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POLICY RECOMMENDATIONS FOR THE 108TH CONGRESS

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16. Tobacco and the Rule of Law

Congress should

- deny funding for the Justice Department's racketeering suit against cigarette makers,
- enact legislation to abrogate the multistate tobacco settlement, and
- reject proposed legislation to regulate cigarette manufacturing and advertising.

Introduction

Ten months after tobacco companies and 46 state attorneys general settled their differences for a quarter of a trillion dollars, the U.S. Department of Justice decided that it wanted a share of the plunder. DOJ's complaint alleged that cigarette companies had been conspiring since the 1950s to defraud the American public and conceal information about the effects of smoking. Specifically, the government contended that industry executives knowingly made false and misleading statements about whether smoking causes disease and whether nicotine is addictive.

On the one hand, DOJ promoted its novel lawsuit against cigarette makers. On the other hand, the same watchdog agency stood idly by while tobacco companies and state attorneys general teamed up to violate the antitrust laws. The multistate tobacco settlement, a cunning and deceitful bargain between the industry and the states, allows the tobacco giants to monopolize cigarette sales and foist the cost onto smokers.

Congress can take affirmative steps to counteract those abuses of executive power: first, by denying funds for DOJ's ongoing lawsuit and, second, by enacting legislation that abrogates the multistate tobacco settlement.

At the same time, Congress should reject any attempt to regulate cigarette advertising or the content of tobacco products.

Deny Funding for DOJ's Racketeering Suit against Cigarette Makers

In its litigation against the tobacco industry, the federal government demanded billions of dollars to pay for health care expenditures—mostly Medicare outlays—related to smoking. DOJ's legal theory was modeled after the states' lawsuits, which were designed to replenish depleted Medicaid coffers. Like the states, the federal government argued that it could sue tobacco companies without stepping into the shoes of each smoker. That way, so the theory goes, DOJ would not be subject to the ''assumption-of-risk'' defense that had been a consistent winner for the industry over four decades of litigation.

As you would expect, government officials understood the assumption-of-risk principle perfectly well. Indeed, former veterans affairs secretary Jesse Brown invoked it when the government itself was threatened with liability for having provided soldiers with cigarettes over many years. It would be ''borderline absurdity'' to pay for ''veterans' personal choice to engage in conduct damaging to their health,'' he said. ''If you choose to smoke, you are responsible for the consequences.''

Evidently that principle applied only if the defendant was a government agency. When private companies were sued, DOJ asserted that it could recover from the tobacco industry merely because smoking injured someone covered by Medicare—even if that person, having voluntarily assumed the risk of smoking, could not recover on his own. The same tobacco company selling the same cigarettes to the same smoker, resulting in the same injury, would be liable only if the smoker was a Medicare recipient and the government was the plaintiff. Otherwise, the assumption-of-risk defense would apply. Liability hinged on the injured party's Medicare status, a happenstance unrelated to any misconduct by the industry.

The federal government also wanted the court to ignore the traditional tort law requirement that causation be demonstrated on a smoker-by-smoker basis. Instead, DOJ wanted to adduce only aggregate statistics, indicating a higher incidence of certain diseases among smokers than among nonsmokers. For example, statistics showed that smokers are more likely than nonsmokers to suffer burn injuries. So tobacco companies would have to pay for many careless persons who fell asleep with a lit cigarette. Similarly, the industry would have to shell out for persons who

had heart attacks and other ''smoking-related'' diseases but who never smoked. Without individualized corroborating evidence, aggregate statistics might suggest liability. Only common sense would dictate otherwise.

To reinforce and supplement its bizarre tort theories, DOJ relied on three statutes: the Medical Care Recovery Act, the Medicare Secondary Payer Act, and the civil provisions of the Racketeer Influenced and Corrupt Organizations Act. Federal judge Gladys Kessler dismissed both the MCRA and MSPA claims out of hand. She allowed the RICO claim to go forward, although she expressed some reservations about the government's ability to prove damages.

Nowadays, RICO is used as a standard bullying tactic by plaintiffs' attorneys, even though the act was supposed to be invoked against organized crime. This time, however, DOJ had to deal with an embarrassing admission, tucked away in the final sentence of the press release that announced its lawsuit: ''There are no pending Criminal Division investigations of the tobacco industry.''

Two dozen prosecutors and FBI agents had conducted a five-year, multi-million-dollar inquiry during which they dissected allegations and plowed through documents for evidence that tobacco executives perjured themselves and manipulated nicotine levels. Whistleblowers and company scientists testified before grand juries. The outcome: not a single indictment of a tobacco company or industry executive.

Nonetheless, then–attorney general Janet Reno somehow conjured up a RICO claim that accused the industry of the very same infractions for which grand juries could not find probable cause. Here's just one example, count number three: In November 1959, the industry ''did knowingly cause a press release to be sent and delivered by the U.S. mails to newspapers and news outlets. This press release contained statements attacking an article written by then–U.S. Surgeon General Leroy Burney about the hazards of smoking.'' There you have it—racketeering, in all its sordid detail.

Clinton administration insiders knew that the charges were trumped up. Former Clinton aide Rahm Emanuel put it this way: ''If the White House hadn't asked, [Reno] would never have looked at it again.'' So it's politics, not law, that's driving this litigation. The American public needs to know that our tort system is rapidly becoming a tool for extortion. Sometimes opportunistic politicians seek money; sometimes they pursue policy goals; often they abuse their power. When Clinton was unable to persuade Congress to enact another tax on smokers, he simply bypassed the legislature and asked a federal court to impose damages in lieu of taxes. Evidently,

anything goes—and the rule of law goes out the window. But Congress can do better. Call off the government's anti-tobacco crusade. Put an immediate stop to DOJ's power grab by denying funds to continue its lawsuit.

Enact Legislation to Abrogate the Multistate Tobacco Settlement

While DOJ presses its campaign to extort money from hapless tobacco companies, the Antitrust Division looks the other way as those same companies, in collaboration with state attorneys general, commit what is arguably the most egregious antitrust violation of our generation—a collusive tobacco settlement that is bilking 45 million smokers out of a quarter of a trillion dollars.

The Master Settlement Agreement, signed in November 1998 by the major tobacco companies and 46 state attorneys general, transforms a competitive industry into a cartel, then guards against destabilization of the cartel by erecting barriers to entry that preserve the dominant market share of the tobacco giants. Far from being victims, the big four tobacco companies are at the very center of the plot. They managed to carve out a protected market for themselves—at the expense of smokers and tobacco companies that did not sign the agreement.

To be sure, the industry would have preferred that the settlement had not been necessary. But given the perverse legal rules under which the state Medicaid recovery suits were unfolding, the major tobacco companies were effectively bludgeoned into negotiating with the states and the trial lawyers. Finding itself in that perilous position, the industry shrewdly bargained for something pretty close to a sweetheart deal.

The MSA forces all tobacco companies—even new companies and companies that were not part of the settlement—to pay ''damages,'' thus foreclosing meaningful price competition. Essentially, the tobacco giants have purchased (at virtually no cost to themselves) the ability to exclude competitors. The deal works like this: Philip Morris, Reynolds, Lorillard, and Brown & Williamson knew they would have to raise prices substantially to cover their MSA obligations. Accordingly, they were concerned that smaller domestic manufacturers, importers, and new tobacco companies that didn't sign the agreement would gain market share by underpricing cigarettes. To guard against that likelihood, the big four and their state collaborators added three provisions to the MSA:

First, if the aggregate market share of the four majors were to decline by more than two percentage points, then their ''damages'' payments

would decline by three times the excess over the two-percentage-point threshold. Any reduction would be charged against only those states that did not adopt a ''Qualifying Statute,'' attached as an exhibit to the MSA. Naturally, because of the risk of losing enormous sums of money, all of the states have enacted the statute.

Second, the Qualifying Statute requires all tobacco companies that did not sign the MSA to post pro rata damages—based on cigarette sales—in escrow for 25 years to offset any liability that might hereafter be assessed! That's right—no evidence, no trial, no verdict, no injury, just damages. That was the stick. Then came the carrot.

Third, if a nonsettling tobacco company agreed to participate in the MSA, the Qualifying Statute would not apply. In fact, the new participant would be allowed to increase its market share by 25 percent of its 1997 level. Bear in mind that no nonsettling company in 1997 had more than 1 percent of the market, which, under the MSA, could grow to a whopping 1.25 percent. Essentially, the dominant companies guaranteed themselves virtually all of the market in perpetuity.

Perhaps as troubling, the settlement has led to massive and continuing shifts of wealth from millions of smokers to concentrated pockets of the bar. Predictably, part of that multi-billion-dollar booty has started its roundtrip back into the political process—to influence state legislators, judges, attorneys general, governors, city mayors, maybe some federal officials. With all that money in hand, trial lawyers have seen their political influence grow exponentially. Every day that passes more firmly entrenches the MSA as a fait accompli, and more tightly cements the insidious relationship between trial attorneys and their allies in the public sector. The billion-dollar spigot must be turned off before its corrupting effect on the rule of law is irreversible.

An obvious way to turn off the spigot is to abrogate the MSA. If it is allowed to stand, the MSA will create and finance a rich and powerful industry of lawyers who know how to manipulate the system and are not averse to violating the antitrust laws. Congress should dismantle the MSA to restore competition. That's a tall order, but the stakes are immense.

Reject Proposed Legislation to Regulate Cigarette Manufacturing and Advertising

Under legislation introduced in June 2002 by Sens. Edward Kennedy (D-Mass.), Mike DeWine (R-Ohio), and Richard Durbin (D-Ill.), the Food and Drug Administration would be authorized to regulate cigarette ads and

ingredients, including nicotine—or to ban nicotine altogether. Lamentably, Philip Morris—the industry leader with the most to gain from restrictions on would-be competitors—quickly chimed in to support many of the proposals. Yet, if tobacco is to be regulated as a drug, Congress will simply be guaranteeing a pervasive black market in tobacco products. FDA regulation that makes cigarettes taste like tree bark, coupled with higher prices, will inevitably foment illegal dealings dominated by criminal gangs hooking underage smokers on an adulterated product freed of all the constraints on quality that competitive markets usually afford.

The war on cigarettes, like other crusades, may have been well-intentioned at the beginning; but as zealotry takes hold, the regulations become foolish and ultimately destructive. Consider the current attempt to control tobacco advertising. Not only are the public policy implications harmful, but there are obvious First Amendment violations that should concern every American who values free expression. Our Constitution protects Klan speech, flag burning, and gangsta rap, which, by the way, directly targets teenagers. But if Tiger Woods showed up in an ad for Camel cigarettes, the anti-tobacco crowd would bring the boot of government down hard on the neck of R.J. Reynolds.

Industry critics point to the impact of tobacco ads on uninformed and innocent teenagers. But the debate is not about whether teens smoke; they do. It's not about whether smoking is bad for them; it is. The real question is whether tobacco advertising can be linked to increases in aggregate consumption. There's no evidence for that link. The primary purpose of cigarette ads, like automobile ads, is to persuade consumers to switch from one manufacturer to another. Six European countries that banned all tobacco ads have seen overall sales *increase*—probably because health risks are no longer documented in the banned ads.

In 1983, the Supreme Court held that government may not ''reduce the adult population . . . to reading only what is fit for children.'' Thirteen years later, the Court affirmed that even vice products like alcoholic beverages are entitled to commercial speech protection. Most recently, the Court threw out Massachusetts regulations banning selected cigar and smokeless tobacco ads. Those ads are not the problem. Kids smoke because of peer pressure, because their parents smoke, and because they are rebelling against authority.

If advertising were deregulated, newer and smaller tobacco companies would vigorously seek to carve out a bigger market share by emphasizing health claims that might bolster brand preference. In 1950, however,

the Federal Trade Commission foreclosed health claims—such as ''less smoker's cough''—as well as tar and nicotine comparisons for *existing* brands. To get around that prohibition, aggressive companies created *new* brands, which they supported with an avalanche of health claims. Filter cigarettes grew from roughly 1 percent to 10 percent of domestic sales within four years.

Then in 1954, the FTC tightened its restrictions by requiring scientific proof of health claims, even for new brands. The industry returned to promoting taste and pleasure; aggregate sales expanded. By 1957, scientists had confirmed the benefit of low-tar cigarettes. A new campaign of ''Tar Derby'' ads quickly emerged, and tar and nicotine levels collapsed 40 percent in two years. To shut down the flow of health claims, the FTC next demanded that they be accompanied by epidemiological evidence, of which none existed. The commission then negotiated a ''voluntary'' ban on tar and nicotine comparisons.

Not surprisingly, the steep decline in tar and nicotine ended in 1959. Seven years later, apparently alerted to the bad news, the FTC reauthorized tar and nicotine data but continued to proscribe associated health claims. Finally, in 1970 Congress banned all radio and television ads. Overall consumption has declined slowly since that time. In today's climate, the potential gains from health-related ads are undoubtedly greater than ever—for both aggressive companies and health-conscious consumers. If, however, government regulation expands, those gains will not be realized. Instead of ''healthy'' competition for market share, we will be treated to more imagery and personal endorsements—the very ads that anti-tobacco partisans decry.

If the imperative is to reduce smoking among children, the remedy lies with state governments, not the U.S. Congress. The sale of tobacco products to youngsters is illegal in every state. Those laws need to be vigorously enforced. Retailers who violate the law must be prosecuted. Proof of age requirements are appropriate if administered objectively and reasonably. Vending machine sales should be prohibited in areas such as arcades and schools where children are the main clientele. And if a minor is caught smoking or attempting to acquire cigarettes, his parents should be notified. Parenting is, after all, primarily the responsibility of fathers and mothers, not the government.

Instead, government has expanded its war on tobacco far beyond any legitimate concern with children's health. Mired in regulations, laws, taxes, and litigation, we look to Congress to extricate us from the mess it helped

create. Yet if Congress authorizes the FDA to regulate cigarette ads and control the content of tobacco products, it will exacerbate the problem. Equally important, Congress will have delegated excessive and ill-advised legislative authority to an unelected administrative agency, and set the stage for significant intrusions on commercial free speech.

Suggested Readings

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