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Bootleggers, Baptists, and Televangelists

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There's a new player in Yandle's classic dynamic.

Bootleggers, Baptists, and Televangelists

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In 1998, 46 state attorneys general, together with a group of private attorneys, reached a Master Settlement Agreement with Philip Morris, R.J. Reynolds, Brown & Williamson, and Lorillard, the nation's four largest cigarette manufacturers. The agreement effectively imposed a hefty tax on smokers nationwide to fund billions of dollars in payouts to the states (and the participating private attorneys) and created barriers to entry into the cigarette business to protect the signatories from price competition. The agreement included a model statute that states had to adopt in order to receive the cash, foreclosing the opportunity for state legislatures to exercise independent review of the settlement. One observer of the agreement described it as "the largest privately negotiated transfer of wealth arising out of litigation in world history."

The settlement and proposed statute substituted a private agreement for the normal processes of regulation and taxation. They dramatically reduced the public's opportunity to participate in both and to hold accountable those responsible for regulatory burdens and tax increases. How Americans ended up with regulation and taxation without representation is a story of "bootleggers, Baptists, and televangelists."

BOOTLEGGERS AND BAPTISTS

In 1983, economist Bruce Yandle published an article in *Regulation* entitled "Bootleggers and Baptists: The Education of a Regulatory Economist." In the article, Yandle set out a crucial insight of public choice theory using the metaphor of the implicit coalition of bootleggers and Baptists behind laws that forbade liquor sales on Sundays. He noted that despite their quite different views on liquor generally, bootleggers and Baptists shared a common interest in restricting Sunday sales. The Baptists, of course, opposed liquor sales generally for moral reasons. The bootleggers wanted to restrict competition on Sundays from legal liquor sellers. While the bootleggers could hardly lobby explicitly for Sunday closing on the grounds that it would allow them to charge more for their product, they could use Baptist arguments to support politicians who publicly supported Sunday closing laws. The implicit coalition of bootleggers and Baptists thus married the economic muscle of the bootleggers to the publicly acceptable policy arguments of the Baptists, allowing both groups to achieve a policy objective neither was strong enough to obtain on its own. Much regulation, Yandle surmised, is the product of similar coalitions.

The history of tobacco regulation includes quite a few episodes of bootleggers-and-Baptists coalitions in the 1960s and 1970s. While there were sporadic efforts to suppress tobacco use almost from the time it appeared in Europe – James I of England published *A Counter-Blaste to Tobacco* in 1604, denouncing smoking as "a custom loathsome to the eye, hateful to the nose, harmful to the brain, dangerous to the lung, and the black stinking fume thereof, nearest resembling the horribly Stygian smoke of the pit that is bottomless" – serious regulatory efforts appeared in the United States only in the 1960s. Prior to then, smoking was a widely accepted practice that government at all levels mostly ignored. Indeed, the federal Food and Drug Administration had been explicitly foreclosed from regulating tobacco when it was created by the 1906 Pure Food and Drug Act and the agency consistently foreswore any jurisdiction over smoking even after the 1938 Food, Drug and Cosmetic Act granted the agency powers over "articles (other than food) intended to affect the structure or any function of the body," a definition that arguably could have been read to include cigarettes as nicotine delivery devices. When confronted with proposed amendments to the food and drug laws to give the FDA jurisdiction,

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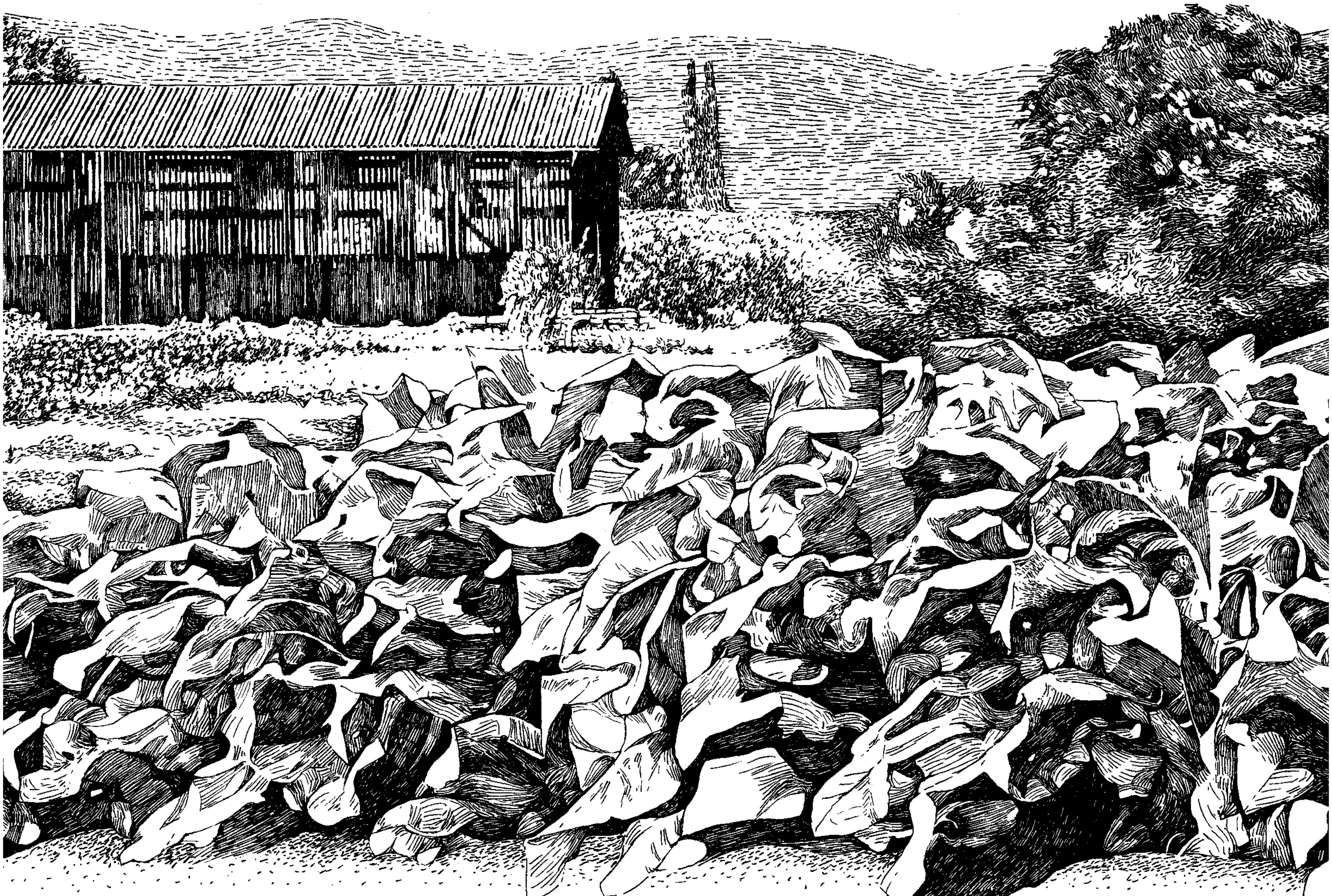
Congress repeatedly rejected such efforts.

A 1953 study of the impact of the tar from tobacco smoke on mice prompted widespread discussion of health concerns about smoking. Responding to the demand for safer cigarettes, manufacturers introduced low-tar brands and added filters to existing brands, resulting in what became known as the "tar derby," an expensive competition to improve safety. When anti-smoking groups demanded government action, however, the tobacco companies were able to negotiate a deal with the Federal Trade Commission to ban all tar and nicotine claims from cigarette advertising, short-circuiting market pressures for safer cigarettes by eliminating health effects as a margin for competition. Although the FTC touted the ban as an example of "industry-government cooperation in solving a pressing problem," the reality was that the "bootleggers" had just succeeded in using "Baptist" rhetoric to reduce competition. As Lee Fritschler concluded in his 1969 analysis of tobacco policy, the regulatory climate of the period was imbued with "a spirit of friendly and quiet cooperation between Congress, the bureaucracy, and the interest group community."

When Surgeon General Luther Terry convened a committee in 1962 to review the scientific evidence on smoking's health effects, health regulators spotted an opportunity to expand their regulatory authority. Only a week after the committee issued its report, the FTC proposed sweeping regulations requiring health warnings on cigarette packages and advertisements, arguing that not telling consumers about potential health effects was an unfair and deceptive trade practice that it had authority to prohibit. Congress, where senators and representatives from tobacco states held powerful positions as a result of the seniority system for committee assignments and the safe seats of many Southern members of Congress, disagreed. After persuading the FTC to withdraw its proposed regulations, the tobacco industry's lobbying team put together a successful legislative package with weaker warning labels and preemption of state and local warning label requirements, and succeeded in moving the debate to the more sympathetic terrain of the halls of Congress. So favorable to tobacco interests was the resulting statute that anti-smoking activists denounced it as "one of the dirtiest pieces of legislation ever." The bootleggers had triumphed over the Baptists again.



MORGAN BALLARD

The bootleggers-and-Baptists pattern was repeated several times during the 1960s. In 1967, John F. Banzhaf III, a New York attorney in private practice, successfully persuaded the Federal Communications Commission to apply the fairness doctrine to tobacco advertising, requiring television stations to provide organizations like the American Lung Association with free anti-smoking ads when they aired tobacco ads. Banzhaf's success persuaded him to leave practice and start up Action on Smoking and Health, one of the first national health interest groups focused on tobacco. (Banzhaf eventually became a law professor at George Washington University and remains active on tobacco issues. His webpage notes approvingly that he has been called "the Osama bin Laden of Torts" and a "Legal Flamethrower.")

The anti-smoking campaign took its toll on sales. Per-capita cigarette consumption fell by 5.7 percent between 1967 and 1970. After the FCC's position was upheld by the courts (in part because of clever lawyering by Banzhaf that maneuvered the appeal into the D.C. Circuit instead of the presumably tobacco-friendly territory of Richmond, Va., and the Fourth Circuit), the FCC prepared to launch additional anti-tobacco regulations.

Again the industry turned to Congress for help and successfully obtained a complete ban on advertising in electronic media beginning in 1971 as a result of the Public Health Cigarette Smoking Act of 1969. The ban not only saved the cigarette companies future ad bills (they spent $200 million on electronic media ads in 1969) and got rid of the anti-smoking public service announcements, but it created a substantial barrier to entry for potential competitors. Since the established brands already enjoyed widespread name recognition, their television and radio advertising was largely aimed at nibbling away at the other established brands' market share and repelling competing brands' efforts to do the same. For a new brand, however, television and radio offered virtually the only way to create quickly an identity for a product. Without access to electronic media, it would be much harder for a new competitor to break into the cigarette market. And without the anti-tobacco ads, per-capita tobacco consumption began to rise again after 1970, returning to 1967 levels by 1973. (A new decline set in then, but the drop was more gradual this time.) Once again, the bootleggers came out of the deal with a good deal more than the Baptists did.

Bootlegger strength on Capitol Hill and in presidential politics protected tobacco into the 1980s. For example, when Joseph Califano, Jimmy Carter's secretary of health, education and welfare, launched an anti-tobacco initiative in 1978 by calling cigarettes "Public Enemy No. 1," Carter quickly distanced himself from Califano's comments, traveling to North Carolina to tell an audience of tobacco warehousemen that he admired "the beautiful quality of your tobacco." Carter's top White House health aide, Peter Bourne, told the American Cancer Society that tobacco had "emotionally stabilizing effects." Califano's friend, Sen. Edward Kennedy, eventually told Califano to resign in April 1979 because his comments jeopardized the Democratic ticket in the South.

Partly as a result of its success in the 1970s, tobacco largely went undisturbed by federal regulators until Clinton administration FDA commissioner David Kessler made an effort to assert his agency's jurisdiction over tobacco. The bootleggers-and-Baptists era of tobacco regulation thus has to be scored as an overall win for the bootleggers.

LAWYERS AND LITIGATION

In addition to periodic assaults by regulators, tobacco companies have experienced three waves of private litigation over the health effects of smoking. The first wave began in 1954 when the first of more than 100 suits were brought on behalf of smokers against tobacco companies under theories of negligence, breach of implied warranty, and breach of express warranty. The tobacco companies successfully argued that smokers knew that smoking was potentially hazardous, making sure that their legal point got through by hiring many of the best law firms in the country to defend the suits and overwhelming the lawyers from small personal injury firms who represented the plaintiffs. By the mid-1960s, this first wave was over and the tobacco companies had not lost a single case.

In 1983, a second wave of tobacco suits began. Using new data on health effects, a group of entrepreneurial plaintiffs' lawyers began suing under theories of strict liability and failure to warn. This time the plaintiffs' bar coordinated their actions to allow them to combine resources in an effort to compete with tobacco's "wall of flesh" defense strategy. Unfortunately for the plaintiffs, the federal warning labels undercut their cases by bolstering the tobacco companies' claim that smokers had assumed the risk of smoking. And juries rarely proved willing to entertain plaintiffs' claims, reasoning that while the tobacco companies may not have been forthright about the exact nature of tobacco's dangers, smokers had to have understood that there was serious risk involved in smoking.

Once again the tobacco companies triumphed, although their victory was tarnished by the public relations disaster of disclosing numerous confidential documents that painted them in an unflattering light. Not only had discovery unearthed much that the tobacco companies wished to keep hidden, but a series of high-profile internal whistleblowers leaked additional documents. (Northeastern University law professor Richard Daynard played a crucial role in ensuring that the documents received widespread dissemination and in coordinating the plaintiffs' suits.)

A new group of attorneys began a third wave of suits in 1992. This time the tobacco powerhouse had an adversary with significant resources: lawyers who had made fortunes in asbestos litigation. Their experience had taught them tactics like "massing up" claims to make the risk of loss unacceptable to defendants. At the top of the plaintiffs' bar, the lawyers had both the resources to pursue a long-term litigation strategy and the professional desire to attain what Dan Zegart's generally flattering account of the tobacco litigation termed "Mount Everest, or maybe Fort Knox." To overcome the assumption-of-risk defense, some of the third-wave cases were built around clients who could claim damages from smoking by others. For example, a class action was filed on behalf of airline stewards affected by secondhand smoke on planes. But avoiding smokers as plaintiffs also kept potential damage awards low, making the suits less economically rewarding for the lawyers. One group of 60 firms pooled contributions (at $100,000 per year per firm) to fund a national class action for $100 billion on behalf of smokers for the costs of the smokers' addiction to nicotine, but this failed when the relatively conservative federal Fifth Circuit Court of Appeals refused to approve the certification of the class. Despite the better funding and the documents from the whistleblowers and the second-wave suits, the third-wave suits were not succeeding.

However, the suits were costing the tobacco companies money. By 1997, the six largest companies were spending $600 million per year on legal bills. And the companies had a legitimate worry that eventually this group of plaintiffs' lawyers might succeed in cracking open "Fort Knox" by winning a case. Despite their success, by the mid-1990s the tobacco companies were in a difficult position.

The bootleggers were in need of new allies because the risk of seemingly endless litigation was taking its toll on their stock prices.

RISE OF THE TELEVANGELISTS

By the 1990s, the regulatory Baptists were tired of their role in the tobacco wars. Each of their victories – banning TV ads, restrictions on tar and nicotine advertising, warning labels – had proven to be helpful for the regulatory bootleggers. But the bootleggers were in need of new allies because the risk of the seemingly endless litigation from the third-wave lawsuits was taking its toll on their stock prices. This led to the rise of the regulatory "televangelists."

As part of the effort to overcome the assumption-of-risk defense, a small group of plaintiffs' lawyers had come up with the idea of suing on behalf of a plaintiff who had never smoked yet had suffered extremely large damages: state governments. State Medicaid programs had paid out considerable sums for smokers' illnesses. If the states could be persuaded to sign on as plaintiffs, the damages could be considerable.

Although the various accounts of the origins of the Medicaid reimbursement theory differ on how much credit is due to which participant, it is generally accepted that Mississippi plaintiffs' counsel Richard "Dickie" Scruggs played a crucial role. (Scruggs was recently in the news when he pleaded guilty in March 2008 to attempting to bribe a judge in an unrelated case.) Not only was Scruggs wealthy enough from his successful asbestos and tort practice, but his law school classmate Michael Moore (no relation to the filmmaker) had become Mississippi's attorney general. Moore brought to the table his ability to commit Mississippi to the lawsuits. (This was not a foregone conclusion; Mississippi governor Kirk Fordice sued Moore in an attempt to withdraw the state from the case. The Mississippi Supreme Court ruled in Moore's favor.) The two soon planned a campaign against the cigarette companies that would combine a public interest rationale with the financial and tactical power of the top plaintiffs' firms in the country and Mississippi filed the first suit in May 1994. Using Scruggs' jet, Moore toured the country, persuading other attorneys general to file their own suits. Minnesota and West Virginia filed suits later that year and Florida and Massachusetts brought suits in 1995. More soon followed and ultimately every state participated.

The attorneys general had several motives for participating. First, bashing tobacco had become good politics as the industry's public image sank as the revelations from the internal documents continued to leak out. Second, there was potentially a great deal of money on the table in any favorable resolution of the claims, both for the lawyers involved (who might then make generous campaign donations to the attorneys general) and for the states (whose grateful legislators might then support the attorneys general in future endeavors). Third, all but seven states choose their attorneys general by election, and the position has traditionally been a stepping stone to higher office. The publicity surrounding the suits was itself valuable for the state attorneys general.

To enhance their suits, some states followed Florida's lead and changed state laws retroactively to make the suits easier to prove. And, although a small number of elite plaintiffs' lawyers provided the legal muscle and financial resources for most states' suits, the states began adding local firms as co-counsel. The local firms typically brought little to the table besides connections to state attorneys general and other officials – and a healthy appetite for fees. (Texas attorney general Dan Morales and a lawyer friend were ultimately convicted of federal charges in connection with Morales' efforts to award the friend 3 percent of Texas' $17.5 billion settlement.)

An important feature of the states' suits was that they were predicated upon forcing a settlement. The claims in the lawsuits were sufficient to get past motions to dismiss – if only because a state judge was unlikely to reject out-of-hand a claim brought by his state's attorney general that held out the promise of billions of revenue for the state treasury. But the lawsuits would have been extraordinarily risky for the public and private lawyers to take to trial. Not only had the private attorneys invested millions in the cases, but trying the cases would expose the weaknesses in the legal theories to more scrutiny than they might be able to stand. Mimicking the asbestos tactic of "massing up" claims, Moore and Scruggs and the other early participants pushed hard to build a broad coalition of states to ensure that the tobacco companies would have no choice but to settle. The tactic worked (with a little help from the FDA's Kessler), as the tobacco companies sought a settlement that would give them "peace, forever."

Kessler played the role of a particularly zealous Baptist, whose zeal was a barrier to a traditional bootleggers-and-Baptist coalition. Having learned from the prior losses to tobacco, Kessler wanted a wholesale restructuring of the tobacco industry. Once Republican control of Congress in 1994 stalled the Clinton administration's legislative agenda, Kessler persuaded the White House to allow him simply to assert that the FDA had jurisdiction over cigarettes as part of a campaign against children smoking. Although the tobacco companies defeated the FDA's effort – largely because it so blatantly contradicted decades of consistent statements by the agency that it lacked such jurisdiction – the FDA's effort made it clear that the industry needed protection.

The attorneys general and plaintiffs' lawyers represented a new type of player that could be dubbed "the televangelist." The regulatory televangelists mouthed the pieties of the Baptists, but the televangelists' focus was on temporal rewards. Even Zegart's pro-plaintiff account of the litigation includes a quote from one lawyer who conceded that though the plaintiffs' lawyers claimed they were engaged in an idealistic crusade, "It's all about the money. Never forget that." The willingness to sacrifice substantive accomplishments enabled the televangelists to utilize the ideological cover that the Baptists provided while freeing the parties from actually worrying about accomplishing the Baptists' policy goals. As the tobacco companies began looking for a solution to their litigation problem, this substantive flexibility would make a settlement possible.

THE RESOLUTION

In early 1997, the four largest tobacco companies began negotiations with the states and their assorted lawyers. The deal that emerged essentially traded the companies' recognition of limited FDA authority over tobacco, $10 billion in initial payments, and annual payments of $15 billion thereafter for immunity from future private lawsuits. The agreement was embodied in a document that became known simply as "the Resolution." (During the negotiations, the four states with fast-approaching trial dates worked out individual resolutions.)

Two provisions were crucial to obtaining the tobacco companies' agreement. First, the structure of the settlement meant that the payments were to come from future revenues, not the companies' bank accounts. Because cigarettes are generally price-inelastic (at least in the short run), the number sold would not fall much if the price goes up. In essence, the tobacco companies were promising to tax their customers for the benefit of the states. Since they were giving away someone else's money, the financial provisions were less painful to the industry than they initially appreciated.

Second, the agreement included provisions that would attempt to protect the settling firms from price competition by newer firms. The problem with the "future price increases as implicit tax" approach to the payment of the damages was that new entrants might undercut the existing firms' sales. Since the suits were predicated on past behavior by the incumbents, there was no basis to bring a new suit against a new entrant. And since the provisions were in a settlement, they bound only the parties to the lawsuits. The solution was to require states to pass statutes that created an alternative payment requirement for non-signatories as part of the package, as well as relieving the defendants of some of their financial obligations if their market share dropped significantly after the settlement.

The willingness to sacrifice substantive change enabled the televangelists to use the Baptists' cover without having to accomplish the Baptists' goals.

The deal soon ran aground on Washington politics. The attorneys general had not reckoned on the fury of the spurned regulatory Baptists, who launched an all-out effort to toughen the settlement's terms. More importantly, the parties had neglected to provide enough revenue and glory for federal politicians. To demonstrate their toughness on public health issues, congressmen and senators piled additional penalties and provisions onto the bill approving the agreement. The Clinton White House withheld its endorsement, despite the hiring of Hillary Clinton's brother, Hugh Rodham, as part of the states' legal team. (Rodham's undistinguished legal career did not involve any major trials, which suggests that his role was to provide "access" in hopes of obtaining presidential backing.) When the bill implementing the agreement took on the appearance of a Christmas tree, the tobacco companies withdrew their support and the federal settlement died in June 1998.

MASTER SETTLEMENT AGREEMENT

None of the parties or lawyers could simply walk away when the federal deal collapsed. The private lawyers had too much money tied up in the cases to write them off as a bad investment, the attorneys general had staked their careers on success, and the tobacco companies still needed protection from the third wave and future suits. In February 1998, the 46 states remaining and the four largest tobacco companies produced a scaled-down version of the Resolution dubbed "the Master Settlement Agreement" (MSA). By eliminating the FDA and immunity provisions, the MSA solved the Resolution's problems with Congress. Reflecting the lower value of a deal without immunity, the MSA lowered the companies' payments to $206 billion from $365 billion. It retained, however, the approach of protecting the incumbents' market share from price competition by new firms and the implicit tax on smokers to fund the deal.

The MSA included a model statute that a state agreeing to the deal would have to adopt. The statute presented state legislatures with a difficult choice: either they accept the MSA in whole, in which case they would be able to spend their state's share of the billions of dollars raised from smokers, or they could reject the proposed statute and their states' smokers would still pay the higher prices necessary to fund the deal but they would lose their claim on the money. Not surprisingly, every state legislature took the money.

Unlike the regulatory Baptists, the televangelists had little interest in continuing once their fees were secure. All the firms that actually did the work on the state suits have since moved on to other areas and no longer do tobacco work.

State legislators proved no more principled. For example, Florida (where the legislature had previously amended the law to make winning the suit easier) found itself with a problem when a private plaintiff won a $145 billion punitive damage award in a tobacco case in 2000. The state quickly amended its appeal bond statute to eliminate the requirement that a *supersedeas* bond for the full amount be posted to prevent execution on the judgment pending appeal. Nor did states live up to their pious rhetoric when it came time to use the money to finance anti-smoking campaigns and other health programs. Less than a third of the revenue received has actually been spent on health-related items and almost none has gone to teen anti-smoking measures, a key rationale for the suits.

FUTURE TELEVANGELISTS

Unfortunately the future is bright for other regulatory televangelists to play a role in regulation. Televangelists are better partners for bootleggers than Baptists because the televangelists care less about the substance and focus on their own rewards. While that is good news for the bootleggers, it is bad news for the groups – like the smokers in the tobacco example – who the bootleggers and televangelists combine against.

Moreover, as the history of tobacco regulation reveals, bootlegger-Baptist coalitions are limited by the inherent conflicts between bootleggers and Baptists. By the 1990s, the health interest groups and public health regulators were no longer willing to participate in such coalitions about tobacco because they had learned from their past failures. The televangelists, on the other hand, were happy to strike a deal with the bootleggers.

Our future likely holds more such arrangements, in part because the combination of asbestos and tobacco money has created a class of entrepreneurial plaintiffs' lawyers who have the resources to attack other businesses in search of the next "Fort Knox." The tobacco lawyers have already begun to sue insurance companies, fast food chains, gun manufacturers, and silica product producers.

Making such alliances more difficult will not be easy. Settlements offer regulators of all types opportunities to make policy outside the public eye. For example, the lengthy MSA documents included no index, and there was no provision for public participation in the settlement hearings as there is with respect to rulemaking. One means of making such coalitions more difficult to form and maintain would be for courts to expand public participation in settlement hearings when the settlement itself proposes regulatory action (such as the implicit tax increase included in the MSA).

A second means of disrupting televangelist-bootlegger alliances is to restrict access to the money that drives the deal forward. A crucial part of the tobacco alliance was the sharing of the spoils between the entrepreneurial lawyers like Scruggs and the politically connected local firms. Requiring all contracts for outside attorneys to be awarded through competitive bidding, with the terms made public, would make it more difficult for state attorneys general to strike deals (implicit or explicit) for contributions from the firms awarded such contracts. Exposing such contracts to sunlight would also allow outside organizations to follow the money trail, making it harder to conceal corrupt bargains like the one struck by Texas' Dan Morales. The potential gains to both bootleggers and televangelists are so large that only constant scrutiny can provide a real check on such alliances. R

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