

No. A-03-2020

**STATE OF MINNESOTA
IN SUPREME COURT**

COUNCIL OF INDEPENDENT TOBACCO MANUFACTURERS
OF AMERICA, CAROLINA TOBACCO COMPANY,
AND WINNER TOBACCO WHOLESALE, INC.,

Appellants,

vs.

THE STATE OF MINNESOTA AND DAN SALOMONE,
IN HIS OFFICIAL CAPACITY AS THE COMMISSIONER OF
THE MINNESOTA DEPARTMENT OF REVENUE,

Respondents.

RESPONDENTS' BRIEF

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
LEGAL ISSUES	1
STATEMENT OF THE CASE.....	2
STATEMENT OF FACTS.....	3
SUMMARY OF ARGUMENT	11
STANDARD OF REVIEW	12
ARGUMENT	13
I. THE ACT’S DISTINCTION BETWEEN SETTLEMENT AND NONSETTLEMENT CIGARETTES DOES NOT VIOLATE THE EQUAL PROTECTION CLAUSE OF THE FOURTEENTH AMENDMENT TO THE UNITED STATES CONSTITUTION OR THE UNIFORMITY CLAUSE OF THE MINNESOTA CONSTITUTION.....	13
A. Decisional Standards.....	13
B. Because The Act Satisfies Minnesota’s Three-Factor Rational Basis Test, It Comports With Both Federal Equal Protection And State Uniformity Requirements.	16
II. BECAUSE THE ACT DOES NOT ABRIDGE APPELLANTS’ RIGHTS TO FREELY SPEAK OR TO PETITION THE GOVERNMENT FOR REDRESS OF GRIEVANCES, IT INVOLVES A CONVENTIONAL ECONOMIC CLASSIFICATION SUBJECT ONLY TO RATIONAL BASIS REVIEW.	23
A. Standard of Review And Presumption Of Constitutionality	23
B. The Act Does Not Abridge Appellants’ Rights To Freely Speak Or To Petition The Government For Redress Of Grievances.....	25
III. THE ACT’S IMPOSITION OF A FEE ON ALL FUTURE SALES OF NONSETTLEMENT CIGARETTES DOES NOT RENDER IT A BILL OF ATTAINDER.....	38
CONCLUSION	42
STATUTORY ADDENDUM	

TABLE OF AUTHORITIES

	Page
CONSTITUTIONAL PROVISIONS	
MINN. CONST. art. I, § 11	38
MINN. CONST. art. I, § 3	23
MINN. CONST. art. I, § 8	23
MINN. CONST. art. X, § 1	13
U.S. CONST. amend. I	23
U.S. CONST. amend. XIV, § 1	13
U.S. CONST. art. I, § 10, cl. 1	38
MINNESOTA STATUTES & LAWS	
Act of May 25, 2003, ch. 127, art. 14, § 9, 2003 Minn. Laws 946-47	8
Minn. Stat. § 297F.24 (2004)	passim
FEDERAL CASES	
<i>A.D. Bedell Wholesale Co. v. Philip Morris, Inc.</i> , 263 F.3d 239 (3d Cir. 2001)	7, 8, 35
<i>City of Dallas v. Stanglin</i> , 490 U.S. 19, 109 S. Ct. 1591 (1989)	1, 24, 25
<i>Communist Party v. Subversive Activities Control Bd.</i> , 367 U.S. 1, 81 S. Ct. 1357 (1961)	1, 38, 39
<i>Consolidated Edison Co. of New York, Inc. v. Pataki</i> , 292 F.3d 338 (2d Cir. 2002)	38
<i>D.H. Overmyer Co. v. Frick Co.</i> , 405 U.S. 174, 92 S. Ct. 775 (1972)	30
<i>Erie Telecommunications, Inc. v. Erie</i> , 853 F.2d 1084 (3d Cir. 1988)	30

<i>Fed. Communications Comm'n v. League of Women Voters of California</i> , 468 U.S. 364, 104 S. Ct. 3106 (1984).....	1, 29, 30, 31
<i>Glickman v. Wileman Bros. & Elliott, Inc.</i> , 521 U.S. 457, 117 S. Ct. 2130 (1997).....	24
<i>Leathers v. Medlock</i> , 499 U.S. 439, 111 S. Ct. 1438 (1991).....	28
<i>Lim v. City of Long Beach</i> , 217 F.3d 1050 (9th Cir. 2000).....	24
<i>Lorillard Tobacco Co. v. Reilly</i> , 533 U.S. 525, 121 S. Ct. 2404 (2001).....	1, 20, 41
<i>Mariana v. Fisher</i> , 226 F. Supp. 2d 575 (M.D. Pa. 2002).....	5, 8
<i>McCloud v. Testa</i> , 97 F.3d 1536 (6th Cir. 1996).....	17
<i>Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue</i> , 460 U.S. 575, 103 S. Ct. 1365 (1983).....	33, 34
<i>Navegar, Inc. v. United States</i> , 192 F.3d 1050 (D.C. Cir. 1999).....	41
<i>Nixon v. Adm'r of Gen. Servs.</i> , 433 U.S. 425, 97 S. Ct. 2777 (1977).....	1, 38, 40
<i>Planned Parenthood of Mid-Missouri and Eastern Kansas, Inc. v. Dempsey</i> , 167 F.3d 458 (8th Cir. 1999).....	39
<i>PTI, Inc. v. Philip Morris, Inc.</i> , 100 F. Supp. 2d 1179 (C.D. Cal. 2000).....	1, 8
<i>Regan v. Taxation With Representation of Washington</i> , 461 U.S. 540, 103 S. Ct. 1997 (1983).....	25, 30
<i>Selective Serv. Sys. v. Minnesota Pub. Interest Research Group</i> , 468 U.S. 841, 104 S. Ct. 3348 (1984).....	38, 40
<i>Speiser v. Randall</i> , 357 U.S. 513, 78 S. Ct. 1332 (1958).....	1, 29, 31

<i>Star Scientific, Inc. v. Beales</i> , 278 F.3d 339 (4th Cir. 2002).....	passim
<i>Stromberg v. California</i> , 283 U.S. 359, 51 S. Ct. 532 (1931).....	23
<i>Terban v. Department of Energy</i> , 216 F.3d 1021 (Fed. Cir. 2000).....	35
<i>United States v. American Library Ass'n</i> , 539 U.S. 194, 123 S. Ct. 2297 (2003).....	28
<i>United States v. Elie</i> , 111 F.3d 1135 (4th Cir. 1997).....	35
<i>Westfarm Associates v. Washington Suburban Sanitation Comm'n</i> , 66 F.3d 669 (4th Cir. 1995).....	17
<i>WMX Technologies, Inc. v. Gasconade County</i> , 105 F.3d 1195 (8th Cir. 1997).....	1, 38, 39, 42

MINNESOTA CASES

<i>AFSCME Councils 6, 14, 65 & 96 v. Sundquist</i> , 338 N.W.2d 560 (Minn. 1983).....	14
<i>Amoco Corp. v. Comm'r of Revenue</i> , 658 N.W.2d 859 (Minn. 2003).....	20
<i>Camping & Ed. Found. v. State</i> , 282 Minn. 245, 164 N.W.2d 369 (1969).....	27
<i>Contos v. Herbst</i> , 278 N.W.2d 732 (Minn. 1979).....	14
<i>Guilliams v. Comm'r of Revenue</i> , 299 N.W.2d 138 (Minn. 1980).....	15
<i>Hegenes v. State</i> , 328 N.W.2d 719 (Minn. 1983).....	14
<i>In re McCannel</i> , 301 N.W.2d 910 (Minn. 1980).....	15

<i>J.L. Shiely Co. v. County of Stearns</i> , 395 N.W.2d 357 (Minn. 1986).....	13
<i>John Hancock Mut. Life Ins. Co. v. Comm'r of Revenue</i> , 497 N.W.2d 250 (Minn. 1993).....	13, 15, 25
<i>Kolton v. County of Anoka</i> , 645 N.W.2d 403 (Minn. 2002).....	passim
<i>LeVake v. Indep. Sch. Dist. No. 656</i> , 625 N.W.2d 502 (Minn. Ct. App. 2001).....	24
<i>Metro. Sports Facilities Comm'n v. County of Hennepin</i> , 478 N.W.2d 487 (Minn. 1991).....	15, 16
<i>Nelson v. Am. Family Ins. Group</i> , 651 N.W.2d 499 (Minn. 2002).....	12
<i>Reserve Mining Co. v. State</i> , 310 N.W.2d 487 (Minn. 1981).....	38, 40
<i>Rio Vista Non-Profit Housing Corp. v. County of Ramsey</i> , 335 N.W.2d 242 (Minn. 1983).....	14
<i>Skeen v. State</i> , 505 N.W.2d 299 (Minn. 1993).....	24
<i>State v. Casino Marketing Group, Inc.</i> , 491 N.W.2d 882 (Minn. 1992).....	24
<i>Westling v. County of Mille Lacs</i> , 581 N.W.2d 815 (Minn. 1998).....	14, 15

OTHER AUTHORITIES

27 <i>State Register</i> (2003).....	16
4 R. Rotunda & J. Nowak, <i>Treatise on Constitutional Law</i> § 20.11 (3d ed. 1999).....	25, 33
71 <i>Am. Jur. 2d State and Local Taxation</i> § 21 (1973).....	20
<i>Black's Law Dictionary</i> (7th ed. 1999).....	17
Henry N. Butler, <i>Economic Analysis for Lawyers</i> (1998).....	17

Minnesota Department of Health,
Preventing and Reducing Tobacco Use (Updated June 4, 2003) 16

Office of Smoking & Health, U.S. Department of Health & Human Services,
Reducing Tobacco Use: A Report of the Surgeon General (2000)..... 6, 17, 22

Tobacco Use Prevention and Local Public Health Endowment,
Minnesota Department of Health,
Annual Report to the Legislature: 2002 Activities (January 2003)..... 4

LEGAL ISSUES

I. Whether the Cigarette Fee Act's distinction between settlement and nonsettlement cigarettes violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution or the Uniformity Clause of the Minnesota Constitution.

- The district court ruled that the Act does not violate equal protection principles. The court of appeals affirmed.

Kolton v. County of Anoka, 645 N.W.2d 403 (Minn. 2002)

Lorillard Tobacco Co. v. Reilly, 533 U.S. 525, 121 S. Ct. 2404 (2001)

Star Scientific, Inc. v. Beales, 278 F.3d 339 (4th Cir. 2002)

II. Whether the distinction between settlement and nonsettlement cigarettes subjects the Act to heightened scrutiny under free speech or equal protection principles.

- The district court ruled that the Act does not abridge free speech rights and is therefore subject only to rational basis review. The court of appeals affirmed.

City of Dallas v. Stanglin, 490 U.S. 19, 109 S. Ct. 1591 (1989)

Fed. Communications Comm'n v. League of Women Voters of California, 468 U.S. 364, 104 S. Ct. 3106 (1984)

Speiser v. Randall, 357 U.S. 513, 78 S. Ct. 1332 (1958)

PTI, Inc. v. Philip Morris, Inc., 100 F. Supp. 2d 1179 (C.D. Cal. 2000)

III. Whether the Act's imposition of a fee upon all future sales of nonsettlement cigarettes renders it a bill of attainder.

- The district court ruled that the Act is not a bill of attainder. The court of appeals affirmed.

Nixon v. Adm'r of Gen. Servs., 433 U.S. 425, 97 S. Ct. 2777 (1977)

Communist Party v. Subversive Activities Control Bd., 367 U.S. 1, 81 S. Ct. 1357 (1961)

WMX Technologies, Inc. v. Gasconade County, 105 F.3d 1195 (8th Cir. 1997)

PTI, Inc. v. Philip Morris, Inc., 100 F. Supp. 2d 1179 (C.D. Cal. 2000)

STATEMENT OF THE CASE

On June 26, 2003, Appellants filed in Ramsey County District Court a motion for a temporary restraining order asking the court to prohibit the Commissioner of Revenue from implementing the Cigarette Fee Act on its July 1, 2003, effective date. Appellants alleged that the Act abridged free speech, violated equal protection and due process guarantees, and was a bill of attainder. On June 30, 2003, the State filed a memorandum in opposition with supporting documentation. Following a hearing held on July 2, 2003, the Honorable John T. Finley filed an order denying Appellants' request for injunctive relief. APP. 63-67.¹

The parties subsequently filed a Stipulation of Facts and cross-motions for summary judgment. On November 19, 2003, Judge Finley filed an order upholding the Act in all respects, and granting the State's motion for summary judgment. APP. 327-49. On August 24, 2004, the Court of Appeals filed a decision affirming the district court. APP. 354-66. On November 16, 2004, this Court granted Appellants' request for further review.

¹ "APP." refers to Appellants' Appendix.

STATEMENT OF FACTS

A. The State Tobacco Lawsuit and Settlements

On August 17, 1994, the State of Minnesota commenced suit (the "State Tobacco Lawsuit") against, *inter alia*, the country's four largest cigarette manufacturers (the "Major Manufacturers")² and Liggett Group, Inc. ("Liggett"). APP. 71. On March 20, 1997, the State entered into a settlement agreement with Liggett (the "Liggett Agreement"). APP. 71-72; Add. at A96-161.³ This agreement required Liggett, among other things: (1) to make certain annual payments to the State, Add. at A124; (2) to provide significant cooperation to the State in the ongoing State Tobacco Lawsuit, *id.* at A112-17; and (3) to significantly restrict its advertising practices, *id.* at A121-22. In exchange, the State released Liggett from all its past and future monetary claims related to the manufacture and/or sale of tobacco products. *Id.* at A130-33.⁴

In May 1998, before the jury returned a verdict in the State Tobacco Lawsuit, the State and the Major Manufacturers entered into the "Minnesota Agreement." APP. 72, 125-55. The Major Manufacturers agreed, among other things: (1) to make six one-time "Settlement Payments" to the State, *id.* at 131-33; (2) to make additional "Annual Payments" to the State in perpetuity, *id.* at 133-34; and (3) to significantly restrict their

² Phillip Morris, Inc., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation and Lorillard Tobacco Company.

³ Appellants did not reproduce the entire Addendum to the parties' Stipulation of Facts. See APP. 1. Where a document is reproduced, the State will cite Appellants' Appendix; otherwise, it will use "Add." to refer to the original Addendum.

⁴ Liggett and the State recently clarified Liggett's annual payment obligations under the Liggett Agreement. APP. 72; Add. at A162-69.

lobbying and advertising activities, *id.* at 139-43. In exchange, the State released the Major Manufacturers from all past and future tobacco-related claims, “including without limitation any future claims for reimbursement for health care costs allegedly associated with the use of or exposure to Tobacco Products.” *Id.* at 134.

At the time of its execution in 1998, the Minnesota Agreement was valued at \$6.1 billion over its first twenty-five years of operation. APP. 73; Tobacco Use Prevention and Local Public Health Endowment, Minnesota Department of Health, *Annual Report to the Legislature: 2002 Activities 2* (January 2003) (Add. at A201-38). The six one-time Settlement Payments due by January 2003 totaled approximately \$1.3 billion. Add. at A204. The separate Annual Payments first due in December 1998 and continuing in perpetuity had an estimated value of \$4.85 billion over twenty-five years. *Id.*

B. The Master Settlement Agreement

On November 23, 1998, approximately six months after execution of the Minnesota Agreement, the Attorneys General of 46 states (not including Minnesota) and six other United States jurisdictions executed the Master Settlement Agreement (“MSA”) with the Major Manufacturers to settle state suits to recover costs associated with treating smoking-related illnesses. APP. 76; MSA § I.⁵ The MSA required the Major Manufacturers (the original participating manufacturers or “OPMs”) to make five “initial payments” on or before January 10, 2003. *See* MSA § IX(b). It also required the Major Manufacturers to make annual payments in perpetuity. *Id.* § IX(c)(1). These payments

⁵ The full text of the Master Settlement Agreement is available at http://www.naag.org/upload/1032468605_cigmsa.pdf.

were expected to total approximately \$206 billion through 2025. The MSA also required the Major Manufacturers to substantially restrict their advertising and lobbying activities. *See id.* § III. In exchange, the settling states released the Major Manufacturers from a wide range of claims, including monetary claims related to the public health-related costs of smoking. *Id.* §§ II(nn), XII, XIII.

C. Impact of Recent Changes in the Cigarette Market

Minnesota's settlement agreements were intended, in part, to ensure that smokers could no longer pass along to the State the health-related costs of their smoking. To finance the Annual Payments in perpetuity required by the Minnesota Agreement (in exchange for which the State had released its future healthcare claims), the Major Manufacturers dramatically increased retail prices,⁶ which, consequently, now reflected state healthcare costs.

The Minnesota Agreement and the State's separate agreement with Liggett initially covered more than 98% of the state cigarette market. APP. 78-79. By 2003, however, the collective market share of nonsettling manufacturers had increased from 2% to 12%. APP.78-79. These manufacturers, which were not making healthcare payments to the State, had been able to offer their cigarettes at prices substantially lower than the Major Manufacturers.

⁶ *Cf. Mariana v. Fisher*, 226 F. Supp. 2d 575 (M.D. Pa. 2002), *aff'd*, 338 F.3d 189 (3d Cir. 2003), *and cert. denied sub nom. Mariana v. Pappert*, 540 U.S. 1179, 124 S. Ct. 1413 (2004) (detailing price increases resulting from implementation of the MSA).

The capture of significant market share by nonsettling manufacturers meant that a significant percentage of smokers was once again able to shift to the State the health-related costs of their smoking. See Office of Smoking & Health, U.S. Department of Health & Human Services, *Reducing Tobacco Use: A Report of the Surgeon General* 19, 352-55 (2000) (“*Surgeon General’s Report*”).⁷ Indeed, the externalization of healthcare costs increased in direct proportion to the expanding market share of nonsettling manufacturers.

D. The MSA Solution

The drafters of the MSA had anticipated that nonsettling manufacturers, by avoiding healthcare payments, would gain market share. The MSA therefore included a model “Qualifying Statute” for each participating state to pass. APP. 76-77. The Qualifying Statute was intended: (1) to encourage all manufacturers to join the MSA as “subsequently participating manufacturers” (“SPMs”), and thus to compensate the states for the healthcare-related costs of their products; and (2) to remove the competitive disadvantage that settling manufacturers would face in competing against nonsettling manufacturers (“NPMs”). *Id.*

The Qualifying Statute encourages MSA participation by distinguishing between manufacturers that participate in the MSA (and thereby agree to bear a portion of the costs their products impose on the states) and NPMs that refuse to do so. APP. 76-77; *Star Scientific, Inc. v. Beales*, 278 F.3d 339, 345-46 (4th Cir. 2002), *cert. denied*, 537

⁷ The full text of the *Surgeon General’s Report* is available at http://www.cdc.gov/tobacco/sgr/sgr_2000/FullReport.pdf.

U.S. 818 (Oct 7, 2002). It requires each NPM to make payments into an escrow fund based on the number of cigarettes the NPM sells in a state. APP. 77. The required payment was approximately 27 cents per pack in 2001 and will increase to 36 cents per pack by 2007 (subject to an inflation adjustment). *A.D. Bedell Wholesale Co. v. Philip Morris, Inc.*, 263 F.3d 239, 245 (3d Cir. 2001). The NPM retains ownership of the escrow fund and of all interest that accrues over the 25-year period the payments must remain in escrow. APP. 77. If a state successfully sues an NPM for healthcare costs, the Qualifying Statute ensures that the state will have a fund from which to collect. *Id.*

Second, the Qualifying Statute prevents NPMs from exploiting the competitive advantage they would otherwise derive from their refusal to join the MSA and to make healthcare payments. APP. 76-77.

The Multistate Settlement Agreement explicitly proclaims its purpose to reduce the ability of non-signatory cigarette manufacturers to seize market share because of the competitive advantage accruing from not contributing to the settlement. It declares that the agreement “effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-a-vis Non-Participating Manufacturers with such Settling States as a result of the provisions of this Agreement.”

Bedell, 263 F.3d at 246 (citation omitted).

The MSA and Qualifying Statutes predictably engendered a spate of litigation. By 2003, courts had sustained the MSA and its related provisions against numerous challenges, including claims based upon: (1) the Sherman and Clayton Acts; (2) the First Amendment; (3) the Equal Protection Clause of the Fourteenth Amendment; (4) the Due Process Clause of the Fourteenth Amendment; (5) the Commerce Clause; (6) the

Compact Clause; (7) the Import/Export Clause; and (8) the constitutional prohibition against bills of attainder.⁸

E. The Minnesota Solution: The Cigarette Fee Act

On May 25, 2003, Governor Pawlenty signed legislation enacting Minn. Stat. § 297F.24. See Act of May 25, 2003, ch. 127, art. 14, § 9, 2003 Minn. Laws 946-47 (“Minn. Stat. § 297F.24” or the “Act”) (APP. 80, 85). The Act imposes a 35-cent per-pack fee upon the sale of “nonsettlement cigarettes.” See Minn. Stat. § 297F.24, subd. 1(a). The statutory term “nonsettlement cigarette” means a cigarette manufactured by a person other than a manufacturer: (a) that “is making annual payments to the state of Minnesota under a settlement of” the State Tobacco Lawsuit; or (b) that “has voluntarily entered into an agreement with the state of Minnesota . . . agreeing to terms similar to those contained in [the Minnesota Agreement] including making annual payments to the state . . . equal to at least 75 percent of the payments that would apply if the manufacturer was one of the four original parties to the [Minnesota Agreement].” Minn. Stat. § 297F.24, subd. 2(1)-(2).

The Act has three stated purposes: (1) to “ensure that manufacturers of nonsettlement cigarettes pay fees to the state that are comparable to costs attributable to

⁸ See, e.g., *Star Scientific, Inc. v. Beales*, 278 F.3d 339 (4th Cir.), cert. denied sub nom. *Star Scientific, Inc. v. Kilgore*, 537 U.S. 818, 123 S. Ct. 93 (2002); *A.D. Bedell Wholesale Co. v. Philip Morris, Inc.*, 263 F.3d 239 (3d Cir. 2001), cert. denied, 534 U.S. 1081, 122 S. Ct. 813 (2002); *Mariana v. Fisher*, 226 F. Supp. 2d 575 (M.D. Pa. 2002), aff’d, 338 F.3d 189 (3d Cir. 2003), and cert. denied sub nom. *Mariana v. Pappert*, 540 U.S. 1179, 124 S. Ct. 1413 (2004); *PTI, Inc. v. Philip Morris, Inc.*, 100 F. Supp. 2d 1179 (C.D. Cal. 2000).

the use of the cigarettes”; (2) to “prevent manufacturers of nonsettlement cigarettes from undermining the state’s policy of discouraging underage smoking by offering nonsettlement cigarettes at prices substantially below the cigarettes of other manufacturers”; and (3) to “fund such other purposes as the legislature determines appropriate.” Minn. Stat. § 297F.24, subd. 1(b).

The Act requires the Commissioner of Revenue to administer the fee “in the same manner as the [cigarette] excise tax imposed under section 297F.05.” Minn. Stat. § 297F.24, subd. 3. Accordingly, the fee is imposed upon cigarette distributors rather than manufacturers. APP. 80. Distributors pay the fee and pass along its cost to their customers, and so on down the distribution chain to the retail level. *Id.* The Act applies to all sales of nonsettlement cigarettes occurring after June 30, 2003. *Id.* at 80, 85.⁹

F. New Agreements Authorized by the Act

Recognizing that the Minnesota Agreement had released the State’s future healthcare claims against the Major Manufacturers in exchange for Annual Payments in perpetuity and the curtailment of certain speech activities, the Legislature authorized the Commissioner to enter similar agreements with manufacturers of nonsettlement cigarettes. APP. 81. Pursuant to his statutory duty to administer the Act, the Commissioner has made two important determinations concerning its proper implementation. *Id.*

⁹ Available legislative history of the Act is part of the record. *See* Affidavit of Patrick J. Finnegan (attached to Defendants’ Memorandum In Support of Their Motion for Summary Judgment).

First, the Act's requirement that new agreements must include "terms similar to those contained" in the Minnesota Agreement means that new agreements must include: (a) similar advertising and lobbying restrictions; and (b) similar release-of-claims provisions. APP. 81. Second, the requirement that new agreements must involve annual payments "equal to at least 75 percent of the payments that would apply if the manufacturer was one of the four original parties" to the Minnesota Agreement mandates payments of at least 48 cents per pack of cigarettes sold in Minnesota. *Id.* at 81-82, 299.

Thus, a manufacturer wishing to obtain from the Commissioner a release of future state healthcare claims must agree, *inter alia*: (a) to make payments to the State equal to 48 cents per pack; and (b) to curtail certain advertising and lobbying activities. APP. 82. Cigarettes produced by manufacturers entering into such agreements are not subject to the Act's 35-cent per-pack fee. *Id.*

By enacting Minn. Stat. § 297F.24, Minnesota passed its own version of a Qualifying Statute, a provision ensuring that the prices of nonsettlement cigarettes reflect the healthcare-related costs inevitably imposed upon the State by their use.

SUMMARY OF ARGUMENT

The Cigarette Fee Act ensures that the price of *every* cigarette sold in Minnesota reflects state healthcare costs. Previous agreements accomplished this objective for cigarettes sold by the Major Manufacturers and Liggett. The Act complements these agreements by imposing a 35-cent per-pack fee on cigarettes sold by all other manufacturers. These manufacturers can—if they wish to obtain a release of future state healthcare claims—agree to make 48-cent per-pack payments and curtail certain speech activities. The decision whether it is worthwhile to enter agreements requiring a 13-cent per-pack premium rests entirely with manufacturers.

The Act is consistent with equal protection principles. It pursues a legitimate state interest: promoting public health. It rationally distinguishes between two classes of products: settlement cigarettes, with prices that reflect the social costs of smoking; and nonsettlement cigarettes, with prices that do not. By imposing a fee solely upon the latter class, the Act ensures that the State receives a healthcare payment for each and every cigarette sold in Minnesota.

The Act is consistent with free speech principles because it does not coerce manufacturers to waive their rights. If a manufacturer wishes to obtain from the State a release of future tobacco-related healthcare claims, it can enter an agreement (a) undertaking a 48-cent per-pack payment, and (b) waiving certain free speech rights. If the manufacturer considers these terms undesirable, it need not enter an agreement, and can simply allow the State to collect the 35-cent per-pack fee from distributors.

The Legislature's mere *offer* of such agreements does not invalidate the Act. Clearly, the State may not use economic coercion to *induce* waivers of free speech rights. It may not, for example, offer *lower* per-pack payments exclusively to manufactures that enter agreements waiving their rights. But here, there is no such economic coercion. Indeed, a manufacturer must pay 48 cents per pack under an agreement, whereas the fee imposed by the Act is only 35 cents per pack. There is plainly no coercion *to enter* agreements.

Finally, the Act does not run afoul of state and federal prohibitions against bills of attainder. A bill of attainder legislatively determines guilt and inflicts punishment for past conduct. The Act does not determine guilt or inflict punishment for past conduct. Instead, it imposes a healthcare fee upon *future* cigarette sales. The Act is not a bill of attainder.

STANDARD OF REVIEW

This case was submitted to the district court by means of a Stipulation of Facts and cross-motions for summary judgment. The court upheld the Act in all respects. When a district court grants summary judgment based on the application of a statute to undisputed facts, the result is a legal conclusion that an appellate court reviews *de novo*. *Nelson v. Am. Family Ins. Group*, 651 N.W.2d 499, 503 (Minn. 2002). The particular decisional standards governing the various issues presented will be discussed below.

ARGUMENT

I. THE ACT'S DISTINCTION BETWEEN SETTLEMENT AND NONSETTLEMENT CIGARETTES DOES NOT VIOLATE THE EQUAL PROTECTION CLAUSE OF THE FOURTEENTH AMENDMENT TO THE UNITED STATES CONSTITUTION OR THE UNIFORMITY CLAUSE OF THE MINNESOTA CONSTITUTION.

A. Decisional Standards

Appellants challenge the Act under the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution, which provides in relevant part that no state shall “deny to any person within its jurisdiction the equal protection of the laws.” U.S. CONST. amend. XIV, § 1. They also challenge the Act under the Uniformity Clause of the Minnesota Constitution, which provides in part that “[t]axes shall be uniform upon the same class of subjects” MINN. CONST. art. X, § 1. When addressing challenges under these provisions, this Court has held that “the scope of their restrictions on the legislative power to tax and to classify is identical” *J.L. Shiely Co. v. County of Stearns*, 395 N.W.2d 357, 359 (Minn. 1986). Moreover, if the challenge “involves neither a suspect classification nor a fundamental right, [courts] review the challenge under a rational basis standard.” *Kolton v. County of Anoka*, 645 N.W.2d 403, 411 (Minn. 2002); *see also John Hancock Mut Life Ins. Co. v. Comm’r of Revenue*, 497 N.W.2d 250, 253 (Minn. 1993) (“The proper standard of review of a challenged economic classification is the rational basis test”)¹⁰

¹⁰ Argument Section II, *infra*, demonstrates that the Act does not abridge Appellants’ free speech rights. Consequently, the Act involves a conventional economic classification subject only to rational basis review.

The federal rational basis test requires a court to determine “whether the challenged classification has a legitimate purpose and whether it was reasonable to believe that use of the challenged classification would promote that purpose.” *Kolton*, 645 N.W.2d at 411 (citations omitted). The Minnesota rational basis test requires that:

(1) The distinctions which separate those included within the classification from those excluded must not be manifestly arbitrary or fanciful but must be genuine and substantial, thereby providing a natural and reasonable basis to justify legislation adapted to peculiar conditions and needs; (2) the classification must be genuine or relevant to the purpose of the law; that is there must be an evident connection between the distinctive needs peculiar to the class and the prescribed remedy; and (3) the purpose of the statute must be one that the state can legitimately attempt to achieve.

Kolton, 645 N.W.2d at 411 (citations omitted).

Judicial review under these rational basis tests is limited to the basic rationality of legislation; it does not extend to questions of “either the factual accuracy or political wisdom of the reasoning and judgments underlying the legislative enactment.” *AFSCME Councils 6, 14, 65 & 96 v Sundquist*, 338 N.W.2d 560, 570 (Minn. 1983). Challenged legislation will be sustained as having a rational basis “if any conceivable state of facts supports it.” *Rio Vista Non-Profit Housing Corp. v. County of Ramsey*, 335 N.W.2d 242, 245-46 (Minn. 1983); *see also Westling v. County of Mille Lacs*, 581 N.W.2d 815, 821-22 (Minn. 1998) (sustaining statute by conceiving of a *possible* legislative basis); *Hegenes v. State*, 328 N.W.2d 719, 721-22 (Minn. 1983) (same).

Under the rational basis test, “[e]very presumption [is] invoked in favor of the constitutionality of an act of the legislature.” *Contos v. Herbst*, 278 N.W.2d 732, 736 (Minn. 1979). Accordingly, “[t]he party challenging the constitutionality of [a] statute

bears the burden of establishing 'beyond a reasonable doubt' that the statute violates a constitutional right." *Westling*, 581 N.W.2d at 819.

Although rational basis review is always deferential, "courts are especially deferential in the context of classifications made by complex tax laws." *John Hancock*, 497 N.W.2d at 253 (internal quotation marks and citations omitted). This is so because "in the field of taxation, the legislature's power is inherently broader." *Guilliams v. Comm'r of Revenue*, 299 N.W.2d 138, 142 (Minn. 1980). Heightened judicial deference recognizes the Legislature's superior competence in the area of taxation. Tax policy, this Court has said, "is peculiarly a legislative function, involving political give-and-take and an awareness of local conditions." *Metro. Sports Facilities Comm'n v. County of Hennepin*, 478 N.W.2d 487, 489 (Minn. 1991). Enhanced deference is also necessary owing to the complexity and inherent imperfection of taxing schemes:

[T]he passage of time has only served to underscore the wisdom of that recognition of the large area of discretion which is needed by a legislature in formulating sound tax policies. * * * It has * * * been pointed out that in taxation, even more than in other fields, legislatures possess the greatest freedom in classification.

* * * No scheme of taxation, whether the tax is imposed on property, income, or purchase of goods and services, has yet been devised which is free of all discriminatory impact. In such a complex arena in which no perfect alternatives exist, the Court does well not to impose too rigorous a standard of scrutiny lest all local fiscal schemes become subjects of criticism under the Equal Protection Clause.

In re McCannel, 301 N.W.2d 910, 917 (Minn. 1980) (quoting *San Antonio School Dist. v. Rodriguez*, 411 U.S. 1, 40, 93 S. Ct. 1278, 1300-01 (1973)).

B. Because The Act Satisfies Minnesota's Three-Factor Rational Basis Test, It Comports With Both Federal Equal Protection And State Uniformity Requirements.

1. The Act pursues legitimate State purposes.

The State clearly may attempt to achieve the purposes specified by the Act.¹¹ See *Kolton*, 645 N.W.2d at 411. Its first stated purpose is to “ensure that manufacturers of nonsettlement cigarettes pay fees to the state that are comparable to the costs attributable to the use of the cigarettes” they sell. Minn. Stat. § 297F.24, subd. 1(b)(1). The Minnesota Department of Health estimates that “[s]moking costs Minnesota approximately \$1.3 billion annually, the equivalent of approximately \$3.36 for every pack of cigarettes sold, or \$277 per Minnesota resident per year.” Minnesota Department of Health, *Preventing and Reducing Tobacco Use* at 1 (Updated June 4, 2003) (Add. at A239-41). Considering that nonsettlement cigarettes recently have sold for as little as \$1.33 per pack, it is obvious that these social costs are *not* reflected in the retail price of such cigarettes. See *27 State Register* 1360-61 (2003) (listing the “presumed legal prices” of cigarettes under the Minnesota Unfair Cigarette Sales Act) (APP. 161-64). Plainly, nonsettlement cigarettes impose substantial negative externalities upon the

¹¹ As this Court has done, the State will address the three factors in reverse order. See *Metro. Sports Facilities Comm'n*, 478 N.W.2d at 489 n.4.

State.¹² The district court found that smoking is a “major public health issue” the costs of which “are borne by various constituencies, including the State.” APP. 336-37.

The Act squarely addresses this problem. It ensures that the prices of all cigarettes sold in Minnesota reflect—in some degree—the healthcare costs they impose on the State. By placing a fee on nonsettlement cigarettes, the Act “internalizes” into the retail prices of such cigarettes the healthcare costs stemming from their use.¹³ Internalization is sound policy because it forces smokers both to face and to bear the true costs of their smoking, rather than allowing them to transfer those costs to the State. *See Surgeon General’s Report* at 352, 355; *see also Westfarm Associates v. Washington Suburban Sanitation Comm’n*, 66 F.3d 669, 679 (4th Cir. 1995) (discussing internalization); Henry N. Butler, *Economic Analysis for Lawyers* 368-70, 382, 410-11 (1998). As the district court concluded, the Act legitimately seeks “to discourage people from voluntarily increasing the cost of health care for the population in general.” APP. 348.

¹² “Negative externalities occur when the private costs of some activity are less than the total costs to society of that activity. As a result, society produces more of the activity than is optimal because private parties engaging in that activity essentially shift some of their costs onto society as a whole.” *McCloud v. Testa*, 97 F.3d 1536, 1551 n.21 (6th Cir. 1996); *see also Black’s Law Dictionary* 604 (7th ed. 1999). This case involves negative externalities because smoking imposes substantial healthcare costs on the State, but, absent a proper level of taxation, those costs are not incorporated into the retail price of cigarettes. *See Surgeon General’s Report* at 352-55 (discussing smoking-related externalities).

¹³ “Internalizing an externality” is defined as “[c]hanging the private costs or benefits so that they equal social costs or benefits; making people responsible for all the costs to other people of their own actions.” Henry N. Butler, *Economic Analysis for Lawyers* 923 (1998). One recognized method of achieving internalization is through “corrective taxes.” *Id.* at 410-11; *see also Surgeon General’s Report* at 352-55 (optimal cigarette tax internalizes smoking-related externalities).

Since 1998, the Minnesota Agreement has ensured healthcare cost internalization for cigarettes sold by the Major Manufacturers. In addition to requiring six “Settlement Payments” (§ II.B), the Minnesota Agreement also requires separate “Annual Payments” in perpetuity (§ II.D). APP. 131-34. In exchange for these two separate classes of payments, the agreement provides the Major Manufacturers with, respectively, a release of the State’s past *and future* healthcare claims. *Id.* at 136-37. The Minnesota Agreement thus secures compensation for past misconduct *and achieves healthcare cost internalization for future cigarette sales.*¹⁴

The Act perfectly complements the Minnesota Agreement by creating a comprehensive scheme for healthcare cost internalization. By the time of the 2003 legislative session, nonsettling manufacturers had increased their collective market share from less than 2% to more than 12%. APP. 78-79. Consequently, a substantial percentage of cigarettes sold in Minnesota once again allowed smokers to externalize the healthcare costs of their smoking. The Legislature addressed this growing problem by passing the Cigarette Fee Act, which ensures that the retail prices of *every* cigarette sold in Minnesota reflects healthcare cost internalization. The court of appeals concluded that “[t]he purpose of Minn. Stat. § 297F.24 is related to the health and well-being of its citizens, particularly youth, which is a legitimate interest of the state.” APP. at 363.

¹⁴ Appellants are simply wrong to assert that *all* payments made by the Major Manufacturers under the Minnesota Agreement are for *past misconduct*. See, e.g., Appellants’ Br. at 12, 45 n.14. The Annual Payments in perpetuity required by that agreement are healthcare cost internalization payments for ongoing cigarette sales, and constitute consideration for the State’s release of its *future* healthcare claims.

Federal courts have held that a state pursues a legitimate purpose by requiring nonsettling cigarette manufacturers to fund escrow accounts from which smoking-related healthcare costs can be recovered. *See, e.g., Star Scientific*, 278 F.3d at 349, 352; *PTI, Inc. v. Philip Morris, Inc.*, 100 F. Supp. 2d 1179, 1207 (C.D. Cal. 2000) (both upholding Qualifying Statutes). More importantly, states are not limited to this “set-aside-and-sue-later” mechanism of securing healthcare payments. In upholding a Qualifying Statute’s escrow requirement, the Fourth Circuit commented as follows:

While we recognize the financial burden that such [escrow] payments might create for any given cigarette manufacturer—a burden represented by the loss of use of significant amounts of money for 25 years—we note that the State surely could properly accomplish the same end by enacting a more financially burdensome form of legislation, such as an act imposing a tax on cigarette manufacturers but giving a tax credit to those who sign the Master Settlement Agreement.

Star Scientific, 278 F.3d at 350. Functionally, the Act does precisely this; it simply distinguishes at the outset between settlement and nonsettlement cigarettes (rather than imposing a general tax with a credit).

Minnesota is not prohibited from imposing a healthcare fee merely because the drafters of the MSA asked participating states to enact Qualifying Statutes implementing an escrow approach. As the district court concluded, “[t]he Minnesota legislature can

establish financial responsibility for [this] public health issue.” *See* APP. 338; *id.* at 348 (similar).¹⁵

The Act’s second stated purpose is to “prevent manufacturers of nonsettlement cigarettes from undermining the State’s policy of discouraging underage smoking by offering nonsettlement cigarettes at prices substantially below the cigarettes of other manufacturers.” Minn. Stat. § 297F.24, subd. 1(b)(2). There can be no doubt that deterring underage smoking is a legitimate State interest. *See Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 564, 121 S.Ct. 2404, 2426 (2001) (“The State’s interest in preventing underage tobacco use is substantial, and even compelling”)

2. The classification employed by the Act is genuine and relevant to its purposes.

The classification “nonsettlement cigarettes” is genuine and relevant to the Act’s stated purposes. *See Kolton*, 645 N.W.2d at 411. The term “settlement cigarettes” refers to cigarettes made by the Major Manufacturers, by Liggett, or by any manufacturer who

¹⁵ Appellants do not challenge the State’s power to tax cigarettes. *See* Appellants’ Br. at 39. Indeed, the State may tax a commodity whose use imposes social costs. “In some instances the expense of a particular public function is met in whole or in part by a tax on those . . . who may be supposed to have caused the expense to be incurred” 71 Am. Jur. 2d *State and Local Taxation* § 21 (1973) (discussing “Special Taxes”). This Court recently explained that the State’s gasoline excise tax is “a ‘special tax’ imposed upon the business of dealing in gasoline, with the purpose of raising revenue for maintenance and construction of the Trunk Highway System.” *Amoco Corp. v. Comm’r of Revenue*, 658 N.W.2d 859, 872 (Minn. 2003) (citation and footnote omitted).

The cigarette fee is likewise a “special tax” upon cigarettes to raise revenue for state healthcare costs caused by smoking. The classification “nonsettlement cigarette” properly recognizes that this purpose *has already been achieved* with respect to settlement cigarettes. The Act complements the Minnesota Agreement.

enters into a new agreement authorized by the Act. The statutory classification “nonsettlement cigarettes” refers to all other cigarettes.

The Annual Payments required by the State’s agreements with settling manufacturers internalize into the retail prices of “settlement cigarettes” the State healthcare costs imposed by their use. The prices of “nonsettlement cigarettes,” by contrast, reflect no such internalization. For this reason, the classification “nonsettlement cigarettes” is directly relevant to the Act’s stated purposes. It precisely identifies: (a) which cigarettes sold in Minnesota do *not* reflect healthcare cost internalization; and, correspondingly, (b) which cigarettes have a “negative externality discount” that undermines the State’s policy of deterring youth smoking. *Cf. Star Scientific*, 278 F.3d at 351-52 (Qualifying Statute’s distinction between settling and nonsettling manufacturers was rationally related to statute’s legitimate purpose of ensuring that nonsettling manufacturers could be held financially accountable for healthcare costs their products imposed on state).

There is strong evidence that increasing the prices of low-cost nonsettlement cigarettes will reduce youth demand. The price-elasticity of cigarettes—the degree to which a change in price produces a change in demand—is far greater among young people than it is among adults:

[T]he effects of increases in cigarette prices are not limited to reductions in average cigarette consumption among smokers but include significant reductions in smoking prevalence. These effects on smoking prevalence constitute both an increase in smoking cessation among smokers and a reduction in smoking initiation among potential young smokers. . . . [A]lthough evidence concerning the effects of prices on adolescent smoking is mixed, the majority of the evidence from recent

studies indicates that adolescents and young adults are significantly more responsive than adults to changes in cigarette prices. Most recent studies found that adolescents and young adults were two to three times more sensitive than adults to price.

Surgeon General's Report at 337. As the district court noted, the availability of low-cost cigarettes substantially increases the probability of youth smoking, and necessarily undermines the State's efforts to combat youth smoking. APP. 337-38, 348. The distinction between settlement and nonsettlement cigarettes directly addresses this problem, and permits the Act to eliminate the negative externality discount that gives nonsettlement cigarettes their price advantage. *Id.* at 336, 337-38.

3. The Act's distinction between settlement and nonsettlement cigarettes is genuine and substantial.

Finally, the distinction between settlement and nonsettlement cigarettes is genuine and substantial, and provides a "natural and reasonable basis" for determining which cigarettes are subject to the Act's 35-cent fee. *See Kolton*, 645 N.W.2d at 411. Settlement cigarettes have higher retail prices that reflect the internalization of State healthcare costs. Nonsettlement cigarettes have lower prices that reflect healthcare cost externalization. The distinction between these two classes of cigarettes is obviously genuine (based on real differences) and substantial (based on differences that really matter). *See* APP. 336. The Act therefore comports with equal protection principles.

II. BECAUSE THE ACT DOES NOT ABRIDGE APPELLANTS' RIGHTS TO FREELY SPEAK OR TO PETITION THE GOVERNMENT FOR REDRESS OF GRIEVANCES, IT INVOLVES A CONVENTIONAL ECONOMIC CLASSIFICATION SUBJECT ONLY TO RATIONAL BASIS REVIEW.

The lower courts concluded that the Cigarette Fee Act does not abridge Appellants' free speech rights under the First Amendment to the United States Constitution¹⁶ or Article I, sections 3 and 8, of the Minnesota Constitution.¹⁷ See APP. 341, 349. More specifically, the court of appeals correctly ruled that the Act does not involve an unconstitutional condition that coerces the surrender of free speech rights. APP. 360-61. Because the Act does not abridge speech, it is not subject to heightened scrutiny. Instead, the Act contains a conventional economic classification that is subject to rational basis review. See *supra* Argument § I.A.

A. Standard of Review And Presumption Of Constitutionality

Before the application of heightened scrutiny is warranted, the party challenging a statute on free speech grounds—under either the First Amendment or the Equal Protection Clause—must make an initial showing that the statute *actually affects speech*. “[W]here a plaintiff claims suppression of speech under the First Amendment, the

¹⁶ The First Amendment provides in part that “Congress shall make no law . . . abridging the freedom of speech . . . or the right of the people . . . to petition the government for a redress of grievances.” U.S. CONST. amend. I. These prohibitions have been incorporated against the states through the Due Process Clause of the Fourteenth Amendment. See, e.g., *Stromberg v. California*, 283 U.S. 359, 51 S. Ct. 532 (1931).

¹⁷ Article I, section 3, of the Minnesota Constitution provides that “all persons may freely speak, write and publish their sentiments on all subjects.” MINN. CONST. art. I, § 3. Article I, section 8, governs the redress of injuries or wrongs. MINN. CONST. art. I, § 8.

plaintiff bears the initial burden of proving that speech was restricted by the governmental action in question.” *Lim v. City of Long Beach*, 217 F.3d 1050, 1054 n.4 (9th Cir. 2000) (citation omitted); *see also LeVake v. Indep. Sch. Dist. No. 656*, 625 N.W.2d 502, 507 (Minn. Ct. App. 2001) (party asserting free-exercise claim has initial burden of proving that state’s requirement burdens party’s religious belief or practice).

Requiring a threshold showing implements the separation of powers. It ensures that the Judiciary (a) applies heightened scrutiny, (b) reverses the normal presumption of constitutionality for statutes, and (c) shifts the burden of proof to the State, exclusively when a legislative measure *actually* affects speech, and not when an effect is merely *alleged* by a litigant. Heightened scrutiny applies to legislatively created classifications only when they “*impinge upon a fundamental right.*” *See, e.g., Skeen v. State*, 505 N.W.2d 299, 312 (Minn. 1993).¹⁸ When a statute does not actually limit a fundamental right, by contrast, it is not subject to heightened scrutiny. *City of Dallas v. Stanglin*, 490 U.S. 19, 25, 109 S. Ct. 1591, 1595 (1989).

In *Stanglin*, for example, the plaintiff alleged that a Dallas ordinance restricting admission to certain dance halls to persons between the ages of 14 and 18 violated the First Amendment right of free association. *Stanglin*, 490 U.S. at 20, 22-23, 109 S. Ct. at 1593-94. “The dispositive question in this case is the level of judicial scrutiny to be

¹⁸ *See also Glickman v. Wileman Bros. & Elliott, Inc.*, 521 U.S. 457, 469, 477, 117 S. Ct. 2130, 2138, 2142 (1997) (legislation not abridging speech “should enjoy the same strong presumption of validity that we accord to other policy judgments made by Congress”); *State v. Casino Marketing Group, Inc.*, 491 N.W.2d 882, 885 (Minn. 1992) (“any provision of law *restricting* [first amendment] rights does not bear the usual presumption of constitutionality”)

applied to the city's ordinance. Unless laws create suspect classifications or impinge upon constitutionally protected rights, it need only be shown that they bear some rational relationship to a legitimate state purpose." *Id.* at 23, 109 S. Ct. at 1594 (internal quotation marks and citations omitted).

The Court rejected the plaintiff's free association claim on the merits. *Stanglin*, 490 U.S. at 23-25, 109 S. Ct. at 1594-95. "The Dallas ordinance, therefore . . . impinges on no constitutionally protected right. The question remaining is whether the classification engaged in by the city survives 'rational-basis' scrutiny under the Equal Protection Clause." *Id.* at 25, 109 S. Ct. at 1595. Unless legislation *actually abridges* a First Amendment right, it is subject to review only under the rational basis test. *Id.*¹⁹

B. The Act Does Not Abridge Appellants' Rights To Freely Speak Or To Petition The Government For Redress Of Grievances.

Appellants' free speech challenge is based primarily on their claim that the Act involves an unconstitutional condition that coerces free speech waivers. Appellants also allege that the Act unconstitutionally distinguishes between manufacturers based on whether they have waived their First Amendment rights. Neither claim is correct.

¹⁹ See also *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 547-51, 103 S. Ct. 1997, 2001-04 (1983) (finding no infringement of First Amendment rights and consequently applying rational basis review rather than heightened scrutiny); *John Hancock*, 497 N.W.2d at 253 (rational basis review applies where "no fundamental right or suspect class is involved"); 4 R. Rotunda & J. Nowak, *Treatise on Constitutional Law* § 20.11, at 289-91 (3d ed. 1999).

1. The Act does not distinguish between manufacturers based on whether they have waived their First Amendment rights.

There is no merit to Appellants' repeated assertion that the Act "draws a facially discriminatory and unconstitutional distinction based solely on whether the tobacco manufacturer has waived its First Amendment rights." Appellants' Br. at 20. First, the Act is not *framed* in terms of speech. Consequently, it cannot "facially" distinguish on the basis of speech. Second, the term by which the statute actually draws its distinction—"nonsettlement cigarettes"—precisely identifies an economic fact about a commodity. As its stated purposes make clear, the Act distinguishes between *cigarettes* based on whether their retail prices reflect state healthcare costs; it does not distinguish between *manufacturers* based on whether they have waived their free speech rights (or on any other basis). Finally, Appellants' entire theory that the Act "singles out" nonsettling manufacturers for refusing—*previously*—to waive their rights makes no sense. *See, e.g.*, Appellants' Br. at 12, 34.

Prior to passage of the Act, nonsettling manufacturers had never been *offered* an opportunity to enter into agreements with the State. Plainly, the Legislature did not "single out" nonsettling manufacturers for having "refused" to do what the State had never asked them to do. In contrast, as has been shown, the Legislature had sound economic reasons for requiring the prices of nonsettlement cigarettes to include a premium for state healthcare costs—just as do the prices of settlement cigarettes. For, as Appellants acknowledge, nonsettlement and settlement cigarettes have comparable health effects. *See* Appellants' Br. at 12.

Likewise, the Legislature did not “reward” the Major Manufacturers with an “exemption” from the fee for having waived their speech rights. The State provided full consideration for this voluntary waiver by releasing its future healthcare claims through the Minnesota Agreement. The Legislature had no reason to retroactively alter the bargain struck in that agreement *to the detriment of the State* by offering the Major Manufacturers a further “reward.” See *Camping & Ed. Found. v. State*, 282 Minn. 245, 250, 164 N.W.2d 369, 372 (1969) (“The basis for all tax exemption is the accomplishment of some public purpose as opposed to favoring of particular persons or corporations at the expense of the taxpayers generally.”) It did, however, have an *economic* reason to exclude settlement cigarettes from the fee: the Minnesota Agreement already ensured that the prices of settlement cigarettes reflected state healthcare costs.

This Court should conclude that the economics of cigarette pricing, rather than the speech conduct of cigarette manufacturers, is the sole basis for the Act’s distinction between settlement and nonsettlement cigarettes. Accordingly, the Court should

conclude that this distinction does not offend free speech principles.²⁰ Whether the Act abridges free speech by imposing an unconstitutional condition—by attempting to coerce *present or future* speech waivers—is, of course, an entirely separate issue.

2. The Cigarette Fee Act does not involve an unconstitutional condition.

a. The unconstitutional conditions doctrine

Under the doctrine of unconstitutional conditions, “the government may not deny a benefit to a person on a basis that infringes his constitutionally protected . . . freedom of speech even if he has no entitlement to that benefit.” *United States v. American Library Ass’n*, 539 U.S. 194, 210, 123 S. Ct. 2297, 2307 (2003) (internal quotation marks and citation omitted). Legislative measures that impose unconstitutional conditions share three basic properties: (1) their purpose is to suppress speech; (2) they contain an explicit statutory reference to speech; and (3) they conditionally offer a government benefit in a manner intended to coerce the surrender of free speech rights. *See, e.g., Fed.*

²⁰ Even if the Act did actually distinguish by speaker, this would not establish a First Amendment violation. Indeed, speaker-based distinctions are not sufficient, standing alone, even to trigger heightened scrutiny. *See, e.g., Leathers v. Medlock*, 499 U.S. 439, 453, 111 S. Ct. 1438, 1447 (1991); *Bellsouth Corp. v. FCC*, 144 F.3d 58, 69 (D.C. Cir. 1998). Appellants would still have to make a threshold showing that the Act actually burdens speech. *See supra* Argument § II.A. Perhaps to this end, Appellants allege that “the State has imposed a tax on the exercise of free speech . . .” Appellants’ Br. at 27. This is plainly incorrect. The Act imposes a fee “upon the sale of nonsettlement cigarettes in this state . . .” Minn. Stat. § 297F.24, subd. 1(a). The incidence of the tax falls solely upon the activity of selling cigarettes. Speech does not trigger the tax, and cannot cause anyone to incur liability for the tax. Consequently, the Act does not impose a tax on speech, and does not burden anyone’s right to speak. Appellants can speak as freely today as they ever could.

Communications Comm'n v. League of Women Voters of California, 468 U.S. 364, 104 S. Ct. 3106 (1984); *Speiser v. Randall*, 357 U.S. 513, 78 S. Ct. 1332 (1958).

Speiser, for example, involved a California statute that annually required veterans seeking a property tax exemption to sign a loyalty oath declaring that they had not engaged in subversive speech. *Speiser*, 357 U.S. at 515, 78 S. Ct. at 1336. California contended that “veterans as a class occupy a position of special trust and influence in the community, and therefore any veteran who engages in the proscribed advocacy constitutes a special danger to the State.” *Id.* at 528, 78 S. Ct. at 1343. Executing the loyalty oath was an express condition precedent to receiving the property tax exemption. *Id.* at 519, 78 S. Ct. at 1338. The statute thus granted the exemption to any veteran who limited his speech, and denied it to any veteran who did not.

The Supreme Court found that the statute was “frankly aimed at the suppression of dangerous ideas.” *Speiser*, 357 U.S. at 519, 78 S. Ct. at 1338 (citation omitted). The statute was framed in terms of speech because it required veterans to sign and substantiate a loyalty oath. The statute involved economic coercion because it offered money in exchange for the surrender of speech rights: “[T]he denial of a tax exemption for engaging in certain speech necessarily will have the effect of *coercing* the claimants to refrain from the proscribed speech.” *Id.* at 519, 78 S. Ct. at 1338 (emphasis added).

In *League of Women Voters*, the challenged statute provided that, “[n]o noncommercial educational broadcasting station which receives a grant from the Corporation for Public Broadcasting . . . may engage in editorializing.” *League of Women Voters*, 468 U.S. at 366, 371 n.7, 104 S. Ct. at 3110, 3113. The Supreme Court

found that this measure was “specifically directed at a form of speech—namely, the expression of editorial opinion—that lies at the heart of First Amendment protection.” *Id.* at 381, 104 S. Ct. at 3118. The Congressional purpose to coerce silence was reflected in the statute’s specific reference to “editorializing.” *Id.* at 366, 371 n.7, 104 S. Ct. at 3110, 3113. Finally, the statute used economic coercion to silence broadcasters by conditioning the availability of government grants upon their willingness to refrain from “editorializing.” *Id.* at 370-71, 399-401, 104 S. Ct. at 3112-13, 3127-28.

A statute that involves an unconstitutional condition coercing the waiver of free speech rights is the functional equivalent of a mandatory prohibition against the exercise of those rights, and therefore is subject to heightened scrutiny. *See League of Women Voters*, 468 U.S. at 374-81, 104 S. Ct. at 3114-18 (applying heightened scrutiny). If, on the other hand, the statute works no coercion, and instead solicits a truly voluntary waiver of rights,²¹ then it is not equivalent to a speech prohibition, and is not subject to heightened scrutiny. *See generally Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 103 S. Ct. 1997 (1983) (rejecting unconstitutional condition challenge to tax provision and therefore applying rational basis review).

²¹ Free speech rights may be voluntarily waived. *See D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174, 187, 92 S. Ct. 775, 783 (1972) (enforcing a contractual waiver of constitutional rights); *Erie Telecommunications, Inc. v. Erie*, 853 F.2d 1084, 1096 (3d Cir. 1988) (finding an effective waiver of First Amendment rights by contract).

b. The Cigarette Fee Act does not involve an unconstitutional condition.

The Act does not have any of the properties of an unconstitutional condition. First, the Act is not aimed at the suppression of speech. Two of the Act's stated purposes are: (1) to "ensure that manufacturers of nonsettlement cigarettes pay fees to the state that are comparable to costs attributable to the use of the cigarettes"; and (2) to "prevent manufacturers of nonsettlement cigarettes from undermining the state's policy of discouraging underage smoking by offering nonsettlement cigarettes at prices substantially below the cigarettes of other manufacturers." Minn. Stat. § 297F.24, subd. 1(b). These are entirely legitimate state objectives unrelated to the suppression of speech.²² See *supra* Argument § I.B.1.

Appellants simply brush aside the Act's legislatively stated purposes, however, and assert that the Act is intended to coerce manufacturers to enter agreements with the State. The *Star Scientific* court flatly rejected a similar attack upon an MSA Qualifying Statute. The plaintiff in that case, a nonparticipating manufacturer ("NPM"), asserted

²² Appellants correctly note that "[i]llicit government intent is not the sine qua non of a violation of the First Amendment." Appellants' Br. at 17 (quoting *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 592 (1983)). This does not mean that intent is irrelevant. Where a provision *actually burdens speech*, the absence of government intent to suppress speech cannot *save* the measure. See Appellants' Br. at 18 (citing cases in which courts have invalidated measures actually burdening speech that were not direct attempts to regulate speech). Illicit intent is plainly relevant, however, in an unconstitutional conditions analysis. See, e.g., *Speiser*, 357 U.S. at 519, 78 S. Ct. at 1338; *League of Women Voters*, 468 U.S. at 366, 371 n.7, 104 S. Ct. at 3110, 3113 (both emphasizing government intent). In concluding that the Act does not involve an unconstitutional condition, therefore, the court of appeals correctly emphasized that the Act "is not a direct attempt to regulate speech." APP. 361.

that Virginia's Qualifying Statute was intended to coerce NPMs into joining the MSA, even though this was not among the statute's expressly stated purposes. *See Star Scientific*, 278 F.3d at 349-50. In rejecting this claim, the court reasoned:

Star Scientific's challenge to the qualifying statute is based on a rejection of the statute's articulated purpose. It would rather infer that the statute was enacted to coerce cigarette manufacturers to sign on to the Master Settlement Agreement. This argument ignores the fact that even if we were to reject the State's articulated purpose for enacting the statute, we would then need only determine that the legislation has some conceivable purpose that is not prohibited by the Constitution. Obviously, one of the conceivable purposes of the statute is the legitimate purpose stated by Virginia Accordingly . . . the qualifying statute does not violate the Due Process Clause of the United States Constitution.

Star Scientific, 278 F.3d at 350 (citations omitted). Appellants' analogous argument should likewise be rejected. The Act does not aim at the suppression of speech.

Second, the Act is not framed in terms of speech. The Act distinguishes between settlement and "nonsettlement" cigarettes. As was previously discussed, the classification "nonsettlement cigarettes" precisely identifies which cigarettes sold in Minnesota do *not* reflect healthcare cost internalization. *See supra* Argument § I.B.2. Unlike the statutes in *Speiser* and *League of Women Voters*, the Act contains no reference whatsoever to speech.

Finally, and most importantly, the Act does not offer manufacturers a government benefit in a manner calculated to coerce the surrender of free speech rights. Under the Act, a nonsettling manufacturer has two options: (1) it can refrain from seeking an agreement, allow the State collect the 35-cent per-pack fee from cigarette distributors, and fully exercise its First Amendment rights; or (2) it can enter an agreement, make

48-cent per-pack payments to the State, and voluntarily curtail certain protected speech activities.

The mere statement of these alternatives shows that the Act does not financially coerce manufacturers *to enter* agreements involving speech waivers. Appellants allege that the Act is coercive because it offers to exempt their products from the Act's 35-cent per-pack fee. Appellants simply ignore the fact, however, that new agreements require 48-cent per-pack payments—a more onerous financial requirement. Thus, if a manufacturer wants its product to bear a *lower* financial burden for state healthcare costs, it will *refrain* from seeking an agreement. The financial incentive, in other words, tends to discourage rather than to coerce new agreements. Had the Legislature really intended to coerce the waiver of free speech rights, as Appellants allege, it surely would not have made entering agreements the *costlier* option.

Although Appellants' unconstitutional condition claim is necessarily based on alleged financial coercion, *see, e.g.*, Appellants' Br. at 21, 29, they urge the Court to ignore a critical financial fact: that it costs more to enter new agreements than to pay the fee. Citing *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 103 S. Ct. 1365 (1983), Appellants assert that this fact is irrelevant to the Court's unconstitutional condition analysis. *See* Appellants' Br. at 28. This is incorrect.

Application of the unconstitutional conditions doctrine *requires* the careful weighing of two alternatives. *See* 4 R. Rotunda & J. Nowak, *Treatise on Constitutional Law* § 20.11, at 285 (3d ed. 1999) ("Courts must in each instance examine the substance of the condition to determine whether it violates constitutional principles.") If the Court

cannot consider the financial consequences of both waiving and retaining a right, then it cannot ascertain whether the State is attempting to coerce a waiver by making waiver the more financially desirable alternative (as in *Speiser*). Appellants cannot invoke a weighing doctrine, but then ask the Court to ignore facts essential to proper weighing.

Second, *Minneapolis Star & Tribune* is entirely distinguishable. The challenged statute in that case imposed a use tax on ink and paper used to produce publications. *Star & Tribune*, 460 U.S. at 577-78 & n.2, 103 S. Ct. at 1368. The State argued, *inter alia*, that the challenged measure actually *avored* publishers because a use tax on raw materials is less onerous than a sales tax on (higher-priced) final products. *Id.* at 588, 103 S. Ct. at 1373. The Court, however, declined the State's invitation to engage in an analysis of "the relative burdens of various *methods of taxation*." *Id.* at 589-90 & nn.12-14, 103 S. Ct. at 1374 (emphasis added).

Appellants' unconstitutional condition claim does not require this Court to evaluate "the relative burdens of various methods of taxation." *Star & Tribune*, 460 U.S. at 589, 103 S. Ct. at 1374. Instead, it raises the very different question of whether the Act coerces manufacturers to enter new agreements. Consideration of the 48-cent per-pack payments required by such agreements is essential to resolution of this issue, and demonstrates that the Act does not involve an unconstitutional condition.

Because the Act does not coerce manufacturers to enter into agreements, it presents them with an entirely voluntary business decision that turns upon each manufacturer's evaluation of the potential tobacco-related healthcare claims the State is offering to release. If a manufacturer concludes that obtaining a release of state claims is

desirable or prudent, it can enter an agreement undertaking a 48-cent per-pack payment and waiving certain First Amendment rights. If a manufacturer does not wish to obtain a release, it can refuse to enter an agreement, allow the State to collect the 35-cent fee from distributors, and continue exercising all of its First Amendment rights.²³

Federal courts have recognized the voluntary nature of the analogous choice under an MSA Qualifying Statute:

Star Scientific was free to join the Master Settlement Agreement as a Subsequent Participating Manufacturer if it concluded that this would have been a better deal for it, but, apparently for business reasons, it elected not to participate in that capacity.

Star Scientific, 278 F.3d at 354; *see also Bedell*, 263 F.3d at 246; *PTI, Inc.*, 100 F. Supp. 2d at 1206-07 (both recognizing this choice and upholding a Qualifying Statute). So long as the Act does not *coerce* settlement—so long as manufacturers are truly free to decide—the Act’s *offer* of settlement on terms acceptable to the State does not violate the constitution.

²³ There is no merit to Appellants’ claim that their choice is “coerced” because they find neither alternative—allowing distributors to pay 35 cents per pack or directly paying 48 cents per pack—to be desirable. *See, e.g.*, Appellants’ Br. at 37 (alleging a Hobson’s Choice). Understandably, Appellants wish to continue selling cigarettes at prices *not* reflecting the social costs of smoking. The Legislature has determined, however, that this is contrary to state policy. The prices of *all* cigarettes sold in Minnesota must now reflect state healthcare costs. Although Appellants would prefer the prices of their cigarettes to reflect neither the fee nor settlement payments, this preference does not make the State’s offer of agreements coercive. A choice is not coerced simply because neither available alternative is considered desirable. *See, e.g., Terban v. Department of Energy*, 216 F.3d 1021, 1026 (Fed. Cir. 2000); *United States v. Elie*, 111 F.3d 1135, 1146 (4th Cir. 1997).

A First Amendment claim similar to Appellants' was considered and rejected in *PTI*. Plaintiff-NPMs challenged California's enactment of the model Qualifying Statute, which required NPMs either: (1) to become signatories to the MSA, which entailed both financial burdens and First Amendment restrictions; or (2) to place substantial amounts into escrow. *PTI, Inc.*, 100 F. Supp. 2d at 1186. MSA payments were tax-deductible whereas escrow deposits were not. *Id.* at 1206. The NPMs argued that the different tax treatment under these two options "essentially punish[ed] tobacco product manufacturers for refusing to join the MSA and submit to its 'restrictions on truthful, non-misleading advertising.'" *Id.* (citation omitted).

The *PTI* court acknowledged that a tax exemption may not be conditioned upon the renunciation of free speech rights. *PTI, Inc.*, 100 F. Supp. 2d at 1206. The court concluded, however, that the Qualifying Statute "does not force plaintiffs to make an analogous, constitutionally-prohibited choice." *Id.* The statute did require NPMs to bear a more onerous tax burden than participating manufacturers. *Id.* The court nevertheless concluded that the MSA's speech restrictions were "wholly separate from the tax consequences stemming from a tobacco distributor's choice to participate in the M.S.A. or subject itself to the terms of a Qualifying Statute" *Id.* at 1206-07. The court upheld the statute and dismissed the NPMs' First Amendment claim because the MSA and Qualifying Statute were not aimed at free speech, and thus were "wholly unlike the situation in *Speiser*, where '[t]he denial [of tax exemption] is frankly aimed at the suppression of dangerous ideas.'" *Id.* at 1206 (brackets in original) (quoting *Speiser*, 357 U.S. at 518, 78 S. Ct. at 1338).

The Qualifying Statute in *PTI* placed an increased financial burden on NPMs, which arguably coerced them to join the MSA and to submit to its speech restrictions. The *PTI* court nevertheless rejected the plaintiffs' unconstitutional conditions challenge. The Cigarette Fee Act, in contrast, places an increased financial burden on manufacturers who enter agreements with the State. Consequently, it affirmatively discourages speech waivers. If the Qualifying Statute in *PTI* was constitutional, then, *a fortiori*, the Act is constitutional as well.

Because the Act does not coerce Appellants to surrender their free speech rights, it does not involve an unconstitutional condition. Consequently, the Act is not subject to heightened scrutiny under free speech or equal protection principles, but is instead subject only to rational basis review. *See supra* Argument § I.

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III. THE ACT'S IMPOSITION OF A FEE ON ALL FUTURE SALES OF NONSETTLEMENT CIGARETTES DOES NOT RENDER IT A BILL OF ATTAINDER.

The Act does not violate state or federal prohibitions against bills of attainder. *See* U.S. CONST. art. I, § 10, cl. 1 (“No State shall . . . pass any Bill of Attainder”); MINN. CONST. art. I, § 11 (“No bill of attainder . . . shall be passed”). A bill of attainder is “a law that legislatively determines guilt and inflicts punishment upon an identifiable individual without provision of the protections of a judicial trial.” *Nixon v. Adm’r of Gen. Servs.*, 433 U.S. 425, 468, 97 S. Ct. 2777, 2803 (1977). “[O]nly the clearest proof could suffice to establish the unconstitutionality of a statute” challenged as a bill of attainder. *Communist Party v. Subversive Activities Control Bd.*, 367 U.S. 1, 83, 81 S. Ct. 1357, 1403 (1961) (citation omitted).

To show that a legislative enactment is a bill of attainder, a plaintiff must demonstrate that the challenged provision has three elements: “specification of the affected persons, punishment, and lack of a judicial trial.” *Selective Serv. Sys. v. Minnesota Pub. Interest Research Group*, 468 U.S. 841, 847, 104 S. Ct. 3348, 3352 (1984); *accord WMX Technologies, Inc. v. Gasconade County*, 105 F.3d 1195, 1201 (8th Cir. 1997); *Reserve Mining Co. v. State*, 310 N.W.2d 487, 490 (Minn. 1981). The Act has none of these elements.

First, the Act does not impermissibly specify affected persons. An indispensable element of a bill of attainder is retrospective focus: it defines *past* conduct as wrongdoing and then imposes punishment on the wrongdoer. *Consolidated Edison Co. of New York, Inc. v. Pataki*, 292 F.3d 338, 349 (2d Cir. 2002). A bill of attainder thus

uses past conduct to designate affected parties. *See Communist Party*, 367 U.S. at 86, 81 S. Ct. at 1405; *WMX Technologies*, 105 F.3d at 1202. Consequently, a description in terms of present or future conduct does not involve prohibited specification of affected persons. *See Communist Party*, 367 U.S. at 86-87, 81 S. Ct. at 1405.

In *Communist Party*, the Supreme Court held that the Subversive Activities Control Act of 1950 was not a bill of attainder because “it attaches not to specified organizations but to described activities in which an organization may or may not engage.” *Id.*, 367 U.S. at 86-87, 81 S. Ct. at 1405. The Court emphasized that “[p]resent activity constitutes an operative element to which the statute attaches legal consequences, not merely a point of reference for the ascertainment of particular persons ineluctably designated by the legislature.” *Id.* at 87, 81 S. Ct. at 1405.

Here, the Act attaches legal consequences to a future activity; it imposes a fee upon the sale of “nonsettlement cigarettes.” As the district court found, manufacturers “can avoid paying the fee simply by not selling cigarettes within the state of Minnesota.” APP. 349; *cf. Communist Party*, 367 U.S. at 86, 81 S. Ct. at 1405. Consequently, nonsettling manufacturers have not been “ineluctably designated by the legislature.” *Communist Party*, 367 U.S. at 87, 81 S. Ct. at 1405. So long as persons can escape the application of a statute by altering the course of their present activities, there can be no complaint of attainder. *WMX Technologies*, 105 F.3d at 1202; *see also Planned Parenthood of Mid-Missouri and Eastern Kansas, Inc. v. Dempsey*, 167 F.3d 458, 465 (8th Cir. 1999) (finding no bill of attainder where organization currently denied funds could qualify for funds by establishing independent affiliate).

In *PTI*, the court dismissed the plaintiff-NPMs' claim that California's Qualifying Statute under the MSA constituted a bill of attainder. The court ruled that the statute did not have the requisite specificity because "[a]pplication of the statute depends entirely on an entity's prospective choice of conduct." *PTI, Inc.*, 100 F. Supp. 2d at 1199. For just these reasons, the Act lacks the specificity required to be a bill of attainder.

Nor does the Act impose punishment. "Forbidden legislative punishment is not involved merely because [an act] imposes burdensome consequences." *Nixon*, 433 U.S. at 472, 97 S. Ct. at 2805. Three inquiries are relevant for deciding this issue: "(1) whether the challenged statute falls within the historical meaning of legislative punishment; (2) whether the statute, 'viewed in terms of the type and severity of burdens imposed, reasonably can be said to further nonpunitive legislative purposes'; and (3) whether the legislative record 'evinces a [legislative] intent to punish.'" *Selective Serv. Sys.*, 468 U.S. at 852, 104 S. Ct. at 3355 (citation omitted); *accord Reserve Mining*, 310 N.W.2d at 490. These inquiries reveal that the Act does not impose punishment.

First, Appellants cannot even plausibly allege that the 35-cent per-pack fee imposed by the Act "falls within the historical meaning of legislative punishment." *See Selective Serv. Sys.*, 468 U.S. at 852, 104 S. Ct. at 3355. "Such punishments included death, 'imprisonment, banishment, and the punitive confiscation of property by the sovereign.'" *PTI, Inc.*, 100 F. Supp. 2d at 1199 (citing *Nixon*, 433 U.S. at 474, 97 S. Ct. at 2806). The *PTI* court summarily rejected the claim that California's Qualifying Statute imposed "legislative punishment." *PTI, Inc.*, 100 F. Supp. 2d at 1199-1200.

And because the Act furthers non-punitive legislative purposes, it does not impose punishment under the second test. The Supreme Court has recognized that deterring underage smoking is a “substantial, and even compelling” state purpose. *Lorillard*, 533 U.S. at 564, 121 S. Ct. at 2426. The district court here concluded: “This is not punishment for producing a lawful product, but rather a fee charged for legitimate legislative public policy purposes” APP. 349. The *PTI* court likewise held that California’s Qualifying Statute was “‘reasonably calculated to achieve a nonpunitive purpose’—closing the loophole in the M.S.A. to ensure the promotion of public health and payment of smoking-related costs.” *PTI, Inc.*, 100 F. Supp. 2d at 1199. And because the required payments under the Act—like those under a Qualifying Statute—are based on sales volume, “they are legitimately targeted to nonpunitive purposes.” *Id.* at 1200.

Finally, the Act does not evince a legislative intent to punish the past conduct of manufacturers producing “nonsettlement cigarettes.” A party claiming that legislation constitutes a bill of attainder must show unmistakable evidence of punitive intent. *Navegar, Inc. v. United States*, 192 F.3d 1050, 1067 (D.C. Cir. 1999). The fee imposed by the Act relates exclusively to future conduct—to cigarette sales occurring after June 30, 2003. Rather than imposing punishment, the fee will ensure: (1) that the price of nonsettlement cigarettes will rise, thereby deterring youth smoking; and (2) that smokers of nonsettlement cigarettes will not be able to shift to the State the healthcare costs of their smoking. As the court of appeals concluded, these purposes are entirely prospective and non-punitive. APP. 365. The Legislature may, without working

attainder, curb behavior it regards as harmful to the public welfare. *WMX Technologies*, 105 F.3d at 1202 (citation omitted).

The Act is not a bill of attainder because it employs a permissible classification rather than an impermissible designation, and because it imposes a fee based on future conduct rather than visiting punishment for past conduct without a judicial trial.

CONCLUSION

The Cigarette Fee Act is fully consistent with equal protection principles. It does not abridge free speech rights, and is therefore subject only to rational basis review. The Act is not a bill of attainder. For these reasons, the State respectfully requests that this Court affirm the lower courts' decisions upholding the Act in all respects.

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**STATUTORY
ADDENDUM**

297F.24 FEE IN LIEU OF SETTLEMENT.

Subdivision 1. **Fee imposed.** (a) A fee is imposed upon the sale of nonsettlement cigarettes in this state, upon having nonsettlement cigarettes in possession in this state with intent to sell, upon any person engaged in business as a distributor, and upon the use or storage by consumers of nonsettlement cigarettes. The fee equals a rate of 1.75 cents per cigarette.

(b) The purpose of this fee is to:

(1) ensure that manufacturers of nonsettlement cigarettes pay fees to the state that are comparable to costs attributable to the use of the cigarettes;

(2) prevent manufacturers of nonsettlement cigarettes from undermining the state's policy of discouraging underage smoking by offering nonsettlement cigarettes at prices substantially below the cigarettes of other manufacturers; and

(3) fund such other purposes as the legislature determines appropriate.

Subd. 2. **Nonsettlement cigarettes.** For purposes of this section, a "nonsettlement cigarette" means a cigarette manufactured by a person other than a manufacturer that:

(1) is making annual payments to the state of Minnesota under a settlement of the lawsuit styled as State v. Philip Morris Inc., No. C1-94-8565 (Minnesota District Court, Second Judicial District), if the style of cigarettes is included in computation of the payments under the agreement; or

(2) has voluntarily entered into an agreement with the state of Minnesota, approved by the attorney general, agreeing to terms similar to those contained in the settlement agreement, identified in clause (1) including making annual payments to the state, with respect to its national sales of the style of cigarettes, equal to at least 75 percent of the payments that would apply if the manufacturer was one of the four original parties to the settlement agreement required to make annual payments to the state.

Subd. 3. **Collection and administration.** The commissioner shall administer the fee under this section in the same manner as the excise tax imposed under section 297F.05 and all of the provisions of this chapter apply as if the fee were a tax imposed under section 297F.05. The commissioner shall deposit the proceeds of the fee in the general fund.

History: 2003 c 127 art 14 s 9