UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA Plaintiff v. PHILIP MORRIS USA, INC., *et al.*, Defendants.	Civil Action No: 99-2496 (GK) Next scheduled court appearance: NONE

NATIONAL ASSOCATION OF CONVENIENCE STORES' REPLY MEMORANDUM CONCERNING ORDER #1015'S POINT OF SALE DISPLAY REQUIREMENTS

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INTRODUCTION

Both the Government and Public Health Intervenors misunderstand and mischaracterize both the serious burdens placed upon retailers by the point-of-sale display requirements contained in Order #1015 (the Order) and the D.C. Circuit's mandate regarding the Order. First, the Government and Intervenors demonstrate a misunderstanding of the business purpose and unique value of the point-of-sale space; second, the Government and Intervenors brush over the constitutional issues presented in this case and mistakenly assert that these issues can be side-stepped through cost-shifting or mediation; third, the Government and Intervenors confuse the constitutional takings clause issues presented in the case; and fourth, the Government and Intervenors ignore the due process and First Amendment infirmities of the point-of-sale display requirement.

I. THE GOVERNMENT AND PUBLIC HEALTH INTERVENORS CONTINUE TO MISUNDERSTAND THE BUSINESS PURPOSE OF POINT-OF-SALE SPACE

A. Retail countertop space is used for the sale of high-margin consumer items; advertising does not displace sales

The Government and Intervenors continue to demonstrate a lack of familiarity with the basic business model under which retailers operate. Accordingly, they make assertions regarding the economic value and business purpose of point-of-sale retail space that are simply not true. *See, e.g.*, United States' Opening Supplemental Brief on Retail Point of Sale ("Government Supp. Br.") at 2; Public Health Intervenors' Supplemental Brief Regarding Corrective Statements at Point-of-Sale ("Intervenors' Supp. Br.") at 6 (stating that retailers' contracts with tobacco company Defendants "allow Defendants to communicate their messages to consumers at the point-of-sale").

Intervenors ignore the critical information provided by retailers in response to the Court's Order. In affidavits submitted in support of NACS' briefs, retailers have made it clear that *they*

do not and would not agree to contracts with tobacco manufacturers that would require them to place advertisements on countertops at the point of sale. Robert Richardson of E-Z Mart informed this Court that "[t]obacco manufacturers have never asked us to include provisions in the contracts requiring us to place signs at the point of sale in E-Z Mart stores . . . . If asked, E-Z Mart would refuse to allow tobacco signage at the point of sale in its stores because that is the most valuable retail space in the stores." Richardson Aff., Ex. C to NACS Supp. Br., ¶¶ 11, 13. Matthew Paduano of Nice N Easy Grocery Shoppes informed this Court that "Nice N Easy does not and would not agree to contracts with manufacturers requiring the company to place signs at the point of sale." Paduano Aff., Ex. C to NACS Supp. Br., ¶ 16.

As NACS has pointed out at length in its previous submission, countertop space at the point-of-sale is unique and constitutes the most valuable retail space in convenience stores. Beckwith Aff., Ex. A to NACS Supp. Br., ¶ 9.[1] The fact that Defendants' contracts with retailers allow Defendants to place signage in other, less valuable parts of the store is irrelevant when considering the propriety of placing advertising messages at the point of sale. *See* Government's Supp. Br. at 6-7; *cf.* Broviak Aff., Ex. B to NACS Supp. Br., ¶ 9 (identifying "the designated spaces in the store in which tobacco signs are allowed" as "the 'sign zone'"). While the Government correctly points out that retailers often rely upon Defendants to provide signage in their stores, the Government ignores the fact that such signs are carefully limited to particular designated areas. *See* Broviak Aff., Ex. B to NACS Supp. Br., ¶ 10 ("The sign zone is typically

[1] It should be noted that NACS' Supplemental Brief included a mathematical error made by NACS counsel. Lyle Beckwith in his affidavit provided an updated estimate of convenience store industry losses of sales due to the use of just a single square foot of countertop space as $201.4 million per year. Counsel attempted to divide this figure by the number of stores in the industry and came up with the mistaken figure of $667 per square foot. NACS Supp. Br. at 7. But with just over 151,000 stores in the industry, the loss of one square foot of retail space is actually $1,333 per year. This error did not appear in Mr. Beckwith's affidavit and was simply a mathematical mistake by counsel.

above or to the side of cigarette fixtures on the back wall behind the sales counter. Some stores also have signs facing out the front window.").

The Government's and Intervenors' failure to recognize the only information submitted to the Court on these issues underscores the serious due process problems presented in this case. Since retailers have never been parties to this case, this Court made its findings of fact without considering any facts or arguments from retailers regarding the unique value and purpose of the point-of-sale space. The Government's and Intervenors' dismissal of the facts presented by individual retailers in support of NACS' briefing only reinforces the principle that retailers cannot legitimately be bound by an Order that "fail[ed] to consider the rights" – or even the basic factual assertions – of retailers. *See United States v. Philip Morris USA, Inc.*, 566 F.3d 1095, 1141 (D.C. Cir. 2009).[2]

B. Analogies between communications media and retail point-of-sale space are not appropriate

In attempting to minimize the impact that the point-of-sale display requirements will have on retailers, Intervenors attempt to equate retailers' point-of-sale counter space with the advertising sections of various media outlets with whom Defendants have been ordered to publish corrective statements. *See* Intervenors' Supp. Br. at 13. This analogy is misguided and brushes over the concerns that retailers have.

[2] In its recently filed supplemental brief, the Government demonstrates its lack of regard for the rights of innocent third party retailers. In a footnote, the Government casually suggests that retailers should be required to post "exterior displays to reach gasoline customers (and passengers in their vehicles) who do not enter Participating Retailers' stores." Government Supp. Br. at 5 n.13. There is no support offered for this suggestion. The Government does not even consider the fact that many retailers derive substantial revenue from existing exterior signs, that they face a number of different regulatory and local law restrictions on the set-up and use of exterior space, and that any court order requiring retailers to display particular exterior signs would raise constitutional issues just like those presented by the point-of-sale display requirements of the Order. Exterior signs were never part of the Order, and it is puzzling that the Government is suggesting them for the very first time at this stage of the case.

First, retail point-of-sale is not "simply a communication vehicle." *See id.* In contrast to media outlets such as newspapers, the primary purpose of a convenience store is not to promulgate information or serve as a vehicle for advertising; the primary purpose of a convenience store is to sell merchandise. Second, in contrast to most print media, third-party advertising is *not* the primary revenue stream of a convenience store; sales of merchandise form the primary revenue stream of a convenience store. While retailers often agree to allow the use of promotional material within the confines of the store, such promotional material is typically authorized at least in part because it promotes merchandise that retailers have for sale. *See, e.g.*, Paduano Aff., Ex. D to NACS Supp. Br., ¶¶ 5-8.

C. Retailers make significant capital investments in their stores

The Government demonstrates its lack of familiarity with the retail industry once again by asserting that "becoming a Participating Retailer requires no capital or other investment." Government Supp. Br. at 11. This unsupported assertion ignores the fact that many retailers have made substantial investments in building the very stores in which advertising is to be displayed, while other retailers have purchased or leased their retail space. Such investment decisions were undoubtedly made with the expectation that the notoriously thin margins for operating a retail store would be covered in part by the sale of high-margin "impulse" items at the point of sale. *See, e.g.*, Broviak Aff., Ex. B to NACS Supp. Br., ¶¶ 14-16 (stating that "the profits generated by impulse items displayed on counters are extremely important to Ricker's profitability").

II. THE GOVERNMENT AND INTERVENORS CONTINUE TO MISUNDERSTAND THE SIGNIFICANCE OF THE ORDER

A. The Order provides no mechanism by which costs could be "shifted" to Defendants

Contrary to the statements of the Government and Intervenors, the costs of the Order cannot be "shifted" to Defendants in any feasible way. *See* Government Supp. Br. at 10; Intervenors' Supp. Br. at 9. The Order does not provide any mechanism by which such costs could be identified and shifted. Even if it were feasible to design an accounting method under which costs could be shifted to Defendants, it would be nearly impossible to craft a meaningful reimbursement mechanism while the Order is in effect – because the Order itself strips retailers of all bargaining power.

Under the express terms of the Order, all of the major tobacco manufacturers will be required to include corrective statement displays at retail point-of-sale in every contract they enter into with a retailer. Individual retailers cannot demand compensation for including such provisions because without them the contracts cannot exist under the Order. No manufacturer would pay extra to bargain for a contractual term required by the Court.

B. The Order's constitutional infirmities are not mere "implementation issues" that can be resolved by a Special Master

Both the Government and Intervenors assert that any problems with the point-of-sale display requirement as it now stands can be solved by the expert involvement of the Special Master. *See* Government Supp. Br. at 4-5, 16; Intervenors' Supp. Br. at 1 ("With regard to implementation issues . . . the Court should direct the parties to resolve those matters in a referral to the Special Master on an expeditious timetable.").

This suggestion is misplaced. NACS stands by its previous representations that the practical challenges of implementing the point-of-sale displays are substantial and will not be easily surmounted. *See* National Association of Convenience Stores' Submission Concerning Order #1015's Point of Sale Display Requirements (May 15, 2011) at 13-14. Even if those issues were addressed, however, the due process, takings and speech issues raised here are not

mere "implementation issues" that can be resolved with mediation or the direction of a Special Master. Rather, they are violations of retailers' constitutional rights. They cannot be resolved through mediation between the parties to this case.

Mediation, and any resulting injunction, could only bind parties to this case. Retailers have never been parties to this case and could not be bound through mediation. *See* Fed. R. Civ. P. 65(d)(2); NACS Supp. Br. at 9. This conclusion would not change even if NACS were invited to participate alongside the parties in mediation sessions. NACS is a trade association that advocates for the interests of the industry as a whole, but it does not have the authority to legally bind its individual member businesses, let alone the many thousands of retailers who are not currently NACS members.

III. THE GOVERNMENT AND INTERVENORS MISSTATE THE TAKINGS CLAUSE ISSUES PRESENTED IN THIS CASE

A. The Government and Intervenors consider only the issue of contractual rights, while the D.C. Circuit focused upon retailers' more fundamental right to determine how their own stores are used

In responding to retailers' description of the harm that would be caused by enforcement of the point-of-sale display requirements, both the Government and Intervenors focus their attention almost entirely upon retailers' contracts with tobacco manufacturers. *See* Government Supp. Br. at 6-8; Intervenors' Supp. Br. at 6-7. By focusing their attention solely upon the terms of existing contracts between retailers and tobacco manufacturers, the Government and Intervenors bypass the more fundamental property interest asserted by retailers – their right to make use of valuable retail countertop space.

In fact, the *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982), case relied upon by the Government demonstrates the merits of NACS' argument. In *Loretto*, the Court found a physical taking occurred based on a regulation that allowed cable equipment to

occupy only 1 ½ cubic feet of space on the exterior of apartment buildings. This was a taking even though the property owner could avoid the requirement by ceasing to rent to tenants. *Id*. at 439 n.17. That is analogous to the situation here – except that the space to be taken by signs based on the Order is far more important and valuable space. And, retailers can only avoid it by ending contracts which provide important revenue to their businesses, much like ceasing to rent to tenants. The fact that this taking may be limited to two years[3] does not change the fact that the Order presents a taking that is, if anything, more onerous than that at issue in *Loretto*.

In addition, the Government misunderstands retailers' contractual rights. The Government claims that retailers do not "have any current contractual or property right *wholly* to prevent Defendants from placing corrective statements in their stores today." Government Supp. Br. at 6. In fact, retailers do have such rights. Signs under the contracts retailers have today are limited to advertising and promotional material designed to increase sales in stores. And, such signs are limited to designated areas in the stores. Broviak Aff., Ex. B to NACS Supp. Br., ¶¶ 9-10. The corrective statements required by the Order do not fit either the substantive or location limitations built into these contracts and violate retailers' contractual rights.

B. The "judicial takings" issue is a red herring

In its supplemental brief, the Government asserts that a takings clause claim may not lie in this case because the doctrine of "judicial takings" has not been firmly established. *See* Government Supp. Br. at 5-7 (discussing *Stop the Beach Renourishment, Inc. v. Fla. Dep't of Envtl. Prot.*, 560 U.S. 702 (2010)).

[3] Intervenors have previously "proposed[d] that each Defendant now be required to individually post the displays for two years, after which the obligation would rotate for the following two years to the next Defendant on the list." Public Health Intervenors' Opening Brief Regarding Corrective Statements in Point-of-Sale Displays (Apr. 1, 2011) at 14. Under such a proposal, some retailers would be required to post mandated point-of-sale displays for a period of time lasting much longer than two years.

This Court need not wade into the history of judicial takings jurisprudence because the state action at issue in this case is not merely that of the court but also of the Department of Justice – the plaintiff in this action that has requested the Order at issue in this case. The Department simply cannot hide its request for, and repeated arguments in favor of, the Order behind the notion that the Court has a free hand to take private property (which it does not). The Order in this case is a taking by both the Department and the Court, and must be analyzed in the same way that all other takings claims are analyzed – which is consistent with the principle laid out by the plurality in *Stop the Beach Renourishment. See* 560 U.S. at 713.[4]

C. Knowledge of the Order does not excuse an unconstitutional taking

While this issue has now been before this Court for several years, the Government overreaches when it asserts that "it has been a salient fact of economic life for Participating Retailers that Defendants' Retail Programs might eventually require them to disseminate the corrective statements." Government Supp. Br. at 11 (citing *Chang v. United States*, 859 F.2d 893, 897 (Fed. Cir. 1988)). That is a remarkable claim given that in 2009 the D.C. Circuit vacated the Order regarding retail point-of-sale display requirements. *Philip Morris*, 566 F.3d at 1142. If the takings clause of the Constitution is to be given any meaningful application, it cannot be circumvented by pointing out that some retailers might have predicted that their property was going to be taken. Even if they had known—and the D.C. Circuit's ruling more than cast doubt on that assertion—such knowledge does not diminish retailers' rights.[5]

[4] It is worth noting that this case is entirely different on the facts from *Stop the Beach Renourishment*. This case does not simply involve an "easement," "contingent interest," or a property interest defined by statute which was the situation in that case. 560 U.S. at 708, 712, 733 n.12. Retail countertop space is purely private property (and the most valuable space in convenience stores). Beckwith Aff., Ex. A to NACS Supp. Br., ¶ 9.

[5] The Government's reliance on *Chang* is inapposite because that case rested on the idea that "the government's actions only prevented the plaintiffs from marketing their services in

IV. THE GOVERNMENT AND INTERVENORS CONTINUE TO IGNORE THE CONSTITUTIONAL ISSUES PRESENTED BY THE POINT-OF-SALE DISPLAY REQUIREMENT

A. The point-of-sale display requirement constitutes compelled speech

The facts are that retailers do not agree with the messages in the signs mandated by the Order. The examples of food labels and other packaging disclosures are inapposite. The Order does not compel disclosures of the type considered by the Supreme Court in *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio*, 471 U.S. 626 (1985), that the Government relies upon. That case involved disclosures that were required to ensure the advertisement in question in that case was not deceptive. *Id*. at 651. The statements required by the Order in this case were designed to remedy past misleading speech by Defendants. That past speech was not retailers' speech and goes beyond factual disclosures like nutritional information on food products. Retailers object to being required speakers who correct Defendants' past statements[6] and, under the First Amendment, they cannot be compelled to do so.

B. The point-of-sale display requirement violates the due process rights of retailers

In its Supplemental Brief, NACS explained the reasons why the point-of-sale display requirement violates the due process rights of retailers. *See* NACS Supp. Br. at 9-11. Notwithstanding the D.C. Circuit's mandate, the Government has not shown how the point-of-sale display requirement can be rewritten in a way that "make[s] due provisions for the rights of innocent persons," i.e., retailers. *See United States v. Philip Morris USA, Inc.*, 566 F.3d 1095, 1141 (D.C. Cir. 2009) (per curiam) (citation and internal quotation marks omitted).

Libya, and their complaint contains no allegation that they were blocked from marketing their services elsewhere." 859 F.2d at 896 (citation omitted).

[6] *See* Broviak Aff., Ex. B to NACS Supp. Br., ¶ 26; Richardson Aff., Ex. C to NACS Supp. Br., ¶ 19; Paduano Aff., Ex. D to NACS Opening Br., ¶ 19.

The Government's Supplemental Brief underscores the extent to which the Government remains willing to punish innocent third parties in its zeal to punish Defendants. The Government states that "the character of the government action is 'to reveal the previously hidden truth about the products and correct Defendants' campaign of deceptive marketing in an attempt to prevent and restrain future RICO violations.'" Government Supp. Br. at 11 (quoting *United States v. Philip Morris USA, Inc.*, 907 F. Supp. 2d 1, 20 (D.D.C. 2012)). The fact that the government action burdens innocent third-party retailers is not even discussed.

While NACS appreciates the opportunity to submit briefing in this case as a non-party, such briefing cannot cure the obvious due process problems inherent in the Order. To date, there have been no evidentiary hearings held to assess the impact of the Order upon retailers. Moreover, NACS cannot purport to bind the 390,000 retailers across the country who have never been joined as parties to the case and have never had the opportunity to participate in this litigation to protect their fundamental property rights.

CONCLUSION

For the foregoing reasons, NACS respectfully urges this Court to abandon the point of sale message requirements of Order #1015.

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Respectfully submitted,

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