IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
TEXARKANA DIVISION

STATE OF TEXAS, Plaintiff, VS. AMERICAN TOBACCO COMPANY, et al., Defendants.	No. 5-96CV-91

STATE OF TEXAS'S MOTION TO ENFORCE SETTLEMENT AGREEMENT

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I. INTRODUCTION

In 1998, the State of Texas reached a historic settlement with major cigarette manufacturers, resolving federal claims that asserted decades of unlawful conduct and sought a wide array of relief, including a comprehensive effort to change the public's understanding of the danger of smoking cigarettes, with the intent of severely reducing the sale and use of cigarettes, as well as reimbursement for potentially billions in healthcare costs.[1] The resulting Comprehensive Settlement Agreement (the "Texas Settlement Agreement") requires annual payments in perpetuity to the State by the settling defendant tobacco manufacturers ("Settling Defendants"). This Court retains jurisdiction over the Texas Settlement Agreement by explicit terms of the agreement itself and pursuant to a January 22, 1998 court order adopting it "as an enforceable order of this Court."[2]

The Texas Settlement Agreement makes clear that the annual settlement payments are owed into each year for perpetuity, and that the payments are intended to compensate Texas not just for cigarettes sold prior to settlement, but also for ongoing and future cigarette sales. All parties intended the Texas Settlement Agreement to be permanent—the agreement explicitly was binding upon all successors and assigns, and, in turn, all of *their* successors and/or assigns.[3] Further, the Texas Settlement Agreement required prior written consent before any right or obligation could be conveyed.[4]

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[1] *See* Comprehensive Settlement Agreement and Release (the "Texas Settlement Agreement"), attached to Final Judgment, entered Jan. 22, 1998 (docket no. 1866), is attached hereto as Exhibit A. Also attached and incorporated by reference are subsequent amendments; Stipulation of Amendment to Settlement Agreement and for Entry of Consent Decree, entered July 24, 1998, (docket no. 2049) attached hereto as Exhibit B; and Agreement to Amendment to Settlement Agreement, dated June 8, 2001, attached hereto as Exhibit C. Defendant Liggett entered into a separate settlement agreement that is unrelated to this matter.

[2] *See* Ex. A, Judgment ¶ 3 and Texas Settlement Agreement ¶ 1, at pp. 1, 3.

[3] *See* Ex. A, Texas Settlement Agreement ¶ 2, at 4.

[4] *Id*.

In a $7.1 billion deal, ITG Brands, LLC ("ITG") acquired four major cigarette brands (the "Acquired Brands") from Defendant and settling party R.J. Reynolds Tobacco Company ("Reynolds") in 2015. Reynolds assigned the Acquired Brands to ITG pursuant to an Asset Purchase Agreement ("APA") and additional related agreements. Though it acknowledged in the APA that the cigarettes were subject to the terms of the Texas Settlement Agreement, Reynolds did not seek or obtain prior consent from Texas as required. ITG was not a party to this lawsuit or the Texas Settlement Agreement, but it acknowledged the applicability of Texas Settlement Agreement to the Acquired Brands in the APA. Those same cigarettes subject to the Texas Settlement Agreement continue to be sold to Texans, now by ITG instead of Reynolds.

The contract between ITG and Reynolds assigning the Acquired Brands indicated a shared intent that ITG would make the required settlement payments for the Acquired Brands to Texas after the sale. Despite that agreement, and the provisions of the Texas Settlement Agreement adopted by this Court, neither Reynolds nor ITG has paid Texas for the Acquired Brands in accordance with the Texas Settlement Agreement since those brands were assigned to ITG.[5]

Reynolds has breached the Texas Settlement Agreement, either by failing to comply with the Texas Settlement Agreement's provisions regarding assignments or because ITG's assignment is not yet effective. Reynolds, thus, remains liable to Texas for the amounts that would have been due to Texas for the Acquired Brands by ITG.

Alternatively, ITG is liable. As a purported successor or assign of Reynolds, ITG had to assume Reynolds' liability for the Acquired Brands under the Texas Settlement Agreement. ITG

[5] Any tobacco company selling cigarettes in Texas that is not a party to the Texas Settlement Agreement must pay a Texas tobacco equity tax. Although ITG should be making payments pursuant to the Texas Settlement Agreement, ITG has instead been making an equity tax payment on the Acquired Brands since 2015. ITG, however, has even made misrepresentations regarding the amount it owes in equity tax. As an alternative to the Motion To Enforce, Texas has provided ITG with notice of the underpayment of the equity tax.

was aware of and acknowledged the Texas Settlement Agreement and amounts due thereunder, yet ITG has failed to make required payments to Texas for the Acquired Brands.

Either Reynolds or ITG, therefore, is in breach of the Texas Settlement Agreement because they have not paid and continue to refuse to pay amounts due under the Texas Settlement Agreement for the Acquired Brands. Texas asks the Court to enforce the Texas Settlement Agreement and its own order, to define the ongoing obligations of the Parties under the Texas Settlement Agreement, and to award damages for past and ongoing breaches.

II. PARTIES

Defendant Reynolds is a tobacco company that is a Settling Defendant under the Texas Settlement Agreement.

ITG is a Texas limited liability company headquartered in Greensboro, North Carolina. ITG was formerly known as Lignum-2, L.L.C and is a subsidiary of Imperial Tobacco Group, PLC, a public limited liability company incorporated under the laws of England and Wales.

III. JURISDICTION AND VENUE

This court had initial jurisdiction over this action pursuant to 28 U.S.C. § 1331, 28 U.S.C. § 1367, 15 U.S.C. § 15, and 18 U.S.C. § 1964. Compl. at 10 (docket no. 1); Fourth Am. Compl. at 8 (docket no. 1328). This Court has continuing exclusive jurisdiction over the parties and the enforcement of the Texas Settlement Agreement. *See* Ex. A, Comprehensive Settlement Agreement and Release 3-4, at 5 ("this Court shall retain jurisdiction for the purposes of . . . enforcing this Settlement Agreement"; parties agree to present "any claims for breach or enforcement of this Settlement Agreement, exclusively to this Court").

IV. FACTUAL BACKGROUND

A. Texas Originally Sued Tobacco Companies For Violations Of Federal Law.

Texas filed the underlying lawsuit making claims under federal law to recover damages from tobacco companies for decades of disinformation and denials regarding the dangerousness of their products. Compl. at 2. The lawsuit sought "to have the tobacco companies' liability to the State judicially recognized and to restore to the State's treasury those funds spent for tobacco-attributable costs to the Medicaid Program, the State Employee Retirement System, the State Employee Group Insurance Program, charity care, tobacco cessation programs and related wellness and health care programs and other damages." *Id.*

B. The Texas Settlement Agreement Requires Payments In Perpetuity by Reynolds.

The State of Texas, Texas's private counsel, and the Settling Defendants—Brown & Williamson Tobacco Corporation; Lorillard; Philip Morris USA Inc.; the United States Tobacco Company; and Reynolds—entered into the Texas Settlement Agreement on January 16, 1998. *See* Ex. A. The Texas Settlement Agreement provides that the Settling Defendants will make certain payments annually and in perpetuity. *See* Ex. B and Ex. C.[6]

The amount of annual payments due by the Settling Defendants under the Texas Settlement Agreement are calculated by the accounting firm PricewaterhouseCoopers ("PwC"). PwC estimates the amount due by December 31 each year, and subsequently adjusts the amount due based upon final reporting by the Settling Defendants, and which may result in a credit or amount due by April 30 of each year. PwC's calculations are based in part on reporting of nationwide sales

[6] The Texas Settlement Agreement was amended after a settlement by the state of Minnesota and the application of a most-favored-nation provision, from "sold" cigarettes to "shipped." Exhibits B and C are the 1998 and 2001 amendments. For background purposes, the states of Mississippi, Florida, and Minnesota also entered into settlement agreements with major tobacco manufacturers. Florida and Minnesota have also brought enforcement actions against ITG, and alternatively Reynolds, for failure to pay on the Acquired Brands. Litigation in Mississippi resulted in ITG becoming a party to that state's settlement agreement.

by the Settling Defendants under a Master Settlement Agreement ("MSA") entered into in November 1998, between tobacco manufacturers and forty-six other states (excluding Texas, Mississippi, Florida, and Minnesota).

C. ITG Expressly Assumed From Reynolds The Liability Of The Acquired Brands.

Subsequent to the 1998 Texas Settlement Agreement, due to a series of mergers and acquisitions, only three Settling Defendants remained in 2015—Philip Morris, Reynolds, and Lorillard. In June 2015, Reynolds and Lorillard effectively merged.[7] To secure antitrust clearance, Reynolds' parent company and Lorillard divested the Acquired Brands, selling the Acquired Brands to ITG for approximately $7 billion.[8] *See* Asset Purchase Agreement, dated July 15, 2014, attached hereto as Exhibit D. The sale of the Acquired Brands expressly included an assignment to ITG of Reynold's rights and obligations under the Texas Settlement Agreement. *See* Ex. D, § 2.01(a), (a)(vi) (Reynolds "shall . . . sell, convey, *assign*, transfer and deliver to [ITG]" transferred assets and "all benefits and credits under the State Settlements in respect of the Acquired Brands . . .) (Emphasis added.), at 10; § 2.01(c) (providing that ITG expressly assumes obligation of liability for the Acquired Brands), at 16. Specifically, the APA also provides that ITG expressly assumes the obligation to make settlement payments on the Acquired Brands and "[s]ubject to the Agreed Assumption terms, all Liabilities under the State Settlements[9] in respect of the Acquired Tobacco Cigarette Brands . . . including [] any recalculation or redetermination of

[7] The following parties agreed to the Texas Settlement Agreement: Plaintiff, the State of Texas; the Settling Defendants, which were five tobacco companies—Brown & Williamson Tobacco Corporation; Lorillard Tobacco Company, Inc.; Philip Morris; Reynolds; and the United States Tobacco Company; and the State of Texas's private counsel. *See* Ex. A at 5 (defining Settling Defendants). Subsequent to the 1998 Texas Settlement Agreement, due to a series of mergers and acquisitions, only three Settling Defendants remained in 2015—Philip Morris, Reynolds, and Lorillard. After the merger of Reynolds and Lorillard in June 2015, only Philip Morris and Reynolds remain as Settling Defendants.

[8] ITG purchased the cigarette brands Kool, Maverick, Salem, and Winston.

[9] The definition of "State Settlements" includes the date and description of the Texas Settlement Agreement. *See* Ex. A to Asset Purchase Agreement.

amounts due in respect of the Acquired [] Brands." § 2.01(c)(vii) ("Assumed Liabilities"), at 17; and § 2.04(a)(ii) (purchase price shall include "the assumption of the Assumed Liabilities by [ITG]"), at 20. To date, neither ITG nor Reynolds has paid the State for the amounts due on the Acquired Brands as required by the Texas Settlement Agreement from mid-2015 to present.

V. ARGUMENT

The Texas Settlement Agreement "shall be binding upon all Settling Defendants and their successors and assigns in the manner expressly provided for herein." Ex. A, Texas Settlement Agreement, ¶ 2, at 6, (Applicability). "None of the rights granted or obligations assumed under this Settlement Agreement by the parties hereto may be assigned or otherwise conveyed without the express prior written consent of all of the parties hereto." *Id.* These provisions reflect the intent of the Texas Settlement Agreement for the State of Texas to receive payments in perpetuity for the covered tobacco products. These provisions bind the Parties and their successors or assigns to the Texas Settlement Agreement.

Reynolds retains its obligations under the Texas Settlement Agreement to the extent it failed to properly assign or convey its rights and liabilities to ITG in a manner that would ensure that Texas received its due payments. Reynolds breached its contractual obligation to obtain written consent from all parties prior to assignment and its continuing obligation to pay for the Acquired Brands. Reynolds' agreement to make payments in perpetuity remains effective.

Alternatively, after ITG purchased the Acquired Brands from Reynolds in June 2015, ITG breached the Texas Settlement Agreement by failing to pay Texas the amounts due on the Acquired Brands. Because neither Reynolds nor ITG has paid the amounts due on the Acquired Brands, Texas suffered losses in 2015, 2016, 2017, 2018, and continues to be shortchanged any additional amounts due until a final judgment is entered by this Court.

The Court should award damages for breach of the Texas Settlement Agreement by either ITG or Reynolds and declare the parties' ongoing obligations. *See, e.g.*, *PEG Bandwidth TX v. Texhoma Fiber, LLC*, 299 F. Supp. 3d 836, 842 (E.D. Tex. 2018) (noting that elements of breach of contract claim are: "(1) the existence of a valid contract between plaintiff and defendant; (2) the plaintiff's performance or tender of performance; (3) the defendant's breach of the contract; and (4) the plaintiff's damage as a result of the breach" (quotations and citations omitted)). Under Texas law, settlement agreements are interpreted like other contracts. *See, e.g.*, *Sandt v. Energy Maint. Servs. Grp. I*, 534 S.W.3d 626, 643 (Tex. App.—Houston [1st Dist.] 2017, pet. denied).

A. Reynolds Is Liable For Breach Of The Texas Settlement Agreement.

Reynolds breached the Texas Settlement Agreement when it transferred the Acquired Brands without obtaining Texas's written consent. By doing so, Reynolds is liable for shortchanging Texas in two distinct ways. First, if Reynolds failed to transfer liability under the Texas Settlement Agreement when it assigned the Acquired Brands to ITG, Reynolds remains liable to Texas for any amounts due for the Acquired Brands. Second, *even if* the assignment to ITG transferred all liability for the Acquired Brands, Reynolds' unilateral, unapproved action manipulated calculations of the amount Reynolds owes under the Texas Settlement Agreement. Reynolds remains liable for underpaying Texas settlement amounts attributable to its other brands (including those acquired from Lorillard).

1. Reynolds remains liable for the Acquired Brands.

If Reynolds failed to assign the rights and obligations of the Texas Settlement to ITG for the Acquired Brands, then Reynolds is still obligated to pay on the Acquired Brands. *See* Ex. A, ¶ 2, at 6, ("None of the rights granted or obligations assumed under this Settlement Agreement by the parties hereto may be assigned or otherwise conveyed without the express prior written consent

of all the parties hereto."). Even when an obligor such as Reynolds assigns its duties or obligations under a contract to another party, the obligor remains liable to the obligee, here the State of Texas, unless the obligee agrees to discharge the obligor's duties, via a novation. *See* RESTATEMENT (SECOND) OF CONTRACTS § 318 cmt. d (AM. LAW INST.) ("[a]n obligor is discharged by the substitution of a new obligor only if the contract so provides or the obligee [the State] makes a binding manifestation of assent, forming a novation.") (emphasis added). Stated differently, absent the express prior written consent of Texas, Reynolds remains liable for the payment on the Acquired Brands.

"Generally speaking, a party cannot escape its obligations under a contract merely by assigning the contract to a third party." *Seagull Energy E & P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342, 346-47 (Tex. 2006) ("Thus as a general rule, a party who assigns its contractual rights and duties to a third party remains liable unless expressly or impliedly released by the other party to the contract."); RESTATEMENT (SECOND) OF CONTRACTS § 318(3) (AM. LAW INST.) ("Unless the obligee agrees otherwise, neither delegation of performance nor a contract to assume the duty made with the obligor by the person delegated discharges any duty or liability of the delegating obligor.").[10] A Florida district court considering the effect of the merger on Florida's settlement

[10] There is ample authority standing for this proposition, including *Honeycutt v. Billingsley*, 992 S.W.2d 570 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) (regarding a contingency fee agreement); *Vandeventer v. All Am. Life & Cas. Co.*, 101 S.W.3d 703, 712-13 (Tex. App.—Fort Worth 2003, no pet.) (novation is a question of parties' intent and is never presumed, rather there must be "clear definite intention on the part of all concerned that such is the purpose of the agreement"). *See also PEG Bandwidth*, 299 F. Supp. 3d at 843 (master services agreement regarding cellular communications services) (citing to *Seagull* for the proposition that "an assignment relieves a party of its obligations only if it effects a novation" and ruling that a seller-company was not released from its obligation after it assigned its interests to buyer-company); *Alliance Imaging, Inc. v. PRHC-Ennis, L.P.*, No. 3:02-CV-1479, 2003 WL 21266753, at *5 (N.D. Tex. May 30, 2003) (finding that original contract not distinguished where no evidence existed of a new contract (citing to *Honeycutt*)) RESTATEMENT (SECOND) OF CONTRACTS § 328, cmt. a (AM. LAW INST.) states "[a] duty cannot be 'assigned' in the sense in which 'assignment' is used in this Chapter. The parties to an assignment, however, may not distinguish between assignment of rights and delegation of duties. A purported 'assignment' of duties may simply manifest an intention that the assignee shall be substituted for the assignor. Such an intention is not completely effective unless the obligor of the assigned right joins in a novation . . ."). A novation is "the substitution of a new agreement between the same parties or the substitution of a new party on an existing agreement." *Honeycutt*,

agreement concluded that Reynolds retained its perpetual liability, despite assigning brands to ITG.[11]

Here, Texas is a party to the Texas Settlement Agreement and has not released Reynolds from its obligations to pay on the Acquired Brands. Texas would have to assent to Reynolds no longer being liable under the Texas Settlement Agreement to make annual payments for the Acquired Brands. *See Seagull*, 207 S.W.3d 342. In *Seagull*, the Supreme Court of Texas addressed whether sale of an oil and gas interest released a seller from its contractual obligations to reimburse operator for costs. *Id.* The court held that "despite selling its working interest, the seller remains liable under the operating agreement, unless released by the operator or the terms of the agreement," reasoning that "[b]ecause neither the operating agreement nor the operator expressly released the seller from its obligations under that agreement," the seller was still liable to the obligee-operator. *Id.* at 344. The court noted that the dispute "turn[ed] on whether the parties to the operating agreement expressly agreed upon the consequences that should follow an assignment of one's interests to a third party." *Id.* at 345 (noting that when interpreting a contract a court's primary concern is "to ascertain and give effect to the intent of the parties as that intent is expressed in the contract" and to discern this intent courts "examine and consider the entire writing in an effort to give effect to all the provisions of the contract so that none will be rendered meaningless" (italics omitted)).[12] Similarly here, Texas has not agreed to release Reynolds from its obligations under the Texas Settlement Agreement. Any argument by Defendants that a transfer of covered

992 S.W.2d at 576 (elements of novation are: "(1) a previous, valid obligation; (2) an agreement of the parties to a new contract; (3) the extinguishment of the old contract; and (4) the validity of the new contract").

[11] *See* Order Granting-in-Part Settlement-Agreement-Enforcement Motions by Florida and Philip Morris, *State of Fla. v. Am. Tobacco Co.*, No. 95-CA-1466 AE MB (Fla. Cir. Ct. Dec. 27, 2017), copy attached as Exhibit E.

[12] Here the Texas Settlement Agreement did make clear what would occur upon assignment, as the settlement is "binding upon all Settling Defendants and their successors and assigns . . . ." Ex. A, ¶ 2, at 6. Consequently, a primary question before the court is whether there was an assignment, thus making ITG liable under the Texas Settlement, or whether Reynolds remains liable because it failed to transfer the liability to ITG.

tobacco products to another releases both from any liability under the Texas Settlement Agreement is contradicted both by the plain intent of the agreement and Defendants' own statements and actions.

Reynolds also failed to acquire the express prior written consent of all parties to the Texas Settlement Agreement before attempting its assignment or conveyance of its obligations under the Texas Settlement Agreement to ITG as was required by the Texas Settlement Agreement. *See* Ex. A ¶ 2, at 6. Texas did not release Reynolds from its obligations. Consequently, Reynolds breached the Texas Settlement Agreement with respect to its purported assignment or conveyance to ITG; Reynolds is liable for damages to the extent that breach prevents the State from recovering sums it otherwise would recover from the Texas Settlement Agreement. *See, e.g., In re Deepwater Horizon*, 785 F.3d 986, 994 (5th Cir. 2015) (settlement agreements are governed by contract principles). The mere sale of the Acquired Brands does not relieve Reynolds of its obligation to pay Texas under the Texas Settlement Agreement. *Seagull*, 207 S.W.3d at 346-47.

Because Reynolds has not been released from its obligation to pay, and breached its duties under the Texas Settlement Agreement with respect to its assignment or conveyance (or attempted assignment or conveyance) to ITG, it is liable to Texas for the amounts due for the Acquired Brands for the years 2015, 2016, 2017, 2018, and into the future.

2. Reynolds is liable for underpayments to Texas on its remaining brands.

Reynolds also breached the Texas Settlement Agreement by failing to account for the transfer of the Acquired Brands with respect to its annual settlement payments. The amount a Settling Defendant owes Texas in a given year is calculated based on a number of factors. Among them are the Settling Defendant's volume of domestic tobacco product sales and its profitability, both compared to a defined "Base Year." *See generally* Ex. C, Appendix A, at 13, "Formula for

Calculating Volume Adjustments." Reynolds assigned the Acquired Brands to ITG and attempted to assign the future liability for those brands, without Texas's express written consent, as required by the Texas Settlement Agreement. When it did so, Reynolds failed to also adjust the Base Year values to provide an accurate comparison of present volume and profitability. This resulted in an artificially-lowered calculation of amounts Reynolds owes Texas each year for shipments of the tobacco brands it retained. By eliminating the four Acquired Brands from its present year calculations, while retaining the associated volume and the expenses attributable to those brands in its Base Year comparison, Reynolds benefits from an unfair and inaccurate under calculation of amounts it owes Texas. Including the four brands in the Base Year but not the present year adjusts the calculation, and gives Reynolds a financial benefit, as if smokers of the Acquired Brands all had suddenly quit—when, in fact, the sales of those cigarettes continue in Texas today. Texas seeks Court intervention to cure the ongoing under calculation of the amounts Reynolds owes Texas each year. Texas also seeks reimbursement of the amounts Reynolds has failed to pay Texas due to the under calculations each year.

B. ITG, as Reynolds' Assign, Expressly Agreed To Assume Liability For The Acquired Brands.

Alternatively, ITG is responsible for the Texas Settlement Agreements payments to Texas, and Texas has a right to enforce the obligations ITG assumed in the APA to make settlement payments related to the Acquired Brands.[13] Pursuant to its terms, the Texas Settlement Agreement

[13] Moreover, the State of Texas appears to be a third-party beneficiary of the APA. *See, e.g., Stine v. Stewart*, 80 S.W.3d 586, 589 (Tex. 2002) (noting that party's status as third-party beneficiary depends solely on parties' intent and holding that contract expressly provided that parties intended to satisfy a debt and detailed how parties would satisfy that debt); *MCI Telecomms. Corp. v. Tex. Util. Elec. Co.*, 995 S.W.2d 647, 651 (Tex.1999). *See also* RESTATEMENT (SECOND) OF CONTRACTS § 318 cmt. d ("[T]he obligee [the State] retains [its] original right against the obligor [Reynolds], even though the obligor manifests an intention to substitute another obligor in his place and the other purports to assume the duty. The obligee [the State] may, however, have rights against the other as an intended beneficiary of the promise to assume the duty.").

"shall be binding upon all Settling Defendants and their successors and assigns in the manner expressly provided for herein." Ex. A, ¶ 2, at 6. In the Asset Purchase Agreement, sellers agreed to "sell, convey, *assign*, transfer and deliver" four cigarette brands acknowledged to be subject to the Texas Settlement Agreement. *See* Ex. D, § 2.01 (a) (emphasis added), at 10. Texas courts have noted that the term "assign" "in its most general sense means the transfer of property or some right or interest from one person to another." *Concierge Nursing Ctrs., Inc. v. Antex Roofing, Inc.*, 433 S.W.3d 37, 45 (Tex. App.—Houston [14th Dist.] 2013, pet. denied) (analyzing rights in context of an insurer's right to recover under a contractual claim). *See also Univ. of Tex. Med. Branch at Galveston v. Allen*, 777 S.W.2d 450, 452-53 (Tex. App.—Houston [14th Dist.] 1989, no writ) (providing overview of the meaning of assign). Both parties to the APA expected ITG to take over payments to Texas once it acquired the brands: ITG expressly agreed, subject to "Agreed Assumption Terms," to assume the obligation to make settlement payments on the Acquired Brands. *See* Ex. D, § 2.01(c), at 16. Here, ITG's sales on the Acquired Brands are sales by an assign of Reynolds, and must be reported by ITG and included in PwC's payment calculations.

The APA indicates a clear intent for ITG to assume Reynold's and Lorillard's obligations to make settlement payments related to the Acquired Brands, and for ITG to use its best efforts to join the Texas Settlement Agreement (as well as the settlement agreements of three other states—Mississippi, Florida and Minnesota). *See* Ex. D, § 2.01(c)(vii) (providing that, "[s]ubject to the Agreed Assumption Terms," ITG assumes liability from Reynolds of "all Liabilities under the State Settlements in respect of the Acquired [] Brands"), at 17; § 2.04(a)(ii) (Purchase Price shall be . . . . "the assumption of the Assumed Liabilities by [ITG]"). Attachment F to the Asset Purchase Agreement, "Agreed Assumption Terms," specifies the basis for calculating "amounts payable after the Closing Date by the Acquiror [ITG] under the State Settlements [including the Texas

Settlement Agreement]," indicating an understanding that ITG would be paying those amounts after sale of the brands. Ex. D, Att. F, § 4.4, at 143; *see also* Lorillard Transfer Agreement, Ex. D, Att. I at 2 ("Lorillard wishes to have [ITG] assume directly from Lorillard certain liabilities"), at 197. Lastly, ITG agreed to use reasonable best efforts to reach agreement with Texas to assume "the obligations of a Settling Defendant" with respect to the Acquired Brands. Ex. D, Att. F ["Agreed Assumption Terms"], art. II, §§ 2.1, 2.2.[14]

In Texas, a buyer assumes a seller's liabilities if expressly agreed to. *See* TEX. BUS. ORGS. CODE ANN. § 10.254 (unless provided for by another statute, "a person acquiring property described by this section may not be held responsible or liable for a liability or obligation of the transferring domestic entity that is not expressly assumed by the person"). Here, ITG expressly listed the Texas Settlement Agreement as an assumed liability. *See* Ex. D, Att. F. *See, e.g., Tyco Valves & Controls, L.P. v. Colorado*, 365 S.W.3d 750, 774 (Tex. App.—Houston [1st Dist.] 2012, pet. granted) (noting that in light of section 10.254 and the requirement of express assumption of liability, "the use of the contractual language of 'successors and assigns,' when connoting assumption of future liability to perform a particular act—such as offering comparable employment—extends to a business entity that makes an express agreement to assume such an obligation as part of an asset purchase"), *aff'd on other grounds*, *Colorado v. Tyco Valves & Controls, L.P.*, 432 S.W.3d 885 (Tex. 2014); *Lockheed Martin Corp. v. Gordon*, 16 S.W.3d 127, 135 (Tex. App.—Houston [1st Dist.] 2000, pet. denied) (in the context of products liability, a purchase of an asset does not make the purchaser liable unless "the acquiring entity expressly

[14] In the APA, Reynolds and ITG purport to define values without advising or consulting Texas. This evidences an intent for ITG to assume the required perpetual settlement payments to Texas, and it also negatively impacts the amounts recovered from Reynolds for the brands it did not assign. Texas seeks the amounts not recovered because Reynolds and ITG agreed to unilaterally adjust the appropriate baseline(s) for damage calculations.

assumes the liability of the obligation" (citing to previous version of TEX. BUS. ORGS. CODE ANN. § 10.254(b)). Here, ITG expressly assumed the liabilities of the Acquired Brands.

ITG's shipments of the Acquired Brands are as an assign of Reynolds, and ITG has expressly assumed Reynolds' liability to make perpetual payments on the Acquired Brands. Thus, the Acquired Brands must be included in PwC's relevant settlement payment calculations as to ITG. The exclusion of the Acquired Brands from PwC's calculations has damaged the State by lowering the amount of payment due the State annually as provided for in the Texas Settlement Agreement. *See* Appendix A to Ex. B, at 45, and Ex. C, at 13. Because ITG has failed to pay on the Acquired Brands, ITG is liable to the State of Texas for the amounts due to Texas for the Acquired Brands for the years 2015, 2016, 2017, 2018, and any current year up to the date of a final judgment by the Court, plus interest.

VI. CONCLUSION AND PRAYER

The proposition that somehow neither ITG nor Reynolds is liable for payments on the Acquired Brands would defeat the purpose and intent of the Texas Settlement Agreement. A Settling Defendant cannot defeat the liabilities and responsibilities to Texas by simply selling a brand of cigarette to another company. *See Arbor Windsor Court, Ltd. v. Weekley Homes, LP*, 463 S.W.3d 131, 138 (Tex. App.—Houston [14th Dist.] 2015, pet. denied) (court will avoid interpretation of a contract that would lead to an absurd result and thus an impermissible construction). Consequently, the Court should find that either Reynolds or ITG is liable to Texas to make payments on the Acquired Brands.

The State of Texas prays that the Court will (1) find that Reynolds has breached the Texas Settlement Agreement; (2) find that Reynolds remains liable for the Acquired Brands; (3) find that Reynolds has breached the Texas Settlement Agreement by using inaccurate baselines as to

volume and expenses, resulting in under calculations of the amounts it owes Texas for the brands it currently holds; and (4) award Texas damages, reasonable attorney's fees, expenses, costs, and prejudgment and post-judgment interest for this breach.

Alternatively, the State of Texas prays that upon final hearing the Court will (1) find that ITG is an assign of Reynolds with respect to the Acquired Brands; (2) find that ITG is and will continue to be liable for payments under the Texas Settlement Agreement on the Acquired Brands; (3) find that ITG has breached the Texas Settlement Agreement by failing to make these payments; (4) award Texas damages, reasonable attorney's fees, expenses, costs, and prejudgment and post-judgment interest. The State of Texas also prays that the Court award such other and further relief, both general and special, at law and in equity, to which the State of Texas may be justly entitled.

Respectfully submitted.

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CERTIFICATE OF CONFERENCE

I hereby certify that in September 2018, counsel from the Office of the Attorney General of Texas conferred with counsel for Reynolds and with counsel for ITG. Counsel for ITG and Reynolds indicated they are opposed to the relief requested in Texas's Motion to Enforce and confirmed that position in subsequent correspondence. Based on those communications, ITG opposes this motion to join. Counsel for Plaintiff spoke with counsel for R.J. Reynolds on January 28, 2019 regarding the instant motion. RJ Reynolds has not yet provided its position on this motion, but Plaintiff will supplement the certificate of conference once RJ Reynolds provides its position. Defendant Philip Morris USA Inc. does not oppose this motion to join.

/s/ *Elizabeth J. Brown Fore*
ELIZABETH J. BROWN FORE
Deputy Division Chief

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the State's *Motion to Enforce Settlement Agreement* has been served via the electronic case filing system with the Court on this the 28th day of January, 2019. ITG Brands, LLC is being served through its registered agent for service of process, Corporation Service Company d/b/a CSC-Lawyers Incorporating Service Company, 211 E. 7th Street, Suite 620, Austin, Texas 78701-4234, in accordance with Rule 4 of the Federal Rules of Civil Procedure.

/s/ *Elizabeth J. Brown Fore*
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Deputy Division Chief