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10 SUPERIOR COURT OF CALIFORNIA
11 COUNTY OF SAN DIEGO

12 **PEOPLE OF THE STATE OF CALIFORNIA, ex. rel.**
13 **BILL LOCKYER, Attorney General of the State of**
California,

14 Plaintiff,

15 v.

16 **PHILIP MORRIS USA, INC., R.J. REYNOLDS**
17 **TOBACCO COMPANY, LORILLARD TOBACCO**
18 **COMPANY, ANDERSON TOBACCO COMPANY LLC,**
19 **BEKENTON USA, CANARY ISLAND CIGAR**
20 **COMPANY, CHANCELLOR TOBACCO COMPANY,**
21 **PLC, COMMONWEALTH BRANDS, INC.,**
22 **COMPANIA INDUSTRIAL DE TABACOS MONTE**
23 **PAZ, S.A., DAUGHTERS AND RYAN, INC., FARMERS**
24 **TOBACCO COMPANY, GENERAL TOBACCO,**
25 **HOUSE OF PRINCE A/S, INTERNATIONAL**
26 **TOBACCO GROUP (LAS VEGAS), INC., JAPAN**
27 **TOBACCO INTERNATIONAL USA, INC., KING**
28 **MAKER MARKETING, INC., KONCI G & D**
MANAGEMENT, KRETEK INTERNATIONAL,
LIBERTY BRANDS, LLC, LIGGETT GROUP, INC.,
M/S DHANRAJ INTERNATIONAL INC., PACIFIC
STANFORD MANUFACTURING CORPORATION,
PETER STOKKEBYE INTERNATIONAL S/A, PT
DJARUM, SANTA FE NATURAL TOBACCO
COMPANY, INC., SHERMAN 1400 BROADWAY,
N.Y.C., INC., TOP TOBACCO, L.P., VIRGINIA
CAROLINA CORPORATION, INC., VON EICKEN
GROUP, AND WIND RIVER TOBACCO COMPANY,

Defendants.

Case No.: J.C.C.P. 4041

**COMPLAINT FOR
RELIEF UNDER THE
TOBACCO MASTER
SETTLEMENT
AGREEMENT,
REGARDING
CALIFORNIA'S
DILIGENT
ENFORCEMENT OF ITS
MSA-RELATED
QUALIFYING STATUTE**

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INTRODUCTION

1. Plaintiff, People of the State of California ("California"), brings this action pursuant to section VII of the Master Settlement Agreement ("MSA") for a Declaratory Order and/or an Enforcement Order that California "diligently enforced" its MSA-related Qualifying Statute during 2003, with the result that California's Allocated Payments due on April 15, 2004, from defendant Participating Manufacturers are not subject to a Non-Participating Manufacturer Adjustment for 2003 ("2003 NPM Adjustment").

2. In November 1998, the Attorneys General of 46 states, the District of Columbia, the Commonwealth of Puerto Rico and four territories ("Settling States") entered into the MSA with the four largest domestic cigarette manufacturers, called the Original Participating Manufacturers ("OPMs"). In return for a release by the Settling States of certain of their past, present and future claims, the OPMs promised, among other things, to: (1) make settlement payments to the Settling States, including payments every April in perpetuity; (2) fund a national foundation devoted to educating the public about the dangers of tobacco use; and (3) adhere to certain restrictions on their advertising, marketing and other practices.

3. The MSA permits other cigarette manufacturers to join the settlement agreement. These manufacturers, called Subsequent Participating Manufacturers ("SPMs"), agree to make settlement payments every April to the Settling States and to adhere to the same restrictions on their advertising, marketing and other practices that apply to the OPMs. To date, over 40 manufacturers have joined the MSA as SPMs. OPMs and SPMs are referred to collectively as "Participating Manufacturers" or "PMs."

PARTIES

4. The state of California has entered into the MSA and thus is a "Settling State" as defined in the agreement. California Attorney General Bill Lockyer is authorized to bring this action to enforce the MSA on behalf of California.

5. Defendants Philip Morris USA, R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company are OPMs, as defined in section II (hh) of the MSA. In 2003, Brown & Williamson Tobacco Corporation, another OPM, merged with defendant R.J. Reynolds Tobacco Company. By

1 virtue of this merger, R.J. Reynolds Tobacco Company acquired the assets, liabilities and contractual
2 obligations of Brown & Williamson Tobacco Corporation.

3 6. The following defendants are SPMs, as defined in section II (tt) of the MSA: Anderson
4 Tobacco Company LLC, Bekenton USA,¹¹ Canary Island Cigar Company, Chancellor Tobacco
5 Company, PLC, Commonwealth Brands, Inc., Compania Industrial de Tabacos Monte Paz, S.A.,
6 Daughters and Ryan, Inc., Farmers Tobacco Company, General Tobacco, House of Prince A/S,
7 International Tobacco Group (Las Vegas), Inc., Japan Tobacco International USA, Inc., King Maker
8 Marketing, Inc., Konci G & D Management, Kretek International, Liberty Brands, LLC, Liggett
9 Group, Inc., M/S Dhanraj International, Inc., Pacific Stanford Manufacturing Corporation, Peter
10 Stokkebye International A/S, PT Djarum, Santa Fe Natural Tobacco Company, Inc., Sherman 1400
11 Broadway N.Y.C., Inc., Top Tobacco, L.P., Virginia Carolina Corporation, Inc., Von Eicken Group,
12 and Wind River Tobacco Company, LLC. All of the above-named defendants are potentially eligible
13 for a 2003 NPM Adjustment.

14 JURISDICTION

15 7. This Court has exclusive jurisdiction over this action to implement and enforce the MSA
16 in California. (MSA, § VII(a)(2).)

17 8. Each and every defendant Participating Manufacturer consented to this Court's jurisdiction
18 when it joined the MSA. (*Id.*, § VII(a)(1).)

19 9. Attorney General Bill Lockyer brings this action pursuant to section VII(c)(1) of the MSA,
20 which authorizes any Settling State to bring an action to enforce the terms of the MSA (or for a
21 declaration construing any such term) with respect to disputes, alleged violations or alleged breaches

22
23 1. Plaintiff is aware that Bekenton has petitioned for bankruptcy and that an automatic stay
24 arises upon the filing of such a petition. Plaintiff nevertheless has named Bekenton as a defendant
25 in this action to avoid the burden of later bringing Bekenton into this action and because plaintiff
26 believes its claim against Bekenton is not subject to the automatic stay. An order issued by the
27 bankruptcy court granting plaintiff relief from the automatic stay applies to this claim, and plaintiff
28 believes, so does a statutory exception to the automatic stay. To remove all doubt about the matter,
however, plaintiff will ask the bankruptcy court to confirm that the automatic stay does not apply to
plaintiff's claim against Bekenton or issue other appropriate relief and in the interim will refrain
from actively prosecuting this action against Bekenton.

1 within such Settling State.

2 10. Before initiating this action, Attorney General Lockyer provided each defendant with
3 written notice of his intent to initiate these proceedings, as required by section VII(c)(2) of the MSA.

4 **CALCULATION OF ANNUAL PAYMENT OBLIGATIONS UNDER THE MSA**

5 11. The MSA provides for annual settlement payments in perpetuity from the PMs pursuant
6 to a complex set of formulas, calculations and adjustments, which are spelled out in section IX of
7 the MSA.

8 12. The Independent Auditor, a public accounting firm selected by the OPMs and the Settling
9 States, calculates the total annual settlement payment that the PMs are obligated to make under the
10 MSA on or before April 15 of each year. (MSA, §§ IX(c) & (i).) California's Allocated Payment
11 is its specified percentage, known as its "Allocable Share," of this total annual settlement payment.
12 California's Allocable Share is 12.7639554%. (MSA, exh. A.)

13 13. A potential adjustment to a Settling State's Allocated Payment is the "NPM Adjustment."
14 (MSA, § IX(d).) Before any Settling State's Allocated Payment can be reduced by an NPM
15 Adjustment, however, several conditions precedent must occur.

16 14. First, there must be a "Market Share Loss." A Market Share Loss exists when the PMs'
17 Market Share in a calendar year (that is, their percentage of the United States cigarette market for
18 that year) drops more than 2% below their combined Market Share in 1997. (MSA, § IX(d)(1)(A),
19 (B).)

20 15. If there is Market Share Loss, then the Market Share Loss percentage is multiplied by a
21 factor of three to arrive at an "NPM Adjustment Percentage." The potential NPM Adjustment is the
22 NPM Adjustment Percentage multiplied by the PMs' total annual payment due on April 15 of the
23 year immediately following the year in which the Market Share Loss occurred. (MSA, §
24 IX(d)(1)(A)(ii).)

25 16. The Independent Auditor has calculated a Market Share Loss for 2003 of 6.24826% and
26 a corresponding NPM Adjustment Percentage of 18.74478%.

27 17. The Independent Auditor also has calculated a potential maximum 2003 NPM Adjustment
28 to the aggregate MSA payment due on April 15, 2004, from the OPMs of \$1,115,394,303.17, and

1 a potential maximum 2003 NPM Adjustment to the aggregate MSA payment due on April 15, 2004,
2 from the SPMs of \$86,113,408.81.

3 18. A Market Share Loss is a necessary, but not a sufficient, condition precedent for reducing
4 any Settling State's Allocated Payment by an NPM Adjustment. A second necessary condition
5 precedent is a determination by "a nationally recognized firm of economic consultants (the 'Firm')"
6 that "the disadvantages experienced [by the Participating Manufacturers] as a result of the provisions
7 of [the MSA] were a significant factor contributing to the Market Share Loss for the year in
8 question." (MSA, § IX(d)(1)(C).)

9 19. On March 27, 2006, the Firm determined that the disadvantages experienced by the
10 Participating Manufacturers as a result of the MSA's provisions were a significant factor
11 contributing to the Market Share Loss for 2003.

12 **DILIGENT ENFORCEMENT EXEMPTION**

13 20. Even where there has been a Market Share Loss *and* a determination by the Firm that the
14 disadvantages experienced by the PMs as a result of the MSA's provisions were a significant factor
15 contributing to the Market Share Loss, a Settling State's Allocated Payment is *not* necessarily subject
16 to an NPM Adjustment. A Settling State's Allocated Payment is not subject to an NPM Adjustment
17 if that Settling State "... continuously had a Qualifying Statute ... in full force and effect during the
18 entire calendar year immediately preceding the year in which the payment in question is due, and
19 diligently enforced the provisions of such statute during such entire calendar year" (MSA,
20 § IX(d)(2)(B)(i), italics added.)

21 21. A "Qualifying Statute" is a statute, regulation, law or rule "that effectively and fully
22 neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-
23 Participating Manufacturers within such Settling State as a result of the provisions of the [MSA]."
24 (MSA, § IX(d)(2)(E).) A Settling State that enacts the "Model Statute," which is set forth in Exhibit
25 T to the MSA, is deemed to have enacted a Qualifying Statute. (*Ibid.*) The Model Statute requires
26 any tobacco product manufacturer whose cigarettes are sold in the State to either: (a) become a
27 Participating Manufacturer and generally perform its financial obligations under the MSA, or (b)
28 place into a qualified escrow account a statutorily specified amount for each cigarette sold in the

1 State. Funds deposited into escrow may be disbursed only to satisfy certain tobacco-related
2 liabilities to the State. The escrow deposit requirement thus guarantees Settling States a source of
3 recovery for tobacco-related liabilities from those tobacco companies which decline to settle these
4 liabilities through the MSA and protects against non-settling tobacco companies' enjoying large,
5 short-term profits and becoming judgement-proof before liability may arise. The escrow deposit
6 requirement also works to level the playing field between the tobacco companies which join the
7 MSA (and agree to its settlement payment obligations and marketing restrictions) and those which
8 choose not do so.

9 22. The MSA mandates that the aggregate amount of the NPM Adjustment that would have
10 applied to the Settling States found exempt from the NPM Adjustment be reallocated to the other
11 Settling States. (MSA, § IX(d)(2)(C).) Thus, the amount of California's potential payment reduction
12 on account of the 2003 NPM Adjustment depends on the aggregate shares of any and all other
13 Settling States also found subject to the same adjustment. California faces a potential payment
14 reduction of at least approximately \$153 million (if all other Settling States are found subject to the
15 2003 NPM Adjustment). However, California's payment reduction could be as high as its entire
16 Allocated Payment for 2003 — i.e., approximately \$818 million.

17 **CALIFORNIA'S DILIGENT ENFORCEMENT**

18 23. In 1999 California enacted a Qualifying Statute. This statute took effect on January 1,
19 2000, and is codified at Health and Safety Code sections 104555-104557. To encourage compliance
20 with, and aid in the enforcement, of its Qualifying Statute, California immediately began tracking
21 NPM sales in California by requiring all tobacco distributors to report to the California Board of
22 Equalization, on a monthly basis, all sales in California of cigarettes and roll-your-own tobacco
23 manufactured by NPMs.

24 24. To encourage compliance with, and aid in the enforcement of, its Qualifying Statute,
25 California adopted implementing regulations. The regulations took effect in April 2002 and are
26 codified at Title 11, California Code of Regulations, sections 999.10-999.14. They require each
27 NPM to file a Certificate of Compliance with the California Attorney General's Office by April 30th
28 of each year. Each NPM must state therein, under penalty of perjury, the number of its cigarettes

1 and ounces of "roll-your-own" tobacco sold in California during the previous year and the amount
2 deposited into a qualified escrow account for such sales. Each NPM also must attach certain
3 supporting documentation, including proof of the escrow deposit from the depository institution.
4 The regulations also require each NPM, before selling or shipping cigarettes or "roll-your-own"
5 tobacco in California, to provide all wholesalers and distributors with written confirmation of its
6 compliance with the Qualifying Statute and implementing regulations. During an NPM's first year
7 of sales in California, the NPM also must file with the California Attorney General's Office an
8 Acknowledgment that it has reviewed California's Qualifying Statute and implementing regulations,
9 and provide all wholesalers and distributors with a copy of the filed Acknowledgment. In addition,
10 the regulations require each wholesaler and distributor to report non-compliant NPMs to the
11 California Attorney General's Office. These regulations encouraged NPMs to comply with
12 California's Qualifying Statute and enhanced California's ability to monitor and verify compliance
13 with its Qualifying Statute and to identify non-compliant NPMs.

14 25. California's Qualifying Statute was continuously in full force and effect during the entire
15 2003 calendar year. The Qualifying Statute's implementing regulations and the Board of
16 Equalization's reporting requirement also were continuously in full force and effect during the entire
17 2003 calendar year.

18 26. California diligently enforced its Qualifying Statute throughout 2003 by taking such
19 enforcement actions as it deemed necessary and/or appropriate to secure voluntary compliance and
20 to enforce the Qualifying Statute against non-compliant NPMs. Such actions include, but are not
21 limited to, the following:

- 22 • Identifying NPMs and tracking their sales in California;
- 23 • Notifying NPMs of their obligations under California's Qualifying Statute and/or implementing
24 regulations;
- 25 • Investigating NPMs suspected of not fully complying with California's Qualifying Statute
26 and/or implementing regulations and demanding full compliance from these NPMs; and
- 27 • Filing and prosecuting to judgment civil actions against NPMs that failed to fully comply with
28 California's Qualifying Statute and/or implementing regulations.

1 27. During 2003 California enacted statutes that strengthened California's ability to enforce
2 its Qualifying Statute. It enacted "complementary legislation," which is codified at Revenue and
3 Tax Code section 30165.1. This legislation mandates, among other things, that every NPM whose
4 cigarettes or roll-your-own tobacco are sold in California annually certify to the California Attorney
5 General's Office that it is in full compliance with California's Qualifying Statute and implementing
6 regulations, and has made all required escrow deposits since 2000. Each NPM must include in its
7 annual certification a list of all brand families of cigarettes and the number of units sold in California
8 during the preceding year, and that it is either registered to do business in California or has appointed
9 a resident agent for service of process. This law also obligates the California Attorney General's
10 Office to develop and maintain a website which lists all NPMs and their brand families that are in
11 full compliance with California's Qualifying Statute and prohibits the sale in California of all
12 cigarettes whose brand family or manufacturer is not listed on the Attorney General's website.
13 Moreover, a distributor which sells non-compliant NPM cigarettes is subject to license revocation
14 or suspension and other penalties. These changes encouraged NPMs that wished to sell in California
15 to fully comply with California's Qualifying Statute.

16 28. Also in 2003 California enacted an "Allocable Share Amendment" to its Qualifying
17 Statute. California's Allocable Share Amendment is codified at Health and Safety Code section
18 104557(b)(2). This amendment closed a loophole in the Qualifying Statute as originally enacted that
19 allowed NPMs which concentrated their sales in selected states to reduce the amount of funds they
20 were required to keep on deposit in escrow. Closing this loophole enhanced California's protection
21 against judgment-proof NPMs.

22 29. California also adopted regulations to implement California's complementary legislation.
23 These regulations took effect in April 2004 and are codified at Title 11, California Code of
24 Regulations, sections 999.10-999.23. Among other things, these regulations require NPMs to
25 submit, in support of their application for listing on the California Attorney General's Office
26 directory, evidence of their compliance with state and federal tobacco laws and regulations, as well
27 as information regarding their business operations. They also require NPMs to retain detailed
28 records of all sales and subject NPMs deemed at risk of not fully complying with California's

1 Qualifying Statute to make deposits into escrow on a quarterly or even more frequent basis. These
2 regulations further strengthened California's ability to promote and procure compliance with its
3 Qualifying Statute.

4 **FIRST CAUSE OF ACTION**
5 **(Against all defendants)**

6 30. Plaintiff realleges and incorporates by reference herein each and every allegation of
7 paragraphs 1 through 29 above.

8 31. An actual controversy has arisen and now exists in that plaintiff contends, and defendants
9 deny, that California diligently enforced its Qualifying Statute during the entire calendar year of
10 2003. Plaintiff therefore seeks a Declaratory and/or Enforcement Order that California diligently
11 enforced its Qualifying Statute during the entire calendar year of 2003 and its Allocated Payments
12 under the MSA originally due on April 15, 2004, are not subject to an NPM Adjustment for 2003.

13 **SECOND CAUSE OF ACTION**
14 **(Against the OPMs)**

15 32. Plaintiff realleges and incorporates by reference herein each and every allegation of
16 paragraphs 1 through 29 above.

17 33. Before 2003, various disputes arose between the Settling States and the OPMs over their
18 claims to an NPM Adjustment for cigarettes sold or shipped in 1999, 2000, 2001 and 2002. One
19 dispute arose between the Settling States and Brown & Williamson concerning a business
20 arrangement it had with Star Scientific Inc. and Star Tobacco, Inc. (collectively "Star"), an NPM.
21 This business arrangement involved Brown & Williamson's manufacturing of cigarettes for Star.
22 The Settling States contended that this business arrangement violated Section IX of the MSA
because it improperly fueled NPM growth and contributed to an invalid NPM Adjustment claim.

23 34. In June 2003 these disputes were resolved by written settlement agreements between the
24 Settling States (including California) and the four OPMs. In these agreements, the OPMs absolutely
25 and unconditionally waived and released the Settling States from any and all claims under Section
26 IX(d) of the MSA (i.e., the NPM Adjustment provision), with respect to cigarettes sold or shipped
27 in 1999, 2000, 2001 and 2002.

28 35. By virtue of these settlement agreements, the OPMs are barred and estopped from

1 contending that California did not diligently enforce its Qualifying Statute in 2003 with respect to
2 cigarettes sold or shipped in 1999, 2000, 2001, and 2002, including cigarettes sold or shipped in
3 2002 for which an escrow deposit came due in April 2003.

4 **PRAYER**

5 Wherefore, plaintiff, the People of the State of California, respectfully prays that the Court:

- 6 1. Enter a Declaratory Order and/or an Enforcement Order finding and declaring that California
7 diligently enforced the provisions of its Qualifying Statute during the entire calendar year of 2003,
8 and therefore California's Allocated Payments originally due on April 15, 2004, are not subject to
9 a 2003 NPM Adjustment.
- 10 2. Award plaintiff its costs incurred in this action; and
- 11 3. Grant plaintiff such other relief as the Court deems just and proper.
- 12

13 Dated: April 17, 2006

14 Respectfully submitted,
15 BILL LOCKYER
Attorney General of the State of California
16 DENNIS ECKHART
Senior Assistant Attorney General
17 ALAN LIEBERMAN
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