STATE V. PHILIP MORRIS, et al. 2004 NCBC 9

STATE OF NORTH CAROLINA — IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION

COUNTY OF WAKE — FILE NO. 98 CVS 14377

STATE OF NORTH CAROLINA,)
)
Plaintiff,)
)
v.)
)
PHILIP MORRIS USA INC.,)
R.J. REYNOLDS TOBACCO COMPANY,)
BROWN & WILLIAMSON TOBACCO)
CORPORATION, individually and as)
successor by merger to the American)
Tobacco Company; and)
LORILLARD TOBACCO COMPANY,)
)
Defendants.)

ORDER AND OPINION.

{1} This matter comes before the Court on plaintiffs' motion for specific performance and the Court's Order of November 16, 2004 which ordered a briefing schedule and hearing to resolve the issue of whether the Tax Offset Adjustment created by the Fair and Equitable Tobacco Reform Act of 2004 ("FETRA") signed into law on October 22, 2004 became effective during calendar year 2004. To resolve this matter, the Court relies upon its interpretation of the National Tobacco Grower Settlement Trust Agreement ("Trust Agreement"), Amendment Number One to the National Tobacco Grower Settlement Trust Agreement ("Amendment One"), and FETRA.[1] After considering the briefs and oral arguments of each party and for the reasons below, this Court finds that the enactment of FETRA on October 22, 2004 activated the Tax Offset Adjustment provision in the Trust permitting the Settlors under the Trust to offset their FETRA payments against payments owed to the Trust for calendar year 2004.

{2} Plaintiff JPMorgan Chase Bank ("Trustee") serves as trustee for the National Tobacco Settlement Trust ("Trust"). The States of Alabama, Florida, Georgia, Indiana, Kentucky, Maryland, Missouri, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Virginia, and West Virginia are each represented by a certification entity created to help administer the Trust pursuant to the Trust Agreement. Plaintiff Certification Entities (collectively "Certification Entities" or "Entities") and Trustee bring the motion for specific performance of the Trust Agreement.

{3} Defendant Philip Morris USA Inc. (formerly known as Philip Morris Incorporated) ("Philip Morris") is a Virginia corporation whose principal place of business is 120 Park Avenue, New York, New York 10017. Defendant R.J. Reynolds Tobacco Company (individually and as successor to R.J. Reynolds Tobacco Company and Brown and Williamson Tobacco Corporation ("Brown and Williamson")) ("Reynolds") is a New Jersey corporation whose principal place of business is Fourth and Main Streets, Winston-Salem, North Carolina 27102. Defendant Lorillard Tobacco Company ("Lorillard") is a Delaware corporation whose principal place of business is 714 Green Valley Road, Greensboro, North Carolina 27404. Defendants (collectively referred to as "Settlors" or "Tobacco Companies") manufacture, advertise, promote and sell cigarettes and other tobacco products. Defendants are parties to the Master Settlement Agreement and the Trust Agreement.

{4} An amicus curiae brief was filed in this matter on December 10, 2004 on behalf of twenty-three named beneficiaries of the Trust ("Phase II Beneficiaries") and the Tobacco Growers Association of North Carolina (collectively "*Amici*").

Ellis & Winters by Richard W. Ellis and Thomas D. Blue Jr., for JPMorgan Chase Bank, as Trustee for National Tobacco Settlement Fund and North Carolina Phase II Tobacco Certification Entity, Inc.; Kelley, Drye & Warren LLP, by Sarah L. Reid for JPMorgan Chase Bank, as Trustee.

Attorneys General for individual State Certification Entities: by Karen E. Long, Special Deputy Attorney General, for the State of North Carolina; Michael Plumley, Assistant Attorney General, for the Kentucky Settlement Trust Corporation; Joel M. Ressler, Chief Deputy Attorney General, for the State of Pennsylvania; Craig A. Nielson, Assistant Attorney General, for the State of Maryland; Daniel W. Champney, Assistant Attorney General, for the State of Tennessee.

McGuireWoods LLP by Alexander H. Slaughter, Michael C. Griffin and Scott C. Oostdyk, for the Virginia Tobacco Trust Certification Board.

Shanahan Law Group by Kieran J. Shanahan and Reef C. Ivey, II, amici curiae for Phase II Beneficiaries and the Tobacco Growers Association of North Carolina.

Brooks, Pierce, McLendon, Humphrey & Leonard, LLP, by Jim W. Phillips, Jr., Robert J. King III and Charles F. Marshall III, for Defendants R.J. Reynolds Tobacco Company, Brown and Williamson Tobacco Company and Lorillard Tobacco Company.

Smith Moore LLP by Larry B. Sitton and Gregory G. Holland; Arnold & Porter by Robert Jones for Defendant Philip Morris USA Inc.

I.
PROCEDURAL HISTORY

{5} In November 1998 the Settlors entered into a Master Settlement Agreement ("MSA") with forty-six states, the District of Columbia, the Commonwealth of Puerto Rico, and four United States Territories. Previously, Florida, Minnesota, Mississippi, and Texas had signed separate agreements with the Settlors.[2] The MSA was primarily designated to reimburse States for the cost of treating smoking-related illnesses. Pursuant to the MSA, a Consent Decree and Final Judgment was entered by the North Carolina Superior Court on December 21, 1998, approving the terms of the MSA. A consent decree and final judgment was entered in each jurisdiction that became a party to the MSA. The tobacco companies immediately raised prices to cover the future costs of the MSA.

{6} Recognizing that the MSA and the increased prices would result in reduced tobacco consumption, the National Tobacco Grower Settlement Trust ("Trust"), often referred to as the "Phase II Trust," was established to provide aid to tobacco quota owners and tobacco growers in the fourteen "Grower States." Pursuant to the MSA, the Trust was established under the terms of the Trust Agreement. The Grower States—Alabama, Florida, Georgia, Indiana, Kentucky, Maryland, Missouri, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Virginia and West Virginia—entered into the Trust Agreement in order to ameliorate the predicted adverse economic difficulties that tobacco quota owners and tobacco growers would face after the MSA. As will appear more fully later, the reduction in consumption would ultimately result in a reduction in quotas.

{7} Section 4.15 of the Trust Agreement designates that this Court is the "Court of Jurisdiction" and that this Court has "exclusive jurisdiction over any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of [the] Trust." The Trust became effective upon entry of this Court's August 19, 1999 Consent Order. The Attorneys General of the fourteen Grower States agreed to the Consent Order, as did the Settlors and JPMorgan Chase Bank as Trustee. In agreeing to the Consent Order, the Attorneys General of the Grower States agreed that disagreements over the Trust would be decided by this Court. Thus, this Court in North Carolina was designated to approve, interpret, implement, administer and enforce the Trust Agreement which necessarily impacts tobacco farmers in every Grower State.[3]

{8} To fund the Trust, the Settlors make an annual payment divided into quarterly installments according to the schedule provided in pages A-1 through A-17 of the Trust Agreement. After December 15, but on or before December 31 of each year, the Trustee distributes the amounts received from the Settlors pursuant to the instructions of the Certification Entities of the Grower States.

{9} Under certain circumstances, the amount that the Settlors must pay into the Trust may be reduced. If the Settlors are forced to pay a "Governmental Obligation" which is paid to, or directed to the benefit of tobacco quota holders and tobacco producers, then the amount the Settlors must pay into the Trust will be reduced. The Trust Agreement defines a Governmental Obligation as:

> the occurrence of any change in a law or regulation or other governmental provision that leads to a new, or an increase in an existing, federal or state excise tax on Cigarettes, or any other tax, fee, assessment, or financial obligation of any kind . . . imposed by any governmental authority.

Trust Agreement at A-5 to A-6.

{10} Schedules A-5 to A-7 of the Trust Agreement contain formulas and definitions that defy easy understanding—lawyers' work at its height. This Court has concluded that the complicated language can be reduced to the following agreement: If in any calendar year Congress passes a plan to buy out tobacco quotas, which plan is paid for by Tobacco Companies, and the value of the buyout plan to tobacco farmers is greater than the amounts owed to them under the Trust, including the amounts owed for the year in which the plan becomes effective, the Tobacco Companies are relieved of the annual payment for that year and all subsequent payments under the Trust. That agreement was confirmed with the execution of Amendment One to the Trust Agreement.

{11} In the fall of 2003, three tobacco manufacturers—Reynolds, Brown and Williamson, and Lorillard—alleged that a Governmental Obligation had occurred which would reduce their payments to the Trust. All three claimed that the United States Senate's proposed tobacco buyout bill, the "Tobacco Market Transition Act of 2003" (S.1490), constituted a Governmental Obligation. Consequently, these tobacco manufacturers refused to make their third quarter 2003 payment into the Trust. The Trustee and several Grower States disagreed with the tobacco manufacturers' position and moved for specific performance of the Trust Agreement in order to force the tobacco manufacturers to adhere to their quarterly Trust payments. After mediation, the Tobacco Companies, Certification Entities and the Trustee agreed to Amendment One to the Trust Agreement, which was approved by this Court on March 31, 2004. The Settlors made all payments scheduled under the Trust Agreement for the year 2003 and agreed to make all future quarterly payments as and to the extent required by the terms of the Trust Agreement and Amendment One.

{12} Amendment One provides for, among other things, a refund of a portion of the payments by the Settlors into the Trust under certain circumstances. Amendment One does not provide the Settlors with a refund of their payments "based upon proposed changes in laws, regulations, or other governmental provisions." Amendment One at ¶ E(b). Therefore, the parties agreed that the Settlors would not be entitled to reduce their payments to the Trust based upon a proposed change of law, such as the proposed Senate bill S.1490. However, Amendment One further provided that:

> A Settlor that has become entitled to a Tax Offset Adjustment under this Schedule A by reason of a Governmental Obligation shall make reasonable estimates of (x) the aggregate amount of Tax Offset Adjustments attributable to that Governmental Obligation to which it expects to become entitled from the year in which the Tax Offset Adjustment is first effective through 2010, (y) the Settlor's share of the remaining Annual Payment to be made in the year in which the Tax Offset Adjustment first becomes effective, and (z) the Settlor's share of all remaining Annual Payments for all years subsequent to the year in which the Tax Offset Adjustment first becomes effective. If the Settlor reasonably estimates that clause (x) in the preceding sentence exceeds the sum of clauses (y) and (z), then such Settlor shall be entitled to a refund, up to the amount of that excess, of its share of the Annual Payment it made during the calendar year in which the Tax Offset Adjustment first became effective, regardless of whether such amounts have been placed in reserve (including all interest accrued thereon).

Amendment One at 2-3. Therefore, by the terms provided in Amendment One, the Settlors, Certification Entities, and Trustee agreed that the Settlors would be entitled to a refund of previous payments to the Trust made in the calendar year in which a Governmental Obligation became "effective" to the extent that the Governmental Obligation exceeded the amount paid.

{13} Finally, Amendment One explicitly provided no resolution to the dispute between the Settlors and the Trustee regarding the "Tax Offset Adjustment Effective Date Dispute." Amendment One provides that:

> The Settlors and the Trustee have different interpretations of the language in the original Agreement concerning the date on or from which any Settlor shall be entitled to a reduction arising from a Tax Offset Adjustment. It is agreed and acknowledged that Amendment Number One does not address or resolve this issue, and nothing in Amendment Number One shall be used or construed to have any bearing on the resolution of such issue.

Amendment One at 3. Thus, the Settlors, Certification Entities, and Trustee did not reach an agreement as to the date from which the Settlors would be entitled to a refund in the event that buyout legislation was enacted.

{14} On October 22, 2004, President Bush signed FETRA into law. FETRA provides for about $10 billion in assessments against tobacco product manufacturers and importers (including the Settlors) to fund payments to tobacco quota holders and tobacco quota producers. Because the funds from assessments against the Settlors will eventually flow to the tobacco quota holders and tobacco producers, these assessments will constitute a Governmental Obligation which reduces the payments owed by the Settlors into the Trust. The Settlors contend that the FETRA assessments entitle them to offset as of October 22, 2004. The Settlors claim that the terms of the Trust Agreement and Amendment One establish that they no longer must pay the fourth quarter installment of their annual payments to the Trust. Moreover, the Settlors claim that they are entitled to a full refund of payments already made in calendar year 2004. The Certification Entities and the Trustee dispute the Settlors' assertions. The Certification Entities and Trustee claim that because the assessments on the Settlors which fund FETRA will not be paid until March 2005, Settlors are not entitled to a refund for Trust payments made during calendar year 2004 and that they must make the last quarter payment. The Trustee and Certification Entities allege that the express language of FETRA, the processes and timetables created for effecting the buyout, and inequities inherent in the Settlors' interpretation require a determination that FETRA is effective in 2005.

{15} Settlors have paid approximately $2.6 billion under the Trust through 2003. Settlors have paid $318 million into the Trust in the first three quarters of calendar 2004. Settlors estimate that the amount remaining to be paid into the Trust in the fourth quarter of calendar year 2004 is $106 million. It is that $424 million which is at issue. Under the Trust Agreement, the Settlors were obligated to pay $5.15 billion dollars into the Trust. Therefore, Settlors would pay a total of $2.7 billion more in Trust payments for the period of 2004 through 2010. Under FETRA, the financial obligation extends to 2014 and totals $9.6 billion. Of that amount, the Settlors estimate that they will pay approximately $8.3 billion. Settlors estimate that they will be assessed $5.1 billion during the period of 2004 through 2010.

II.
HISTORICAL CONTEXT

{16} FETRA constitutes a seismic shift on the landscape of tobacco farms throughout the United States and will impact tobacco farming worldwide.[4] The big jolt was preceded by many warning tremors. To understand the issues before the Court, it is helpful to review the history of the changes in the tobacco industry in the last decade and the evolving market for tobacco leaf and cigarettes. These changes have fractured the once stable relationship between tobacco farmers and manufacturers of tobacco products in the United States. At its core, FETRA provides that by the end of 2014 all tobacco leaf will be purchased on an unrestricted international market.[5] It dismantles previous federally regulated quota and price support systems and pays tobacco farmers for the loss of that protection. Since the dismantling of those systems benefits the tobacco companies, Congress made them pay for it.

A.

{17} There are two basic kinds of tobacco: flue-cured and burley. Together they account for approximately 93 percent of the tobacco crop in the United States. Flue-cured tobacco is grown in North Carolina, Virginia, South Carolina, Georgia and Florida. Burley is grown primarily in Kentucky, Tennessee, Ohio, Indiana, Missouri, Virginia and West Virginia and to a lesser extent in North Carolina. Smaller quantities of tobacco are grown in Maryland and Pennsylvania. Historically, U.S.-produced tobacco has been of higher quality than foreign grown tobacco, thus carrying a higher price. Over the last decade, improved cultivation and marketing techniques have increased both the quality and price competitiveness of foreign leaf. In fact, Brazil has surpassed the United States in exports of tobacco leaf. The United States is still the largest importer of leaf and the largest exporter of cigarettes. Significantly, tobacco leaf and cigarette exports make a large contribution to the United States balance of trade, contributing $1.7 billion to our trade balance in 2002. Unlike some other products, tariffs on tobacco in major importing countries have been relatively low. That is because many countries in Europe and elsewhere do not grow tobacco and have no domestic industry to protect. They are low-production, high-consumption markets. On the other hand, low-wage countries like Malawi have high production and low consumption. Exporting cheap leaf helps their balance of payments. The United States has been unique as both a high-consumption, high-production market.

{18} Since 1938 tobacco farmers in the United States have been the beneficiaries of a federal market stabilization/price support program. The tobacco program provided a steady supply of high quality leaf tobacco and also stabilized and supported grower incomes through price supports and marketing quotas. Under the quota system, the amount of leaf a producer can sell during a given season is set by the federal government. Quota is tied to very specific property. Therefore, the only way a producer of tobacco can sell his or her product in the United States is to own or lease quota from a quota owner. Land which carries with it a quota is therefore more valuable because the quota can be leased within certain geographic restraints. The quota system thus perpetuated tobacco planting in and limited it to counties where quota was assigned. All quota is assigned to land in the Grower States listed above. Maryland and Pennsylvania have no quota holders. The difference between the number of quota owners and tobacco farmers is substantial. There are 80,000 active tobacco farmers. In contrast, there are over 300,000 absentee tobacco quota holders. In 2002 those 80,000 tobacco farmers actually produced 890 million pounds of leaf worth more than $1.5 billion. It is clear then that part of the cost of that leaf was for leasing quota, a wholly artificial cost created by the federal statutory scheme. Elimination of the quota system, then, is likely to have three results: a decrease in the cost of production (leasing costs being eliminated) and an increase in the amount produced in the United States (restrictions on production being eliminated), combined with a reduction in the price paid for leaf by the defendant Tobacco Companies (both domestically and internationally).[6]

{19} Quota is set annually by the federal government based upon demand and forecast of demand by the Tobacco Companies. That fact is important in this situation because quota has been on a steady decline since at least 1997 as a result of a decrease in U.S cigarette consumption and an increase in imports of foreign tobacco by the defendants. Significantly, quotas in 2003 were only 63 percent of 1999 levels. Burley farmers saw quota reduced by 45 percent in 2000. From a tobacco farmer's perspective, the longer it took to get a buyout of quota, the less value the buyout was likely to have. The leverage provided by pending close elections on the state and national levels in 2004 provided the best timing for a buyout for tobacco farmers and the tobacco industry. Quotas had one other adverse effect: They set artificial limitations on quality grades based upon historical purchases, not market demand, consequently driving tobacco companies to foreign markets as well, and thus reducing quota.

{20} The tobacco program also provided a price support system administered through non-recourse loans.[7] The general effect of the price support program was to cause the floor price to increase. A USDA report summarizes the situation this way:

> Because of the way the support price is calculated, the tobacco program nearly always results in annual price increases. The price depends on the average U.S. cost of producing leaf (which almost always goes up from year to year) and recent annual prices. Higher prices beget sliding demand (and greater imports), which results in smaller quotas, because expected domestic demand and exports demand, significant factors in quota calculation, are lower. The downward spiral caused by higher prices--prices rise, demand decreases, quotas shrink, but prices still continue to increase-- is the cause of much of the tobacco farmers woes . . . and their current interest in a buyout.[8]

{21} Change was present in the tobacco manufacturing sector. The industry has been consolidating steadily. Philip Morris controls approximately one-half of the domestic market for cigarettes, and Reynolds (which has merged with Brown and Williamson) and Lorillard most of the rest. The industry has been divided, particularly on the terms of a buyout. Philip Morris supported a buyout tied to FDA regulation of tobacco, and the other companies were opposed to any FDA regulation in connection with a buyout. [9] United States consumption has declined. Wholesale prices for tobacco products in the United States have risen. In 2001 the wholesale price of a pack of cigarettes in the United States had risen to $2.25 while the export price had remained steady at about 40 cents a pack. Federal and state excise taxes have been increasing steadily. The average smoker paid about $250 in tobacco taxes in 2000. Cost has a direct correlation to consumption. As costs go up, consumption goes down. As will be seen below, the industry saw the cost of smoking rising, consumption declining, domestic tobacco prices rising, domestic production limited, and foreign leaf becoming more appealing from the standpoint of reducing costs. The major manufacturers now produce cigarettes in over a hundred other countries. The loss of that business has affected the balance of trade.

{22} It is worth pausing here to look at consumption in the United States. Consumption has decreased about 2 percent annually from 1981 to 2003, including a particularly steep decline from 1999 through 2001. The year 2003 was a watershed year in the sense that it was the first time in decades that U.S. consumers spent less for tobacco products than they did the year before. Even though the costs to consumers went up, consumption decreased sufficiently to offset the rising costs. That fact had to be a strong jolt to tobacco manufacturers and farmers. It indicated that the market could not bear significant increases at the retail level without triggering offsetting decreased demand. Wholesale prices had increased 122 percent since 1998 and excise taxes had increased 74 percent. It seems clear that everyone in the industry had a vested interest in maintaining or reducing costs. The price of leaf was an obvious place to look. The trend was clear. In 2003 the percentage of the consumer dollar spent on cigarettes increased for taxes and manufacturers and decreased for tobacco farmers, wholesalers and retailers— a point the Court will return to later.

{23} One way for tobacco manufacturers to alleviate the adverse consequences of the tobacco support program was to bypass it. In 2002 Philip Morris and other tobacco companies started contracting directly with farmers to buy their tobacco, bypassing the auction market. It was a scenario fraught with peril for tobacco farmers, but most quickly signed on to the contract program. Today at least 80 percent of all leaf is probably sold under contract rather than at auction, and the percentage is probably much higher. The result was the almost certain demise of the tobacco price support program. [10] FETRA gives the price support program a decent burial. The switch to contract pricing was driven by the tobacco companies and took place after the execution of the MSA and the Phase II Trust. The shift is important because it places primary responsibility for the demise of the quota system on the Tobacco Companies. It explains why they should pay for it.

{24} Brands came under attach from cheaper generic cigarettes. Discounts had to be offered to retailers to retain market share. With a shrinking market, competition for the remaining smokers and new ones became more intense. Quality became more important where marketing was limited. The contract system was, in part, an effort by the Tobacco Companies to address cost and quality issues more directly than could be accomplished under the quota/price support system. The impact of the switch to contract purchasing is clear from the following quote.

> One key contracting issue is the relationship between price and quality. In general, buyers are willing to pay for higher quality, which generally costs more to produce. Tobacco contracts contain strong incentive to improve tobacco quality, and it is possible that cigarette manufacturers sought to raise quality in order to offset the effects of the Compensation Agreement's price increases and marketing restrictions on cigarette demand.
>
> Growers can affect tobacco quality only to an extent, through their choices of farming, harvesting,

> curing, and sorting techniques. By paying prices based on quality, contracts can give growers incentives to increase the share of high-quality tobacco and decrease the share of low-quality tobacco in each crop.
>
> A comparison of auction and contract price data indicates that tobacco contract pricing rewards high quality and punishes low quality.[11]

{25} Costs had to be held down or reduced after MSA because higher prices meant less consumption. Getting higher quality for the dollar cut costs. Eliminating the price support system by contracting eliminated the steady rise in leaf prices. The switch to contracting was one of the most significant unintended consequences of the MSA and Phase II Trust. It benefited the Tobacco Companies in many ways.

{26} The typical tobacco farm was changing as well. The number of farms was declining at an extraordinary rate. Farms were getting bigger. Leasing of quota was increasing. Technology was making the larger flue-cured farm more cost-effective and the smaller burley farms less competitive. The quota system restricted restructuring of the market. Foreign competition was taking huge chunks out of the domestic market. The tobacco support system made U.S. tobacco uncompetitive on the international market from a price standpoint, reducing U.S. exports and making the market more international. Consumption was down, and the contract system threatened the price support system. There is little doubt that the small tobacco farmer was and is struggling and perhaps is on the verge of extinction.

{27} In the midst of this turmoil and possibly causing large parts of it came the Master Settlement Agreement.[12] Signed on November 16, 1998, Phase I committed the tobacco companies to (1) pay the states $206 billion over 25 years, (2) pay $1.75 billion for antismoking measures and research to reduce youth smoking, and (3) agree to limitations on advertising, including bans on using cartoon characters in advertising, selling "branded" merchandize and sponsoring sporting events. The MSA, along with the settlements with four other states, portended ongoing inflation in cigarette prices and a correlative reduction in consumption.

{28} To pay the cost of the MSA, Phase II, and other settlements, the Tobacco Companies raised the wholesale price of a pack of cigarettes 45 cents on the day the MSA was signed. Combined with stiff increases in excise taxes, this price increase has blunted consumption. The economic effect of high prices was not lost on advocates of stronger restrictions on the sale of tobacco products, particularly to the young. They learned that as prices go up, consumption goes down, and concomitantly, if prices go down, consumption may go up. Those simple economics explain why opponents of the buyout bill tried to attach FDA oversight to the bill. Plainly stated, they were afraid the bill would result in lower prices for cigarettes stemming from lower costs for leaf, making cigarettes cheaper for young people to buy.

{29} The MSA also provided for a Phase II. Under Phase II the Tobacco Companies agreed to pay $5.15 billion over 12 years into a trust fund designed to compensate tobacco quota holders and growers for the potential impact on their sales and income resulting from any drop in consumption created by the MSA. As can be seen from the discussion above, the forecast of adverse consequences for quota holders and growers was chillingly accurate and was greatly accelerated by the actions of the tobacco companies. It is the Phase II Trust and payments owed under its terms which bring us to the issues before the court.

{30} Before turning there, the Court notes one other historical fact of relevance. On December 20, 2000, a class action was filed in the United States District Court for the Middle District of North Carolina captioned *DeLoach v. Philip Morris Companies, Inc.*, on behalf of all persons holding a quota to grow flue-cured tobacco or burley tobacco in the United States and all domestic producers of flue-cured and burley tobacco. No. 00CV01235, 2001 U.S. Dist. LEXIS 16909, at *5-6 (M.D.N.C. July 24, 2001). The defendants included all the major tobacco manufacturers and leaf merchants. It accused the defendants of fixing the price for flue-cured and burley tobacco, conspiring to undermine the auction system and manipulating purchases so as to reduce the quotas under the federal program. *Id.* at *5-7. The case was settled by agreement executed on May 15, 2003 and approved by Judge William Osteen on October 1, 2003. *DeLoach v. Lorillard*, No. 04-1923, 2004 U.S. App. LEXIS 25009, at *5 (4th Cir. Dec. 6, 2004). A separate settlement was reached with R.J. Reynolds on the day the trial was to begin. *Id.* at *3. By virtue of the settlements class members were to receive over $200 million in damages. *DeLoach* First Settlement Agreement § 2. Other provisions are of interest. Article 4 of the May 15, 2003 Settlement Agreement provided for commitments to purchase leaf in specified percentages ("Volume commitments"). *Id.* at §§ 4.1 – 4.9. The timing of those commitments was altered if "Buyout Legislation" was enacted during the period. *Id.* at § 4.4. Further, Section 5.3 of the agreement provided that $5 million would be paid directly to the plaintiffs' co-lead counsel, Howery & Simon, to support fees and expenses incurred in supporting Buyout Legislation tied to FDA regulation. *Id.* at § 5.3. Article 5 applied only to Defendant Philip Morris. Philip Morris supported FDA regulation as part of a buyout, and the other tobacco companies did not want FDA regulation as part of the buyout.

{31} The settlement is relevant to this Court in the following respects. It establishes that the intent of the tobacco growers was to seek buyout legislation that included FDA regulation. It provided the funds for a lobbying effort to begin in 2003, and it helps explain the effort of the Tobacco Companies to extricate themselves from the Trust obligations as early as 2003. It demonstrates to the Court that the Tobacco Companies and the growers, each with highly compensated and competent lobbyists, were hard at work on the buyout issue as early as 2003. Their efforts came to fruition in 2004, an election year.

{32} The enormous benefits to be reaped by both Tobacco Companies and tobacco farmers from the buyout are obvious. Tobacco farmers get a huge financial benefit from the buyout. The smallest farmers will get tens of thousands of dollars and the largest farmers and quota holders, millions.[13] The system which prevented or impeded the creation of larger, more cost-effective farms and made U.S.-grown tobacco noncompetitive on the world market was dismantled in an orderly fashion which would permit many older farmers to retire. Quotas, which were steadily declining, were bought out at 2002 levels. Tobacco Companies got what they most needed, a future free market for tobacco leaf. With quotas eliminated, the cost of leaf domestically would drop and potentially have the effect of reducing international prices as well.[14] A price support system that had steadily increased the price of U.S.-grown leaf was eliminated for the future. The cost of the buyout could be funded by elimination of future payments under Phase II (which had already been provided for in the 1998 price increase) and lower tobacco costs.[15] Once the buyout payments are over, the cost savings will drop to the bottom line. All of that could be accomplished without the same level of price increase that affected consumption after 1998.

{33} At age sixty-six, the quota and price support system was showing its age and was ready for retirement. Both tobacco farmers and Tobacco Companies reaped enormous benefits from and solved critical problems by the passage of FETRA.

{34} However, with FETRA, ironically a part of the American Jobs Creation Act of 2004, Congress shifted yet another industry to an international free market economy. With the buyout, tobacco farmers fared far better than the textile workers and furniture workers in their home states, who had no similar transition.

B.

{35} In October 1997, Senators John McCain (R-AZ) and Harold Ford (D-TN) made the first significant proposals for a quota buyout in the LEAF (Long-Term Economic Assistance for Farmers) Act of 1997. Over the last several years, numerous bills were proposed which included buyouts for quota owners, transition payments for growers, and the termination or privatization of the tobacco program.[16] Several proposals included a community development component. Almost seven years after the first significant proposal for a tobacco buyout, advocates would find success in the months preceding the election of 2004.

{36} The American Jobs Creation Act of 2004 ("Jobs Act") was introduced on June 6, 2004 by Representative William M. Thomas (R-CA). The Jobs Act was cosponsored by forty additional congressmen. In Title VI, the Jobs Act included the Fair and Equitable Tobacco Reform Act of 2004 ("FETRA"). The House bill passed by recorded vote on June 17, 2004. It provided quota holders $7 per pound and producers $3 per pound based upon 2002 quota allotments or levels. The payments were to be made in equal installments over five years, fiscal years 2005 through 2009. The House bill, which applied to the 2005 and subsequent crops of tobacco, capped payments at $9.6 billion and provided that the Settlors would not fund the buyout.

{37} The Senate amendment passed on July 15, 2004. It provided quota holders $8 per pound and producers $4 per pound based upon 2002 quota allotments or levels. The payments were to be made in equal installments over a 10-year period. The amendment capped payments at $12 billion. The payments were to be funded by assessments on the Settlors. It also restricted where tobacco could be grown and the amount that could be produced. It applied to the 2004 and subsequent crops of tobacco. In addition, the amendment included FDA regulation and set aside funds to support the development in communities that previously heavily relied upon the revenue generated from the production of quota tobacco.

{38} On July 15, 2004, the Senate appointed conferees Senators Grassley (R-IA), Hatch (R-UT), Nickles (R-OK), *Lott* (R-MS), Snowe (R-ME), Kyl (R-AZ), Thomas (R-WY), *Santorum* (R-PA), Smith (R-OR), *Bunning* (R-KY), *McConnell* (R-KY), Gregg (R-NH), Baucus (D-MT), *Rockefeller* (D-WV), Daschle (D-SD), Breaux (D-LA), Conrad (D-ND), *Graham* (D-FL), Jeffords (I-VT), Bingaman (D-NM), Lincoln (D-AR), Kennedy (D-MA) and Harkin (D-IA). On September 29, 2004 the House appointed conferees Representatives Thomas (R-CA), DeLay (R-TX), Crane (R-IL), McCrery (R-LA), Rangel (D-NY), Levin (D-MI), *Goodlatte* (R-VA), Boehner (R-OH), Stenholm (D-TX), Barton (R-TX), *Burr* (R-NC), Waxman (D-CA), Johnson (R-TX), Miller (D-CA), Sensenbrenner (R-WI), Smith (R-TX) and Conyers (D-MI). The members whose names are in italics are from Grower States. Conference was held on September

29, 2004 and continued on October 4 through October 6, 2004. On October 7, 2004, the conferees agreed to file a conference report. On the same day, the House agreed to the conference report. The Senate agreed to the conference report on October 11, 2004. The conference agreement provided quota holders $7 per pound on their basic quota level paid in equal installments over 10 years. The basic quota level for poundage quotas is based upon the 2002 tobacco marketing year. Non-poundage quotas' basic levels are determined by calculating the product of the basic quota level from the 2002 tobacco marketing year and the average yield production per acre of the period covering the 2001, 2002, and 2003 crop years for that type of tobacco in the county where the tobacco was grown. In addition, the conference agreement provided eligible producers $3 per pound based on their base quota level paid in equal installments over 10 years. The base quota level for producers of flue-cured and burley tobacco was equal to the effective marketing quota for the 2002 marketing year for quota tobacco produced on the specific farm. The base quota level for producers of other kinds of tobacco was the product of the basic tobacco farm acreage allotment for the 2002 marketing year established by the Secretary for quota tobacco produced on the farm and the average annual yield of quota tobacco per acre on the farm during the 2001, 2002, and 2003 crop years. Total payments were not to exceed $10.14 billion. The conference agreement applied to the 2005 and subsequent crops of tobacco.

{39} Unlike the original House bill, the conference agreement provides that the payments to tobacco quota owners and tobacco quota producers were to be funded by assessments on tobacco product manufacturers and importers. Quarterly assessments will be paid into the newly created Tobacco Trust Fund. Each tobacco product manufacturer and importer will pay assessments based upon its market share. In addition to funding payments to tobacco quota holders and tobacco quota producers, the Tobacco Trust Fund will subsidize losses incurred by the USDA.

{40} Unlike the Senate amendment, the conference agreement does not provide a community development fund, nor does it allow FDA regulation. No provision was made for payments to farmers in Maryland and Pennsylvania, who did not hold quotas.

{41} On October 21, 2004, the bill as stated in the conference agreement was presented to President Bush. The President signed the bill the next day, October 22, 2004. The bill became Public Law No. 108-357. The law became effective on the date of enactment. H.R. 4520, *Joint Explanatory Statement of the Committee of Conference* at 218 (Oct. 7, 2004). The Joint Statement is the only legitimate legislative record available.

{42} Several sections in FETRA have become the subject of varying interpretations coinciding with the arguments presented by parties to this litigation. Section 614 states that "[t]he amendments made by this subtitle shall not affect the liability of any person <u>under any provision of law so amended</u> with respect to the 2004 or an earlier crop of each kind of tobacco." (Emphasis added). Section 622(e)(2) states that the Secretary shall make contract payments to each eligible tobacco quota holder "during each of the fiscal years 2005 through 2014." Section 623(d)(2) states that the Secretary shall make contract payments to each eligible producer of tobacco "during each of the fiscal years 2005 through 2014." Section 624(a) states that "[c]ontract payments required to be made for a fiscal year shall be made by the Secretary as soon as practicable." Section 625(b)(1) states that the Secretary "shall impose quarterly assessments during each of fiscal years 2005 through 2014 . . . on each tobacco product manufacturer and tobacco product importer that sells tobacco products in domestic commerce in the United States during that fiscal year." Section 625(b)(2) states that the quarterly assessments shall "begin[] with the calendar quarter ending on December 31 of each of fiscal years 2005 through 2014." Section 625(d)(1) provides that the "Secretary shall provide each manufacturer or importer subject to an assessment . . . with written notice setting forth the amount to be assessed against the manufacturer or importer for each quarterly payment period . . . not later than 30 days before the date payment is due." Section 625(d)(3) states, "Assessments shall be collected at the end of each calendar year quarter . . . ." Section 643 entitled "Effective Date" provides that "[t]his title and the amendments made by this title shall apply to the 2005 and subsequent crops of each kind of tobacco."

{43} It is abundantly clear that Congress was keenly aware of the impact of FETRA on the Phase II payments. Numerous members of the Conference Committee which hammered out the final compromise between the House and Senate versions of the buyout bill were from Grower States or states in which the Tobacco Companies were headquartered. [17] They included senators McConnell and Bunning from Kentucky and Representative Burr from North Carolina, for example. Many members of Congress from Grower States sit on the boards of state Certification Entities. The Attorneys General in each Grower State were fully knowledgeable of the timing problems which needed to be addressed in FETRA. Both the Tobacco Companies and the growers were well represented by lobbyists.[18] Finally, this Court took the unusual step of contacting each member of the Conference Committee to urge them to resolve the timing issues under the Phase II Trust by the manner in which the buyout legislation was structured.[19] It is simply inconceivable that Congress ignored the existence of the Phase II Trust and the payout timing issues when it enacted FETRA. It had to decide how much would be paid, who would pay it, as well as when and where the money would come from. The 2004 Phase II payout of $400 million was not insignificant, even by Congressional standards.

{44} That point brings the Court to a discussion of the failure of the parties and their counsel to follow a suggestion made by the Court on numerous occasions. The parties had it within their power to agree on language that would go into the bill that would clarify whether the 2004 Phase II payment would be eliminated or be preserved. Congress could then have made an open and honest decision on how the buyout was to be funded, and there would not have been any necessity for this phase of the litigation before the Court. The Court suggested that the parties take such action, particularly while they were using the services of a mediator. For reasons unknown to the Court, neither side was willing to solve the problem in an easy and understandable fashion which would have eliminated the present controversy. Rather, the parties left the courts of North Carolina to glean from a minimal record whether Congress understood what it was doing and what it intended. [20]

{45} It is likely that the benefits to growers and Tobacco Companies were so great that neither side was willing to lose their benefits from the legislation in a fight over language that would solve the Phase II issues for the Court. In that sense they rest together in a bed of their own making. The opportunity for passage of a bill of this nature was in all probability rare and unique.[21] The Tobacco Companies and the growers seized that opportunity, leaving the Court to determine Congressional intent rather than requesting that Congress clearly express it. What Congress intended, if that can be determined, impacts the Court's interpretation of the Trust Agreement.

{46} Recognizing that reasonable minds can differ on the issue and that the Supreme Court of North Carolina is likely to have the final word, this Court must make the first attempt to decide the issue. The Court believes that Congress provided the Tobacco Companies with the opportunity to avoid the 2004 Trust payment by (1) making the effective date of FETRA 2004 and (2) providing that the Tobacco Companies would be assessed for the fourth calendar quarter of 2004.

{47} The Court has reluctantly concluded that Congress gave each side language from which it could argue it should prevail under the Trust, and the members of Congress gave themselves credit for passing the bill before the election. Likewise, the Court will be surprised if the Secretary of Agriculture takes any definitive action before the appeal in this case is decided.

III.

{48} The Court next turns to an explanation of the position of the parties, an analysis of their arguments and the reasoning behind the Court's determination.

A.

{49} It is necessary to begin the discussion with a significant caveat that concerns the potential action of the Secretary of Agriculture. As the Court reads FETRA, there is the possibility that the Secretary of Agriculture could make an assessment against the tobacco companies and require payment of that assessment in December 2004. No assessment has been made as of the date of this opinion and no payment has been made by the Tobacco Companies. Should an assessment be made and a payment made by December 31, 2004, the provisions of Amendment One to the Trust Agreement, referred to in paragraph 12 above, would control the disposition of this case.

{50} That provision, agreed to by the parties, would make it mandatory that a refund of all 2004 payments be made by the Trustee and render the remaining part of this opinion immaterial. For that reason, the Court is ordering that a copy of this decision be brought to the attention of the Secretary of Agriculture immediately. Counsel for the Tobacco Companies, as well as counsel for the Trustee and the State Certification Entities are charged with this responsibility. They may act in concert or separately, but each shall report to the Court upon completion of notice to the Secretary. While the time is short, the Court is confident that this holding will not come as any surprise to the Secretary, who has received substantial correspondence from members of Congress concerning issuance of an assessment.[22]

{51} The more difficult issue presented is the Settlors' rights to receive a refund and to skip the fourth payment in the event there is no 2004 assessment and payment under FETRA. The position of the parties on each side of the issues is summarized below.

B.

Trustee, Certification Entities, Growers

{52} It is the position of the Trustee and Certification Entities that the Settlors are not relieved of their obligation to make the fourth-quarter installment and final payment of 2004 into the Trust. The Trustee and Entities claim that the Settlors are not entitled to a refund of their 2004 payments paid to date. Further, the Trustee and Entities urge the distribution of the 2004 Trust funds to tobacco growers and tobacco quota owners. Primarily, the Trustees and Entities urge that the Settlors' payment obligation under FETRA is effective in 2005 and therefore no Tax Offset Adjustment or refund is available for 2004. The Trustees and Certification Entities rely upon their interpretation of the express language of the Trust Agreement, their interpretation of the express language of FETRA, the processes and timetables created for effecting the buyout, and their interpretation of the equities involved.

{53} Under certain circumstances identified in the Trust Agreement, the Settlors are entitled to reduce the amount of the annual payments they must make to the Trust. The Settlors are entitled to a Tax Offset Adjustment if a Governmental Obligation is incurred which creates a benefit for tobacco growers and tobacco quota owners. *See* Trust Agreement at A-5 to A-7. Under Amendment One to the Trust Agreement, where Settlors become entitled to a Tax Offset Adjustment, the Settlors are entitled to a refund of their Trust contributions already paid in that year which equal or are less than the amount of the Governmental Obligation. The Trustee and Entities acknowledge that FETRA may allow Tax Offset Adjustments in the future. However, the Trustee and Entities argue that the Settlors' demands for the refund of their 2004 payments is premature. Trustee and Entities focus on the language found on page A-7 of the Trust Agreement:

> In the event of such a Governmental Obligation, the amount otherwise required to be paid by each Settlor each year (after taking account of all adjustments or reductions hereunder) shall be reduced by an amount equal to the product of the amount of such Governmental Obligation *paid* in connection with Cigarettes manufactured by the Settlor (or tobacco or tobacco products used by the Settlor to manufacture Cigarettes) for the same year multiplied by the ratio of the Grower Governmental Obligation divided by the amount of the Governmental Obligation, which reduction amount may be carried forward to subsequent years as necessary to ensure full credit to the Settlor.

Trust Agreement at A-7 (emphasis added). The Trustee and Entities cite this language as a clear and unambiguous temporal element which must be satisfied in order to trigger a refund or offset.

{54} The Trustee and Certification Entities argue that the timing of the assessments does not affect the ability of the Settlors to become eligible for a Tax Offset Adjustment. Rather, the Settlors gain eligibility only through the properly noticed payment of such an assessment. Trustee and Certification Entities allege that FETRA has not triggered a payment which would entitle Settlors to the Tax Offset Adjustment. Further, the Secretary must follow the provisions in FETRA that lead to an assessment, a task that the Trustee and Entities allege makes clear that no assessment will be made in 2004.

{55} In response to the Settlors' reliance on the Trust Agreement language which allows the Settlors to "reduce its annual payment by a reasonable estimate of any such reduction and adjust its payment after the actual amount is finally determined," the Trustee and Certification Entities propound that the Settlors cannot reduce their 2004 annual payments because there is no way that the Settlors will become eligible for a refund or offset in 2004. Trust Agreement at A-8.

{56} The Trustee and Entities also argue that an interpretation of the express language of FETRA does not entitle the Settlors to a refund or offset in 2004. Although Settlors alleged that sections 625(b) and (d) of FETRA required the Secretary of Agriculture to give the Settlors notice of the first assessment on December 1, 2004 with payment due on December 31, 2004, the Trustee and Entities allege that FETRA did not make clear whether such an assessment would in fact occur or actually be paid. In fact, the Trustees and Entities allege that Congress created a FETRA assessment and payment system that could not be operative in 2004.

{57} In support of this proposition, Trustee and Certification Entities direct attention toward Section 625(b)(2) of

FETRA in which Congress mandated that assessments against the Settlors could only occur after the Tobacco Trust Fund ("TTF") had made buyout-related expenditures. Only two types of TTF expenditures allow the Secretary to make assessments against the Settlors.

{58} The first type of TTF expenditure would be a contract payment to tobacco quota holders and tobacco quota producers. *See* FETRA § 625(b)(2)(A). The Trustee and Entities allege that such a payment could not occur in 2004. In order to make a contract payment, the Secretary would have to issue an offer of contract to all of the hundreds of thousands of potential buyout recipients, wait for and then review their applications, accept those that qualify, and then make the payments. The Trustee and Certification Entities suggest that the volume of potential payees (last year there were 355,517 Phase II payees) will take months to service. In fact, the Trustee and Certification Entities proffer a USDA press release which stated that the Secretary will not even start offering contracts until the spring of 2005.[23]

{59} The second type of TTF expenditure that could occur in 2004 would be loan pool stock losses. The Trustee and Certification Entities suggest that no loan pool stock losses could be incurred by the TTF in 2004 due to four reasons. First, a determination of loss for loan pool stocks will not occur until the respective tobacco marketings are completed, which will occur no sooner than the fourth quarter of calendar year 2005. *See* 7 C.F.R. § 1464.10; 7 C.F.R. § 723.104. Second, section 641 of FETRA requires that there be an attempt to sell loan pool stocks, which would not be completed until several months after the conclusion of the 2004 crop year. Third, the Secretary has not approved a plan for the TTF to assume debt, therefore precluding the TTF from accepting loan losses. Finally, no losses will occur until the quota system ends due to the requirement that all loan pool stocks be sold by the TTF at market prices. *See* FETRA § 641(d).

{60} In further support of their argument that Congress did not intend for FETRA to be effective in 2004, Trustee and Certification Entities emphasize that the Secretary made no assessment on December 1, 2004, nor has such an assessment been made to date. The Trustee and Certification Entities claim that the Secretary has properly interpreted FETRA to require no 2004 payment into the TTF. As set forth above, the Trustee and Entities claim that no assessment can be made until the TTF has made expenditures. Second, the Secretary must determine market share based upon information provided by the Settlors. The Trustee and Entities claim that this information will not be available for several months. Third, the Trustee and Entities purport that the Secretary cannot make assessments until appeal procedures are in place. Again, the Trustee and Entities point out that this has not yet occurred. Moreover, Trustee and Entities cite section 625(i)(2) of FETRA which affords the Secretary 180 days from the day of enactment to establish the rules by regulation. Finally, the Trustee and Entities claim that the Secretary is not mandated by FETRA to issue an assessment in the first fiscal quarter of 2005.

{61} Furthermore, the Trustee and Entities also highlight the language in FETRA which provides that it is a forward-looking statute. Section 614 states that the "amendments made by this subtitle shall not affect the liability of any person under any provision of law so amended with respect to the 2004 or an earlier crop of each kind of tobacco." (emphasis added by the Court). Additionally, section 643 of FETRA specifies an effective date for the statute as a whole as applying only to the 2005 and subsequent crops of tobacco. The Trustee and Entities suggest that the timing of assessments against the Settlors begins with the Secretary's contract payments to tobacco quota holders and tobacco quota producers. Sections 622(e)(2) and 623(d)(2) state that the Secretary will make contract payment to each eligible tobacco quota owner and tobacco quota producer during each of the fiscal years 2005 through 2014. The Secretary is to make these payments "as soon as practicable." FETRA § 624(a). The Secretary will make assessments against the Settlors to cover the amounts of these payments. FETRA § 625(b)(2). The Trustee and Entities suggest that FETRA provides for a catch-up assessment against the Settlors such that the assessment that would have coincided with the first fiscal quarter of 2005 will actually be paid at the same time as the final payment of fiscal year 2014. See FETRA § 625 (d)(3)(A). Therefore, FETRA does not mandate an assessment in the first quarter of fiscal year 2005. That characterization runs directly contrary to the express mandates of FETRA which require the Secretary of Agriculture to make and collect an assessment for the October to December quarter of 2004. FETRA § 625 (b)(2).

{62} In addition, the Trustee and Certification Entities argue that allowing the Settlors to receive an offset and refund for 2004 would not be the "fair and equitable" result that Congress intended with the passage of FETRA. A 2004 effective date for the tax offset adjustments would create a gap in payments to eligible tobacco quota holders and tobacco quota producers. Pursuant to the Trust Agreement and Amendment One, tobacco quota holders and tobacco quota producers are scheduled to receive payments from the Trust funds between December 15 and December 31, 2004. Trustee and Certification Entities allege that if the Settlors' interpretation of FETRA is correct, the tobacco quota holders and tobacco quota producers would receive no payment for 2004. Under sections 622(e)(2) and 623(d)(2) of FETRA, tobacco quota holders and tobacco producers may not receive a contract payment until as late as September 2005. The Trustee and Certification Entities posit that Congress could not have intended to create a gap of nearly two years for farmers who have already incurred quota cuts and suffered financial impact from falling tobacco demand. The Trustee and Entities argue that, in contrast, the Settlors will gain a more favorable long-term business climate because of the enactment of FETRA.

{63} The Trustee and Entities also point to the legislative history of FETRA in support of its argument that it should not affect crop year 2004. The original bill which passed the House of Representatives applied its terms to the 2005 and subsequent crops of tobacco. The Senate amendment applied its terms to the 2004 and subsequent crops of tobacco. The conference agreement and FETRA applied its terms to the 2005 and subsequent crops of tobacco. The Trustee and Entities suggest that this provides further support that FETRA has not created a tax offset adjustment for 2004. Moreover, the amount of grower benefit decreased in the conference agreement, suggesting that the 2004 Trust payments should remain fully intact.

{64} In further support of the Trustee and Entities' interpretation of the Congressional intent of FETRA, they note the substantial first-hand knowledge base upon which Congress relied. Each of the Class A Phase II certification entities contains members of such State's congressional delegation on the entities' Board. The Trustee and Entities claim that members of Congress who served on the entities' Boards understood the administrative problems that would be created by trying to make a 2004 assessment against the Settlors. Further, these members of Congress understood the consequences that a withheld 2004 Trust payment would have on farmers. On November 23, 2004 several members of Congress wrote Ann M. Veneman, the Secretary of Agriculture, conveying their understanding that FETRA contemplates a Trust payment to farmers in 2004.

{65} In conclusion, the Trustee and Entities acknowledge that FETRA may allow Tax Offset Adjustments in the future. However, the Trustee and Entities allege that currently no Tax Offset Adjustments are available to the Settlors to reduce the Annual Payment due to the Trust for calendar year 2004. Therefore, the Trustee and Entities urge that the Settlors should not be relieved of their obligation to make payment to the Trust for the fourth quarter of calendar year 2004 and that the 2004 Trust funds should be distributed.

C.

Tobacco Companies/Settlors

{66} Settlors claim that no fourth quarter installment should be paid to the Trust in 2004. Furthermore, Settlors claim that the previous three installments to the Trust already paid in 2004 should be refunded. Settlors primarily base their position on an interpretation of the Trust language and an interpretation of Amendment One.

{67} Settlors urge the strict interpretation of the Trust Agreement and Amendment One, without what Settlors claim to be the misinterpretation or misapplication of FETRA by the Trustee and Certification Entities.

{68} Settlors argue that the language of the Trust Agreement at pages A-5 through A-7 entitles Settlors to a "Tax Offset Adjustment." The Tax Offset Adjustment provision states:

> [T]he amounts to be paid by the Settlors in each of the years 1999 through and including 2010 shall also be reduced *upon the occurrence* of any change in a law or regulation or other governmental provision that leads to a new, or an increase in an existing, federal or state excise tax on Cigarettes, or any other tax, fee, assessment, or financial obligation of any kind . . . imposed by any governmental authority ("Governmental Obligation") that is based on the purchase of tobacco or tobacco products or on production of Cigarettes or use of tobacco in the manufacture of Cigarettes at any stage of production or distribution or that is imposed on the Settlors, to the extent that all or any portion of such Governmental Obligation is used to provide . . . direct or indirect payments . . . for the benefit of Tobacco Growers [or] Tobacco Quota Owners . . . .

Trust Agreement at A-6 to A-7 (emphasis added).

{69} Settlors insist that the enactment of FETRA on October 22, 2004 constituted the occurrence of a change in law imposed by a governmental authority that caused assessments to be made against the Settlors which would be paid to tobacco growers and tobacco quota owners. Settlors argue that whether or not an assessment is made or collected in 2004 pursuant to FETRA, the change in law occurred with the enactment of the law. In support, the Settlors rely upon the only piece of legislative history which states that FETRA "is effective on the date of enactment." *See* H.R. 4520, Joint Explanatory Statement of the Committee of Conference at 217, 218 (Oct. 7, 2004). In addition, Settlors note the Trust Agreement language which provides that Settlors become entitled to a Tax Offset Adjustment "upon" the occurrence of the change in law. The word "upon" is "used to indicate the exact moment or point of" an event. *See* Webster's II New College Dictionary 764 (1995). Hence, the Settlors allege that their entitlement to a Tax Offset Adjustment under the Trust occurred with the enactment of FETRA.

{70} Settlors argue that further support for their position is provided in the Trust Agreement on page A-7. Settlors allege that A-7 provides instructions for the calculation of the Tax Offset Adjustment. Page A-7 provides:

> In the event of such a Governmental Obligation, the amount otherwise required to be paid by each Settlor

> each year (after taking account of all adjustments or reductions hereunder) shall be reduced by an amount equal to the product of the amount of such Governmental Obligation *paid in connection with* Cigarettes manufactured by the Settlor . . . for the same year . . . .

Trust Agreement at A-7 (emphasis added). Settlors claim that this section reflects that the change in law has already been triggered. Therefore, an assessment need not be paid for the Settlors to become entitled to the Tax Offset Adjustment, as the Trustee and Entities have primarily argued.

{71} Moreover, Settlors claim that the Trust Agreement mandates that a "reasonable estimate" may be made to allow the Settlor to reduce its payment to the Trust even before the actual amount of the new Governmental Obligation is known. Settlors cite the "reasonable estimate" provision on page A-7, which states:

> The Settlor may reduce its annual payment by a reasonable estimate of any such reduction and adjust its payment after the actual amount is finally determined.

Trust Agreement at A-7. Therefore, even though no assessment or payment has been made by the Settlors based upon FETRA, the Settlors argue that they are entitled to estimate the reduction that would be allowed by the Tax Offset Adjustment which was triggered by the enactment of FETRA. Settlors also allege that the language of the Trust Agreement is anticipatory in providing that the change in law need only "lead to" a new or increased Governmental Obligation. *See* Trust at A-5. Thus, the Settlors claim that no assessment by the Secretary or payment obligation due to FETRA needs to occur in order to justify a Tax Offset Adjustment. However, Settlors expect that their estimates of what the assessment due would be under FETRA for the first fiscal quarter of 2005/last calendar quarter of 2004 far outweigh the amount due to the Trust for that quarter.

{72} Settlors suggest that the context of the negotiation of the Trust Agreement lends further support to their interpretation of the language of the Trust. The Settlors allege that they only agreed to pay more than $5.1 billion to the Trust for the benefit of the tobacco growers and quota holders over 12 years with the condition that the Trust Agreement would include appropriate adjustments. The prospect of tobacco buyout legislation lead to the terms of the Trust Agreement that allow the Settlors to minimize the potential for double payments to the Trust and to financing a buyout. Therefore, in anticipation of buyout legislation, the Settlors argue that they negotiated the terms of the Trust Agreement with the Trustee and Certification Entities and are entitled the agreement which was made.

{73} Thus, the Settlors contend that the enactment of FETRA entitles them to a Tax Offset Adjustment based upon the language of the Trust Agreement. Although the Settlors claim that the language of the Trust Agreement does not preclude their entitlement to a Tax Offset Adjustment without a payment to fund the buyout in 2004, in the alternative, the Settlors claim that FETRA specifies an assessment will be made against the Settlors in 2004. Specifically, FETRA states that the first assessment will be made against the Settlors in the first fiscal quarter of 2005, the quarter ending on December 31, 2004. *See* FETRA § 625(b)(2).

{74} Settlors allege that in addition to an offset of their fourth quarter of 2004 payment to the Trust they are also entitled to a refund of their previous three quarterly payments due to the agreement reached in Amendment One. Amendment One, agreed to by parties in Spring 2004, entitles Settlors, under certain circumstances, to a refund of previous payments to the Trust in the year in which a Tax Offset Adjustment first became effective. Amendment One provides:

> A Settlor that has become entitled to a Tax Offset Adjustment under this Schedule A by reason of a Governmental Obligation shall make reasonable estimates of (x) the aggregate amount of Tax Offset Adjustments attributable to that governmental Obligation to which it expects to become entitled from the year in which the Tax Offset Adjustment is first effective through 2010, (y) the Settlor's share of the remaining Annual Payment to be made in the year in which the Tax Offset Adjustment first becomes effective, and (z) the Settlor's share of all remaining Annual Payments for all years subsequent to the year in which the Tax Offset Adjustment first become effective. If the Settlor reasonably estimates that clause (x) in the preceding sentence exceeds the sum of clauses (y) and (z), then the Settlor shall be entitled to a refund, up to the amount of that excess, of its share of the Annual Payment it made during the calendar year in which the Tax Offset Adjustment first became effective, regardless of whether such amounts have been placed in reserve (including all interest accrued thereon).

Amendment One at 2-3.

{75} The Settlors argue that applying the formula set out in Amendment One entitles them to a full refund of their 2004 payments to the Trust. Settlors reasonably estimate that (x), the total amount of Tax Offset Adjustments to which the Settlors expect to become entitled from 2004 through 2010, is $5.1 billion. Settlors reasonably estimate that (y), the amount remaining to be paid to the Trust in 2004, is $106 million. Settlors reasonably estimate that (z), the total amount that the Settlors would owe to the Trust for 2005 through 2010, is $2.4 billion. Because the reasonable estimate of (x) is greater than the reasonable estimate of (y) plus (z) by more than $2.5 billion, greatly exceeding the $318 million already paid into the Trust by Settlors in 2004, the Settlors claim that they are entitled to a refund of all payments they have made to the Trust in 2004.

{76} Settlors claim that FETRA and its legislative history are not relevant to whether or not Settlors are entitled to an offset of the fourth quarter Trust payment and a refund of the previously made payments for the three preceding quarters. However, Settlors argue, that these provide further support for Settlors' position. As mentioned above, Settlors claim that FETRA mandates that the Secretary "impose quarterly assessments during each of fiscal years 2005 through 2014." FETRA § 625(b)(1). Therefore, FETRA mandates an assessment in the first quarter of fiscal 2005, or by December 31, 2004. Thus, Settlors argue that FETRA operates to trigger the Tax Offset Adjustment and refund.

{77} Settlors also find the legislative history, though sparse, to favor their position. Settlors point to the noticeable absence of Phase II payments in the text of FETRA. Settlors allege that Congress could have addressed the issue in a number of ways. Congress could have included language which purports to alter the timing of a Tax Offset Adjustment. Congress could have independently required the Settlors to make 2004 Phase II payments. Congress could have increased the amount of any assessment in the event that the Settlors are entitled to a Tax Offset Adjustment for 2004. Settlors insist that the members of Congress were well aware of the issue and did nothing to address it. Settlors argue that the plain language of the statute is dispositive of Congress's intent. Moreover, Settlors suggest that Congress chose not to preserve Phase II payments by requiring Settlors to finance the buyout legislation. The House bill would have been financed by the federal government instead of Settlors, thus ensuring that Phase II payments would continue. However, Congress chose to assess the Settlors, which Settlors suggests provides evidence of a lack of intent to protect Phase II payments.

{78} Finally, Settlors argue that FETRA's effects are irrelevant to whether or not Settlors are entitled to a Tax Offset Adjustment and refund. However, Settlors note that FETRA will greatly benefit tobacco growers and quota holders, rather than causing inequity.

{79} In summary, Settlors implore the Court to strictly construe the language of the Trust Agreement and Amendment One to determine Settlors' eligibility to a Tax Offset Adjustment and refund of the payments to the Trust for 2004.

D.

Court Analysis

1. *FETRA*

{80} Since the language of the Trust and FETRA is complex and the mixing of the calendar years, fiscal years and base periods confusing, the Court has created a visual picture of the overlap between the Trust payments and FETRA payments, omitting immaterial intervening years.

Phase II Assessment Year	**FETRA Assessment Year**	**When Paid by Tobacco Companies**	**Base Period for Assessment**
Quarterly Assessment	**Quarterly Assessment**		
Calendar Year 1999			
January - March		March 1999	
April - June		June 1999	
July - September		September 1999	
October - December*		December 1999	1/1/98-12/31/98
Calendar Year 2003			
January - March		March 2003	
April - June		June 2003	
July - September		September 2003	
October - December*		December 2003	1/1/02-12/31/02
Calendar Year 2004			***1/1/03 - 12/31/03 -- If no Phase II payment, there is 6 month gap; if payment made, a 6 month overlap*.**
January - March		March 2004	
April - June		June 2004	
July - September	**Fiscal Year 2005**	Sept.2004	
October - December	*Oct. - Dec. 2004*	*Dec 2004? - Mar 2005*	*July - Sept. 2003*
	Jan. -March 2005	*June 2005*	*Oct. - Dec. 2003*
	April - June 2005	*Sept. 2005*	*Jan. - March 2004*
	July - Sept. 2005	*Dec. 2005 (fiscal 2006)*	*April - June 2004*
	Fiscal Year 2006		
	Oct. - Dec. 2005	*Mar. 2006*	*July - Sept. 2004*
	Jan. -March 2006	*June 2006*	*Oct. - Dec. 2004*
	April - June 2006	*Sept. 2006*	*Jan. - March 2005*
	July - Sept. 2006	*Dec 2006 (fiscal 2007)*	*April - June 2005*
	Fiscal Year 2014		
	Oct. - Dec. 2013	*March 2014*	*July - Sept. 2013*
	Jan. -March 2014	*June 2014*	*Oct. - Dec. 2013*
	April - June 2014	*Sept. 2014*	*Jan. - March 2014*
	July - Sept. 2014	*Sept. 2014 †*	*April - June 2014*

			No base period assessment for remainder of 2014 although payment is made

*Annual Payment to Farmers
†This payment would have been due in December 2014, the first quarter of fiscal year 2015, but for the nstruction in FETRA Section 625(d) (3) (A) accelerating the final payment.

{81} The visual picture shows that there is an overlap of the FETRA fiscal year and the Trust calendar year. It also shows that the Tobacco Companies will be assessed for the fourth calendar quarter and that they will be assessed in 2005 based on their cigarette production for 2004. What Congress deftly did was to move the base period up so that there was no 2004 quarter assessment based on 2004 cigarette production. However, that insures that all of 2004 will be used as a base period for assessment.

{82} The Court has highlighted the relevant sections of the chart. If growers are correct, the Tobacco Companies have to make Phase II payments for all 2004 and the Tobacco Companies end up with a double payment (ostensibly for December quarter 2004) but do not make that double payment until September 30, 2014. Significantly, the Trustee and the Certifying Entities argue that the Tobacco Companies must pay for 2004 even though a statute was passed creating in that year a buyout obligation far in excess of any amount owed to the Phase II Trust for 2004 and all ensuing years. That position is contrary to both the spirit and the letter of the Trust Agreement.

{83} The strange delay in the first payment under FETRA can be understood looking at the chart. The federal government operates on a fiscal year. FETRA was a fiscal year 2005 program starting on October 1, 2004. The Conference Committee obviously understood that if the Tobacco Companies ended up having to make a December payment under Phase II they would have to make two payments for the same December quarter unless the December payment under FETRA was delayed. In fairness, Congress delayed the first payment until March and put the catch up payment at the end of the buyout. Congress doubled the September 2014 payment so that the program did not go into the next fiscal year for just one quarter. Looking at it a different way, Congress knew that if a payment was made in December 2004, the Trustee and Certification Entities had no case to claim the 2004 annual payment.

2. The Equities

A. The Tobacco Companies

{84} With FETRA the tobacco manufactures achieved a goal critical to their survival—a means to control the price of their most expensive cost component, leaf. The bill dismantles the price support system that drove up costs and gives the manufacturers the ability to control their own destiny by contract pricing and purchase of foreign tobacco. With cost control, they have the possibility of keeping prices at a level that will not diminish consumption. They accomplished that without the burden of FDA regulation which might have further reduced consumption.

{85} Of course, between now and 2014 they will have to pay for the benefit they received. The bill is about 8.3 billion dollars. That figure is on top of amounts already paid under the Phase II Trust. While the amount seems large on its face, the cost may not be nearly that high. The Tobacco Companies will have three ways to pay the bill.

{86} First, they are relieved of future payments under Phase II in the amount of $2.7 billion. Those were part of the future costs built into the 1998 price increase.

{87} Second, they can decrease prices for leaf and increase wholesale prices. That process has begun already.[24] The Tobacco Companies can save enormous sums and can easily reduce leaf prices by at least the amount that represents (a) the costs savings to non-quota holding farmers who had to pay for quota or (b) the amount quota holding farmers will receive under FETRA in lieu of their previous quota. While FETRA is in effect, this will be a break-even proposition for the farmers and the Tobacco Companies if the price is only reduced by the amount of the quota being replaced with buyout payments. The Tobacco Companies expenditures are the same amount, they just go to different places. Farmers receive the same total income when leaf price and buyout payments are combined as they did before. When FETRA payments are over, the cost savings will drop to the bottom line for the Tobacco Companies. If the reduction in the price of U.S. tobacco is greater than the amount required to fund the buyout, the Tobacco Companies will have even more money to pay for the buyout. If the drop in the price of U.S. grown tobacco causes a price drop in the international market or more of the cheaper foreign tobacco is purchased, the Tobacco Companies may receive an immediate cost reduction that drops to the bottom line. Since all U.S. tobacco will be sold on contract, the Tobacco Companies are in a better position to set price. Only the *DeLoach* settlement restricts their purchase of foreign tobacco.

{88} On the distribution side, Tobacco Companies may take more of the share of consumer dollars from retailers and wholesalers or pass some cost increase along to smokers. Phillip Morris and Reynolds have already announced reductions in retailer discounts and some price increases.[25] Thus, Tobacco Companies are in a position to pass buyout costs down to leaf producers and up to retailers, thus increasing the percentage of the consumer dollar spent on tobacco retained by the manufacturers. That has been a trend in the industry. As noted in paragraph 28 above, manufacturers and taxes have been taking more of the tobacco consumer’s dollar, and the share going to farmers and retailers has diminished. The economic impact which begins in 2005 makes it hard to believe that the bottom line of the Tobacco Companies will be adversely affected by the buyout. It may be benefited.

B. Tobacco Farmers

{89} Tobacco farmers got what they wanted in the buyout bill. They will be paid over $10 billion in addition to what they have received under Phase II to give up a quota system that was declining rapidly and a price support system that was doomed. Their leaf may now be competitively priced for export, and larger, more cost-effective farms can be created without buying quota. They do not even have to wait for annual payments as they did under Phase II. They will get contracts that they can take to the bank and assign for a cash payment of the discounted value. If the Secretary of Agriculture does her job, that opportunity might happen as early as March 2005. Such a process could provide payments that dwarf the amount of what the 2004 Phase II payments would have been. Farmers get the money directly rather than it being filtered through government entities. Many older farmers will be able to retire.

{90} The Court has attached to this opinion Appendix I prepared by the Certifying Entities and Appendix II prepared by Settlors. Each is designed to show the projected benefits to farmers under four scenarios proposed by the Court. These projections provide a good picture of the benefits to tobacco farmers from FETRA. In addition, tobacco farmers have received or will receive over $200 million in settlement payments from the Tobacco Companies in the *DeLoach* class action. That settlement was designed in part to compensate farmers for loss of quota. The Court also notes that FETRA sets benefits based on quota levels for 2002, not 2004. Counsel for the parties were not able to definitively enlighten the Court on why 2002 was chosen as a base year and whether or not it increased the amount to be paid by the Tobacco Companies under FETRA. If it did increase the amount, that would be a further reason why the Tobacco Companies should not be required to make the 2004 payment. Since there is no definitive answer to that question, the Court has not considered it in connection with this decision.

{91} Will there be a "gap" in the receipt of money? Assuredly so. It shouldn't be long, and it appears to the Court it should be worth the wait. Would it have been better to get both the Phase II check and the buyout payment? No doubt about it. Will it cause some temporary hardship? Yes. However, it is a safe bet that the financial institutions in farming communities who want the farmers' business when the buyout checks come in will be understanding and flexible. The Court expects that when the full effect of the buyout is known this country will see a dramatic decrease in small tobacco farms. That is probably bad.

{92} The Court notes here that the Trustee, the Certifying Entities, the Attorneys General in each Grower State and presumably the leadership of the various growers associations have all been aware of this potential problem since at least 2003. It would indeed be unfortunate for tobacco farmers, particularly small farmers, if those knowledgeable about the problem have failed to bring it to their attention. This Court has sent the parties to mediation to resolve the issue, suggested how the issue could be resolved in Congress and required the parties to file prompt status reports and brief the issues on an expedited basis. Farmers deserve a quick answer. It is unfortunate that the answer from this Court is not favorable for them and comes days before Christmas. However, entry of the Order now will speed resolution by the appellate courts. This timing and turn of events could have been avoided had the parties followed the Court's earlier suggestion about agreeing on language to go in the buyout bill and Congress had passed the bill earlier.

{93} Congress continued its inexorable drive to an international free market economy. It did so at little or no cost to the federal budget. It eliminated an unworkable program it had created and probably helped our balance of trade. It gave both sides what they wanted and needed. It has probably helped increase income tax revenues in Grower States for 2005.

{94} And yes, there are a few members of Congress in Grower States who undoubtedly owe their reelection to passage of the buyout bill.

{95} One side effect of FETRA and the elimination of future trust payments is that there is no longer any constraint on Grower States' abilities to raise excise taxes on cigarettes. Under Phase II, Grower States agreed that if they raised excise taxes, payments to the Trust for farmers in their states could be reduced by the amount of the tax increase. The Tobacco Companies had a built-in restraint on excise tax increases in Grower States. It is gone.[26]

{96} Nor do Grower States have to worry about protecting their farmers from quota reductions. Those are gone. To the extent any increase in excise taxes results in lower consumption, U. S. tobacco farmers have the protection of the volume commitments in the *DeLoach* settlement and a greater ability to export their products. Any Grower State that feels that its small tobacco farmers have somehow been penalized by the timing of FETRA may now simply increase the state excise tax on cigarettes and funnel that money to programs for those farmers and communities they believe have been penalized. Pennsylvania and Maryland in particular might resort to this method of self-help. Kentucky could add it to its already existing program.

3. Legal Analysis

{97} Despite all the complicated formulas and the arguments over the equities, the issue here is simple: Does the Trust Agreement provide that the Tobacco Companies' obligations to fund the Phase II Trust cease upon passage of buyout legislation that creates a financial obligation greater than the remaining financial obligation under the Phase II Trust, or does the obligation to fund the Phase II Trust continue until there is an actual payment by the Tobacco Companies under the buyout program? The position of the Trustee and Certification Entities is appealing because it provides a means to force the Tobacco Companies to fill the gap in payments to farmers created by the passage of the buyout bill late in the year. Certainly there are equitable arguments to support that position. However, that is not the agreement the parties made in 1998 when the Phase II trust was created. The language and the structure of the Trust Agreement simply do not support the interpretation urged by the Trustee and the Certification Entities. Both support the position of the Tobacco Companies.

{98} The Trustee and Certification Entities do not seriously contest the underlying premise of the Tobacco Companies' argument that they are not required to fund both the Phase II Trust and a bigger buyout. That is what the document plainly and unmistakably provides. The Trustee argues only that the Tobacco Companies cannot claim the benefit of that bargain until they actually pay something. That is the legal hook they use to preserve the 2004 payment despite the bargain struck in 1998. They argue it would not be fair to interpret the agreement in such a way that a statute which did not require any payment under a buyout for years would relieve the Tobacco Companies of their current annual payment obligations under the Trust. Obviously they are correct. However, it is equally true that the agreement should not be interpreted in a way that would require annual payments through the end of the trust period even though Congress passed buyout legislation now requiring a payout larger than the Trust obligations commencing in 2011. That would be the result under the Trustee's analysis. Nor does the structure of the payments under the Trust support such an analysis. If release from the payment obligation is contingent upon prepayment of an obligation, the Tobacco Companies could always be made to pay by simply making payment under the buyout later than payment under the Trust.

{99} Nor has the Court found persuasive the Certification Entities argument that there is no right under the agreement for the Tobacco Companies to estimate what their future obligations will be. It engrafts on the agreement an unattainable precision and it does not fit the language. If, as the Trustee concedes, the agreement contains the basic premise that the Tobacco Companies not pay twice for both a buyout and Phase II, the Tobacco Companies have to be able to estimate what their obligations will be. The agreement specifically provides for that to be done on a reasonable basis and a procedure to adjust if the estimates are wrong. There will clearly be adjustments of the allocations among the Settlors and allocations among the Settlors and other parties responsible for funding the buyout. While the final totals are set by

FETRA, the annual allocations must be determined in the future. A federal buyout was clearly and undeniably one of the "Governmental Obligations" contemplated by the Trust Agreement. The Trustee and the Certification Entities seek to use the language in Schedule A-7 of the agreement about how the amount of an offset is determined to restrict the language in schedules A-5 and A-6 which determine when the Tobacco Companies are entitled to an offset. To do so would fundamentally alter the express language in the latter schedules.

{100} Nor does the Court find the language of A-7 particularly supporting of the Certification Entities argument. The key paragraph reads:

> In the event of such a Governmental Obligation, the amount otherwise required to be paid by each Settlor each year (after taking account of all adjustments or reductions hereunder) shall be reduced by an amount equal to the product of the amount of such Governmental Obligation *paid* in connection with Cigarettes manufactured by the Settlor (or tobacco or tobacco products used by the Settlor to manufacture Cigarettes) for the same year multiplied by the ratio of the Grower Governmental Obligation divided by the amount of the Governmental Obligation, which reduction amount may be carried forward to subsequent years as necessary to ensure full credit to the Settlor.

{101} The Certification Entities place their reliance on the use of the word "paid" in the fifth line, arguing that it requires payment before there can be an offset of any kind. That interpretation would require a trust payment before an offset could occur. However, the prior language in the sentence reads "In the event of such a Governmental Obligation, the amount otherwise required to be paid by each Settlor each year." The sentence acknowledges the prior existence of an obligation which must be paid by the Settlor. That is why the work "paid" appears in the fifth line. It is not a temporal precondition.

{102} The Court cannot ignore the language in A-7 defining the amount "paid" as being "in connection with Cigarettes manufactured by the Settlor for the same year." That phrase also indicates that the reference is to the obligation, not a temporal precondition.

{103} The language in A-7 which permits a Settlor to make an estimate of its Government Obligation and adjust the payment after the "actual amount is fairly determined" is likewise inconsistent with a precondition of payment.

{104} The Certification Entities' narrow construction of the reasonable estimate language to apply only to changes resulting from increases in excise taxes does not fit the structure of the agreement. The paragraph in Schedule A-7 providing for the reasonable estimate of an offset refers to two types of Governmental Obligations, those resulting from laws or regulations adopted by Grower States (e.g., excise taxes) and all other governmental obligations as defined in the agreement (e.g., buyout payments). Both are referred to prior to the key sentence which reads: "The Settlor may reduce its annual payment by a reasonable estimate of *any* such reduction and adjust its payment after the actual amount is finally determined." The Trustee would limit the phrase highlighted to the preceding sentence dealing only with Grower State obligations. The Court interprets that sentence to refer to both kinds of obligations, particularly since the word "any" is used. The use of "any such" reduction indicates that it applies to all reductions contemplated in the paragraph.

{105} The Court concludes the following as a matter of law.

1. FETRA became effective on October 22, 2004 when President Bush signed it. The only piece of legislative history confirms the effective date of the act. *See* H.R. 4520, Joint Explanatory Statement of the Committee of Conference at 218. A conference report "is the most persuasive evidence of congressional intent besides the statute itself." *Resolution Trust Corp. v. Gallagher*, 10 F.3rd 416, 421 (7th Cir. 1993). *See also, Gozlon-Peretz v. United States,* 498 U.S. 395, 404 (1991) holding that, "absent a clear direction by Congress to the contrary, a law takes effect on the date of its enactment." Even a cursory glance at the statute shows that it imposed immediate obligations on any number of people and governmental entities. For example, it directed the Secretary of Agriculture to make an assessment against the Tobacco Companies as early as December 1, 2004.
2. FETRA changed the law. There can be no doubt that the statute made enormous changes in the law, dismantling federal programs, which had been in place for over 60 years.
3. FETRA created a Governmental Obligation for 2004 as defined under the terms of the Trust Agreement. As is clear from the chart in paragraph 80 above, FETRA provides for an assessment period which includes the last quarter of calendar year 2004. It also provides that in fiscal years 2005 and 2006 the Tobacco Companies will be assessed based upon cigarettes manufactured in calendar year 2004.
4. Settlors are entitled under the terms of A-7 of the Trust Agreement to a reduction of the amounts owed to the Phase II Trust for 2004 based upon the amount of the Governmental Obligation paid under FETRA in connection with cigarettes manufactured by Settlors for 2004. In 2004 Settlors became obligated to make payments to the Tobacco Trust Fund which exceeded the amount due for the same year under Phase II.
5. The "Grower Governmental Obligation" and the "Governmental Obligation" as both are defined in the Trust Agreement are the same. Accordingly, the provisions of A-7 of the Trust Agreement provide that the reduction for 2004 is determined by the amount paid in connection with cigarettes manufactured in 2004.
6. Under the provisions of A-7 Settlors may reasonably estimate their obligations under FETRA. Settlors can and have made a reasonable estimate of their obligations. Settlors do not have the option not to pay the FETRA assessment when it comes due. Whether the Court considers one quarter, two quarters or four quarters of 2004, the amount of Tax Offsets available to Settlors for cigarettes manufactured in 2004 exceeds $106 million, the amount due by Settlors under the Phase II Trust for the fourth quarter of calendar year 2004. Therefore, no payment is due for the December quarter.
7. Amendment One to the Trust Agreement provides that Settlors are entitled to a refund of previous payments made during the year if the amount of the Tax Offset Adjustments to which Settlors expect to become entitled from 2004 through 2010 exceed the combination of the amount remaining to be paid to the Trust in 2004 and the total amount that the Settlors would owe to the Trust for 2005 through 2010. While there may be some statistically insignificant variations, the Tax Adjustments for 2004 through 2010 are $5.1 billion and that amount exceeds the combination of $106 million and $2.4 billion owed for the balance of 2004 and the remainder of the life of the Trust.

8. Accordingly Settlors are entitled to a refund of the amounts previously paid for 2004 subject to the reserves permitted by Amendment One.

CONCLUSION

{106} In this case, it is not up to the courts to make the policy decision Congress could have made with precision. Rather, it is the duty of this Court to interpret the language of the contract between the parties in light of what Congress actually did. Despite all the formulas and complicated language, the contract was a simple deal, and the States got the benefit they bargained for in 1998. Both parties struck while the iron was hot to get the legislation passed in 2004. If the benefit of the buyout had been less than the 2004 annual payment plus the remaining 2005-2010 payments, the tobacco farmers were protected. Since it was far greater than that, the Tobacco Companies are legally entitled to the benefit of their bargain—a reduction in the amount owed in the year of enactment. The "gap" in the timing of payments and thus in receipt of benefits by farmers was created by the fact that Congress passed the legislation at the end of the year.

{107} There are equitable arguments to be made for rewriting the agreement to compensate for the loss of the 2004 payment. After all, the Tobacco Companies changed the economics of the quota system by switching to a contract system and purchasing more foreign tobacco. In the last analysis, however, that approach requires the Court to rewrite the agreement based upon what it perceives the equities to be.[27] That is not what courts should do, and the public should not want them to do that. The parties should be free to write their own contracts without fear that some judge will later decide it should have been written differently.

{108} FETRA contains an assessment to be paid for cigarettes manufactured in the last calendar quarter of 2004. There is simply no way to get around that fact and the fact that the change in law was effective in October 2004. That was the price paid for getting the bill passed at the most propitious moment. What Congress did, rather than specifically helping the growers by assuring that no assessment was made for 2004, was to put some provisions in the statute from which growers might argue that they are entitled to payment for 2004. They can say to their constituents, "We tried to help you." But the bottom line remains that when the Trustee and the Certification Entities entered into Amendment One, they confirmed the original deal that if a buyout occurred in 2004 which provided for assessment against the Tobacco Companies for 2004 and the total to be received by the growers was more than the remaining benefits under the Trust, the 2004 annual payment was lost.

{109} Although the Courts sometimes engage in statutory interpretation designed to cure "less than meticulous drafting,"[28] that is not what this case is about. FETRA was meticulously drafted and, in this Court's view, specifically done so to support the Trustee's position that the 2004 Phase II annual payment should be distributed to farmers. However, the documents to be interpreted by the Court are the Trust Agreement and Amendment One. Those documents contain the agreement between the parties.

{110} This Court is not taking away any benefit Congress intended to bestow on tobacco farmers. Rather, the Court is enforcing a bargain made in connection with the establishment of the Trust and agreement to Amendment One. "If in any year Congress passed a buyout plan to be paid for by the Tobacco Companies that was greater than the then remaining trust payments due, including payments due for the year of passage, all remaining payments including the payment for the year of passage were reduced." That is what the original agreement provided and what Amendment One confirmed while also confirming that Tobacco Companies could not guess as to when the legislation would pass or what it would say; it had to actually be enacted. On October 22, 2004, it was enacted.

{111} Nor is the Court being critical of Congress. The Congressional representatives and lobbyists got the farmers the best possible deal they could get at the best possible time. It was a great one. *See* Press Release, Congressman Bob Etheridge, *supra*; Press Release, Senator Mitch McConnell, *supra*. They did everything they could to avoid sacrificing the 2004 payment in the process, but this Court remains convinced that they knew exactly what risks they were taking but could not pass up the opportunity to get the bill passed before the election.[29] Their tobacco farming constituents had told them to do so. [30] Whatever explanations they may offer, the reality is that they could have simply and easily preserved the 2004 payments by providing an effective date of January 1, 2005 and insuring that no assessment was made for the first fiscal quarter of 2005/last calendar quarter of 2004, or they could have taken the chance of waiting until 2005 to try to get the bill passed then. In fact, if this Court is wrong about Congressional intent, Congress can pass legislation amending FETRA to do just that and should be able to get that done before the appellate process is exhausted here. Such an amendment would eliminate some of the arguments made by the Tobacco Companies. It would in no way delay the work of the Secretary of Agriculture in getting the contracts executed. The Secretary of Agriculture may significantly reduce the "gap" in payment created by late passage by getting the contracts out quickly. She could have accelerated the process by making the December 1, 2004 assessment and collecting the December 31, 2004 payment. The Court recognizes the political difficulty of such a decision. It would have foreclosed the Trustee's argument.

{112} It would be far more pleasing to the Court to play the role of Santa's helper on this twenty-third day of December rather than be subjected to the inevitable comparison to the Grinch. The Court recognizes all too well that the delay between when the Phase II checks would have been received and the date contracts are signed under FETRA (permitting farmers to obtain financing of their buyout benefits) will impose hardship on small farmers in particular. Congress could have avoided that hardship by passing FETRA earlier in the year. The Secretary of Agriculture can ameliorate the impact by swift completion of the contracting process.

{113} Courts are sometimes called upon to make extremely difficult decisions. This is one. If judges do what is pleasing or popular rather than applying the rule of law, our system fails. The Supreme Court may ultimately[31] decide this Court's legal analysis is wrong. If it does so, and it may, the Supreme Court decision will be based upon a sound analysis of the law and fundamental contract interpretation. That is what makes our judicial system work.

{114} It is hereby ordered:

1. The motions of the Trustee and the Certification Entities for specific enforcement of the Tobacco Companies' obligation to make the December 2004 payment to the Phase II Trust is denied.
2. As a matter of law, the Tobacco Companies are entitled to a refund of the amounts previously paid to the Phase II Trust for 2004. The Trustee shall present to the Court a plan for providing reimbursement of those amounts. In the event of an appeal, this provision of the Order is stayed pending further order

of this Court or the appellate courts of this State. No bond shall be required of the Trustee on appeal.

3. The Trustee is hereby enjoined from making any distribution of the 2004 payments to the Phase II Trust to the Certification Entities pending further order of this Court or the appellate courts of this State.

4. This is a final order affecting the substantial rights of thousands of citizens of this State and other States. A prompt resolution of the issues decided here is necessary and there is no just cause for delay in any appeal of this action. The parties are entitled to expedited treatment.

This 23rd day of December 2004.

APPENDIX I

APPENDIX II

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[1] All filings in this matter are available on the North Carolina Business Court's website, www.ncbusinesscourt.net, under "Active Cases."

[2] It is worth noting here that this was one of the few occasions on which "big tobacco" found itself out-sized. This was a hard fought negotiation between big companies and big government. Both sides were ably represented. It was a fair fight. There was no inequality in the bargaining positions.

[3] No party suggests that the Trust be terminated. The buyout itself, as well as the functionality of the Phase II Trust and the Tobacco Trust Fund, would be altered by the bankruptcy of the Tobacco Companies. The Court notes that such an eventuality could result from an unfavorable outcome for the Tobacco Companies in the $280 billion fraud lawsuit currently pending in the United States District Court for the District of Columbia before Judge Kessler. Other pending class action litigation against the Tobacco Companies could also create potential bankruptcy problems.

[4] It is helpful to look at the Phase II Trust as a patch for the injury inflicted by the MSA, and FETRA as the permanent cure.

[5] In that regard, it joins a long list of Congressional legislation removing governmental regulation and moving the United States economy towards an international free market status.

[6] See paragraph 32 infra for a discussion of the reduction in leaf prices for Tobacco Companies.

[7] For a more complete discussion of the turmoil in the price support program see this Court's opinion in *Bailey v. Flue-Cured Tobacco Stabilization Cooperative Board*, 2002 NCBC 3, *aff'd* 158 N.C. App. 449, 581 S.E.2d 811 (2003).

[8] Thomas C. Capehart, Jr., *U.S. Tobacco Industry Responding to New Competitors, New Challenges,* AMBER WAVES, Sept. 2003, at 17, *available at* http://www.ers.usda.gov/Amber Waves/September03/Features/USTobaccoIndustry.htm.

[9] See paragraph 28 infra for a discussion of the relationship of FDA regulation to the issues before Congress.

[10] *See Bailey*, 2002 NCBC 3 at ¶ 12, *aff'd* 158 N.C. App. 449, 581 S.E.2d 811 (2003).

[11] James MacDonald et al., *Contracts, Markets, and Prices: Organizing the Production and Use of Agricultural Commodities*, AER 837, Economic Research Service, USDA at 45 (Nov. 2004) *available at* http://www.ers.usda.gov/publications/aer837/.

[12] In economic terms, the need to dismantle the quota system was an unintended consequence of the MSA.

[13] *See* Appendix I; Appendix II; *See also* Press Release, Congressman Bob Etheridge (NC), Etheridge Calls for Quick Buyout Payments (Oct. 25, 2004), *available at* http://www.house.gov/etheridge/Press-BuyoutImplementation.htm; Press Release, Sen. Mitch McConnell (KY), Column by Senator Mitch McConnell on Tobacco Buyout (Oct. 19, 2004) *available at* http://mcconnell.senate.gov/record.cfm?id=227569&start=41.

[14] U.S. leaf was generally more expensive because of the price support system. As the price of U.S. leaf comes down it will naturally exert downward pressure on international prices. The cost of leaf is the largest single cost of production. By obtaining a free market the Tobacco Companies obtain the opportunity to control the largest component of production cost, thus permitting them to hold down price increases or reduce wholesale prices. It was the prospect of price reductions leading to increased consumption that lead some members of Congress to oppose the buyout without FDA regulation. A buyout without regulation was a benefit to at least Reynolds and Lorillard. Philip Morris did not oppose FDA regulation.

[15] Since most U.S. tobacco is now purchased on contract, Tobacco Companies will naturally drop the price to reflect that farmers either no longer have to make lease payments to quota holders and that farmers with quota will benefit from the buyout. That price reduction is already apparent in the market place. *See Lower tobacco prices seen after quota,* GREENSBORO NEWS AND RECORD, Dec. 3, 2004, *available at* http://www.news-record.com/news/now/tobacco120304.htm.

[16] From 1997 through 2004 over twenty tobacco buyout bills were introduced in Congress.

[17] The members of the conference committee from Grower States are highlighted in paragraph 38 above.

[18] See paragraph 31 above.

[19] The Court emailed or faxed each member with a message that read:

> I write as judge of the North Carolina Business Court, the court which has jurisdiction over the interpretation and enforcement of the Phase II Trust entered into by the 14 major tobacco producing states and the four major tobacco companies. Earlier this year some members of those groups engaged in litigation regarding the interpretation of the trust document. While the parties were able to resolve that litigation, I write to let you know that the provisions of the buy-out bill currently being considered by you in conference could spark additional litigation between the parties.
>
> I have discussed this issue with counsel for some of the states and the companies and I understand that their

> representatives in Washington are aware of the litigation-sensitive issues and how the bill might be structured so as to avoid another round of litigation. On behalf of this Court and the judicial system of the State of North Carolina, I would ask that you consider their views on this important issue as you go about your work.

E-mail from the Honorable Ben F. Tennille, Special Superior Court for Complex Business Cases, North Carolina Business Court (Oct. 6, 2004, 08:45:00 EST) (on file with Court).

[20] The Congressional record is not illuminating. The final bill was drafted in Conference Committee and passed hastily. Post election statements are less helpful to the Court and do not address the problem that Congressional legislation often has unintended consequences for which members of Congress are loath to take responsibility.

[21] On May 5, 2000, at a rare moment in time, the planets Mercury, Venus, Earth, Mars, Jupiter and Saturn and Earth's moon were all aligned with the Sun. The opportunity for passage of this bill was probably no less unique.

[22] *See* Letter from 28 members of the United States House of Representatives to Secretary of Agriculture Ann M. Veneman (Nov. 23, 2004) (on file as exhibit to Certification Entities' Brief Concerning FETRA and Supporting 2004 Mot. Specific Performance); Letter from 10 members of United States Senate to Secretary of Agriculture Ann M. Veneman (Nov. 23, 2004) (on file as exhibit to Certification Entities' Brief Concerning FETRA and Supporting 2004 Mot. Specific Performance).

[23] Press Release, USDA, USDA Holds November 22 Public Meeting on Tobacco Transition Assessments, Announces Initial Program Provisions (Nov. 16, 2004), http://www.fsa.usda.gov/pas/FullStory.asp?StoryID=1930.

[24] *See Lower tobacco prices seen after quota*, GREENSBORO NEWS AND RECORD, Dec. 3, 2004, *available at* http://www.news-record.com/news/now/tobacco120304.htm.

[25] *See* Press Release, R.J. Reynolds Tobacco Company, R.J. Reynolds Announces Price Adjustments (Dec. 13, 2004), *at* http://www.rjrt.com/NR/NRreleases_rjrtview.asp?postID=1010; *Philip Morris increases prices for its cigarettes*, WINSTON-SALEM J., Dec. 11, 2004, *at* http://www.journalnow.com/servlet/Satellite?pagename=WSJ%2FMGArticle%2FWSJ_BasicArticle&c=MGArticle&cid=1031779625678&path=!business!tobacco&s=1037645508942.

[26] The political leadership in North Carolina has already begun to discuss consideration of an increase in the cigarette excise tax as one way to cure the state's budget problems. *See* David Rice, *Raising of state tax surfaces anew*, WINSTON-SALEM J., Dec. 15, 2004, *at* http://www.journalnow.com/servlet/Satellite?pagename=WSJ%2FPage%2FWSJ_StandardIndex&c=Page&cid=1040651999075.

[27] While the Court has made some attempt to set out the equities above, others might have a completely different assessment or might disagree with the Court's views. That is precisely why judges should confine themselves to interpreting the language of the agreements where that can be done based on the documents themselves.

[28] Koons Buick Pontiac GMC, Inc. v. Nigh, 125 S. Ct. 460, No. 03-377, 2004 U.S. LEXIS 7979, at *8 (Nov. 30, 2004).

[29] The Court cannot totally discount the possibility that the politicians in Washington put language in the bill that the lobbyists for both the Growers and the Tobacco Companies asked to be included to bolster their positions on trust interpretation issues. In that unfortunate event, it would be even more important for the Court to look at the actual impact of the bill.

[30] *See, e.g.*, Cecil Yancy, *Grassroots Effort Pushing Tobacco Buyout*, Southeast Farm Press, Aug. 20, 2004 (noting grower Keith Parrish's "crusade" for the buyout, and quoting him as stating at a Senate hearing, "I wouldn't want to be a senator or congressman running for re-election in November if the tobacco buyout doesn't pass.") http://southeastfarmpress.com/news/82004Tobacco-buyout/.

[31] The decision to grant a writ of petition for discretionary review lies exclusively with the North Carolina Supreme Court. This Court can only express its views that the issues decided here are as important as any the Supreme Court is likely to see in the future and they deserve expedited treatment. Timing is critical.