



Tobacco Public Policy Center at Capital University Law School

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Case Background:

***State of Ohio ex rel. Petro v. R.J. Reynolds, et al.*¹**

Ohio Sues to Compel Payments Required by 1998 Master Settlement Agreement

On April 19, 2006, the State of Ohio filed suit in Franklin County Common Pleas Court to compel payments required under the 1998 [Master Settlement Agreement](#) (MSA). [Documents filed with the court can be viewed here.](#)

The MSA ended litigation that had been brought against the cigarette industry by more than forty state attorneys general, including the Attorney General of Ohio. The attorneys general, beginning with the Attorney General of Mississippi in 1994, filed suits against the cigarette manufacturers seeking enforcement of state laws and recovery for medical costs incurred in treating sick and dying cigarette smokers.

Under the agreement, the cigarette manufacturers agreed to make annual payments to the settling states and to abide by certain advertising and marketing restrictions. In return, the states gave up their legal claims against the cigarette manufacturers – including claims that the manufacturers had been violating state consumer protection and antitrust laws for decades.

This year, two cigarette companies that are parties to the MSA – R.J. Reynolds Tobacco Co. and Lorillard Tobacco Corp. – withheld approximately \$38 million in required payments due to the State of Ohio under the terms of the agreement. The companies put the \$38 million into a “disputed payment account” and are claiming the right to reduce their payments to Ohio. This claim is without merit, as discussed below. In the meantime, the reduction in payments may cause the State to cut funding for entities expecting to receive MSA-related payments, including the Public Health Priorities Trust Fund and the Biomedical Research and Technology Transfer Fund.

R.J. Reynolds and Lorillard also withheld MSA payments due to the other settling states, and more than twenty of those states have filed separate suits against those companies to recover wrongfully withheld MSA payments.

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Relevant MSA Section

Under Section IX of the MSA, cigarette companies that signed the MSA may reduce their payments to a state if they meet a three-part test. They must establish that (a) they have lost a certain amount of market share to Non-Participating Manufacturers (NPMs) who were not parties to the agreement, (b) the MSA was a “significant factor” in the loss of market share, and (c) the state did not “diligently enforce” a requirement that NPMs make escrow payments to the state comparable to what they would have had to pay had they been parties to the agreement.

In March, an arbitrator ruled that the parties to the agreement had lost market share to the NPMs and that the MSA had been a “significant factor” to the agreement.² However, R.J. Reynolds and Lorillard have not shown that Ohio has failed to “diligently enforce” its law with respect to NPMs.³ Thus, R.J. Reynolds and Lorillard are not entitled to reduce their payments to Ohio.

What Happens Next?

There may well be a prolonged procedural dispute over the proper forum for determining this issue, even before the merits of the case are addressed. The cigarette companies have a long record of repeatedly appealing any judgments contrary to their interests. Ultimately, if Ohio can show that it has diligently enforced the NPM law, it will recover the withheld funds (with interest). But it may be months or years until that occurs.

The legislature could pressure R.J. Reynolds and Lorillard to make their full MSA payment by proposing an increase in the state’s cigarette tax to make up for the amount withheld. A cigarette tax increase of less than 10 cents per pack would be required to make up the differential. Such action could deter the cigarette companies from making a dispute over the NPM adjustment a yearly affair.

The Broader Picture

Cigarette-related disease and death continues to impose a tremendous toll on Ohio taxpayers. Approximately 18,900 adults in Ohio die from smoking-related illnesses every year, and smoking causes more than \$4 billion in annual productivity losses. Meanwhile, the MSA signatories remain extremely profitable companies. The parent company of [R.J. Reynolds recently announced an increase in net income of 22.8% during the past year](#), and [Lorillard had a net sales increase of 7.5%](#). Despite claims that it has “reformed” since the MSA, [R.J. Reynolds continues to market to kids and oppose policies to reduce smoking](#). Here in Ohio, [R.J. Reynolds is actively backing a proposed constitutional amendment](#) that would permit smoking in many public places and override existing smokefree ordinances in local communities.

By withholding funds they are required to pay the state under the MSA, R.J. Reynolds and Lorillard are needlessly causing the State of Ohio to spend money (possibly millions of dollars) on protracted litigation. That money will not be available for other state priorities. In short, the tobacco companies are renegeing on their agreement, and Ohio taxpayers are once again stuck with the bill.

¹ Franklin County Court of Common Pleas, Case # 97-CVH-055114 (Judge David W. Fais)

² The current dispute is based primarily on R.J. Reynolds' and Lorillard's claim that they are entitled to a retroactive reduction of the 2004 MSA payments (based on a reduction in 2003 market share). This issue may continue to recur as market shares for subsequent years are disclosed.

³ The relevant law was passed in 1999 and codified at Ohio Rev. Code § 1346.01 *et seq.* The statute's constitutionality was recently upheld in *Carolina Tobacco Co. v. Petro*, 2006 Ohio 1205 (Ohio Ct. App. 2006).