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THE WHITE HOUSE
WASHINGTON

August 22, 1998

MEMORANDUM FOR THE PRESIDENT

THROUGH: Erskine Bowles
FROM: Bruce Reed
Elena Kagan
SUBJECT: Tobacco Idea

Dick Scruggs called us yesterday with an idea for how to achieve our goals on tobacco without legislation. We have discussed this idea with Erskine, and all of us believe that it is very interesting. If you agree that Scruggs's suggestion is worth pursuing, Erskine will take the steps necessary to do so. Until he does, we should not raise this idea with anyone else.

Scruggs proposes that the federal government enter into a consent decree with the tobacco companies to settle our claims for Medicare costs. As a matter of mechanics, we probably would do this by filing two documents simultaneously with a court: a complaint against the companies and a proposed settlement agreement.

Under Scruggs's proposed consent decree, the companies would make the payments called for in the June 20th settlement agreement -- i.e., \$368 billion plus capped industry-wide lookbacks. About \$200 billion of this amount would go to states settling their own suits against the companies, with the remainder going to the federal government. Any state that wished to continue its suit against the companies could do so, but the state's share of the money then would revert to the federal government. Scruggs had no view on whether the states should have to use some portion of their money for specified purposes (e.g., child care). He did note that the federal government would have to leave the full \$200 billion with the states, rather than seek to recapture its usual share of Medicaid recoveries.

In addition to containing these monetary provisions, the consent decree would require the companies to drop their legal challenge to the FDA rule and to accept the FDA's assertion of jurisdiction over tobacco products. The decree also would mandate that the companies adhere to all the youth access and advertising restrictions contained in the June 20th settlement agreement.

The consent decree of course could not give the companies the liability protections contemplated in the June 20th agreement; for that, an act of Congress is necessary. Scruggs suggests, however, that the decree contain some kind of set-off or credit for punitive damages. Under the scheme he proposes, a company could subtract from its required payment to a state any punitive damages awarded against the company in that state's courts, up to the full amount



of the required payment. Scruggs believes that the states will go along with this provision, even though it appears to put everything they get out of the settlement at some risk (at least if their courts award punitive damages).

Scruggs also proposes that the consent decree give the settling companies some kind of protection against new entrants to the tobacco market (or existing companies with tiny market shares). This protection, according to Scruggs, is necessary to alleviate the fear of the companies that agreeing to this settlement will allow new companies to undercut them. Although Scruggs is uncertain about precisely how to provide this protection, he suggests that the FDA agree to regulate settling companies somewhat differently from other companies -- for example, by agreeing not to ban products manufactured by settling companies, but retaining authority to ban products manufactured by all others.

Erskine and we believe that as outlined here and putting aside all legal questions, the settlement is deficient in two respects. First, the settlement does not include any protection for farmers. We could solve this problem by insisting that the companies agree to purchase a set amount of tobacco leaf each year from American farmers. Second, the settlement seems slightly underfunded. We need to get something -- even if not much -- more than the original \$368 billion (perhaps the \$428 in Senator Hatch's bill) to sell this settlement as a huge victory.

Even more important, we will have to address a number of legal issues before we can enter into this kind of settlement. First, we will have to figure out a legal way of giving about \$200 billion in settlement monies to the states; this provision potentially conflicts with the federal government's obligation to place legal awards in the U.S. Treasury for later appropriation by Congress or with the federal government's obligation to recoup a portion of state Medicaid recoveries. Second, we will have to find a sure way to protect the FDA rule; the settling companies' agreement to drop their suit is insufficient if other parties (*e.g.*, retailers, advertisers, other manufacturers) can continue the suit, or bring a very similar suit the next morning. Third, we will have to inspect very closely any proposals to give a competitive advantage to settling companies, in light of both our antitrust policies and our regulatory objectives.

All that said, we think this approach presents us with an exciting opportunity. According to Scruggs, key Wall Street analysts have told him that the industry might well be interested in this kind of deal. (Scruggs claims not to have talked with industry officials.) We think you should give Erskine the go-ahead to send out some feelers.

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