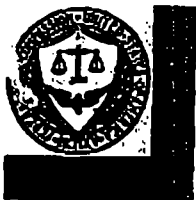


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# Federal Trade Commission

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Re: The Global Tobacco Settlement

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PREPARED STATEMENT OF THE FEDERAL TRADE COMMISSION  
ON ADVERTISING, MARKETING AND ANTITRUST ISSUES IN  
THE GLOBAL TOBACCO SETTLEMENT

PRESENTED BY  
ROBERT PITOFKY, CHAIRMAN

BEFORE THE  
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION  
UNITED STATES SENATE

MARCH 3, 1998

03/02/99 MON 10:10 FAX 202 512 5555 FEDERAL TRADE

Mr. Chairman and members of the Committee, I am here at the request of the Committee to present the testimony of the Federal Trade Commission ("FTC" or "Commission")<sup>1</sup> on two subjects related to the global tobacco settlement. First, I will address proposed restrictions on the advertising, marketing and sale of tobacco products, as well as possible areas for FTC involvement. Second, I will discuss our concerns about any antitrust exemption in the context of a proposed settlement.

#### **FTC Jurisdiction and Historical Overview**

The FTC has a long history of reviewing many aspects of the tobacco industry and its advertising and marketing practices. Section 5 of the Federal Trade Commission Act prohibits unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.<sup>2</sup> Under Section 5, one of the FTC's major responsibilities is the regulation of national advertising, including the advertising and promotion of cigarettes, smokeless tobacco, and other tobacco products. The FTC also enforces Section 12 of the FTC Act, which prohibits the dissemination of false advertisements for food, drugs, devices, or cosmetics.<sup>3</sup> In its regulation of food, over-the-counter drugs, medical devices, and cosmetics, the

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<sup>1</sup> This written statement represents the views of the Federal Trade Commission, with Commissioner Mary L. Azcuenaga not participating. My oral presentation and response to questions are my own, and do not necessarily represent the views of the Commission or any other Commissioner.

<sup>2</sup> 15 U.S.C. § 45.

<sup>3</sup> 15 U.S.C. § 52.

Commission shares jurisdiction with the Food and Drug Administration ("FDA"). FTC and FDA work closely with one another in these areas. For nearly 30 years the two agencies have operated under a Memorandum of Understanding that gives primary responsibility over the advertising of these products, with the exception of prescription drugs, to FTC, and primary responsibility over labeling to FDA.<sup>4</sup>

The FTC's law enforcement activities involving tobacco advertising and promotion date back to the 1930s.<sup>5</sup> In 1962, the FTC's request for technical guidance from the U.S. Public Health Service was among the factors that led the Surgeon General to establish an advisory panel to undertake a comprehensive analysis of the data on smoking and health. This advisory panel in turn led to the historic 1964 Report of the Surgeon General finding that cigarette smoking presented significant health risks. In that year, the Commission concluded that in light of the mounting evidence of the serious health risks caused by cigarette smoking, the failure of the cigarette manufacturers to warn consumers of such a danger violated Section 5 of the FTC Act. As a result, the Commission decided to require tobacco companies to inform the

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<sup>4</sup> Since adoption of the Memorandum of Understanding, FDA has also been granted express jurisdiction over the advertising of restricted medical devices. Medical Device Amendments of 1976, Pub. L. No. 94-295, 90 Stat. 539 (1976). The FTC, however, retains concurrent jurisdiction over the advertising of restricted medical devices under Section 5 of the FTC Act and, with the exception of the power to regulate statutorily mandated statements of intended use, under Section 12. See *In re Dahlberg*, 1995-1 Trade Cas. (CCH) ¶ 70,963 (D. Minn. 1995).

<sup>5</sup> See, e.g., *Julep Tobacco Co.*, 27 F.T.C. 1637 (1938) (stipulation prohibiting claims that Julep cigarettes help counteract throat irritations due to heavy smoking and never make the throat dry or parched).

public about the dangers of smoking.<sup>6</sup> This trade regulation rule, which would have required warnings in cigarette advertising and on tobacco packages, eventually was superseded in 1965 by passage of the Federal Cigarette Labeling and Advertising Act ("Cigarette Act"), which required warnings on tobacco packages.<sup>7</sup> In 1972, pursuant to its Section 5 authority, the FTC issued consent orders mandating for the first time that the major cigarette manufacturers place health warnings in cigarette advertisements.<sup>8</sup>

Today, the FTC has a number of tobacco-related responsibilities in addition to its Section 5 authority. These include the statutory authority to administer the Cigarette Act, and to administer and enforce the Comprehensive Smokeless Tobacco Health Education Act ("Smokeless Tobacco Act").<sup>9</sup> The Cigarette Act authorizes the Commission to ensure that the Surgeon General's mandated health warnings are displayed in alternating sequence on cigarette packaging and advertising in the United States. It also directs the Commission to publish an

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<sup>6</sup> See Trade Regulation Rule for the Prevention of Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. 8324, 8354 (1964).

<sup>7</sup> Pub. L. No. 89-92, 79 Stat. 282 (1965), *as amended by* Pub. L. No. 98-474, 98 Stat. 2204 (1984), and by Pub. L. No. 99-92, § 11, 99 Stat. 393, 402-04 (1985), *current version at* 15 U.S.C. § 1331 (1994).

<sup>8</sup> See *Lorillard et al.*, 80 F.T.C. 455, 460-65 (1972) (consent orders). Under the orders entered into with six tobacco manufacturers, the companies were required to disclose the Surgeon General's warning in identified forms of advertising. The consent orders were modified in 1981, when the Commission sought civil penalties in federal district court against each of the cigarette companies for failure to comply with the 1972 orders. See *United States v. Lorillard*, No. 76-Civ. 814 (JMC) (S.D.N.Y. July 13, 1981). In 1984, Congress amended the Cigarette Act to require rotational warnings for both advertising and package labeling.

<sup>9</sup> 15 U.S.C. §§ 4401 *et seq.*

annual report to Congress on cigarette advertising and promotion.<sup>10</sup> The Smokeless Tobacco Act directs the Commission to promulgate regulations governing the health warnings on packaging and advertising for smokeless tobacco products and to publish a biennial report to Congress on smokeless tobacco advertising and promotion. The Commission has issued regulations specifying the placement and rotation of the warnings, and requiring companies to submit plans setting forth their rotation schedule.<sup>11</sup> In addition, tar, nicotine and carbon monoxide yields for cigarettes are currently determined pursuant to the "FTC method," a uniform testing methodology adopted by the Commission more than thirty years ago; these ratings are then disclosed to consumers in certain forms of advertising pursuant to a voluntary agreement among industry members. The Commission also publishes an annual report listing the tar, nicotine, and carbon monoxide yields of domestic cigarettes. Finally, the FTC enforces the ban on broadcasting smokeless tobacco advertisements on radio and television.

## **Recent Activities**

### **Consumer Protection**

The FTC's tobacco advertising program is an important part of the agency's consumer protection mission. The Commission has taken a number of actions in this area in the past year. Last May, for example, the Commission issued a complaint against R. J. Reynolds

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<sup>10</sup> Although the Commission administers the Cigarette Act, the Department of Justice enforces it.

<sup>11</sup> 16 C.F.R. § 307. Unlike the Cigarette Act, the Smokeless Tobacco Act gives the Commission authority to enforce the health warning requirement.

Tobacco Co. alleging that the company's Joe Camel advertising campaign induced many young people to begin or continue to smoke, or increased the risk that they would do so, and as a result caused, or was likely to cause, significant injury to their health and safety.<sup>12</sup> The FTC is also in the process of reviewing its tar and nicotine testing methodology to determine what changes are necessary to ensure that the test more accurately reflects smokers' actual experience smoking low tar and nicotine cigarettes.

### Competition

The FTC also addresses tobacco issues as part of its competition mission and has many years of experience examining the competitive structure of the tobacco industry. The Commission has, for example, investigated the competitive practices of cigarette firms and challenged the 1994 merger between The American Tobacco Company and Brown & Williamson, a challenge that was subsequently settled by a negotiated order.<sup>13</sup> In addition, this

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<sup>12</sup> The *R. J. Reynolds* matter is currently pending before the agency in litigation before an administrative law judge. Accordingly, the Commission cannot discuss the merits of these allegations. Any decisions in this matter must be based solely on the record of the proceeding and the facts presented therein.

Other law enforcement actions brought by the Commission in recent years include *American Tobacco Co.*, FTC Docket No. C-3547 (Jan. 3, 1994) (consent order settling allegations that advertisements misrepresented the relative amount of tar that smokers of Carlton cigarettes would take in); *Alan Phan*, FTC Docket No. C-3417 (March 12, 1993) (consent order settling allegations that advertisements misrepresented the health risks of smoking certain non-tobacco cigarettes); *Pinkerton Tobacco Co.*, FTC Docket No. C-3364 (Jan. 9, 1992) (consent order settling allegations that smokeless tobacco company's sponsorship of televised truck and tractor pull violated ban on television advertising of smokeless tobacco products).

<sup>13</sup> *FTC v. B.A.T. Industries p.l.c.*, 94 Civ 7849 (motion for preliminary injunction filed Oct. 31, 1994, S.D.N.Y.); *B.A.T. Industries p.l.c.*, FTC Docket No. D.9271 (consent order 1995). Under the April 1995 settlement, BAT agreed to divest certain assets, including brand names

(continued...)

past September, in response to a request from members of the Congressional Task Force on Tobacco and Health, Commission staff prepared an analysis of the potential impact of the proposed tobacco settlement on competition, prices, industry profits and government revenues.<sup>14</sup> In October 1997, the Commission also testified before the Senate Judiciary Committee's Subcommittee on Antitrust, Business Rights, and Competition on the competitive and economic implications of the antitrust exemption proposed in the settlement.

### **Proposed Advertising and Marketing Restrictions in the Proposed Global Tobacco Settlement**

As part of the effort to prevent underage use of tobacco, the proposed global tobacco settlement and the various proposed implementation bills would impose significant restrictions on the advertising, marketing and promotion of tobacco products. These restrictions would be either enacted directly by Congress or achieved through consensual agreements between the tobacco industry and the state and federal governments. The proposed restrictions include

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<sup>13</sup>(...continued)

(Montclair, among others) and production facilities. That divestiture was completed in October 1996.

<sup>14</sup> Federal Trade Commission, "Competition and the Financial Impact of the Proposed Tobacco Industry Settlement," Report prepared by the staff of the Bureaus of Economics, Competition and Consumer Protection at the request of the Congressional Task Force on Tobacco and Health, September 1997 ("Staff Report"). The Staff Report concluded that several features of the settlement, most notably the broad antitrust exemption, might allow cigarette manufacturers to realize substantial profits by increasing the prices of cigarettes beyond the level needed to satisfy the annual payments included in the settlement. Although government revenues associated with the settlement would also be substantial, the cigarette firms would be able to retain about two-thirds of the financial benefits that would flow from any enhanced coordination associated with the antitrust exemption. In November, FTC staff submitted a supplemental evaluation to Congress addressing issues raised by the tobacco industry regarding the September Staff Report.

banning all outdoor and Internet tobacco advertising; prohibiting brand-name tobacco sponsorship of sporting events; excluding human or cartoon figures from all tobacco advertising; limiting tobacco ads to black-and-white text when they appear in publications with a significant underage readership; banning the use of the name or logo of a tobacco brand on non-tobacco merchandise; and prohibiting the use of any non-tobacco brand name as a brand name for a tobacco product.

The FTC strongly supports the goal of reducing tobacco use by minors. As has been reported by other agencies, tobacco products pose significant health risks, causing an estimated 400,000 deaths each year. Moreover, studies report that most of those who use tobacco products begin when they are under 18, when they are less likely to fully understand the serious long-term health effects posed by tobacco use.<sup>15</sup> By the time these individuals are older and can better assess the health consequences, they are likely to be addicted.<sup>16</sup> Therefore, one effective means of reducing the death and disease caused by tobacco is to prevent tobacco use by minors.

Through its 1992 amendments to the Public Health Service Act, Congress already has recognized that serious public health concerns warrant restricting the sale of tobacco products to

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<sup>15</sup> See, e.g., U.S. Department of Health and Human Services, *Preventing Tobacco Use Among Young People: A Report of the Surgeon General*, Atlanta, Georgia: U.S. Department of Health and Human Services, Public Health Service, Centers for Disease Control and Prevention, National Center for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health, 1994 ("1994 Surgeon General's Report"); Regulations Restricting the Sale and Distribution of Cigarettes and Smokeless Tobacco Products to Protect Children and Adolescents, 60 Fed. Reg. 41,314 (1995) ("FDA proposed tobacco regulations") and 61 Fed. Reg. 44,396 (1996) ("FDA final tobacco regulations").

<sup>16</sup> See, e.g., 1994 Surgeon General's Report at 104; FDA proposed tobacco regulations; FDA final tobacco regulations.

minors.<sup>17</sup> We believe that limiting the advertising, marketing and promotion of tobacco products directed to children can be an appropriate and necessary part of a comprehensive approach to reducing youth tobacco use. Such limitations can serve as an important complement to other strategies, such as access restrictions and public education, to reduce underage tobacco use.

The FTC further believes that any effort to restrict tobacco advertising to young people must be sufficiently broad to be effective. The FTC each year issues a report on the advertising and promotional expenditures of U.S. cigarette manufacturers. Those reports show that after cigarette manufacturers were prohibited from advertising on television and radio in 1969 (a prohibition that was intended, in part, to protect children), they put tens of millions of dollars into print advertising to sell their products. In more recent years, the cigarette manufacturers have shifted an increasing amount of money away from traditional advertising and into sponsorships and so-called "trinkets and trash" — T-shirts, caps, and other logo-adorned merchandise — that some believe are very attractive to young people.<sup>18</sup> To prevent simply another such shift in marketing strategy, a set of advertising and marketing restrictions that addresses the many different ways in which tobacco may be marketed and advertised to minors is necessary.

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<sup>17</sup> Section 1926 of the Public Health Service Act conditions a state's receipt of the full amount of Federal block grants for prevention and treatment of substance abuse upon the recipient state's having in effect "a law providing that it is unlawful for any manufacturer, retailer, or distributor of tobacco products to sell or distribute any such product to any individual under the age of 18." 42 U.S.C. § 300x-26(a)(1).

<sup>18</sup> See, e.g., Institute of Medicine, *Growing Up Tobacco Free: Preventing Nicotine Addiction in Children and Youths*, pp. 108-110 (Barbara S. Lynch and Richard J. Bonnie, eds., 1994).

Finally, the advertising and marketing restrictions contained in the proposed global settlement involve a number of complex Constitutional issues. A full discussion of these issues is beyond the scope of this testimony. Nonetheless, the FTC articulated the position in its 1996 comment on FDA's proposed tobacco regulations that restrictions that are appropriately tailored to prevent the advertising and marketing of tobacco to minors will withstand First Amendment scrutiny.<sup>19</sup>

### **The FTC's Role**

Preventing underage use of tobacco products will require concerted and coordinated effort by the various agencies of the federal government, as well as by states and localities. The FDA has compiled a record concerning the harm done by tobacco products and has issued regulations to address these problems. We believe that FDA's efforts have been valuable in promoting public health and that Congress should affirm FDA's authority to regulate tobacco products as it would any other drug or device.

We also believe that the FTC can make a significant contribution to any post-settlement regulation of tobacco advertising. As discussed earlier, the FTC has extensive experience in administering and enforcing the laws that regulate advertising in general and tobacco advertising in particular. Moreover, the FTC is a civil law enforcement agency with investigative and enforcement tools that are well-adapted to regulating tobacco advertising. The Commission, for example, has the power to subpoena documents and testimony, and can issue administrative

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<sup>19</sup> Comment of the Federal Trade Commission, *In the Matter of Regulations Restricting the Sale and Distribution of Cigarettes and Smokeless Tobacco Products to Protect Children and Adolescents*, Department of Health and Human Services, Food and Drug Administration, Docket No. 95N-0253 (January 1996).

complaints and conduct administrative proceedings that may result in the issuance of cease and desist orders against practices found to be unfair or deceptive.<sup>20</sup> In proper cases, the Commission also has statutory authority to file suit directly in federal district court to obtain preliminary and permanent injunctive relief, redress for injured consumers, or disgorgement of ill-gotten gains.<sup>21</sup>

At minimum, we therefore believe that it is important that any legislation contain an express reservation of the FTC's Section 5 and Section 12 jurisdiction, *i.e.*, that nothing in the legislation is intended to alter or amend the FTC's authority over unfair or deceptive acts or practices or the dissemination of false advertisements.<sup>22</sup> A provision expressly preserving FTC's authority ensures that the Commission will be able to continue to bring the kinds of cases it has always brought in the tobacco area. It also enables the FTC to address unfair or deceptive acts and practices in the advertising or marketing of tobacco products that might not otherwise be covered by the settlement, or for which the FTC Act provides better or more flexible enforcement tools. For example, the FTC recently received a petition complaining about the advertising of "no additive" cigarettes and suggesting that such ads make a deceptive health

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<sup>20</sup> 15 U.S.C. § 45. A practice is "deceptive" if it makes a representation or omission of fact that is likely to mislead consumers acting reasonably under the circumstances, and that representation or omission is material. See Letter from the Commission to the Honorable John D. Dingell, Chairman, Committee on Energy and Commerce, U.S. House of Representatives (Oct. 14, 1983); *reprinted in Cliffdale Associates, Inc.*, 103 F.T.C. 110, appendix (1984). A practice is "unfair" if it is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. 15 U.S.C. § 45(n).

<sup>21</sup> 15 U.S.C. § 53(b).

<sup>22</sup> The proposed tobacco settlement negotiated by the state attorneys general provides that the FTC is "to retain existing authority, except for 'tar,' nicotine, and carbon monoxide testing."

claim. Although FDA under the settlement legislation would likely also have authority over such a claim, it might have to initiate a lengthy rulemaking proceeding to address the general use of "no additive" claims, whereas the FTC can directly investigate a particular advertiser and, if the complaint is borne out, take appropriate enforcement action.

Should Congress, as part of the tobacco legislation currently being considered, determine that the FTC has a role to play in administering the settlement's advertising provisions, the Commission's considerable experience with advertising regulation and the tobacco industry will make it possible to carry out such enforcement responsibilities vigorously and competently.

In contrast, to the extent that there are responsibilities set out in the tobacco legislation that depend on scientific knowledge rather than familiarity with advertising practices or the structure of the marketplace, we believe that such responsibilities are most appropriately undertaken by agencies like the Department of Health and Human Services ("HHS"), through either FDA or one of its other health agencies, whose staff possess such expertise. For example, measuring tar, nicotine, and other smoke constituent yields involves complex scientific and methodological questions. Accordingly, the Commission supports proposals that would transfer responsibility for determining such smoke constituent yields to HHS.

We would further observe that we have carried out other Congressionally-mandated responsibilities in close cooperation with other federal agencies and with state authorities. We would take the same approach with any additional legislative authority. As noted earlier, there are many areas in which we share jurisdiction with FDA and work closely with it, dividing our responsibilities for the regulation of foods, drugs, devices, and cosmetics based on our respective areas of expertise.

Moreover, the FTC regularly coordinates its enforcement efforts with state officials.

We share a common enforcement approach with the states on many fronts, with many states enforcing consumer protection statutes and rules patterned after those enforced by the Commission. Separately, recent legislation has expressly granted states the authority to enforce three of the FTC's most prominent consumer protection laws and regulations -- the Telemarketing Sales Rule,<sup>23</sup> the 900-Number Rule,<sup>24</sup> and the Fair Credit Reporting Act.<sup>25</sup> Joint state and federal enforcement in these and other areas has been highly successful, resulting in more extensive and effective enforcement than would otherwise have been possible.<sup>26</sup>

The state attorneys general have played a critical role in bringing forth a comprehensive tobacco settlement. Should that settlement be enacted, the state attorneys general will, and should, continue to play an important role in enforcing its terms. Based on our experience, we strongly support the dual federal-state enforcement scheme contemplated by the proposed settlement. Coordinated federal-state enforcement of the proposed restrictions on tobacco

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<sup>23</sup> 16 C.F.R. § 310.

<sup>24</sup> Trade Regulation Rule Pursuant to the Telephone Disclosure and Dispute Resolution Act of 1992, 16 C.F.R. § 308.

<sup>25</sup> 15 U.S.C. § 1681 *et seq.*

<sup>26</sup> For further information on recent efforts by the FTC and state officials to coordinate enforcement activities, see generally Federal Trade Commission, *The Power of Partnerships: FTC-State Cooperative Efforts* (Bureau of Consumer Protection, March 1996); Federal Trade Commission, *Report to Congress Pursuant to the Federal Trade Commission Act Amendments of 1994* (February 1995).

advertising and marketing seems particularly appropriate as many of the proposed restrictions have specific, local applications.<sup>27</sup>

### **Antitrust Exemption**

Let me now turn to the industry's request for an antitrust exemption for activities relating to the settlement. Any proposal for antitrust immunity is a serious matter and deserves careful examination. Antitrust immunity that is unnecessary, imprecise or excessively broad can enable firms to engage in collusive arrangements that could harm consumers. As a general matter, immunity from the antitrust laws is exceptional and disfavored — there are few industries or competitive situations in which the antitrust laws do not apply.<sup>28</sup>

As noted earlier, on October 29, 1997, I presented the Commission's testimony on this issue before the Senate Judiciary Committee's Subcommittee on Antitrust, Business Rights, and Competition. That testimony addressed the proposed antitrust exemption contained in the June 20, 1997, proposed tobacco settlement and our analysis was based on our understanding of the

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<sup>27</sup> Although much tobacco advertising is most efficiently monitored and enforced on a national basis — for example, advertising on the Internet or in national magazines — restrictions on other forms of advertising or marketing, such as point-of-sale advertising and the use of local media (e.g., local newspapers) to advertise tobacco products, are more likely to be effectively enforced if there is a clear grant of enforcement authority to the states.

<sup>28</sup> See generally ABA Section of Antitrust Law, Antitrust Law Developments 1135 (4th ed. 1997) ("With few exceptions, the antitrust laws apply to all industries.").

industry's antitrust liability concerns at that time.<sup>29</sup> We stated that an antitrust exemption is not required in order to achieve the goals outlined in the proposed settlement.

At the same October 29 hearing, an industry representative, Mr. Meyer G. Koplow, presented testimony in support of an antitrust exemption, outlining five possible reasons an exemption might be needed.<sup>30</sup> Today, I would like to revisit the Commission's October 29 testimony and discuss some additional matters raised by the industry's October 29 testimony and subsequent events.

The fundamental issue is whether the implementation of any terms of the settlement or of any statutory provisions would require collaborative conduct on the part of the tobacco product manufacturers, or whether unilateral compliance with such provisions would suffice. If Congress determines that collaborative conduct is reasonably needed for any legitimate purpose, any antitrust exemption should be narrowly drawn to cover only that conduct.

The immunity provision contained in the proposed global tobacco settlement is very broad. It reads as follows:

In order to achieve the goals of this agreement and the Act relating to tobacco use by children and adolescents, the tobacco product manufacturers may, notwithstanding the provisions of the Sherman Act, the Clayton Act, or any other federal or state antitrust law, . . .

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<sup>29</sup> FTC staff had previously examined the proposed immunity provision in detail and presented its analysis in an appendix to the Staff Report on the proposed settlement. See Staff Report, *supra* note 14.

<sup>30</sup> Testimony of Meyer G. Koplow before the Subcommittee on Antitrust, Business Rights, and Competition (October 29, 1997).

jointly confer, coordinate or act in concert, for this limited purpose.<sup>31</sup>

At the time of the Commission's October 29 testimony, it appeared that the tobacco product manufacturers wanted the proposed immunity provision to protect them in three hypothetical situations. First, manufacturers suggested that they might need to discuss and agree on issues relating to the pass-through of Annual Payment amounts. Second, manufacturers contended that they might need to agree to implement privately the proposed marketing and advertising restrictions in the event that statutory provisions are invalidated on First Amendment grounds. Third, manufacturers stated that they might find it necessary to join forces to deal with retailers that undermine efforts to reduce underage smoking.

Mr. Koplow's October 29 testimony addressed the first and third issues but did not discuss any possible need for private implementation of marketing and advertising restrictions in the event of a successful First Amendment challenge to statutory restrictions. Rather, Mr. Koplow stated that an antitrust exemption was needed because "[t]he industry is agreeing, pursuant to a protocol— a contract with the federal government and the states — not to engage in various forms of advertising, marketing, and promotion . . . ."<sup>32</sup> In addition to this issue and the issues relating to the pass-through of Annual Payment costs and joint dealings with uncooperative retailers, Mr. Koplow's testimony also discussed a need for an exemption for the allocation of annual payment amounts and tort liability costs on a market share basis, as well as

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<sup>31</sup> Proposed Global Tobacco Settlement, Appendix IV, part C.2.

<sup>32</sup> Testimony of Meyer G. Koplow, supra note 30, at 2.

for “further actions going forward on an industry-wide basis that could be necessary to reduce underage incidence.”

The following is a discussion of whether any of these situations warrants a grant of immunity.

**(1) Collaboration on the Pass-Through of Annual Payment Amounts**

The industry’s October 29 testimony acknowledged that an antitrust exemption might not be needed for this purpose if a pass-through requirement is enacted as part of the statute. Thus, the industry agrees with the Commission’s view. If a pass-through provision were enacted, manufacturers could comply individually with the statutory requirement. Moreover, even without a legal requirement to pass on the Annual Payment amounts, the industry’s historical record, as well as economic logic, demonstrates that firms would pass on the Annual Payment amounts without needing to engage in an agreement requiring an antitrust exemption.<sup>33</sup>

A related issue is whether an antitrust exemption would be necessary for the purpose of allocating shares of the Annual Payment amounts and tort liability costs. If an appropriate statutory mechanism were provided, however, the tobacco firms would not have to enter into agreements for that purpose. For example, if the Annual Payment amounts are to be allocated according to each manufacturer’s share of sales or some similar method, the statute could specify the mechanism for doing so. A neutral third party could be assigned the task of determining the

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<sup>33</sup> The Annual Payments would be treated as an added (marginal) cost of business and would be taken into account in setting price. In fact, certain studies have shown that tobacco product manufacturers historically have been able, without any apparent express collaboration, to impose price increases that exceed any additional costs they may have incurred. Staff Report at v, 25-26.

allocations, and the manufacturers could be directed to transmit sales information to that third party. Such an approach would obviate the need for any agreement among the manufacturers.

## **(2) Collaboration on Marketing and Advertising Restrictions**

Some have also argued that certain marketing or advertising restrictions might have to be implemented by agreement among the manufacturers in the event that statutory provisions containing such restrictions are invalidated on First Amendment grounds. The Commission's October 29 testimony stated that the call for antitrust immunity was premature since we could not predict the likelihood and outcome of any First Amendment challenge. In addition, we noted that it would be necessary to more closely examine whether the embodiment of the marketing and advertising restrictions in state and possibly federal consent decrees -- or, as Mr. Koplow has suggested, in a protocol with the states or the federal government -- might in fact obviate the need for an antitrust exemption. The Commission continues to believe that the industry has not demonstrated a need for an antitrust exemption on these grounds.

## **(3) Joint Action to Address Problems with Uncooperative Retailers**

Another reason advanced for antitrust immunity is that the manufacturers might need to join forces to deal with retailers that undermine the manufacturers' efforts to reduce underage smoking by not complying with restrictions on access to tobacco products by underage consumers. As I testified on October 29, although retailer compliance with access restrictions is a valid concern, it does not appear that manufacturers would have to engage in potentially anticompetitive conduct, such as a group boycott, to address the problem of an uncooperative retailer.

First, the proposed legislation, as contemplated by the settlement, would contain incentives for the manufacturers to respond individually to non-complying retailers. The strong penalties for not meeting target reductions in underage smoking could be abated to some extent under the proposed legislation if a manufacturer acted in good faith and took all reasonable steps to achieve the required reduction.<sup>34</sup> A unilateral decision to reduce or stop dealing with a non-complying retailer should be evidence of good faith, and hence a manufacturer would have an incentive to take such action. Therefore, no antitrust immunity would be required to achieve this result.

Second, the proposed legislation would provide additional mechanisms for state enforcement if a retailer failed adequately to control sales to minors. For example, the state could suspend or revoke the retailer's license to sell cigarettes, or it could assess other penalties.<sup>35</sup> Assuming state enforcement is rigorous, private agreement among the manufacturers to engage in self-help enforcement appears unnecessary.<sup>36</sup>

#### **(4) Catch-all Provision for Future Agreements**

Finally, the Commission is especially concerned about the proposal for a catch-all immunity provision, such as the one contained in the proposed global tobacco settlement. The industry's broad-based proposed immunity provision seeks to address purely hypothetical situations and presents a significant risk of price increases (and industry profits) higher than

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<sup>34</sup> See Proposed Global Tobacco Settlement, Title II and Appendix IV.

<sup>35</sup> See *id.*, Title I, Part D, and Appendix II.

<sup>36</sup> Self-help enforcement by agreement among the manufacturers also would raise serious questions about the rights of third parties who are targeted by the manufacturers.

those contemplated by the settlement. Moreover, this provision is inconsistent with most instances where antitrust exemptions have been used. In the rare cases where Congress has conferred a statutory grant of immunity for joint action of competitors, the provisions have more typically excluded specific classes of commerce from the antitrust laws or have exempted a specific transaction or agreement that has been approved by a federal agency, usually in the context of a regulated industry.<sup>37</sup> In contrast, the immunity proposed in the tobacco settlement does not seek to exempt defined categories of transactions or agreements.

The Commission believes that the overall proposed immunity provision is problematic in that it is limited only by the general reference to the goals of the settlement agreement and the proposed implementing statute.<sup>38</sup> Because one of the goals of the settlement is to discourage underage smoking through higher prices that reflect a pass-through of the Annual Payment amounts,<sup>39</sup> the immunity provision might be construed to permit the manufacturers to agree on the actual prices of their cigarettes, not simply on the amount of their Annual Payments. Although the proposed immunity provision does include a requirement of prior approval by the

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<sup>37</sup> See Staff Report at A-3 - A-4. Prior approval of an agreement by a federal agency has not been required where the scope of the immunity was very limited, but broader grants of immunity have been accompanied by strict controls on the development and implementation of agreements. *Id.* at A-4 - A-5.

<sup>38</sup> Manufacturers are left to determine on their own, in the first instance, what joint activity may be appropriate to carry out the purposes of the statute. Although those determinations are subject to review, the resolution of any disputes over the manufacturers' determinations may require costly litigation.

<sup>39</sup> Proposed Global Tobacco Settlement, Title VI, part B.7.

Department of Justice for "any plan or process for taking action pursuant to this section,"<sup>40</sup> the proposed provision presents significant risks of unintended or inconsistent effects. Even a limited discussion among the manufacturers could result in impermissible "signaling" and result in anticompetitive price increases or other harm to consumers. It would also be difficult to monitor and control the scope of such discussions.

Further, the type of exemption mechanism proposed by the industry, requiring approval by either the Commission or the Department of Justice for proposed courses of action, would thrust upon the specified agency an unwarranted and unrealistic regulatory function. The proposed provision is extremely broad and has no limiting principles based on real and identified needs for an exemption. As a result, the agency would be faced with the possibility of a large number of applications covering a wide range of conduct that in theory might be linked to some goal of the settlement. Each application would require the agency to study the effects on the industry, consumers, and third parties, and determine whether the proposed exemption would be consistent with statutory goals and the public interest. This would detract from the agencies' core mission of enforcing the antitrust laws.

I also would like to discuss an antitrust immunity provision that we have not previously addressed -- an exemption for newly-formed tobacco industry trade associations, subject to

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<sup>40</sup> *Id.*, Appendix IV, part C.2. There is a major exception to that requirement, however. Under the proposal, prior approval would not be required for "specific actions taken in accordance with an approved plan." *Id.* Since the specific actions need not be disclosed, a number of anticompetitive agreements could take place without the government's knowledge. Although Mr. Koplow's testimony noted that the industry's application for an exemption under this provision would provide details of the proposed action, that would not obviate our remaining concerns.

oversight by the Attorney General. The Commission sees no apparent justification for such an exemption. The antitrust laws are flexible enough to accommodate the many legitimate activities of trade associations, which also occasionally enter into agreements that are anticompetitive and harm consumers. Over the years, the Commission has brought a number of enforcement actions involving various kinds of trade associations. The proposed exemption for any new tobacco trade association is not necessary and could set an unfortunate precedent.

Accordingly, the Commission believes that the industry has not established a need for any antitrust exemption in order to implement the proposed settlement. Although we firmly believe that the tobacco companies ought not to be subject to increased exposure to potentially damaging private antitrust suits as a result of the settlement, they have not demonstrated that to be a likely outcome. Of course, if the tobacco companies ever do establish the need for an antitrust exemption, the issue can be addressed at that time. The Commission is available to work with the Committee if that need arises.

## Summary

In light of the FTC's expertise in consumer protection and competition matters, the Commission believes it can make a substantial contribution to any post-settlement regulation of tobacco advertising and to consideration of other issues raised by the proposed settlement.