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USING TORT SETTLEMENTS TO CARTELIZE

Ian Ayres*

The tobacco company settlements, with four individual states (Florida, Minnesota, Mississippi and Texas) and the subsequent multi-state agreement of November 1998, represent a legal innovation in cartelization technology.¹ These new settlements allow state and local governments to act as cartel ringmasters - writing enforceable contracts which will predictably (i) raise the market price toward the monopoly level, (ii) split the supra-competitive profits with the government, and (iii) deter new entry. If such settlements are enforceable, states that have virtually no nexus with a set of industry producers - and in fact have not been injured by the industry - may nonetheless "race to the bottom" by suing and settling with an industry in order to enjoy a share of the cartel profits. Unfortunately, it is far from clear that such settlements currently run afoul of the law, and this Article accordingly recommends that federal legislation should prohibit the types of settlement structures that are most likely to produce cartel-like results.

It has been understood that anticompetitive settlements can be produced when competitors sue each other in intellectual property or merger contexts.² It has also been understood that captured state agencies may cartelize in-state producers of a particular product.³ But the individual state tobacco settlements suggest that a state may profitably cartelize out-of-state producers. States may settle fallacious tort claims to cartelize industries with which the state has no contacts whatsoever. The Minnesota tobacco settlement, for example, allowed

William K. Townsend Professor, Yale Law School. ian.ayres@yale.edu. This piece is based on Ian Ayres, *Comment*, in BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 395 (Martin Neil Bailey et al. eds., 1998), which responded to the excellent article, Jeremy Bulow & Paul Klemperer, *The Tobacco Deal*, in BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 323 (Martin Neil Bailey et al. eds., 1998). Bruce Ackerman, Akhil Amar, and Kenji Yoshino provided helpful comments.

¹ See generally Jeremy Bulow & Paul Klemperer, *The Tobacco Deal*, in BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 376-77 (Martin Neil Bailey et al. eds., 1998).

² Joseph F. Brodley, *Antitrust Standing in Private Merger Cases: Reconciling Private Incentives and Public Enforcement Goals*, 94 MICH. L. REV. 1 (1995); J. Stephen Simms, *Scope of Action Against Unfair Import Trade Practices Under Section 337 of the Tariff Act of 1930*, 4 NW. J. INT'L L. & BUS. 234 (1982). Guido Calabresi long ago saw that tort settlements might serve as a focal point for firms in coordinating an anti-competitive price increase. See Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961).

³ *Parker v. Brown*, 317 U.S. 341 (1943).

out-of-state cigarette manufacturers to coordinate charging higher prices in exchange for reduced legal liability.⁴

This Article focuses on two attributes of the settlements:

- (1) damages are contingent on the prospective quantity of sales; and
- (2) damages only accrue above some exempt offset quantity.⁵

The November 1998 multistate agreement contained both aspects. Defendants agreed to pay damages of \$0.35 per pack on prospective national sales, but for small companies a certain percentage of sales were exempt.⁶ Making damages contingent on future quantities sold increases the manufacturers' marginal cost and therefore can predictably increase the price toward the monopoly level. Exempting a certain number of units produced (the "offset" amount) from the damage calculation can allow the state to share the cartel profits with the producers.

To see how these two provisions work together to cartelize the price and split the profits, imagine, for example, that the state of Alaska sues Archer Daniels Midland and other producers of lysine on the cockamamie theory that lysine production creates a particular type of acid rain which has harmed the citizens of Alaska.⁷ Before the suit, lysine is selling at a competitive price of, say, \$100 per ton; and, at the monopoly price of \$120 per ton, 100 million tons could be sold. Immediately following the suit, the parties enter into a settlement whereby Alaska will be paid damages of \$20 per ton on all lysine

⁴ Bulow & Klemperer, *supra* note 1, at 373 & n.127.

⁵ As discussed below, such an "offset" provision was used to limit the production of new entrants.

⁶ Bulow & Klemperer, *supra* note 1, at 376-77.

⁷ Lysine producers such as Archer Daniels Midland ("ADM") have already shown a sharp interest in colluding:

Beginning in 1996, the Antitrust Division prosecuted Archer Daniels Midland and others for participating in an international cartel organized to suppress competition for lysine, an important livestock and poultry feed additive. The cartel had inflated the price of this important agricultural input by tens of millions of dollars during the course of the conspiracy. ADM pled guilty and was fined \$100 million - at the time the largest criminal antitrust fine in history.

Prepared Testimony of John M. Nannes Deputy Assistant Attorney General, Antitrust Division, before the Senate Committee on Agriculture, Nutrition and Forestry, Federal News Service (Apr. 27, 2000).

produced nationally by the industry in any future year in excess of 50 million tons. This hypothetical lysine settlement would likely (a) raise the price of lysine to the monopoly level; and (b) split the monopoly profits between the lysine producers and the settling state. If there were no offset, it would be easy to see that the marginal cost of all lysine would increase by \$20, so one would expect to see the price increase from \$100 (the pre-settlement, competitive price) to \$120 (the post-settlement, monopoly price). Now, imagine the effect of a 1% (1 million ton) offset. One would still expect manufacturers to sell all lysine at \$120 per ton, because competition drives price toward the cost of producing the last ton of lysine, the marginal cost. If the offset is increased to 50 million tons, one should still expect the price of all lysine to be \$120 per ton. For this price and this offset, Alaska would earn "damages" of \$1 billion (50 million \times \$20) and the lysine producers would earn \$1 billion on the 50 million ton offset or inframarginal units.

But wait, it gets worse. Before agreeing to settle Alaska's fallacious suit, the lysine producers may wait to see if some other state would be willing to cartelize their industry for a smaller fee. Nevada may be willing to sue and grant the producers a 60 million ton offset. The larger the offset, the larger the proportion of the profits the producers will retain. In short, a race to the bottom may develop. In the extreme case of state competition, some state might be willing to cartelize the lysine producers for a paltry share of the cartel profits (fearing that the producers move on to settle with another state).⁸ Thus, one might imagine Alaska (or a third state, say, Hawaii) countering by offering to settle for a 90 million ton offset - which would give the producers 90% of the cartel profits (and exact only a 10% ringleader fee).

Of course, for any state settlement to be effective, it must be true that new entrants do not compete down the "settled" price. Accordingly, cartelizing tort settlements are most likely to be effective where there are independent barriers to entry. But even without such structural barriers to entry, it is possible to structure the tort settlement itself to dampen the incentive for unconstrained entry. The November 1998 multistate agreement shows that states can provide powerful carrots and sticks to discourage entry. The settlement by its terms applied only to R.J.R., Philip Morris, Brown & Williamson, and Lorillard, thus raising the possibility that new entrants could enter the cigarette market with a

⁸ It is important to remember that the state's (acid rain) tort claim is, by assumption, fallacious and could not succeed if the defendants refused to settle.

\$0.35 per pack cost advantage (on a product that only cost \$0.20 per pack to produce).⁹ To deter such entry, the agreement included a carrot provision that allowed small producers who voluntarily subject themselves to the per-pack damages to keep all of the revenues on sales of up to 125% of 1997 sales. Alternatively, the agreement also mandated the "stick" that states are encouraged to pass model statutes requiring new entrants and small companies that do not subject themselves to the higher prices to make "trust fund" payments to cover the costs and damages resulting from potential future litigation.¹⁰ The trust fund payments would equal the same amount per pack as the consensual damages per pack under the multistate deal, but would not be deductible. As Bulow and Klemperer note, non-deductibility of the same nominal amounts means that "a payment of \$0.35 a pack would require a price increase of about \$0.55 a pack, putting a nonsignatory at a \$0.20 price disadvantage."¹¹ Finally, the "trust fund" payments would need to be made on all packs sold rather than simply those in excess of 125% of base sales (which would occur if the producer consented to the aforementioned "carrot").¹² The agreement was also careful to give the individual states strong incentives to pass the model legislation and defend it from constitutional attack. States that did not pass the model statute risked forfeiting their entire share of the per-pack damages; and states that passed the law but whose state courts declared it invalid would lose up to 65% of their cut of the cartel revenues.

If such shenanigans do not violate federal law, we are potentially in a lot of trouble. Individual states may be tempted to cartelize private industries under the guise of settling sham litigation. Unfortunately, the thesis of this Article is that the state cigarette settlements in particular, and the sham litigation in general, are not clearly illegal. The remainder of this Article assesses three different reasons why the state settlements - and more generally the ploy of basing settlement payments on the prospective quantities of product sold nationally - might be unenforceable. For convenience, this Article will refer to these rationales,

⁹ Bulow & Klemperer, *supra* note 1, at 377.

¹⁰ *Id.*

¹¹ *Id.*

¹² The proposed tobacco resolution of June 20, 1997 contained analogous "sticks" to encourage the participation of non-settling firms. *Id.* Non-participating firms would have been required to escrow as a bond against future legal claims (for 35 years) 150% as much money as they would have had to pay under the proposed per-pack damages. *Id.* at 338 n.33.

respectively as the non-legislated taxation, extraterritorial taxation, and cartelization theories.

I. NON-LEGISLATED TAXATION

While this Article has argued that the tobacco settlements are a cartel device, the settlements can also be seen as imposing an extraterritorial tax.¹³ Viewed as a tax, the settlements might be criticized on the ground that the taxing power belongs to the legislature – not to the executive, and certainly not to the industry. This is not, however, the primary reason to question the legality of the settlements. For one thing, the power of taxation is a matter of state constitutional law, and a state could repeal a constitutional restriction (if it currently has one) requiring the legislature to impose all taxes, or the legislature (or the legislature's delegate) might be willing to enter into the same type of settlement to transfer money from other states' citizens to its own fisc.

There is also the important question of whether this settlement constitutes a tax or a fee. Even though there is some basis at the federal level for thinking that taxes are a matter solely for the legislature,¹⁴ courts have narrowly defined what constitutes a "tax." It is simply not the case that all payments to the government are taxes which must grow out of legislative action. For example, in upholding the FCC's collection of cable fees, the Supreme Court in 1974 had this to say about the difference between taxes and fees:

Taxation is a legislative function, and Congress, which is the sole organ for levying taxes, may act arbitrarily and disregard benefits bestowed by the Government on a taxpayer and go solely on ability to pay, based on property or income. A fee, however, is incident to a voluntary act, e.g., a request that a public agency permit an applicant to practice law or medicine or construct a house or run a broadcast station. The public agency performing those services normally may exact a fee for a

¹³ *Id.*

¹⁴ See *National Cable Television Ass'n v. United States*, 415 U.S. 336, 340 (1974) ("Taxation is a legislative function, and Congress, . . . is the sole organ for levying taxes . . ."). This conclusion is based on Article I, Section 8, Clause 1 of the United States Constitution, which grants Congress the "Power to lay and collect Taxes." *Id.* at 341.

grant which, presumably, bestows a benefit on the applicant, not shared by other members of society.¹⁵

The legislative action requirement for taxation is probably an attempt to assure a broad-based political check against unwanted taxes, but a voluntary payment in exchange for a benefit is not a tax because the consent of the payer substitutes for the political check. Similarly, the fact that the tobacco companies consented to the state settlements may be considered by the courts as a substitute for the legislative-political check.¹⁶

II. EXTRATERRITORIAL TAXATION

A potentially stronger basis for challenging such settlements turns on the extraterritorial effect of "taxation." In 1881, the Supreme Court defined the extraterritoriality principle succinctly and unanimously in *Bonaparte v. Tax Court*¹⁷: "No State can legislate except with reference to its own jurisdictions."¹⁸ The more majestic language of Chief Justice John Marshall in *McCulloch v. Maryland*¹⁹ is also apposite:

It is admitted that the power of taxing the people and their property is essential to the very existence of government, and may be legitimately exercised on the objects to which it is applicable, to the utmost extent to which the government may chuse to carry it. The only security against the abuse of this power, is found in the structure of the government itself. In imposing a tax the legislature acts upon its constituents. This is in general a sufficient security against erroneous and oppressive taxation. . . . Would the people of any one State trust those of another with a power to control the most

¹⁵ *Id.* at 340-41. The Supreme Court has also upheld judicially imposed taxes to fund school desegregation remedies. See *Missouri v. Jenkins*, 495 U.S. 33 (1990).

¹⁶ Of course, if the incidence of the settlement will fall largely on consumers, the question arises whether the companies' consent is sufficient.

¹⁷ 104 U.S. 592 (1881).

¹⁸ *Id.* at 594. The Supreme Court rejected the claim that a state issuing bonds could - because of the full faith and credit clause - exempt those bonds from the taxation of other states where the bondholder lived. *Id.*

¹⁹ 17 U.S. (4 Wheat.) 316 (1819).

insignificant operations of their State government? We know they would not.²⁰

The specific prohibition against states taxing activities that occur outside their jurisdiction is now normally said to be an implicit requirement of the Fourteenth Amendment's due process clause.²¹ In 1940, the Supreme Court articulated the basic standard for determining whether a tax was "extraterritorial," that is, whether it violated the due process clause:

[The] test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.²²

As one scholar has noted:

This rather amorphous standard has been found to have two components. First, "no tax may be imposed unless there is some minimal connection between [the activities generating the income] and the taxing State." Second, "the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.'"²³

Under these standards, the settling states would argue that they have given something in return to the cigarette manufacturers - to wit, limitations on tort liability. Opponents of the settlement would argue, however, that the cigarette revenue attributed to the state for tax

²⁰ *Id.* at 428, 431.

²¹ This prohibition on extraterritorial taxation actually predates the passage of the Fourteenth Amendment. See *Hays v. Pacific Mail Steam-ship Co.*, 58 U.S. (17 How.) 596, 599-600 (1854). The extraterritoriality principle also at times raises dormant commerce clause and full faith and credit clause issues. Donald H. Regan, *Siamese Essays: (i) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (ii) Extraterritorial State Legislation*, 85 MICH. L. REV. 1865 (1987). The state cigarette settlements do not implicate the dormant commerce clause because they do not "favor local businesses over out-of-state businesses." See *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970).

²² *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

²³ Seth Goldstein, Note, "Resident" Taxpayers: Internal Consistency, Due Process, and State Income Taxation, 91 COLUM. L. REV. 119, 128-29 (1991) (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-73 (1978)).

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purposes was not rationally related to values connected with the taxing state. Florida has an interest in its in-state cigarette sales, but basing the settlement amount on cigarettes manufactured and sold outside the state is arguably not rationally related to Florida's interest. This argument is even stronger in this Article's lysine hypothetical, where the state is not suing to redress any actual harm, but solely to organize an industrial cartel.

Although it is clearly true that an explicit attempt by the Florida legislature to impose a \$0.02 per pack national excise tax would be unconstitutional, it is equally true that not every corporate settlement payment to a state that may have the effect of raising the ultimate price of the corporation's products is unconstitutional. One can easily imagine, for example, a scenario where Exxon's payments to the state of Alaska for the Valdez oil spill could have caused Exxon to increase its gasoline prices.²⁴ As an initial matter, the question of extraterritorial taxation only arises if one characterizes the settlement payments as a tax (which raises again all of the previous section's concerns about the fee vs. tax distribution). While these payments have many of the economic features of taxes, Bulow and Klemperer's own analysis highlights some crucial differences in legal consequences. For example, the settlement liability may not survive bankruptcy of the current manufacturers in the same way that tax liabilities would - some tax liabilities take special priority and are passed on automatically to subsequent purchasers, which may not be true for settlement liability. Moreover, the settlements bind only those manufacturers who consent.²⁵ As earlier mentioned, this is not the consent of the out-of-state consumers who have to bear the primary incidence of the "tax." But even setting aside this shortcoming, the consent limitation means that Liggett and future entrants would not be liable to pay the prospective per-pack damages. Competition from

²⁴ Although lump sum payments are often sunk (no pun intended) and do not affect the marginal prospective cost, one can imagine circumstances where lump sum payments would increase a corporation's marginal cost of capital and possibly its product price. Indeed, Peter Cramton and his colleagues have shown that rivals for FCC wireless communication licenses tried to raise each other's sunk costs, possibly to affect their ability to compete in the downstream consumer market. Peter Cramton et al., *Efficient Relocation of Spectrum Incumbents*, 41 J.L. & ECON. 647 (1998).

²⁵ The Supreme Court has considered whether a corporation's consent by choosing to do business in a state is sufficient to constitute what otherwise would be an unconstitutional extraterritorial tax. In *Western Union Tel. Co. v. Kansas ex rel. Coleman*, 216 U.S. 1, 34-38 (1910), the Court held that a state had no power to condition the right to do local business on the payment of an extraterritorial tax. Justice Holmes dissented, arguing that the company had made a voluntary agreement. *Id.* at 52.

non-consenting manufacturers at least might mitigate the extra-territorial effect. Traditional excise taxes do not allow this competitive reaction from uncovered firms. Of course, the November 1998 multistate agreement also shows how states can try to dampen such competitive reaction by punishing entrants who do not join in the agreement and by rewarding new entrants that do join in.

If the issue ever reached a competent court, the most compelling reason why the settlement might be struck down concerns its explicit attempt to regulate extraterritorial behavior. Exxon's Valdez settlement may have indirect effects on out-of-state transaction prices, but that settlement did not explicitly change the marginal out-of-state cost of transacting in the same way the state cigarette settlements do. The Supreme Court in *Brown-Forman Distillers Corp. v. New York State Liquor Authority*²⁶ showed an antipathy to at least one type of explicit extraterritoriality regulation.²⁷ *Brown-Forman* concerned the constitutionality of New York's "affirmation law," which required distillers that sold to wholesalers in New York to file monthly price schedules for their products and to affirm that they would not sell liquor at a lower price to any wholesaler anywhere else in the country during this period. Distillers who violated this affirmation could have their license to sell liquor in New York revoked. The Supreme Court struck down this explicit attempt to regulate out-of-state prices - even though the regulation did not discriminate against out-of-state trade and was not easily characterized as a tax - because of the direct and explicit nature of the attempt to affect extraterritorial transactions.

Although this extraterritorial due process challenge is the strongest grounds for attacking the state settlements, grave procedural barriers may preclude competent litigants from bringing suit before a competent tribunal. Who has standing to complain about the violation? It is far from clear that a cigarette smoker would be allowed to intervene to raise the claim. And even those new entrants that refused to sign the agreement would not want to challenge it, because the agreement amongst its rivals would create a pricing umbrella which would allow it to profitably raise its own price. Furthermore, because state courts are often thought to join the other branches of state government in competitive federalism races, we should not put great faith in state tribunals being able to make disinterested determination of either this

²⁶ 476 U.S. 573 (1986).

²⁷ *Id.*

standing question or the underlying substantive issue.²⁸ Yet, it is hard to conceive how such issues would make their way to a federal court with a less self-interested incentive to review the claim. It should not be surprising that no court has to date been presented with this substantive issue.

III. CARTELIZATION

An alternative to the previous "tax" characterization is to attack the state settlements as an attempt by states to help cartelize the cigarette industry. Under this interpretation, the state settlements would be seen as agreements among the cigarette manufacturers and the individual states whereby the manufacturers would agree to raise prices and give their increased profits to the state in return for reduced tort liability. Or, under the more extreme lysine hypothetical, the state would be helping industries raise prices and split the profits between the manufacturers and the state (by means of the offset amount).

The problem with this theory is that "state action" is broadly immunized from Sherman Act antitrust scrutiny. Congress could prohibit anticompetitive state regulations, but the Supreme Court has held that Congress did not intend the Sherman Act to restrain even anti competitive state action.²⁹ Bulow and Klemperer recognized that a "state action" doctrine would allow a state to enter into a settlement which would raise the in-state price of cigarettes just as it "allows cities and taxi owners to fix fares without running foul of the federal antitrust laws,"³⁰ but they do not seem to recognize that this doctrine also allows states to orchestrate higher prices that predominantly fall on out-of-state consumers. For example, in the mother of all state action cases, *Parker v. Brown*,³¹ the Supreme Court refused to strike down a California statute that created a commission to set prices and restrict output among California raisin growers. Like the Mississippi tobacco settlement, the California raisin regulations tend to raise the price on in-state and out-of-state consumers. The fact that the vast majority of consumers affected by the statute would be out-of-state does not affect the legality of the state's action.

²⁸ Ian Ayres, *Judging Close Corporations in the Age of Statutes*, 70 WASH. U. L.Q. 365 (1992).

²⁹ See *Parker v. Brown*, 317 U.S. 341, 350-51 (1943).

³⁰ Bulow & Klemperer, *supra* note 1, at 373 n.128.

³¹ 317 U.S. 341 (1943).

Indeed, the prevailing standard for determining whether otherwise anticompetitive conduct is immune under the state action doctrine is the two-prong *Midcal* test which requires that the challenged restraint must be "clearly articulated and affirmatively expressed as state policy" and "actively supervised" by the state.³² These requirements, however, would do little to thwart either the cigarette settlements or the more pernicious lysine race-to-the-bottom. The settlements do more than merely give the cigarette manufacturers an opportunity to collude: they "clearly articulate" a mandated payment per pack.³³ The states would also actively supervise the collusion, for example, by auditing the yearly collection of the settlement amount.³⁴ The Supreme Court has emphasized that the active supervision requirement does not imply that the regulation must take the public interest into account:

Our decisions make clear that the purpose of the active supervision inquiry is not to determine whether the State has some normative standard, such as efficiency, in its regulatory practices. Its purpose is to determine whether the State has exercised sufficient independent judgement and control so that the details of the rates or prices have been established as a product of deliberate state intervention, not simply by agreement among private parties.³⁵

Courts will not inspect the purpose or effect of the regulation, only whether it is the true byproduct of state action.

The single relevant exception to this broad doctrinal immunity concerns circumstances when the state itself is a "commercial participant" who colludes with other industry members. But the

³² *California Retail Dealers Ass'n. v. Midcal Aluminum*, 445 U.S. 97, 105 (1980); see also *Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48 (1985).

³³ This supervision requirement prevents the state from frustrating "the national policy in favor of competition . . . by casting a 'gauzy cloak of state involvement' over what is essentially a private price-fixing agreement." *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 345 (1987).

³⁴ There is some question whether the state policy has to be articulated by a legislature. See *Hallie v. City of Eau Claire*, 471 U.S. 34, 43 (1985); John Shepard Wiley, Jr., *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713 (1986). This raises an antitrust analog to the earlier issue of nonlegislative taxation. It may be that nonlegislative cartelization may fall outside of the state action doctrine; however, state legislatures should have ample incentives to enter into the lysine deal.

³⁵ *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 634-35 (1992); see also *New England Motor Rate Bureau, Inc. v. FTC*, 908 F.2d 1064, 1074 (1st Cir. 1990).

Supreme Court has recently emphasized that the “commercial participant” exception does not cover every potential state “conspiracy”:

There is no . . . conspiracy exception. The rationale of *Parker* was that, in light of our national commitment to federalism, the general language of the Sherman Act should not be interpreted to prohibit anticompetitive actions by the States in their governmental capacities as sovereign regulators. [T]his immunity [however,] does not necessarily obtain where the State acts not in a regulatory capacity but as a commercial participant in a given market. That is evident from . . . *Union Pacific R. Co. v. United States*, 313 U.S. 450 (1941), which held unlawful . . . certain rebates and concessions made by Kansas City, Kansas, in its capacity as the owner and operator of a wholesale produce market that was integrated with railroad facilities. These sentences should not be read to suggest the general proposition that even governmental regulatory action may be deemed private – and therefore subject to antitrust liability – when it is taken pursuant to a conspiracy with private parties. The impracticality of such a principle is evident if, for purposes of the exception, “conspiracy” means nothing more than an agreement to impose the regulation in question. Since it is both inevitable and desirable that public officials often agree to do what one or another group of private citizens urges upon them, such an exception would virtually swallow up the *Parker* rule: All anticompetitive regulation would be vulnerable to a “conspiracy” charge.³⁶

The only realistic hope of voiding the state settlements on antitrust grounds would lie in squeezing them into the “commercial participant” exception. Clearly being an active conspirator is not enough. Although the state is not a participant in the manufacturing of cigarettes, a court might be willing to find that the state participated in the market by claiming its share of the oligopoly profits. But as with the extraterritorial taxation, substantial standing and jurisdictional barriers would need to

³⁶ *City of Columbia v. Omni Outdoor Adver., Inc.*, 499 U.S. 365, 374-75 (1991); see also E. THOMAS SULLIVAN & JEFFREY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS § 3.07[A], at 90-103 (3d ed. 1998).

be crossed before the substantive claim could be heard by a competent tribunal.

IV. CONCLUSION

The individual state deals, in particular, represent a striking regulatory innovation that threatens to externalize beyond the consenting parties the majority of the deal's costs. If such shenanigans are legal, they provide a blueprint for future mischief - a classic race-to-the-bottom. Unfortunately, no one has uncovered a silver bullet that would be certain to kill the beast. The extraterritorial taxation effect *might* violate the due process clause and the state's financial participation in cartel profits *might* run afoul of the Sherman act, but it may be difficult for out-of-state consumers to pursue these claims in federal court (not subject to race-to-the-bottom pressure).

Simply because the state deals do not clearly violate current federal law, however, does not mean that they could not be made to. Congress should seriously consider prohibiting state settlements which condition payments on future out-of-state sales - or at least require stronger showings of out-of-state effects before allowing extraterritorial regulation³⁷ - especially if such output-contingent damages are combined with offsets (to split the cartel profits) or ancillary incentives to curb new entry.

There is a substantial (but less likely than not) chance that the current lawsuits by more than 30 cities, counties and states will be settled with an industry-wide agreement that includes output-contingent damages and producer offsets. Guns, like cigarettes, are a "pariah" product which perversely makes strange bedfellows of the industry shareholders and the far left. Both of these groups favor monopoly pricing - the left because it reduces consumption, shareholders because it by definition maximizes profits. Even fallacious suits against pariah industries are therefore likely to be more politically feasible than suits against other industries.³⁸

³⁷ Unfortunately, the pathological lysine example was at least formally supported by Alaska's claim of an environmental externality (acid rain). Alaska under such a hypothetical federal statute would argue that payments conditioned on future lysine production were rationally related to the amount of prospective damage that would rain down.

³⁸ It is also interesting to note the parallel between Liggett and Smith & Wesson as the early defectors in the industry's struggles against the state.

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Of course, there is great enmity and distrust between industry and government officials - but this was surely the case with tobacco as well. Anticompetitive reactions have become an explicit part of the response to the Smith & Wesson's initial settlement. Six states are currently investigating whether other industry participants have engaged in concerted exclusionary behavior to punish Smith & Wesson.³⁹ And gun manufacturers have sued police enforcement agencies for conspiring to purchase only from Smith & Wesson.⁴⁰ While the battlefield currently turns on exclusionary strategies and counterstrategies, the disputants - including the government plaintiffs - may all too soon see that there is more money to be made by colluding than by excluding.

³⁹ 6 States in Antitrust Probe of Gun Makers, UNITED PRESS INT'L, Apr. 6, 2000.

⁴⁰ David Lightman, *Gun-makers Fight Back with Lawsuit*, THE HARTFORD COURANT, Apr. 27, 2000, at A24.