No. 15-1299

IN THE

Supreme Court of the United States

PHILIP MORRIS, USA, INC., R.J. REYNOLDS TOBACCO, CO., ET AL.,

Petitioners,

v.

COMMONWEALTH OF PENNSYLVANIA, BY KATHLEEN G. KANE, IN HER OFFICIAL CAPACITY AS ATTORNEY GENERAL OF THE COMMONWEALTH OF PENNSYLVANIA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COMMONWEALTH COURT OF PENNSYLVANIA

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Federal Arbitration Act prohibits contracting parties from agreeing that judicial review of an arbitration award in state court shall be governed by state-law standards?

2. Whether the court below, applying the state-law equivalent of the federal-law standard announced in *Oxford Health Plans LLC v. Sutter*, erred in finding that the arbitrators' decision in this case was not derived from the essence of the contract?

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STATEMENT OF THE CASE

1. In 1997, respondent, the Commonwealth of Pennsylvania, filed a complaint against petitioners alleging, *inter alia*, that they had engaged in a conspiracy to conceal and misrepresent the harmful nature of cigarettes. The suit sought compensatory damages (and other relief) to recompense the increase in the Commonwealth's Medicaid payments caused by the health effects of petitioners' products. Other states brought similar suits. Pet. App. 59a-60a.

In 1998, the Commonwealth and 51 other states and territories (together, the "Settling States") settled their claims against petitioners by executing the Master Settlement Agreement ("MSA"). Pet. App. 4a; *see also* Master Settlement Agreement, https://www.attorneygeneral.gov/uploadedFiles/MainSite/Content/Consumers/Tobacco/msa.pdf (last visited June 21, 2016).

Under the MSA, petitioners agreed to abide by a number of rules aimed at decreasing smoking rates. They also contracted to make annual payments to the Settling States in perpetuity. Under the MSA, the Commonwealth had a contract right to a payment of approximately $370,000,000 for fiscal year 2003, subject to limited potential adjustments specified in the MSA. Pet. App. 61a.

The MSA enumerates an exclusive limited set of circumstances under which a Settling State's annual payment may be reduced. At issue here is the Non-Participating Manufacturers' Adjustment ("NPM Adjustment"), which the parties negotiated to address

petitioners' concern that the MSA potentially placed them at a competitive disadvantage vis-à-vis other companies who declined to participate in the settlement. Pet. App. 6a. Pursuant to § IX(d) of the MSA, if the independent auditor concludes that the petitioners experienced a market share loss attributable to the MSA, those companies are entitled to seek a reduction in the annual payment—the NPM Adjustment. Unless the exclusive exception set forth in § IX(d)(2) applies, the NPM Adjustment for a particular year is borne by *all* of the Settling States according to their respective allocable shares. Pet. App. 209a-215a.

Pursuant to MSA § IX(d)(2), a state may avoid its share of the NPM Adjustment only if it affirmatively proves that it "diligently enforced" a "Qualifying Statute." Pet. App. 214a-219a*; see also* Pet. App. 44a-45a, 48a. If a state proves its diligence, the amount of the NPM Adjustment that would otherwise have reduced its annual payment is "reallocated among all [non-diligent] Settling States pro rata in proportion to their respective Allocable Shares." MSA § IX(d)(2)(C) (Pet. App. 215a). A state that fails to prove its diligence (and does not have its diligence conceded by the other parties to the MSA), on the other hand, has its annual payment reduced by the amount of both (1) its own allocable share of the total NPM Adjustment, and (2) an additional amount consisting of its share of liability shifted from the states that are found diligent.

The Commonwealth Court and Court of Common Pleas both referred to a state's own Allocable Share of the NPM Adjustment amount as the "First Tier" of

the NPM Adjustment, and the amount that is reallocated from other states that proved their diligence as the "Second Tier" of the NPM Adjustment. Pet App. 6-7, 50, 64, 128. Importantly, in no circumstance does the MSA provide that a state's Second Tier amount can shift to a nondiligent state without also shifting the First Tier amount.

If a party to the MSA wants to enter into a side agreement with another party varying their respective rights, it may do so, but only if it does not affect any nonsignatory to the side agreement. MSA § XVIII(j) prohibits amendment unless it is "by a written instrument executed by all . . . Settling States affected by the amendment." *See* Respondents' Supplemental Appendix to this Opposition ("Supp. App.") 3a.

2. After the independent auditor determined that petitioners suffered a market share loss in 2003, disputes arose regarding the diligence of various Settling States. Pet. App. 7a. The disputes proceeded to arbitration under MSA § XI(c), which requires arbitration of all disputes regarding adjustments to the annual payment. Pet. App. 227a.

After eight diligence arbitration hearings were held, but before any diligence determinations were made, petitioners reached a settlement with 19 of the Settling States—17 of which had been involved in contested diligence proceedings. The terms of the settlement are set forth in a "Term Sheet," dated November 14, 2012. Pet. App. 69a. Each of the 19 states that initially signed the Term Sheet and three additional states that joined later (together, "Term

Sheet States"), agreed to a reduction of its annual payment in an amount equal to 46% of its allocable share of the NPM Adjustment for the years 2003 through 2012. Pet. App. 70a.

Shortly after informing the arbitration panel of the Term Sheet, petitioners and the Term Sheet States filed a proposed "Stipulated Partial Award." The Non-Term Sheet States objected, but after briefing and two hearings, the panel issued its Partial Settlement and Award ("Partial Settlement Award"). Under the Partial Settlement Award, the "Independent Auditor" (the entity under the MSA that calculates payments to the states) is to reduce the total dollar amount of the 2003 NPM Adjustment "by a percentage equal to the aggregate Allocable Shares of the [Term Sheet] States." Pet. App. 144a. That means that none of the Term Sheet States' First Tier NPM Adjustment responsibility is to be shifted to any state that has not joined the Term Sheet; rather, it is simply extinguished as part of the settlement.

The Partial Settlement Award, however, treats the Term Sheet States' Second Tier NPM Adjustment responsibility completely differently, even though that, too, had been extinguished as part of the settlement. It directs the Independent Auditor to treat all of the Term Sheet States as "not subject to the 2003 NPM Adjustment for the purposes" of performing the reallocation calculation. Pet. App. 144a. In plain language, that means that a large part of the Second Tier NPM Adjustment payment responsibility of the Term Sheet States was to be shifted onto the other states even though there was

never any agreement, concession or finding that any of the Term Sheet States were diligent. And such a reallocation was not even provided for, or agreed to, by the parties signing the Term Sheet, let alone the states that were not party to the Term Sheet.

Diligence hearings for the Non-Term Sheet States resumed after the panel issued the Partial Settlement Award. The panel issued its Final Award on September 11, 2013, finding nine states to be diligent and finding the Commonwealth and five other Settling States nondiligent, and hence subject to the NPM Adjustment. Pet. App. 12a,73a.

Once the panel made its diligence determinations for the Non-Term Sheet States, the full effect of its Partial Settlement Award became clear. Twenty-six states proved their diligence or had their diligence conceded by the parties to the MSA. Those 26 states, therefore, won the right under the MSA to avoid a reduction of their 2003 annual payment. The allocable share of those 26 states that needed to be "reallocated" as part of the other states' NPM Adjustment totaled $528 million. Pet. App. 39a-40a.

A second set of 26 states did not prove their diligence in 2003—the 20 contested Term Sheet States that were relieved of the responsibility of proving their diligence by the Term Sheet and the six states that attempted to prove their diligence but failed. In accord with the MSA's plain terms, the $528 million should have been reallocated as part of each of the 26 states' NPM Adjustment. If that had happened, the amount the Commonwealth would

have received under the terms of the MSA would have been reduced by $116,457,190.73. Pet. App. 19a, 86a.

Under the Partial Settlement Award, however, whatever should have been reallocated to the Term Sheet States before the settlement was instead to be shifted onto the six nondiligent states. Thus, instead of splitting the $528 million between 26 states, that amount was reallocated to only six states, including the Commonwealth. Pet. App. 144a. This meant that the Commonwealth's payment was to be reduced an additional $125,852,472.81, for a total reduction of $242,309,663.54. As Pennsylvania's base 2003 annual payment was $369,807,760.89, the arbitration panel's ruling threatened to lower the payment to only $127,498,097.35. Pet. App. 86a-89a.

3. The Commonwealth filed two motions in the Court of Common Pleas—one to modify or vacate in part the Panel's Partial Settlement Award, and the other to vacate the Panel's Final Award finding the Commonwealth non-diligent in 2003. After extensive briefing and a lengthy hearing, the court granted the motion to modify the Partial Settlement Award and denied the motion to vacate the Final Award. Pet. App. 59a-128a.

As for the Partial Settlement Award, the court held that the panel's reallocation method "is not rationally derived" from the MSA, and "is contrary to the plain language of the MSA." Pet. App. 122a. The court further held that the panel's decision "violate[d] section XVIII(j) of the MSA, which prohibits amendments to the MSA that are not signed by all Settling States 'affected' by such amendment." Pet.

App. 122a-126a. The court explained that the panel ruling could not be brushed off as "procedural." Rather, it was a "dramatic [substantive] deviation from the terms of the contract." Pet. App. 126a.

4. Petitioners appealed to the Commonwealth Court. The Commonwealth Court, sitting en banc, unanimously affirmed. Pet. App. 1a-58a. After laying out the facts, the Commonwealth Court analyzed the various standards of review available. It began with § 10 of the Federal Arbitration Act ("FAA"), which, under this Court's precedent, directs a reviewing court to determine whether the award draws its "*essence from the contract*," Pet. App. 22a, 25a-27a (*citing Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064, 2068 (2013)) (emphasis added by the Commonwealth Court). Under this "essence test," a court examines whether the award can be "rationally derived" from the agreement. Pet. App. 25a. The court explained that as long as the arbitrator is arguably construing the contract, a court may not correct mistakes, no matter how "good, bad or ugly" they may be. Pet. App. 26a (*quoting Oxford Health*, 133 S. Ct. at 2070-71). Quoting *Oxford Health*, the Commonwealth Court noted that a court may vacate or modify an award only if it is not "draw[ing] its essence from the contract," and "simply reflect[s] [the arbitrator's] own notions of economic justice." Pet. App. 27a (quoting *Oxford Health*, 133 S. Ct. at 2070-71).

The Commonwealth Court then examined the Pennsylvania Uniform Arbitration Act ("UAA") standard of review found in 42 Pa. Stat. and Cons. Stat. Ann. § 7302(d)(2), which governs whenever

"[t]he Commonwealth government submits a controversy to arbitration." Pet. App. 28a. Although § 7302(d)(2) instructs courts to review arbitration awards under the familiar J.N.O.V. standard, the Commonwealth Court explained that "[t]he Courts of this Commonwealth consistently hold that the J.N.O.V. standard of review is the same as the [*Oxford Health*] essence test." Pet. App. 28a. The Commonwealth Court noted that the "essence test" would also apply under the statutory arbitration standard in § 7314 (for arbitration awards governed by statutory arbitration not involving the Commonwealth). Pet. App. 32a.

The Commonwealth Court then held that, under the terms of the MSA itself, the contracting parties had agreed that state-law standards of review — here, embodied in § 7302(d)(2) — would apply in state court. The court explained that although the MSA calls for the "arbitration itself [to] be conducted in accordance with the FAA, [MSA] Sections II(p), VII(a), and XVIII(n) dictate it is the law of the [relevant] Settling State that provides the standards of review for post-arbitration proceedings in state court." Pet. App. 34a. "Thus," the court concluded, "the parties indicated their choice to apply state enforcement mechanisms as opposed to those found within the FAA." Pet. App. 34a.

Alternatively, the court held that even if the parties had not specifically agreed to state review and had designated FAA review instead, "[t]he FAA standards of review do not apply to a state trial court's review over an arbitration award" under Pennsylvania law. Pet. App. 34a (quoting *Trombetta*

v. Raymond James Fin. Servs., Inc., 907 A.2d 550, 569 (Pa. Super. Ct. 2006). And the Commonwealth Court cited federal and state Supreme Court cases expressly stating that the FAA does not preempt state-law review standards. Pet. App. 34a-35a.

The Commonwealth Court made clear, however, that "[a]lthough the parties spend a great deal of effort advocating the various standards of review, it makes little difference in this case." Pet. App. 37a. The court explained:

> [B]oth the FAA standard and the UAA statutory standard require "essence test" review derived from federal decisional law. *Oxford Health* ... Under either standard, the award may be vacated if the arbitrator's interpretation cannot be rationally derived from the contract.

Pet. App. 37a.

The court then affirmed the trial court's holding that, because the Award "deviates from the MSA's express terms and disregards the intent of the parties regarding how the reallocation would be shared, … the award does not draw its essence from the agreement." Pet. App. 54a. The court explained:

> Although the panel had jurisdiction over the dispute, it was not authorized to disregard MSA language or fashion a new remedy based on its own notions of economic justice. That is not what the parties bargained for. Rather, the parties bargained for the panel's

> construction of the MSA itself, i.e., a rational interpretation of the contract language. The panel was obliged to apply the MSA as written without imposing additional terms that modify or limit what the parties expressed.

Pet. App. 53a (citations omitted); *see also id*. at 50a ("By fashioning its own formula not derived from the terms of the MSA, the panel again exceeded the scope of its authority").

Moreover, the Commonwealth Court agreed with the Court of Common Pleas that "the panel departed from the MSA's clear terms and 'amended' the MSA without agreement of 'all' parties 'affected by the amendment,'" which the MSA requires for all amendments. Pet. App. 49a; *see also* Pet. App. 48a; Supp. App. 3a.

5. Petitioners thereafter sought review by the Pennsylvania Supreme Court. On December 23, 2015, the Pennsylvania Supreme Court, without dissent, issued a per curiam order denying petitioners' Petition for Allowance of Appeal. Pet. App. 129a-132a.

Petitioners then petitioned to this Court for a writ of certiorari.

REASONS TO DENY CERTIORARI

While the restoration of $125 million to help pay for cancer research and medical care was an important victory for the citizens of the Commonwealth, this case presents no significant

issue of legal importance regarding the clash of state and federal law. Rather, all this case presents is a dispute over a state court's interpretation of a contract under state law and a question of how the *Oxford Health* "essence test" applies to the facts of this case. Neither of these issues merits the Court's review.

Petitioners suggest that review should be granted to determine whether state law may compel the application of state, rather than federal, standards to judicial review of arbitral awards in state court. But the primary basis of the Commonwealth Court's opinion is that the parties themselves agreed in the MSA to review in state court under state standards of review. This finding is a simple matter of contract interpretation—a fact-specific question of state law that is not appropriate for this Court's review.

Moreover, the question of which standard of judicial review applies is, in this case, academic. As the Commonwealth Court held, Pennsylvania law mirrors the federal standard: both require application of the "essence test" derived from this Court's labor arbitration jurisprudence. Whether the Pennsylvania courts correctly applied that standard in this case — and it is clear that they did — is a fact-bound issue that does not warrant review by this Court.

The petition should be denied.

I. Neither The Commonwealth Court's Contract Interpretation, Nor The Court's Preemption Analysis, Merit This Court's Review

A. The Commonwealth Court's contract interpretation raises a fact-specific, state-law issue inappropriate for this Court's review.

Petitioners repeatedly assert that review here is necessary to resolve the "grave" question whether states may require review of all arbitration awards under standards of review set by state law. *See* Pet. 2 (decision below "allows states … to undermine FAA-governed arbitration agreements by *mandating* more stringent judicial review of arbitration awards than the FAA authorizes") (emphasis added); Pet. 14 ("States … would be allowed to undermine FAA-governed arbitration agreements by *mandating* merits-based judicial review that goes beyond the … judicial review permitted by the FAA") (emphasis added); Pet. 19 (the Court in *Hall Street* "in no way suggested that *a State may compel* parties to submit to expanded review despite the FAA") (emphasis in original).

This argument ignores that the Commonwealth Court's ruling that state law governs the standard of review was premised in the first instance on an express finding that the parties here *agreed* in the MSA to judicial review in state court, under state-law standards of review. *See* Pet. App. 34a ("the parties [to the MSA] indicated *their choice* to apply state enforcement mechanisms as opposed to those found within the FAA") (emphasis added). Petitioners,

remarkably, do not even mention this key holding in their statement of the case. *See* Pet. 9-11. Indeed, they do not mention it at all until page 30 of their 33-page petition, when they attempt to brush it aside as both "immaterial" to whether this Court should grant review and "erroneous." It is neither.

Whether the Commonwealth Court correctly interpreted the contract "is ordinarily a question of state law, which this Court does not sit to review." *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 474 (1989); *DIRECTV, Inc. v. Imburgia*, 136 S. Ct. 463, 468 (2015). Rather, the question for the Court is simply "whether, assuming the [MSA] meant what [the Commonwealth Court] found it to mean, [that provision of the MSA] is nevertheless pre-empted by the FAA." *Volt*, 489 U.S. at 476. This Court's precedent is clear that if parties agree upon a controlling legal standard—as the parties did here—that standard governs irrespective of the FAA.

The Commonwealth Court's determination of the parties' intent through the MSA's terms to have state law apply upon review in state court, then, can hardly be "immaterial." Pet. 30. Congress intended the FAA to "place[] arbitration agreements on equal footing with all other contracts," *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006), and so, "as with any other contract, the parties' intentions control," *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985). Thus, in *Hall Street Assos. LLC v. Mattel, Inc.*, 552 U.S. 576, 590 (2008), this Court ruled that parties "may contemplate enforcement under state statutory or

common law . . . where judicial review of different scope is arguable." And most recently, in *Imburgia, Inc. v.* 136 S. Ct. at 468, this Court held that the FAA "allows parties to an arbitration contract considerable latitude to choose what law governs some or all of its provisions."[1]

As the Court said in *Volt*,

> the federal policy is simply to ensure the enforceability, *according to their terms*, of private agreements to arbitrate. Interpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration—rules which are manifestly designed to encourage resort to the arbitral process—simply does not offend … any … policy embodied in the FAA

Id., 489 U.S. at 476 (emphasis added). The FAA thus exists to give effect to the contract rights of parties who negotiate arbitration agreements, and nothing in this Court's cases suggests that parties' right to

[1] Because *Imburgia* supports honoring the parties' contractual adoption of state-law standards of review, petitioners' suggestion of a remand in light of that case is nothing short of bizarre. Moreover, unlike in *Imburgia,* there is no hostility to the FAA or arbitration evinced by the Commonwealth Court here, given its embrace of the *Oxford Health* standard of review. Finally, had petitioners thought that *Imburgia* was relevant to the disposition of the present case, they could have sent it as a supplemental authority to the Pennsylvania Supreme Court. It speaks volumes that they did not do so.

bargain for enforcement of arbitral awards under state standards of review is curtailed by FAA.

And while the interpretation of a state-law contract by a state court is not a proper matter for this Court's consideration, the Commonwealth Court's reading of this contract was far from "erroneous." The Commonwealth Court's opinion gives effect to the express terms of the MSA, which provide for review in state court, governed by state law. Petitioners erroneously focus on one clause of the MSA: § XI(c), which provides that "[t]he arbitration shall be governed by the United States Federal Arbitration Act." As this Court has cautioned, however, in construing an agreement containing an arbitration clause, the "important inquiry [is] the meaning of [all] provisions taken together." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 59 (1995). Here, the Commonwealth Court properly held that, when viewed as a whole, the provisions of the MSA make clear that § XI(c) is limited to the arbitration itself and does not speak to the law that will apply in state court on review. As to that question, the Commonwealth Court found that the MSA has clear terms that specify that state law will control in the review afforded in state court.

In so interpreting the contract, the Commonwealth Court cited sections II(p) and VII(a) of the MSA, *see* Supp. App. 1a, 2a, which grant "exclusive jurisdiction" over enforcement of the MSA to "the respective court in each Settling State." With respect to these state-court proceedings, the Commonwealth Court explained that the contract, in § XVIII(n), *see* Supp. App. 4a, dictates that they "shall

be governed by the laws of the relevant Settling State, without regard to the conflict of law rules of such Settling State." Considering all of these provisions, the Commonwealth Court correctly determined that the MSA clearly evidences "the parties['] . . . choice to apply state enforcement mechanisms as opposed to those found within the FAA." Pet. App. 34a.

Thus, the Court's reading of the contract's choice of law provision is both well founded and dispositive to the question that petitioners wish to raise here regarding what law should apply on review in state court.

B. The Commonwealth Court was correct that, even had the parties not expressly agreed to have state law apply, in this context, state law would govern the standard of review applied in state court.

For the reasons discussed above, the Commonwealth Court's holding that the MSA itself requires application of state standards of review is both correct and independently sufficient to support its decision to look to state-law standards of review. This holding is strictly a matter of contract interpretation under state law that is inappropriate for this Court's review. We note, however, that the Commonwealth Court was also fully correct in holding in the alternative that, even in the absence of the parties' contractual agreement to apply state law, state law would apply in the state court review of the arbitration award in this context.

Section 7302(d)(2) of the UAA applies to *all* arbitration involving the Commonwealth and requires that whenever the "Commonwealth government submits a controversy to arbitration," a state

> court in reviewing an arbitration award pursuant to this subchapter *shall* . . . modify or correct the award where the award is contrary to law and is such that had it been a verdict of a jury the court would have entered a different judgment or a judgment notwithstanding the verdict.

42 Pa. Stat. and Cons. Stat. Ann. § 7302(d) (emphasis added). The statute "provide[s] a legislative mandate for reviewing an arbitration panel's alleged errors of law" that state courts are not free to ignore. *Trombetta v. Raymond James Fin. Servs., Inc.*, 907 A.2d 550, 571 (Pa. Super. Ct. 2006). While here the parties' choice of state law by agreement obviates this issue, nothing in the FAA preempts or bars a state court's compliance with this mandate.

By its express terms, the FAA's standard of review applies only to federal courts. *See* 9 U.S.C. § 10 (limiting application to cases in "the United States court in and for the district wherein the award was made" (emphasis added)); *id.* § 11 (similar); *see also Volt*, 489 U.S. at 477 n.6 ("[W]e have never held that §§ 3 and 4, which by their terms appear to apply only to proceedings in federal court, . . . are nonetheless applicable in state court."); *Trombetta*, 907 A.2d at 568-69 (applying *Volt*, noting that § 10 "appear[s] to apply only to proceedings in federal court").

Moreover, the FAA "contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." *Volt*, 489 U.S. at 477. While the FAA sets forth "a *substantive* rule . . . to foreclose state legislative attempts to undercut the enforceability of arbitration agreements," *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) (emphasis added), "[t]here is no federal policy favoring arbitration under a certain set of *procedural* rules," *Volt*, 489 U.S. at 476 (emphasis added). Because Pennsylvania's post-arbitration procedural mechanisms have no bearing on the FAA's substantive rules governing the arbitration itself, the Commonwealth Court correctly held that the "FAA standard speaks only to actions in federal court and does not preempt state law in state court actions." Pet. App. 24a.

And there is no risk here that the state standard might frustrate the objectives underlying the FAA given the parties' choice of state law, and, as we discuss below, *see infra* Section II, the Commonwealth Court's construction of the applicable state-law standard to embody the same standard and limitations on review as articulated by this Court in *Oxford Health* in regard to the FAA.

C. There is no conflict requiring this Court's review and this case would not provide a suitable vehicle for resolving the alleged conflict.

Petitioners assert that six state courts of last resort have held FAA § 10 applicable to state court review of arbitral awards. This case, however, does

not present a suitable vehicle for addressing any alleged conflict between state and federal law because the parties expressly elected state standards of review, *see supra* Section I.A, and because the Commonwealth Court applied the *Oxford Health* standard, which petitioners agree governs under the FAA, *see infra* Section II.

Moreover, none of the cases petitioners rely upon to evidence an alleged split are relevant here. To our knowledge, no court has disagreed with Commonwealth Court's primary holding in this case. No case –certainly, no case cited by petitioners – holds that the FAA overrides the agreement of the parties as to judicial-review standards to apply in state court. No case, that is, holds that FAA standards apply in state court even where the parties have agreed otherwise.[2]

Indeed, in four of the cases petitioners cite, the parties did not even dispute the appropriate standard of review; the courts in those cases simply noted the unremarkable principle that the FAA generally

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[2] All of the cases petitioners cite involve arbitration disputes between private parties pursuant to contracts that differ significantly from the MSA. This case, by contrast, involves arbitration with a sovereign state, which is not subject to any litigation or arbitration except by its consent and only on terms to which it expressly agrees. *See Monaco v. Mississippi*, 292 U.S. 313, 329 (1934). As the Commonwealth Court held, the Commonwealth never consented to the FAA's standard of review, and instead insisted upon explicit terms providing for judicial review in state court governed by state law. Pet. App. 24a. Thus, there is no authority to impose a different standard on the sovereign state.

governs arbitration of disputes involving interstate commerce and perfunctorily applied the FAA's standard of review. In *U.S. Electronics., Inc. v. Sirius Satellite Radio, Inc.*, 958 N.E.2d 891, 892 (N.Y. 2011), for instance, the parties presented no argument regarding the judicial standard of review, and in *Hilton Constr. Co. v. Martin Mech. Contractors, Inc.*, 303 S.E.2d 119, 120 (Ga. 1983), "[b]oth sides . . . insisted that [the court] construe and apply Section 10." And by the time the question reached the South Dakota Supreme Court in *Vold v. Broin & Associates, Inc.*, the plaintiff had abandoned its argument that state law governed review of the arbitral award. Brief for Appellee at 12, *Vold v. Broin & Assocs.*, 699 N.W.2d 482 (S.D. 2005) (No. 23464), 2005 WL 1900771, *12. As the issue was effectively conceded, the court applied the FAA standard of review without discussion or analysis. *Vold*, 699 N.W.2d at 487. Similarly, the Nebraska Supreme Court in *Dowd v. First Omaha Sec. Corp.*, 495 N.W.2d 36, 42 (Neb. 1993), simply applied the FAA standard of review based on its determination that federal law controlled the arbitration itself, again without any separate analysis regarding the appropriate standard.

Two other of petitioner's cases—*Birmingham News Co. v. Horn*, 901 So.2d 27, 46 (Ala. 2004) and *Hecla Min. Co. v. Bunker Hill Co.*, 617 P.2d 861, 868 n.3 (Idaho 1980)—did reject arguments for the application of state-law standards and instead applied § 10 of the FAA.[3] *See Birmingham News*, at

[3] Petitioners also attempt to manufacture a split using two state-court opinions interpreting the MSA. In *State v. Philip*

43-48; *Hecla*, at 865. But in neither of those cases did the court find that the parties *agreed* to the use of state-law standards; in fact, both were decided before this Court made clear in *Hall Street* that parties "may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable." 552 U.S. at 590; *see also Imburgia*, 136 S. Ct. at 468. And, as here, the standard of review was not dispositive in *Hecla*, as the Idaho Supreme Court found that the state and federal standards are "so similar as to constitute a distinction without a difference." *Hecla*, 617 P.2d at 868 n.3.

Thus, there is no split on this issue warranting review, and this case is a wholly unsuitable vehicle for addressing the claimed split.

Morris, Inc., 123 A.3d 660, 679 (Md. Ct. Spec. App. 2015), a Maryland court reached the same conclusion as the Commonwealth Court did here, but an intermediate Missouri court in *State v. Am. Tobacco Co.*, No. ED 101542, 2015 WL 5576135 (Mo. Ct. App. Sept. 22, 2015), *appeal transferred to Mo. S. Ct.*, No. SC95422, reached a contrary conclusion. Both of these cases, however, like the present case, are state-court interpretations of a contract that do not merit this Court's review. Moreover, the MSA, by providing for individual state review as a bargained-for term, contemplated potentially different interpretations from different state courts.

II. Since In This Case The State Standard Of Judicial Review Is Identical To That In The FAA, The Question Of Which Standard Controls Is Academic And Does Not Warrant Review By The Court.

If, as we discussed above, the parties to a contract are free to decide for themselves what standard controls review of an arbitral award in state court — if, as the Court suggested in *Imburgia*, they "might choose to have portions of their contract governed by the law of Tibet [or] the law of pre-revolutionary Russia," *id.*, 136 S. Ct. at 468 — then it makes no difference whether the standard of review the parties choose mirrors the FAA standard. But even if the parties are not free to depart from the FAA standard, this case would be a wholly inappropriate vehicle for resolving that question because in this case the state standard chosen by the parties does in fact mirror the FAA standard.

A. The Pennsylvania standard of review is the same as the "essence test" derived from *Oxford Health*.

Although the Commonwealth Court held that, pursuant to the parties' agreement, state law controls the standard of review in this case, it also held that the state standard closely mirrors the FAA standard, and that the result in this case would be *the same* under either.

The Commonwealth Court reiterated numerous times that both Pennsylvania law and the FAA required application of the same "essence test." *See,*

e.g., Pet. App. 36a ("the FAA standard and the UAA statutory standard both require an arbitration award be upheld if the award draws its essence from the contract"); Pet. App. 37a ("both the FAA standard and the UAA statutory standard require 'essence test' review derived from federal decisional law"); Pet. App. 37a-38a ("Under either the FAA or the UAA's statutory provisions, the award may be modified or vacated under the essence test … if the award is not rationally derived from the agreement."). The Court expressly held that the result would be the same under state or federal law because "under *any* standard of review … the panel exceeded its powers by acting beyond the material terms of the MSA, from which its authority was derived." Pet. App. 54a (emphasis added); *see also* Pet. App. 37a ("Although the parties spend a great deal of effort advocating the various standards of review, it makes little difference in this case."); Pet. App. 44a ("Under any standard of review, the trial court properly modified the Partial Settlement Award because the panel exceeded its authority under the MSA.").

Thus, the question whether state or federal law controls is wholly academic here—as the Commonwealth Court quoted, cited, and applied the standard that petitioners agree is controlling, *i.e.*, the standard articulated by this Court in *Oxford Health*. Indeed, a decision by this Court in favor of either the federal or state standard would have zero impact on this case and would therefore be merely advisory. *See Herb v. Pitcairn*, 324 U.S. 117, 126 (1945) ("[O]ur power is to correct wrong judgments, not to revise opinions. We are not permitted to render an advisory opinion, and if the same judgment would be rendered

by the state court after we corrected its views of federal laws, our review could amount to nothing more than an advisory opinion.").

B. The Commonwealth Court correctly applied the "essence" test.

What we are left with, then, is petitioners' contention that, in reviewing the arbitral award in this case, the courts below misapplied the *Oxford Health* "essence" test and thereby reached an incorrect result. *See* Pet. 21-29. That fact-bound contention, however, does not present a significant question of law meriting the Court's discretionary review. *See, e.g., United States v. Johnston*, 268 U.S. 220, 227 (1925) ("We do not grant a certiorari to review evidence and discuss specific facts"). Nor, in any event, are petitioners correct, as we now briefly discuss.

In reviewing the award, Commonwealth Court acknowledged that "an arbitration award that even arguably construes or applies the contract must stand, regardless of a court's view of its merits," and, quoting *Oxford Health*, began its analysis by stating that "[s]o long as the arbitrator was arguably construing the contract, a court may not correct his mistakes, however good, bad, or ugly they may be." Pet. App. 26a (*quoting Oxford Health*, 133 S. Ct. at 2070–2071) (internal alterations omitted). Commonwealth Court clearly understood and properly characterized the *Oxford Health* limited exception that permits vacatur or modification only in the rare case where the decision wholly deviates from the contract such that the award cannot be "rationally

derived" from the essence of the agreement. Pet. App. 25a. Adhering to the *Oxford Health* standard, the Court explained that a court may vacate or modify an award only if it is not drawn "on the essence of the contract," and instead "simply reflects [the arbitrator's] own notions of economic justice." Pet. App. 27a (*quoting Oxford Health*, 133 S. Ct. at 2070-71).

In applying this standard, Commonwealth Court properly recognized that the arbitration panel had dramatically deviated from the terms of the MSA. When the NPM Adjustment applies to a given year's MSA Payment, every state's annual MSA Payment will be potentially subject to a reduction. Section IX(d)(2)(B)-(C) of the MSA provides the exclusive mechanism by which a state can avoid the NPM Adjustment and shift its share to the other states: by proving that it "diligently enforced" its Qualifying Statute.

Because the 20 contested Term Sheet States never proved their diligence, neither those Term Sheet States, nor petitioners that settled with them, had any right under the MSA to shift any share of those states' potential NPM Adjustment onto the Commonwealth. Section XVIII(j) of the MSA provides that the MSA can be amended only by agreement of "all" parties "affected by the amendment," and "[t]he terms of any such amendment shall not be enforceable in any Settling State that is not a signatory to such amendment." In essence, this provision is a "fail safe" which protects every party from side agreements between some parties, such as the Term Sheet, being used to modify the terms

between all parties. Petitioners and the Term Sheet States understood that, and therefore did not place any language in the Term Sheet itself purporting to shift those shares onto the states that refused to sign the Term Sheet. As counsel for petitioners explained at the hearing before the arbitration panel: "Oh, yes, the term sheet is silent on how to do this intentionally because we didn't want to be accused of amending the MSA[.]" Commonwealth Court Supp. Record. at 151, *Commonwealth of Pennsylvania v. Philip Morris USA, Inc.et al.*, Nos. 803 C.D. 2014 & 804 C.D. 2014 (Pa. Commw. Ct. Apr. 10, 2014).

The arbitration panel likewise had no power to alter the agreement and force, without their consent, non-Term Sheet States to bear the Second Tier NPM Adjustment responsibility of the 20 contested Term Sheet States. As the Court of Common Pleas held:

> While the [petitioners] were free to settle with the [Term Sheet] States as to the amounts of their annual payments, these parties could not do so in a way that "affected" the rights of Pennsylvania. In entering the Partial Settlement Award, the Panel should have done so in a way that would not even potentially implicate the rights of the other Settling States as it was beyond the authority of the Panel to enter the Partial Settlement Award in a way that affected the rights of any other Settling State without that Settling State's consent.

Pet. App. 123a.

Petitioners try to excuse the panel's deviation from the MSA under doctrines of damages allocation among jointly and severally liable defendants. But, as the Commonwealth Court understood, this is not a tort or breach of contract case:

> Judgment reduction doctrines are applicable to tort or breach of contract cases where each defendant is jointly and severally liable for the entirety of the damages. This is not a tort action, and there was no breach of contract. Moreover, the Settling States are not jointly and severally liable for any "damages." In fact, there is no liability, rather only a right to a contracted payment and agreed-upon rules for when that payment may be reduced. Unlike in tort or breach of contract cases, there is no "liability" for the "whole" NPM Adjustment as the potential NPM Adjustment reduction is capped at the amount of the Settling State's Allocated Payment for that year. The panel's application of the pro rata judgment reduction was not drawn from the essence of the MSA, and it went well beyond the scope of the panel's authority under the MSA.

Pet. App. 41a.

The contract here provides all of the relevant answers. Only states that prove their diligence may shift their NPM Adjustment amount to non-diligent states, (MSA § IX(d)(2)(B)), and then they must shift all of that amount, not some arbitrary portion of it, (MSA § IX(d)(2)(C)). And when other states do not

prove their diligence and instead decide to enter into a side agreement with petitioners, that side agreement cannot "affect[]" the Commonwealth, (MSA § XVIII(j)), Supp. App. 3a.

Nothing in the MSA grants arbitrators power to disturb the carefully bargained-for rights and responsibilities of the Settling States or to independently amend the MSA to shift one state's share of its NPM Adjustment responsibilities onto another without its consent. In bestowing such power upon themselves in contravention of the express terms of the MSA, the arbitration panel exceeded its powers, issuing an award that "simply reflects [their] own notions of economic justice rather than drawing its essence from the contract." *Oxford Health*, 133 S. Ct. at 2068; *accord United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 38 (1987). ("[T]he arbitrator's award . . . must draw its essence from the contract and cannot simply reflect the arbitrator's own notions of industrial justice.")

Thus, the Commonwealth Court's ruling is correct, breaks no new ground, creates no conflict with federal law or any decision of this Court, and does not warrant review by this Court.

CONCLUSION

For the foregoing reasons, the petition should be denied.

Respectfully submitted,

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RESPONDENT'S SUPPLEMENTAL APPENDIX

Excerpts from the Master Settlement Agreement

Full Master Settlement Agreement can be found at https://www.attorneygeneral.gov/uploadedFiles/MainSite/Content/Consumers/Tobacco/msa.pdf

EXCERPT FROM MSA SECTION II

(p) "Court" means the respective court in each Settling State to which this Agreement and the Consent Decree are presented for approval and/or entry as to that Settling State.

EXCERPT FROM MSA SECTION VII

(a) Jurisdiction. Each Participating Manufacturer and each Settling State acknowledge that the Court: (1) has jurisdiction over the subject matter of the action identified in Exhibit D in such Settling State and over each Participating Manufacturer; (2) shall retain exclusive jurisdiction for the purposes of implementing and enforcing this Agreement and the Consent Decree as to such Settling State; and (3) except as provided in subsections IX(d), XL(c), and XVII(d) and Exhibit O, shall be the only court to which disputes under this Agreement or the Consent Decree are presented as to such Settling State. Provided, however, that notwithstanding the foregoing, the Escrow Court (as defined in the Escrow Agreement) shall have exclusive jurisdiction, as provided in section 15 of the Escrow Agreement, over any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, the Escrow Agreement.

EXCERPT FROM MSA SECTION XVIII

(j) Amendment and Waiver. This Agreement may be amended by a written instrument executed by all Participating Manufacturers affected by the amendment and by all Settling States affected by the amendment. The terms of any such amendment shall not be enforceable in any Settling State that is not a signatory to such amendment. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving party or parties. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, nor shall such waiver be deemed to be or construed as a waiver by any other party.

EXCERPT FROM MSA SECTION XVIII

(n) Governing Law. This Agreement (other than the Escrow Agreement) shall be governed by the laws of the relevant Settling State, without regard to the conflict of law rules of such Settling State. The Escrow Agreement shall be governed by the laws of the State in which the Escrow Court is located, without regard to the conflict of law rules of such State.