NLWJC - Kagan
DPC - Box 052 - Folder-006

Tobacco-Settlement: Notes & Memos [2]

Matt Myers Tobacco Mtg 1-30-98

Bliley - have to get into act together - otherwise do small bill.
window isn't closed for him.
Hatch's staff thinks the same.

MM: Need process after - w/in 30 days.
Endgame has to be directly involved - call Bliley, e.g. - how do we do this?
Waxman doesn't want a bill.

DM: Gunn advising on piecemeal approach

MM: Do both simultaneously - and we can take off after piecemeal
(They are probably doing only youth access - maybe a little bit of $)
↓ including penalties on kids
build off Gordon Smith's proposal

MM: Marty Meehan would do bill of this kind if you provide some cover.
↓ (Chairman of House Tobacco Task Force)
Work w/ Hansen

→ Liability
Think in terms of class
for public - independently
in public's interest.
(not so much smokers' camp)
* Tie cap to meeting youth targets
Sunset cap - e.g. 10 yrs.
Not apply to any lawsuit based on documents not made public
(encourages disclosure)

MM: If we spend another month doing the current proposed strategy, we won't have time.
You can enlist Kennedy etc - you won't be skewered.
Hatch may get talked out of liability.

Make whole thing optional - you don't have to settle, but you don't get any $.

BR - Find Lippart route

Go thru Lott + Gingrich? or do ourselves?

Tobacco - notes + memos

THE WHITE HOUSE

WASHINGTON

September 11, 1997

'97 SEP 12 AM 11:18

MEMORANDUM FOR THE PRESIDENT

FROM: Donna Shalala
Bruce Reed

SUBJECT: Tobacco

This memorandum (1) details the Administration process to review the proposed tobacco settlement; (2) describes the current context regarding tobacco; and (3) analyzes the substantive terms of the settlement and presents recommendations and options for an Administration proposal on tobacco.

I. ADMINISTRATION REVIEW OF SETTLEMENT

The Administration has engaged in an intensive review of the settlement on two fronts. Internally, four work groups were created and dozens of officials from across the Administration participated in their reviews. These work groups were: Regulatory Issues; Program and Budget Issues; Legal Issues; and, Industry Performance and Accountability Issues. They conducted a line-by-line analysis of the 68-page settlement document; in addition, they sought to explore alternative approaches to proposals contained in the settlement. This has not been done in an attempt to "fix" the settlement but rather to assess the adequacy of the settlement's provisions and to provide the Administration with the basis for articulating its positions and principles if a decision is made to encourage a legislative initiative.

Externally, the Vice President, Secretary Shalala and Bruce Reed met with individuals and groups representing a wide variety of views and interests to make certain that the Administration is aware of diverse viewpoints and has the benefit of expertise from outside the Administration. These consultations have been with public health and tobacco control organizations, state attorneys generals, tobacco industry lawyers, representatives of the smokeless and cigar industries, tobacco industry "whistle blowers," representatives of the retail, vending and the advertising industries, agricultural leaders from the Southeastern tobacco-growing states, and officials from the Brooke Group (Liggett). This broad range of viewpoints has informed the Administration's review and analysis. These consultations have made clear that any legislative proposal will be buffeted from many sides, several of which were not included in the negotiations among the state attorneys generals, plaintiffs' attorneys, and the tobacco industry.

II. EVENTS AND INTERESTS LIKELY TO SHAPE POLITICAL LANDSCAPE

While the proposed tobacco settlement presents the President with an opportunity to exercise again his leadership on this vital public health issue, there are many other factors beyond the settlement that shape the current landscape and will change it in the future. Some enhance the opportunity presented to the President; some limit it.

A. Public Health Community

Since the June announcement of the settlement, the public health community has become increasingly skeptical of the particular elements of the settlement and, more important, has become increasingly unified in their criticisms. At the same time, the public health community is willing to consider and back the possibility of a legislative solution. It should also be noted that the unity of the public health community can be easily fractured: While they generally agree on what's wrong with the settlement, they have different ideas on what good solutions would be.

The principal public health criticisms of the settlement are:

- Restricting FDA's authority in any fashion
- Proposing ineffective "look back" penalties on companies for not reducing underage smoking
- Limiting disclosure of industry documents
- Failing to increase the price of cigarettes sufficiently
- Preempting state and local restrictions that might be tougher than the settlement (the impact on additional state restrictions is unclear)
- Failing to address international tobacco control
- Limiting liability, i.e., eliminating past punitive damages and capping future punitive damages and eliminating class actions (The public health community will always have a lingering concern about limiting liability as the basis for a settlement. It is not only a desire to "punish" this industry, but also reflects a belief that the threat of litigation is needed to keep this industry in check.)

Moreover, there is a small but significant portion (American Lung Association, Stan Glantz, grass roots tobacco control groups like the state GASPS, and Public Citizen) of the public health community that believes the settlement should be scuttled entirely, not fixed. The public health community is well aware of all these tensions, and in fact, this community attempted to forge a consensus again in August. Representatives of 11 groups met August 8, and worked over the next two weeks to present the Administration with a consensus document. However, this "consensus" statement ended up saying little more than that the public health community would like to see a settlement reached and would be willing to work for it; they could not come to terms as to what the settlement should in fact look like. Also, this "consensus" statement does not preclude individual groups from identifying issues of particular

concern for them and actively seeking support in Congress for their viewpoint.

B. Lawsuits and Disclosure

A number of tobacco lawsuits are proceeding: the second-hand smoke lawsuit in Florida by the airline attendants; various private lawsuits, both individual suits and class-actions; and the Medicaid lawsuits by the states, most importantly those in Texas and Minnesota because of their timing. Any verdict against the tobacco industry will be widely viewed as another reason either not to negotiate with the industry or to take a stronger stance against the industry on several elements in the proposal. On the other hand, a verdict for the industry is likely to be seen as a reason to move forward with a legislative solution and weakening our position in any negotiations.

Just as important as the impact of any verdict is the disclosure issue raised by these lawsuits. Especially in the Medicaid lawsuit in Minnesota, state attorneys hold out the prospect of new industry documents coming to light that go far beyond any disclosed to date. In Florida and Minnesota, preliminary findings of fraud and criminal activity were made by either judges or special masters, and previously privileged documents are now being reviewed for public disclosure (in Florida, documents were disclosed in early August; in Minnesota, it is expected documents would become public by early 1998 when the case goes to trial). In addition, there is the possibility of indictments and trials because of ongoing DOJ criminal investigations and the resulting disclosure of secret documents in that process. Because no one really knows what is in the still secret documents, one concern is that they reveal activity that would generate such public outrage, that any accommodation with the industry would be seen as "selling out." In addition, some tie the disclosure issue to consideration of whether the immunity provisions of the settlement are adequate. Some Democrats, such as Sen. Patrick Leahy, take the position that any consideration of limiting liability has to be predicated on full disclosure of the documents.

Another factor on the legal front is the industry challenge to the FDA rule. Oral arguments on the appellate case were made in the Fourth Circuit on August 11, and two of the three judges voiced skepticism of the FDA rule. We do not know when the three-judge panel of the Fourth Circuit Court of Appeals will rule. Appeal to the en banc Fourth Circuit and the Supreme Court is available.

C. Congress

The Congressional horizon is receding into 1998 very quickly. In recent days, several Congressional leaders have said that legislative action on the settlement is unlikely in 1997. The Senate Republican leadership has made tentative plans to consider any tobacco legislation piecemeal, with at least six different committees having jurisdiction over parts of the settlement: Commerce, Judiciary, Labor, Agriculture, Environment and Public Works, and Finance. The

House Republican leadership has not indicated how it wants to proceed, although Rep. Richard Armey has said he expects similar divided consideration in the House. In the Senate and House, the Democratic leaderships are attempting to hold together tobacco-state and tobacco-control Democrats and present a united front. The potential of working with Congressional Democrats on this issue is very real and would give the Administration significant leverage in dealing with the GOP leadership.

D. Farmers

With regard to the Hill, the approach the Administration takes toward the issue of helping tobacco farmers may be the most significant. The settlement's failure to deal with tobacco farmers provides a significant opening for the Administration. Even some GOP members who have traditionally been supportive of the industry -- like Rep. Thomas Bliley -- are now saying their main concern will be helping their farm constituency. The farmers who in the past have provided substantial political cover to the industry can now be separated from the companies if they believe that will be in their best interest.

E. Affected Industries

In addition to the agricultural interests, several other segments of the economy are going to watch any settlement closely, e.g., hospitality industry with regard to environmental tobacco smoke (ETS), advertising and retail industries with regard to advertising and access restrictions, the asbestos industry and trial lawyers with regard to immunity. Each of these industries will have to make decisions on how a settlement affects its interests and when it wants to weigh in on the Hill. There is every indication that all of these industries will be very active and are already seeking to line up support for their cause on the Hill.

III. REVIEW OF SUBSTANTIVE ISSUES RAISED BY SETTLEMENT

The rest of this memorandum analyzes key aspects of the proposed settlement and highlights strengths and weaknesses. In providing this analysis, we do not mean to suggest that you should propose "fixes" to the settlement when you discuss tobacco legislation next week. To the contrary, we believe (though there are some strong arguments to the contrary) that you should set forth your own principles and plan for tobacco legislation. The following analysis, however, helps to illuminate some of the questions you will have to answer in deciding what to propose and communicating your views to the public.

One important note: This memorandum contains numerous representations as to what the tobacco industry is, or is not, willing to accept. These representations refer to what the tobacco industry is saying today. We have no reason to believe that these, in fact, are bottom line

positions of the industry.

A. FDA Authority

The first priority of the Administration in considering tobacco legislation should be to confirm and protect the jurisdiction of the FDA to regulate tobacco products -- including through the reduction or elimination of nicotine or other constituents.

Even as written, the settlement's provision on FDA jurisdiction had certain virtues. First, the provision specifically conferred jurisdiction to regulate tobacco products on the FDA, thereby removing the legal uncertainty now attending the FDA rule. Second, the provision established a "risk reduction" standard to guide the regulation of tobacco products in place of the "safety and efficacy" standard applicable to other drugs and devices. This change in standard could facilitate the FDA's regulation of tobacco products.

This provision of the settlement, however, also contained several glaring weaknesses. First, as you noted in your first comments on the settlement, the FDA would have to prove a negative in order to reduce or eliminate nicotine -- i.e., that the action would not create a significant demand for contraband products. Second, the FDA could not eliminate nicotine for a period of 12 years. Third, the FDA could not take any action to modify tobacco products without surmounting a number of procedural hurdles -- e.g., formal rulemakings -- not usually applicable to administrative action.

The public health community will demand -- and we believe the industry will grudgingly accept -- a legislative proposal that corrects these weaknesses. Any Administration proposal should eliminate the 12-year waiting period and the special procedural hurdles in the current settlement. It also should remove the necessity of the FDA's making a contraband finding. At one point, the industry proposed flipping the burden of proof on the contraband issue, so that the FDA could not take action if a party affirmatively demonstrated that doing so would create a significant contraband market. But even this approach puts too much weight on the contraband issue, which should be only one factor in the FDA's regulatory decisionmaking. To maintain maximum flexibility, one approach is to authorize the FDA to order changes to tobacco products based on a consideration of relevant factors, including relative risks to public health and technical feasibility.

Recommendation: Call for legislation preserving FDA authority over tobacco products, unencumbered by procedural or substantive criteria that may diminish that authority, and ensuring that FDA remains flexible to meet the future health challenges of tobacco.

B. Lookback Penalties

The settlement sets ambitious targets for reductions in teen smoking of 30% in 5 years,

50% in 7 years, and 60% in 10 years. The most recent data show underage prevalence at 18.2% in 1996, which means approximately 3.5 million youths aged 13-17 are daily smokers. Because the settlement targets are based on youth prevalence over the past decade, which has averaged 15.2%, the declines from current levels necessary to comply with the agreement would have to be 42% over 5 years, 58% over 7, and 67% over 10.

It is extremely difficult to predict how much teen smoking would decline under the settlement. While teen smokers are particularly sensitive to price -- Treasury has assumed that a price increase of 10% will reduce youth prevalence by 7% (compared to 2.6% for adults), and some studies suggest youth smoking will drop as much as 12% for every 10% increase in price -- we have never had a price shock of this magnitude. The Treasury Department estimates that the combined price rise from the current settlement and the 15-cent excise tax increase in the budget agreement would be about 80 cents by year 5, resulting in a 20% decrease from current youth smoking levels -- still well short of the settlement targets. Restrictions on access and advertising should reduce youth smoking still further, but no one can truly estimate the combined effect of price increases, access and advertising restrictions, and whatever activity the industry might undertake to counter these changes.

Under the settlement, companies would have to pay $80 million for each percentage point they fall short, which is supposed to recapture the industry's projected profits from hooking that many young smokers. (The Treasury Department says a more accurate projection of profits would be $60 million a point, which is roughly equal to $80 million after taxes.) Public health groups have praised the idea of targets and penalties, but complain that the settlement does not give companies sufficient incentive to stop hooking teenagers. The major criticisms against the current penalties are that they are tax-deductible, abatable, capped at $2 billion in a given year, not company-specific, and too small to serve as a deterrent.

The companies say that they could accept penalties of $80 million a point that were not tax-deductible and could not be abated. They say they are unwilling to increase the price per point or to eliminate the $2 billion annual cap.

One alternative approach would be to measure the number of teenagers who smoke a particular company's brands, and assess a company-by-company surcharge of $1,000 (about 2 ½ times foregone profits) per teen smoker in excess of the youth reduction targets. A second approach would combine the company-by-company surcharge with a system of graduated penalties that get stiffer the more the industry misses the targets. For example, the industry could be required to pay $200 million for each point missed between 0 and 30 percent, $400 million for each point missed between 30 and 50 percent, and $600 million for each point missed between 50 and 60 percent. Under this approach, the penalties could reach as high as $1 a pack by year 10 if youth smoking failed to decline.

Recommendation: Call for legislation holding each tobacco company accountable for reducing the use of tobacco by youths and subjecting companies to serious financial loss for failing to

meet targets.

Alternative penalty schemes are outlined further in the charts on funding options attached to this memorandum.

C. Marketing, Advertising, and Labeling

The advertising and marketing restrictions in the settlement are very strong. They include all the restrictions in the FDA rule -- most notably, requirements of black-on-white advertising and bans on tobacco brand names in non-tobacco merchandise. The district court struck down these restrictions as inconsistent with the FDA's statutory authority, and the issue is not likely to be resolved quickly in court. The settlement also includes restrictions on advertising and marketing going far beyond the FDA rule, such as restrictions on point-of-sale advertising and bans on outdoor advertising, Internet advertising, the use of human images and cartoon characters, and payments for tobacco product placement in movies and other media. The Justice Department believes that all of these restrictions are highly vulnerable to constitutional challenge and that some flatly violate the First Amendment.

The Department of Justice believes that these additional restrictions on advertising should not be part of any legislation, but only of the consent decrees or other contracts entered into by the industry and Attorneys General. To the extent the restrictions are part of the legislation -- or seen as a condition of the legislation -- serious constitutional issues will arise. To the extent the restrictions are part only of the settlement agreements, their chance of being upheld would be significantly increased. (Larry Tribe, among others, believes that so long as the advertising restrictions are a function only of consent decrees and private agreements, they raise *no* constitutional issues. The Justice Department, by contrast, thinks that a court *might* strike down these advertising restrictions, even if included only in consent decrees or contracts, on the ground that the government coerced the companies to enter into these contracts in an effort to accomplish indirectly what it could not do directly.)

Assuming the advertising restrictions are included in consent decrees and agreements, serious questions relating to enforcement of the advertising restrictions arise. Each Attorney General settling a suit by consent would be able to enforce the restrictions in his or her state. But what of states in which there is no consent decree? Or what of states with inattentive Attorneys General? The proposed settlement agreement makes reference to a binding "national protocol" -- a contract designed to enhance enforcement of the advertising restrictions (and other provisions) in the consent decrees. But there is no consensus on precisely who will sign the protocol or how it will work in practice. As the legislative process unfolds, we must keep a close eye on this scheme -- and especially on any legislative references to it -- to ensure that it provides an effective mechanism for enforcing the advertising restrictions while not increasing the vulnerability of the restrictions to constitutional challenge (by making their enforcement something other than a matter of simple contract law).

We also should insist on statutory confirmation of FDA authority over the advertising and marketing of tobacco products, as part of our broader effort to secure legislation conferring full regulatory authority on the FDA. This grant of authority is valuable even though the settlement agreements will go further than the FDA could, precisely because the FDA probably will not have authority to enforce the contracts between the industry and the states. With a specific grant of authority, the FDA itself could enforce the restrictions contained in its 1996 rule, as well as any other constitutionally permissible restrictions it might wish to impose in the future.

In addition to including restrictions on advertising, the settlement contains provisions to require "Canadian-style" warning labels -- i.e., strengthened warnings (such as "cigarettes cause cancer" and "smoking can kill you") that appear on 25% of the front or display panel of tobacco products, printed in alternating black-on-white or white-on-black type. These provisions would strengthen significantly the existing warning labels, both in the starkness of the message and in its size and placement on tobacco products.

Recommendation: Call for legislation making explicit FDA authority to regulate the advertising of tobacco products and toughening warning labels on cigarette products. (Make limited reference to the tobacco industry's agreement to restrict advertising and do not say anything to suggest that this agreement is a condition of legislation.)

D. Access and Licensing

The access and licensing provisions of the settlement significantly enhance the ability of the government to prevent youth access to tobacco products. The current FDA rule establishes 18 as the federal minimum age of sale, requires retailers to check photo identification of anyone under 27, bans vending machines and self-service displays from actual establishments accessible to children, and eliminates free samples and the sale of single cigarettes. The proposed settlement incorporates these access restrictions while also banning all cigarette vending machines and requiring tobacco products to be placed out of reach of consumers in any facility that children may enter. Even more important, the settlement would establish a retail licensing scheme to enforce these access restrictions. FDA and Treasury agree that such a system will significantly further your goal of reducing youth access to tobacco. Assuming adequate funding, legislation creating a licensing system could count as one of the principal virtues of the settlement agreement.

As written, however, the licensing provision of the settlement contains some important ambiguities. Most critically, the settlement is vague as to who -- state authorities, federal authorities, or some combination of the two -- will administer the licensing scheme. We are not yet in a position to make a final recommendation on this question. FDA's current inclination is to give responsibility for running the scheme to the states, but to retain the power to revoke licenses. We are not yet sure whether such an approach would work as a practical matter; neither are we certain whether it could be accomplished consistently with the Constitution. Rather than

recommending a specific scheme, we should commit only to working with Congress and the Attorneys General on this question.

The settlement's licensing provision also now contains an inadequate penalty structure. Most troublesome, the settlement provides for permanent license revocation only after a licensee's tenth offense within two years. Because licensing officials are unlikely to conduct ten compliance checks on a single retailer in a two-year time frame, this provision is essentially meaningless. We should insist on strengthening the penalty scheme -- including by making mandatory revocation a real weapon -- without getting into a level of detail unsuitable at this stage of the process.

These provisions are not particularly high-profile. They have not attracted much attention, and nothing we say about them will alter the politics of the deal in either direction. But the provisions, if strengthened and clarified along the lines suggested, could prove one of the virtues of enacting tobacco legislation.

Recommendation: Call for legislation imposing strong access restrictions and establishing an effective retail licensing scheme with tough penalties.

E. Documents

For decades, the tobacco industry has failed to disclose essential facts in its possession about the dangers and addictiveness of tobacco products. In particular, the industry has used both the attorney-client and the work product privileges to cloak scientific research and findings -- and possibly to shield evidence of criminal or fraudulent behavior. The Attorneys General attempted to address this issue through creation of a special court to resolve all privilege claims made by the industry. Although the proposed system has certain virtues, it also suffers from serious defects. The industry is willing to make certain minor changes in the proposed scheme, but will not accept changes recommended by the Justice Department and FDA. Even these changes will not satisfy the harshest critics of the settlement, such as Skip Humphrey.

The settlement calls for a national document depository and a three-judge panel (appointed by the Judicial Conference of the United States) to provide expedited rulings on whether documents should remain privileged. The Attorneys General fought hard for this provision for two essential reasons. First, anyone -- not just a litigant, but any member of the public (including the New York Times or David Kessler) -- could ask the panel to review allegedly privileged documents. In this sense, the settlement establishes a Freedom of Information Act for tobacco documents. Second, the requester would not have to make the normal showing required in litigation for *in camera* review of a document: a *prima facie* case that the document is not privileged -- because, for example, it advanced a scheme of crime or fraud.

The Justice Department, however, believes that this scheme, adopted without change, would pose serious dangers. DOJ points out that no one knows whether or how this panel will work -- whether the judges (or special masters appointed by them) will be competent; whether they will be so swamped with document requests as to create an enormous backlog; whether they will favor one side over the other. DOJ also notes that this panel will have sole authority to rule on claims of privilege. While under the current system many courts may adjudicate a claim of privilege (with a finding of privilege in one court often not precluding the opposite finding in another), the special three-judge panel's decisions would be binding in all courts in all litigation in the United States. On top of these Justice Department concerns, the FDA should have access to all documents -- even those rightfully privileged -- to determine whether they contain scientific or other health-related information (for example, reflecting the industry's extensive research on nicotine addiction) relevant to the regulation of tobacco products.

To meet these agency concerns, the Administration could offer alternative disclosure provisions. First, we could make any administrative disclosure process non-exclusive, so that a litigant could challenge a privilege claim in litigation even if the special panel had not completed review of the document in question or had ruled in favor of the company. (By contrast, a finding by the special panel that a document is not privileged would bind the company in all other proceedings.) Second, we could provide the FDA with access to all health-related documents, notwithstanding any claims of privilege.

The industry claims that it will not accept either of these changes, though it will accept a scheme allowing courts to rule on a privilege claim if the special panel has not yet done so. The industry also proposes adding a provision to the settlement to require each company to identify and disclose all health-related information contained in privileged documents, without turning over the documents themselves. Under this proposal, the special panel could find that a company had failed to disclose such information and levy substantial penalties. Finally, the industry has expressed a willingness to consider a different scheme for selecting the people to sit on the special panel.

On the other side, some in Congress and the public health community will find even the alternative provisions described above to be inadequate. These changes do not broadly abrogate the industry's attorney-client or work-product privileges. The Justice Department has expressed serious concerns about any such breach of the privilege, arguing that such an approach would undermine the privilege generally and would enable a tobacco company official charged with criminal conduct to assert a violation of his Sixth Amendment right to effective assistance of counsel. But some will demand the complete abrogation of the companies' attorney-client privilege as a term of the settlement -- or, even more broadly, insist (as Sen. Leahy, Rep. Waxman, and Attorney General Skip Humphrey already have done) that the tobacco companies disclose all privileged documents before any consideration of a settlement takes place.

Recommendation: Call for legislation ensuring broad disclosure of tobacco industry documents.

Options:

A. Call for legislation creating exclusive document depository system and compelling release of scientific and other health-related information in allegedly privileged documents (but not documents themselves).

B. Call for legislation creating non-exclusive document depository system, compelling release of scientific and other health-related information in allegedly privileged documents, and providing the FDA with access to all such documents.

C. Call for legislation requiring full public disclosure of all allegedly privileged documents.

F. Environmental Tobacco Smoke

The best available scientific evidence indicates that environmental tobacco smoke (ETS) causes disease and death in non-smokers. The Environmental Protection Agency (EPA) classifies ETS as a Class A carcinogen and estimates that it is responsible for about 3,000 lung cancer deaths each year in non-smoking adults. The EPA also has found that ETS threatens the health of hundreds of thousands of children with asthma and other respiratory illnesses. Serious ETS restrictions, which ban smoking in public places or at work except in enclosed areas exhausted directly to the outside, reduce exposure to ETS and the harm it causes. At the same time, such restrictions lead many smokers to quit smoking entirely and many more to cut down. Indeed, among the many smoking cessation tools -- including substantial price increases -- ETS restrictions may well be the most effective.

All agree that the settlement's provision on ETS is extremely valuable. The proposed legislation would broadly prohibit smoking in public places, without preempting even stricter state or local laws. A remaining question is whether to exempt restaurants (but not fast food restaurants), bars, private clubs, hotel guest rooms, casinos, bingo parlors, and tobacco merchants from a broad ETS restriction. H.R. 3434, which the Administration supported, exempts restaurants (including fast food restaurants) and bars. The proposed rule on ETS that OSHA issued in 1994 does not include any exemption for the hospitality industry. HHS would prefer to cut back on the exception in the settlement, noting that many of the exempted work places pose the greatest threat to non-smokers. The Department of Labor (OSHA) would keep the exemption essentially as is on the ground that trying to include restaurants, casinos, etc. would make the whole provision politically unsalable.

Recommendation: Call for legislation imposing strict restrictions on smoking in public places.

Option: Include exception for some or all the hospitality industry (restaurants, casinos, etc.)

G. Liability and Other Legal Issues

The price of everything in the settlement agreement is, of course, protection from civil liability. The settlement limits total liability to $5 billion each year (with any unspent portion of a base $4 billion fund reverting to the government), prohibits class action and other joinder and consolidation devices, and eliminates punitive damage claims (but requires a payment of billions of dollars in punitive damages directly payable to the public). There is little doubt about the value of these provisions to the tobacco companies.

On the other hand, there is some debate about whether these provisions harm public health interests. The tort system, of course, generally serves to deter conduct that causes injury to health and safety. Many in the public health community believe that imposing caps on damages, eliminating punitive damages and barring class actions will diminish this deterrent effect and encourage the industry to cause still further harm. Others believe that these changes will not reduce deterrence (recall that $5 billion in annual compensatory damages is $5 billion more than the industry has ever paid before) -- or at least that they are more than outweighed by provisions putting into effect a comprehensive regulatory scheme to regulate future behavior. They also argue that making the companies pay a punitive damage award for past misconduct to the public (for use in health research, etc.) makes far more sense from a public health perspective than allowing such funds to go as windfalls to individual plaintiffs.

The Justice Department believes that we would further advance public health interests by insisting on the removal of any limits on punitive damages for future misconduct. In DOJ's view, we should make clear that plaintiffs can seek such awards, and that these awards shall not count toward or be subject to yearly limits. The continued potential for unrestricted punitive damages will support the regulatory aspects of the legislation in deterring willful misconduct and otherwise changing corporate behavior. At the same time, this change will enable the legal system to punish the industry, over and above compensatory damages, for any future misbehavior.

DOJ also has urged us to consider some changes to the prohibition on class actions, joinder, consolidation, and other aggregation devices. The first point to make about this prohibition is that there is a substantial risk that it would be invalidated as applied to state courts for violating the Tenth Amendment. Any provision of this kind thus would have to be accompanied by explicit severance language. In addition, DOJ would like to define the ban on aggregation more narrowly -- in particular, to allow some consolidation of cases prior to trial for purposes of conducting discovery and adjudicating pre-trial motions. This change, which would entail amendment of the current multidistrict litigation statute, would allow individual plaintiffs to share discovery materials and reduce discovery and other pre-trial costs. The industry apparently will resist any change to the provision on class actions, joinder, and consolidation. But given the cap on annual damages, it is hard to see why such changes matter so much to the industry. Moreover, the industry may see consolidation schemes of the kind DOJ would like to protect as less threatening than mechanisms (whether class actions or joinder rules) that

permanently tie many cases together, letting numerous "bad facts" cases ride in the wake of a couple of "good facts" cases all the way to judgment.

The FTC and Antitrust Division of the Justice Department are both concerned about the breadth of the antitrust exemption contained in the proposed settlement agreement, noting that it might protect such activities as price-fixing, mergers to monopoly, predatory pricing, and agreements not to produce reduced-risk products. The FTC and Antitrust Division note that they presumptively disfavor exemptions to the antitrust laws and that any exemption for tobacco companies must be limited to what is strictly necessary to serve the purposes of our tobacco proposal. Though we do not have specific language, the general idea would be to allow collusion only where strictly necessary to accomplish the purpose of reducing youth smoking.

We also must insist that neither the settlement nor any eventual legislation (including provisions relating to documents) will apply to or have preclusive effect on federal grand jury investigations or criminal prosecutions. In particular, the settlements and legislation should include a so-called "Halper provision," by which the participating companies waive any argument that the civil penalties in the settlement constitute a bar under the double jeopardy clause to criminal prosecution.

Finally, the preemption provisions of the proposed settlement are among its most baffling aspects -- muddled, internally contradictory, and seemingly senseless. We should try to clarify them so that they preserve current FDA authority, while enabling states in appropriate circumstances to go beyond the provisions of the settlement agreement. More specifically, where existing law requires states to petition the FDA to regulate tobacco, states would remain under that obligation and the FDA would retain its current authority; where existing law allows states to regulate tobacco on their own, states could impose any regulations more stringent than the new federal standards. It is very difficult to know how much (if at all) this scheme deviates from what the drafters of the settlement intended. In any case, it is hard to imagine that the issue would drive any party from the table.

Recommendation: Condition limits on liability and aggregation (class actions, etc.) on complete satisfaction of all other demands. Make clear that federal legislation cannot in any way affect criminal prosecutions or more stringent state regulation.

H. Farmers

We have made clear that tobacco farmers should receive protection in any legislative settlement, and that the Administration will work closely with members of Congress from tobacco states to forge a consensus. Secretary Glickman has traveled to tobacco markets in Virginia and North Carolina to express this commitment directly to farmers.

Farmers are interested in continuation of the governmental tobacco program, guaranteed

purchase at set levels of tobacco crops by cigarette companies, and some provision for buy out and transition to other crops, on a voluntary basis. Farm groups and tobacco state members have not yet coalesced around a consensus proposal. One plan put forward this month by Senators Ford and McConnell would require companies to buy a minimum amount of domestic tobacco over 25 years and would install penalties on companies that do not meet the stated goals for tobacco buying. The proposal would also create a "Tobacco Community Revitalization Fund" administered by USDA, but not subject to the appropriation process, which could spend up to $1 billion a year for 25 years from the settlement fund. This Revitalization Fund would cover costs related to the tobacco program such as administration and crop insurance, make supplemental payments of up to $500 million to producers whose income from tobacco drops substantially below the 1996 level, pay up to $100 million in benefits for displaced cigarette factory workers, and provide up to $250 million a year for rural economic development grants.

Recommendation: Vow to protect tobacco farmers and communities in tobacco legislation.

I. International Issues

As you know, the settlement does not address international sale of tobacco products. Public health groups have criticized this aspect of the settlement; more broadly, they are pushing for the United States to take a leadership role in fighting tobacco's rapid global growth. Worldwide, there are 3 million tobacco-related deaths annually, and the World Health Organization expects that number to rise to 10 million by 2025, with 75% of annual deaths occurring in developing countries.

Some have suggested changes to normal trade policy as a response to the global spread of tobacco. USTR's current policy is to fight discriminatory barriers on behalf of all industries, including tobacco. One proposal is for USTR to stop providing such assistance to tobacco companies, on the ground that the entry of U.S. tobacco companies into foreign countries has arguably increased tobacco consumption. Your trade advisors, however, do not believe that we should take such action at this time.

As you noted just after announcement of the settlement, the United States can act by example in the area of tobacco control. That means, first and foremost, adopting policies to reduce smoking in this country. In addition, it means strengthening the Administration's leadership role in global and bilateral efforts to reduce smoking, including by providing assistance to international organizations. Finally, and at the very least, it means that U.S. embassies and missions act consistent with domestic policies by curtailing their involvement in tobacco marketing and export promotion activities. HHS is working with the Departments of State and Commerce on new guidelines on this issue.

Recommendation: Support efforts by other countries and international organizations to reduce smoking around the world.

J. Funding

Although the settlement is advertised at $368.5 billion, a variety of factors conspire to leave us with considerably less than that to spend on any new initiatives. The $368 billion is a 25-year number, and must be adjusted downward to reflect a projected drop in cigarette consumption of about 15%. For scoring purposes, OMB adjusts the amount down still further to reflect lost business tax revenue and lost federal excise tax revenue from decreased consumption. Most of the rest of the money in the settlement is already spoken for, to pay for civil suits, cessation programs, counteradvertising, and the states' Medicaid claims. No specific provision is made to reimburse the federal government for its Medicaid or Medicare expenses.

Options for How Much the Industry Should Pay

The attached charts outlines options on how much funding to seek and how to spend it. A chart attached to this memo suggests four options for how much the industry should pay:

1. Current settlement: This option assumes repeal of the $50 billion tax credit in the budget agreement, restoring gross industry payments to the original level negotiated by the attorneys general -- $368 billion over 25 years, with lookback penalties of up to $32 billion over that period. This option would raise cigarette prices by approximately 60 cents a pack (on top of the 15-cent increase in the budget agreement).

2. Tough penalties: This option assumes the full level of base payments in Option 1 ($368 billion), with dramatically tougher penalties on the industry if it fails to reduce teen smoking (which could raise up to $303 billion over 25 years). These penalties would include a company-by-company surcharge, as well as stiff penalties of up to $1 a pack. The entire option would raise cigarette prices between 60 cents and $1.60 a pack, depending on the industry's success in reducing teen smoking.

3. Restore promised investment revenues: This option assumes the amount of payments necessary to fund additional public health investments at a level that reflects what some supporters of the original settlement said would be available. Under this option, the industry would make gross payments of $620 billion over 25 years. This option includes the company-by-company surcharge, but not the steeper youth penalties. This option would raise cigarette prices by $1 a pack.

4. $1.50 per pack: This option assumes the level of industry payments necessary to increase cigarette prices by $1.50 a pack right away, which David Kessler and Rep. Waxman have urged. Under this option, the industry would make gross payments of $943 billion over 25 years.

Ways to Spend Additional Funding

The current settlement would fund a variety of public health initiatives, including a counteradvertising campaign; smoking cessation programs; FDA enforcement; other tobacco control efforts; and a $4-billion-a-year trust fund that could serve as a 21st Century Research Fund dedicated to biomedical and tobacco-related research.

A chart attached to this memorandum outlines possible uses for additional funds, if any.

Tobacco - settlement - notes + memos

THE WHITE HOUSE

WASHINGTON

February 23, 1998

MEMORANDUM FOR THE CHIEF OF STAFF

FROM: Bruce Reed

SUBJECT: Tobacco Strategy

Tomorrow we've scheduled a weekly tobacco strategy meeting with you and a group of senior White House, OMB, Treasury, and HHS officials. We hope to hold these meetings on at least a weekly basis. Among the issues we would like to discuss at tomorrow's meeting are:

- **Legislative strategy**: Larry Stein and I have suggested key members of Congress that you should meet with as soon as possible to reaffirm our commitment to enact comprehensive bipartisan tobacco legislation to reduce youth smoking. We would like your permission to start scheduling these meetings. We also would like to discuss the:
  - progress of bipartisan efforts -- i.e., Chafee-Harkin and McCain-Hollings;
  - need for budget resolution language that is generally consistent with our tobacco-related budget proposals (OMB is drafting proposed language);
  - ongoing Hill negotiations regarding farmers and farm communities.

- **Upcoming Presidential opportunities**: We are trying to put together an event for the President or Vice President this week to announce a new advertising campaign to reinforce the FDA rule -- one year old on February 28th -- that requires retailers to check photo identification of anyone under age 27 and prohibits them from selling tobacco products to anyone under age 18. In addition, we recommend that the President use his March 12th speech to the Attorneys General to generate momentum for comprehensive tobacco legislation. We also believe a speech to the American Medical Association (the President is invited for March 8-10) would be a good forum to discuss tobacco.

- **Administration working groups**: DPC is chairing a series of working group meetings to develop more detailed positions on the dozen or so issues likely to be key to a legislative deal. These issues include: farmers and farming communities; minority communities; FDA jurisdiction and authority; licensing schemes; advertising and marketing provisions; industry penalties and lump-sum upfront payment; industry documents; antitrust; civil liability, including class actions; legal fees; international tobacco control; relationship of tobacco to drug policy.

Tobacco - ntr - advertising
and notes + memos

Marketing, Advertising, and Labeling

The Administration understands that separate and apart from any legislation, the tobacco industry will voluntarily agree in consent decrees and contracts to restrict its advertising and marketing of tobacco products. These voluntary limitations will include but go beyond restrictions imposed by the FDA in its August 1996 rule.

Notwithstanding these agreements, the Administration will press for legislative language that confirms the FDA's authority to regulate the advertising and marketing of tobacco products, as asserted in its August 1996 rule. The Administration will carefully review any legislative language relating or referring to the industry's consent decrees or contracts to ensure that such language does not limit or in any way interfere with the FDA's use of this authority. The Administration also will carefully review such language to ensure consistency with constitutional requirements.

The Administration supports legislation to require "Canadian-style" warning labels -- i.e., strengthened warnings (such as "cigarettes cause cancer" and "smoking can kill you") that appear on 25% of the front or display panel of tobacco products, printed in alternating black-on-white or white-on-black type. The Administration also supports legislation to require warnings of similar prominence on advertisements for tobacco products.

Internal notes:

The advertising and marketing restrictions in the settlement are very strong. They include all the restrictions in the FDA rule -- most notably, requirements of black-on-white advertising and bans on tobacco brand names in non-tobacco merchandise. The district court struck down these restrictions as inconsistent with the FDA's statutory authority. The Court of Appeals clearly will not reverse this decision, and the Supreme Court probably will leave it alone as well. The settlement also includes restrictions on advertising and marketing going far beyond the FDA rule, such as restrictions on point-of-sale advertising and bans on outdoor advertising, Internet advertising, the use of human images and cartoon characters, and payments for tobacco product placement in movies and other media. Congress could not enact such restrictions consistent with the Constitution.

The above statement is written to emphasize that the restrictions on advertising are part of consent decrees and other contracts -- not part of our proposed legislation. To the extent the restrictions are a part of the legislation -- or seen as a condition of the legislation -- serious constitutional issues will arise. To the extent the restrictions are a part only of the settlement agreements, they probably will be permissible as voluntary relinquishments of rights.

The statement insists on statutory confirmation of FDA authority over the advertising and marketing of tobacco products. This grant of authority is valuable even though the settlement agreements go further than the FDA could, because the FDA will have no authority to enforce

the contracts between the industry and the states. With a specific grant of authority, the FDA itself could enforce the restrictions contained in its 1996 rule, as well as any other constitutionally permissible restrictions it might wish to impose in the future.

The statement contemplates that the legislation may refer to the consent decrees. Such a reference could make sense to bolster enforcement of the agreements, to include them within a broader severance scheme (e.g., what happens if a court invalidates part of an agreement?), or for certain other reasons. The statement, however, makes clear that the Administration will carefully scrutinize any reference of this kind to ensure that it does not interfere with FDA authority -- and more important, to ensure that it does not bring the advertising restrictions so far within the legislative scheme as to increase their vulnerability to constitutional challenge.

The part of the statement relating to labels on packages and advertisements is consistent with the provisions of the settlement agreement. These provisions would strengthen significantly the existing warning labels, both in the starkness of the message and in its size and placement on tobacco products.

Tobacco - settlement - licensing and enforcement

Access and Licensing

This Administration is committed to taking effective action to prevent youth access to tobacco. The FDA rule contains numerous provisions to limit youth access, including establishing 18 as the federal minimum age of sale, requiring retailers to check photo identification of anyone under 27, and eliminating free samples and the sale of single cigarettes. These provisions will help parents to keep their children safe from tobacco products.

The Administration supports legislation that will advance this effort still further. This legislation, in addition to incorporating access restrictions from the FDA rule, shall ban all cigarette vending machines and require tobacco products to be placed out of reach of consumers in any facility that children may enter.

In addition and even more important, the Administration supports legislation to establish an effective licensing scheme to enforce these access restrictions. This scheme shall prohibit any unlicensed person from selling tobacco products to consumers; institute a strict scheme of criminal and civil penalties, including license suspension or revocation, for violations of licensing laws; and impose licensing fees to cover the costs of administering the licensing system.

The Administration will work with Congress on the appropriate distribution of responsibility between the federal and state governments for administering this scheme and imposing penalties. In addition, the Administration will work with Congress on the appropriate level of penalties for violating licensing laws, including by selling tobacco products to minors. These penalties cannot impinge on any existing powers of the FDA to impose civil penalties and must be sufficiently stringent to deter violations; in particular, the threshold for permanently revoking licenses should not be set so high as to lost its power to deter retailers from selling tobacco to minors.

Internal notes:

The above statement embraces the settlement's provisions on youth access restrictions. These provisions, which codify and then go beyond the FDA rule, significantly advance the effort to limit youth access to tobacco products.

Even more important to that effort is the provision for establishing a retail licensing system. FDA and Treasury agree that such a system is necessary for adequate enforcement of youth access provisions. Assuming adequate funding, legislation creating a licensing system would count as one of the principal virtues of the settlement agreement.

The proposed settlement is vague as to who -- state authorities, federal authorities, or some combination of the two -- should administer the licensing scheme. We are not yet in a position to make a concrete recommendation on this question. FDA's current inclination is to

give responsibility for running the scheme to the states, but to retain the power to revoke licenses. We are not sure whether such an approach would work (or even how it could be done); the above statement therefore says only that we will work with Congress on this issue.

The statement also indicates that the penalty structure attached to the licensing scheme needs further thought and strengthening, but does not now commit ourselves to a particular set of penalties. The statement includes language about preserving FDA authority as a safeguard, in light of the settlement's failure to make this point explicit. More meaningfully, the statement suggests that the penalty scheme set out in the settlement is too lenient. The settlement provides for permanent license revocation only after a licensee's tenth offense within two years. Because licensing officials are unlikely to conduct ten compliance checks on a single retailer in a two-year time frame, this provision is essentially meaningless. The above statement indicates that we want mandatory revocation to be a real weapon, without getting into a level of detail unsuitable at this stage of the process.

Tob-reg-notes+memos

Jim - New draft with recommendations added to meet your concerns. (I think it's better this way.)
Elena

FDA Authority

The first priority of the Administration in considering tobacco legislation should be to confirm and protect the jurisdiction of the FDA to regulate tobacco products -- including through the reduction or elimination of nicotine or other constituents. This goal will necessitate substantial changes in the proposed settlement agreement.

Even as written, the settlement's provision on FDA jurisdiction had certain virtues. First, the provision specifically conferred jurisdiction to regulate tobacco products on the FDA, thereby removing the legal uncertainty now attending the FDA rule. (The Fourth Circuit panel sounds almost certain to rule against the FDA, and the Supreme Court may well uphold this decision.) Second, the provision established a "risk reduction" standard to guide the regulation of tobacco products in place of the "safety and efficacy" standard applicable to other drugs and devices. Because the former makes sense when applied to inherently dangerous products whereas the latter does not, the change in standard would facilitate the FDA's regulation of tobacco products.

This provision of the settlement, however, also contained several glaring weaknesses. First, as you noted in your first comments on the settlement, the FDA would have to prove a negative in order to reduce or eliminate nicotine -- i.e., that the action would not create a significant demand for contraband products. Second, the FDA could not eliminate nicotine for a period of 12 years. Third, the FDA could not take any action to modify tobacco products without surmounting a number of procedural hurdles -- e.g., formal rulemakings -- not usually applicable to administrative action.

The public health community will demand -- and we believe the industry will grudgingly accept -- a legislative proposal that corrects these weaknesses. This proposal would eliminate the 12-year waiting period and the special procedural hurdles in the current settlement. It also, and perhaps most important, would remove the necessity of the FDA's making a contraband finding. At one point, the industry proposed flipping the burden of proof on the contraband issue, so that the FDA could not take action if a party affirmatively demonstrated that doing so would create a significant contraband market. But even this approach puts too much weight on the contraband issue, which should be only one factor in the FDA's regulatory decisionmaking. The better approach is to authorize the FDA to order changes to tobacco products based on a simple finding that this change would reduce the risk of the product to the public and is technologically feasible, after consideration of the full range of consequences of the change, including the possible creation of a contraband market.

Recommendation: Assert the need for legislation to provide the FDA with unfettered authority to regulate tobacco products (including the reduction or elimination of nicotine).

Penalties

The settlement sets ambitious targets for reductions in teen smoking of 30% in 5 years, 50% in 7 years, and 60% in 10 years. The most recent data show underage prevalence at 18.2%

in 1996, which means approximately 3.5 million youths aged 13-17 are daily smokers. Because the settlement targets are based on youth prevalence over the past decade, which has averaged 15.2%, the declines from current levels necessary to comply with the agreement would have to be 42% over 5 years, 58% over 7, and 67% over 10.

It is extremely difficult to predict how much teen smoking would decline under the settlement. While teen smokers are particularly sensitive to price -- Treasury has assumed that a price increase of 10% will reduce youth prevalence by 7% (compared to 2.6% for adults), and some studies suggest youth smoking will drop as much as 12% for every 10% increase in price -- we have never had a price shock of this magnitude. The Treasury Department estimates that the combined price rise from the current settlement and the 15-cent excise tax increase in the budget agreement would be about 80 cents by year 5, resulting in a 20% decrease from current youth smoking levels -- still well short of the settlement targets. Restrictions on access and advertising should reduce youth smoking still further, but no one can say how much.

Under the settlement, companies would have to pay $80 million for each percentage point they fall short, which is supposed to recapture the industry's projected profits from hooking that many young smokers. (The Treasury Department says a more accurate projection of profits would be $60 million a point, which is roughly equal to $80 million after taxes.) Public health groups have praised the idea of targets and penalties, but complain that the current scheme does not give companies sufficient incentive to stop hooking teenagers. The major criticisms against the current penalties are that they are tax-deductible, abatable, capped at $2 billion in a given year, and too small to serve as a deterrent.

The companies might accept penalties of $80 million a point that were not tax-deductible and could not be abated. They say they are unwilling to increase the price per point or to eliminate the $2 billion annual cap.

We recommend a system of graduated penalties that get stiffer the more the industry misses the targets. The industry would pay $200 million a point for each point missed between 0 and 30 percent, $400 million a point for each point missed between 30 and 50 percent, and $600 million a point each point missed between 50 and 60 percent. There would be an additional company-by-company surcharge of approximately $30 million a point that would reflect a company's share of youth smokers. These penalties would be non-deductible and could not be abated. Because the charge would be locked in as a permanent price increase, it would have a substantial impact in further reducing smoking by youth (and adults). Under this approach, the penalties could reach as high as $1 a pack by year 10 if youth smoking failed to decline.

Recommendation: Call for legislation with tough penalties, increasing the price of cigarettes by up to $1 per pack, to reduce youth smoking.

Marketing, Advertising, and Labeling

The advertising and marketing restrictions in the settlement are very strong. They include

all the restrictions in the FDA rule -- most notably, requirements of black-on-white advertising and bans on tobacco brand names in non-tobacco merchandise. The district court struck down these restrictions as inconsistent with the FDA's statutory authority. The Court of Appeals is highly unlikely to reverse this decision, and the Supreme Court probably will let it stand as well. The settlement also includes restrictions on advertising and marketing going far beyond the FDA rule, such as restrictions on point-of-sale advertising and bans on outdoor advertising, Internet advertising, the use of human images and cartoon characters, and payments for tobacco product placement in movies and other media. Congress could not enact such restrictions consistent with the First Amendment.

The Department of Justice believes that these restrictions on advertising should not be part of any legislation, but only of the consent decrees or other contracts entered into by the industry and Attorneys General. To the extent the restrictions are part of the legislation -- or seen as a condition of the legislation -- serious constitutional issues will arise. To the extent the restrictions are part only of the settlement agreements, they *probably* will be permissible as voluntary relinquishments of rights. (Larry Tribe, among others, believes that so long as the advertising restrictions are a function only of consent decrees and private agreements, they raise *no* constitutional issues. The Justice Department, by contrast, thinks that a court *might* strike down these advertising restrictions, even if included only in consent decrees or contracts, on the ground that the government coerced the companies to enter into these contracts in an effort to accomplish indirectly what it could not do directly.)

Assuming we follow the Justice Department's recommendation, serious questions relating to enforcement of the advertising restrictions arise. We know that each Attorney General will be able to enforce the restrictions in his or her state. But what of states in which there is no consent decree? Or what of states with inattentive Attorneys General? The proposed settlement agreement makes reference to a binding "national protocol" -- a contract designed to enhance enforcement of the advertising restrictions (and other provisions) in the consent decrees. But there is no consensus on precisely who will sign the protocol or how it will work in practice. We must keep a close eye on this scheme -- and especially on any legislative references to it -- to ensure that it provides an effective mechanism for enforcing the advertising restrictions while not increasing the vulnerability of the restrictions to constitutional challenge (by making their enforcement something other than a matter of simple contract law).

We also should insist on statutory confirmation of FDA authority over the advertising and marketing of tobacco products. This grant of authority is valuable even though the settlement agreements will go further than the FDA could, precisely because the FDA will have no authority to enforce the contracts between the industry and the states. With a specific grant of authority, the FDA itself could enforce the restrictions contained in its 1996 rule, as well as any other constitutionally permissible restrictions it might wish to impose in the future. Such a provision should be acceptable to all parties.

In addition to including restrictions on advertising, the settlement contains provisions to require "Canadian-style" warning labels -- i.e., strengthened warnings (such as "cigarettes cause cancer" and "smoking can kill you") that appear on 25% of the front or display panel of tobacco

products, printed in alternating black-on-white or white-on-black type. These provisions would strengthen significantly the existing warning labels, both in the starkness of the message and in its size and placement on tobacco products. We do not recommend any changes to them.

Recommendation: Call for legislation giving the FDA explicit authority to regulate the advertising of tobacco products and toughening warning labels on cigarette products. (Make limited reference to the tobacco industry's agreement to restrict advertising and do not say anything to suggest that this agreement is a condition of legislation.)

Access and Licensing

The access and licensing provisions of the settlement significantly enhance the ability of the government to prevent youth access to tobacco products. The current FDA rule establishes 18 as the federal minimum age of sale, requires retailers to check photo identification of anyone under 27, and eliminates free samples and the sale of single cigarettes. The proposed settlement incorporates these access restrictions while also banning all cigarette vending machines and requiring tobacco products to be placed out of reach of consumers in any facility that children may enter. Even more important, the settlement would establish a retail licensing scheme to enforce these access restrictions. FDA and Treasury agree that such a system is necessary for adequate enforcement of youth access provisions. Assuming adequate funding, legislation creating a licensing system could count as one of the principal virtues of the settlement agreement.

As written, however, the licensing provision of the settlement contains some important ambiguities. Most critically, the settlement is vague as to who -- state authorities, federal authorities, or some combination of the two -- will administer the licensing scheme. We are not yet in a position to make a final recommendation on this question. FDA's current inclination is to give responsibility for running the scheme to the states, but to retain the power to revoke licenses. We are not yet sure whether such an approach would work (or even how it could be done); rather than recommending a specific scheme, we should commit only to working with Congress and the Attorneys General on this question.

The licensing provision also now contains an inadequate penalty structure. Most troublesome, the settlement provides for permanent license revocation only after a licensee's tenth offense within two years. Because licensing officials are unlikely to conduct ten compliance checks on a single retailer in a two-year time frame, this provision is essentially meaningless. We should insist on strengthening the penalty scheme -- including by making mandatory revocation a real weapon -- without getting into a level of detail unsuitable at this stage of the process.

These provisions are not particularly high-profile. They have not attracted much attention, and nothing we say about them will alter the politics of the deal in either direction. But the provisions, if strengthened and clarified along the lines suggested, could prove one of the great virtues of enacting tobacco legislation.

Recommendation: Call for legislation imposing strong access restrictions and establishing an effective retail licensing scheme with tough penalties.

Documents

For decades, the tobacco industry has failed to disclose essential facts in its possession about the dangers and addictiveness of tobacco products. In particular, the industry has used both the attorney-client and the work product privileges to cloak scientific research and findings -- and possibly to shield evidence of criminal or fraudulent behavior. The Attorneys General attempted to address this issue through creation of a special court to resolve all privilege claims made by the industry. Although the proposed system has certain virtues, it also suffers from serious defects. The industry is willing to make certain minor changes in the proposed scheme, but will not accept changes recommended by the Justice Department and FDA. Even these changes will not satisfy the harshest critics of the settlement, such as Skip Humphrey.

The settlement calls for a national document depository and a three-judge panel (appointed by the Judicial Conference of the United States) to provide expedited rulings on whether documents should remain privileged. The Attorneys General fought hard for this provision for two essential reasons. First, anyone -- not just a litigant, but any member of the public (including the New York Times or David Kessler) -- could ask the panel to review allegedly privileged documents. In this sense, the settlement establishes a Freedom of Information Act for tobacco documents. Second, the requester would not have to make the normal showing required in litigation for *in camera* review of a document: a *prima facie* case that the document is not privileged -- because, for example, it advanced a scheme of crime or fraud.

The Justice Department, however, believes that this scheme, adopted without change, would pose serious dangers. DOJ points out that no one knows whether or how this panel will work -- whether the judges (or special masters appointed by them) will be competent; whether they will be so swamped with document requests as to create an enormous backlog; whether they will favor one side over the other. DOJ also notes that this panel will have sole authority to rule on claims of privilege. While under the current system many courts may adjudicate a claim of privilege (with a finding of privilege in one court often not precluding the opposite finding in another), the special three-judge panel's decisions would be binding in all courts in all litigation in the United States. On top of these Justice Department concerns, the FDA would like access to all documents -- even those rightfully privileged -- to determine whether they contain scientific or other health-related information (for example, reflecting the industry's extensive research on nicotine addiction) relevant to the regulation of tobacco products.

To meet these agency concerns, we could strengthen the document provisions in two key ways. First, we could make the administrative disclosure process non-exclusive, so that a litigant could challenge a privilege claim in litigation even if the special panel had not completed review of the document in question or had ruled in favor of the company. (By contrast, a finding by the

special panel that a document is not privileged would bind the company in all other proceedings.) Second, we could provide the FDA with access to all health-related documents, notwithstanding any claims of privilege.

The industry claims that it will not accept either of these changes, though it will not object to a scheme allowing courts to rule on a privilege claim if the special panel has not yet done so. The industry also proposes adding a provision to the settlement to require each company to identify and disclose all health-related information contained in privileged documents, without turning over the documents themselves. Under this proposal, the special panel could find that a company had failed to disclose such information and levy substantial penalties. Finally, the industry has expressed a willingness to consider a different scheme for selecting the people to sit on the special panel.

On the other side, some in Congress and the public health community will find even the changes recommended by the agencies to be inadequate. These changes do not broadly abrogate the industry's attorney-client or work-product privileges. The Justice Department has expressed serious concerns about any such breach of the privilege, arguing that this approach would undermine the privilege generally and would enable a tobacco company official charged with criminal conduct to assert a violation of his Sixth Amendment right to effective assistance of counsel. But some will demand the complete abrogation of the companies' attorney-client privilege as a term of the settlement -- or, even more broadly, insist (as Sen. Leahy, Rep. Waxman, and Attorney General Skip Humphrey already have done) that the tobacco companies disclose all privileged documents before any consideration of a settlement takes place.

Options:

A. Call for legislation creating exclusive document depository system and compelling release of scientific and other health-related information in allegedly privileged documents (but not documents themselves).

B. Call for legislation creating non-exclusive document depository system, compelling release of scientific and other health-related information in allegedly privileged documents, and providing the FDA with access to all such documents.

C. Call for legislation requiring full public disclosure of all allegedly privileged documents.

Environmental Tobacco Smoke

The best available scientific evidence indicates that environmental tobacco smoke (ETS) causes disease and death in non-smokers. The Environmental Protection Agency (EPA) classifies ETS as a Class A carcinogen and estimates that it is responsible for about 3,000 lung cancer deaths each year in non-smoking adults. The EPA also has found that ETS threatens the health of hundreds of thousands of children with asthma and other respiratory illnesses. Serious ETS restrictions, which ban smoking in public places or at work except in enclosed areas

exhausted directly to the outside, reduce exposure to ETS and the harm it causes. At the same time, such restrictions lead many smokers to quit smoking entirely and many more to cut down. Indeed, among the many smoking cessation tools -- including substantial price increases -- ETS restrictions may well be the most effective.

All agree that the settlement's provision on ETS is extremely valuable, and needs few changes. The proposed legislation would broadly prohibit smoking in public places, without preempting even stricter state or local laws. The only question is whether to accept without change the settlement's exception for restaurants (but not fast food restaurants), bars, private clubs, hotel guest rooms, casinos, bingo parlors, and tobacco merchants. H.R. 3434, which the Administration supported, exempts restaurants (including fast food restaurants) and bars. The proposed rule on ETS that OSHA issued in 1994 does not include any exemption for the hospitality industry. (In a number of other ways, however, the settlement is more protective of public health than the OSHA rule, which in any event would face serious legal challenges if finally issued.) HHS would prefer to cut back on the exception in the settlement, noting that many of the exempted work places pose the greatest threat to non-smokers. The Department of Labor (OSHA) would keep the exemption essentially as is on the ground that trying to include restaurants, casinos, etc. would make the whole provision politically unsalable.

Recommendation: Call for legislation imposing strict restrictions on smoking in public places.

Options:

A. Include exception for some or all the hospitality industry (restaurants, casinos, etc.)

B. Eliminate any such exception.

Liability and Other Legal Issues

The price of everything in the settlement agreement is, of course, protection from civil liability. The settlement limits total liability to $5 billion each year (with any unspent portion of a base $4 billion fund reverting to the government), prohibits class action and other joinder and consolidation devices, and eliminates punitive damage claims (but requires a payment of billions of dollars in punitive damages directly payable to the public). There is little doubt about the value of these provisions to the tobacco companies.

On the other hand, it is not at all clear that these provisions harm public health interests. Instituting a comprehensive regulatory scheme, while keeping in place the possibility of $5 billion in annual compensatory damages ($5 billion more than the industry has ever paid before), should influence future corporate behavior at least as well as the litigation system usually manages to do. Moreover, making the companies pay a punitive damage award for past misconduct to the public (for use in health research, etc.) makes far more sense from a public health perspective than allowing such funds to go as windfalls to individual plaintiffs. Of course, these provisions do decrease the likelihood of bankrupting the tobacco companies. But as long

as Americans are addicted to tobacco products, it is not clear how bankrupting the industry would serve the public health.

We should further advance public health interests by insisting on the removal of any limits on punitive damages for future misconduct. We would make clear that plaintiffs can seek such awards, and that these awards shall not count toward or be subject to yearly limits. The continued potential for unrestricted punitive damages will support the regulatory aspects of the legislation in deterring willful misconduct and otherwise changing corporate behavior. At the same time, this change will enable the legal system to punish the industry, over and above compensatory damages, for any future misbehavior. The industry can hardly argue against this change to the settlement agreement.

We also might consider some changes to the prohibition on class actions, joinder, consolidation, and other aggregation devices. The first point to make about this prohibition is that it will probably be invalidated as applied to state courts for violating the Tenth Amendment. Any provision of this kind thus will have to be accompanied by explicit severance language. In addition, we may want to define the ban on aggregation more narrowly -- in particular, to allow some consolidation of cases prior to trial for purposes of conducting discovery and adjudicating pre-trial motions. The Justice Department recommends this change, which would entail amendment of the current multidistrict litigation statute, to allow individual plaintiffs to share discovery materials and reduce discovery and other pre-trial costs. The industry apparently will resist any change to the provision on class actions, joinder, and consolidation. But given the cap on annual damages, it is hard to see why such changes matter so much to the industry. Moreover, the industry may see consolidation schemes of this kind as less threatening than mechanisms (whether class actions or joinder rules) that permanently tie many cases together, letting numerous "bad facts" cases ride in the wake of a couple of "good facts" cases all the way up to judgment.

The FTC and Antitrust Division of the Justice Department are both concerned about the breadth of the antitrust exemption contained in the proposed settlement agreement, noting that it might protect such activities as price-fixing, mergers to monopoly, predatory pricing, and agreements not to produce reduced-risk products. The FTC and Antitrust Division have not come to closure on exact language to include in legislation, but agree that the exemption should allow collusion only for the purpose of reducing youth smoking (by uniformly passing on the costs of the settlement and penalties and agreeing on advertising restrictions). We should insist on a narrowing of the antitrust exemption, but not yet propose specific language. The industry almost certainly will accept this change.

We also must insist that neither the settlement nor any eventual legislation (including provisions relating to documents) will apply to or have preclusive effect on federal grand jury investigations or criminal prosecutions. In particular, the settlements and legislation should include a so-called "Halper provision," by which the participating companies waive any argument that the civil penalties in the settlement constitute a bar under the double jeopardy clause to criminal prosecution.

Finally, the preemption provisions of the proposed settlement are among its most baffling aspects -- muddled, internally contradictory, and seemingly senseless. We should try to clarify them so that they preserve current FDA authority, while enabling states in appropriate circumstances to go beyond the provisions of the settlement agreement. More specifically, where existing law requires states to petition the FDA to regulate tobacco, states would remain under that obligation and the FDA would retain its current authority; where existing law allows states to regulate tobacco on their own, states could impose any regulations more stringent than the new federal standards. It is very difficult to know how much (if at all) this scheme deviates from what the drafters of the settlement intended. In any case, it is hard to imagine that the issue would drive any party from the table.

Recommendation: Indicate willingness to accept certain limits on liability and aggregation (class actions, etc.) if all other demands are met. Make clear that punitive damages for future misconduct will not be limited. Also indicate willingness to accept a narrow antitrust exemption to effect the purpose of reducing youth smoking. Make clear that federal legislation will in no way affect criminal prosecutions or more stringent state regulation.

Options: (need not be decided by time of announcement)

A. Accept legislation prohibiting all aggregation devices (class actions, joinder, consolidation, etc.)

B. Insist on a narrower prohibition, which allows consolidation and similar mechanisms to provide plaintiffs with certain litigation economies.

Farmers

We have made clear that tobacco farmers should receive protection in any legislative settlement, and that the Administration will work closely with members of Congress from tobacco states to forge a consensus. Secretary Glickman has traveled to tobacco markets in Virginia and North Carolina to express this commitment directly to farmers.

Farmers are primarily interested in continuation of the governmental tobacco program, guaranteed purchase at set levels of tobacco crops by cigarette companies, and some provision for buy out and transition to other crops, on a voluntary basis. Farm groups and tobacco state members have not yet coalesced around a consensus proposal. One plan put forward this month by Senators Ford and McConnell would require companies to buy a minimum amount of domestic tobacco over 25 years and would install penalties on companies that do not meet the stated goals for tobacco buying. The proposal would also create a "Tobacco Community Revitalization Fund" administered by USDA, but not subject to the appropriation process, which could spend up to $1 billion a year for 25 years from the settlement fund. This Revitalization Fund would cover costs related to the tobacco program such as administration and crop insurance, make supplemental payments of up to $500 million to producers whose income from tobacco drops substantially below the 1996 level, pay up to $100 million in benefits for displaced

cigarette factory workers, and provide up to $250 million a year for rural economic development grants.

The best way to address this issue is to secure an agreement from the companies to maintain current purchases of domestic leaf, even if domestic consumption declines. Because of GATT, Congress cannot require companies to purchase a set level of domestic tobacco. However, a private contract between growers and the industry would probably not trigger a GATT violation.

Recommendation: Vow to protect tobacco farmers and call on tobacco companies to maintain current purchases of domestic leaf.

Option: Call for tobacco companies to make additional payments to protect tobacco farmers and their communities (see separate funding section of this memo).

Funding

Although the settlement is advertised at $368.5 billion, a variety of factors conspire to leave us with considerably less than that to spend on any new initiatives. The $368 billion is a 25-year number, and must be adjusted downward to reflect a projected drop in cigarette consumption of about 15%. For scoring purposes, OMB adjusts the amount down still further to reflect lost business tax revenue and lost federal excise tax revenue from decreased consumption. Most of the rest of the money in the settlement is already spoken for, to pay for civil suits, cessation programs, counteradvertising, and the states' Medicaid claims.

At current funding levels, the main decision to be made is how best to spend the $25 billion research trust fund, which could serve as a 21st Century Research Fund dedicated to cancer and other tobacco-related research.

Additional funds could be raised by:

1) Eliminating the $50 billion tax credit in the budget agreement. This would increase the 25-year number from $368 billion to $430 billion, and free up about $2 billion a year for new initiatives. That money could be used to double tobacco-related illness research ($1.3 billion per year) and make targeted investments in tobacco-related public health initiatives such as school-based clinics, Healthy Start programs, cancer prevention, and substance abuse treatment.

2) Strengthening the penalties for failing to reduce teen smoking. The current penalties generate about $25 <ck> billion over 25 years, all of which goes to the states to expand anti-smoking efforts. A graduated penalty scheme could increase the 25-year number to $___ billion, which could be evenly divided between the states and the federal government. This would generate $__ billion a year beginning in year 5, which could be dedicated to additional research and/or coverage expansions, such as allowing people between ages 55 and 65 to buy into Medicare ($2-4 billion per year); covering workers between jobs ($2-3 billion per year) and

Medicaid outreach ($500 million to $1 billion per year).

3) Increasing the industry's up-front one-time payment, from $10 billion to $30 billion, and indexing the inflation adjuster to GDP rather than CPI (since GDP is more in line with medical cost growth). This would increase the 25-year number to $___ billion, and generate $_ billion a year, which could be used for any of the initiatives outlined above, other investments such as child care ($500 million to $1 billion per year) or medical education for doctors training in children's hospitals ($300 million per year), or deficit reduction (offsetting lost federal excise tax revenue from declining cigarette sales).

The industry will vehemently resist any effort to move beyond current funding levels. The most outspoken tobacco opponents, such as Senator Kennedy and Skip Humphrey, have called for a 25-year number in the range of $600-800 billion. Rep. Waxman and David Kessler would like to see a $1.50 a pack increase, which would require $900 billion over 25 years (although it could also be achieved by combining current base payments with enhanced penalties of about 90 cents a pack).

Additional paper is attached to this memo more fully detailing the funding options.

Tobacco - Memos - Memos

2-10-98

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THE WHITE HOUSE

WASHINGTON

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February 6, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed
Larry Stein
Elena Kagan

SUBJECT: Tobacco Legislative Strategy

We have met in recent weeks with Erskine, OVP, HHS, OMB, NEC and Counsel's Office to review our legislative strategy on tobacco. This memo lays out a consensus approach. In brief, we will use the next six weeks to lay the groundwork for a possible summit by (1) attacking Republican plans to enact piecemeal legislation; (2) praising comprehensive bills that meet your principles, particularly Senator Conrad's; and (3) holding meetings with the Democratic Caucus and quiet conversations (led by Erskine) with key Republicans in both the House and Senate. At the end of this time, we will evaluate whether to call a bipartisan summit to negotiate comprehensive tobacco legislation.

Background

As you know, prospects for passing comprehensive tobacco legislation this year are uncertain. The major obstacles are (1) the complexity and scope of such legislation and the sheer number of egos and committees involved, and (2) the special difficulty of reaching agreement on liability limits, which many Members see as necessary, but few will vocally support.

Republicans appear to be divided into three camps. Some Republicans, especially in the Senate (e.g., Hatch, McCain, Hyde, and probably Lott), want to pass comprehensive legislation modeled on the June 20 settlement. Others (e.g., Gingrich, Kasich) are leaning toward a simple excise tax increase, with the proceeds funding an income tax cut. Still a third -- and growing -- group (e.g., Nickles, Armey, Delay) supports a bill without any significant price increase, ostensibly aimed at youth smoking (through provisions on access, marketing, etc.), but unlikely to accomplish any of your objectives. The difficulty of the liability issue cuts against the first group and plays into the hands of the second and third. In particular, the proponents of a money-free bill hope that by allying themselves with liberal Democrats on liability limits, they can effectively curtail tobacco legislation.

Many, if not most, Senate Democrats will coalesce around a bill that Sen. Conrad intends to introduce within the next week. (Rep. Fazio will probably introduce a companion bill in the House.) This bill will meet your five principles for tobacco legislation. It will have a large price increase (though the allocation of the proceeds is only partly consistent with our budget); a

strong section on FDA jurisdiction; good marketing and access provisions, etc. It will not include any liability limits (except that it will allow states to settle their tobacco suits for a share of the money). The Democrats most likely not to sign on to this bill will be those from tobacco states.

So far, no bipartisan bill has emerged in either chamber. Senators Harkin and Chafee are working on a comprehensive bill with some liability limits, but they still have much work to do; in addition, it remains to be seen whether these two Senators (whatever the merits of their bill) can attract significant support. Reps. Bliley and Waxman have had some discussions about a comprehensive bill, but the two remain very far apart on many critical issues.

Recommendation

Our recommended strategy is to use the next six weeks to place pressure on Republicans to negotiate on a comprehensive bill, while conveying to them the sincerity of our desire to enact such legislation. At the end of six weeks, if the legislative process remains bogged down, we will decide whether to call Republican and Democratic leaders to a budget-like summit process.

1. Attack Republican plans to enact piecemeal legislation. We will enlist other Democrats and the public health community in strenuously opposing Republican plans to enact piecemeal legislation. Through events, statements, and testimony, we will demonstrate the need for comprehensive legislation -- involving, most notably, substantial price increases -- to reduce youth smoking. We will make the case that the proposed Republican approach of enacting a "youth" bill without substantial price increases has no hope of achieving our objectives. In our first salvos on this subject next week, the Vice President may take part in tobacco event, and you can announce new estimates of the effect of our plan on youth smoking.

2. Support comprehensive legislation, especially Sen. Conrad's bill. We expect Sen. Conrad to introduce his bill next week, and we believe you should greet it warmly without making an outright endorsement. You should make the point that it is a comprehensive bill consistent with each of your five principles. At the same time, you should stress the importance of bipartisanship on this issue and encourage others to come forward with comprehensive legislation. This invitation should ensure that your support for Conrad's bill does not polarize the issue along partisan lines. If additional comprehensive bills meeting your principles emerge -- especially of a bipartisan nature -- you should express support for them as well.

3. Talk to Democratic caucuses and key Republicans. Erskine, Donna, Larry, and Bruce will talk to the Democratic Caucus in both the House and the Senate to assure them that we will insist on tough legislation -- that we will not compromise too much or too early. At the same time, Erskine will begin quiet conversations with key Republicans to persuade them that we are serious about enacting legislation -- that we do not intend to use tobacco as a political issue.

4. Keep liability limits on the table, without supporting them. To maintain our ability to

work out a compromise, we will try to keep liability limits on the table, without ourselves supporting them. Our consistent line -- we have used it for the last six months -- is that (1) we would prefer a comprehensive bill without any liability limits, but that (2) if we get everything we want -- if we get a comprehensive bill that satisfies each of the President's five principles -- then reasonable limits on liability "would not be a dealbreaker."

Justice Department testimony to this effect caused consternation among some Democrats this week; they argued that we should not yet (or, perhaps, ever) indicate a willingness to compromise on this issue. We disagree; we think that in order to preserve our ability to craft a comprehensive bill that can pass the Congress, we must prevent liberal Democrats and conservative Republicans from joining to make liability limits unacceptable. In the main, however, we will try not to talk about the liability issue. We will make the point that it is a sideshow and that the real battle is between comprehensive and piecemeal legislation.

5. Call a summit, if still appropriate. We believe that we may well have to call a budget-like summit to enact comprehensive tobacco legislation. A summit will remove complications arising from multiple committee jurisdiction and provide cover for all parties on difficult issues like liability. The steps described above will lay the groundwork for a summit, by placing intense pressure on the Republicans to agree to comprehensive tobacco legislation, while convincing them that we will not play politics with the issue. We should not talk about this idea, because it is possible that no summit will be necessary -- that these steps will get the legislative process rolling without any special intervention. We will continually reassess this issue, but place ourselves in position to hold a summit in about six weeks.

Tobacco - settlement - env. tobacco smoke and notes + memos

Environmental Tobacco Smoke

The best available scientific evidence indicates that environmental tobacco smoke (ETS) causes disease and death. The Environmental Protection Agency (EPA) classifies ETS as a Class A carcinogen **[check]** and estimates that it is responsible for about 3,000 lung cancer deaths each year in non-smoking adults. The EPA also has found that ETS threatens the health of hundreds of thousands of children with asthma and other respiratory illnesses. The Surgeon General, in a study concluding that ETS causes serious disease among non-smokers, determined that simple separation of smokers and nonsmokers within the same airspace may reduce, but does not eliminate harmful exposure to ETS.

For these reasons, the Administration supports legislation to restrict smoking in workplaces and other public facilities. This legislation, like the President's recent Executive Order on tobacco smoke in federal facilities, shall ban smoking in public places or at work except in enclosed areas exhausted directly to the outside. The legislation may include appropriate but limited exceptions to this ban, as in H.R. 3434, for prisons and the hospitality industry (but not including fast food restaurants). The legislation shall not preempt or otherwise affect any federal, state, or local law, regulation, or rule that imposes stricter limitations on ETS. The legislation shall ensure that the Occupational Safety and Health Administration possesses all necessary (including all currently existing) authority to regulate and enforce the law in this area.

Internal notes:

The above statement is essentially consistent with the proposed settlement's provision on ETS. This provision is one of the most valuable aspects of the settlement, given the risk of ETS to non-smokers, the success of ETS measures in inducing smokers to quit (or at least cut down), and the political difficulty of making headway on this issue without the tacit consent of the tobacco companies.

The only major question in this area is whether to exempt the hospitality industry (and if so, what parts of the industry) from the ban on indoor smoking. The proposed settlement exempts restaurants (but not fast food restaurants), bars, private clubs, hotel guest rooms, casinos, bingo parlors, and tobacco merchants. H.R. 3434, which the Administration has supported, exempts restaurants (including fast food restaurants) and bars. The proposed rule on ETS that OSHA issued in 1994 does not include any exemption for the hospitality industry. (In a number of other ways, however, the settlement is more protective of the public health than the OSHA rule, which in any event would face serious legal challenges if finally issued.) DOL recommends accepting the exception in the settlement; HHS recommends eliminating the exception. The above statement retains an exception, leaves some wiggle room with respect to its precise scope, but hints that it would cover only bars and non-fast food restaurants.

On another point, the above statement will enable us to inspect legislative language carefully to ensure that it does not (1) preempt any more health-protective laws, whether federal,

state, or local, or (2) deprive OSHA of any necessary regulatory or enforcement authority. Current language in the settlement creates some ambiguities with respect to these issues.

tobacco - settlement - notes + memos

THE WHITE HOUSE

WASHINGTON

January 28, 1998

MEMORANDUM FOR THE CHIEF OF STAFF

FROM: Bruce Reed
Elena Kagan

SUBJECT: Tobacco Legislative Strategy

We have met in recent weeks with Legislative Affairs, NEC, OMB, OVP, and Counsel's Office to review options on tobacco strategy. We would like to use the meeting this afternoon to discuss the pros and cons of the two leading strategic options that have emerged from our process.

As you know, prospects for passing comprehensive tobacco legislation this year are uncertain. So far, no consensus -- or even plausible -- bipartisan bill has emerged in either chamber. The major obstacles are (1) the complexity and scope of such legislation and the sheer number of egos and committees involved, and (2) the special difficulty of reaching agreement on liability limits, which many Members see as necessary, but few will vocally support. In addition, some Members fear that the ground will shift in the next few months, because of the Minnesota trial and the likely release of new documents. As a result, many are now tempted to pass a piecemeal bill, ostensibly aimed at youth smoking, but unlikely to accomplish the President's objectives.

In the House, the Speaker has indicated that tobacco legislation should go through the normal committee process, which would make Rep. Bliley the principal player. Bliley has worked cooperatively with Rep. Dingell on the release of tobacco company documents. He also has begun discussions with Rep. Waxman about comprehensive legislation -- but the two remain far apart on many critical issues.

In the Senate, no decisions have been made about how to proceed -- except, perhaps, to let the House go first. The Senator ostensibly in charge of this issue for Republicans -- Sen. Nickles -- has expressed little enthusiasm for going forward. Sens. Hatch and McCain, who chair committees central to the tobacco issue, would like to pass comprehensive legislation and have scheduled hearings. Sen. Conrad, whom Sen. Daschle appointed to coordinate the tobacco issue for the Democrats, is drafting a bill that will probably look like the bills already proposed by Kennedy and Lautenberg -- i.e., a bill with big dollar amounts and no liability limits. Chafee and Harkin are trying to work together on a bill, but no one knows whether it will take shape or what will be in it.

Given this context, we have two main legislative options: (1) encourage bipartisan, committee-driven efforts, especially in the House; or (2) call for a "tobacco summit" or other leadership-driven process, in which we would play a key negotiating role.

In considering these options, you should be aware that we could begin negotiating a tobacco bill almost immediately. The budget process forced us to make decisions about previously contested issues relating to the size of industry payments. We long ago reached agreement on the principal non-financial issues, although some details remain open. The only major issue on which we have not yet developed a position is how best to protect tobacco farmers. In addition, we are working with the Justice Department to develop a range of possible middle-ground positions on liability limits.

1. Encourage bipartisan, committee-driven efforts.

Under this option, we would do as much as we could to encourage a Bliley-Waxman collaboration, while also providing support to other potential bipartisan efforts in critical committees (e.g., Durbin-McCain in the Senate).

Pros:

- If Bliley and Waxman agree on comprehensive legislation, it will sail through the House and probably force the Senate to take similar action.

- Any bill that Waxman signs on to will be substantively strong and will attract the support of the entire public health community.

Cons:

- The prospects of Bliley and Waxman agreeing on comprehensive legislation are not very good, given their substantive differences on the issue, especially on liability; Waxman does not share all the President's views and does not want this legislation as much as the President.

- A committee-driven process is likely to take time, and time is the enemy of comprehensive legislation given the Minnesota trial and the short Congressional calendar.

2. Call for a tobacco summit or other leadership-driven process.

Under this option, we would call on the House and Senate leadership of both parties to engage with us in a summit-type process to craft comprehensive tobacco legislation. One model would establish a core group of leaders from both chambers, with limited participation of relevant committee chairs.

Pros:

- A summit or similar process may be the only way to surmount the many obstacles to passage of comprehensive tobacco legislation. It provides cover for all parties on difficult issues like liability, and removes any complications arising from multiple committee jurisdiction.

- A summit or similar process will ensure that we play a central role in the crafting of comprehensive legislation, rather than cede control to people who may not share our priorities.

- A summit will give us something bold and ambitious to do in the next few months, as well as demonstrating our commitment to this issue.

Cons:

- Republicans, especially in the House, may refuse to take part in a summit or similar process.

- If we go the summit route, some Democrats and public health advocates may well peel off from us and attack any eventual legislation as a backroom deal.

- Relatedly, some Democrats in Congress and within the Administration believe that the longer we play out this issue, the weaker the Republicans and the tobacco industry will become.

Tobacco - Settlement - Notes + memos

THE WHITE HOUSE

WASHINGTON

February 6, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed
Larry Stein
Elena Kagan

SUBJECT: Tobacco Legislative Strategy

We have met in recent weeks with Erskine, OVP, HHS, OMB, NEC and Counsel's Office to review our legislative strategy on tobacco. This memo lays out a consensus approach. In brief, we will use the next six weeks to lay the groundwork for a possible summit by (1) attacking Republican plans to enact piecemeal legislation; (2) praising comprehensive bills that meet your principles, particularly Senator Conrad's; and (3) holding meetings with the Democratic Caucus and quiet conversations (led by Erskine) with key Republicans in both the House and Senate. At the end of this time, we will evaluate whether to call a bipartisan summit to negotiate comprehensive tobacco legislation.

Background

As you know, prospects for passing comprehensive tobacco legislation this year are uncertain. The major obstacles are (1) the complexity and scope of such legislation and the sheer number of egos and committees involved, and (2) the special difficulty of reaching agreement on liability limits, which many Members see as necessary, but few will vocally support.

Republicans appear to be divided into three camps. Some Republicans, especially in the Senate (e.g., Hatch, McCain, Hyde, and probably Lott), want to pass comprehensive legislation modeled on the June 20 settlement. Others (e.g., Gingrich, Kasich) are leaning toward a simple excise tax increase, with the proceeds funding an income tax cut. Still a third -- and growing -- group (e.g., Nickles, Armey, Delay) supports a bill without any significant price increase, ostensibly aimed at youth smoking (through provisions on access, marketing, etc.), but unlikely to accomplish any of your objectives. The difficulty of the liability issue cuts against the first group and plays into the hands of the second and third. In particular, the proponents of a money-free bill hope that by allying themselves with liberal Democrats on liability limits, they can effectively curtail tobacco legislation.

Many, if not most, Senate Democrats will coalesce around a bill that Sen. Conrad intends to introduce within the next week. (Rep. Fazio will probably introduce a companion bill in the House.) This bill will meet your five principles for tobacco legislation. It will have a large price increase (though the allocation of the proceeds is only partly consistent with our budget); a

strong section on FDA jurisdiction; good marketing and access provisions, etc. It will not include any liability limits (except that it will allow states to settle their tobacco suits for a share of the money). The Democrats most likely not to sign on to this bill will be those from tobacco states.

So far, no bipartisan bill has emerged in either chamber. Senators Harkin and Chafee are working on a comprehensive bill with some liability limits, but they still have much work to do; in addition, it remains to be seen whether these two Senators (whatever the merits of their bill) can attract significant support. Reps. Bliley and Waxman have had some discussions about a comprehensive bill, but the two remain very far apart on many critical issues.

Recommendation

Our recommended strategy is to use the next six weeks to place pressure on Republicans to negotiate on a comprehensive bill, while conveying to them the sincerity of our desire to enact such legislation. At the end of six weeks, if the legislative process remains bogged down, we will decide whether to call Republican and Democratic leaders to a budget-like summit process.

1. Attack Republican plans to enact piecemeal legislation. We will enlist other Democrats and the public health community in strenuously opposing Republican plans to enact piecemeal legislation. Through events, statements, and testimony, we will demonstrate the need for comprehensive legislation -- involving, most notably, substantial price increases -- to reduce youth smoking. We will make the case that the proposed Republican approach of enacting a "youth" bill without substantial price increases has no hope of achieving our objectives. In our first salvos on this subject next week, the Vice President may take part in tobacco event, and you can announce new estimates of the effect of our plan on youth smoking.

2. Support comprehensive legislation, especially Sen. Conrad's bill. We expect Sen. Conrad to introduce his bill next week, and we believe you should greet it warmly without making an outright endorsement. You should make the point that it is a comprehensive bill consistent with each of your five principles. At the same time, you should stress the importance of bipartisanship on this issue and encourage others to come forward with comprehensive legislation. This invitation should ensure that your support for Conrad's bill does not polarize the issue along partisan lines. If additional comprehensive bills meeting your principles emerge -- especially of a bipartisan nature -- you should express support for them as well.

3. Talk to Democratic caucuses and key Republicans. Erskine, Donna, Larry, and Bruce will talk to the Democratic Caucus in both the House and the Senate to assure them that we will insist on tough legislation -- that we will not compromise too much or too early. At the same time, Erskine will begin quiet conversations with key Republicans to persuade them that we are serious about enacting legislation -- that we do not intend to use tobacco as a political issue.

4. Keep liability limits on the table, without supporting them. To maintain our ability to

work out a compromise, we will try to keep liability limits on the table, without ourselves supporting them. Our consistent line -- we have used it for the last six months -- is that (1) we would prefer a comprehensive bill without any liability limits, but that (2) if we get everything we want -- if we get a comprehensive bill that satisfies each of the President's five principles -- then reasonable limits on liability "would not be a dealbreaker."

Justice Department testimony to this effect caused consternation among some Democrats this week; they argued that we should not yet (or, perhaps, ever) indicate a willingness to compromise on this issue. We disagree; we think that in order to preserve our ability to craft a comprehensive bill that can pass the Congress, we must prevent liberal Democrats and conservative Republicans from joining to make liability limits unacceptable. In the main, however, we will try not to talk about the liability issue. We will make the point that it is a sideshow and that the real battle is between comprehensive and piecemeal legislation.

5. Call a summit, if still appropriate. We believe that we may well have to call a budget-like summit to enact comprehensive tobacco legislation. A summit will remove complications arising from multiple committee jurisdiction and provide cover for all parties on difficult issues like liability. The steps described above will lay the groundwork for a summit, by placing intense pressure on the Republicans to agree to comprehensive tobacco legislation, while convincing them that we will not play politics with the issue. We should not talk about this idea, because it is possible that no summit will be necessary -- that these steps will get the legislative process rolling without any special intervention. We will continually reassess this issue, but place ourselves in position to hold a summit in about six weeks.

Tobac - cartle - notes + memos

THE WHITE HOUSE

WASHINGTON

February 3, 1998

MEMORANDUM FOR THE CHIEF OF STAFF

FROM: Bruce Reed
Larry Stein
Elena Kagan

SUBJECT: Tobacco Legislative Strategy

Since our last meeting with you, we have continued to consider legislative options on tobacco. As this memo will further describe, we think there are three basic approaches to enacting tobacco legislation: (1) unite behind a Democratic bill (Senator Conrad's, Senator Kennedy's or our own) and attempt to ram it through Congress over Republican opposition; (2) rely on centrist members of Congress to create and move a bipartisan proposal; and (3) lay the groundwork for a possible summit by attacking piecemeal legislation and holding meetings with key Republicans; if still appropriate after about six weeks, call a bipartisan summit to negotiate comprehensive legislation. Legislative Affairs and the DPC favor the third option.

Since our last meeting, Congress has made no noticeable progress in the direction of bipartisan comprehensive tobacco legislation. We have learned that Senators Harkins and Chafee are working together on a bill, but we do not believe they can draw significant support. Reps. Bliley and Waxman have made no further progress, and many question whether Waxman wants a bill at all. We do not know of any other bipartisan discussions.

Meantime, Republicans in both Houses (particularly Sen. Nickles and Rep. Delay) have broached the idea of a very limited bill, containing no liability limits but also no price increases. These members hope that by allying themselves with liberal Democrats on liability limits, they can effectively control the size and scope of tobacco legislation.

We believe that our immediate goal must be to make such piecemeal legislation unacceptable, while keeping liability limits on the table (since it may well be difficult to pass a substantial price increase without them). Our longer term goal is, of course, to gain majority support for comprehensive legislation. Three options for accomplishing this objective follow.

1. Attempt to ram through a democratic bill.

This strategy tries to pass tobacco legislation in the same way Democrats passed an increase in the minimum wage two years ago. We would unite Democrats behind a single bill (Sen. Conrad's, Sen. Kennedy's, or our own) and then try to push it through Congress over Republican opposition -- for example, by repeatedly offering it as an amendment to other legislation.

Pros:

- This option will unite most Democrats and the public health community, and will place Republicans on the defensive in an election year.

- If the Republicans give in, this option will produce a bill without liability limits (although perhaps without the full price increase we want).

Cons:

- This option probably will not succeed in producing comprehensive tobacco legislation. A partisan strategy will embolden Democrats to hold on to tobacco as a political issue and alienate Republicans who otherwise might support a comprehensive approach.

- Most of our hopes for domestic accomplishments this year depend on the passage of comprehensive tobacco legislation. A high-risk, predominantly political strategy jeopardizes our budget and domestic policy agenda.

2. Foster and rely on bipartisan centrist coalitions.
This strategy involves trying to promote bipartisan efforts -- e.g., Bliley-Waxman, Harkin-Chafee -- and then trying to build support for them on both sides of the aisle.

Pros:

- If we can get the right Members (e.g., Bliley-Waxman, McCain-Durbin) to join forces, a bipartisan bill would catalyze the process and lead to the passage of comprehensive legislation.

- A number of Republicans, especially in the Senate, share our goals and principles, so this process probably would produce a comprehensive bill with a substantial price increase (but with limits on liability).

Cons:

- The prospects of the right Members coming together on a bill are remote. Bliley and Waxman are far apart on the issues. Harkin and Chafee are close, but cannot attract much support. No one else is talking with each other, and both Republican and Democratic leadership are discouraging these efforts.

- We will not know for some time whether a bipartisan bill will emerge, and in the meantime the Republicans will continue to assail us for not supporting specific legislation.

3. Lay the groundwork for and call a tobacco summit.

Under this option, we would spend the next six weeks laying the groundwork for a possible summit by (1) enlisting other Democrats and the public health community in opposing any Republican plan to enact piecemeal legislation, (2) indicating general support for Conrad's bill, without an outright endorsement, and (3) holding one-on-one meetings with key Republicans in the Senate and House to convince them that we are serious about negotiating, not just playing politics. If the legislative process remains bogged down, we would then call Republican and Democratic leaders to a budget-like summit process.

Pros:

- A summit or similar process stands the best chance of surmounting the many obstacles to passage of comprehensive tobacco legislation and puts us in the best position to dictate the terms.
- A summit will give us something bold and ambitious to do in the next few months. And in laying the groundwork for the possible summit, we will present an aggressive message and united front against piecemeal legislation, without driving away moderate Republicans.

Cons:

- Republicans may refuse to take part in a summit or similar process.
- Some Democrats and public health advocates may attack the summit as a backroom deal and fight any legislation that emerges from it.

tobacco - [illegible] -
notes + memos

float our compromise??
save for summit?
give to Harkin/Chafee now?

Tobacco

[illegible] - attach piecemeal

media - [illegible] Conrad?
Harkin?
both?
own?
or anything else (Hansen-Meehan)

?

battle over budget resolution --
must [illegible] revenue fund.
(late March/early Apr)

it will take this
sooner or later -
have to make [illegible]
available [illegible]
landscape as
favorable

language - bring them [illegible]
jobs / chastise
summit / budget process.

Tobacco - settlement - notes + memos

Toby Donenfeld @ OVP
02/05/98 05:53:10 PM

Record Type: Record

To: Elena Kagan/OPD/EOP

cc: Donald H. Gips/OVP @ OVP
Subject: tobacco

This is the e-mail Ron sent that Don and I were talking to you about. Would you mind giving me a call at your convenience so we can sort this out? We are starting to plan for a VP Wednesday event and I want to make sure we're all on the same page. Thanks.

Toby
x6-6265

---------- Forwarded by Toby Donenfeld/OVP on 02/05/98 05:54 PM ----------

Ron Klain
02/04/98 03:29 PM

To: Albert Gore/OVP
cc: (bcc: Toby Donenfeld/OVP)
Subject: tobacco

The proposal to emerge from Erskine's meeting was as follows:

1. We would try to put YOU out next week to fire a shot accross the bow of the GOP to say that any tobacco bill must be comprehensive, i.e., include a price hike. We are working to see if OMB/Treas can generate numbers as to a projected reduction in teen smoking under our plan, so we would have news to announce when you go out.

2. We expect Conrad's bill the following week. When it comes, POTUS will make a statement praising it, saying it is a good bill that is consistent with his principles. He will also say that he hopes this issue can be biparstian, and not just partisan -- and he hopes others will come forth with bills that are also consistent with his principles (so as to not scare off the moderate Repubs who want to help, and so as to not alienate other Dems like Waxman, Harkin, etc., who are also drafting bills).

3. Erskine will begin quiet conversations with moderate Repubs to try to see if they will come onto Conrad or something very close to Conrad.

I think that this is a good approach.

FTC - Tobacco

H/S Commerce -

S/T - Subcom on Antitrust

Tody B - McCain - asked FTC to scope out expansion - marketing/advertising
[Thurman + Ecom - looking at price effects on black market - working w/ Treas Dept. (Helen Baker (CEA)]

Panel 2 - real Q is fed/st enforcement - interesting ways to go.
- examples where state AGs authorized to enforce fed law/reg.
- mechanisms for coordinating pleadings

Reputation
Telemarketing / Fair Credit

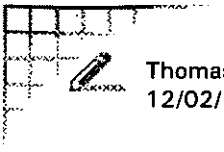
FTC saying directly: we should have current marketing suits.
- residual suits - maintained in settlement
- more specific, the better

FTC + states are in best position to enforce.

Detail - what we've been asked to achieve through current settlements
- Joe Camel - ad banning further advertising
- Tar + nicotine disclosures done through current ag.

Antitrust - letter from Justice
- FTC agrees w/ Lottman line
- Pit. Thinks no need for AT exemption -
  - perhaps some greater need for flexibility than DOJ says.
  - EG - if advert restrictions struck down, give more room to states to pursue to reduce smoking to young people.
  - Theoretical poss - Q more.

tobacco - settlement - notes + memos



Thomas L. Freedman
12/02/97 08:35:11 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc: Mary L. Smith/OPD/EOP
Subject: Tobacco update

Info from today:

1. Decisions for document release are due by Dec. 4th, the MN. trial is scheduled for January. Humphrey supposedly wants to put off the trial date.

2. Bliley is supposedly still keeping his distance from industry. Waxman and Bliley have had staff talks, but seem in no hurry.

3. Myers complains about Downey's group opposing his efforts from the left and making things difficult.

4. Some speculation that Hatch will get some (4-5) moderate R's on his bill eventually.

5. A tentative hearing scheduled for Dec. 10 in Judiciary (Courts & Intellectual Property) on attorneys fees. Bilirakis hearing on Medicaid.

Tobacco - settlement - notes + memos

Tacco - industry meeting - notes

Hatch also talking to Kennedy, but Repubs don't want him to

Gp Pres: Hatch Pete Do McCain Lugar DeWine Chafee

Lott to talk to Hatch
Plan is House - first.

House up in air.
Speaker trying to figure out what direction he wants to go.
Policy doesn't like special process idea. B. convinced G - he's in charge
2> take lead - talk w/ Hyde/Archer/Smith - want to catch up w/ Sen
want to talk w/ WH
hearings before end of yr - probably here
Boehner etc - decided initiative needs to move - going to try to focus caucus.

Conrad mtg w/ Fazio - joint bill?
W. Ind will not be part of Conrad bill

Hatch will?) have own bill

Conrad will have documents, informational, as leitus
↳ piece of it - or may be easier short judicially

Kennedy - at $1.50 a pack / include VA / create civil liability

Chafee: unless you have Tune 20 + Pres bill, all you'll have is the "antagonists". Tobacco needs to approve this (said NO before)

?? Hagel will take some time to figure out how to fit this up.

Greenwood to get more involved

Boehner says only person in WH they trust is EB

BL: wants to be here in Jan/Feb

BL: If Lugar bill in bag, we have probs being able to control Hatch - Stevens - Lugar - if one of them rises on to, e.g. Kennedy - real problems.

But Repubs have want to move forward together - bring WH in

Chesley - But once Dems come in w/ they bills, hard for WH to do this. (ask w/ Repub bills)
I've heard they want to do it w/ WH -
someone has to tell WH.
Prob - Ken/Conrad will come in w/ their bills

BL - Lott needs to name a head person
Snyder - L. is slowing things down

[They can't agree on a bill!]

Sniping at each other - whose fault?

Nov. 4
4:00 pm.

tobacco - settlement - notes + memos

Bruce N. Reed
09/29/97 01:32:02 PM

Record Type: Record

To: Thomas L. Freedman/OPD/EOP
cc: Elena Kagan/OPD/EOP
bcc:
Subject: Re: Tobacco

Looks good. On the Q&A's, you should be able to use the ones we did before. On the WH structure, I'm not sure we need 3 coordinating groups -- given the modest attendance last week.
Thomas L. Freedman

Thomas L. Freedman
09/28/97 03:19:56 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP
cc:
Subject: Tobacco

As I see it, we will need 5 products for the tobacco meeting this week. Here are the categories and the directions I think we should head in.

1. Talking points
The essential points would be:

* Kids. This is about protecting kids.

* Bi-partisan. We should all be able to get behind legislation to control smoking in America. This will be a bipartisan process. It is a large bill, it effects many states, and millions of people. I will work with Congress, but I recognize they will hold hearings and follow their process.

* Promptness. Congress should take this up soon and make it high priority.

2. Q and A's

Q. Why didn't POTUS submit a bill?
A. The President set out his priorities for the bill. Congress legislates. The principles are clear, 1-5, it shouldn't be hard to get a bill to the floor.

Q. When should a bill pass?

A. It should be at the top of the agenda for this year. There is nothing more important than saving thousands of children from taking up smoking. Three thousands are starting everyday.

Q. Is POTUS just playing politics with this? Why didn't he show leadership?
A. He's taken this issue on from the first, and taken the issue this far, and is confident we will get a resolution of the issue. we will get a bill by working together.

Q. Will negotiations include industry?
A. The industry is a piece of this, but there isn't a need to negotiate with them.

Q. What is the role of the VPOTUS?
A. VPOTUS will take a leadership role in the legislation.

3. Research questions
I've attached research questions on: who is to blame, what arguments work best, why people think a bill may not happen. We should list some on specific disputes we should test. (We should talk about these).

4. Legislative Strategy
Aspects of the legislative strategy.

1). Goal. Pass bill that embodies the President's principles by early next year.

2). Timeline.

a). POTUS announces principles for legislation.

b). Outreach to Congressional leaders indicating Administration commitment to passing a bill. (We should discuss this step very soon).

c) Public meeting with POTUS/VPOTUS and congressional leaders-- public statement that bill is important to country and should be top priority of next year.

d) Congressional Action. Hearings begin, many pieces of legislation are introduced. Some are comprehensive, some more limited.

e) Administration Action. Administration consistently urges adherence to principles outlined by POTUS. POTUS/VPOTUS events emphasizing need for action-- involve children, farmers, second-hand smoke science. POTUS urges issue not be fragmented and a comprehensive piece of legislation be passed.

f). Congressional Action Continues. Larger coalitions coalesce around Senatorial leaders on issue (Kennedy/Hatch) and House chairman (Bliley).

g) Administration Endorsements. Administration uses following options to maintain progress of legislation: private meetings to encourage coalitions of legislators, and encourage useful combinations of bills, public comment on aspects of pending legislation to indicate support; public comment/events to indicate criticism of pace of progress or negative direction of bill.

h) Congressional Vote Taking. Bills reach committee and floor.

i). Presidential Involvement Options. Options include Presidential statement, SAP, or invitations to leaders to WH to coordinate/ resolve disputes.

j). Bill is voted on.

Dangers. Possible Republican approaches include:

* A public attack on the President for showing no leadership and playing politics with issue;

* A private strategy of fragmenting the issue and letting only certain parts of the bill advance to interminable hearings.

* A laissez-faire strategy of letting chaos reign on the issue for a while.

* An attack on the Administration for not protecting farmers, for imposing taxes/government regulation, for helping trial attorneys. Others?

Answers.

* Leadership. This President has shown courage in attacking problem. We can do events and maybe take more Administrative action if R's are recalcitrant. Easy to hold their feet to fire to get things done.

* Fragmentation. Privately urge prompt timeline for comprehensive bill.

* Specific Issues. Keep debate on kids. Defend farmers.

5. WH Structure and Next Steps

Three Working Groups
1. Tobacco Coordination Group. Agency and WH staff meeting every Thursday to coordinate policy and event planning.

2. Tobacco Communications Group. Group meets to plan specific Administration communications events.

3. Tobacco Legislative Group. Group meets to track legislative developments and plan next steps.

* Regular meetings with VPOTUS staff for event scheduling and strategy

Weekly conference call with Mike Moore's group

Weekly conference call/Meeting with Public health group (includes VP/HHS)

Next Actions that Need to be Taken
1. Prepare for POTUS/leadership meeting.

2. Hilley/Bowles outreach to Lott/Gingrich.

3. Coordinate Reed/ Shalala visits to key Hill members over next two weeks.

4. Schedule of events for rest of '97.

Tobacco - settlement - notes + memos

DRAFT OUTLINE OF MEMORANDUM FOR THE PRESIDENT

FROM: **BRUCE REED**

RE: **MEETING WITH CONGRESSIONAL LEADERS ON TOBACCO ON OCTOBER 1, 1997**

DATE: **SEPTEMBER 30, 1997**

I. LEGISLATIVE STRATEGY

A. THEMES

* Bill requires bi-partisan support

* Danger of fragmentation

* Popularity of issue counters Congressional inaction

* Administration will strategically endorse Congressional efforts at coalition building as legislation reaches Committees and floor.

B. WHO IS ATTENDING

II. GOALS FOR MEETING

* Publicly emphasize need for prompt action.

* Show interest in bi-partisanship.

III. TALKING POINTS

A. Welcome. Glad so many members could come. Demonstrates the breadth of interest.

B. Crucial issue for America's future. Thousands of kids start everyday. Not about money.

C. Announce Children's Health News.

D. Tobacco shouldn't be a political issue. Need for bi-partisanship.

E. Outline crucial elements for bill. Reduce teen smoking w/penalties, full authority for FDA to regulate tobacco, change tobacco marketing, broad document disclosure, progress toward other health goals (second hand smoke), protect farmers and their communities.

F. Need for Prompt Action. This is top of country's agenda. Let's agree we should get it done by next year.

G. Working Together. Complex legislation, affects many people, many states. Recognize Congress will hold hearings, but this is too important for us not to get done.

IV. Q'S AND A'S

Q. Why didn't the president submit legislation on tobacco?

A. No one can have any doubts about where the President stands. The five principles he set out are clear. And he is committed to helping Congress act and hold hearings and get a bill to the floor. But the American people will not put up with finger pointing as to why there is no bill.

Q. When should a bill pass?
A. It should be at the top of the agenda for this year. There is nothing more important than saving thousands of children from taking up smoking. Three thousand are starting everyday.

Q. Is POTUS just playing politics with this? Why didn't he show leadership?
A. He's taken this issue on from the first, and taken the issue this far, and is confident we will get a resolution of the issue. we will get a bill by working together.

Q. Will negotiations include industry?
A. The industry is a piece of this, but there isn't a need to negotiate with them.

Q. What is the role of the VPOTUS?
A. VPOTUS will take a leadership role in the legislation.

Tobacco - primer - notes + memos

DRAFT

MEMORANDUM FOR ERSKINE BOWLES

FROM: **BRUCE REED**
ELENA KAGAN

RE: **TOBACCO STRATEGY AND WHITE HOUSE SUPPORT PLAN**

DATE: **SEPTEMBER 30, 1997**

The following plan is designed to provide communications and legislative support for the passage of a tobacco bill containing the five policy elements described by the President on September 17, 1997. The strategy's objective is passage of the bill by early next year.

The plan has three components. First, it lays out a legislative strategy based on the principles that: the bill will require bi-partisan support for final passage; that there will be some opposition to the bill reaching the floor and therefore a sustained Administration message is required; and that the greatest dangers to the bill's passage are delay and opponents' ability to fragment consideration of the issue in various Committees. Second, this memorandum describes a communication strategy to counter Congressional inaction by emphasizing the following themes: children and the health damage they suffer via inaction; the bi-partisan nature of this effort; and the need for Congress to take this matter up promptly. Finally, this memorandum suggests an internal White House working group support structure to further this effort.

I. Goals and Legislative Strategy

This proposal seeks to optimize the opportunities for passage of comprehensive tobacco legislation that includes the President's principles by early next year. The five key elements of the President's plan are: (1) a comprehensive approach to reducing youth smoking including tough penalties if targets are not met; (2) full authority for FDA to regulate tobacco targets; (3) changes in the way the tobacco industry behaves in marketing and disclosure; (4) progress toward other public health goals; and (5) protection for tobacco farmers and their communities.

While we believe the goal of passage of comprehensive legislation is feasible, a successful strategy will have to account for various attacks that are likely to be employed by opponents of the pact. We believe these arguments will be of three types. First, political opponents of the President have criticized the President for failing to submit full legislative language to Congress and blamed the President for any delay in passage of a bill. This has been the initial line of criticism following the President's announcement. Second, there is the possibility that opponents of an agreement will attempt to fragment and confuse the issues,

eventually permitting perhaps only restricted portions of a bill to advance following lengthy hearings. Finally, opponents of legislation may make substantive attacks such as a law would not adequately protect farmers, that it might lead to restrictions on class action suits, or that it represents a windfall to lawyers.

The Administration has a number of arguments to deploy in response to these expected attacks. The strongest argument, and one supported by research data, indicates that the public is particularly frustrated by partisan bickering in the tobacco dispute, and anxious for solutions that will protect America's children. In addition, this President has a strong history of leadership on smoking issues and can draw upon that legacy in future disagreements with Congress.

The following chronology indicates the sequence in which these arguments might be played out, and the corresponding type of action that the Administration should be prepared to take.

a). POTUS announces principles for legislation. (Review of Agreement. Completed).

b). Outreach to Congressional leaders indicating Administration commitment to passing a bill. (On-going).

c). Public meeting with POTUS/VPOTUS and congressional leaders-- public statement that bill is important to country and should be top priority of next year. (Scheduled for October 1, 1997).

d). Congressional Action. Hearings begin, many pieces of legislation are introduced-- some bills are comprehensive, others are more limited. (Hearings have begun with Administration witnesses. Few bills introduced as yet).

e). Administration Action. Administration urges adherence to principles outlined by President. POTUS/VPOTUS events emphasizing need for action-- involve children, farmers, second-hand smoke science. POTUS urges issue not be fragmented and a comprehensive piece of legislation be passed. (VPOTUS has completed one event and has tentative plans for 3 regional events. POTUS to give statement at October 1st event. On-going).

f). Congressional Action Continues. Larger coalitions coalesce around Senatorial leaders on issue (Kennedy/Hatch likely to emerge as key Senatorial leaders) and House chairman (Rep. Bliley key House Republican).

g) Administration Endorsements. Administration uses following options to maintain progress of legislation: private meetings to encourage coalitions of legislators and encourage useful combinations of bills, public comment on aspects of pending legislation to indicate support; public comment/events to indicate criticism of pace of progress or negative direction of bill.

h) Congressional Vote Taking. Bills reach committee and floor. (Options for Presidential involvement include Presidential statement, SAP, or invitations to leaders to WH to coordinate/ resolve disputes.)

II. Communications Strategy

Over at least the next several months the crucial communications issue will be encouraging Congress to take up the issue of tobacco. At the initial event on October 1st we recommend emphasizing arguments that suggest it is in Congress' interest to move the legislation and to set a general timetable for action. The twin arguments that achieve this are stressing the bi-partisan source of the concern-- children-- and the need for prompt action.

The President's comments could be structured according the themes of bi-partisanship and the need for quick action, using the following talking points.

I.	Welcome.	Glad so many members could come. Demonstrates the breadth of interest.
II.	Crucial issue for America's future.	Thousands of kids start everyday. Not about money.
III.	Shouldn't be a political issue.	Need for bi-partisanship.
IV.	Outline crucial elements for bill.	Reduce teen smoking w/penalties, full authority for FDA to regulate tobacco, change tobacco marketing, broad document disclosure, progress toward other health goals (second hand smoke), protect farmers and their communities.
V.	Need for Prompt Action.	This is top of country's agenda. Let's agree we should get it done by next year.
VI.	Working Together.	Complex legislation, affects many people, many states. Recognize Congress will hold hearings, but this is too important for us not to get done.

As suggested above, either during the meeting or in meeting with the press the President

is likely to be pressed as to why he didn't submit complete legislation. We suggest the President stress that he set out his priorities for the bill. The five principles he set out are clear. And that Congress should act and hold hearings and get a bill to the floor.

Other likely questions include:

Q. When should a bill pass?
A. It should be at the top of the agenda for this year. There is nothing more important than saving thousands of children from taking up smoking. Three thousands are starting everyday.

Q. Is POTUS just playing politics with this? Why didn't he show leadership?
A. He's taken this issue on from the first, and taken the issue this far, and is confident we will get a resolution of the issue. we will get a bill by working together.

Q. Will negotiations include industry?
A. The industry is a piece of this, but there isn't a need to negotiate with them.

Q. What is the role of the VPOTUS?
A. VPOTUS will take a leadership role in the legislation.

III. White House Structure and Next Steps

Over the next several months the primary actions that the Administration will be required to take are legislative-- to encourage hearings and development of appropriate legislation-- and communications oriented-- to scheduling events to maintain public awareness of the issue. The following structure and working groups have been meeting to plan and develop these operations.

Bruce Reed and Elena Kagan of the DPC are coordinating the Adinistration's response. The primary tobacco planning meeting is the Tobacco Strategy Group. It has begun meeting every Thursday. The meeting includes representatives from the DPC, NEC, HHS, VPOTUS, OPL, Intergovernmental Affairs, CEA, Legislative Affairs, Treasury, USDA, and DOJ. The function of the group is to coordinate policy and event planning.

The DPC also holds regular meetings with VPOTUS staff for event scheduling and strategy.

In addition there are two weekly telephone conference calls: first with Mike Moore's group including (Moore, Scruggs, and Coale), the second with members of the public health group including Kessler, Koop, Myers, and leading health organizations such as the American

Heart Association, the American Medical Association, the American Cancer Society. These meetings will include the VP staff and HHS.

Finally, the DPC will hold specific meetings on legislative, communications, and rapid response issues as they arise.

Tobacco - title - legal issues and notes + memos

Liability and Other Legal Issues

In the event that Congress passes legislation meeting all of the Administration's demands for punishing and regulating tobacco companies -- including a payment of more than $20 billion [?] in punitive damages payable to the public -- the Administration will accept provisions barring class actions and punitive damages for past misconduct and imposing yearly limits of $5 billion on certain civil damages. The legislation itself will both exact penalties for past behavior and regulate future behavior, while a significant pool of money (especially given the historic failure of smokers to collect any damages) will be available to compensate injured plaintiffs.

The Administration will oppose -- and will not accept legislation including -- any limits on punitive damages for future misconduct. These damages shall not count toward or be subject to yearly limits; tobacco companies shall pay the full amount of such damages over and above all other payment obligations. The continued potential for unrestricted punitive damages will support the regulatory aspects of the legislation in deterring willful misconduct and otherwise changing corporate behavior.

Also in the context of broader legislation, the Administration will support a provision that gives tobacco companies an exemption from the antitrust laws, so long as that exemption is no broader than necessary to accomplish its purpose -- reducing youth consumption of tobacco products. The Administration will review the language of the exemption carefully to ensure that it does not protect such activities as price-fixing, mergers to monopoly, predatory pricing, and agreements not to produce reduced-risk products.

The Administration respects recent efforts by states and localities to regulate tobacco products, and it will oppose any changes in preemption law that would frustrate these efforts. In the absence of a strong justification, legislation therefore shall not affect the FDA's existing authority to allow states and localities to impose requirements on tobacco products; nor shall legislation preempt state-law tort suits or state and local requirements that are more stringent than their federal counterparts.

Internal notes:

The liability provisions are, of course, what the tobacco companies get out of the proposed settlement. As written, they eliminate the possibility of a cataclysmic hit by limiting total liability to $5 billion each year; and they diminish the likelihood of any successful lawsuits by prohibiting class action and other joinder devices. The above statement takes a bit of the sting out of these provisions by making clear that any punitive damages for future misconduct will not be subject to the damages cap. (The statement is also silent about whether we would accept the prohibition not only of class actions, but also of other joinder devices; the Justice Department has some doubts about whether we should.) But there is little doubt about the value of the provisions -- arising from the certainty they offer -- to the tobacco companies.

On the other hand, it is not at all clear that these provisions harm public health interests. Instituting a comprehensive regulatory scheme, while keeping in place the possibility of capped compensatory damages and uncapped punitive damages, should influence future corporate behavior at least as well as the litigation system usually manages to do. Moreover, making the companies pay a punitive damage award for past misconduct to the public (for use in health research, etc.) makes far more sense from a public health perspective than allowing such funds to go as windfalls to individual plaintiffs. Of course, these provisions do decrease the likelihood of bankrupting the tobacco companies. But as long as Americans are addicted to tobacco products, it is very unclear that this result would serve the public health; indeed, the exact opposite argument is at least equally plausible.

The FTC and antitrust division of the Justice Department are both concerned about the breadth of the antitrust exemption contained in the proposed settlement agreement. They have not come to closure on appropriate language, but agree that an exemption should allow collusion to reduce youth smoking while prohibiting collusion for other purposes. The statement above serves as a placeholder, indicating that the Administration will take a serious interest in the drafting of this provision.

The preemption provisions of the proposed settlement are among its most baffling aspects -- muddled, internally contradictory, and seemingly senseless. The statement above essentially favors a status quo approach (which the FDA favors): in circumstances where existing law requires states to petition the FDA to regulate tobacco, states would remain under that obligation; in circumstances where existing law allows states to regulate tobacco on their own, states could impose any regulations more stringent than the new federal standards. It is very difficult to know how much (if at all) this scheme deviates from what the drafters of the settlement intended.

Tobacco - settlement - document disclosure and internal memos

Document Disclosure

For decades, the tobacco industry has failed to disclose essential facts in its possession about the dangers and addictiveness of tobacco products. Indeed, the tobacco companies have used the attorney-client and/or work-product privileges to cloak scientific research and findings -- and to shield evidence of the companies' criminal or fraudulent behavior. It is therefore necessary to establish an effective and speedy mechanism to pierce fraudulent or otherwise improper claims of privilege and to force the disclosure of information that will advance public health interests.

The Administration supports legislation to create a national tobacco document depository and require tobacco companies to turn over immediately all documents (including assertedly privileged documents and detailed privilege logs) relating to the health effects of tobacco products, the use of nicotine in those products, and the sale or marketing of those products to children. Companies may not claim privilege in this process for any descriptions or analyses of scientific research conducted or paid for by the company. **[Correct phrasing?]** A three-person Board, appointed consistent with the Constitution, shall review documents claimed to be privileged -- including through an expedited process allowing any person, without a prima facie showing, to challenge a privilege claim -- shall disclose any document found not to be privileged (with that determination binding on the company), and may impose appropriate monetary sanctions.

Under the legislation, this administrative process will not be the only means to contest a claim of privilege. Any person can challenge a claim of privilege in a legal action against a tobacco company, even if the Board of the depository has upheld or failed to rule on the claim. In addition, the administrative process will not govern the disclosure of documents to the FDA. Companies must disclose to the FDA all documents containing information about the health effects or addictive qualities of tobacco products, regardless of any claim of privilege. **[Correct phrasing?]**

Internal notes:

The proposal outlined above strengthens the document disclosure provisions of the settlement in several ways. First, the proposal makes the administrative disclosure process non-exclusive, so that a litigant can challenge a privilege claim in a lawsuit, even if the Board of the depository has not completed its review or has ruled in favor of the company. (By contrast, a Board finding that a document is not privileged binds the company in all other proceedings.) Second, the proposal provides the FDA with access to all health-related documents, notwithstanding any claims of privilege. Third, the proposal somewhat broadens the category of materials for which companies cannot claim a privilege in the administrative process. In addition, the proposal as outlined here gives us some wiggle-room on details -- relating, for example, to the composition of the Board (which the Justice Department believes is unconstitutional as written) and the procedures that the Board will follow.

The proposal, however, does not broadly abrogate the attorney-client or work-product privileges, as Rep. Waxman's proposed legislation would do. The Justice Department has expressed serious concerns about any broad abrogation of the privilege, arguing that such an approach would undermine the privilege generally and would enable a tobacco company official charged with criminal conduct to assert a violation of his Sixth Amendment right to effective assistance of counsel. But some public health groups may demand the abrogation of the companies' attorney-client privilege in a settlement -- or, even more broadly, insist (as Sen. Leahy, Rep. Waxman, and Attorney General Skip Humphrey have done) that the tobacco companies disclose all privileged documents before any consideration of a settlement takes place.

Tobacco - settlement - env. tobacco smoke and notes + memos

Environmental Tobacco Smoke

The best available scientific evidence indicates that environmental tobacco smoke (ETS) causes disease and death. The Environmental Protection Agency (EPA) classifies ETS as a Class A carcinogen **[check]** and estimates that it is responsible for about 3,000 lung cancer deaths each year in non-smoking adults. The EPA also has found that ETS threatens the health of hundreds of thousands of children with asthma and other respiratory illnesses. The Surgeon General, in a study concluding that ETS causes serious disease among non-smokers, determined that simple separation of smokers and nonsmokers within the same airspace may reduce, but does not eliminate harmful exposure to ETS.

For these reasons, the Administration supports legislation to restrict smoking in workplaces and other public facilities. This legislation, like the President's recent Executive Order on tobacco smoke in federal facilities, shall ban smoking in public places or at work except in enclosed areas exhausted directly to the outside. The legislation may include appropriate but limited exceptions to this ban, as in H.R. 3434, for prisons and the hospitality industry (but not including fast food restaurants). The legislation shall not preempt or otherwise affect any federal, state, or local law, regulation, or rule that imposes stricter limitations on ETS. The legislation shall ensure that the Occupational Safety and Health Administration possesses all necessary (including all currently existing) authority to regulate and enforce the law in this area.

Internal notes:

The above statement is essentially consistent with the proposed settlement's provision on ETS. This provision is one of the most valuable aspects of the settlement, given the risk of ETS to non-smokers, the success of ETS measures in inducing smokers to quit (or at least cut down), and the political difficulty of making headway on this issue without the tacit consent of the tobacco companies.

The only major question in this area is whether to exempt the hospitality industry (and if so, what parts of the industry) from the ban on indoor smoking. The proposed settlement exempts restaurants (but not fast food restaurants), bars, private clubs, hotel guest rooms, casinos, bingo parlors, and tobacco merchants. H.R. 3434, which the Administration has supported, exempts restaurants (including fast food restaurants) and bars. The proposed rule on ETS that OSHA issued in 1994 does not include any exemption for the hospitality industry. (In a number of other ways, however, the settlement is more protective of the public health than the OSHA rule, which in any event would face serious legal challenges if finally issued.) DOL recommends accepting the exception in the settlement; HHS recommends eliminating the exception. The above statement retains an exception, leaves some wiggle room with respect to its precise scope, but hints that it would cover only bars and non-fast food restaurants.

On another point, the above statement will enable us to inspect legislative language carefully to ensure that it does not (1) preempt any more health-protective laws, whether federal,

state, or local, or (2) deprive OSHA of any necessary regulatory or enforcement authority. Current language in the settlement creates some ambiguities with respect to these issues.

Tobacco - settlement - FDA jurisdiction and notes + memos

FDA Regulation

The first priority of the Administration, in considering any tobacco legislation, shall be to confirm and protect the jurisdiction of the FDA to regulate tobacco products. This authority can be no less strong -- though because of the nature of the product, it may be somewhat different -- than that which the FDA exercises over other drugs and devices. Further, the authority cannot be circumscribed by any special procedural rules or requirements. The FDA must be able to regulate tobacco products, including by ordering the reduction or elimination of nicotine or other constituents, through its normal procedures in the furtherance of public health interests.

The Administration therefore supports legislation specifically empowering the FDA to require the modification of tobacco products based on a finding that this change would reduce the risk of the product to the public and is technologically feasible. **[Pick one of the following two sentences:]** [The FDA shall consider all relevant factors in making this determination, including the number of addicted tobacco users, the availability of alternative products, and the risk of a significant contraband market in tobacco products resulting from the proposed action.] [The FDA need make no further findings in support of this decision, but consistent with its duty to protect the public health, the FDA may not go forward if a party affirmatively demonstrates that the action would create a significant contraband market in tobacco products.] The FDA may order a modification of a tobacco product (including the reduction or elimination of nicotine) at any time, although a decision to eliminate nicotine shall not take effect for two years to allow time for congressional review. In determining whether to require modification of a tobacco product, the FDA shall use its normal procedures.

Internal Notes:

Even as written, the settlement's provision on FDA jurisdiction had significant virtues. First, the provision specifically conferred jurisdiction to regulate tobacco products on the FDA, thereby removing the legal uncertainty now attending the FDA rule. (The Fourth Circuit almost certainly will rule against the FDA; the Supreme Court is a toss-up.) Second, the provision established a "risk reduction" standard to guide the regulation of tobacco products in place of the "safety and efficacy" standard applicable to other drugs and devices. Because the former makes sense when applied to inherently dangerous products whereas the latter does not, the change in standard would facilitate the FDA's regulation of tobacco products.

This provision of the settlement, however, also contained several glaring weaknesses. First, the FDA was required to prove a negative in order to reduce or eliminate nicotine -- i.e., that the action would not create a significant demand for contraband products. Second, the FDA could not eliminate nicotine for a period of 12 years. Third, the FDA could not take any action to modify tobacco products without surmounting a number of procedural hurdles -- e.g., formal rulemakings -- not usually applicable to administrative action.

The above statement eliminates the 12-year prohibition and the special procedural hurdles

contained in the proposed settlement. The statement offers two alternatives on the contraband issue. The first and preferable alternative is to convert the contraband question from a make-or-break finding into a mere "consideration." The second alternative is to flip the burden of proof on the contraband issue, so that the tobacco industry will have to prove that the proposed action will create a contraband market (instead of the FDA having to prove that it will not). This alternative removes the burden of proving a negative from the FDA, but still makes the FDA's action wholly dependent on the question of whether it will create a contraband market.

Tobacco - settlement - notes + memos

Consensus Recommendation

In your speech, you should call for federal legislation on tobacco, and pledge to work with Congress over the next year to get it done. You should set forth the key elements you believe should be addressed in tobacco legislation:

1. **Reducing youth smoking**, through a comprehensive approach of penalties, price increases, counteradvertising, state and local prevention efforts, and advertising and access restrictions. You would say that the price of the current settlement is too low to reduce youth smoking and meet our other health goals, and that we need stiff penalties that force tobacco companies to take responsibility for reducing youth smoking. You would call for **a combination of payments and penalties that would increase the price of cigarettes by up to $1.50 a pack as needed to meet our goals of significantly reducing youth smoking over the next decade.**

2. **Affirming FDA's full authority to regulate tobacco products.**

3. **Holding the tobacco industry accountable to reduce youth smoking and change the way it does business**, through penalties and document disclosure.

4. **Meeting other public health goals** (such as environmental tobacco smoke restrictions, international efforts, smoking cessation programs, and increased funding for public health research and other health objectives).

5. **Protecting tobacco growers and their communities.**

Tobacco - settlement - notes + memos

September 5, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed

SUBJECT: Tobacco Update

When you return next week, Secretary Shalala and I will give you detailed recommendations on how to proceed on tobacco. We are scheduled to meet with you on Friday, and you are scheduled to announce your position on Tuesday the 16th. This memo is a brief summary of what we are likely to recommend and what strategic and policy decisions you will need to make.

I. Overview

Although the industry was hoping for quick passage, some Republican leaders in both houses said this week that the tobacco settlement was too complicated for Congress to enact before they adjourn in late October. Lott would still like to get it done this year, but with the legislation being referred to six committees in the Senate alone, we need to stake out positions that can hold up over time.

Over the past two months, we have held extensive discussions with the public health community, attorneys general, members of Congress, and farmers. The public health community will welcome our recommendations on most issues: guaranteeing full authority for FDA to regulate nicotine; imposing tougher penalties on the industry if it fails to reduce teen smoking; demanding an additional $50 billion to offset the credit in the budget agreement; making it somewhat easier to disclose industry documents; looking out for tobacco farmers; and so on. The only concerns of tobacco opponents that we cannot easily meet are dramatically increasing the overall price tag (Kennedy would like to see it doubled, to $700 billion) and demanding to see all the documents before capping liability (Leahy, Waxman, and Skip Humphrey are pushing for "no immunity without disclosure").

The central strategic question is how far we want to push the industry for additional concessions, at the risk of losing this opportunity altogether. Bruce Lindsey and I have

repeatedly pressed the industry on the most important issues -- FDA, penalties, and documents -- with only modest progress. We met with them again today, and will continue to press them next week, but penalties remain a serious stumbling block.

Bruce believes we should not go forward unless we have the industry on board, because without an agreement on everything the industry will be free to use its considerable influence in Congress to undermine provisions it doesn't like -- for example, gutting the FDA provisions if it wins in the 4th Circuit. Secretary Shalala and the Vice President strongly believe we should not reach agreement with the industry, because any deal with tobacco companies will be suspect, and won't have enough congressional buy-in to withstand 6-12 months of debate in Congress.

This debate may become moot, if we can't get the industry to come around by next week on our bottom-line issues. In that case, I believe we should be both tough and reasonable, by demanding more than the industry can stomach right now (on FDA and penalties), but not more than they can possibly swallow in the end. I share Bruce's concerns about the industry's clout and penchant for mischief, but a little tension between us and the industry might actually help us during a drawn-out congressional debate. If we make this a fight over tougher penalties to reduce teen smoking (rather than how much money we want in return for capping liability), I believe we can beat the industry on a few points, even in this Congress -- especially in an election year.

II. Major Recommendations

A. FDA Authority

The first priority of the Administration in considering any tobacco legislation should be to confirm and protect the jurisdiction of the FDA to regulate tobacco products. The FDA must be able to regulate tobacco products, including by ordering the reduction or elimination of nicotine or other constituents, through its normal procedures in the furtherance of public health interests -- without any special procedural rules or requirements. We should call on Congress to pass legislation specifically empowering the FDA to require the modification of tobacco products based on a finding that this change would reduce the risk of the product to the public and is technologically feasible.

The industry still wants to put one hurdle in front of FDA, by saying the FDA may not go forward if a party affirmatively demonstrates that the action would create a significant contraband market in tobacco products. But we believe the FDA should only have to consider contraband as one of many relevant factors, including the number of addicted tobacco users and the availability of alternative products. We would eliminate two other weaknesses in the settlement -- the 12-year waiting period before FDA could ban nicotine, and the special procedural hurdles such as formal rulemakings.

B. Documents

For decades, the tobacco industry has failed to disclose essential facts in its possession about the dangers and addictiveness of tobacco products, and used attorney-client privilege to cloak scientific research and findings and possibly shield evidence of criminal or fraudulent behavior. It is therefore necessary to establish an effective and speedy mechanism to pierce fraudulent or otherwise improper claims of privilege and to force the disclosure of information that will advance public health interests. The documents issue has become a rallying cry for the most strident opponents of a settlement, led by Skip Humphrey.

The settlement calls for a national documents depository and a three-judge panel to provide expedited rulings on whether documents should remain privileged. We recommend strengthening the document provisions by 1) allowing litigants to challenge privilege claims in individual lawsuits, even if the three-judge panel had already ruled, and 2) providing the FDA with access to all health-related documents, notwithstanding any claims of privilege. That will enable the FDA to put the industry's considerable expertise on nicotine to good use.

Even these steps will not go far enough to please Leahy, Waxman, and Humphrey, who want to break the companies' attorney-client privilege and insist that the tobacco companies disclose all privileged documents before any consideration of a settlement. But the Justice Department has expressed serious concerns about any broad abrogation of the privilege, arguing that such an approach would undermine the privilege generally and might enable a tobacco company official charged with criminal conduct to assert a violation of his Sixth Amendment right to effective assistance of counsel.

C. Penalties

The settlement sets ambitious targets to reduce youth smoking by 30% in 5 years, 50% in 7 years, and 60% in 10 years, and would require companies to pay $80 million for each percentage point they fall short. Public health groups have praised the idea of targets and penalties, but complain that the current scheme does not give companies sufficient incentive to stop hooking teenagers. Our main problems with the current penalties are that they are tax-deductible, abatable, capped at $2 billion, and too small to serve as a deterrent.

We can strengthen the penalties in a variety of ways -- all of which the industry has so far resisted -- but our current preferred option is a two-tier system, with graduated penalties that get stiffer if the industry misses the targets by a substantial margin. The first tier of penalties would require companies to pay $80 million per point if the industry missed the targets by less than 5 points in year 5, less than 10 points in year 7, and less than 15 points in year 10. This penalty would be non-deductible, could not be abated, and would reflect a company's share of the youth market. If the industry missed by a greater margin, companies would pay the full first-tier penalty, and their settlement payment would be increased by a penny a pack for each additional

percentage point by which they missed the target. This second-tier penalty would cost companies about $240 million a point, and has the additional virtue of locking in a permanent price increase that will help further reduce smoking by youth (and adults). Under this approach, if youth smoking went down by 30% over 10 years, instead of 60%, the industry would pay $1.2 billion in financial penalties and be forced to raise prices another 15 cents a pack on top of that.

D. Farmers

We have made clear that tobacco farmers should receive protection in any legislative settlement, and that the Administration will work closely with members of Congress from tobacco states to forge a consensus. Secretary Glickman has traveled to tobacco markets in Virginia and North Carolina to express this commitment directly to farmers.

Farmers are primarily interested in continuation of the governmental tobacco program, guaranteed purchase at set levels of tobacco crops by cigarette companies, and some provision for buy out and transition to other crops, on a voluntary basis. Because farm groups and tobacco state members have not yet coalesced around a consensus proposal, we don't need to commit to a specific plan yet. The most discussed proposal is one released this month by Senators Ford and McConnell that would require companies to buy a minimum amount of domestic tobacco over 25 years and would install penalties on companies that do not meet the stated goals for tobacco buying. The proposal would also create a "Tobacco Community Revitalization Fund" administered by USDA, but not subject to the appropriation process, which could spend up to $1 billion a year for 25 years from the settlement fund and would cover costs related to the tobacco program such as administration and crop insurance, make supplemental payments of up to $500 million to producers whose income from tobacco drops substantially below the 1996 level, pay up to $100 million in benefits for displaced cigarette factory workers, and provide up to $250 million a year for rural economic development grants.

E. Funding

Although the settlement is advertised at $368.5 billion, a variety of factors conspire to leave us with considerably less than that to spend on any new initiatives. The $368 billion is a 25-year number, and must be adjusted downward to reflect a projected drop in cigarette consumption of about 15%. For scoring purposes, OMB adjusts the amount down still further to reflect lost business tax revenue and lost federal excise tax revenue from decreased consumption. Most of the rest of the money in the settlement is already spoken for, to pay for civil suits, cessation programs, counteradvertising, and the states' Medicaid claims. The main decision you will need to make is how best to spend the $25 billion research trust fund, which most of us believe should be a 21st Century Research Fund dedicated to cancer and other tobacco-related research.

Some in the Administration (primarily the Treasury Department) and in Congress (led by Kennedy) believe the industry should be soaked for $600-700 billion. This is probably a dealbreaker for the industry, but it would free up additional funds for new initiatives.

F. Other Issues

We will need to propose improvements in other, less prominent areas, which we will detail for you next week. These include limiting the industry's antitrust exemption to prevent unnecessary collusion and removing a little-noticed cap on punitives for future misconduct.

We will give you a more detailed memo on all these recommendations next week, and bring you up to date on our discussions with the industry, the Hill, and the public health community.

Tobacco-settlement - notes + memos

Consensus Recommendation

In your speech, you should call for federal legislation on tobacco, and pledge to work with Congress over the next year to get it done. You should set forth the key elements you believe should be addressed in tobacco legislation:

1. **Reducing youth smoking**, through a comprehensive approach of penalties, price increases, counteradvertising, state and local prevention efforts, and advertising and access restrictions. You would say that the price of the current settlement is too low to reduce youth smoking and meet our other health goals, and that we need stiff penalties that force tobacco companies to take responsibility for reducing youth smoking. You would call for **a combination of payments and penalties that would increase the price of cigarettes by up to $1.50 a pack as needed to meet our goals of significantly reducing youth smoking over the next decade.**

2. **Affirming FDA's full authority to regulate tobacco products.**

3. **Holding the tobacco industry accountable to reduce youth smoking and change the way it does business**, through penalties and document disclosure.

4. **Meeting other public health goals** (such as environmental tobacco smoke restrictions, international efforts, smoking cessation programs, and increased funding for public health research and other health objectives).

5. **Protecting tobacco growers and their communities.**

Tobacco - settlement -
notes + memos

Strategic Considerations

I. Overview of Speech. In your speech, you should address the issues you most care about in tobacco legislation. These key elements are:

- Reducing youth smoking, through a comprehensive approach involving penalties, price increases, counteradvertising, and access and marketing restrictions.
- Affirming FDA's full authority to regulate tobacco products.
- Holding industry accountable and changing the way it does business, through penalties and document disclosure.
- Furthering other public health goals (environmental tobacco smoke restrictions, international efforts, smoking cessation programs, and increased funding for public health research and other health objectives).
- Protecting tobacco growers and their communities.

II. Level of specificity, especially on funding issues. In addressing certain of these issues -- particularly those involving funding -- you will have to decide how much detail to provide to the public. In any scenario, you would say that the price of the current settlement is too low to reduce youth smoking and meet our other health goals, and that we need stiff penalties that force tobacco companies to take responsibility for reducing youth smoking. You can then describe your plan in one of the following ways:

A. We will work with Congress to determine how much we need to increase the price of cigarettes to meet our goals.

B. The combination of payments and penalties in tobacco legislation needs to increase the price of a pack of cigarettes by between $1 and $1.50 to meet our goals.

C. Tobacco legislation needs to increase the price of a pack of cigarettes by between $1 and $1.50 to meet our goals, and I recommend **[select and describe a particular payment option, as set out in accompanying documents.]**

FDA Authority

The first priority of the Administration in considering tobacco legislation should be to confirm and protect the jurisdiction of the FDA to regulate tobacco products -- including through the reduction or elimination of nicotine or other constituents. This goal will necessitate substantial changes in the proposed settlement agreement.

Even as written, the settlement's provision on FDA jurisdiction had certain virtues. First, the provision specifically conferred jurisdiction to regulate tobacco products on the FDA, thereby removing the legal uncertainty now attending the FDA rule. (The Fourth Circuit panel sounds almost certain to rule against the FDA, and the Supreme Court may well uphold this decision.) Second, the provision established a "risk reduction" standard to guide the regulation of tobacco products in place of the "safety and efficacy" standard applicable to other drugs and devices. Because the former makes sense when applied to inherently dangerous products whereas the latter does not, the change in standard would facilitate the FDA's regulation of tobacco products.

This provision of the settlement, however, also contained several glaring weaknesses. First, as you noted in your first comments on the settlement, the FDA would have to prove a negative in order to reduce or eliminate nicotine -- i.e., that the action would not create a significant demand for contraband products. Second, the FDA could not eliminate nicotine for a period of 12 years. Third, the FDA could not take any action to modify tobacco products without surmounting a number of procedural hurdles -- e.g., formal rulemakings -- not usually applicable to administrative action.

The public health community will demand -- and we believe the industry will grudgingly accept -- a legislative proposal that corrects these weaknesses. This proposal would eliminate the 12-year waiting period and the special procedural hurdles in the current settlement. It also, and perhaps most important, would remove the necessity of the FDA's making a contraband finding. At one point, the industry proposed flipping the burden of proof on the contraband issue, so that the FDA could not take action if a party affirmatively demonstrated that doing so would create a significant contraband market. But even this approach puts too much weight on the contraband issue, which should be only one factor in the FDA's regulatory decisionmaking. The better approach is to authorize the FDA to order changes to tobacco products based on a simple finding that this change would reduce the risk of the product to the public and is technologically feasible, after consideration of the full range of consequences of the change, including the possible creation of a contraband market.

Penalties

The settlement sets ambitious targets for reductions in teen smoking of 30% in 5 years, 50% in 7 years, and 60% in 10 years. The most recent data show underage prevalence at 18.2% in 1996, which means approximately 3.5 million youths aged 13-17 are daily smokers. Because the settlement targets are based on youth prevalence over the past decade, which has averaged 15.2%, the declines from current levels necessary to comply with the agreement would have to

be 42% over 5 years, 58% over 7, and 67% over 10.

It is extremely difficult to predict how much teen smoking would decline under the settlement. While teen smokers are particularly sensitive to price -- Treasury has assumed that a price increase of 10% will reduce youth prevalence by 7% (compared to 2.6% for adults), and some studies suggest youth smoking will drop as much as 12% for every 10% increase in price -- we have never had a price shock of this magnitude. The Treasury Department estimates that the combined price rise from the current settlement and the 15-cent excise tax increase in the budget agreement would be about 80 cents by year 5, resulting in a 20-25% decrease from current youth smoking levels -- still well short of the settlement targets. Restrictions on access and advertising should reduce youth smoking still further, but no one can say how much.

Under the settlement, companies would have to pay $80 million for each percentage point they fall short, which is supposed to recapture the industry's projected profits from hooking that many young smokers. (The Treasury Department says a more accurate projection of profits would be $60 million a point, which is roughly equal to $80 million after taxes.) Public health groups have praised the idea of targets and penalties, but complain that the current scheme does not give companies sufficient incentive to stop hooking teenagers. The major criticisms against the current penalties are that they are tax-deductible, abatable, capped at $2 billion in a given year, and too small to serve as a deterrent.

The companies might accept penalties of $80 million a point that were not tax-deductible and could not be abated. They say they are unwilling to increase the price per point or to eliminate the $2 billion annual cap.

We recommend a two-tier system, with graduated penalties that get stiffer if the industry misses the targets by a substantial margin. For example, the first tier of penalties could require companies to pay $80 million per point if the industry missed the targets by less than 5 points in year 5, less than 10 points in year 7, and less than 15 points in year 10. This penalty would be non-deductible, could not be abated, and would reflect a company's share of the youth market. If the industry missed by a greater margin, companies would pay the full first-tier penalty, and a surcharge permanently added on to the price of a pack of cigarettes to reflect the remaining shortfall. This additional charge would be the equivalent of a non-deductible second-tier penalty representing a larger multiple of profits and rising over time -- e.g., $___ million a point in year 5, $___ million a point in year 7, $___ million a point in year 10. Because the charge would be locked in as a permanent price increase, it would help further reduce smoking by youth (and adults). Under this approach, the penalties could reach as high as __ cents a pack by year 10 if youth smoking failed to decline.

Marketing, Advertising, and Labeling

The advertising and marketing restrictions in the settlement are very strong. They include all the restrictions in the FDA rule -- most notably, requirements of black-on-white advertising and bans on tobacco brand names in non-tobacco merchandise. The district court struck down

these restrictions as inconsistent with the FDA's statutory authority. The Court of Appeals is highly unlikely to reverse this decision, and the Supreme Court probably will let it stand as well. The settlement also includes restrictions on advertising and marketing going far beyond the FDA rule, such as restrictions on point-of-sale advertising and bans on outdoor advertising, Internet advertising, the use of human images and cartoon characters, and payments for tobacco product placement in movies and other media. Congress could not enact such restrictions consistent with the First Amendment.

The Department of Justice believes that these restrictions on advertising should not be part of any legislation, but only of the consent decrees or other contracts entered into by the industry and Attorneys General. To the extent the restrictions are a part of the legislation -- or seen as a condition of the legislation -- serious constitutional issues will arise. To the extent the restrictions are a part only of the settlement agreements, they probably will be permissible as voluntary relinquishments of rights.

Assuming we follow the Justice Department's recommendation, serious questions relating to enforcement of the advertising restrictions arise. We know that each Attorney General will be able to enforce the restrictions in his or her state. But what of states in which there is no consent decree? Or what of states with inattentive Attorneys General? The proposed settlement agreement makes reference to a "national protocol" -- a contract designed to enhance enforcement of the advertising restrictions (and other provisions) in the consent decrees. But there is no consensus on precisely who will sign the protocol or how it will work in practice. We must keep a close eye on this scheme -- and on any legislative references to it -- to ensure that it provides an effective mechanism for enforcing the advertising restrictions while not increasing the vulnerability of the restrictions to constitutional challenge (by making their enforcement something other than a simple matter of contract law).

We also should insist on statutory confirmation of FDA authority over the advertising and marketing of tobacco products. This grant of authority is valuable even though the settlement agreements will go further than the FDA could, precisely because the FDA will have no authority to enforce the contracts between the industry and the states. With a specific grant of authority, the FDA itself could enforce the restrictions contained in its 1996 rule, as well as any other constitutionally permissible restrictions it might wish to impose in the future. Such a provision should be acceptable to all parties.

In addition to including restrictions on advertising, the settlement contains provisions to require "Canadian-style" warning labels -- i.e., strengthened warnings (such as "cigarettes cause cancer" and "smoking can kill you") that appear on 25% of the front or display panel of tobacco products, printed in alternating black-on-white or white-on-black type. These provisions would strengthen significantly the existing warning labels, both in the starkness of the message and in its size and placement on tobacco products. We do not recommend any changes to them.

Access and Licensing

The access and licensing provisions of the settlement significantly enhance the ability of the government to prevent youth access to tobacco products. The current FDA rule establishes 18 as the federal minimum age of sale, requires retailers to check photo identification of anyone under 27, and eliminates free samples and the sale of single cigarettes. The proposed settlement incorporates these access restrictions while also banning all cigarette vending machines and requiring tobacco products to be placed out of reach of consumers in any facility that children may enter. Even more important, the settlement would establish a retail licensing scheme to enforce these access restrictions. FDA and Treasury agree that such a system is necessary for adequate enforcement of youth access provisions. Assuming adequate funding, legislation creating a licensing system could count as one of the principal virtues of the settlement agreement.

As written, however, the licensing provision of the settlement contains some important ambiguities. Most critically, the settlement is vague as to who -- state authorities, federal authorities, or some combination of the two -- will administer the licensing scheme. We are not yet in a position to make a final recommendation on this question. FDA's current inclination is to give responsibility for running the scheme to the states, but to retain the power to revoke licenses. We are not yet sure whether such an approach would work (or even how it could be done); rather than recommending a specific scheme, we should commit only to working with Congress and the Attorneys General on this question.

The licensing provision also now contains an inadequate penalty structure. Most troublesome, the settlement provides for permanent license revocation only after a licensee's tenth offense within two years. Because licensing officials are unlikely to conduct ten compliance checks on a single retailer in a two-year time frame, this provision is essentially meaningless. We should insist on strengthening the penalty scheme -- including by making mandatory revocation a real weapon -- without getting into a level of detail unsuitable at this stage of the process.

These provisions are not particularly high-profile. They have not attracted much attention, and nothing we say about them will alter the politics of the deal in either direction. But the provisions, if strengthened and clarified along the lines suggested, could prove one of the great virtues of enacting tobacco legislation.

Documents

For decades, the tobacco industry has failed to disclose essential facts in its possession about the dangers and addictiveness of tobacco products. In particular, the industry has used both the attorney-client and the work product privileges to cloak scientific research and findings -- and possibly to shield evidence of criminal or fraudulent behavior. The Attorneys General attempted to address this issue through creation of a special court to resolve all privilege claims made by the industry. Although the proposed system has certain virtues, it also suffers from serious defects. The industry is willing to make certain minor changes in the proposed scheme, but will not accept changes recommended by the Justice Department and FDA. Even these

changes will not satisfy the harshest critics of the settlement, such as Skip Humphrey.

The settlement calls for a national document depository and a three-judge panel (appointed by the Judicial Conference of the United States) to provide expedited rulings on whether documents should remain privileged. The Attorneys General fought hard for this provision for two essential reasons. First, anyone -- not just a litigant, but any member of the public (including the New York Times or David Kessler) -- could ask the panel to review allegedly privileged documents. In this sense, the settlement establishes a Freedom of Information Act for tobacco documents. Second, the requester would not have to make the normal showing required in litigation for *in camera* review of a document: a *prima facie* case that the document is not privileged -- because, for example, it advanced a scheme of crime or fraud.

The Justice Department, however, believes that this scheme, adopted without change, would pose serious dangers. DOJ points out that no one knows whether or how this panel will work -- whether the judges (or special masters appointed by them) will be competent; whether they will be so swamped with document requests as to create an enormous backlog; whether they will favor one side over the other. DOJ also notes that this panel will have sole authority to rule on claims of privilege. While under the current system many courts may adjudicate a claim of privilege (with a finding of privilege in one court often not precluding the opposite finding in another), the special three-judge panel's decisions would be binding in all courts in all litigation in the United States. On top of these Justice Department concerns, the FDA would like access to all documents -- even those rightfully privileged -- to determine whether they contain scientific or other health-related information (for example, reflecting the industry's extensive research on nicotine addiction) relevant to the regulation of tobacco products.

To meet these agency concerns, we could strengthen the document provisions in two key ways. First, we could make the administrative disclosure process non-exclusive, so that a litigant could challenge a privilege claim in litigation even if the special panel had not completed review of the document in question or had ruled in favor of the company. (By contrast, a finding by the special panel that a document is not privileged would bind the company in all other proceedings.) Second, we could provide the FDA with access to all health-related documents, notwithstanding any claims of privilege.

The industry claims that it will not accept either of these changes, though it will not object to a scheme allowing courts to rule on a privilege claim if the special panel has not yet done so. The industry also proposes adding a provision to the settlement to require each company to identify and disclose all health-related information contained in privileged documents, without turning over the documents themselves. Under this proposal, the special panel could find that a company had failed to disclose such information and levy substantial penalties. Finally, the industry has expressed a willingness to consider a different scheme for selecting the people to sit on the special panel.

On the other side, some in Congress and the public health community will find even the changes recommended by the agencies to be inadequate. These changes do not broadly abrogate

the industry's attorney-client or work-product privileges. The Justice Department has expressed serious concerns about any such breach of the privilege, arguing that this approach would undermine the privilege generally and would enable a tobacco company official charged with criminal conduct to assert a violation of his Sixth Amendment right to effective assistance of counsel. But some will demand the complete abrogation of the companies' attorney-client privilege as a term of the settlement -- or, even more broadly, insist (as Sen. Leahy, Rep. Waxman, and Attorney General Skip Humphrey already have done) that the tobacco companies disclose all privileged documents before any consideration of a settlement takes place.

Environmental Tobacco Smoke

The best available scientific evidence indicates that environmental tobacco smoke (ETS) causes disease and death in non-smokers. The Environmental Protection Agency (EPA) classifies ETS as a Class A carcinogen and estimates that it is responsible for about 3,000 lung cancer deaths each year in non-smoking adults. The EPA also has found that ETS threatens the health of hundreds of thousands of children with asthma and other respiratory illnesses. Serious ETS restrictions, which ban smoking in public places or at work except in enclosed areas exhausted directly to the outside, reduce exposure to ETS and the harm it causes. At the same time, such restrictions lead many smokers to quit smoking entirely and many more to cut down. Indeed, among the many smoking cessation tools -- including substantial price increases -- ETS restrictions may well be the most effective.

All agree that the settlement's provision on ETS is extremely valuable, and needs few changes. The proposed legislation would broadly prohibit smoking in public places, without preempting even stricter state or local laws. The only question is whether to accept without change the settlement's exception for restaurants (but not fast food restaurants), bars, private clubs, hotel guest rooms, casinos, bingo parlors, and tobacco merchants. H.R. 3434, which the Administration supported, exempts restaurants (including fast food restaurants) and bars. The proposed rule on ETS that OSHA issued in 1994 does not include any exemption for the hospitality industry. (In a number of other ways, however, the settlement is more protective of public health than the OSHA rule, which in any event would face serious legal challenges if finally issued.) HHS would prefer to cut back on the exception in the settlement, noting that many of the exempted work places pose the greatest threat to non-smokers. The Department of Labor (OSHA) would keep the exemption essentially as is on the ground that trying to include restaurants, casinos, etc. would make the whole provision politically unsalable.

Liability and Other Legal Issues

The price of everything in the settlement agreement is, of course, protection from civil liability. The settlement limits total liability to $5 billion each year (with any unspent portion of a base $4 billion fund reverting to the government), prohibits class action and other joinder and consolidation devices, and eliminates punitive damage claims (but requires a payment of billions of dollars in punitive damages directly payable to the public). There is little doubt about the

value of these provisions to the tobacco companies.

On the other hand, it is not at all clear that these provisions harm public health interests. Instituting a comprehensive regulatory scheme, while keeping in place the possibility of $5 billion in annual compensatory damages ($5 billion more than the industry has ever paid before), should influence future corporate behavior at least as well as the litigation system usually manages to do. Moreover, making the companies pay a punitive damage award for past misconduct to the public (for use in health research, etc.) makes far more sense from a public health perspective than allowing such funds to go as windfalls to individual plaintiffs. Of course, these provisions do decrease the likelihood of bankrupting the tobacco companies. But as long as Americans are addicted to tobacco products, it is not clear how bankrupting the industry would serve the public health.

We should further advance public health interests by insisting on the removal of any limits on punitive damages for future misconduct. We would make clear that plaintiffs can seek such awards, and that these awards shall not count toward or be subject to yearly limits. The continued potential for unrestricted punitive damages will support the regulatory aspects of the legislation in deterring willful misconduct and otherwise changing corporate behavior. At the same time, this change will enable the legal system to punish the industry, over and above compensatory damages, for any future misbehavior. The industry can hardly argue against this change to the settlement agreement.

We also might consider whether to allow some consolidation of cases prior to trial for purposes of conducting discovery and adjudicating pre-trial motions. The Justice Department recommends this change, which would entail amendment of the current multidistrict litigation statute, to allow individual plaintiffs to share discovery materials and reduce discovery and other pre-trial costs. The industry apparently will resist any change to the provision on class actions, joinder, and consolidation. But given the cap on annual damages, it is hard to see why such changes matter so much to the industry. Moreover, the industry may see consolidation schemes of this kind as less threatening than mechanisms (whether class actions or joinder rules) that permanently tie many cases together, letting numerous "bad facts" cases ride in the wake of a couple of "good facts" cases all the way up to judgment.

The FTC and Antitrust Division of the Justice Department are both concerned about the breadth of the antitrust exemption contained in the proposed settlement agreement, noting that it might protect such activities as price-fixing, mergers to monopoly, predatory pricing, and agreements not to produce reduced-risk products. The FTC and Antitrust Division have not come to closure on exact language to include in legislation, but agree that the exemption should allow collusion only for the purpose of reducing youth smoking (by uniformly passing on the costs of the settlement and penalties and agreeing on advertising restrictions). We should insist on a narrowing of the antitrust exemption, but not yet propose specific language. The industry almost certainly will accept this change.

Finally, the preemption provisions of the proposed settlement are among its most baffling

aspects -- muddled, internally contradictory, and seemingly senseless. We should try to clarify them so that they preserve current FDA authority, while enabling states in appropriate circumstances to go beyond the provisions of the settlement agreement. More specifically, where existing law requires states to petition the FDA to regulate tobacco, states would remain under that obligation and the FDA would retain its current authority; where existing law allows states to regulate tobacco on their own, states could impose any regulations more stringent than the new federal standards. It is very difficult to know how much (if at all) this scheme deviates from what the drafters of the settlement intended. In any case, it is hard to imagine that the issue would drive any party from the table.

Farmers

We have made clear that tobacco farmers should receive protection in any legislative settlement, and that the Administration will work closely with members of Congress from tobacco states to forge a consensus. Secretary Glickman has traveled to tobacco markets in Virginia and North Carolina to express this commitment directly to farmers.

Farmers are primarily interested in continuation of the governmental tobacco program, guaranteed purchase at set levels of tobacco crops by cigarette companies, and some provision for buy out and transition to other crops, on a voluntary basis. Farm groups and tobacco state members have not yet coalesced around a consensus proposal. One plan put forward this month by Senators Ford and McConnell would require companies to buy a minimum amount of domestic tobacco over 25 years and would install penalties on companies that do not meet the stated goals for tobacco buying. The proposal would also create a "Tobacco Community Revitalization Fund" administered by USDA, but not subject to the appropriation process, which could spend up to $1 billion a year for 25 years from the settlement fund. This Revitalization Fund would cover costs related to the tobacco program such as administration and crop insurance, make supplemental payments of up to $500 million to producers whose income from tobacco drops substantially below the 1996 level, pay up to $100 million in benefits for displaced cigarette factory workers, and provide up to $250 million a year for rural economic development grants.

The best way to address this issue is to secure an agreement from the companies to maintain current purchases of domestic leaf, even if domestic consumption declines. Because of GATT, Congress cannot require companies to purchase a set level of domestic tobacco. However, a private contract between growers and the industry would probably not trigger a GATT violation.

Funding

Although the settlement is advertised at $368.5 billion, a variety of factors conspire to leave us with considerably less than that to spend on any new initiatives. The $368 billion is a 25-year number, and must be adjusted downward to reflect a projected drop in cigarette

consumption of about 15%. For scoring purposes, OMB adjusts the amount down still further to reflect lost business tax revenue and lost federal excise tax revenue from decreased consumption. Most of the rest of the money in the settlement is already spoken for, to pay for civil suits, cessation programs, counteradvertising, and the states' Medicaid claims.

At current funding levels, the main decision to be made is how best to spend the $25 billion research trust fund, which could serve as a 21st Century Research Fund dedicated to cancer and other tobacco-related research.

Additional funds could be raised by:

1) Eliminating the $50 billion tax credit in the budget agreement. This would increase the 25-year number from $368 billion to $430 billion, and free up about $2 billion a year for new initiatives. That money could be used to double tobacco-related illness research ($1.3 billion per year) and make targeted investments in tobacco-related public health initiatives such as school-based clinics, Healthy Start programs, cancer prevention, and substance abuse treatment. All your advisers support this option.

2) Strengthening the penalties for failing to reduce teen smoking. The current penalties generate about $25 <ck> billion over 25 years, all of which goes to the states to expand anti-smoking efforts. A graduated penalty scheme could increase the 25-year number to $___ billion, which could be evenly divided between the states and the federal government. This would generate $__ billion a year beginning in year 5, which could be dedicated to additional research and/or coverage expansions, such as allowing people between ages 55 and 65 to buy into Medicare ($2-4 billion per year); covering workers between jobs ($2-3 billion per year) and Medicaid outreach ($500 million to $1 billion per year). DPC, HHS, NEC, and Treasury all support this approach.

3) Increasing the industry's up-front one-time payment, from $10 billion to $30 billion, and indexing the inflation adjuster to GDP rather than CPI (since GDP is more in line with medical cost growth). This would increase the 25-year number to $___ billion, and generate $_ billion a year, which could be used for any of the initiatives outlined above, other investments such as child care ($500 million to $1 billion per year) or medical education for doctors training in children's hospitals ($300 million per year), or deficit reduction (offsetting lost federal excise tax revenue from declining cigarette sales). Treasury supports this approach, although it would probably be a dealbreaker.

The industry will vehemently resist any effort to move beyond current funding levels. The most outspoken tobacco opponents, such as Senator Kennedy and Skip Humphrey, have called for a 25-year number in the range of $600-800 billion. Rep. Waxman and David Kessler would like to see a $1.50 a pack increase, which would require $900 billion over 25 years (although it could also be achieved by combining current base payments with enhanced penalties of about 90 cents a pack).

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IV. Administration Strategy

The Administration wants to give momentum to a legislative package that will ~~effectively~~ put in place a national tobacco control policy ~~for the 21st Century that will have as its primary focus the~~ focused on protection ~~of our~~ children's health. ~~From this point today to the passage of such legislation and the President's signing of a bill, the road is filled with uncertainties.~~ It is increasingly clear that Congress will not act on such legislation until 1998. The public health community wants a legislative solution but is very skeptical of the details of the settlement. Many parties -- most noticeably tobacco farmers -- were not at the table for the negotiations on the settlement and how to involve them and keep them involved are still matters for discussion. The disclosure of industry documents -- whether in state lawsuits or in potential DOJ criminal actions -- may radically change the shape and tenor of public debate. Finally, while many have weighed in on the settlement, there are still other potential critics such as the FTC whose statements may also substantially affect congressional and public views of the settlement.

All said

While the settlement takes the nation another step down the road to legislation, it also presents substantial obstacles to passage of legislation. First, the process by which the settlement came to be is troublesome. As noted above, substantial stakeholders -- such as farmers -- were not involved and furthermore the process did not provide for congressional ownership and action on legislation. Second, on a substantive level, the settlement is seriously flawed as the previous analysis sections shows, e.g., limiting FDA authority, inadequate disclosure and financial provisions, lack of real accountability on part of industry to reduce youth smoking, and overly broad anti-trust exemptions. Thus, if the Administration uses the settlement as the basis for moving legislation, the Administration becomes the target of all those criticisms. Given the additional criticisms still to come of the deal (e.g., congressional hearings, FTC analysis) and the need for flexibility in a protracted congressional debate, the settlement finally does not advance the Administration's goal of getting solid and effective tobacco control legislation for the 21st Century.

The primary goal of a Presidential statement must be to give momentum to the legislative process by describing what the Administration wants, by forcing Congress to take responsibility of acting, and by giving the Administration maximum leverage in those negotiations. On issues that the Administrations cares about, the statement should set specific bars but always with an eye to maintaining negotiating leverage. The Administration also wants to involve relevant stakeholders in the process and keep them committed to the process.

Here are the principles that the President could use to lay out his vision for a legislatively-mandated tobacco control policy for the 21st Century:

o Provisions of legislation will be ultimately measured by how well they protect the nation's children and adolescents.

o Preserve FDA's authority over tobacco products, unencumbered by procedural or substantive criteria that may diminish that authority

- No restrictions on factors Agency must consider, types of actions Agency may take or

statutory classifications that Agency must follow
- No altered standards of judicial review
- No treatment for particular types of products or claims

o Ensure that FDA remains flexible to meet the future health challenges of tobacco
- Able to impose additional requirements on marketing and manufacture and to expand Agency's jurisdiction based on changing marketplace or new science

o Hold each tobacco company accountable for reducing the use of tobacco by youths, and ensure that penalties provide real economic incentives

o Achieve maximum disclosure of documents possible
- Public health agencies must have complete and ready access to documents to do their jobs
- Public has right to know and burden should be on industry for proving otherwise

o Recognize that reduction in tobacco use will have major impact on farmers and the economies of their areas and they must be involved in the legislative process

o Provide sufficient financial resources to meet public health goals and address the industry's past behavior
- Money must be additive (not substitute for existing appropriations)
- No tax deductibility

o Create an international strategy that puts the U.S. in a leadership position on tobacco control and mirrors domestic efforts to reduce tobacco use among young people

o Express willingness to discuss other issues, such as civil liability, but only in the context of comprehensive legislative solution that is consistent with principles described above

If the proposed settlement -- even "fixed" -- is enacted into law it will not accomplish what the principles stated above aim to achieve. But if Congress crafts a legislative package that is consistent with these principles, and places public health considerations above all others, then a comprehensive solution and a tobacco control policy for the 21st Century are within our reach.

List of Recommendations:

FDA Authority: "Preserve FDA's authority over tobacco products, unencumbered by procedural or substantive criteria that may diminish that authority, and ensure that FDA remains flexible to meet the future health challenges of tobacco."

Penalties: "Hold each tobacco company accountable for reducing the use of tobacco by youths, and ensure that penalties provide real economic incentives."

Farmers: "Recognize that the reduction in tobacco use will have a major impact on farmers and the economies of their areas and that they must be involved in the legislative process."

Funding: "Recommendation: Provide sufficient financial resources to meet public health goals and address the industry's past behavior. Options: . . . ."

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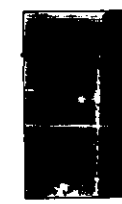
September 5, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed

SUBJECT: Tobacco Update

When you return next week, Secretary Shalala and I will give you detailed recommendations on how to proceed on tobacco. We are scheduled to meet with you on Friday, and you are scheduled to announce your position on Tuesday the 16th. This memo is a brief summary of what we are likely to recommend and what strategic and policy decisions you will need to make.



I. Overview

Although the industry was hoping for quick passage, some Republican leaders in both houses said this week that the tobacco settlement was too complicated for Congress to enact before they adjourn in late October. Lott would still like to get it done this year, but with the legislation being referred to six committees in the Senate alone, we need to stake out positions that can hold up over time.

Over the past two months, we have held extensive discussions with the public health community, attorneys general, members of Congress, and farmers. The public health community will welcome our recommendations on most issues: guaranteeing full authority for FDA to regulate nicotine; imposing tougher penalties on the industry if it fails to reduce teen smoking; demanding an additional $50 billion to offset the credit in the budget agreement; making it somewhat easier to disclose industry documents; looking out for tobacco farmers; and so on. The only concerns of tobacco opponents that we cannot easily meet are dramatically increasing the overall price tag (Kennedy would like to see it doubled, to $700 billion) and demanding to see all the documents before capping liability (Leahy, Waxman, and Skip Humphrey are pushing for "no immunity without disclosure").

The central strategic question is how far we want to push the industry for

additional concessions, at the risk of losing this opportunity altogether. Bruce Lindsey and I have repeatedly pressed the industry on the most important issues -- FDA, penalties, and documents -- with only modest progress. We met with them again today, and will continue to press them next week, but penalties remain a serious stumbling block.

Bruce believes we should not go forward unless we have the industry on board, because without an agreement on everything the industry will be free to use its considerable influence in Congress to undermine provisions it doesn't like -- for example, gutting the FDA provisions if it wins in the 4th Circuit. Secretary Shalala and the Vice President strongly believe we should not reach agreement with the industry, because any deal with tobacco companies will be suspect, and won't have enough congressional buy-in to withstand 6-12 months of debate in Congress.

This debate may become moot, if we can't get the industry to come around by next week on our bottom-line issues. In that case, I believe we should be both tough and reasonable, by demanding more than the industry can stomach right now (on FDA and penalties), but not more than they can possibly swallow in the end. I share Bruce's concerns about the industry's clout and penchant for mischief, but a little tension between us and the industry might actually help us during a drawn-out congressional debate. If we make this a fight over tougher penalties to reduce teen smoking (rather than how much money we want in return for capping liability), I believe we can beat the industry on a few points, even in this Congress -- especially in an election year.

II. Major Recommendations

A. FDA Authority

The first priority of the Administration in considering any tobacco legislation should be to confirm and protect the jurisdiction of the FDA to regulate tobacco products. The FDA must be able to regulate tobacco products, including by ordering the reduction or elimination of nicotine or other constituents, through its normal procedures in the furtherance of public health interests -- without any special procedural rules or requirements. We should call on Congress to pass legislation specifically empowering the FDA to require the modification of tobacco products based on a finding that this change would reduce the risk of the product to the public and is technologically feasible.

The industry still wants to put one hurdle in front of FDA, by saying the FDA may not go forward if a party affirmatively demonstrates that the action would create a significant contraband market in tobacco products. But we believe the FDA should only have to consider contraband as one of many relevant factors,

including the number of addicted tobacco users and the availability of alternative products. We would eliminate two other weaknesses in the settlement -- the 12-year waiting period before FDA could ban nicotine, and the special procedural hurdles such as formal rulemakings.

B. Documents

For decades, the tobacco industry has failed to disclose essential facts in its possession about the dangers and addictiveness of tobacco products, and used attorney-client privilege to cloak scientific research and findings and possibly shield evidence of criminal or fraudulent behavior. It is therefore necessary to establish an effective and speedy mechanism to pierce fraudulent or otherwise improper claims of privilege and to force the disclosure of information that will advance public health interests. The documents issue has become a rallying cry for the most strident opponents of a settlement, led by Skip Humphrey.

The settlement calls for a national documents depository and a three-judge panel to provide expedited rulings on whether documents should remain privileged. We recommend strengthening the document provisions by 1) allowing litigants to challenge privilege claims in individual lawsuits, even if the three-judge panel had already ruled, and 2) providing the FDA with access to all health-related documents, notwithstanding any claims of privilege. That will enable the FDA to put the industry's considerable expertise on nicotine to good use.

Even these steps will not go far enough to please Leahy, Waxman, and Humphrey, who want to break the companies' attorney-client privilege and insist that the tobacco companies disclose all privileged documents before any consideration of a settlement. But the Justice Department has expressed serious concerns about any broad abrogation of the privilege, arguing that such an approach would undermine the privilege generally and might enable a tobacco company official charged with criminal conduct to assert a violation of his Sixth Amendment right to effective assistance of counsel.

C. Penalties

The settlement sets ambitious targets to reduce youth smoking by 30% in 5 years, 50% in 7 years, and 60% in 10 years, and would require companies to pay $80 million for each percentage point they fall short. Public health groups have praised the idea of targets and penalties, but complain that the current scheme does not give companies sufficient incentive to stop hooking teenagers. Our main problems with the current penalties are that they are tax-deductible, abatable, capped at $2 billion, and too small to serve as a deterrent.

We can strengthen the penalties in a variety of ways -- all of which the industry has so far resisted -- but our current preferred option is a two-tier system, with graduated penalties that get stiffer if the industry misses the targets by a substantial margin. The first tier of penalties would require companies to pay $80 million per point if the industry missed the targets by less than 5 points in year 5, less than 10 points in year 7, and less than 15 points in year 10. This penalty would be non-deductible, could not be abated, and would reflect a company's share of the youth market. If the industry missed by a greater margin, companies would pay the full first-tier penalty, and their settlement payment would be increased by a penny a pack for each additional percentage point by which they missed the target. This second-tier penalty would cost companies about $240 million a point, and has the additional virtue of locking in a permanent price increase that will help further reduce smoking by youth (and adults). Under this approach, if youth smoking went down by 30% over 10 years, instead of 60%, the industry would pay $1.2 billion in financial penalties and be forced to raise prices another 15 cents a pack on top of that.

D. Farmers

We have made clear that tobacco farmers should receive protection in any legislative settlement, and that the Administration will work closely with members of Congress from tobacco states to forge a consensus. Secretary Glickman has traveled to tobacco markets in Virginia and North Carolina to express this commitment directly to farmers.

Farmers are primarily interested in continuation of the governmental tobacco program, guaranteed purchase at set levels of tobacco crops by cigarette companies, and some provision for buy out and transition to other crops, on a voluntary basis. Because farm groups and tobacco state members have not yet coalesced around a consensus proposal, we don't need to commit to a specific plan yet. The most discussed proposal is one released this month by Senators Ford and McConnell that would require companies to buy a minimum amount of domestic tobacco over 25 years and would install penalties on companies that do not meet the stated goals for tobacco buying. The proposal would also create a "Tobacco Community Revitalization Fund" administered by USDA, but not subject to the appropriation process, which could spend up to $1 billion a year for 25 years from the settlement fund and would cover costs related to the tobacco program such as administration and crop insurance, make supplemental payments of up to $500 million to producers whose income from tobacco drops substantially below the 1996 level, pay up to $100 million in benefits for displaced cigarette factory workers, and provide up to $250 million a year for rural economic development grants.

E. Funding

Although the settlement is advertised at $368.5 billion, a variety of factors conspire to leave us with considerably less than that to spend on any new initiatives. The $368 billion is a 25-year number, and must be adjusted downward to reflect a projected drop in cigarette consumption of about 15%. For scoring purposes, OMB adjusts the amount down still further to reflect lost business tax revenue and lost federal excise tax revenue from decreased consumption. Most of the rest of the money in the settlement is already spoken for, to pay for civil suits, cessation programs, counteradvertising, and the states' Medicaid claims. The main decision you will need to make is how best to spend the $25 billion research trust fund, which most of us believe should be a 21st Century Research Fund dedicated to cancer and other tobacco-related research.

Some in the Administration (primarily the Treasury Department) and in Congress (led by Kennedy) believe the industry should be soaked for $600-700 billion. This is probably a dealbreaker for the industry, but it would free up additional funds for new initiatives.

F. Other Issues

We will need to propose improvements in other, less prominent areas, which we will detail for you next week. These include limiting the industry's antitrust exemption to prevent unnecessary collusion and removing a little-noticed cap on punitives for future misconduct.

We will give you a more detailed memo on all these recommendations next week, and bring you up to date on our discussions with the industry, the Hill, and the public health community.