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STATE OF MINNESOTA

COUNTY OF RAMSEY

DISTRICT COURT

SECOND JUDICIAL DISTRICT

Court File No. C1-94-8565

THE STATE OF MINNESOTA, BY HUBERT H. HUMPHREY, III, ITS THEN ATTORNEY GENERAL,

and

BLUE CROSS AND BLUE SHIELD OF MINNESOTA,

Plaintiffs,

v.

PHILIP MORRIS USA, INC., R.J. REYNOLDS TOBACCO COMPANY, BROWN & WILLIAMSON TOBACCO CORPORATION, B.A.T. INDUSTRIES, P.L.C., BRITISH-AMERICAN TOBACCO COMPANY LIMITED, BAT (U.K. & EXPORT) LIMITED, LORILLARD TOBACCO COMPANY, THE AMERICAN TOBACCO COMPANY, LIGGETT GROUP, INC., THE COUNCIL FOR TOBACCO RESEARCH-U.S.A., INC., and THE TOBACCO INSTITUTE, INC.,

Defendants,

A.H. HERMEL CANDY & TOBACCO CO.; HENRY'S FOODS, INC.; SANDSTROM'S, INC.; M.AMUNDSON CIGAR & CANDY CO., LLP; THE WATSON COMPANIES, INC.; GRANITE CITY JOBBING COMPANY, INC.; MINTER WEISMAN CO.; SEGAL WHOLESALE, INC., COUNSEL OF INDEPENDENT TOBACCO MANUFACTURERS OF AMERICA, and COMMON WEALTH BRANDS, INC.,

Intervenors.

ORDER

FILED
Court Administrator
DEC 20 2005
By CW Deputy

The amended Motion of the Defendants' and Defendants' distributors for enforcement of the Settlement Agreement requests that the Court find that the health impact fee (HIF) violates the Settlement Agreement and Stipulation for Entry of Consent Judgment (Settlement Agreement) as to the Defendants and the Defendants' distributors and further requests that the Court declare that the HIF violates the contract clauses of the United States and Minnesota Constitutions.

The intervenors (A.H. Hermel, et al.) move for the same relief. Commonwealth seeks the Court to declare, if it exempts the Defendants from the HIF, the HIF unconstitutional and void.

Counsel for Independent Tobacco Manufacturers of America asks, assuming the named defendants are found not responsible for the HIF, the Court to declare the HIF unconstitutional because it would selectively enforce the HIF against entities similarly situated, constituting a special law because the settling manufacturers and distributors are exempted from the fee and because the distinction between it and the other settling manufacturers and distributors constitutes an arbitrary and capricious classification not relevant to the stated purposes of the HIF, thereby violating the due process provisions of the state and federal constitutions.

APPEARANCES

MOVANTS:

PHILLIP MORRIS: Peter Sipkins, Esq., and Edward B. Magarian, Esq., Dorsey & Whitney L.L.P., 50 South 6th Street, Suite 1500, Minneapolis, Minnesota, 55402-1498 and Murray R. Gainick, Esq., *pro hac vice* and Amand Agneshwar, Esq., Arnold & Porter, L.L.P., 555 12th Street NW, Washington, D.C., 2004-1206.

R.J. REYNOLDS and LORILLARD: Walter A. Pickhard, Esq., Faegre &Benson, L.L.P., 90 South 7th Street, Suite 2200, Minneapolis, Minnesota, 55402-3901, and Stephen R. Patton, Esq., *pro hac vice*, and Jonathon E. Moore, Esq., *pro hac vice*, Kirkland & Ellis, 200 East. Randolph, Chicago, Illinois, 60601.

LIGGETT GROUP filed a separte lawsuit and has not joined in the motion of the other defendants, Rueben A. Mjannes, Esq., Lindquist & Vennum, P.L.L.P., 805 8th Street, Suite 4200, Minneapolis, Minnesota, 55402.

RESPONDENTS:

STATE OF MINNESOTA: Michael J. Vanselow, Deputy Attorney General and Bradford S. Delapena, Assistant Attorney General, 445 Minnesota Street, Suite 1100, St. Paul, Minnesota.

GOVERNOR TIMOTHY PAWLENTY: Karen Janish, Esq., State Capitol, St. Paul, Minnesota, 55155.

INTERVENORS:

A.H. Hermel, et al.: Randy G. Gullickson, Esq., Anthony Ostlund & Baer, P.A., 90 South 7th Street, Suite 3600, Minneapolis, Minnesota, 55402.

Council of Independent Manufacturers of America: Thomas H. Boyd, Esq., and Karl E. Robinson, Esq., Winthrop & Weinstine, P.A., 225 South 6th Street, Suite 3500, Minneapolis, Minnesota, 55402-4629.

Commonwealth Brands, Inc.: Scott G. Knudsen, Esq., Briggs & Morgan, 80 South 8th Street, Suite 2200, Minneapolis, Minnesota, 55402.

Based upon the arguments of counsel and the entire file:

IT IS THEREFORE ORDERED THAT:

1. The oral Order made at the hearing on September 29, 2005 to allow intervention by A.H. Hermel Candy & Tobacco Company, et al., Commonwealth Brands, Inc., and the Council of Independent Tobacco Manufacturers of America, previously granted, is now **CONFIRMED**.

2. The Motions of the defendants to find that the Health Impact Fee violates the Settlement Agreement and is unconstitutional are **GRANTED**.

3. The Motions of the Intervenors to find that the Health Impact Fee cannot be enforced against them because it constitutes a selective enforecement and deprives them of equal protection under the law is **GRANTED**.

4. The defendants and the intervenors are entilted to credit or refunds, to the extent paid.

5. The attached Memorandum is made a part hereof.

6. Notice to Counsel by mail is sufficient for all purposes.

Dated: December 20, 2005

BY THE COURT;

Michael F. Fetsch
Judge of District Court

MEMORANDUM

INTERVENTION

The intervenors have satisfied each prong of Rule 24.01 and 24.02, Minn.R.Civ.P. Intervention is to be granted liberally. *Luthen v. Luthen*, 596 NW2d 278 (Minn.App. 1999). The holding in *Van Meveren v. Van Meveren*, 603 NW2d 671 (Minn.App. 1999) is not apposite to the analysis. *Van Meveren* denied intervention to an adult daughter of the parties in a custody matter involving her minor brothers. That decision must be read in the context of Minnesota statutory and case law. A third person, that is person not one of the parents, may seek custody by a third party custody petition. An adult daughter does not otherwise have a cogniziable interest in the custody dispute over her minor brothers.

The rule is designed to permit intervention as a right if, as a practical matter, the Court's decision in the pending action could impair or impede that party's ability to protect its interest. Here the intervenors have : (1) timely moved to intervene; (2) have an interest relating to the property or transaction that is the subject of the action, albeit that that interest is contingent and dependent upon how the Court addresses the defendants' motion; (3) have shown that the Court's judgment could impair or impede the parties' ability to protect that contingent interest; and, (4) the intervenors' interests are not adequately represented by the existing parties. *Nash v. Wollan*, 656 NW2d 585, 591 (Minn.App. 2003).

Permissive intervention lies within the District Court's discretion. Here that discretion is exercised in favor of the intervenors who would be unduly delayed or

prejudiced by a denial of their participation. *Nash v. Wollan, supra.* The intervenors have shown "... a special and concrete stake in the ultimate determination ...", *Id.*

THE HEALTH IMPACT FEE

Background

The Settlement Agreement mandated that the settling defendants pay to the State of Minnesota funds which approximate two and one quarter (2.25) billion dollars to date. These payments: "...are in satisfaction of all of the State of Minnesota's claims for damages incurred by the State . . . including without limitation . . . claims for health care expenditures . . ." A. p.7., and do

> "release and forever discharge all Defendants and their . . . distributors . . . from any and all liabilities whatsoever . . . whether legal, equitable or statutory ('Claims') that the State of Minnesota . . . ever had, now has or hereafter can, shall, or may have, as follows: . . ." S.A., III. B. p.12-13.

and also release the defendants

> "b. for future conduct, only as to monetary claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products." S.A., III.B., p. 13

and

> "The State of Minnesota hereby covenants and agrees that it shall not hereafter sue or seek to establish civil liability against any person or entity covered by the release provided under Paragraph III.B based, in whole or in part, upon any of the Released Claims, and the State of Minnesota agrees that this covenant and agreement shall be acomplete defense to any such civil action or proceeding." S.A., III.. B. p. 13

HEALTH IMPACT FEE

The Legislature enacted a health impact fee (H.I.F.), the stated purpose of which was " . . . to recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by youths." Laws 2005, First Special Session, Ch. 4, Art. 4, Sec. 2., subd.1.

This legislation seeks to recover those costs from the settling defendants which are prohibited by the settlement agreement.

In addition to the payments required by the agreement, the defendants also agreed to limitations upon their conduct, including not to challenge certain legislation, to produce documents relating to the enactment or repeal or in opposition to state legislation or state executive action, to disclose payments to any state or local official in Minnesota, to discontinue billboards and transit advertisements of tobacco products in this state, not to make any motion picture in the United States which makes reference to or uses as a prop any cigarette, cigarette package, etc., and to cease marketing, licensing, distributing, selling or offering by direct mail.

The limitations were presumably sought by the State to advance the non-smoking cause and thereby lessen the State's health care costs.

The Court rejects the Attorney General's argument that the Settlement Agreement unconstitutionally inhibits the power of the Legislature. The Legislature, while not signatory to, has acquiesced and assented to the settlement by its conduct of actively employing settlement funds to achieve legislative purposes.[1]

[1] Minn. Stat. § 297F.24 legislatively also acknowledges and acquiesces to the settlement as is more fully discussed below.

The defendants' distributors are parties because the settlement names them as beneficiaries. S.A., III..B., p-12.

The Health Impact Fee, enacted July 14, 2005, became effective August 1, 2005. The purpose of the fee was to reimburse the state for "... the cost of smoking attributable expenses incurred by government health care programs [and will be 75 cents per pack]." Office of Governor Tim Pawlenty, *Governor Pawlenty Leads Efforts to Solve Legislative Impasse (May 20, 2005), at 1.*

The Minnesota Department of Revenue, *Use of Fees versus Taxes* (updated May 18, 2005) characterized a fee as "approximat[ing] the costs incurred by, or imposed upon government. The inclusion of the bill within an "Omnibus Health and Human Services Bill" providing policy and funding, establishing the tobacco health impact fee and appropriating money" clearly indicates that the $.75 per pack was not a tax. Had it been a tax it would have been likely included in the "Omnibus Tax Bill" passed the same day, which bill had provisions relating to the collection of excise and sales taxes on tobacco products. *See* H.F. 138, Art. 6, Section 20. That the state sought reimbursement of tobacco-related health care costs clearly violates the Settlement Agreement.

The mechanism by which the funds collected by the $.75 H.I.F. also militate against finding that it is a tax, rather than a fee, because the Human Services Commissioner must annually certify to the Finance Commissioner the "... tobacco use attributable costs..". Upon receipt of that certification, the Finance Commissioner is then mandated to transfer from the H.I.F. fund to the general fund an amount sufficient to offset the certified expenditures. The H.I.F. is imposed upon and collected from the

distributors of tobacco products. It is they who are statutorily commanded to pay the H.I.F. and their failure to do so subjects them to license revocation.

A separate lawsuit is not necessary in order to confer jurisdiction upon the district court. That jurisdiction is retained and preserved by the Settlement Agreement, I.A., p.3.

The Attorney General's reading of the release, which would limit its operating effect only to "judicial claims", ignores definition of claims within the settlement agreement, which is much broader, and includes "... liabilities of any nature whatsoever" including those of a "statutory" nature. The H.I.F. is statutory in nature and directly imposes that from which the defendants are protected by the Settlement Agreement.

The Governor's argument that the H.I.F. can be applied to the settling defendants because it was designed "to reduce tobacco use, particularly among youths," is similarly foreclosed by the Settlement Agreement. The Governor's argument that the imposition of the fee H.I.F. on the distributor does not violate the agreement fails to recognize that the distributors are protected in the same manner and to the same extent as are the defendants.

The essential benefits of the settlement agreement to the defendants was that it reduced to liquidated form, those damages which the state sought to collect by its lawsuit. The state is bound, like any other party is bound, to the contracts to which it freely and knowingly enters, and from which it benefits. For the state now to argue that it is not bound by its contract undermines and potentially eviserates the constitutional provision contained in Article I, Section 11 of the Minnesota Constitution which provides

that "No bill of obtainder, ex post facto law, or any law impairing the obligation of contracts shall be passed."

The argument that any interference with the collection of the H.I.F. is an impairment of the legislative power is flawed. The impairment is self-imposed by the Settlement Agreement. While the Legislature is free to raise revenue by means of a tax, and all parties agree that there would be no basis to override such a tax, the purpose of this legislation was to seek governmental reimbursement for the costs associated with tobacco which distinguishes the H.I.F from a tax and makes it a fee.

In the context of the argument of whether or not a municipality's enactment was a revenue-raising device, which would be prohibited, or a fee, the Supreme Court indicated that the key to determining whether or not a particular item is a fee or tax is whether or not it has a direct relationship to the costs which the reimbursement (fee) seeks. *Country Jo, Inc., v. City of Eagan*, 560 NW2d 681, 686 (Minn. 1997). The totality of all circumstances, which include the descriptive information released by the Governor's Office and the Department of Revenue, as well as the statutorily expressed purpose, all require the conclusion that the H.I.F. is a fee. The Attorney General makes a number of other arguments in an effort to preserve the H.I.F. The Legislature, however, acknowledges the Settlement Agreement by having passed Minn. Stat. § 297F.24 which contains a "fee in lieu of settlement" imposed upon nonsettling tobacco companies. By this enactment the Legislature approves and endorses the Settlement Agreement, even if its receipt and use of the funds from the agreement were not sufficient to bind it.

The Attorney General argues that the "unmistakability doctrine" is applicable to preserve the H.I.F. He argues that the state cannot waive its soveriegn powers unless it does so in umistakable terms, which, he claims, it has not done. Here the state has consented to a Settlement Agreement which involves neither the eradication or usurpation of its soveriegn power but its assent to a contract, of the nature and type, which the state enters into every day in a variety of situations.

The defendants, in addition to their contractual claim, have proven a "contracts clause" violation which requires them, first, to prove the existence of a contract; second, the impairment of that obligation by state law; and, third, that the impairment is not a reasonable means to a legitimate end protecting the vital interests of the community.

To demonstrate " ... a significant and legitimate public interest ..." the "level of impairment increases the level of scrutiny to which the legislation is subjected." *Christenson v. Minneapolis Municipal Employees*, 331 NW2d 740, 750-751. Here the state seeks to abrogate that which what it has promised but offers neither to forego future payments or to refund past payments. It is impossible to find that the legislation is a reasonable device which serves the end of protecting the vital interests of the community.

INTERVENORS

By holding that the H.I.F. is not applicable to the distributors of the settling defendants, there is created this dichotomy. The distributors of the nonsettling defendants must collect the $.75 per cigarette package fee, whereas the distributors of the settling defendants do not. The resultant situation creates an anomoly in the marketplace by which the settling defendants' products will have a distinct marketplace

advantage in price. The purpose of the legislation was to recover health-related costs and to prevent tobacco use by youths. The youths who smoke will not by this legislation cease smoking. They will cease smoking the more expensive cigarettes and buy the less expensive cigarettes from the settling defendants' distributors.

Minnesota already imposes a fee on Commonwealth and other non-settling manufacturers to cover the health-related costs of smoking. This is a $.35 per pack fee. Minn. Stat. § 297F.24 (1)(a). The fee is inapplicable to the distributors of the settling defendants and was designed to equalize payments between the settling defendants and other companies that have not settled. The legislative purpose of the H.I.F. was to require all manufacturers to pay. In light of my decision above, the H.I.F., as applied to the distributors of the nonsettling defendants, who comprise approximately ten percent of the market, will be selectively enforced only as to the remaining ten percent. None of the statute's stated statutory goals will be fulfilled. The nonsettling defendants will be singled out and deprived of equal protection under the Uniform Taxation Clause of the Minnesota Constitution. The statute fails because what is left are distinctions which are manifestly arbitrary and fanciful and because it contains a classification not justified by any distinctive means peculiar to this class and contains a legislative purpose which no longer can be achieved. E.g., *Miller Brewing Company v. State*, 284 NW2d 353, 356 (Minn. 1979).

If the resulting classification does not promote the purposes of the statute, it can no longer stand. *Kolton v. County of Anoka*, 645 NW2d 403, 411 (Minn. 2002). Requiring the nonsettling distributors to pay the H.I.F. would be the functional equivalent of a special legislation singling out for special privilege the settling defendants and in

derogation to the nonsettling defendants under Art. 12, Sec. 1, Minnesota Constitution, *See also, Nichols v. Walter, 37 Minn. 264, 270-71, 33 NW 800, 801 (1887),* standing for the proposition that a law which is general in its passage but special in its application violates the constitution.

There is no manner in which the legislation can be compartmentalized so as to save it in part while declaring it unconstitutional in part. The law was designed to apply to all cigarette sales and now fails because it is only applicable to ten percent of those sales. *See, Minnesota Cable Communications Ass'n v. Minnesota Cable Communications Board*, 288 NW2d 721, 723 (Minn. 1980).

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