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APR 10 1998

THE WHITE HOUSE
WASHINGTON

April 9, 1998

THE PRESIDENT HAS SEEN

4-13-98

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed
Elena Kagan

SUBJECT: McCain Legislation

With the overwhelming vote in favor of the McCain legislation in the Senate Commerce Committee and the subsequent announcement of the tobacco industry that it will fight this legislation, we have entered into a new phase of our effort to procure a comprehensive tobacco bill to reduce youth smoking. The Commerce Committee vote last week brought new momentum to this legislative effort. The industry's response should only add to that momentum, by making it even harder for Members of Congress to block legislation, lest they look as if they are doing the industry's bidding.

The broad consensus among your advisors is that we should aim for a strong, comprehensive bill that meets our core public health objectives and that the industry might reluctantly swallow in the end. Without industry consent, some provisions in comprehensive legislation (i.e., the most far-reaching advertising restrictions) would be impossible, while other provisions (e.g., narrower advertising restrictions and lookback penalties) would be in litigation for years. We should not compromise our objectives to secure that consent, but at the same time we should not ask for more than we need to achieve our public health goals and in the process destroy any chance of industry acquiescence. In any event, most of your advisors believe that efforts to push the price too far would be counterproductive, because tobacco-state Democrats will join with Republicans to derail a bill that goes as far as some in the public health community might like. Instead, we should try to address the aspects of the McCain bill that are most important to us and to securing broad Democratic support.

Copied
Reed
Kagan
Bowie

Your advisors also agree that the best way to get this kind of bill is to engage in negotiations with Senators Lott, Daschle, McCain, and Hollings that are designed to produce an agreed-upon bill to go to the Senate floor. The greatest danger we face is chaos on the Senate floor, in which some amendments roll back what we already have achieved (e.g., on FDA jurisdiction), while other amendments make the bill essentially unpassable (e.g., by stripping all liability protections while increasing the overall price of the deal).

We recommend against direct discussions with the industry at this stage; we doubt they would level with us anyway. Assuming Senator Hollings is in the room, we should have a decent sense of the industry's concerns, and of course we have more-than-adequate lines of communication to the public health community.

PHOTOCOPY
WJC HANDWRITING

4-13-98

We list below several aspects of the McCain legislation in which we should seek changes during these negotiations. Note that FDA jurisdiction does not appear on this list; we were able to reach an agreement on this issue with Senators McCain and Frist, prior to the Commerce Committee vote, that satisfies all our regulatory needs and objectives.

I. Youth Lookback Penalties

We already have said that Congress must strengthen the lookback penalties in the McCain legislation, by incorporating some company-specific penalties and raising the cap on the industry surcharge. The incorporation of some company-specific penalties is a core demand of the public health community, and is strongly supported by HHS and Treasury. Such penalties, however, may be unacceptable to the industry, and especially to Phillip Morris because of its disproportionately large share of the youth market. (Unlike industrywide penalties, which can be passed on in the form of higher prices, company-specific penalties come straight out of a company's profits.) Bruce Lindsey has noted that even if we need to make demands in this area, we should not let the issue of company-specific penalties become grounds for vetoing the bill. We agree, but think it is important to try to find a way to address this issue.

A number of approaches are available, and we should not now tie ourselves down to any of them. A company-specific penalty developed by Treasury and HHS would impose a \$500 fee for every child by which a company misses the targets (i.e., if a company misses the target by 10,000 children, it would pay a fee of \$5,000,000). This per-child surcharge represents the present value of the profits a company would gain from addicting a teenager over his lifetime. Treasury estimates that the total cost of this penalty -- i.e., across all companies -- could reach as much as \$500 million a year. Another approach, probably more acceptable to the industry, would be to allow suits between companies for redistribution of the industry-wide penalty. Such indemnification suits would create a potential for transforming the industry surcharge into a company-specific penalty scheme, without increasing the overall cost of the penalty provisions. We will continue to try to develop creative solutions in this area so that we can enter negotiations with a range of proposals.

Raising the cap on industry-wide penalties is obviously an easier matter. We would suggest proposing a change from the current \$3.5 billion to \$4 to \$5 billion if possible.

II. Price per Pack and Spending

Price per Pack

We should not demand any increase in the McCain bill's funding levels in the first five years, because McCain essentially adopted our own budget numbers (while adding a \$10 billion up-front payment). We recommend waiting until CBO scores the McCain bill before deciding whether to seek any increase in funding levels in later years. (McCain has asked CBO to score his bill by the time Congress returns.) Congressional scorekeepers may well estimate that the

yearly payments in the bill will increase the price of cigarettes not by the \$1.10 we estimated, but by the \$1.50 that the public health community has most often demanded. The higher figure may result from assumptions by CBO that (1) states will use the opportunity to increase state excise taxes, further reducing the number of packs sold and (2) the bill will significantly increase the black market for cigarettes, resulting in fewer than expected packs sold through the legitimate retail market. By reducing the number of expected packs sold, both of these changes would increase the per-pack price estimate, because the annual industry payment set in legislation would be spread among fewer packs. Once we know the actual per-pack price increase calculated by Congressional scorekeepers, we will be in a better position to determine whether we should push for a small increase in funding levels after the fifth year.

Spending

We hope for bipartisan consensus on much of the spending: we think Members could agree on approximately \$10 billion over 5 years for farmers; \$10 billion for prevention, cessation, counteradvertising, FDA enforcement, and other public health programs; \$10-15 billion for research (the Republicans may want to limit these funds to NIH); and \$20-25 billion for states. This distribution leaves about \$15 billion on the table, which Republicans will want to spend on Medicare or tax cuts and Democrats will want to spend on programs like child care and school construction.

One issue will concern the use of the state money. Our budget earmarked 57 percent of the state funding for child care, class size, and Medicaid outreach initiatives. As we go forward, we should argue at a minimum for a menu of state programs, such as child care and education, on which states would have to use a significant portion of their funds. For example, in the Harkin-Chafee bill, half of the state funds must be spent on one of 20 listed programs, which include child care, K-12 education, Medicaid, the Child Health Insurance Program, and Head Start.

Another issue, more important in the out-years, concerns the amount of money allocated to paying legal judgments. The June 20th settlement put only a few billion dollars into the tort fund in the first five years, on the theory that lawsuits against the industry would take some time to come to judgment. Congress may well use the same assumption, given competing spending priorities. But once this initial grace period is concluded, Congress must figure out how to fund legal judgments. The June 20th settlement placed a \$5 billion annual cap on judgments, with \$4 billion coming from the industry's base payments to the government and \$1 billion (a kind of copayment) from the defendant companies' coffers. The McCain bill establishes a \$6.5 billion cap; McCain contemplated that \$5.2 would come from the industry's base payments, with \$1.3 as a copayment, but his bill does not actually address this issue. Some in the public health world may begin to call for the entire amount to be paid by the companies, outside of their payments to the government. This change, however, would add an enormous amount to the total cost of the deal and could doom prospects for legislation. Room for a tort fund thus will have to be found in the out-years by squeezing some of the spending listed above.

4-13-98

III. Antitrust Exemption

The McCain bill contains antitrust exemptions for the tobacco industry that are not necessary to achieve the goals of the legislation and may have serious anticompetitive effects. As written, the bill exempts any and all agreements designed to "reduce the use of tobacco products by underage individuals." This exemption could cover (among other things) price-fixing agreements of all sorts. The Department of Justice believes strongly, and we agree, that we should oppose all antitrust exemptions, except possibly for a narrowly-drawn exemption designed to allow companies to agree to restrict their advertising and marketing to children.

IV. International Tobacco Control Efforts

As part of the public health spending noted above, we believe we should include significant funding (\$200 million a year) for international tobacco control efforts. These funds should be spent on both governmental and non-governmental efforts to promote public health and smoking prevention efforts abroad.

The McCain bill has several additional international provisions that we would like to change so that they do not interfere with our diplomatic and trade priorities. For example, although we support the bill's effort to prohibit U.S. government support for promotion of tobacco overseas, we need to ensure that the language does not interfere with USTR's ability to negotiate tariff reductions or interfere with treatment of other products. In addition, the McCain bill contains a provision that the State Department and HHS consider problematic and unenforceable, which would require U.S. companies to abide by the new labeling and advertising requirements when doing business in other countries. The industry strongly objects to these provisions for a different reason, because it views them as a real threat to its international operations.

V. Environmental Tobacco Smoke

The McCain bill would exempt the hospitality industry (restaurants, bars, casinos, etc.) from its environmental tobacco smoke provisions, which ban smoking, except in enclosed and specially ventilated areas, in public facilities. In addition, the bill would allow individual states to "opt out" of all of the provisions, even if the state had no ETS protections of its own. Although HHS strongly opposes the hospitality exception (workers in the hospitality industry face grave risks from second-hand smoke), we doubt it is politically feasible to remove it. We should, however, try hard to eliminate the state opt-out provision, which could leave many of the nation's citizens without any protection from ETS. Alternatively, we might consider pushing the Harkin-Chafee approach to this issue, which rather than imposing a ban would provide funds to States that progressively reduce exposure to ETS.

4-13-90

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We believe we should adhere to the basic structure of the liability provisions in the McCain legislation. If we need to make these provisions a bit tougher, we can try to raise the cap from the current \$6.5 billion to the \$8 billion contained in Harkin-Chafee. Note, however, that doing so only compounds the budgetary issues surrounding the tort fund noted earlier in this memo: to the extent that money for tort judgments come from the industry's payments to the government, that money squeezes out funds for public health and other priorities; conversely, to the extent that money for tort judgments comes over and above the industry's payments to the government, the expected cost of the deal to the industry increases.

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Finally, we may want to change the provisions in the McCain legislation that deny the liability cap to certain companies. The current provision, which has received almost no attention, lifts the cap for companies that miss the youth lookback target by more than 20 percentage points if they also have violated the Act or taken action to "undermine the achievement of youth smoking reductions." Because of the vagueness of this standard, the provision may have little or no effect. We should either tighten it (by linking the cap only to objective measures) or discard it entirely. Especially if we try to make the liability provisions tougher in other areas, agreeing to eliminate the provision may prove useful.

VII. Constitutional Issues

The Department of Justice is prepared to recommend changes to the advertising, marketing, and other speech-related provisions of the legislation in the event that the industry does not sign protocols agreeing to these restrictions. The Department also would like us to press for the elimination of all provisions regulating non-commercial speech, such as one that forbids companies from lobbying Congress, regardless whether the companies offer agreement.

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Conclusion

In summary, we would recommend seeking these improvements:

Youth Lookback Penalties

- Incorporate some company-specific component in the penalty scheme
- Increase the industry-wide surcharge cap from \$3.5 billion to between \$4 and \$5 billion

Price and Spending

- No change in annual payment amounts in first five years; wait until CBO scores before deciding whether to seek later changes
- Ensure spending on research, public health, and farmers, press for spending on child care and education, or at least a menu including these programs

Antitrust Exemption

- Eliminate the antitrust exemption

International Tobacco Control

- Support funding for governmental and non-governmental organizations
- Narrow provision prohibiting U.S. support for promotion of tobacco overseas to ensure it does not interfere with USTR authority to negotiate treaties
- Remove requirement that companies must abide by new labeling and marketing requirements when operating overseas

Environmental Tobacco Smoke

- Eliminate "opt-out" provision that allows states to adopt weaker laws

Liability

- Retain basic structure of liability priorities
- Consider modifying level of cap and relation of cap to youth reduction targets

Constitutional Issues

- Recommend changes to minimize Constitutional difficulties

WHITE HOUSE STAFFING MEMORANDUM

CLOSE HOLD

Date: 4/11/98

ACTION / CONCURRENCE / COMMENT DUE BY: _____

Subject: MCCAIN LEGISLATION

	ACTION	FYI		ACTION	FYI
VICE PRESIDENT	<input type="checkbox"/>	<input checked="" type="checkbox"/>	McCURRY	<input type="checkbox"/>	<input type="checkbox"/>
BOWLES	<input type="checkbox"/>	<input checked="" type="checkbox"/>	McGINTY	<input type="checkbox"/>	<input type="checkbox"/>
McLARTY	<input type="checkbox"/>	<input type="checkbox"/>	NASH	<input type="checkbox"/>	<input type="checkbox"/>
PODESTA	<input type="checkbox"/>	<input checked="" type="checkbox"/>	REED	<input type="checkbox"/>	<input type="checkbox"/>
MATHEWS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	RUFF	<input type="checkbox"/>	<input type="checkbox"/>
RAINES	<input type="checkbox"/>	<input type="checkbox"/>	SMITH	<input type="checkbox"/>	<input type="checkbox"/>
BEGALA	<input type="checkbox"/>	<input type="checkbox"/>	SOSNIK	<input type="checkbox"/>	<input type="checkbox"/>
BERGER	<input type="checkbox"/>	<input type="checkbox"/>	SPERLING	<input type="checkbox"/>	<input type="checkbox"/>
BLUMENTHAL	<input type="checkbox"/>	<input type="checkbox"/>	STEIN	<input type="checkbox"/>	<input checked="" type="checkbox"/>
ECHAVESTE	<input type="checkbox"/>	<input type="checkbox"/>	STERN	<input type="checkbox"/>	<input type="checkbox"/>
EMANUEL	<input type="checkbox"/>	<input checked="" type="checkbox"/>	STRETT	<input type="checkbox"/>	<input type="checkbox"/>
GIBBONS	<input type="checkbox"/>	<input type="checkbox"/>	VERVEER	<input type="checkbox"/>	<input type="checkbox"/>
IBARRA	<input type="checkbox"/>	<input type="checkbox"/>	WALDMAN	<input type="checkbox"/>	<input type="checkbox"/>
KLAIN	<input type="checkbox"/>	<input type="checkbox"/>	YELLEN	<input type="checkbox"/>	<input type="checkbox"/>
LEWIS	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
LINDSEY	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
MARSHALL	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
			_____	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

THIS HAS BEEN SENT TO POTUS

RESPONSE:

CLOSE HOLD

THE WHITE HOUSE

WASHINGTON

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Comments:

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WHITE HOUSE STAFFING MEMORANDUM

CLOSE HOLD

Date: 4/11/98

ACTION / CONCURRENCE / COMMENT DUE BY:

Subject: MCCAIN LEGISLATION

	ACTION	FYI		ACTION	FYI
VICE PRESIDENT	<input type="checkbox"/>	<input checked="" type="checkbox"/>	McCURRY	<input type="checkbox"/>	<input type="checkbox"/>
BOWLES	<input type="checkbox"/>	<input checked="" type="checkbox"/>	McGINTY	<input type="checkbox"/>	<input type="checkbox"/>
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MATHEWS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	RUFF	<input type="checkbox"/>	<input type="checkbox"/>
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BERGER	<input type="checkbox"/>	<input type="checkbox"/>	SPERLING	<input type="checkbox"/>	<input type="checkbox"/>
BLUMENTHAL	<input type="checkbox"/>	<input type="checkbox"/>	STEIN	<input type="checkbox"/>	<input checked="" type="checkbox"/>
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GIBBONS	<input type="checkbox"/>	<input type="checkbox"/>	VERVEER	<input type="checkbox"/>	<input type="checkbox"/>
IBARRA	<input type="checkbox"/>	<input type="checkbox"/>	WALDMAN	<input type="checkbox"/>	<input type="checkbox"/>
KLAIN	<input type="checkbox"/>	<input type="checkbox"/>	YELLEN	<input type="checkbox"/>	<input type="checkbox"/>
LEWIS	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
LINDSEY	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
MARSHALL	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
			_____	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

THIS HAS BEEN SENT TO POTUS

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SUBJECT: McCain Legislation

With the overwhelming vote in favor of the McCain legislation in the Senate Commerce Committee and the subsequent announcement of the tobacco industry that it will fight this legislation, we have entered into a new phase of our effort to procure a comprehensive tobacco bill to reduce youth smoking. The Commerce Committee vote last week brought new momentum to this legislative effort. The industry's response should only add to that momentum, by making it even harder for Members of Congress to block legislation, lest they look as if they are doing the industry's bidding.

The broad consensus among your advisors is that we should aim for a strong, comprehensive bill that meets our core public health objectives and that the industry might reluctantly swallow in the end. Without industry consent, some provisions in comprehensive legislation (i.e., the most far-reaching advertising restrictions) would be impossible, while other provisions (e.g., narrower advertising restrictions and lookback penalties) would be in litigation for years. We should not compromise our objectives to secure that consent, but at the same time we should not ask for more than we need to achieve our public health goals and in the process destroy any chance of industry acquiescence. In any event, most of your advisors believe that efforts to push the price too far would be counterproductive, because tobacco-state Democrats will join with Republicans to derail a bill that goes as far as some in the public health community might like. Instead, we should try to address the aspects of the McCain bill that are most important to us and to securing broad Democratic support.

Your advisors also agree that the best way to get this kind of bill is to engage in negotiations with Senators Lott, Daschle, McCain, and Hollings that are designed to produce an agreed-upon bill to go to the Senate floor. The greatest danger we face is chaos on the Senate floor, in which some amendments roll back what we already have achieved (e.g., on FDA jurisdiction), while other amendments make the bill essentially unpassable (e.g., by stripping all liability protections while increasing the overall price of the deal).

We recommend against direct discussions with the industry at this stage; we doubt they would level with us anyway. Assuming Senator Hollings is in the room, we should have a decent sense of the industry's concerns, and of course we have more-than-adequate lines of communication to the public health community.

We list below several aspects of the McCain legislation in which we should seek changes during these negotiations. Note that FDA jurisdiction does not appear on this list; we were able to reach an agreement on this issue with Senators McCain and Frist, prior to the Commerce Committee vote, that satisfies all our regulatory needs and objectives.

I. Youth Lookback Penalties

We already have said that Congress must strengthen the lookback penalties in the McCain legislation, by incorporating some company-specific penalties and raising the cap on the industry surcharge. The incorporation of some company-specific penalties is a core demand of the public health community, and is strongly supported by HHS and Treasury. Such penalties, however, may be unacceptable to the industry, and especially to Phillip Morris because of its disproportionately large share of the youth market. (Unlike industrywide penalties, which can be passed on in the form of higher prices, company-specific penalties come straight out of a company's profits.) Bruce Lindsey has noted that even if we need to make demands in this area, we should not let the issue of company-specific penalties become grounds for vetoing the bill. We agree, but think it is important to try to find a way to address this issue.

A number of approaches are available, and we should not now tie ourselves down to any of them. A company-specific penalty developed by Treasury and HHS would impose a \$500 fee for every child by which a company misses the targets (i.e., if a company misses the target by 10,000 children, it would pay a fee of \$5,000,000). This per-child surcharge represents the present value of the profits a company would gain from addicting a teenager over his lifetime. Treasury estimates that the total cost of this penalty -- i.e., across all companies -- could reach as much as \$500 million a year. Another approach, probably more acceptable to the industry, would be to allow suits between companies for redistribution of the industry-wide penalty. Such indemnification suits would create a potential for transforming the industry surcharge into a company-specific penalty scheme, without increasing the overall cost of the penalty provisions. We will continue to try to develop creative solutions in this area so that we can enter negotiations with a range of proposals.

Raising the cap on industry-wide penalties is obviously an easier matter. We would suggest proposing a change from the current \$3.5 billion to \$4 to \$5 billion if possible.

II. Price per Pack and Spending

Price per Pack

We should not demand any increase in the McCain bill's funding levels in the first five years, because McCain essentially adopted our own budget numbers (while adding a \$10 billion up-front payment). We recommend waiting until CBO scores the McCain bill before deciding whether to seek any increase in funding levels in later years. (McCain has asked CBO to score his bill by the time Congress returns.) Congressional scorekeepers may well estimate that the

yearly payments in the bill will increase the price of cigarettes not by the \$1.10 we estimated, but by the \$1.50 that the public health community has most often demanded. The higher figure may result from assumptions by CBO that (1) states will use the opportunity to increase state excise taxes, further reducing the number of packs sold and (2) the bill will significantly increase the black market for cigarettes, resulting in fewer than expected packs sold through the legitimate retail market. By reducing the number of expected packs sold, both of these changes would increase the per-pack price estimate, because the annual industry payment set in legislation would be spread among fewer packs. Once we know the actual per-pack price increase calculated by Congressional scorekeepers, we will be in a better position to determine whether we should push for a small increase in funding levels after the fifth year.

Spending

We hope for bipartisan consensus on much of the spending: we think Members could agree on approximately \$10 billion over 5 years for farmers; \$10 billion for prevention, cessation, counteradvertising, FDA enforcement, and other public health programs; \$10-15 billion for research (the Republicans may want to limit these funds to NIH); and \$20-25 billion for states. This distribution leaves about \$15 billion on the table, which Republicans will want to spend on Medicare or tax cuts and Democrats will want to spend on programs like child care and school construction.

One issue will concern the use of the state money. Our budget earmarked 57 percent of the state funding for child care, class size, and Medicaid outreach initiatives. As we go forward, we should argue at a minimum for a menu of state programs, such as child care and education, on which states would have to use a significant portion of their funds. For example, in the Harkin-Chafee bill, half of the state funds must be spent on one of 20 listed programs, which include child care, K-12 education, Medicaid, the Child Health Insurance Program, and Head Start.

Another issue, more important in the out-years, concerns the amount of money allocated to paying legal judgments. The June 20th settlement put only a few billion dollars into the tort fund in the first five years, on the theory that lawsuits against the industry would take some time to come to judgment. Congress may well use the same assumption, given competing spending priorities. But once this initial grace period is concluded, Congress must figure out how to fund legal judgments. The June 20th settlement placed a \$5 billion annual cap on judgments, with \$4 billion coming from the industry's base payments to the government and \$1 billion (a kind of copayment) from the defendant companies' coffers. The McCain bill establishes a \$6.5 billion cap; McCain contemplated that \$5.2 would come from the industry's base payments, with \$1.3 as a copayment, but his bill does not actually address this issue. Some in the public health world may begin to call for the entire amount to be paid by the companies, outside of their payments to the government. This change, however, would add an enormous amount to the total cost of the deal and could doom prospects for legislation. Room for a tort fund thus will have to be found in the out-years by squeezing some of the spending listed above.

III. Antitrust Exemption

The McCain bill contains antitrust exemptions for the tobacco industry that are not necessary to achieve the goals of the legislation and may have serious anticompetitive effects. As written, the bill exempts any and all agreements designed to "reduce the use of tobacco products by underage individuals." This exemption could cover (among other things) price-fixing agreements of all sorts. The Department of Justice believes strongly, and we agree, that we should oppose all antitrust exemptions, except possibly for a narrowly-drawn exemption designed to allow companies to agree to restrict their advertising and marketing to children.

IV. International Tobacco Control Efforts

As part of the public health spending noted above, we believe we should include significant funding (\$200 million a year) for international tobacco control efforts. These funds should be spent on both governmental and non-governmental efforts to promote public health and smoking prevention efforts abroad.

The McCain bill has several additional international provisions that we would like to change so that they do not interfere with our diplomatic and trade priorities. For example, although we support the bill's effort to prohibit U.S. government support for promotion of tobacco overseas, we need to ensure that the language does not interfere with USTR's ability to negotiate tariff reductions or interfere with treatment of other products. In addition, the McCain bill contains a provision that the State Department and HHS consider problematic and unenforceable, which would require U.S. companies to abide by the new labeling and advertising requirements when doing business in other countries. The industry strongly objects to these provisions for a different reason, because it views them as a real threat to its international operations.

V. Environmental Tobacco Smoke

The McCain bill would exempt the hospitality industry (restaurants, bars, casinos, etc.) from its environmental tobacco smoke provisions, which ban smoking, except in enclosed and specially ventilated areas, in public facilities. In addition, the bill would allow individual states to "opt out" of all of the provisions, even if the state had no ETS protections of its own. Although HHS strongly opposes the hospitality exception (workers in the hospitality industry face grave risks from second-hand smoke), we doubt it is politically feasible to remove it. We should, however, try hard to eliminate the state opt-out provision, which could leave many of the nation's citizens without any protection from ETS. Alternatively, we might consider pushing the Harkin-Chafee approach to this issue, which rather than imposing a ban would provide funds to States that progressively reduce exposure to ETS.

VI. Liability Provisions

We believe we should adhere to the basic structure of the liability provisions in the McCain legislation. If we need to make these provisions a bit tougher, we can try to raise the cap from the current \$6.5 billion to the \$8 billion contained in Harkin-Chafee. Note, however, that doing so only compounds the budgetary issues surrounding the tort fund noted earlier in this memo: to the extent that money for tort judgments come from the industry's payments to the government, that money squeezes out funds for public health and other priorities; conversely, to the extent that money for tort judgments comes over and above the industry's payments to the government, the expected cost of the deal to the industry increases.

Finally, we may want to change the provisions in the McCain legislation that deny the liability cap to certain companies. The current provision, which has received almost no attention, lifts the cap for companies that miss the youth lookback target by more than 20 percentage points if they also have violated the Act or taken action to "undermine the achievement of youth smoking reductions." Because of the vagueness of this standard, the provision may have little or no effect. We should either tighten it (by linking the cap only to objective measures) or discard it entirely. Especially if we try to make the liability provisions tougher in other areas, agreeing to eliminate the provision may prove useful.

VII. Constitutional Issues

The Department of Justice is prepared to recommend changes to the advertising, marketing, and other speech-related provisions of the legislation in the event that the industry does not sign protocols agreeing to these restrictions. The Department also would like us to press for the elimination of all provisions regulating non-commercial speech, such as one that forbids companies from lobbying Congress, regardless whether the companies offer agreement.

Conclusion

In summary, we would recommend seeking these improvements:

Youth Lookback Penalties

- Incorporate some company-specific component in the penalty scheme
- Increase the industry-wide surcharge cap from \$3.5 billion to between \$4 and \$5 billion

Price and Spending

- No change in annual payment amounts in first five years; wait until CBO scores before deciding whether to seek later changes
- Ensure spending on research, public health, and farmers, press for spending on child care and education, or at least a menu including these programs

Antitrust Exemption

- Eliminate the antitrust exemption

International Tobacco Control

- Support funding for governmental and non-governmental organizations
- Narrow provision prohibiting U.S. support for promotion of tobacco overseas to ensure it does not interfere with USTR authority to negotiate treaties
- Remove requirement that companies must abide by new labeling and marketing requirements when operating overseas

Environmental Tobacco Smoke

- Eliminate "opt-out" provision that allows states to adopt weaker laws

Liability

- Retain basic structure of liability priorities
- Consider modifying level of cap and relation of cap to youth reduction targets

Constitutional Issues

- Recommend changes to minimize Constitutional difficulties