

**State of New York v Morris**

2006 NY Slip Op 30251(U)

March 13, 2006

Supreme Court, New York County

Docket Number: 0400361/1997

Judge: Charles E. Ramos

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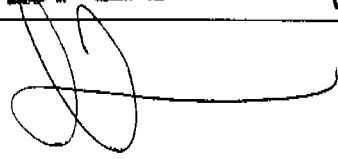
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**CHARGES E. BAIRD**

Dated: 2/13/08



~~DECISION IN MOTION REFERENCE~~  
WITH ACCOMPANYING MEMORANDUM  
MOTION IS DECIDED IN ACCORDANCE

~~DECISION IN MOTION REFERENCE~~  
WITH ACCOMPANYING MEMORANDUM  
MOTION IS DECIDED IN ACCORDANCE

NEW YORK  
COUNTY CLERK'S OFFICE

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**FILED**

Upon the foregoing papers it is ordered that this motion

Cross-Motion:  YES  NO

Replying Affidavit

Answering Affidavit — Exhibits

Notice of Motion/Order to Show Cause — Affidavit — Exhibits

PAPERS NUMBERED

The following papers, numbered to \_\_\_\_\_ were read on this motion to the

*Handwritten notes:* 01/11/08, 01/11/08

*Handwritten notes:* State of NY, 01/11/08

MOTION CAL. NO. \_\_\_\_\_

MOTION SEQ. NO. 040

MOTION DATE \_\_\_\_\_

INDEX NO. \_\_\_\_\_

*Handwritten:* 11/13/08

PRESENT: \_\_\_\_\_

*Handwritten signature:* [Signature]

PART 2

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: COMMERCIAL DIVISION

-----X  
THE STATE OF NEW YORK and ELIOT SPITZER,  
Attorney General of the State of New York,  
for an on behalf of the PEOPLE OF THE  
STATE OF NEW YORK,

Plaintiffs,

-against-

Index No. 400361/97

PHILIP MORRIS INCORPORATED; PHILIP  
MORRIS COMPANIES, INC.; RJR NABISCO,  
INC.; RJR NABISCO HOLDINGS CORP.;  
RJ REYNOLDS TOBACCO CO.; THE AMERICAN  
TOBACCO CO., INC.; AMERICAN BRANDS,  
INC.; BROWN & WILLIAMSON TOBACCO CORP.;  
LORILLARD TOBACCO COMPANY; LORILLARD  
INCORPORATED; LOEWS CORPORATION; UNITED  
STATES TOBACCO COMPANY; U.S.T., INC.;  
B.A.T. INDUSTRIES, P.L.C.; BRITISH  
AMERICAN TOBACCO COMPANY, LTD.; BATUS  
HOLDINGS, INC.; THE COUNCIL FOR TOBACCO  
RESEARCH-USA, INC.; and TOBACCO INSTITUTE,  
INC.,

Defendants.

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**Charles Edward Ramos, J.S.C.:**

The People of the State of New York, seek to prevent the  
defendants tobacco manufacturers from reducing their obligation  
to fund the 1997 "Tobacco Settlement" with settling states by  
\$1.14 billion for the year 2003 (and presumably, for each year  
thereafter by a similar amount). Under the Master Settlement  
Agreement ("MSA"), tobacco manufacturers have paid \$40 billion to  
the settling states, of which New York has been paid \$5.3  
billion.

Plaintiffs by and through their attorney, Eliot Spitzer,  
Attorney General of the State of New York, move for an order  
pursuant to § VII [c] of the MSA and § VII [A] of the consent  
decree and final judgment, dated December 23, 1998, granting a

declaration that, (1) each time the term "Market Share Loss" is used in § IX [d] [1] of the MSA, it carries the same meaning as "Market Share Loss", as defined in § IX [d] [1] [B], to ensure that the economic consulting firm (the "Firm"),<sup>1</sup> jointly selected by the settling states and the tobacco manufacturers participating in the MSA, give effect to the term's defined meaning under the MSA; and (2) construing the phrase "whether the disadvantages experienced as a result of the provisions of the MSA were a significant factor contributing to the 'Market Share Loss'" ("Significant Factor Determination") (§ IX [d] [1] [C]), to mean that, with respect to tobacco products sold in 2003, the MSA requires the Firm, after excluding the first 2% of any MSA-related loss of market share, whether the MSA's disadvantages that caused any additional decline were a "significant factor" contributing to the 5.95% "Market Share Loss" from 1997 to 2003.

#### **Background**

This action, along with actions brought by forty-six other states, was settled in November of 1998, with some of the defendant tobacco manufacturers ("Original Participating Manufacturers" or "OPMs"), pursuant to the MSA. Subsequently, forty additional tobacco companies have signed onto the MSA ("Subsequent Participating Manufacturers" or "SPMs") (collectively, the OPMs and the SPMs are referred to as the "Participating Manufacturers" or "PMS") (the defendant tobacco product manufacturers that did not participate in the MSA are

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<sup>1</sup> In May of 2004, the parties retained the Brattle Group.

referred to as "Non-Participating Manufacturers" or "NPMs").

Pursuant to Article III of the MSA, significant advertising and marketing restrictions were imposed on the PMs, such as prohibitions on certain types of advertising that target youth and patrons of outdoor events. Additionally, the MSA requires the PMs to make substantial financial payments totaling \$ 2.4 billion annually to the settling states each year according to their volume of sales in the tobacco market for the purpose of offsetting the financial burden borne by the settling states in treating smoking-related illnesses (MSA § IX [b]).

Out of concern that the NPMs, which are necessarily not bound by the MSA's marketing restrictions and carry no MSA payment obligations, would be benefitted by the competitive advantages brought on by the newly-imposed restrictions on the PMs, the settling states agreed to a provision in the MSA that creates incentives for such states to enact a "qualifying statute", for the purpose of equalizing any resulting competitive advantages that the NPMs might realize in addition to providing the settling states security for potential future damages in the event that these NPMs are eventually found culpable.<sup>2</sup>

The MSA additionally provides that if any settling state does not enact and diligently enforce its qualifying statute, or

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<sup>2</sup> Under the MSA, a "qualifying statute" is defined as "a settling state's statute, regulation, law and/or rule that effectively and fully neutralizes the cost disadvantages that the PMs experience vis-a-vis NPMs within such Settling State as a result of the provisions of this Agreement" (MSA § IX [d] [2] [E]; See Model Statute, Exhibit T, annexed to the MSA).

if other denominated conditions precedent are met, a settling state's annual MSA payment from a PM will be reduced and potentially eliminated entirely, to offset the resulting loss in a PM's market share (referred to as an "NPM Adjustment").

**NPM Adjustment**

Under § IX [d] of the MSA, the three conditions precedent established that might result in an NPM Adjustment, thereby reducing a PM's annual settlement payment to a settling state, are:

- (i) determination that the PMs have suffered a Market Share Loss since 1997 (MSA § IX [d] [1] [B]);
- (ii) determination that the disadvantages experienced as a result of the MSA were "a significant factor" of a PM's Market Share Loss ("Significant Factor Determination") (MSA § IX [d] [1] [C]); and
- (iii) a settling state's failure to diligently enforce its qualifying statute (MSA § IX [d] [2]).

Pursuant to the MSA, the first and second of the above conditions precedent are to be determined by the Firm, while any determination made as to a settling state's enforcement of its qualifying statute is to be made by the court. This provision is clear and unambiguous, though mathematically complicated. Accordingly, the Court's role is to read the MSA as written, giving each provision due consideration.

**Jurisdiction**

In the first instance, the PM's assert that the terms of the

MSA prevent this Court from any adjudication of the issues herein. In support of that claim, the PM's make the unsupported statement that the MSA "**explicitly** excludes the Significant Factor Determination (contained in MSA § IX [C]), from the jurisdiction of this Court." In fact, the limitation on this Court's jurisdiction is not so sweeping as the PM's assert.

As relevant to this proceeding, the MSA provides at § VII [a] that this Court retains exclusive jurisdiction over the MSA, the PM's and the settling states, except as provided at MSA § IX [d]. The only limitation upon this Court's exclusive jurisdiction is set forth in MSA § IX [d], and appears at subsection IX [C] which provides that:

The determination of the Firm with respect to this issue<sup>3</sup> shall be conclusive and binding upon all parties, and shall be final and non-appealable.

No other limitation on this Court's jurisdiction appears in that Section.

The PMs' argument assumes that all contract interpretation with respect to NPM Adjustment is within the province of the Firm and that this Court has no role to play. Had the parties intended to exclude this Court from any jurisdiction over this particular Section, the MSA could have so provided. Their agreement was simply to make the Firm's determination non-appealable, which is the typical case in arbitration. The logic of the PM's view is that courts generally would have no role to

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<sup>3</sup> "This issue" as used in this provision refers to the calculation of NPM Adjustment.

play in any arbitrations because they are non-appealable. That is clearly not the case.

Moreover, the panelists sitting on the Firm's arbitration committee are not the typical arbitrators: they comprise expert economists whose obligations under the MSA are relegated to the determination of purely economic issues as relates to the Significant Factor Determination. Their function is not to rule on legal issues, as is the case with typical arbitrators.

Thus the role, if any, to be played by this Court depends upon our determination of the issue of contract interpretation and whether or not that is appropriate for this Court's attention or best left to the Firm.

While agreements to arbitrate are favored and enforceable, whether the parties have submitted a particular issue to arbitration in addition to the scope of an arbitration clause itself is an issue for the Court to determine (*Von Steen v Musch*, 3 Misc 3d 207, 213 [Sup Ct, NY County 2004]). Here, while the PMs are correct in arguing that the MSA confers authority to the Firm to render the Significant Factor Determination based upon its "econometric" analyses, the issue squarely before the Court in this motion is construction of a contract provision, clearly within the purview of this Court's jurisdiction and beyond the scope of the subject matter the parties submitted to the Firm. Finally, this Court's jurisdiction in this matter was a subject specifically agreed to between the parties.

"Each Participating Manufacturer and each  
Settling State acknowledge that the Court:

(1) has jurisdiction over the subject matter of the action; (2) shall retain exclusive jurisdiction for the purposes of implementing and enforcing this Agreement and the Consent Decree" (MSA § IX [d]).

#### The Motion

The amount of NPM Adjustment at issue in this motion is for the calendar year 2003. It is not disputed that the first condition precedent to the imposition of an NPM adjustment has occurred: the Firm determined that the PMs suffered a "Market Share Loss" in 2003 of 5.95%.

A dispute has arisen, however, concerning the second condition precedent relating to the Significant Factor Determination under MSA § IX [d] [1] [C]: what definition of "Market Share Loss" the Firm should utilize in rendering its determination of a PMs' NPM Adjustment.

According to the Attorney General, the Firm misapplied the term "Market Share Loss", as used under the MSA, which led to the miscalculation of the NPM Adjustment for the year of 2003; thus the Attorney General seeks a declaratory order from this Court construing this term.<sup>4</sup> The Attorney General maintains that the PMs and the settling states agreed that the first 2% of any MSA-related loss in a PM's overall market share loss would be excluded from the definition of "Market Share Loss" and would not result in any NPM Adjustment. Therefore, any NPM Adjustment

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<sup>4</sup> Pursuant to MSA § VII [c], any settling state or PM may "bring an action in the Court to enforce the terms of this Agreement [or for a declaration construing any such term]" (bracketed material appears in the original).

would be triggered only if a PM's MSA-related Market Share Loss was greater than 2%, and if so, the first 2% of such MSA-related loss would not be factored into the NPM Adjustment calculation, as reflected in MSA § IX [d] [1] [B].<sup>5</sup>

Further, the Attorney General asserts that as the Firm is responsible for rendering the Significant Factor Determination for the express purpose of determining if any NPM Adjustment for a given time period is warranted based on the extent of MSA-related loss, this necessarily leads to the interpretation that the term "Market Share Loss", was intended to cover MSA-related Market Share Loss, and not the total loss of market share.

#### **The Firm's Proposed Determination**

On March 1, 2006, the Firm issued a proposed determination holding that the MSA was a "significant factor" contributing to the PMs' market share loss from 1997 to 2003, and went on to calculate an NPM Adjustment for the year 2003 totaling \$1.14 billion, which translates into a loss to the settling states of payments from the PMs in this amount. The Firm is poised to make a final determination on this issue on March 27, 2006.

In reaching its conclusion that the NPM Adjustment for the

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<sup>5</sup> Under MSA § IX [d] [1] [B] [iii], "Market Share Loss" is equal to the "Base Aggregate Participating Market Share" ("BAPMS"), minus the Actual Aggregate Participating Manufacturer Market Share" ("AAPMS").

The BAPMS is equal to the sum of the applicable market shares for the year 1997 **minus two percentage points**, (MSA § IX [d] [1] [B] [I]).

The AAPMS is the sum of the applicable PM market share for a particular year, (MSA § IX [d] [1] [B] [ii]).

year 2003 is \$1.14 billion, the Firm made the following determinations: for the calendar year 1997 prior to the MSA's execution, the PMs' market share totaled 99.58% and the PMs' market share for 2003 was 91.63%. The Firm went on to calculate "Market Share Loss" for the year 2003 as being 5.95%, by utilizing the following formula:

99.58% [market share in 1997] minus 91.63%  
[market share for 2003], which equals 7.95% -  
2% = 5.95%. Further, the Firm determined  
that of the total Market Share Loss, 3% to  
3.5% was attributable to the MSA.

Yet instead of comparing the MSA-related loss [3-3.5%], to the Market Share Loss of 5.95%, the Firm considered the impact that the MSA-related loss had on the **total** loss of market share of 7.95%. Because the Firm determined that 3% to 3.5% of a nearly 8% loss in market share would be considered significant by an economist, the Firm concluded that the disadvantages caused by the MSA was a significant factor in the PMs' "Market Share Loss" entitling them to an NPM Adjustment.

Underlying the conclusion that the MSA was a significant factor, the Firm took the view contrary to the Attorney General, that the term "Market Share Loss" as used in the MSA does not impose a two percent threshold on MSA-related loss. Instead, the Firm maintains that the full, MSA-related loss of market share (3-3.5%) should be compared to the **total** PM share loss (7.95%) in its Significant Factor Determination.

This Court agrees with the Attorney General. The Firm misconstrued "Market Share Loss" and improperly compared the MSA-

related loss to the **entire** loss of market share of 7.95% rather than comparing the MSA-related loss to the Market Share Loss. The MSA dictates an automatic exclusion of 2% of any decline in market loss, which here was 5.95%. "[the Firm] shall determine whether the disadvantages experienced as a result of the provisions of this Agreement [the MSA] were a significant factor contributing to the **Market Share Loss** for the year in question"]. (MSA § IX [d] [1] [C]). Therefore, the Court determines that the Firm should have compared the MSA-related loss to the Market Share Loss of 5.95%.

An additional snag in MSA § IX [d] [1] [B]'s calculation arises, however, as relates to what is the appropriate figure of MSA-related loss that should be compared to the Market Share Loss in the Firm's Significant Factor Determination.

According to the Attorney General, in considering the extent of the MSA-related loss against the Market Share Loss of 5.95% (as opposed to the **total** market loss of 7.95%), the MSA ensures an MSA-related loss threshold of 2% before any NPM Adjustment can be made. Thus, in addition to subtracting 2% from the "BAPMM" under MSA § IX [d] [1] [B] [i], any consideration of whether to fix an NPM Adjustment is dependent on an MSA-related loss of at least two percent, which 2% loss is not to be considered in the Significant Factor Determination.

Accordingly, whereas the Firm considered the significance of a 3% to 3.5% MSA-related loss to a total market loss of 7.95%, the Attorney General argues that the MSA dictates that the Firm

consider the significance of a 1% to 1.5% MSA-related loss to the Market Share Loss of 5.95% in its Significant Factor Determination. The relevant MSA-related loss that is to be considered by the Firm in its Significant Factor Determination for the year 2003 is therefore an MSA-related loss of 3% to 3.5% minus 2%, against a Market Share Loss of 5.95%.

The PMS (comprised of defendants Philip Morris USA Inc., R.J. Tobacco Company and Lorillard Tobacco Company), dispute the Attorney General's interpretation that the Significant Factor Determination requires a two per cent numerical threshold of MSA-related loss in order to trigger an NPM Adjustment, maintaining rather, that if the parties intended for this outcome, they would have expressly provided for it.

In considering the parties' respective positions, the Court determines that the Firm's and the PMS' interpretation of the provisions render meaningless that portion of the Agreement which calls for the subtraction of 2% to the Market Share Loss in order to determine the impact of MSA-related loss as against Market Share Loss in the underlying Significant Factor Determination.

Under well-established principles of contract construction, an interpretation which renders terms and provisions meaningless is insupportable (*Ruttenberg v Davidge Data Systems, Corp.*, 215 AD2d 191, 196 [1<sup>st</sup> Dept 1995]), "It is a recognized rule of construction that a court should not adapt an interpretation which will operate to leave a provision of a contract without force and effect. An interpretation that gives effect to all the

terms of an agreement is preferable to one that ignores terms or accords them an unreasonable interpretation").

Here, according to the Firm, "the reference to 2 percentage points was embedded in the definition of a term which is then used in another defined term that is then used in the instruction to the Firm" (Proposed Determination, ¶ 116). In other words, the Firm assumed that the direction to subtract two percentage points from the BAPMM under MSA § IX [d] [1] [B] in order to establish Market Share Loss was gratuitous and seemingly served no purpose.

The result that flows from such interpretation is illogical and unintended, however. Failing to interpret the provision's direction to subtract two percentage points from the BAPMM as a two percent threshold on MSA-related loss for the triggering of an NPM Adjustment will lead to situations where an NPM Adjustment is fixed in the absence of any MSA-related loss.

For example, in situations where the Firm determines that the MSA-related loss is less than two percent, whether an NPM Adjustment is rendered will depend on the extent of the non-MSA related loss and not the MSA-related loss. Therefore, in this situation, an NPM Adjustment will be rendered and a PM's payment reduced based upon non-MSA related loss. Such a result is unacceptable under the express terms of the MSA, because an NPM Adjustment is to be rendered only if the Firm determines that losses attributable to the MSA were significant (MSA § IX [d] [1] [C]), yet this is the interpretation that the Firm is

relying on in making its Significant Factor Determination.

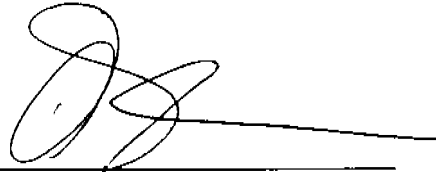
The Firm even considered the realization of this very scenario in its Proposed Determination, yet rejected the contrary interpretation that avoids such an outcome based upon the conclusion that the subtraction of two percentage points is significant only insofar as it is "embedded in the definition of a term which is then used in another term" (Proposed Determination, ¶ 116).

However, the parties agree that the subtraction of two percentage points was to serve a very specific and express purpose in the establishment of a mechanism to render an NPM Adjustment, based entirely upon the relationship, if any, between a PM's loss of market share (which is defined as loss of market share minus 2%), and loss attributable to the MSA (MSA § IX [d] [1] [C]), and not losses that were unrelated to the MSA. Thus, inclusion of the two percent numerical threshold on MSA-related loss serves to isolate the impact of that loss so that an adequate comparison can be made as against the Market Share Loss, which, again, is defined as the BAPMM minus two percent. Therefore, to divorce the meaning of Market Share Loss from its purpose in the Significant Factor Determination negates the *raison d'être* the NPM Adjustment scheme was established.

Accordingly, because the Firm's interpretation leads to situations where an NPM Adjustment will not be based on the extent of MSA-related loss, which is entirely beyond the scope of the Firm's authority and deflates the very purpose of fixing an

NPM Adjustment under the MSA, the Court grants the Attorney General's motion and declares that the term "Market Share Loss" as used in the MSA, carries the same meaning as defined in § IX [d][1][B]. The Firm shall undertake its Significant Factor Determination under MSA § IX [d][1][C] in conformity with this Court's construction of the meaning of the term, and consider the extent of the impact of MSA-related loss on Market Share Loss, only after first excluding two percent from any MSA-related loss of market share, if found.

Dated: March 13, 2006



J.S.C.  
**CHARLES E. RAMOS**

Counsel are hereby directed to obtain an accurate copy of this Court's opinion from the record room and not to rely on decisions obtained from the internet which have been altered in the scanning process.

**FILED**

MAR 13 2006

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NEW YORK**