Articles + Publications | March 17, 2021

Fla. Tobacco Settlement Ruling Offers Caution on Contracts

WRITTEN BY

Agustin E. Rodriguez | Dascher Pasco

Published in Law360 on March 17, 2021. Reprinted here with permission.

In December 2020, the Florida Supreme Court refused to take up R.J. Reynolds Tobacco Co.'s appeal of a ruling requiring the company to continue to make annual tobacco settlement payments to the state of Florida.

The court's refusal to hear the case leaves in place, in perpetuity, Reynolds' obligations to make payments under Florida's 1997 tobacco settlement agreement on the volumes of certain cigarette brands that Reynolds no longer owns — having sold these brands to ITG Brands LLC in a 2015 asset purchase.

As a result, Reynolds' parent company, British American Tobacco PLC, took a $555 million charge, and stands to owe more than $75 million per year in unanticipated settlement payments going forward.[1]

The Florida appellate court described the case as "a tale of two contracts."[2] The reality is more complex — and serves as a reminder to settling parties that their agreements will be strictly construed. This cautionary tale is all the more important as state attorneys general and other regulators continue to resolve disputes via individual or multistate settlement agreements.

The Tobacco Settlements

In the mid-1990s, more than 40 states commenced litigation against the nation's largest cigarette companies, seeking monetary, equitable and injunctive relief under various consumer protection and antitrust laws. The first case was filed in May 1994 by Mississippi's attorney general.

After several years of litigation and a failed attempt to obtain a national settlement through congressional legislation, the cigarette companies entered into separate settlements with four states: Mississippi, Florida, Texas and Minnesota.

Those agreements released the settling defendants from liability for health care costs, in exchange for changes in business conduct and annual payments made in perpetuity.[3]

The Florida settlement agreement, or FSA, was signed in August 1997 by Philip Morris USA, Reynolds, Brown & Williamson Tobacco Corp. and Lorillard Tobacco Co. The FSA guaranteed the state billions of dollars in perpetuity in compensation for money Florida allegedly spent treating sick smokers. At the time, it was one of the largest

court-approved settlements in U.S. history.

The 1998 tobacco master settlement agreement, or MSA, was an agreement signed after the individual state settlements between tobacco manufacturers and the other 52 state and territory attorneys general. It resolved certain claims against the participating manufacturers, in exchange for the release from liability for health care costs allegedly caused by smoking.

Specifically, in exchange for the release from liability, the participating manufacturers agreed to certain restrictions related to the advertising, marketing and promotion of cigarettes that were otherwise protected under the First Amendment, as well as to make annual payments in perpetuity to the settling states.[4]

Initially, there were only four participating manufacturers — the same entities comprising the aforementioned settling defendants — but dozens of other tobacco manufacturers signed on to the MSA, resulting in a comprehensive overhaul of the tobacco industry in the U.S.

Under the MSA, the original participating manufacturers, including Reynolds, make an annual payment that is calculated according to each manufacturer's relative market share, defined as "an [original participating manufacturer's] respective share (expressed as a percentage) of the total number of individual Cigarettes shipped in or to the fifty United States … by all the Original Participating Manufacturers during the calendar year immediately preceding the year in which the payment at issue is due."[5]

Importantly, the MSA contains a transfer-of-brands provision that prohibits original participating manufacturers from selling or transferring certain assets, including cigarette brands, to any person or entity, unless the person or entity is another original participating manufacturer or assumes the obligations of an original participating manufacturer prior to the transaction.

Additionally, any purchaser or transferee must become, prior to the sale or acquisition, a participating manufacturer.[6]

The individual state settlements also provide that the settling defendants must make annual payments based on their market share.[7] However, unlike the MSA, the individual state settlements did not contain a brand transfer clause.

In the individual state settlements, the only provision governing a change in circumstances was the amendment provision, requiring the terms of the agreements to be modified only by written agreement executed by the waiving party, or in the case of Minnesota, both parties.[8]

Thus, while the participating manufacturers and the settling defendants are held to similar financial and business conduct requirements under the MSA and the individual state settlements, respectively, the difference in the assignability clauses of these agreements has had significant consequences for Reynolds.

R.J. Reynolds v. Florida

Since the signing of these tobacco settlements, the cigarette industry has seen significant consolidation, starting

with the merger of Brown & Williamson with Reynolds in 2004.[9]

In mid-2015, Reynolds purchased and merged with Lorillard, acquiring Lorillard's flagship Newport cigarette brand. For antitrust reasons, Reynolds sold four cigarette brands — Kool, Winston, Salem and Maverick — to ITG.[10]

Because of the brand transfer provision referenced above, ITG at the closing of the transaction immediately acceded to all of the MSA's requirements of an original participating manufacturer with respect to the transferred brands — including all payment obligations relating to the sales volume of those brands.

Remarkably, the parties agreed to close their merger even though ITG only had to use "reasonable best efforts" to become a party to the individual state settlements. After the closing, ITG reportedly engaged the individually settling states with respect to possibly joining their settlements, but managed to reach an agreement only with the state of Mississippi, and never joined the FSA, the Texas agreement or the Minnesota agreement.[11]

By the time the parties' annual payments were next due under the individual state settlements, both Reynolds and ITG claimed to have no obligation to pay on the volumes of the transferred brands in any of the individually settled states. Florida was the first state to bring its lawsuit against Reynolds and ITG jointly and severally, and was joined in its suit by the other original participating manufacturer, Philip Morris USA.[12]

The Florida lawsuit was followed by suits in Minnesota and Texas, in March 2018 and January 2019 respectively.

The Florida court succinctly summarized the facts of the case: "One contract, the FSA. The other contract, the Asset Purchase Agreement, entered in 2014, where Reynolds sold four brands of cigarettes to ITG Brands for seven billion dollars."[13]

In the litigation, Reynolds argued that, due to the sale of the transferred brands to ITG, "it is no longer required to pay the state under" the FSA, that the brands "are no longer part of Reynolds' market share and that ITG, the new owner of these brands, had agreed to use 'reasonable best efforts' to become part of the FSA."[14]

Specifically, Reynolds argued that "once it stopped manufacturing, selling, and shipping the [transferred] Brands, they were no longer part of its Market Share for purposes of calculating the annual payments."[15]

The court disagreed, finding, "simply put, that a contract is a contract, and that Reynolds continues to be liable under the contract with the State of Florida."[16] In reaching this conclusion, the court relied heavily on two facts.

First: "[T]he [FSA] could be 'amended only by a writing executed by all signatories. … It is undisputed that there was no written agreement by the signatories to the [FSA] altering or waiving Reynolds' payment obligations to Florida."[17]

In the absence of a written amendment to the FSA, "Reynolds' payment obligations continued in full force and effect under the" FSA, and the lack of such an agreement "alone compels affirmance" of the trial court's ruling that Reynolds remained liable for the payments.

Second: No obligation in the FSA or the asset purchase agreement required ITG to take over Reynolds' responsibilities and obligations under the FSA.[18] The asset purchase agreement "could not extinguish Reynolds' responsibilities and obligations under the [FSA], as it was a separate agreement not involving all the parties to the" FSA.[19]

Furthermore, while the asset purchase agreement "stated that ITG assumed Reynolds' liabilities under the FSA, it also stated that ITG had to use 'reasonable best efforts' to reach an agreement with Florida to become a party to the FSA" and "[i]t is undisputed that ITG never became a party to the [FSA]."[20] Because ITG never became a party to the FSA, it could not be bound by the provisions of that agreement.[21]

The court rejected Reynolds' assertion that once it "stopped manufacturing, selling, and shipping the Acquired Brands, they were no longer part of its Market Share for purposes of calculating the annual payments."[22]

In doing so, the court noted that "[n]othing in the Market Share provision establishes that assignment of the Acquired Brands to ITG somehow extinguishes Reynolds' liability in the absence of a signed written agreement to the" FSA.[23]

By the time of the decision of the Florida Appellate Court, the lower courts in the other individually settled states had rendered decisions against Reynolds.

The Florida court recognized those decisions, and in support of its conclusion cited both the U.S. District Court for the Eastern District of Texas' 2020 decision in *Texas v. American Tobacco Co.* and the Minnesota District Court for the Second Judicial District's 2019 ruling in *In Re: Petition of the State of Minnesota for an Order Compelling Payment of Settlement Proceeds Related to ITG Brands LLC*.[24]

Specifically, the Florida court noted that in *Texas v. American Tobacco Co*., the Texas court rejected "Reynolds' argument that its liability was extinguished by the Market Share provision, concluding 'that the Market Share provision does not apply to the legal question of liability following an assignment.'"[25]

In the Minnesota action, the Minnesota court concluded simply that "Reynolds remained liable absent an agreement otherwise" and "allowing Reynolds to escape liability by transferring assets was 'absurd' and contrary to the purpose of the agreement."[26]

In sum, Reynolds' failure to ensure compliance with the express terms of the FSA, and its failure to execute the asset purchase agreement in a manner that required the assumption of liability by ITG, led to Reynolds' failure to alter its obligations under the FSA.

Settlement Agreements as Contracts

Most courts hold that disputes concerning a settlement agreement are governed by applicable state contract law, whether the underlying claim is state or federal.[27]

Furthermore, as the U.S. Supreme Court noted in *Mastrobuono v. Shearson Lehman Hutton* in 2005, it is a "cardinal principle of contract construction: that a document should be read to give effect to all its provisions and

to render them consistent with each other."[28] However, "[i]f contract terms are unambiguous, then the inquiry is over."[29]

In fact, courts have indicated that the precise language used in a settlement agreement may be even more important than that of an ordinary contract because, as the U.S. Court of Appeals for the Federal Circuit said in *Panduit Corp. v. HellermannTyton Corp*. in 2006, the language "reflect[s] an agreement by hostile litigants on more than just contract terms; they reflect a compromise of contested legal positions in matters that are the subject of litigation."[30]

This is exemplified in *Panduit*, where the court found that a settlement agreement did not bar a competitor from making and selling a part that was similar to the part identified in the agreement.[31] The court reached this conclusion by relying on the express terms of the agreement, finding that where they were unambiguous, there was no reason to look to the parties' intent.[32]

The use of precise language is equally important in contractual assignments. As stated by Vladimir Rossman and Morton Moskin in their treatise on commercial contracts, "[A]bsent an express provision to the contrary, contract rights are freely assignable."[33]

Accordingly, where the party to a settlement agreement wishes to assign an obligation, if it is not prohibited by the settlement, a later assignment can be effective if it executed properly.

Whether or not an assignment is effective ultimately depends on the laws of the state. For example, in a survey of contract law, Boaz Morag, Elizabeth Brody and Alvaro Mon Curreno noted that "New York law requires a greater showing than that generally required in other jurisdictions to demonstrate that the assignee agreed to assume the assignor's obligations under a contract."[34]

More generally, as exemplified by the Court of Special Appeals of Maryland's 1989 opinion in *P/T Ltd. II v. Friendly Mobile Manor Inc.*, it is not uncommon to require "an express manifestation to accept an assignor's duties," and where no such express manifestation exists, an assignee will be presumed not to have assumed those duties.[35]

The application of these principles becomes all the more important where the settlement agreement governs more than just the relationship between the contracting parties, but includes injunctive terms or requirements that impact the settling defendants' future behavior and obligations.[36]

To the extent a party enters into a contract or other agreement that may implicate the terms of a settlement agreement, they must ensure that those contracts meet the carefully negotiated terms in settlement agreements in order to ensure the intended result.[37]

Furthermore, to the extent a party attempts to assign its rights or delegate its duties under a settlement agreement, it must not only ensure such assignment is permitted, but must take into account the laws of the state governing the later contract. If an assignment is not complete under those laws, the party may find that it has assigned its rights without properly delegating its obligations.

Conclusion

As demonstrated by the Reynolds case in Florida, a settlement agreement is a binding contract between the parties with effects that may very well impact future business decisions.

In order to ensure future contracts have the desired effect, parties should not only carefully consider any past settlement's requirements, but also ensure that the later contracts clearly and adequately express the parties' desired outcome.

For the reasons discussed in this article, those decisions will most likely have the intended effect where the parties carefully consider basic contractual principles — specifically, the implication of express and unambiguous terms, and the relevant laws governing assignment and delegation of rights and duties.

---

[1] Richard Craver, BAT discloses $555 million in MSA dispute charges involving Reynolds, ITG, Winston-Salem Journal (Feb. 17, 2021, https://journalnow.com/business/local/bat-discloses-555-million-in-msa-dispute-charges-involving-reynolds-itg/article_9f5425ee-712b-11eb-9637-a36769e7352c.html#:~:text=British%20American%20Tobacco%20Plc%20said,Settlement%20Agreement%2Dtype%20payments%20dispute. *See also* Piper Sandler, BAT Takes £400M Provision for Settlement Costs; Ongoing Costs Remain a Risk (Feb. 17, 2021, https://piper2.bluematrix.com/sellside/EmailDocViewer?encrypt=4e172a1e-a0cf-4bf2-85f6-315f09120bf8&mime=pdf&co=Piper.

[2] *R.J. Reynolds Tobacco Co. v. State of Florida*, 301 So.3d 269, 271 (Fla. Ct. App.).

[3] In each agreement, the settling defendants liable for the terms of the individual state settlements were defined only as "those Defendants in this action that are signatories" to the relevant agreement. *Florida v. Am. Tobacco Co. et al.*, Case No. 95-1466AH (Fla. Cir. Ct.), Settlement Agreement at p. 5; *Texas v. Am. Tobacco Co. et al*., Case No. 5-96CV-91 (E.D.Tex.), Texas Comprehensive Settlement Agreement and Release at p. 5 (hereinafter "Texas Agreement"); *Minnesota et al. v. Philip Morris et al*., Case No. C1-84-8565 (Minn. Dist. Ct.), Settlement Agreement and Stipulation for Entry of Consent Judgment at p. 4 (hereinafter "Minnesota Agreement"); *In re Mike Moore, Attorney General ex rel. State of Mississippi Tobacco Litigation*, Case No. 94-1429 (Ch. Jackson Cty.), Comprehensive Settlement Agreement and Release at p. 5 (hereinafter "Mississippi Agreement").

[4] *Master Settlement Agreement*, National Association of Attorneys General (1998), https://naagweb.wpenginepowered.com/wp-content/uploads/2020/09/2019-01-MSA-and-Exhibits-Final.pdf [hereinafter MSA].

[5] MSA at Sections II(mm).

[6] MSA at Section XVIII(c).

[7] The definition of "market share" in the individual state settlements is substantially similar to the definition of relative market share in the MSA.

[8] FSA at Section VI(D); Texas Agreement at ¶ 23; Minnesota Agreement at Miscellaneous Provisions, Section I (G); Mississippi Agreement at ¶ 22.

[9] In 2004, B&W and Reynolds were merged in a broader consolidation by BAT, thereby removing one of the settling defendants/OPMs. Press Release, FTC, By Unanimous Vote, FTC Closes its Investigation Into Proposed Merger of RJR and Brown & Williamson (June 22, 2004), https://www.ftc.gov/news-events/press-releases/2004/06/unanimous-vote-ftc-closes-its-investigation-proposed-merger-rjr.

[10] Press Release, FTC, Winston, Kool, Salem, and Maverick Will Be Sold to British Tobacco Marketer Imperial (May 26, 2015), https://www.ftc.gov/news-events/press-releases/2015/05/ftc-requires-reynolds-lorillard-divest-four-cigarette-brands .

[11] ITG's liability pursuant to the asset purchase agreement is currently being litigated in the Delaware courts. R.J. Reynolds, 301 So. 3d at 273, n. 1; *see ITG Brands LLC v. Reynolds Am. Inc. et al.*, C.A. No. 2017-0129-AGB, 2017 WL 5903355 (Del. Ch. Nov. 30, 2017). Notably, a Delaware court held that ITG's contractual obligations to make "reasonable best efforts" to assume Reynolds' obligations under the individual state settlements continues until ITG actually has made reasonable best efforts to assume those obligations and did not cease upon the closing of the transaction. *Id*. Other questions surrounding the asset purchase agreement remain in the Delaware courts. *See ITG Brands LLC v. Reynolds Am. Inc. et al.*, C.A. No. 2017-0129-AGB, 2019 WL 4593495 (Del. Ch. Sept. 23, 2019) (denying summary judgment on the issue of whether ITG is liable for the $93 million in unpaid settlement payments).

[12] Phillip Morris USA joined the litigation "[b]ecause Reynolds' and [ITG's] conduct also had the effect of shifting onto Philip Morris millions of other dollars in payment obligations for which Reynolds and/or Imperial are responsible." Specifically, "due to the mechanics of the Profit Adjustment, additional amounts would be owed by Reynolds and/or Imperial vis-à-vis Philip Morris if it is adjudged that Imperial is liable." *R.J. Reynolds v. Florida*, Nos. 4D18-2616, 4D18-2715, 2019 WL 4619772 (Fla. Dist. Ct. App.).

[13] R.J. Reynolds, 301 So.3d at 271.

[14] *Id*.

[15] *Id*. at 275.

[16] *Id*. at 271.

[17] *Id*. at 274.

[18] *Id*. at 275.

[19] *Id*.

[20] *Id*.

[21] *Id*.

[22] *Id*.

[23] *Id*.

[24] *Id*. 276.

[25] *Id*. (citing *Am. Tobacco Co*., 441 F. Supp. 3d at 451).

[26] *Id*. (citing *In Re Petition*, No. 62-CV-18-1912, at 17).

[27] Jim Wagstaffe, Enforcing Settlement and Consent Decrees, Lexis Practice Advisor Journal, (Sep. 12, 2018), https://www.lexisnexis.com/lexis-practical-guidance/the-journal/b/pa/posts/enforcing-settlements-and-consent-decrees (citing *Skilstaf Inc. v. CVS Caremark Corp.*, 669 F.3d 1005, 1017 (9th Cir. 2012); *Dillard v. Starcon Int'l Inc.*, 483 F.3d 502, 506 (7th Cir. 2007) (settlement of federal claim enforced "just like any other contract"); *Panduit Corp. v. HellermannTyton Corp*., 451 F.3d 819, 825 (Fed. Cir. 2006) (state law governs interpretation of patent infringement settlement agreement that did not require reference to patent statute).

[28] *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 63 (U.S. 1995) (collecting cases); see also Restatement (Second) of Contracts § 203(a) (1981).

[29] *See* supra, Section II., Tobacco Settlements.

[30] Panduit Corp., 451 F. 3d at 827 (citing *U.S. v. Armour & Co.*, 402 U.S. 673, 681–82, 91 S.Ct. 1752, 29 L.Ed.2d 256 (1971) ("Consent decrees are entered into by parties to a case after careful negotiation has produced agreement on their precise terms")).

[31] *Id*.

[32] *Id*. *See also Skilstaf Inc.*, 669 F.3d at 1015-1016 (holding that the unambiguous language of the settlement agreement must be interpreted strictly).

[33] Vladimir Rossman and Morton Moskin, Com. Cont. Strategies Drafting & Negotiating § 2.04[A], 2nd Ed. (2021).

[34] Boaz Morag, Elizabeth Brody and Alvaro Mon Curreno, Commercial Transactions, Assignability of Commercial Contracts (NY) Practical Law Practice Note w-010-1902 (March 2020) (citing *ATC Healthcare Servs. Inc. v. Pers. Sols. Inc.*, 2006 WL 3758618, at *6 (E.D.N.Y. Dec. 19, 2006)).

[35] *P/T Ltd. v. Friendly Mobile Manor*, 79 Md.App. 227, 556 A.2d 694, 699 ("Under the common law, by the great weight of authority, the assignee of rights, benefits, or privileges under a contract did not become responsible for the assignor's duties unless he expressly assumed performance of those duties").

[36] *See e.g.* Press Release, California Attorney General, Attorney General Becerra Announces Settlement Against Equifax Providing $600 Million in Consumer Restitution and State Penalties (July 22, 2019), https://oag.ca.gov/news/press-releases/attorney-general-becerra-announces-settlement-against-equifax-providing-600 (describing injunctive terms impacting future business practices).

[37] Panduit Corp., 451 F.3d at 827.

RELATED INDUSTRIES + PRACTICES

- Consumer Products
- Government + Regulatory
- State Attorneys General
- Tobacco + Nicotine