

IN THE COURT OF COMMON PLEAS  
FRANKLIN COUNTY, OHIO

STATE OF OHIO, ex rel. ATTORNEY  
GENERAL JIM PETRO, et al.,

Case No.: 97 CVH 055114

Plaintiffs,

Judge David W. Fais

vs.

R.J. REYNOLDS TOBACCO CO., et al.,

Defendants.

**COPY**

**MOTION OF THE STATE OF OHIO FOR A DECLARATORY  
ORDER REGARDING DILIGENT ENFORCEMENT**

The State of Ohio ("Ohio") brings this proceeding in its sovereign capacity, by and through its Attorney General, Jim Petro. Pursuant to sections VII(a) and (c) of the Master Settlement Agreement (the "MSA") between Ohio and signatory tobacco product manufacturers, Ohio requests: (1) the Court issue a Declaratory Order that, for calendar year 2003, Ohio diligently enforced R.C. 1346.01-.02, enacted as Ohio's "Qualifying Statute" under Section IX(d)(2)(B) of the MSA and, therefore, that Ohio is not subject to an NPM Adjustment under Section IX(d) of the MSA for 2003; and (2) upon making such declaration, that the Court further order all "Participating Manufacturers" withholding or offsetting against any MSA payments owed to Ohio on this basis to immediately pay all sums owed, plus any accrued interest.

Respectfully submitted,

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## MEMORANDUM IN SUPPORT OF MOTION

### I. INTRODUCTION

In November 1998, Ohio joined over forty other states, plus the District of Columbia, Puerto Rico and four United States territories (collectively, the “Settling States”), and entered into the MSA with the four major tobacco product manufacturers in the United States – Philip Morris, USA, Lorillard Tobacco Company (“Lorillard”), Brown & Williamson Tobacco Company (“Brown and Williamson”) and R.J. Reynolds Tobacco Company (“RJRT”).<sup>1</sup> These four companies, the “Original Participating Manufacturers,” MSA § II(hh), were subsequently joined in the MSA by over forty additional tobacco product manufacturers, the “Subsequent Participating Manufacturers.” MSA § II(tt). The Original Participating Manufacturers and the Subsequent Participating Manufacturers are referred to jointly in the MSA as “Participating Manufacturers.” MSA § II(jj).

The MSA requires the Participating Manufacturers to make global annual payments to the Settling States in the amounts specified in MSA Section IX(c)(1). Under Section IX(c)(1), these annual payments are subject to three potential adjustments to reflect inflation (calculated pursuant to MSA Ex. C), changes in annual cigarette sales volume (calculated pursuant to MSA Ex. E) and any NPM Adjustment (as determined under MSA Section IX (d)). Once any such adjustments are made to the global annual payments, Ohio and the other Settling States receive their respective percentage of the payments, as specified in MSA Ex. A, on April 15 each year.<sup>2</sup> Based on a claimed entitlement to an NPM Adjustment for 2003, RJRT – on behalf of itself and the former Brown & Williamson – and Lorillard have withheld approximately \$755 million in

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<sup>1</sup> On July 30, 2004, RJRT and Brown & Williamson – the second and third largest tobacco product companies, respectively, in the United States – merged. Pursuant to the merger agreement, RJRT assumed all of Brown & Williamson’s obligations under the MSA.

<sup>2</sup> Because April 15, 2006 was a Saturday, the MSA annual payments for 2006 were not due until April 17.

settlement monies payable to the Settling States on April 17, 2006. Ohio's share of the withheld amount is approximately \$38 million (Susan C. Jensen Aff. at ¶ 2, attached hereto as Ex. 1).

The NPM Adjustment was crafted to take into account any qualifying loss of the Participating Manufacturers' market share to the Non-Participating Manufacturers. Significantly, however, the MSA *bars* any application of the NPM Adjustment to Ohio's MSA payments if Ohio had a "Qualifying Statute" in full force and effect for the year at issue and "diligently enforced the provisions of such statute" during that time. MSA § IX(d)(2)(B)(i). Ohio had a Qualifying Statute – R.C. 1346.01-.02 – and was diligently enforcing its provisions in 2003. Accordingly, no NPM Adjustment for 2003 can be applied to Ohio's MSA payments.

Under Section VII(a) of the MSA, this Court retains "exclusive jurisdiction . . . for the purposes of implementing and enforcing this Agreement and the Consent Decree." The MSA also allows Ohio to bring an action to "enforce the terms of this Agreement (or for a declaration construing any such term ("Declaratory Order")) with respect to disputes . . . within such Settling State." MSA §§ VII(c)(1). In this context, Ohio seeks (1) a Declaratory Order that it diligently enforced the provisions of R.C. 1346.01-.02 in 2003 and (2) an order requiring all Participating Manufacturers to promptly pay Ohio any disputed amount withheld because of a claimed right to a 2003 NPM Adjustment, including any applicable interest.<sup>3</sup>

## **II. PURPOSES OF AND PAYMENTS UNDER THE MSA**

The MSA globally resolved litigation brought by Ohio and nearly forty other states, *see* MSA Ex. D, and accomplished a number of broad purposes, including: the recoupment by the

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<sup>3</sup> With the exception of the Subsequent Participating Manufacturer Bekenton USA, Inc. ("Bekenton"), Ohio seeks declaratory relief against all Participating Manufacturers claiming an entitlement to a 2003 NPM Adjustment. Bekenton has filed for Chapter 11, and Ohio will await a ruling from Bekenton's bankruptcy court regarding the applicability of the automatic stay before moving against Bekenton. With regard to the second part of Ohio's requested relief, Ohio currently knows only that RJRT and Lorillard have withheld from their MSA payments based on a claimed 2003 NPM Adjustment. In the event other Participating Manufacturers have so withheld, Ohio will supplement the present Motion.

Settling States of massive state expenditures relating to tobacco-related disease; the cessation of egregious tobacco industry conduct, such as targeted marketing to minors; and the advancement of public health measures, such as funding to reduce youth smoking and for public education regarding the harmful health effects of smoking tobacco products.

In this regard, the annual MSA payment sums set forth in Section IX(c)(1) of the MSA, net of any adjustments, is allocated to the Settling States based on each state's "Allocable Share." *See* MSA § II(f). Ohio is the fourth largest recipient of MSA settlements proceeds and has an Allocable Share of 5.0375098%. *See* MSA Ex. A.

To date, more than \$40 billion has been paid to the Settling States pursuant to the MSA, of which Ohio has received over \$2.2 billion. (Susan C. Jensen Aff. at ¶ 3). In 2005, Ohio received \$321,141,241.56 in MSA payemnts. (*Id.* at ¶ 4).<sup>4</sup> Based on calculations performed by PWC, absent Participating Manufacturers withholding MSA payment amounts otherwise due and owing, Ohio would have received \$331,330,800.11 in MSA payments for 2006. (*Id.* at ¶ 5).

### **III. APPLICABILITY OF THE NPM ADJUSTMENT**

The present Motion concerns the propriety of the claimed 2003 NPM Adjustment. PWC has calculated the total NPM Adjustment for 2003 to be \$1,201,507,711.98. (*Id.* at ¶ 6).<sup>5</sup> Before the NPM Adjustment can be applied to any Settling State's annual MSA payment, however, two preconditions must be satisfied. First, there must be a finding that the MSA was a "significant factor" in any "Market Share Loss," a term of art defined in Section IX(d)(1)(B)(iii) of the MSA.

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<sup>4</sup> Under the MSA, the entity responsible for calculating the payments owed and to be received, and for collecting the information necessary for performing these calculations, is the Independent Auditor. MSA § XI(a)(1). The accounting firm PricewaterhouseCoopers ("PWC") is the current Independent Auditor.

<sup>5</sup> Of the total potential NPM Adjustment for 2003, the Original Participating Manufacturers' potential NPM Adjustment is \$1,135,394,303.17 and the Subsequent Participating Manufacturers' potential NPM Adjustment is \$459,399, 410.56. (*Id.*)

Second, the Participating Manufacturers must demonstrate that the particular Settling State was not diligently enforcing a Qualifying Statute for the year in question.

**A. Significant Factor Determination**

Before the NPM Adjustment can be applied to *any* state's payment, there must be a finding by an economic consulting firm that "the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question." MSA § IX(d)(1)(C). This separate proceeding is known as the "significant factor determination." If it is determined "that the disadvantages experienced as a result of the provisions of this Agreement were not a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall not apply." *Id.*

A significant factor proceeding was initiated by the Original Participating Manufacturers on April 28 and 29, 2005. (Susan C. Jensen Aff. at ¶ 7). On March 27, 2006, the economic consulting firm The Battle Group determined that the MSA was "more likely than not" a significant factor contributing to a 2003 "Market Share Loss." (*Id.*). Under the MSA, this determination is not appealable. MSA § IX(d)(1)(C).

**C. Diligent Enforcement**

Despite the March 27, 2006 significant factor determination, the application of the 2003 NPM Adjustment to Ohio is *not self-executing*. In this regard, the MSA provides:

A Settling State's Allocated Payment shall not be subject to an NPM Adjustment . . . if such Settling State continuously had a Qualifying Statute (as defined in subsection (2)(E) below) in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year.

MSA § IX(d)(2)(B). To summarize, an *individual state's* MSA payment will not be subject to an NPM Adjustment if: (1) the state has a Qualifying Statute in full force and effect, and (2) that

state is *diligently enforcing* its Qualifying Statute during the calendar year in question.

The MSA contains a Model Statute which the parties expressly agreed shall constitute a Qualifying Statute. See MSA § IX(d)(2)(E) and Exhibit T. The Model Statute requires all tobacco manufacturers to either (1) join the MSA and make the payments required by that agreement, or (2) deposit into escrow a fixed sum per cigarette that is essentially equal to the per-cigarette costs imposed by the MSA. The escrow requirement is designed primarily to create a resource against which Ohio can recover in the event it wins a judgment against a Non-Participating Manufacturer for health related costs associated with the Non-Participating Manufacturer's tobacco products.

It is undisputed that Ohio enacted the Model Statute, which went into effect on June 30, 1999. See Am. Sub. H.B. No. 362 (123d General Assembly), *codified at* R.C. 1346.01-.03. Thus, the only question that remains is whether Ohio was diligently enforcing its Qualifying Statute during 2003.

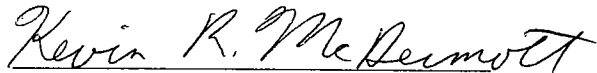
#### **IV. THE PRESENT CONTROVERSY AND REQUESTED RELIEF**

As noted previously, RJRT – on of itself and the former Brown & Williamson – and Lorillard withheld amounts owed for 2006 based on a claimed entitlement to a 2003 NPM Adjustment. Thus, the issue of Ohio's diligent enforcement for 2003 is fully ripe for adjudication. Ohio seeks (1) a Declaratory Order that it diligently enforced the provisions of R.C. 1346.01-.02 in 2003 and (2) an order requiring all withholding Participating Manufacturers

to promptly pay Ohio any disputed sums withheld because of a claimed right to a 2003 NPM Adjustment, including any applicable interest.

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**CERTIFICATE OF SERVICE**

The undersigned hereby represents that a true and accurate copy of the foregoing was sent to undersigned counsel this 18th day of April, 2006, via regular U.S. Mail, postage pre-paid, to the following address:

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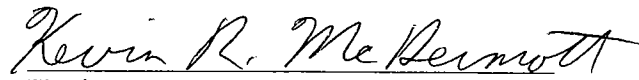
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# **EXHIBIT 1**

**IN THE COURT OF COMMON PLEAS  
FRANKLIN COUNTY, OHIO**

STATE OF OHIO, ex rel. ATTORNEY	:	Case No.: 97 CVH 055114
GENERAL JIM PETRO, et al.,	:	
	:	Judge David W. Fais
Plaintiffs,	:	
	:	
vs.	:	
	:	
R.J. REYNOLDS TOBACCO CO., et al.,	:	
	:	
Defendants.	:	

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**AFFIDAVIT OF SUSAN C. JENSEN**

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STATE OF OHIO           :  
                                  :  
                                  :        ss  
COUNTY OF FRANKLIN  :

Susan C. Jensen, being first duly sworn, states as follows:

1.     I make this affidavit based on my own personal knowledge as Paralegal and Custodian of Records with the State of Ohio Attorney General’s Office, Tobacco Unit. All capitalized terms not otherwise defined herein have the same meaning as in the Motion Of The State Of Ohio For A Declaratory Order Regarding Diligent Enforcement (the “Motion”).

2.     Based on a claimed entitlement to an NPM Adjustment for 2003, RJRT – on behalf of itself and the former Brown & Williamson – and Lorillard have withheld approximately \$755 million in settlement monies payable to the Settling States on April 17, 2006. Ohio’s share of the withheld amount is approximately \$38 million.

3.     To date, more than \$40 billion has been paid to the Settling States pursuant to the MSA, of which Ohio has received over \$2.2 billion.

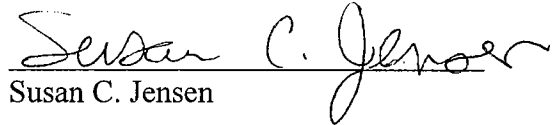
4.     In 2005, Ohio received \$321,141,241.50 in MSA payments.

5. Based on calculations performed by PWC, absent Participating Manufacturers withholding MSA payment amounts otherwise due and owing, Ohio would have received \$331,330,800.11 in MSA payments for 2006.

6. PWC has calculated the total NPM Adjustment for 2003 to be \$1,201,507,711.98. Of the total potential NPM Adjustment for 2003, the Original Participating Manufacturers' potential NPM Adjustment is \$1,115,394,303.17 and the Subsequent Participating Manufacturers' potential NPM Adjustment is \$86,113,408.81.

7. A significant factor proceeding was initiated by the Original Participating Manufacturers on April 28 and 29, 2005. On March 27, 2006, the economic consulting firm The Battle Group determined that the MSA was "more likely than not" a significant factor contributing to a 2003 "Market Share Loss."

FURTHER AFFIANT SAYETH NAUGHT.

  
Susan C. Jensen

SWORN TO AND SUBSCRIBED in my presence  
this 17~~th~~ day of April, 2006.

  
Notary Public



DAMIAN W. SIKORA, ATTORNEY AT LAW  
NOTARY PUBLIC, STATE OF OHIO  
My commission has no expiration date  
Section 147.03 R.C.