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SCANNED ON 5/1/2007

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

PRESENT: C. E. Ramos PART 53

Index Number : 400361/1997

STATE OF NEW YORK

vs

PHILIP MORRIS

Sequence Number : 048

DECLARATORY JUDGMENT

INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

is decided in accordance with accompanying memorandum decision and order.

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER. THIS CONSTITUTES THE DECISION AND ORDER OF THE COURT. THE CLERK IS DIRECTED TO ENTER JUDGMENT ACCORDINGLY. THE CLERK IS NOT REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 4/19/07

CHARLES E. RAMOS

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

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

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THE STATE OF NEW YORK and ELIOT SPITZER, Attorney General of the State of New York, for and 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.; R.J. 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; UST, INC.; B.A.T. INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY, LTD.; BATUS HOLDINGS, INC.; THE COUNCIL FOR TOBACCO RESEARCH - U.S.A., INC.; and the TOBACCO INSTITUTE, INC.,

Defendants.

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Charles Edward Ramos, J.S.C.:

In this action, plaintiff, the State of New York and Eliot Spitzer on behalf of the People of New York (collectively, NY State) seek a declaratory judgment in relation to a Master Settlement Agreement, dated November 23, 1998 (MSA). The MSA was originally signed by the Settling States in resolution of litigation asserting claims for monetary, equitable, and injunctive relief against the four largest American tobacco companies (the Original Participating Manufacturers, or OPMs) under state consumer protection, and/or antitrust laws, for health-care costs arising from the treatment of smoke-related

illnesses. More than 40 additional tobacco companies (the Subsequent Participating Manufacturers, or SPMs) joined the MSA after its initial execution. The OPMs and SPMs are sometimes collectively referred to herein as the "Participating Manufacturers" or "PMs."

Provisions of the MSA require the Settling States to place restrictions similar to those set forth in the MSA on non-participating manufacturers (NPMs), in order to protect the market shares of the PMs. See MSA §IX(d)(2). To implement this aspect of the settlement, the MSA required NY State, as all the Settling States, to enact and "diligently enforce" (a term undefined in the MSA) legislation imposing those similar restrictions and payment obligations (Qualifying Statutes) on the NPMs. Id. In this way, the payments of the Settling States into a Foundation (as defined in the MSA, §VI) created by the MSA would not erode as a result of adverse market conditions for the PMs.

This dispute concerns the application of an adjustment to the PMs' annual payments known as the Non-Participating Manufacturer Adjustment (the NPM Adjustment). Under this arrangement, if a PM loses market share to the NPMs, the NPM Adjustment is applied, thereby reducing the PMs' payment into the Foundation. However, where a particular state proves that it "diligently enforced" its Qualifying Statute, its share of the NPM Adjustment is to be reallocated to other states that either did not have a Qualifying Statute, or, having such a Statute,

failed to "diligently enforce" it.

The MSA explicitly delegates the calculation of all payments owed pursuant to the MSA to an "Independent Auditor" (the IA), and provides that all parties shall provide the IA with information necessary to perform such calculations. See MSA, §XI(a)(1). In addition, the MSA provides that "[a]ny dispute controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the [IA] ... shall be submitted to binding arbitration [under] the United States Federal Arbitration Act." MSA, §XI(c), hereinafter sometimes referred to as the "Arbitration Clause."

The OPMs argue that the issue of whether NY State "diligently enforced" its Qualifying Statute is subject to arbitration. NY State argues, conversely, that this Court must determine the meaning of "diligently enforced," and that definition is not subject to arbitration.

NY State now moves this Court, pursuant to CPLR 3001, for an order declaring that: (i) NY State has "diligently enforced" its "Qualifying Statute" under the MSA if the PMs have at least 97.6% of the tobacco market in New York for a particular year; (ii) certain agreements made among some of the PMs preclude them from relying upon escrow amounts owed from 1999-2002 in alleging lack of "diligent enforcement" under the MSA; (iii) under the MSA and New York law, NY State "diligently enforced" the MSA unless its enforcement activities were illegal, fraudulent, or conducted in bad faith; and (iv) NY State "diligently enforced" the provisions

of its Qualifying Statute in the calendar year of 2003. NY State also seeks costs and fees for this action.

The OPMs cross-move[1] to compel arbitration of this matter under the Federal Arbitration Act (9 USC §2) and as required under the Arbitration Clause (MSA §XI[c]). Both sides submit that their respective positions are supported by the intent of the MSA and the language of the Arbitration Clause.

Here, the parties have elected to apply the United States Federal Arbitration Act (FAA) to the arbitration itself. A determination of whether to compel arbitration, therefore, is a threshold issue, and the function of this Court is preliminarily limited to "ascertaining whether the party seeking arbitration is making a claim which on its face is governed by the contract." *United Steelworkers of America v American Mfg. Co.*, 363 US 564, 568 (1960). If there was an agreement to arbitrate, the Court may also determine the scope of that agreement, and if some, but not all, of the claims in this action are subject to arbitration, the Court must determine whether to stay the remainder of the proceedings pending arbitration. *Stout v J.D. Byrider*, 228 F3d 709, 714 (6th Cir 2000), cert denied 531 US 1148 (2001). It is only if there is a determination that there was no proper agreement to arbitrate that this Court should address the substantive aspects of NY State's motion.

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[1] The OPMs are defined as Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated, and R.J. Reynolds Tobacco Company in the MSA. Brown & Williamson Tobacco Corporation, however, has not cross-moved herein.

More fully, the MSA states, with reference to resolution of disputes, that

> [a]ny dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the [IA] (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX[j] or subsection XI[i]) shall be submitted to binding arbitration before a panel of three neutral arbitrators [which] shall be governed by the United States Federal Arbitration Act.

All parties agree that the IA made a provisional determination not to apply an NPM Adjustment in calculating the 2003 Market Share Loss (as defined in the MSA). All parties also acknowledge that the OPMs dispute whether New York "diligently enforced" it Qualifying Statute. The question is whether or not this matter is a "dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor...." MSA, Arbitration Clause.

NY State also seeks a declaration that certain settlement agreements, entered into as of June 2003 (the 2003 Agreements), preclude the OPMs from relying on any amount in escrow from 1999-2002 in claiming that NY State failed to "diligently enforce" its Qualifying Statute in 2003. NY State claims that the disputes arising under 2003 Agreements are not arbitrable because those Agreements state that they "contain an entire, complete and integrated statement of each and every term and provision to, by and among the parties relating to the settlement of the NPM Adjustment Disputes, [and are] not subject to any condition not provided for herein ...."

In this regard, this Court concurs with NY State. The 2003 Settlement Agreements are complete on their face, and clearly indicate an intention to relinquish any further rights to dispute NPM Adjustments from those specific years. This is true because the 2003 Agreements specifically reference the MSA and the Arbitration Clause.

The FAA states that written arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 USCA §2. Thus, NY State and the OPMs were entitled to forgo the prior agreement to arbitrate the NPM Adjustments from 1999-2002. See e.g. *Martin v Peyton*, 246 NY 213, 218 (1927) ("[a]n existing contract may be modified later by subsequent agreement, oral or written").

The OPM respondents do not address this argument at all, except to note that the 2003 Agreements do not affect the ability of the OPMs to argue that NY State did not "diligently enforce" its Qualifying Statute in 2003. Moreover, the 1999-2002 escrow amounts established pursuant to the 2003 Agreements are patently beyond the purview of the IA, the Firm, or the Arbitration Clause, as those amounts have now been settled by the jural act of executing a release. See e.g. *Booth v 3669 Delaware, Inc.*, 92 NY2d 934, 935 (1998). Therefore, the part of the motion of NY State seeking to preclude the OPMs from relying on any escrow amounts owed from 1999-2002 as settled in the 2003 Agreements is granted.

However, where, as here, the parties have agreed to submit all claims "relating to" the NPM Adjustment to arbitration, this Court, though cognizant of the issues raised by NY State, cannot weigh the merits of NY State's grievances, or consider the equities of its claims given the Appellate Division's ruling in *State of New York v Philip Morris Inc.*, 30 AD3d 26 (1st Dept 2006).

As an alternative argument, NY State asserts that arbitration of whether New York "diligently enforced" its Qualifying Statute is barred by the doctrine of sovereign immunity. NY State, by relying on *Home Tel. & Tel. Co. v City of Los Angeles*, (211 US 265 [1908]) for the proposition that the Arbitration Clause is non-enforceable as against the doctrine of sovereign immunity, is stating that it had no right to enter into the MSA in the first place. *Home Tel. & Tel. Co.*, 211 US at 273 "[n]o other body than the supreme legislature [in this case, the legislature of the state] has the authority to make such a surrender, unless the authority is clearly delegated to it by the supreme legislature. The general powers of a municipality or of any other political subdivision of the state are not sufficient. Specific authority for that purpose is required." (emphasis added).

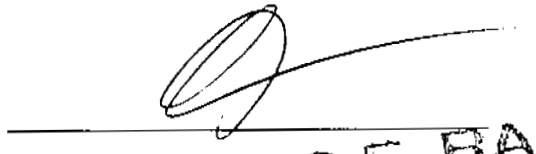
Although nullifying the agreement may now appear to be a more attractive alternative than dealing with the consequences of the terms of the MSA, this position is inconsistent with NY State's treatment of the agreement to date. Avoidance of the

terms of the MSA will require more than the grounds asserted here because there is no indication that a determination that NY State failed to "diligently enforce" its Qualifying Statute has any bearing on the police powers of New York. Such a determination by the arbitrators will not determine what NY State may, in its sole discretion, elect to do. It will only determine if NY State has complied. The only repercussion for non-compliance is an adjustment to the amount of money paid to NY State and the other Settling States; there is no implication for sovereign immunity.

As a final matter, this Court disagrees with NY State's interpretation of the decision of the Appellate Division, First Department in *State of New York v Philip Morris Inc.*, supra, to the effect that the decision does not necessitate arbitration. It clearly does.

Settle order.

Dated: April 19, 2007



CHARLES E. RAMOS
J.S.C.

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.