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

THE STATE OF TEXAS,	§	
	§	
Plaintiff,	§	
	§	
v.	§	**CIVIL ACTION NO. 5:96-CV-00091-JRG**
	§	
AMERICAN TOBACCO CO, PHILIP MORRIS USA, IMPERIAL TOBACCO GROUP BRANDS, LLC, R.J. REYNOLDS TOBACCO COMPANY ET AL.	§	
	§	
Defendants.	§	

MEMORANDUM OPINION AND ORDER

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Introduction

In January of 1998, faced with potentially crippling liability and a fellow tobacco manufacturer who had decided to cooperate with the State of Texas ("Texas"), the nation's remaining major tobacco manufacturers agreed to settle all claims with Texas on the eve of a trial set to begin in the United States District Court for the Eastern District of Texas, Texarkana Division.[1] Over twenty years later, this Court now confronts disputes emanating from that settlement.

The Texas Comprehensive Settlement Agreement and Release ("Texas Settlement") provides that each settling defendant would make annual payments to Texas in perpetuity. After being amended twice, the final Texas Settlement provided that payments to Texas would be based on the number of cigarettes sold each year, in order to proportionately compensate Texas for the money it spends providing medical treatment to its citizens suffering from illnesses caused by the accused tobacco products. The Texas Settlement payments were perpetual by design to continually reimburse Texas for the increase in its citizens' healthcare costs. In exchange for these perpetual payments, Texas furnished each settling defendant with an equally perpetual release from

[1] Justice Don Willett, writing for the Texas Supreme Court, subsequently set out the circumstances giving rise to this case:

> This case arises in part from historic litigation that buffeted the tobacco industry in the last decade of the twentieth century. The Lone Star State was a significant player in that litigation. Just over twenty years ago, Texas sued several of the nation's leading tobacco companies, asserting violations of numerous state and federal fraud, racketeering, antitrust, conspiracy, and other laws.
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> Texas's claims were that these companies knowingly misrepresented their products as safe and targeted minors in their advertisements. More than 40 states filed similar suits against the tobacco industry. The companies' collective defense faltered, however, when one of the companies, Liggett, settled with Texas and several other states (the Liggett Settlement), agreeing in large part to cooperate with the states in their suits against the remaining defendants.

Hegar v. Tex. Small Tobacco Coal., 496 S.W.3d 778, 781 (Tex. 2016) (Willett, J.).

liability—Texas forever waived any claims related to the use of or exposure to their tobacco products.

The Texas Settlement framework largely functioned as anticipated for seventeen years. However, in 2015, one of the settling manufacturers—R.J. Reynolds Tobacco Company ("Reynolds")—informed Texas that it no longer intended to make Texas Settlement payments regarding a sizeable number of cigarettes. Reynolds explained that it had sold four of its major brands—Winston, Salem, Kool, and Maverick ("Acquired Brands")—for approximately seven billion dollars, and that it would no longer make payments to Texas for those brands.[2] The purchaser-by-assignment of the Acquired Brands, Imperial Tobacco Group Brands, LLC ("Imperial"), similarly disclaimed any intent to compensate Texas under the Texas Settlement for the sale of cigarettes produced under the Acquired Brands. According to Reynolds and Imperial, liability for the annual sales of those sixteen billion cigarettes had been extinguished by virtue of the contract assigning those brands to Imperial. Reynolds disclaimed liability because it no longer owned the Acquired Brands; Imperial disclaimed liability because it is not a signatory to the Texas Settlement. Instead, Reynolds and Imperial took the position that Texas must file a new lawsuit against Imperial if it wanted to be compensated for sales under the Acquired Brands going forward.

Texas disagreed. After sending a formal demand to Imperial and Reynolds, Texas filed its Motion to Enforce the Texas Settlement ("Texas' Motion to Enforce"). Texas claims that nothing in the Texas Settlement gives settling defendants, such as Reynolds, the power to unilaterally extinguish their liability, and Texas advances theories of contract liability applicable to both Reynolds and Imperial. Texas urges that under well-settled Texas law, a contracting party cannot unilaterally eliminate its obligations under a contract via an assignment to a third party. Texas also

[2] Approximately 16,000,000,000 cigarettes are manufactured and sold every year under these four brands.

emphasizes that the Texas Settlement expressly binds successors and assigns, and Imperial acknowledges itself to be an "assign" of the Acquired Brands in the contract by which it purchased those brands. Finally, Texas urges that the central purposes of the Texas Settlement—finality and medical reimbursement—would be undercut if a settling defendant could eliminate its obligations under the Texas Settlement, while still profiting from the sales of those same cigarettes via a sale of the brands themselves.

Philip Morris USA ("PMUSA"), the only remaining settling defendant[3] from the Texas Settlement (besides Reynolds) filed a similar Motion to Enforce the Texas Settlement ("PMUSA's Motion to Enforce") (collectively, "Motions to Enforce"). PMUSA based its motion on injuries it claims arise from Reynolds' wrongful distortion of the relative payment allocation system created within the Texas Settlement. PMUSA asserts that the less Reynolds pays, the more it pays. PMUSA also represents that if this Court recognizes a route for Reynolds to escape the obligations imposed by the Texas Settlement, PMUSA will likely do the same.

The Texas Settlement is a contract, and the role of this Court in interpreting that contract is to ascertain the expressed intent of its parties. As such, the question presented by the Motions to Enforce is whether the signatories to the Texas Settlement expressed an intent to allow the settling tobacco manufacturers to unilaterally extinguish their payment obligations under the Texas Settlement by selling the brands which form the subject matter of the Texas Settlement. For the reasons described herein, the Court concludes they did not.

Accordingly, having considered the Motions to Enforce, and for the reasons set forth herein, Texas' Motion to Enforce (Dkt. No. 2214) is **GRANTED-IN-PART**, **DENIED-IN-**

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[3] While PMUSA is formally postured as a defendant to the underlying civil litigation, PMUSA joins Texas' effort to enforce the Texas Settlement. Accordingly, in this Order, the Court will use the designation "Defendants" to refer collectively to only Imperial and Reynolds, who jointly oppose the motions urged by Texas and PMUSA.

PART, and **CARRIED-IN-PART** to the extent and as set forth herein. For the same reasons, PMUSA's Motion to Enforce (Dkt. No. 2222) is **GRANTED-IN-PART**, **DENIED-IN-PART**, and **CARRIED-IN-PART** to the extent and as set forth herein.[4]

I. <u>Factual and Procedural History</u>

A. Original Litigation

Texas filed the litigation which gave rise to the Texas Settlement on March 28, 1996. Texas alleged that medical research increasingly showed that consumption of tobacco products had harmful health consequences and that Texas had spent significant sums of money through its delivery of Medicaid and other state-level healthcare programs to "citizens who suffer, or have suffered, from tobacco related injuries, disease or sickness" resulting from the settling defendants' tobacco sales. *Original Complaint*, Dkt. No. 1 at 5. According to the Complaint, the nation's major tobacco manufacturers had systematically targeted children and youth with cigarette advertisements, in order to produce early-in-life addiction, and had collectively conspired to produce misinformation about the medical effects of cigarette consumption, cumulatively costing Texas billions of dollars in medical expenses. On the basis of these factual allegations, Texas asserted violations of the Federal Racketeer Influenced and Corruption Act, violations of federal and state antitrust law, and a panoply of state-level products liability and tort theories related to Texas' healthcare expenditures related to tobacco-related illnesses. *Fourth Amended Complaint*, Dkt. No. 1328.

[4] At the joint request of the parties, the Court previously issued an order bifurcating the issue of liability under the Texas Settlement from an issue related to the relative allocation of payment obligations between the settling defendants—an issue primarily advanced by PMUSA, as the party whose relative payment obligations have been allegedly distorted as a result of the sale of the Acquired Brands. *See Bifurcation Order*, Dkt. No. 2328. Since this Order determines that Reynolds remains liable under the Texas Settlement for the payments on the Acquired Brands, the remaining issue related to profit adjustment now appears moot. The Court will invite additional briefing on the disposition of the profit adjustment issue in a separate order filed contemporaneously herewith.

Texas named every major domestic tobacco manufacturer as a defendant. The list of such defendants includes: The American Tobacco Company; R.J. Reynolds Tobacco Company; Brown & Williams Tobacco Corporation; B.A.T. Industries P.L.C.; Philip Morris, Inc.; Liggett Group, Inc. ("Liggett"); Lorillard Tobacco Company, Inc. ("Lorillard"); and the United States Tobacco Company.[5]

B. The Texas Settlement, the Master Settlement Agreement, and the Other Previously Settled States ("PSS") Agreements

The negotiations giving rise to the Texas Settlement began in earnest when one of the nation's largest tobacco manufacturers—Liggett—settled with the several states that had brought suit, and "agree[d] in large part to cooperate with the states in their suits against the remaining defendants." *Hegar v. Tex. Small Tobacco Coal.*, 496 S.W.3d 778, 781 (Tex. 2016). The Texas Supreme Court has succinctly summarized the events giving rise to the Texas Settlement after Liggett began cooperating with the several states:[6]

> Shortly thereafter, the states and tobacco defendants executed a Memorandum of Understanding and Proposed Resolution (Proposed Resolution). The Proposed Resolution sought "to forge an unprecedented national resolution of the principal issues and controversies associated with the manufacture, marketing and sale of tobacco products in the United States." According to the Proposed Resolution, federal legislation would provide the vehicle for implementing the solution and ensuring "comprehensive regulation of the tobacco industry while preserving the right of individuals to assert claims for compensation."
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> The Proposed Resolution would primarily require the remaining defendants to make annual payments in perpetuity "to fund health benefits program expenditures and to establish and fund a tobacco products liability judgments and settlement fund." Those payments would total approximately $368.5 billion over the first 25 years. The payments would be adjusted for inflation and changes in the defendants' sales. The Proposed Resolution would also impose significant limitations on the defendants' marketing of their products. In return, the states would waive their claims against the defendants as well as future claims arising from the sale or use

[5] As a result of mergers and acquisitions, the majority of these manufacturers no longer exist as they did when this action was commenced. The only remaining settling defendants are PMUSA and Reynolds.

[6] Justice Don Willett, writing for a unanimous Texas Supreme Court.

of tobacco products. The Proposed Resolution never became federal law, but it would serve as the blueprint for several settlements in the following months.

The Master Settlement Agreement (MSA) was the largest of the subsequent settlements, involving 46 states plus American territories and the District of Columbia (collectively, settling states). Under the MSA, the settling states released past, pending, and future claims against the remaining defendants (deemed "participating manufacturers") that sought "recovery for Medicaid and other public health expenses incurred in the treatment of smoking-induced illnesses." Tracking the Proposed Resolution, the MSA required the participating manufacturers to make initial payments followed by perpetual annual payments based on their market share and product sales. The MSA also imposed marketing restrictions on the participating manufacturers, forbidding advertising to minors and requiring initiatives to prevent such advertising. The MSA permits other tobacco manufacturers to join the MSA, generally requiring these "subsequent participating manufacturers" to comply with the MSA's restrictions and ongoing payment scheme to receive the same release of claims that the participating manufacturers received.

Texas was not a party to the MSA. Instead, Texas and three other states—Minnesota, Mississippi, and Florida—reached individual settlements with the remaining tobacco defendants. For purposes of this case, the differences between these settlements are negligible. The Texas Comprehensive Settlement Agreement and Release (Comprehensive Settlement) accomplished much of what the Proposed Resolution would have accomplished, exemplified by the Comprehensive Settlement's constant invocation of the Proposed Resolution and the Proposed Resolution's attachment to the Comprehensive Settlement as an appendix. It stated that Texas and the remaining defendants (settling manufacturers)—Philip Morris, Inc., R.J. Reynolds Tobacco Co., Brown & Williamson Tobacco Co., Lorillard Tobacco Co., and United States Tobacco Co.—desired to settle on terms "comparable to those contained in the Proposed Resolution, which terms will achieve for Texas immediately and with certainty the financial benefits it would receive pursuant to the Proposed Resolution."

The Comprehensive Settlement required the settling manufacturers to make initial payments to Texas of $725 million—Texas's 7.25% share of the $10 billion initial payment to the states set out in the Proposed Resolution. The Comprehensive Settlement also required the settling manufacturers to make annual payments in perpetuity. Adjusted by inflation and the settling manufacturers' market share and product sales, the payments may increase, decrease, and even end if a manufacturer stops selling tobacco products altogether. The Comprehensive Settlement stated that the initial payments "constitute[d] reimbursement for public health expenditures by the State of Texas." It further stated that "[a]ll other payments . . . are in satisfaction of all of the State of Texas's claims for damages incurred by the State in the year of payment or earlier years, including those for reimbursement of Medicaid expenditures and punitive damages." Pursuant to a most-favored-nation

> provision, the amount of the payments corresponds to the amount required under the Minnesota settlement, which costs settling manufacturers approximately $0.64 per cigarette pack. The parties to this litigation do not dispute that the settling manufacturers' payments to the State result in annual revenue of approximately $500 million.
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> As in the MSA and Proposed Resolution, the Comprehensive Settlement prohibited the settling manufacturers from marketing to minors and required them to support programs created to reduce underage smoking. Further, the Comprehensive Settlement prevented the settling manufacturers from opposing any legislative or administrative initiatives to strengthen penalties for tobacco-product sales to minors and for minors in possession of those products.
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> In return, the Settlement secured robust immunity for the settling manufacturers, though they admitted no wrongdoing and disclaimed any liability. Texas released all past claims "that were or could have been made in this action or any comparable federal or state action." And as to future claims, Texas released those claims "directly or indirectly based on . . . the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without any limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products."

Id. at 781–83. As noted by the Fifth Circuit, after "the parties executed the original [Texas Settlement] they have amended it twice."[7] *Texas v. Am. Tobacco Co.*, 463 F.3d 399, 401–02 (5th Cir. 2006). "On July 24, 1998, the parties entered into the Stipulation of Amendment to Settlement Agreement and for Entry of Consent Decree ('1998 Amendment'), and on June 8, 2001, the parties entered into the Agreement to Amendment to Settlement Agreement ('2001 Amendment')." *Id.* at 402.

> The 1998 Amendment reflects Texas' exercise of its rights under the Original Agreement's "Most Favored Nation" provision to adopt the more favorable terms of the settlement agreement reached between the Settling Defendants and the State of Minnesota on May 8, 1998. The Original Agreement tied the formula for calculating the annual payments to the "respective share of *sales* of cigarettes by unit for consumption in the United States." Apparently, some of the Settling Defendants began marketing cigarettes in "two for one" or "buy two get one free" promotions. "Free" cigarettes given as part of such promotions would likely be excluded from the annual payment calculations of the Original Agreement because they would not have been considered cigarettes "sold." Perhaps recognizing the

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[7] As used herein, the Court will refer to the original settlement along with the two amendments collectively as the "Texas Settlement."

> potential decrease in the amount of the settlement payments presented by these promotions, the settlement agreement reached between the State of Minnesota and the Settling Defendants tied the Settling Defendants' annual payment obligations to *shipped* cigarettes. Texas and the Settling Defendants thereafter entered into the 1998 Amendment, which changed the annual payment provisions by tying the annual payment calculations to the "number of cigarettes *shipped* for domestic consumption." *See 1998 Am.,* at Appx. A (emphasis added).

Id.

The 1998 Amendment also requires each settling defendant to make payments to the private lawyers hired by Texas to represent it in prosecuting the underlying action ("Private Counsel"). *1998 Amdt.*, Dkt. No. 2222-2 at 24 § 22. Specifically, the 1998 Amendment included a provision incorporating a document entitled the Texas Fee Payment Agreement, which provided that each settling defendant would make payments to Texas' Private Counsel based on each settling defendant's Market Share. *Id.* at 27 § 24 (integrating the Texas Fee Payment Agreement as part of the "entire, complete and integrated statement" of the terms of the Texas Settlement); *see also generally Texas Fee Payment Agreement*, Dkt. No. 2222-11.

The payment to Texas' Private Counsel was made in addition to the payment made by settling defendants to Texas itself. *See Texas Fee Payment Agreement*, Dkt. No. 2222-11 at 2 § 1. The payment to Texas' Private Counsel is calculated using the same definition of Market Share as the payment made to Texas under the Texas Settlement. *Id.* at 16 § 24 ("Terms used herein that are defined in the Settlement Agreement . . . are . . . used in this Agreement as defined in the Settlement Agreement."); *compare id.* at 13 § 15(d) (defining the Texas Fee Payment Agreement obligation as follows: "Each Settling Defendant shall severally pay, ***pro rata in proportion to its respective Market Share***, its share of the amounts" of payment due to Texas' Private Counsel), *with 1998 Amdt.,* Dkt. No. 2222-2 at 11 § 7 (defining the Texas Settlement payment obligation as follows: "Each of the Settling Defendants . . . agrees that, on December 31, 1999 and annually thereafter on December 31st of each year after 1999 . . . it shall severally cause to be paid . . . ***pro rata in proportion to its Market Share***, its share of" the amounts due to Texas under the Texas Settlement).

The 2001 Amendment was also directed towards the specifics of payment calculation and addressed the definition of the term "net operating profits" as used in the 1998 Amendment. *2001 Amdt.*, Dkt. No. 2214-4 at 4 § 5 (clarifying that profit adjustment based on a settling defendant's "net operating profits" shall exclude "investment income" in such calculation). Both amendments agreed that the original agreement remains "in full force" unless a term was expressly revised. *See id.* at 2 § 2 ("The provisions of this Agreement supplement and amend the terms of the Original Agreement and the Stipulation of Amendment, which shall remain in full force and effect except insofar as they are expressly revised by the provisions of this Agreement."); *1998 Amdt.*, Dkt. No. 2222-2 at 3 § 1 (same).

C. The 2004 Motion to Enforce

This dispute is not the only time this Court has addressed a motion to enforce the Texas Settlement. *Texas v. Am. Tobacco Co.*, 463 F.3d 399 (5th Cir. 2006). On May 27, 2004, Texas filed a Motion to Enforce the Texas Settlement against Brown & Williams Tobacco Co. ("B&W"), which had begun to manufacture cigarettes for Star Tobacco & Pharmaceuticals ("Star"), a non-signatory to the Texas Settlement. *Id.* at 401. Under the Texas Settlement, B&W had only reported the cigarettes it directly sold, and had not included the cigarettes which it manufactured for Star. *Id.* "Had B&W reported those cigarettes as its own, Texas claims it would have received an additional $16,420,252 in settlement payments for the years 1999 through 2002." *Id.* at 405.

B&W defended on the ground that the Texas Settlement was ambiguous on this question, and that the parties had engaged in a course of performance suggesting that B&W was not liable for the cigarettes it manufactured for Star. Specifically, the Texas Settlement requires the group of settling defendants to make payments on "the aggregate number of cigarettes shipped for domestic consumption," and calculated each individual defendant's payments based on "such Settling Defendant's audited reports of shipments of Tobacco Products provided to the [Securities and Exchange Commission ('SEC')] (or, in the case of any Settling Defendant that does not provide such reports to the SEC, audited reports of shipments containing the same shipment information as contained in the reports provided to the SEC)." *Id.* at 404–05. Since B&W was "a subsidiary of a British corporation, B&W does not report to the SEC." *Id.* at 406.

B&W argued that "audited reports of shipments" was a term of art given unique meaning by the course of performance of the parties. According to B&W, the reference to "audited reports" was directed to reports made to a private industry organization called Management Science Associates, Inc. ("MSA, Inc."). *Id.* at 402. "MSA, Inc. is an independent third party that has been collecting information related to tobacco companies' shipments to wholesalers for over thirty years. As part of its Cigarette Research Audit ('CRA') program, MSA, Inc. collects and reports information from cigarette manufacturers concerning shipments to their wholesalers and distributors." *Id.* at 402–03. Pursuant to the reporting "agreement between MSA, Inc. and B&W," "B&W only reports the cigarettes it ships through its own distribution system"—not "the contract-manufactured cigarettes" it made for Star. *Id.* at 403. Accordingly, B&W's argument proceeded as follows—"audited reports" is ambiguous; the parties' course of performance suggests "audited reports" was a reference to MSA, Inc. reports; and MSA, Inc. reports only include direct shipments, not the Star shipments. *Id.*

This Court agreed and found that "since its inception, all of the annual payments due under the Texas Settlement Agreement have been based on MSA, Inc.'s 'Shipments to Wholesale' reports." *Id.* at 409. This Court also found that Texas had expressly and intentionally agreed to calculate cigarette shipments by reference to MSA, Inc. reports "in 2002 when the State and the Settling Defendants entered into an engagement letter with PriceWaterhouseCoopers ('PWC')." *Id.* at 404. As the Court explained, "PWC was engaged to collect 'shipment volume data' from each Settling Defendant and, based on that data, to calculate the payments due under the Texas Settlement Agreement." *Id.* Pursuant to the terms of that engagement letter, all parties agreed that "shipment volume data" was to be calculated by reference to reports to MSA, Inc. *Id.* In view of Texas' express prior consent to the use of MSA, Inc. reports, this Court found a course of performance suggesting nonliability for B&W. *Id.*

Texas appealed this Court's judgment, arguing for the first time on appeal that this Court should not have considered parol evidence without expressly finding the Texas Settlement to be ambiguous. *Id.* at 406 n.13. Texas also urged that, in any case, the Texas Settlement was not ambiguous with respect to this question. *Id.*

The Fifth Circuit affirmed this Court's judgment. While noting that this Court did not expressly address whether the Texas Settlement was ambiguous, the Fifth Circuit conducted its own review and found that the Texas Settlement contained a latent ambiguity. *Id.* at 409–10. The Fifth Circuit found the term "audited reports of shipments" to be latently ambiguous since the Texas Settlement was "completely lacking in detail" about the nature of the audited reports. *Id.* at 410. The Texas Settlement does not set out implementation detail regarding "audited reports," such as *who* would implement such audits and *how* specifically such audits were to be conducted. *Id.* Since the Texas Settlement left those implementation matters unspecified, the Fifth Circuit found that the application of that term, in practice, revealed an ambiguity. *Id.* Concluding that the term was latently ambiguous, the Fifth Circuit found no error in this Court's review of course of performance parol evidence as a means to determine what "audited reports" meant. The Fifth Circuit also determined that this Court's "findings of fact [were] supported by the evidence and certainly are not subject to attack under the clear error standard of review." *Id.*

D. Texas Tobacco Equity Tax Statute

It is helpful to briefly describe the Texas Tobacco Equity Tax ("Tobacco Equity Tax"), enacted by the Texas Legislature in 2013. Tex. Health & Safety Code § 161.603 *et seq*. While the Texas Settlement is designed to recover tobacco-related healthcare costs from settling manufacturer defendants, the Tobacco Equity Tax is designed "to recover the State's health care costs imposed by non-settling manufacturers' products," by imposing "a tax on those manufacturers." *Tex. Small Tobacco Coal.*, 496 S.W.3d at 780. The Tobacco Equity Tax applies to all "non-settling manufacturers," a class "defined as manufacturers of cigarettes or cigarette tobacco products that did not sign either the Liggett Settlement or the [Texas] Settlement." *Id.* at 783.

The Tobacco Equity Tax relies upon a self-reporting regime from non-settling manufacturers who convey information to the Texas Comptroller of Public Accounts ("Texas Comptroller") or the Texas Office of the Attorney General ("Texas Attorney General"). *See* Tex. Health & Safety Code § 161.606. Since the tax is imposed on cigarettes produced by non-settling tobacco manufacturers, but is directly paid by downstream tobacco distributors, the statute directs the Texas Comptroller to maintain a website indicating the identity of non-settling manufacturers. *Id.* § 161.605(g). The statute also authorizes the Texas Comptroller or the Texas Attorney General, in their discretion, to conduct "reasonable periodic audits" in order "to ensure compliance with this subchapter." *Id.* § 161.609.

E. Asset Purchase Agreement to Present

The crux of the dispute presently before the Court is the result of an Asset Purchase Agreement ("APA") executed between Imperial and Reynolds in 2015. As part of a twenty-seven billion dollar transaction whereby Reynolds would acquire one of the only remaining major tobacco companies—Lorillard—Reynolds was compelled by the United States Department of Justice to divest and sell four of its most popular brands: Winston, Kool, Salem, and Maverick.[8] The Acquired Brands comprise approximately eight percent of the total domestic cigarette market in the United States, representing approximately sixteen billion cigarettes produced and sold each year.

The APA is a contract of more than two-hundred pages governed by Delaware law that memorializes the purchase and sale agreement between Imperial and Reynolds. *APA*, Dkt. No. 2222-6. "The aggregate 'Purchase Price'" for the assets being sold to Imperial—including the Acquired Brands[9]—included two elements. *Id.* § 2.04(a). First, Imperial paid Reynolds "an amount in cash equal to $7,056,202,000." *Id.* Second, the "Purchase Price" also included "the assumption of the Assumed Liabilities by [Imperial]."[10] *Id.*

In the APA, Reynolds agreed to "sell, convey, assign, transfer and deliver" to Imperial both its "right, title and interest" in the Acquired Brands and "all benefits and credits under the State Settlements in respect of the Acquired Brands that relate to the period after the Closing Date." *Id.* § 2.01(a), § 2.01(a)(vi). Reynolds also conveyed "all claims, causes of action, defenses and rights of offset or counterclaim against third parties relating to any Transferred Asset or any Assumed Liability." *Id.* § 2.01(a)(v). Imperial further agreed to "purchase, acquire and accept" the same. *Id.*

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[8] Antitrust clearance from the Department of Justice was conditioned on the sale of the Acquired Brands.

[9] The assignment of the Acquired Brands included transfer of then-existing raw tobacco, tobacco farmland, brand-related intellectual property, existing fabricated cigarettes, and other related assets.

[10] The "Assumed Liabilities" are expressly set forth in the APA.

Imperial also undertook a variety of obligations related to the Acquired Brands. *Id.* § 2.01(c). For example,"[s]ubject to the Agreed Assumption Terms" set out in the APA, Imperial assumed from Reynolds "all Liabilities under the State Settlements in respect of the Acquired Tobacco Cigarette Brands." *Id.* § 2.01(c)(vii). The APA also reflects a specific mechanism for calculating the "amounts payable after the Closing Date by [Imperial] under the State Settlements," including the Texas Settlement. *Id.* at Ex. F, § 4.4. That mechanism provides that Imperial will *only* be liable under the State Settlements for the Acquired Brands, and will not include its other cigarette sales as part of the payments Imperial would make. *Id.*

One of the negotiated terms that Reynolds sought and obtained was that Imperial would undertake "reasonable best efforts" to become a party to the Texas Settlement. *Id.* at Ex. F., § 2.2. Specifically, Imperial agreed to "use its reasonable best efforts to reach agreements with each of the Previously Settled States, by which the [Imperial] will assume, as of the Closing, the obligations of a Settling Defendant under the PSS Agreement with each such State, with respect to the Acquired Tobacco Cigarette Brands, on the same basis as the Settling Defendants prior to the Closing."[11] *Id.*

Imperial and Reynolds reached out to Texas during 2015 in an attempt to join the Texas Settlement. Both Defendants had negotiated a joinder letter, suggesting a recalibrated set of payment obligations under the Texas Settlement in addition to the assignment of the Acquired Brands. However, Defendants neither informed PMUSA nor sought its consent to join, as required under the express terms of the Texas Settlement. The Texas Settlement provides: "None of the

[11] Imperial failed to undertake "the obligations of a Settling Defendant" by "the Closing" of the APA in 2015. That failure is the subject of a breach of contract action between Reynolds and Imperial, and is presently pending before the Chancery Court of Delaware. *See also ITG Brands, LLC v. Reynolds Am., Inc.*, No. CV 2017-0129-AGB, 2017 WL 5903355, at *9–*12 (Del. Ch. Nov. 30, 2017) (Bouchard, C.) (rejecting as "absurd" Imperial's contention that its obligations to use "reasonable best efforts" terminated as of the date when the APA closed). Reynolds is also seeking indemnity for any judgment against it levied under the PSS Agreements, including the Texas Settlement.

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." *Texas Settlement*, Dkt. No. 2222-1 at 4 § 2. Based on the failure to obtain PMUSA's consent, Texas rejected the offer as inconsistent with the express terms of the Texas Settlement.[12]

After Imperial "continued back and forth with [Texas] in February, March, April of 2015," it was unable to reach an agreement with Texas, because Texas refused to join Imperial to the Texas Settlement in a manner that did not comply with its terms. *Hearing Tr.*, Dkt. No. 2354 at 63:24–64:1. No agreement was reached by the date the APA closed in late 2015.[13]

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[12] At the hearing before this Court, Reynolds disagreed that Texas had rejected Imperial's offer to join the Texas Settlement. However, in the Chancery Court of Delaware, Imperial described the interaction with Texas as follows:

> [I]n Texas we gave them a draft joinder in January 2015. We had some conversations with it in April 2015 in which it said, you know, essentially you got to go get Philip Morris involved here because we don't think you can join without Philip Morris' consent. And we never heard another word from Texas until a demand letter in August of 2018, this year.

Del. 6/4/19 Hearing Tr. at 37:20–38:3, *ITG Brands, LLC v. Reynolds Am. Inc.*, C.A. No. 2017-0129-AGB (Del. Ch. June 4, 2019). Texas described the interaction similarly before this Court:

> After we met in 2014 with [Imperial] and with Reynolds, you know, the State did have concerns about the method that [Imperial] was proposing to join because it did not comport with the method that is actually contained in the contract itself, in the settlement agreement for that -- you know, to make that change, to insert a new party into the Texas Settlement Agreement.

Hearing Tr., Dkt. No. 2354 at 15:12–18. Counsel for Reynolds, by contrast, told this Court that Texas actually never responded. In the hearing before this Court, Reynolds told the Court that Texas had not responded at all. The following colloquy occurred between counsel for Reynolds and the Court:

> COUNSEL FOR REYNOLDS: The State was put on notice of the pending transaction in 2014 prior to -- put on notice by [Imperial] --
>
> THE COURT: But it's also uncontested that the State did not consent, correct?
>
> COUNSEL FOR REYNOLDS: Your Honor, the State did not consent, and to -- to Reynolds's knowledge, the State did not respond.

Id. at 43:10–17. The Court has no reason to believe counsel for Reynolds was intentionally misspeaking. However, the Court also has no basis to believe that the substantively identical descriptions from Texas and Imperial are incorrect.

[13] One primary reason that the Texas Settlement required the consent of all parties before a joinder could occur is that the payment framework of the Texas Settlement is relative. While Texas receives approximately the same amount of money each year, the distribution of payment burdens among the settling defendants can vary substantially. As detailed later in this Order, the joinder order proposed by Reynolds and Imperial could have distorted their payment

Having purchased the Acquired Brands, Imperial reported to the Texas Comptroller that it was a non-settling manufacturer. Imperial, in effect, told the Texas Comptroller that it was subject to the Tobacco Equity Tax, but not the Texas Settlement. Without auditing Imperial's report, the Texas Comptroller updated its website to reflect Imperial's submission. This online update listed the Acquired Brands as the brands of a non-settling manufacturer. Imperial also submitted Tobacco Equity Tax payments for the Acquired Brands, which the Texas Comptroller passively accepted. *Hearing Tr.*, Dkt. No. 2354 at 13:15–20 ("[T]he equity tax payments were accepted passively by the comptroller's office, but there was never any agreement that those payments were somehow to be made in lieu of the payments pursuant to the Texas Settlement Agreement.").

F. The Present Motions to Enforce

Texas filed the instant Motion to Enforce the Settlement Agreement ("Texas' Motion to Enforce") on January 28, 2019. Texas primarily argues that Reynolds is liable for breach of the Texas Settlement under a variety of theories, but also argues alternatively that Imperial must make the Texas Settlement payments on the Acquired Brands. Texas also urged that it is a third-party beneficiary of the APA between Reynolds and Imperial, because the APA contemplates Imperial's performance of actions in satisfaction of Reynolds' legal obligations to Texas.

Shortly after Texas filed its Motion to Enforce, PMUSA followed suit and filed its Motion to Enforce the Settlement Agreement ("PMUSA's Motion to Enforce") (collectively, "Motions to Enforce") on January 31, 2019.

In addition to echoing many of Texas' arguments, PMUSA focuses significantly on Reynolds' actions under the Texas Settlement. As described above, the Texas Settlement has two annual payment provisions: a provision requiring settling defendants to pay Texas, and a parallel

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obligations in a manner that would proportionately *increase* PMUSA's obligations (and concomitantly decrease Reynolds' obligations).

provision requiring settling defendants to pay Texas' Private Counsel. Both provisions calibrate payments in proportion to each settling defendant's Market Share, using the same definition of Market Share.

Even after the closing of the APA—and continuing through the present—Reynolds has included the Acquired Brands as part of its Market Share, but only when calculating payments made to Texas' Private Counsel. Reynolds does not include the same Acquired Brands as part of its Market Share when making payments to Texas itself. PMUSA argues that Reynolds cannot have it both ways. When pressed at oral argument on the Motions to Enforce, Reynolds indicated that it was willing to concede that the Acquired Brands should be included in the payments under the Texas Settlement to Texas' Private Counsel. Oddly, however, part of Reynolds' reasoning for such concession was because those payments are less expensive than the payments to Texas.[14]

1. Joining Imperial and Extensive Discovery

On May 22, 2019, pursuant to Federal Rule of Civil Procedure 25, Imperial was voluntarily joined to the instant litigation by order of this Court. *Joinder Order*, Dkt. No. 2276 ("A party who receives any interest in assets that are subject to a settlement agreement may be joined in settlement enforcement proceedings pursuant to Fed. R. Civ. P. 25.") (citing *Negron-Almeda v. Santiago*, 579 F.3d 45, 53 (1st Cir. 2009)). Imperial agreed to join on the condition that it receive discovery, which the Court subsequently granted.

Though all parties apparently agreed—and still agree—that the Texas Settlement is unambiguous, Reynolds and Imperial both sought extensive discovery from Texas. Out of an

[14] Though payments to Texas and Texas' Private Counsel are calculated by reference to the same base number of cigarettes, the payments due to Texas are calculated by reference to a higher percentage rate than the payments to Texas' Private Counsel.

abundance of caution, and in view of the truth-seeking purpose of discovery, the Court ordered substantial discovery from Texas.[15]

Over Texas' persistent objections, the Court granted nearly every discovery request sought by either Imperial or Reynolds. *See Discovery Order*, Dkt. No. 2278. The Court required Texas to produce responsive documents not only from the Office of the Texas Attorney General, but also required Texas to canvass "all state agencies" for responsive documents. *Id.* at 5. Though Texas asked the Court to limit discovery to "a date range spanning January 1, 2014 through January 27, 2019," the Court granted the requests for production from Reynolds and Imperial based on "a date range spanning March 28, 1996, through June 28, 2019." *Id.* The Court granted all but one of Imperial's requests for production, and granted twelve of Reynolds' nineteen separate requests for production addressed to Texas. *Id.* Finally, the Court ordered Texas to produce a witness pursuant to Federal Rule of Civil Procedure 30(b)(6) for seven hours of deposition. *Id.*

In the interest of fairness, the Court also granted Texas' requests for discovery. Texas asked Reynolds and Imperial to produce the document production from the related litigation in Florida and Minnesota, *see infra* Section I.G, which was unopposed by Reynolds and Imperial, as well as all "non-privileged documents relating to the Texas Settlement Agreement, from January 1, 2014, to January 27, 2019" and a 30(b)(6) witness from Imperial and from Reynolds, respectively, for a cumulative total of seven hours.

This Court has gone out of its way to ensure that each party received the broadest proportional discovery which they sought, so that no one would stand before the Court at its hearing on the Motions to Enforce and complain that they had been precluded in any way from being fully knowledgeable and prepared. No such complaints were made.

[15] PMUSA neither sought nor received discovery, ostensibly because any such documents had already been exchanged twice over in PMUSA's related disputes with Imperial and Reynolds in Florida and Minnesota.

2. Imperial's Failure to Join the Texas Settlement

The Court held a hearing on the Motions to Enforce on October 29, 2019. Given the sophisticated nature of the parties, and the discovery each had obtained, the Court asked each party: Why have the parties been unable to resolve this issue?

According to Imperial and Reynolds, Imperial stood ready to join the Texas Settlement at the closing of the APA in 2015. With cooperation, Texas could have received the remedy it now asks the Court to order—payment on the Acquired Brands—and PMUSA would not be stuck with a disproportionate part of the Texas Settlement's allocated payments.

So what remains in dispute? As is often the case, the devil is in the details—namely, the details concerning the relative allocation of payments between PMUSA, Imperial, and Reynolds. As noted above, Imperial and Reynolds refused to seek PMUSA's prior written consent before seeking to join the Texas Settlement, and Texas declined to consent to Imperial's joinder in a manner that would violate the consent provisions in the Texas Settlement. When the Court asked whether Imperial ever sought PMUSA's consent, Imperial indicated that it had not. *Hearing Tr.*, Dkt. No. 2354 at 133:14–18. However, Imperial did not explain *why* it had not.

Keeping in mind that these manufacturers exist in a world of constant competition with each other, the answer appears to relate to the commercial advantages and disadvantages between PMUSA and Imperial or Reynolds. Though this issue is set to be more fully explored in the latter portion of the bifurcated briefing schedule,[16] the Texas Settlement makes plain that PMUSA has legitimate interests that may be adversely affected by improper joinder of another settling party. Texas is primarily interested in receipt of the correct ***overall*** amount demanded by the Texas Settlement. The settling defendants, however, are primarily interested in the appropriate allocation

[16] *See supra* n.4 (describing the bifurcation order and process).

of that overall amount among and ***between themselves***. It is reasonable that PMUSA would have legitimate concerns that modifications to the Texas Settlement, negotiated in its absence, may have serious consequences that place a disproportionate liability on PMUSA. Indeed, such a joinder without PMUSA's participation or consent appears to be the cause of significant litigation regarding the Mississippi Settlement. *See infra* Section I.G.3.

This reveals a proverbial chicken-and-egg conundrum where negotiations between the relevant parties—Texas, Imperial, Reynolds, and PMUSA—appeared to break down. Texas refused to negotiate without PMUSA; Imperial and Reynolds refused to negotiate with them.

G. Other PSS Litigation

Reynolds, Imperial, and PMUSA have also been embroiled in litigation in the other Previously Settled States ("PSS" and "PSS Agreements")—Mississippi, Florida, and Minnesota. Florida and Minnesota have both entered a judgment finding Reynolds liable (and leaving open the question of Imperial's liability), while the litigation in Mississippi appears to have been partly resolved by a negotiated settlement joining Imperial to the Mississippi Settlement.

While these other actions do not govern this Court's reasoning or result, the Court reviews the disputes in Florida, Minnesota, and Mississippi to fully explain the existing legal landscape over which these parties have traveled to get to this Court. The Court considers the decisions reached in these actions to the extent their reasoning is persuasive.

1. Florida

On December 27, 2017, the Circuit Court for the Fifteenth Judicial Circuit of Florida ("Florida Court") issued its Order Granting-In-Part Settlement-Agreement-Enforcement Motions ("Florida Court's Judgment") brought by Florida and PMUSA. The Florida Court began by reciting the history of Florida's August 25, 1997 settlement, which it referred to as the Florida

Agreement. *Fla. Ct. Judgment*, Dkt. No. 2222-7 at 1. The Florida Agreement imposes "payments to Florida every December 31 in perpetuity" based on each settling defendant's "proportionate share" as measured by such defendant's Market Share. *Id.* at 2. In exchange, "Florida executed a release of all its claims for substantial damages, primarily in the form of health-care costs, which it alleged it had incurred and would continue to incur due to the tobacco-parties' alleged predatory and deceptive practices in the marketing of their cigarettes." *Id.*

The annual payments received by the State of Florida ("Florida") are adjusted in several respects, pursuant to an amendment to the Florida Agreement that was executed on September 11, 1998 ("September 1998 Amendment"). *Id.* at 2 nn. 3–4. Those adjustments include adjustments for inflation, for the relative volume sold by the settling defendants, and for the relative profitability of the settling defendants. *Id.* The September 1998 Amendment included a provision entitled the "Florida Fee Payment Agreement," which provides payment to the private counsel hired by Florida to prosecute the underlying action which gave rise to the Florida Agreement. *Id.*

The relevant dispute in the Florida Court arose in much the same manner as the present dispute. Following Reynolds' assignment of the Acquired Brands to Imperial, Reynolds "modified its payments under the Florida Agreement subsequent to the mid-2015 closing and justified the new payments exclusively on the fact that Imperial, not Reynolds, was selling the cigarettes under the four brands Reynolds transferred to Imperial." *Id.* at 2–3. As a result, "Florida filed its motion to enforce the Florida Agreement against Reynolds and Philip Morris filed a similar motion." *Id.* at 3.

On Florida's motion, the Florida Court joined Imperial to that litigation on March 30, 2017, and on June 8, 2017, "set the matter for hearing on 'liability only.'" *Id.* "In the context of this matter, the liability question is whether Reynolds, Imperial, either or both is-or-are obligated to make payments to Florida for cigarettes sold for consumption in the United States under the four brands transferred by Reynolds to Imperial." *Id.*

As an initial matter, the Florida Court found that Imperial had not assumed liability for any payments under the Florida Agreement. Specifically, the Florida Court recognized that Imperial's liability turned on the interpretation of its promise, in the APA, to use "reasonable best efforts" to join the Texas, Mississippi, Minnesota, and Florida Settlements. *Id.* at 7–9. Accordingly, the Florida Court concluded that the "reasonable best efforts" provision "is to be determined by the Delaware Chancery Court," where the interpretation of that provision of the APA is presently being litigated.[17] *Id.* at 9; *see also id.* at 12 ("Once again, it is for the Delaware Court, not this Court, to determine Reynolds' and Imperial's rights and obligations under their asset-purchase agreement.").

The Florida Court then turned to the issue of whether Reynolds remained liable under the Florida Agreement, and concluded that it did. Florida law, which follows the general common law rule governing assignments related to contract obligations, provides that a party may not relieve itself of its liability under a contract via an assignment. *Id.* at 12. Surveying the common law, the Florida Court concluded that a party is not relieved of liability based on an assignment of *either* a contract itself, *or* the assets which form the subject matter of the contract. *Id.* at 12–13. Accordingly, the Florida Court found that Reynolds remained liable under the Florida Agreement.

As an additional basis for its holding, the Florida Court looked to Reynolds' continued payments to Florida's private counsel, pursuant to the 1998 Amendment to the Florida Agreement. Notably, and as is true in the instant case, at the time the Florida Court issued its Order, Reynolds

[17] Indeed, the scope of obligations imposed by the term "reasonable best efforts" is an issue of construction presently pending before the Delaware Chancery Court. Depending on the Delaware Chancery Court's construction of "reasonable best efforts," such term may furnish an independent basis for Imperial to be liable for payments under the Texas Settlement. *See infra* Section III.F; Part IV.

included the Acquired Brands in calculating its payment obligations with respect to Florida's private counsel, but omitted the Acquired Brands from its calculation of the same payment obligations to the State of Florida—even though both payments are calculated based on "the same pro-rata share based on nationwide cigarette sales." *Id.* at 14. The Florida Court diplomatically suggested that it was "not entirely persuasive" for Reynolds to acknowledge an ongoing obligation to pay Florida's private counsel counting cigarettes produced as part of the Acquired Brands, and yet simultaneously omit the same cigarettes from payments to the State of Florida. *Id.* Accordingly, the Florida Court concluded that Reynolds remained liable under the Florida Agreement.

2. Minnesota

On September 24, 2019, the District Court for the Second Judicial District of Minnesota ("Minnesota Court") entered an Order and Memorandum ("Minnesota Court's Judgment") addressed to cross-motions for summary judgment filed by the State of Minnesota ("Minnesota"), Imperial, and PMUSA.[18] The Minnesota Court reached substantially the same result as the Florida Court. With respect to Reynolds, it granted Minnesota's motion for summary judgment and PMUSA's accompanying motion to enforce the 1998 Settlement Agreement and Stipulation for Entry of Consent Judgment ("Minnesota Settlement Agreement"). *Minn. Ct. Judgment*, Dkt. No. 2344-1 at 1–2. However, with respect to Imperial, the Minnesota Court denied both Minnesota's motion for summary judgment and PMUSA's motion to enforce the Minnesota Settlement Agreement, finding that a fact question had been raised as to Imperial's assumption of liability. *Id.* Imperial's cross-motion for summary judgment was denied in all respects. *Id.* It appears that Reynolds did not urge an affirmative request for relief.

[18] The Minnesota Court entertained motions for summary judgment under a holding of the Minnesota Supreme Court, which provides that "[a] district court 'shall treat a motion to enforce a settlement agreement as it would a motion for summary judgment.'" *Minn. Ct. Judgment*, Dkt. No. 2344-1 at 11 (quoting *Voicestream Minneapolis, Inc. v. RPC Props., Inc.*, 743 N.W.2d 267, 273 (Minn. 2008)).

The Minnesota Court began by recounting the history of the Previously Settled States, and the respective state settlement agreements. *Id.* at 2–4. In addition to recounting much of the same information addressed by the Florida Court, the Minnesota Court identified portions of the APA that impose obligations and secure rights in the Acquired Brands to Imperial. In quoting the language of the APA, the Minnesota Court set forth as follows:

> Under the APA, Reynolds agreed to "sell, convey, assign, transfer and deliver" to [Imperial] its "right, title and interest" in the Acquired Brands and the benefits and credits under the State Settlements, including Minnesota which relate to the period after the closing date. Specifically, [Imperial] agreed to assume:
>
>> all Liabilities under the State Settlements in respect of the Acquired Tobacco Cigarette Brands that relate to the period after the Closing Date, including (A) any recalculation or redetermination of amounts due in respect of the Acquired Tobacco Cigarette Brands that relate to the period after the Closing Date.
>
> Under the APA, [Imperial] also agreed that with the assistance of Reynolds and Lorillard:
>
>> in communications and negotiations as required by the Agreement, shall use its reasonable best efforts to reach agreements with each of the Previously Settled States, by which [Imperial] will assume, as of the Closing, the obligations of a Settling Defendant under the PSS Agreement with each such State, with respect to the Acquired Tobacco Cigarette Brands, on the same basis as the Settling Defendants prior to the Closing.
>
> The APA also included Agreed Assumption terms, which applied before and after the closing:
>
>> As soon as practicable after the date of this Agreement, and both before and after the Closing, each of the Parties shall . . . make all such communications with and provide all such information to . . . the States . . . and take all such other steps . . . as are necessary and/or expedient for the purposes of . . . obtaining the agreement as necessary of the States . . . to the Agreed Assumption Terms.
>>
>> * * *
>>
>> . . . each of the Parties undertakes that from and after the date of this Agreement and both before and after the Closing it shall . . . adhere fully to

> and not deviate in any respect from the Agreed Assumption Terms including in any communications with any of the States . . .
>
> Each of [Imperial] and [Reynolds] further undertakes from and after the Closing, to take . . . all such steps as are necessary or expedient . . . to cause the Agreed Assumption Terms, as applicable, to become fully effective and binding on each of the States.

Id. at 5–6 (omissions in original).

In reaching its conclusions about liability, the Minnesota Court first rejected Reynolds' argument that *no one* was liable for payments under the Minnesota Settlement Agreement. "Reynolds' contention that no one has responsibility for settlement payments for the sales of the Acquired Brands is contrary to the essential purpose of the Minnesota Settlement Agreement," which provides that compensatory payments were to be made to Minnesota in perpetuity. *Id.* at 14.

Second, the Minnesota Court examined the structure of the Minnesota Settlement Agreement, which by its terms provides that each settlement payment is designed "not only to compensate Minnesota for health-care costs relating to cigarettes sold in the year of the settlement payment, but also for 'damages incurred by the State in . . . earlier years related to the subject matter of this action.'" *Id.* at 14–15. Under the plain language of the Minnesota Settlement Agreement, a "Settling Defendant is therefore responsible for paying in the current year, for the damage its cigarettes caused in the past." *Id.* at 15. Accordingly, "[i]t would be contrary" to that express purpose "if a Settling Defendant could avoid responsibility for current and future harm to Minnesota" resulting from "the past sales of its cigarettes" by selling those brands, "unilaterally extinguish[ing] any liability for future settlement payments, and walk[ing] away." *Id.* The Minnesota Court noted that continuing liability was textually consistent with the fact that Reynolds and the other Settling Defendants "explicitly agreed to a definition which included their 'successors and assigns' in the obligation to make future settlement payments as well." *Id.*

Finally, as an independent basis for finding liability, the Minnesota Court agreed with the Florida Court's finding that "an asset purchase does not extinguish liabilities associated with that asset." *Id.* at 16. As the Florida Court did, the Minnesota Court surveyed the common law and relevant treatises and found that such authorities uniformly supported its holding that Reynolds should remain liable for its contractual obligations. *Id.* at 16–17 (collecting cases and treatises).

In holding Reynolds liable, the Minnesota Court rejected Reynolds' contention that its liability was limited by the Market Share provision of the Minnesota Settlement Agreement. As summarized by the Minnesota Court, Reynolds contended "that it should no longer be responsible for settlement payments on cigarettes from the Acquired Brands which it no longer sells because those sales are no longer part of its market share." *Id.* at 15. "While this argument has some superficial appeal," the Minnesota Court explained, Reynolds' argument was ultimately inconsistent with the design of the Minnesota Settlement Agreement and the inclusion of a successors-and-assigns clause. *Id.* at 15–16. "'Market Share' is defined in the Minnesota Settlement Agreement to include the market share of Settling Defendants, which includes their 'successors and assigns.' Accordingly, absent an agreement otherwise, the market share of its successors or assigns remain the obligation of Reynolds as a Settling Defendant." *Id.*

The Minnesota Court also rejected the absence of an express "brand transfer" provision as a basis for releasing Reynolds and Imperial from liability.[19] The Minnesota Court explained that

[19] As used here, a "brand transfer" provision refers to an express provision prohibiting a settling defendant from transferring cigarettes or cigarette brands. Reynolds and Imperial contended that since the Master Settlement Agreement contained an explicit "brand transfer" provision, while the Minnesota Settlement Agreement did not contain a "brand transfer" provision, the Court should infer that "the intent of the parties in the resolution of the Minnesota Lawsuit was to allow for the Settling Parties to transfer their brands and extinguish their liability for future settlement payments." *Minn. Ct. Judgment*, Dkt. No. 2344-1 at 17.

the absence of an express provision boiled down to a drafting choice, because such a provision was unnecessary in light of settled common law relating to contract assignment. Even in the absence of a brand transfer provision, "Reynolds as obligor under the Minnesota Settlement Agreement, could not divest itself of liability for settlement payments on the Acquired Brands without the consent of Minnesota as the obligee." *Id.* at 17. While it could have been a belt-and-suspenders choice to include an express brand transfer provision in the PSS Agreements, the Minnesota Settlement—when read in light of the established common law governing contract assignments—was enough to create a continuing obligation with respect to Reynolds without an additional brand transfer provision. *Id.*

Further, the Minnesota Court also rejected the brand transfer argument on the grounds that it would produce a contractual absurdity and Minnesota courts attempt to avoid contract interpretations that produce such results. As the Minnesota Court explained:

> [T]he idea that the parties to the Minnesota Lawsuit negotiated a resolution which bound the Settling Defendants and their successors and assigns to making perpetual settlement payments in exchange for a permanent release of all claims, yet allowed for the opportunity for a Settling Defendant to snuff out its liabilities by simply transferring its assets, is absurd. The intent of the parties to the Minnesota Settlement Agreement was to obtain an agreement from the Settling Defendants, including Reynolds, to make payments in perpetuity to offset Minnesota's public health care expenditures associated with the use of their cigarettes. To allow Reynolds to escape its obligation by selling the Acquired Brands to another cigarette manufacturer, resulting in no one making settlement payments, would defeat the purpose of the Minnesota Settlement Agreement.

Id. at 17 (citation omitted) (citing *Brookfield Trade Ctr., Inc. v. City of Ramsey*, 584 N.W.2d 390, 394 (Minn. 1998) ("We read contract terms in the context of the entire contract and will not construe the terms so as to lead to a harsh and absurd result.")).

The Minnesota Court then turned to Imperial's liability. Imperial broadly alleged "that Minnesota has no enforceable rights against it, because Minnesota was neither a party to the APA, nor was Minnesota a third-party beneficiary." *Id.* at 19. The Minnesota Court rejected that argument out of hand. First, it found that Imperial was a third-party beneficiary under the APA, because Imperial had made promises which conferred direct benefits on Minnesota. In the Minnesota Court's view, "[b]y promising in the APA to negotiate with Minnesota to assume the benefits, credits and obligations of Reynolds under the Minnesota Settlement Agreement, [Imperial] cannot credibly contend that Minnesota has no direct or third-party interest in the APA." *Id.*

Second, the Minnesota Court determined that there was a dispute of fact as to whether Imperial is liable under the "successors and assigns" clause in the Minnesota Settlement. In the Minnesota Court's view, Imperial's status as a "successor or assign" turned on the interpretation of ambiguous provisions of the APA, including the "reasonable best efforts" clause, which governed the scope of obligations assumed by Imperial. *Id.* at 22–23. Since the procedural posture before the Minnesota Court was a series of motions for summary judgment, the Minnesota Court indicated that it could not conclusively resolve the underlying fact questions related to the interpretation of the APA. *Id.*

3. Mississippi

The litigation in Mississippi exists in a substantially different posture than the other settlement disputes discussed above. Presently, it remains pending before the Chancery Court of Mississippi ("Mississippi Court"). The Mississippi litigation resolved, in substantial part, when Imperial elected to voluntarily join the Mississippi Settlement.

Despite Imperial's joinder, it appears that there are ongoing disputes as to the manner in which Imperial was joined. Imperial was joined without PMUSA's consent, and in a manner that allegedly damaged PMUSA financially. Specifically, PMUSA alleged that the joinder letter submitted by Imperial and Reynolds (and the Mississippi Court order adopting the same) not only joined Imperial, but altered the relative "allocation of the profit adjustment under the [Mississippi Settlement] agreement, in a way . . . that directly affects [PMUSA] to the tune of many millions of dollars a year . . . without telling [PMUSA]." *Miss. Ct. Oral Arg. Tr.*, Dkt. No. 2357-61 at 8:4–23. PMUSA suggested that Reynolds and Imperial misled the Mississippi Court by presenting Imperial's request for joinder as "agreed," when in fact such request was made "without providing any notice, or opportunity for hearing" to PMUSA.[20] *Id.* at 8:20–23. The litigation appears to be ongoing, subject to an apparently pending motion to stay, which is the most recent docket entry on the public docket for the Mississippi litigation. *See* https://perma.cc/7M2C-AXNY.[21]

II. **Threshold Issues and Procedural Approach**

Before turning to the merits of the Motions to Enforce, the Court addresses four threshold issues: subject-matter jurisdiction, choice of law, issue preclusion (raised by Imperial), and an allegation that the Texas Settlement precludes review of the Motions to Enforce (raised by Reynolds).

As a matter of procedure, the Court will follow the procedure previously approved by the Fifth Circuit in evaluating motions to enforce the Texas Settlement. When this Court last construed the Texas Settlement, the Court received motions to enforce, took evidentiary submissions, heard arguments related to the same, and issued an order which made subsidiary findings of fact and conclusions of law related to the Texas Settlement. In affirming this Court's prior order, the Fifth

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[20] This issue—the distortion of profit adjustment and payment allocation—is the basis upon which Texas refused to consent to Imperial's attempt to join the Texas Settlement without first securing the consent of PMUSA. The existence of the Mississippi litigation shows that Texas' concerns were real and substantial.

[21] To avoid the issues of link rot and reference rot, the Court uses a persistent identifier link to archive the public docket for the Mississippi litigation, as available at the time this Order is issued. *See, e.g.*, Christine L. Borgman, *Open Data, Grey Data, and Stewardship: Universities at the Privacy Frontier*, 33 Berkeley Tech. L.J. 365, 378 n.34 (2018) (highlighting the importance of "persistent identifiers" that are able to permanently "'resolve to a location' online," in order "to facilitate access in addition to identification").

Circuit agreed that this Court had appropriately made findings of fact in support of its conclusions of law. Accordingly, in disposing of the instant Motions to Enforce, the Court will follow the same procedural approach as was previously approved by the Fifth Circuit: the Court has received pertinent evidence, heard argument, and accordingly issues this Order setting forth its findings of fact and conclusions of law as a part hereof.

A. Subject-Matter Jurisdiction

The Court has an independent obligation to determine its subject-matter jurisdiction. *Lemaire Illumination Techs., LLC v. HTC Corp.*, No. 2:18-cv-00021-JRG, 2019 WL 1489065, at *2 (E.D. Tex. Apr. 4, 2019) (citing *McCorvey v. Hill*, 385 F.3d 846, 848 (5th Cir. 2004)) ("Federal courts 'are under an independent obligation to examine'" whether subject-matter jurisdiction exists).

"With consent of the parties, a district court may expressly retain jurisdiction over a settlement agreement in order to enforce the parties' compliance with that agreement and thereafter may assert jurisdiction over breach of settlement claims." *Energy Mgmt. Servs., LLC v. City of Alexandria*, 739 F.3d 255, 261 n.3 (5th Cir. 2014) (citing *Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 380–81 (1994)). A final judgment may make a settlement agreement "part of the order of dismissal" in one of two ways—"either by separate provision (such as a provision 'retaining jurisdiction' over the settlement agreement) or by incorporating the terms of the settlement agreement in the order." *Kokkonen*, 511 U.S. at 381.

The Court's final judgment in this case expressly incorporates the Texas Settlement. *Final Judgment,* Dkt. No. 1866. The Court indicated that "pursuant to Fed. R. Civ. P. 58, the Court does hereby ORDER, ADJUDGE, and DECREE as follows: the Comprehensive Settlement Agreement and Release (attached as Exhibit A) is hereby adopted and incorporated herein as an enforceable order of this Court." *Id.* at 1 ¶ 1.

In addition to incorporating the Texas Settlement itself, the Court also independently ordered the parties to comply with the terms of the Texas Settlement. *Id.* at 1 ¶ 4 (ordering that "the parties shall comply with all terms and conditions contained in the Comprehensive Settlement Agreement and Release, Exhibit 1, Costs, Expenses and Fees and other attachments"). Accordingly, this Court has subject-matter jurisdiction to dispose of the present Motions to Enforce.

B. Choice of Law

By its terms, the Texas Settlement must be interpreted under Texas law. *Texas Settlement*, Dkt. No. 2222-1 at 28 § 26 ("This Settlement Agreement shall be governed by the laws of the State of Texas."). "It is a 'well-settled rule that the construction and enforcement of settlement agreements are governed by principles of local law applicable to contracts generally.'" *In re Deepwater Horizon*, 785 F.3d 986, 994 (5th Cir. 2015) (quoting *Fla. Educ. Ass'n, Inc. v. Atkinson*, 481 F.2d 662, 663 (5th Cir. 1973)); *accord Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938); *BNSF Ry. Co. v. Panhandle N. R.R., L.L.C.*, 946 F.3d 705, 711 (5th Cir. 2020).

Under Texas law, settlement agreements are interpreted according to the law generally governing contractual agreements. *Sandt v. Energy Maint. Servs. Grp. I, LLC*, 534 S.W.3d 626, 642 (Tex. App.—Houston [1st Dist.] 2017, pet. denied) ("Under Texas law, we interpret settlement agreements like other contracts."). This is because settlement agreements *are* contracts, which reflect agreements related to the resolution of legal disputes. *McCoy v. Rogers*, 240 S.W.3d 267, 275–76 (Tex. App.—Houston [1st Dist.] 2007, pet. denied). Accordingly, the Court will apply Texas contract law to the interpretation of the Texas Settlement.

While a variety of other choice of law issues have arisen, including issues related to the law of Florida, Delaware, and Minnesota, for efficiency's sake, the Court will address each subsidiary choice of law issue in context, rather than addressing all choice-of-law issues here.

C. Issue Preclusion

As an initial matter, the Court must address Imperial's contention that this Court should apply issue preclusion to reject PMUSA's Motion to Enforce. Imperial asserts that the Florida Court's Judgment determined that Imperial was not liable under the Florida Agreement, and argues that PMUSA is precluded from relitigating the issue with respect to the Texas Settlement. *Imperial Resp.*, Dkt. No. 2341 at 12.

In response, PMUSA suggests that Imperial's argument is misplaced. Initially, issue preclusion "does not apply, because, as [Imperial] notes, the issues are 'nearly identical' to Minnesota and Florida, and 'nearly identical' is not identical." *PMUSA Reply*, Dkt. No. 2345 at 12. Further, to the extent the Court should find a preclusive effect, PMUSA argues that the Court should give effect to the decision of the ***Minnesota*** Court—not the Florida Court—because the Minnesota Court's Judgment was later in time. *Id.* And the Minnesota Court recognized that Imperial could be liable "if it is an 'assign'"—a question unresolved by the Minnesota Court. *Id.*

Though Imperial only asks the Court to apply preclusion to PMUSA, Texas argues that issue preclusion cannot apply to Texas because Texas "was not a party in Florida," which is required for any form of preclusion to attach. *Texas Reply*, Dkt. No. 2346 at 7.

To determine the preclusive effect of a state court judgment, federal courts apply the preclusion rules of the state whose court issued the judgment. *Shimon v. Sewerage & Water Bd. of New Orleans*, 565 F.3d 195, 199 (5th Cir. 2009). "The Supreme Court has held that 'under the Full Faith and Credit Act a federal court must give the same preclusive effect to a state-court judgment as another court of that State would give.'" *Id.* (quoting *Parsons Steel, Inc. v. First Ala. Bank*, 474 U.S. 518, 523 (1986)).

When multiple courts have previously rendered a judgment addressed to the same issue, a subsequent court may give preclusive effect *only* to the decision of the final court to render judgment. *Americana Fabrics, Inc. v. L & L Textiles, Inc.*, 754 F.2d 1524, 1529–30 (9th Cir. 1985). *Americana Fabrics* addressed a scenario where a third court was required to choose between giving a preclusive effect to the judgment of a first court, or the subsequent judgment of a second court. In such a case, "[t]he governing rule to be applied is quite clear. The third court should give res judicata effect to the last previous judgment entered." *Id.* (citing *Treinies v. Sunshine Mining Co.*, 308 U.S. 66, 75–78 (1939); 18 Charles Wright, Arthur Miller & Edward Cooper, *Federal Practice and Procedure* § 4404 (1981); Hon. Ruth B. Ginsburg, *Judgments in Search of Full Faith and Credit: The Last-in-Time Rule for Conflicting Judgments*, 82 Harv. L. Rev. 798 (1969)).

Americana Fabrics articulates several rationales for the Supreme Court's "rule of 'last in time'":

> The formal rationale behind the rule is that the implicit or explicit decision of the second court, to the effect that the first court's judgment is not res judicata, is itself res judicata and therefore binding on the third court. The decision is not binding because it is correct; it is binding because it is last. The rule furthers the purposes of res judicata because it "end[s] the chain of relitigation . . . by stopping it where it [stands]" after entry of the second court's judgment, and thereby discourages relitigation in a third court. If an aggrieved party believes that the second court erred in not giving res judicata effect to the first court's judgment, then the proper avenue of redress is appeal of the second court's judgment, not collateral attack in a third court.

Id. at 1530 (citing *Treinies*, 308 U.S. at 77–78; *Porter v. Wilson*, 419 F.2d 254, 258–59 (9th Cir. 1969)) (alterations in original).

Notably, the Minnesota Court expressly found that neither the Florida Court's Judgment nor any decision by the Delaware Chancery Court gave rise to preclusion. *Minn. Ct. Judgment*, Dkt. No. 2344-1 at 21 (recognizing that the Florida Court's Judgment and a decision by the Delaware Chancery court "are informative," but are not "dispositive ***or preclusive*** with regard to any obligations [Imperial] may have under the Minnesota Settlement Agreement"). Accordingly, this Court similarly holds that no previous judicial decision—whether rendered by Minnesota, Delaware, or Florida—gives rise to issue preclusion in this case.

The foregoing makes clear that the Florida Court's Judgment cannot give rise to issue preclusion in this case. As noted above, Imperial claims this litigation and the Florida litigation involve identical issues because both cases ostensibly involved "'identical' claimed breaches of contract, the same facts, the same transaction, 'substantively identical' settlement language, the same APA, the same principles of law, and the same claims." *Imperial Resp.*, Dkt. No. 2341 at 12. Yet every one of those facts applies with equal force to the Minnesota litigation, and the Minnesota Court's Judgment was issued later in time than the Florida Court's Judgment. Thus, under the "last in time" rule, if preclusion should apply at all, it should apply only to the Minnesota Court's Judgment—not the Florida Court's Judgment.[22] Accordingly, the Florida Court's Judgment does not preclude PMUSA in any respect related to this case.

In the alternative, even if the Florida Court's Judgment were appropriate to consider as a basis for issue preclusion, Florida law limits issue preclusion to circumstances where "an identical

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[22] Minnesota law does not suggest any preclusive effect is appropriate with respect to the issues raised by enforcement of the Texas Settlement. Minnesota squarely assigns "the burden to establish" that collateral estoppel is applicable to "[t]he party asserting collateral estoppel." *Mach v. Wells Concrete Prod. Co.*, 866 N.W.2d 921, 927 (Minn. 2015) (quoting *Lange v. City of Byron*, 255 N.W.2d 226, 228 (Minn. 1977)). Imperial has not carried that burden, given that Imperial does not urge that the Minnesota Court's Judgment should be given preclusive effect. Further, Imperial could not carry its burden under Minnesota law for one of the same reasons its claim fails under Florida law—Minnesota limits issue preclusion to circumstances where the "issue was identical to one in a prior adjudication," and the issues before the Minnesota court are merely analogous to the issues before this Court, rather than identical to the issues presented herein. *See id.* (citing *Nelson v. Am. Family Ins. Grp.*, 651 N.W.2d 499, 511 (Minn. 2002)). At issue in the Minnesota Court was the Minnesota Settlement, read in light of Minnesota law; at issue in this Texas federal court is the Texas Settlement, read in light of Texas law. This point is sufficient to reject application of any form of preclusion.

issue" was "presented in a prior proceeding." *Lucky Nation, LLC v. Al-Maghazchi*, 186 So. 3d 12, 14 (Fla. 4th DCA 2016). Florida law also requires that "the parties in the two proceedings must be identical." *Id.* For the latter reason, issue preclusion cannot apply to Texas because Texas was undisputedly not a party to the Florida litigation. That determination appears to be conclusive of the impact of issue preclusion, because both PMUSA and Texas seek substantially and functionally identical relief. Since Texas may appropriately seek the entirety of the relief pending before the Court, it is unclear how a finding of preclusion as to PMUSA would alter the Court's approach to the merits.

Further, the issues presented in this case are different than the issues decided by the Florida Court. This Court must apply a different body of law (Texas law) to a different settlement agreement (Texas Settlement) that was reached under different circumstances to evaluate a different issue of liability (that is, liability for Texas Settlement payments). Both Texas and Florida cases rely on analogous principles of contract interpretation and both ask each respective court to interpret analogous agreements, but merely analogous issues are not "identical issues." *See id.*

On balance, this Court finds that issue preclusion does not apply to this case. Texas is not Florida (or Minnesota) and the Texas Settlement is not the Florida Settlement (or the Minnesota Settlement). Further, in the unlikely event that the Texas Settlement could overlap with another state's settlement to a sufficient degree for preclusion to attach, *only* the Minnesota Court's Judgment could receive preclusive effect in this case under the last-in-time rule. Accordingly, the Court concludes that issue preclusion does not apply to the Motions to Enforce in this case.

D. Contractual Limits on Review

In a single paragraph, Reynolds argues that the court lacks jurisdiction to entertain the Motions to Enforce because the parties have contractually limited this Court's ability to review disputes about Market Share. Reynolds claims that "under the express terms of the Agreement, [PricewaterhouseCoopers' ('PwC')] determination of the parties' Market Share dispute is final and non-appealable." *Reynolds Resp.*, Dkt. No. 2340 at 16–17 (citing *1998 Amdt.* at 12–13 § 8; *In re Deepwater Horizon*, 785 F.3d at 995 n.8). In pertinent part, § 8 of the 1998 Amendment to the Texas Settlement recites the following:

> ***In the event of a disagreement between or among any Settling Defendants as to their respective shares of any payment due to be paid on a Market Share basis pursuant to the Settlement Agreement and this Stipulation of Amendment*, *each Settling Defendant shall*** pay its undisputed share of such payment promptly on or before the date on which such payment is due, and shall, within 21 days of such date, ***submit its Shipment Reports for the year in question to a third party to be selected by agreement of Settling Defendants (the "Third Party"), who shall determine the Market Share of each Settling Defendant*** within three business days of receipt of such Shipment Reports. ***The decision of the Third Party shall be final and non-appealable, and shall be communicated by facsimile to each person designated to receive notice hereunder***. . . . .

1998 Amdt., Dkt. No. 2222-2 at 12–13 § 8 (emphasis added). According to Reynolds, this is a dispute about Market Share, and such disputes must be submitted to a third-party neutral—in this case, PwC, who Reynolds submits has been appropriately designated under § 8.

PMUSA responds that Reynolds' argument "fails for numerous, independently sufficient reasons." *PMUSA Reply*, Dkt. No. 2345 at 8. First, by its own terms, § 8 "applies only to 'a disagreement between or among any Settling Defendants,' and so is irrelevant to disputes like this one as to what [Texas] is owed." *Id.* Second, "Reynolds does not point to any evidence the Settling Defendants ever 'selected' PwC to finally resolve this (or any other) dispute." *Id.* Third, § 8 "does not apply in any event, because these motions present the *legal* question whether payment obligations on transferred brands continue; per the Settlement Agreement, *this Court*—not any accountant—is the arbiter of that issue." *Id.* (citing *Texas Settlement*, Dkt. No. 2345-1 at 3–4). Fourth, "although the Florida Agreement has the same provision, Reynolds never made this argument in Florida." *Id.* (citing *Fla. Agreement*, Dkt. No. 2345-13 at 82789–90). Fifth, "following the Florida court's ruling, PwC has included the transferred brands in calculating what Reynolds owes Florida—yet Reynolds is appealing." *Id.* Indeed, PMUSA points out that Reynolds has made directly contradictory representations to other courts. Specifically, Reynolds asserted to the Mississippi Chancery Court: "'the Court decides and PwC implements. That is the way it has always been, Your Honor. The Court decides the legal issues and PwC implements it, not the reverse. PwC is not a lawyer.'" *Id.* (quoting *Miss. Oral Arg. Tr.*, Dkt. No. 2345-61 at 87:19–22).

Texas similarly disputes Reynolds' argument. Initially, Texas echoes PMUSA's textual argument that § 8 does not apply under "the plain language of the contract," because this is a dispute between Texas and Settling Defendants, which falls outside of the carveout for disagreements that are "between or among" the settling defendants. *Texas Reply*, Dkt. No. 2346 at 10. Texas further suggests that Reynolds' description of PwC is inconsistent with the structure of the Texas Settlement and the uniform course of performance of the parties. *Id.* "Reynolds attempts to inflate the role of [PwC] beyond that of an accounting firm into that of a legal tribunal empowered to dictate not only the amounts due under the [Texas Settlement] but to make legal determinations as to its enforcement." *Id.*

At the hearing on the Motions to Enforce set by the Court, the Court pressed Reynolds with respect to its position on the role of PwC in the Texas Settlement, and counsel for Reynolds substantially walked its argument back on this issue.

> COUNSEL FOR REYNOLDS: Reynolds has, from the inception of the Texas Settlement Agreement, paid every dime that PricewaterhouseCoopers has attributed to it. And, ***Your Honor, that's important not because Pricewaterhouse supplants the -- the authority of any Court but because it was the independent third party that all of the parties***, including the State -- the State ***agreed should determine what was owed,*** based on the amount of cigarettes shipped for domestic consumption.

> THE COURT: ***But their role was to do a calculation based on an existing structure, not to offer legal advice or to construe legal relationships in any kind of binding way, correct***?
>
> COUNSEL FOR REYNOLDS: ***A hundred percent correct, Your Honor.***
>
> THE COURT: Okay.
>
> COUNSEL FOR REYNOLDS: ***Nor are we arguing that*** -- I'd like to say here we are not arguing that ***PricewaterhouseCoopers has any -- any effect -- any binding effect on this Court***. ***We'd -- we'd be foolish to say so.***

Hearing Tr., Dkt. No. 2354 at 54:24–55:18 (emphasis added). As PMUSA notes in its briefing, Reynolds' representations to this Court were consistent with the representations it has made to other courts, including the Chancery Court of Mississippi.

The Mississippi Court held an evidentiary hearing on December 4, 2015, where PMUSA asked the Mississippi Court to vacate one of its previous orders joining Imperial to the Mississippi Settlement, because the joinder was done without PMUSA's consent and with alterations to the Mississippi Settlement's payment allocation scheme. *Miss. Oral Arg. Tr.*, Dkt. No. 2345-61 at 7:4–8:23. PMUSA alleged that such alterations injured PMUSA's economic interests to the benefit of Reynolds and Imperial.

To resolve the foregoing issue, PMUSA proposed that the parties voluntarily delegate the issue to PwC, which PMUSA suggested could bring its expertise to bear on determining whether Imperial had been joined in a way that would unfairly reallocate payment obligations under the Mississippi Settlement. *Id.* at 35:15–20 ("What Your Honor should do, respectfully, is, if we can't agree as to how things change and how we ought to move things around as a result of the brand transfer to [Imperial], let PwC decide, and, then, if there is a dispute, the parties can come back to Your Honor with a complete record.").

Reynolds rejected PMUSA's proposal, on the grounds it would upset the appropriate allocation of authority between the courts and the accountants set out in the PSS Agreements.[23] *Id.* at 87:14–24. In addressing "PMUSA's proposal," Reynolds argued that asking PwC to resolve the issue "puts the cart before the horse." *Id.* at 87:17–18. Reynolds explained, "the court decides and PwC implements. ***That is the way it has always been***, Your Honor. The court decides the legal issues and PwC implements it, not the reverse. PwC is not a lawyer." *Id.* at 87:19–22 (emphasis added). In Reynolds' view, any preliminary resolution by PwC "would create uncertainty without court guidance, and it would needlessly drag out the issue," because only a court has the authority to actually resolve legal questions related to liability under the state settlements at issue. *Id.* at 87:23–24.

In view of the foregoing admissions in both the Mississippi Court and this Court, it is not clear what remains of Reynolds' argument on this issue. At both colloquies, Reynolds candidly and correctly acknowledged that the PSS Agreements—including the Texas Settlement—distinguish between the legal question of liability for cigarettes that are sold (*i.e.*, the question of "who must pay?"), and the accounting question addressed to quantifying the number of cigarettes that are sold (*i.e.*, the question of "how much must be paid?"). In both Mississippi and this Court, Reynolds recognized that "PwC is not a lawyer" and that it would "be foolish to say" that PwC's determination has "***any*** binding effect on this Court." *Miss. Oral Arg. Tr.*, Dkt. No. 2345-61 at 7:4–8:23; *Hearing Tr.*, Dkt. No. 2354 at 54:24–55:18 (emphasis added). Since Reynolds acknowledges that PwC is tasked only with the accounting question, and Reynolds recognizes that

[23] Reynolds' representations to the Mississippi Court about PwC's role are relevant to the Texas Settlement because PwC was engaged with a single engagement letter for all four Previously Settled States, and because each PSS Agreement reflects the same allocation of responsibility between the courts and the accountants. *PwC Engagement Letter*, Dkt. No. 2357-5. Reynolds' description of PwC's role with respect to the Mississippi Settlement is accordingly informative of PwC's role with respect to the Texas Settlement, because PwC plays the same accounting role for both Mississippi and Texas under the terms of the engagement letter and the two respective states' settlement agreements.

the question of "legal relationships" is reserved for this Court by the express text of the Texas Settlement, Reynolds has substantively conceded that this Court has the authority to evaluate the legal questions presented by the Motions to Enforce. Reynolds' admissions thus constitute a standalone basis to reject this argument.

Since Reynolds has not formally withdrawn this argument, to avoid any doubt, the Court reaches and rejects Reynolds' contention that the Court's ability to evaluate the Motions to Enforce has been contractually limited by the role of PwC in addressing disputes about Market Share.

The Texas Settlement expressly reserves and recognizes this Court's authority to evaluate "any" disputes related to the enforcement or breach of the Texas Settlement. Section 1 of the Texas Settlement provides, in pertinent part, the following fountainhead of jurisdiction for this Court:

> Jurisdiction. Settling Defendants and the State of Texas acknowledge that this Court has jurisdiction over the subject matter of this action and over each of the parties hereto, and that this Court shall retain jurisdiction for the purposes of implementing and enforcing this Settlement Agreement. ***The parties hereto agree to present any disputes under this Settlement Agreement, including without limitation any claims for breach or enforcement of this Settlement Agreement, exclusively to this Court.***

Texas Settlement, Dkt. No. 2222-1 at 3–4 § 1 (emphasis added). Accordingly, the plain text of § 1 broadly delegates resolution of "any disputes under [the Texas Settlement]" to this Court, and enumerates specifically the examples of "any claims for breach or enforcement" as being appropriate for resolution by this Court. *Id.* The Motions to Enforce are literally "claims for . . . enforcement" of the Texas Settlement, and are predicated on allegations of "breach" of the Texas Settlement. *See id.* The Motions to Enforce thus fall within the broad assignment of "any disputes" to this Court for exclusive resolution.

Further, § 8's finality provision does not apply to this dispute because § 8 limits its applicability to payment allocation disputes "between or among Settling Defendants." *See id.* § 8.

The finality provision in § 8 arises in a specific context within the Texas Settlement, which suggests that it does not apply to motions to enforce based on allegations of breach. As noted above, the Texas Settlement provides that Texas receives approximately the same amount of money each year. The relative allocation of payments between or among settling defendants, however, is adjusted each year in view of the relative profitability of those defendants, as well as the relative volume of sales from those defendants, compared to the "base year" profitability and cigarette volume set out in the Texas Settlement.[24] Depending on how profitable (or unprofitable) a settling defendant is—or how much (or little) it sells—both its payment obligations and the payment obligations of the other settling defendants may change significantly. Accordingly, the settling defendants may dispute—between or among themselves—the relative allocation of payments, as an accounting matter. That dispute is then submitted to an accounting firm—PwC—whose decision is final.

This context makes clear that the finality mechanism is not applicable to enforcement actions predicated on breach of contract theories. The finality mechanism is *only* applicable to those decisions made by PwC, who in turn *only* takes up that particular class of dispute—accounting disputes over relative allocation of payment.[25] However, the finality mechanism in § 8 is not designed to divest the Court of jurisdiction over legal disputes relating to the allocation of liability under the Texas Settlement.

In sum, the Court concludes that § 8 does not bar this Court's review of the pending Motions to Enforce because § 8 is addressed to a different type of dispute (accounting disputes

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[24] The Texas Settlement establishes certain preset values from the year 1997 as the "base year" for reference and comparison during each year annually thereafter. The sales of the Acquired Brands remain included in the base year for Reynolds.

[25] This does not mean, however, that PwC is responsible for determining the legal issue bifurcated by the Court, which goes to whether—as a legal matter—the Acquired Brands remain proper for inclusion in the reference base year of 1997, if liability for those brands is assigned to Imperial. Though more closely related to the role PwC, that issue too is an issue for the Court, and turns on an interpretation of the Texas Settlement.

over relative Market Share) between a different class of parties (settling defendants). Since this dispute involves Texas, and a legal question of enforcement predicated on allegations of breach, the Court finds that the Texas Settlement expressly preserves this Court's ability to hear this dispute. Thus, the Texas Settlement does not prevent this Court from evaluating the Motions to Enforce.

III. Delegation Under Texas Common Law and Breach of Contract

Both the Minnesota Court and the Florida Court found that Reynolds continued to be liable under the common law doctrine that obligations under a contract cannot be destroyed by an assignment of that contract or its subject matter. Both courts found that because Reynolds undertook an obligation to make payments on the Acquired Brands, that obligation continued even after the sale of the Acquired Brands. As explained below, the Texas Supreme Court has announced an analogous doctrine, and that doctrine applies with equal force to Reynolds' conduct in this case. Given that this was the primary basis of decision in both the Florida Court and the Minnesota Court, the Court addresses this issue first.

A. Contentions of the Parties

Texas argues that Reynolds remains bound to the obligations it assumed under the Texas Settlement, including the obligation to make payments on sales of the Acquired Brands. Texas law recognizes that an assignment does not relieve a party of its obligations under a contract. *Texas Motion to Enforce*, Dkt. No. 2214 at 8. An assigning party "remains liable unless expressly or impliedly released by the other party to a contract." *Id.*

Texas directs the Court's attention to the Texas Supreme Court's decision in *Seagull Energy E&P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342, 346–47 (Tex. 2006), and argues that Reynolds remains liable under the Texas Settlement based on a straightforward application of

Seagull. In exchange for a release from potentially overwhelming liability, Reynolds knowingly undertook the obligation to make payments on the Acquired Brands, as well as its other cigarette brands, when it signed the Texas Settlement. To eliminate those obligations, Texas argues that it "would have to assent to Reynolds no longer being liable under the Texas Settlement." *Id.* at 9. However, Reynolds may not unilaterally "escape its obligations," under the Texas Settlement by virtue of its assignment of the Acquired Brands. *Id.* at 8 (quoting *Seagull*, 207 S.W.3d at 346–47). Further, Texas argues, the Texas Settlement evinces an intent that any potential assignments would not defeat any party's rights, by providing that it "shall be binding upon all Settling Defendants and their successors and assigns in the manner expressly provided for herein." *Id.* at 12 (citing *Texas Settlement*, Dkt. No. 2222-1 at 4 § 2).

The Court notes that the Texas Settlement also imposes a variety of non-monetary restrictions, including limiting advertising to children and certain lobbying activities, which would also be nullified under Reynolds' approach. *Id.* at 9. Indeed, when the Court asked if Imperial was bound by the Texas Settlement's advertising-to-children and lobbying restrictions, at least with respect to the Acquired Brands, Reynolds said ***no***. *Hearing Tr.*, Dkt. No. 2354 at 126:25–128:10.

Reynolds disagrees with Texas' contention and argues that this doctrine only applies when a party assigns the entire contract, or an obligation under the contract. In Reynolds' view, it did not assign any *obligation* to pay for the Acquired Brands—it merely sold *assets*, which Reynolds says were effectively unencumbered. According to Reynolds, it had an obligation to make Texas Settlement payments for the Acquired Brands only ***before*** they were acquired by Imperial, but such obligation as of Imperial's acquisition ceased pursuant to the Market Share provision of the Texas Settlement.[26]

[26] Reynolds has gone to great lengths to dispute this characterization, claiming that its argument is not that the obligation to pay disappears, but rather that Reynolds never had an obligation to pay on the Acquired Brands in the

In response, PMUSA supports the position taken by Texas, saying that "[i]t is hornbook law in Texas that an asset purchase does not extinguish any of the underlying obligations associated with those assets." *PMUSA Motion to Enforce*, Dkt. No. 2222 at 6 (citing *Seagull*, 207 S.W.3d at 344). PMUSA additionally cites a treatise which has been repeatedly relied upon by the Texas Supreme Court for the proposition that "[a]lthough a sale of assets may allow an injured plaintiff to proceed against the successor corporation, it does not vitiate the original company's liability." *Id.* at 7 (citing 15 William Meade Fletcher et al., Fletcher Cyclopedia of the Law of Private Corporations § 7123 (perm. ed., rev. vol. 2017)).

PMUSA also argues that its position is consistent with the explicit purposes of the Texas Settlement. First, the Texas Settlement expressly provides that the obligations contained therein run "in perpetuity" and are intended to be made binding on "successors and assigns." *Id.* at 8. PMUSA contends that these terms, when read together, reveal contractual purposes that are discordant with releasing Reynolds from its obligations. *Id.*

Second, the reimbursement framework created by the Texas Settlement would be undermined if Reynolds' assignment of the Acquired Brands extinguished its obligation to make payments thereupon. Under the Texas Settlement, each year's payment is "in settlement of all of the State of Texas's claims for damages incurred by the State in the year of payment or earlier years." *Id.* at 9 (citing *1998 Amdt*., Dkt. No. 2222-2 at 7 § 4).

first place—its obligations were limited to cigarettes it sold, pursuant to the Market Share provision, and since it no longer sells the Acquired Brands, its obligation no longer extends to those cigarettes. *See Hearing Tr.*, Dkt. No. 2354 at 42:6–10 ("I'd like to frame our argument thusly, which is that Reynolds does not claim that any obligation has been extinguished but rather that liability is calculated on brands -- on cigarettes sold by Reynolds, not brands previously owned by Reynolds."). The Court recognizes why Reynolds seeks to frame its argument in that manner, but concludes that such framing obscures the crux of the issue: according to Reynolds, it was obligated to pay for the Acquired Brands before the assignment but was not obligated to pay after the assignment. In every sense of the term, Reynolds asks the Court to hold that the obligation to pay for the Acquired Brands is extinguished by means of Reynolds' assignment to Imperial. The Court declines to so hold.

The Texas Settlement includes reimbursement for "earlier years" as part of each year's payment because of the continuous and inseverable nature of the injuries that can result from use of tobacco products. *See id.* As an example: imagine a smoker that started smoking Salem cigarettes on the day after the Texas Settlement went into effect in 1998, and stopped smoking altogether on the day before the APA was consummated in 2015. Then, consider that in 2016, this particular smoker developed lung cancer that was indisputably caused by the previous years of smoking Salem cigarettes while Salem was owned by Reynolds. Under Defendants' theory of the Texas Settlement, Texas would be owed no reimbursement because the smoker's diagnosis (and medical treatment) happened ***after*** the Acquired Brands were assigned to Imperial. That result is simply irreconcilable with the text and business purposes of the Texas Settlement.

PMUSA also argues such result would be unreasonable, inequitable, and oppressive because it "would allow [Reynolds] to reap an immediate profit" of $7,000,000,000.00 "without ensuring that [Texas] receives the corresponding payments that [it] bargained for" in the Texas Settlement. *PMUSA Motion to Enforce*, Dkt. No. 2222 at 10. To allow such asymmetry would "nullify the parties' intent and the contract's purpose in violation of basic canons of Texas contract law." *Id.* at 10–11 (citing *Frost Nat'l Bank v. L & F Distribs., Ltd.*, 165 S.W.3d 310, 312–13 (Tex. 2005)). Further, PMUSA argues that adopting Defendants' position "presents a road map for the complete unraveling of the [Texas Settlement]. If the brand transfer here is permitted to extinguish the obligations on the Acquired Brands, nothing prevents the remaining Settling Defendants from repeating this maneuver with their own brands – leaving Texas empty-handed." *Id.* at 9.

With respect to Reynolds' Market Share argument, PMUSA responds in two ways. First, PMUSA argues that the Market Share provision deals with the method for determining the ***number*** of cigarettes sold, rather than allocating ***liability*** for cigarettes that have been assigned. Relying on the maxim that the specific controls over the general, PMUSA notes that the Texas Settlement contains a specific clause that addresses whether liability can be eliminated by an assignment—the successors and assigns clause. As the Texas Supreme Court concluded on similar facts in *Seagull*, an interpretation such as Reynolds' "reads far too much" into the Market Share provision.

Second, PMUSA notes that Reynolds has taken inconsistent positions on whether the Market Share provision embraces the Acquired Brands. At present, Reynolds ***includes*** the Acquired Brands in the Market Share calculation for payments made to Texas' Private Counsel. At the same time, Reynolds ***omits*** the Acquired Brands from its Market Share for the payments it makes to Texas. As noted above, the Texas Settlement provides that both Texas ***and*** its Private Counsel would receive payments that are calculated based on the same definition of Market Share for each Settling Defendant.

The Court pressed both Imperial and Reynolds on this point at the hearing it held. For its part, Imperial's counsel offered no explanation or defense for Reynolds' conduct, and instead suggested that the Court direct the query to Reynolds.

> THE COURT: If Reynolds did not include those Acquired Brands . . . in the calculation of market share for purposes of paying under the Texas Fee Payment Agreement, would [Imperial] otherwise owe payments under the Texas Fee Payment Agreement based on those Acquired Brands?
>
> COUNSEL FOR IMPERIAL: No, Your Honor, because [Imperial] is not a party either to the Texas settlement or to the related fee payment agreement.
>
> THE COURT: ***So are you telling me that Reynolds is paying gratuitously*** to the lawyers?
>
> COUNSEL FOR IMPERIAL: ***I don't know why Reynolds – that's a question for Reynolds's counsel.***"

Hearing Tr., Dkt. No. 2354 at 131:19–22 (emphasis added). When the Court asked Reynolds, it offered two explanations: the payments to Texas' Private Counsel were less expensive in view of their limited duration, so Reynolds was willing to make such payments, and the rights maintained by Texas' Private Counsel had "accrued" previously. *See id.* at 123:13–124:19. Neither is persuasive.[27]

It is hard for this Court not to speculate that perhaps Reynolds was more concerned about incurring the wrath of Texas' Private Counsel than the wrath of the Texas Attorney General. In any event, and all speculation aside, Reynolds' conduct is inconsistent and at the same time, quite telling. What matters is ***what*** Reynolds has done, rather than any subjective rationale as to ***why*** Reynolds has done it.

B. Legal Standard

The Texas Supreme Court addressed the scope of assignor liability in *Seagull Energy E&P, Inc. v. Eland Energy, Inc.*, 207 S.W.3d 342 (Tex. 2006). *Seagull* involved a contract governing the development of minerals contained beneath two offshore oil and gas blocks. *Id.* at 344. The relevant contract—an operating agreement—provided that one of the lessees, Seagull Energy E&P ("Seagull"), would develop the minerals contained beneath the offshore blocks on behalf of all other parties who had interests in the leases covering the blocks. *Id.*

"In 1994, Eland Energy, Inc. purchased an interest in both leases, acquiring a 1.09375% interest . . . and a 9.41719% interest" respectively in the two offshore blocks. *Id.* "As the new owner, Eland expressly assumed certain rights and responsibilities under two offshore operating agreements, each applicable to its respective block." *Id.* One such obligation applicable to both blocks "provided that Eland and the other lessees were to share the cost of operations in proportion

[27] With respect to the former rationale, Reynolds' willingness to meet its less expensive obligations—but not its costlier ones—is no basis to avoid liability. The latter rationale is similarly unavailing, both as a factual and legal matter. Texas' rights (and its performance under the Texas Settlement) had "accrued" with the execution of the Texas Settlement. By the covenants in the Texas Settlement, Texas then and thereby released the settling defendants from liability, in perpetuity. That release *was* Texas' performance, and its rights vested contemporaneously thereto: Texas then became entitled to payments as set out in the Texas Settlement. If the rights of Texas' Private Counsel had already accrued, then so too had the rights of Texas.

to their respective interests, and that Seagull, as operator," would develop "the minerals and collect the operating costs from the other lessees." *Id.*

Two years later, in 1996, Eland sold its interests in the leases to a third party, and assigned its rights and obligations under the operating agreements to that third party. *Id.* After the third party "failed to reimburse Seagull for its share of operating costs," Seagull brought suit against Eland. *Id.*

Both Eland and Seagull moved for summary judgment. *Id.* Much like Reynolds in the instant case, Eland argued that it was not obligated to pay for post-1996 operating costs because it did not own any interest in the leases during that time period. *Id.* at 345. The contract at issue defined "Participating Interest" as "the respective percentage of participation of each Party . . . based on ownership in the Lease," and required "each Party" to "reimburse [Seagull] in proportion to its Participating Interest."[28] *Id.* Since it had no ownership in the leases after 1996, Eland argued that the "Participating Interest" definition eliminated its liability. *Id.* In contrast, Seagull argued that "Texas contract law generally provides that an assignor's contractual obligations survive assignment unless the contract expressly provides otherwise or the assignor obtains an express release. Because the operating agreements here were silent on the subject and [Seagull] did not expressly release Eland," Seagull claimed that Eland remained liable. *Id.* Eland then argued that the definition of Participating Interest, combined with the provision allocating payments according to Participating Interest, made that general rule inapplicable. *Id.* The trial court agreed with Seagull, and granted summary judgment. *Id.* at 344.

The court of appeals reversed and "concluded that Eland had no continuing liability under the operating agreements after the assignment of its working interest because the agreements did

[28] Eland's argument with respect to "Participating Interest" is much like Reynolds' argument concerning the Market Share calculations called for in the Texas Settlement.

not expressly provide for such a continuing obligation." *Id.* at 344–45. That court agreed that Eland's "obligation to pay expenses under the operating agreement terminated on the date it sold its interests because the agreement imposed liability for expenses only upon ***current*** working interest owners." *Id.* at 345 (emphasis in original).

The Texas Supreme Court granted Seagull's petition for review, and concluded that Eland remained liable. In the court's view, the dispute turned "on whether the parties to the operating agreement expressly agreed upon the consequences that should follow an assignment of one's interest to a third party." *Id.* As an initial matter, the court rejected Eland's argument based on the Participating Interest term and the related payment obligation. While acknowledging both terms, the court concluded that "Eland . . . reads far too much into these provisions. Nowhere do they mention the subject of release or the consequences which are to follow the assignment of a working interest." *Id.* at 346. Indeed, these provisions governed the calculation of the ***amount*** of payment due under the contract—not the allocation of liability for that amount. *Id.* "Thus, we disagree with Eland that the parties expressly agreed that an assignment of a working interest was to operate as a novation, effectively ending any further obligation of the assignor under the operating agreement." *Id.* "The operating agreement simply does not explain the consequences of an assignment of a working interest to a third party." *Id.*

Given that contract's silence on the consequences of an assignment, the Texas Supreme Court looked to the common law for a rule of construction. It concluded that "[g]enerally speaking, a party cannot escape its obligations under a contract merely by assigning the contract to a third party." *Id.* at 346–47. "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." *Id.* at 347. Applying this common law rule, the court concluded that Eland remained liable. *Id.* "Because the operating agreement did not expressly provide that Eland's obligations under the operating agreement should terminate upon assignment and Seagull did not expressly release Eland following the assignment of its working interest, we reverse the court of appeals' judgment and render judgment for Seagull as the trial court did." *Id.*

In summary, "[u]nder Texas contract law, an assignor's contractual obligations generally 'survive assignment unless the contract expressly provides otherwise or the assignor obtains an express release.'" *Republic Petroleum LLC v. Dynamic Offshore Res. NS LLC*, 474 S.W.3d 424, 430 (Tex. App.—Houston [1st Dist.] 2015, pet. denied) (quoting *Seagull*, 207 S.W.3d at 345).[29]

C. Reynolds Improperly Narrows *Seagull*

Reynolds contends that *Seagull* only applies to transfers of contracts, and that it does not apply to transfer of the assets that form the subject matter of a contract. Reynolds argues that *Seagull* is an inadequate basis to find Reynolds liable. The Court rejects this argument.

First, Reynolds does not cite a single case or other authority that has narrowed *Seagull* in the manner it proposes. Reynolds has not identified any case distinguishing *Seagull* from applying to asset transfers rather than assignment of contract rights. Likewise, this Court has found none.

Second, Reynolds' argument is inconsistent with the reasoning in *Seagull*. *Seagull* provides a rule applicable when parties do not expressly specify the consequences of an assignment. Nothing in *Seagull* turns on the nature of the assignment—either assignment of the payment

[29] In addition to its general rule, which the Court relies upon, *Seagull* also recognizes that "[e]ven when the contract does not expressly provide for the consequences resulting from the assignment of one's interest, the contract's subject or other circumstances may indicate that obligations were not intended to survive assignment." *Seagull,* 207 S.W.3d at 347. Like the defendant in *Seagull*, Reynolds does not argue here that the Texas Settlement's "subject or other circumstances" imply that it should be released of its obligations after assignment. Just as the *Seagull* defendant could have paid money to fulfill its obligations under the applicable operating agreement after it assigned its leasehold interests, Reynolds could pay money after its assignment of the Acquired Brands, in order to fulfill its obligations to Texas. There is nothing about the subject or circumstances of the Texas Settlement that implies, in any way, that Reynolds should be released from obligations upon the transfer of the Acquired Brands. In this regard, and otherwise, *Seagull* is on all fours with the instant case. Without an express release from Texas—and there is none—the assignment by Reynolds does not allow it to escape its existing obligations under the Texas Settlement.

obligations under the operating agreement, or assignment of the underlying working interests in the leases at issue. Instead, *Seagull* provides a framework for determining the consequences of an assignment when a contract does not otherwise expressly provide for the consequences of such assignment, and there is no release given by the obligee. Accordingly, the rule and analysis set out in *Seagull* are directly on point here.

Third, *Seagull* reflects a general rule—continuing liability—that may be informed by the relevant contract's "subject" or "other circumstances." Thus, even if the general rule announced by *Seagull* did not squarely govern this case—and the Court finds that it does—the Court would apply *Seagull* to this contract's "subject" or "other circumstances" pursuant to the ordinary rules of contractual interpretation in Texas. These rules direct that the Court be informed by the text, structure, and business purposes of the Texas Settlement, which reflect the parties' expressed intent. The text, structure, and business purposes support the conclusion that Reynolds' liability continues despite its assignment of the Acquired Brands. *See infra* Section III.D.2. Thus, even if the default rule announced in *Seagull* would not apply to *all* asset sales, it certainly applies to *this* asset sale, in light of the ordinary application of contract law to the Texas Settlement.

Fourth, the guidance of the Fifth Circuit's decision in *Texas Industries* is contrary to Reynolds' position. *See infra* Section III.D.2.b.iii (applying *Tex. Indus. v. Brown*, 218 F.2d 510, 512 (5th Cir. 1955)). As noted above, *Texas Industries* explained that in addition to "an assignment of the contract," "neither a sale nor lease" of the assets at issue would "effectuate a release of [the original contracting party's] obligations under the contract." *Tex. Indus.*, 218 F.2d at 512. The rule set out in *Texas Industries* is closely akin to the rule set out in *Seagull*—*i.e.*, absent a specific release, an assignment (of either a contract or an asset) will not obviate a party's contractual obligations. *See also Republic Petroleum*, 474 S.W.3d at 430 ("Under Texas contract law, an assignor's contractual obligations generally 'survive assignment unless the contract expressly provides otherwise or the assignor obtains an express release.'" (quoting *Seagull,* 207 S.W.3d at 345)).

The rule in *Texas Industries* is also consistent with the broader common law rule, which is relied upon in both the decisions of the Minnesota Court and the Florida Court, as well as in the cases cited by those courts. In summarizing the common law on the subject, Williston on Contracts explains that the basis for the doctrine "is sufficiently obvious when attention is called to it, for otherwise obligors would find an easy practical way of escaping their obligations: . . . obligors could free themselves of their obligations by the simple expedient of assigning them . . . ." 29 Samuel Williston & Richard A. Lord, *Williston on Contracts* § 74:27 (4th ed.). The Fletcher Cyclopedia, a leading treatise on the law of corporations,[30] also confirms that Reynolds remains liable under the common law rule. The treatise provides that:

> Although a sale of assets may allow an injured plaintiff to proceed against the successor corporation, it does not vitiate the original company's liability. The right of the injured party to elect to proceed against the [original] corporation, the successor corporation, or both cannot be altered per se by the corporations, although the corporations can regulate how such liability will be allocated among themselves.

Fletcher et al., *supra*, § 7123; *accord Golden State Bottling Co. v. N.L.R.B.*, 414 U.S. 168, 182 (1973) (citing § 7123 as setting forth "the general rule of corporate liability"). Reynolds seeks to achieve precisely the result prohibited by this doctrine: it attempts to "free [itself] of [its] obligations" under the Texas Settlement "by the simple expedient of assigning" the Acquired

[30] For over a century, the Supreme Court of Texas, the Fifth Circuit Court of Appeals, and the United States Supreme Court have all repeatedly cited Fletcher's Cyclopedia as an authoritative treatise on the law of corporations and corporate liability. The Texas Supreme Court has even disapproved of Texas intermediate appellate courts on the basis of inconsistency with Fletcher's Cyclopedia. *See Texam Oil Corp. v. Poynor*, 436 S.W.2d 129, 130 & n.2 (Tex. 1968) (following "[t]he rule which Fletcher says is 'the better and majority rule,'" and accordingly disapproving a decision from a Texas intermediate appellate court).

Brands. Williston & Lord, *supra*, § 74:27. Accordingly, Reynolds may not "vitiate" its "liability" to Texas through "a sale of assets." Fletcher et al, *supra*, § 7123.

D. Text and Context Demonstrate Reynolds Remains Liable

In all contract cases, the task of the court "is to ascertain the parties' true intentions as expressed in the language they chose." *Plains Expl. & Prod. Co. v. Torch Energy Advisors Inc.*, 473 S.W.3d 296, 305 (Tex. 2015) (citing *Moayedi v. Interstate 35/Chisam Rd., L.P.*, 438 S.W.3d 1, 7 (Tex. 2014)). Since parties may make drafting choices in light of the circumstances under which a contract is reached, Texas courts "'construe contracts from a utilitarian standpoint bearing in mind the particular business activity sought to be served.'" *Apache Deepwater, LLC v. McDaniel Partners, Ltd.*, 485 S.W.3d 900, 906–07 (Tex. 2016) (quoting *Lenape Res. Corp. v. Tenn. Gas Pipeline Co.*, 925 S.W.2d 565, 574 (Tex. 1996)). To do so, Texas courts "examine the entire agreement and seek to harmonize and give effect to all provisions so that none will be meaningless." *Nassar v. Liberty Mut. Fire Ins. Co.*, 508 S.W.3d 254, 258 (Tex. 2017) (quoting *Gilbert Tex. Constr., L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118, 126 (Tex. 2010)).

As noted above, *Seagull* furnishes a rule of contract construction where the contract is silent on the result of an assignment. The Court applies that rule to determine that Reynolds is liable. However, the Court also concludes that even if the rule announced in *Seagull* does not apply to all asset transfers, there are case-specific justifications—based on the ordinary rules of contract interpretation—for applying that rule to the Texas Settlement. Nothing in *Seagull* suggests that it intends to displace the ordinary application of contract law to determine liability based on an assignment. Applying Texas contract law, the Court finds that the text, structure, and "particular business activit[ies] sought to be served" by the Texas Settlement uniformly demonstrate that Reynolds remains liable for the Acquired Brands.

1. Texas Did Not Consent

All parties agree that Texas has not consented, expressly or otherwise, to release Reynolds from its liability under the Texas Settlement.[31] Accordingly, the Court next turns to whether the context or subject matter of the Texas Settlement supports a finding of continued liability for Reynolds.

2. The Text and Business Purposes of the Texas Settlement Demonstrate That Reynolds Remains Liable

Both the text and context of the Texas Settlement demonstrate that Reynolds remains liable for payments under the Texas Settlement. In the following Sections, the Court will first examine each business purpose that is expressly set out in the Texas Settlement, and then will examine specific textual indicators which confirm that Reynolds remains liable for the Acquired Brands.

a. <u>Every Business Purpose of the Texas Settlement Suggests Liability Continues</u>

Since parties negotiate specific terms in light of a specific business context, Texas courts construe contracts from "a utilitarian standpoint" while "bearing in mind the particular business activity sought to be served." *Apache Deepwater*, 485 S.W.3d at 906–07. Accordingly, in construing the Texas Settlement, the Court now turns to the business purposes which the Texas Settlement sought to serve.

[31] The Court does not interpret Reynolds' and Imperial's submission of parol evidence related to the Texas Comptroller to suggest that Texas consented to release Reynolds from its obligations under the Texas Settlement. However, to the extent Reynolds and Imperial ask the Court to draw that inference as a factual matter, the Court finds that the relevant parol evidence does not suggest that Texas consented to release Reynolds. *See infra* Section III.D.2.d. Further, the actions of the Texas Comptroller's employees cannot effectuate a release under the Texas Settlement, because the Texas Settlement provides that any waiver of rights must be made in a writing. *See Texas Settlement*, Dkt. No. 2222-1 at 24 § 23.

i. Finality

The language of the Texas Settlement reflects finality as a business purpose of the settlement agreement.[32] Texas law recognizes that the business purpose of a settlement agreement is to resolve disputes with finality. In Texas, a settlement agreement is meant to forever settle the dispute at hand, rather than merely deferring the dispute to a later date.

A recent case illustrates how the Fifth Circuit applies this principle. *In re Pirani*, 824 F.3d 483 (5th Cir. 2016). The matter before the Fifth Circuit in *In re Pirani* concerned interpretation of a settlement agreement under Texas law. *Id.* at 488–89. A hotel developer, as a debtor in a bankruptcy proceeding, alleged breach of a loan agreement against a number of investors in a hotel development deal that subsequently fell apart. *Id.* at 489. In response, the investors alleged that a settlement executed by the hotel developer released them from any liability under the loan agreement. *Id.* at 490. The hotel developer disputed that the settlement agreement barred his individual claims, because the settlement only included a release from "the Company." *Id.* at 492–93. Accordingly, the developer argued that only his corporate entity was bound by the settlement. *Id.* Since the developer asserted that he was not personally bound to the settlement agreement, he asserted that his personal breach claims in the bankruptcy court could proceed. *Id.*

The phrase "the Company" was defined in multiple ways throughout the settlement agreement. *Id.* at 494–95. The settlement included a definition in the opening paragraph which included the hotel developer in his individual capacity, and a definition in a later provision—§ 3.1(a)—that only included the developer's corporate entity. *Id.* Since the relevant release

[32] To avoid duplication, the Court sets out its analysis of specific textual indicators in the Texas Settlement below, in Section III.D.2.b. For the reasons set out therein, the following textual provisions specifically support the Court's conclusion that finality was an intended business purpose of the Texas Settlement: Section III.D.2.b.ii (discussing payments-in-perpetuity terms); Section III.D.2.b.iii (discussing successors-and-assigns term); Section III.D.2.b.v (discussing prior written consent term).

language was contained in nearby § 3.2, the developer contended that specific-over-general canon of Texas contract interpretation favored using the narrow § 3.1(a) definition of "the Company" rather than the global definition in the opening paragraph. *Id.* The investors urged that the definition in § 3.1(a) applied only to the subsections ***within*** that section—that is, §§ 3.1(a)–(d)—and that the global definition applied to the remainder of the contract, including the release language in § 3.2. *Id.*

The Fifth Circuit agreed with the investors, and applied the broader definition of "the Company" to hold that the settlement agreement bound and barred the hotel developer's individual claims. *Id.* at 495–96. While both sides had advanced plausible arguments for each definition of "the Company," the *Pirani* court selected the construction that effectuated the goal of finality inherent in the settlement agreement. *Id.* Accordingly, this holding instructs courts to prefer constructions which effectuate finality interests over constructions that vitiate finality. *Id.* The Fifth Circuit explained:

> The overall context of the agreement also supports this result. Under Texas law, courts are expressly permitted to take into account the "objectively determinable" "facts and circumstances surrounding [the] contract" that "give context to the parties' transaction." *Kachina Pipeline*, 471 S.W.3d at 450 (citation omitted). ***Here, the most critical relevant circumstance is that the contract is a settlement agreement, drafted and entered into for the purpose of settling claims between two sides to a dispute.*** Those two sides are defined in the opening paragraph, with "the Company" encompassing all parties on the [hotel developer's] side of the dispute. ***In the context of a settlement agreement, section 3.2 makes the most sense if the promise to secure releases for [the investors] is binding all of the parties on the other side of the dispute***.

Id. (emphasis added).

Consistent with *Pirani*, the Texas Settlement evinces the purpose of finally settling disputes related to the sale of tobacco products, including the Acquired Brands. As with the settlement in *Pirani*, the Texas Settlement was "drafted and entered into for the purpose of settling claims between two sides to a dispute," and "makes the most sense" if its obligations are "binding on all of the parties on the other side of the dispute," including their successors and assigns—as expressly provided for in the Texas Settlement. *See id.* Accordingly, finding that liability for the Acquired Brands is not extinguished by Reynolds' assignment is consistent with the finality interests manifest in the Texas Settlement.

By contrast, Defendants' position is inconsistent with finality. Both Imperial and Reynolds argue that if Texas wants to receive any payments for the harm caused by public consumption of the Acquired Brands, it must file a new suit and relitigate with Imperial the claims it previously settled with Reynolds.

Defendants' position would not only vitiate the finality of the Texas Settlement with respect to the Acquired Brands, but would do the same to the entire agreement. At the hearing on the instant Motions to Enforce, PMUSA all-but-admitted that it would follow Reynolds' example if the Court permitted Reynolds to escape its obligations under the Texas Settlement by transferring assets. "If the position of Reynolds and [Imperial] were adopted . . . it would be a roadmap—in fact, it would almost be ***imperative*** for the settling Defendants to escape their liability under the settlement agreement" by following the model established by Reynolds. *Hearing Tr.*, Dkt. No. 2354 at 27:3–13 (emphasis added). Accordingly, PMUSA argued that permitting defendants to unilaterally escape their liability would "destroy" the Texas Settlement. *Id.*

The Court does not view PMUSA's statement as a threat. Instead, the Court simply concludes that PMUSA provided a candid description of how it likely would proceed, if Reynolds' example was vindicated. That scenario is not only possible but is likely, given that PMUSA—and

Reynolds for that matter—could likely retain all or virtually all of the profit from those cigarettes, while completely avoiding liability therefor.[33]

There is no textual or contextual basis to conclude that the parties to the Texas Settlement intended to permit such a result. As noted above, on the eve of a trial, the parties created a settlement that imposed payments in perpetuity on every major tobacco manufacturer in the nation. It would be unreasonable for a comprehensive settlement to be read as only partial, incomplete, and terminable at the obligated Defendants' unilateral option.

Defendants' construction of the Texas Settlement is incompatible with the purpose of finality. The Court concludes that the finality-related business purpose and context of the Texas Settlement support a finding that the parties intended liability for Reynolds to continue after assignment of the Acquired Brands.

[33] Reynolds' interpretation would permit settling defendants to completely avoid all existing obligations under the Texas Settlement while retaining all, or virtually all, of the profit from those cigarette sales. Consider the following scenario: if this Court adopts Reynolds' theory of the Texas Settlement, Reynolds (or PMUSA for that matter) could create a distinct corporate entity ("ReynoldsSub"). Reynolds could assign ownership of all of its cigarettes to ReynoldsSub, while maintaining its status as the sole shareholder in ReynoldsSub. As the sole shareholder, Reynolds would maintain complete control over the issuance of dividends by ReynoldsSub, permitting Reynolds to reap the profit from the sales of its cigarettes. Further, its status as sole shareholder would leave Reynolds in control of the organization and conduct of ReynoldsSub, despite the observation of corporate formalities between the two.

Under Reynolds' theory, ReynoldsSub would not be an "assign" within the meaning of the Texas Settlement, since it only possesses Reynolds' brands, cigarettes, and intellectual property—not any of Reynolds' rights or obligations under the Texas Settlement. If the Court adopted Reynolds' construction of the Texas Settlement, liability for all of those cigarettes simply goes up in smoke, since the Market Share provision applies only to direct sales by Reynolds, and the cigarettes would be sold by ReynoldsSub. If Texas (or Minnesota, Mississippi, and Florida) wished to collect repayment for the damage caused by the sale of those tobacco products sold by ReynoldsSub, the several states would have to file an entirely new lawsuit.

This scenario is neither idle nor hypothetical. As noted above, PMUSA candidly informed the Court that if the Court creates a legitimate path by which it may avoid its Texas Settlement obligations, it will do so. In light of its duties to its shareholders, why wouldn't it? The Texas Settlement imposes sizeable financial obligations on the settling defendants, and Texas would face serious practical obstacles if it was forced to file a new lawsuit and redo the work of the Texas Settlement. *See supra* Section III.D.2.b.ii (describing "problems of proof" related to causation and damages that would arise out of the existence of the Texas Settlement). Forcing Texas into a redo-scenario easily leaves the settling defendants far better off than they are under the yoke of the Texas Settlement. This scenario, or a comparable scenario organized to the same end, is a natural result of adopting the construction urged by Reynolds. To permit such a scenario is to end the Texas Settlement. The Court finds that such a result would be oppressive, inequitable, and unreasonable. According, application of that canon of construction strongly favors continuing liability under the Texas Settlement on this basis.

ii. Reimbursement

a) The Texas Settlement contemplates proportional reimbursement for Texas' healthcare expenditures, including past cigarette consumption

The Texas Settlement sets forth a reimbursement framework that is consistent with Reynolds remaining liable. Specifically, the Texas Settlement includes a separate provision addressing the purpose of the "payments to be made by Settling Defendants." *1998 Amdt.*, Dkt. No. 2222-2 at 7 § 4. Section 4 of the 1998 Amendment provides:

> The payments to be made by Settling Defendants under this Stipulation of Amendment during the year 1998 are in settlement of the State's claims for reimbursement for public health expenditures of the State of Texas incurred in the year of payment or earlier years related to the subject matter of this Action, including without limitation expenditures made by the State's Employees' Health Insurance Program and Charity Care programs. ***All other payments made by Settling Defendants*** pursuant to this Stipulation of Amendment ***are in settlement of all of the State of Texas's claims for damages incurred by the State in the year of payment or earlier years related to the subject matter of this Action***, ***including claims for reimbursement of Medicaid expenditures*** and punitive damages, except that no part of any payment under the Settlement Agreement or this Stipulation of Amendment is made in settlement of an actual or potential liability for a fine, penalty (civil or criminal) or enhanced damages or as the cost of a tangible or intangible asset or other future benefit.

Id. (emphasis added); *accord Texas v. Am. Tobacco Co.*, 463 F.3d 399, 401 (5th Cir. 2006) ("On March 28, 1996, the State of Texas sued several major tobacco companies ***seeking reimbursement for various smoking-related health care expenditures***.") (emphasis added). This payment framework is necessary because of the various ways in which tobacco-related illnesses manifest themselves. Tobacco-related injuries frequently accrue over a period of years, only presenting after a substantial period of time. This risk remains even after the use of tobacco products stops. *See supra* Section III.A (giving the example of a Salem smoker with a time-lagged injury).

As a result, the Texas Settlement involves a methodology approximating the amount of damage caused by the tobacco products of each settling defendant for each given year. When more Texans smoke a settling defendant's cigarettes (measured by the volume of cigarettes purchased in a given year), the Texas Settlement assigns proportionally greater liability to that defendant for that year. This design is consistent with the perpetual nature of the payment framework set out by the Texas Settlement. Given that no reimbursement structure would guarantee all the funds needed every year to address that year's treatment demands,[34] the perpetual nature of the agreed-upon reimbursement framework ensures that Texas always has the resources—in any given year—to dedicate towards its citizens' medical care.

Texas argues that this reimbursement framework is only coherent if liability continues for the Acquired Brands. At the Court's hearing on the Motions to Enforce, Texas offered the following example to illustrate its point:

> So just as an example, say you have Jane Smith, she starts to smoke Winston cigarettes in 2001. She smokes for 15 years and unfortunately is diagnosed with cancer from her smoking in 2016. Reynolds stopped paying the State of Texas for the Winston brands in 2015. So when Smith gets cancer, the State has to begin making Medicaid payments for Ms. Smith's healthcare. In that situation, the State has not been paid for any of Ms. Smith's healthcare costs because none of the yearly payments were for future harm. And the Texas Settlement Agreement required that perpetual payment so that the State would not be in a position where it had to pay for Smith's medical care without reimbursement for those costs.
>
> . . .
>
> [T]he claim language of the agreement demonstrates that this intent was for a payment to be in perpetuity, because if we aren't paid every year, we won't catch people like Ms. Smith. And, unfortunately, the reality is that lots of people get very sick.

[34] This principle follows from the fact that tobacco-related illnesses may manifest at unpredictable times and in unpredictable ways.

Hearing Tr., Dkt. No. 2354 at 17:20–19:16.

Reynolds counters that this result is acceptable under the Texas Settlement, because the same result would occur if Reynolds simply stopped selling cigarettes at all. In Reynolds' view, since Reynolds could unilaterally *stop selling* the Acquired Brands without breaching the Texas Settlement, it can also *assign* the Acquired Brands without breaching the Texas Settlement.

This argument is misplaced. A scenario where the Acquired Brands were *no longer sold at all*—and thus no longer contribute to the harm of Texas citizens—is very different than a situation where the Acquired Brands continue to be sold in Texas, but by someone other than Reynolds. The Court agrees that the Texas Settlement evinces a mutually-agreed business purpose of providing perpetual reimbursement. That business purpose is only consistent with continuing liability for Reynolds with respect to the Acquired Brands.

In sum, the Court finds that reimbursement is an explicit business purpose of the Texas Settlement, and that such purpose would be frustrated without continuing liability for Reynolds.

b) Texas is not judicially estopped from asserting reimbursement as a purpose of the Texas Settlement

Reynolds advances the argument that Texas is judicially estopped from asserting that the Texas Settlement includes "compensation for past acts" based on positions that Texas took in a separate action before the Texas Supreme Court.

Texas had the opportunity to discuss the Texas Settlement in a constitutional challenge brought against the Tobacco Equity Tax statute pursuant to the Equal and Uniform Clause of the Texas Constitution. *See supra* Section I.D (describing the Tobacco Equity Tax). When such challenge reached the Texas Supreme Court, Texas intervened and defended the law. *Tex. Small Tobacco Coal.*, 496 S.W.3d at 785. The challengers—a coalition of smaller tobacco manufacturers—asserted that the Tobacco Equity Tax was unconstitutional because it was not "uniform" in its application. The coalition argued that the Texas Settlement payments were really about ***punishment***, not reimbursement, and so the Texas Settlement was not a valid way to distinguish between classes of manufacturer. Texas asserted that Texas Settlement payments were not ***exclusively*** punitive—even if they were designed, in part, to punish, such payments also included an ongoing reimbursement framework designed to reimburse healthcare costs to Texas. Ultimately, the Texas Supreme Court agreed with Texas and upheld the constitutionality of the Tobacco Equity Tax.

Reynolds' argument fails because the position Texas took in the *Texas Small Tobacco Coalition* case is not inconsistent with its position here. Further, there is no judicial reliance—as is required for judicial estoppel—because the Texas Supreme Court explicitly reached its conclusion without relying on a finding related to the underlying purposes of the Texas Settlement. *Cf. Gabarick v. Laurin Mar. (Am.) Inc.*, 753 F.3d 550, 553 (5th Cir. 2014) (requiring judicial reliance). In fact, that Court went to great lengths to make its restraint clear. The Texas Supreme Court expressly refused to determine the purpose of the payments made under the Texas Settlement. *Tex. Small Tobacco Coal.*, 496 S.W.3d at 788–92 ("[A]s a matter of judicial restraint, we *must* not decide the meaning of those payments today.") (emphasis in original). For these reasons, Reynolds' judicial estoppel argument is of no effect.

b. <u>Taken as a Whole, the Texas Settlement Demonstrates Continuing Liability</u>

Contracts must be construed in a manner that will "harmonize and give effect to all the provisions of the contract so that none will be rendered meaningless." *J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 229 (Tex. 2003) (citing *Universal C.I.T. Credit Corp. v. Daniel*, 243 S.W.2d 154, 158 (Tex. 1951)). "No single provision taken alone will be given controlling effect;

rather, all the provisions must be considered with reference to the whole instrument." *Id.* The following provisions, when harmonized rationally, support finding Reynolds liable.

i. No Release Provision

The most directly relevant indicator is the absence of a release provision. In *Seagull*, the contract did not include a provision that expressly released the contracting party from its obligations following an assignment, neither did it include a provision that expressly extended the contracting party's obligations after an assignment. *Seagull*, 207 S.W.3d at 345. As here, the contract was "silent on the subject" of post-assignment liability for the assignor. *Id.*

The *Seagull* court concluded that the absence of an express release provision was sufficient to support continuing liability for the assignor. *Id.* at 347. Specifically, *Seagull* explained that the assignor's liability continued "[b]ecause the operating agreement did not expressly provide that [the assignor's] obligations under the operating agreement should terminate upon assignment and [the injured party] did not expressly release [the assignor] following the assignment of its working interest." *Id.*

Here, no one disputes that the Texas Settlement does not contain any provision that could be construed as a release to be effective upon an assignment of the type Reynolds has made. Reynolds could have negotiated for a "release upon assignment" provision. It did not. Accordingly, as in *Seagull*, the absence of an express release provision is sufficient to find that Reynolds remains liable for the Acquired Brands under the Texas Settlement.

ii. Payments in Perpetuity

The Texas Settlement provides that Settling Defendants shall make Texas Settlement payments in perpetuity. The Texas Settlement provides that each Defendant shall make payments "on December 31, 1999 and annually thereafter on December 31st of each year after 1999." *1998*

Amdt., Dkt. No. 2222-2 at 11 § 7. The phrase "annually thereafter" is unambiguous.[35] It is unqualified, includes no termination condition, and by its plain text literally encompasses every year after the Texas Settlement is executed.[36]

The interpretation of the Texas Settlement, as presented in this case by Defendants, is irreconcilable with a perpetual payment framework. Reynolds argues, in essence, that it is only liable as long as it produces and sells cigarettes branded under the Acquired Brands. Reynolds seems content to argue that if it were to sell the Acquired Brands for billions of dollars (which it did) Texas has no recourse under the Texas Settlement. This construction contradicts the perpetual payment structure of the Texas Settlement.

Imperial argues that since it disclaims any rights under the Texas Settlement, Texas can simply initiate new litigation against Imperial for the harm caused by the Acquired Brands. The

[35] As noted above, the Court finds that "annually thereafter" is unambiguous on its face. However, for the purpose of argument, to the extent "annually thereafter" might elsewhere be read as ambiguous, the Court alternatively makes the following factual findings that the phrase "annually thereafter" was understood by the parties to the Texas Settlement as imposing payment obligations in perpetuity.

First, there is a uniform course of performance from the settling defendants which shows that Texas Settlement payments are ongoing. Both Reynolds and PMUSA—the only remaining settling defendants—continue to make Texas Settlement payments for all of their brands (with the obvious exclusion that Reynolds has stopped making payments on the Acquired Brands).

Second, in documents filed with the United States Securities and Exchange Commission, Reynolds documented its understanding that the Texas Settlement "***imposed future payment obligations <u>in perpetuity</u> on RJR Tobacco***, B&W, Lorillard Tobacco and other major U.S. cigarette manufacturers." *Reynolds 2015 Form 10-K*, Dkt. No. 2222-8 at 111 (emphasis added). These statements were made prior to the present litigation, in a context where Reynolds had a legal obligation to make accurate statements. The Court credits them as such.

Those statements are also consistent with the position taken under oath by Reynolds' then-CEO Andrew J. Schindler that payment obligations under the Texas Settlement last "forever." *Schindler Fla. Trial Testimony*, Dkt. No. 2222-9 at 54711:25–54712:4 ("Q. Do Reynolds' obligations stop after 25 years under the MSA and the other four agreements? A. No, they don't. Q. ***How long do they go on?*** A. ***<u>Forever.</u>***") (emphasis added). Other Reynolds executives took an identical position under oath. *See, e.g.*, *Orlowsky Fla Trial Testimony*, Dkt. No. 2222-10 at 55899:16–55900:7 ("Q: Let's start with the MSA and other state agreements. . . . Q. Do your financial obligations under those agreements end after 25 years? A. No, they do not. ***They go on <u>forever</u>*** .") (emphasis added). In view of the foregoing, the Court factually finds that the term "annually thereafter" was understood by the parties to impose an obligation to make Texas Settlement payments in perpetuity.

[36] The inclusion of an adjustment for inflation is also additional evidence that the signatories to the Texas Settlement understood that payments would be made in perpetuity—if payments were only intended to be made for a relatively short period of time, there would be a correspondingly lessened need to include an adjustment for inflation. While the inclusion of this term is not determinative of the duration of payments, it remains additional evidence consistent with an ongoing payment arrangement.

Court rejects this suggestion because it would result in an unreasonable, oppressive, and inequitable construction of the Texas Settlement. *See Frost Nat'l Bank*, 165 S.W.3d at 313 (explaining that courts must avoid contract constructions that are "unreasonable, inequitable, and oppressive"). Indeed, it would vitiate the very purpose of a settlement agreement and subject Texas to a potentially endless stream of litigation.

However, Imperial's suggestion that Texas simply file a new lawsuit reveals more fundamental problems. The compounding nature of tobacco injuries creates a material problem of proof that could bar any effective relief that Texas could seek. In any new action, Imperial would surely argue that Texas cannot prove that its citizens' medical illnesses (and resultant expenses) are caused by *Imperial's* sales of the Acquired Brands. Imperial would be able to claim that it is impossible to disaggregate the post-2015 harm caused by Imperial from the pre-2015 harm caused by Reynolds. Accordingly, absent some reliable measure of disaggregated damages, which may be foreclosed by the very nature of tobacco-related injuries, Imperial would surely assert that it cannot be held liable in any such new litigation. *See, e.g.*, *Bostic v. Ga.-Pac. Corp.*, 439 S.W.3d 332, 359 (Tex. 2014) (vacating judgment in favor of asbestos plaintiff because there was no "basis for the jury to apportion liability between these two sources of asbestos").

Compounding the issue, a follow-on suit would not only involve disaggregating between "two sources" of cigarettes, but would involve resolving the impact of the releases already given by Texas. Notably, Imperial has not disclaimed its right to rely on the Texas Settlement to immunize itself from liability for the cigarettes that were sold by Reynolds under the Acquired Brands. In that sense, Imperial has retained the right to benefit from the releases granted by the Texas Settlement, even if it does not identify as a beneficiary under the contract itself. The practical result of Imperial's retention of its right to rely on the releases in the Texas Settlement is that

Imperial could very well receive, as a functional matter, a perpetual release of liability while avoiding making corresponding payments in perpetuity.

iii. Successors and Assigns Clause

The Texas Settlement provides, in pertinent part: "This Settlement Agreement shall be binding upon all Settling Defendants and their successors and assigns in the manner expressly provided for herein." *Texas Settlement*, Dkt. No. 2222-1 at 4 § 2.

The Fifth Circuit relied on a similar clause in *Texas Industries v. Brown* to find that an original contract signatory's liability continued even though the assets which formed the "subject matter" of the contract had been transferred. 218 F.2d 510 (5th Cir. 1955). *Texas Industries* dealt with a requirements contract addressed to three lightweight concrete manufacturing plants. *Id.* at 511. The manufacturing plants relied on a material known as "aggregate" to manufacture lightweight concrete, and the requirements contract obligated the concrete manufacturer to purchase all the aggregate that the manufacturer needed from the supplier for a period of sixty months. *Id.* The contract also purported to be binding on the manufacturer's "successors and assigns." *Id.*

After only sixteen of the sixty months, the manufacturer leased the concrete plants to a third party, and thereafter rejected further shipments of aggregate on the basis that ***he*** no longer required any aggregate since ***he*** did not operate the plants. *Id.* The aggregate supplier brought suit against the concrete manufacturer and his third-party lessees, alleging that the manufacturer was liable for breach of contract and the lessees were liable for inducing breach of contract. *Id.* at 511–12. The trial court granted summary judgment to the plant owners "solely upon the contention that their obligation under the contract was extinguished by the leasing arrangement." *Id.* at 512.

The Fifth Circuit reversed. It explained: "In our opinion, neither a sale nor lease of the three block plants, nor an assignment of the contract, by the [concrete manufacturer] could in law effectuate a release of their obligations under the contract without the consent" of the aggregate supplier. *Id.* The Fifth Circuit identified three independent actions—"sale . . . of the three block plants," "lease of the three block plants," and "assignment of the contract"—and held that ***none of them*** could "effectuate a release" of liability under the original contract. *Id.* Specifically, the Fifth Circuit explained to release the manufacturer from liability would defeat the express intent of the parties. "The written agreement shows on its face that the requirements of the three block plants were the subject matter of the sale, and were within the contemplation of the parties." *Id.* Given that "the plants" themselves had "never ceased to operate," it would be inconsistent with the contract to release the concrete manufacturer from its liability under the contract. *Id.*

The Fifth Circuit also directly pointed to the contract's "successors and assigns" clause. *Id.* at 513. The clause provided, in pertinent part, as follows: "the terms and provisions of this contract shall inure to the benefit of and ***be binding upon the parties hereto, and upon the heirs, executors, administrators, successors and assigns of each party hereto***." *Id.* (emphasis added). The court explained that inclusion of a successors and assigns clause was evidence that the parties intended liability to continue for the original contracting party. *Id.* The "provisions" of the successors and assigns clause "strengthen our conclusion that [the manufacturer was] not released from but remained obligated" under the contract, despite the transfer of the plants to the lessees. *Id.* In the Fifth Circuit's view, the successors and assigns clause "makes clear . . . that the contracting parties took pains to anticipate and provide against contingencies such as are now being put forward as reasons for terminating the contract." *Id.* In other words, a "successors and assigns" clause reflects an effort by the parties to ensure that the obligations of the contract could not be defeated by transferring the "subject matter" of the contract. *Id.*

The Fifth Circuit surveyed applicable case law reaching back as far as the late 1800s, and found that the authorities reached a uniform outcome: the original contracting party remained liable on a contract when the "subject matter" of the contract was sold, leased, assigned, or otherwise transferred to a third party. *See id.* at 512–13.[37] Not without significance, the language and analysis conducted by the Fifth Circuit in *Texas Industries* is almost identical to the language used by the Texas Supreme Court in *Seagull*. *See Seagull*, 207 S.W.3d at 347 (instructing courts to examine whether either "the contract's subject" ***or*** "other circumstances" indicated whether or not the obligations were "intended to survive assignment"); *compare id.* (construing contract in light of "the contract's subject"), *with Tex. Indus.*, 218 F.3d at 512 (construing contract in light of "the subject matter of the contract"). The analytical similarities between the Fifth Circuit's opinion in *Texas Industries* and the Texas Supreme Court's decision in *Seagull* confirm that both decisions are connected links in the same chain of precedent.

A faithful application of *Texas Industries* in combination with *Seagull* directs the Court to conclude that Reynolds remains liable under the Texas Settlement for sales of the Acquired Brands. The "subject matter" rationale, the "successors and assigns" rationale, and the uniformity of the common law rationale all indicate that Reynolds should not avoid its liability under the Texas Settlement by means of its assignment of the Acquired Brands.

[37] *See Tex. Indus.*, 218 F.2d at 512–13 (citing *Kamm v. Pritchard*, 296 F. 871, 872 (5th Cir. 1924) ("[W]here the owners of timberland and lumber mills had contracted with the plaintiffs to sell to them all of their output of lumber, the Fifth Circuit held that, although the contract contained no covenant by defendants not to sell their entire lumber operation, the contract was nevertheless enforceable by the plaintiff, and damages were recoverable.")); *see also, e.g.*, *id.* (citing *Wells v. Alexandre*, 85 Sickels 642, 130 N.Y. 642 (1891) ("In *Wells v. Alexandre*, the court held that the sale of steamers after making a contract for the supply of coal to them for one year did not relieve the original owners from the obligation to take the coal that the ordinary and accustomed use of the steamers required." (internal citation omitted))).

Notably, the Court is persuaded that the weight of common law authority supports the Court's finding of continuing liability for Reynolds. The purpose of the common law rule that assignments do not extinguish obligations is directly relevant here. Professor Williston's well-regarded treatise on contracts extracts the rationale for this rule from the common law, and summarizes it as follows:

> It has been stated that the duties under a contract are not delegable inter vivos in a true sense under any circumstances; that is, ***one who owes money*** or is bound to any performance whatsoever ***cannot by its own act, or by any act in agreement with anyone else, except its creditor, divest itself of the duty and substitute the duty of another***. "No one can assign his liabilities under a contract without the consent of the party to whom he is liable." ***This is sufficiently obvious when attention is called to it, for otherwise obligors would find an easy practical way of escaping their obligations:*** "While a party to a contract may as a general rule assign all his beneficial rights, except where a personal relation is involved, his liability under the contract is not assignable inter vivos because any one who is bound to any performance whatever or who owes money cannot by any act of his own, or by any act in agreement with any other person than his creditor or the one to whom his performance is due, cast off his own liability and substitute another's liability. ***If this were not true, obligors could free themselves of their obligations by the simple expedient of assigning them*** . . . ." The Uniform Commercial Code provides in this regard that a delegation of performance does not relieve the delegating party of the duty to perform or of any liability for breach of contract.

Williston & Lord, *supra*, § 74:27 (emphasis added). From this straightforward rationale, it follows that a party cannot free itself from its "obligations by the simple expedient of assigning them." *Id.* Texas law follows this rule, as must this Court. *See Capitan Enters., Inc. v. Jackson*, 903 S.W.2d 772, 776 (Tex. App.—El Paso 1994, writ denied).

iv. "In the Manner Expressly Provided For Herein"

The Texas Settlement also provides that it shall be binding on successors and assigns "in the manner expressly provided for herein." In pertinent part, § 2 provides:

> This Settlement Agreement shall be binding upon all Settling Defendants and their successors and assigns ***in the manner expressly provided for herein*** and shall inure to their benefit and to that of their respective directors, officers, employees, attorneys, representatives, insurers, suppliers, distributors and agents, and to that of

> any of their present or former parents, subsidiaries, affiliates, divisions or other organizational units of any kind; and the predecessors, successors and assigns of any of the foregoing.

Texas Settlement, Dkt. No. 2222-1 at 4 § 2 (emphasis added). Imperial puts forward a strained argument as to this phrase. In Imperial's view, the phrase "***expressly*** provided for herein" modifies "successors and assigns" to mean that only the ***releases*** are "binding on successors and assigns," and consequently, the Texas Settlement does not impose continuing payment obligations because "the ***payment*** sections do not mention successors and assigns." *Imperial Resp.*, Dkt. No. 2341 at 16 (emphasis in original). The Court rejects Imperial's interpretation for two reasons.

First, Imperial's argument conflates "benefits" that "inure" with "obligations" that "bind." The releases from liability are ***benefits*** that inure to the benefit of Reynolds' successors and assigns. It is unclear how Reynolds' assigns are ***bound*** by a benefit that inures in their favor. Yet Imperial claims that the only section which "shall be binding" on successors and assigns is the beneficial "waiver and release" provisions, rather than the payment obligations.

Second, Imperial next disclaims those benefits by indicating that it is ***not bound*** to accept the waiver and release from Texas. Such may reflect an effort to avoid liability under the "prior written consent" prong of § 2, which requires such consent whenever a right under the Texas Settlement is assigned. *See Texas Settlement*, Dkt. No. 2222-1 at 4 § 2. Thus, Imperial's argument that it does not benefit from the Texas Settlement's releases is irreconcilable with Imperial's construction suggesting that the releases in the Texas Settling "shall be binding" on Imperial.

The better reading of this phrase is that "in the manner expressly provided for herein" means "on the same terms as are expressly set out herein." PMUSA argues, and the Court agrees, that this term is designed to ensure that any successors and assigns are bound on equal terms as an original settling defendant—that is, bound in the manner expressly provided for in the Texas

Settlement. The phrase "expressly" refers to the explicit terms of the Texas Settlement ("herein"), and the obligations of the Texas Settlement constitute "the manner" in which each settling defendant is bound. This interpretation is most consistent with the antecedent phrase "shall be binding." Obligations can be binding, but benefits inure.

This construction is also the most consistent with the stated purposes of the Texas Settlement. By ensuring that the assigns of settling defendants were bound to the same extent as the original settling defendants, this provision of the "successors and assigns" clause was aimed to avoid precisely this type of scenario, where an assignment is alleged to diminish the rights of the other signatories to the Texas Settlement. Instead, this term expresses the intent that successors and assigns must be bound not in some partial or incomplete way, or in some way that lessens the rights secured by the Texas Settlement, but instead must be bound "in the manner expressly provided for" by the Texas Settlement. In that sense, this construction facilitates both the finality interests of the Texas Settlement, as well as the reimbursement framework.

Accordingly, this Court finds that this provision of § 2, which provides that the Texas Settlement "shall be binding upon all settling defendants and their successors and assigns ***in the manner expressly provided for herein***," reflects that successors and assigns would be bound to the same extent as an original settling defendant. This provision is designed to avoid diminishment of Texas' rights as a result of a succession or assignment. As a result, this provision supports a finding that the parties to the Texas Settlement intended that liability for the Acquired Brands should continue even after an assignment.

v. Prior Written Consent

The Texas Settlement includes a provision that prohibits assignment of rights or obligations without the prior written consent of all other signatories to the Texas Settlement. Specifically, the

Texas Settlement provides in pertinent part: "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." *Texas Settlement*, Dkt. No. 2222-1 at 4 § 2.

Since this clause its substantially similar to the "successors and assigns" clause analyzed *supra* in Section III.B.2.b.iii, the Court's analysis materially overlaps with the analysis previously set forth therein. The Court incorporates that analysis by reference. That said, the Court finds there are two additional observations worth noting.

First, if a settling defendant cannot *assign* an obligation without the other parties' prior written consent, it follows that the same defendant cannot *extinguish* an obligation without the other parties' prior written consent.

Second, this section limits a party's ability to "assign[] ***or otherwise convey***[]" rights or obligations under the Texas Settlement. Consistent with the reasoning of *Texas Industries*, this clause confirms that the parties did not intend Reynolds to be able to escape its liabilities under the Texas Settlement through ***any*** form of conveyance.

Accordingly, the Court concludes that the "prior written consent" provision supports the conclusion that Reynolds remains liable under the Texas Settlement for the Acquired Brands.

c. <u>The Market Share Provision Supports Liability Rather Than Excusing It</u>

Reynolds argues that its liability is limited—and is now fully excused—by the Market Share provision in the Texas Settlement. Specifically, Reynolds asserts that the quantity of liability is measured by the "Market Share" definition, and that the Market Share definition only imposes liability for cigarettes which it currently sells.

The Texas Settlement defines Market Share as follows:

> (b) "Market Share" means a Settling Defendant's respective share of sales of Cigarettes, by number of individual Cigarettes shipped in the United States for domestic consumption, as measured by such Settling Defendant's audited reports of shipments of Tobacco Products provided to the U.S. Securities and Exchange Commission ("SEC") (or, in the case of any Settling Defendant that does not provide such reports to the SEC, audited reports of shipments containing the same shipment information as contained in the reports provided to the SEC) ("Shipment Reports"), during (i) with respect to payments made pursuant to paragraph 7 of this Stipulation of Amendment, the calendar year ending on the date on which the payment at issue is due (or, in the case of the payment due on November 1, 1998, the calendar year ending December 31, 1998), regardless of when such payment is made, and (ii) with respect to all other payments made pursuant to this Stipulation of Amendment and the Settlement Agreement, the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made;

1998 Amdt., Dkt. No. 2222-2 at 5–6 § 3(b). Further, the Texas Settlement provides the following payment requirement:

> Each of the Settling Defendants further agrees that, on December 31, 1999 and annually thereafter on December 31st of each year after 1999 (subject to final adjustment within 30 days), it shall severally cause to be paid into the registry of the Court and in accordance with and subject to paragraph 17 of this Stipulation of Amendment, pro rata in proportion to its Market Share, its share of 7.25% of the following amounts (in billions) . . . .

Id. at 10–12 § 7. Based upon a combination of the Market Share provision and the payment provision, Reynolds asks the Court to conclude that its obligations under the Texas Settlement, at least with respect to the Acquired Brands, have now terminated. The Court declines for the following reasons.

First, the Court finds as a matter of law that the Market Share provision does not apply to the legal question of liability following an assignment. Second, to the extent (if any) that the Market Share provision is relevant to the issue of Reynolds' post-assignment liability, Reynolds' continued inclusion of the Acquired Brands in its Market Share payment to Texas' Private Counsel is tantamount to an admission by Reynolds that it remains liable to Texas.

i. Market Share Relates to Payment Quantification, Not the Legal Attribution of Liability for Payment

As an initial matter, the Market Share argument which Reynolds makes is very similar to the Participating Interest argument rejected by the Texas Supreme Court in *Seagull*. The contract in *Seagull* required the defendant to "reimburse [the plaintiff for operating costs] in proportion to its Participating Interest," and it defined "Participating Interest" as the defendant's ownership in the oil and gas leases. *Seagull*, 207 S.W.3d at 345. Since the defendant did not own any participating interest *after* its assignment, the defendant claimed the contract imposed no liability for that period of time. *Id.* at 344–45. Instead, the defendant contended that its "obligation to pay . . . terminated on the date it sold its interests because the agreement imposed liability for expenses only upon ***current*** working interest owners." *Id.* at 345 (emphasis in original).

The Texas Supreme Court squarely rejected that argument, concluding instead that the defendant "reads far too much into these provisions." *Id.* at 346. The *Seagull* court found those provisions were addressed to the ***amount*** of payment, not the issue of ***responsibility*** for payment. *Id.* The provisions cited by the *Seagull* defendant simply did not "mention the subject of release or the consequences which are to follow the assignment of a working interest" in the leases. *Id.*

Following *Seagull*, the Market Share provision is inapplicable to the issue of legal liability now before the Court. The Texas Settlement distinguishes between disputes over attribution of ***liability for payments*** (which is an issue reserved for this Court, and which is determined by reference to legal principles) and disputes over ***quantity of payments*** (which is an issue delegated in part to PwC, and determined by reference to the Market Share provision). In the instant case, no party disputes how many cigarettes are being sold or how much would be due; rather, the parties dispute who must pay. Reynolds' attempt to recast the Market Share provision as a provision controlling the consequences of an assignment conflicts with the remaining text and context of the Texas Settlement. *See supra* Sections III.C.2.a–b. As in *Seagull*, the Texas Settlement has a definition quantifying the amount of payments which are due. As in *Seagull*, the Texas Settlement imposes a pro rata obligation to pay based on that payment quantity term. And as in *Seagull*, the Court concludes that the original contracting party—here, Reynolds—remains liable.

By contrast, a finding that the Market Share provision does not control post-assignment liability is consistent with the foregoing textual and contextual indicators. The canon of construction that provisions within a contract be read, wherever feasible, in harmony and not in conflict with one another supports a finding that the Market Share provision does not relieve Reynolds from liability.

Before this Court, Reynolds acknowledged that the Texas Fee Payment Agreement, which is a part of the Texas Settlement, uses the same Market Share definition for both payments to Texas and to Texas' Private Counsel.

> THE COURT: Do you agree that the market share definition in the Texas Fee -- Fee Payment Agreement is the same definition of market share that's in the Texas Settlement Agreement?
>
> COUNSEL FOR REYNOLDS: I do, Your Honor.
>
> THE COURT: Okay. Do you acknowledge that Reynolds, by including the Acquired Brands and its definition of market share for purposes of the Texas Fee Payment Agreement -- well, first of all, do you agree that Reynolds does that, that they include the Acquired Brands in their definition of market share for purposes of the Texas Fee Payment Agreement?
>
> COUNSEL FOR REYNOLDS: Your Honor, under the Asset Purchase Agreement, Reynolds did elect to do so, yes.

Hearing Tr., Dkt. No. 2354 at 114:23–115:11. Given those two concessions, the Court pressed Reynolds to explain its inconsistent conduct.

> THE COURT: I don't know how you can say Reynolds continued to make the payments under the attorney's fees agreement because that's the commitment they made, and at the same time say, but notwithstanding the commitment Reynolds made to the State of Texas in the settlement agreement, it's not going to include the Acquired Brands in the market share calculation for paying the State.
>
> COUNSEL FOR REYNOLDS: Your Honor, one moment because I do need to read what Mr. Leibenstein handed me.
>
> THE COURT: That's fine.
>
> COUNSEL FOR REYNOLDS: But his handwriting is outside of my grasp. One moment. I apologize. May I speak with him?
>
> THE COURT: You may consult with co-counsel.
>
> COUNSEL FOR REYNOLDS: Your Honor, and I think -- I think Mr. Leibenstein and I -- I had the discussion that I attempted to make a point less artfully with the Court. Again, the attorney's fees -- and this goes to the State's shifting position. The attorney's fees were for past conduct. The attorney fees were accrued at the time the settlement agreement was signed.

Id. at 119:1–20.[38]

This explanation is unpersuasive. Under the Texas Settlement, each settling defendant obtained a full release from liability in perpetuity. At that moment, Texas immediately "accrued" its entitlement to payment (as did Texas' Private Counsel, for legal services).

Further, the ***motivation*** for providing payments—*e.g.*, whether they were "accrued"—is wholly unrelated to the calculation for such payments. The Acquired Brands either are part of Reynolds' Market Share, as that term is defined in the Texas Settlement, or they are not. Reynolds'

[38] Reynolds also attempted to distinguish the payments to Private Counsel from the payments to Texas, on the basis that the payments to Private Counsel are less expensive because they "do not exist in perpetuity." *Hearing Tr.*, Dkt. No. 2354 at 123:8 –124:19; *see also, e.g.*, *id.* at 124:11–14 ("So I understand the inconsistency there, but when we're talking, again, about forward-looking payments, these -- these in a few years, a relatively few years as -- as against perpetuity, then those obligations will cease."). The Court summarily rejects this argument, which is not an appropriate basis of distinction.

own conduct in making payments to Texas' Private Counsel recognizes that the Acquired Brands appropriately remain within its Market Share. Reynolds cannot now pretend that its conduct does not exist or fails to have meaning.

ii. Texas Fee Payment Agreement

Reynolds' conduct in paying attorneys' fees to Texas' Private Counsel confirms that its liability to Texas continues, because Reynolds continues to recognize that the Acquired Brands fall within its Market Share.

As described above, the Texas Settlement obligates settling defendants to make two sets of annual payments—one annual payment to the State of Texas, and a separate annual payment to the Private Counsel Texas hired to represent it in prosecuting the 1996 litigation. Both payments are based on a single definition of Market Share. The State of Texas gets a larger percentage of each defendant's Market Share, while Texas' Private Counsel gets a smaller percentage. Since Reynolds sold the Acquired Brands as part of the APA, it has stopped making payments for the Acquired Brands to Texas—***but has continued to make payments for the Acquired Brands to Texas' Private Counsel***. Thus, to the extent that the Market Share provision is relevant, it supports ongoing liability for Reynolds.

d. The Texas Comptroller's Employees

Imperial and Reynolds rely on the conduct of several employees of the Texas Comptroller of Public Accounts to argue that Texas has acquiesced in the exclusion of the Acquired Brands from the Texas Settlement.

In 2015, Imperial submitted paperwork to the Texas Comptroller indicating that the Acquired Brands were subject to the Tobacco Equity Tax, but not the Texas Settlement. Consistent with the ministerial handling of the paperwork submitted by Imperial, the employees of the Texas Comptroller added the Acquired Brands to the Comptroller website, reflecting the information that

Imperial submitted: that the Acquired Brands were ***not*** subject to the Texas Settlement. Imperial and Reynolds now argue that Texas itself has conceded that the Acquired Brands are subject only to the Tobacco Equity Tax.

The Court disagrees. As a threshold matter, this is parol evidence. Further, the conduct of employees within the Texas Comptroller's office, administratively processing a unilateral submission from Imperial, does not reflect a knowing concession by Texas. Such conduct is not effective to bind Texas to a particular course of performance.[39] Finally, as a factual matter, the Court does not find that Texas actually engaged in a course of performance conceding nonliability for either Reynolds or Imperial.

i. Course of Performance Evidence Is Inappropriate

As an initial matter, the Court rejects this argument because it is parol evidence which may only be used to shed light on an ambiguous contract. *URI, Inc. v. Kleberg Cty.*, 543 S.W.3d 755, 764–65 (Tex. 2018) ("Only where a contract is ambiguous may a court consider the parties' interpretation and 'admit extraneous evidence to determine the true meaning of the instrument.'" (quoting *David J. Sacks, P.C. v. Haden*, 266 S.W.3d 447, 450–51 (Tex. 2008))). All parties to this case agree that the Texas Settlement is unambiguous, and the Court does not find otherwise. Therefore, the Court does not consider this course of performance evidence.

ii. The Conduct of Several of the Comptroller's Employees Is Not Competent Course of Performance Evidence That May Bind Or Limit Texas' Rights

Texas law is replete with restrictions on the ability of "officers and agents" to modify or limit legal rights to which the State would otherwise be entitled. *Tex. Co. v. State*, 281 S.W.2d 83,

[39] Despite relying on the actions of the Texas Comptroller's employees, Imperial and Reynolds spend no time arguing the antecedent question of whether this evidence is cognizable under Texas law. Despite a need to do so, Imperial and Reynolds simply do not address whether several employees of the Texas Comptroller may bind Texas to a course of performance.

88 (Tex. 1955); *see also State v. Durham*, 860 S.W.2d 63, 67–68 (Tex. 1993) (explaining that "[t]he acts and conduct of its officers and agents cannot estop it from recovering" payments which are otherwise due). Texas law would not support a finding of estoppel, laches, or any other limitation based on this conduct. *State v. Emeritus Corp.*, 466 S.W.3d 233, 250 (Tex. App.—Corpus Christi 2015, pet. denied) (explaining that Texas "is not subject to the defenses of limitations, laches, or estoppel"). The question is thus whether Texas would nonetheless permit a course of performance theory to abrogate rights that Texas would otherwise have under the Texas Settlement. The Court concludes Texas would not so permit.

There are a number of rationales for restricting the ability of random state employees to limit Texas' rights. First, the well-ordered functioning of government "would be undermined if a government agent could—through mistake, neglect, or an intentional act—effectively" nullify Texas' legal rights "by ignoring, misrepresenting, or misinterpreting" its duties. *City of White Settlement v. Super Wash, Inc.*, 198 S.W.3d 770, 773 (Tex. 2006); *see also City of San Angelo v. Deutsch*, 91 S.W.2d 308, 309 (Tex. 1936) ("The decisions in this state have consistently protected the public from liability and loss on account of mistakes, negligence, and unauthorized acts of public officials in the performance of public or governmental duties. Mistakes or unauthorized acts of officials charged with the custody and disposition of public land do not estop the state or deprive it of its property."). In the best-case scenario, Texas would constantly be at the mercy of its least competent employees if such employees could limit Texas' rights—and in the worst case, deliberate misconduct might intentionally strip the state of its rights. *Lubbock Cty. Water Control & Imp. Dist. v. Church & Akin, L.L.C.*, 442 S.W.3d 297, 300–01 (Tex. 2014) ("[I]t remains a fundamental principle of Texas law, intended 'to shield the public from the costs and consequences of improvident actions of their governments.'" (quoting *Tooke v. City of Mexia*, 197 S.W.3d 325, 331–32 (Tex. 2006))).

Second, Texas' rights are held "for the benefit of all the people of the state." *Durham*, 860 S.W.2d at 68. If only a subset of employees could strip the public of its rights, such employees—whether through mistake or misconduct—might grievously injure the public. *Id.* at 67–68. For that reason, the Texas Supreme Court has uniformly rejected "ratification by estoppel" arguments that would limit Texas' entitlement to payments. *Id.*; *see also Weatherly v. Jackson*, 71 S.W.2d 259, 266 (Tex. 1934) ("To the authorities ***may be added the rule that the failure of public officers to perform their duties will not work an estoppel against the state***.") (emphasis added). Texas courts have also rejected limitations that would obstruct Texas' "responsibility and duty to enforce health care" rights that are designed "to protect its citizens." *Emeritus Corp.*, 466 S.W.3d at 251. Indeed, Texas law is careful to limit any waiver of the State's rights, in order to avoid obstructing predictable payments that are intended for public use. *Tex. Nat. Res. Conservation Comm'n v. IT-Davy*, 74 S.W.3d 849, 854 (Tex. 2002).

These limitations remain true with respect to binding the State to contractual duties and obligations. *State ex rel. Dep't of Criminal Justice v. VitaPro Foods, Inc.*, 8 S.W.3d 316, 322 (Tex. 1999). "[O]nly persons authorized by the Constitution or a statute can make a contract binding on the State. All state officers' powers are fixed by law, and all persons dealing with them are charged with notice of the limitations on those powers. Only persons having actual authority to act on behalf of the State can bind the State in contract." *Id.* (citing *State v. Ragland Clinic–Hosp.*, 159 S.W.2d 105, 106 (Tex. 1942)).

Adopting the approach advocated by Reynolds and Imperial would circumvent the well-settled Texas principle of law that limitations do not run against the State, and that Texas' agents and officers may not deprive the State of rights. The Texas Supreme Court has long recognized that litigants may not create a backdoor limitations argument by suggesting that inaction on Texas' part had altered its substantive rights. *See Truehart & Andrews v. Babcock,* 49 Tex. 249, 258–59 (1878).

Notably, Reynolds expressly recognized before this Court that the employees of the Texas Comptroller were not capable of binding Texas to a course of performance.

> COUNSEL FOR REYNOLDS: The State, likewise, required [Imperial] to make equity fee payments as a non-settling manufacturer, quote, because they were non-settlement cigarettes. And here you see a tax policy representative from the comptroller's office. This is in 2016, following the acquisition, saying: Ms. Wright is correct, Winston, Salem, Kool, and Maverick are now under SPM. Now they're subsequent participating manufacturers, and they -- so it's not as though this was not being discussed --
>
> THE COURT: ***Can the comptroller bind the State of Texas through an email like that?***
>
> COUNSEL FOR REYNOLDS: ***No, Your Honor***, the comptroller can't bind the State of Texas, ***but it does tell the State – it does tell us how the State of Texas viewed [Imperial]***, just as PM did, as an entity that had not yet joined the settlement agreement and thus was not subject.
>
> THE COURT: ***It tells us how one person in the comptroller's office viewed it.***
>
> COUNSEL FOR REYNOLDS: ***It -- it does, Your Honor. It does -- that's -- that's completely fair***.
>
> THE COURT: ***It doesn't purport to speak for the State, and it doesn't purport to speak for the comptroller of public accounts, correct?***
>
> COUNSEL FOR REYNOLDS: ***It does not, Your Honor.*** Only insofar as those -- those individuals are confirming the basis by which the State is collecting payments.

Hearing Tr., Dkt. No. 2354 at 57:20–58:20 (emphasis added).

iii. Conduct Was Passive

As noted above, the Texas Comptroller's employees are not automatically tasked with auditing a manufacturer's self-reporting. Imperial provided un-audited information to state employees, who then performed what is clearly a ministerial task. This cannot be recast as knowing decision-making. Nothing in the record before the Court suggests that these employees understood the relationship between the Acquired Brands and the Texas Settlement, let alone that their conduct might be imputed to Texas as a course of performance.

Indeed, Imperial recognized that the conduct of the Texas Comptroller employees was only reactive. While displaying a demonstrative image of the Texas Comptroller's website during the hearing before this Court, Imperial engaged in the following colloquy.

> COUNSEL FOR IMPERIAL: This is the version of the website they put up when they were treating us as a non-settling manufacturer, which is an SPM.
>
> THE COURT: In response to the form that you submitted?
>
> COUNSEL FOR IMPERIAL: In response to the form that we submitted.

Hearing Tr., Dkt. No. 2354 at 66:23–67:4. The Court factually concludes that the Texas Comptroller's employees were behaving in a reactive and passive manner, rather than affirmatively engaging in a course of performance under the Texas Settlement.

In sum, the Court concludes that the Texas Comptroller's employees could not legally create a course of conduct as described by Imperial and binding on Texas. Further, in the alternative, the Court makes the finding of fact that the conduct of such employees does not demonstrate a course of performance suggesting that the Acquired Brands fall outside the Texas Settlement.

E. Reynolds Is Liable For Breach of the Prior Written Consent Clause in Texas Settlement § 2

Reynolds breached the Texas Settlement by transferring the releases included in the Texas Settlement to Imperial without the prior written consent of the Texas Settlement signatories. As noted above, the Texas Settlement provides "[n]one 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." *Texas Settlement*, Dkt. No. 2222-1 at 4 § 2. One of the rights under the Texas Settlement is the right to a release with respect to the Acquired Brands. *See, e.g.*, *id.* at 15–16 § 13 (stipulating to dismissal of the underlying action with prejudice); § 14 (providing a perpetual release).

Reynolds transferred that release to Imperial as part of the APA. Article II of the APA provides that Reynolds and Lorillard shall "sell, convey, assign, transfer and deliver," a series of assets, including the Acquired Brands (which are defined as part of the "Transferred Assets"), and the following:

> (v) ***all*** claims, causes of action, ***defenses*** and rights of offset or counterclaim against third parties ***relating to any Transferred Asset or any Assumed Liability***, including unliquidated rights under manufacturers' or vendors' warranties, except for claims for refunds of any Taxes paid prior to the Closing Date;

APA, Dkt. No. 2222-6 at 5 art. II § 2.01(a)(v) (emphasis added). The affirmative defense of "release" unambiguously falls within the term "defenses . . . relating to ***any*** Transferred Asset or Assumed Liability." *Seven Invs., LLC v. AD Capital, LLC*, 32 A.3d 391, 396 (Del. Ch. 2011) (recognizing that "release" is a defense).[40] The Transferred Assets include the Acquired Brands, and Texas' release of liability is a complete defense to any claim of liability for the Acquired

[40] The APA is construed pursuant to Delaware law. *See infra* Part IV. Accordingly, the Court relies on a Delaware Chancery Court opinion in setting out the plain textual meaning of "defense." Further, while the Court defers to the Delaware Chancery Court for all fact-bound interpretation of any ambiguous provisions of the APA, the Court finds that § 2.01(a)(v) is unambiguous in transferring the "defense" of release for the Acquired Brands to Imperial. Accordingly, the Court reaches the meaning of § 2.01(a)(v).

Brands. Accordingly, the APA expressly includes a transfer of a right under the Texas Settlement to Imperial.[41] Since the Texas Settlement expressly prohibits such an assignment, Reynolds breached the Texas Settlement. However, this assumption does not cause Imperial to be liable under the Texas Settlement, given that the releases are a right—not an obligation—which is expressly assumed. Since Texas law appears to require ***obligations*** to be expressly assumed for liability under a contract to attach, and this provision deals with rights, it does not create direct liability for Imperial.

***

For all the reasons set forth above, the Court holds that Reynolds remains liable for the Acquired Brands under the Texas Settlement.

[41] The APA includes a provision which states:

> "Notwithstanding any other provision of this Agreement to the contrary, this Agreement shall not constitute an agreement to assign, directly or indirectly, any Transferred Asset or any claim or right or any benefit arising thereunder or resulting therefrom if an attempted direct or indirect assignment or transfer thereof, without the consent of a third party, would constitute a breach, default, violation or other contravention thereof, would be ineffective with respect to any party to an agreement concerning such Transferred Asset, claim or right or would in any way adversely affect the rights of the Acquiror or the Sellers (as applicable) thereto or thereunder, and such consent has not been obtained on or prior to the Closing Date."

APA, Dkt. No. 2222-6 at 5 art. II § 2.02(a). While inartfully drafted, the import of this provision is to disclaim any assignment of any right or asset if such assignment would be a breach of any contract or "would in any way adversely affect the rights" of Reynolds or Imperial. While this might hypothetically have limited the transfer of any defenses, Reynolds and Imperial do not press the applicability of this provision. Indeed, given that two courts have found Reynolds liable for breach of contract based on the transfer of the Acquired Brands, a faithful application of this provision would suggest that the assignment of the Acquired Brands was itself ineffective. Since neither Reynolds nor Imperial appear to desire that result, it appears they have made the strategic choice not to assert this provision as a limitation that the Court should consider when construing the APA, despite spending considerable time discussing whether various assignments under the APA constitute a breach of contract. To the extent Reynolds and Imperial wished to press the position that § 2.02(a) limited transfers, it would necessarily require both parties to argue that the transfers of the Acquired Brands and related assets were not actually effective. Imperial and Reynolds had ample opportunity to argue that § 2.02(a) limited their liability and declined to do so. Accordingly, given the apparently strategic choice made by Reynolds and Imperial not to discuss this issue, the Court finds any argument based on this provision waived. *See Firefighters' Ret. Sys. v. Grant Thornton, LLP*, 894 F.3d 665, 670 n.18 (5th Cir. 2018) ("[A]n argument not raised before the district court cannot be asserted the first time on appeal"); *Dallas Gas Partners, L.P. v. Prospect Energy Corp.*, 733 F.3d 148, 156–57 (5th Cir. 2013) ("If a party fails to assert a legal reason why [relief] should . . . be granted, that ground is waived and cannot be considered or raised on appeal."); *Maverick Recording Co. v. Harper*, 598 F.3d 193, 197 (5th Cir. 2010) (holding that a party "waived her constitutional challenge ***by failing to raise it [in the district court] in a manner that would allow the district court to rule on it***"); *Kelly v. Foti*, 77 F.3d 819, 823 (5th Cir. 1996) ("[The] raising party must present the issue ***so that it places the opposing party and the court on notice*** that a new issue is being raised").

F. Imperial

Imperial asserts that it is not liable under the Texas Settlement, despite the existence of a clause therein which purports to bind successors and assigns. Imperial points to Texas Business Organizations Code § 10.254, which altered the common law rule for binding successors and assigns in the context of a sale of assets. Section 10.254 recites in pertinent part: "Except as otherwise expressly provided 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." Tex. Bus. Org. Code § 10.254(b). At least one Texas intermediate appellate court has held that a "successors and assigns" clause is no longer self-executing, because a contract purporting to bind successors and assigns cannot ***actually*** bind successors and assigns unless the successor or assign also expressly consents to be bound. *See C.M. Asfahl Agency v. Tensor, Inc.*, 135 S.W.3d 768, 775 (Tex. App.—Houston [1st Dist.] 2004, no pet.).

Asfahl involved an assign that had only purchased assets, and had not expressly consented to be bound. *Id.* at 780–81. That court held that the assign could not be liable under the original contract between the parties. *Id.* "[E]ven if the 'continuity provisions' of the . . . sales and marketing agreements . . . purported to bind their 'successors and assigns,' those agreements could not contravene the protections that article 5.10(B)(2) afforded [to the assign] in acquiring the assets of the [the assignor] entities unless [the assign] expressly agreed to be bound by the . . . agreements." *Id.* at 791.[42] Thus, according to *Asfahl*, a successors-and-assigns clause is not self-executing to bind an assignee without the assignee's express consent. *Id.*

[42] Texas Business Corporations Act article 5.10(B) is the predecessor statute to Texas Business Organizations Code § 10.254. Despite stylistic wording differences between the two statutes, Texas courts have interpreted article 5.10(B) and § 10.254 identically. *In re 1701 Commerce, LLC*, 511 B.R. 812, 823 (Bankr. N.D. Tex. 2014) (citing

The Court finds Imperial is not directly liable under the Texas Settlement pursuant to the successors and assigns clause. As noted below, Imperial may be liable pursuant to its undertakings in the APA, depending on the Delaware Court's construction of the obligations undertaken by Imperial. However, Imperial is not liable under the Texas Settlement merely by virtue of the "successors and assign" clause, in light of § 10.254 and *Asfahl*. The Court does not ultimately pass on whether Imperial has expressly assumed obligations under the Texas Settlement by virtue of its promises in the APA, in view of the Court's decision to defer construction of the APA to the Delaware Court.

Though Imperial's liability is limited by Texas statutory law, Imperial is still an assign within the meaning of the Texas Settlement. Under Texas law, "[t]he term 'assignment' has a comprehensive meaning and in its most general sense means the transfer or setting over of property or some right or interest from one person to another." *Epstein v. Wendy's Int'l, Inc.*, No. 14-04-00704-CV, 2006 WL 535759, at *2 (Tex. App.—Houston [14th Dist.] 2006, pet. denied) (citing *Twelve Oaks Tower I, Ltd. v. Premier Allergy, Inc.*, 938 S.W.2d 102, 113 (Tex. App.—Houston [14th Dist.] 1996, no writ); *Univ. of Tex. Med. Branch at Galveston v. Allan*, 777 S.W.2d 450, 452 (Tex. App.—Houston [14th Dist.] 1989, no writ)). An assignment "is a manifestation by the owner of a right or property of [its] intention to transfer such right or property to another." *Twelve Oaks*, 938 S.W.2d at 113; *Pape Equip. Co. v. I.C.S., Inc.*, 737 S.W.2d 397, 399 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.).

The APA unambiguously and expressly provides that Imperial is an assign of Reynolds. Under the APA, Reynolds promised to "sell, convey, ***assign***, transfer and deliver" a variety of assets, including the Acquired Brands which form the subject matter of the Texas Settlement. *APA*,

E-Quest Mgmt., LLC v. Shaw, 433 S.W.3d 18, 23–24 (Tex. App.—Houston [1st Dist.] 2013, pet. denied)); *see also Ford, Bacon & Davis, L.L.C. v. Travelers Ins. Co.*, 635 F.3d 734, 737 (5th Cir. 2011).

Dkt. No. 2222-6 at 5 art. II § 2.01(a). The APA unambiguously involves "the transfer . . . of property or some right or interest" from Reynolds to Imperial. *See Epstein*, 2006 WL 535759, at *2.

Despite the finding that Imperial is an assign, and considering the totality of the existing circumstances, this Court elects to defer ultimate resolution of the Motions to Enforce, as they relate to Imperial and the issue of its liability to Texas, to the pending litigation in the Delaware Chancery Court between Imperial and Reynolds. The Court is persuaded that judicial restraint in this regard is the better course. The legal obligations, if any, between Texas and Imperial are largely informed by the APA, which is subject to Delaware law and best determined there. For these reasons, and mindful of comity between Texas and Delaware, this Court exercises judicial restraint to leave the issues between Reynolds and Imperial within the capable hands of the Delaware Court. Such issues include the scope and nature of the obligations undertaken by Imperial pursuant to the APA, and whether Imperial expressly assumed liability under the Texas Settlement by virtue of the APA.

Both the Florida Court and Minnesota Court recognized that it was possible that the Delaware Court would construe the APA to find that Imperial expressly assumed the PSS Agreement obligations. For example, if Imperial's covenant to use "reasonable best efforts" to join the PSS Agreements requires the actual assumption of PSS obligations, then the "reasonable best efforts" term ***is*** an express assumption of liability. However, the parties have not asked this Court to construe "reasonable best efforts," nor have they briefed the question. Instead, the parties note that the appropriate construction of "reasonable best efforts" is presently before the Delaware Chancery Court. Based upon recognized notions of comity and judicial efficiency, this Court defers the construction of "reasonable best efforts," with full knowledge that such represents a separate theory by which Imperial might find itself liable under the Texas Settlement.

IV. <u>Texas' Third-Party Beneficiary Status</u>

Texas also advances the argument that it is a third-party beneficiary of the APA and urges this Court to follow the decision of the Minnesota Court, which found that Texas was unambiguously a third-party beneficiary of the APA because the APA expressly contracts for providing Texas Settlement payments to Texas. *See Texas Reply*, Dkt. No. 2346 at 7 (quoting *Minn. Ct. Judgment*, Dkt. No. 2346-6 at 19 ("[Imperial] cannot credibly contend that Minnesota has no direct or third-party interest in the APA.")).

This Court also defers this issue to be taken up as part of the Delaware action, to the extent Texas is inclined to intervene therein. The parties do not dispute that Delaware law generally governs the formation and interpretation of the APA. The plain text of the APA confirms that Delaware law governs its interpretation. *APA*, Dkt. No. 2222-6 at 82 § 12.12(a); *Coca-Cola Bottling Co. of Elizabethtown v. Coca-Cola Co.*, 98 F.R.D. 254, 264 (D. Del. 1983). Accordingly, the Court instead defers to the Delaware Court the issue of whether Texas is a third-party beneficiary under the APA. In this too, the Court is informed by accepted notions of comity and judicial efficiency.

V. <u>Conclusion</u>

The text, structure, and purpose of the Texas Settlement clearly establish that Reynolds remains liable for the Acquired Brands under the Texas Settlement, and this Court so holds.

Both *Seagull* and *Texas Industries* make clear that Reynolds cannot eliminate its obligations under the Texas Settlement by assigning the Acquired Brands. As in *Seagull*, the Texas Settlement has no express provision addressing the consequences of a subsequent assignment. As in *Texas Industries*, both the contract itself ***and*** the "subject matter" of the contract are subject to the rule regarding continuing post-assignment liability. Accordingly, as in both cases, the original contracting party—here, Reynolds—remains liable. Additionally, the consensus of the common law authorities, as interpreted by preeminent treatises, the other PSS courts, and the Fifth Circuit, confirms that Reynolds remains liable.

The ordinary rules of contract interpretation independently demonstrate the propriety of Reynolds' continued liability. The text, structure, and business purposes of the Texas Settlement uniformly reflect the parties' intention not to permit an assignment to extinguish liability thereunder. Accordingly, the Court finds that Reynolds remains liable under the Texas Settlement for the full amount of any and all payments due regarding the Acquired Brands.

Reynolds also remains liable under the clause requiring Texas' written consent prior to the assignment of any rights. Reynolds promised not to assign any rights under the Texas Settlement without the prior written consent of the other parties thereto. When Reynolds assigned all defenses related to the Acquired Brands to Imperial, including the defense of "release" arising from the Texas Settlement, Reynolds breached that promise.

Finally, Imperial is unambiguously an assign within the meaning of the Texas Settlement. However, a final determination of the scope of the obligations undertaken by Imperial under the APA is a matter more properly presented to the Delaware Court. To the extent that court determines that Imperial expressly assumed obligations which require Imperial to join the Texas Settlement, Imperial may be directly liable to Texas or it may be indirectly liable via a potential right held by Reynolds to seek reimbursement from Imperial. Those issues are left to the Delaware Court. The Court similarly defers the issue of Texas' status as a third-party beneficiary under the

APA to the Delaware Court. To the extent Texas seeks to vindicate any rights under the APA, it must intervene to do so in that forum.

* * *

In writing *The Common Law*, Justice Holmes observed:

> The very office of construction is to work out, from what is expressly said and done, what would have been said with regard to events not definitely before the minds of the parties, if those events had been considered.

Hon. Oliver Wendell Holmes, *The Common Law* 303 (1881). It is unclear whether the parties in 1998 envisioned the unprecedented consolidation that would occur within the domestic tobacco industry during the intervening two decades. However, it is certainly clear that no one considered—in light of Reynolds' perpetual promise to pay Texas regarding the Acquired Brands—that Reynolds would sell those brands for seven billion dollars and at the same time maintain that its responsibility to continue its payments to address the misery and costs visited upon the people of Texas by those brands had been snuffed out. Reynolds accepted a perpetual release in return for agreeing to make perpetual payments. Nothing that has intervened since then has lessened that obligation. Reynolds remains as liable today as it was when it entered into the Texas Settlement in 1998.

So ORDERED and SIGNED this 25th day of February, 2020.

Rodney Gilstrap

RODNEY GILSTRAP
UNITED STATES DISTRICT JUDGE