

THE WHITE HOUSE

WASHINGTON

September 21, 1998

MEMORANDUM FOR THE CHIEF OF STAFF

FROM: Bruce Reed
Elena Kagan

SUBJECT: Tobacco Update

This memo (1) advises you of recent conversations we have had with an attorney for the industry, which confirm that the industry has no interest in expanding its expected settlement with the states, in the way suggested by Dick Scruggs, to include the federal government; (2) informs you of a recent NGA/NAAG proposal that Congress pass legislation eliminating the federal government's claim for a portion of state tobacco recoveries, and outlines a compromise proposal that Governor Chiles may suggest to you on Tuesday; and (3) outlines a new idea of Bruce Lindsey's to try to use the state settlement discussions to gain clear FDA jurisdiction over tobacco products.

1. Meyer Koplw, the outside counsel for Philip Morris, told us last week that the industry has no interest in bringing the federal government into its settlement discussions with the states. (Our initial conversations with Koplw took place the week before last, but Koplw took some time to speak with his client and get back to us.) According to Koplw, the industry does not think it makes sense to upset the state negotiations, given how close they are to success, in order to pursue a broader settlement whose prospects of completion are highly uncertain. (Koplw, of course, speaks only for Philip Morris, but if Philip Morris is not interested in talking with us, we can bet that no one else is either.)

In explaining this conclusion, Koplw first noted the legal complexities involved in crafting a comprehensive settlement -- in particular, the difficulty of insulating the liability protections and the FDA provisions from legal challenge. Although he thought there was some chance of resolving these issues to all parties' satisfaction, he said (correctly) that we would have to do much hard work before knowing whether such a resolution was possible. Koplw also noted the practical difficulties involved in the Scruggs scheme; for example, he believes that the states would not agree to any arrangement that would subtract punitive damages from their share of the money. Finally, Koplw stressed the "psychological" difficulties of attempting to reach an agreement. The industry, according to Koplw, simply does not trust us; it fears that we will bow to political pressure and increase our demands during negotiations.

Koplow left open the possibility that the industry would want to deal with us separately at some future time, after it had completed the state settlement. He noted that Philip Morris wants to resolve all government claims, including potential claims by the federal government. He implied that the kind of deal Philip Morris contemplates would not necessitate legislation and would include (1) money, (2) FDA jurisdiction, and (3) certain marketing restrictions excluded from the state settlement (in part so the industry has something to offer the federal government). He did not specifically raise liability protections in this context.

2. The National Association of Attorneys General (NAAG) wrote a letter to Congressional leaders last week urging them to pass legislation before Congress adjourns to “clarify that the Health Care Finance Administration should not assert any claims against state tobacco recoveries” (letter attached). We can expect the NGA to support this demand strongly; indeed, Republican Governors probably have talked already with Senator Lott and Speaker Gingrich about moving this legislation. A set of talking points prepared for Democratic Governors, for use in a recent phone call with the Administration, urges us to support the legislation, as does a letter that Senator Graham just sent you (talking points and letter attached).

Governor Chiles is meeting with you on Tuesday, primarily to discuss this issue. (As you know, Florida has a very special interest in the issue because it is one of four states to have completed a settlement with the industry.) Chiles may urge you to support a bill that simply eliminates the federal government’s claim to any tobacco recovery, as described above. His staff, however, has suggested that Chiles may come in with a compromise option, predicated on the agreement we reached with the NGA in the context of the McCain legislation. Under this approach, the federal government would renounce its claim to a state recovery only when the state agreed to use half its money on a menu of seven items: child care; child welfare; the maternal and child health block grant; the substance abuse block grant; the safe and drug free schools program; Eisenhower education grants; and the state match for the children’s health insurance program (subject to a six percent ceiling). This approach would give us exactly what we would have gotten from the “state side” of the McCain legislation, and we should seriously consider it -- especially given the alternative legislation that the NGA and NAAG are proposing.

We should note that any proposal restricting the federal government’s ability to bring claims against the states will involve serious budget issues. The Congressional Budget Office currently projects that the federal government will recoup \$1.2 billion over five years from state tobacco settlements; we can expect the Office to score even Chiles’s compromise approach at approximately that amount. The Governors supposedly have agreed on a plan to reimburse the federal government for this cost, under which they would divide the cost amongst themselves based on their share of the total settlement funds. OMB is currently evaluating this proposal.

3. Bruce Lindsey has proposed a more ambitious plan for using our recoupment claims as leverage to get something out of a state settlement. Under the Lindsey plan, we would drop our recoupment claims if a state agreed to (1) take 45 percent of the money unrestricted; (2) use

45 percent of the money for the seven items on our menu; and (3) give over 10 percent of the money to a "tort fund" which would pay legal judgments against the industry. If the judgments failed to exhaust the tort fund, the remaining money in the fund would return to the unrestricted state pot. Conversely, if the judgments exceeded the tort fund, the remaining liability would come out of the restricted state pot -- and if that too were exhausted, would revert to the industry. In exchange for this potentially valuable benefit the industry would agree to FDA jurisdiction -- if possible, through the settlement itself; if not, by dropping its opposition to legislation.

The great virtue of this scheme is that it could make the state settlement partly our victory: if everything works correctly, we would achieve the important goal of full FDA jurisdiction. The scheme, however, raises at least three questions. First, we may not be able to convert this deal into an effective guarantee of FDA jurisdiction. The legal difficulty of getting regulatory jurisdiction through a settlement is heightened in this scheme because we probably could not be a party to the agreement; moreover, the industry's assurance that it would not fight a legislative solution (even if it is believed) hardly guarantees the result we want in a Congress replete with FDA-haters. Second, even if we could surmount this problem, the states may well refuse to consider this plan, given that it puts more than half of their money at risk of going back to the industry for legal judgments. Third, the left in our own party may react with outrage to this agreement, arguing that we effectively have "bought" FDA jurisdiction by granting the industry relief from liability. We would have to explore these questions more thoroughly before pursuing this option.