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Constitutional and Antitrust Violations of the Multistate Tobacco Settlement

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Executive Summary

The 1998 tobacco settlement is a sophisticated, white-collar crime instigated by contingency fee lawyers in pursuit of unimaginable riches. In collaboration with state attorneys general and the four leading tobacco companies, they concocted a scheme that forces all tobacco companies—even new companies and companies that didn't join the settlement—to engage in a program of price fixing and monopolization. Essentially, the major cigarette makers bought permission to fix prices and exclude competitors.

Not surprisingly, the object of the crime is money—$206 billion to the states and billions more to contingency fee lawyers. The cover for the crime is the maddening complexity of the Master Settlement Agreement, which documents the deal. The real victims are the people whom the states and their lawyers set out to protect—smokers, who get nothing out of the settlement yet must pay the entire cost.

Have the collaborators found a loophole through which to enrich themselves at the expense of politically powerless smokers? The answer is no. Put bluntly, the MSA is illegal and unconstitutional. It is an agreement among the states that, without congressional approval, is specifically prohibited by the Commerce and Compacts Clauses of the Constitution. Because the MSA exceeds the power and authority of the states, *Noerr-Pennington* and state action exemptions to the antitrust laws do not apply. The MSA thus constitutes per se antitrust violations.

States that are receiving billions of dollars from the settlement can hardly be expected to prosecute tobacco companies for antitrust infractions. Nor can the Clinton administration, which helped negotiate the MSA and is now pursuing a similar federal settlement with the industry. Fortunately, there are alternatives to public-sector enforcement. Injunctive relief and treble damage remedies are available in private lawsuits brought directly by injured parties, including smokers and nonparticipating tobacco companies. This paper lays out the legal theories in support of those actions.

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Introduction

The Master Settlement Agreement, entered into on November 17, 1998, by the major U.S. tobacco companies[1] and the attorneys general of 46 states, provides for the payment by the tobacco companies of $206 billion in "damages,"[2] plus billions more in fees to the states' private lawyers. The costs are added to the prices of the companies' tobacco products and paid by consumers as price increases. The settling tobacco companies are able to pass the costs of the settlement on to consumers because the MSA forces all other tobacco companies—even those that were not part of the settlement—to pay "damages" as well.[3] The result of the settlement is that the settling tobacco companies have purchased, with smokers' money, permission to raise prices collusively and suppress competition. In return for not enforcing the antitrust laws, the states receive a new source of revenue, which is essentially the same as a national excise tax but without the budgetary and fiscal controls applicable to taxes. The people who devised that scheme—namely, the states' contingency fee lawyers—have become multimillionaires and, in a few cases, billionaires through payment to them of "fees" (collected from smokers). The problem that lies at the root of all this—namely, sick smokers—has simply been forgotten. They receive virtually nothing of value from the settlement and are forced to pay for the whole thing.

The ostensible justification for the MSA is that the states spent money over the years for medical services provided to indigent smokers under the Medicaid laws, and the tobacco companies are claimed to owe that money to the states. The MSA is the settlement of approximately 40 state lawsuits asserting such claims. Although there are studies that indicate that the states have made more money from taxing the sales of cigarettes than they ever spent on medical services for smokers, that is not the subject of this paper. Rather, the focus of this paper is the legality of the MSA and the price-fixing mechanisms that it uses to impose and pass on to consumers the "damages" and attorneys' fee payments required from the tobacco companies.

As we shall see, the MSA involves actions by the states that exceed the powers of the states as limited by the Commerce Clause and the Compacts Clause of the Constitution. The collusive actions of the tobacco companies under the MSA are destructive of competition; they are the types of actions that constitute per se violations of the antitrust laws. Inasmuch as the states have exceeded their constitutional authority in agreeing to and implementing the MSA, neither they nor the settling tobacco companies are exempt from the antitrust laws under the state action exemption doctrine or the *Noerr-Pennington* immunity doctrine. In the absence of an exemption or immunity under one of those doctrines, the MSA violates the federal antitrust laws.

Because the states are receiving billions of dollars in "damages" pursuant to the MSA, the state attorneys general can hardly be expected to enforce the antitrust laws with respect to the agreement. And inasmuch as the White House helped negotiate the MSA and the Department of Justice is pursuing a similar type of settlement with tobacco companies, neither the Department of Justice nor the Federal Trade Commission is likely to prosecute participants in the MSA for violations of the antitrust laws. However, injunctive relief and treble damage remedies are available to the injured parties—smokers and the nonsettling tobacco companies—in private lawsuits.

A Brief History of the MSA

The MSA is the settlement of approximately 40 lawsuits commenced by various states to recover amounts expended by the states under their respective Medicaid statutes for medical services provided over the years to indigent smokers. The states' lawsuits did not claim any damages for the benefit of injured or sick smokers.

Settlement discussions between the tobacco companies and the state attorneys general began in early 1997. An initial settlement agreement (referred to as the Resolution) was announced on June 20, 1997, by Michael Moore, the attorney general of Mississippi, who had been instrumental in prosecuting Mississippi's suit against the tobacco companies and in lobbying other states to commence similar lawsuits.[4] The Resolution was a settlement agreement among the state attorneys general, their contingency fee lawyers, and the tobacco companies, as well as a proposal to Congress for legislation; and by its terms the Resolution was not effective until approved by Congress. The Resolution contained essentially the same scheme as the MSA for the collection and payment of taxlike revenues (characterized as "damages") by the tobacco companies to the states in exchange for settlement of claims and permission to raise prices collusively and exclude competitors.

Upon receipt of the Resolution in June 1997, Congress immediately began to develop amendments and alternative settlement arrangements that were substantially more onerous to the tobacco companies. The leading contender among those was the McCain bill in the Senate, which would have provided for more than $500 billion in "damages" payments in exchange for releases (broader than those of the MSA but narrower than those of the Resolution), as well as the right to pass the costs on to consumers.

The McCain bill failed to obtain approval in the Senate, and, by January 1998, both it and the Resolution had been effectively rejected by Congress.[5]

Four states—Florida, Mississippi, Texas, and Minnesota—signed separate settlement agreements with the tobacco companies shortly after Congress's rejection of the McCain bill. Those agreements are substantially similar to the MSA and served as models for the MSA. The MSA itself was signed by the tobacco companies and the attorneys general of the other 46 states on November 17, 1998. The states have not asked Congress to approve the MSA. By its terms, the MSA could not be fully implemented until courts in 80 percent of the states in number and aggregate "damages" allocations had approved it.[6]

The most significant provisions of the MSA are the prohibition of many types of advertising, the funding of studies on underage smoking, the assessment and payment of "damages," and the protection of the settling tobacco companies against competition from other existing or yet-to-be-formed tobacco companies.[7]

Anti-competitive Nature of the MSA

The purchase price is the "damages" and attorneys' fees that the settling tobacco companies agreed to pay to the states and their contingency fee lawyers.

The MSA is essentially a contract for the purchase by the tobacco companies of a license to restrain trade.[8] The purchase price is the "damages" and attorneys' fees (nearly a quarter of a trillion dollars) that the settling tobacco companies agreed to pay to the states and their contingency fee lawyers. In return, the settling tobacco companies received permission to employ collusive and coercive measures to protect their profitability and 99 percent market share of the tobacco business.[9] There are two parts to the scheme: (1) agreements among the settling tobacco companies to equalize their per-cigarette "damages" costs and protect their respective market shares from competition from each other and (2) measures to neutralize the cost disadvantages that settling tobacco companies would otherwise experience vis-à-vis nonsettling tobacco companies as a result of their agreement to pay "damages." The following is a summary of how the scheme works.

Equalizing Costs and Raising Prices

In the MSA, the settling tobacco companies allocated the obligation to pay the $206 billion "damages" among themselves on the basis of their current market shares.[10] Those "damages" constitute more than 33 percent of the wholesale price of cigarettes.[11] The MSA's allocation system ensures that each

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settling tobacco company will pay proportionately (i.e., in proportion to its market share) the same amount of "damages" and can pass its "damages" on to its customers without creating a relative price disadvantage for itself. The settling tobacco companies have thus equalized a major component of their costs.[12]

Through the MSA, moreover, the settling tobacco companies have eliminated price competition and agreed to maintain their prices at elevated levels. Specifically, because the MSA's "damages" allocation system is based on current market shares, if a participating tobacco company were to cut its prices and increase its market share, its allocation of the fixed amount of "damages" would increase by the same percentage as its market share, and its profitability would decrease. Also, the MSA provides that, if the settling tobacco companies as a group lose market share, individual settling tobacco companies that lose market share may reduce their "damages" by three times their market share loss in excess of 2 percentage points. On the other hand, settling tobacco companies that increase their market shares are not allowed to reduce their "damages."[13] Thus, it does not make economic sense for the settling tobacco companies to compete on the basis of price under the rules of the MSA.

To eliminate one remaining possible means of competition, the MSA prohibits virtually all forms of tobacco advertising.[14] Finally, the MSA provides for three meetings per year among the participating tobacco companies, the attorneys general, and the directors of the Foundation[15] "to evaluate the success of this Agreement." Since all three of those parties profit from the tobacco companies' anti-competitive practices, the discussions in those meetings will undoubtedly concern how well the MSA is doing at maintaining the participating tobacco companies' market shares, keeping prices up, and excluding nonparticipating competitors and additional measures for improving success in those activities.[16]

By those devices, the settling tobacco companies have created, for and among themselves, a cartel controlling costs and prices in over 99 percent of the tobacco market.

Fixing Prices and Excluding Competitors

Although the settling tobacco companies accounted for over 99 percent of the tobacco market in 1997, the addition of "damages" to the prices charged to consumers would give a price advantage to nonsettling tobacco companies that had not agreed to pay "damages," and, as a result, those companies might charge lower prices. To eliminate the risk that such a price differential might reduce the settling tobacco companies' profitability and market shares,[17] the settling tobacco companies and the states agreed to a number of measures to prevent nonsettling tobacco companies from increasing their sales and market shares at the expense of the settling tobacco companies. Generally, those measures involve forcing all states to join the MSA and forcing nonsettling tobacco companies to increase their prices, freeze their level of sales, or get out of the business. Specific measures incorporated in the MSA include the following:

1. The MSA punishes states that refuse to join (or that drop out of) the MSA. Consumers in any state that refuses to join the MSA must nevertheless pay collusively raised tobacco prices, but the state does not receive any "damages" payments. Moreover, if a state court invalidates (e.g., because it is unconstitutional or otherwise illegal) the Qualifying Statute[18] of a state that had previously joined the MSA, that state's "damages" payments can be reduced by up to 65 percent.[19]
2. The Qualifying Statute that the MSA compels each state to enact gives nonsettling tobacco companies three choices: (i) they can sign the MSA and pay "damages" (if they increase their sales above a certain amount); (ii) they

can refuse to sign the MSA and deposit 150 percent of what they would otherwise pay as “damages” into a 25-year escrow as “security” against possible liabilities in the future; or (iii) they can drop out of the business.[20] Any tobacco company that fails to adopt one of those three choices is liable for fines and can be banned from the tobacco business for two years.

3. The MSA requires a participating manufacturer (i.e., other than the original four settling tobacco companies) to pay “damages” in the same proportionate amounts as the original participating manufacturers if it increases its market share above its 1998 market share or 125 percent of its 1997 market share, whichever is higher.[21] If a tobacco company reaches the point of paying “damages,” it is prevented from growing any further by the MSA’s ban on many types of advertising that would otherwise be allowed, and by the addition of approximately 33 percent to the company’s costs (i.e., “damages”). Those measures effectively limit all tobacco companies, other than the original five settling tobacco companies, to less than 1 percent of the tobacco market.
4. The apportionment of “damages” among participating manufacturers (including tobacco companies that subsequently join the MSA) on the basis of their current market shares, and the system for reducing “damages” payments for participating tobacco companies that lose market share or sales (but not for tobacco companies that gain market share), eliminates price competition and enforces price maintenance on the part of all participating manufacturers.[22]
5. The MSA creates a $50 million enforcement fund for use by the state attorneys general to threaten nonparticipating tobacco companies or to defend against challenges to the MSA scheme.[23] Thus, the state attorneys general have become the enforcers for the settling tobacco companies’ cartel.
6. The MSA prohibits the sale of assets or products by participating tobacco companies to tobacco companies that do not sign the MSA.[24]
7. The MSA prohibits most types of advertising for tobacco products, thereby stabilizing the market shares of the settling tobacco companies (arguably at a higher level of profitability since they no longer have to pay for competitive ads) and creating a barrier to entry into or expansion in the business by nonsettling tobacco companies.[25]
8. Compliance with the MSA throughout the industry is monitored by mandatory, secret meetings and the sharing of competitive information among the settling tobacco companies.[26]

The end result is that the states and a small number of their favored attorneys receive “damages” of $206 billion plus contingency fee payments; the settling tobacco companies have purchased (at the expense of smokers and at virtually no cost to themselves) the ability to raise prices collusively and confine competitors to less than 1 percent of the tobacco market; and smokers, who are the purported victims, receive nothing of value and are punished for the legal act of smoking by having to pay the “damages” and attorneys’ fees agreed to by the tobacco companies.

If there is concern that similar tactics might be used to punish other unpopular groups in the future, the good news is that the scheme constitutes criminal violations of the federal and state antitrust laws. Of course, that is the bad news as well.

The MSA constitutes criminal violations of the federal and state antitrust laws.

Interstate Operation of the MSA

A legal analysis of the MSA must start with an examination of the effects of the MSA on interstate commerce.[27] The $206 bil-

To the extent that the MSA obstructs or regulates interstate commerce without congressional consent, it violates the Commerce Clause of the Constitution.

lion of "damages" that the tobacco companies agreed to pay does not come from the tobacco companies' assets or customary revenues. It comes from price-fixing premiums charged to their customers. So long as all tobacco companies raise their prices by the amount of their "damages" payments, and the final prices of cigarettes remain at or below the "monopoly" pricing level (i.e., the price to which a monopolist could raise its prices without suffering a significant loss of sales), the tobacco companies will maintain their respective market shares and (at least) their customary levels of profitability. That scheme will work, however, only if all competitors in the business pay "damages" and add the same to their prices. If a single company can charge significantly less per pack than the rest of the industry, or if a single state refuses to participate, the scheme will come tumbling down. Much of the MSA is devoted to preventing competing tobacco companies from charging lower prices and to forcing all states to sign the MSA. To the extent it operates and achieves its effects across state lines, the MSA constitutes an interstate (as opposed to intrastate) restraint, or regulation, of trade.

Some of the basic interstate features of the MSA (referred to sometimes as the "interstate provisions of the MSA") are the following:

1. The "damages" payable to each state are based on total, national sales of cigarettes, not on each state's individual sales.[28]
2. A state that refuses to adopt a Qualifying Statute, or that adopts the statute and subsequently repeals it, is penalized in that its citizens are still charged the "price-fix" premium and the state could lose part of its share of the "damages" payments. That scheme requires the participation of many states.[29]
3. A "Firm" is retained by the participating states to determine which states and which tobacco companies are complying with the MSA and which are not, and how much to penalize those that are not complying.[30]
4. Tobacco companies that sign the MSA are forbidden to sell their products or manufacturing assets to nonparticipating manufacturers anywhere in the United States.[31]
5. The MSA sets up a $50 million Enforcement Fund and an organization of attorneys general to conduct litigation against tobacco companies that do not comply with, or that challenge, the MSA.[32]
6. The MSA protects price-fixing tobacco companies by reducing their "damages" payments if they lose national market share to nonparticipating tobacco companies.[33]
7. The MSA sets up a system of advertising regulations that is intended to be interstate in effect.[34]

Although the MSA is characterized as 46 separate agreements, all parties sign the same document, and the MSA does not go into effect until 80 percent of the states have signed.[35] Most important, the MSA is designed to operate on a national, interstate basis and to exert financial and political pressure, through the manipulation of rewards and punishments, on all states and tobacco companies to sign up. The MSA directly affects interstate commerce through its "multistate" design and operation.

Constitutional Violations

The Commerce Clause

To the extent that the MSA obstructs or regulates interstate commerce without congressional consent, it violates the Commerce Clause of the Constitution (Article I, section 8), which provides, "The Congress shall have power . . . To regulate Commerce . . . among the several States."

There are limitations to the constitutional delegation of regulatory power to Congress under the Commerce Clause and the implicit

prohibition of regulatory power to the states, but the interstate provisions of the MSA clearly trespass on federal territory.

An analysis of permissible regulation of commerce by states is contained in *Parker v. Brown*.[36] In that case, the Supreme Court defined two general areas within which states may regulate commerce: (i) "where the regulation is imposed before any operation of interstate commerce occurs"[37] (referred to as the "mechanical test") and (ii) where such regulation must be allowed for the "accommodation of the competing demands of the state and national interests involved"[38] (referred to as the "accommodation test").

The interstate provisions of the MSA do not satisfy the mechanical test because they operate directly on people, organizations, and businesses outside any one state (as well as within the state). In that respect, they are quite different from state regulations involving local zoning laws or local, intrastate sales taxes or user fees (which have been found to fall within the mechanical test). The MSA is intended to exert powerful forces on all states to create an interstate regime to raise prices collusively; exclude competition; and, generally, regulate the tobacco business. One obvious example of the interstate nature of the scheme is that, under the MSA, if a state court invalidates that state's Qualifying Statute, the other participating states can take away (and redistribute among themselves) up to 65 percent of the offending state's allocated share of the "damages" payments.[39] Clearly, such interstate effects cannot be viewed as "imposed before any operation of interstate commerce occurs."

As for the accommodation test, the *Parker* case describes five circumstances in which the federal government might be willing to "accommodate" state actions with interstate consequences,[40] none of which is applicable to the MSA. Each exception is summarized below, followed by a brief statement explaining why it does not apply:

1. *Where "Congress has not exerted its power under the Commerce Clause."* In the case of tobacco, however, Congress has addressed regulation of the tobacco industry in the Cigarette Advertising and Labeling Act of 1965, as amended.[41]
2. *Where the state regulations apply to "matters of local concern."* In the case of tobacco, the MSA is designed to prevent nonparticipating manufacturers from selling cigarettes at lower prices anywhere in the nation. The MSA effectively sets up a national regime for regulating the tobacco business and fixing prices.
3. *Where the matter regulated "is one which may appropriately be regulated in the interest of the safety, health and well-being of local communities, and which, because of its local character and the practical difficulties involved, may never be adequately dealt with by Congress."* As the state attorneys general are quick to point out whenever asked why smokers receive none of the "damages" payments, the MSA has nothing to do with sick smokers. It is intended to settle state claims either for monies spent under state Medicaid programs or for antitrust, consumer fraud, and racketeering violations.[42] Less than 4 percent of the "damages" is earmarked for anti-youth-smoking advertising, with the rest going unrestricted to attorneys general and their contingency fee attorneys. Inasmuch as all 50 states already prohibited cigarette sales to minors, the "health and welfare" connection is window-dressing.
4. *Where "[because] of its local character . . . state regulation can operate without substantially impairing the national interest in the regulation of commerce by a single authority."* In the case of tobacco, however, the MSA creates a second national regulatory authority in addition to Congress (i.e., the National Association of Attorneys General). Recall that Congress rejected both the Resolution and the McCain bill, which suggests an unwillingness to subordinate its regulatory authority to the states under the MSA.

The MSA is designed to prevent nonparticipating manufacturers from selling cigarettes at lower prices anywhere in the nation.

"Damages" are based on national sales and operate in the same manner as a national sales tax.

5. *Where the regulations involved are "local regulations whose effect upon the national commerce is such as not to conflict but to coincide with a policy which Congress has established with respect to it."* The MSA creates a national (not local) regulatory regime, at least with respect to the interstate provisions of the MSA. The collusive pricing and exclusion of nonparticipating manufacturers clearly conflict with the federal antitrust laws; the "damages" are based on national sales and operate in the same manner as a national sales tax (even though states are not permitted to impose national taxes); and the advertising provisions conflict with the Cigarette Advertising and Labeling Act of 1965, as amended. Congress refused to approve the Resolution and the McCain bill, so Congress cannot be said to have consented to the policy of the attorneys general.

As the Supreme Court in *Parker* explains, the accommodation test reflects the desire of the federal government to recognize and accommodate the interface between the separate areas of federal and state autonomy in our federal system of government. It is not intended, however, to allow the states to intrude into and regulate interstate commerce in tobacco or any other product.

Two further attempts to fit the MSA within some exemption from the Commerce Clause should be addressed, because an obvious effort has been made to construct the appearance of an argument. The first contention is that the MSA is 46 separate and independent agreements and that, as to each state, the MSA is strictly an internal, local matter between the tobacco companies and that state. If that were so, the identical nature of each of the 46 agreements would be mere coincidence, which is beyond credibility. Moreover, the MSA could go into effect only after ratification by 80 percent of all states,[43] and all states signed the same document, directly or by counterpart signature pages.[44] The plain purpose of the interstate provisions of the MSA is to create and enforce a national, interstate regime for collusive pricing and exclusion of competitors. It is impossible to view the MSA as a local, individual state matter.

The second contention is that all 50 states will have agreed to virtually identical arrangements; thus there is no one to complain. That overlooks 45 million smokers of a perfectly legal product who must pay more than $206 billion in collusive price increases. It also overlooks any tobacco company forced by the MSA to pay "damages," even though it was never determined to have any liability.

In short, the MSA is an extreme intrusion by the states into interstate commerce, which infringes on the federal government's powers over interstate commerce and violates the Commerce Clause of the Constitution.

The Compacts Clause

The Founding Fathers did not intend that the states should be able to get together and by agreement create a new government or regime among themselves, replacing the prerogatives and powers of the constitutionally created federal government. That concern is specifically addressed in the Compacts Clause of the Constitution (Article I, section 10), which provides, "No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State."

The Supreme Court has interpreted that provision as prohibiting the states from forming "any combination tending to the increase of political power in the states, which may encroach upon or interfere with the just supremacy of the United States."[45] The constitutional prohibition applies to any form of agreement. "The Clause reaches both 'agreements' and 'compacts,' the formal as well as the informal. The relevant inquiry must be one of impact on our federal structure."[46] Moreover, application of the Compacts Clause need not await evidence that federal prerogatives have been eroded. As the Court went on to state, "The perti-

nent inquiry is one of potential, rather than actual, impact upon federal supremacy."[47]

Short of secession from the Union, it is hard to imagine an agreement or compact among the states that would be more in violation of the Compacts Clause than the MSA.[48] Raising many of the same concerns that the Supreme Court raised in *Multistate Tax Commission*, the MSA authorizes member states to exercise powers they could not exercise in its absence, such as the collection of "damages" based on sales in other states and the interstate regulation of cigarette advertising. States are forced by other states to join the MSA by the threat of loss of "damages" payments if they do not join, or if they resign from, the MSA. A $50 million Enforcement Fund is established and administered by a centralized group to litigate or defend against those who do not comply with the MSA. The loss of "damages" payments is determined by a "Firm" on behalf of the overall group. None of those actions could be accomplished by a single state acting alone, without the involvement of other states bound together by the MSA.

The states infringe on Congress's taxing powers (Article I, section 8, of the Constitution) by collecting "damages" based on sales in other states. They infringe on Congress's powers over interstate commerce by effectively repealing the federal antitrust laws as they apply to tobacco and by regulating an area of interstate commerce already regulated by Congress under the Cigarette Advertising and Labeling Act of 1965, as amended.[49]

In addition, the MSA has, in effect, by agreement among the states, created a new bankruptcy system for tobacco companies despite Congress's enumerated power in that area.[50] The MSA provides that tobacco companies may not seek relief from the MSA in a bankruptcy proceeding.[51] That provision would appear to violate the federal bankruptcy code. Indeed, the MSA itself is a substitute bankruptcy scheme designed by the states for the tobacco companies, which the states' lawsuits rendered "insolvent."[52] The $206 billion liability agreed to by the tobacco companies exceeds the fair valuation of all their property.[53] Instead of reorganizing or liquidating the tobacco companies in a manner that protects all creditors (as the bankruptcy laws require), the MSA allows the tobacco companies to have their liabilities paid by their customers (many of whom could be claimants as a result of smoking-related diseases). The states' multistate bankruptcy scheme effectively preserves the shareholders' interests intact, while shifting the debtor's liability costs to one of the classes of creditors—the smokers.

Finally, not only does the MSA infringe on the prerogatives of Congress, it contradicts the Tobacco Control Act.[54] In that act, Congress gave its consent that "any of the states in which tobacco is produced may negotiate a compact or compacts for the purpose of regulating and controlling the production of, or commerce in, any one or more kinds of tobacco therein." That grant of authority to the states was carefully limited, however. "Nothing in [the Tobacco Control Act] shall be construed to grant the consent of Congress to negotiate any compact for regulating or controlling the production of, or commerce in, tobacco for the purpose of fixing the price thereof, or to create or perpetuate monopoly, or to promote regimentation."[55]

The state attorneys general, by compact among the states, have agreed to do what Congress made clear the states could not do—namely, enter into a multistate agreement that implements and promotes price fixing, creates and perpetuates a monopoly, and promotes regimentation in the market.

If the states can do those things without the consent of Congress, they are free, by agreement among themselves, to rewrite the Constitution. The actions of the states clearly have both actual and potential impacts on federal supremacy and thus violate the Compacts Clause of the Constitution.

It is hard to imagine an agreement or compact among the states that would be more in violation of the Compacts Clause than the MSA.

The MSA Exceeds the Constitutional Authority of the States

In violating the Commerce Clause and the Compacts Clause, the MSA exceeds the power and authority of the states to take cer-

The Supreme Court stated, "A state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful."

tain actions. As the Supreme Court stated in *Parker*, "The governments of the states are sovereign within their territory save only as they are subject to the prohibitions of the Constitution or as their action in some measure conflicts with powers delegated to the National Government or with Congressional legislation enacted in the exercise of those powers."[56] The Commerce Clause of the Constitution does not withdraw from the states all authority over interstate commerce, yet the MSA crosses the limits into areas of interstate authority reserved to the federal government. With respect to the Compacts Clause, the MSA violates a direct constitutional prohibition. The states, by agreement among themselves and without the consent of Congress, have created an assessment (which they call "damages") on revenues earned in other states; they have repealed the antitrust laws, collusively raised prices, restricted output, and excluded competition in tobacco on a nationwide basis; they have created a national regulatory system for the advertising and sale of tobacco; they have created a substitute bankruptcy system for tobacco companies; and they have violated the Tobacco Control Act. The states have no more power or authority to take such actions than they have to declare war on a foreign country to force it to stop selling cigarettes.[57]

Antitrust Violations

The collection of nearly a quarter trillion dollars of "damages" and attorneys' fees from smokers for payment to the state attorneys general and their contingency fee lawyers is effectuated through a system of collusive cost sharing, price fixing, and exclusion of competitors agreed to in the MSA. Unquestionably, the officers of private companies attempting to implement such a scheme would go to jail and pay substantial fines under the Sherman Antitrust Act. That act provides in relevant part: "Every contract . . . in restraint of trade or commerce among the several states . . . is declared to be illegal. Every person who shall make any contract . . . hereby declared to be illegal shall be deemed guilty of a felony."[58]

On its face, the MSA appears to violate the Sherman Act in exquisite detail. But does the MSA in fact violate the Sherman Act? The answer to that question depends on the application of three principles of interpretation of the antitrust laws—the doctrines of preemption, state action exemption, and *Noerr-Pennington* immunity.

Preemption

The doctrine of preemption provides, "A state or local government act may be preempted on its face when it compels something that the federal antitrust laws clearly prohibit, which generally means a per se violation of the antitrust laws."[59]

The Supreme Court stated the preemption principle in *Parker:* "A state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful."[60]

Indisputably, collusive pricing and conspiring to exclude competition are per se violations of the antitrust laws. Without question the MSA embodies a national scheme for collusive pricing and exclusion of competition. Certainly, if the tobacco companies, acting alone, concocted such a scheme, they would be committing per se violations of the Sherman Act. Applying the preemption doctrine, the Sherman Act preempts state actions under the MSA that purport to legalize the tobacco companies' interstate collusive pricing and exclusion of competition—at least to the extent the tobacco companies and the states are not entitled to an exemption or immunity under the state action exemption or *Noerr-Pennington* immunity doctrines.

State Action Exemption

The state action doctrine of exemption from the antitrust laws was formulated by the Supreme Court in *Parker*. As explained in a later Supreme Court case applying the doctrine: "*Parker v. Brown* . . . held that the federal antitrust laws do not prohibit a state *'as sover-*

eign' from imposing certain anticompetitive restraints *'as an act of government.'*"[61]

Defining the limits of the *Parker* state action exemption, the *Lafayette* opinion went on to explain: "We therefore conclude that the *Parker* doctrine exempts only anticompetitive conduct engaged in *as an act of government* by the state *as sovereign,* or, by its subdivision, pursuant to state policy to displace competition with regulation or monopoly public service."[62]

The Court was quite clear that "for purposes of the *Parker* doctrine, not every act of a state or a state agency is that of the state as sovereign."[63] In the landmark case of *Ex Parte Young,* the Supreme Court held that unconstitutional actions by a state are void and beyond the sovereign and governmental capacity of the state:

> [If the] act to be enforced is . . . unconstitutional . . . the use of the name of the state to enforce an unconstitutional act to the injury of the complainants is a proceeding *without the authority of,* and one which does not affect, the state in its *sovereign* or *governmental capacity.* It is simply an illegal act upon the part of a state official, in attempting by the use of the name of the state to enforce a legislative enactment which is void, because unconstitutional. If the act which the state Attorney General seeks to enforce be a violation of the Federal Constitution, the officer in proceeding under such enactment comes into conflict with the superior authority of that Constitution, and he is in that case stripped of his official or representative character and is subjected in his person to the consequences of his individual conduct.[64]

Clearly, unconstitutional actions by a state cannot be the basis for exemption from the antitrust laws under the state action exemption, since such actions are beyond the states' sovereignty and are, therefore, not acts of government.

In an area in which the state is ordinarily sovereign, such as *intrastate* commerce, the state may, as an act of government, regulate commerce or create a monopoly, so long as the relevant branch of the state is operating within the realm of the state's sovereignty and its acts are both authorized by the state and supervised by the state. For example, a state department of commerce could, within the state action exemption from the antitrust laws, establish a single, private power company to provide electricity within the state, so long as the creation of the monopoly was authorized by the state and the operation of the monopoly was adequately supervised by the state. In such a case, intrastate activity is within the realm of the state's sovereignty. The creation of the monopoly is authorized by the state, and the operation of the monopoly is supervised by the state. In the case of the MSA, on the other hand, the states are acting beyond their powers and in areas in which they are not sovereign and that are outside their governmental capacity. That conclusion must be reached regardless of whether the analysis focuses on the actions of the states themselves in approving the MSA and adopting Qualifying Statutes or on the actions of the state attorneys general in signing the MSA and implementing it.

Recall that the MSA is essentially an interstate regulation of commerce in tobacco that fixes prices and excludes competition. The states are acting in violation of the Commerce Clause and the Compacts Clause of the Constitution (and thus beyond their authority) in agreeing among themselves to adopt and implement the interstate provisions of the MSA. Inasmuch as those provisions of the MSA are beyond the authority of the states and in violation of the Constitution, it cannot be said that in adopting and implementing the MSA the states are acting within an area in which they are "sovereign," or that their acts in violation of the Constitution are legitimate "acts of government." Clearly, in those areas, the states are

Unconstitutional actions by a state cannot be the basis for exemption from the antitrust laws under the state action exemption.

The focus of the *Noerr-Pennington* doctrine is on the effort to influence public officials. It does not immunize collusive activity apart from the process of petitioning the government.

not sovereign, their acts are not acts of government, and the state action exemption does not apply.

The acts of the attorneys general under the MSA cannot be "authorized" within the meaning of the *Parker* doctrine if the states themselves (i.e., the ultimate authorizing entities) are not empowered to take the actions. Again, the state action exemption simply does not apply.

Noerr-Pennington Immunity

Another possible exemption from the antitrust laws for the MSA is the *Noerr-Pennington* immunity doctrine.[65] The doctrine provides a limited exemption from the antitrust laws for individuals petitioning the government, initiating suit in the courts, or facilitating communications to governmental decisionmakers. As the Court stated in *Noerr*, "No violation of the [Sherman] Act can be predicated upon mere attempts to influence the passage or enforcement of laws."[66]

Under the doctrine, competitors acting in concert to request legislation to legalize anticompetitive behavior are not liable under the Sherman Act, even if the conduct that they seek to legalize would otherwise be illegal. The doctrine applies to the commencement of litigation as well as to petitioning for legislation or regulatory action, and the availability of immunity under the doctrine is not affected by the petitioners' motives in seeking the particular government action.

The doctrine does not, however, absolve petitioners from all antitrust concerns; and, as will be seen, it has little if any effect on any liability of the parties to the MSA.

The doctrine applies to the act or process of petitioning for governmental action. In the case of the MSA, that would be the initial suits by the states against the tobacco companies for refunds of their Medicaid payments and the joint petition of the states and tobacco companies to Congress for approval of the Resolution. Also, in implementing the MSA, the tobacco companies and the attorneys general have petitioned or will petition state courts for judicial consent decrees, and they have petitioned or will petition the state legislatures to enact Qualifying Statutes. Those particular acts might qualify for *Noerr-Pennington* immunity (but probably do not, because of the "sham" exception discussed below).

Such immunity would not apply, however, to collusion among the tobacco companies whereby they determined the amount of "damages" that each would pay (and tack on to its cigarette prices) or the tactics that would be used to exclude competitors; it would not apply to the MSA itself; nor would it apply to the carrying out of the MSA through collusion among tobacco companies to fix prices and exclude competitors. Those actions are the essence of the anticompetitive scheme irrespective of whether anyone petitions the government, and they are per se violations of the Sherman Act.

The focus of the *Noerr-Pennington* doctrine is on the effort to influence public officials. It does not immunize collusive activity apart from the process of petitioning the government. In the *Pennington* case, for example, the Supreme Court specifically found that collusive activity between a union and certain favored employers to impose higher costs on other employers was violative of the antitrust laws, notwithstanding that the union and the employers had petitioned the secretary of labor to facilitate their scheme.[67] Moreover, in his concurring opinion in that case, Justice Douglas stated that "an industry-wide agreement containing those features [to force some competing employers out of business] is prima facie evidence of a violation."[68] The MSA is likewise prima facie evidence of a violation.

Antitrust scholars Philip Areeda and Herbert Hovenkamp are quite clear that prepetition collusion (such as that of the tobacco companies to agree on each company's level of "damages" and the tactics for excluding competitors) violates the antitrust laws regardless of whether the government is later petitioned.

> [C]onsider a combination of competitors that discussed among them-

> selves the "appropriate price" for their product in order to petition the government for legislation that would support their price in some manner. This should constitute unlawful price collaboration because their discussions create a severe danger to competition without being in any way indispensable for conducting protected political activity.[69]

The *Noerr-Pennington* distinction between anti-competitive activities, on the one hand, and advocacy, on the other, is explicit in the *Airport Car Rental Antitrust Litigation* decision: "[The] Sherman Act prohibits participation in, not advocacy of, anticompetitive activities. . . . For liability to be imposed on them [i.e., those attempting to influence public officials], they must be participants in the scheme."[70]

The *Noerr-Pennington* doctrine must also be read in relation to the *Parker* state action exemption (discussed above). *Noerr-Pennington* is complementary to the state action exemption; it does not override it or swallow it up. Thus, if anti-competitive conduct is exempted from antitrust liability because it constitutes state action, *Noerr-Pennington* completes the purpose of the state action exemption by providing that citizens petitioning the government for the particular state action do not incur a separate antitrust liability. On the other hand, if the anti-competitive actions fail to qualify for the state action exemption, the fact that the actors petitioned the government for approval does not somehow immunize those actions from antitrust liability. The difference between the two doctrines is that *Noerr-Pennington* is an exemption for citizens engaging in the political process (i.e., petitioning government) whereas *Parker* state action is an exemption for state governing bodies (and their employees) in the exercise of their governmental functions. If the anti-competitive state actions are not legitimate acts of government, the fact that the proponents petitioned the state to perform them does not legalize them under the antitrust laws.

Under the Commerce Clause and the Compacts Clause, the states lack the power and authority to enter into a multistate compact that infringes on federal prerogatives; consequently, the tobacco companies have no antitrust immunity in collaborating with the states to carry out the anti-competitive elements of the MSA, regardless whether they may at some time or other have petitioned the government.

In fact, in the case of the MSA, it is likely that even the petitioning by the tobacco companies fails to qualify for immunity under *Noerr-Pennington* as a result of the "sham" exemption to the doctrine.

The Supreme Court in *City of Columbia v. Omni Outdoor Advertising, Inc.* described a "sham" situation as one that "involves a defendant whose activities are 'not genuinely aimed at procuring favorable governmental action' at all . . . , not one 'who genuinely seeks to achieve his governmental result, but does so through improper means.'"[71]

The key determinant of whether or not the action is a "sham" is whether the petitioner had (in the case of filing a lawsuit) probable cause on which to base his claim.[72] In commencing their lawsuits against the tobacco companies, the states may conceivably have had some element of probable cause for their claims. The settlement of those lawsuits, however, is a different matter. It involved a period of intense collusion during which the parties concocted the scheme, agreed to the "damages" with which each tobacco company would be assessed, and determined the mechanisms and details of the price-fixing and competition-suppressing scheme that became the MSA. The tobacco companies and the attorneys general then took the package to the state courts for approval. The former (intercompany negotiation) activities did not involve petitioning, and the latter activities (petitioning the courts) constituted a baseless petition, in that the states lacked the power to adopt and implement the MSA. Areeda and Hovenkamp describe the standard applicable to litigation: "[T]he issue is different in the adjudication setting. One

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who requests a court to do something that is clearly unconstitutional or unlawful is in effect filing a 'baseless' petition which is then governed by the rules for such claims [applicable to sham transactions]."[73]

Inasmuch as the states and the tobacco companies knew that the MSA violated the Compacts Clause and the antitrust laws (see "Prior Knowledge of Antitrust Violations," below), the requests for state court approvals of the MSA were a sham—to which *Noerr-Pennington* does not apply.

The MSA is also implemented through legislation—namely, the enactment of the Qualifying Statutes. Areeda and Hovenkamp compare the litigation standard for "sham" with the legislation standard for "sham": "The all-important difference is that a defined body of law and procedure sets limits on the content of judicial or quasi-judicial opinions, but no equivalent body establishes effective limits on the petition to the legislature."[74]

Yet the Constitution is one body of law that does, indeed, limit legislative acts. Accordingly, the petitions of the attorneys general and the tobacco companies to the state legislatures to approve the Qualifying Statutes under the MSA are every bit as much a sham as are the petitions to state courts. The Constitution, in particular, the Compacts Clause, prohibits states from adopting such statutes. Thus, there was no merit to the petitions. The states and tobacco companies knew that their petitions had no merit. Their actions were thus a "sham,"[75] with no immunity under the *Noerr-Pennington* doctrine.

In summary, *Noerr-Pennington* immunity clearly does not apply to the prepetition collusion of the tobacco companies in allocating "damages" among themselves and devising a scheme for excluding competition, to the MSA itself, or to the price-fixing and competition-excluding implementation activities of the MSA. Inasmuch as the states acted beyond their powers and authority in adopting the MSA, the "sham" exception probably prevents application of *Noerr-Pennington* immunity even to the petitioning involved in obtaining state court approvals of the MSA and state legislature approvals of the Qualifying Statutes.

Summary of Preemption, State Action, and *Noerr-Pennington* Analyses

Neither state action exemption nor *Noerr-Pennington* immunity applies to the MSA. In the absence of those exemptions or immunities, the actions of the tobacco companies and the states relating to the MSA must be viewed as attempts to authorize federal antitrust violations. But the preemption doctrine causes the federal antitrust laws to prevail over such invalid state actions. The *Lafayette* case makes it quite clear that, in the absence of an exemption under the state action doctrine, the federal antitrust laws apply.[76] *Pennington* reaches a similar result in the absence of immunity under the *Noerr-Pennington* doctrine.[77] Thus, the interstate pricing collusion and suppression of competition provisions embodied in the MSA are, per se, actionable violations of the federal antitrust laws.

Prior Knowledge of Antitrust Violations

The authors of the MSA will not be surprised to hear that it constitutes criminal violations of the federal antitrust laws. The evidence that they knew that before the MSA was negotiated is overwhelming.

Some of the lawyers who negotiated and drafted the MSA also negotiated and drafted the earlier Resolution, which was made contingent on congressional approval, undoubtedly because its lawyer-authors were aware that the Compacts Clause of the Constitution requires congressional approval of compacts or agreements among the states that infringe on the sovereignty of the United States.[78] In anticipation of congressional approval, the Resolution contained the following exemption from the federal antitrust laws: "In order to achieve the goals of this agreement, . . . the tobacco product manufacturers may, notwithstanding the provisions of the Sherman Act, the Clayton Act, or any other

federal or state antitrust law, act unilaterally, or may jointly confer, coordinate or act in concert, for this limited purpose."[79]

The subsequent McCain bill in the Senate (which failed to pass) eventually had a similar provision. That language does not appear in the MSA. Instead, the MSA contains the following disclaimer:

> Each Participating Manufacturer . . . acknowledges . . . that certain provisions of this Agreement may require it to act or refrain from acting in a manner that could otherwise give rise to state or federal constitutional challenges, and that . . . it . . . waives . . . any and all claims that the provisions of this Agreement violate state or federal constitutions.[80]

When the Resolution bogged down in Congress in late 1997 and the often-amended McCain bill became the leading contender for a congressionally approved settlement agreement, the tobacco industry, unhappy with many aspects of the McCain bill, became concerned with a version of the bill that lacked a specific exemption from the federal antitrust laws. At that time, the tobacco companies maintained a Web site on which they addressed the most important issues of the day relating to the tobacco settlement. The following "issue paper" appeared among other industry statements on that site:[81]

> LIMITED ANTITRUST PROTECTION
>
> *The McCain bill (S.1414) does not include the narrow, limited antitrust protection that is essential to allow the tobacco industry to enter into the Protocol and carry out various of the commitments that are designed to reduce underage tobacco use.* The bill should accordingly be amended to reflect the following considerations:
>
> **Advertising and marketing changes require antitrust protection.** In order to avoid constitutional difficulties, the companies' agreement to change marketing and advertising practices—for example, by eliminating all billboards and other outdoor advertising, brand sponsorships of sporting events and concerts, and human images in any advertising—must be voluntary and not compelled. *Any such voluntary collective agreement constitutes a restraint on competition that is per se illegal under the antitrust laws. Only if the industry is granted limited protection from both government and private lawsuits can it enter into voluntary agreements to limit advertising and marketing competition.*
>
> **The "Pass-Through" of industry payments requires antitrust protection.** The settlement requires the industry to pass through to consumers the costs of settlement payments (thereby increasing the price of tobacco products). *The industry should not be exposed to antitrust liability for any such pass-through requirement which has been demanded as a step to combat underage use of tobacco products.*
>
> **Industry boycotts of sellers of tobacco products to underage persons require antitrust immunity.** The industry must be free collectively to cut off distributors or retailers that sell tobacco products to underage persons (or disregard the industry's voluntary advertising and marketing restrictions). *Ordinarily, any such collective cutoff could be regarded as an illegal group boycott under the antitrust laws. Under the Proposed Resolution, any such action by the industry would, in each instance, require approval by the Department of Justice. Limited antitrust protection is essential to legalize collective industry action to deal with businesses that sell tobacco products to underage users and to authorize the DOJ to approve such actions by the industry.*
>
> **Attorney General approval of new plans to reduce underage**

The tobacco industry can enter into voluntary agreements to limit advertising and marketing competition only if it is granted limited protection from both government and private lawsuits.

> **tobacco use.** In addition to the resolution's proposed measures for reducing underage use of tobacco products, other approaches may be suggested in the future. *Accordingly, any legislation should include provisions to allow the industry to present plans for new measures to the Attorney General for approval, and to exempt the industry from antitrust liability for approved activities under such plans.*

Thus, the tobacco industry, which tried but was unable to obtain congressional approval of either the Resolution or the McCain bill, was fully aware that without such approval arrangements substantially similar to those in the MSA would violate the federal antitrust laws.

Another proof that the industry, the state attorneys general, and the contingency fee lawyers knew that the MSA violated federal antitrust laws is that they buried a $50 million war chest (financed by moneys taken from smokers) in the MSA to discourage and delay any challenges to their illegal scheme. Specifically, the MSA provides:

> The Attorneys General of the Settling States, acting through NAAG, shall establish a fund ("The States' Antitrust/Consumer Protection Tobacco Enforcement Fund") . . . which will be maintained by such Attorneys General to supplement the Settling States' (1) enforcement and implementation of the terms of this Agreement and the Consent Decrees, and (2) investigation and litigation of potential violations of laws with respect to Tobacco Products. . . . Each Original Participating Manufacturer shall . . . severally pay its Relative Market Share of $50,000,000 to the Escrow Agent . . . who shall disburse such monies to NAAG.[82]

The state attorneys general buried a $50 million war chest in the MSA to discourage and delay any challenges to their illegal scheme.

The Resolution and the McCain bill required the payment of substantially greater "damages" and imposed substantially more stringent advertising and marketing requirements on the industry than does the MSA. Consequently, if the tobacco companies were inclined to violate their agreements, they would have been far more likely to violate the Resolution or the McCain bill than the MSA. However, no such "war chest" provision appeared in either the Resolution or the McCain bill—undoubtedly, because the authors anticipated receiving congressional approval. In fact, why would the tobacco industry violate an agreement that grants it the right to fix prices and exclude competitors on a national basis? Obviously, the attorney generals' war chest is not meant to be used against the tobacco companies. It is a recognition that the MSA violates the antitrust laws, and its purpose is to discourage and delay anyone who chooses to challenge the MSA's illegal scheme.

Attempts to Rationalize Antitrust Violations

The MSA constitutes violations of the federal antitrust laws, which are criminal laws. Considering the stature of the offices and institutions involved in the illegal price-fixing activities, we must ask whether there are any other explanations that might decriminalize those activities. Three arguments come to mind: (i) the price-fix premiums charged to smokers are "just a tax"; (ii) the price-fix premiums are a "regulatory fee"; and (iii) the entire scheme is justified because it is a "settlement" of tobacco companies' liabilities. The arguments do not withstand scrutiny.

The Price-Fix Premium Is "Just a Tax." Whether or not Congress could or should impose a tax on the sale of cigarettes equivalent to the "damages" imposed by the MSA, Congress did not do so. Under our Constitution, moreover, not just anybody can impose a tax. If the price-fix premium on cigarettes were a tax, it would be a national tax that would go to the federal government and not to the states. Only Congress can impose a tax on the national sales of a product.[83] The states could impose a tax on

cigarette sales within their respective borders, but the Compacts Clause of the Constitution prevents them from imposing such a tax on a multistate basis through agreements among the states, except with the consent of Congress (which they did not obtain).

The tobacco companies argued against characterizing the "damages" assessments as taxes in one of their Internet issue papers titled "Excise Tax Treatment for Industry Payments Is Inappropriate."[84] The industry noted that tax treatment would subject the payments to budget rules and fiscal controls applicable to tax revenues. Another reason not to treat "damages" as taxes, not openly addressed by the industry, is that tax revenues do not usually form the basis for awarding lawyers' contingency fees. In any event, neither Congress nor the states have enacted the price-fix premiums as taxes on the sale of cigarettes, and the argument that the payments are "just a tax" simply does not apply.

The Price-Fix Premium Is a Regulatory Fee. Again, whether Congress could or should impose a national regulatory fee on the sale of cigarettes, it has not chosen to do so. The states could impose a regulatory fee on the sale of tobacco within their respective borders, but the Compacts Clause of the Constitution prohibits them from imposing a national regulatory fee without the consent of Congress (which they have not received). Congress never delegated regulatory authority over tobacco to the state attorneys general. Consequently, there is no basis for arguing that the price-fix premiums are a regulatory fee imposed on the sale of cigarettes.

The "Damages" Are Merely "Settlement Payments." In its issue paper, "Excise Tax Treatment for Industry Payments Is Inappropriate," the industry argues that its "payments are properly characterized as settlement payments paid to settle previous damages claims."[85] Given the history of the MSA and the fact that the payments are neither taxes nor regulatory fees, it is undoubtedly true that the payments are, in fact, a settlement. Nonetheless, the method by which the industry obtains the money to make the payments is price fixing and restraint of trade, which are crimes. By analogy, if the tobacco companies were to steal the money to settle the states' claims, they would be guilty of stealing, which is a crime. The fact that state officials are involved in facilitating the stealing or price fixing in order to maximize the states' settlement payments does not lessen the crime but compounds it. There is no exception to the antitrust laws or any other criminal law merely because the money being taken illegally is to be used to settle a claim.

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Remedies

The MSA violates the Constitution and the antitrust laws, and there are victims of those violations. The victims include smokers, whose money is being taken to settle lawsuits in which they were not involved or represented. The victims also include tobacco businesses that were not parties to the settlement but are forced to pay "damages" for which they have no liability. Another victim is Congress, which has been replaced in a number of its constitutional roles by the National Association of Attorneys General and the MSA assemblage of states.

There are violators of the law who are profiting from their crimes: The major tobacco companies have used consumers' money to persuade law enforcement officials to refrain from enforcing (and to violate) the antitrust laws. Contingency fee lawyers have used the MSA to pay themselves billions of dollars as a reward for having devised an illegal price-fixing scheme. Under the MSA, the private lawyers for 46 states will receive $750 million per year for the first five years and $500 million per year thereafter *indefinitely*.[86] The violators include the states, which have ignored the Constitution to tap into the wealth of 45 million (mostly medium- to low-income) Americans—namely, smokers. The violators also include the state attorneys general, who refrain from enforcing the antitrust laws in exchange for the political and other rewards that accrue to them as the recipients and dis-

pensers of $206 billion of "damages" and billions more in attorneys' fees.

Is there a remedy? Or are we witnessing the commission of a perfect crime? The answer to the first question is that remedies are available. The answer to the second question depends on whether and how the remedies are used. The factors that must be examined are (a) customary law enforcement agencies and their self-imposed disabilities, (b) victims of the violations and the nature of the victims' injuries, and (c) terms and conditions of the legal remedies.

Who Will Enforce the Law?

State Law Enforcement Officials. The states' attorneys general are responsible for protecting all the citizens of their respective states, including citizens who smoke cigarettes, from violations of the law. Among the laws that the attorneys general are expected to enforce are the federal and state antitrust laws. The state attorneys general have not brought any actions on behalf of their citizens for violation by the MSA of the antitrust laws, because it is quite clear that they would lose the "damages" payments provided for them under the MSA. Thus, by constructing a settlement mechanism (the MSA) that is based on violations of the antitrust laws, the state attorneys general have put themselves in a scandalous conflict of interest: they can enforce the antitrust laws on behalf of consumers and lose the price-fix premium for their states, or they can implement the MSA and allow the consumers of their respective states to be bilked by an illegal price-fixing scheme.

The nonsettling tobacco companies must pay "damages" even though they have no liability and were not involved in any cases.

Federal Law Enforcement Officials. The Department of Justice, Antitrust Division, has authority to enforce the antitrust laws on behalf of the United States. On September 22, 1999, however, the department commenced an action against the tobacco companies, very similar to the actions of the states. Prof. G. Robert Blakey of Notre Dame Law School (one of the consultants engaged by the DOJ to plan the lawsuit) explained that "this case is not made to win, it's made to settle."[87] Undoubtedly, the DOJ plans a settlement similar to the MSA. Moreover, the MSA itself, at least in its early stages, is reported to have been brokered and negotiated by presidential aide Bruce Lindsey at the request of the president.[88] Thus, the DOJ is not likely to prosecute antitrust violations by the MSA.

The Federal Trade Commission, which also has authority to enforce the antitrust laws, is unlikely to proceed against MSA antitrust violations for much the same political reasons.[89]

The Settling Tobacco Companies. The settling tobacco companies must not be mistaken for victims of the MSA. If the settlement stands, they have bought, at somebody else's expense, the right to fix prices and exclude competitors; they have settled at least some of their liabilities; and they have evaded bankruptcy. The mechanism by which they have done those things, moreover, will serve to divert losses in future lawsuits away from themselves and onto their consumers. Thus, the tobacco companies will not challenge the settlement.

Who Are the Victims?

Smokers. Forty-five million smokers are the primary victims of the MSA. The major tobacco companies have colluded to raise cigarette prices by $206 billion over the next 25 years. Smokers cannot change suppliers or brands to escape the higher prices because the MSA excludes tobacco companies that do not pay "damages."[90] Smokers (who according to the states' lawsuits are addicted to cigarettes) are trapped into paying the price-fix premiums. Those are classic "antitrust injuries," engineered by masters of the trade.[91]

Nonsettling Tobacco Companies. The nonsettling tobacco companies are confined to less than 1 percent of the tobacco business. If they try to increase their market shares, they must pay "damages" even though they have no liability and were not involved in any cases. The ban on advertising is another barrier to any possible market growth for them. The nonsettling tobacco companies that later signed the MSA were compelled to do so by the threat of litigation and the rewards and punishments dispensed through the MSA. Those companies that have refused to

sign the MSA are effectively excluded from the tobacco business by the penalties imposed by the Qualifying Statutes.

Congress. The institution of Congress is also a victim of the MSA. The states, by forming a separate compact among themselves, have created a new tax for 45 million Americans and a new bankruptcy system for tobacco companies; they have effectively repealed the antitrust laws in the area of tobacco products; and they have created a new regulatory regime administered by the National Association of Attorneys General in an area of interstate commerce previously regulated by Congress. The states have also ignored Congress's Tobacco Control Act and the Cigarette Advertising and Labeling Act of 1965, as amended. Those actions diminish the authority and role of Congress.

What Legal Redress Is Available?

The primary remedies for the type of injuries caused by the MSA are declaratory judgment under the Federal Declaratory Judgment Act[92] and injunctive relief and monetary damages (including treble damages) under the federal and state antitrust laws.[93] In appropriate circumstances those remedies can be pursued on an individual or class action basis, but they do not apply to all potential plaintiffs under all circumstances. Accordingly, we turn to a discussion of those remedies and the applicable rules of standing affecting who may bring an action and under what circumstances.

Declaratory Judgment. The Federal Declaratory Judgment Act provides a means for challenging the constitutionality of the MSA. An action brought under that act would probably be combined with a request for a permanent injunction barring further implementation of the unconstitutional or illegal provisions of the MSA. Key requirements for standing to bring such an action are the following:

a. The petitioner must have a practical interest in the declaration being sought.
b. There must be an actual case or controversy.
c. In the case of a statute or regulation, the petitioner must be subject to and adversely affected by the statute or regulation.[94]

A declaratory judgment would seem most appropriate for a (nonsettling) tobacco company seeking to enter the market or expand its market share. The state Qualifying Statutes in effect require that such a company sign the MSA or pay the equivalent of "damages" into a 25-year escrow (or stay out of the business). The petitioner would seek a declaration that the Qualifying Statute is unconstitutional and unenforceable, because it violates the Commerce Clause and the Compacts Clause of the Constitution, and request a permanent injunction against enforcement of the MSA. Under the Supreme Court's ruling in *Ex Parte Young,* the action would be brought against the state attorney general rather than the state itself to avoid the problem of state immunity under the Eleventh Amendment to the Constitution.[95]

A smoker or class of smokers would have a more difficult time obtaining relief under the Declaratory Judgment Act. Although the smoker is clearly injured by having to pay the price-fix premiums, he is not a party to the MSA, and the state Qualifying Statute does not directly apply to him.

Federal and State Antitrust Injunctive Relief and Damages.[96] Injunctive relief and treble damages are remedies under the federal antitrust laws,[97] and similar remedies are available under most states' laws.[98]

The rules of standing for injunctive relief are relatively uncomplicated and are similar under the federal antitrust laws and most state antitrust laws. Generally, a party must have sustained or be threatened with antitrust injuries arising from a violation of the antitrust laws. It is not necessary that the plaintiff will receive (or has received) injuries as a result of *direct* dealings with the defendant. Consequently, both smokers (who are usually indirect purchasers of cigarettes from the settling tobacco companies) and nonsettling tobacco companies (which

Injunctive relief and treble damages are remedies under the federal antitrust laws, and similar remedies are available under most states' laws.

If the MSA is allowed to stand, it will create and finance a powerful industry of lawyers who are not averse to violating the Constitution or the laws.

may be direct or indirect purchasers or manufacturers) have standing to seek injunctive relief under the federal and state antitrust laws, provided that they can show actual or threatened antitrust injuries, such as those resulting from the MSA.

The rules of standing are more complicated with respect to the federal and state treble damages antitrust statutes. Generally, under the federal statute (e.g., section 4 of the Clayton Act) there are the following requirements for standing to sue:[99]

a. Plaintiff must have suffered an antitrust injury.
b. Plaintiff's injury must have been caused by defendant.
c. Damages must not be speculative or difficult to quantify or apportion. Nor may damages create the risk of overlapping claims (i.e., between different buyers in the distribution chain).
d. There must not be a risk of duplicate recovery.

As a practical matter, those standing requirements have prevented consumers who purchase *indirectly* from a price-fixing seller from suing for treble damages under the federal antitrust laws. The "indirect purchaser rule" derives from the fact that those who violate the federal antitrust laws are not allowed to defend against their direct purchasers by claiming that the plaintiffs passed the price increase on to their own customers and were, to such extent, not harmed. The direct purchaser is entitled to claim the full amount of the illegal price increases as his damages.[100] Exceptions to the indirect purchaser rule exist for situations in which (i) the injury is necessarily passed down the distributional chain, as in "cost-plus agreements," and (ii) the defendant controls the plaintiff's direct seller or the plaintiff controls the direct purchaser from the defendant.[101] Unless the MSA produces the equivalent of those exceptions, the federal treble damages remedy is probably limited to direct purchasers from the price-fixing tobacco companies. Plaintiffs could include distributors, jobbers, and some retailers, but not smokers.

In recent years, a number of states have enacted treble damages statutes that have the effect of eliminating the indirect purchaser rule. New York is one such state and California is another. The Supreme Court has held that state statutes that allow indirect purchasers to sue for damages under state antitrust laws supplement the federal antitrust laws and do not violate them.[102] In states that have eliminated the indirect purchaser rule, smokers, retailers, manufacturers, and others who did not purchase directly from the settling tobacco companies still have standing under state antitrust law to sue for treble damages.

As a general rule, unless a state has waived immunity, it is immune from suits for damages under the Eleventh Amendment to the Constitution.[103] Pursuant to a fiction created by the Supreme Court, however, state officers can be enjoined by the federal courts from violating the Constitution. An officer's unconstitutional actions are not attributed to the state for purposes of Eleventh Amendment immunity because unconstitutional actions are beyond the sovereignty or governmental capacity of the state.[104]

Antitrust suits can be brought by classes of individuals or firms as well as by a single individual or firm. Rule 23 of the *Federal Rules of Civil Procedure* specifies the conditions for bringing class actions in federal court.[105] The rule applies in the same manner to antitrust claims as to other claims.[106]

Congressional Remedies and Risks. The MSA has been very profitable to those who conceived and implemented it, and the temptation will exist to effect similar deals in the future. That type of deal, however, is destructive of the nation's economy, the Constitution, and the rule of law. Unfortunately, if the MSA is allowed to stand, it 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 Constitution or the laws.

The most important protections against that threat are the Constitution and Congress.

In the present instance, the Constitution has not failed. The people who drafted the MSA did not find constitutional loopholes that enabled them to enrich themselves at the expense of others. Instead, they violated the Constitution (and the antitrust laws).

The greatest risk going forward probably lies in the congressional arena, because that is where the next step in the tobacco conspiracy will play out. Recall that DOJ sued the tobacco companies for Medicare recovery on September 22, 1999. When the lawsuit was announced, there was much criticism that the suit lacked merit and constituted "piling on."[107] However, the lawsuit may be an important element in the overall plan by governmental proponents of the MSA (and, most likely, the tobacco companies). Specifically, the lack of congressional approval of the MSA is a gaping hole in the legal fabric of the MSA. If the DOJ lawsuit is settled pursuant to a scheme similar to that of the MSA, or if the federal government otherwise indicates its approval of the tobacco litigation, an argument will be made that the equivalent of congressional approval has been received. That purpose is consistent with the history of the DOJ lawsuit, namely: (i) Congress was asked to make an unusual appropriation of $20 *million* to finance the litigation (which Congress declined to do); (ii) Professor Blakey commented, "This case is not made to win, it's made to settle"; and (iii) Attorney General Reno originally opposed bringing the case because it was baseless.[108] How will Congress or a U.S. district court react to a proposed settlement offer of the DOJ suit in the area of $160 billion or so?[109] Avoiding approving the MSA (and thus completing the perfect crime) will take courage, an understanding of how the scheme undermines Congress's role in the government, and a high regard for the Constitution.

Conclusion

The MSA violates the Commerce Clause and the Compacts Clause of the Constitution. Consequently, the states acted beyond their powers in constructing and implementing the MSA, and their actions are not exempted from the antitrust laws by the state action doctrine or the *Noerr-Pennington* doctrine. The MSA effectuates collusion, price fixing, and exclusion of competition by the major tobacco companies; it violates federal and state antitrust laws; and it subsidizes a coterie of trial lawyers at over $500 million per year indefinitely for having devised an illegal price-fixing scheme. Victims of the MSA—smokers, sellers, and (nonsettling) manufacturers of tobacco products—have incurred and are incurring antitrust injuries; and smokers are being forced to finance a scheme that takes their money and gives them nothing in return. The institution of Congress and the rule of law are also victims. Fortunately, remedies are available. Victims who assert those remedies will perform a great service for themselves and, more important, for the nation.

The most important protections against the threats posed by the MSA are the Constitution and Congress.

Notes

1. The original tobacco companies that entered into the MSA were Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated, and R. J. Reynolds Tobacco Company. Those companies are referred to in the MSA as the "original participating manufacturers." The next largest tobacco manufacturer, Liggett Group, Inc., joined the settlement three days after the others signed and is included (together with the original participating manufacturers) wherever this study refers to the "settling tobacco companies."

2. The term "damages" is used in quotation marks because the payments provided for in the MSA are not based on a calculation of losses suffered by the states or injuries suffered by smokers. Rather, they are amounts that the settling parties determined could be added to the price of cigarettes without significantly reducing sales of cigarettes. The obligation to pay the "damages" is allocated among the settling tobacco companies on the basis of their respective market shares. See Master Settlement Agreement §§ II(mm), IX(b), and IX(c). (Cited hereafter as MSA.) The full text, including exhibits, of the MSA can be found at http://www.awpublish.com/settle.html. See also Jeremy Bulow and Paul Klemperer, "The Tobacco Deal," Brookings Papers on Economic Activity: Microeconomics 1998, November 1998, p. 19. Professors Bulow and Klemperer present an economic analysis of the MSA and also the predeces-

sor settlement attempts, the Resolution, and the McCain bill. Bulow and Klemperer explain that "damages" under the MSA are assessed and collected in much the same way as state excise taxes. However, the assessments are not characterized as taxes in order to avoid state budgeting and spending controls, and to enable the states' private attorneys to assess contingency fees against the total payment amounts. Professor Bulow is the current director of the Bureau of Economics of the Federal Trade Commission.

3. The nonsettling tobacco companies are given an alternative to paying "damages": they can maintain a market share equal to their 1998 share or no more than 125 percent of their 1997 share. Sales of the nonsettling tobacco companies represented less than 1 percent of the tobacco market divided among more than 100 competitors. Either way, the nonsettling tobacco companies are confined to a minuscule slice of the tobacco business.

4. An account of events leading up to the Resolution is contained in Carrick Mollenkamp et al., *The People vs. Big Tobacco, New Jersey* (Princeton, N.J.: Bloomberg, 1998).

5. Defeat of the McCain bill came within one week after the Senate approved an amendment that would have limited contingency fees for the states' private lawyers to $4,000 per hour. The fee cap apparently killed the bill, with various antitobacco groups claiming that the fee award cap would discourage plaintiffs' lawyers from taking tobacco cases in the future. *Mealey's Litigation Report: Tobacco* (King of Prussia, Pa.: Mealey, June 18, 1988), p. 4. The reason the states' private lawyers balked at that limit was that they expected (and ultimately received) far more. Lawyers' fees under the Texas settlement were expected to exceed $90,000 per hour. David E. Rosenbaum, "Senate Approves Limiting Fees Lawyers Get in Tobacco Cases," *New York Times,* June 17, 1998, p. A1.

6. See MSA §§ II(U) and (SS), VI(c)(3), and XI(f)(4)(C).

7. The following is a brief synopsis of the MSA:

Article I: Recitals.
Article II: Definitions.
Article III: Permanent Relief. Bans many types of advertising, including use of cartoon characters, sponsorship by tobacco brands of concerts or sporting events, billboard and transit advertising, use of tobacco brand names on other products (e.g., T-shirts) for merchandising.
Article IV: Public Access to Documents. Requires the tobacco companies to provide access to industry documents through creation of a document repository and Web site.
Article V: Tobacco Control and Underage Use Laws. Prohibits the tobacco companies from challenging state tobacco laws.
Article VI: Establishment of a National Foundation. Authorizes the National Association of Attorneys General (NAAG) to set up a foundation to fund studies to reduce youth smoking and prevent tobacco-related diseases; allocates $9.2 billion of "damages" for that purpose.
Article VII: Enforcement. Provides state court jurisdiction for enforcement of the MSA and consent decrees entered pursuant to it.
Article VIII: Certain Ongoing Responsibilities of the Settling States. Describes MSA enforcement and implementation roles for the NAAG, including creation and use of a $50 million States Antitrust/Consumer Protection Tobacco Enforcement Fund (the Enforcement Fund).
Article IX: Payments. Provides for collection of $206 billion of "damages" and the mechanism whereby the tobacco companies are protected from competitors who might charge lower prices.
Article X: Effect of Federal Tobacco-Related Legislation. Protects the tobacco companies against being required to make double payments in the event the federal government enacts tobacco-related legislation providing benefits to the states.
Article XI: Calculation and Disbursement of Payments. Specifies who will decide adjustments to payments made by tobacco companies in the event some tobacco companies increase or decrease market shares, how those payments will be calculated, and when payments will be made.
Article XII: Settling States' Release, Discharge and Covenant. Provides for releases by the states relating to settled litigation.
Article XIII: Consent Decrees and Dismissal of Claims. Requires states and tobacco companies to terminate Medicaid recoupment suits and submit the MSA and consent decrees to the courts for approval.
Article XIV: Participating Manufacturers' Dismissal of Related Lawsuits. Provides for releases by the tobacco companies of certain claims against the states.
Article XV: Voluntary Act of the Parties. Requires that the tobacco companies waive claims that the MSA violates state or federal constitutions.
Article XVI: Construction. Provides that neither side will receive a preference with respect to interpretation of the MSA, and affirms that the states do not approve the acts or practices of the tobacco companies.
Article XVII: Recovery of Costs and Attorneys' Fees. Requires that the tobacco companies pay the states' attorneys' fees, and specifies the manner for establishing attorneys' fees.

Article XVIII: Miscellaneous. Contains approximately nine pages of devices to protect the results of the MSA, such as "most-favored-nation" provisions, prohibitions on sales of assets by tobacco companies, arrangements for ongoing meetings and consultation, and prohibitions against declaring bankruptcy.

Exhibits: Exhibits A through U to the MSA include such things as a "Tobacco Enforcement Fund Protocol" (Exhibit J) relating to use of the NAAG's $50,000,000 Enforcement Fund; the tobacco companies' respective "Market Capitalization Percentages" (Exhibit K); a "Model Consent Decree" (Exhibit L); a "Model State Fee Payment Agreement" (Exhibit O) for determining states' private attorneys' contingency fees; and a "Model Statute," referred to elsewhere as a Qualifying Statute (Exhibit T), which forces nonsettling tobacco companies either to pay "damages" or to stay out of the business.

8. The MSA states that it is intended to protect underage smokers. That is not the real intent, as the following considerations demonstrate:

a. The MSA's advertising restrictions are the work product of state attorneys general and their contingency fee lawyers, who have no authority or competence to legislate or regulate. There is considerable dispute as to whether the ad restrictions will have any significant effect on underage smoking.

b. The elimination of advertising reduces costs for the tobacco cartel and creates a barrier to entry for potential competitors. That is consistent with and supportive of the anti-competitive purposes of the MSA.

c. The advertising regulations would be superfluous if the states enforced laws prohibiting the sale of cigarettes to minors, which prior to the MSA were on the books in all 50 states.

d. The moneys allocated to curb underage smoking are a small percentage of the "damages" being collected (approximately 4 percent).

e. The participating tobacco companies are excused from making anti-youth-smoking payments in any year after 2004 in which their combined market share decreases by 1 percent from the preceding year. MSA § IX (e). Thus, such purpose is secondary at most.

f. The lawsuits settled by the MSA were not brought for the benefit of smokers, underage or otherwise. They were brought to obtain reimbursement for the states.

g. The uses to which the states are putting the "damages" that they collect have little to do with the prevention of underage smoking. Funds are being used for such things as new sidewalks, tax cuts, boot camps, and school construction. Less than 8 percent of the states' discretionary "damages" payments is earmarked for anti-smoking campaigns. Alissa J. Rubin, "States Fund Variety of Programs with Tobacco Money," *Washington Post,* December 27, 1999, p. A5.

9. Bulow and Klemperer describe the tobacco industry as "a tight oligopoly dominated by four highly profitable firms controlling 98.6 percent of the market" (Philip Morris, RJR, Brown & Williamson, and Lorillard) with a fifth company (Liggett) holding a 1.3 percent share. Beyond that group, "over 100 fringe firms . . . in aggregate have perhaps 0.1 percent of the market." Bulow and Klemperer, p. 4 n. 7.

10. "[Each] Original Participating Manufacturer shall severally pay . . . its Market Capitalization Percentage (as set forth in Exhibit K) of . . . [the initial $12.7 billion of 'damages' payments]." MSA § 1X(b). "[Each] Original Participating Manufacturer shall severally pay . . . its Relative Market Share of the . . . [specified annual payments 'in perpetuity']." MSA § IX(c). The Market Capitalization Percentage measures the relative market shares in 1997 of a market consisting of Philip Morris, Brown & Williamson, Lorillard, and R. J. Reynolds (i.e., the Original Participating Manufacturers). MSA Exhibit K. The Relative Market Share measures an Original Participating Manufacturer's respective share of the total number of cigarettes shipped in the immediately preceding year by all Original Participating Manufacturers. MSA § II(mm).

11. *Bedell Wholesale Company, Inc. v. Philip Morris Incorporated, et al.,* Civil Action No. 99-558 (W.D. Pa.), Brief in Support of Plaintiffs' Motion for Partial Summary Judgment, at 4.

12. Basing the "damages" allocation on current market share means that the allocation is not intended to reflect the settling tobacco companies' relative degrees of liability. Since there is a significant latency period between tobacco exposure and tobacco-related disease, an allocation based on each company's actual liability would reflect past market shares, past sales, and past marketing claims (and possibly past levels of tar and nicotine of the various brands). In fact, the MSA's system for allocating "damages" has nothing to do with relative degrees of liability and everything to do with rigging the tobacco market and paying for permission to do so. See Bulow and Klemperer, pp. 18, 22.

13. The MSA prescribes a formula whereby a participating manufacturer may receive a reduction of its "damages" payments if the participating tobacco companies collectively suffer a market share loss caused by "disadvantages experienced as a result of the provisions of this Agreement." The aggregate amount of the "damages" adjustment (referred to as the "NPM Adjustment Percentage") is calculated as follows: "[If] the Market Share Loss for the immediately preceding year . . . is greater than 0 (zero) and less . . . than 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the product of (x) such Market Share Loss and (y) 3 (three)." MSA § IX(d)(1)(A)(ii). The loss of market share is based on comparison with a Base Aggregate Participating Manufacturer Market Share, which is the aggregate market shares of all Participating Manufacturers in 1997 minus two percentage points. MSA § IX(d)(1)(B)(i). The amount of the "damages" adjustment is allocated among participating manufacturers whose market shares fall below their respective 1997 market shares. MSA § IX(d)(3). "[A] nationally recognized firm of accountants (the 'Firm') shall determine whether the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss. . . . If [so], the NPM Adjustment . . . shall apply." MSA § IX(d)(1)(C).

14. MSA, Article III.

15. The Foundation is a charitable trust or foundation created by the attorneys general under the MSA to support the study of underage smoking and programs to prevent tobacco-related diseases. MSA, Article VI.

16. MSA § VIII(a)(2).

17. Tobacco companies that are not subject to "damages" payments (either because the states in which they operate do not support the MSA or because the tobacco companies operate in markets outside the reach of the MSA) also pose a risk to the "damages" income of the states. But the MSA allows participating tobacco companies that lose market share or sales to reduce their "damages" payments. MSA § IX(d) and Exhibit E.

18. The MSA requires each state to enact a Qualifying Statute, which is defined in the MSA as a "Settling State's statute . . . that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers . . . as a result of the provisions of this Agreement." MSA § IX(d)(2)(E).

19. "A Settling State's Allocated Payment shall not be subject to an NPM Adjustment . . . if such Settling State continuously had a Qualifying Statute . . . in full force and effect." MSA § IX(d)(2)(B). "If . . . a court . . . invalidates . . . the . . . [Qualifying Statute] with respect to such Settling State . . . then the NPM Adjustment . . . shall still apply to such Settling State's Allocated Payments but . . . shall not exceed 65 percent of the amount of such Allocated Payments." MSA § IX(d)(2)(F).

The effect of the MSA on state officials considering whether or not to join the MSA is reflected in the following statement by Attorney General Bill Pryor of Alabama:

> For those, like me, who rejected the legal theories used to sue the tobacco industry, the settlement was structured to persuade all states, even states with substantial tobacco farming, to participate. The settlement created an increase in the price of cigarettes for payments to all states; if a state refused to participate in the settlement, the smokers of that state nevertheless would pay higher prices to fund payments to other states. States that opposed the deal as "too soft" on the industry likewise were in a difficult position. That is why all 46 states that had not already settled with the industry agreed to the settlement.

William H. Pryor Jr., "A Comparison of Abuses and Reforms of Class Actions and Multigovernment Lawsuits," *Tulane Law Review,* forthcoming.

20. A model form of Qualifying Statute is annexed to the MSA as Exhibit T. The model Qualifying Statute provides that any tobacco company that refuses to sign the MSA must deposit in 25-year escrow an amount that (because it is not deductible for income tax purposes) is approximately 150 percent of the amount it would be required to pay as "damages" if it signed the MSA. The ostensible purpose of that escrow is security against potential future liability.

21. "A Subsequent Participating Manufacturer shall have payment obligations under this Agreement only in the event that its Market Share . . . exceeds the greater of (1) its 1998 Market Share or (2) 125 percent of its 1997 Market Share. . . . [Such] Subsequent Participating Manufacturer shall make payments corresponding to those due . . . from the . . . [Original Participating Manufacturers]." MSA § IX(i)(1). The formula for calculating those payments is specified in MSA § IX(i)(2).

22. MSA §§ IX(c), IX(d), and Exhibit E.

23. "The Attorneys General . . . shall establish a fund . . . to supplement 'the Settling States' (1) enforcement . . . of this Agreement . . . , and (2) . . . litigation of potential violations of laws. Each Original Participating Manufacturer shall . . . pay its Relative

Market Share of $50,000,000." MSA § VIII(c).

24. "[The] release [from litigation provided under the MSA for settling tobacco companies] . . . shall not apply to retailers, suppliers or distributors to the extent of any liability arising from the sale or distribution of Tobacco Products of . . . any non-Released Party." MSA § XII(a)(8). "No Original Participating Manufacturer may sell . . . any of its cigarette brands . . . or cigarette businesses . . . to any person or entity unless such person or entity is an Original Participating Manufacturer . . . [or] agrees to assume the obligations of . . . [an Original Participating Manufacturer]." MSA § XVIII(c).

25. MSA, Article III.

26. The MSA requires tobacco companies to share sales, pricing, profitability, market share, and other traditionally confidential information. See, for example, MSA §§ II(jj), IX(d)(3)(C)(ii), XI(a)(1), and XI(d)(2). A "Firm" and independent auditor hired under the MSA for collecting such information are required to share it with the tobacco companies, which are required, in turn, to "cooperate" with each other. See MSA §§ IX(d)(1)(C) and XI(a)(1). Tobacco companies designate representatives to meet with each other, and regular meetings are scheduled "to evaluate the success of this Agreement" (MSA § VIII(a)(2)) and to discuss "disputes" (MSA § XVIII(m)). The proceedings of such meetings are secret (MSA § IX(d)(2)(G)). The Model Consent Decree prescribed by the MSA prohibits some types of collusion but very pointedly does not prohibit collusion with respect to pricing and anticompetitive market practices. MSA, Exhibit L, Part V. The state attorneys general are participants in and profit from the price collusion and market allocation scheme prescribed in the MSA—yet no one can inquire into the meetings and data shared among the tobacco companies and the state attorneys general. For example, MSA § III(p) provides: "Documents and information provided to Settling State antitrust authorities shall be kept confidential by and among such authorities." To the same effect, see MSA §§ IX(d)(1)(C) and X(a)(1).

27. Much of the following legal analysis focuses on the interstate nature of the MSA and the restraints, incentives, and collaboration embodied in the MSA. States have substantial autonomy over matters that take place solely within their boundaries but very limited rights to engage in activities that affect interstate commerce. Moreover, states are prohibited from entering into agreements with other states that could infringe on federal prerogatives without the consent of Congress. To the extent the states, through the MSA, go too far into either of those areas, they not only violate the Constitution, they also expose themselves, their contingency fee lawyers, and the settling tobacco companies to liabilities under the antitrust laws from which they might otherwise be exempt. As we shall see, the states and the MSA go far into the forbidden areas.

28. Bulow and Klemperer, p. 18.

29. MSA § IX(d)(2).

30. See MSA § IX(d)(1)(C).

31. See MSA §§ XII(a)(8) and XVIII(c).

32. See MSA § VIII(c).

33. See MSA § IX(d)(1)(C).

34. See MSA § III.

35. See MSA §§ II(U), II(SS), VI(c)(3), and XI(f)(4)(C).

36. *Parker v. Brown,* 317 U.S. 341 (1943).

37. Ibid. at 361.

38. Ibid. at 362.

39. See MSA § IX(d)(2)(F).

40. *Parker* at 362–63.

41. 15 U.S.C. §§ 1331–41. An amendment to the 1965 act states, among other things: "No requirement or prohibition based on smoking and health shall be imposed under State law with respect to the advertising or promotion of any cigarettes the packages of which are labeled in conformity with the provisions of this chapter." Public Health Cigarette Smoking Act of 1969, 15 U.S.C. § 1334(b). Congress has thus clearly evidenced its intent to regulate tobacco.

42. Stephen Labaton, "Smokers Seek to Gain Share of Settlement," *New York Times,* January 26, 2000, p. A1.

43. MSA § II(u).

44. MSA § XVIII(q).

45. *Virginia v. Tennessee,* 148 U.S. 503, 519 (1893).

46. *United States Steel Corp. v. Multistate Tax Commission,* 434 U.S. 452, 470–71 (1978).

47. Ibid.

48. A history of the Compacts Clause and evolving Supreme Court interpretation are contained in ibid. at 459–69.

49. In the act's declaration of policy and purpose, Congress provides that "the purpose of this chapter [is] to establish a comprehensive Federal program to deal with cigarette labeling and advertising with respect to any relationship between smoking and health." 15 U.S.C. § 1331.

50. "The Congress shall have Power . . . [to] establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." Constitution, Article I, section 8.

51. MSA § XVIII(u)(1)(D).

52. The term "insolvent" is defined in the bankruptcy code as a "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation." 11 U.S.C. § 101(32).

53. Bulow and Klemperer estimated the market value of the equity of the firms at about $150 billion before subtracting the MSA liability. Bulow and Klemperer, p. 19 n. 78.

54. Tobacco Control Act, 7 U.S.C. § 515 et seq.

55. The House of Representatives debates that led to inclusion of the foregoing language, limiting the states' ability to enter into anti-competitive compacts, illustrate the concerns of Congress:

> [I]f this bill is enacted into law [without the limitation] a dangerous precedent will become established whereby a few states can control any particular commodity they produce. . . . Any form of compact or agreement which . . . amounts to collusion that would tend to foster and encourage monopoly would penalize the many to take care of the few. 80 *Cong. Rec.* 5187 (1936) (Rep. Dewey Jackson Short, R-Mo.).
>
> Finally, may I say that this measure [without the limitation] contemplates a compact or agreement between states to control production and raise prices. To corporations who attempt such a policy, we point an accusing finger and say they are attempting to violate the antitrust laws by a monopolistic practice. Can states do it with Federal sanction? To say the least, it presents an interesting question that will one day return to plague us if this bill [without the limitation] becomes law. 80 *Cong. Rec.* 5205 (1936) (Rep. Everett Dirksen, R-Ill.).

56. *Parker* at 359–60.

57. The Compacts Clause is in the same section (i.e., Article I, section 10) of the Constitution that prohibits states from entering into treaties with foreign countries, laying imposts or duties on imports or exports, or engaging in war. Violations of the Compacts Clause, like state declarations of war, are clearly beyond the powers of the states.

58. 15 U.S.C.A. §§ 1–7.

59. Philip Areeda and Herbert Hovenkamp, *Antitrust Law,* rev. ed. (New York: Aspen Law & Business, 1997), ¶ 222(a)(I)(A).

60. *Parker* at 351.

61. *Lafayette v. Louisiana Power & Light Co.,* 435 U.S. 389, 391 (1978). Emphasis added.

62. Ibid. at 413. Emphasis added.

63. Ibid. at 410.

64. *Ex Parte Young,* 209 U.S. 123, 159–60 (1908). Emphasis added.

65. The doctrine was first announced in the 1961 Supreme Court case of *Eastern Railroad Conference v. Noerr Motor Freight,* 365 U.S. 127 (1961), and confirmed four years later in *United Mine Workers of America v. Pennington,* 381 U.S. 657 (1965).

66. *Noerr* at 135.

67. The *Pennington* case involved a conspiracy between the United Mine Workers and certain employers to impose onerous contract terms on other employers in order to force them out of business. Although petitioning of the secretary of labor was held to be immune from antitrust liability, that was not the case with respect to the conspiratorial activities themselves. The Court stated: "Thus the relevant labor and antitrust policies compel us to conclude that the alleged agreement between UMW and the large operators to secure uniform labor standards throughout the industry, if proved, was not exempt from the antitrust laws." *Pennington* at 669.

68. Ibid. at 673.

69. Areeda and Hovenkamp, ¶ 203, p. 198.

70. *Airport Car Rental Antitrust Litig.,* 521 F. Supp. 568, 583 (N.D. Cal. 1981), aff'd, 693 F.2d 84 (9th Cir. 1982), cert. denied, 462 U.S. 1133 (1983); cited by Areeda and Hovenkamp, p. 242.

71. *Columbia v. Omni Outdoor Advertising, Inc.,* 499 U.S. 365, 380 (1991).

72. William C. Holmes, *Antitrust Law Handbook* (St. Paul, Minn.: West, 1999), p. 758.

73. Areeda and Hovenkamp, p. 242.

74. Ibid.

75. *Noerr* at 144.

76. *Lafayette* at 416–17.

77. *Pennington* at 669.

78. Bulow and Klemperer also note that the collusive nature of the Resolution necessitated congressional approval: "In effect the Resolution facilitated collusion among the companies to raise prices. . . . The only problems were that the antitrust authorities might challenge the Resolution's collusive pricing and the related entry deterrence provisions needed to maintain high prices. *Therefore these terms of the deal and others . . . required Congressional legislation."* Bulow and Klemperer, p. 2. Emphasis added.

79. Resolution, Appendix IV § C2, http://www.tobaccoresolution.com/index1.html.

80. MSA, Article XV. A similar provision also appeared in the Resolution (Title III, Part B, final paragraph) even though the proponents anticipated receiving congressional approval.

81. http://www.tobaccoresolution.com/index1.html, under "Issue Briefs." Emphasis added.

82. MSA § VIII(c).

83. Article I, section 8, of the Constitution provides: "The Congress shall have Power To lay and collect Taxes."

84. http://www.tobaccoresolution.com/index1.html, under "Issue Briefs."

85. Ibid.

86. Bulow and Klemperer, p. 36.

87. Quoted in Holman W. Jenkins Jr., "Another Tobacco Lawsuit (Yawn)," *Wall Street Journal,* September 29, 1999, p. A23.

88. Mollenkamp et al., p. 212 et seq.

89. In a prepared statement to the Senate Subcommittee on Antitrust on October 29, 1997, FTC chairman Robert Pitofski concluded that higher tobacco prices are desirable; still, he recommended against a special antitrust exemption for the tobacco industry because he felt the risk of collusion was too great and the tobacco companies would raise their prices too much. That strange conclusion reflects the dilemma of an antitrust law enforcer who has decided that he will tolerate a limited amount of price fixing. At the time of the hearing, it was assumed that the Resolution would receive congressional approval (which it did not). Thus, although its reasoning seems confused, the FTC is fully aware of the antitrust issues and has chosen not to act.

90. See MSA § IX(i) and Exhibit T.

91. An "antitrust injury," as defined by the Supreme Court, is "injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful." *Brunswick Corp. v Pueblo Bowl-O-Mat, Inc.,* 429 U.S. 477, 489 (1977). Antitrust injuries must be established in order for an antitrust plaintiff to prevail.

92. 28 U.S.C.A. § 2201.

93. The MSA may also involve additional criminal and constitutional violations—for example, federal and state anti-bribery laws prohibit payments by the tobacco companies to the state attorneys general to influence the enforcement (or nonenforcement) of antitrust laws. See, for example, the federal anti-bribery laws at 18 U.S.C. § 201 et seq. and 18 U.S.C. § 666; and, in New York, *McKinneys Penal Law* § 200 et seq. See also the Racketeering Influenced Corrupt Organization (RICO) laws that prohibit the use of monies obtained through a pattern of illegal activities. 18 U.S.C. § 1961. The requirement of the MSA's Qualifying Statute that nonparticipating manufacturers deposit "damages" in a 25-year escrow as security against potential future liability undoubtedly constitutes a bill of attainder in violation of Article I, section 10, of the Constitution and a violation of due process under the Fifth and Fourteenth Amendments to the Constitution.

94. See the discussion of standing in "Declaratory Judgment," *American Jurisprudence* 22A, 2d ed., secs. 25–32.

95. *Ex Parte Young* at 155–56.

96. To date, there has been relatively little antitrust litigation concerning the MSA. A case on behalf of smokers, *Hise v. Philip Morris,* 46 F. Supp. 2d 1201 (N.D. Okla. 1999), aff'd, 2000 WL 192892 (10th Cir. Feb. 18, 2000), was dismissed on *Noerr-Pennington* (immunity) and *Illinois Brick* (standing) grounds, among others. The judgment was rendered before any discovery had occurred. The following statement indicates that the court did not waste much time on the case: "Because the Complaint and the allegations contained therein

must fail as a matter of law, the Court sees no reason to burden defendants with the additional time and expense involved in proceeding to discovery." Ibid. at 1205.

In support of its *Noerr-Pennington* rationale, the court stated: "The Court finds no evidence which even remotely suggests that defendants intended to use the MSA as an anti–competitive weapon to exclude or harass competitors." Ibid. at 1207. With respect to price fixing, the court found that "plaintiffs failed to adequately plead a price-fixing conspiracy." Ibid. at 1208. On that point, however, the court did state: "Of course, the Court does not believe that defendants were free at any time, either prior to or after execution of the MSA, to enter into a conspiracy to fix tobacco prices." Ibid. at 1208.

The plaintiffs apparently raised the Compacts Clause argument, but again, ineffectively: "Citing Article 1, Sec. 10 of the Constitution, plaintiffs allege that the parties to the MSA formed an unlawful confederation . . . by entering into and executing the MSA. Plaintiffs cite no authority for their extraordinary claim, and the Court finds and concludes that this claim is plainly frivolous." Ibid. at 1210.

In another action against tobacco companies, this one by a cigarette distributor, *Bedell v. Philip Morris,* Civil Action No. 99-558 (W.D. Pa. 2000), the court dismissed two counts under the Sherman Act. Notably, however, the plaintiffs in both *Bedell* and *Hise* failed to comprehend, or at least they appear not to have argued, the interrelationship of the Commerce Clause, the Compacts Clause, state action immunity, and the *Noerr-Pennington* exemption. Nor did the courts' decisions address that interrelationship.

In *Bedell*, for example, the court ruled that the tobacco companies were protected by *Noerr-Pennington* in negotiating and executing the MSA, and by state action exemption to the extent that the companies' acts were mandated by the MSA. Moreover, said the court, "[T]he MSA was undertaken by the settling states functioning in their sovereign capacities." *Bedell* at 11. Yet it is impossible to reconcile the MSA with the Commerce and Compacts Clauses. And, to the extent the MSA violates those provisions of the Constitution, the states could not approve and implement the MSA "functioning in their sovereign capacities." Because the plaintiffs failed to make that connection in their briefs, neither *Bedell* nor *Hise* comes to grips with the central thesis of this paper.

See also the following two cases:

(a) *PTI, Inc. v. Philip Morris,* Case No. 99-08235 NM (C.D. Cal., Aug. 13, 1999). Plaintiff, PTI, Inc., an importer of cigarettes, is suing the settling tobacco companies for antitrust violations, constitutional violations, and unfair competition, among other things, in a 142-page complaint. The case is still in its early stages.

(b) *Forces Action Project LLC v. State of California,* Case No. C99-0607 MJJ (N.D. Cal., Jan. 5, 2000). This smokers' case, which was dismissed on summary judgment motion, is currently on appeal. The plaintiffs based their action on equal protection and due process theories under the Fourteenth Amendment to the Constitution and 42 U.S.C. §§ 1983 and 1985.

97. Section 4 of the Clayton Act, 15 U.S.C. § 14, provides for treble damages as follows: "[A]ny person who shall be injured in his business or property by reasons of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found . . . and shall recover threefold the damages by him sustained, and the cost of the suit including a reasonable attorneys fee."

Section 16 of the Clayton Act provides for injunctive relief as follows: "Any person . . . shall be entitled to sue for and have injunctive relief in any court of the United States having jurisdiction over the parties, against threatened loss or damage by a violation of the antitrust laws."

98. New York's treble damages statute (*McKinney's General Business Law* § 340), which provides consumers with a remedy against indirect sellers, provides in pertinent part: "[A]ny person who shall sustain damages by reason of any violation of [the New York antitrust laws] shall recover three-fold the actual damages sustained thereby, as well as costs not exceeding ten thousand dollars, and reasonable attorneys fees. . . . In any action pursuant to this section, the fact that . . . any person who has sustained damages by reason of violation of this section has not dealt directly with the defendant shall not bar or otherwise limit recovery."

99. Thomas V. Vakerics, *Antitrust Basics* (New York: Law Journal Seminars Press, 1987) § 3.03[2].

100. *Hanover Shoe, Inc. v. United Shoe Machinery Corp.,* 392 U.S. 481 (1968).

101. *Illinois Brick Co. v. Illinois,* 431 U.S. 720, 736 (1977).

102. *California v. ARC America Corp.,* 490 U.S. 93 (1989).

103. The Eleventh Amendment provides: "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another state, or by citizens or subjects of any foreign state." In *Haus v. Louisiana,* 134 U.S. 1 (1890), the doctrine of sovereign immunity was expanded to cover suits against a state by its own citizens.

104. *Ex Parte Young* at 159. See also Charles Alan Wright, Arthur R. Miller, and Edward H. Cooper, *Federal Practice and Procedure: Jurisdiction,* 2d ed. (St. Paul, Minn.: West, 1988) § 4231.

105. For certification as a class, *Federal Rule of Civil Procedure* 23 requires that the members of the class be too numerous to join in the action; the named plaintiffs' claim must be typical of the claims of the other class members; common questions of law and fact must predominate over questions affecting individual members of the class; the named plaintiff must be able to protect fairly and adequately the interest of the members of the class; and a class action must be superior to other possible methods for the fair and efficient adjudication of the controversy.

106. See Holmes § 8.09.

107. See "Uncle Sam vs. Big Tobacco," *The Economist,* October 2, 1999, p. 22.

108. See Jenkins.

109. That represents the approximate difference between the $365 billion "damages" agreed in the Resolution and the $206 billion "damages" of the MSA. And, of course, it will all be paid by smokers.

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