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## Litigation

### FL: State Supreme Court Declines To Intervene In *Engle* Trial

Tobacco manufacturers suffered a setback on December 27<sup>th</sup> when the **Florida Supreme Court** refused to intervene in the multi-billion dollar *Engle et al. vs. RJ Reynolds Tobacco Company (RJR) et al.* class-action trial, leaving the industry open to the possibility of a lump-sum punitive damage award. In what was characterized as an extremely "terse order," the Supreme Court denied the industry's petition to intervene but left open the possibility of another appeal to the State appellate court. "Said writ is hereby denied but without prejudice to raise the underlying issues as appropriate in any subsequent direct appeal to the district court," read the court's ruling.

Although the threat of a lump-sum punitive damage award remains, Salomon Smith Barney analyst Martin Feldman cautioned that if granted, such an award would not be distributed until all individual compensatory damages are awarded - something that could take decades to complete. "It's psychologically very challenging for the industry," conceded Feldman,

**Quote of the week:**  
"To rule and not address the merits is puzzling" - Morgan Stanley Dean Witter analyst David Adelman

"but I don't believe it will impact the cash flows of the industry any meaningful extent in the near future." Goldman Sachs analyst Marc Cohen believes that State Supreme Court intervention at this point would have been unusual and

that the request to post a bond, should the industry lose in Phase II, is something that would be appealed.

Credit Suisse First Boston analyst Bonnie Herzog and David Adelman of Morgan Stanley Dean Witter expressed surprise at the high court's decision. Said Adelman, "It was disappointing and it's puzzling because the court took the unusual action of indicating it might rule on the issue. The vast majority they just reject out of hand. Here they went over the threshold. To rule and not address the merits is puzzling."

Tobacco stocks took a nose dive following the news, with Loews Corp., British American Tobacco Plc (BAT) and RJR hitting new lows. Herzog called the drop "a total overreaction" and Adelman added, (see *Engle* on page 2)

## Excise Taxes

### NY: Senate Approves 55¢ Cigarette Tax Hike

On December 28<sup>th</sup>, the **New York State Senate** unanimously approved the \$9 billion *Health Care Reform Act (HCRA)*, a measure that will increase the State cigarette excise tax 55¢ to \$1.11 per pack. Just prior to the Senate vote, Governor George Pataki (R) amended the bill by withdrawing cigars, chewing and pipe tobacco from the originally across-the-board tax increase, allowing the "less popular" forms of tobacco to escape a doubling in taxes. State Assemblyman Alexander Grannis (D-Manhattan) said that lawmakers were informed that Pataki's decision was based on the notion that "the public understands cigarette taxes. When you say 'sin taxes,' by that the public understands you mean cigarette taxes. But

when you add cigars and the others, then it becomes a broader general taxing issue that doesn't resonate as well with the public." If approved by Pataki, the *HCRA* - slated to take effect on March 1, 2000 - will also derive approximately \$500 million from the State's tobacco settlement each year.

Less than a week before its Senate passage, Philip Morris USA (PM) issued a statement decrying the State Assembly's decision to pass the *HCRA*. Ellen Merlo, PM senior vice president of corporate affairs cautioned that such legislation could have a devastating effect on both taxpayers and State business owners. "It is unfair to single out smokers to pay for (see **Tax** on page 2)

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"These stocks have been punished twice before [based on other litigation concerns]. It's overkill already." As for the immediate future, Herzog predicted tobacco stocks will remain in tight trading until *Engle's* Phase II is over. However, Herzog added, "The short term risk-reward ratio (for investors) is attractive because the stocks' down side is limited." For Philip Morris Cos. (PM) stock, both Adelman and Herzog pointed out that the market has virtually eliminated all value of the tobacco portion of the business from the company's stock price. "It's trading on the value of global Kraft Foods, Miller and Philip Morris Capital," said Herzog. "The market has bankrupted the value of tobacco." Phase II of the trial is scheduled to resume on January 18<sup>th</sup> (Reuters 12/27, 12/28, AP, Goldman Sachs 12/28).

**Manufacturers Request Dismissal Of DOJ Suit**

Tobacco manufacturers filed papers on December 27<sup>th</sup> asking that U.S. District Judge Gladys Kessler dismiss the Federal lawsuit filed against them by the U.S. Department of Justice (DOJ) seeking reimbursement for 50 years of "ill-gotten" profits made from cigarette sales to the elderly, Federal employees, veterans and military personnel. The industry's motion - filed in U.S. District Court for the District of Columbia - asserted that the Federal government is, among other things, ignoring last year's \$206 billion settlement with State attorneys general. "This is a wonderful example of how the Federal government came charging in demanding relief for something that's already been settled," said Philip Morris USA associate general counsel Greg Little. "The government is ignoring the most significant development in tobacco this century."

In addition, the industry accused the government of ignoring "well settled principles of law merely because the industry is an unpopular one" and challenged the suit's claims under the *Racketeer-Influenced Corrupt Organizations Act (RICO)* - allegations that the DOJ found insufficient to support its criminal case. "These claims are based on precisely the same allegations that the government has determined do not permit it to maintain a criminal RICO action," the companies charged. "On the very day the government filed this lawsuit, it acknowledged that its widely publicized, highly touted, five-year series of grand jury investigations would have to be abandoned without so much as a single indictment against any of these defendants."

The manufacturers also charged the government with attempting to turn its case into a quasi class-action suit. Defense attorneys labeled the suit "a nationwide aggregated melange of the infinitely variegated injuries and claims of millions of individual health-care recipients to be supposedly 'proven' by statistics without any allegations or proof as to a single individual's injury." Further, the companies cited a 1947 Supreme Court decision, *U.S. vs. Standard Oil Company*, in its argument. That case barred Federal government lawsuits seeking recovery of medical costs unless explicitly authorized by Congress. The manufacturers also pointed out that Congress declined to pass a Clinton administration bill in 1998 that would have settled future tobacco suits, and used it to accuse the government of "illegitimately seeking to achieve through litigation what had been denied by Congress in legislation." According to Judge Kessler's trial plans, DOJ attorneys have until February 25, 2000 to respond to the industry's dismissal motions (Business Wire 12/27, Winston-Salem Journal, WSJ 12/28).

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new spending that should be everyone's responsibility," said Ms. Merlo. "The funding sources being considered to pay for the health care proposals in Albany will hurt the business community and taxpayers throughout the State."

In addition, Ms. Merlo warned that cigarette sales in New York State have steadily decreased in the last eight years and that trend is expected to continue. "Legislators should question the funding of a program whose costs will continue to grow with a revenue source that will continue to decline. If historical trends continue, additional tax increases would be needed in the future to help fill the budget shortfall," Ms. Merlo stated. PM estimates that the proposed tax

increase could result in taxable sales losses of 19.2 percent or nearly 226.4 million cigarette packs. The loss of 2,350 jobs - mostly in the retailing and wholesaling of cigarettes - would also result from the increased tax. "A tax increase of this magnitude will have a devastating impact on small business owners and their employees," warned Ms. Merlo. "The impact could be felt in every community in the State" (Business Wire 12/23, AP 12/27, 12/28).

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**NY: B&W Criticized For Leading Citizen Lobbying Effort**

Newspapers in Syracuse, New York reported this week that Brown & Williamson Tobacco Corp. (B&W) is allegedly behind a major telephone lobbying campaign to squelch the State's 55¢ per pack