NO. 84265-0-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

STATE OF WASHINGTON,

Respondent/
Cross-Appellant,

v.

AMERICAN TOBACCO, et al.,

Appellants/
Cross-Respondents.

RESPONDENT/CROSS-APPELLANT'S REPLY BRIEF

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I. INTRODUCTION

Federally recognized Native American tribes possess authority to impose and collect tribal tax independent from the State's taxing authority. Tribal cigarette tax stamps and resulting tribal cigarette tax revenue are not the same thing as State cigarette tax stamps and State cigarette tax revenue.

The Arbitration Panel's conclusion that tribal cigarette stamps and taxes are the same thing as State cigarette stamps and taxes constitutes error on the face of the arbitration award. The Panel's conflation of tribal taxing authority with State taxing authority is an error of law, not an error of fact. Under Washington law, an arbitration panel exceeds its authority when a legal error is apparent from the face of an award, and its award must be vacated under RCW 7.04A.230(1)(d).

II. ARGUMENT

A. State Law Applies

The trial court ruled that State law provides the legal standard for vacating an arbitration award under the Master

Settlement Agreement (MSA). *See* CP 1204 ¶ 6. The trial court was correct. The Participating Manufacturers (PMs) argue that the trial court instead should have applied the standards set forth in the Federal Arbitration Act (FAA). Appellants' Joint Cross-Response and Reply Brief (Resp. Br.) at 11–15. But the MSA provision relied on by the PMs addresses an arbitration itself; it does not address subsequent court review. The MSA provides that NPM Adjustment arbitration is subject to the FAA. MSA § XI(c). But this provision does not address subsequent court *review* of an arbitration award. Rather, the MSA provides that the MSA "shall be *governed* by the laws of the relevant setting state . . . ." MSA § XVIII(n) (emphasis added).

The PMs' argument that the FAA applies to State court review of an arbitration award has been rejected by the two state appellate courts that have analyzed whether State law governs court review of an arbitration award. Following the 2003 NPM Adjustment arbitration, the Maryland intermediate appellate court harmonized the MSA provisions referenced above and

concluded that the state standards for whether an award should be vacated applied. *Maryland v. Phillip Morris, Inc.*, 225 Md. App. 214, 123 A.3d 660, 673–75 (Md. App. 2015) (vacating arbitration award in part). The Maryland court explained that while the parties had agreed to arbitrations being governed by the FAA, that provision did not mandate that judicial review of the arbitration decision would be under the FAA as well. Rather, the MSA provided that a court in each state would resolve disputes under the agreement, deemed the MSA court, and the governing law for the MSA would be the law in the applicable state. This meant that motions to vacate an arbitration award should be decided under the standards in state law, not federal law. *Id*.

Pennsylvania's intermediate appellate court similarly held that State law governed review of arbitration awards under the MSA and rejected the PMs' argument to apply the FAA. *Com. ex rel. Kane v. Phillip Morris USA, Inc.*, 114 A.3d 37, 57–58 (PA. Comm. Ct. 2015) (vacating award in part).

Further support for the Pennsylvania analysis was provided by the New Mexico MSA Court. *State of New Mexico ex rel. King v. Philip Morris*, *USA*, No. D-101-cv-1997-01235 (N.M. 1st Judicial Dist. Court Sept. 27, 2016) (unpublished order denying in part and granting in part New Mexico's motion to vacate final arbitration award, attached as Appendix A). While the New Mexico court did not expressly decide whether state or federal law applied, it found "persuasive and compelling" the Pennsylvania court's analysis of why vacatur was warranted on an issue where that court applied the state law standard for vacatur. *See* Appendix A at 7.

This Court should follow the well-reasoned approach of the courts in Maryland, Pennsylvania, and New Mexico.[1] The

[1] In another appellate case following the 2003 arbitration, Missouri chose not to contest the PMs' argument that the federal standard applied. *State ex rel. Greitens v. Am. Tobacco Co.*, 509 S.W.3d 726, 735 (Mo. S. Ct. 2017). The Missouri Supreme Court applied the federal standard and analyzed whether the Panel "exceeded its powers" by reflecting its "own notions of economic justice," rather than "drawing its essence from the

parties to the MSA agreed that disputes would generally be decided by the MSA court, which in Washington's case is King County Superior Court. CP 225. The parties also agreed that Washington law would govern the MSA. CP 294. The trial court was correct to apply Washington law in reviewing the State's motion to vacate.

B. Vacatur is Mandatory When Error is Apparent on the Face of an Arbitration Award

RCW 7.04A.230 provides the statutory grounds for vacating an arbitration award in Washington. At issue is subsection (1)(d), which provides that "the court shall vacate an award . . . " where an arbitrator exceeds his or her power. An arbitration panel exceeds its authority when there is error on the face of the award. *Broom v. Morgan Stanley DW Inc.*, 169 Wn.2d 231, 240–41, 236 P.3d 182 (2010); *Federated Servs. Ins. Co. v. Pers. Representative of Est. of Norberg*, 101 Wn. App. 119, 126,

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contract." *Id*. at 735–36. The Court still vacated part of the award under the federal standard.

4 P.3d 844 (2000). When a dispute is about the law and not about the application of law to the facts, then an error of law is subject to judicial review and vacatur. *Norberg*, 101 Wn. App. at 126. The court in *Norberg* explained that where a "dispute is about law, not about evidence" and "can be decided by reference to existing law without resort to the evidence that was before the arbitrators and without second-guessing their application of the law to the facts," then "an issue of law apparent on the face of the award" was "a proper subject of a motion to vacate".

Similarly, the Supreme Court in *Broom* stated:

> Although arbitrators are empowered to interpret the [National Association of Securities Dealers] Code, their interpretations may not violate state law. And though arbitrators have the discretion to interpret section 10304 as they see fit, that discretion is bounded by Washington's case law and statutes. Because, under our cases, state statutes of limitations may not apply to arbitrations absent the parties' agreement, the arbitrators were not authorized to apply those limits to the Brooms' claims.

Broom, 169 Wn.2d at 245; *Norberg*, 101 Wn. App. at 126 (arbitration disputes over the law are subject to judicial review).

1. Interpretation of "Units Sold" is a legal question

No matter how many times the PMs say otherwise, the question of whether cigarette packs with tribal tax stamps meet the statutory definition of "units sold" in RCW 70.157.010(j) is a legal question, not a factual one. "Units sold" is defined in plain and unambiguous terms by reference to State, not tribal, tax stamps:

> "Units sold" means the number of individual cigarettes sold in the State by the applicable tobacco manufacturer . . . during the year in question, *as measured by excise taxes collected by the State on packs bearing the excise tax stamp of the State or "roll-your-own"* tobacco containers.

RCW 70.157.010(j) (emphasis added).

A Native American tribe is not the State of Washington, nor is it a state agency, nor a subsidiary of the State. It is a separate sovereign. *See Am. Vantage Cos., Inc. v. Table Mountain Rancheria*, 292 F.3d 1091, 1096 (9th Cir. 2002) (tribes do not belong to state political communities, rather they are distinct, independent political communities). The 29 federally

recognized tribes within the boundaries of Washington State were established primarily through treaties negotiated with the federal government prior even to the existence of Washington as a state. *See United States v. Wash.*, 384 F.Supp. 312, 330 (W.D. Wash. 1974). While the tribes are subject to federal law, they possess many attributes of sovereignty, including the right to impose taxes within the boundaries of their territories. *Merrion v. Jicarella Apache Tribe*, 455 U.S. 130, 137, 102 S. Ct. 894, 71 L. Ed. 2d 21 (1982).

The number of "units sold" by NPMs in Washington over the course of a year or whether Washington diligently enforced escrow deposits for those sales are questions of fact for arbitration panels. In contrast, whether a pack of tribally tax stamped cigarettes falls within the plain language of "units sold" as defined in RCW 70.157.010(j) is a question of law.

As the trial court correctly reasoned, the only cigarettes that meet the relevant statutory definition are those which have a State excise tax stamp applied which reflects the payment of

State tax. CP 1203 ¶ 3. Cigarettes sold under tribal compacts have tribal stamps reflecting taxes paid to the tribes and plainly do not meet the statutory definition of "units sold." In fact, the statute authorizing compacts between the State and tribes provides on its face that the State is withdrawing its sovereign authority to impose cigarette excise tax and each compacting tribe will exercise its sovereign authority to impose tribal tax. RCW 43.06.455(3). The trial court's interpretation was not in a vacuum as claimed by the PMs, but rather the type of statutory interpretation that courts engage in all the time.

The PMs' primary attempt at an argument for why the units sold definition is not a legal question but a factual one involves the Puyallup Tribe's cigarette compact. Seven months after the order that is the subject of the appeal and cross-appeal in this case, the PMs sought "clarification" of the order due to a difference between the Puyallup compact and the other State-tribal compacts. As with all State-tribal cigarette compacts, the Puyallup compact includes retrocession of State taxing authority

and the Tribe stamps cigarettes under the tax stamp of the Puyallup Tribe. All of the revenue is Puyallup tribal revenue, but the Tribe agrees to share 30% of its revenue with the State. RCW 43.06.465.

The statute authorizing the Puyallup compact was enacted in 2005. Laws of 2005, ch. 11, § 2. The trial court ruled that the PMs' motion was both untimely and wrong on the merits. The PMs have appealed that order separately.[2]

The tribal tax revenue sharing aspect of the Puyallup cigarette compact is set by statute and other than the number of tribal compact cigarettes sold each year does not other vary from year to year. Similarly, the definition of "units sold" is set by statute and does not change. There are no facts to find for each new NPM Adjustment Arbitration regarding tribal compact cigarettes and "units sold." Compact tribal cigarettes are all sold

[2] This other appeal is numbered 84691-4-I. The State moved to consolidate the appeals. Over the PMs' objection, the cases have now been linked. Ruling (Jan. 31, 2023).

under tribal tax stamps with the tribes collecting tribal taxes and those cigarettes either meet the statutory definition of "units sold" (cigarettes sold under a State tax stamp and State tax collected) or they do not.

The PMs' attempt to draw a factual distinction actually demonstrates that units sold *is* subject to legal interpretation. The trial court's ruling that the only cigarettes that are units sold are those with State stamps reflecting the payment of State tax was easily applied to this slight factual variation. The Puyallup compact cigarettes still involve tribal stamps and tribal tax. The State's contractual agreement to receive a portion of the tribal tax revenue does not change that, as the trial court correctly ruled. In any event, that slight factual variation shows that the interpretation of "units sold" is a question of law, and that question of law can be applied to various facts.

2. The Panel erred by considering extrinsic materials to interpret an unambiguous statute

The face of the 2004 Arbitration Panel's award reflects two primary errors made by the Panel.[3] First, the Panel ignored the rules of statutory interpretation in reaching its conclusion. Where the language of a statute, in the context of any related statutes, is clear and unambiguous, a court must give effect to that plain meaning. *Dep't of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 10–11, 43 P.3d 4 (2002). In such circumstances, the court does not consider extrinsic sources in discerning the statute's meaning. *Jametsky v. Olson*, 179 Wn.2d 756, 762, 317 P.3d 1003 (2014). It is clear that the Panel was swayed by what it called the "intramural debate" over how to interpret "units sold" in light of tribal compact legislation. CP 97–121. But

[3] The State's cross-appeal challenges the trial court's denial of the State's motion to vacate. Because the State's argument for vacatur depends on first establishing error on the face of the arbitration award, the State addresses this part of the motion, even though the trial court agreed that such error occurred.

emails and memos by attorneys are irrelevant in interpreting an unambiguous statute.

Because the statute is clear that tribal compact cigarettes cannot possibly meet the definition of "units sold," there is no need to delve deep into the debate over how to apply the statute, but the State does wish to correct the record to avoid any misunderstanding. The State did not change its position, as the PMs allege, nor did the Attorney General's Office as a whole ever take the position that tribal compact sales were units sold. *See, e.g.*, Resp. Br. at 58.

The Qualifying Statute defining units sold and explaining the obligations of non-participating manufacturers to deposit escrow for each unit sold was enacted in 1999. Laws of 1999, ch. 393, codified at RCW 70.157. The Legislature later enacted tribal compact cigarette legislation in 2001, which authorized the State to negotiate cigarette tax compacts with the tribes. Laws of 2001, ch. 235, codified at RCW 43.06. Thereafter, the State and tribes began negotiating and executing compacts.

These tax compacts required the State agencies involved in escrow enforcement—primarily the Attorney General's Office (AGO) and the Department of Revenue (DOR)—to determine how to count tribal compact cigarettes when interacting with Non-Participating Manufacturers that were obligated to deposit escrow for each cigarette defined as a "unit sold." The DOR took the position that the statute was plain and unambiguous that tribal cigarettes were not units sold because they had tribal stamps. *See* CP 115–16. The attorney charged with escrow enforcement at the AGO, who naturally was inclined to take an aggressive position to assure that manufacturers deposited adequate escrow and to avoid any negative consequences such as being found to be "non-diligent" in an NPM Adjustment arbitration proceeding, advocated for requiring manufacturers to make escrow deposits for tribal compact cigarettes. *See* CP 116–18. Attorneys in the Washington AGO exchanged emails with colleagues from other states and the National Association of Attorneys General (NAAG), who expressed various views in informal discussions.

See, e.g., CP 120 n.44 (describing a survey created by a NAAG attorney to collect the views of attorneys in different states about the issue). Eventually the issue was elevated to Attorney General Rob McKenna. In 2005, General McKenna reviewed the statute and based on the clear limitation in the statute of "units sold" as requiring state stamps and state taxes, made the determination that the AGO would not require escrow for tribal compact cigarettes. *See* CP 120–21. The AGO has held this position consistently since then, and has never held a contrary position. And this position is consistent with the DOR.

None of this ultimately affects how this Court interprets the statute. The trial court was correct to conclude that the statute is plain and unambiguous, and that the Panel erred on the face of the arbitration award by concluding otherwise.

3. Indian tribes' sovereign authority to impose taxes is not derived from the State

The Panel's brief explanation of its reasoning for interpreting the "units sold" definition also reveals a basic

misunderstanding of Native American law, explained in greater detail in the amicus brief submitted by seven tribes. *See* Amicus Curiae Brief of Indian Tribal Governments who are Parties to Cigarette Tax Compacts with the State of Washington. The Panel articulated its view that it was the State that had authorized tribes to tax:

> Washington did not simply repeal its cigarette tax. Through a statutorily created and regulated system, Washington *authorized* compact tribes to collect the same tax that the state imposes. There is no evidence that absent the authorizing statutes, the state would have *permitted* the tribes to impose and collect cigarette taxes.

CP 122 (emphasis added).

This analysis, which immediately precedes the Panel's conclusion, misunderstands a basic and uncontroversial point about taxation in Indian Country. While there is frequent controversy over *states'* authority to impose taxes for transactions occurring on reservation lands, there is no longer controversy that *tribes* have the authority to impose such taxes. Tribes derive this authority from their inherent position as

sovereigns. *Merrion*, 455 U.S. at 137 ("The power to tax is an essential attribute of Indian sovereignty because it is a necessary instrument of self-government and territorial management."). A state does not "authorize" a tribe to impose taxes on its own reservation. A tribe is not equivalent to a local government such as a county or city that needs State authority before it imposes a tax. *See Am. Vantage Cos., Inc.*, 292 F.3d at 1096.

The Panel's explanation was contrary to law when it explained that Washington "authorized compact tribes to collect the same tax that the state imposes." CP 122. Washington did not authorize tribes to collect taxes. They already possessed inherent authority to do so. It is not the same tax because it is the tax of a separate sovereign. What the State gave up is the ability to collect its own taxes, if tribes met certain conditions. RCW 43.06.455(3).

Again, how the Panel reached at its incorrect interpretation of the definition of "units sold" is not ultimately the issue. Rather, the Panel reached an interpretation of the statute that was

contrary to Washington law, which means that the Panel committed error on the face of the arbitration award, and therefore exceeded its authority under RCW 7.04A.230(1)(d).

The PMs offer only the most minimal defense of the Panel's units sold interpretation on the merits, and they do not engage with the text of RCW 70.157.010(j). In the context of their appeal of the order granting the State declaratory relief, the PMs object to the State's assertion that they waived argument on the merits of the "units sold" definition. Resp. Br. at 60. But then they again decide not to argue the language of the statute, instead re-characterizing the Panel's improper statutory construction as "fact-finding." *Id.* at 61. As the trial court explained, cigarette packs with tribal stamps are not "units sold" because they do not have State stamps reflecting the payment of State taxes. CP 1203–04 ¶ 4. The Panel committed error on the face of the arbitration award by concluding otherwise, as the trial court correctly ruled. CP 1204 ¶ 6.

C. RCW 7.04A.230 Requires Vacatur if One of the Grounds Is Found

The statute identifying the six grounds upon which an arbitration award must be vacated does not contain an additional implied prejudice requirement. Nevertheless, Washington was prejudiced by the Panel's legal error regarding tribal compact cigarette sales.

1. The Legislature specifically identified when an arbitration award must be vacated

The PMs' primary argument on the State's cross-appeal is not to defend the Panel's interpretation of the statute, but to argue that the State was not prejudiced by the error. Resp. Br. at 19–25. The PMs apply the wrong legal standard. This is not a criminal case, where the Court looks to whether any error was harmless, by determining whether the evidence otherwise supported the verdict. Nor is this a case about whether substantial evidence supported a trial court's conclusions of law. Rather, there is a specific statute that controls whether vacatur of an arbitration award is warranted.

RCW 7.04A.230(1) provides that if an arbitration panel exceeds its powers, "the court shall vacate" the award. The State is not arguing that any minor error, such as, for example, a typographical or mathematical error, requires vacatur. Rather, there are six statutory grounds identified that require vacatur. All involve serious issues with the arbitration award. None are trifling matters. By mandating vacatur when one of the six grounds under RCW 7.04A.230 has been found, the Legislature has determined that such errors are inherently appropriate for vacatur and should be remanded to the arbitration panel for determinations consistent with the instructions of the court.

The PMs argue that there is an additional implied requirement to show prejudice. *See* Resp. Br. at 19–20. That argument is inconsistent with the statute for two reasons. First, for three of the statutory grounds for vacatur, including (1)(d) at issue here, one of the options for the trial court is to remand to the same arbitrator. The outcome of such a remand could be the same result or a different result. But if the party seeking vacatur

has the burden to show it was harmed by the error, it would make little sense to allow remand which has the potential to result in no ultimate change in the outcome. Second, one of the six grounds, (1)(f), specifically requires that inadequate notice "prejudice substantially the rights of a party to the arbitration proceeding." Therefore, when the Legislature wanted to require prejudice as a prerequisite to vacatur, it said so.

For their asserted prejudice requirement, the PMs primarily rely on *Saleemi v. Doctor's Associates, Inc.*, 176 Wn.2d 368, 292 P.3d 108 (2013). However, *Saleemi* did not analyze the mandatory language in RCW 7.04A.230. Rather, *Saleemi* addressed a challenge to the pre-arbitration decisions by a trial court about which state's law would apply and whether particular portions of the arbitration agreement were enforceable. *See id*. at 376. Our Supreme Court was also influenced by the inefficiency of waiting until after an arbitration to challenge the court's pre-arbitration decisions. *See id*. at 386. That case is therefore not on point.

The PMs also rely on the reasoning for the prejudice requirement in *Saleemi* that requiring prejudice promotes the purposes of arbitration, which are speed and convenience. Resp. Br. at 20. Those purposes do not apply here. The PMs, after losing the tribal compacts issue in the 2003 arbitration, decided to re-argue the identical position in the 2004 arbitration. The arbitration took seven years. The State's challenge to the 2004 decision is paired with a request for declaratory relief to decide the issue once and for all. And the PMs have also sought to vacate a ruling that they do not like from the 2004 Panel regarding the impact of the adverse decision upon Washington.[4] Efficiency is gained from resolving the tribal compacts issue definitively, not by ignoring it.

[4] This "reallocation" issue, which affects the size of the reduction in a state's payment if it is found non-diligent, is currently pending at King County Superior Court. Regardless of the outcome, it is likely to result in a third appeal stemming from the 2004 arbitration alone.

The only other Washington case relied on by the PMs for its prejudice argument is *Thomas v. French*, 99 Wn.2d 95, 659 P.2d 1097 (1983). That case stands for the proposition that where hearsay evidence is wrongfully admitted, it must be prejudicial to warrant reversal. Therefore, that case is also inapposite. The vacatur analysis is controlled by RCW 7.04A.230's language, not the cases cited by the PMs.

2. The error did prejudice the State

Even assuming, however, that there is some burden on the State to show prejudice, it can do so on this record. The PMs rely very heavily on a single footnote, which states that the Panel's finding on tribal compact cigarettes was "not determinative." CP 176 n.116. Read in proper context, the Panel did not mean that their analysis of the tribal compact issue was irrelevant or not material to their analysis. The Panel meant, as it said in the second sentence of the footnote, that other evidence of non-diligence would still support the Panel's conclusion if it was wrong about tribal compact cigarettes.

If this Court undertakes a prejudice analysis, it should examine the Panel's award as a whole, not a single footnote. The footnote minimizing the importance of the tribal compact issue contradicts the Panel's other statements about how important the issue was and the Panel's prominent and extensive analysis of it. Discussion of the tribal issue is the first and most prominent issue in the Washington-specific decision, spanning nearly the entire first half of the opinion. CP 91–122 (pages 7–38 of the Washington decision). The Panel even expressly recognized the materiality of the issue by stating that "[t]he definition of units sold issue is significant to the Washington hearing due to the large volume of tribal sales under the compact system." CP 91. The Panel also stated that it was required to grapple with the issue because of its "importance" and the millions of tribal compact cigarette sales. CP 96. The Panel similarly remarked that "[b]ecause of the importance of the issue, the written record of the DOR/[AGO] debate merits a detailed review." CP 107. This creates serious doubt that the Panel would have reached the same

result if it had correctly interpreted the "units sold" definition. It suggests that the footnote was an effort by the Panel instead to discourage further litigation and judicial review of the decision. But review of arbitration awards, while limited, is mandatory under statute and cannot be varied by the parties or by an arbitrator. *See Barnett v. Hicks*, 119 Wn.2d 151, 161, 829 P.2d 1087 (1992) (parties to an arbitration cannot define the scope of subsequent court review).

While the State's argument below and on appeal focused on the definition of "units sold" as applied to tribal sales, the consequences of the trial court's proper interpretation of the statutory language and the Panel's error also demonstrate flaws in other parts of the Panel's analysis. In multiple places, the Panel faulted the State for failing to detect certain contraband schemes. In one example, the Panel faults Washington for failing to detect a scheme involving a retailer called Blue Stilly that involved hundreds of millions of unstamped contraband cigarettes. CP 172–73. But contraband, which involves the retail sale of

either cigarettes without a state tax stamp or cigarettes with the tax stamp of a different state, are also by definition not "units sold," because they involve cigarettes that do not have a stamp of the State of Washington and for which no tax has been paid to the State. The Panel even acknowledged this, yet cited these examples as showing the inadequacy of Washington's enforcement efforts. *Compare* CP 172–73 and CP 173 n.112.

Furthermore, there are many indications in the Panel's analysis that the diligence determination was a close call. The Panel concluded that Washington did many things right in 2004. The following factors weighed in Washington's favor:

- "Washington deserves credit for enacting both complementary legislation[5] and [allocated share repeal] legislation." CP 138.

[5] Complementary legislation, codified at RCW 70.158, provided important tools to the AGO to aid escrow enforcement. Chief among them, the AGO was authorized to create a directory of approved Non-Participating Manufacturers prior to their sales of cigarettes in Washington.

- The AGO, which was the primary agency responsible for diligent enforcement, "devoted adequate resources to escrow enforcement." CP 139.
- Washington took adequate steps to identify manufacturers selling cigarettes in Washington and to vet those Non-Participating Manufacturers who would be permitted to sell here. CP 141.
- Washington adequately delisted [prohibited sales from] Non-Participating Manufacturers that failed to deposit escrow. CP 143.
- Washington made a "reasonable and effective use of litigation as an enforcement tool against noncompliant NPMs." CP 144.
- Washington actively worked with NAAG and other states on enforcement matters. CP 151.

These many positive factors indicate that the outcome of the hearing may well have been different if the Panel correctly

interpreted and applied the definition of "units sold" in RCW 70.157.010(j).

There is a substantial likelihood that the Panel's misinterpretation of "units sold" affected the outcome of the arbitration. Almost half of the Washington-specific decision is devoted to the issue. CP 91–122 (pages 7–38 of the Washington decision). It was the first issue addressed by the Panel. The error was interrelated with and logically affects other findings by the Panel. The trial court should have vacated the arbitration award, and either remanded to a new panel or the same panel.

III. CONCLUSION

RCW 7.04A.230 provides the standards for whether an NPM Adjustment arbitration award must be vacated. Vacatur is required where an arbitration panel exceeds its authority, which occurs if there is error on the face of an arbitration award. The Panel's conclusion that tribal compact cigarette sales are "units sold" as defined by RCW 70.157.010(j), which include only those cigarettes in packs containing state tax stamps, was error

on the face of the arbitration award. Accordingly, this Court should order that the award be vacated. Given the nature of the error and the serious inconsistencies in the award, the State requests that the matter be remanded to an arbitration panel to determine the State's diligence under the correct interpretation of "units sold" as defined by RCW 70.157.010(j).

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RESPECTFULLY SUBMITTED this 7th day of February 2023.

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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 7th day of February 2023, at Olympia, Washington.

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Assistant Attorney General

NO. 84265-0-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

STATE OF WASHINGTON,

Respondent/
Cross-Appellant,

v.

AMERICAN TOBACCO, et al.,

Appellants/
Cross-Respondents.

APPENDIX TO RESPONDENT/CROSS-APPELLANT'S REPLY BRIEF

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Respondent/Cross-Appellant State of Washington submits this Appendix in support of their Reply Brief.

RESPECTFULLY SUBMITTED this 7th day of February 2023.

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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 7th day of February 2023, at Olympia, Washington.

/s/ Joshua Weissman
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STATE OF WASHINGTON,

v.

AMERICAN TOBACCO, et al.

State of Washington Court of Appeals, Division I;
No. 84265-0-I

APPENDIX A TO RESPONDENT/CROSS-APPELLANT'S REPLY BRIEF

NUMBER	**DESCRIPTION**
1.	*State of New Mexico, ex rel. Gary K. King, Attorney General of the State of New Mexico v. Philip Morris, USA, et al.,* No. D-10-cv-1997-01235 (N.M. 1st Judicial Dist. Court Sept. 27, 2016); Order Denying Plaintiff State of New Mexico's Motion to Vacate Final Arbitration Award and Order Granting Plaintiff State of New Mexico's Motion to Vacate Partial Arbitration Award

STATE OF NEW MEXICO
COUNTY OF SANTA FE
FIRST JUDICIAL DISTRICT COURT

No. D-101-CV-1997-01235

STATE OF NEW MEXICO, ex rel.
GARY K. KING, ATTORNEY GENERAL
OF THE STATE OF NEW MEXICO,

Plaintiff,

vs.

PHILIP MORRIS, USA, et al.,

Defendants.

ORDER DENYING
PLAINTIFF STATE OF NEW MEXICO'S MOTION TO VACATE FINAL ARBITRATION AWARD

AND

ORDER GRANTING
PLAINTIFF STATE OF NEW MEXICO'S
MOTION TO VACATE PARTIAL ARBITRATION AWARD

THIS MATTER having come before the Court upon Plaintiff's Motion to Vacate Final Arbitration Award and Motion to Vacate Partial Arbitration Award, and the Court having considered the briefing and arguments presented and being otherwise well advised in the premises, FINDS:

The parties in this matter are parties to the Master Settlement Agreement entered into in 1998 between participating manufacturers of tobacco products ("Participating Manufacturers") and states with whom they settled claims for product liability and other consumer claims for injuries that cigarette makers' products caused to states and their residents ("Settling States").

Tobacco manufacturers that did not participate in the Master Settlement Agreement are known as "Nonparticipating Manufacturers," or "NPMs."

A key obligation that the cigarette manufacturers undertook by entering into the Master Settlement Agreement was to make annual payments in perpetuity to New Mexico and other participating states. A dispute over the annual payments resulted in an Arbitration Panel ("Panel") rendering two decisions. One decision pertains to New Mexico's diligence in enforcing a statute that it was incentivized to pass under the Master Settlement Agreement. The Panel's second decision essentially created and adopted an ancillary agreement that the tobacco companies entered into with a group of states that did not include New Mexico. Plaintiff claims that the decisions resulted in denying New Mexico the contract rights it is entitled to under the Master Settlement Agreement and that the ancillary agreement improperly shifted millions of dollars of additional liability onto New Mexico in contravention of its contract rights.

Plaintiff State of New Mexico brings its Motions pursuant to the terms of the Master Settlement Agreement, Agreement Regarding Arbitration, Federal Arbitration Act, 9 U.S.C. §§ 10(a)(3) & (4), and the New Mexico Uniform Arbitration Act, §§ 44-7A-6 and 44-7A-24, NMSA 1978.

PLAINTIFF'S MOTION TO VACATE FINAL ARBITRATION AWARD

With regard to its Motion to Vacate Final Arbitration Award, Plaintiff asks this Court to vacate the Final Award entered by a nationwide arbitration panel against New Mexico on September 11, 2013, pursuant to the conclusion of the 2003 NPM Adjustment Dispute, and, to the extent the Final Award incorporates the Partial Award, asks that the Partial Award be vacated or modified. Plaintiff's Motion to Vacate Final Arbitration Award, at 1, 20. Plaintiff contends that the final award should be vacated because the Panel ignored New Mexico's fulfillment of its

obligations under the Master Settlement Agreement, disregarded the law, and refused to consider relevant evidence.

As Plaintiff recognizes, "[j]udicial review of an arbitration panel's decision . . . is narrow." State of New Mexico's Motion to Vacate Final Arbitration Award, at 10; *compare Sheldon v. Vermonty*, 269 F.3d 1202, 1206 (10th Cir. 2001) (indicating that courts interpreting the Federal Arbitration Act only recognize "a handful of judicially created reasons that a [court] may rely upon to vacate an arbitration award" (citation and internal quotation marks omitted)), *with Matteson v. Ryder Sys.*, 99 F.3d 108, 113 (3d Cir. 1996) (indicating that courts must not "simply . . . 'rubber stamp' the interpretations and decisions of arbitrators") (used as persuasive authority). The Panel's conclusion that New Mexico was not diligent in enforcing its qualifying statute is based on a proper application of the Master Settlement Agreement. The Panel properly considered relevant evidence in a rational, consistent, and non-arbitrary manner, and acted within its authority defined by the Master Settlement Agreement. The Panel's determination of New Mexico's non-diligence was not against the weight of the evidence. Consequently, this Court declines to vacate the final award and DENIES the State of New Mexico's Motion to Vacate Final Arbitration Award.

PLAINTIFF'S MOTION TO VACATE PARTIAL ARBITRATION AWARD

Plaintiff State of New Mexico asks this Court to "vacate the Partial Award insofar as it treats the contested Signatory States as not subject to the 2003 NPM Adjustment, and instead require the contested Signatory States to be treated as subject to the 2003 NPM Adjustment for the sole purpose of calculating New Mexico's 2003 NPM Adjustment liability." Plaintiff's Opening Brief in Support of its Motion to Vacate Partial Arbitration Award, at 20.

Defendants argue that the Panel "was properly performing its 'delegated task of interpreting [the] contract.'" Certain Participating Manufacturers' Combined Response Brief to New Mexico's Motions to Vacate Final and Partial Arbitration Awards, at 8 (quoting *Oxford Health Plans, LLC v. Sutter*, 133 S. Ct. 2064, 2070 (2013) (alterations in Brief). They assert that the Panel's methodology was "based on an *express* construction of the *text* of the MSA's provisions governing reallocation of the NPM Adjustment in light of the *background law* governing judgment reductions for partial settlements." Id., at 7-8 (emphasis in Brief).

Under the Federal Arbitration Act, an arbitration is subject to vacatur:

> (1) where the award was procured by corruption, fraud, or undue means;
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or any other misbehavior by which the rights of any party have benn prejudiced; or
> (4) *where the arbitrators exceeded their powers*, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a) (emphasis added).

In New Mexico, upon motion to the court by a party to an arbitration proceeding, the court shall vacate an award made in the arbitration proceeding if:

> (1) the award was procured by corruption, fraud or other undue means;
> (2) there was:
> (A) evident partiality by an arbitrator appointed as a neutral arbitrator;
> (B) corruption by an arbitrator; or
> (C) misconduct by an arbitrator prejudicing the rights of a party to the arbitration proceeding;
> (3) an arbitrator refused to postpone the hearing upon showing of sufficient cause for postponement, refused to consider evidence material to the controversy or otherwise conducted the hearing contrary to Section 16, so as to prejudice substantially the rights of a party to the arbitration proceeding;
> (4) *an arbitrator exceeded the arbitrator's powers*;

(5) there was no agreement to arbitrate, unless the person participated in the arbitration proceeding without raising the objection under Section 16(c) not later than the beginning of the arbitration hearing; or
(6) the arbitration was conducted without proper notice of the initiation of an arbitration as required in Section 10 so as to prejudice substantially the rights of a party to the arbitration proceeding.

§ 44-7A-24 (emphasis added).

Arbitration of Master Settlement Agreement disputes is conducted pursuant to the Federal Arbitration Act ("FAA"). MSA § IX(c). However, the Master Settlement Agreement is interpreted according to the laws of the relevant Settling State. MSA § IVIII(n). The arbitration agreement establishes the parameters of the arbitrator's authority. *See generally, McMillan v. Allstate Indem. Co.*, 2004-NMSC-002, ¶ 8 (indicating that arbitration is derived from parties' agreement); 9 U.S.C. § ("arbitration [must] proceed in the matter provide for in such agreement"); *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002) (indicating that arbitration is a matter of contract). Both New Mexico and Federal law provide that an arbitration award that exceeds the authority granted to the arbitrators through the parties' agreement must be vacated. *See* NMSA 1978, § 44-7A-24(4); 9 U.S.C. § 10(a)(4); *see also Matter of Arbitration Between Melun Indus., Inc., and Strange*, 898 F. Supp. 990, 992 (S.D.N.Y. 1990) (indicting that, pursuant to the FAA, "courts will vacate an award where the arbitrator has . . . exceeded the scope of authority granted to him [or her or it] by the contractual provision providing for arbitration") (used for persuasive authority). Under the FAA, vacatur is permitted if the arbitrators "abandoned their interpretive role" in favor of their "own notions of economic justice." *Oxford Health*, 133 S. Ct. at 268, 270.

The Master Settlement Agreement provides, in part:

(A) The NPM Adjustment set forth in subsection (d)(1) shall apply to the Allocated Payments of all Settling States, *except* as set forth below.

(B) A Settling State's Allocated Payment shall not be subject to an NPM Adjustment:

(i) if such Settling State continuously had a Qualifying Statute (as defined in subsection (2)(E) below) in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year; . . . .

(C) The aggregate amount of the NPM Adjustments that would have applied to the Allocated Payments of those Settling States that are not subject to an NPM Adjustment pursuant to subsection (2)(B) shall be reallocated among all other Settling States pro rata in proportion to their respective Allocable Shares . . . and such other Settling States' Allocated Payments shall be further reduced accordingly.

MSA § IX(d)(2) (emphasis added).

Plaintiff State of New Mexico's Motion to Vacate Partial Arbitration Award concerns the Arbitration Panel's approval of the partial settlement at the request of the largest cigarette manufacturers and claims that that the settlement exceeded the Panel's powers and authority. Plaintiff asserts that the Panel's substitution of an ancillary agreement for the Master Settlement Agreement's reallocation formula resulted in more than doubling what New Mexico's liability should be under the Master Settlement Agreement's unambiguous terms.

Defendants contend that the Panel's methodology "was based on an *express* construction of the text of the Master Settlement Agreement's provisions . . . in light of the *background law* governing judgment reductions for partial settlements," This Court finds their argument unpersuasive in that they point to no ambiguity that would require the Panel to employ gap-fillers or "background law" to construct the text. Defendants' Response Brief, at 7-8 (emphasis in Brief). It is unclear to this Court what an "express construction" amounts to under applicable law. The express, unambiguous language of the Master Settlement Agreement, however, does expressly define the reallocation formula to be used.

This Court finds persuasive and compelling the approach set forth by the Commonwealth Court of Pennsylvania in *Commonwealth of Pennsylvania v. Philip Morris USA, Inc., et al.*, filed April 10, 2015, and included in the Fourth Notice of Supplemental Authority for State of New Mexico's Motion to Vacate Partial Award, filed in this matter on December 23, 2015. As did that Court, this Court finds that the Master Settlement Agreement unambiguously establishes the conditions under which the parties agreed that a state's NPM Adjustment responsibility would shift to other states, that is, only if the state diligently enforced its qualifying statute. *See* MSA § IX(D)(2)(B). Put another way, the NPM Adjustment applies to states unless they demonstrate that they diligently enforced their statutes. States who fail to demonstrate their diligence are subject to reallocation. The Master Settlement Agreement also unambiguously establishes how the Master Settlement Agreement can be amended. MSA § XVIII(j).

Here, the Panel exceeded its authority under the Master Settlement Agreement. The Panel departed from that Agreement's clear and unambiguous language regarding reallocation and amendment of the Master Settlement Agreement. Instead, the Panel created a new, ancillary contract under the guise of contract interpretation of the reallocation provision, despite that provision containing no ambiguity. The Panel substituted its own sense of what was beneficial for most of the parties, or its own sense of economic justice, and omitted the diligent enforcement condition unambiguously required for exemption from reallocation. It essentially substituted its own reallocation formula in lieu of that of the Master Settlement Agreement, generated its own award based on that formula, and failed to enforce the express terms of the Master Settlement Agreement. The parties are bound by the terms of the Master Settlement Agreement and the Panel's authority is defined and limited by those terms.

The Panel's approach resulted in more than doubling what New Mexico's financial obligation should be under the Agreement. By rendering its own version of economic justice—perhaps to avoid what Defendants' view as "a windfall benefit"—the Panel's ancillary agreement results in New Mexico bearing a much greater portion of the 2003 NPM Adjustment than it should under the express terms of the Master Settlement Agreement. *See* Defendants' Response Brief, at 10.

In the above respects, the Panel exceeded its authority as defined and limited by the Master Settlement Agreement, which is the source of the Panel's authority. To the extent the Partial Award treats the contested Signatory States as not being subject to the 2003 NPM Adjustment, it shall be vacated. New Mexico's 2003 NMP Adjustment shall be calculated accordingly. Plaintiff State of New Mexico's Motion to Vacate Partial Arbitration Award shall therefore be GRANTED.

IT IS THEREFORE ORDERED that Plaintiff State of New Mexico's Motion to Vacate Final Arbitration Award shall be, and hereby is, **DENIED.**

IT IS FURTHER ORDERED that that Plaintiff State of New Mexico's Motion to Vacate Partial Arbitration Award shall be, and hereby is, **GRANTED.**

DATED this 27th day of September, 2016.

Raymond Z. Ortiz, District Judge
Division III

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Comments:

Per the Clerk's instruction on 2/8/23, Respondent has been instructed to re- file the Reply Brief originally filed yesterday, 2/7/23, along with the appendix, as one file. No other substantive changes have been made.

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