

---

---

FORFEITING FEDERALISM: THE FAUSTIAN PACT WITH BIG  
TOBACCO

*Ryan D. Dreveskracht*\*

\* Ryan Dreveskracht is an Associate at Galanda Broadman, PLLC. His practice focuses on representing tribal governments in public affairs, energy, gaming, taxation, and general economic development. He can be reached at 206.909.3842 or ryan@galandabroadman.com. The Author would like to thank Dale White, Lane Morgan, and John Peebles for their thoughtful comments and suggestions on earlier drafts of this work. Any mistakes are my own.

## INTRODUCTION

“Certainly many of us never anticipated that states would become addicted to the tobacco money as a way to finance their operations.”

- Scott Harshbarger, Attorney General, State of Massachusetts<sup>1</sup>

This article discusses the effects of the largest legal settlement in United States history: the so-called Master Settlement Agreement<sup>2</sup>, or “MSA.” Part I discusses the settlement generally, and its intended effect on the U.S. tobacco market. Parts II through IV discuss the unintended consequences of the settlement.<sup>3</sup> Part II considers how states got into their current disarray, and how a perceived state windfall of billions of dollars ended up putting states on what by all accounts now appears to be very real risk of insolvency. Part III examines how the major tobacco companies are using the states’ dire financial condition to stifle tribal sovereignty and Indian industry. Part IV analyzes the federal government’s role in similar oppressive tactics. The concluding section suggests lessons that might be learned from the MSA. In sum, it appears that state attorneys generals’ encroachment upon state legislatures’ policy-making, effectively binding each state into a deal with the major tobacco companies, resulted in a benefit only to “Big Tobacco” companies and not the states.

In addition, tribal governments have suffered the brunt of the abuse in that states and the federal government have effectively been forced to attack tribal sovereignty at the behest of these major tobacco companies. In the modern era of states’ rights,<sup>4</sup> from a purely legal perspective “it is simple enough for many states and local governments — as well most federalism commentators — to ignore Indian nations.”<sup>5</sup>

---

<sup>1</sup> Gordon Fairclough & Vanessa O’Connell, *Co-Dependents: Once Tobacco Foes, States Are Hooked on Settlement Cash - Philip Morris Verdict Sparks Scramble to Shield Firm*, WALL ST. J., April 2, 2003, at A1.

<sup>2</sup> *Id.* See generally Andrew J. Haile & Matthew W. Krueger-Andes, *Landmark Settlements and Unintended Consequences*, 44 U. TOL. L. REV. 145 (2012).

<sup>3</sup> See generally Haile & Krueger-Andes, *supra* note 2.

<sup>4</sup> See generally David H. Getches, *Beyond Indian Law: The Rehnquist Court’s Pursuit of States’ Rights, Color-Blind Justice and Mainstream Values*, 86 MINN. L. REV. 267 (2002).

<sup>5</sup> Matthew L. M. Fletcher, *Tribal Disruption and Federalism*, 77 MONT. L. REV. 28 (forthcoming 2015) (citing Steven Paul McSloy, *Border Wars: Haudenosaunee Lands and Federalism*, 46 BUFF. L. REV. 1041, 1041–42 (1998)).

However, on a practical level, states can no more ignore tribal interests than they can federal interests, which often overlap.<sup>6</sup> As noted by Justice Sandra Day O’Conner: “Today in the United States, we have three types of sovereign entities — the Federal government, the States, and the Indian tribes. Each of the three sovereigns has its own judicial system, and each plays an important role in the administration of justice in this country.”<sup>7</sup> Through a series of legal determinations in the 21<sup>st</sup> century, it has become clear that tribal governments have certain authorities. For example, tribal governments may levy their own taxes and regulate their own lands and persons who enter those lands and to do so without state interference. The result is “a new conception of federalism that includes a very active third sovereign.”<sup>8</sup> Although “[t]he longstanding legal debate within federalism has been primarily over the appropriate distribution of sovereign authority to wield decision-making power between the national government and the [s]tates,” state and federal policymakers can no longer ignore that “governmental decision-making authority in the United States involves not only the national and state governments, but also the tribal nations.”<sup>9</sup> Unfortunately, by means of the MSA, Big Tobacco has forced states and the federal government to flout this conception of federalism by (1) upsetting the distribution of regulatory authority vis-à-vis these three sovereigns, and (2) denying tribal governments any decision-making authority in regard to state and federal law and policy that has a direct effect on the political integrity, economic security, and health and welfare of these governments and their citizens.<sup>10</sup>

## I. THE TOBACCO SETTLEMENTS

In May of 1994, Mississippi Attorney General Mike Moore filed the first state mass tort lawsuit against the tobacco industry.<sup>11</sup> The suit alleged that

---

<sup>6</sup> See generally *Williams v. Lee*, 358 U.S. 217 (1959).

<sup>7</sup> Sandra Day O’Connor, *Lessons from the Third Sovereign: Indian Tribal Courts*, 33 TULSA L.J. 1, 1 (1997).

<sup>8</sup> Nancy Carol Carter, *American Indians and Law Libraries: Acknowledging the Third Sovereign*, 94 LAW. LIBR. J. 7, 13 (2002).

<sup>9</sup> Carol Tebben, *An American Trifederalism Based upon the Constitutional Status of Tribal Nations*, 5 U. PA. J. CONST. L. 318, 318 (2003).

<sup>10</sup> See generally Nicholas C. Zaferatos, *Planning the Native American Tribal Community: Understanding the Basis of Power Controlling the Reservation Territory*, 64 J. AM. PLAN. ASS’N 395 (1998) (citing *Montana v. United States*, 450 U.S. 544 (1981)).

<sup>11</sup> Complaint, *Moore v. American Tobacco Co.*, No. 94-1429 (Jackson Cnty. Miss. Ch. Ct. May 23, 1994), available at [http://www.library.ucsf.edu/sites/all/files/ucsf\\_assets/ms\\_complaint.pdf](http://www.library.ucsf.edu/sites/all/files/ucsf_assets/ms_complaint.pdf) [hereinafter *Mississippi Complaint*]. The suits were filed by attorneys experienced in mass tort litigation who “were convinced that the unfolding revelations of the tobacco industry’s indifference to public health concerns

the country's largest tobacco manufacturers — also known as “Big Tobacco”<sup>12</sup> — “manufactured, tested, designed, promoted, marketed, packaged, sold, distributed, and/or placed into the stream of commerce in and into the State numerous brands of defective, unreasonably dangerous and hazardous cigarettes,” thereby causing Mississippi to “suffer[] harm and has incur[] significant expenses associated with the provision of necessary health care and other such necessary assistance under various State programs to certain eligible citizens numbering in the thousands who suffer, or who have suffered, from tobacco-related injuries, diseases or sickness.”<sup>13</sup> Moore and his colleagues' theory was to “sue on behalf of states, which had not chosen to smoke but were still being forced to pay health care costs, and that the tobacco companies had gotten rich because of it.”<sup>14</sup> Other states soon followed. For the next three years, the states' attorneys unearthed via discovery<sup>15</sup> numerous secret tobacco documents showing that Big Tobacco “knew cigarettes were addictive and dangerous,” purposefully hid this information from the public, and even “intentionally target[ed] minors with their advertising.”<sup>16</sup>

By 1997, after several more states filed similar lawsuits, Big Tobacco negotiated with a group of State Attorneys Generals to reach a comprehen-

---

could be translated into mass industry liability, as in asbestos litigation.” Robert L. Rabin, *The Tobacco Litigation: A Tentative Assessment*, 51 DEPAUL L. REV. 331, 337 (2001) (citing PETER PRINGLE, CORNERED: BIG TOBACCO AT THE BAR OF JUSTICE 13–15 (1998)).

<sup>12</sup> See Craig P. Raysor, *From the Sword to the Pen: A History and Current Analysis of U.S. Tobacco Marketing Regulations*, 13 DRAKE J. AGRIC. L. 497, 508–14 (2008) (discussing the “Big Tobacco's . . . take over [of] the bulk of the tobacco industry”). As of 2001, Philip Morris, Inc.; R.J. Reynolds Tobacco Co., Inc.; Brown & Williamson Tobacco Corp.; and Lorillard Tobacco Co., all original signatories to the MSA, were responsible for 98% of cigarette sales in the United States. *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*, 263 F.3d 239, 241 (3d Cir. 2001). What is more, it appears that they are now in the process of merging. Press Release, Reynolds American Inc., Reynolds American to Acquire Lorillard in Transaction Valued At \$27.4 Billion (July 15, 2014), available at <http://www.prnewswire.com/news-releases/reynolds-american-to-acquire-lorillard-in-transaction-valued-at-274-billion-267143881.html>.

<sup>13</sup> *Mississippi Complaint*, *supra* note 11, at 1.

<sup>14</sup> Mark Curriden, *Up in Smoke: How Greed, Hubris and High-Stakes Lobbying Laid Waste to the \$246 Billion Tobacco Settlement*, 93 A.B.A. J. 26, 27 (2007) (quoting Richard Scruggs, co-counsel for the State of Mississippi). See generally CURTIS WILKIE, *THE FALL OF THE HOUSE OF ZEUS* (2010) (depicting the story of Richard Scruggs, arguably the most successful plaintiff's lawyer in America).

<sup>15</sup> See, e.g. Michael V. Ciresi et al., *Decades of Deceit: Document Discovery in the Minnesota Tobacco Litigation*, 25 WM. MITCHELL L. REV. 477 (1999).

<sup>16</sup> Curriden, *supra* note 14, at 28. The various suits also alleged claims of civil conspiracy, willful and negligent breach of a special duty, fraudulent misrepresentation, fraudulent concealment, negligent design, strict liability, unfair trade practices, public nuisance, negligent and intentional entrustment, and even “intentionally . . . targeting African Americans” with their defective product. *A.D. Bedell Wholesale Co.*, 263 F.3d at 242 n.10 (citation omitted). The unearthed documents are generally available online. See WORLD HEALTH ORG., *THE TOBACCO INDUSTRY DOCUMENTS: WHAT THEY ARE, WHAT THEY TELL US, AND HOW TO SEARCH THEM* (2d ed. 2004).

sive, nationwide settlement of the states' claims.<sup>17</sup> On the heels of numerous tort lawsuits where individual plaintiffs would eventually amass billions of dollars worth of judgments on their own,<sup>18</sup> a settlement that would fully and finally immunize Big Tobacco from any further personal injury litigation was warmly received.<sup>19</sup> After a hurried three months of negotiations, on June 20, 1997, the states and Big Tobacco announced a settlement at a press conference that aired live on CNN.<sup>20</sup> Later that month, the National Association of Attorneys General and Big Tobacco jointly petitioned Congress for a global resolution of the state lawsuits, which included a bar to "suits by persons claiming injury or damage caused by conduct taking place prior to" the agreement<sup>21</sup>, a \$368.5 billion payment to the states, and federal legislation that imposed strict regulatory restrictions on the tobacco industry.<sup>22</sup> Congress, however, rejected the proposed settlement, instead opting for legislation that "would require [Big Tobacco] to pay more money and accept greater regulatory and marketing restrictions than they had [initially] agreed."<sup>23</sup> Big Tobacco opted out of further negotiations.<sup>24</sup>

In 1998, Mississippi, Florida, Texas, and Minnesota settled their suits against Big Tobacco, recovering over \$35 billion without an act of Congress.<sup>25</sup> With trial dates looming, on November 16, 1998, a number of State Attorneys General and Big Tobacco reached an agreement called the "Master Settlement Agreement," which, too, did not require Congressional approval.<sup>26</sup> Under the terms of this agreement, these states released Big To-

---

<sup>17</sup> *Star Scientific, Inc. v. Beales*, 278 F.3d 339, 344 (4th Cir. 2002).

<sup>18</sup> In early 1999, a San Francisco court would return a verdict for \$1.5 million in compensatory damages and \$50 million in punitive damages in favor of a former smoker with lung cancer. John Schwartz, *Jury Awards Ex-Smoker \$51.5 Million*, WASH. POST, Feb. 11, 1999, at A2. The following month, an Oregon jury awarded \$81 million, including \$79.5 million in punitive damages, to the family of a lung cancer victim. Sandra Torry, *Record \$81 Million Award in Tobacco Case*, WASH. POST, Mar. 31, 1999, at A6. In 2000, a Florida jury awarded \$145 billion to a class of 500,000 to 700,000 sick smokers in the state. Michael Bradford, *Punitive Tobacco Award Fought*, BUS. INS., Nov. 12, 2000, <http://www.businesinsurance.com/article/20001112/ISSUE01/10001681>.

<sup>19</sup> According to defense counsel, "When we told them we were willing to do away with the Marlboro Man and Joe Camel, I thought the AGs were going to have a heart attack. They were shocked." Curriden, *supra* note 14, at 28. (quoting Phil Carlton, counsel for Big Tobacco).

<sup>20</sup> Curriden, *supra* note 14, at 29.

<sup>21</sup> PROPOSED TOBACCO INDUSTRY SETTLEMENT (1997), available at <http://www.cnn.com/US/9705/tobacco/docs/proposal.html>.

<sup>22</sup> *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*, 263 F.3d 239, 242 (3d Cir. 2001).

<sup>23</sup> *Star Scientific, Inc. v. Beales*, 278 F.3d 339, 344 (4th Cir. 2002)

<sup>24</sup> Curriden, *supra* note 14, at 30. In the next eight years, not a single piece of tobacco-control legislation would even make it to a vote.

<sup>25</sup> Robin Miller, *Validity, Construction, Application, and Effect of Master Settlement Agreement (MSA) Between Tobacco Companies and Various States, and State Statutes Implementing Agreement; Use and Distribution of MSA Proceeds*, 25 A.L.R. FED. 6th 435, §2 (2007).

<sup>26</sup> *Star Scientific*, 278 F.3d at 344.

bacco from all claims on past conduct based on the sale, use, and marketing of tobacco products.<sup>27</sup> They also released future claims arising from injury caused by exposure to tobacco, including future claims of reimbursement of healthcare costs associated with citizens' exposure to tobacco products.<sup>28</sup> The MSA permitted non-settling states to participate in the settlement if they opted in within seven days — a time limit that “offered almost no opportunity for public health critics to mount an effective response” and “placed overwhelming economic and political pressure on attorneys general to join.”<sup>29</sup> This resulted in all 46 states signing onto the agreement<sup>30</sup> — an agreement estimated to be worth over \$200 billion over twenty-five years.<sup>31</sup> The states were getting paid, at least ostensibly, but the MSA omitted much of the regulatory and marketing restrictions that the proposed Congressional legislation would have imposed on Big Tobacco.<sup>32</sup>

## II. MONEY NOT WELL SPENT

While the MSA was “primarily designated to reimburse States for the cost of treating smoking-related illnesses,” neither the MSA nor its enacting pieces of state legislation ensured that any money recouped was actually spent on cessation programs, anti-smoking efforts, expenses associated with the provision of health care, or anything else remotely having any tie to preventing or repairing the damage caused by the tobacco industry.<sup>33</sup> In 2007, Mark Curriden wrote:

---

<sup>27</sup> *Id.* at 345.

<sup>28</sup> *Id.*

<sup>29</sup> ALLAN BRANDT, *THE CIGARETTE CENTURY: THE RISE, FALL, AND DEADLY PERSISTENCE OF THE PRODUCT THAT DEFINED AMERICA* 431 (2007).

<sup>30</sup> *See id.* (“For a state to reject billions of dollars to take a chance with a judge and jury constituted too great a political risk for any elected official. Even those critical of the new agreement offered their consent.”)

<sup>31</sup> *Star Scientific*, 278 F.3d at 343. For each cigarette sold anywhere in the United States, Big Tobacco pays an MSA Escrow Agent. The payment is then allocated among the Settling States according to an “Allocable Share” formula in the MSA. *See Grand River Enter. Six Nations, Ltd. v. Pryor*, No. 02-5068, slip op. at 2 n.3 (S.D.N.Y. May 31, 2006). For example, as of 2006, New York’s allocable share was 12.760310% (one of the largest); Vermont’s was 0.4111851% (one of the smallest). *Id.*

<sup>32</sup> *See Star Scientific*, 278 F.3d at 344. The congressional proposal would have: earmarked ½ of all funds to combat teenage smoking; mandated Food & Drug Administration oversight; imposed federal advertising restrictions; granted immunity from state prosecutions; eliminated punitive damages in individual tort suits; prohibited the use of class actions, or other joinder or aggregation devices without Big Tobacco’s consent; exempted Big Tobacco from federal antitrust laws; and called for payments to the States of \$368.5 billion over twenty-five years. *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*, 263 F.3d 239, 242 (3d Cir. 2001). In contrast, the MSA contains no such restrictions and provides baseline payments of \$200 billion over twenty-five years. *Id.*

<sup>33</sup> *State v. Philip Morris USA, Inc.*, No. 98-CVS-14377, 2004 WL 2966013, at \*1 (N.C. Supp. Dec. 23, 2004). Under the Medicaid statute, states were required to return the federal government its share of any

Despite a commitment from the governors and legislators to use the money to address anti-smoking and health care concerns, only pennies on the dollar have actually gone to those causes. Instead, the money has gone to meet budget shortfalls or to pay for tax cuts. In Virginia, some of the tobacco settlement was used to build new seats at a NASCAR speedway, while New York used some of its money for sprinklers and golf carts for a course near Buffalo. Georgia renovated a hotel. Alabama funded a boot camp for young adult males. And North Carolina actually used money to build a tobacco warehouse.<sup>34</sup>

Today, it appears that this type of spending was just the tip of the iceberg. While \$200 billion, over twenty-five years, sounds like a lot of money, for cash-strapped states with budget deficits and capital improvements that remained unfinanced, the thought of turning unsecured annual payments into upfront infusions of cash to states was extremely attractive.<sup>35</sup> Further, at the time, states feared if Big Tobacco faced additional tort lawsuits from individuals or the federal government, “they may face bankruptcy or move overseas, leaving the states empty-handed.”<sup>36</sup>

---

recoveries of Medicare expenditures. See 42 U.S.C. § 1396(b) (2012). In 1999, however, the President signed the Emergency Supplemental Appropriations Act, which waived any federal claim to tobacco settlement monies and otherwise removed any and all restrictions on state spending. Emergency Supplemental Appropriations Act of 1999, Pub. L. No. 106-31, 113 Stat. 103.

<sup>34</sup> Curriden, *supra* note 14, at 30; see also Cezary Podkul, *How Wall Street Tobacco Deals Left States With Billions in Toxic Debt*, PROPUBLICA (Aug. 7, 2014, 7:00 AM), <http://www.propublica.org/article/how-wall-street-tobacco-deals-left-states-with-billions-in-toxic-debt> (Mississippi Attorney General Mike Moore stating that the “states . . . made a ‘sucker bet’ that diverted the winnings of the fight away from their intended purpose”). Mississippi, home of Moore, is the only state that has “used the money for its intended purpose completely.” Fitzhugh Mullan, *Reagan, Clinton, Tobacco, and Children: An Interview with C. Everett Koop*, 23 HEALTH AFF. 180, 184 (2004). The recession also likely played a large part in the state’s use of this money. As explained by Walter Jones and Gerard Silvestri: “[I]n 2000, the economy began to go into recession as the ‘dot.com’ bubble burst, and stock markets indices dropped rapidly. On September 11, 2001, after the terrorist attacks on New York City and Washington, DC, the economy was further dampened by declines in tourism and air travel. The economy began to pull out of the recession in 2003, but states that had cut taxes a few years earlier found that they did not have revenues adequate to meet major needs across all programs. Increasing taxes as a response would be politically dangerous for politicians who had gained or held office through the promise of reduced taxes. Inevitably, the temptation to treat MSA revenues as a ‘cookie jar’ to be tapped for budget shortfalls was irresistible.” Walter J. Jones & Gerard A. Silvestri, *The Master Settlement Agreement and Its Impact on Tobacco Use 10 Years Later: Lessons for Physicians About Health Policy Making*, 137 CHEST 692, 694–95 (2010).

<sup>35</sup> See, e.g., CAL. BUDGET PROJECT, BUDGET BRIEF, BORROWING AGAINST THE FUTURE: IS SECURITIZING CALIFORNIA’S TOBACCO SETTLEMENT REVENUES THE BEST WAY TO CLOSE THE BUDGET GAP?, (2002), available at <http://www.cbpp.org/pdfs/2002/020402Tobacco.pdf>; JOHN KASPRAK, CONN. OFFICE OF LEGISLATIVE RESEARCH, SECURITIZATION OF TOBACCO SETTLEMENT FUNDS, 2002-R-0736 (2002), available at <http://www.cga.ct.gov/2002/olrdata/ph/rpt/2002-R-0736.htm>.

<sup>36</sup> KASPRAK, *supra* note 35. The threat of bankruptcy by one or more tobacco companies was most recently raised on September 21, 2004, when the U.S. Justice Department and Big Tobacco began the trial phase of the government’s \$280 billion federal racketeering lawsuit. Tim Loehrke, *Big Showdown: Tobacco Trial Begins*, USA TODAY, [http://usatoday30.usatoday.com/money/industries/2004-09-20-tobacco\\_x.htm#](http://usatoday30.usatoday.com/money/industries/2004-09-20-tobacco_x.htm#) (last updated Sept. 21, 2004, 3:43 PM). In this suit, the government is suing the tobacco

Under this logic, “since there is no guarantee that the state will actually receive all of the projected payments, it is better to have the cash in hand and use or invest it now.”<sup>37</sup> Known as “securitization,” the financial instruments were structured as follows:

[S]tate and local governments sell their tobacco settlement revenue stream to a special purpose entity (“SPE”) established for the purpose of issuing bonds backed by these funds and paying the debt service on them. The SPE is designed to be legally separate and “bankruptcy remote” from the government entity. This means that the credit rating for these bonds is separate from the state or local government’s rating and is based on the credit worthiness of the tobacco industry and the structure of the financing. The government entity bears no financial responsibility for the bonds, and the bond purchasers bear any risk that the bonds will not be repaid. The interest paid on the bonds issued through securitizing the tobacco settlement payments may either be subject to federal and state income taxes or exempt from such taxes, depending on a number of factors including the intended use of the proceeds. . . . After a state creates an SPE and transfers some or all tobacco settlement payments to it, the SPE can issue the bonds. The SPE pledges a portion of each annual settlement payment to pay the debt service and assumes all of the risk. The remaining settlement amount after payment of the debt service, often called the “residual,” could be used as the state chooses. It might be put into the general fund for annual appropriations, or placed in another special fund for future purposes. The actual bond structure depends on a number of factors such as: (1) the rating the state wants for the bonds; (2) the amount of money the state wants in an up-front payment; (3) bond proceed usage; and (4) rating agencies’ requirements and their assumptions.<sup>38</sup>

However, what the states failed to adequately take into account in securitizing their payments, was (1) the high interest rate made the bonds expensive; (2) a state would end up with only a slight fraction of the amount it would have received over the long term; (3) securitization is an expensive transaction, involving fees for investment bankers, brokers, accountants, and lawyers — all of whom have their own interests in mind; (4) selling off the revenue stream upfront would result in a state budget hole in the future; (5) a state legislature’s ability to adapt to a state’s needs and priorities would be limited; (6) if future payments were insufficient to cover the bonds issued by the third party, a state could face pressure, both politically and legally, to back the bonds<sup>39</sup>; (7) there might be a loss of market share to

---

co companies to recover the companies’ “ill-gotten gains” under the federal Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961. *United States v. Philip Morris USA, Inc.*, 449 F. Supp. 2d 1, 32 (D.D.C. 2006).

<sup>37</sup> KASPRAK, *supra* note 35.

<sup>38</sup> KASPRAK, *supra* note 35.

<sup>39</sup> KASPRAK, *supra* note 35.



nonparticipating manufacturers<sup>40</sup>; and (8) as discussed in more detail below, if there was a threat of insufficient future payments, a state might be forced to concede to Big Tobacco's demands in regard to diligent enforcement of the "qualifying statute" required by the MSA.<sup>41</sup>

Since 1999, 19 states (and certain counties in New York and California)<sup>42</sup> have securitized their share of MSA payments,<sup>43</sup> resulting in billions of dollars in toxic debt — *\$64 billion on just \$3 billion advanced*, to be precise.<sup>44</sup> The debt became "toxic" because of the same miscalculation that led to the housing bubble of 2007:<sup>45</sup> a decline in tobacco consumption above what was estimated, and outdated calculations on loss of market share to nonparticipating manufacturers — i.e. any non-Big Tobacco manufacturers, including tribal manufacturers.<sup>46</sup> As to the former, the drop of roughly 3.5 percent in Big Tobacco consumption realized in the past twenty years is nearly double that projected by the securitization agreements.<sup>47</sup> As to the latter, states have now been forced by the MSA with a Hobson's Choice: protect Big Tobacco's market share by enacting laws that attack otherwise legal enterprises; or face losing billions of dollars.<sup>48</sup> Despite attempts to shield SPE's from affecting states' revenue stream, the debt will not simply disappear. In the event of default, bondholders will still be responsible to taxpayers for subsequent tobacco income on bonds that will continue to earn an estimated \$1.6 billion in interest.<sup>49</sup> Additionally, the adverse credit rating for SPEs will be assigned to states, and this will dissuade bondhold-

---

<sup>40</sup> CAL. DEBT & INV. ADVISORY COMM'N, ISSUE BRIEF, TOBACCO SECURITIZATION: BOND ISSUANCE IN CALIFORNIA 8 (2008), available at <http://www.treasurer.ca.gov/cdiac/reports/tobacco.pdf>.

<sup>41</sup> *Star Scientific v. Beales*, 278 F.3d 339, 346 (4th Cir. 2002). California State Treasurer Bill Lockyer has likened securitization to "payday loans, with their delayed payments, astronomical interest rates and catastrophic balloon payments." Ken Broder, *California Helps Wall Street Pocket 44% of Landmark Tobacco Settlement*, ALLGOV CALIFORNIA (Sept. 19, 2014), <http://www.allgov.com/usa/ca/news/where-is-the-money-going/california-helps-wall-street-pocket-44-of-landmark-tobacco-settlement-140919?news=854296>.

<sup>42</sup> See Cezary Podkul & Claire Kelloway, *Investors Haul in Nearly Half the Tobacco Settlement Cash*, PROPUBLICA (Sept. 11, 2014, 8:00 AM), <http://www.propublica.org/article/investors-haul-in-nearly-half-the-tobacco-settlement-cash> ("California and New York are unique in that, unlike the other states party to the settlement, they share their settlement proceeds with county governments and some cities.").

<sup>43</sup> GLEN ANDERSON & CATHRYN STEEVES, NUVEEN INV., TOBACCO BONDS: CAREFUL CREDIT ANALYSIS IS THE KEY 1 (Jul. 2014), available at <http://www.nuveen.com/Home/Documents/Viewer.aspx?fileId=63396>.

<sup>44</sup> Podkul, *supra* note 34.

<sup>45</sup> See generally RICHARD A. POSNER, *A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION* (2009) (discussing the housing bubble of 2007).

<sup>46</sup> See Podkul, *supra* note 34.

<sup>47</sup> Podkul, *supra* note 34; see ANDERSON & STEEVES, *supra* note 43.

<sup>48</sup> "Certain new technologies, such as electronic cigarettes ("e-cigs"), nicotine patches or smoking cessation drugs also pose a risk to consumption." ANDERSON & STEEVES, *supra* note 43.

<sup>49</sup> Podkul, *supra* note 34.

ers from investing in traditional bonds,<sup>50</sup> causing what has been described by California State Treasurer Bill Lockyer as a widespread “negative fallout in the market” of government bonds.<sup>51</sup>

In a July 2012 report, Moody’s Investors Service (“Moody’s”) found that the volume adjustment component of MSA — the provision meant to protect Big Tobacco’s market share (discussed in more detail below) — will result in 74 percent of the aggregate outstanding balance of all the tobacco settlement bonds going into default.<sup>52</sup> By May of 2014, that number had risen to 80 percent.<sup>53</sup> In other words, not only will there be no “residual” for states, but 80 percent of the states’ SPEs will fail. In order to avoid an inevitable crash in bond ratings, some states, such as California, are restructuring their tobacco bonds to include an “appropriation pledge” that will infuse its general budget with monies to pay the bonds back when tobacco revenues are insufficient.<sup>54</sup> Thus, states, while technically receiving millions of dollars from Big Tobacco, will actually be *paying* those millions *and more* to bondholders, resulting in an overall net loss of billions of dollars. In this situation Wall Street, not the states, will be the beneficiary.

Whether the current state of affairs is due to another modern Wall Street swindle,<sup>55</sup> Big Tobacco’s continuing heist of state interests, state fiscal malpractice,<sup>56</sup> or a combination thereof, the outlook is not good for the public treasury.

### III. BIG TOBACCO FORCES STATES TO ATTACK TRIBES

In 2011, I published a three-part series for the *Native American Times*, warning Indian Country of the threat posed by the MSA.<sup>57</sup> At the time,

---

<sup>50</sup> Podkul, *supra* note 34.

<sup>51</sup> Broder, *supra* note 41.

<sup>52</sup> Matt Wirz, *Tobacco Bonds Could Go Up in Smoke, Moody’s Says*, WALL ST. J., Jul. 12, 2012, <http://blogs.wsj.com/marketbeat/2012/07/12/tobacco-bonds-could-go-up-in-smoke-moodys-says>.

<sup>53</sup> Podkul, *supra* note 34.

<sup>54</sup> Mike Cherney, *California Tobacco Bond Sale a Hit with Investors*, WALL ST. J., Apr. 2, 2013, <http://online.wsj.com/news/articles/SB10001424127887324020504578399012544703592>.

<sup>55</sup> See Podkul, *supra* note 34 (“Investment bankers from Citigroup, the now defunct Bear Stearns and others who, along with consultants and lawyers, have pocketed more than \$500 million in fees for their financial engineering . . . They now stand to make more as the governments look to rework old deals and try to get even more tobacco cash upfront.”).

<sup>56</sup> See Appellee’s Brief at 24, *Kentucky v. Alliance Tobacco Corp.*, No. 03-11030, 2004 WL 2055866 (W.D. Ky. 2004) (arguing that “[s]elling off 25 years of tobacco settlement payments to close a hole in a single year’s budget is fiscal malpractice”).

<sup>57</sup> Ryan Dreveskracht, *Cigarette Tax: Not About Money?*, NATIVE AM. TIMES, Jul. 1, 2011, *available at* 2011 WLNR 14764796; Ryan Dreveskracht, *Part II: Cigarette Tax - Still Not About Money*, NATIVE AM. TIMES, Aug. 5, 2011, *available at* 2011 WLNR 16743828; Ryan Dreveskracht, *Part III: Cigarette*

states like New York were coming down hard on tribal governments that refused to collect state taxes on Indian tobacco,<sup>58</sup> even though the state would collect much more money if they collected their own “use taxes,” which equally applied and did not affront tribal sovereignty by treating tribal governments as mere state tax collectors.<sup>59</sup> Recognizing that states’ waging these zero-sum battles against their neighboring sovereigns made no economic sense, and considering that states have absolutely no authority to enforce any judgment against tribal governments or peoples,<sup>60</sup> I posed the question: what “prompted [states] to turn a blind eye to compacting — a tried and true source of problem-free revenue?”<sup>61</sup>

The answer: the MSA. Big Tobacco was concerned that it would lose money — which is the usual position of a non-prevailing party in a multi-billion-dollar civil suit. However, rather than take the hit, Big Tobacco immediately raised its cigarette prices to “cover the future costs of the MSA.”<sup>62</sup> Naturally, the concern was that price increases would create a competitive disadvantage when compared to nonparticipating manufacturers — tobacco manufacturers that had done no wrong (or had not yet even come into existence).<sup>63</sup>

Big Tobacco originally inserted provisions into the MSA that protect its market shares and profitability.<sup>64</sup> Specifically, the MSA allows Big Tobacco to reduce their damage payments if they “lose market share during a given year,” as determined by a group of economic consultants designated under procedures established in the MSA.<sup>65</sup> In addition, the MSA required that states enact a statute, drafted by Big Tobacco,<sup>66</sup> mandating that every nonparticipating manufacturer either (1) join the MSA and its state payment

---

*Tax - Okay, Maybe it is About Money*, NATIVE AM. TIMES, Aug. 12, 2011, available at 2011 WLNR 17869966.

<sup>58</sup> See, e.g., *Oneida Nation of New York v. Cuomo*, 645 F.3d 154, 158 (2d Cir. 2011).

<sup>59</sup> Dreveskracht, *Cigarette Tax: Not About Money?*, *supra* note 57.

<sup>60</sup> *Oklahoma Tax Comm’n v. Citizen Band of Potawatomi*, 498 U.S. 505, 507 (1991).

<sup>61</sup> Dreveskracht, *Part III: Cigarette Tax - Okay, Maybe it is About Money*, *supra* note 57.

<sup>62</sup> *State v. Philip Morris USA, Inc.*, 618 S.E.2d 219, 221 (N.C. 2005).

<sup>63</sup> *Star Scientific, Inc. v. Beales*, 278 F.3d 339, 345 (4th Cir. 2002).

<sup>64</sup> *Id.* at 345–46.

<sup>65</sup> *Id.* at 346. Participating manufacturers do not make these payments to individual States. Instead, each manufacturer makes a single, nationwide payment in the overall amount calculated and determined by the Independent Auditor. The Independent Auditor then allocates those nationwide payments among the States by applying pre-set “Allocable Share” percentages previously negotiated by the states. *State v. Philip Morris USA, Inc.*, 927 A.2d 503, 506 (N.H. 2007).

<sup>66</sup> See *Grand River Enter. Six Nations, Ltd. v. Pryor*, No. 02 Civ.5068 (JFK), 2006 WL 1517603, at \*2 (S.D. N.Y. May 31, 2006) (noting that the “MSA’s participating manufacturers played a key role in drafting the Allocable Share Amendments,” and that the “Settling States made sure that they had the manufacturers’ ‘blessing’ before the legislation could be considered safe for enactment”).

program, or (2) pay into an escrow account in an amount determined by each manufacturer's sales volume in the state — an amount roughly equal to what Big Tobacco would pay under the MSA.<sup>67</sup>

“If a State does not enact and diligently enforce a qualifying statute, it can lose future payments.”<sup>68</sup> In order to ensure that they complied with Big Tobacco's demands, after enactment of the Escrow Statutes, states passed “Contraband Statutes” that require nonparticipating manufacturers to annually certify to the state attorney general that they are either (1) signed onto the MSA, or are (2) making escrow deposits.<sup>69</sup> Each statute penalizes non-compliance by denying state tax stamps and rendering the tobacco “contraband,” thereby prohibiting the sale of cigarettes in that state by the nonparticipating manufacturer.<sup>70</sup> In other words, the state tax stamps are not only about tax, but serve also — and most importantly — as indicia of compliance with the state's MSA scheme. This forces smaller or independent tobacco companies to pay for Big Tobacco's mistakes. Quite literally — and despite grandstanding by state officials who tritely claim that nonparticipating manufacturers “must pay their fair share” of state taxes<sup>71</sup> — unless these businesses opt into the MSA, they cannot pay state taxes, no matter how hard they try.<sup>72</sup>

What about those businesses that do not pay state taxes at all? What about tobacco businesses that operate wholly in Indian Country or are operated by nontaxable sovereign tribal entities and are not subject to state Es-

---

<sup>67</sup> *Grand River Enter. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 163 (2d Cir. 2005). Unlike Big Tobacco, which pays outright into the settlement fund, nonparticipating manufacturers retain title to the escrowed funds, and interest, for twenty-five years — at which point the funds will be released to the nonparticipating manufacturer. *Id.*

<sup>68</sup> *Star Scientific*, 278 F.3d at 346.

<sup>69</sup> *Grand River Enter. Six Nations, Ltd.*, 425 F.3d at 164.

<sup>70</sup> *Id.*

<sup>71</sup> Kenneth Lovett, *Gov. Cuomo Enforces Taxes on Cigarette Sales, Seizes \$1.2M From Indian Tribes Who Flaunt Laws*, N.Y. DAILY NEWS (Jul. 16, 2011, 4:00 AM), <http://www.nydailynews.com/new-york/gov-cuomo-enforces-taxes-cigarette-sales-seizes-1-2m-indian-tribes-flaunt-laws-article-1.161070>.

<sup>72</sup> See *Grand River Enter. Six Nations, Ltd. v. King*, No. 02-5068, 2008 WL 4615838, at \*1 (S.D. N.Y. Oct. 14, 2008) (“[S]tates also enacted ‘Contraband Statutes,’ which deny manufacturers that do not comply with the Escrow Statutes a tax stamp, essentially prohibiting the sale of their cigarettes.”); *Grand River Enter. Six Nations, Ltd. v. Pryor*, No. 02-5068, 2003 WL 22232974, at \*3 (S.D. N.Y. Sept. 29, 2003) (“The Certification Statute is a companion to the Escrow Statute and prohibits the sale of cigarettes in a state (by denying the manufacturers a [tax] stamp — the equivalent of a license) by companies that fail to comply with the Escrow Statute.”). Ironically, nonparticipating manufacturers' escrow payments are taxed, while MSA payments made by Big Tobacco are tax deductible. *Freedom Holdings, Inc. v. Spitzer*, 447 F. Supp. 2d 230, 238 (S.D. N.Y. 2004).

crow Statutes?<sup>73</sup> What about the third sovereigns?<sup>74</sup> What about governments that, before the MSA, formed reciprocal relationships with states to realize mutual revenues from tobacco sales?<sup>75</sup> None of that matters. Their interests are ignored. Regardless of whether tribal entities are legally immune from state law, they are competing participants in the tobacco market, who are taking business from Big Tobacco. Unless states “diligently enforce” their Contraband Statutes — which in the eyes of Big Tobacco means going after all manufacturers, regardless of the legality of their operations<sup>76</sup> — they will lose their money.<sup>77</sup> Money that is, as discussed above, already spent. At this point, states simply can ill afford *not* to bow to Big Tobacco’s demands. To do so would be to risk certain financial ruin.

For at least six states, the threat of defaulting on their MSA settlement bonds is a rather harsh reality. In 2012, Big Tobacco withheld payments to fifteen states (Colorado, Illinois, Iowa, Maine, New York, North Dakota, Ohio, Oregon, Washington, Indiana, Kentucky, Maryland, Missouri, New Mexico, and Pennsylvania), claiming that these states did not “diligently enforce” their Contraband Statutes.<sup>78</sup> An arbitration panel ruled in September of 2013 that six states (Indiana, Kentucky, Maryland, Missouri, New Mexico, and Pennsylvania) will receive approximately \$500 million less in MSA payments from tobacco manufacturers than expected, and will also be subjected to a 50 to 60 percent reduction in 2014 MSA payments.<sup>79</sup>

---

<sup>73</sup> See *Grand River Enter. Six Nations, Ltd.*, 2006 WL 1517603, at \*2 (“[C]igarettes sold on Native American reservations are exempt from escrow payments. . . . On Native American reservations, packs typically are sold without state excise tax stamps.”).

<sup>74</sup> See Matthew L.M. Fletcher, *Resisting Federal Courts on Tribal Jurisdiction*, 81 U. COLO. L. REV. 973, 1021 (2010) (noting tribes’ “rightful place as the third sovereign”); Matthew L.M. Fletcher, *Same-Sex Marriage, Indian Tribes, and the Constitution*, 61 U. MIAMI L. REV. 53, 56 (2006) (noting that Indian tribes should be introduced “into the Federal Union as the third sovereign”); Samantha A. Moppett, *Acknowledging America’s First Sovereign*, 35 OKLA. CITY U. L. REV. 267, 335 (2010) (noting the “existence of Indian tribes a[s] th[e] third sovereign entity in the United States”).

<sup>75</sup> See, e.g., WASH. REV. CODE § 43.06.466 (Yakama Nation cigarette tax agreement); TOBACCO TAX COMPACT BETWEEN THE STATE OF OKLAHOMA AND THE KAW NATION (2013); see generally Matthew L.M. Fletcher, *The Power to Tax, the Power to Destroy, and the Michigan Tribal-State Tax Agreements*, 82 U. DET. MERCY L. REV. 1 (2005) (discussing tribal-state tax agreements generally).

<sup>76</sup> See e.g. *State v. Philip Morris Inc.*, 61 A.D.3d 575, 577 (N.Y. Ct. App. 2009) (New York State arguing that that under state law “cigarettes sold on tribal lands within the State are exempt from taxation” and “[b]ecause of both the manner in which ‘units sold’ is calculated and the State’s policy regarding cigarettes sold on tribal lands, [nonparticipating manufacturers] who sell cigarettes on tribal lands are not required to make annual escrow deposits.”).

<sup>77</sup> As argued by Big Tobacco apologists, nonenforcement of the states’ escrow statutes on Indian lands would “render the MSA’s diligent enforcement requirement meaningless — a result clearly not bargained for, contemplated, or intended by the parties.” Haile & Krueger-Andes, *supra* note 2, at 169.

<sup>78</sup> Brian M. Haynes & Anne Hampton Andrews, *Disputed 2003 MSA Payments Resolved*, SMOKE SHOP, Dec. 2013, at 44.

<sup>79</sup> *Id.*

Further, the arbitration ruling only applied to states fulfilling requirements in 2003, while the question of whether some states “diligently enforced” their Contraband Statutes from 2003 to 2014 is still in dispute.<sup>80</sup> In 2012, a group of 19 states secretly negotiated a settlement of the MSA’s nonparticipating manufacturer adjustment (“NPM Adjustment”) — a provision that provides for a potential reduction in Big Tobacco’s annual payments to the states if there is an “aggregate market share loss” to nonparticipating manufacturers<sup>81</sup> — for years 2003-2014.<sup>82</sup> The settlement reduced the NPM Adjustment penalty for those years in return for (1) “credits against the participating states’ portion of MSA payments,”<sup>83</sup> and (2) a significant expansion of the scope of state enforcement obligations “beyond the terms of the MSA.”<sup>84</sup> Specifically, with expansion of enforcement, the states are required to compel escrow deposits for all tobacco sales made in the state, “regardless of whether those sales were subject to state excise tax or tax-exempt” — i.e. to specifically target “tribal sales,” the enforcement of which will indisputably violate federal law.<sup>85</sup> A number of non-settling states have opposed the settlement, however. In August 2013, motions to invalidate the settlement were filed in at least 13 state courts.<sup>86</sup> As of now, no state has received a ruling that is adverse to the settlement, but appeals are in process.<sup>87</sup> This dispute will be discussed in greater detail below.

---

<sup>80</sup> See Press Release, Philip Morris USA, Philip Morris USA and Other Manufacturers Prevail in Decade-Long Settlement Payment Dispute (Sept. 11, 2013), available at <http://www.businesswire.com/news/home/20130911006374/en/Philip-Morris-USA-Manufacturers-Prevail-Decade-Long-Settlement#.VD1HK9R4rms> (noting that “[s]tates that did not join the December 2012 settlement still face NPM adjustment disputes for years 2004 through 2012” and that Big Tobacco is “fully prepared to move forward with the arbitration for the 2004 dispute, and for all of the remaining years as well.”).

<sup>81</sup> *Grand River Enter. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 163 (2d Cir. 2005).

<sup>82</sup> ARIZ. OFFICE OF THE ATTORNEY GEN., PROGRAM SUMMARY: MASTER SETTLEMENT AGREEMENT 2 (2014), available at <http://www.azleg.gov/jlbc/psatmsa.pdf>; N.M. OFFICE OF THE ATTORNEY GEN., SUMMARY OF THE TOBACCO MASTER SETTLEMENT AGREEMENT 8 (2013), available at <http://www.nml.egis.gov/lcs/handouts/TSROC%2006112013%20Item%203%20Summary%20of%20the%20Tobacco%20Master%20Settlement%20Agreement.pdf>.

<sup>83</sup> ARIZ. OFFICE OF THE ATTORNEY GEN., *supra* note 82, at 2.

<sup>84</sup> N.M. OFFICE OF THE ATTORNEY GEN., *supra* note 82, at 8.

<sup>85</sup> N.M. OFFICE OF THE ATTORNEY GEN., *supra* note 82, at 8. The settlement would require that states require escrow on all sales that it “reasonably could have known about.” Although this term is not defined, “it at least suggests that cigarette sales need not be reported to be subject to escrow.” N.M. OFFICE OF THE ATTORNEY GEN., *supra* note 82, at 8.

<sup>86</sup> ARIZ. OFFICE OF THE ATTORNEY GEN., *supra* note 82, at 2.

<sup>87</sup> ARIZ. OFFICE OF THE ATTORNEY GEN., *supra* note 82, at 2.

---

---

## VI. BIG TOBACCO FORCES THE FEDERAL GOVERNMENT TO ATTACK TRIBES

It is not just the states that have been forced into doing Big Tobacco's dirty work.<sup>88</sup> Although "[f]ederal and state governments lack authority to tax cigarettes sold to members of Native American tribes" and, "[t]hus, cigarettes to be consumed on the reservation by enrolled tribal members are tax-exempt" and need not bear stamps,<sup>89</sup> Big Tobacco has lobbied Congress to enact federal statutes, such as the Smuggled Tobacco Prevention ("STOP") Act.<sup>90</sup> The STOP Act would require that tribal manufacturers comply with state Contraband Statutes.<sup>91</sup> These efforts have already caused confusion on the part of federal enforcement agencies, such as the Bureau of Alcohol, Tobacco, Firearms, and Explosives ("ATF"), who mistakenly believe that tribes are committing "MSA fraud" by failing to remit state escrow payments.<sup>92</sup> On the other hand, ATF's "confusion" is equally likely to have stemmed from its purposefully "exceed[ing its] statutory authority" in order to divert millions of dollars of cash and proceeds into ATF agents' personal accounts.<sup>93</sup> According to a recent U.S. Department of Justice audit, ATF officials have used the excuse that "some Native American tribes and reservations" are "sell[ing] cigarettes without paying the requisite . . . state excise taxes" in order to conduct illicit undercover operations, a single one of which resulted in roughly \$15 million in cash and proceeds being heisted by local ATF offices and so-called "confidential informants."<sup>94</sup>

In November of 2014, in yet another attempt to force federal agencies to attack nonparticipating manufacturers, Big Tobacco filed what, at first blush, appears to be a peculiar lawsuit against the U.S. Department of Agri-

---

<sup>88</sup> See Doug Rendleman, *A Cap on the Defendant's Appeal Bond?: Punitive Damages Tort Reform*, 39 AKRON L. REV. 1089, 1130 (2006) ("[T]he MSA converted the state governments into business partners with their former adversaries, the tobacco companies.").

<sup>89</sup> *City of New York v. Milhelm Attea & Bros.*, 550 F. Supp. 2d 332, 337 (E.D.N.Y. 2008).

<sup>90</sup> H.R. 2990, 113th Cong. (2013).

<sup>91</sup> See *Why Indian Country Must Stop the STOP Act*, NAT'L TOBACCO TRADE ASS'N, [http://www.ncai.org/initiatives/partnerships-initiatives/ncai-tax-initiative/Why\\_Indian\\_Country\\_Must\\_Stop\\_the\\_STOP\\_Act.pdf](http://www.ncai.org/initiatives/partnerships-initiatives/ncai-tax-initiative/Why_Indian_Country_Must_Stop_the_STOP_Act.pdf) (last visited Feb. 23, 2015).

<sup>92</sup> Jeff Cohen, *Current ATF Cigarette Diversion Initiatives*, [http://www.taxadmin.org/fta/meet/09\\_tobacco/papers/Diversion.pdf](http://www.taxadmin.org/fta/meet/09_tobacco/papers/Diversion.pdf) (last visited Feb. 23, 2015).

<sup>93</sup> OFFICE OF THE INSPECTOR GEN. - AUDIT DIVISION, U.S. DEP'T OF JUSTICE, AUDIT REPORT 13-36, AUDIT OF THE BUREAU OF ALCOHOL, TOBACCO, FIREARMS, AND EXPLOSIVES' USE OF INCOME-GENERATING, UNDERCOVER OPERATIONS ii (2013), available at <http://www.justice.gov/oig/reports/2013/a1336.pdf>.

<sup>94</sup> *Id.* at 2, 14-15.

culture (“USDA”).<sup>95</sup> The suit seeks a roughly \$400,000 reduction in payments owed to the USDA based on USDA’s alleged failure to account for unreported cigarette production and sales in calculating Big Tobacco’s market share under the Fair and Equitable Tobacco Reform Act of 2004 (“FETRA”),<sup>96</sup> a statute that directs the U.S. Secretary of Agriculture to offer tobacco farmers annual payments, paid by tobacco manufacturers in an amount equal to their “pro rata share of total gross domestic [tobacco] volume.”<sup>97</sup>

According to Big Tobacco, the offset is warranted because USDA has “failed to account for . . . non-reporting, unlicensed Native American cigarette manufacturers” who sell “a substantial portion of th[eir] cigarettes to non-Native Americans.”<sup>98</sup> The lawsuit is peculiar because, like the states’ attack on tribes via their Contraband Statutes, even if Big Tobacco’s allegations were true, the lawsuit makes no economic sense. Protracted litigation will surely ensue, racking up attorneys’ fees that will far outstrip the mere \$400,000 reduction sought. With annual profits of \$90 billion a year,<sup>99</sup> the lawsuit is a drop in the bucket — hardly something worth ruining an affable relationship with the Secretary of Agriculture over. That is, until the MSA comes into the picture.

In order to understand how the MSA is involved, we must address the enactment of the FETRA. Since 1938, United States tobacco farmers had been the beneficiaries of a federal market stabilization/price support program that utilized marketing “quotas.”<sup>100</sup> Under this system, the USDA set the amount of tobacco a producer could sell during a given season and the price at which he could sell it and tied to very specific property that only

---

<sup>95</sup> See Complaint for Declaratory & Injunctive Relief at 2, *R.J. Reynolds Tobacco Co. v. U.S. Dep’t of Agric.*, No. 14-1388 (D.D.C. Aug. 14, 2014) (hereinafter “USDA Complaint”).

<sup>96</sup> 7 U.S.C. §§ 518-518f (2012).

<sup>97</sup> § 518d(i)(4)(B); *State v. Philip Morris USA Inc.*, 618 S.E.2d 219, 223 (N.C. 2005).

<sup>98</sup> USDA Complaint, *supra* note 95, at 4.

<sup>99</sup> Paul M. Barrett, *Why Big Tobacco Shrugs at a \$24 Billion Verdict*, BLOOMBERGBUS. (July 20, 2014), <http://www.businessweek.com/articles/2014-07-20/reynolds-americans-24-billion-verdict-in-florida-doesnt-matter>.

<sup>100</sup> See 7 U.S.C. §§ 1311–16 (2000) (repealed 2004) (providing overview of statutory quota system); *Cole v. U.S. Dep’t of Agric.*, 33 F.3d 1263, 1265–66 (11th Cir. 1994) (providing an overview of the statutory and regulatory framework). As explained by the North Carolina Supreme Court in *State v. Philip Morris USA*, “In 1938 the federal government began implementing price supports and marketing quotas for U.S. tobacco in an effort to stabilize the domestic tobacco market. Quotas limited production and confined the cultivation of tobacco to specific tracts of land. While the federal government adjusted quota levels annually based on tobacco companies’ demand, federal price supports kept tobacco prices elevated. 618 S.E.2d 219, 220 (N.C. 2005); see also Raysor, *supra* note 12, at 514–25 (discussing in detail federal involvement in the tobacco market).”



existed in specific jurisdictions in specific states.<sup>101</sup> The only way a producer of tobacco could sell his product was to own or lease “quota.”<sup>102</sup> This limited tobacco production to these specific jurisdictions and specific states.<sup>103</sup> Over time, many quotas fell into beneficiaries who did not use them, resulting in over 300,000 absentee quota holders.<sup>104</sup> Because of the limited access to quota, a large amount of the cost of producing tobacco came from leasing quota which has been described as “a wholly artificial cost created by the federal statutory scheme.”<sup>105</sup> In the early 1990s, the inflated cost of American tobacco under this system was high enough that it became cheaper to import tobacco from countries in Africa and South America.<sup>106</sup> Tobacco imports rose even atop of huge reductions in quota prices<sup>107</sup> and a 350 percent tariff on tobacco imports.<sup>108</sup> Between 1981 and 1997, domestic tobacco output declined by roughly 20 percent and was estimated to continue to decline exponentially.<sup>109</sup> By the end of 1997, there was “little doubt that the small tobacco farmer was . . . struggling and perhaps is on the verge of extinction” due to the quota system.<sup>110</sup> Although

---

<sup>101</sup> *State v. Philip Morris USA Inc.*, No. 98-CVS-14377, 2004 WL 2966013, at \*4 (N.C. Super. Dec. 23, 2004). Tobacco farmers were not unique in this respect. The Nation’s most prominently grown crops are subject to a government-imposed quota system. *See e.g.*, 7 U.S.C. §§ 1321–1330 (corn); §§ 1331–1340 (wheat); §§ 1341–1350 (cotton); §§ 1351–1356 (rice); §§ 1357–1359a (peanuts).

<sup>102</sup> A penalty was specified in 7 U.S.C. § 1314(a) for the marketing of tobacco in excess of a producer’s allotment. 7 U.S.C. § 1314(a) (2000). Producers who resell excess-quota tobacco also were subject to a penalty. 7 C.F.R. § 723.410(g) (2005). “The [quota] program was very data intensive, requiring USDA’s Farm Service Agency (FSA) to maintain detailed annual records of every tobacco farmer who owned or leased tobacco quota, including the exact location of the quota. The program also yielded rich market price data since tobacco was historically sold via government-sanctioned tobacco auctions. Prices were closely tied to the government-set minimum support prices guaranteed under the federal tobacco program. No tobacco could be legally sold in the U.S. without providing a significant amount of farm-level production and marketing data to the government agency administering the tobacco program.” Kelly J. Tiller & LaKeya N. Jones, *Post-Buyout Burley Tobacco Production and Trends in the Traditional Burley Regions of Tennessee, North Carolina and Virginia* 3 (S. Agric. Econ. Ass’n., Working Paper No. 34987, 2007), available at <http://ageconsearch.umn.edu/bitstream/34987/1/sp07ti04.pdf>.

<sup>103</sup> *Philip Morris USA Inc.*, 2004 WL 2966013, at \*4.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> Seyward Darby, *Governmental Buyout Terminates Tobacco Quotas*, CHRONICLE (Oct. 12, 2004), <http://www.dukechronicle.com/articles/2004/10/13/governmental-buyout-terminates-tobacco-quotas>; *see also Philip Morris USA Inc.*, 2004 WL 2966013, at \*7 (“Foreign competition was taking huge chunks out of the domestic market. The tobacco support system made U.S. tobacco uncompetitive on the international market from a price standpoint . . .”).

<sup>107</sup> *See generally* Blake A. Brown & Laura L. Martin, *Price Versus Quota Reductions: U.S. Flue-Cured Tobacco Policy*, 28 J. AGRIC. & APPLIED ECON. 445 (1996), available at <http://ageconsearch.umn.edu/bitstream/15112/1/28020445.pdf> (discussing policy of “reducing quota to maintain price versus a policy of allowing price to fall to maintain quota.”).

<sup>108</sup> DAVID SKULLY, U.S. TARIFF RATE QUOTAS AND AGOA MARKET ACCESS 4 (2010), available at [http://www.agritrade.org/Publications/documents/USTRQsandAGOApolicyfocus\\_full.pdf](http://www.agritrade.org/Publications/documents/USTRQsandAGOApolicyfocus_full.pdf).

<sup>109</sup> *Tobacco country fights back*, ECONOMIST (Mar. 19, 1998), <http://www.economist.com/node/158071>.

<sup>110</sup> *Philip Morris USA Inc.*, 2004 WL 2966013, at \*4–7.

talk of putting the quota system to an end had been gaining steam since the early 1990s,<sup>111</sup> legislation was formally introduced to put it to an end in 1997.<sup>112</sup>

Then, in 1998 — in the midst of utter turmoil for tobacco farmers — came the MSA, which would have sounded the death knell had it not been for “Attorneys General from tobacco-producing states strongly advocating that some MSA payments go toward agricultural funding and rural economic development.”<sup>113</sup> As explained by the North Carolina Supreme Court in *State v. Philip Morris USA*,<sup>114</sup>

[Big Tobacco] immediately raised prices to cover the future costs of payments due under the MSA. The parties anticipated this rise in prices would curtail tobacco consumption; indeed, reduced consumption was one of the aims of the MSA. They also understood decreased demand for tobacco products could cause tobacco [farmers] significant economic hardship. The MSA therefore required that [Big Tobacco] meet with the political leadership of the fourteen tobacco growing states . . . to devise a plan for mitigating the MSA’s potentially negative economic consequences. These meetings produced the National Tobacco Grower Settlement Trust [whereby Big Tobacco] pledged to spend approximately \$5.15 billion on economic assistance to tobacco farmers . . . [Big Tobacco] agreed to the Trust because doing so was a condition of the settlement that had relieved them of potentially bankrupting liability for smoking-related healthcare costs. Additionally, the Trust shields [Big Tobacco] from claims the [growers] might otherwise bring for economic damages suffered as a result of the MSA.<sup>115</sup>

Essentially, the “Phase II” MSA payments were meant to ease tobacco farmers’ worries, “as they would be given time to diversify their crop to include other commodities separate from tobacco, or to allow the quota holders to cease planting tobacco altogether.”<sup>116</sup> To calculate exactly how much Big Tobacco was to pay under this Phase II of the MSA, the assessment for a given calendar year would be determined by taking the specified base payment for that year and applying a “Volume Adjustment,” which either

---

<sup>111</sup> See Cecil H. Yancy, Jr., *Timing Was Right for Tobacco Buyout*, SE. FARM PRESS (Jan. 5, 2005), <http://southeastfarmpress.com/timing-was-right-tobacco-buyout>.

<sup>112</sup> Universal Tobacco Settlement Act, S. 1415, 105th Cong. § 821 (1997).

<sup>113</sup> DANIEL J. ROSENBAUM, RICHARD L. BARNES & STANTON A. GLANTZ, *A FEW MORE LAPS TO GO: TOBACCO INDUSTRY POLITICAL INFLUENCE, PUBLIC HEALTH ADVOCACY AND TOBACCO CONTROL POLICY MAKING IN INDIANA 1893-2011*, CTR. FOR TOBACCO CONTROL RES. & EDUC. 97–98 (June 2011).

<sup>114</sup> *State v. Philip Morris USA Inc.*, 618 S.E.2d 219 (N.C. 2005).

<sup>115</sup> *Id.* at 221 (footnotes omitted).

<sup>116</sup> Raysor, *supra* note 12, at 529–30.

increased or decreased the Big Tobacco's payment, depending on the number of cigarettes shipped during the preceding calendar year.<sup>117</sup>

The deal, however, was not the boon expected by tobacco farmers. During the first three years of the Phase II agreement, a total of about \$1 billion was distributed to the 14 participating states.<sup>118</sup> This total was about \$71 million less than estimated and “primarily attributable to adjustments made to trust payments as a result of a decrease in the volume of cigarettes shipped” by Big Tobacco.<sup>119</sup> Another adjustment to payments was the “Tax Offset Adjustment.”<sup>120</sup> Apparently, “[t]he parties drafted [Phase II] knowing federal and state governments might take additional measures to aid tobacco farmers” and that these “measures would probably entail additional assessments” against Big Tobacco.<sup>121</sup> The Tax Offset Adjustment entitled Big Tobacco to reduce its annual payment in response to the imposition of a “Governmental Obligation,” defined as “a new or increased” obligation to pay monies “used in whole or in part for the benefit of tobacco farmers.”<sup>122</sup> Meaning, essentially, that if Big Tobacco was required by law to pay any more than the amount it agreed to pay under Phase II, Phase II payments and all of the benefit that the tobacco farmers were supposed to receive from the MSA would disappear in lieu of a new benefit conferred by state or federal legislation.

As it turns out, Big Tobacco had no intent of paying out under Phase II. From 1998 on, Big Tobacco ramped up its lobbying efforts to pass buyout legislation similar to the 1997 bill, in order “to extricate themselves from the Trust obligations.”<sup>123</sup> Their efforts came to fruition in 2004, an election year.<sup>124</sup> Surreptitiously tucked into Title VI of the American Jobs Creation Act of 2004 was the FETRA<sup>125</sup> — the first law to move an American crop “instantaneously from a government-regulated market to a free-market sys-

---

<sup>117</sup> *Philip Morris USA Inc.*, 618 S.E.2d at 222.

<sup>118</sup> U.S. GEN. ACCOUNTING OFFICE, REPORT NO. GAO-03-262R: STATES' ALLOCATIONS OF PHASE II FUNDS 6 (2002), available at <http://www.gao.gov/assets/100/91635.pdf>.

<sup>119</sup> *Id.*

<sup>120</sup> *Philip Morris USA Inc.*, 618 S.E.2d at 222.

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

<sup>123</sup> *State v. Philip Morris USA Inc.*, No. 98-CVS-14377, 2004 WL 2966013, at \*8 (N.C. Super. Dec. 23, 2004).

<sup>124</sup> *Id.* “The leverage provided by pending close elections on the state and national levels in 2004 provided the best timing for a buyout for tobacco farmers and the tobacco industry.” *Id.* at \*5; see also *id.* at \*12 (“The opportunity for passage of a bill of this nature was in all probability rare and unique. The Tobacco Companies and the growers seized that opportunity. . .”).

<sup>125</sup> American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418, 1521–36.

tem.”<sup>126</sup> The Senate bill passed on July 15, 2004, and provided that the federal government would buyout all quota, with payments funded by assessments levied on Big Tobacco.<sup>127</sup> After Senate and House conferences, on October 11, 2004, an agreed-upon bill was passed, providing quota holders \$7 per quota pound (\$1 less than the Senate bill), paid in equal installments over 10 years, with total payments not to exceed \$10.14 billion (\$1.86 billion less than the Senate bill).<sup>128</sup> In addition, and most importantly, the final bill<sup>129</sup> provided that the buyout would be funded by assessments on *all* tobacco product manufacturers and importers, not just those of Big Tobacco, based upon their market share.<sup>130</sup> Because of the Tax Offset Adjustment, Phase II payments disappeared.<sup>131</sup>

At the same time, FETRA inflicted harm upon tobacco farmers — the supposed beneficiary — because it mandated a forced sale of tobacco quota at a below-market price.<sup>132</sup> Thus, as with most forced sales,<sup>133</sup> although

---

<sup>126</sup> Matthew N. Leerberg, *Takings and Statutory Entitlements: Does the Tobacco Buyout Take Quota Rights Without Just Compensation?*, 55 DUKE L.J. 865, 866 (2006).

<sup>127</sup> *Philip Morris USA Inc.*, 2004 WL 2966013, at \*10. The Senate bill also restricted where tobacco could be grown, the amount produced, and included FDA regulation and set aside funds to support the development in communities that previously heavily relied upon the revenue generated from the production of quota tobacco. The final bill excluded all of this. *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.* at \*11 (“On October 21, 2004, the bill as stated in the conference agreement was presented to President Bush. The President signed the bill the next day.”)

<sup>130</sup> *Id.* The FETRA contains a two-step process for the USDA to determine quarterly assessments owed by tobacco product manufacturers and importers. First, assessments are allocated among six classes of tobacco products: (1) cigarettes; (2) cigars; (3) snuff; (4) chewing tobacco; (5) pipe tobacco; and (6) roll-your-own tobacco. Next, the assessments are allocated on a pro-rata basis among the manufacturers and importers within each of the six classes of tobacco products. *Philip Morris USA, Inc. v. Vilsack*, 736 F.3d 284, 286 (4th Cir. 2013).

<sup>131</sup> *Philip Morris USA Inc.*, 2004 WL 2966013, at \*3, \*12 (“It is abundantly clear that Congress was keenly aware of the impact of FETRA on the Phase II payments.”).

<sup>132</sup> See Leerberg, *supra* note 126, at 872 (“The Buyout Payments are ‘offered’ to the tobacco quota holders. Although this might imply that quota holders have an option to reject the Buyout Payments, thereby obviating a takings claim by giving a quota holder a choice, FETRA negates the value of the quota rights regardless of whether the ‘offer’ is accepted.”). As eloquently described by the Court in *Philip Morris USA Inc.*: “With FETRA the tobacco manufactures achieved a goal critical to their survival — a means to control the price of their most expensive cost component, leaf. The bill dismantles the price support system that drove up costs and gives the manufacturers the ability to control their own destiny by contract pricing and purchase of foreign tobacco. With cost control, they have the possibility of keeping prices at a level that will not diminish consumption. They accomplished that without the burden of FDA regulation which might have further reduced consumption. Of course, between now and 2014 they will have to pay for the benefit they received. The bill is about 8.3 billion dollars. That figure is on top of amounts already paid under the Phase II Trust. While the amount seems large on its face, the cost may not be nearly that high. The Tobacco Companies will have three ways to pay the bill. First, they are relieved of future payments under Phase II in the amount of \$2.7 billion. Those were part of the future costs built into the 1998 price increase. Second, they can decrease prices for leaf and increase wholesale prices. That process has begun already. The Tobacco Companies can save enormous sums and can easily reduce leaf prices by at least the amount that represents (a) the costs savings to non-

FETRA at least partially compensated quota holders for their rights to grow tobacco, it also represented “a sudden shift to financial independence for those . . . persons [who] rel[ie]d on the stream of income from leasing the quota right to tobacco farmers.”<sup>134</sup> The economics of the FETRA have been aptly described by Craig Raysor as follows:

[A]ssessments are to be collected quarterly over the ten year period beginning with the 2005 fiscal year, which the yearly amount would equal out to about one billion dollars. The assessments are apportioned to gross domestic volume share of the market held by each class of tobacco product. The amount to be paid by the cigarette manufacturer could be roughly \$0.05 per pack if the market share remains similar for cigarettes to the 2004 market year. . . . The unfortunate aspect is that these numbers are not as high per farmer as the payout from the manufacturers suggest. The top one percent of recipients will receive a fourth of the payments, equaling about \$600,000 average over the ten years, while the bottom eighty percent will receive about \$5,000 over the ten year period.<sup>135</sup>

Adding insult to injury, after the buyout Big Tobacco — who hold a virtual monopoly on the industry — began purchasing tobacco through direct contracts, which “gave preference to larger, consolidated farms, and which

---

quota holding farmers who had to pay for quota or (b) the amount quota holding farmers will receive under FETRA in lieu of their previous quota. While FETRA is in effect, this will be a break-even proposition for the farmers and the Tobacco Companies if the price is only reduced by the amount of the quota being replaced with buyout payments. The Tobacco Companies expenditures are the same amount, they just go to different places. Farmers receive the same total income when leaf price and buyout payments are combined as they did before. When FETRA payments are over, the cost savings will drop to the bottom line for the Tobacco Companies. If the reduction in the price of U.S. tobacco is greater than the amount required to fund the buyout, the Tobacco Companies will have even more money to pay for the buyout. If the drop in the price of U.S. grown tobacco causes a price drop in the international market or more of the cheaper foreign tobacco is purchased, the Tobacco Companies may receive an immediate cost reduction that drops to the bottom line. Since all U.S. tobacco will be sold on contract, the Tobacco Companies are in a better position to set price. . . . On the distribution side, Tobacco Companies may take more of the share of consumer dollars from retailers and wholesalers or pass some cost increase along to smokers. Phillip Morris and Reynolds have already announced reductions in retailer discounts and some price increases. Thus, Tobacco Companies are in a position to pass buyout costs down to leaf producers and up to retailers, thus increasing the percentage of the consumer dollar spent on tobacco retained by the manufacturers. That has been a trend in the industry. . . . *The economic impact of [FETRA] makes it hard to believe that the bottom line of the Tobacco Companies will be adversely affected by the buyout. It may be benefited.*” 2004 WL 2966013, at \*22–23 (emphasis added).

<sup>133</sup> See generally Holly YoungBear-Tibbetts, *Without Due Process: The Alienation of Individual Trust Allotments of the White Earth Anishinaabeg*, 15 SAMPLE AM. INDIAN CULTURE & RES. J. 93 (1991).

<sup>134</sup> Leerberg, *supra* note 126, at 867.

<sup>135</sup> Raysor, *supra* note 12, at 537–39; see also Leerberg, *supra* note 126, at 891 (“FETRA effects a taking of the quota holders’ property interest in their quota rights and does not provide just compensation.”).

gave the tobacco industry increased leverage over market price.<sup>136</sup> Today almost all tobacco is sold by direct contracting with the Big Tobacco, allowing Big Tobacco to completely “dictate the market.”<sup>137</sup> This new industrialized system is essentially the same as the stripped-down streamline market in the chicken and hog industry<sup>138</sup>:

Under this contracting system, a tobacco company functions as a bank that gives a farmer credit in the form of seed, fertilizer, pesticide, and technical support at the beginning of the year. In exchange for this tangible credit, the farmer agrees to sell his crop to that company. At the end of the growing season, the company’s leaf buyers determine the grade or quality of the farmer’s tobacco leaf. Because the price of tobacco leaf depends on the grade, the company is essentially able to set the price of the tobacco. Often, the company’s payment to the farmer is less than the value of the initial credit, creating a vicious cycle in which farmers fall into debt, continue growing tobacco in an attempt to repay their debt, and, as a result, become even further indebted. Additionally, almost all direct contracts with tobacco companies stipulate that farmers assume the production risk of growing tobacco, including “all loss and damage to the crop due to bad weather.” This stipulation is less kind than the original price support system, which aimed to protect farmers from uncontrollable natural causes that wreaked havoc on their crops. As a result of this exploitive contracting system, many farmers may be growing tobacco involuntarily, unable to break free of the cycle of debt.<sup>139</sup>

But this is not the end of Big Tobacco’s FETRA benefit. It turns out, the \$200 billion windfall that the states obtained in the MSA, too, was not actually intended to come from Big Tobacco, as far as Big Tobacco was concerned.<sup>140</sup> As can be expected, in the months shortly after the tobacco settlements went public Big Tobacco’s share prices fell steeply.<sup>141</sup> Between 2002 and 2003, for example, R.J. Reynolds’ share price fell from \$70 to \$27 per share.<sup>142</sup> In 2003, however, Big Tobacco explained to its shareholders that “it had strategies in place” to remain profitable.<sup>143</sup> One of these “strategies,” discussed above, was lobbying for Contraband Statutes that

---

<sup>136</sup> DANIEL J. ROSENBAUM, RICHARD L. BARNES & STANTON A. GLANTZ, A FEW MORE LAPS TO GO: TOBACCO INDUSTRY POLITICAL INFLUENCE, PUBLIC HEALTH ADVOCACY AND TOBACCO CONTROL POLICY MAKING IN INDIANA 1893-2010, CTR. FOR TOBACCO CONTROL RES. & EDUC. 88 (Oct. 2010).

<sup>137</sup> Raysor, *supra* note 12, at 542.

<sup>138</sup> See Christina Rogers, *Smoking Out a New Venture*, DAILY PRESS, Oct. 30, 2006, at C2.

<sup>139</sup> Anna R. Kuperstein, *Tobacco’s Weakest Link: Why Tobacco Farmers Are Essential Players in the Fight Against Big Tobacco*, 11 J. HEALTH CARE L. & POL’Y 103, 107–08 (2008) (footnotes omitted).

<sup>140</sup> See Raysor, *supra* note 12, at 528–29 (“At first blush, th[e MSA] may seem like a major blow to the profits of the tobacco companies. However, the true brunt of the MSA payments were going to be passed down the supply line as the cigarette companies would charge more for the cigarettes and recoup the money from the consumers.”).

<sup>141</sup> *Freedom Holdings, Inc. v. Spitzer*, 447 F. Supp. 2d 230, 240 (S.D. N.Y. 2004).

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

helped to enforce the Escrow Statutes, thus ensuring that nonparticipating manufacturers had “equivalent obligations” to pay under the MSA, creating something close to price parity.<sup>144</sup>

Big Tobacco’s second strategy was to use the MSA’s NPM Adjustment provision to actually *make* money. The NPM Adjustment, recall, provides for a potential reduction in Big Tobacco’s annual payments to the states if there is an “aggregate market share loss” to nonparticipating manufacturers.<sup>145</sup> In addition, if the NPM Adjustment is triggered, payments into the settlement fund are not merely reduced proportionally. For example, if Big Tobacco lost 10 percent of its market share to a new entrant or other company that did not sign the MSA, it would be able to reduce its payments by as much as 24 percent.<sup>146</sup> As the NPM Adjustment was explained by the Sixth Circuit Court of Appeals in *Tritent Int’l v. Kentucky*:

[T]he NPM Adjustment . . . provides that the payments by [Big Tobacco] to the settling states may be adjusted according to the “NPM Adjustment Percentage.” According to this provision, if a nationally recognized firm of economic consultants determines that [Big Tobacco] ha[s] lost market share as a result of compliance with the MSA, [Big Tobacco]’s required payments to the settling states will be reduced to account for the loss. The NPM Adjustment therefore gives the settling states an incentive to protect the market dominance of [Big Tobacco], because otherwise the settling states themselves will receive less funds.<sup>147</sup>

Under this provision, then, if Big Tobacco raised its cigarette prices to a level that not only made up for any monies paid out to the states, but that actually created a large profit, it might be able to “shed” some market share to the nonparticipating manufacturers — who, because of the Escrow and Contraband Statutes, are not able to completely undercut them — while at the same time lowering their MSA payments. In essence, through manipulation by Big Tobacco, the NPM Adjustment was reduced to “an agreement among competitors to allow rival [manufacturers] to flourish in an attempt to trigger the NPM Adjustment to reduce their own MSA payments.”<sup>148</sup>

---

<sup>144</sup> *Id.* at 240–41

<sup>145</sup> *Grand River Enter. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 163 (2d Cir. 2005).

<sup>146</sup> *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*, 263 F.3d 239, 244 (3d Cir. 2001) (citing Hanoch Dagan & James J. White, *Governments, Citizens, and Injurious Industries*, 75 N.Y.U. L. REV. 354, 381 (2000)).

<sup>147</sup> *Tritent Int’l v. Kentucky*, 467 F.3d 547, 550–51 (6th Cir. 2006); *see also A.D. Bedell Wholesale Co.*, 263 F.3d at 244 n.18 (quoting text of the NPM Adjustment).

<sup>148</sup> *Grand River Enter. Six Nations, Ltd. v. King*, 783 F. Supp. 2d 516, 530 (S.D.N.Y. 2011); *see also id.* at 527 (discussing an export report concluding the same); *Freedom Holdings Inc.*, 447 F. Supp. 2d at 255 (“[T]he allocation of substantial payments among [Big Tobacco] according to their relative market share, with adjustments that vary directly with their sales volume, provides a disincentive to gain market

This strategy appears to be working. Since 1998, Big Tobacco has seen its sales reduced by roughly 24 percent, losing 12 percent of its market share.<sup>149</sup> At the same time, however, Big Tobacco has doubled the price of its product<sup>150</sup> — resulting in a substantial net gain.<sup>151</sup> Big Tobacco's stock prices began to rise in May of 2003, and have generally continued in the same direction since.<sup>152</sup> During the same period, the volume of nonparticipating manufacturers' sales rose roughly 1,271 percent, growing its market share from 0.5 percent in 1998 to 8.2 percent in 2003.<sup>153</sup>

This brings our attention to Big Tobacco's FETRA lawsuit that seeks to force the USDA "to account for . . . non-reporting, unlicensed Native American cigarette manufacturers."<sup>154</sup> The FETRA, requires the submission of several reports to the USDA, in order to determine a manufacturer's "market share of gross domestic volume."<sup>155</sup> Big Tobacco counts on these numbers being as high as possible, so that they can trigger the NPM Adjustment under the MSA. The FETRA lawsuit, in other words is not about a \$400,000 reduction in FETRA payments. It is about forcing tribes to be complicit in Big Tobacco's plot to dupe states out of even more MSA money.

#### CONCLUSION

The practical effects stemming from the new era of MSA assault are potentially (and likely) devastating for states and tribes alike. In the future, state attorneys general should not be so hasty. A seven-day deadline im-

---

share at each other's expense and an incentive to increase their prices, rather than their output, as the way to maximize their profits. Thus, as plaintiffs argue, [Big Tobacco] ha[s] been increasing their prices even beyond that necessary to recoup their payments to the states, while experiencing decreased sales volume and market share.").

<sup>149</sup> *Freedom Holdings Inc.*, 447 F. Supp. 2d at 239.

<sup>150</sup> See U.S. DEP'T OF AGRIC., TOBACCO AT A CROSSROAD, A CALL FOR ACTION, FINAL REPORT OF THE PRESIDENT'S COMMISSION ON IMPROVING ECONOMIC OPPORTUNITY IN COMMUNITIES DEPENDENT ON TOBACCO PRODUCTION WHILE PROTECTING PUBLIC HEALTH 9 (2000) (finding that since the beginning of 1998, the major U.S. cigarette companies have increased their prices by more than \$1.10 per pack, more than doubling the price of an average pack of cigarettes.); Christopher David Gray, *Troubled Oregon Counties Turn to Cigarette Tax for Public Health*, LUND REPORT (Mar. 18, 2013), <https://www.thelundreport.org/content/troubled-oregon-counties-turn-cigarette-tax-public-health> ("[T]obacco companies have increased their prices by \$2 since 1998, almost doubling their revenue per pack . . .").

<sup>151</sup> Michael Felberbaum, *Reynolds' Net Rises on Higher Cigarette Prices*, YAHOO FINANCE (Oct. 21, 2014, 9:45 AM), <http://finance.yahoo.com/news/reynolds-net-rises-higher-cigarette-120431602.html>.

<sup>152</sup> *Freedom Holdings Inc.*, 447 F. Supp. 2d at 240–41.

<sup>153</sup> *Id.* at 239–40.

<sup>154</sup> USDA Complaint, *supra* note 95, at 4.

<sup>155</sup> *United States v. Belcorp of Am., Inc.*, No. 09-21472-Civ., 2010 WL 2301798, at \*2 (S.D. Fla. June 8, 2010); see also 7 U.S.C. § 518d(h) (2012); 7 C.F.R. § 1463.7 (2014).



posed by Big Tobacco should not “pressure” states to do anything.<sup>156</sup> Rather, legislative pre-approval, via the enactment of statutes, should carry the day.<sup>157</sup> The MSA called for the states to enact Qualifying and Contraband Statutes that should have been reviewed and rejected by the state legislatures based on principles of sovereignty and federalism.<sup>158</sup> At minimum, such a debate would have included participation by tribal governments and financial and public health experts.<sup>159</sup>

The current state of affairs will likely further drive a wedge between states, tribes, and the federal government; upsetting the delicate balance that the sovereigns have built up in more recent years.<sup>160</sup> Since the mid-1990s, states have come to realize that negotiation and agreement with tribes confers mutual benefit.<sup>161</sup> Unfortunately, however, the MSA’s impediments in regard to nonparticipating manufacturers do not create an exception for tribal tobacco or tribal sovereignty. Big Tobacco has insisted that states attack tribal sovereignty, and that they do so “diligently.” For its part, the federal government — flouting its duty to “afford protection” against state intrusion upon tribal sovereignty — has colluded with Big Tobacco.<sup>162</sup> Federal agents often scoff at assertions of tribal sovereignty,<sup>163</sup> likely for

---

<sup>156</sup> Cf. BRANDT, *supra* note 29, at 431 (“Although [states’ Attorneys General] continued to support state-by-state litigation to resolve the suits, arguing that the states that had negotiated individual settlements had achieved more, the pressures bringing the attorneys general into the [MSA] were intense.”).

<sup>157</sup> See generally Christopher Schroeder, *The Multistate Settlement Agreement and the Problem of Social Regulation Beyond the Power of State Government*, 31 SETON HALL L. REV. 612 (2001).

<sup>158</sup> See generally Wenona T. Singel, *The First Federalists*, 62 DRAKE L. REV. 775 (2014) (calling for an “engagement of federalism’s values in judicial review of tribal jurisdictional disputes”).

<sup>159</sup> Gabriel S. Galanda, *Advancing the State-Tribal Consultation Mandate*, INDIAN COUNTRY TODAY, <http://indiancountrytodaymedianetwork.com/2012/10/17/advancing-state-tribal-consultation-mandate> (last visited Feb. 9, 2015).

<sup>160</sup> See Alex Tallchief Skibine, *Indian Gaming and Cooperative Federalism*, 42 ARIZ. ST. L.J. 253, 282 (2010) (noting that through compacting and federal self-determination legislation, the Nation has “achiev[ed] what could be called cooperative tri-federalism: a version of federalism involving the tribes, the federal government, and the states.”).

<sup>161</sup> See generally Matthew L.M. Fletcher, *Retiring the Deadliest Enemies Model of Tribal-State Relations*, 43 TULSA L. REV. 73 (2007). This includes, for example, tax revenues, economic development projects, law enforcement cooperatives, and even new roads and infrastructure. See, e.g., Dick Clever, *Tribal Business: Powerhouse of Tulalips Lights a County*, PUGET SOUND BUS. J. (May 17, 2013, 3:00 PM), <http://www.bizjournals.com/seattle/print-edition/2013/05/17/powerhouse-of-tulalips-lights-a-county.html?page=all> (discussing an interlocal agreement to rebuild a road system).

<sup>162</sup> Gale Courcy Toensing, *Big Tobacco Rewrites Nebraska Law to Subvert Tribal Sovereignty*, INDIAN COUNTRY TODAY (May 14, 2011), <http://indiancountrytodaymedianetwork.com/2011/05/14/big-tobacco-rewrites-nebraska-law-subvert-tribal-sovereignty-34019>; Joseph P. Kalt & Joseph W. Singer, *Myths and Realities of Tribal Sovereignty: The Law and Economics of Indian Self-Rule 3* (John F. Kennedy Sch. of Gov’t Faculty Research Working Papers Series, Paper No. RWP04-016, 2004) available at <http://www.mynafsa.org/wp-content/uploads/2011/10/Myths-and-Realities-of-Tribal-Sovereignty.pdf>.

<sup>163</sup> See, e.g., *Confederated Tribes & Bands of the Yakama Nation v. Holder*, No. CV-11-3028-RMP, 2012 WL 893913, at \*3–4 (E.D. Wash. Mar. 15, 2012).

their own personal or professional benefit. Further, federal legislation, particularly the FETRA, the STOP Act, and the Contraband Cigarette Trafficking Act (“CCTA”),<sup>164</sup> require tribes to play an instructive part in ensuring that Big Tobacco gets out from under the MSA scot-free, and that Indian tobacco manufacturers experience the brunt of the sanctions supposedly levied upon Big Tobacco.<sup>165</sup>

Furthermore, states — despite their best efforts to cower to Big Tobacco — will teeter on bankruptcy, and some of will fall. States already receive reductions to their bond and credit ratings, which has increased costs and reduced the ability to raise funds through issuing other bonds. Indeed, roughly 79 percent of these bonds are now rated by Moody’s at “B1” or lower,<sup>166</sup> ranking on the bottom of Moody’s scale as “speculative” and “subject to high credit risk.”<sup>167</sup>

In considering the first iteration of the MSA, Senator Judd Gregg, chairman and ranking member of the Senate Budget Committee, had this to say about the deal:

[S]ignificant, I think, is the fact that . . . we are claiming that we are actually harming the tobacco companies. This argument is being made in the marketplace of ideas around here that this tobacco bill is somehow, in some way, an attack on big tobacco, when with the immunity language in it, it is just the opposite — it is a protective blanket. It is an iron curtain of protection for big tobacco. . . . [W]e made a deal with the devil — or somebody made a deal with the devil. . . . I just wanted to highlight that at this point because I think the debate has gotten a little topsy-turvy. It is a little topsy-turvy when a bill is giving, for the first time in the history of our Nation, and in the jurisprudence history of our Nation, product liability protection of immense value to an industry that has produced a product that is inherently deadly and is addictive and is targeted on kids — the first time we are going to do that, and that bill is, for some reason, perceived as being anti-tobacco. It is not anti-tobacco. It is actually very pro-tobacco.<sup>168</sup>

<sup>164</sup> 18 U.S.C. §§ 2341–2346 (2012); 15 U.S.C. § 378 (2012); 7 U.S.C. § 518 (2012).

<sup>165</sup> See, e.g., *Grey Poplars Inc. v. Brands of Cigarettes*, 282 F.3d 1175, 1177 (9th Cir. 2002) (“The fact that the CCTA refers to state law of taxation does not make it any less a federal statute . . . [T]he CCTA is a federal statute of general applicability and it applies equally to Indians, even on the reservation . . . .”); Nichole Friedrichs, *Northeast Region Update*, FED. INDIAN LAW, Spring 2012, at 9; Oliver J. Semans, *The Stop Act is an Encroachment on Tribal Sovereignty*, INDIAN COUNTRY TODAY MEDIA NETWORK, <http://indiancountrytodaymedianetwork.com/2012/04/10/stop-act-encroachment-tribal-sovereignty> (last visited Mar. 2, 2015).

<sup>166</sup> Hillary Flynn, *Strategists Concerned Muni Investors Can’t Manage Tobacco Bonds’ Risk*, BOND BUYER (May 8, 2014, 5:14 PM), [http://www.bondbuyer.com/issues/123\\_89/strategists-concerned-muni-investors-cant-manage-tobacco-bonds-risk-1062321-1.html](http://www.bondbuyer.com/issues/123_89/strategists-concerned-muni-investors-cant-manage-tobacco-bonds-risk-1062321-1.html).

<sup>167</sup> MOODY’S INVESTORS SERV., MOODY’S RATING SYMBOLS & DEFINITIONS 8 (2009).

<sup>168</sup> 144 CONG. REC. S4953 (May 18, 1998) (statement of Sen. Judd Gregg).

In the words of Judge Richard Posner, “a deal with the devil is always a Faustian pact.”<sup>169</sup> Today, the states and the federal government are reaping the seeds sown by that Faustian pact, and Big Tobacco is taking it to the bank. Not to be outdone in malevolency, Wall Street is also in on the deal. Tribal governments and industry, meanwhile, are neglected afterthoughts, punished for the mistakes of Big Tobacco.

In 1998, Professors Mark R. Tonelli and Leonard D. Hudson remarked on the MSA: “[B]efore we make any deal with the devil, we best remember Faustus. If the devil is still around in 25 years, we will certainly regret having signed on the dotted line today.”<sup>170</sup> Today, states, tribes, and the federal government have been pitted against each other on the tobacco front. According to the most recent analysis, it is almost certain that “tobacco bonds will default in the not too distant future . . . , as early as mid-2020s and early-2030s.”<sup>171</sup> I think it is safe to say that we already regret signing that dotted line — if we going to are honest about the costs of the MSA, we should be.

---

<sup>169</sup> *Gaiman v. McFarlane*, 360 F.3d 644, 649 (7th Cir. 2004).

<sup>170</sup> Mark R. Tonelli & Leonard D. Hudson, *A Faustian Pact with Tobacco Industry*, SEATTLE TIMES (Feb. 12, 1998), <http://community.seattletimes.nwsouce.com/archive/?date=19980212&slug=2733976>.

<sup>171</sup> Flynn, *supra* note 166.

