

NO. 33873

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

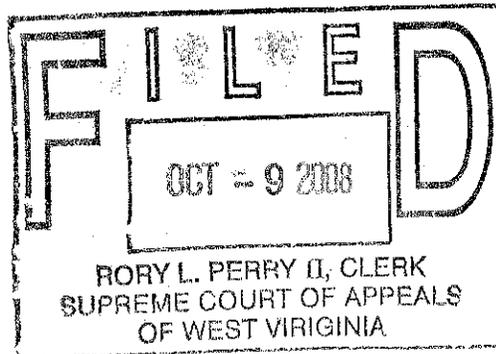
DARRELL V. McGRAW, JR., ATTORNEY  
GENERAL, ex rel. STATE OF WEST VIRGINIA, et al.,

Appellants/Plaintiffs Below,

v.

THE AMERICAN TOBACCO COMPANY, et al.,

Appellees/Defendants Below.



**APPELLEES' ORIGINAL PARTICIPATING MANUFACTURERS' BRIEF**

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and LORILLARD TOBACCO  
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## KIND OF PROCEEDINGS AND NATURE OF LOWER COURT RULING

This case involves a payment dispute that courts in all 48 States to decide the issue (including all 19 appellate courts to rule) have held must be arbitrated under the plain and unambiguous language of the Tobacco Master Settlement Agreement (“MSA”). In March 2006, the Independent Auditor, which is responsible for determining the payments owed by Appellees Philip Morris USA Inc., R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company (the “Original Participating Manufacturers” or “OPMs”) and other “Participating Manufacturers” (“PMs”),<sup>1</sup> issued its “Final Calculation,” refusing the PMs’ request for a reduction to their April 17, 2006 annual payment called a “Non-Participating Manufacturer” (or “NPM”) Adjustment. The Auditor did so, at the urging of West Virginia and the other “Settling States,” based on a legal presumption that the States were “diligently enforcing” their “Qualifying Statutes” and, therefore, were exempt from the Adjustment.

The OPMs served notice that they disputed the Auditor’s determination, and requested that West Virginia arbitrate the parties’ dispute pursuant to Section XI(c) of the MSA, which requires arbitration of all disputes “arising out of or relating to” the Auditor’s calculations or determinations, including “any dispute concerning the operation or application of any of the adjustments . . . and allocations in subsection IX(j),” such as the NPM Adjustment and diligent enforcement defense to that Adjustment. West Virginia refused the OPMs’ demand, and instead filed a motion asking the circuit court to intervene and declare that the State need not submit the parties’ dispute to arbitration. The OPMs moved to compel arbitration.

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<sup>1</sup>“Participating Manufacturers” include the OPMs and tobacco companies that subsequently joined the MSA (“Subsequent Participating Manufacturers” or “SPMs”).

The State concedes that the underlying dispute regarding the Auditor's refusal to apply the NPM Adjustment must be arbitrated. Br. at 10; Order at 4, R. 329; Tr. at 26-28, R. 341. It nevertheless maintains that its diligent enforcement defense to that Adjustment must be severed from the overall dispute, kept from the arbitrators, and resolved by the circuit court. The circuit court rejected this argument, holding that the plain language of the MSA requires that the parties' entire dispute, including the State's diligent enforcement defense, be resolved by arbitration before a nationwide panel of three former federal judges. Courts in 47 other States also have unanimously agreed, holding that this dispute "falls clearly within the [MSA's] arbitration provision," *Connecticut v. Philip Morris, Inc.*, 905 A.2d 42, 51 (Conn. 2006) ("*Connecticut IP*"), that the "plain and unambiguous language of the MSA's arbitration provision requires arbitration," *Illinois v. Lorillard Tobacco Co.*, 865 N.E.2d 546, 554 (Ill. App. Ct. 2007) ("*Illinois IP*"), and that "[t]o hold otherwise [would be] contrary to both the spirit and the plain language of the Master Settlement Agreement," *New York v. Philip Morris Inc.*, 30 A.D.3d 26, 31 (N.Y. App. Div. 2006) ("*New York IP*").

## **STATEMENT OF FACTS**

### **I. THE MSA'S PAYMENT PROVISIONS**

Under the MSA, each PM makes a single annual payment determined on a nationwide basis by a single Independent Auditor. MSA § IX(c)(2), (i)(2), [pp. 57-58, 78-80] (Ex. A to OPMs' Memo. to Motion to Compel Arbitration ("*OPMs' Memo*")) R. 79. Beginning with a base payment obligation (e.g., \$8 billion for 2005), the Auditor makes all calculations and determinations necessary to determine each PM's annual payment, including the application and amount of various potential adjustments. MSA §§ IX(c), (j), XI(a)(1), [pp. 56-58, 80-83, 86-87] R. 79.

After the Auditor determines each PM's annual payment, it allocates the payments among the States using previously determined "Allocable Share[s]". MSA § II(f), [p. 4] R. 79. The PMs thus do not make payments to, nor owe any specific amount to, any individual State. Rather, each PM makes one, nationwide payment that the Auditor allocates among the States.

One of the Adjustments the Auditor must determine each year is the NPM Adjustment, which reduces PMs' payments in compensation for their "Market Share Loss" to companies not subject to the MSA's marketing restrictions and payment obligations ("Non-Participating Manufacturers" or "NPMs"). MSA Section IX(d)(1) provides that the Adjustment "shall apply" if (a) the PMs collectively lose more than two percent of their pre-MSA market share to NPMs, and (b) an economic consulting firm determines the MSA was a "significant factor" contributing to that loss. *See* MSA § IX(d)(1), (d)(2)(A), [pp. 58-63] R. 79.

MSA Section IX(d)(2) sets forth how the Auditor is to allocate the NPM Adjustment among the States, and states the general rule that the Adjustment "shall apply to the Allocated Payments of all Settling States." [p. 63] R. 79. The only exception is where a State shows it "diligently enforced" a statute imposing similar payment obligations on NPMs (a "Qualifying Statute," attached to the MSA as Exhibit T, R. 79). MSA § IX(d)(2)(B), [pp. 63-64] R. 79.<sup>2</sup>

The MSA's drafters anticipated that unless the States enacted and diligently enforced such statutes, the MSA would place PMs at a significant cost disadvantage vis-à-vis NPMs and cause PMs to lose market share to NPMs. This in turn would reduce PMs' annual payments to the States. *See* [MSA Exhibit T at 1] R. 79. To create an incentive for States to enact and enforce such statutes, the MSA provides that a State's "Allocated Payment" shall not be subject

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<sup>2</sup> West Virginia, like other States, adopted the Model Statute set forth in Exhibit T to the MSA. *See* W. Va. Code § 16-9B-1 *et seq.*

to the NPM Adjustment if that State “continuously had a Qualifying Statute . . . and diligently enforced the provisions of such statute.” MSA § IX(d)(2)(B), [p. 63] R. 79. If a State qualifies for this exemption, the Auditor must reallocate that State’s share of the NPM Adjustment among the States that do not qualify, “pro rata in proportion to their respective Allocable Shares.” MSA § IX(d)(2)(C), [p. 64] R. 79.

Consequently, the diligent enforcement determination as to any one State has a direct impact on the annual payments received by every other State. Moreover, diligent enforcement determinations can affect whether there will be an NPM Adjustment at all and its amount. If *every* State demonstrates diligent enforcement, there would be no adjustment for the year in question. *Id.* And, if only a few States fail to prove diligent enforcement, the NPM Adjustment can be no greater than the annual aggregate payment otherwise due those States. *Id.*

## II. THE ROLE OF THE INDEPENDENT AUDITOR

Section XI(a) of the MSA provides that the Auditor shall make all calculations and determinations necessary to determine the payments due under the MSA, including the amount and allocation of any adjustments. MSA § XI(a)(1), [p. 86] R. 79. Section IX(j) specifies how payments “shall be calculated” and the 13 specific steps the Auditor must follow each year in applying adjustments to the base payment. [pp. 80-83] R. 79. The sixth step specifies that the “NPM Adjustment *shall be* applied . . . pursuant to subsections IX(d)(1) and (d)(2).” *Id.* (emphasis added). Section IX(d)(1), in turn, sets forth the NPM Adjustment, and Section IX(d)(2) sets forth the diligent enforcement exemption to that Adjustment. [58-68] R. 79. Thus, contrary to the State’s suggestion (Br. at 3-5), the Auditor not only has the authority, but is required, to determine each year whether to apply the NPM Adjustment and the diligent enforcement exemption to that Adjustment.

### III. THE MSA'S ARBITRATION PROVISION

Consistent with its adoption of a single, nationwide payment for each PM, the MSA requires that any dispute “arising out of or relating to” the Auditor’s calculations and determinations “shall be submitted to binding arbitration” before a nationwide panel of three former federal judges:

*Resolution of Disputes.* Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (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, each of whom shall be a former Article III federal judge.

MSA § XI(c), [p. 88] R. 79. Significantly, this clause is not limited to “appellate”-type review of determinations and calculations that already have been made by the Auditor. *See* Br. at 4, 16-17, 19. It also requires arbitration of “any dispute . . . arising out of or relating to” any of the Auditor’s calculations and determinations. MSA § XI(c), [p. 88] R. 79 (emphasis added).

The Arbitration Clause goes on to list examples of arbitrable disputes, including “any dispute concerning the operation or application of any of the adjustments” set forth in Section IX(j) of the MSA, which specifically includes Section IX(d)(1)’s NPM Adjustment and Section IX(d)(2)’s “diligent enforcement” exemption. *Id.* Accordingly, any dispute “concerning” either the NPM Adjustment or the diligent enforcement exemption is expressly subject to binding arbitration before a panel of three former federal judges.

### IV. THE DISPUTE OVER THE PMS' 2006 PAYMENTS

The present dispute concerns the Auditor’s refusal to apply an NPM Adjustment to the PMs’ 2006 annual payments – a determination the PMs dispute and West Virginia and the other Settling States defend. The Auditor determined that a triggering Market Share Loss had occurred for 2003, and in March 2006, the economic consulting firm found that the MSA was a

“significant factor” contributing to that loss. 3/29/06 Notice of Final Calculation, (Ex. I at 4 to OPMs’ Memo) R. 79. Because the MSA provides that where these two conditions are met, the NPM Adjustment “*shall apply*” (MSA § IX(d)(1)(C), [pp. 61-62] R. 79 (emphasis added), the PMs requested that the Auditor apply the 2003 NPM Adjustment to their April 2006 payments.

West Virginia and the other States urged the Auditor to deny the Adjustment on the same ground as in prior years, *viz.*, by presuming the States had diligently enforced their Qualifying Statutes. *See* Mar. 6, 2006 NAAG Letter, (Ex. H at 1 to OPMs’ Memo) R. 79 (“nothing the Firm has done or may do requires or authorizes the Independent Auditor to alter its established and entirely correct treatment of any potential 2003 NPM Adjustment”); Feb. 27, 2004 NAAG Letter, (Ex. K at 3 to OPMs’ Memo) R. 79 (“there is a legal presumption that state officials are enforcing state laws that must be given effect”).

The Auditor agreed, determining not to change its “current approach to the application of the NPM Settlement Adjustment” (Mar. 29, 2006 Notice of Final Calculation at 5), which was to “presume” diligent enforcement, to deny the NPM Adjustment on that basis, and to direct “that the dispute is to be submitted to binding arbitration in accordance with subsection XI(c) of the MSA.” Apr. 13, 2004 Notice of Dispute, (Ex. L at 2 to OPMs’ Memo) R. 79; *see also* Mar. 5, 2004 Notice of Prelim. Calculation, (Ex. J at 2 n.1 to OPMs’ Memo) R. 79 (adopting States’ request for a presumption of diligent enforcement).

On April 10, 2006, the OPMs served notice that they disputed the Auditor’s determination, and on April 20, 2006, they requested that West Virginia arbitrate the dispute pursuant to Section XI(c) of the MSA.<sup>3</sup> The State refused the OPMs’ demand, and instead asked

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<sup>3</sup> On the MSA payment date, the OPMs nevertheless paid the full amounts calculated by the Auditor. Because the parties disputed the applicability of the 2003 NPM Adjustment, however, two PMs -- RJR  
(Continued...)

the circuit court to intervene in the dispute and declare that the State was exempt from the NPM Adjustment because it had diligently enforced its Qualifying Statute. R. 1-22. On October 27, 2006, the OPMs moved to compel arbitration. R. 82-108.

## V. THE CIRCUIT COURT'S RULING IN FAVOR OF ARBITRATION

After considering the parties' submissions, arguments, and relevant authority, the circuit court (Berger, J.) held that the MSA's Arbitration Clause "must be arbitrated under the MSA's plain language before one nationwide arbitration panel of three former federal judges." Order at 2-3, R. 327-28. In so holding, the circuit court "reject[ed] the State's contention that its diligent enforcement defense is separate and distinct from the Auditor's determination whether to apply the NPM Adjustment, which the State concedes is arbitrable." R. 329.

*First*, "Section XI(c) broadly requires that 'any' dispute 'arising out of or relating to calculations performed by, or any determinations made by, the Auditor,' 'shall be arbitrated.'" R. 329. The court found that "[t]his dispute, including the State's diligent enforcement defense, clearly arises out of, and relates to, determinations the MSA requires the Independent Auditor to make each year – whether to apply the NPM Adjustment and the diligent enforcement exemption to that adjustment." *Id.* Thus, "the dispute here, including the State's diligent enforcement defense, clearly falls within Section XI(c)'s broad "arising out of or relating to" language." *Id.*

*Second*, the circuit court found that the Arbitration Clause's "including without limitation" provision independently requires arbitration of this dispute. It observed that "Section XI(c) goes on to provide specific examples of disputes that *are* arbitrable, 'including, without

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and Lorillard -- paid the disputed Adjustment into the MSA's "Disputed Payments Account" as provided in MSA § XI (d)(7), (8). Pursuant to the MSA, these sums are deposited into an interest-bearing account maintained by a national Escrow Agent agreed to by the parties (Citibank). [MSA Ex. B at B-1 to B-2] R. 79.

limitation, any dispute concerning the operation or application of any of the adjustments . . . and allocations described in subsection IX(j) . . . .” *Id.* (emphasis in original). “[S]ubsection IX(j) specifically includes the NPM Adjustment and the diligent enforcement exemption to that Adjustment.” *Id.* “Accordingly, the MSA expressly mandates that the present dispute, which concerns the ‘application’ of the NPM Adjustment and the diligent enforcement exemption to that Adjustment and the ‘allocation’ of the NPM Adjustment among the Settling States, be arbitrated.” *Id.*

*Third*, the circuit court found that the MSA provision that the State relied upon in opposing arbitration – Section VII – “expressly excludes the dispute here from this Court’s jurisdiction.” *Id.* That provision “states that ‘*except as provided in subsections . . . IX(d) [and] XI(c),*’ this Court ‘shall be the only court to which disputes under the Agreement are . . . presented as to such Settling State.’” *Id.* (emphasis in original). “Section VII thus expressly excludes from this Court’s jurisdiction disputes, like this one, that fall within Section XI(c). Further, it specifically excludes disputes, such as this one, falling under Section IX(d), which in turn includes both the NPM Adjustment and the diligent enforcement exemption the State invokes here.” Order at 5, R. 330. Finally, the circuit court stayed the State’s Motion for Declaratory Judgment. *Id.*

## **VI. APPELLATE AND MSA COURT RULINGS IN 48 STATES ORDERING ARBITRATION OF THIS DISPUTE**

In so ruling, the circuit court joined courts in 47 other States (including all 19 appellate courts to consider the issue) that have held that “the plain and unambiguous language of the MSA requires arbitration of this dispute.” *New Hampshire v. Philip Morris USA, Inc.*, 927 A.2d 503, 511 (N.H. 2007) (“*New Hampshire IP*”); *see also, e.g., New York v. Philip Morris Inc.*, 8

N.Y.3d 574, 581 (N.Y. 2007) (“*New York IIP*”) (“the arbitration provision . . . ‘expressly and unequivocally encompasses the subject matter of the particular dispute’”).<sup>4</sup>

These courts rejected the same arguments the State repeats here, including its contentions that: dispute over the States’ diligent enforcement defense is not arbitrable; the Auditor lacks authority to make such determinations; the Auditor never made a determination when acceding to the States’ request to presume diligent enforcement; the MSA does not require that this dispute be resolved before a single, nationwide arbitration panel comprised of three former federal judges; and the OPMs waived their right to dispute the 2003 NPM Adjustment in agreements that settled their 1999-2002 NPM Adjustment claims.

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<sup>4</sup> See, e.g., also *Alabama v. Lorillard Tobacco Co.*, 2008 WL 821054, at \*5 (Ala. 2008) (“*Alabama IP*”) (“the clear and unambiguous language of the arbitration provision compels arbitration”); *Arizona v. Philip Morris Inc.*, No. 07-0083, at 10-11 (Ariz. Ct. App. May 24, 2007) (“*Arizona IP*”) (Ex. 68 to Appendix to OPMs’ Opp. to Petition (“Apx.”)) (dispute is “included within the arbitration clause, [and] the language of the clause is very broad”); *Connecticut v. Philip Morris, Inc.*, 2005 WL 2081763, at \*34 (Conn. Super. Ct. Aug. 3, 2005) (arbitrability “not a close case”) (“*Connecticut IP*”); *Delaware v. Philip Morris USA Inc.*, 2007 WL 1138472, at \*1 (Del. Apr. 17, 2007) (“*Delaware IP*”) (affirming trial court’s holding that “the plain language of the Agreement’s broad arbitration clause covered the dispute”); *Illinois v. Lorillard Tobacco Co.*, 865 N.E.2d 546, 554 (Ill. App. Ct. 2007) (“*Illinois IP*”) (“plain and unambiguous language of the MSA’s Arbitration Provision requires arbitration”); *Indiana v. Philip Morris Tobacco Co.*, 879 N.E.2d 1212, 1220 (Ind. App. 2008) (“*Indiana IP*”) (“both the language and the structure of the MSA require that the dispute . . . be submitted to a single, national arbitration panel”); *Maryland v. Philip Morris Inc.*, 944 A.2d 1167, 1178 (Md. Ct. Spec. App. 2008) (“*Maryland IP*”) (“clear and unambiguous language of the MSA compels arbitration”) ”); *Michigan v. Philip Morris USA*, No. 273665, 2007 WL 1651839, at \*5 (Mich. Ct. App. June 7, 2007) (“*Michigan IP*”) (“arbitration of this dispute is plainly required”); *North Carolina v. Philip Morris USA, Inc.*, 2008 WL 4467962, 9 (N.C. App. Oct. 7, 2008) (“In short, the plain language of the MSA establishes that the issue of the application of the NPM Adjustment for 2003, including the question of diligent enforcement, must be arbitrated.”) (“*North Carolina IP*”) [note: because of the recency of this opinion, the Westlaw version is not yet paginated; pin cites to this opinion refer to the page of the opinion as printed]; *North Dakota v. Philip Morris Inc.*, 732 N.W.2d 720, 727 (N.D. 2007) (“*North Dakota IP*”) (“[T]he plain and unambiguous language of the settlement agreement requires arbitration of the parties’ dispute.”); *Vermont v. Philip Morris USA Inc.*, 2008 WL 269613, ¶ 19 (Vt. 2008) (“*Vermont IP*”) (to deny arbitration would be “contrary to both the spirit and the plain language of the [MSA]”).

## RESPONSE TO ASSIGNMENTS OF ERROR

I. The circuit court correctly held – as has every other appellate and MSA court to rule – that the plain language of the MSA requires arbitration of the parties’ entire dispute concerning the 2003 NPM Adjustment, including the State’s defense that it qualifies for a diligent enforcement exemption to that Adjustment.

II. The circuit court correctly held – as has every other appellate and MSA court to address the issue – that the plain language of Section XI(c) of the MSA requires that this dispute be submitted to nationwide arbitration before a panel of three former federal judges.

III. The circuit court correctly held – as has every other appellate and MSA court to address the issue – that the State’s release defense to the NPM Adjustment must be arbitrated.

### STANDARD OF REVIEW

As the OPMs explain in greater detail in their opposition to the State’s petition, a writ of prohibition “is an appropriate method by which to obtain review by this Court of a circuit court’s decision to compel arbitration.” *State ex rel. v. Saylor*, 613 S.E.2d 914, 920 (W. Va. 2005) (citation omitted); *see also Copley v. NCR Corp.*, 394 S.E.2d 751 (W. Va. 1990).<sup>5</sup> “A writ of

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<sup>5</sup> Contrary to the State’s unsupported *assertion* (Br. at 6 n.5), an order compelling arbitration is *not* a final order that is subject to immediate appeal. *See, e.g., Wesley Ret. Servs., Inc. v. Hansen Lind Meyer, Inc.*, 594 N.W.2d 22, 28 (Iowa 1999) (order compelling arbitration is interlocutory and not appealable because it does not “finally adjudicate[] the rights of the parties”); *Chem-Ash, Inc. v. Ark. Power & Light Co.*, 751 S.W.2d 353, 354 (Ark. 1988) (order compelling arbitration is not appealable); *Muao v. Grosvenor Props., Ltd.*, 122 Cal. Rptr. 2d 131, 134–35 (Cal. Ct. App. 2002) (“the order compelling arbitration cannot be said to involve the merits nor does it necessarily affect the order of dismissal”); *Teufel Constr. Co. v. Am. Arbitration Ass’n*, 472 P.2d 572, 573 (Wash. App. 1970) (“an order compelling arbitration is not final and therefore is not appealable.”). As the State concedes, an order is not final unless it “ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.” (Br. at 6 n.5 (quoting *Durm v. Heck’s, Inc.*, 401 S.E.2d 908, 912 (W. Va. 1991))). Here, however, there has been *no* ruling on the merits; in fact, the parties have not even begun to litigate the merits before the arbitration panel. Far from deciding the case, the circuit court’s ruling specifically contemplates – indeed orders – that there be an adjudication of the merits before the arbitration panel. Nor did the circuit court’s order “leave[] nothing  
(Continued...)

prohibition is appropriate only where there are *substantial, clear cut, legal errors* plainly in contravention of a clear statutory, constitutional, or common law mandate which may be resolved independently of any disputed facts and only in cases where there is *a high probability* that the trial will be completely reversed if the error is not corrected in advance.” *State ex rel. Canton v. Sanders*, 601 S.E.2d 75, 79 (W. Va. 2004) (emphasis added). The State does not even purport to make such a showing here.

### ARGUMENT

The circuit court correctly held that the plain and unambiguous language of the MSA requires arbitration of this dispute. The State concedes that the 2003 NPM Adjustment dispute must be arbitrated. Br. at 10; Order at 4, R. 329. The State cites no authority for the counter-intuitive notion that, while the PMs’ NPM Adjustment claim is arbitrable, the State’s diligent enforcement defense to that claim can be separated out and resolved in another forum. As the circuit court correctly found, the plain and unambiguous language of the MSA refutes the State’s contention.

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for the court to do but execute the judgment.” Rather, the circuit court merely *stayed* the State’s motion for declaratory judgment pending arbitration. Order at 5, R. 330. After the arbitration is completed, the circuit court may confirm, vacate, or modify the arbitration ruling. *See* W. Va. Code §§ 55-10-3, 55-10-4 & 55-10-6.

Nor did the circuit court make an “express determination ... that there is no just reason for delay” or an “express direction for the entry of judgment as to such claims or parties” under W. Va. Code § 58-5-1. (*See* Br. at 6 n.5.) The State did not request, and the Circuit Court did not order, such certification. Nor is this a case in which the order is final “in nature and effect.” (Br. at 6 n.5 (citing *Hubbard v. State Farm Indem. Co.*, 584 S.E.2d 176, 183 (W. Va. 2003)). As the Court explained in *Hubbard*, a judgment may be considered final in nature and effect “only if it possesses the requisite degree of finality. That is, the judgment must completely dispose of at least one substantive claim.” *Hubbard*, 584 S.E.2d at 184. As explained above, the circuit court’s order here did not address the substance of the parties’ dispute, but rather expressly refers litigation of the merits to the arbitration panel and stays the State’s motion for declaratory judgment pending the outcome of the arbitration.

Were this an appeal of a final order, however, the OPMs do not dispute that the proper standard of review is *de novo*.

*First*, the MSA's Arbitration Clause requires that "any matter arising out of, or relating to, the subject matter of the Independent Auditor's calculations and determinations" must be arbitrated. *New York II*, 30 A.D.3d at 31 (emphasis in original); *see also* MSA § XI(c), [p. 88] R. 79. It is undisputed that the Auditor determined not to apply the NPM Adjustment. And it is equally clear that the State's diligent enforcement defense "arises out of or relates to" that determination. Diligent enforcement is "inextricably linked with the NPM Adjustment" and is "mentioned in the MSA only as part of the NPM Adjustment mechanism – it serves no other role." *E.g., Idaho v. Philip Morris, Inc.*, No. CVOC 9703239D, slip op. at 8 (Idaho Dist. Ct. June 30, 2006) ("*Idaho I*"), (Ex. 24 to OPMs' Reply Memo) R. 242-66. *See also* MSA § IX(d)(2), [pp. 63-68] R. 79; *Arizona II*, at 14. The State's effort to "exclude[] the diligent enforcement dispute from the settlement agreement arbitration clause" simply ignores that Section XI(c) requires arbitration of "[a]ny dispute, controversy or claim arising from or relating to" the Auditor's determinations. *Commonwealth v. Philip Morris Inc.*, 864 N.E.2d 505, 512-13 (Mass. 2007) ("*Massachusetts I*").

*Second*, were there any doubt as to the applicability of the Arbitration Clause, it would be eliminated by Section XI(c), which provides specific examples of disputes that *are* arbitrable, "including, without limitation, any dispute concerning the operation or application of any of the adjustments . . . described in subsection IX(j) . . ." "Since subsection IX(j) specifically includes the NPM Adjustment and the 'diligent enforcement' exemption . . . , the MSA clearly mandates that the present dispute over the 'application' of the NPM Adjustment [must] be arbitrated." *District of Columbia v. Philip Morris USA Inc.*, No. 2006 CA 003176B, at 2 (D.C. Super. Ct. Sept. 26, 2006), (Ex. 52 to OPMs' Suppl. Submission) R. 279. *See also Massachusetts II*, 864 N.E.2d at 513; *New York III*, 8 N.Y.3d at 581-82.

*Third*, the only MSA provision upon which the State affirmatively relies – Section VII (Br. at 14-15) – specifically excludes this dispute from MSA courts’ jurisdiction in two separate ways. It broadly excludes disputes, like this one, that must be arbitrated under Section XI(c). See MSA § VII(c), [p. 49] R. 79 (“Except as provided in subsection[] . . . XI(c) . . . .”); see also *Massachusetts II*, 864 N.E.2d at 512-13 (Section VII “keeps disputes about the auditor’s determinations out of the circuit court because of the applicability of the arbitration provision”). In addition, Section VII specifically excludes matters “provided in subsection[] IX(d),” which includes both the NPM Adjustment and the subsidiary diligent enforcement determination at issue here. See, e.g., *Michigan II*, 2007 WL 1651839, at \*4; *Illinois II*, 865 N.E.2d at 554.

*Fourth*, the structure of the MSA’s payment provisions compels arbitration. The MSA imposes a unitary, nationwide payment obligation on each PM based on its nationwide sales. “[T]he agreement’s broad referral to an arbitration panel of ‘[a]ny dispute, controversy or claim arising out of’ the independent auditor’s calculations or determinations reflects the necessity of creating a uniform, nationwide set of rules by which the independent auditor is to calculate the annual payments.” *Connecticut II*, 905 A.2d at 50.

These concerns are “even more acute” with respect to a claim, like the State’s, that it is exempt from the NPM Adjustment because it diligently enforced a Qualifying Statute. *Maryland II*, 944 A.2d at 1180 (quoting *Connecticut I*, 2005 WL 2081763, at \*39). “[U]nder § IX(d)(2)(C), if the NPM Adjustment is determined not to apply to a given state because it diligently enforced its Qualifying Statute, the amount by which its allocated share would have been reduced is reallocated pro rata to other Settling States to which the NPM Adjustment does apply.” *Idaho I*, at 11. Accordingly, the determination regarding diligent enforcement with respect to one State can affect the payments of all other States, and each State has a vital interest

in whether other States are exempt from the NPM Adjustment because they diligently enforced their Qualifying Statutes.

*Fifth*, any doubt regarding arbitrability would be resolved by the well-settled presumption in favor of arbitration. As this Court has recognized, the Federal Arbitration Act (which the parties agreed would govern (MSA § XI(c)) requires any doubts be resolved in favor of arbitration, and that arbitration be compelled unless it can be said with “positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute.” *AT&T Techs, Inc. v. Comm’s Workers of Am.*, 475 U.S. 643, 650 (1986); *Board of Educ. of the County of Berkeley v. W. Harley Miller, Inc.*, 236 S.E.2d 447-48 (W. Va. 1977). The State does not even purport to meet that standard here. Nor could it. The fact that courts in 47 other States have concluded that the plain and unambiguous language of the MSA requires arbitration demonstrates that the State cannot overcome the presumption. Indeed, the State does not even purport to do so. Accordingly, the circuit court correctly held that the parties’ entire dispute regarding the 2003 NPM Adjustment must be arbitrated.

The State’s contention that it is entitled to its own arbitration panel (Br. at 21-30) is likewise refuted by the MSA’s plain language. Section XI(c) requires that each of the “two sides” to the “dispute” shall select an arbitrator – not each “State” or “party” as to each “issue.” MSA § XI(c), [p. 88] R. 79. Moreover, the State’s claim that “nationwide” arbitration will be “chaotic” or impose “enormous costs” on the State is wrong. The State *agrees* that the MSA requires nationwide arbitration of the underlying dispute concerning the NPM Adjustment. Its attempt to exclude the States’ diligent enforcement defenses from that arbitration and instead resolve them in 52 separate state-specific arbitrations in which up to 51 other States must

intervene to protect their interests will multiply exponentially the cost and complexity of resolving the 2003 NPM Adjustment dispute.

Finally, the State's assertion that the circuit court "ignored" its claim that the OPMs "released" their right to contest diligent enforcement (and thus the NPM Adjustment) in 2003 through agreements settling their NPM Adjustment claims for 1999-2002 (Br. at 11, 30-32) must be arbitrated for the same reasons the circuit court held the remainder of the dispute arbitrable. *See* Order at 4, R. 329. The State's assertion that its release defense must be excluded from the nationwide arbitration because the June 2003 Agreements do not include separate arbitration clauses is contrary to well-settled law that such settlement and release defenses must be arbitrated where, as here, the claim to which they relate is arbitrable, regardless of whether the settlement agreements contain their own arbitration clause.

**I. THE CIRCUIT COURT CORRECTLY HELD THAT THE PLAIN LANGUAGE OF THE MSA REQUIRES THAT THE PARTIES' ENTIRE DISPUTE BE ARBITRATED.**

**A. The State Ignores The Plain Language Of The MSA's Arbitration Clause That Requires Arbitration Here.**

While the State acknowledges that the "proper legal focal point" for interpreting the Arbitration Clause is its "plain language" (Br. at 5), it ignores key language in the MSA's Arbitration Clause that the circuit court correctly held "clearly" and "unambiguously" requires arbitration here. Order at 3-4, R. 328-29.

*First*, the MSA's Arbitration Clause provides that all disputes "*arising out of or relating to*" the Auditor's determinations "*shall be*" submitted to arbitration. MSA § XI(c), [p. 88] R. 79 (emphasis added). Courts uniformly have held that provisions like Section XI(c) are the "paradigm of a broad [arbitration] clause," *Collins & Aikman Prods. Co. v. Building Sys., Inc.*, 58 F.3d 16, 20 (2d Cir. 1995), and "constitute[] the broadest language the parties could

reasonably use,” *Fleet Tire Serv. of N. Little Rock v. Oliver Rubber Co.*, 118 F.3d 619, 621 (8th Cir. 1997). Such language encompasses any claims “connected to,” “associated with,” or “brought ‘with reference to’” the subject matter of the clause. *New York III*, 8 N.Y.3d at 581; *Vermont II*, 2008 VT at ¶ 17; *Coregis Ins. Co. v. American Health Found.*, 241 F.3d 123, 128-29 (2d Cir. 2001). The drafters incorporated this broad language to ensure that disputes relating to “any aspect” of the Auditor’s calculations or determinations would be resolved through arbitration in a single nationwide forum. *See* MSA §§ XI(c), (d)(3), [pp. 88-90] R. 79.

The State does not dispute that the Auditor must determine whether to apply the NPM Adjustment, and that it made such a determination here. Br. at 9. Nor does it dispute that the diligent enforcement “relates to” that Adjustment. To the contrary, it recognizes that whether the NPM Adjustment is applied “turns on whether the Settling States, each of which had in effect throughout 2003, a so-called ‘Qualifying Statute,’ diligently enforced the statute during the year.” Br. at 6-7. As the circuit court held, West Virginia’s claim of diligent enforcement clearly “aris[es] from or relat[es] to” that determination. “The plain and ordinary meaning of the term ‘relating to’ suggests that the parties intended to subject to arbitration a broad field of issues having connection with or referring to the Independent Auditor’s determinations,” including “the issue of whether a state has diligently enforced a qualifying statute.” *Hawaii v. Philip Morris USA*, No. 06-1-0695, at 6 (Haw. Cir. Ct. Aug. 3, 2006) (Ex. 6 to OPMs’ Reply) R. 242-66. In fact, diligent enforcement and the NPM Adjustment are “inextricably interrelated”: the plain language of the MSA makes clear that the only role of diligent enforcement is in determining

whether the NPM Adjustment applies, and, if so, how it is allocated among the States. *Arizona II*, at 14; *New Hampshire II*, 927 A.2d at 512; *Massachusetts II*, 864 N.E.2d at 513.<sup>6</sup>

*Second*, Section XI(c)'s "including without limitation" clause specifically includes diligent enforcement among the disputes that the parties agreed would be arbitrated. The circuit court expressly relied on this provision as an alternative ground for its decision. Order at 3, R. 328. That provision contains specific examples of disputes that are arbitrable, including "any dispute concerning the operation or application of any of the adjustments . . . and allocations described in subsection IX(j)." MSA § XI(c), [p. 88] R. 79. "Since subsection IX(j) specifically includes the NPM Adjustment and the 'diligent enforcement' exemption . . . the MSA clearly mandates that the present dispute over the 'application' of the NPM Adjustment [must] be

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<sup>6</sup> See also, e.g., *Alabama II*, 2008 WL 821054, at \*5 ("diligent enforcement is significant only in determining whether the nonparticipating manufacturer adjustment applies, and, if so, how the adjustment is allocated among the settling states."); *Maryland II*, 944 A.2d at 1177 ("The diligent enforcement question, mentioned in the MSA only as part of the NPM Adjustment, is an indispensable underlying issue of the overall NPM Adjustment and, thus, the determination and calculations are inextricably linked."); *New Mexico v. The American Tobacco Co.*, No. 27,833, at 9 (N.M. Sept. 3, 2008) ("*New Mexico IP*") (Ex. 85, Suppl. Authorities filed 2/8/08) (same); *North Carolina II*, at 8 ("The NPM adjustment cannot be divorced from the question whether a state diligently enforced its escrow statute."); *Idaho I*, at 8-9 (diligent enforcement "is inextricably linked with the NPM Adjustment because the diligent enforcement determination necessarily controls the outcome of any NPM Adjustment"); *Oregon v. Philip Morris USA, Inc.*, No. 0604-04252 (Or. Cir. Ct. Sept. 6, 2006) at 5 ("The existence of a Qualifying Statute and [a Settling State's] diligent enforcement of it have absolutely no significance apart from the NPM Adjustment.") (Ex. 19 to OPM's Reply) R. 242-19; *Hawaii*, at 7 ("[D]iligent enforcement [is] intertwined in and necessary to the determination . . . of the NPM Adjustment."); *South Carolina v. Brown & Williamson, et al.*, 97-CP-40-1686, at 6 (Cty. of Richmond, Apr. 26, 2007) ("*South Carolina I*"), (with respect to diligent enforcement and the NPM Adjustment refusal, "[t]he two issues are necessarily intertwined, and under the plain and unambiguous language of Section XI(c), both must be arbitrated") Ex. 77 to Apx.

West Virginia concedes as much, observing that "[i]t is uncontroverted that West Virginia will not receive an adjustment in its payments . . . if it is determined that West Virginia diligently enforced its qualifying statute . . ." Br. at 2, 6. In fact, the State explicitly sought a "Declaratory Order . . . that, as a result [of its diligent enforcement], no 2003 NPM Adjustment shall be applied. . . ." OPMs' Motion at 2, R. 2 (emphasis in original).

arbitrated.” *District of Columbia*, at 2.<sup>7</sup> The State simply ignores this language, even though it concedes that this Court has “consistently maintained” that a contract must be read in its entirety (Br. at 24) and the Circuit Court expressly relied on this provision as an alternative ground for its decision (Order at 3, R. 328).

**B. The MSA’s Provision Concerning The Jurisdiction Of MSA Courts Likewise Makes Clear That This Dispute Is Arbitrable.**

The only MSA provision upon which the State affirmatively relies is Section VII. Br. at 14-15. However, that provision further confirms that this dispute is arbitrable. As the circuit court correctly held, Section VII “expressly excludes” diligent enforcement disputes from the jurisdiction of the MSA courts. Order at 4-5, R. 329-30.<sup>8</sup>

*First*, Section VII provides that “[e]xcept as provided in subsection . . . XI(c),” the MSA court shall have exclusive jurisdiction for purposes of enforcing the MSA as to that State. MSA § VII(a), (c), [pp. 48, 49] R. 79. Section XI(c) is the MSA’s Arbitration Clause. Accordingly, disputes that fall within Section XI(c), such as the one here, are expressly excluded from the circuit court’s jurisdiction under the MSA. *See Alabama II*, 2008 WL 821054, at \*5; *Illinois II*, 865 N.E.2d at 553-54; *Massachusetts II*, 864 N.E.2d at 512-13.

*Second*, the dispute here is independently excluded from MSA court jurisdiction by Section VII’s exception for matters “provided in subsection IX(d),” which includes both the NPM Adjustment (§ IX(d)(1)) and the subsidiary diligent enforcement determination

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<sup>7</sup> *See also New York III*, 8 N.Y.3d at 581 (this language is “especially compelling” in requiring arbitration of diligent enforcement defense); *Delaware II*, 2007 WL 1138472, at \*1 (including without limitation provision “compels arbitration to determine the issue of diligent enforcement”); *Massachusetts II*, 864 N.E.2d at 513.

<sup>8</sup> The authority the State cites is inapposite. *See* Br. at 20 (citing *State ex rel. City Holding Co. v. Kaufman*, 609 S.E.2d 855, 859 (W. Va. 2004)). *Kaufman* involved a contract that, unlike the MSA, expressly “excluded arbitration.”

(§ IX(d)(2)). Despite its recognition that contracts must be read in their “entirety” (Br. at 24), the State simply ignores this language, which likewise makes clear that “whether the participating states failed to diligently enforce qualifying legislation” is an issue that is “expressly outside the jurisdiction of the [MSA] court.” *See, e.g., Michigan II*, 2007 WL 1651839, at \*4; *Illinois II*, 865 N.E.2d at 554; *Massachusetts II*, 864 N.E.2d at 514; *Arizona II*, at 10.

That the circuit court and other MSA Courts do not have jurisdiction over this dispute is further confirmed by Section VII’s limitation of state court jurisdiction to “disputes, alleged violations or alleged breaches *within such Settling State*.” MSA § VII(c)(1), [p. 49] R. 79 (emphasis added). This is not such a dispute. The decision as to the State’s diligent enforcement is not limited to West Virginia but – as the State concedes (Br. at 7-8) – will affect the rights and interdependent payments received by every other Settling State. The inherently national character of payment-related disputes like this one is exactly “why the MSA carves out an exception to the MSA court’s jurisdiction for payment-related disputes in the Arbitration Provision.” *Illinois II*, 865 N.E.2d at 554. In short, the sole provision upon which the State relies makes clear that the circuit court lacks jurisdiction to resolve the State’s diligent enforcement defense.<sup>9</sup>

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<sup>9</sup> The State’s reliance on Section VII(f) (Br. at 25) is misplaced for similar reasons. That provision calls for cooperation among the States in disputes that are *not* arbitrable. In such cases, conflicts among different States’ interpretation of the MSA do not render the MSA unenforceable or performance impossible. For example, a PM can advertise NASCAR races in States where it is allowed but refrain in States where it is not. *See, e.g., People ex rel. Lockyer v. R.J. Reynolds Tobacco Co.*, 11 Cal. Rptr. 3d 317 (Cal. App. 2004); *People ex rel. Lockyer v. R.J. Reynolds Tobacco Co.*, 132 Cal. Rptr 2d 151 (Cal. App. 2003); *State ex rel. Goddard v. R.J. Reynolds Tobacco Co.*, 75 P.3d 1075 (Ariz. App. 2003). Payment-related disputes are different. Their effect is not limited to a particular State, and there can be only one rule that governs, not 52 separate ones. As courts in all 48 States to address the issue have found, this specifically includes the diligent enforcement exemption the State claims here. *See discussion infra* at 8, 13.

**C. The Arbitration Clause Is Not Limited To “Appeals” From Specific Calculations Or Determinations Made By The Auditor.**

The State’s response to the MSA’s plain language is premised entirely on its unsupported assertion that the Arbitration Clause is limited to appeals of matters the Auditor has already “decided.” Br. at 17; *see also id.* at 4, 16, 19. The circuit court properly found that the MSA’s plain language refutes this contention. *See Order at 2-4, R. 327-29.*

*First*, the MSA’s broad “arising out of or relating to” language encompasses not only “appeals” from the Auditor’s specific determinations, but also “[a]ny dispute . . . *arising out of or relating to*” any such calculation or determination. As other appellate courts have held in rejecting this same argument, Section XI(c) is *not* limited to “appeals” from determinations “actually committed to, and actually made by, the [i]ndependent [a]uditor in the first instance.” *Connecticut II*, 905 A.2d at 52. Accordingly, arbitration is required “regardless of whether the independent auditor actually ‘determined’ whether the state ‘diligently enforced’ its qualifying legislation.” *Michigan II*, 2007 WL 1651839, at \*4.<sup>10</sup>

*Second*, the unqualified language of the next clause of Section XI(c) provides that arbitrable disputes “includ[e], without limitation, any dispute concerning the operation or

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<sup>10</sup> *See also, e.g., Maryland II*, 944 A.2d at 1179 (“[A]rbitration is required regardless of whether the independent auditor actually determined whether a state has ‘diligently enforced its qualifying legislation.’”); *Massachusetts II*, 864 N.E.2d at 513 (the MSA’s broad “arising out of or relating to” language and its “including without limitation” provision specifically “include[] disputes over issues not actually determined, just as well as those over issues which are actually determined”); *North Dakota II*, 732 N.W.2d at 728 (“[T]here is nothing in the arbitration clause limiting arbitration to those questions actually determined. . . . [Section XI(c)’s plain] language includes disputes over issues not actually determined, just as well as those over issues which were actually determined”); *New York III*, 8 N.Y.3d at 580 (the MSA does not “limit arbitration to *review* of calculations performed or decisions reached by the Independent Auditor”); *Illinois II*, 865 N.E.2d at 553 (“Even if the present dispute does not involve a direct challenge to a determination made by the Independent Auditor, the dispute would still be subject to mandatory arbitration because the MSA provides that all disputes ‘arising out of or relating to’ such determinations must be arbitrated.”).

application of any of the adjustments . . . and allocations described in subsection IX(j).” Section IX(j) specifies how payments “shall be calculated,” and expressly references application of the NPM Adjustment “pursuant to subsections IX(d)(1) and (d)(2).” Section IX(d)(1), in turn, sets forth the NPM Adjustment, and Section IX(d)(2) provides the diligent enforcement exemption to that Adjustment. The clause thus expressly encompasses the State’s diligent enforcement defense, and further refutes the State’s “interpretation” that arbitration is limited to “appeals” of specific determinations that the Auditor “has made.” *See, e.g., Illinois II*, 865 N.E.2d at 554; *New York II*, 30 A.D.3d at 31; *Massachusetts II*, 864 N.E.2d at 512-13; *North Dakota II*, 732 N.W.2d at 728.

Courts have unanimously held that the MSA’s plain language makes clear that “the State[s] agreed to arbitrate the diligent enforcement issue.” *Arizona II*, at 9. As the New York Appellate Court found in rejecting this same argument when the States (including West Virginia as *amicus*) raised it there, the State’s interpretation would rewrite that language to impose limitations it does not contain and to read the broad “arising out of or relating to” language and “including without limitation” provision out of the agreement.

**D. Arbitration Would Be Required Even Under The State’s Interpretation Because The Auditor In Fact Made A Diligent Enforcement Determination.**

Assuming *arguendo* Section XI(c) was limited to review of determinations actually “made” by the Auditor, this dispute still would be arbitrable. As the circuit court correctly found, the Auditor expressly denied the NPM Adjustment based on a legal presumption of diligent enforcement. Order at 3, R. 328; *see also* 3/29/06 Notice of Final Calculation at 5, (Ex. I to OPMs’ Memo) R. 79; 2/27/04 NAAG letter, (Ex. K to OPMs’ Memo) R. 79. Accordingly, “the Independent Auditor made such [a] determination[] here.” Order at 3, R. 328. *See also Alabama II*, 2008 WL 821054, at \*7 (“When the auditor presumed that the settling states had

diligently enforced their respective qualifying statutes, the auditor made a determination.”); *Arizona II*, at 12 (“the Auditor did make a diligent enforcement determination”); *New Hampshire II*, 927 A.2d at 510 (“the Independent Auditor *did*, in fact, make a determination regarding diligent enforcement”); *North Dakota II*, 732 N.W.2d at 729 (“the Auditor did make a diligent enforcement determination”).<sup>11</sup>

Indeed, diligent enforcement was “the only basis upon which the Auditor could have denied the Adjustment.” Order at 3-4, R. 328-29. As the State concedes, Section IX(d)(1)’s requirements for the Adjustment – a “Market Share Loss” for which the MSA was a “significant factor” – had both been satisfied. *See* Br. at 8-9; 3/29/06 Notice of Final Calculation at 4, (Ex. I to OPMs’ Memo) R. 79. Section IX(d) required, therefore, that the Adjustment “shall apply to the Allocated Payments of all Settling States” (MSA § IX(d)(1)-(2), [pp. 58-68] R. 79), and diligent enforcement was “the *only* means by which the auditor could have denied the NPM adjustment for that year was by affirmatively finding that there was diligent enforcement by the States.” *Massachusetts II*, 864 N.E.2d at 513 (emphasis added); *New Hampshire II*, 927 A.2d at

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<sup>11</sup> *See also, e.g., Indiana II*, 879 N.E.2d at 1218 (“The decision of the Independent Auditor to employ this presumption [of diligent enforcement] constitutes a determination.”); *Maryland II*, 944 A.2d at 1179 (“[T]he only way the auditor could have denied the NPM Adjustment for the 2003 calendar year was by finding that the states diligently enforced their statutes.”); *Massachusetts II*, 864 N.E.2d at 513 (“Whether the auditor made this determination [of diligent enforcement] explicitly, or impliedly, or by employing a presumption makes no difference.”); *Idaho I*, at 9 (“[T]here has, in fact, been a determination by the Independent Auditor as to diligent enforcement and this dispute arising out of that determination must, by the terms of the MSA, be arbitrated.”); *Oregon*, at 5 (“The Independent Auditor has, in fact, necessarily made a determination about [the State’s] diligent enforcement of its statute.”); *Virginia v. Brown & Williamson Tobacco Corp.*, No. HJ-2241 at 4-5 (Richmond Cir. Ct. Aug. 9, 2006) (“The Independent Auditor chose not to apply the Adjustment based on the presumption that the states diligently enforced their Qualifying Statutes. This decision by the Independent Auditor was a ‘determination.’”) (Ex. 9 to OPMs’ Reply) R. 242-66; *Ohio v. R.J. Reynolds Tobacco Co.*, 97CVH05-5114, at 15 (Ohio Ct. Common Pleas Sept. 25, 2006) (Auditor’s decision regarding diligent enforcement satisfied the standard definition of “determination”, which is “[t]he act of making or arriving at a decision,” quoting *American Heritage Dictionary*, Fourth Ed.). *Id.* at Ex. 25.

511-12; *Arizona II*, at 12; *North Carolina II*, at 9; *North Dakota II*, 732 N.W.2d at 728 (it is “logically necessary that the auditor did make a diligent enforcement determination”).

The State’s attempt to dismiss the Auditor’s determination as merely “provisional” (Br. at 6, 9-10, 19-20) is refuted by the record. Both the State and the Auditor referred to the Auditor’s denial of the NPM Adjustment as “Final.” See, e.g., 3/29/06 Notice of Final Calculation at 1, (Ex. I to OPMs’ Memo) R. 79 (describing determination as “final”); 3/6/06 NAAG letter at 1, (Ex. H to OPMs’ Memo) R. 79 (describing Auditor’s ruling as a “final determination”). And for good reason: it was final. The Independent Auditor determined that the 2003 NPM Adjustment did not apply to the PMs’ 2006 payment. The fact that the Adjustment might be applied in subsequent years does not mean that this was not a final determination as to the amount due in 2006.

The State’s attempted distinction between “provisional” and “final” diligent enforcement determinations also is refuted by the MSA. The Auditor’s broad authority to make calculations and determinations relating to the PMs’ annual payments under Section XI(a) contains no such distinction or limitation. Nor does Section IX(j)’s list of the specific calculations and determinations the Auditor “shall” make each year, including whether the NPM Adjustment and the diligent enforcement exemption apply. And, Section XI(c) does not limit arbitration to “provisional” diligent enforcement determinations. To the contrary, it provides that “*any* dispute concern the operation or application of” the diligent enforcement exemption “shall be submitted to arbitration” before a nationwide arbitration panel.

In sum, the State sought and secured a determination from the Auditor refusing the NPM Adjustment on the basis of diligent enforcement. It cannot now argue that its diligent enforcement claim does not “relate to” the Auditor’s determination. Nor does the State cite any

support for its counterintuitive argument that, although a claim may be arbitrable, the defenses to that claim are not.<sup>12</sup>

**E. The Auditor Has Express Authority To Make The Diligent Enforcement Determination.**

The State's related assertion that the Auditor is limited to accounting functions and is "not authorized or qualified to make" a diligent enforcement determination (Br. at 2-5) is refuted by the State's repeated requests that the Auditor deny the NPM Adjustment and that it do so by applying a purported "legal presumption" of diligent enforcement. *See* 2/27/04 NAAG letter to the Auditor, (Ex. K to OPMs' Memo) R. 79.

As the circuit court held, "the MSA not only authorizes but requires the Auditor to determine each year whether the NPM Adjustment and the diligent enforcement exemption to that Adjustment apply." Order at 3, R. 328. Section XI(a) makes clear that the Auditor has specific authority to determine whether States diligently enforced their Qualifying Statutes as part of deciding whether to apply an NPM Adjustment. *New York II*, 30 A.D.3d at 31; *New Hampshire II*, 927 A.2d at 511-12; *Maryland II*, 944 A.2d at 1177; *North Carolina II*, at 9. That provision broadly requires that the "Auditor shall calculate *and determine* the amount of all payments owed pursuant to this Agreement, *the adjustments*, reductions and offsets thereto . . . , [and] *the allocation of such payments, adjustments*, reductions, offsets and carry-forwards among the Participating Manufacturers and *among the Settling States.*" MSA § XI(a)(1), [p. 86] R. 79

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<sup>12</sup> The State's assertion that there is "no existing dispute" regarding its diligent enforcement (Br. at 4) is likewise refuted by the record. While the State faults the PMs for failing to "address the merits of the State's Motion" (Br. at 4), the law is well-settled that arbitrability is a threshold question that must be decided before any consideration of the merits, and that in ruling on that threshold question it is improper for the court to consider the merits. *See, e.g., AT&T Techs.*, 475 U.S. at 649-50 (court considering motion to compel arbitration "is not to rule on the potential merits of the underlying claims," which must be "decided, not by the court asked to order arbitration, but . . . by the arbitrator").

(emphasis added). Thus, the Auditor has broad authority to make all “determinations” regarding the PMs’ payments, including the “application” and “allocation” of an NPM Adjustment based on the diligent enforcement exemption. *See, e.g., Alabama II*, 2008 WL 821054, at \*6 (State’s “contention that the auditor is not authorized to make the [diligent enforcement] determination is contradicted by the plain language of the agreement”); *Michigan II*, 2007 WL 1651839, at \*5; *Arizona II*, at 13; *North Carolina II*, at 8-9.<sup>13</sup>

If there were any doubt on this matter, it would be resolved by Section IX(j), which specifically requires the Auditor to determine whether the Section IX(d)(1) NPM Adjustment and the Section IX(d)(2) diligent enforcement exemption apply. Section IX(j) sets forth how “[t]he payments due under this Agreement *shall* be calculated.” The “sixth” step specifically requires that “the NPM Adjustment *shall be applied* . . . pursuant to subsections IX(d)(1) [the NPM Adjustment] and (d)(2) [diligent enforcement exemption].” “Accordingly, the MSA not only authorizes but requires the Auditor to determine each year whether the NPM Adjustment and the diligent enforcement exemption to that Adjustment apply.” Order at 3, R. 328; *see also, e.g., Maryland II*, 944 A.2d at 1178 n.13; *Arizona II*, at 13-14; *North Carolina II*, at 8.<sup>14</sup>

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<sup>13</sup> The State repeatedly mischaracterizes a brief the OPMs filed in Kentucky as somehow conceding that the Auditor lacks authority to determine diligent enforcement. *See* Br. at 5, 14, 18. In fact, in the excerpt the State cites the OPMs took the same position they take here: the arbitration panel has the “ultimate” or final authority on this issue. The Kentucky MSA Court agreed, compelling arbitration and rejecting the same arguments the State repeats here.

<sup>14</sup> Several MSA provisions make clear that the Auditor is charged with determining many issues that transcend “accounting” calculations and involve legal and factual determinations, all of which are ultimately subject to arbitration before a panel of three former federal judges. The MSA requires the Auditor to determine, for example: (a) whether the OPMs’ payments under “Federal Tobacco-Related Legislation” satisfy certain legal requirements set forth in the MSA and, therefore, qualify as an offset to OPMs’ payments (MSA § X, [p. 84] R.79); (b) whether and to what extent its Preliminary Calculation should be revised as a result of information provided by or issues raised by the parties (MSA § XI(d)(4), [pp. 89-90] R. 79); (c) what assumptions it should employ if there is missing information (MSA § XI(d)(5), [pp. 90-92] R. 79); (d) whether and to what extent it should revise its calculations once

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Despite this plain language, the State asserts – without providing any support – that MSA courts must decide diligent enforcement. Br. at 20-21. Indeed, the State does not cite *any* MSA provision that delegates any payment-related issue to MSA courts. Where the parties intended to create an exception to the Auditor’s broad authority under Section XI(a) to make payment-related determinations – as in the case of the significant factor determination – they said so expressly. See MSA § IX(d)(1)-(2), [pp. 58-68] R. 79. They did not do so with respect to diligent enforcement. To the contrary, diligent enforcement determines how the NPM Adjustment is “allocate[d] . . . among the Settling States,” and therefore falls four-square within the Auditor’s authority under Section XI(a).

Most importantly, the Arbitration Clause does not limit arbitrable disputes to accounting-related matters. To the contrary, Section XI(c) broadly requires arbitration of “[a]ny dispute . . . arising out of or relating to calculations performed by, or any determinations made by,” the Auditor. And the choice of three former federal judges as arbitrators – rather than a panel of accountants – underscores that arbitration is not limited to accounting-related calculations. See, e.g., *Maryland II*, 944 A.2d at 1178 n.13.<sup>15</sup>

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additional information becomes available (*id.*); (e) the “best estimate” of information that is available but is withheld by a party to the MSA (MSA § XI(d)(5)(B), [pp. 91-92] R. 79); (f) whether and to what extent such “estimate” should be “revised . . . in light of any dispute filed” by the parties (*id.*); (g) what “reasonable basis”) should be used for allocating and charging applicable taxes against the escrow accounts under the MSA (MSA § XI(f)(1), [pp. 95-96] R. 79); and (h) whether “all applicable conditions for the disbursement” of payments have been satisfied (MSA § XI(j), [p. 110] R. 79).

<sup>15</sup> The State’s further claim that the Auditor acknowledged in its March 7, 2006 Notice of Preliminary Calculation that it is “not qualified” to decide diligent enforcement (*see* Br. at 3, 5, 9, 18-19), is both irrelevant and inaccurate. The MSA’s language controls here, not the Auditor’s interpretation, and it makes clear that the Auditor is not only authorized but required to decide diligent enforcement. Moreover, the State fails to inform the Court that the Auditor specifically omitted in its *Final* Calculation the language the State cites from its *Preliminary* Calculation after the OPMS objected that it misstated the OPMS’ position and misconstrued the MSA. 3/29/06 Notice of Final Calculation at 5, (Ex. I to OPMS’ Memo) R. 79; 3/16/06 R.J. Reynolds letter to the Auditor, (Ex. 26 to OPMS’ Reply) R. 242-66.

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## II. THE STRUCTURE OF THE MSA'S PAYMENT PROVISIONS COMPELS ARBITRATION.

The circuit court correctly held that arbitration is further compelled by the MSA's single, unitary payment structure, which requires that disputes relating to the Auditor's calculations and determinations be decided by "one clearly articulated set of rules that apply universally in a process where all parties can fully and effectively participate." *New York II*, 30 A.D.3d at 31-32. If the rule were otherwise, the result would be "chaos"; the potentially conflicting decisions of "numerous state and territorial courts" would render the calculation of PMs' payment obligations impossible. *Id.* See also *Massachusetts II*, 864 N.E.2d at 512; *Illinois II*, 865 N.E.2d at 554; *Connecticut II*, 905 A.2d at 50.

The State admits that the MSA calls for a "single nationwide payment" (Br. at 2), and does not dispute that it is therefore essential that the NPM Adjustment and other payment-related disputes be resolved through a single, nationwide arbitration. Nevertheless, the State focuses on the subsidiary diligent enforcement determination, which it maintains is "state-specific." Br. at 7-8. But, as other courts have found in rejecting this same argument, these concerns are "even more acute" regarding a State's claim that it is exempt from the NPM Adjustment because it diligently enforced a Qualifying Statute. *Maryland II*, 944 A.2d at 1180 (citing *Connecticut I*, 2005 WL 2081763, at \*39).<sup>16</sup>

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Accordingly, the language the State cites was "misconceived under the direct language" of the MSA and "retracted". *Idaho I*, at 3 n.4; *Arizona II*, at 13 n.6. Moreover, the State does not dispute that the Auditor consistently has directed the parties to resolve diligent enforcement disputes through binding arbitration in accordance with subsection XI(c). 4/13/04 Notice, (Ex. L to OPMs' Memo) R. 79. Indeed, the Auditor has maintained that "the MSA requires the parties to submit all payment-related disputes to binding arbitration." See Auditor Mem., *Tobacco L.P. v. Kentucky*, No. 05-CI-1172, at 6 (Ky. Cir. Ct. Oct. 2005), (Ex. 30 to OPMs' Reply) R. 242-46.

<sup>16</sup> In arguing that the diligent enforcement determination is "state-specific", the State relies heavily on the decision of the Pennsylvania MSA Court. However, it fails to inform the Court that the Pennsylvania  
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It is critical that the States' diligent enforcement defense be resolved in a single, nationwide proceeding. "Since the granting of an exemption by one settling state will automatically lead to the reallocation of its allocated portion of the NPM adjustment to all other non-exempt settling states, each governmental signatory has its own self-interest at stake in the outcome of this issue, which is necessarily in conflict with every other state." *Massachusetts II*, 864 N.E.2d at 512-13 (quoting *New York II*, 30 A.D.3d at 31-32). It is therefore "vitally important" that such issues "be resolved under one clear set of rules that apply with equal force to every Settling State . . . after a process in which all affected such parties can meaningfully participate." *Connecticut I*, 2005 WL 2081763, at \*39. A contrary result would "defeat[] the whole purpose of having a Master Settlement Agreement." *New York II*, 30 A.D.3d at 32; *New Hampshire II*, 927 A.2d at 510; *Massachusetts II*, 864 N.E.2d at 512.

Nor does the MSA "provide[] that the laws of each separate Settling State shall govern that Settling State's 'diligent enforcement' determination." Br. at 7, 15, 23-24. The provision the State cites – Section XVIII(n) – is a general choice of law provision in the "Miscellaneous" section of the MSA. It does *not* refer to "diligent enforcement." To the contrary, the diligent enforcement determination is governed by a single *contractual* standard set forth in MSA § IX(d)(2)(B), which applies to every State. The MSA creates – and requires – "a uniform, nationwide set of rules by which the independent auditor is to calculate the annual payments." *Connecticut II*, 905 A.2d at 50; *see also, e.g., North Dakota II*, 732 N.W.2d at 730; *District of Columbia*, at 3. That uniform contractual standard applies to the model statute set forth in Exhibit T that, as the State concedes (Br. at 2), has been adopted by all Settling States, including

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MSA Court held that that State's diligent enforcement defense must be arbitrated: *Commonwealth v. Philip Morris, Inc.*, 2006 WL 3792623, at \*3 (Pa. Ct. Common Pleas Dec. 12, 2006), *review denied*, *Commonwealth v. Lorillard Tobacco Co.*, No. 64 EM 2007 (Pa. June 26, 2008).

West Virginia. In short, the MSA's "general choice-of-law provision does not trump the very specific, clear and unambiguous arbitration clause set forth in Section XI(c), which requires that the parties arbitrate their dispute concerning the State's diligent enforcement of its Qualifying Statute." *South Carolina I*, at 7-8.

### **III. THE STATE DOES NOT EVEN PURPORT TO OVERCOME THE WELL-SETTLED PRESUMPTION IN FAVOR OF ARBITRATION.**

Because the MSA's Arbitration Clause "clearly and unambiguously requires arbitration of this dispute" (Order at 3, R. 328), there is no need to rely on a presumption here. But if there were any question as to the arbitrability of this dispute, it would be resolved by the well-settled presumption in favor of arbitration. The Federal Arbitration Act ("FAA") governs here, both because the MSA concerns interstate commerce and because the parties expressly agreed that the FAA would control in Section XI(c). 9 U.S.C. § 1 *et seq.*; *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983). The FAA requires that arbitration provisions be construed "as broadly as possible," *Oldroyd v. Elmira Sav. Bank, FSB*, 134 F.3d 72, 76 (2d Cir. 1998), and "that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration." *Moses H. Cone*, 460 U.S. at 24. Accordingly, any doubts concerning the scope of arbitrable issues must be resolved in favor of arbitration, *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989), and a motion to compel arbitration "should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted

dispute.” *AT&T Techs., Inc. v. Comm’s Workers of Am.*, 475 U.S. 643, 650 (1986) (quoting *United Steel Workers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582-83 (1960)).<sup>17</sup>

The State does not even attempt to meet this standard here. Nor could it. “The outcomes of [the] decisions in sister states preclude . . . [a] finding ‘with positive assurance that the [MSA] arbitration clause is not susceptible of an interpretation that covers the asserted dispute.’” *Idaho I*, at 10 (citation omitted); *see also Maryland II*, 944 A.2d at 1181 (this “overwhelming and uniform authority” presents “a near insurmountable hurdle” under positive assurance test). The State’s only reference to these uniform decisions by courts in 48 States occurs in a footnote that asserts without any explanation or analysis that the decisions are not persuasive. Br. at 14 n.8.

Instead, the State argues that the presumption only applies to “broad” clauses and that the arbitration clause here is “narrow.” *See* Br. at 20-21. This argument is wrong as a matter of law; the presumption applies whether an arbitration clause is “broad” or “narrow.” *See, e.g., Ivax Corp. v. B. Braun of Am., Inc.*, 286 F.3d 1309, 1320 n.23 (11th Cir. 2002) (recognizing “no such distinction” between broad and narrow arbitration clauses with respect to the presumption of arbitrability); *Int’l Bhd. of Elec. Workers Local 2188 v. Western Elec. Co.* (5th Cir. 1981), 661 F.2d 514, 516 n.3 (“[I]n determining whether a dispute is within the confines of the arbitration clause, the presumption of arbitrability applies, regardless of whether one party characterizes the clause as ‘narrow.’”).

In any event, the MSA’s Arbitration Clause is not “narrow.” To the contrary, it is “the paradigm of a broad clause” (*Ohio*, at 22; *North Carolina v. Philip Morris USA Inc.*, 2006 WL

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<sup>17</sup> *See Local Div. No. 812 of Clarksburg, W. Va., of the Amalgamated Transit Union v. Central W. Va. Transit Auth.*, 365 S.E.2d 76, 80 (W. Va. 1987) (recognizing “strong” federal policy favoring arbitration and the “positive assurance” test); *Board of Education v. W. Harley Miller, Inc.*, 236 S.E.2d 439, 445 n.4 (W. Va. 1977) (recognizing a strong West Virginia public policy favoring arbitration, consistent with the approach taken by the FAA).

3490937 at 9 (N.C. Super. Dec. 4, 2006)), which “employs broad language in defining the scope of the disputes that fall within that subject matter.” *Connecticut II*, 905 A.2d at 49.<sup>18</sup> The State fails to address these and other authorities which are directly on point.<sup>19</sup>

**IV. THE CIRCUIT COURT CORRECTLY HELD THAT THE PLAIN LANGUAGE OF THE MSA REQUIRES SUBMISSION OF THE PARTIES’ DISPUTE TO NATIONWIDE ARBITRATION.**

The State’s assertion that the MSA does not require arbitration before a single nationwide arbitration panel (Br. at 21-30) is likewise refuted by the plain language of the agreement. Section XI(c) expressly provides that “[e]ach of the two *sides* to the *dispute* shall select one arbitrator.” MSA § XI(c), [p. 88] R. 79 (emphasis added). The MSA does not provide that “each State” or “each Participating Manufacturer” selects its own arbitration panel or that there will be separate arbitration panels for each “issue.” Rather, “the MSA refers to the two sides to this agreement settling their disputes by choosing one arbitrator for each side. Those two sides are (1) the PMs (which contend they are entitled to an NPM Adjustment) and (2) the Settling States (which contend that no NPM Adjustment can be applied.” *Indiana II*, 879 N.E.2d at 1220.

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<sup>18</sup> See also *Alabama II*, 2008 WL 821054, at \*5 (“This Court has repeatedly stated ‘that the words ‘relating to’ in the arbitration context are given a *broad construction*.’” (emphasis in original)); *Delaware II*, 2007 WL 1138472, at \*1-2 (“[T]he settlement agreement has a broad arbitration clause, the plain language of which covers the dispute in question.”); *Vermont*, 2008 VT at ¶ 17 (“The phrase ‘related to’ is broad, ordinarily encompassing matters ‘connected to,’ ‘associated with’ and ‘brought with reference to’ that which is subject to arbitration.”).

<sup>19</sup> The State’s assertion that an arbitration clause cannot be “broad” if it applies only to particular categories of disputes is refuted by the case law. See, e.g., *CD Partners, LLC v. Grizzle*, 424 F.3d 795, 800 (8th Cir. 2005) (clause making arbitrable disputes “arising out of or relating to” operation of business was “broadly worded”); *Martek Biosciences Corp. v. Zuccaro*, No. 04 3349, 2004 WL 2980741, at \*1 (D. Md. Dec. 23, 2004) (finding “any dispute, controversy or claim arising out of or relating to Section 1.5 of this Agreement” to be a broad arbitration clause). The cases cited by the State (Br. at 21) are inapposite. They did not involve either broad “arising out of or relating to” language or an “including without limitation” clause that referenced the dispute in question as an example of a dispute that was arbitrable.

The MSA's nationwide payment structure likewise requires that this dispute be resolved through nationwide arbitration: "payments by the PMs are national payments and the NPM Adjustment is a national adjustment." *Id.* Similarly, "the application of the diligent enforcement defense for any Settling State affects all other Settling States, thus creating the need for a single decision-maker, and making it all the more important to resolve these disputes under a single set of rules that apply equally to each Settling State." *Id.*; *see also Alabama II*, 2008 WL 821054, at \*9; *Massachusetts II*, 864 N.E.2d at 512-131.

Accordingly, courts across the country have uniformly rejected the State's contention that there must be "fifty-two separate arbitration proceedings," *Connecticut II*, 905 A.2d at 51 n.12, and held that the dispute concerning the 2003 NPM Adjustment, including the Settling States' diligent enforcement defenses, must be submitted to "a single arbitration panel of three federal judges," *New York II*, 30 A.D.3d at 32-33.<sup>20</sup> The State does not even attempt to explain away the MSA's plain language and nationwide payment structure or these authorities.<sup>21</sup>

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<sup>20</sup> *See also, e.g., Alabama II*, 2008 WL 821054, at \*10 ("[T]he agreement requires a national, as opposed to a local, arbitration proceeding."); *Michigan II*, 2007 WL 1651839, at \*2 ("This court finds that the objective and intent of the parties was to mediate 'any dispute' before a National Arbitration panel for resolution."); *Indiana II*, 879 N.E.2d at 1219 ("[b]oth the language and structure of the MSA require that the dispute . . . must be submitted to a single, national arbitration panel"); *Illinois II*, 865 N.E.2d at 554 (finding "compelling logic to having these disputes handled by a single arbitration panel of three federal judges, rather than numerous state and territorial courts"); *Massachusetts II*, 864 N.E.2d at 512-13 ("submitting disputes involving the decision of the Independent Auditor to a neutral panel of competent arbitrators, who are guided by one clearly articulated set of rules that apply universally in a process where all parties can fully and effectively participate . . . ensures fairness for all parties to the MSA"); *New Mexico II*, at 11 ("The MSA calls for a nationwide arbitration process."); *New York v. Philip Morris Inc.*, No. 3682N-3683N, at 41-42 (N.Y. App. Div. May 15, 2008) ("*New York IV*") ("This Court rejected plaintiffs' arguments that each Settling State constituted a 'side' to the dispute, under section XI(c) of the Master Settlement Agreement, with the right to select its own arbitrator."); *North Dakota II*, 732 N.W.2d at 730 ("there is a compelling logic to having these disputes handled by a single arbitration panel of three federal judges"); *Washington v. Philip Morris USA, Inc.*, No. 59036-7-I, at 8 (Wash. Ct. App. Feb. 21, 2007) ("nationwide resolution of the adjustment issue is essential to the smooth operation of the [MSA]"); *Oregon*, at 6 ("the Settling States represent one 'side' of the dispute and the PMs represent the other 'side.'"); *Idaho I*, at 12 (the "each side" language of Section XI(c) means that "all the Settling States are  
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Ignoring the MSA's plain language, the State instead argues that nationwide arbitration "would be perpetual, at enormous cost to the taxpayers of this and every other jurisdiction." Br. at 28.) Not only are such claims legally irrelevant, they are factually wrong. The State has "agreed" to arbitrate the Independent Auditor's determination not to apply the 2003 NPM Adjustment and, therefore, the State *will be* participating in the nationwide arbitration proceedings. Br. at 10.<sup>22</sup> The only issue here is whether the State is entitled to exclude its diligent enforcement defense from that nationwide proceeding and have it decided by a separate arbitration panel. Accordingly, the State's position would only *multiply* the proceedings and therefore *increase* the time and cost associated with making such determinations.

Moreover, the State's speculation that a national arbitration would be "chaotic" and "perpetual" is simply wrong. Br. at 28. The State both exaggerates the difficulty of a nationwide arbitration and ignores the efficiencies of applying one uniform set of standards in a nationwide proceeding in which all parties can participate and are subject to final and binding determinations. Indeed, the State does not even attempt to explain how such a proceeding would be less workable or expeditious than litigating this issue 52 times in 52 separate MSA courts

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to come together to choose one representative arbitrator who would sit on the only arbitration panel provided for in the MSA").

<sup>21</sup> The cases the State cites (Br. at 27) are completely inapposite. Those cases have nothing to do with arbitration or interpretation of a contract, but rather involve decisions whether to transfer a case between two federal district courts. See *Kendricks v. Hertz Corp.*, 2008 WL 3914135 (D.V.I. 2008); *Chicago Metallic Corp. v. Lee-Behrent Co.*, 1988 WL 72302 (N.D. Ill. 1988).

<sup>22</sup> The State does not dispute that this issue will be resolved as part of the nationwide arbitration proceeding that courts in 48 States have ordered. Indeed, disputes regarding the NPM Adjustment must be resolved in a single, nationwide proceeding. The NPM Adjustment is calculated by the Independent Auditor on a nationwide basis and applied to a PM's single, nationwide annual payment obligation, based on changes in its nationwide market share. It is not paid to a particular State or calculated on a state-by-state basis. Accordingly, the Independent Auditor must apply a single uniform rule with respect to this adjustment. Either the Adjustment applies to a given payment or it does not.

each year with the inevitable conflicting rulings and standards and delays from appeals. *See Idaho I*, at 12 (the “diligent enforcement determination would take years to resolve if left to this and other state courts”).

As the Alabama Supreme Court found, “conducting 52 separate arbitration proceedings would likely be fraught with the same type of inequitable and inconsistent results that would arise were the individual state courts to resolve this dispute. Independent resolution of diligent enforcement disputes by local arbitration panels would likely result in the development of ‘fifty-two different sets of payment rules’ that would unfairly burden some states and benefit others and result in ‘wave after costly wave of new litigation.’” *Alabama II*, 2008 WL 821054, at \*10 (quoting *Connecticut II*, 905 A.2d at 50).<sup>23</sup> Furthermore, as the court in South Carolina recently explained: “Nationwide arbitration would give the Independent Auditor one set of standards and guidelines, instead of multiple, conflicting standards that differ according to the state(s) involved.” 9/30/08 Letter Opinion, *South Carolina v. Brown & Williamson, et al.* (97-CP-40-1686), Addendum at 2.

The State’s assertion that the circuit court’s decision here is “fatally flawed” and must be remanded because it is devoid of “findings of facts and conclusions of law” regarding nationwide arbitration (Br. at 22) is simply wrong. The circuit court expressly found that the “MSA’s plain

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<sup>23</sup> The State’s assertion that alleged “conflicts” among the States preclude nationwide arbitration is likewise baseless. There is no conflict among the States with respect to the selection of an arbitrator given that all States have the same interest in selecting an arbitrator who will affirm the Auditor’s denial of the NPM Adjustment and adopt a lax standard for determining whether the States diligently enforced. Moreover, the potential conflicts among the States as to each State’s diligent enforcement is precisely why courts throughout the country have unanimously held that the arbitration must be a nationwide one. Under the MSA’s reallocation provision, “the application of the diligent enforcement defense for any Settling State affects all other Settling States, thus creating the need for a single decision-maker, and making it all the more important to resolve these disputes under a single set of rules that apply equally to each Settling State.” *Indiana II*, 879 N.E.2d at 1220 (rejecting State’s “conflicts” argument).

language” required “one nationwide arbitration panel of three former federal judges.” Br. at 22 (citing R. 327-28). The State does not explain what is allegedly missing from the circuit court’s opinion, given that the court expressly relies on MSA Section XI(c), which in turn expressly states that each of the “two sides” to this dispute must select an arbitrator to serve on a panel comprised of “three former Article III judges.” Order at 3, R. 328; MSA § XI(c), [p. 88] R. 79. Moreover, the cases the State cites are simply inapposite, addressing situations in which a court failed to make “factual findings” in ruling on a motion for *summary judgment*. See Br. at 22 (citing *Fayette Cty. Nat. Bank v. Lilly*, 484 S.E.2d 232, 233 (W. Va. 1997); *Rowe v. Grapevine Corp.*, 527 S.E.2d 814, 830 (W. Va. 1999).<sup>24</sup> Here, the State acknowledges that the arbitrability of this dispute constitutes a “pure matter of law” (Br. at 12) involving construction of the plain language of a contract. Thus, no such findings of fact are necessary. See *McDaniel v. Kleiss*, 503 S.E.2d 840, 844 (W. Va. 1998) (“[W]e find that the contractual language is clear and unambiguous. Thus, there are no factual findings by the circuit court that must be considered to interpret the contract.”).

**V. THE CIRCUIT COURT CORRECTLY HELD THAT THE STATE’S RELEASE DEFENSE MUST BE ARBITRATED.**

Finally, the circuit court properly ordered this entire dispute to arbitration, including the State’s defense that the OPMs “released” their right to contest diligent enforcement (and thus the NPM Adjustment) in 2003 through agreements settling their NPM Adjustment claims for 1999-

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<sup>24</sup> In *Taylor v. Elkins Home Show, Inc.*, 558 S.E.2d 611, 615-617 (W. Va. 2001), for example, the Court refused to extend *Lilly* to orders granting post-verdict judgments as a matter of law pursuant to Rule 50(b). Moreover, the Court observed that even in circumstances where such findings are required, the appellate court may “make independent factual determinations without resorting to remand where the record contains sufficient dispositive facts for decision.” *Id.* at 617. See also *Lilly*, 484 S.E.2d. at 237 (declining to remand case where “disposition turns on a separate legal issue”); *Toth v. Bd. of Parks & Recreation Comm’rs*, 593 S.E.2d 576, 580 (W. Va. 2003) (declining remand where court is “able to resolve the issue raised in this particular instance without a detailed order from the court”).

2002 must be arbitrated. *See* Br. at 30-32; Order at 4, R. 329 (holding that “the MSA expressly mandates that the present dispute, which concerns the ‘application’ of the NPM Adjustment. . . be arbitrated”).<sup>25</sup>

The State’s release defense must be arbitrated for the same reasons that the rest of the parties’ dispute regarding the 2003 NPM Adjustment must be arbitrated. That defense, too, concerns the applicability of the NPM Adjustment and therefore falls within the plain language of the MSA’s Arbitration Clause. Indeed, the premise for that defense is a disputed interpretation of the MSA’s diligent enforcement exemption that itself must be arbitrated. And, these issues are common to all the States: either the June 2003 Agreements “released” the OPMs’ 2003 NPM Adjustment claim or they did not; there cannot be more than one answer to this question, much less a different answer for each of 52 Settling States.

The fact that the June 2003 agreements do not contain their own arbitration clause is completely irrelevant. *See* Br. at 32-33. “[W]hat is dispositive is that the dispute in which those agreements are being asserted as a defense is arbitrable.” *New Hampshire II*, 927 A.2d at 512 (collecting cases); *see also Maryland II*, 944 A.2d at 1183 (“The dispute over whether the June 2003 Agreements prohibit the original manufacturers from contesting diligent enforcement in 2003 falls within the purview of the auditor’s determination concerning the applicability of the NPM Adjustment and, therefore, must be presented as part of the arbitration process.”). The law is well-settled “that the arbitrator should decide ‘allegation[s] of waiver, delay, or a like defense

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<sup>25</sup> The State’s suggestion that the circuit court did not rule on its “release” defense (Br. at 11, 30) is inaccurate. The PMs’ motion, which the Court granted, sought arbitration of the parties’ entire dispute concerning the 2003 NPM Adjustment, including the State’s release defense. OPMs’ Motion at 2, R. 83; OPMs’ Memo at 24-25 n.5, R.107-08; OPMs’ Reply at 23-24, R. 264-65. That in so ruling the Court did not specifically address the release issue is not surprising in view of the fact that the State raised the release issue only once as an afterthought at the end of its brief below and then did not refer to that defense at all during oral argument. *See* State’s Opp. at 47-50, R. 208-11.

to arbitrability.” *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 84 (2002); *see also North Carolina II*, at 10 (“It is well established that once a court has determined that a claim is subject to arbitration, then the merits of that claim - including any defenses - must be decided by the arbitrator.”). Accordingly, “a settlement agreement is an arbitrable subject when the underlying dispute is arbitrable, except in circumstances where the parties *expressly exclude* the settlement agreement from being arbitrated.” *Niro v. Fearn Int’l, Inc.*, 827 F.2d 173, 175 (7th Cir. 1987). There is no such exclusion here.<sup>26</sup>

Moreover, West Virginia’s release defense is premised on an interpretation of *the MSA* that is disputed by the PMs. The State’s theory is that because “enforcement actions against the NPMs *during calendar year 2003 . . . could only relate to cigarette sales made by NPMs in West Virginia from 1999 through 2002,*” the OPMs’ release of any NPM Adjustment claim with respect to cigarettes sold in 1999-2002 likewise “released” their claim for a 2003 NPM Adjustment. Br. at 30 (emphasis in original); *see also id.* at 11. While this contention is refuted by the plain language of the MSA and the June 2003 Agreements, the point here is that West Virginia’s release defense is not a freestanding issue that can be decided apart from the MSA.

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<sup>26</sup> *See DVC-JPW Investors v. Gershman*, 5 F.3d 1172, 1174 (8th Cir. 1993); *Gen’l Drivers Salesmen & Warehousemen’s Local 984 v. Malone & Hyde, Inc.*, 23 F.3d 1039, 1044 (6th Cir. 1994) (“The evaluation of the weight, if any, to be accorded to the settlement agreement is a determination committed to the arbitrators’ discretion under the NASD arbitration agreement and under the Federal Arbitration Act.”); *Aluminum Brick & Glass Workers Int’l Union v. AAA Plumbing Pottery Corp.*, 991 F.2d 1545, 1548 (11th Cir. 1993). The lone decision the State cites – *City Holding Co. v. Kaufman*, 609 S.E.2d 855 (W. Va. 2004) (Br. at 32-33) – is not to the contrary, and in fact, undercuts the State’s position here. The contract there expressly excluded the subject dispute – involving the exercise of stock options under a Stock Incentive Plan – from the scope of arbitration. *Id.* at 600 (“the carve out provision clearly states ‘no provisions’ of the Severance Agreement ‘shall affect the rights . . . under . . . [the] Stock Incentive Plan’”). No such language excludes the State’s release defense from the scope of arbitration in the MSA. In fact, the clear and unambiguous language of the MSA compels arbitration of the State’s release defense, which “relates to” the PMs’ 2003 NPM Adjustment claim and “concerns” whether the NPM Adjustment “applies”.

Rather, it is premised on a disputed interpretation of the MSA's diligent enforcement exemption that is itself subject to arbitration.

That is why every appellate and MSA court to consider the issue has held that the exact same "release" defense West Virginia asserts here must be resolved by the arbitrators. *See, e.g., New Hampshire II*, 927 A.2d at 512 (release defense "must be presented as part of the arbitration process"); *New York IV*, at 40-41 ("Since the issue of diligent enforcement is arbitrable, the issue of whether the June 2003 agreements between the Original Participating Manufacturers and the 52 states and territories that settled certain tobacco-related lawsuits (the Settling States) preclude the Original Participating Manufacturers from alleging a lack of diligent enforcement is also arbitrable"); *North Carolina II*, at 10 ("The State's assertion that the PMs' claim for a reduction is barred by the 2003 Tobacco Settlement Agreements constitutes a defense to the claim. The issue, must, therefore, be decided by the arbitration panel."); *Rhode Island v. Brown & Williamson Tobacco Corp.*, No. 97-3058, at 8 (R.I. Super. Ct. Mar. 27, 2007) ("[I]t is well settled law that arbitrators, not reviewing courts, should decide allegations of waiver.") (Ex. 35 to OPMs' Reply) R. 242-66; *Colorado v. R.J. Reynolds Tobacco Co.*, No. 97CV3432, at 7 (Colo. Dist. Ct. July 19, 2006) ("The Court declines to consider [the release] argument at this time as such arguments are a matter subject to the arbitration provisions of the MSA"). *Id.*, Ex. 5.<sup>27</sup>

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<sup>27</sup> While the circuit court made no ruling on the merits of the release defense and the merits are not before the Court, West Virginia's "release" defense has no merit. Among other things, it is refuted by the very agreements on which it is purportedly based. The release language the State cites does not mention the supposedly released 2003 NPM Adjustment Claim, but rather is limited to "claims . . . under Section IX(d)" – i.e., claims for NPM Adjustments – "with respect to Cigarettes shipped or sold during 1999, 2000, 2001, and 2002." RJR Settlement Agreement ¶ 6, (Ex. 49 to OPMs' Reply) R. 242-66; Br. at 31. This language is hardly surprising since the only "claim" an OPM has under Section IX(d) is for an NPM Adjustment, and the OPMs' NPM Adjustment for a particular year is based on the cigarettes shipped or sold in that year. Thus, releasing any claim "under Section IX(d) . . . with respect to cigarettes shipped or sold during 1999, 2000, 2001, and 2002" is simply a precise way of releasing any claim for an NPM  
(Continued...)

## CONCLUSION

For the foregoing reasons, the OPMs request that the Court affirm the circuit court's order compelling arbitration of the parties' entire dispute regarding the 2003 NPM Adjustment before a nationwide arbitration panel of three former federal judges, and deny any further relief to the State.

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Adjustment with respect to those years. Diligent enforcement, on the other hand, is not a "claim" the OPMs make. Nor is it based on the cigarettes they shipped or sold in a particular year. Rather, it is a *defense* to a claim for an NPM Adjustment that the States must assert and prove. Moreover, it concerns the States' enforcement of their escrow statutes as to NPMs – not cigarettes shipped or sold by *OPMs*. MSA § IX(d)(2), [pp. 63-68] R. 79. The State's notion that this provision nonetheless works a release of the future, unknown 2003 claim is nothing more than an after-the-fact lawyer construct. If the parties had intended to release the 2003 claim, they would have said so expressly, as they did with respect to the 1999-2002 claims.

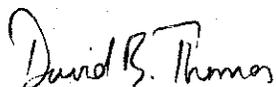
Any doubt on this score is removed by the remaining provisions of the June 2003 Agreements, which expressly *preserve* the 2003 NPM Adjustment claim. The agreements acknowledge that, although the 1999-2002 claims were being resolved, there continued to be a dispute "[w]ith respect to potential NPM Adjustments relating to Cigarettes shipped or sold *in 2003* and subsequent years. (Ex. 49 to OPMs' Reply at ¶ 8) R. [242-66] (emphasis added); *see also Maryland II*, 944 A.2d at 1183 ("[P]aragraph 8 reserves the original participating manufacturers' right to seek a NPM Adjustment for the year 2003."). The June 2003 Agreements go on to set forth procedures for the OPMs' pursuit of the *preserved* 2003 claim.

Finally, the language of the release provisions in the SPMs' June 2003 agreements does not support the State's argument. *See Br.* at 11. Those agreements released the exact same 1999-2002 NPM Adjustment claims, which were the only claims in dispute in June 2003. The fact that they did so by referring to the SPMs' "Market Share" for 1999-2002 instead of their "cigarettes sold" is simply a different way of saying the exact same thing; under the MSA, a PM's "Market Share" is based on the number of cigarettes it sold in that year. MSA § II(z), [p. 9] R. 79. Nor is it surprising that the two sets of agreements used slightly different wording to accomplish the same result. They were negotiated separately by different parties and attorneys.

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TOBACCO COMPANY (Original Participating  
Manufacturers);

Appellees/Defendants,

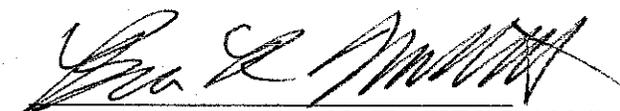
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# **“Addendum”**



State of South Carolina  
The Circuit Court of the Third Judicial Circuit

George C. James, Jr.  
Judge

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September 30, 2008

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RE: State of South Carolina v. Brown & Williamson, et al. (97-CP-40-1686)

Gentlemen:

After a careful review of all written submissions, arguments, and case law from other states, I conclude that the Master Settlement Agreement (MSA) requires nationwide arbitration, as opposed to state-specific arbitration. I am also unpersuaded by the State of South Carolina's argument that I lack jurisdiction to hear this motion. According to S.C. Code Ann. §15-48-180, an agreement to arbitrate "confers jurisdiction on the [state district] court to enforce the agreement." Because the parties disagree over the mode of arbitration, I continue to have jurisdiction to enforce the MSA's arbitration provision.

On January 23, 2008, the Original Participating Manufacturer's (OPM's) filed a *Notice of Motion for Further Relief in Connection with the Court's Prior Order Compelling Arbitration*, along with a memorandum in support of its motion. The Subsequent Participating Manufacturers (SPM) joined in the OPM's motion the same day. The OPM and SPM requested clarification of my April 27, 2007 *Order Granting Motion to Enforce the Arbitration Provisions of the Master Settlement Agreement*, specifically requesting that the arbitration be heard by a nationwide arbitration panel, as opposed to a state-specific arbitration panel. The State of South Carolina subsequently filed its *Memorandum in Opposition to: (a) OPM Motion for Further Relief in Connection with the Court's Prior Order Compelling Arbitration; and (b) SPM Joinder of OPM Motion for Further Relief in Connection with the Court's Prior Order Compelling Arbitration* on May 1, 2008. In response, the OPM and SPM both filed their *Reply in Support of Motion for Further Relief in Connection with the Court's Order Compelling Arbitration* on May 12, 2008, setting forth more support for their motion.

After the May 21, 2008 hearing, the State of South Carolina filed a *Supplemental Memorandum in Opposition to: (a) OPM Motion for Further Relief in Connection with the Court's Prior Order Compelling Arbitration; and (b) SPM Joinder in OPM Motion for Further Relief in Connection with the Court's Prior Order Compelling Arbitration* on June 4, 2008. The Participating Manufacturers (PMs) subsequently filed two (2) separate *Supplemental Memorandum of Participating Manufacturers in Support of Motion for Further Relief*, one on June 4, 2008 and the other on June 6, 2008. On June 12, 2008, the State of South Carolina filed its *Response to PM's 06.06.08 "Supplemental Reply," and as an Additional Supplemental Memorandum in Opposition to: (a) OPM Motion for Further Relief in Connection with the Court's Prior Order Compelling Arbitration; and (b) SPM Joinder in OPM Motion for Further Relief in Connection with the Court's Prior Order Compelling Arbitration*. Since that time, no other material has been filed.

After reviewing all of these documents, along with case law from other states, I have come to the conclusion that the MSA requires disputes to be submitted to a nationwide arbitration panel, as opposed to a state-specific arbitration panel for several reasons. First, the plain language in MSA Section XI(c) does not set forth a geographical limit as to the arbitrator's origin, only that each "side" can choose one arbitrator who will work with the other arbitrator to decide on a third arbitrator. This court agrees with the New York County Supreme Court in its rejection of the proposition that "each Settling State constituted a 'side' to the dispute, under section XI(c) of the Master Settlement Agreement, with the right to select its own arbitrator." *The State of New York, et al. v. Philip Morris Inc., et al.*, 2008 NY Slip Op. 04447 (N.Y. App. Div. May 15, 2008) [emphasis added]. Instead, "the Settling States constitute one side for purposes of the diligent enforcement dispute." *Id* at 41 [emphasis added]. Second, the MSA refers collectively to "all Settling States," all of whom receive a "single annual payment," allocated among all of the Settling States. Diligent enforcement decisions as to one state affect payments to every other State under MSA Section IX(d)(2)(C)'s reallocation provision which demands a single, nationwide payment. Under the MSA, the PM money is pooled collectively and allocated among all Settling States; therefore, each payment made affects all other states. The MSA's payment and reallocation systems necessitate nationwide administration and the arbitration panel should be similarly structured. Third, considerations of efficiency and universality demand nationwide arbitration. Nationwide arbitration would give the Independent Auditor one set of standards and guidelines, instead of multiple, conflicting standards that differ according to the state(s) involved. Additionally, parties to the disputes would be able to gauge potential success for claims and would know litigation thresholds before entering into costly litigation; thereby avoiding litigation of frivolous claims and preventing future claims from arising.

The underlying rationale behind nationwide litigation was perhaps best stated by a New York court: "[t]he mechanism of submitting disputes involving the decisions of the Independent Auditor to a neutral panel of competent arbitrators, who are guided by one clearly articulated set of rules that apply universally in a process where all parties can fully and effectively participate, obviates this problem and ensures fairness for all parties to the MSA. To hold otherwise is contrary to both the spirit and plain language of the Master Settlement Agreement." *New York v. Philip Morris Inc.*, 813 N.Y.S.2d 71, 76, 2006 N.Y. Slip Op. 02635 (N.Y. 2006). Several states' recent court decisions also support my decision to order a single, nationwide arbitration panel,

including but not limited to Alabama, *Alabama v Lorillard Tobacco Co.*, No. 1060988 (Ala. Mar. 28, 2008), California, *In re Tobacco Cases*, No. JCCP 4041 (Cal. Super. Ct. Aug. 23, 2006), Idaho, *Idaho v. Philip Morris, Inc.*, No. CV OC 97 03239D (Idaho Dist. Ct. June 30, 2006), Illinois, *People of the State of Illinois v. Phillip Morris, Inc, et al.* No. 96 L 13146 (Ill. Cir. Ct. April 1, 2008), Indiana, *Indiana v. Phillip Morris Tobacco Co.*, 879 N.E.2d 1212, 2008 WL 271559 (Ind. Ct. App. Feb. 1, 2008), Maryland, *Maryland v. Philip Morris, Inc.*, No. 2844 (Md. Ct. Spec. App. Mar. 27, 2008), and Vermont, *Vermont v. Philip Morris USA Inc., et al.*, 2008 VT 11, 2008 WL 269613 (Vt. Feb. 1, 2008).

In light of all of the information presented to me, I am granting the PMS' Motion for Further Relief to require the State of South Carolina to submit the dispute to nationwide binding arbitration. My decision reflects the clear intention of the parties to the MSA and encourages uniformity, efficiency and justice. I am requesting counsel for the OPMs and SPMs to prepare a proposed order and send it to me in Microsoft Word format by October 27, 2008. Of course, please forward a copy of the proposed order to Mssrs. Hamm and Cotter at the same time.

If you have any further questions, please do not hesitate to contact me via telephone at (803) 436-2150 or my law clerk via e-mail at [gjameslc@sccourts.org](mailto:gjameslc@sccourts.org).

Yours very sincerely,

George C. James, Jr.

GCJjr:bm

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NO. 33873

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

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THE WEST VIRGINIA PUBLIC EMPLOYEES  
INSURANCE AGENCY; and THE WEST  
VIRGINIA DEPARTMENT OF HEALTH AND  
HUMAN RESOURCES,

Appellants/Plaintiffs,

v.

THE AMERICAN TOBACCO COMPANY; et al.

Appellees/Defendants.

**CERTIFICATE OF SERVICE**

DAVID B. THOMAS, counsel for Appellee and Original Participating Manufacturer Philip Morris USA Inc., and on behalf of Appellees and Original Participating Manufacturers R.J. Reynolds Tobacco Company and Lorillard Tobacco Company, hereby certifies that copies of "APPELLEES' ORIGINAL PARTICIPATING MANUFACTURERS' BRIEF" have been served this the 9<sup>th</sup> day of October, 2008, as follows:

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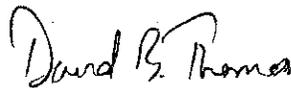
Counsel for Defendants

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