

Wagering War

Robert A. Levy*[†]

Cato Institute

INTRODUCTION

Professor John Warren Kindt advocates that states file ‘mega-lawsuits’ to hold the gambling industry financially liable for the ‘social and economic impact gambling has on US society (Kindt, 2001, p. 18)’. After all, asserts Kindt, ‘[p]athological gamblers tend to engage in forgery, theft, embezzlement, drug dealing, and property crimes to pay off gambling debts (p. 22)’. Moreover, he continues, ‘financial, marital, occupational, and legal problems [are] endemic to pathological gamblers,’ who also experience above-average levels of ‘depression, insomnia, migraines, intestinal disorders, anxiety attacks, high blood pressure, cardiac problems, and other stress-related medical conditions (pp. 22–23)’.

That’s quite a litany of grievances. And who better to foot the bill than the gambling industry, which somehow enticed the rubes into parting with their money then, presumably, enticed the government into paying for their depression, insomnia, migraines, you name it.

The parallels to the states’ hugely successful tobacco Medicaid recoupment suits are obvious, says Kindt (p. 35). So why not use those suits as a blueprint for a new round of plunder? Never mind that time-honored principles of tort law would be wiped out in the process. When billions of dollars in ‘damages’ are available, states should not be

deterred by quaint ideas like personal responsibility and assumption of risk.

If that sounds like a harsh indictment, consider the appalling assault on the rule of law that the tobacco litigation exemplified.

TOBACCO WARS: EXTORTION PARADING AS LAW

Three dozen states, faced with ballooning Medicaid costs, decided that litigation against the tobacco industry would be a relatively painless path to fiscal fitness. Couching their legal claims in the lofty cant of public health, they sought to recover tax-funded Medicaid expenditures for tobacco-related injuries. The states could have raised taxes on cigarettes, of course. That option would have been simpler, less expensive, and quicker; and the parties who would have paid the tax—smokers and tobacco companies—would have been the same parties that would ultimately pick up any bill for court-awarded damages. Why then were lawsuits substituted for taxation?

Here’s the principled answer—although not the real answer, as we shall see: Even though it may be more efficient to raise revenue by legislation than by litigation, the courtroom and not the legislature is where accused wrongdoers have an opportunity to defend themselves. The court is the proper forum for evidence, fact-finding, and verdict, following a trial before a jury of peers. As a just society, we cannot suffer our legislature to embark upon a punitive crusade against a disfavored industry without guaranteeing due process of law.

Unhappily, in the real world, the reason that the states opted for Medicaid recovery suits instead of tax hikes had everything to do with politics and nothing to do with due process. Both taxes and tobacco companies were immensely unpopular; so

*Correspondence to: Cato Institute, 1000 Massachusetts Avenue, N.W., Washington D.C. 20001.
E-mail: rlevy@cato.org

[†]Robert A. Levy is senior fellow in constitutional studies at the Cato Institute. This paper is drawn in substantial part from other material published by the author. See ‘Taxation Through Litigation,’ in *Politics, Taxation, and the Rule of Law: The Power to Tax in Constitutional Perspective* (Don Racheter & Richard Wagner eds., Kluwer Academic Publishers, 2002); ‘Turning Lead into Gold,’ *Legal Times*, August 23, 1999; ‘Tobacco Medicaid Litigation: Snuffing Out the Rule of Law,’ Cato Institute Policy Analysis No. 275, June 20, 1997.

the states took the politically safe course by avoiding the first and attacking the second. To effect that scheme, the states came up with a quasi tax, camouflaged as litigation damages. It was far easier to sue a baneful industry than to attach yet another users' fee to a product already bloated with government exactions. But there was one large fly in the ointment.

Until March 2001, there had not been a single final adjudication of damages against a tobacco company in more than four decades of litigation (Rabin, 1992). Industry defendants invariably prevailed, first, by disputing that tobacco was the cause of a particular person's ailment and, second, by demonstrating that the plaintiffs knowingly and voluntarily assumed the risk of smoking, in which case they were responsible for the adverse health effects.

That set the stage for some legal legerdemain—a fresh wave of litigation by state attorneys general, beginning in 1994, grounded in a new claim that gave the states more legal rights than any aggrieved cigarette smoker. Florida became the first state to codify the new claim—by amending its Medicaid Third-Party Liability Act in 1990 and 1994.¹ That statute is the one recommended by Kindt as a model for the proposed lawsuits against the gambling industry (p. 26).

In two essential respects the Florida law tilted the playing field hopelessly against the tobacco companies. The express language of the statute left little room for doubt.

- First, 'causation and damages ... may be proven by use of statistical analysis without showing any link between a particular individual's illness and his use of the defendants products'.
- Second, 'assumption of risk and all other affirmative defenses normally available to a liable third party are to be abrogated to the extent necessary to ensure full recovery by Medicaid from third-party resources'.

Before the new dispensation, the state could assert only those theories of recovery against cigarette makers that an injured patient could assert. That is, under a process called subrogation, if an insurer—like Medicaid—sues to recoup its outlays for a patient, the insurer must step into the shoes of the patient and convince a jury that the patient's claim is valid. Thus, the same rules of evidence, the same standards of responsibility, and

the same burden of proof would apply to the state Medicaid system, suing under subrogation, as to the patient if he had sued on his own behalf. A tobacco company that would not have been liable in a direct suit by a smoker, would not be liable in a similar suit by a state standing in the smoker's shoes.

That principle of law was cavalierly dismissed to pick the deep pockets of the tobacco industry. Not surprisingly, when self-interested politicians determine the legal regime under which a few friendless corporations will be fleeced, there is great potential for mischief. As of early June 1997, 35 states² and several cities had filed Medicaid recovery suits against the industry. Each state raised much the same claims that the Florida case raised, but only in Vermont and Maryland was there, like in Florida, a supporting statute. The other states and cities argued that judges, as a matter of fairness and equity, should adopt legal rules corresponding to those in Florida, even without a law similar to that state's Medicaid Third-Party Liability Act.

The irony—or outrage, depending upon your perspective—is that the Medicaid recovery suits were instigated by states to recover costs that they voluntarily incurred by participating in the federal Medicaid program—costs supposedly attributable to a product that the states refused to declare illegal. As University of Chicago law professor Richard Epstein put it: 'The government can decide that it's not going to provide ... this kind of insurance ... It might even ... decide that it's going to ban tobacco ... But the one alternative that is absolutely unacceptable is ... retroactively [to] impose a system of liability which nobody dreamed of (Federalist Society, 1996).'

Liability Without Causation

Yet that is precisely what 35 states and assorted other governmental units did; they retroactively embraced a legal regime that nobody dreamed of. First, they ignored the rules of causation. In mass tort cases, statistical evidence combined with other corroborating evidence can 'supply a useful link in the process of proof (Tribe, 1971)'. But statistics alone are not enough. 'An essential element of the plaintiff's cause of action for negligence, or for that matter for any other tort, is that there be some reasonable connection between the act or omission

of the defendant and the damage which the plaintiff has suffered.’³

Florida, however, substituted its own rendition of the law of causation.

In any action brought under this subsection, the evidence code shall be liberally construed regarding the issues of causation and of aggregate damages. The issue of causation and damages in any such action may be proven by use of statistical analysis. . . . [If] the number of recipients for which medical assistance has been provided by Medicaid is so large as to cause it to be impractical to join or identify each claim, the agency shall not be required to so identify the individual recipients for which payment has been made, but rather can proceed to seek recovery based upon payments made on behalf of an entire class of recipients.⁴

In other words, under the Third-Party Liability Act, the state could sue the tobacco industry for health expenditures attributable to smoking by Medicaid recipients without disclosing (1) the names of recipients, (2) whether recipients actually smoked, or (3) whether smokers had illnesses that could be traced to tobacco use. All that had to be disclosed were aggregate statistics for Florida Medicaid recipients as a group.

That process was fundamentally flawed. If an insurance company were filing subrogation actions, each claimant would be required to disclose his medical record. Likewise, tobacco company defendants should have been able to investigate the legitimacy of each plaintiff’s claims⁵ and explore such questions as whether and how much each claimant smoked. Yet unlike any other tort action by any other plaintiff, Florida’s showing of causation did not have to be injury-specific. Instead, the state could show generalized causation based upon no more than aggregate epidemiological data—notwithstanding authoritative and near-universal acknowledgement that ‘[e]pidemiology cannot prove causation (Federal Judicial Center, 1994)’.

In fact, epidemiological studies are highly suspect whenever the relationship between two variables (say, gambling and stress-related medical problems) is complicated by ‘confounding factors’—i.e., factors that are associated with both the outcome (medical problems) and the alleged cause (gambling). Even Kindt acknowledges that ‘there appears to be some connection between the

excessive use of alcohol and/or tobacco and pathological gambling (p. 29)’. And gambling critic Ronald Reno has written that ‘about half of compulsive gamblers experience problems with alcohol and substance abuse (Reno, 1996)’. Thus, the use of alcohol, tobacco and narcotics—known causes of medical problems—is also correlated with gambling. Under those conditions, the separate effect of gambling on health is virtually impossible to isolate with confidence.

Assumption of Risk

That’s not all. To eliminate any possibility that the tobacco companies could mount a successful defense, the states abolished the assumption-of-risk doctrine, which had immunized the industry from liability for 40 years. That doctrine says: ‘If the user or consumer ... is aware of the danger, and nevertheless proceeds unreasonably to make use of the product and is injured by it, he is barred from recovery (Restatement (Second) of Torts, 1965)’.

Thus, under a traditional tort regime if a consumer knows about the risks of smoking, yet still smokes and thereby contracts a tobacco-related illness, he has no more claim against the tobacco manufacturer than would a non-smoker who suffers the same illness from another source. A state may thereafter provide no financial assistance, some assistance, or complete assistance to the victim, but the amount of assistance has no effect on the responsibility of the tobacco manufacturer to the individual or to the state (Van Alstyne, 1994).

No matter. The states simply wiped that rule off the books and, for good measure, made the new rule retroactive so that it would apply to illnesses allegedly caused by cigarettes sold decades earlier. As the president of the Maryland Senate blurted to the *Washington Post* in an unguarded moment, ‘We agreed to change tort law, which was no small feat. We changed centuries of precedent in order to assure a win in this case (Cherry, 2000)’.

Even without recourse to its usual assumption-of-risk defense, the tobacco companies thought they could rely upon an analogous defense known as ‘unclean hands’. That doctrine says simply that the plaintiff’s own fault is relevant to what if any remedy he is entitled to (Black’s Law Dictionary, 1991). In other words, if Florida engaged in activities that had the effect of exacerbating any harms attributable to tobacco, the state might not

be able to recover for those harms. Like assumption of risk, unclean hands takes into account the extent to which alleged damages may have arisen or increased as a result of the plaintiff's behavior. Also like assumption of risk, the doctrine of unclean hands is rooted in the principle that holds parties accountable for the consequences of their own conduct.

Think about that principle in the gambling context. By 1999, Kindt tells us, there were 37 states with lotteries and 28 states with casinos (p. 22). '[B]ecause the states legalized gambling, particularly casino-style gambling, during the 1980s and 1990s', it might be argued that they 'should not thereafter be allowed to benefit financially via mega-lawsuits against an industry which the states have promoted (p. 29).' Not so fast, cautions Kindt. 'The states could counter this argument by claiming that they were deceived by the gambling industry with regard to the cost/benefits of introducing gambling into state economies (p. 30).'

Yet that counter-argument is not likely to gain much traction with the states—for reasons that Kindt himself concedes. '[T]hroughout the 1990s, there was growing evidence substantiating that the socio-economic costs of legalized gambling activities... outweighed the value of the jobs and income (p. 31).' Even if the states were once deceived, any claims they might file against the gambling industry would indicate that they are now well-informed. Logically, then, the states cannot insist that pathological gambling is a continuing burden on the taxpayer unless they simultaneously announce that all state lotteries will promptly be shut down and state-sanctioned casinos will be taxed more heavily. Not likely. With 15% of casino revenues going to the host state and another 5% to local municipalities, (Kindt, p. 30), the states would not risk killing the goose that's laying the golden eggs. Judges and juries, therefore, should have no difficulty concluding that the states' hands are worse than 'unclean'. Perhaps filthy would be a more accurate characterization.

In one important respect, Kindt's broader analysis is correct: The gambling model and the tobacco model are indeed parallel. Neither tobacco nor gambling industry defendants would be able to assert their principal defenses, and states would be exempted from having to prove causation. That means a negotiated settlement is

nothing but a shakedown based on a new and repugnant rule of law: states need money; disfavored industries have money; ergo, the industry pays and the states collect.

New Litigation Model

There's more. If lawsuits against the gambling industry are patterned on the tobacco model, as Kindt has urged, the litigation formula will include three corrosive ingredients carried over from the cigarette wars.

First, coordinated actions by multiple government entities impose enormous legal fees on defendants. For that reason, multiple lawsuits will be used to extract money notwithstanding that the underlying cases are without merit. The pockets of companies involved in the gambling industry are surely no deeper than the pockets of the cigarette giants. Accordingly, coordinated litigation could bring the gambling companies to the negotiating table even sooner. Disregard that the suits are baseless. We are not dealing with law, but with extortion parading as law.

Second, the states' lawsuits against cigarette makers were concocted by a handful of private attorneys who entered into contingency fee contracts with the government. In effect, members of the private bar were hired as government subcontractors, but with a huge financial share in the outcome.

When a private lawyer subcontracts his services to the government, he bears the same responsibility as a government lawyer. He is a public servant beholden to all citizens, including the defendant, and his overriding objective is to seek justice. Imagine a state attorney paid a contingency fee for each indictment that he secures, or state troopers paid per speeding ticket. The potential for corruption is enormous. Still, the states in their tobacco suits doled out multi-billion-dollar contracts to private counsel—not per-hour fee agreements, which might occasionally be justified to acquire unique outside competence or experience, but contingency fees, a sure-fire catalyst for abuse of power. And those contracts were awarded without competitive bidding to lawyers who often bankrolled state political campaigns (Lochhead, 1996).

Government is the single entity authorized, in narrowly defined circumstances, to wield coercive power against private citizens. When that

government functions as prosecutor or plaintiff in a legal proceeding in which it also dispenses punishment, adequate safeguards against state misbehavior are essential. That is why in civil litigation we rely primarily upon private remedies with redress sought by, and for the benefit of, the injured party and not the state. As the Supreme Court cautioned more than 60 years ago, an attorney for the state 'is the representative not of an ordinary party to a controversy, but of a sovereignty whose obligation to govern impartially is as compelling as its obligation to govern at all'.⁶

Put bluntly, contingency fee contracts between government and a private attorney should be illegal. We cannot in a free society condone private lawyers enforcing public law with an incentive kicker to increase the penalties.

Third, and perhaps most important, laws are supposed to be enacted by legislatures, not by the executive or judicial branches. In too many instances, government-sponsored litigation has been a substitute for failed legislation. That process violates the principle of separation of powers—a centerpiece of the federal and many state constitutions. Evidently, none of that matters to many of the attorneys general and their allies in the private bar. In an attempt to circumvent the legislative process, they pursue through litigation what was rejected by the legislature. So much for limited government and separation of powers. We are left with the executive state. Return of the king.

LESSONS FOR THE FUTURE

There are lessons to be learned from all of this. If we do nothing to rein in baseless, state-sponsored lawsuits, private attorneys and their accomplices in the public sector will continue to invent legal theories to exact tribute from friendless industries. That outcome will likely entice government officials who are eager to avoid the political risk that attaches to higher taxes. It is far easier to swap litigation for taxation, then pay gobs of money to private contingency fee lawyers to do the dirty work. But there can be no pretense that litigation of that sort has any basis in the rule of law.

When the politicians misbehave, the courts are the final bulwark in safeguarding our rights. But voters and jurors must be warned that our tort system is rapidly becoming a tool for blackmail by a cabal of public officials and trial lawyers.

Sometimes they seek money; sometimes they pursue policy goals; often they abuse their power. Take it from former labor secretary Robert Reich, certainly not renowned for his opposition to imperious government. Reich tells us that his ex-boss in the White House, President Clinton, launched 'lawsuits to succeed where legislation failed. The strategy may work', Reich adds, 'but at the cost of making our frail democracy even weaker. . . . This is nothing short of faux legislation, which sacrifices democracy to the discretion of administration officials operating in utter secrecy (Reich, 2000).'

Reich has it just about right. But the problem outlives the Clinton White House. It infests many of the state houses and city halls. Like most infestations, this one can be fumigated. When we condone the selective and retroactive application of extraordinary legal principles, intended specifically to transfer resources from disfavored defendants to favored plaintiffs—or even worse, to the public sector—we substitute political cronyism for fundamental fairness, profane the rule of law and debase personal freedom.

NOTES

1. Fla. Stat. Ann. Section 409.910 (1995).
2. In order of filing date: Mississippi 5/94, Minnesota 8/94, West Virginia 9/94, Florida 2/95, Massachusetts 12/95, Louisiana 3/96, Texas 3/96, Maryland 5/96, Washington 6/96, Connecticut 7/96, Kansas 8/96, Arizona 8/96, Michigan 8/96, Oklahoma 8/96, New Jersey 9/96, Utah 9/96, Illinois 11/96, Iowa 11/96, New York 1/97, Hawaii 1/97, Wisconsin 2/97, Indiana 2/97, Alaska 4/97, Pennsylvania 4/97, Montana 5/97, Arkansas 5/97, Ohio 5/97, South Carolina 5/97, Missouri 5/97, New Mexico 5/97, Nevada 5/97, Vermont 5/97, New Hampshire 6/97, Colorado 6/97, Oregon 6/97. Source: State Tobacco Information Center, Internet site www.stic.neu.edu, June 11, 1997.
3. Prosser and Keeton on Torts (5th ed., 1984). Section 41, p. 263. See also *Washington v. Davis*, 426 US 229 (1976), and *Arlington Heights v. Metropolitan Housing Development Corp.*, 429 US 252 (1977), holding that statistical proof, without more, is insufficient to establish discrimination for purposes of a constitutional challenge under the Equal Protection Clause.
4. Fla. Stat. Ann. Section 409.910(9)-(9)(a) (1995).
5. According to the tobacco industry, claims-fraud is rampant in Florida's Medicaid system. See Scott Gold, 'Tobacco Industry Argues Medicaid Fraud in Florida,' *South Florida Sun-Sentinel*, May 23, 1997.
6. *Berger v. United States*, 295 US 78,88 (1935).

REFERENCES

- Black's Law Dictionary*. Abridged (6th edn.). West Publishing Co.: St. Paul, Minn. 1991. 1058.
- Cherry SR. 2000. Litigation lotto. *Insight on the News* **April 3**: 10.
- Federal Judicial Center. 1994. *Reference Manual on Scientific Evidence*. United States Government Printing Office. Washington, DC: 157.
- Federalist Society. 1996. National Conference on Civil Justice and the Litigation Process. Do the merits and the search for truth matter any more? September 12, *Transcript* 200–01.
- Kindt JW. 2001. The costs of addicted gamblers: should the states initiate mega-lawsuits similar to the tobacco cases? *Managerial and Decision Economics* **22**(1–3): 17–63.
- Lochhead C. 1996. The growing power of trial lawyers. *Weekly Standard* **September 23**: 21.
- Rabin RL. 1992. A sociolegal history of the tobacco tort litigation. *Stanford Law Review* **44**: 853; Reuters, Brown & Williamson Pays Florida Smoker \$1.1 Million.' March 8, 2001.
- Reich RB. 2000. Smoking guns. *American Prospect* **January 17**: 64.
- Reno RA. 1996. The dicemen cometh. *Police Review* **March–April**: 42
- Restatement (Second) of Torts*. 1965. American Law Institute; St. Paul, Minn. Section 402A(comment n).
- Van Alstyne WW. 1994. Denying due process in the Florida courts: a commentary on the 1994 Medicaid third-party liability act of Florida. *Florida Law Review* **46**: 563, 576.
- Tribe L. 1971. Trial by mathematics: precision and ritual in the legal process. *Harvard Law Review* **84**: 1329, 1350.