law is not barred by sovereign immunity." *Scott v. Alphonso Crutch Life Support Ctr.,* 392 S.W.3d 132, 137 (Tex.App.-Austin 2009, pet. denied) (mem. op.) (citing *Rylander v. Caldwell,* 23 S.W.3d 132, 135 (Tex.App.-Austin 2000, no pet.) ("when a party's rights have been violated by the unlawful acts of a state official or by a state agent acting pursuant to an unconstitutional law, the suit is not an action against the State requiring the State's consent")); *see Texas Dep't of State Health Servs. v. Holmes,* 294 S.W.3d 328, 336 (Tex.App.-Austin 2009, pet. denied) ("Texas law is clear that private parties may seek declaratory relief against state officials who are acting pursuant to an allegedly unconstitutional law," and it is "well recognized that declaratory relief is the proper remedy when challenging the constitutionality of a statute and that plaintiffs are not required to obtain the State's consent before suing for declaratory judgment").

8 Section 112.108 provides:

> Except for a restraining order or injunction issued as provided by this subchapter, a court may not issue a restraining order, injunction, declaratory judgment, writ of mandamus or prohibition, order requiring the payment of taxes or fees into the registry or custody of the court, or other similar legal or equitable relief against the state or a state agency relating to the applicability, assessment, collection, or constitutionality of a tax or fee covered by this subchapter or the amount of the tax or fee due, provided, however, that after filing an oath of inability to pay the tax, penalties, and interest due, a party may be excused from the requirement of prepayment of tax as a prerequisite to appeal if the court, after notice and hearing, finds that such prepayment would constitute an unreasonable restraint on the party's right of access to the courts. The court may grant such relief as may be reasonably required by the circumstances. A grant of declaratory relief against the state or a state agency shall not entitle the winning party to recover attorney fees.

Tex. Tax Code § 112.108.

9 *See also FM Express Food Mart, Inc. v. Combs,* No. 03–12–00144–CV, 2013 WL 1149551, at *6 n. 6 (Tex.App.-Austin Mar. 15, 2013, no pet.) (mem. op.) (noting holding in *Bandag* that section 112.108 was unconstitutional); *Local Neon Co. v. Strayhorn,* No. 03–04–00261–CV, 2005 WL 1412171, at *6 n. 6 (Tex.App.-Austin June 16, 2005, no pet.) (mem. op.) ("the Comptroller concedes on appeal that this Court held section 112.108 unconstitutional").

10 *See also Dancetown, U.S.A., Inc. v. State,* 439 S.W.2d 333, 336 (Tex.1969) ("Differences in the commodities sold or services rendered are generally regarded as a proper basis for classification in the absence of any showing to the contrary."); *Hurt,* 110 S.W.2d at 900–01 ("merchants may be divided into classes and the classes taxed in different amounts and according to different standards," and "[m]ere differences in methods of conducting businesses have long been recognized in this state as sufficient to support the classification of merchants for the purpose of levying occupation taxes"); *Texas Co. v. Stephens,* 100 Tex. 628, 103 S.W. 481, 485 (1907) ("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.").

11 "Cigarette tobacco products" are roll-your-own tobacco or tobacco that is suitable for use in cigarettes and is likely to be used in such a way. Tex. Health & Safety Code § 161.602(3).

12 The State asserts that the settlement agreement's ongoing annual payments are "not tied to prior bad acts: They are tied to big tobacco's future sales, and calculated to offset the State's ongoing health care costs." However, the State does not cite to any portion of the settlement agreements that supports that statement. Instead, the 1998 Settlement stated that payments made in 1998 "constitute[d] reimbursement for public health expenditures of the State of Texas" and that "[a]ll other payments made by Settling Defendants pursuant to this Settlement Agreement are in satisfaction of all of the State of Texas's claims for damages incurred ... in the year of payment *or earlier years,* including those for reimbursement of Medicaid expenditures and *punitive damages.*" (Emphases added.) After setting out seven specific sums to be paid to various entities, the agreement then stated that "[a]ll remaining amounts, including any amounts due to be paid by Settling Defendants after December 31, 1998, are to be allocated to the general revenue fund of the State of Texas to be used for such purposes as the State of Texas may determine."

13 In its initial brief and its reply brief, the State provides two full-page discussions about Small Tobacco's alleged manufacture and sale of flavored cigarettes, allegations Small Tobacco denies, noting that federal law bans the sale of "flavored cigarettes" but not "flavored cigars." The State also provided this Court, as an exhibit to its reply brief, three packs of what it characterizes as "grape-flavored cigarettes" but which are labeled as flavored "cigars." Despite placing some emphasis on its allegations related to flavored cigarettes, the State concurs in its reply brief that Small Tobacco's "sale of flavored cigarettes is not relevant to the elements of their claim, of course." In asking us to deny Small Tobacco's motions for sanctions, it asks us to take judicial notice of the "legislative fact" that Small Tobacco sells "flavored cigarettes" but then argues that it never "said that the tobacco companies [Small Tobacco] are federal lawbreakers. It said only that they sell flavored cigarettes, and indeed they do." For the State to emphasize disputed facts not in the record and make allegations that imply a violation of federal law, while agreeing that the issue is not relevant to the case, raises some concerns for this Court.

APPENDIX B

496 S.W.3d 778
Supreme Court of Texas.

Glenn Hegar, in His Official Capacity as Texas Comptroller, and Ken Paxton, in His Official Capacity as Texas Attorney General, Petitioners,
v.
Texas Small Tobacco Coalition, and Global Tobacco, Inc., Respondents

NO. 14–0747
|
Argued December 8, 2015
|
OPINION DELIVERED: April 1, 2016
|
Rehearing Denied September 23, 2016

Synopsis

Background: Coalition of tobacco manufacturers, retailers, and distributors brought action against state, alleging that tax imposed on manufacturers that did not settle in previous tobacco litigation was unconstitutional. The District Court, Travis County, 345th Judicial District, Stephen Yelenosky, J., found the tax unconstitutional. State appealed. The Austin Court Of Appeals, 440 S.W.3d 304, affirmed. State petitioned for review.

Holdings: The Supreme Court, Willett, J., held that:

[1] tax did not violate Equal and Uniform Clause of state constitution;

[2] Legislature was within its discretion to consider effect of settlement agreement when establishing tax classifications;

[3] Legislature could rationally conclude that settlement payments were reimbursements for health care costs; and

[4] Legislature was not required to tax both settling manufacturers and non-settling manufacturers.

Judgment of the Court of Appeals reversed and remanded.

West Headnotes (15)

[1] Taxation
Equality and uniformity in general
371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general
The mandate that taxation shall be equal and uniform generally applies only within classes, not between classes. Tex. Const. art. 8, § 1(a).

Cases that cite this headnote

[2] Constitutional Law
Presumptions and Construction as to Constitutionality
92 Constitutional Law
92VI Enforcement of Constitutional Provisions
92VI(C) Determination of Constitutional Questions
92VI(C)3 Presumptions and Construction as to Constitutionality
92k990 In general
A challenged statute is entitled to a strong presumption of constitutional validity.

Cases that cite this headnote

[3] Constitutional Law
Taxation and revenue legislation
92 Constitutional Law
92VI Enforcement of Constitutional Provisions
92VI(C) Determination of Constitutional Questions
92VI(C)3 Presumptions and Construction as to Constitutionality
92k1006 Particular Issues and Applications
92k1012 Taxation and revenue legislation
The strong presumption of constitutional validity is particularly robust where the constitutionality of taxation statutes is challenged. Tex. Const. art. 8, § 1(a).

Cases that cite this headnote

[4] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

The Legislature need only have a rational basis in constructing tax classifications; that is, the Legislature must attempt to group similar things and differentiate dissimilar things in formulating rational classifications, and must show that the classifications reasonably relate to the purpose of the tax. Tex. Const. art. 8, § 1(a).

Cases that cite this headnote

[5] Taxation

Power of legislature in general

371 Taxation
371I In General
371k2013 Power of legislature in general

The Legislature must have discretion in structuring tax laws. Tex. Const. art. 8, § 1(a).

Cases that cite this headnote

[6] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

In the non-property context, the nature of the taxpayer necessarily lies at the heart of any inquiry under the Equal and Uniform Clause of the state constitution. Tex. Const. art. 8, § 1(a).

Cases that cite this headnote

[7] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

The Legislature retains full discretion when it attempts to group similar things and differentiate dissimilar things for purposes of taxation, subject to the general rule that the differences must be real, not fanciful. Tex. Const. art. 8, § 1(a).

Cases that cite this headnote

[8] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

The Equal and Uniform Clause of the state constitution primarily suggests a simple question as to whether the challenged tax classification is rational and reasonably related to the purpose of the tax. Tex. Const. art. 8, § 1(a).

Cases that cite this headnote

[9] Taxation

Cigarettes and tobacco products

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3629 Cigarettes and tobacco products

Tax per cigarette pack imposed on tobacco manufacturers that were not parties to settlement agreement in previous tobacco litigation did not violate Equal and Uniform Clause of state constitution; distinction between settling and non-settling manufacturers was rational, as settling manufacturers shouldered $500–million–per–year burden and operating restrictions that non-settling manufacturers did not bear, tax's legitimate purpose was to recover

health care costs to state imposed by non-settling manufacturers and to prevent undermining of state's policy of reducing underage smoking by offering cigarettes at prices that were substantially below prices of settling manufacturers, and tax classifications were reasonably related to purposes. Tex. Const. art. 8, § 1(a); Tex. Health & Safety Code Ann. § 161.601 et seq.

Cases that cite this headnote

[10] Taxation

Cigarettes and tobacco products

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3629 Cigarettes and tobacco products

Legislature was within its discretion to consider effect of settlement agreement between state and some tobacco manufacturers when establishing settling manufacturer and non-settling manufacturer tax classifications, and implementing per-cigarette-pack tax on non-settling manufacturers; legislature was not required to turn blind eye to real-world consequences of litigation, and settling manufacturers incurring $500–million–per–year burden was sufficiently fundamental transformation that distinguished settling manufacturers from non-settling manufacturers, which would not have paid anything absent tax. Tex. Const. art. 8, § 1(a); Tex. Health & Safety Code Ann. § 161.601 et seq.

Cases that cite this headnote

[11] Taxation

Equality and uniformity in general

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general

The discretion inherent in the Legislature's authority to attempt to group similar things and differentiate dissimilar things for tax purposes is hobbled by no substantial handicap other than the overriding rule that any claimed difference be "real." Tex. Const. art. 8, § 1(a).

Cases that cite this headnote

[12] Taxation

Cigarettes and tobacco products

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3629 Cigarettes and tobacco products

Legislature could rationally conclude that certain tobacco manufacturers' payments required under settlement agreement with state were reimbursements for ongoing health care costs, rather than punishment, as required for tax per cigarette pack on non-settling manufacturers to satisfy rational basis review under Equal and Uniform Clause of state constitution; settlement expressly provided that state waived without limitation any future claims for reimbursement for health care costs in consideration of payments to be made by settling manufacturers, and settlement endorsed goal of accomplishing unprecedented and comprehensive regulation of tobacco industry. Tex. Const. art. 8, § 1(a); Tex. Health & Safety Code Ann. § 161.601 et seq.

Cases that cite this headnote

[13] Constitutional Law

Reasonableness or rationality

92 Constitutional Law
92VII Constitutional Rights in General
92VII(A) In General
92k1055 Reasonableness or rationality

Rational-basis review does not require the Legislature to show that its understanding of the record before it is infallible.

Cases that cite this headnote

[14] Taxation
Cigarettes and tobacco products
371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3629 Cigarettes and tobacco products
Legislature was not required to tax tobacco manufacturers that settled previous litigation with state, and were required to make $500–million–per–year payment, when it taxed non-settling manufacturers per cigarette pack, in order to satisfy Equal and Uniform Clause of state constitution; Legislature rationally believed that state was already recovering from settling manufacturers health care costs that flowed from settling manufacturers' products, it would have been irrational to demand costs two times over, and enactment of across-the-board tax would have undermined Legislature's policy goal of preventing underage smoking, by allowing non-settling manufacturers to offer products at lower prices more attractive to youth. Tex. Const. art. 8, § 1(a); Tex. Health & Safety Code Ann. § 161.601 et seq.

Cases that cite this headnote

[15] Taxation
Equality and uniformity in general
371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(B) Regulations
371k3625 Validity of Acts and Ordinances
371k3627 Equality and uniformity in general
Only an extreme and clear case would justify an interference by the courts with the legislative action in constructing tax classifications. Tex. Const. art. 8, § 1(a).

Cases that cite this headnote

West Codenotes

Negative Treatment Reconsidered
Tex. Health & Safety Code Ann. §§ 161.601, 161.602, 161.603, 161.604, 161.605, 161.606, 161.607, 161.608, 161.609, 161.610, 161.611, 161.612, 161.613, 161.614

***780** ON PETITION FOR REVIEW FROM THE COURT OF APPEALS FOR THE THIRD DISTRICT OF TEXAS

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Opinion

Justice Willett delivered the opinion of the Court.

Amid nationwide tobacco litigation in the 1990s, the State of Texas individually settled its lawsuit against several of the largest tobacco companies over smoking-related Medicaid costs. The multibillion dollar settlement principally requires the settling manufacturers to make annual payments of approximately $500 million to the State in perpetuity. In return, the State waived without limitation, among other things, any future reimbursement claims against the settling manufacturers.

In 2013, the Legislature passed House Bill 3536, which sought to recover the State's health care costs imposed by *non*-settling manufacturers' products through a tax on those manufacturers. This case concerns whether that taxation scheme violates the Equal and Uniform Clause of the Texas Constitution. We hold that it does not. Accordingly, we reverse the court of appeals' judgment

and remand to that court for consideration of the non-settling manufacturers' remaining challenges to the tax.

***781 I**

In this case, we write against the backdrop of national tobacco litigation, a momentous era culminating in some of the largest and most extensive civil litigation settlements in American history. We begin with an overview of the tobacco liability claims of the 1990s before turning to the facts of this case.

A

This case arises in part from historic litigation that buffeted the tobacco industry in the last decade of the twentieth century. The Lone Star State was a significant player in that litigation. Just over twenty years ago, Texas sued several of the nation's leading tobacco companies, asserting violations of numerous state and federal fraud, racketeering, antitrust, conspiracy, and other laws.

Texas's claims were that these companies knowingly misrepresented their products as safe and targeted minors in their advertisements. More than 40 states filed similar suits against the tobacco industry. The companies' collective defense faltered, however, when one of the companies, Liggett, settled with Texas and several other states (the Liggett Settlement), agreeing in large part to cooperate with the states in their suits against the remaining defendants. As relevant here, Liggett agreed to make annual payments to the states, and the states waived their claims against Liggett. The Liggett Settlement led to settlement negotiations involving the remaining defendants that culminated in a nationwide settlement and state-specific settlements.

The Liggett Settlement prompted serious settlement discussions between the states and the remaining tobacco defendants. Shortly thereafter, the states and tobacco defendants executed a Memorandum of Understanding and Proposed Resolution (Proposed Resolution). The Proposed Resolution sought "to forge an unprecedented national resolution of the principal issues and controversies associated with the manufacture, marketing and sale of tobacco products in the United States." According to the Proposed Resolution, federal legislation would provide the vehicle for implementing the solution and ensuring "comprehensive regulation of the tobacco industry while preserving the right of individuals to assert claims for compensation."

The Proposed Resolution would primarily require the remaining defendants to make annual payments in perpetuity "to fund health benefits program expenditures and to establish and fund a tobacco products liability judgments and settlement fund." Those payments would total approximately $368.5 billion over the first 25 years. The payments would be adjusted for inflation and changes in the defendants' sales. The Proposed Resolution would also impose significant limitations on the defendants' marketing of their products. In return, the states would waive their claims against the defendants as well as future claims arising from the sale or use of tobacco products. The Proposed Resolution never became federal law, but it would serve as the blueprint for several settlements in the following months.

The Master Settlement Agreement (MSA) was the largest of the subsequent settlements, involving 46 states plus American territories and the District of Columbia (collectively, settling states). Under the MSA, the settling states released past, pending, and future claims against the remaining defendants (deemed "participating manufacturers") that sought "recovery for Medicaid and other public health expenses incurred in the treatment of smoking-induced illnesses." Tracking the Proposed Resolution, the MSA required the participating ***782** manufacturers to make initial payments followed by perpetual annual payments based on their market share and product sales. The MSA also imposed marketing restrictions on the participating manufacturers, forbidding advertising to minors and requiring initiatives to prevent such advertising. The MSA permits other tobacco manufacturers to join the MSA, generally requiring these "subsequent participating manufacturers" to comply with the MSA's restrictions and ongoing payment scheme to receive the same release of claims that the participating manufacturers received.

Texas was not a party to the MSA. Instead, Texas and three other states—Minnesota, Mississippi, and Florida—reached individual settlements with the remaining tobacco defendants. For purposes of this case, the differences between these settlements are negligible. The Texas Comprehensive Settlement Agreement and Release

(Comprehensive Settlement) accomplished much of what the Proposed Resolution would have accomplished, exemplified by the Comprehensive Settlement's constant invocation of the Proposed Resolution and the Proposed Resolution's attachment to the Comprehensive Settlement as an appendix. It stated that Texas and the remaining defendants (settling manufacturers)—Philip Morris, Inc., R.J. Reynolds Tobacco Co., Brown & Williamson Tobacco Co., Lorillard Tobacco Co., and United States Tobacco Co.—desired to settle on terms "comparable to those contained in the Proposed Resolution, which terms will achieve for Texas immediately and with certainty the financial benefits it would receive pursuant to the Proposed Resolution."

The Comprehensive Settlement required the settling manufacturers to make initial payments to Texas of $725 million—Texas's 7.25% share of the $10 billion initial payment to the states set out in the Proposed Resolution. The Comprehensive Settlement also required the settling manufacturers to make annual payments in perpetuity. Adjusted by inflation and the settling manufacturers' market share and product sales, the payments may increase, decrease, and even end if a manufacturer stops selling tobacco products altogether. The Comprehensive Settlement stated that the initial payments "constitute[d] reimbursement for public health expenditures by the State of Texas." It further stated that "[a]ll other payments ... are in satisfaction of all of the State of Texas's claims for damages incurred by the State in the year of payment or earlier years, including those for reimbursement of Medicaid expenditures and punitive damages." Pursuant to a most-favored-nation provision, the amount of the payments corresponds to the amount required under the Minnesota settlement, which costs settling manufacturers approximately $0.64 per cigarette pack. The parties to this litigation do not dispute that the settling manufacturers' payments to the State result in annual revenue of approximately $500 million.

As in the MSA and Proposed Resolution, the Comprehensive Settlement prohibited the settling manufacturers from marketing to minors and required them to support programs created to reduce underage smoking. Further, the Comprehensive Settlement prevented the settling manufacturers from opposing any legislative or administrative initiatives to strengthen penalties for tobacco-product sales to minors and for minors in possession of those products.

In return, the Settlement secured robust immunity for the settling manufacturers, though they admitted no wrongdoing and disclaimed any liability. Texas released all past claims "that were or could have been made in this action or any comparable ***783** federal or state action." And as to future claims, Texas released those claims "directly or indirectly based on ... the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without any limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products."

B

But what of those tobacco manufacturers who are not parties to either the MSA or the state-specific settlements? The Proposed Resolution cautioned that its achievements "would be substantially undercut if certain companies were free to ignore the limitations it imposes, and were instead able to sell tobacco products at lower prices (because they were not making the payments described above) and through less restricted advertising and marketing activities." Following the Proposed Resolution's idea of imposing ongoing payments or escrow obligations on these non-settling manufacturers (NSMs), the MSA and individually settling states established similar methods of dealing with NSMs.

The MSA suggested, and every MSA state has enacted, an escrow statute that requires "non-participating manufacturers" to deposit annual fees. The statutes generally provide that the MSA states can recover a judgment or settlement against NSMs from those escrow accounts. But if any fees remain in the escrow accounts after 25 years, they may be returned with interest to the manufacturers who paid the fees. NSMs have challenged those statutes on due-process and equal-protection grounds, but every federal court to consider those challenges has rejected them. [1]

Minnesota sought to achieve the same goal through a tax on NSMs. That tax currently equates to $.50 per cigarette pack. In 2006, the Minnesota Supreme Court considered the NSMs' challenge to that tax on equal-and-uniform grounds and rejected the challenge, upholding the tax as rational and reasonably related to its goals of recovering health care costs and reducing underage smoking. [2]

In 2013, Texas followed suit. The Legislature passed House Bill 3536, which added Subchapter V to Chapter 161 of the Texas Health & Safety Code. Subchapter V imposes a tax,[3] similar to Minnesota's tax, on NSMs, defined as manufacturers of cigarettes or cigarette tobacco products that did not sign either the Liggett Settlement or the Comprehensive Settlement.[4] The Legislature enumerated various purposes underlying the tax:

> (1) 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 by offering cigarettes and cigarette tobacco products at prices that are substantially below ***784** the prices of cigarettes and cigarette tobacco products of other manufacturers;
>
> (3) protect the tobacco settlement agreement and funding, which has been reduced because of the growth of sales of non-settling manufacturer cigarettes and cigarette tobacco products, for programs that are funded wholly or partly by payments to this state under the tobacco settlement agreement and recoup for this state settlement payment revenue lost because of sales of non-settling manufacturer cigarettes and cigarette tobacco products;
>
> (4) ensure evenhanded treatment of manufacturers and further protect the tobacco settlement agreement and funding by imposing a partial payment obligation on non-settling manufacturers that already make payments on Texas sales under the master settlement agreement until a credit amendment to that agreement that will provide those manufacturers with a credit for payments to Texas is effective; and
>
> (5) provide funding for any purpose the legislature determines.[5]

The tax is approximately $0.55 per cigarette pack for NSMs who did not join the MSA, and $0.15 per cigarette pack for those NSMs who became subsequent participating manufacturers under the MSA. All taxes paid "shall apply on a dollar for dollar basis to reduce any judgment or settlement on a released claim brought against the manufacturer that made the payment."[6]

C

Respondents in this case (collectively, the Coalition) are manufacturers, retailers, and distributors who are subject to this taxation scheme. The Coalition sued the Comptroller and Attorney General (the State), alleging that the tax is unconstitutional under the Equal and Uniform Clause of the Texas Constitution and the Equal Protection and Due Process Clauses of the United States Constitution. Specifically, the Coalition claimed that the tax classifications unconstitutionally discriminate against NSMs. The State filed a plea to the jurisdiction, claiming, among other things, that the Coalition had not pleaded viable constitutional claims. The trial court considered that plea along with competing motions for summary judgment. The court rejected the plea and the State's motion for summary judgment, and granted the Coalition's motion for summary judgment, declaring the tax unconstitutional under both the Texas Constitution and the United States Constitution.

The court of appeals affirmed by addressing only the Equal and Uniform Clause claim.[7] The court found no difference between settling manufacturers' products and NSMs' products.[8] It described the Legislature's purposes as "laudable," but nonetheless held that "imposing a tax on only one class of identical products is not equal and uniform under Texas law and cannot be upheld."[9]

We granted the State's petition for review. The Coalition has agreed that its legal arguments "are the same for both the Texas Settlement Agreement and the Liggett Agreement." For ease of reference, we therefore proceed on that understanding, denoting both settlements as "the Settlement" and denoting the settling companies under both settlements collectively as ***785** "settling manufacturers," as Chapter 161 does.

II

[1] **[2]** **[3]** **[4]** **[5]** The Equal and Uniform Clause is succinct: "Taxation shall be equal and uniform."[10] That mandate generally applies only *within* classes, not *between* classes, and so we have established a two-pronged framework within which we assess the validity of statutory tax classifications. First, a challenged statute

is entitled to a "strong presumption" of constitutional validity.[11] This presumption is particularly robust where the constitutionality of taxation statutes is challenged.[12] Second, the Legislature need only have a rational basis in constructing tax classifications.[13] That is, the Legislature must "attempt to group similar things and differentiate dissimilar things" in formulating rational classifications, and must show that the classifications reasonably relate to the purpose of the tax.[14] And above all, "the Legislature must have discretion in structuring tax laws."[15]

No party questions the applicability of the presumption of constitutionality here. Instead, the parties dispute the formulation and application of the rational-basis standard. We therefore begin with a clarification of that standard and then apply it to the facts before us.

A

The parties primarily debate the correctness of the court of appeals' rendition of the rational-basis standard. The court of appeals emphasized that, in assessing the rationality of tax classifications, its "focus must be on the subject of the tax, not the entity being taxed."[16] The court then observed that both settling manufacturers and NSMs make identical tobacco products, which were, in its view, the taxed subject matter.[17] Therefore, the court reasoned, despite the "laudable" goals of recovering health care costs to the State and reducing underage smoking, "imposing a tax on only one class of identical products is not equal and uniform under Texas law and cannot be upheld."[18] The State says that a difference in products may be a *sufficient* condition for upholding different tax classifications, but it is not a *necessary* condition. The Coalition counters that, pursuant to its test, the court of appeals appropriately sought to identify *any* difference between settling manufacturers and NSMs and found none.

We do not think the court of appeals' analysis can be read as generously as the Coalition suggests. In addition to its emphasis in the quotations above on the nature of the products, the court repeated that refrain at least two more times. The court stated that there was "no indication in this record that the taxed subject matter ... differs even slightly when manufactured by [NSMs] versus [settling manufacturers]."[19] Elsewhere, it looked for "justif [ication] [for] the unequal treatment ***786** of identical products."[20] Given the court's earlier statement that its "focus must be on the subject of the tax, not the entity being taxed,"[21] it appears the court kept its word by focusing only on the identical nature of the tobacco products manufactured by settling manufacturers and NSMs.

[6] That constricted approach diverges from our settled precedent. We have made clear that, "[a]t least where non-property taxes are concerned, the Equal and Uniform Clause generally only prohibits unequal or multiform taxes that are imposed on members of the same class *of taxpayers*."[22] This understanding is deeply embedded in our caselaw. Over 100 years ago, we asked in *Texas Co. v. Stephens* in the occupation-tax context whether "an attempted classification has [any] reasonable basis in the nature of the *businesses* classified[.]"[23] And just a few Terms ago, we reaffirmed this understanding in *Nestle,* another occupation-tax case, noting that "classifying taxpayers for purposes of an occupation tax is not an exception to the Equal and Uniform Clause but a consequence of it."[24] The court of appeals' insistence on focusing on the products and *not* on the entity being taxed is thus at odds with the concerns of the Equal and Uniform Clause. Products do not pay taxes; taxpayers do. For that reason, in the non-property context, the nature of the taxpayer necessarily lies at the heart of any Equal and Uniform Clause inquiry.

[7] This is not to say that differences in taxpayers' products are wholly irrelevant to this inquiry. The Legislature may well find those differences helpful in distinguishing one taxpayer from another. For example, no reasonable person would dispute that an ice cream manufacturer could be classified differently than a computer manufacturer. On that understanding, we have previously mentioned a "[d]ifference[ ] in the commodities sold or services rendered" as a difference to which the Legislature may look in constructing tax classifications.[25] In the same vein, we have explained that "[d]ifferences in the profits derived" and "differences in methods of conducting businesses" are also permissible differences upon which the Legislature may rely.[26] Although those differences may be sufficient to sustain tax classifications, none of those differences are the sine qua non of

rational tax classifications. Nor is that list of differences exclusive. Our precedents may only be said to delineate the core, not the perimeter, of permissible tax-classification distinctions. All of this flows from the fact that the Legislature retains full discretion when it "attempt[s] to group similar things and differentiate dissimilar things," [27] subject, of course, to ***787** the general rule that the differences must be real, not fanciful. [28] Absent a violation of that rule, our deferential tradition compels respect for the Legislature's differentiating function.

[8] In the end, the Equal and Uniform Clause primarily suggests a question as simple as its text: Is the challenged tax classification rational and reasonably related to the purpose of the tax?

B

[9] Applying that familiar standard, we have little trouble finding that this taxation scheme does not violate the Equal and Uniform Clause.

The Legislature's distinction between settling manufacturers and NSMs is rational on at least two grounds. First, no party disputes that the settling manufacturers shoulder a $500–million–per–year burden that NSMs do not bear. Asked directly about that distinction at oral argument, the Coalition's counsel candidly admitted, "Apart from [this] tax, [we] would not be paying anything" to the State. Second, the settling manufacturers function under operating restrictions to which NSMs are not subject. The Coalition says it operates under similar restrictions because it too is legally prohibited from using marketing tactics designed to entice youth. But the Settlement's operating restrictions go further than prohibiting certain marketing tactics. The Settlement prohibits the settling manufacturers from "challeng[ing] existing or proposed legislative or administrative initiatives insofar as they effectuate" objectives like strengthening civil penalties for sales of tobacco products to minors and for minors in possession of these products. That restriction would implicate serious First Amendment concerns if not for the settling manufacturers' agreement, and the Coalition has pointed us to no evidence in the record that its members are subject to a similar restriction.

Those distinctions establish sufficient differences in business operations to justify the non-settling-manufacturer and settling-manufacturer tax classifications. Our emphasis on businesses' burdens in *Nestle* indicates as much. There, we assessed different franchise-tax classifications and upheld them based on the different burdens the businesses could bear: "[T]he Legislature could certainly conclude that employers' burdens—like compensation, unemployment insurance, and vicarious liability—are greater than those for a business whose work is done by independent contractors." [29] That distinction by analogy is even stronger here. Whereas an employer in *Nestle could* be subject to higher payments, the settling manufacturers *are* subject to higher payments. Indeed, we deferred to what the Legislature "could certainly conclude" in *Nestle,* [30] but here we need only accept the Coalition's concession that its members make no comparable payments to the State. The restriction on the settling manufacturers' challenges to legislative and administrative initiatives further accentuates the differences ***788** between settling manufacturers and NSMs. *A fortiori* the differences in burdens—"the conditions under which [the businesses] are pursued" [31] —render these tax classifications rational.

The Legislature has also articulated legitimate purposes for the tax. The Legislature primarily aimed to "recover health care costs to the state imposed by non-settling manufacturers," and "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." [32] The Coalition concedes that all tobacco products impose health care costs on the State, and it does not seriously dispute that the State may generally seek to recover those costs. It also acknowledges that "the government has a legitimate interest in preventing underage smoking." And rightly so. In *American Tobacco Co. v. Grinnell,* we observed that until the late-twentieth century, "unlike the general dangers associated with smoking, ... the danger of addiction from smoking cigarettes was not widely known and recognized in the community in general, or, particularly, by children or adolescents." [33] We cited approvingly to a Food and Drug Administration regulation, which explained that "because of tobacco's addictive effects, the only way to prevent the ensuing disease and death is

to prevent children and adolescents from starting to use tobacco[.]" [34] We therefore agree with the Coalition that recovering health care costs to the State and preventing underage smoking are legitimate purposes underlying the tax. [35]

And finally, the tax classifications are reasonably related to the goals of recovering health care costs and reducing underage smoking. The parties have stipulated that all tobacco products impose health care costs on the State. And the Coalition recognizes that the payments under the Settlement, at least *in part,* reimburse the State for health care costs that flow from settling manufacturers' products. Because no similar reimbursement mechanism was in place for NSMs, it was logical for the ***789** Legislature to recover those costs from NSMs whose products create the same health risks. As a corollary, the Legislature could have reasonably determined that if NSMs did not bear the health care costs of their products, they could offer their products at prices substantially lower than the prices of settling manufacturers' products, which would entice youth and undermine the goal of reducing underage smoking. The Legislature in fact *did* so determine, [36] and we hold its classifications are sufficiently related to its stated goals.

* * *

At bottom, the tax classifications do not violate the Equal and Uniform Clause.

III

The Coalition raises a number of objections to this taxation scheme. It first argues that a settlement may never be considered to classify and tax non-settling parties differently. It then argues that even if a settlement may be considered, the effect of *this* Settlement should not be considered because its perpetual restrictions on settling manufacturers are their punishment for past conduct, and it would be unconstitutional to subject NSMs to similar conditions when they were never sued and never settled. Its final argument is that the Legislature should have taxed *all* manufacturers, not only NSMs, if it truly wanted to recover health care costs. We find none of these arguments persuasive.

A

[10] The Coalition's broadest argument is that "it is never reasonable to use a private settlement agreement to resolve litigation as a basis for discriminatory taxation." [37] But we have previously approved the effect of a settlement in the face of an Equal and Uniform Clause challenge. And in any event, that broad argument conflicts with the constitutional requirement that the Legislature "attempt to group similar things and differentiate dissimilar things." [38]

This is not the first time we have been asked to consider the effect of a settlement in an Equal and Uniform Clause challenge. Our decision in *Fort Worth Independent School District v. City of Fort Worth* turned in part on such a consideration. [39] In the 1930s, after the United States Court of Appeals for the Fifth Circuit held that Bell's rights-of-way for the placement of poles and wires throughout the City of Fort Worth were taxable property interests, Bell's attorney wrote the City, stating "it will be difficult to formulate a basis of valuation that will not give rise to recurring controversies each year." [40] The attorney expressed hope for "some equitable basis" to "settle the tax question" and ***790** "thus terminate the litigation that has been in progress for several years." [41] Specifically, the attorney proposed that Bell pay the City a percentage of its gross revenue each year. [42] Bell and the City negotiated a settlement, which resulted in the City passing an ordinance that required Bell to annually pay two percent of its gross receipts "in lieu of any tax." [43] Bell then executed "a written acceptance of 'the terms of said resolution' as 'approving the settlement and compromise' of the pending litigation." [44] Bell made those annual payments for 55 years. [45]

Bell later challenged the ordinance on the ground that it violated the Equal and Uniform Clause. [46] As we noted, "[n]o other taxpayer in the district had a similar arrangement." [47] Nonetheless, we held that Bell had "failed to establish that the 1936 arrangement was unlawful." [48] Indeed, "[t]he City and the School District were authorized to settle their tax dispute with Bell, which involved difficult valuation issues that were likely to be

disputed for years, by agreeing to an amount that they were satisfied would approximate the tax liability." [49] We cautioned that "[n]either a taxing authority nor a taxpayer can circumvent the constitutional restrictions on, or requirements for, taxation merely by agreeing to settle a dispute." [50] But it is equally true, we stated, that "a fair settlement of a legitimate dispute that contemplates the market value of the property is not unconstitutional simply because it is not an appraisal and assessment done by standard procedure." [51] We therefore held that Bell had failed to establish a violation of the Equal and Uniform Clause. [52]

As with all other cases, that case is, of course, distinguishable on the facts–it dealt with ad valorem taxes, the settlement was a clear attempt to approximate tax liability, the underlying litigation giving rise to the settlement did not contain allegations of wrongdoing, and the property taxpayers not privy to the settlement were not necessarily "competitors" with Bell. All true enough. But as to the broader question of whether the Legislature may, at least in some circumstances, look to the effect of a settlement when establishing tax classifications, that case is not meaningfully distinguishable. Indeed, ours would be an exceedingly odd jurisprudence if it found the effect of a settlement not only constitutionally *significant* but also constitutionally *sufficient* to satisfy tax liability pursuant to the Equal and Uniform Clause, but a verboten consideration when the Legislature ponders whether to impose a tax *at all*. A fair reading of *Fort Worth Independent School District* does not compel that result.

[11] And for good reason: We have time and again underscored that it is the ***791** province of the Legislature to "attempt to group similar things and differentiate dissimilar things." [53] The discretion inherent in that authority is hobbled by no substantial handicap other than the overriding rule that any claimed difference be "real." [54] That discretion does not require the Legislature to turn a blind eye to the real-world consequences of litigation. Such a blinkered approach would be irrational. At least when the effect of a settlement is to fundamentally transform an entity's business operation, that effect can be considered. We think that incurring a perpetual $500–million–per–year burden is a sufficiently fundamental transformation that distinguishes settling manufacturers from the Coalition, which, in its own words, "would not be paying anything" absent this tax. The Legislature was thus within its discretion to consider the effect of the Settlement when establishing the settling-manufacturer and NSM tax classifications.

The Coalition complains that there is no workable test that would govern when the Legislature may properly consider a settlement—how wide-ranging must the settlement be? How important must the settlement be? To whom must the settlement be important? What purposes underlying the settlement are relevant in the Equal and Uniform Clause inquiry? All good questions that we need not answer today. Suffice it to say that in the mine run of cases, aside from tax-liability-approximation cases like *Fort Worth Independent School District,* settlements will be unlikely to so fundamentally transform an entity's business operation as to permit the Legislature's consideration. This case may well concern the most extreme settlement that we will ever consider, as evidenced by the State's acknowledgment that the Settlement accomplished changes that "neither legislation nor court judgments could have accomplished." We leave for another day whether it is the *only* settlement that the Legislature may duly consider.

B

[12] The Coalition's fallback argument is that the effect of *this* Settlement is an inappropriate factor for the Legislature to consider because it serves as the settling manufacturers' punishment for their pre–1998 conduct. We were never accused of wrongdoing, we were never sued, and we never had an opportunity to settle, says the Coalition, and thus the settling manufacturers' punishment cannot be a rational basis for classifying NSMs differently. The State counters that the annual payments are not punitive, but are instead annual reimbursements to the State for ongoing health care costs imposed by the settling manufacturers' products.

From the outset, it is worth pausing to appreciate the sheer breadth of the Coalition's position. Its position is that for sempiternity (or at least until the settling manufacturers decide to stop selling tobacco products), the settling manufacturers will be punished for conduct that occurred during a finite, pre–1998 period in time. Fifty, five hundred, or even five *thousand* years from now, the settling manufacturers will still be making atonement, according to the Coalition. Never mind that the Settlement expressly

disclaims any wrongdoing on the part of the settling manufacturers, that punishment-centered view of ***792** the perpetual payments is breathtaking. The Coalition's only response to that observation is: The pre–1998 conduct was *really* bad. [55]

[13] We need not divine the role of those payments today, however, because this is an Equal and Uniform Clause challenge, not a contract-interpretation dispute. Contrary to the latter, which necessarily turns on establishing the *correct* interpretation of a contract, the former turns (as relevant here) on whether the Legislature's tax classification is rational. Rational-basis review does not require the Legislature to show that its understanding of the record before it is infallible. Of course, the Legislature may not rely on the preposterous, but at least where the contractual language provides firm support for the Legislature's interpretation, the Legislature cannot be said to have acted irrationally. This is the case here. The Settlement expressly provides that the State waived without limitation "any future claims for reimbursement for health care costs allegedly associated with use of or exposure to [the settling manufacturers'] Tobacco Products" in "consideration of the payments to be made by the Settling Defendants." From that language combined with the Settlement's endorsement of the Proposed Resolution's goal of accomplishing "unprecedented and comprehensive regulation of the tobacco industry," the Legislature "could certainly conclude" that the settling manufacturers, as distinct from NSMs, currently reimburse the State for ongoing health care costs associated with their products. [56] The Legislature's interpretation of the payments under the Settlement is therefore rational. [57]

Moreover, as a matter of judicial restraint, we *must* not decide the meaning of those payments today. Though no party in this case has challenged the validity of the Settlement, a definitive description of the payments either way—reimbursement for health care costs or punishment—would prematurely place a thumb on the scales in any future litigation concerning the Settlement's validity. The Coalition's counsel admitted as much at oral argument, noting in response to a suggestion that any punishment for pre–1998 conduct must cease at some point, "If they want to litigate [over whether] the contract is valid, that would be the argument to be made." Without an actual challenge to the Settlement, without full briefing from all parties to the Settlement, and without complete vetting of the parties' potential arguments in the lower courts, we are ill-prepared to offer—and constitutionally prohibited from offering [58]—an advisory interpretation of the Settlement that could have significant, lasting consequences.

C

[14] The Coalition's remaining argument is that the Legislature should have ***793** taxed *everybody* —both settling manufacturers and NSMs—if it truly wanted to recover health care costs. [59] But there are commonsense reasons why the Legislature could have chosen to tax only NSMs, and our precedent compels deference to those reasons.

First, the Legislature believes (rationally so, as discussed above) that the State is already recovering from settling manufacturers the health care costs that flow from the settling manufacturers' products. It would be nigh irrational to demand these costs two times over. Our Constitution does not require the Legislature to err on the side of taxation.

Second, if the Legislature had enacted an across-the-board tax, it would have been forced to undermine at least one of its policy goals, which was to prevent underage smoking. The Legislature's theory was that, contrary to the settling manufacturers, NSMs had the distinct advantage of not bearing the health care costs of their products, thereby enabling them to offer their products at lower prices more attractive to youth. Reducing underage smoking, the theory goes, thus depends upon NSMs bearing the burden of the health care costs imposed by their products. But if the Legislature were forced to tax both settling manufacturers and NSMs, that tax would *double* the settling manufacturers' cost burden, while only subjecting NSMs to one layer of costs, potentially leaving unresolved one of the initial problems the Legislature set out to fix: The cost-burden disparity between settling manufacturers and NSMs, along with the concerns of that disparity's effect on underage smoking, would remain unchanged. It was therefore rational for the Legislature to decline to tax the settling manufacturers.

* * *

[15] Our Equal and Uniform Clause caselaw explains that "only an extreme and clear case ... would justify an interference by the courts with the legislative action." [60] This is not that case. Whatever may be said of the tax, it is not "an arbitrary, unreasonable, or unreal one," [61] and it thus does not violate the Equal and Uniform Clause. We therefore reverse the court of appeals' judgment and remand to the court of appeals for consideration of the Coalition's remaining challenges to the tax.

All Citations

496 S.W.3d 778, 59 Tex. Sup. Ct. J. 534

Footnotes

1 *See Xcaliber Int'l Ltd. v. Louisiana,* 612 F.3d 368 (5th Cir.2010); *Grand River Enters. Six Nations, Ltd. v. Beebe,* 574 F.3d 929 (8th Cir.2009); *Grand River Enters. Six Nations, Ltd. v. Pryor,* 425 F.3d 158 (2d Cir.2005); *Star Scientific, Inc. v. Beales,* 278 F.3d 339 (4th Cir.2002); *S & M Brands, Inc. v. Summers,* 393 F.Supp.2d 604 (M.D.Tenn.2005); *PTI, Inc. v. Philip Morris Inc.,* 100 F.Supp.2d 1179 (C.D.Cal.2000).

2 *See Council of Indep. Tobacco Mfrs. of Am. v. State,* 713 N.W.2d 300 (Minn.2006).

3 The statute calls the measure a "fee," but all parties agree that the measure functions as a tax subject to the Equal and Uniform Clause. *See TracFone Wireless, Inc. v. Comm'n on State Emergency Commc'ns,* 397 S.W.3d 173, 175 n. 3 (Tex.2013).

4 *See* TEX. HEALTH & SAFETY CODE §§ 161.602–.603.

5 *Id.* § 161.601.

6 *Id.* § 161.612.

7 440 S.W.3d 304.

8 *Id.* at 311.

9 *Id.*

10 TEX. CONST. art. VIII, § 1(a).

11 *Vinson v. Burgess,* 773 S.W.2d 263, 266 (Tex.1989).

12 *In re Nestle USA, Inc.,* 387 S.W.3d 610, 623 (Tex.2012) (citing *Vinson,* 773 S.W.2d at 266).

13 *See id.* at 622–23.

14 *See id.*

15 *Id.* at 623.

16 440 S.W.3d 304, 311.

17 *See id.*

18 *Id.*

19 *Id.*

20 *Id.*

21 *Id.*

22 *TracFone Wireless, Inc. v. Comm'n on State Emergency Commc'ns,* 397 S.W.3d 173, 181 (Tex.2013) (emphasis added).

23 *Tex. Co. v. Stephens,* 100 Tex. 628, 103 S.W. 481, 485 (1907) (emphasis added).

24 *Nestle,* 387 S.W.3d at 620.

25 *Dancetown, U.S.A., Inc. v. State,* 439 S.W.2d 333, 336 (Tex.1969).

26 *See Stephens,* 103 S.W. at 485; *Hurt v. Cooper,* 130 Tex. 433, 110 S.W.2d 896, 901 (1937).

27 *Nestle,* 387 S.W.3d at 622. *See also id.* at 623 ("[W]e believe that the Legislature must have discretion in structuring tax laws."); *Stephens,* 103 S.W. at 485 ("The considerations upon which [tax] classifications shall be based are primarily within the discretion of the Legislature.").

28 *See Stephens,* 103 S.W. at 485 ("The courts ... 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." (emphasis added)).

29 *Nestle,* 387 S.W.3d at 623.

30 *Id.*
31 *Stephens,* 103 S.W. at 485.
32 TEX. HEALTH & SAFETY CODE §§ 161.601(1)–(2).
33 951 S.W.2d 420, 430 (Tex.1997).
34 *Id.* at 430–31. *See also FDA v. Brown & Williamson Tobacco Corp.,* 529 U.S. 120, 161, 120 S.Ct. 1291, 146 L.Ed.2d 121 (2000) ("[T]obacco use, particularly among children and adolescents, poses perhaps the single most significant threat to public health in the United States.").
35 Having found these purposes constitutionally sufficient, we do not consider the Coalition's argument that the Legislature's other purposes impermissibly seek to protect settling manufacturers' market share. For that proposition, the Coalition relies upon various antitrust cases together with writings from our recent Due Course of Law decision in *Patel v. Texas Department of Licensing & Regulation,* 469 S.W.3d 69 (Tex.2015). It appears the Coalition represented to the court of appeals that it "filed suit requesting the trial court to declare the Act unconstitutional as violating the ... Due Course of Law Clause[ ] of the Texas Constitution," Appellee's Br. 13, even though its amended petition never mentions that Clause. And the Coalition argued at length in the court of appeals about the Due Course of Law Clause. *See id.* at 35–37. We think those cases and their tests are properly limited to the particular legal frameworks in which they arose, and in any event, we leave it to the court of appeals to determine whether the Coalition has preserved what amounts to a Due Course of Law challenge.
36 *See* TEX. HEALTH & SAFETY CODE § 161.601(2).
37 At various points in its brief, the Coalition rephrases this objection to say that it is never reasonable to use a business's *voluntary decision* as a basis for discriminatory taxation. We agree with that formulation of the objection: A *decision* to settle cannot by itself constitutionally distinguish that business from identical businesses. But assessing the decision is not the same as assessing the *effect* of the decision. The Equal and Uniform Clause is concerned with what, if any, change in the business flows from the effect of the decision to settle.
38 *Nestle,* 387 S.W.3d at 622.
39 22 S.W.3d 831 (Tex.2000).
40 *Id.* at 835–36.
41 *Id.* at 836.
42 *Id.*
43 *See id.* at 836–37.
44 *Id.* at 838.
45 *See id.*
46 *Id.* at 839.
47 *Id.* at 844.
48 *Id.*
49 *Id.* at 844–45.
50 *Id.* at 845.
51 *Id.*
52 *See id.*
53 *Nestle,* 387 S.W.3d at 622.
54 *Tex. Co. v. Stephens,* 100 Tex. 628, 103 S.W. 481, 485 (1907).
55 In the Coalition's view, "the astounding allegations of wrongdoing against [settling manufacturers] in the tobacco litigation do support the large ongoing annual payments."
56 *See Nestle,* 387 S.W.3d at 623.
57 We express no opinion on the role, if any, of a settlement in this rational-basis analysis if the effect of the settlement was clearly intended to be punitive.
58 *See, e.g., Brooks v. Northglen Ass'n,* 141 S.W.3d 158, 164 (Tex.2004) ("A judicial decision reached without a case or controversy is an advisory opinion, which is barred by the separation of powers provision of the Texas Constitution." (citing TEX. CONST. art. II, § 1)).
59 Of course the Legislature is not *required* to tax everybody. As discussed above, settling and non-settling manufacturers comprise different classes, and the Equal and Uniform Clause only applies *within* classes.
60 *Stephens,* 103 S.W. at 485.

61 *Id.*