

NLWJC - Kagan

DPC - Box 043 - Folder 002

Tobacco-Settlement – Antitrust

What is an antitrust exemption?

Antitrust law generally seeks to preserve competition in the marketplace by preventing unreasonable restraints on trade, price discrimination, price fixing, and monopolies. In particular, antitrust laws prohibit collusion among firms to raise prices or engage in other anti-competitive conduct. An antitrust exemption allows competitors to collude under specified circumstances.

Why do the tobacco companies claim that they need an antitrust exemption?

Supporters of the tobacco companies claim that comprehensive tobacco legislation should contain an antitrust exemption because, they believe, the companies cannot comply with the legislation's provisions to reduce youth smoking (including marketing restrictions and price increases) without such an exemption and that the companies need an exemption in order to ensure that retailers and distributors comply with the law.

Do the tobacco companies need an antitrust exemption?

No. There is no reason that the tobacco companies need to collude in order to comply with the law. The tobacco companies do not need to collude to comply with the marketing and advertising restrictions, the provisions related to youth access, the payment provisions, or any of the bill's other provisions. The legislation creates straightforward obligations on the tobacco industry and each company can comply individually.

Nor is an antitrust exemption needed in order for the tobacco companies to ensure that their distributors and retailers do not sell tobacco products to minors or otherwise violate the new law. Compliance among distributors and retailers with any legal requirement that they make tobacco products less accessible to minors or that they comply with other restrictions can be enforced directly by federal, state, and local governments. Moreover, comprehensive legislation should contain sufficient incentives for tobacco companies to instill compliance in their distributors and retailers, without the need for insulating group boycott activity from antitrust scrutiny.

What will happen if tobacco companies get an undeserved antitrust exemption?

An antitrust exemption will not advance the purposes of the legislation. Moreover, as the FTC has concluded, if tobacco companies get an antitrust exemption, they may be able to use the legislation to collude and thereby increase their profitability significantly. Those increased profits would not go to the public health or to advance other important public purposes; they would simply line the tobacco companies' coffers.

**Comprehensive Tobacco Legislation
Should Not Have a ^{blanket} Antitrust Exemption**

I DON'T LIKE THIS ONE. EK SHOULD REWRITE TO SAY WE SHOULD NARROW THE EXEMPTION & WHY.

^{blanket} Tobacco companies advocate an antitrust exemption for the industry as part of any comprehensive tobacco legislation. Such exemptions are not necessary to achieve the goals of the legislation and may have anticompetitive effects that serve only to enrich the tobacco industry at the expense of confirmed smokers.

Nobody cares about this issue (except DOJ), so we should tone down the rhetoric + not get people more worried than necessary.

What is an antitrust exemption?

Antitrust law generally seeks to preserve competition in the marketplace by preventing unreasonable restraints on trade, price discrimination, price fixing, and monopolies. In particular, antitrust laws prohibit collusion among firms to raise prices or engage in other anti-competitive conduct. An antitrust exemption allows competitors to collude under specified circumstances.

Why do the tobacco companies claim that they need an antitrust exemption?

Tobacco companies claim that comprehensive tobacco legislation should contain an antitrust exemption because, they believe, they cannot comply with the legislation's provisions to reduce youth smoking (including marketing restrictions and price increases) without such an exemption and that the companies need an exemption in order to ensure that retailers and distributors comply with the law.

Do the tobacco companies need a ^{blanket} antitrust exemption?

~~No. There is no reason that the tobacco companies need to collude in order to comply with the law. The tobacco companies do not need to collude to comply with the marketing and advertising restrictions, or any of the bill's other provisions. The legislation creates straightforward obligations on the tobacco industry and each company can comply individually.~~

~~Nor is an antitrust exemption needed in order for the tobacco companies to ensure that their distributors and retailers do not sell tobacco products to minors or otherwise violate the new law. Compliance among distributors and retailers with youth access or other restrictions can be enforced directly by federal, state and local governments. Moreover, comprehensive legislation should contain sufficient incentives for tobacco companies to instill compliance in their distributors and retailers, without an antitrust exemption.~~

Is an antitrust exemption necessary for tobacco companies to be able to enter the protocol?

Proponents argue that the antitrust exemption is necessary to permit the tobacco companies to enter a protocol. However, antitrust laws do not prevent the tobacco companies from entering into a protocol with the federal government individually. Moreover, the tobacco companies are permitted, under well-established antitrust principles, to petition the government

collectively in order to clarify or modify the protocol. A statutory antitrust exemption is not necessary for such collective action.

What will happen if tobacco companies get an ^{blanket} undeserved antitrust exemption?

^{blanket} An antitrust exemption will not advance the purposes of the legislation. Moreover, as the FTC has concluded, if tobacco companies get an ^{broad} antitrust exemption, they may be able to use the legislation to collude and thereby increase their profitability significantly. Those increased profits would not go to the public health or to advance other important public purposes; ~~they would simply line the tobacco companies' coffers~~

Conclusion

The antitrust laws are the chief legal protector of the free-market principles on which the American economy is based. Even the most carefully and narrowly drawn antitrust exemptions often result in unintended anticompetitive effects. For this reason, antitrust exemptions should be enacted only in exceedingly rare instances in which the fundamental free-market values underlying the antitrust laws are compellingly outweighed by a clearly paramount and incompatible policy objective. There is no important policy objective in this case that could not be advanced by other means -- namely, through direct enforcement of the marketing restrictions, price increase requirements, and other provisions of a comprehensive tobacco bill.

United States Department of Justice

Antitrust Division



Fax Number: 514-0306
Voice Number: 514-2512

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FAX COVER SHEET

DATE: May 11, 1998
TO: Elena Kagan
of:
Fax Number: 456-2878
FROM: Doug Melamed/Bob Potter

Pages Sent (including this sheet): 4

Remarks: Enclosed are two versions of possible antitrust language. We would prefer the short, one-page version. However, if there is insistence regarding some type of filing with the AG for certain conduct, we could accept version 2 -- which significantly does not key an antitrust exemption off approval by the AG of the conduct. That remains unacceptable to us.

SEC. _____. ANTITRUST EXEMPTION FOR REFUSAL TO DEAL WITH DISTRIBUTORS AND RETAILERS WHO SELL TOBACCO PRODUCTS TO UNDERAGE PERSONS.

(a) EXEMPTION. -- Subject to subsection (b), the antitrust laws shall not apply to conduct by a tobacco manufacturer that consists of --

(1) establishing with other tobacco manufacturers an entity, not affiliated with any tobacco manufacturer, for the sole purpose of compiling a list of distributors or retailers of tobacco products who sell tobacco products to underage persons in violation of this Act;

(2) providing such entity with information regarding any distributor or retailer of tobacco products who the manufacturer becomes aware is selling tobacco products to underage persons in violation of this Act;

(3) obtaining from time to time the list compiled by such entity;
or

(4) refusing to furnish tobacco products to a distributor or retailer on such list solely because of such distributor's or retailer's sales of tobacco products to underage persons.

(b) DISCLOSURE AND PUBLICATION. -- Subsection (a) shall apply with respect to an entity described in subsection (a)(1) only if such entity retains the documents relating to its establishment or operation and makes such documents available for examination --

(1) upon request by --

(A) the Attorney General; or

(B) the attorney general of a State.

(c) DEFINITION OF ANTITRUST LAWS. -- For purposes of subsection (a), the term "antitrust laws" has the meaning given it in subsection (a) of the first section of the Clayton Act, except that the term includes section 5 of the Federal Trade Commission Act to the extent that such section 5 applies to unfair methods of competition.

Subtitle E Antitrust Provisions

SEC. 1161 REVIEW OF CONDUCT

A participating tobacco product manufacturer or manufacturers may request that the Attorney General of the United States review, pursuant to any procedures established by the Attorney General, a plan to comply with the requirements of this Act regarding reduction of use of tobacco products by underage persons. Upon receipt of such a request, if the Attorney General determines that the plan will not unduly restrain competition, the Attorney General may advise the parties seeking review that the Attorney General does not intend to challenge the proposed conduct.

SEC. 1162 LIMITED ANTITRUST EXEMPTION FOR REFUSAL TO DEAL WITH DISTRIBUTORS AND RETAILERS WHO SELL TOBACCO PRODUCTS TO UNDERAGE PERSONS.

(a) EXEMPTION. -- Subject to subsection (b), the antitrust laws shall not apply to conduct by a tobacco manufacturer that consists of --

(1) establishing with other tobacco manufacturers an entity, not affiliated with any tobacco manufacturer, for the sole purpose of compiling a list of distributors or retailers of tobacco products who sell tobacco products to underage persons in violation of this Act;

(2) providing such entity with information regarding any distributor or retailer of tobacco products who the manufacturer becomes aware is selling tobacco products to underage persons in violation of this Act;

(3) obtaining from time to time the list compiled by such entity;
or

(4) refusing to furnish tobacco products to a distributor or retailer on such list solely because of such distributor's or retailer's sales of tobacco products to underage persons.

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documents relating to its establishment or operation and makes such documents available for examination --

(1) upon request by --

(A) the Attorney General; or

(B) the attorney general of a State.

SEC. 1163 SAVINGS CLAUSE

Except as provided in Section 1162, nothing in this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws.

SEC 1164 DEFINITION OF ANTITRUST LAWS

For purposes of Subtitle E, the term "antitrust laws" has the meaning given it in subsection (a) of the first section of the Clayton Act, except that the term includes section 5 of the Federal Trade Commission Act to the extent that such section 5 applies to unfair methods of competition.

- too broad
- AG

Conv. w/ Tom Perotti / George Rivera 5/11

1. Their proposal

a. ~~(a)~~ (c) we are law enforcement agency - prosecutors
wanting to push us into reg af - make policy
don't want to pass just in view AT exemptions
open-ended auth; no trade or expertise

(b) app to boycott distributors, ours is narrower
prob here: support manuals collect names of all distrib-
decide when they have anticompet reasons - to get
something from them and -- put it into play.
when mt manuals collect app distributors?

• support other product - app to suppress import
common thing. All manuals except one - we're
going to return to do bus w/ distrib or
retailer who handles this other product.

Big 5 - came up w/ list of duties for
distrib - for support purpose of reducing
youth smoking. Fund those duties -
but new enactment could not fund this.

(1) requires that purpose of af ← We're agreeing, but it has technical probs.
be solely to stop ~~pro~~ underage
consumption
but ok to boycott just bec
distrib has sold to kids - but allows them to account the

(2) breakdown allows manuals puts up
firewalls ^{don't} app af -
same purpose.
it customer has to do only w/ establishing
entity - that then acts as clearinghouse
they're not collaborating here - as to
this or any other temptation to engage in anti-conv conduct

(a) lot is broad + nebulous - don't even know yet what's in P.

If phys. to meet are req'd to do something, they can
do comply w/out fear of AT laws.

gins Rumbil: How are we going to comply w/ this in such a way
as to be anticomp.

- e.g. ^{agree on} how best to raise Δ to pay assessments -
value & prices to monopoly level - beyond
what they need.

- any # of apps to behave like a monopoly.

advertising / research together

allows them to behave like monopoly

e.g. not going to do safer products b/c this
could \uparrow youth demand.

- new entrants won't have same apprec of youth
smoking habits, but to crush comp. for new
entrants.

all has some relationship ^{to} complying w/ protocol

not needed: once in place, they can comply.

Advertising? Don't need specific exemption.

AT exempt

You have direct leg.

" " protocol. \rightarrow incl. req. to deal w/ distrib./retailer
in cert way
don't need to deal w/ each other ~~directly~~

subj. to penalties if violate above of
if P. sets struck down? Shouldn't be with contingent provisions.

mainly that's } go to cover of distrib
all you need } control of downstream sale + marketing

George Stone

305-0085

version 2 - codified business review process

Tobacco - settlement -
antitrust



U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

March 3, 1998

The Honorable Michael DeWine
Chairman, Subcommittee on Antitrust,
Business Rights, and Competition
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

In response to your and Senator Kohl's request, this letter contains the Department of Justice's evaluation of the proposal to create an antitrust exemption for tobacco product manufacturers as part of tobacco legislation currently under consideration. Although our evaluation is necessarily preliminary and is subject to revision as consideration of tobacco legislation progresses, the general principles expressed herein are likely to be applicable to any tobacco legislative proposal that includes an antitrust exemption. An identical reply letter has been prepared and sent to Senator Kohl.

The American economy is based on free-market principles. In essence, businesses generally are free to choose the products and services they will offer and the prices they will charge. At the same time, individuals are free to choose the products and services they will purchase, taking into account the prices charged for such goods and services. Competition among businesses, each attempting to be successful in selling its products, leads to the best quality products, the lowest prices and the highest level of innovation.

The antitrust laws are designed to prevent this freedom of choice from being undermined through anticompetitive means. These laws ensure that businesses will not stifle competition to the detriment of consumers.

The importance of antitrust to our economy has been recognized numerous times by the Supreme Court. The Court has stated that price agreements are illegal under the antitrust laws

The Honorable Michael DeWine
United States Senate
Page 2

because they are a threat to "the central nervous system of the economy," United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940), and that the antitrust laws represent "fundamental national economic policy." Carnation Co. v. Pacific Westbound Conference, 383 U.S. 213, 218 (1966). The words of the Court that perhaps best express the true importance of the antitrust laws are the following: "Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the preservation of our fundamental personal freedoms." United States v. Topco Associates, Inc., 405 U.S. 596, 610 (1972).

Because of the importance of the antitrust laws to the nation's economic policy, exceptions to the antitrust laws should be made very sparingly. Antitrust exemptions should be enacted only in rare instances in which the fundamental free market values underlying the antitrust laws are outweighed by a paramount policy objective. We realize that the basic goals of the antitrust laws and the critical effort to reduce youth smoking through significant price increases in tobacco products are somewhat in tension. Yet efforts to reduce smoking through modifications in the antitrust laws must make certain that such modifications are carefully and narrowly crafted to avoid unintended adverse consequences.

We believe that some of the proposed antitrust exemptions likely will have just such unintended consequences. As we understand it, the principal antitrust exemptions for tobacco product manufacturers that have been mentioned as possibilities include: an exemption for price-fixing, an exemption for dealings with distributors and retailers, and an exemption for coordinated advertising. Such antitrust exemptions might be appropriate if it could be demonstrated that, without such exemptions, enforcement of the antitrust laws would prevent conduct that is necessary to further the objective of reducing the incidence of tobacco use among minors.

In the Department's view, an antitrust exemption is not needed to enable tobacco product manufacturers to raise the price of tobacco products in order to decrease demand for them among minors, or to finance any government education or health programs designed to curtail tobacco use and alleviate its adverse health effects. These objectives can be advanced to the same extent by means that do not permit the tobacco companies to engage in

The Honorable Michael DeWine
United States Senate
Page 3

conduct that, but for an exemption, would violate the antitrust laws. For example, imposing an assessment against tobacco companies, as some have proposed, would have effects on both price and demand. Once the amount to be assessed against the tobacco companies were set, the tobacco companies would pass the costs of the assessment through the marketing chain to their consumers. Unlike an antitrust exemption for price-fixing, which could have the perverse effect of increasing the profits of the tobacco companies at the expense of consumers who are addicted to tobacco, such an assessment would achieve the desired price increase for tobacco products without further enriching the tobacco companies as a result.

The Department also believes that an antitrust exemption is not needed so that tobacco product manufacturers might act collectively to guard against the possibility of distributors and retailers undermining efforts to limit the extent to which minors are exposed to tobacco products. Adequate compliance among distributors and retailers with any legal requirement that they make tobacco products less accessible to minors can be enforced directly by federal, state, and local governments. Moreover, if legislation provides sufficient incentives for individual tobacco product manufacturers to assist in efforts to reduce sales of their tobacco products to minors, manufacturers can be expected to take steps on their own to ensure cooperation by their distributors and retailers. There should be no need for the type of coordinated conduct among manufacturers that might violate the antitrust laws.

The third proposed antitrust exemption is for tobacco product manufacturers to engage in coordinated advertising and marketing. The Department would want to examine the desirability of such an exemption closely in the context of the overall legislation. Such an exemption might not be necessary if other provisions in court orders or legislation were sufficient to ensure that advertising and marketing programs were suitably restricted. If such measures are not fully available, however, a limited antitrust exemption might appropriately assist in efforts to reduce tobacco use by minors. Any such exemption would need to be drafted narrowly and carefully so as to minimize the risk that it could be used to cloak anticompetitive collaboration by tobacco manufacturers beyond that necessary to achieve that overriding goal.

The Honorable Michael DeWine
United States Senate
Page 4

Some have attempted to answer the concerns regarding the creation of antitrust exemptions by suggesting that legislation should provide that exemptions for particular conduct will be conditioned on ad hoc Justice Department approval. We strongly urge you not to pursue such an approach, which would take the Department outside its traditional law enforcement role and turn it into a regulatory body. That would require the creation of an entirely new regulatory apparatus within the Antitrust Division and raise a host of questions regarding such important considerations as procedural due process, and it could significantly increase the Antitrust Division's need for resources and risk distracting it from its law enforcement mission.

We realize that antitrust is just one of many important policy factors Congress must consider in developing effective legislation to deal with the health problems associated with tobacco use. If, notwithstanding our concerns, you should decide to move forward with consideration of antitrust exemptions, the Department would be pleased to work with you in crafting them as narrowly and precisely as possible to achieve their purpose without creating unnecessary anticompetitive effects.

The Office of Management and Budget advises that from the standpoint of the Administration's program there is no objection to the submission of this report.

Thank you for your interest in the Department's views and for your support of federal antitrust enforcement.

Sincerely,



Ann M. Harkins
Deputy Assistant Attorney General

5/5

Anti-trust

(1st AT exempt)

1. Most strongly - don't want to be put in role of regulator.
 can make avail. cur and business review procedure.
 inst expectation + comp is law out - don't want to assess
 derivability -- even comp effects -- of other conduct
 direct resources / involvement in pol. 2's
 precedential effect.
 standardless - not will equipped to decide whether a scheme
 is compatible w/ goals of statute - no expertise in
 reducing youth smoking.

2. Other exemptions - bias always against
 ↑ price not just ↑ price - means would give them added
 profit - undue profit - enrich selves.
 Test: nec. to allow priv phys to do what we want?
 Damp - anti-bif in exemption / spillover effect

one area where legit issue -
 ind. lookbacks - incentive for free riding
 ideal sol - co-specific targets.
 if don't get - inhibits suit scheme. (negative)
 2nd poss - not want to encourage act to prevent
 free riding - enable cos to act in concert
 language:

namer: abil to cut off
 non-compliant distributors

provided however, that exempt
 does not apply to conduct
 that is restrictive of other
 people's products.

tabacco - settlement -
antitrust



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

LEGISLATIVE REFERENCE DIVISION
ECONOMICS, SCIENCE, AND GENERAL GOVERNMENT BRANCH

TO:

Karen Wilson - DOJ
Elena Kagan - DPC

FROM: INGRID SCHROEDER
phone: (202) 395-3883
FAX: (202) 395-3109

DATE: 2/25/98

NUMBER OF PAGES (including this cover sheet): 6

COMMENTS:

HHS cmts on Tobacco antitrust letter

Please call (202) 395-3454 to report any difficulties with transmission of this fax.


DEPARTMENT OF HEALTH & HUMAN SERVICES

OFFICE OF THE SECRETARY

February 25, 1998

 Office of the General Counsel
 Legislation Division
 Washington, DC 20201

NOTE TO: INGRID M. SCHROEDER (OMB)

Re: Department of Justice Report on Attorneys General and Tobacco Industry Report on Tobacco Settlement Plan - Antitrust Exemption for Tobacco Product Manufacturers - Draft Letter (LRM ID: IMS247)

HHS has the following comments so far on the draft letter. We cannot give final HHS clearance at this time as we have not heard from all reviewers.

A mark-up of the letter is attached and the revisions are explained below.

The letter in several places refers to a tobacco settlement. The reference to a "settlement" is inaccurate and should be deleted throughout the letter. **Unless this change is made, HHS will not clear the letter.**

There is a conflict between two statements on page two. The third sentence of paragraph one asserts that there is a tension between the basic goals of antitrust law and efforts to reduce youth smoking through significant price increases. Then, the first sentence of paragraph three states that the Department of Justice's view is that an antitrust exemption is not needed to enable tobacco manufacturers to raise tobacco product prices sufficiently to decrease demand by minors for tobacco products, implying that the price increases would not be so significant as to require an antitrust exemption.

On page two, paragraph two, first line, the word "the" should be "that" and the word "propose" should be "proposed".

On page three, paragraph two, first line, the words "need and" should be inserted before "desirability".

In the same paragraph two on page three, options for antitrust exemptions should not be suggested. Thus, the sentence beginning "If such provisions " and all that follows in that paragraph should be deleted. Similarly, on page four, paragraph one, all language other than boilerplate language should be deleted from the paragraph so that antitrust exemption alternatives are not suggested.

Jane K. Taylor
 202-690-7773

Attachment



U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

Draft

The Honorable Michael Dewine
Chairman, Subcommittee on Antitrust,
Business Rights, and Competition
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

In response to your and Senator Kohl's request, this letter contains the Department of Justice's evaluation of the proposal to create an antitrust exemption for tobacco product manufacturers as part of the tobacco ~~settlement~~-legislation currently under consideration. Although our evaluation is necessarily preliminary and is subject to revision as consideration of the overall tobacco ~~settlement~~-legislation progresses, the general principles expressed herein are likely to be applicable to any tobacco-~~settlement~~ legislative proposal that includes an antitrust exemption. An identical reply letter has been prepared and sent to Senator Kohl.

The American economy is based on free-market principles. In essence, businesses generally are free to choose the products and services they will offer and the prices they will charge. At the same time, individuals are free to choose the products and services they will purchase, taking into account the prices charged for such goods and services. Competition among businesses, each attempting to be successful in selling its products, leads to the best quality products, the lowest prices and the highest level of innovation.

The antitrust laws are designed to prevent this freedom of choice from being undermined through anticompetitive means. These laws ensure that businesses will not stifle competition to the detriment of consumers.

The importance of antitrust to our economy has been recognized numerous times by the Supreme Court. The Court has stated that price agreements are illegal under the antitrust laws because they are a threat to 'the central nervous system of the

economy." United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940), and that the antitrust laws represent "fundamental national economic policy." Carnation Co. v. Pacific Westbound Conference, 383 U.S. 213, 218 (1966). The words of the Court that perhaps best express the true importance of the antitrust laws are the following: "Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the preservation of our fundamental personal freedoms." United States v. Topco Associates, Inc., 495 U.S. 586, 610 (1972).

Because of the importance of the antitrust laws to the nation's economic policy, exceptions to the antitrust laws should be made very sparingly. Antitrust exemptions should be enacted only in exceedingly rare instances in which the fundamental free market values underlying the antitrust laws are compellingly outweighed by a clearly paramount policy objective. [We realize that the basic goals of the antitrust laws and the critical effort to reduce youth smoking through significant price increases in tobacco products are somewhat in tension.] Yet efforts to reduce smoking through modifications in the antitrust laws must make certain that such modifications are carefully and narrowly crafted to avoid unintended adverse consequences.

We believe ^{that} some of the proposed antitrust exemptions likely will have just such unintended consequences. As we understand it, the principal antitrust exemptions for tobacco product manufacturer conduct that have been mentioned as possibilities are an exemption for price-fixing, an exemption for dealings with distributors and retailers, and an exemption for restricting advertising. Such antitrust exemptions might be appropriate if it could be demonstrated that, without such exemptions, enforcement of the antitrust laws would prevent conduct that is necessary to further the objective of reducing the incidence of tobacco use among minors.

In the Department's view, an antitrust exemption is not needed to enable tobacco product manufacturers to raise the price of tobacco products in order to decrease demand for them among minors or to finance any government education or health programs designed to curtail tobacco use and alleviate its adverse health effects. These objectives can be achieved without permitting the tobacco companies to engage in conduct that, but for an exemption, would violate the antitrust laws -- by imposing an assessment against tobacco companies, as some have proposed. Once the government program needs are determined and the amount to be assessed against the tobacco companies is set, the tobacco companies will pass the costs of the assessment through the

conflict?

marketing chain to their consumers. Any further increase in prices desired in order to reduce tobacco use could be achieved directly by increasing federal and state excise taxes on tobacco products. Unlike an antitrust exemption for price fixing, which could have the perverse effect of increasing the profits of the tobacco companies at the expense of consumers who are addicted to tobacco, these measures would achieve the desired price increase for tobacco products without further enriching the tobacco companies as a result.

The Department also believes that an antitrust exemption is not needed in order to enable tobacco product manufacturers to ensure that their distributors and retailers do not undermine the objective of reducing use of tobacco products among minors. Adequate compliance among distributors and retailers with any legal requirement that they make tobacco products less accessible to minors can be enforced directly by federal, state, and local governments. Moreover, if the legislation provides sufficient incentives for tobacco product manufacturers to ensure that sales of their tobacco products to minors decline satisfactorily, manufacturers can be expected to take steps on their own to ensure cooperation by their distributors and retailers. There should be no need for the type of coordinated conduct among manufacturers that might violate the antitrust laws.

The Department is skeptical about the ^{need and} desirability of an antitrust exemption to permit tobacco product manufacturers to coordinate their advertising and marketing in order to direct them away from minors. Such an exemption would not be necessary if other provisions included in court orders as part of the settlement or elsewhere in the legislation were sufficient to ensure that advertising and marketing would not be directed at minors. ~~If such provisions were not available, and if coordination of advertising and marketing by the tobacco manufacturers were thought necessary to further the overriding goal of reducing tobacco use by minors, a limited antitrust exemption might be appropriate. Any such exemption should be drafted narrowly and carefully so as to minimize the risk that it could be used to cloak anticompetitive collaboration by tobacco manufacturers beyond that necessary to achieve that overriding goal.~~

Some have attempted to answer the concerns regarding the creation of antitrust exemptions by suggesting that legislation should provide that exemptions for particular conduct will be conditioned on ad hoc Justice Department approval. We strongly urge you not to pursue such an approach, which would take the Department outside its traditional law enforcement role and turn it into a regulatory body. That would require the creation of a totally new regulatory apparatus within the Antitrust Division

and raise a host of questions regarding such important considerations as procedural due process, and it could significantly increase the Antitrust Division's need for resources and risk distracting it from its law enforcement mission.

I realize that antitrust is just one of many important policy factors Congress must consider in developing effective legislation to deal with the health problems associated with tobacco use. If, notwithstanding our concerns, you should decide to move forward with consideration of antitrust exemptions, the Department would be pleased to work with you in crafting them as narrowly and precisely as possible to achieve their purpose without creating unnecessary anticompetitive effects.

delete all but boilerplate language from this paragraph

[OMB paragraph]

Thank you for your interest in the Department's views, and for your interest in antitrust enforcement.

Sincerely,

Andrew Fois
Assistant Attorney General

tobacco settlement -
antitrust

2/25/98

**TO: Josh Gotbaum
Elena Kagan
Sherman Boone
Don Gips
Bruce Lindsey
Peter Jacoby
Sally Katzen**

**cc: Jim Jukes
Jim Murr
Richard Turman
Jill Pizzuto**

**FROM: Ingrid Schroeder
ext. 53883**

URGENT

RE: Justice Letter on Tobacco Antitrust

Attached is the Justice redraft of the tobacco antitrust letter. This redraft includes changes/edits requested by DPC (Kagan) and HHS.

The paragraph that is marked ^{on p. 3} is the subject of an HHS appeal to DPC. HHS would prefer that this paragraph take out all support for an antitrust exemption and read as follows:

"The Department is skeptical about the need and desirability of an antitrust exemption to permit tobacco product manufacturers to coordinate their advertising and marketing in order to direct them away from minors. Such an exemption would not be necessary if other provisions included in court orders as part of the settlement or elsewhere in the legislation were sufficient to ensure that advertising and marketing would not be directed at minors."

Since we need to clear this letter tonight (for a S. Judiciary hearing tomorrow) we will need your comments ASAP. Please call me at ext. 53883 with any comments or changes to the letter.

Will keep you posted on the outcome of the appeal.



U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

The Honorable Michael DeWine
Chairman, Subcommittee on Antitrust,
Business Rights, and Competition
Committee on the Judiciary
United States Senate
Washington, DC 20510

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United States Senate
Page 2

because they are a threat to "the central nervous system of the economy," United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940), and that the antitrust laws represent "fundamental national economic policy." Carnation Co. v. Pacific Westbound Conference, 383 U.S. 213, 218 (1966). The words of the Court that perhaps best express the true importance of the antitrust laws are the following: "Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the preservation of our fundamental personal freedoms." United States v. Topco Associates, Inc., 405 U.S. 596, 610 (1972).

Because of the importance of the antitrust laws to the nation's economic policy, exceptions to the antitrust laws should be made very sparingly. Antitrust exemptions should be enacted only in rare instances in which the fundamental free market values underlying the antitrust laws are outweighed by a paramount policy objective. We realize that the basic goals of the antitrust laws and the critical effort to reduce youth smoking through significant price increases in tobacco products are somewhat in tension. Yet efforts to reduce smoking through modifications in the antitrust laws must make certain that such modifications are carefully and narrowly crafted to avoid unintended adverse consequences.

We believe that some of the proposed antitrust exemptions likely will have just such unintended consequences. As we understand it, the principal antitrust exemptions for tobacco product manufacturers that have been mentioned as possibilities include: an exemption for price-fixing, an exemption for dealings with distributors and retailers, and an exemption for coordinated advertising. Such antitrust exemptions might be appropriate if it could be demonstrated that, without such exemptions, enforcement of the antitrust laws would prevent conduct that is necessary to further the objective of reducing the incidence of tobacco use among minors.

In the Department's view, an antitrust exemption is not needed to enable tobacco product manufacturers to raise the price of tobacco products in order to decrease demand for them among minors, or to finance any government education or health programs designed to curtail tobacco use and alleviate its adverse health effects. These objectives can be advanced to the same extent by means that do not permit the tobacco companies to engage in

The Honorable Michael DeWine
United States Senate
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conduct that, but for an exemption, would violate the antitrust laws. For example, imposing an assessment against tobacco companies, as some have proposed, would have effects on both price and demand. Once the amount to be assessed against the tobacco companies were set, the tobacco companies would pass the costs of the assessment through the marketing chain to their consumers. Unlike an antitrust exemption for price-fixing, which could have the perverse effect of increasing the profits of the tobacco companies at the expense of consumers who are addicted to tobacco, such an assessment would achieve the desired price increase for tobacco products without further enriching the tobacco companies as a result.

The Department also believes that an antitrust exemption is not needed so that tobacco product ~~manufacturers~~^{manufacturers} might act collectively to guard against the possibility of distributors and retailers undermining efforts to limit the extent to which minors are exposed to tobacco products. Adequate compliance among distributors and retailers with any legal requirement that they make tobacco products less accessible to minors can be enforced directly by federal, state, and local governments. Moreover, if legislation provides sufficient incentives for individual tobacco product manufacturers to ensure that sales of their tobacco products to minors decline satisfactorily, manufacturers can be expected to take steps on their own to ensure cooperation by their distributors and retailers. There should be no need for the type of coordinated conduct among manufacturers that might violate the antitrust laws. *assist in efforts to reduce*

* The Department is more receptive to the possibility of an antitrust exemption allowing tobacco product manufacturers to engage in coordinated advertising and marketing -- although the Department still would want to examine the desirability of such an exemption closely in the context of the overall legislation. Such an exemption might not be necessary if other provisions in court orders or legislation were sufficient to ensure that advertising and marketing programs were suitably restricted. If such measures are not fully available, however, a limited antitrust exemption might be appropriate to further the overriding goal of reducing tobacco use by minors. Any such exemption would need to be drafted narrowly and carefully so as to minimize the risk that it could be used to cloak anticompetitive collaboration by tobacco manufacturers beyond that necessary to achieve that overriding goal.

might appropriately assist in efforts to reduce

The Honorable Michael DeWine
United States Senate

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Page 4

Some have attempted to answer the concerns regarding the creation of antitrust exemptions by suggesting that legislation should provide that exemptions for particular conduct will be conditioned on ad hoc Justice Department approval. We strongly urge you not to pursue such an approach, which would take the Department outside its traditional law enforcement role and turn it into a regulatory body. That would require the creation of a entirely new regulatory apparatus within the Antitrust Division and raise a host of questions regarding such important considerations as procedural due process, and it could significantly increase the Antitrust Division's need for resources and risk distracting it from its law enforcement mission.

We realize that antitrust is just one of many important policy factors Congress must consider in developing effective legislation to deal with the health problems associated with tobacco use. If, notwithstanding our concerns, you should decide to move forward with consideration of antitrust exemptions, the Department would be pleased to work with you in crafting them as narrowly and precisely as possible to achieve their purpose without creating unnecessary anticompetitive effects.

The Office of Management and Budget advises that from the standpoint of the Administration's program there is no objection to the submission of this report.

Thank you for your interest in the Department's views and for your support of federal antitrust enforcement.

Sincerely,

Andrew Fois
Assistant Attorney General

tobacco - settlement - antitrust

Doug -
Here are our suggested changes; sorry this took so long.

REVISED DRAFT

Let. me know 2/19/98 if you have any problems.

Elena

cc: David Ogden

Dear Chairman DeWine:

In response to your and Senator Kohl's request, this letter contains the Department of Justice's evaluation of the proposal to create an antitrust exemption for tobacco product manufacturers as part of the tobacco settlement legislation currently under consideration. Although our evaluation is necessarily preliminary and is subject to revision as consideration of the overall tobacco settlement legislation progresses, the general principles expressed herein are likely to be applicable to any tobacco settlement legislative proposal that includes an antitrust exemption.

The American economy is based on free-market principles. In essence, businesses generally are free to choose the products and services they will offer and the prices they will charge. At the same time, individuals are free to choose the products and services they will purchase, taking into account the prices charged for such goods and services. Competition among businesses, each attempting to be successful in selling its products, leads to the best quality products, the lowest prices and the highest level of innovation.

The antitrust laws are designed to prevent this freedom of choice from being undermined through anticompetitive means. Those laws ensure that businesses will not stifle competition to the detriment of consumers.

The importance of antitrust to our economy has been recognized numerous times by the Supreme Court. The Court has stated that price agreements are illegal under the antitrust laws because they are a threat to "the central nervous system of the economy," United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940), and that the antitrust laws represent "fundamental national economic policy." Carnation Co. v. Pacific Westbound Conference, 383 U.S. 213, 218 (1966). The words of the Court that perhaps best express the true importance of the antitrust

- 2 -

laws are the following: "Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the preservation of our fundamental personal freedoms." United States v. Topco Associates, Inc., 495 U.S. 596, 610 (1972).

Because of the importance of the antitrust laws to the nation's economic policy, exceptions to the antitrust laws should be made very sparingly. Antitrust exemptions should be enacted only in ~~exceedingly~~ rare instances in which the fundamental free market values underlying the antitrust laws are ~~compellingly~~ outweighed by a ~~clearly~~ paramount policy objective. Even in those instances, any antitrust exemption must be carefully and narrowly crafted to address that objective in the least anticompetitive method available.

Having these general principles in mind, the Department has evaluated the various antitrust exemptions currently under discussion in connection with the proposed tobacco settlement legislation. As we understand it, the principal antitrust exemptions for tobacco product manufacturer conduct that have been mentioned as possibilities are an exemption for price-fixing, an exemption for dealings with distributors and retailers, and an exemption for restricting advertising. Such antitrust exemptions might be appropriate if it could be demonstrated that, without such exemptions, enforcement of the antitrust laws would prevent conduct that is necessary to further the objective of reducing the incidence of tobacco use among minors.

In the Department's view, an antitrust exemption is not needed to enable tobacco product manufacturers to raise the price of tobacco products in order to decrease demand for them among minors or to finance any government education or health programs designed to curtail tobacco use and alleviate its adverse health effects. These objectives can be achieved without permitting the tobacco companies to engage in conduct that, but for an exemption, would violate the antitrust laws -- by imposing an assessment against tobacco companies, as some have proposed. ~~Once the government program needs are determined and the amount to be assessed against the tobacco companies is set, the tobacco companies will pass the costs of the assessment through the marketing chain to their consumers. Any further increase in prices desired in order to reduce tobacco use could be achieved directly~~

-- though the Department staff would want to examine such an exemption closely in the context of the overall legislation and settlement.

the desirability of

such an assessment

by increasing federal and state excise taxes on tobacco products. Unlike an antitrust exemption for price fixing, which could have the perverse effect of increasing the profits of the tobacco companies at the expense of consumers who are addicted to tobacco, these measures would achieve the desired price increase for tobacco products without further enriching the tobacco companies as a result.

The Department also believes that an antitrust exemption is not needed in order to enable tobacco product manufacturers to ensure that their distributors and retailers do not undermine the objective of reducing use of tobacco products among minors. Adequate compliance among distributors and retailers with any legal requirement that they make tobacco products less accessible to minors can be enforced directly by federal, state, and local governments. Moreover, if the legislation provides sufficient incentives for tobacco product manufacturers to ensure that sales of their tobacco products to minors decline satisfactorily, manufacturers can be expected to take steps on their own to ensure cooperation by their distributors and retailers. There should be no need for the type of coordinated conduct among manufacturers that might violate the antitrust laws.

and

move receptive to

The Department is also skeptical about the desirability of an antitrust exemption to permit tobacco product manufacturers to coordinate their advertising and marketing in order to direct them away from minors. Such an exemption would not be necessary if adequate restrictions on advertising and marketing directed at minors were included in court orders as part of the settlement, if constitutionally permissible government restrictions on such advertising and marketing were included in the legislation, or if the legislation gave the tobacco manufacturers/individually sufficient incentives to direct their advertising and marketing away from minors. If none of these alternatives is available, and if coordination of advertising and marketing by the tobacco manufacturers were thought necessary to further the overriding goal of reducing tobacco use by minors, a limited antitrust exemption might be appropriate. Any such exemption should be drafted narrowly and carefully so as to minimize the risk that it could be used to cloak anticompetitive collaboration by tobacco manufacturers beyond that necessary to achieve that overriding goal.

might

sufficient +

sufficiently

strong

to further the overriding goal of reducing tobacco use by minors.

Some have attempted to answer the concerns regarding the creation of antitrust exemptions by suggesting that legislation should provide that exemptions

measures are not fully available, however,

a broad range of

- 4 -

for particular conduct will be conditioned on ad hoc Justice Department approval. We strongly urge you not to pursue such an approach, which would take the Department outside its traditional law enforcement role and turn it into a regulatory body. That would require the creation of a entirely new regulatory apparatus within the Antitrust Division and raise a host of questions regarding such important considerations as procedural due process, and it could significantly increase the Antitrust Division's need for resources and risk distracting it from its law enforcement mission.

I realize that antitrust is just one of many important policy factors Congress must consider in developing effective legislation to deal with the health problems associated with tobacco use. If, ~~notwithstanding our concerns~~, you should decide to move forward with consideration of antitrust exemptions, the Department would be pleased to work with you in crafting them as narrowly and precisely as possible to achieve their purpose without creating unnecessary anticompetitive effects.

Thank you for your interest in the Department's views, and for your interest in antitrust enforcement.

Tobacco settlement - anti-trust

United States Department of Justice

Antitrust Division

950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001
Fax Number: 202-616-7320
Voice Number: 202-514-2410



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FAX COVER SHEET

DATE: January 30, 1998
TO: Elena Kagan
of:
Fax Number: 202-456-2878
FROM: A. Douglas Melamed

*EK -
I agree w/ your
concerns.
let's talk...
AM*

Pages Sent (including this sheet): 6

Remarks: Here's the draft. Our response was expected in mid-January.

*Bruce - See the attached. I have two concerns -
(1) The argument assumes company-specific penalties in several places
(2) I'm not sure I buy the argument re speech restrictions (even
if there are penalties, ^{we should enable} the companies to agree on this).
Let me know what you think.
Elena*

Enclosed for your review is our response to Senators DeWine (Antitrust Subcommittee Chairman) and Kohl (Ranking Minority on Antitrust Subcommittee) regarding their request for our views on the need for antitrust exemptions in tobacco settlement legislation. We would like to send a response to them next week.

DRAFT 1/15/98

Dear Chairman DeWine:

In response to your and Senator Kohl's request, this letter contains the Department of Justice's evaluation of the proposal to create an antitrust exemption for tobacco product manufacturers as part of the tobacco settlement legislation currently under consideration. As a preface to our evaluation, let me note that it is necessarily preliminary, and the analysis contained herein is subject to revision as consideration of the overall tobacco settlement legislation progresses. Having said that, it is also important to note that the antitrust laws are crucial to the effective functioning of the American economy and the general principles expressed herein are likely to be applicable to any tobacco settlement legislative proposal which has as one of its parts an antitrust exemption.

The American economy is based on free-market principles. In essence, businesses generally are free to choose the products and services they will offer and the prices they will charge. At the same time, individuals are free to choose the products and services they will purchase, taking into account the prices charged for such goods and services. The antitrust laws are designed to prevent this freedom of choice from being undermined through anticompetitive means.

Competition among businesses each attempting to be successful in selling its products, leads to the best quality products, the lowest prices and the highest level of innovation. The antitrust laws ensure that businesses will not stifle this competition to the detriment of the consumer.

The importance of antitrust to our economy has been recognized numerous times by the Supreme Court. The Court has stated that price agreements are illegal under the antitrust laws because they are a threat to "the central nervous system of the economy," United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940), and recognized that the antitrust laws represent "fundamental national

economic policy." Carnation Co. v. Pacific Westbound Conference, 383 U.S. 213, 218 (1966). The words of the Court that perhaps best express the true importance of the antitrust laws are the following: "Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the preservation of our fundamental personal freedoms." United States v. Topco Associates, Inc., 495 U.S. 596, 610 (1972).

As a consequence of the importance of the antitrust laws to the nation's economic policy, exceptions to the antitrust laws should be made exceedingly sparingly. Indeed, antitrust exemptions should be enacted only in exceedingly rare instances in which the fundamental free market values underlying the antitrust laws are compellingly outweighed by a clearly paramount policy objective. Even in those exceedingly rare instances, any antitrust exemption must be carefully and narrowly crafted to address that objective in the least anticompetitive method available.

Having these general principles in mind, the Department has evaluated the various antitrust exemptions currently under discussion in connection with the proposed tobacco settlement legislation. As far as we can determine, the principal antitrust exemptions for tobacco product manufacturer conduct that have been mentioned as possibilities are an exemption for price-fixing, an exemption for dealings with distributors and retailers, and an exemption for restricting advertising.

Such antitrust exemptions might be appropriate if it could be demonstrated that, without such exemptions, enforcement of the antitrust laws would prevent conduct that is necessary to further the objective of reducing the incidence of tobacco use among minors.

In the Department's view, an antitrust exemption is not needed to enable tobacco product manufacturers to raise the price of tobacco products in order to decrease demand for them among minors and to finance any government education or health programs designed to curtail tobacco use and alleviate its adverse health effects. It appears that these objectives can be achieved without enabling the tobacco companies to violate the antitrust laws -- by imposing an assessment against tobacco companies, as some have proposed. Once the ~~government program~~ needs are determined and the amount to be assessed against the tobacco companies is set, the tobacco companies will pass the costs of the assessment through the marketing chain to their consumers. Any further increase in prices desired in order to reduce tobacco use could be achieved directly by increasing federal and state excise taxes

public health

on tobacco products or indirectly by [individually] penalizing each firm for excessive consumption of its products by minors. Unlike an antitrust exemption for price fixing, which could have the perverse effect of increasing the profitability of the tobacco companies at the expense of consumers who are addicted to tobacco, the measures outlined above would achieve the desired price increase for tobacco products without further enriching the tobacco companies as a result.

co-by-co penalties

The Department also believes that an antitrust exemption is not needed in order to enable tobacco product manufacturers to ensure that their distributors and retailers do not undermine the objective of reducing use of tobacco products among minors. If, as some have suggested, [each tobacco product manufacturer is made subject to significant penalties to the extent that sales of its own tobacco products to minors do not decline satisfactorily,] that will create sufficient incentive for each manufacturer to take steps on its own to instill cooperation in its distributors and retailers. There will be no need for the type of coordinated conduct among manufacturers that might violate the antitrust laws. And in any event, compliance among distributors and retailers with any legal requirement that they make tobacco products less accessible to minors can be enforced directly by federal, state, and local governments.

co-by-co penalties

Nor does the Department currently believe an antitrust exemption is needed to enable tobacco product manufacturers to coordinate their advertising and marketing to direct them away from minors. Some have raised concerns that if advertising restrictions are enforced by government, they might be challenged under the First Amendment. According to this view, in the event of a successful constitutional challenge, the manufacturers would be left to "enforce" the advertising restrictions themselves. Individual manufacturers might find it difficult to restrain themselves, the argument goes, without some assurance that their competitors were similarly restraining themselves rather than stepping into the vacuum to increase their own sales to minors. But such an agreement among the manufacturers, if it is feared, would be subject to challenge under the antitrust laws.



But this is another objective that apparently can be achieved without creating an antitrust exemption. Even assuming that government enforcement of advertising restrictions proves to be impermissible under the First Amendment -- a questionable assumption, given the restrictions against cigarette advertising that have already withstood constitutional challenge, see, e.g., Penn Advertising of Baltimore, Inc. v. Mayor and City Council of Baltimore, 63 F.3d 1318 (4th Cir. 1995), cert. denied, 117 S.Ct. 1569 (1997) -- each tobacco product manufacturer would make its own

not really-check with OLC

calculation of the costs and benefits of directing its advertising away from minors. And if each manufacturer faces stiff penalties for failure to reduce use of its own tobacco products by minors, it should have ample incentive to curb its advertising directed at minors without the need to collaborate with its rivals.

co-by-co penalties

In fact, relying on coordination among tobacco product manufacturers to achieve the objective of reducing advertising directed at minors, in the absence of sufficiently high penalties directed at each manufacturer individually for its own products, likely would prove elusive, because the success of even the collusive approach would still depend on the manufacturers' incentives to reduce sales to minors. In short, the penalty probably is needed to achieve the objective in any event. The antitrust exemption is of little import -- except for unintended competitive harm it might cause.

not really - they're doing this for every thing else they do.

why not do both? ↑

Some have attempted to answer the concerns regarding the creation of antitrust exemptions by suggesting that legislation provide that exemptions to particular conduct be conditioned on ad hoc Justice Department approval. We strongly urge you not to pursue this approach, which would take the Department outside its traditional law enforcement role and turn it into a regulatory body. This would require the creation of a entirely new regulatory apparatus within the Antitrust Division, and raise a host of questions regarding such important considerations as procedural due process, which could significantly increase the Antitrust Division's need for resources as well as risk distracting it from its law enforcement mission. If Congress deems such a regime to be required, it more appropriately should be placed in a regulatory, not law enforcement, agency.

I realize that antitrust is just one of many important policy factors Congress must consider in developing effective legislation to deal with the health problems associated with tobacco use, and if you should decide to move forward with consideration of antitrust exemptions, the Department would be pleased to work with you in crafting them as narrowly and precisely as possible to achieve their purpose without creating unnecessary anticompetitive effects.

Thank you for your interest in the Department's views, and for your interest in antitrust enforcement.

WACHTELL, LIPTON, ROSEN & KATZ
 The Honorable Orrin G. Hatch
 October 31, 1997
 Page 2

The retail price structure is set forth below:

(\$/pack)	August 1997	2002	2007
On-going Settlement ¹	--	0.72	0.83
Industry Price ²	0.83	0.97	1.13
Federal Excise Tax ³	0.24	0.39	0.39
State Excise Taxes	0.33	0.33	0.33
Trade Margin	0.34	0.48	0.51
Sales Tax ⁴	0.08	0.13	0.15
Total	<u>1.82</u>	<u>3.02</u>	<u>3.34</u>

Increase Versus
 August Retail Price

\$	1.20	1.52
%	65.9%	83.5%

Philip Morris believes that the foregoing estimates are conservative as they exclude the following:

- any increases in state excise taxes which have historically risen at an annual rate of approximately 5%.
- any price increase to reflect the imposition of surcharges that would result from failing to meet specified youth smoking incidence reduction targets.
- any price increases to reflect the industry's obligations with regard to defense costs and those judgment or settlement costs which remain the obligation of the industry and plaintiffs' attorney's fees.

Finally, in the estimate, the wholesaler and retailer margins expressed as a percentage of retail price are projected to decline from a prevailing level of 19% to 16% in 2002 and 15% in 2007.

The Philip Morris estimate may also be compared with the estimates of Wall Street analysts who are projecting retail price

¹ Reflects on-going payments inflated at the minimum escalator of 3%.

² Assumes industry price will increase by an annual inflation rate of 2.5%.

³ Reflects an increase in the federal excise tax of \$0.10/pack in 2000 and \$0.15/pack in 2002.

⁴ Reflects prevailing national average tax of 4.7%.

WACHTELL, LIPTON, ROSEN & KATZ
The Honorable Orrin G. Hatch
October 31, 1997
Page 3

increases in real terms, i.e., expressed in 1997 dollars, of between \$1.10/pack and \$1.18/pack by 2002 and \$1.50/pack and \$2.02/pack by 2007. Thus, according to these analysts, the terms of the proposed national tobacco resolution, as they currently stand, would increase the real retail price of cigarettes by up to 65¢ in 2002 and 111¢ by 2007.

At the same hearing you also requested our proposed language for the antitrust exemption. I am enclosing our proposed draft language for such an exemption.

Please let me know if I can be of any further assistance.

Sincerely



Meyer G. Koplow

MGK/tv

SEC. 802. LIMITED ANTITRUST EXEMPTION.

(a) The federal antitrust laws and any similar law of any State shall not apply to any joint discussion, consideration, review, action or agreement by or among any participating manufacturers, or any individuals acting on behalf of any participating manufacturers, for the purposes of, and limited to —

- (1) entering into the Protocol or a Consent Decree;
- (2) refusing to deal with a distributor, retailer or other seller of tobacco products that distributes such products for sale to, or offers for sale or sells such products to, underage persons, or that otherwise fails to comply with applicable requirements of the Act, the Protocol or the Consent Decree; or
- (3) submitting an application relating to, entering into, or complying with or otherwise carrying out the terms of any plan or program that has been approved under subsection (b) of this section.

(b) The Attorney General of the United States is authorized to approve upon application of one or more participating manufacturers plans or programs to reduce the use of tobacco products by underage persons. Prior to approving any such plan or program, the Attorney General shall determine that approval is appropriate as part of the effort to reduce the use of tobacco products by underage persons and will not have the effect of unduly restraining competition. Any such application shall be approved or disapproved in writing within 90 days from the date of submission to the Attorney General. Upon written withdrawal by the Attorney General of any approval hereunder, the provisions of paragraph (a)(3) of

**this section shall not apply to any subsequent act or omission to act by reason of
such approval.**

ORRIN G. HATCH, UTAH, CHAIRMAN

STROM THURMOND, SOUTH CAROLINA
CHARLES E. GRASSLEY, IOWA
ARLEN SPECTER, PENNSYLVANIA
PHIL THOMPSON, TENNESSEE
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United States Senate

COMMITTEE ON THE JUDICIARY

WASHINGTON, DC 20510-6275

MANUEL CUOMI, Chief Counsel and Staff Director
BRUCE A. COHEN, Minority Chief Counsel

October 29, 1997

The Honorable Janet Reno
Attorney General
U.S. Department of Justice
10th and Constitution Ave., NW
Washington, DC 20530

Dear General Reno:

As you know, the proposed global tobacco settlement includes a provision granting broad antitrust immunity to the tobacco industry. Currently, the Subcommittee on Antitrust, Business Rights and Competition is in the process of determining whether an antitrust exemption is actually required to help meet the goals of the proposed agreement and, if so, how that exemption should be crafted. We are very concerned that the draft immunity provision has thus far received little attention and that, while a carefully crafted proposal is something of which we could all be proud, the failure to develop appropriate language could result in a final product that all of us end up regretting for decades to come.

For that reason, and given the Justice Department's expertise in this area, we request that you instruct the Antitrust Division to undertake an analysis of the competitive impact of the proposed exemption. As part of this analysis, we ask that the Division determine whether any such immunity is necessary and, if you conclude that it is, provide us with statutory language that you believe is appropriate. In order to incorporate your ideas in any legislation to be introduced, we request that the Division complete its work within sixty days. We also request that you ensure your analysis has the involvement of the President, whose support will be crucial to any bipartisan solution.

Thank you for your consideration of this important matter. Please feel free to call us with any additional questions or concerns.

Sincerely,

MIKE DEWINE
Chairman
Antitrust, Business Rights
and Competition Subcommittee

HERB KOHL
Ranking Member

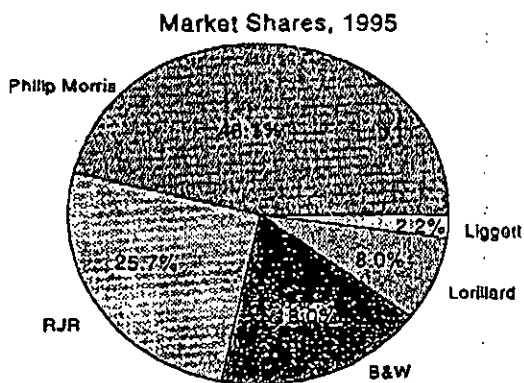
cc: President William Jefferson Clinton
Joel Klein, Assistant Attorney General
Bruce Reed, Domestic Policy Adviser
Donna Shalala, Secretary of Health and Human Services

SPECIAL ANALYSIS

Price Fixing in Smoke-Filled Rooms

One of the major goals of antitrust policy is to prevent companies from getting together to fix prices. In most cases, such behavior is illegal irrespective of any potential mitigating circumstances (such as achieving greater production efficiencies). But some antitrust experts worry that the pending tobacco settlement might relax this constraint.

Competition versus collusion. Even in highly concentrated industries, where prices may be higher than would prevail under perfect competition, rivalry among firms and the illegality of explicit collusion tend to keep prices below the level that would maximize overall industry profits. In the tobacco industry, for example, two firms account for about three-quarters of U.S. sales, with three other firms accounting for most of the rest (see chart). Gross profit margins in the industry are high, accounting



for about 30 to 35 cents of the \$1.85 price of a pack of cigarettes. More intense price rivalry among existing firms or the entry of new firms into the market would probably squeeze these margins and push prices (net of excise taxes) closer to production costs. Nevertheless, the current market price appears to be far below the price that would maximize overall industry profits.

How high can they go? Statistical evidence suggests that consumers would reduce purchases of cigarettes by about 4 percent in response to a 10 percent increase in price. Faced with such "inelastic" demand, the industry could increase profits by raising prices: The gain in profits on the cigarettes it continued to sell would more than offset the loss in profits resulting from selling fewer cigarettes. Over time, consumers would probably demonstrate a greater price responsiveness as fewer people take up smoking and more people quit. At some point, further increases in prices would be unprofitable because the losses from reductions in quantity sold would offset the gains from higher prices. One economist has calculated that the profit-maximizing price is at least \$4.00 a pack, but it could be higher than that. In short, if firms were free to collude, they would have an incentive to raise prices substantially.

Implications. In general, the antitrust laws forbid collusion to fix prices because higher prices increase industry profits at the expense of consumer welfare and economic efficiency. In the case of cigarettes, however, higher prices further the social policy goal of reducing smoking. The tobacco settlement does not give the companies *carte blanche* to raise prices, but it does illustrate how two desirable public policy goals can come into conflict.



DEPARTMENT OF JUSTICE
Antitrust Division

Tobacco settlement -
~~capital issues~~
antitrust

JOEL I. KLEIN
Assistant Attorney General

Bruce L / ~~Domestic Policy Council~~

Main Justice Building
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(202) 514-2401 / (202) 616-2645 (f)
antitrust@justice.usdoj.gov (internet)
<http://www.usdoj.gov> (World Wide Web)

July 29, 1997

Bruce Reed
Domestic Policy Council
The White House
OEOB, Room 216
Washington, D.C. 20500

Re: Tobacco Settlement

Dear Bruce:

It was good to talk to you about the tobacco settlement, and I look forward to working with you on these issues in the future.

As you know, some of our economists prepared a memorandum a few weeks ago outlining our preliminary thoughts on a number of issues. For obvious reasons, one point that I want to highlight is our concern about the proposed antitrust exemption. Ordinarily, of course, we are very reluctant to support exemptions from the antitrust laws. Those laws embody important principles that should be generally and widely applied and any exemption always makes the next one easier. Insofar as antitrust laws may prevent the tobacco companies from enhancing their profits by anticompetitive conduct, their continued application might be especially desirable in these circumstances.

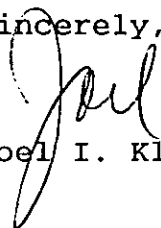
To be sure, if there were overriding public health considerations that could be served only, or most efficiently, by a limited relaxation of ordinary antitrust principles, a narrow exemption might be worth considering. I am not confident, however, that a simple desire to reduce tobacco consumption by increasing cigarette prices merits an exemption here. Cigarette price increases might best be achieved by some form of excise tax or other penalty that would reduce consumption without enabling the tobacco companies to profit from increased prices. If such

Bruce Reed
July 29, 1997
Page 2

alternatives are not available, and it is thought desirable to permit the tobacco companies to coordinate their behavior in order to raise prices or otherwise to further public health objectives, we would urge that any antitrust exemption be drawn as narrowly and precisely as possible so as not to permit more anticompetitive behavior than necessary to achieve those objectives.

I look forward to discussing this and other issues at your convenience.

Sincerely,



Joel I. Klein

cc: Larry Summers
Janet Yellen

08/29/97 FRI 12:08 FAX 202 326 3585

FEDERAL TRADE

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Tobacco-settlement -
antitrust

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

cc: Bruce
I have not responded

OFFICE OF
CONGRESSIONAL RELATIONS

August 29, 1997

Mr. Bruce Reed
Assistant to the President for Domestic Policy
The White House
Washington, D. C. 20500

Dear Bruce:

I wanted you to be aware that the Congressional Task Force on Tobacco and Health has written Chairman Pitofsky of the Federal Trade Commission, requesting an analysis of the potential economic impact of the proposed tobacco settlement on cigarette prices. As you will see in the attached letter from the Task Force, they have requested that we provide the analysis by September 15, 1997.

Jodie Bernstein, the FTC Director of Consumer Protection and I would welcome a brief meeting, or at least a phone conversation with you about this matter and a general discussion of FTC activities on tobacco. Elizabeth Drye of your office, informed us that White House Counsel recommended that the FTC not participate in the White House "working group" on the tobacco settlement... but I feel it is important that you are aware of our activities.

If a brief meeting is possible or if a phone call works out better for you, please contact me on 202/326-2468. Jodie Bernstein can be reached on 202/326-3430.

Thanks for your attention. Jodie and I feel strongly that you should know what Commission activities are ongoing and I look forward to hearing from you.

With every good wish.

Sincerely,

Lorraine C. Miller, Director
Office of Congressional Relations

MARTIN T. VEEHAN
CO-CHAIR

JAMES V. HANSEN
CO-CHAIR

Congressional Task Force on Tobacco and Health
United States House of Representatives
Washington, D.C. 20515
August 1, 1997

The Honorable Robert Pitofsky
Chairman
Federal Trade Commission
Sixth Street & Pennsylvania Avenue, N.W.
Washington, D.C. 20580

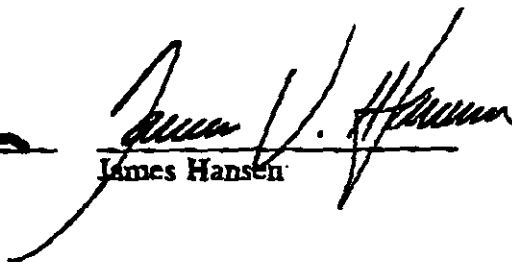
Dear Chairman Pitofsky,

As you are aware, the proposed comprehensive settlement with the tobacco industry will profoundly alter the competitive structure of the tobacco industry in the United States. We understand that the Federal Trade Commission has previously reviewed the potential impact of mergers and other competitive issues in this industry. In light of your experience with these issues, we are requesting that you provide us with an analysis of the potential economic impact of the proposed settlement on cigarette prices, industry profits and government revenues. Such an analysis would be of great assistance to us in our review of the proposed settlement. We request that you provide us with the requested analysis no later than September 15, 1997.

Sincerely,


Martin T. Veehan


Henry Waxman


James Hansen