Note to readers: Attorney General Wasden submitted the following article to Fortune magazine in response to a nine-page article published in the magazine's March, 2005 edition. Fortune declined to publish the attorney general's article, saying they did not have space to include more than 200 words. The attorney general provided a shortened letter for publication and makes the full article available here for those who are interested.

STATE OF IDAHO
OFFICE OF THE ATTORNEY GENERAL
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Tobacco Story Hides Benefits In Smokescreen

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By
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Idaho Attorney General

As co-chair of the Tobacco Committee of the National Association of Attorneys General, I appreciate FORTUNE providing me an opportunity to respond to a recent article critical of the national tobacco settlement.

The article, published in the March edition, does not fairly describe the tobacco Master Settlement Agreement of 1998 (MSA). I would like FORTUNE readers to know that the MSA has accomplished a great deal.

Substantial increases in the price of cigarettes since the MSA and the MSA's restrictions on tobacco advertising and marketing have been important contributors to the more than 20 percent reduction in underage smoking. An important, but often-overlooked, element of the MSA was creation of the American Legacy Foundation (Foundation) to conduct an on-going advertising campaign to discourage youth smoking. Peer-reviewed research published in the March issue of the American Journal of Public Health concluded that the foundation's national **truth**® youth smoking prevention campaign accelerated the decline in youth smoking rates between 2000 and 2002. The research directly attributed 22 percent of the overall decline in youth smoking during those years to the **truth** campaign. The study found that by 2002, there were approximately 300,000 fewer youth smokers as a result of **truth**.

The fact that the MSA took the form of an agreement in the settlement of litigation provided a remarkable opportunity for the states to achieve an important public health goal that might otherwise never have been achieved. The four major tobacco companies that signed the MSA in 1998, representing more than 97 percent of the U.S. market, agreed not to target kids in the advertising, promotion, and marketing of cigarettes. They agreed to eliminate cartoon characters like Joe Camel from their advertising. They agreed to stop using billboards and transit ads for cigarettes. They agreed to eliminate merchandise that advertises cigarette brands and they agreed to refrain from making health claims about cigarettes.

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These restrictions probably could not have been accomplished by legislation because of First Amendment protections of commercial speech. Any such legislative attempts would have resulted, at best, in years of protracted litigation, while the tobacco companies continued the advertising practices prohibited by the MSA.

Additionally, the MSA required the "Original Participating Manufacturers" (OPMs) to pay $10.95 billion during the first five years. It also requires annual payments in perpetuity. The ongoing payments recognize both the massive health care costs the states incur because of cigarette smoking and that all cigarettes impose such costs. A fundamental principle of the MSA is that cigarette companies should not be permitted to impose these costs on the states' taxpayers without providing some reimbursement of those costs.

A cigarette is a cigarette, regardless of who sells it. Each cigarette increases state funded health care costs. Recognizing this, the MSA permits other companies, known as "Subsequent Participating Manufacturers" (SPMs) to join the agreement.

SPMs were not required to make the large initial payments required of the original manufacturers. Like the original manufacturers, however, they do make annual payments for each cigarette they sell. The SPMs' per cigarette payments are slightly lower than the per cigarette payments made by the original manufacturers. SPMs are also required to comply with the advertising restrictions and other public health provisions of the MSA. As an inducement to participate, SPMs who joined in the first 90 days did not pay on that portion of sales equal to their pre-MSA market share, but they pay at the same level as the majors for all cigarettes sold above this level. The SPMs have increased both their total sales and their market share, while the original settling manufacturers have seen a decline in market share.

The article's principal criticism of the MSA is based on the economic incentive for the states to pass laws applying to a third group of tobacco companies that refused to join the MSA, the "Non-Participating Manufacturers" (NPMs). These laws are intended to achieve the same purpose as the MSA: to compensate the states for the costs imposed by cigarettes. All of the MSA states enacted laws requiring NPMs to make deposits into an escrow account for each cigarette sold. The escrow deposits were intended to be equal to the per-cigarette payments of the SPMs.

There was, however, an unforeseen problem with the original escrow statutes and because of this problem, they don't accomplish their purpose. Instead, they permit some companies to pay only a fraction of the cost their cigarettes impose on the states. The article is correct in stating that the result is highly inequitable, but the beneficiaries of the inequalities are the NPM companies that exploit this unintended consequence.

When the escrow statutes were written, all of the tobacco companies in the U.S. operated nationally. The escrow statutes, however, inadvertently created new market niches. Entrepreneurs were quick to spot these opportunities and create new companies, focusing their sales efforts on individual states and/or groups of selected states.

These new companies pay virtually nothing into escrow in the states where their sales are concentrated. The more they concentrate sales in those states, the more health care costs they impose on those states but, perversely, the less they pay per cigarette. For example, the company featured in the article, S&M Brands, sells about 50 percent of its cigarettes—more than one billion cigarettes per year—in Virginia. Under the original escrow statute, S&M Brands was required to put about 16 cents per carton in escrow to compensate Virginia. The original and subsequent manufacturers pay $4 per carton, 2,400 percent more than S&M Brands pay.

This disparity created a large economic opportunity for the NPMs. They enjoyed a huge price advantage over their competitors who were making much larger per-cigarette payments, even though NPM cigarettes cause as much injury as any others. Predictably, the NPMs have acquired a significant share of the market.

In addition, the NPMs are not bound by the public health requirements of the MSA. They can, and do, continue to engage in outdoor advertising, brand name merchandising, and the other promotional practices abolished by the MSA. This threatens to roll back the dramatic drop in underage youth smoking and is of great concern to the states.

The fact that the original escrow statutes created opportunities for NPMs hurt the states and their citizens in several respects. First, they discouraged companies from joining the MSA and observing its public health restrictions. Second, they rewarded companies that stayed outside the agreement by permitting them to sell cigarettes without assuming responsibility for any significant portion of the cost their cigarettes imposed on the states and their citizens. Third, they sell cigarettes cheap, a huge enticement to kids.

In Idaho, the legislature eliminated the loophole on terms that we believe are fair to the NPMs. Other states have enacted, or are considering, similar legislation, which will allow NPMs, OPMs and SPMs to compete on a level playing field. In that context, we invite NPMs to join the forty-five other tobacco product manufacturers that have joined the MSA, committing to its public health provisions.

The article's preferred solution—throw out the MSA and resort to a federal tax—is not persuasive. It does not address how federal legislation could impose the important and highly beneficial restrictions on cigarette advertising and promotion contained in the MSA. Nor does it explain how a federal tax would help the states recover the costs they bear as a result of cigarette smoking. Additionally, the article's claim that the states cannot regulate interstate commerce and that the MSA violates the Interstate Compact Clause is wrong. Every court that has reviewed such claims has rejected them.

The MSA has been described by the United States Supreme Court as a "landmark" public health agreement, Lorillard Tobacco Corp. v. Reilly, 533 U.S. 525, 533 (2001), that addresses "one of the most troubling public health problems facing the Nation today." Food

& Drug Admin. v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 125 (2000). It should not be rejected but embraced for the monumental good it has accomplished for America's youth and the nation's public health.

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The author is Attorney General of the State of Idaho, co-chair of the National Association of Attorneys General Tobacco Committee and a member of the board of directors of The American Legacy Foundation.