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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

UNITED STATES OF AMERICA, Plaintiff, v. KING MOUNTAIN TOBACCO CO., INC., Defendant.	Case No.: 1:14-CV-03162-RMP **REPLY IN SUPPORT OF DEFENDANT KING MOUNTAIN TOBACCO CO., INC.'S MOTION FOR SUMMARY JUDGMENT** **DATE: September 16, 2015** **TIME: 1:30 p.m.** **PLACE: Yakima, WA** **With Oral Argument**

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii
INTRODUCTION 1
ARGUMENT 1
I. FETRA Violates the Fifth Amendment Takings Clause 1
A. Government Taking of Money Using a Non-Tax Assessment is Subject to Constitutional Takings Prohibitions 1
B. The Per Se Physical Takings Rule is the Appropriate Analysis Here. 3
1. The two takings tests 3
2. FETRA results in a per se physical taking 3
3. In the alternative, FETRA results in a regulatory taking 4
II. FETRA Violates the Due Process Clause 8
III. FETRA Violates Other Constitutional Protections 9
CONCLUSION 10
CERTIFICATE OF SERVICE 11

TABLE OF AUTHORITIES

CASES:

Armstrong v. United States,
364 U.S. 40 (1960)……7, 10

Brown v. Legal Foundation of Washington
538 U.S. 216 (2003)…… *passim*

Commonwealth Edison Co. v. United States,
271, F.3d 1327, 1342……7

Eastern Enterprises v. Apfel,
524 U.S. 498
(1998)……..*passim*

Greenwood v. F.A.A.,
28 F.3d 971, 977 (9th Cir 1994)……...10

Horne v. United States Department of Agriculture,
576 U.S. __, 2015 WL 2473384 (U.S. June 22, 2015) ……..*passim*

Koontz v. St. Johns River Water Management District,
133 S.Ct. 2586 (2013)……..…….....1, 4

Nixon v. United States,
978 F.2d 1269 (D.C. Cir. 1992)……..……..4

Orji v. Napolitano,
No. C11-898MJP, 2012 WL 527424 (W.D. Wash. Feb. 16, 2012)……10

Penn Central Transportation Co. v. New York City,
438 U.S. 104 (1978)……..4

Phillips v. Washington Legal Found.,
524 U.S. 156, 170 (1998)……..2, 4

Swisher Int'l, Inc. v. Schafer,
550 F.3d 1046 (11th Cir. 2008)……...3, 10

Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency,
535 U.S. 302 (2002)……..3

United States v. Native Wholesale Supply Co.,
822 F. Supp. 2d 326 (W.D.N.Y. 2011)……..3

Webb's Fabulous Pharmacies, Inc. v. Beckwith,
449 U.S. 155 (1980).....2, 4

STATUTES:

7 U.S.C. §§ 518 to 519a (2006) (FETRA).....*passim*

U.S. CONST. amend. V.....*passim*

RULES:

Local Rule CR 16(g).....10

INTRODUCTION

Last month the Supreme Court held that the USDA cannot constitutionally enforce an agricultural scheme that takes property without just compensation. *Horne v. Dep't of Agric.*, 576 U.S. __, 2015 WL 2473384 (U.S. June 22, 2015). Yet Plaintiff's Response cites to *Horne* in only one paragraph, and then only to argue that it is not controlling here because "FETRA obligates tobacco manufacturers to pay money and therefore does not effect a taking." ECF No. 44 at 3. But the Supreme Court has on numerous occasions confirmed that money can qualify as "property" under the Fifth Amendment. *E.g. Koontz v. St. Johns River Water Mgmt. Dist.*, 133 S. Ct. 2586, 2601 (2013) (discussing "cases in which we treated confiscations of money as takings despite their functional similarity to a tax"). When the government uses a monetary exaction to transfer money from one business to another, that taking is subject to Fifth Amendment protections. FETRA violates those protections, and cannot be enforced against King Mountain.

ARGUMENT

I. FETRA Violates the Fifth Amendment Takings Clause.

A. Government Taking of Money Using a Non-Tax Assessment is Subject to Constitutional Takings Prohibitions.

The Fifth Amendment prohibits the government from taking property for a public use without just compensation. Plaintiff's first argument is that this constitutional protection does not apply when money is the property that is taken.[1]

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[1] *E.g.* "FETRA obligates tobacco manufacturers to pay money and therefore does not effect a taking" [Response (ECF 44 at 3)]; "mixing raisins (*Horne)* with monetary obligations (FETRA), King Mountain erroneously asserts the Court should view FETRA as a taking *per se* [id.]; "King Mountain nevertheless suggests that the payment of money, by itself, can constitute a taking" [id. at 6].

But the Supreme Court has held on multiple occasions that government taking of money is subject to Fifth Amendment protections, as Plaintiff itself recognizes at page 6 of the Response when it attempts to distinguish Supreme Court precedent applying takings analysis to government taking of money.

Recognizing that the Supreme Court has extended takings protections to money, Plaintiff abandons its "money isn't protected" argument and instead claims that controlling Supreme Court cases can be distinguished because they deal with "a separately identifiable fund of money." Yet the only Supreme Court case Plaintiff cites as authority for this proposition did not involve "a separately identifiable fund of money." *Eastern Enterprises v. Apfel*, 524 U.S. 498, 538 (1998). And in any event, FETRA is a taking from a separately identifiable property interest – the interest King Mountain has in transferring its property into the domestic market for sale.[2] This is not an excise tax for the privilege of doing business, nor an exaction taking a company's general funds to pay for health insurance. FETRA takes money based entirely upon King Mountain's transfer of specific, identifiable property into the domestic market for sale.[3]

The Supreme Court has held that governmental taking of money through a means other than taxation can be unconstitutional. *E. Enters.*, 524 U.S. at 554 ("This case involves not an interest in physical or intellectual property, but an ordinary liability to pay money, and not to the Government, but to third parties"); *Webb's Fabulous Pharmacies, Inc. v. Beckwith,* 449 U.S. 155, 164 (1980) (takings

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[2] *Phillips v. Washington Legal Found.*, 524 U.S. 156, 170 (1998) (discussing "longstanding recognition that property is more than economic value; it also consists of 'the group of rights which the so-called owner exercises in his dominion of the physical thing,' such 'as the right to possess, use **and dispose of** it.'" (Citations omitted; emphasis added)).

[3] USDA Statement of Material Facts in Support of Its Motion for Summary Judgment, ECF No. 15-1, at ¶ 1, 2.

protections applied to money); *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 235 (2003) (same). The fact that FETRA imposes a monetary exaction (not a tax) is not alone sufficient to insulate FETRA from constitutional scrutiny.

B. The Per Se Physical Takings Rule is the Appropriate Analysis Here.

1. The two takings tests.

Takings Clause jurisprudence recognizes two separate ways in which the government can act to trigger Fifth Amendment protections, both of which are dependent on the nature of the government action and not the type of property taken: 1.) When the government physically takes property courts apply a per se taking rule; and 2.) When the government limits property use through regulation courts apply a more complex analysis to determine the "justice and fairness" of the government action. As noted by the Supreme Court in *Horne*, "[i]t is 'inappropriate to treat cases involving physical takings as controlling precedents for the evaluation of a claim that there has been a 'regulatory taking,' and vice versa.'" *Horne* at *7 (citation omitted).[4]

2. FETRA results in a per se physical taking.

FETRA does not impose any regulatory restrictions on King Mountain, nor on King Mountain's use of its money. Instead, under FETRA the government simply takes King Mountain's money through an assessment (not a tax). This "categorical taking" of money from King Mountain requires application of the "clear rule" takings analysis. *Tahoe-Sierra Preservation Council v. Tahoe*

[4] All of the cases from other jurisdictions that addressed constitutional takings challenges to FETRA were entered before the Supreme Court decided *Horne*, and all improperly applied the regulatory takings analysis. *Swisher Int'l, Inc. v. Schafer*, 550 F.3d 1046 (incorrectly employing regulatory takings analysis); *United States v. Native Wholesale Supply Co.*, 822 F. Supp. 2d 326 (W.D.N.Y. 2011) (same).

Regional Planning Agency, 535 U.S. 302, 323 (2002) ("we do not ask whether a physical appropriation advances a substantial government interest" under the "clear rule" governing "categorical taking[s]"); *Nixon v. United States*, 978 F.2d 1269, 1284 (D.C. Cir. 1992) ("[t]he rationale for the *per se* rule is that actual occupation of property obviates an in-depth factual inquiry to determine whether one's economic interests have been sufficiently damaged as to warrant compensation").[5]

The "clear rule" analysis applies to non-tax taking of money. So, for example, in *Webb's*, the Court applied a per se analysis to appropriation of money, explaining, "a State, by *ipse dixit*, may not transform private property into public property without compensation." 449 U.S. 155, 164 at 6. *See also Koontz*, 133 S. Ct. at 2600 (applying per se takings approach to challenged government monetary assessment); *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 235 (2003) (same).

Here, the USDA seeks to take money from King Mountain – a complete taking, not a regulatory restriction. The constitutionality of that taking without compensation must be assessed through application of the "clear rule" per se physical taking analysis. *Koontz*, 133 S. Ct. at 2600-02 (government "confiscations of money [are] takings despite their functional similarity to a tax").

3. In the alternative, FETRA results in a regulatory taking.

A "physical *appropriation* of property [gives] rise to a *per se* taking, without regard to other factors." *Horne* at *6 (emphasis in original).[6] But if the Court declines to apply the clear rule analysis here, it should at a minimum apply the

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[5] As the Supreme Court has noted, the justness and fairness inquiry, "by its nature, does not lend itself to any set formula, and . . . is essentially ad hoc and fact intensive." *E. Enters.*, 524 U.S. at 523-24.

[6] *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 235 (2003) (in monetary takings case, the court stated: "We agree that a *per se* approach is more consistent with the reasoning in our *Phillips* opinion than *Penn Central*'s ad hoc analysis").

more fact specific analysis required to evaluate regulatory taking of money, just as the Supreme Court did in *E Enters. v. Apfel*, 524 U.S. 498 (1998). In analyzing whether a regulatory taking had occurred in *Eastern*, the Supreme Court recognized that its inquiry:

> by its nature, does not lend itself to any set formula, and the determination whether "justice and fairness' require that economic injuries caused by public action [must] be compensated by the government, rather than remain disproportionately concentrated on a few persons," is essentially ad hoc and fact intensive.

Id. The Court then identified several factors to be considered:

> "[T]he economic impact of the regulation, its interference with reasonable investment backed expectations, and the character of the governmental action."

Id. (citations omitted).

Addressing the first factor – economic impact – the Plaintiff's only response is a factual assertion, unsupported by the record, that FETRA assessments are not retroactive, and therefore they cannot have an economic impact on King Mountain. But FETRA is retroactive as it only benefits a discreet set of businesses that were in the market prior to FETRA's enactment. That is the same scheme disapproved in *Eastern* – one which compensates for past activity through assessments on future market participants. As *Eastern* confirms, it is the nature of the wrong sought to be corrected by Congress, not the timing of the monetary exaction, that makes a scheme retroactive. Simply because the money to pay for a retroactive scheme comes from future sales does not change that analysis. And even if this were not a retroactive scheme, simply because assessments were held to impose a retroactive economic impact in one case does not mean that other cases involving current financial obligations do not have an unacceptable economic impact.

Plaintiff itself recognizes that "the $6.372 million King Mountain is sued for is a large sum." ECF No. 44 at 8. Plaintiff's unsupported factual opinion that this

"large sum" can be "passed on to customers" ignores that the same thing was true in *Eastern* – the company there could have raised its prices[7]. But the ability, *vel non*, to simply charge more money to customers in a competitive market was not the issue in *Eastern*, and it is not the issue here. In any event, the Plaintiff's simplistic view of market pricing ignores the extremely competitive pricing demands of the cigarette market, especially for small, relatively unknown companies like King Mountain.[8]

As to the second factor, Plaintiff once again simply argues that only retroactive monetary assessments can impact reasonable investment backed expectations. Yet as noted above, FETRA is a retroactive scheme just like the flawed scheme rejected in *Eastern*.[9] And even if it were not retroactive, that alone does not magically resolve its interference with Plaintiff's investment expectations. Plaintiff concedes that FETRA was not enacted when King Mountain entered the Market. Unable to address FETRA's interference with King Mountain's investment backed expectations, Plaintiff argues that "buyout proposals" and unrelated existing tax schemes somehow override the Court's obligation to

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[7] Eastern "was a signatory to every NBCWA executed between 1947 and 1964." It was still an operating business "Although it left the coal industry in 1965." 524 US. at 499.

[8] See, e.g., Value Line Industry Analysis: Tobacco("Given the limited opportunities for growth in this highly competitive industry, brand equity support is crucial in developing customer loyalty. A leading market position gives a company greater pricing power, which is important, especially under difficult economic conditions. The leader of a particular product category often determines price points.") http://www.valueline.com/Stocks/Industries/Industry_Analysis__Tobacco.aspx#.Vaguw_lVhBc.

[9] The program in *Eastern* that could not pass muster was a compassionate health insurance funding system for retired coal miners. In contrast, there is no rationale for the Government to force King Mountain to make payments to the very tobacco growers who benefitted from the government's price support system for decades.

consider the impact of FETRA itself. Plaintiff's argument that "other costs imposed on participants in the tobacco industry when KM entered the market" immunize FETRA against challenge is insufficient to overcome the interference FETRA has on King Mountain's reasonable investment backed expectations.

As to the third factor – the character of the governmental action – the Response simply ignores the critical problems with FETRA identified in the opening memorandum. So, for example, the Plaintiff does not dispute that "the nature of the governmental action in this case is quite unusual." *Eastern*, 524 U.S. at 537. Nor does Plaintiff dispute that FETRA assessments are unrelated to any commitment that King Mountain made, or to any injury it caused, or to any benefit it received.[10] And the Response does not deny that FETRA forced companies like King Mountain to bear a burden which should have been borne by the public as a whole. *Armstrong v. United States*, 364 U.S. 40, 49 (1960). The $9.6 billion in FETRA payments to growers is little more than a naked wealth transfer, as FETRA does not even purport to: (1) compensate growers for any burden they endured under the price support system, or (2) recoup from manufacturers some economic benefit that they derived from the program. 7 U.S.C. § 518, *et seq*. It was growers who benefitted from artificially high prices during the decades-long price support

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[10] *Accord Commonwealth Edison Co. v. United States*, 271 F.3d 1327, 1342 (Fed. Cir. 2001) (distinguishing Supreme Court cases that held *tax* legislation unconstitutional, stating: "those decisions were limited to situations involving a 'wholly new tax.' *Id.* EPACT, unlike the statutes at issue in those two cases, is not a mere revenue-raising measure. Rather, it represents an assessment on particular existing domestic utilities, which Congress concluded **benefited from** the government's operation of the uranium enrichment facilities, and which Congress also concluded were **themselves partially responsible for the problem** the statute seeks to remedy." (Emphasis added).

program. The Response does not explain why those same growers should continue to benefit at the expense of a new company such as King Mountain, which had no involvement in the old system. And the Response ignores the manner in which FETRA promoted the interests of Big Tobacco at the public's expense.

And the third factor "character of the governmental action" here – FETRA's wealth transfer mechanism which takes money through assessments (not a tax) for the benefit of private parties – is unconstitutional because it does not constitute public benefit. *Horne* at *13, Thomas, J. concurring ("The Takings Clause imposes a meaningful constraint on the power of the state— the government may take property only if it actually uses or gives the public a legal right to use the property" (internal quotations and citation omitted)); *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 231 (2003) ("While it confirms the State's authority to confiscate private property, the text of the Fifth Amendment imposes two conditions on the exercise of such authority: **the taking must be for a "public use"** and "just compensation" must be paid" (emphasis added)).

II. FETRA Violates the Due Process Clause.

FETRA violates due process because paying yet more money to the beneficiaries of an historic price control scheme is not a rational way to "instantaneously" move a billion dollar industry to a free-market system. Justice Kennedy was the fifth vote for holding the Coal Act unconstitutional in *Eastern,* but not based on the Takings Clause which he found "unnecessary" to invoke. *Eastern* 524 U.S. at 539. Instead, Justice Kennedy found that the Act violated the Due Process Clause because it imposed liability on a company that had not participated in the conduct that harmed the miners, and which could not have anticipated being subject to liability after the fact. *See Eastern* 524 U.S. at 547-50. Here, FETRA imposes liability after the fact on companies like King Mountain

that had no involvement in the old price support program that enriched tobacco growers. In a model of twisted logic, because growers will no longer benefit from a price support system that enriched them for decades, Congress decided to enrich them for an additional ten years through a wealth transfer scheme funded not by taxes but from monetary exactions taken from companies like King Mountain.

A tax might be rational, and a less seismic transition might have been rational. But taking non-tax money from one business that did not benefit from the old system, and giving it to another business that did benefit from the old system, and doing so as part of a financial scheme to change the core operation of a market overnight, is not sufficiently rational to survive due process scrutiny. Moreover, the ultimate effect of FETRA has been very different on new, small companies like King Mountain - which were not parties to and did not benefit from the old federal price support and quota system, were not party to and did not benefit from the MSA contracts, and who did not benefit from the new FETRA system.

III. FETRA Violates Other Constitutional Protections.

Because of FETRA's unquestioned benefit to private companies that profited for decades from government price fixing (ignored in the Response), FETRA's unquestioned benefit to Big Tobacco (ignored in the Response), and FETRA's unequal treatment of small companies that received no benefit such as King Mountain (ignored in the Response), FETRA violates both the equal protection clause, and the unconstitutional conditions doctrine. As to equal protection, FETRA cannot withstand scrutiny under rational basis review as noted above and in the opening memorandum, including because its application results in unequal treatment of King Mountain and infringes on King Mountain's right to engage in commerce. Past involvement in the old tobacco support system plays no role in calculating FETRA assessments. If the government deems it appropriate to pay

businesses that benefitted for decades from government fixed pricing, those costs should be borne by the public as a whole. *Armstrong*, 364 U.S. at 49. At the very least, it is inappropriate for the vast majority of the public to escape any costs, while multi-million dollar assessments are imposed on companies like King Mountain that were not involved in the old price support system.

FETRA has a coercive affect and impermissibly burdens King Mountain's right to access American markets. It requires King Mountain to pay a monetary exaction – not a tax – to transfer specific property into interstate commerce.[11] If King Mountain transfers specific property into interstate commerce, the government takes money from the sale of that product and gives it to another business. *Accord Swisher Int'l, Inc. v. Schafer*, 550 F.3d 1046, 1058 (11th Cir. 2008) (describing FETRA takings as "a cost of doing business in the industry"). But as the Supreme Court held in *Horne*, engaging in interstate commerce: "although certainly subject to reasonable government regulation, is similarly not a special governmental benefit that the Government may hold hostage, to be ransomed by the waiver of constitutional protection." *Horne* at *10.[12]

CONCLUSION

The Court should enter summary judgment in favor of King Mountain.

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[11] See footnote 3 above.

[12] In its "Introduction" Plaintiff makes a vague "waiver" reference. ECF 44 at 1. But Plaintiff makes no waiver argument nor does it provide any waiver case citation. *Greenwood v. F.A.A.*, 28 F.3d 971, 977 (9th Cir. 1994) ("a bare assertion does not preserve a claim"). *See* Local Rule CR 16(g); *Orji v. Napolitano*, No. C11-898MJP, 2012 WL 527424, at *2 (W.D. Wash. Feb. 16, 2012) ("Plaintiff's motion was filed in accordance with the rules, so it is properly before the Court").

July 20, 2015

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on July 20, 2015, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF System which will send notification of such filing to the following:

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/s/ Randolph Barnhouse
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