UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, **Plaintiff,** **v.** **PHILIP MORRIS USA INC.,** **f/k/a PHILIP MORRIS INC., et al.,** **Defendants.**	**Civil No. 99-CV-02496 (GK)** **Next scheduled court appearance:** **None**

UNITED STATES' OPENING BRIEF ON RETAIL POINT OF SALE

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INTRODUCTION

One of the most important parts of the Court's injunctive remedies is ordering the Defendants to disseminate corrective statements. The Defendants have contracts with hundreds of thousands of retailers across the country, under which they dictate the size, type, number, and location of marketing materials within the stores of participating retailers. The Court ordered that Defendants require their participating retailers to display the Court's corrective statements. On appeal, the D.C. Circuit instructed this Court to examine the effect of these provisions on the retailers considered as "innocent persons."

Retail point-of-sale corrective statements, as the Court found, are important for the Court's corrective messages to reach consumers. "In-store placement displays and signs are key methods by which Defendants communicate brand information and communicate a brand's central message or image," and the Court's remedy "uses the same vehicles which Defendants have themselves historically used." *United States v. Philip Morris USA Inc.*, 449 F. Supp. 2d 1, 660 at ¶ 3111, 928 (D.D.C. 2006), *aff'd in part & vacated in part*, 566 F.3d 1095 (D.C. Cir. 2009) (per curiam), *cert. denied*, 561 U.S. ___, 130 S. Ct. 3501 (2010). Failing to use this medium to communicate to consumers would limit and diminish the effectiveness of the Court's corrective-statement remedy.

Finally, any burden on retailers is far less than has been suggested, and can in any event be shifted to Defendants. Data from the Association for Convenience & Petroleum Retailing (NACS) (formerly known as the National Association fo Convenience Stores) indicates that retailers' burden under this part of the Court's remedy would be less than 0.4% of their annual *revenues* from selling cigarettes—and would total less than $5 million in lost *profits* per year across the entire industry. Even this comparatively small burden, though, need not rest on retailers' shoulders; the Court has the authority to shift the financial burden to Defendants, because it is part of the cost of preventing Defendants from continued RICO violations.

FACTUAL AND PROCEDURAL BACKGROUND

1. PROCEDURAL HISTORY

In its Final Order, the Court directed as follows:

> Each of the corrective statements approved pursuant to Section III(B)(¶ 5) of this Final Judgment and Remedial Order shall also be designed by Defendants for inclusion in a Countertop Display and Header Display at retail point-of-sale. Each Defendant that utilizes a Retail Merchandising Program shall require retailers who participate in such program to display each Countertop Display in a position of prominent visibility for the entire four month period, until it is replaced by a subsequent Countertop Display during the two-year duration set forth in Section III(B)(¶ 7)(a) of this Order. Each Defendant that utilizes a Retail Merchandising Program shall require retailers who participate in such program to display each Header Display in an equivalent position with any other brand advertising header for the entire period on the same schedule, whether monthly or quarterly, that any other brand advertising header is utilized. The Header Display shall be of at least equivalent size as any other brand advertising header or headers provided by Defendants. During the two year period set forth in Section III(B)(¶ 7)(a) of this Order, each Defendant shall include each of the five Court approved corrective statements in a Countertop Display and Header Display at least once. Each Defendant shall suspend from its Retail Merchandising Program for a period of one year any retailer that fails to comply with this provision.

449 F. Supp. 2d at 939-40.

On appeal, the D.C. Circuit stated that retailers who would be affected by the point-of-sale component of the corrective-statement remedy "did not receive notice of this remedy or an opportunity to present evidence or arguments to the district court regarding the impact the injunction would have on their businesses." *Philip Morris USA Inc.*, 566 F.3d 1095, 1141 (D.C. Cir. 2009) (per curiam), *cert. denied*, 561 U.S. ___, 130 S. Ct. 3501 (2010). Defendants filed an affidavit from the National Association of Convenience Stores (NACS) before this Court, in support of Defendants' post-judgment motion for a stay[1]; referencing that affidavit and an amicus brief that NACS filed on the appeal, the D.C. Circuit observed that NACS indicated that countertop space is the most important space within a convenience store, and that the loss of one square foot of countertop space can cost the industry $82 million in sales per year. *Id.* The D..C. Circuit held that this Court had erred "by failing to consider the rights of retailers and crafting an injunction that works a potentially serious detriment to innocent persons not parties to or otherwise heard in the district court proceedings." *Id.* at 1141-42. Accordingly, the Court of Appeals vacated the point-of-sale portion of the corrective-statement remedy and remanded for this Court "to evaluate and 'mak[e] due provision for the rights of innocent persons.' " *Id.* at 1142 (quoting 18 U.S.C. § 1964(a); brackets added by court).

The Court previously directed the parties to submit praecipes "suggest[ing] independent third parties who should be asked to file briefs on the impact of point-of-sale displays." Order #14 at 3 (R. 5878; 2/25/2011). The same order directed the parties to file simultaneous briefs on April 1, 2011, regarding their "positions on point-of-sale displays," and simultaneous responses on April 15, 2011. *Id.*

2. IMPORTANCE OF RETAIL POINT-OF-SALE MARKETING

a. Size and effects of Defendants' POS presence

The scientific literature confirms the Court's finding that retail stores are "one of Defendants' central vehicles for communication of brand imagery and promotional offers" to young people. 449 F. Supp. 2d at 659, ¶ 3110. Defendants' own research shows that most young people purchase their

[1] The organization has since changed its name to become the Association for Convenience & Petroleum Retailing (NACS).

cigarettes at convenience stores. *Id.* at 592, ¶ 2773. As a result, "retail environments, such as convenience stores and gas retailers frequented by teenagers[,] heavily promote tobacco use." *Id.* at 660, ¶ 3110.

In Monograph 14, issued in 2001, the National Cancer Institute found evidence of "a causal relationship between tobacco marketing and smoking initiation," and reported that "the conclusion that there is a causal relationship between tobacco marketing and smoking initiation seems unassailable." 449 F. Supp. 2d at 568, ¶¶ 2660, 2661 (internal quotation marks omitted; quoting NCI Monograph 14, *Changing Adolescent Smoking Prevalence* (2001)). The National Cancer Institute's more recent Monograph 19, issued in 2008, is even more emphatic. Its chapter 7, titled "Influence of Tobacco Marketing on Smoking Behavior," concludes thus:

> The total weight of evidence from multiple types of studies, conducted by investigators from different disciplines, using data from many countries, demonstrates a causal relationship between tobacco advertising and promotion and increased tobacco use, as manifested by increased smoking initiation and increased per capita tobacco consumption in the population.

National Cancer Institute, U.S. Dep't of Health & Human Services, Tobacco Control Monograph No. 19, *The Role of the Media in Promoting and Reducing Tobacco Use* at 281 (2008).

As might be expected, point-of-sale promotions in particular affect consumers, especially youth. A recent review article found support for "an association between PoS marketing and displays and increased smoking susceptibility, experimentation, and uptake among children, even after adjustment for a range of plausible confounding factors." Janine Paynter & Richard Edwards, *The Impact of Tobacco Promotion at the Point of Sale: A Systematic Review*, 11 Nicotine & Tobacco Research 25, 31 (2009). A study published in the *American Journal of Public Health* found that, after controlling for other variables, "weekly or more frequent exposure to retail tobacco marketing was associated with a 50% increase in the odds of ever smoking—nearly as much as the effect of exposure to a parent or household member who smokes." Lisa Henriksen, Ellen C. Feighery, Yun Wang et al., *Association of Retail Tobacco Marketing with Adolescent Smoking*, 94 Am. J. Pub. Health 2081, 2082 (2004). A recent longitudinal study of more than 1,300 middle-school students, grades 6-8, confirmed this result, finding that "adolescents' exposure to widespread cigarette advertising at the point of sale is a risk factor for smoking initiation." Lisa Henriksen, Nina C. Schleicher, Ellen C. Feighery et al., *A Longitudinal Study of Exposure to Retail Cigarette Advertising and Smoking Initiation*, 126 Pediatrics 232, 236 (2010). *See also* J. Paynter, R. Edwards, P.J. Schluter et al., *Point of Sale Tobacco Displays and Smoking Across 14-15 Year Olds in New Zealand: A Cross-Sectional Study*, 18 Tobacco Control 268, 272 (2009) (concluding that "young people's exposure to tobacco displays at the POS [point of sale] is significantly associated with being susceptible to smoking, experimenting with smoking and current smoking.").

There is also evidence that tobacco companies appear to target the largest displays at the stores that are most popular with youth. L. Henriksen, E.C. Feighery, N.C. Schleicher et al., *Reaching Youth at the Point of Sale: Cigarette Marketing is More Prevalent at Stores Where Adolescents Shop Frequently*, 12 Tobacco Control 315, 317 (2004) (reporting "stores popular among adolescents displayed more than three times as many cigarette marketing materials outside, and contained twice as much shelf space for Marlboro, Camel, and Newport"). A 2008 study found that high-school students whose schools were near retailers with a moderate density of tobacco advertising were statistically significantly more likely to smoke than students attending schools that did not have retail-store tobacco advertising close by. L. Henriksen, E.C. Feighery, N.C. Schleicher et al., *Is Adolescent Smoking Related to the Density and Proximity of Tobacco Outlets and Retail Cigarette Advertising Near Schools?*, 47 Preventative Medicine 210, 212 (2008).

In addition, point-of-sale displays also affect smokers who are trying to quit; "[t]hose trying to avoid smoking commonly experience urges to purchase cigarettes when confronted with cigarette displays." Melanie Wakefield, Daniella Germain & Lisa Henriksen, *The Effect of Retail Cigarette Pack Displays on Impulse Purchase*, 103 Addiction 322, 325 (2007). Moreover, exposure to point-of-sale advertising weakens teenagers' reported resolve not to smoke over the next year. Melanie Wakefield, Daniella Germain, Sarah Durkin et al., *An Experimental Study of Effects on Schoolchildren of Exposure to Point-of-Sale Cigarette Advertising and Pack Displays*, 21 Health Educ. Research 338, 345 (2006). The Defendants use point-of-sale promotions to increase their sales in two ways, "through impulse purchase and long-term conversion." Newport "Pleasure on Wheels" Program Training Manual, 92092557/2570 at 2560 (JD-022251) (admitted).

According to Defendants' research, "the best, most visible, point of sale spots [are] 'on the counter, behind the counter or cashier, and on and around the door,' " 449 F. Supp. 2d at 660, ¶ 3114 (citation omitted), and Defendants' contracts require retailers to display their signs and marketing materials in precisely those locations. Point-of-purchase advertising "exposes and potentially affects everyone: the young who grow up seeing tobacco as . . . on a par with milk and bread and come to underestimate its risks; the adult smoker who is reminded and cued to smoke now and more often; . . . the would-be quitter whose intentions to quit are undermined; and the ex-smoker tempted to relapse and resume smoking." Richard W. Pollay, *More Than Meets the Eye: On the Importance of Retail Cigarette Advertising*, 16 Tobacco Control 270, 271 (2007).

b. Incentive programs

The importance of retail point-of-sale promotions is demonstrated by the fact that cigarette companies spent over $10 *billion* on this type of promotion in 2006 alone. Federal Trade Commission, *Cigarette Report for 2006*, tbl. 2C at 4 (2009) ($9.8 billion in price discounts paid to retailers or wholesalers to reduce the retail price of cigarettes paid by consumers, plus another $436 million spent on promotional allowances to retailers). The primary financial component of Defendants' retail programs comes in the form of discounted prices that retailers pay on cigarettes; Philip Morris, for example, offers its participating retailers between 3 and 50 cents per pack. Philip Morris USA Inc., "Retail Leaders Program 2010 Agreement: Plan Groups I, H, and X," at 1 (9510000036/0072 at 0036) (hereafter "Philip Morris Retail Leaders Program: Plan Groups I, H, and X") (Ex. 1). Randomly-selected retailers interviewed as part of a recent study indicated that "[t]he single most important issue" to be able to compete in the retail market for tobacco is to offer a competitive price; almost all of them participated in retail-program contracts in order to be able to do so. Robert John, Marshall K. Cheney, & M. Raihan Azad, *Point-of-Sale Marketing of Tobacco Products: Taking Advantage of the Socially Disadvantaged?*, 20 J. Health Care for Poor & Underserved 489, 498 (2009).

Such retail merchandising contracts are "the most potent part of a tobacco company's marketing arsenal." T. Dewhirst, *POP Goes the Power Wall? Taking Aim at Tobacco Promotional Strategies Utilised at Retail*, 13 Tobacco Control 209, 209 (2004) (editorial) (citing M. Beirne, *Tobacco Row: Cigarette Makers Step up Retail War*, Brandweek, Dec. 2002, at 3). Interviews with retailers reveal that participating in Defendants' retail programs requires surrendering a great deal of control:

> It's not an offer. Because of the contract, they will tell you how it's going to be. It's not an offer, it's a mandatory thing. It has to be the way that they want it. Especially, shelving. All the shelving, has to be their way. (South Asian male, owner, former smoker, below average tier)

John, Cheney & Azad, *Point-of-Sale Marketing of Tobacco Products*, 20 J. Health Care for Poor & Underserved at 498.

> Apparently, the tobacco company sales representatives had exclusive control over the placement of products and advertisements by virtue of the contracts. The tobacco company sales representatives visited the stores and placed signs according to their store-specific plan-o-grams, with which storeowners had barely any involvement.
>
> > They say they want to put up this new sign. They literally come in and change our signs without us telling them . . . . They do that themselves. We don't call them and ask them to do it. . . . We don't get to say as long as we are on the contract with the company, then whatever the company sends out . . . to use for advertising. (Caucasian female, manager, smoker, above average tier)

Id. at 499. Another study that interviewed retailers, published in 2003, similarly concluded that "[t]obacco companies exert substantial control over the retail environment by requiring retailers to place their products in the most visible locations and to place specific amounts and types of advertising in certain locations in the store." E.C. Feighery, K.M. Ribisl, P.I. Clark et al., *How Tobacco Companies Ensure Prime Placement of Their Advertising and Products in Stores: Interviews with Retailers about Tobacco Company Incentive Programmes*, 12 Tobacco Control 184, 187 (2003).

A nationally representative study of retailers found that 65% participated in cigarette-manufacturer incentive programs, and nearly 80% of participating retailers reported cigarette company control over placement of marketing materials in their stores. Ellen C. Feighery, Kurt M. Ribisl, Nina C. Schleicher et al., *Retailer Participation in Cigarette Company Incentive Programs*

Is Related to Increased Levels of Cigarette Advertising and Cheaper Cigarette Prices in Stores, 38 Preventive Med. 876, 876 (2004).

The National Association of Convenience Stores recently reported that average sales of cigarettes per convenience store in 2009 were $576,354, and that 66% of all cigarette sales are made at convenience stores. Ctr. for Tobacco Policy & Organizing, *Cigarettes Generate Big Revenue for Convenience Stores: Analysis of 2010 State of the Industry Report* (2011) (summarizing 2009 data reported by the Association for Convenience & Petroleum Retailing (NACS)).

To participate in RJR's Retail Partners program, "the Contracted Retailer must comply with RJR's requests for in-store promotion and advertising of its product as well as provide RJR with input on pricing. One of the objectives of RJR's buy-down program is to ensure the prominent placement of RJR's advertising and promotional displays (i.e., point-of-purchase displays, other signage)—known in the industry as 'presence.' RJR's 'presence' in the retail stores allows it the opportunity to support current marketing campaigns and/or promote the future development of certain products." *R.J. Reynolds Tobacco Co. v. Mkt. Basket Food Stores, Inc.*, No. 5:05CV253-V, 2007 WL 319965, at *3 (W.D.N.C. Jan. 30, 2007).

Defendants take seriously their authority to force retailers to place and maintain their marketing materials in specified places within retail stores. A sales representative who does not force retail stores to comply with these provisions stands to be fired. *Rodio v. R.J. Reynolds Tobacco Co.*, 416 F. Supp. 2d 224, 238 (D. Mass. 2006) (upholding termination of R.J. Reynolds sales representative who was fired in part for failing to place and maintain R.J. Reynolds point-of-sale materials on front counters of retail stores).

c. Importance of POS as location for corrective statements

Defendants have used and continue to use point-of-sale displays to communicate with consumers, and as the Court found, they use "these same vehicles very effectively." 449 F. Supp. 2d at 927. It is very important for the success of the Court's injunction that the corrective statements be displayed at the retail point-of-sale; people notice and pay attention to messages that are displayed there.

ARGUMENT

On appeal, NACS (now known as the "Association for Convenience & Petroleum Retailing (NACS)") raised concerns that the retail point-of-sale display component of the Court's order would affect its members. As discussed below, to the extent that financial harm would otherwise accrue to retailers, it would be proper for the Court to order Defendants to bear those costs. However, NACS's constitutional and other arguments do not require the Court to back away from having Defendants use one of their most powerful communication means to communicate corrective statements.

1. THE FIRST AMENDMENT DOES NOT PREVENT THE COURT FROM REQUIRING DEFENDANTS TO CHANGE THE TERMS OF THEIR "RETAIL PROGRAMS"

NACS argued before the D.C. Circuit that requiring retailers to display corrective statements constituted compelled speech, in violation of the First Amendment. This is mistaken for several reasons. First, participants in Defendants' retail programs have already agreed to allow their stores to display whatever signs or displays Defendants and Defendants' agents may require. Participants in R.J. Reynolds' "Retail Partners" program are required to "permit RJRT to choose the utilization of RJRT 'Featured Space' with regard to display type and advertising size and configuration." R.J.

Reynolds, "Retail Partners Marketing Plan Contract: 2010 Amended Pack Outlet Plan" (hereafter "Retail Partners Marketing Plan Contract") (Ex. 2).[2] "Featured Space" is defined as merchandising space a certain height above the floor that is "highly visible from the point of purchase." *Id.* Customer checkout areas must be at least 6' wide, "with a profile of merchandising on the selling counter no higher than 12" to ensure clear visibility of the RJRT 'Featured Space'." *Id.* R.J. Reynolds is guaranteed equal counter display space to match any competitors, and participating retailers are required to "maintain display and advertising space according to RJRT authorized plan-o-gram." *Id.* at 6.

Lorillard requires retailers that participate in its Excel Merchandising Plan to maintain a specified number of point-of-sale advertising pieces that feature only Newport, and an additional number that feature Newport and Maverick/Old Gold. *See, e.g.*, 2010 Lorillard Tobacco Company Excel Merchandising Plan Description—Excel Plan: E-1 Category C, at C(1), (2) (hereafter "Excel Plan: E-1 Category C") (Ex. 3) (contract for gas stations selling 25 Lorillard cartons per week, requiring retailer to "[m]aintain four (4) permanent POS pieces, to include Gas Islands, where Newport is the only brand merchandised," and to "[m]aintain five (5) permanent POS pieces, to include Gas Islands, where Newport and Maverick/Old Gold are merchandised"); 2010 Lorillard Tobacco Company Excel Merchandising Plan Description—Excel Plan: E-2 Category C, at C(1), (2) (hereafter "Excel Plan: E-2 Category C") (Ex. 4) (contract for retailers selling 5 Lorillard cartons per week, requiring retailer to maintain three permanent Newport-only POS pieces, and four Newport and Maverick/Old Gold permanent POS pieces). Moreover, retailers participating in

[2] The exhibit has a watermark reading "DRAFT"; but it is the Retail Partners contract that counsel for R.J. Reynolds gave the United States.

Lorillard's program must also agree to "[a]ccept and place appropriate advertising for Wholesale Delivery Program (WDP) product and promotions within Lorillard's merchandising space and in other designated store locations and maintain for the duration of the promotion as instructed by Lorillard." Excel Plan: E-1 Category C, at C(4) (emphasis omitted) (Ex. 3); Excel Plan: E-2 Category C, at C(4) (Ex. 4) (same).

Participants in the Philip Morris Retail Leader program "authorize[] PM USA, its affiliates, and third parties contracted by PM USA or its affiliates to move (1) any non-PM USA items, including but not limited to, point of sale materials, signs, light boxes, products, and any or all parts of a fixture" out of space allocated on to Philip Morris Plan-o-Gram; and (2) "any Cigarette Signs or non-cigarette signs from the PM USA Signage Zone." Philip Morris Retail Leaders Program: Plan Groups I, H, and X, at Ex. F § 1(B) (9510000036/0072 at 0061) (Ex. 1); *see also id.* at ¶¶ 7-8 (9510000036/0072 at 0040) (similar). Philip Morris is allowed to dictate "[t]he size and number of all Fixtures, Displays and OPMs [overhead pack merchandisers] . . . at the sole discretion of PM USA or its affiliates." *Id.* at Ex. F § 8 (9510000036/0072 at 0061).

Thus, retail stores in Defendants' programs have already given over control of the size, content, and location of the signs and displays in their own stores. In interviews, retailers who signed such contracts reported that "the tobacco companies took control of the tobacco advertising in the store, leaving very little flexibility for the owners, regardless of any personal views against advertising tobacco products (which some of them expressed)." John, Cheney & Azad, *Point-of-Sale Marketing of Tobacco Products*, 20 J. Health Care for Poor & Underserved at 501. Retailers who object on principle to being told what signs to display in their shops will not participate in Defendants' retail programs, and will thus be unaffected by the Court's order; retailers who have signed onto Defendants' retail programs have turned over control over the messages communicated to their customers.

Second, the Court's Order does not compel retailers to do anything; rather it compels Defendants to change the terms that they offer in their contracts. As discussed in the next section below, Defendants' retail program contracts authorize them to change their contract terms with minimal or no notice at all to retailers; the Court would simply order Defendants to change the terms of their agreements.

Third, nothing in the Court's decision interferes with the First Amendment "consider[ation] that tobacco retailers . . . have an interest in conveying truthful information about their products to adults, and adults have a corresponding interest in receiving truthful information about tobacco products." *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 564 (2001). A retailer's "constitutionally protected interest in *not* providing any particular factual information in his advertising is minimal." *Zauderer v. Office of Disciplinary Counsel of the Supreme Ct. of Ohio*, 471 U.S. 626, 651 (1985) (emphasis in original). Obliging Defendants to change the composition of the marketing and communication messages required by their retail programs does not offend retailers' First Amendment rights.

2. RETAILERS DO NOT HAVE PROPERTY RIGHTS TO THE CONTINUATION OF CONTRACTS THAT ARE TERMINABLE AT WILL

NACS argued before the D.C. Circuit that before being "bound by an injunction" that would "affect substantially the rights of non-parties," retailers were entitled to notice and an opportunity to be heard under the Fifth Amendment's Due Process clause. NACS Amicus Br. at 17. The D.C. Circuit indicated that it was error to impose the retail point-of-display requirement without either receiving submissions from retailers or "independently consider[ing] the impact of this program on affected retailers." *Philip Morris USA*, 566 F.3d at 1141. On remand, the Court asked the parties to "suggest[] independent third parties who should be asked to file briefs on the impact of point-of-sale displays," Order #14 at 3 (R. 5878; 2/25/2011), and the United States reiterates its recommendation that the Court invite submissions from appropriate trade groups as to the retail point-of-sale provisions of the Court's order. U.S. Praecipe Re. Independent Third Parties Potentially Affected by Retail-Display Component of the Court's Corrective-Statement Remedy (R. 5886; filed 3/7/2011).

NACS was mistaken that the retail-display aspect of the corrective-statement remedy would deprive retailers of property rights in violation of the Due Process clause. The property rights that the Due Process clause protects "are not created by the Constitution. Rather they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law—rules or understandings that secure certain benefits and that support claims of entitlement to those benefits." *Bd. of Regents of State Colls. v. Roth*, 408 U.S. 564, 577 (1972). Moreover, "[t]o have a property interest in a benefit, a person clearly . . . must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it." *Id.*; *see also Perry v. Sindermann*, 408 U.S. 593, 601-02 (1972) (decided same day as *Roth*). To have a protected due-process property right in the continuation of a contract, a person must have "more than an abstract need or desire for it," but instead "a legitimate claim of entitlement to it." *Roth*, 408 U.S. at 577. Thus, a professor who had no contractual, statutory, or university-rule right to continued employment "surely had an abstract concern in being rehired, but he did not have a property interest sufficient to require the University authorities to give him a hearing." *Id.* at 578. *Accord Bishop v.*

Wood, 426 U.S. 341, 344, 345 & n.9 (1976) ("A property interest in employment can, of course, be created by ordinance, or by an implied contract," but holding that there is no property right in continued employment in a position that is terminable at will); *Fed. Deposit Ins. Corp. v. Henderson*, 940 F.2d 465, 475 (9th Cir. 1991) ("[I]n most states, the general rule is that a public employee terminable at will does not have a property interest in continued employment, while an employee whose contract provides, either expressly or by implication, that he may only be terminated for cause does have such an interest.") (citations and emphasis omitted).

As in employment-at-will cases, Defendants' retail program contracts do not give retailers vested property rights to indefinite continuation of their contracts, much less to indefinite continuation of their contracts without changes or modifications. To the contrary, the retail program contracts can be terminated with little or no advance notice. Defendants can amend the contract terms at their sole discretion with little or no advance notice. Philip Morris's Retail Leader program specifies that either party can terminate the agreement effective 30 days after delivery of a termination notice. Philip Morris USA Inc., "Retail Leaders Program 2010 Agreement: Plan Groups I, H, and X," at Ex. E § 1(B) (9510000036/0072 at 0060) (Ex. 1). The contract authorizes Philip Morris to amend the agreement, in whole or in part, at any time in its sole discretion. *Id.*, Ex. F § 36 (9510000036/0072 at 0065).

R.J. Reynolds' retail program specifies that R.J. Reynolds "may elect in its discretion and at any time (i) to suspend any or all types of payments under this [contract], . . . and/or (iii) immediately to terminate this [contract]." R.J. Reynolds, "Retail Partners Marketing Plan Contract" at 4 (bottom of page) (Ex. 2); *see also id.* at 8 (bottom of page) (somewhat inconsistently providing that "[e]ither party can terminate this [contract] without cause upon ten (10) days notice"). The Retail Partners contract authorizes R.J. Reynolds to amend its terms on 10 days' notice. *Id.* at 8 (bottom of page).

Lorillard has two forms of retail programs, Excel and Non-Excel; the contracts for both specify that they are terminable at will. 2010 Lorillard Excel Merchandising Agreement at 2, § C (Ex. 5) ("Either party may terminate this Agreement upon notice effective from the date of notice."); 2010 Lorillard Tobacco Company Non-Excel Merchandising Agreement at 2, § C (Ex. 6) (same).

In sum, under R.J. Reynolds' and Lorillard's retail-program contracts, then, retailers can be terminated with no advance notice; and Philip Morris's contract authorizes it to amend the contract's terms, in whole or in part, at any time in its sole discretion. Retailers are not entitled to continued contractual relations. Under Defendants' retail contracts, retailers simply do not have protected property interests in having any particular set of contractual terms continue without disruption. Their position is akin to a convenience-store manager whose employer terminated him after the Department of Agriculture suspended the store from its food-stamp program: "[H]e as an individual enjoys no legally cognizable interest in working for a store which can accept food stamps, nor does he claim that he has a property interest enforceable against the government in maintaining his private employment with The Circle K Corporation." *Castaneda v. U.S. Dep't of Agric.*, 807 F.2d 1478, 1480 (9th Cir. 1987). Retailers do not have a legally cognizable interest in holding contracts with cigarette manufacturers that are not subject to a corrective-statement injunction; and they do not have a property interest enforceable against the government in maintaining terms of their pre-injunction retail program contracts.

3. THIS COURT'S POINT-OF-SALE DISPLAY REQUIREMENTS IS NOT A "TAKING" SUBJECT TO THE FIFTH AMENDMENT

In its amicus brief, NACS contended that the Court's point-of-sale display requirements amounted to a "taking of retailers' contract rights without just compensation," because the order, when enforced, "interferes with valid contracts between retailers and tobacco manufacturers without just compensation." NACS Amicus Br. at 22. The argument is mistaken.

To be sure, a valuable contract right is property within the meaning of the Takings Clause, and if taken for public use the government could be liable. *Omnia Commercial Co. v. United States*, 261 U.S. 502, 508 (1923). But what the Takings Clause protects is property taken by the government, not all diminishment or reduction in property value that may be due to governmental action. Thus in *Omnia*, the Court observed that "destruction of, or injury to, property is frequently accomplished without a 'taking' in the constitutional sense." *Id.* at 508. The Omnia company had a contract with a steel manufacturer to purchase a large quantity of steel at a below-market price; but before any steel was delivered to Omnia, the government requisitioned the manufacturer's entire production for the year. The Court held that there was no compensable taking of Omnia's contract, stating that the Taking clause covers only direct appropriations of private property and not "consequential loss or injury resulting from lawful governmental action." *Id.* at 510. "As a result of this lawful governmental action (the requisitioning of the steel) the performance of the contract was rendered impossible. It was not appropriated, but ended." *Id.* at 511. In this case, it certainly is true that the Court's order will result in changes to the terms of the Retail Program contracts. But any disruption that retailers would experience is far less than the Supreme Court found did not amount to a taking in *Omnia*.

Even where it is "undeniable" that prohibitions on the sale of certain property "prevent the most profitable use" of the property, there is no taking under the Due Process clause. *Andrus v. Allard*, 444 U. S. 51, 66 (1979) (prohibition on sale of eagle feathers); *see also id.* at 67 (citing *Everard's Breweries v. Day*, 265 U.S. 545, 556, 563 (1924) (finding no violation of Takings Clause where federal ban on sale and possession of intoxicating liquors left dealers holding large amounts of stock that they could not sell and could only dispose of, after de-alcoholization at considerable cost)).

In the same way, the retailers' objection that the Court's Final Order would direct Defendants to modify their retail programs' terms does not amount to a taking of retailers' property. In the face of similar objections, the U.S. Court of Appeals for the Federal Circuit held that there was no taking when private airport passenger and baggage screening services' contracts with airlines were disrupted due to a new statute requiring the government itself to provide airport security screening. *Huntleigh USA Corp. v. United States*, 525 F.3d 1370, 1380-82 (Fed. Cir.), *cert. denied*, 129 S. Ct. 626 (2008). Because "any losses that Huntleigh suffered were indirect," arising only due to "modified governmental regulation of the airlines, which resulted in adverse economic consequences for Huntleigh," the court held, there was no "taking" under the Fifth Amendment, even though the new statute "had the effect of 'frustrating' Huntleigh's business expectations." *Id.* at 1380. *Accord Kearney & Trecker Corp. v. United States*, 688 F.2d 780, 783 (Ct. Cl. 1982) (holding no taking where "[t]he government did not appropriate any of the rights the plaintiff had under the contract but only made it impossible for the plaintiff to perform it"), *cert. denied*, 460 U.S. 1051 (1983).

The case law discussed here demonstrates that even if this Court's order made it impossible for retailers and Defendants to contract with one another; made performance of their contracts more difficult; or frustrated the purpose of their contracts, there would be no Fifth Amendment taking.

4. RETAILERS ARE NOT WRONGLY STIGMATIZED

The corrective statements before the Court would not be issued in retailers' names, and would not mention retailers. Nonetheless, there has been some suggestion that any corrective statement would unfairly tarnish retailers. This is mistaken. To be sure, under certain circumstances a protectible liberty interest may be implicated "where a person's good name, reputation, honor, or integrity is at stake because of what the government is doing to him." *Roth*, 408 U.S. at 573 (quotation marks and brackets omitted). But in *Paul v. Davis*, 424 U.S. 693 (1976), the Supreme Court held that a sheriff's including a person's name and photograph on a flyer captioned "Active Shoplifters" implicated no due-process interest. Although the poster may have seriously limited the plaintiff's future employment opportunities, *id.* at 697, the Court held that it did not extinguish any rights; state "law does not extend to [him] any legal guarantee of present enjoyment of reputation." *Id.* at 711-12. The recommended corrective statements before the Court do not refer to retailers, and there is no reason to think they would diminish retailers' reputations; but even if they did, they would not violate retailers' rights.

5. THE RICO STATUTE'S REQUIREMENT TO MAKE "DUE PROVISION FOR THE RIGHTS OF INNOCENT PARTIES" ALLOWS THE COURT TO MAKE DEFENDANTS BEAR THE COST OF ANY UNDUE BURDEN ON RETAILERS

RICO's civil provisions authorize district courts "to prevent and restrain violations of section 1962 of this chapter by issuing appropriate orders . . . making due provision for the rights of innocent persons." 18 U.S.C. § 1964(a).

As shown below, RICO's requirement to afford "due provision for the rights of innocent persons" does not put out of reach any injunction to prevent and restrain additional RICO violations that might also impose hardships on "innocent persons." Rather, the requirement is that the Court tailor its injunctions to reduce unwarranted and irremediable burdens on "innocent persons." This is illustrated by the case that the D.C. Circuit cited in this portion of its discussion, *Cook Inc. v. Boston Sci. Corp.*, 333 F.3d 737, 744 (7th Cir. 2003). The district court found that one of two co-exclusive licensees to a drug had wrongfully assigned its license to a maker of medical stents, as part of its efforts to develop a stent coated with the drug; the two co-exclusive licensees were effectively competing to develop such a product and gather the necessary data to obtain FDA approval to market it in the United States. *Id.* at 741-43. Because damages due to the misconduct could not be estimated, the district court enjoined the wrongdoing co-licensee from continuing its misconduct, and prohibited it from using the information or data it had acquired through its misconduct for commercial purposes—"including the purpose of obtaining regulatory approval to sell paclitaxel-coated stents in the United States or elsewhere." *Id.* at 744 (emphasis omitted). On appeal, the Seventh Circuit held that this final clause was improper, because it would potentially harm patients —innocent persons—who might benefit from a paclitaxel-coated stent. *Id.*

Importantly, though, the *Cook* court did *not* hold that an injunction with negative effects on innocent persons is improper *per se*, or that such an injunction should be invalidated for that reason alone. Instead, it ruled, an injunction's negative effects upon innocent persons "must be balanced against the harm . . . from narrowing the injunction." *Id.* In that case, there was no legally cognizable harm; any harm in a legal sense to the plaintiff would arise from competing against an FDA-approved product from its competitor, the *Cook* court stated, and not from its competitor's winning FDA approval as such. *Id.* Accordingly, the injunction's prohibition against using improperly-acquired data to gain regulatory approval had negative effects for patients who might benefit from an FDA-approved device; and this had to be balanced against a harm that would not actually flow from FDA approval of the competitor's device at all. *Id.*

Matters are wholly different here than in the *Cook* case on which the D.C. Circuit relied. The Court here is seeking to prevent future fraud and deception against consumers, by ensuring that corrective statements are communicated to consumers in ways that attract attention, communicate clearly and meaningfully, and are remembered. As discussed at length above, the retail point-of-sale environment is "one of Defendants' central vehicles for communication," 449 F. Supp. 2d at 659, ¶ 3110, and Defendants pay some $10 *billion* per year to promote their products to retailers' customers at retail points of sale. Cigarette marketing *causes* increased smoking initiation and increased per-capita cigarette sales, NCI Monograph No. 19, *The Role of the Media in Promoting and Reducing Tobacco Use* at 281; and exposure to point-of-sale marketing and displays is linked to "increased smoking susceptibility, experimentation, and uptake among children." Paynter & Edwards, *Impact of Tobacco Promotion at the Point of Sale*, 11 Nicotine & Tobacco Research at 31. The Court should not withdraw from having its corrective statements communicated to the same consumers at these same retail points of sale. Any burden placed on retailers "must be balanced against the harm . . . from narrowing the injunction." *Cook*, 333 F.3d at 744. To "narrow[] the injunction" by eliminating the Court's corrective statements from the retail environment would harm "innocent persons," *id.*, far more than placing even an unrelieved financial burden upon retailers. In any event, as discussed below, that financial burden should be shifted to Defendants.

It should be noted that the financial burden, even if it was borne solely by retailers, would be far less than Defendants have suggested—approximately 0.4% of their cigarette sales *revenue,* and less than $5 million in lost *profits* across the entire industry per year. According to the NACS affidavit that Defendants filed in 2006 , each square foot of countertop space is worth $82 million of lost revenue per year across the industry. 8/30/2006 Lyle Beckwith Decl. ¶ 10 (filed as Defs.' Mot. to Stay Final J. & Remedial Order Pending Appeal, Ex. 10 (R. 5746; filed 9/1/2006)). Because the Court's countertop displays will be 30" x 18", or 3.75 square feet, the lost *revenue* per year would be $307.5 million across the industry as a whole. Accepting the NACS affidavit's figure of 140,000 convenience stores across the country, 8/30/2006 Beckwith Decl. ¶ 3, these industry-wide lost revenues would average a bit less than $2,200 in lost revenue per store each year. The most recent data from NACS shows average convenience-store revenues from cigarette sales of approximately $575,000 per year. Ctr. for Tobacco Policy & Organizing, *Cigarettes Generate Big Revenue for Convenience Stores* (citing 2009 data from the Association for Convenience & Petroleum Retailing (NACS) as showing average sales of cigarettes per store of $576,354). Dividing the lost revenue figure by the annual revenue figure yields 0.38%. Thus, even if the full burden were left on retailers' shoulders, retailers who participate in Defendants' retail programs would lose less than 0.4% of their revenue from selling cigarettes.

The size of the financial burden is even smaller when considering retailers' potential lost profits. The food and drug-store industry operates on very tight profit margins—1.5% in 2008. *Top Industries: Most Profitable*, Forbes, May 4, 2009, *available at* http://money.cnn.com/magazines/fortune/fortune500/2009/performers/industries/profits/. The lost *profits* due to losing 3.75 square feet of countertop space would thus be approximately 1.5% of the industry-wide lost revenues, calculated above as $307.5 million/year. This works out to less than $5 million of lost *profits* per year, industry-wide.

Even though NACS's figures indicate that the financial burden would be less than 0.4% of retailers' revenue from selling cigarettes, and less than $5 million in profits per year, the Court should not leave that burden on retailers' shoulders. RICO violators should be made to bear the costs of preventing and restraining violations. Thus the Second Circuit held that where a corrupt union official was found liable for RICO violations, and it was necessary to impose a monitor on the union to prevent and restrain future violations, the union official personally should be ordered to contribute to the monitor's costs, because "[f]orcing the Local to bear the entire remaining cost of the monitorship would plainly have an impact on the amount and/or utilization of the dues paid by individual union members." *United States v. Sasso*, 215 F.3d 283, 292 (2d Cir. 2000). Thus in this case, to whatever extent the Court finds that its order would impose wrongful hardships on retailers, Defendants should pay for them.

CONCLUSION

For the reasons addressed above, the United States respectfully urges the Court to retain the retail-display component of the corrective-statement remedy.

Dated: April 1, 2011
Washington, D.C.

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___/s/______________________________

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, **Plaintiff,** **v.** **PHILIP MORRIS USA INC.,** **f/k/a PHILIP MORRIS INC., et al.,** **Defendants.**	**Civil No. 99-CV-02496 (GK)** **Next scheduled court appearance: None**

EXHIBITS IN SUPPORT OF THE UNITED STATES' OPENING BRIEF ON RETAIL POINT OF SALE

Exhibit	Description
1	Philip Morris USA Inc., "Retail Leaders Program 2010 Agreement: Plan Groups I, H, and X" (Bates Nos. 9510000036/0072)
2	R.J. Reynolds, "Retail Partners Marketing Plan Contract: 2010 Amended Pack Outlet Plan"
3	2010 Lorillard Tobacco Company Excel Merchandising Plan Description—Excel Plan: E-1 Category C
4	2010 Lorillard Tobacco Company Excel Merchandising Plan Description—Excel Plan: E-2 Category C
5	2010 Lorillard Excel Merchandising Agreement
6	2010 Lorillard Tobacco Company Non-Excel Merchandising Agreement