

GOVERNMENTS, CITIZENS, AND INJURIOUS INDUSTRIES

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In this Article, Professors Hanoch Dagan and James White study the most recent challenge raised by mass torts litigation: the interference of governments with the bilateral relationship between citizens and injurious industries. Using the tobacco settlement as their case study, Dagan and White explore the important benefits and the grave dangers of recognizing governments' entitlement to reimbursement for costs they have incurred in preventing or ameliorating their citizens' injuries. They further demonstrate that the current law can help capture these benefits and guard against the entailing risks, showing how subrogation law can serve as the legal foundation of the governments' claims, and how takings law can be used as a check against governmental abuse.

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INTRODUCTION

Citizens sue industries for tort injuries. That is familiar. Governments sue the same industries for costs suffered in ameliorating or preventing those injuries. That is unfamiliar. This new pattern of litigation and settlement inherently puts the government in competition with its citizens. It also facilitates the government's fulfillment of its public responsibility. This Article deals with these vices and virtues.

The tobacco litigation by the states and the settlement of that litigation (the largest ever) is the most prominent example of this pattern of government suing injurious industries. A similar pattern is developing in the gun industry where more than twenty suits have been brought against the manufacturers.¹ Industries waiting in the wings for this treatment include lead paint makers,² and perhaps even brewers, distillers, and producers of fatty foods.³

¹ See Paul M. Barrett & Milo Geyelin, *Big National Law Firms Leap to Help Gun Industry as It Fights Suits by Cities*, *Wall St. J.*, July 14, 1999, at B7.

² See Sandra Torry, *Lead Paint Could Be Next Big Legal Target*, *Wash. Post*, June 10, 1999, at A1. Actually, Rhode Island has just begun litigation against lead paint manufacturers. See Judyth Pendell, *Trial Lawyers' Next Target: The Paint Industry*, *Wall St. J.*, Oct. 18, 1999, at A49.

³ Similar triangulars occur not only in the setting of injurious industries, but also in the context of international human rights cases. For example, in July 1995, the South African Parliament passed an act giving members of the apartheid government amnesty against civil claims. See *Promotion of National Unity and Reconciliation Act of 1995*, Act 34, §20(7). The Azanian Peoples Organization, a largely black anti-apartheid group, challenged the constitutionality of the Act, claiming that their constitutional rights were violated because they could not seek reparations for their injuries through legal action. See *Azanian Peoples Organisation (AZAPO) v. President of the Republic of South Africa*, 1996 (4) SALR 671, 672 (CC). The South African Constitutional Court held that the provisions did violate part of the constitution, but ultimately justified their validity on the basis of the constitution's epilogue, which allowed programs geared toward national unity and reconciliation. See *id.* at 682-83. However, the court refused to find that the South African government did not owe any duty to compensate the victims of apartheid and their families for injuries and losses suffered, although the court indicated that full compensation was not

always necessary, and that in some cases, "symbolic" compensation (such as erecting a gravestone for a family's lost relative) would be sufficient. See *id.* at 695-96:

The resources of the State have to be deployed imaginatively, wisely, efficiently and equitably to facilitate the reconstruction process. . . . [However,] it is much too simplistic to say that the objectives of the Constitution could only properly be achieved by saddling the State with the formal liability to pay, in full, the provable delictual claims of those who have suffered patrimonial loss

....

The practical effect of this decision has been to decrease plaintiffs' awards. See Jeremy Sarkin, *The Effect of Constitutional Borrowings on the Drafting of South Africa's Bill of Rights and Interpretation of Human Rights Provisions*, 1 U. Pa. J. Const. L. 176, 201-02 (1998); see also Jennifer J. Llewellyn & Robert Howse, *Institutions for Restorative Justice: The South African Truth and Reconciliation Commission*, 49 U. Toronto L.J. 355, 369 (1999).

Another litigation triangle occurred in India in the wake of the December 2, 1984 Bhopal chemical plant disaster. The accident caused nearly 2000 deaths and 200,000 injuries when deadly gas escaped from a Union Carbide plant near Bhopal, India. See Jamie Cassels, *The Uncertain Promise of Law: Lessons from Bhopal 3-5* (1993) (discussing details of the disaster). In an attempt to consolidate the claims, the Indian government enacted legislation. See C.I.S. Part IIA (1985), *The Bhopal Gas Leak Disaster (Processing of Claims) Act*, New Delhi, 29 Mar. 1985. The Act empowered the government to be the exclusive agent of the claims of all of Union Carbide's victims. See *id.* § 3. Because the government of India was also named as a defendant in the suit for negligently monitoring the industry, this legislation had the effect of putting the Indian government on both sides of the litigation. Several commentators on the Bhopal litigation conclude that this arrangement produced rather harmful results for the actual victims of the disaster. See, e.g., Cassels, *supra*, at 222-28.

After the litigation had been in play for several years, the Supreme Court of India suddenly acquiesced to a settlement that had been secretly negotiated between Union Carbide and the government of India that required Union Carbide to pay \$470 million in damages. See *id.* at 222-23. Given the enormity of the catastrophe, the settlement was a clear victory for Union Carbide. See *id.* Despite vociferous protestations from the accident victims as well as the international news media, the Indian government accepted the settlement enthusiastically on behalf of the injured victims. See *id.* at 222-28. Meanwhile, on average, families of those who had died in the accident received only \$14,500 each, those with permanent disabling injuries received approximately \$4500 each, and those who had not been permanently injured were awarded about \$3125 each. See *id.* at 229.

A similar arrangement arose in Israel following a 1952 agreement between Israel and Germany. In consideration for the money paid by Germany to Israel as reparation for the material damages caused by the Nazis to the Jewish people, Israel agreed that Holocaust survivors who were naturalized in Israel prior to October 31, 1953 would not be entitled to sue Germany for health-related damages. See H.C. 5263/94 *Hirschenzon v. Minister of Finance*, 49(5) P.D. 837. Before the constitutionalization of the right to property, the Israeli Supreme Court sent complaints to the legislature. See *id.* at 841. But recently, after such constitutionalization, see *Basic Law: Human Dignity and Liberty*, 1992, S.H. 1391, the Court agreed to take a more active stance. In *Hirschenzon*, Holocaust survivors challenged the Minister of Finance's refusal to separate their annuities from the annuities given to other groups of physically challenged people (such as soldiers injured in combat). See *Hirschenzon*, 49(5) P.D. at 842. A majority of the Israeli Supreme Court held that this refusal was illegal, and that while setting their annuity, the Minister of Finance must take into account the State's deprivation of the Holocaust survivors' claims against Germany. See *id.* at 844-45, 847-48. The minority went even further, saying that these Holocaust survivors have an a priori valid takings claim, and raising further doubts as to the validity

In this Article we address some of the questions raised by this recent pattern of litigation and settlement. We assume throughout that consumers or third parties have actually been harmed by the products at issue, be it cigarettes, guns, etc., and have valid claims against the pertinent industry.⁴ We explore the intricate legal questions arising from the triangular relationship among the players in these high-profile cases: governments, citizens, and defendant industries. We have two major purposes: identifying the proper cause of action of governments against industries and setting their appropriate boundaries; and discussing the inherent risks in allowing such claims and pointing to the way they should be addressed.

We take the triangle of states, smokers, and the tobacco industry as our case study. Part I of this Article traces the tobacco saga, which gives us a rich context of litigation and settlement that vividly demonstrates the questions we address in this Article. This Part concludes that some of the quid pro quo given by the states to the tobacco manufacturers is actually at the expense of third parties: competitors (and hence future consumers) and injured smokers.

Part II discusses the general question of the liability of an injurious industry to a government which has incurred preventative and ameliorative costs due to the harms inflicted by that industry on its citizens. We do not cover the whole range of causes of action that were raised by the states in their suits against the tobacco companies, which were by and large rejected (justifiably, in our view) by the courts.⁵ Instead, we focus solely on the restitutionary claim of subrogation. Although subrogation was not adequately presented by the states, it is their only valid claim. Part II explains why subrogation

of the statutory arrangement limiting their entitlement to the said annuity. See *id.* at 846-47.

As the tobacco settlement is now making clear, these litigation triangles can result in suits by the injured against the governments seeking individual restitution. See Stephen Labaton, *Medicaid Smokers Seek to Gain a Share of States' Settlement*, *N.Y. Times*, Jan. 26, 2000, at A11 (discussing pending lawsuits that seek to capture any settlement funds over what state Medicaid programs paid to treat smokers for Medicaid recipients who suffered from smoking-related illnesses).

⁴ This is, to be sure, a debatable matter, on which we disagree between ourselves. For conflicting views respecting the liability of the tobacco industry to smokers, compare Jon D. Hanson & Kyle D. Logue, *The Costs of Cigarettes: The Economic Case for Ex Post Incentive-Based Regulation*, 107 *Yale L.J.* 1163, 1175-76 (1998) (recommending compensation to smokers as way to regulate tobacco industry), with W. Kip Viscusi, *Smoking: Making the Risky Decision* 151 (1992) (arguing for increased efforts to inform consumers of risks of smoking). Professor Dagan subscribes to the former view, while Professor White prefers the latter. Our interest in this Article, however, is strictly limited to the questions that arise if we assume the industry's liability to the citizens.

⁵ See *infra* note 90.

should be available to governments against industries, but also sets the conditions and limitations of this restitutionary claim.⁶

Part III takes up in detail the serious legal challenges of injured citizens (smokers in our case study) that may arise regarding the legality of possible settlement provisions between governments and defendant industries. The issues raised in Part III epitomize some of the dangers of allowing governments to sue injurious industries for their preventative and ameliorative costs and thus emphasize the limits of the legitimate cause of action identified in Part II. These dangers are also considered in Part IV, which addresses some broader public policy concerns.

I

THE TOBACCO CASE STUDY

Along with the fifteenth-century discovery of the New World came the discovery of tobacco and its use by Europeans.⁷ Not far behind this earliest use came the belief that smoking tobacco was bad for one's health⁸ and the suspicion that it was addictive.⁹ In the last forty years these concerns have been confirmed by epidemiological studies that now show, even to the satisfaction of the tobacco manufacturers,¹⁰ that smoking tobacco causes illnesses including

⁶ But cf. Doug Rendelman, *Common Law Restitution in the Mississippi Tobacco Settlement: Did the Smoke Get in Their Eyes?*, 33 Ga. L. Rev. 847, 899, 930 (1999) (concluding that law of restitution does not provide valid cause of action against tobacco companies, assuming—contrary to our assumption—that tobacco companies are not liable to smokers for damages).

⁷ See William Everett Bailey, *The Invisible Drug* 5 (1996) (discussing distribution of tobacco by Spanish and Portuguese sailors in 1500s). Also recall the monologue by Bob Newhart in which he reports Sir Walter Raleigh's discovery of tobacco's use in the colonies. In his imaginary conversation with a representative in London, we hear the London side of the phone call: "They wrap it in paper and put it in their mouths?" "They do what, Walt?" (Incredulously) "They light it?"

⁸ See Stanton A. Glantz et al., *The Cigarette Papers* 1 (1996) (discussing first report of tobacco's ill effects in 1665); Richard Kluger, *Ashes to Ashes* 15-16 (1996) (discussing beginnings of concern for tobacco's ill effects on health).

⁹ See Bernard Lewis, *The Middle East* 161 (1995) (quoting Turkish historian, Ibrahim Pechevi, writing circa 1635):

The fetid and nauseating smoke of tobacco was brought in the year 1009 [1600-01 CE] by English infidels, who sold it as a remedy for certain diseases of humidity. Some . . . pleasure-seekers and sensualists . . . became addicted, and soon even those who were not pleasure-seekers began to use it. Many even of the great ulema and the mighty fell into this addiction.

¹⁰ See Sandra Torrey & John Schwartz, *Contrite Tobacco Executives Admit Health Risks Before Congress*, Wash. Post, Jan. 30, 1998, at A14 (discussing tobacco executives' admissions to Congress that smoking is hazardous); see also Suein L. Hwang, *Tobacco Firm Gives Frank Advice Online*, Wall St. J., Apr. 9, 1999, at B1 (noting that Brown & Williamson's website acknowledges that "[t]he evidence is sufficient to determine that smoking causes disease").

cancer,¹¹ heart disease, and emphysema.¹²

Because injuries from tobacco were so insidious, making it easy to believe that use in moderation was not deadly, most Americans embraced tobacco use prior to 1960. For a time in twentieth-century America, cigarettes were chic; smoking in American movies was portrayed in a favorable light well beyond World War II.¹³ Formal restrictions on smoking and social taboos against it (particularly against women smoking) declined between 1920 and 1960.¹⁴ Even during this time, however, public attitudes were not uniformly positive toward tobacco. One person's "chic" was another's "stinking weed." Even smokers referred to cigarettes pejoratively as "coffin nails" or "cancer sticks," and many parents who smoked discouraged their children from smoking. In the latter half of this century, however, public intolerance toward smokers has sharply increased. Despite increasing antagonism, almost no one thought there was a possibility that tobacco manufacturers might have tort liability for a legal product,¹⁵ a belief formally enshrined in Professor Prosser's comment to section 402A of the Restatement (Second) of Torts: "Good tobacco is not unreasonably dangerous merely because the effects of smoking may be harmful."¹⁶

¹¹ In 1964, Surgeon General Luther L. Terry released the first official U.S. recognition that smoking causes cancer. See U.S. Dep't of Health, Educ., & Welfare, *Smoking and Health* (1964); see also *Mortality Trends for Selected Smoking-Related Cancers and Breast Cancer—United States, 1950-1990*, 42 *Morbidity & Mortality Wkly. Rep.* 857 (1993) (describing mortality trends for cancers at least 70% attributable to smoking and other tobacco use).

¹² See U.S. Dep't of Health & Human Servs., *Reducing the Health Consequences of Smoking: 25 Years of Progress. A Report of the Surgeon General* (1989).

¹³ See Bailey, *supra* note 7, at 38-40.

¹⁴ One of us can remember the signs in cracked and peeling paint on the doors of Hutchins Hall at the Law School in Ann Arbor that prohibited bringing "lighted tobacco" into the building in 1959. Smoking was then so common in and out of Hutchins Hall that the signs had the quaint appearance of an ancient and abandoned prohibition.

¹⁵ Only a gifted few foresaw cigarettes' fate. In a 1984 article entitled "End of the Trail," Garrison Keillor portrays the last days of America's remaining smokers. Shortly after "adoption of the Twenty-eighth amendment," one of the last known smokers writes to her children on the inside of a cigarette pack while hiding out:

Down to 1 cart. PIMs. Not my fav. Down to 1 cg/day. After supper. Hate to say it but it tastes fant. So rich, so mild. I know you never approvd. Sorry. In the 50s it was diffrent, we all smokd. Felt like movies. So gracefl, tak'g cg from pk, the mtch, the lite, one smooth move. Food, sex, then smoke. Lng drags. Lrnd Fr. exh. Then sudd. it was 82 and signs apprpd (Thanx for Not S). In my home! Kids naggng like fishwives & yr dad sudd. went out for track. I felt *ambushed*. Bob Dylan smokd, Carson, Beatles. I mean WE'RE NOT CRIMINALS. Sorry. Too late now. More soon. Love, Mother.

Garrison Keillor, *End of the Trail*, *New Yorker*, Sept. 17, 1984, at 45.

¹⁶ Restatement (Second) of Torts § 402A cmt. i (1965) (addressing strict liability for defective product).

This Part provides a brief narrative of the tobacco litigation, describing what events caused the shift in the tobacco companies' previous immunity from liability for injuries relating to tobacco use. We then describe the history of the tobacco companies' settlement with the state attorneys general. We attempt to explain why the tobacco companies agreed to such large payments, particularly in the absence of any explicit settlement provisions that would have protected the companies from bankruptcy.

A. *The Tobacco Litigation*¹⁷

Until the 1990s, no smoker had recovered successfully against the tobacco companies. Starting in the mid-1950s, individual plaintiffs brought a series of cases, sometimes in tort but more often for violations of the warranty of merchantability.¹⁸ Litigation then subsided until the 1980s. In 1984, a plaintiff won the first jury verdict against a tobacco company in *Cipollone v. Liggett Group, Inc.*¹⁹ The *Cipollone* verdict was eventually overturned on appeal,²⁰ however, and other cases had equally unsatisfactory outcomes for plaintiffs.²¹

Although there were several more jury verdicts for plaintiffs in the mid-1990s,²² most individual plaintiffs continued to have a difficult time either defeating tobacco companies at trial or having their verdicts upheld on appeal.²³ In 1999, for example, the tobacco manufac-

¹⁷ This narrative is highly condensed. For a more exhaustive history, see *After the Fall: The Cigarette Papers, the Global Settlement, and the Future of Tobacco Litigation*, 49 S.C. L. Rev. 311, 312-22 (1998).

¹⁸ The most notable case, *Green v. American Tobacco Co.*, 304 F.2d 70 (5th Cir. 1962), rev'd, 325 F.2d 673 (5th Cir. 1963) (finding in favor of plaintiff on strict liability issue), spanned 12 years and included six appeals and two jury trials.

¹⁹ 593 F. Supp. 1146 (D.N.J. 1984), rev'd in part and aff'd in part, 893 F.2d 541 (3d Cir. 1990), aff'd in part and rev'd in part, 505 U.S. 504 (1992).

²⁰ See *Cipollone*, 893 F.2d at 541.

²¹ See Todd M. Blackmar, Note, *Perez v. Brown & Williamson Tobacco Corp.: The Validity of Seeking Protection from Ourselves*, 29 U. Tol. L. Rev. 727, 735 (1998).

²² In a rare case, a California jury awarded two million dollars in compensatory and punitive damages to Milton Horowitz, a former smoker who developed mesothelioma after smoking cigarettes in the 1950s that contained asbestos in their filters. See Suein L. Hwang, *Former Smoker Is Awarded \$2 Million in Suit over Illness Blamed on Filter*, Wall St. J., Sept. 5, 1995, at B6. The defendant's appeals eventually failed after Horowitz's death in 1996. See *Justices Refuse to Halt Lorillard Damage Payment*, Wall St. J., May 19, 1998, at B12; *Lorillard Pays \$1.5 Million to Partly Settle Lawsuit*, Wall St. J., Jan. 2, 1998, at 13.

²³ In August 1996, a Florida jury awarded \$750,000. See John Schwartz, *Florida Smoker Wins \$750,000 in Damages*, Wash. Post, Aug. 10, 1996, at A3 (reporting on landmark August 1996 Florida verdict against Brown & Williamson). The appeals court found a statute of limitations problem and overturned the verdict. See *Brown & Williamson Tobacco Corp. v. Carter*, 723 So. 2d 833 (Fla. App. 1998) (holding that action was barred by statute of limitations). In another Florida case, the jury awarded the family of a

turers suffered two multimillion dollar judgments,²⁴ but they also won judgments of no liability in at least six cases brought by individual plaintiffs.²⁵

Despite the limited success of individual plaintiffs during this decade, however, the 1990s have seen several important changes that have significantly affected the tobacco companies' fortunes. Plaintiffs have asserted novel claims that the addictive qualities of nicotine might relieve the plaintiff from the burden of assuming the risk.²⁶ Plaintiffs are better financed than earlier plaintiffs had been.²⁷ A flood of information and documents has come forth favorable to plaintiffs' cases.²⁸ Plaintiffs' lawyers may have discovered a relatively

dead smoker \$1 million. See Myron Levin, *Verdict Deals Tobacco Firms a Historic Defeat*, L.A. Times, June 11, 1998, at A1 (reporting on \$1 million Florida verdict, noting first instance of punitive damage award). This time, the case had been tried in the wrong venue, and the appellate court overturned the verdict. See *Brown & Williamson Tobacco Corp. v. Widdick*, 717 So. 2d 572 (Fla. Dist. Ct. App. 1998) (holding that trial court abused its discretion in denying motion for change of venue).

²⁴ A California jury returned a \$51.5 million verdict and an Oregon plaintiff received an \$80.3 million verdict. See Milo Geyelin, *Philip Morris Hit with Record Damages*, Wall St. J., Mar. 31, 1999, at A3 [hereinafter Geyelin, *Record Damages*] (reporting on Oregon verdict against Philip Morris). The tobacco industry has appealed and both verdicts were reduced. See Milo Geyelin, *Philip Morris Punitive Damages Cut 50% to \$25 Million in California Case*, Wall St. J., Apr. 7, 1999, at B6; Milo Geyelin, *Tobacco Firms Win a Verdict in Cancer Case*, Wall St. J., July 12, 1999, at A24.

²⁵ A \$1 million verdict was overturned by an appeals court in Florida. See Ann Davis, *Appeals Court in Florida Throws Out \$1 Million Brown & Williamson Verdict*, Wall St. J., Feb 2, 1999, at B8. In May of 1999, a Memphis jury found in favor of tobacco company defendants and against the families of three deceased smokers. See Milo Geyelin, *Tobacco Firms Get a Victory in Tennessee Case*, Wall St. J., May 11, 1999, at B5. Several days later, a federal jury in Missouri found that Brown & Williamson was not liable for a death arising from lung cancer. See Milo Geyelin, *Brown & Williamson Wins Suit in Smoking Case*, Wall St. J., May 14, 1999, at B7. In June, a federal judge in Wisconsin granted motions for summary judgment and entered judgment in favor of several tobacco manufacturers. See *Insolia v. Philip Morris Inc.*, 53 F. Supp. 2d 1032, 1036 (W.D. Wis. 1999) (holding that plaintiffs failed to come forth with sufficient proof to create genuine dispute of fact). A Mississippi jury refused to find the tobacco industry liable for the fatal disease resulting from decades of breathing secondhand smoke. See *Tobacco Industry Ruled Not Liable in Mississippi Case*, Wall St. J., June 3, 1999, at A12. Most recently, a Louisiana jury returned a verdict in favor of Brown & Williamson and R.J. Reynolds. See *Brown & Williamson Individual Case Courtroom* (visited Jan. 16, 2000) <http://www.browbandwilliamson.com/2_courthouse/1_individual/iccrecent.html>.

²⁶ See Richard L. Cupp, Jr., *A Morality Play's Third Act: Revisiting Addiction, Fraud and Consumer Choice in "Third Wave" Tobacco Litigation*, 46 U. Kan. L. Rev. 465, 471-85 (1998) (discussing recent plaintiff attempts to minimize assumption of risk defense).

²⁷ See Milo Geyelin, *Behind Giant Tobacco Verdicts, a Legal SWAT Team*, Wall St. J., Apr. 12, 1999, at B1 (reporting that members of Tobacco Trial Lawyers Association pool their assets and information and have pocketbooks deep enough to enable them to pay thousands of dollars to cover administrative costs of growing organization).

²⁸ Much of this information has become available through the attorneys general suits. See Ann Davis, *Tobacco Documents May Hold the Key to Florida's Suit*, Wall St. J., May

inexpensive but moderately effective way of trying tobacco cases.²⁹ And public attitudes about smoking have shifted.³⁰ Evidence of this change includes prohibitions on smoking in public, even in bars,³¹ the paucity of hotel rooms where smoking is permitted,³² and the sight of smoking office workers huddled outside in freezing weather.

Further, the types of plaintiffs have begun to shift. First, class actions in tobacco litigation began in 1994 with the landmark case *Castano v. American Tobacco Co.*³³ Because of the difficulties with class certification, class actions initially seemed to pose no real threat to the tobacco industry.³⁴ Recently, that proved untrue in one state court case.³⁵

11, 1998, at B2 (suggesting that documentation may affect tobacco litigation not only in terms of proof but also in jury perception).

²⁹ It appears that plaintiffs' attorneys have developed an assembly-line litigation method enabling them to keep costs low without sacrificing effectiveness. See Geyelin, *supra* note 27, at B1.

³⁰ See Robert L. Rabin & Stephen D. Sugarman, *Smoking Policy: Law, Politics, and Culture* 5-6 (1993) (noting change in popular culture toward smoking).

³¹ See, e.g., Cal. Lab. Code § 6404.5 (West 1999) (prohibiting smoking in bars and taverns); Julie Ha, *L.A. Launches Crackdown on Smoking in Bars, Restaurants*, *L.A. Times*, July 8, 1999, at B3 (discussing new enforcement measures).

³² Only 45% of the hotel rooms in America are designated as smoking, and several hotels are following a current trend of banning smoking altogether. See Larry Olmstead, *Smoke-Free Stays Not Always Guaranteed*, *Investor's Bus. Daily*, May 11, 1999, at A1.

³³ 84 F.3d 734 (5th Cir. 1996) (decertifying multistate class for recovering nicotine addiction). After the *Castano* plaintiffs failed to gain certification, plaintiffs attempted to form classes limited to residents of particular states. See Milo Geyelin, *Lawyers Battling the Tobacco Industry Are Confronting Logistical Nightmare*, *Wall St. J.*, May 28, 1996, at A4.

³⁴ See *Castano*, 84 F.3d at 734. The sole exception to the certification problem for plaintiffs was *Broin v. Philip Morris, Inc.*, 641 So. 2d 888 (Fla. Dist. Ct. App. 1994), a suit on behalf of a class of flight attendants for damages related to exposure to second-hand smoke. The tobacco companies settled the case for \$349 million, none of which went to individual plaintiffs; the money is to be used to establish a foundation that will study tobacco-related diseases and their treatment. See *id.*; Bob Van Voris, *Latest Tobacco Headache: Flight Attendants' Case*, *Nat'l L.J.*, May 26, 1997, at A1. The flight attendants can still sue individually, but the settlement abrogates any claim for punitive damages. See *Dissident Flight Attendants Object to Secondhand Smoke Settlement*, *Wash. Post*, Jan. 27, 1998, at A7. Similarly, asbestos class action settlements have repeatedly suffered from certification issues, especially relating to exposed but currently asymptomatic future plaintiffs. See *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295 (1999) (finding certification impermissible due to insufficient showing of limited fund, inclusiveness, and equitable treatment); *Georgine v. Amchem Products, Inc.*, 83 F.3d 610 (3d Cir. 1996) (decertifying class because it fails typicality, adequacy of representation, predominance, and superiority requirements), *aff'd*, *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997).

³⁵ A Miami jury found the tobacco companies liable for concealment and civil conspiracy in the first class-action lawsuit ever to go to trial. See Milo Geyelin, *'Class' Trial Finds Tobacco Firms Liable*, *Wall St. J.*, July 8, 1999, at A3. In Australia, smokers have brought a class action against cigarette manufacturers. See Joanne Painter, *Dying Man Leads First Action Against Tobacco Companies*, *Sydney Morning Herald*, Apr. 12, 1999, at 5, available in 1999 WL 34603.

Second, various governmental entities began to file their own suits. More than forty states filed suit against the tobacco companies to recover funds expended for treating tobacco-related illnesses of their states' residents.³⁶ The states asserted causes of action such as fraud, antitrust, and conspiracy;³⁷ the primary focus of the suits, however, was to force the tobacco industry to pay for the additional health care costs incurred by the states because of their residents' smoking.³⁸ Cities and municipalities followed, suing for costs incurred for treatment of residents with tobacco-related illnesses.³⁹ Some foreign countries have brought suit in American courts, including Bolivia, Guatemala, Nicaragua, Panama, Thailand, Venezuela, and Brazil.⁴⁰ Other countries and provinces, including British Columbia and the Marshall Islands, have sued in their home courts.⁴¹ Even in France, where smoking is widely accepted, a state health insurer has plans to sue the tobacco industry.⁴² Union health funds and other insurers have also sued to recover costs paid for treating individuals with tobacco-related illnesses.⁴³

³⁶ See, e.g., *Massachusetts v. Philip Morris, Inc.*, 942 F. Supp. 690 (D. Mass. 1996); *Junda Woo, Mississippi Wants Tobacco Firms to Pay Its Cost of Treating Welfare Recipients*, Wall St. J., May 24, 1994, at A2.

³⁷ See *State Files Tobacco Suit*, Wall St. J., Sept. 21, 1994, at B11 (discussing West Virginia suit).

³⁸ See Plaintiff's Complaint, *Minnesota v. Philip Morris Inc.* (No. C1-95-1324) (D. Minn. Aug. 17, 1999) ("The premise of this action is that this industry . . . should pay for the staggering health care costs caused by its actions in violation of the laws of this State.").

³⁹ See, e.g., *San Francisco v. Philip Morris, Inc.*, No. C-96-2090 DLJ, 1998 WL 230980 (N.D. Cal. Mar. 3, 1998) (stating plaintiff's claim that tobacco companies misled residents); *County of Cook v. Philip Morris, Inc.*, No. 97C3295, 1997 WL 667777 (N.D. Ill. Oct. 17, 1997).

⁴⁰ See Alison Frankel, *One Planet, A Multitude of Tobacco Plaintiffs*, Am. Law., Apr. 1999, at 24 (discussing suits brought by Bolivia, Thailand, Venezuela, Guatemala, and Nicaragua); *Rio Sues U.S. Tobacco Firms for Cost of Treating Smokers*, Wall St. J. Interactive Ed., July 14, 1999 (discussing Brazil's suit) <<http://interactive.wsj.com>>; see also *Republic of Bolivia v. Philip Morris Cos.*, 39 F. Supp. 2d 1008, 1008-09 (S.D. Tex. 1999) (transferring case, in humorous fashion, to United States District Court for District of Columbia as more appropriate venue).

⁴¹ See Sandra Torry, *Cigarette Firms Sued by Foreign Governments; Tobacco Industry Faces Foreign Lawsuits in U.S.*, Wash. Post, Jan. 17, 1999, at A12.

⁴² See *French Agency to Sue Tobacco Companies*, L.A. Times, Feb. 17, 1999, at C2.

⁴³ See, e.g., *Steamfitters Local Union No. 420 Welfare Fund v. Philip Morris, Inc.*, 171 F.3d 912 (3d Cir. 1999) (stating claims to recover for costs of treating union members' smoking-related illnesses); *West Virginia-Ohio Valley Area I.B.E.W. Welfare Fund v. American Tobacco Co.*, 29 F. Supp. 2d 733, 734 (S.D. W. Va. 1998) (same); *Kentucky Laborers Dist. Council Health and Welfare Trust Fund v. Hill & Knowlton, Inc.*, 24 F. Supp. 2d 755, 761 (W.D. Ky. 1998) (same). In the first of these suits to go to trial, a federal jury in Ohio found in favor of the tobacco industry against a class containing over 100 union health funds. See Milo Geyelin, *Tobacco Firms Win in Union-Fund Trial*, Wall St. J., Mar. 19, 1999, at A3. An Israeli health fund has also sued. See *Israeli Lawyer Takes on Big Tobacco*, Nat'l L.J., Oct. 12, 1998, at A11.

Together, these developments portend a less rosy future for defendant tobacco companies than their winning records might predict. An \$80 million verdict in Oregon, before a judge who was described as fair and not adverse to the tobacco industry, may be especially suggestive of these new dangers.⁴⁴ It is thus unsurprising that the tobacco companies entered negotiations with representatives from the biggest group of plaintiffs, the state attorneys general.

B. *The Settlement with the States*

1. *First Negotiations with the Attorneys General*

Representatives of the tobacco industry began settlement negotiations with a small group of the attorneys general in the spring of 1997.⁴⁵ The tobacco companies agreed to make a large payment to the states. In exchange, the attorneys general would endorse a federal bill that would limit the tobacco companies' liability to individual and class plaintiffs in various ways and would modify some aspects of the public health law. An agreement to this effect (AG Agreement) was reached between the tobacco companies and the attorneys general group on June 20, 1997.⁴⁶

Although the AG Agreement's proposal for federal legislation was not adopted by Congress, it is worth examining here. First, the proposal is relevant to our analysis of the settlement that was eventually made between the states and the tobacco companies. More importantly, any future federal legislative proposals will almost surely use the civil liability limitations in the AG Agreement as a template.⁴⁷ We concern ourselves with two aspects of the original proposal: the payments by the tobacco companies, and the changes to civil liability.

a. *Payments and Recipients of Payments.* The total payment under Title VI (Programs/Funding) of the AG Agreement over the

⁴⁴ See Geyelin, *Record Damages*, supra note 24, at A3. It appears that the presiding judge in Portland held no particular grudge against the tobacco manufacturers. Judge Anna Brown had thrown out a claim that Marlboros are a defective product. She held that there was insufficient proof that Philip Morris had the opportunity to sell a safer alternative. See *id.*

⁴⁵ See Milo Geyelin & Suein L. Hwang, *What Brought Big Tobacco to the Table*, Wall St. J., Apr. 18, 1997, at B1 (describing players in negotiations).

⁴⁶ Proposed Tobacco Industry Settlement, June 20, 1997 (visited Mar. 2, 2000) <<http://stic.neu.edu/6-20-settle.htm>> [hereinafter AG Agreement].

⁴⁷ For discussion of the settlement, see *infra* text accompanying note 77. We expect the civil liability terms of the AG Agreement to be copied for two reasons. First, they were the product of extended negotiation with the attorneys general. Second, terms similar to those in the AG Agreement did appear in the McCain bill when it was in committee. See *infra* note 65 and accompanying text.

twenty-five years after signing was projected to be \$368.5 billion.⁴⁸ The identity of the persons who were to receive the lion's share of the money was not clear.⁴⁹ Assuming that approximately \$3 billion would have gone annually for research and educational programs, and that an amount from \$0 to \$5 billion may have eventually gone to plaintiffs, \$7 to \$12 billion annually would have been available for division among the states paid annually to the state governments.⁵⁰

The payments to the states were justified principally as reimbursement of medical costs paid by the states.⁵¹ These payments were not for the individual suffering of people who contracted diseases or died from smoking. They were not payments to the states for the loss of quality of life of smokers who would otherwise be working at a higher level and enjoying life more fully, nor did they appear to go to any individual plaintiff in a lawsuit. Rather, they were payments for the economic loss to the states because the states—through the Medicaid program—would pay out more money earlier than if their citizens had not smoked.

b. Modification of Manufacturers' Civil Liability. Title VIII of the Agreement sought restrictions on the manufacturers' potential civil liability to individuals, governmental agencies, and others acting

⁴⁸ See AG Agreement, *supra* note 46, tit. VI.

⁴⁹ Title VII (Public Health Funds from Tobacco Settlement) contemplated annual payments in the range of \$2 to \$3 billion for various public health activities and the establishment of a public health trust of \$25 billion. In the first year of the Agreement, \$1 billion would have gone to various programs to reduce tobacco use, fund research, assist the FDA in enforcing certain provisions of the Agreement, and compensate those who lost tobacco industry sponsorship. This amount would have gradually increased to \$1.5 billion annually. In each of the first four years of the Agreement, \$1 billion would have been paid into a trust fund to be used to help individuals quit smoking by providing financial assistance and identifying the most effective methods of quitting. After four years, this amount would have increased to \$1.5 billion annually. See *id.* tit. VII. The annual payments were to come out of the "total payment," which would have amounted to approximately \$15 billion per year starting in the fifth year.

⁵⁰ However, the Agreement did "authorize and fund from Industry Payments the annual payment to all states of significant, ongoing financial compensation to fund health benefits program expenditures and to establish and fund a tobacco fund liability judgment and settlement fund." *Id.* Preamble, at 3. In addition, a proposed consent decree between the tobacco industry and the states would have reiterated "obligations to make monetary payments to the States reflecting their reasonable share of the total provided by the Act." *Id.* tit. III(B). "Significant financial compensation" and "reasonable share" were not defined.

⁵¹ See John Schwartz & Sandra Torry, Tobacco Pact Calls for Strict Federal Controls, *Wash. Post*, June 21, 1997, at A1 (outlining agreement regarding payment to states and federal control over manufacture and marketing of cigarettes); John Schwartz, U.S. Wants Share of Tobacco Deals, *Wash. Post*, Nov. 5, 1997, at A19 (explaining federal government's plan to recover its pro-rata share of Medicaid-related recovery).

on behalf of injured smokers.⁵² First, Title VIII(A)(1) provided for the dismissal of current actions and prohibition of future actions by the attorneys general or by any other arm of government. Second, Section (B)(1) barred punitive damages in individual tort actions. Third, Title VIII(4)(1) barred plaintiffs from bringing "addiction" claims.⁵³ Fourth, Section (B)(2) prohibited class actions or similar consolidations.⁵⁴ An explicit provision allowing removal to the federal courts further protected the tobacco companies from adverse state court interpretations of these rules.⁵⁵ Whether the bar would have been a large or small change in current law depends upon how one reads the cases⁵⁶ in both federal and state courts that have denied class certification and the Florida case that allowed it. The removal rule may have had some effect, as federal courts appear to have been more vigilant in restricting class actions than have state courts.⁵⁷

Taken together, it is possible that the prohibitions on class actions and punitive damages, and the restriction on "addiction" claims, would have stifled civil tobacco litigation. To the extent class actions

⁵² In part, they also received a restriction on the power of the Food and Drug Administration to outlaw tobacco. See AG Agreement, *supra* note 46, Preamble, tit. I.

⁵³ Although the AG Agreement did not define "addiction," this provision may have been intended to bar affirmative "addiction" claims that have recently been used as a counter to the defense of assumption of risk.

⁵⁴ Both of the latter two provisions applied only to suits for past behavior. With one exception, Section C of Title VIII granted the tobacco manufacturers protections against future claims similar to those granted in Section B as to past claims. The only important exception was for punitive damages. Section B barred recovery of punitive damages for past acts; Section C allowed the recovery of punitive damages for future claims. Presumably, future claims were those that arose out of the tobacco manufacturers' behavior after the effective date of the Agreement. Possibly the manufacturers were willing to expose themselves to punitive damages for acts committed after the Agreement was signed on the theory that the Agreement itself, the massive payments under it, and the education that will be done as a part of it would have ruled out the possibility of punitive damages in the future.

⁵⁵ See *id.* tit. I(B)(2).

⁵⁶ See, e.g., *Barnes v. American Tobacco Co.*, 176 F.R.D. 479 (E.D. Pa. 1997) (decertifying class of Pennsylvania smokers); *Reed v. Philip Morris Inc.*, No. 96-5070, 1997 WL 538921 (D.C. Super. Aug. 18, 1997) (denying plaintiff's motion for class certification of District of Columbia smokers); *R.J. Reynolds Tobacco Co. v. Engle*, 672 So. 2d 39 (Fla. Dist. Ct. App. 1996) (limiting class action to Florida residents rather than broader class of U.S. residents that lower court had certified). But see *Hoskins v. R.J. Reynolds Tobacco Co.*, N.Y. L.J., Oct. 31, 1997, at 30 (N.Y. Sup. Ct. Oct. 30, 1997) (certifying damages class of nicotine dependent New York residents and injunctive class of New York cigarette purchasers).

⁵⁷ See, e.g., Sandra Torry, *Cigarette Firms Lose Huge Suit: Jury Finds 'Outrageous Conduct'*, Wash. Post, July 8, 1999, at A1 ("Florida's courts have interpreted statutes allowing class action cases much more loosely than other states and federal courts."). See generally Susan E. Kearns, Note, *Decertification of Statewide Tobacco Class Actions*, 74 N.Y.U. L. Rev. 1336 (1999) (arguing that neither federal nor state courts should certify statewide tobacco class actions).

became less available, for example, plaintiffs' lawyers might be less willing to undertake the cost of expensive experts, motions and interlocutory appeals, the substantial risk of a trial loss,⁵⁸ and the certain appeal of any victory by a tobacco defendant,⁵⁹ all for the sake of an individual plaintiff with no possibility of punitive damages.⁶⁰

Furthermore, Title VIII limited the total amounts to be paid by the tobacco companies in settlement and for judgments for past and future acts to "33 percent of annual industry base payments," a figure that effectively capped total annual payments to injured plaintiffs at \$5 billion (ignoring upward adjustments because of inflation).⁶¹ While the tobacco manufacturers' liability to plaintiffs was limited to one-third of their annual payment in any one year, the provision also gave them a credit for 80% of any amount paid to plaintiffs.⁶²

⁵⁸ American juries have tended to focus on the individual responsibility of smokers and absolve the tobacco companies of liability for smoking-related harms. See Valerie P. Hans, *The Jury's Response to Business and Corporate Wrongdoing*, 52 *Law & Contemp. Probs.* 177, 198 (1989). "Despite . . . internal documents detailing how much the companies knew about the addictiveness of nicotine and the health risks of smoking, most people still believe smoking is a personal choice and that smokers have only themselves to blame for their illnesses." Milo Geyelin, *Focus Groups Back Tobacco Firm's Stance*, *Wall St. J.*, July 23, 1996, at B5.

⁵⁹ See, e.g., *Cipollone v. Liggett Group, Inc.*, 893 F.2d 541 (3d Cir. 1990) (appealing, primarily, jury instructions), *aff'd in part and rev'd in part*, 505 U.S. 404 (1992); *Brown & Williamson Tobacco Corp. v. Carter*, 723 So. 2d 833 (Fla. Dist. Ct. App. 1998) (appealing for statute of limitations violations among other issues); *Brown & Williamson Tobacco Corp. v. Widdick*, 717 So. 2d 572 (Fla. Dist. Ct. App. 1998) (appealing trial court's denial of motion to transfer venue).

⁶⁰ Today tobacco suits are extraordinarily expensive for plaintiffs' lawyers. See *Haines v. Liggett Group, Inc.*, 814 F. Supp. 414, 418 (D.N.J. 1993) (citing law firm's motion to withdraw as plaintiffs' counsel, enumerating costs exceeding \$5 million); Andrew Blum, *Anti-Smoking Cause Gets Infusion of New Blood*, *Nat'l L.J.*, Oct. 30, 1989, at 1 (calling plaintiff's victory in watershed tobacco case "pyrrhic" because of high costs).

⁶¹ The "base payment" under Title VI rose from a total of \$6 billion in year one to \$15 billion in year nine. According to Section VIII(B)(9), amounts unpaid in one year because of the 33% cap would have rolled over to succeeding years. Also under paragraph (9), only the first \$1 million of any judgment for more than \$1 million was to be paid until others were paid in any year when the 33% aggregate cap was reached. Thus, if one recovered a \$2 million judgment and the total of the judgments in that year exceeded one-third of the base payment, the claimant would have received a payment of no more than \$1 million in the first year; the remaining portion would then roll over to the second year. It is unclear whether payments carried over from the first year would have come ahead of or behind settlements and judgments in year two or whether all would share *pro rata*.

⁶² This term was found in a single sentence in Title VIII(9) that read as follows: "Any judgments/settlements run against defendant but give rise to 80 cents on the dollar credit against annual payment in the year paid." This provision was not explained in any way. The text following it reads, "Suitable provision for settlement consultation and permission. Manufacturers control insurance claims, and any insurance recovery obtained by manufacturers (net of cost) on account of judgment and/or settlement covered by above sharing arrangement allocated 80% to annual payments. Manufacturers retain any insurance proceeds on account of defense costs." AG Agreement, *supra* note 46, tit. VII(B)(9).

The 80% credit was a critical part of the AG Agreement and is likely to reappear in any twenty-first-century federal legislation. Assume that the tobacco manufacturers would have received a bill from a governmental agency each year for approximately \$15 billion. This bill would come whether they settled cases with 100 plaintiffs, 1000 plaintiffs, or no plaintiffs. Apparently, the manufacturers could deduct 80% of these settlements from the \$15 billion charge. Together with the provision limiting the annual liability to one-third of the base payment (one-third of \$15 billion), the maximum payment made to plaintiffs would be \$5 billion, while the maximum deduction would be 80% of \$5 billion, or \$4 billion. This means that in a year when a \$15 billion payment was due and in which the tobacco manufacturers paid \$5 billion in settlement of lawsuits, their total payment would be \$16 billion ($\$5 + (\$15 - \$4) = \16).

The formula led to two possible rewards in the AG Agreement for potential plaintiffs, to be compared with the substantial drawbacks the AG Agreement would have imposed on them.⁶³ The Agreement may have reduced the tobacco companies' incentive to oppose individual suits. Under the 80% credit rule, tobacco manufacturers who paid out \$5 billion to plaintiffs received a credit against their \$15 billion governmental bill of \$4 billion (80% of the \$5 billion paid to plaintiffs). Each dollar paid to plaintiffs—up to \$5 billion per year—would thus cost only 20 cents. Even if the tobacco manufacturers successfully opposed all lawsuits, they would still be presented with a government bill for \$15 billion. Their savings from complete success would have been \$1 billion, less the added costs of full-fledged litigation.

It is possible that some tobacco companies would have litigated all cases in order to achieve some portion of the \$1 billion savings, or at least those cases most likely to prove defense victories. Such efforts, however, would be undertaken only if litigation could lower the total annual judgments below \$5 billion by at least an amount that exceeded the added cost of that defense. If tobacco companies had a choice of paying \$5 billion annually either to a governmental agency or to a set of plaintiffs, their incentive to oppose the plaintiffs' suits

⁶³ It is not clear that any explicit provision in the AG Agreement favored plaintiffs. Even the provision that established the settlement fund may not have favored plaintiffs. Absent the AG Agreement, the money that would have gone into the fund—and more—would have been available in the treasury of the various tobacco manufacturers. A provision of the settlement that may have helped plaintiffs established a depository for tobacco industry documents. It is not clear how helpful this would be, since so many documents have already come out. Minnesota alone has gathered 33 million pages of internal tobacco industry documents for its lawsuit against tobacco companies. See Pat Widder, *Congress Considers Tobacco Subpoena*, *Chi. Trib.*, July 31, 1997, at 5.

would decline, perhaps even to zero. Presumably tobacco manufacturers would prefer to pay \$5 billion to their former and current customers than to governments. To the extent the formula would have reduced the tobacco companies' incentives to litigate, either in general or against deserving plaintiffs, the settlement would have given something of value to prospective plaintiffs.

The second advantage to plaintiffs, at least those of the more distant future, might be the allocation of cigarette manufacturers' cash flows (i.e., the priority scheme) implicit in the AG Agreement. Since the AG Agreement would have limited the total amount that plaintiffs could recover from all manufacturers to \$5 billion per year, it would have protected most of the tobacco manufacturers from the danger of bankruptcy resulting from one or more giant verdicts.⁶⁴ As long as the tobacco companies stayed in business, their assets would be available to future plaintiffs.

2. *The Negotiation with Congress*

During the last half of 1997, Congress held hearings on various bills that were submitted to implement the AG Agreement. In March 1998, all of the various interests were close to agreement on a bill introduced by Senator John McCain (McCain bill),⁶⁵ which enlarged and slightly modified the AG Agreement. As it appeared in committee, the bill had provisions protecting the tobacco manufacturers from class actions and capping the tobacco industry's civil liability at \$6.5 billion annually. It also settled all state suits. The cost had risen from \$368.5 billion in the AG Agreement to \$516 billion in the McCain bill, and some of the public health aspects were modified. The McCain bill also required increases in cigarette prices to discourage youth smoking. Otherwise, the federal bill was patterned after and similar to the AG Agreement.

When the McCain bill was reported out of committee in April 1998, it did not have the protections from civil liability that were in the original Agreement and in the committee version. Shortly after the bill moved to the Senate floor, Steven Goldstone, CEO of RJR Nabisco, publicly complained about the legislation and claimed that it

⁶⁴ Liggett, with a market share of less than two percent, was exempt from paying toward the initial \$10 billion settlement payment to keep it out of bankruptcy. See Joel B. Obermayer, *Liggett Bids Hunt for Help*, *The News & Observer* (Raleigh, N.C.), Oct. 8, 1997, at D1, available in 1997 WL 7856560.

⁶⁵ See S. 1414, 105th Cong. (1997); see also Albert R. Hunt, *The McCain Tobacco Bill: A Step Forward*, *Wall St. J.*, Apr. 2, 1998, at A23.

would put the industry out of business.⁶⁶ The cigarette manufacturers withdrew their support for the bill and successfully campaigned to defeat the legislation.⁶⁷ They maintained that the deal was nothing more than a tax hike on cigarettes that would largely affect lower-income consumers.⁶⁸ The McCain bill died in June 1998.⁶⁹

3. *Second Negotiations and Settlement*

Prior to the failure of the federal legislation, a number of states had already settled parts of their cases against the tobacco industry.⁷⁰ In July 1997, Mississippi became the first state to make a deal with the entire tobacco industry in a settlement totaling \$3.4 billion.⁷¹ Florida followed suit in August, making an \$11.3 billion deal,⁷² and Texas set-

⁶⁶ See Jeffrey Taylor, *RJR's Chief Says Tobacco Deal Is Dead*, *Wall St. J.*, Apr. 9, 1998, at A3 (stating concern of RJR CEO Steven Goldstone that company would have to seek bankruptcy protection if tobacco bill passed).

⁶⁷ See Nancy Gibbs, *The Tobacco Bill Almost Made It Until the Republicans Decided to Blow It Off*, *Time*, June 29, 1998, at 38-40 (citing tobacco industry's \$40 million ad campaign as one reason bill died); Myron Levin, *Unwittingly Allied Forces Laid Tobacco Bill to Rest*, *L.A. Times*, June 23, 1998, at A1 ("Big Tobacco didn't like what Congress was up to and rose up to swat away the threat.").

⁶⁸ See Major Garrett & Kenneth T. Walsh, *Congress Snuffs Out the Tobacco Bill*, *U.S. News & World Rep.*, June 29, 1998, at 30 (discussing public's negative reactions to tobacco bill thanks to anti-bill campaign); Melinda Henneberger, *A Big Ad Campaign Helps Stall the Bill to Reduce Smoking*, *N.Y. Times*, May 22, 1998, at A1 (alluding to plight of those who would not be able to pay more for cigarettes).

⁶⁹ See John McCain, *We Blew It*, *Wash. Post*, June 24, 1998, at A17 (stating that Senate "has squandered the opportunity" to address serious national problem regarding smoking); Sandra Torry & Helen Dewar, *Senate GOP Kills McCain Tobacco Bill*, *Wash. Post*, June 18, 1998, at A1. The tobacco industry spent \$40 million on the anti-settlement advertising blitz, and \$58 million on lobbying during 1998. See Sandra Torry & Nathan Abse, *Big Tobacco Spends Top Dollar to Lobby: \$58 Million in '98 Kept Legislation at Bay*, *Wash. Post*, Apr. 9, 1999, at A37. Even after the McCain bill was dead, industry lobbying continued to prevent its revival. See *id.* It is unclear whether the tobacco manufacturers withdrew their support because the bill that was introduced omitted the protections from individual suits or whether they thought the cost was too high even if the protections had still been in place.

⁷⁰ In March 1996, Liggett began settling with states, starting with Mississippi, Louisiana, West Virginia, Florida, and Massachusetts. See *Liggett Pays First Part of Tobacco Settlement*, *Wall St. J.*, Apr. 9, 1996, at A10. It continued the trend by settling with twenty more states a year later. See John M. Broder, *20 States Ask the White House to Spare One Cigarette Maker*, *N.Y. Times*, Aug. 21, 1997, at A19 (discussing Liggett's settlement deals with states).

⁷¹ See John Schwartz & Sandra Torry, *Tobacco Firms, Mississippi Settle*, *Wash. Post*, July 4, 1997, at A1.

⁷² See John Schwartz, *Cigarette Makers Settle Florida Suit for \$11.3 Billion*, *Wash. Post*, Aug. 26, 1997, at A1; see also *State v. American Tobacco Co.*, No. 95-1466H (Fla. Cir. Ct. Aug. 25, 1997) (approving and adopting settlement), cited in 723 So. 2d 263, 266-68 (Fla. 1998). The trial judge's plan called for punitive damages to be awarded in one lump sum. The Florida State Court of Appeals initially rejected this plan. In late October, however, a Florida State Court of Appeals panel revived the prospect of a lump-sum punitive damage award. See Milo Geyelin, *Tobacco Firms Suffer Setback as Court Revives Pros-*

tled at the beginning of 1998 for \$14.5 billion.⁷³ Minnesota took its case to trial and settled after closing arguments for more than \$6.5 billion.⁷⁴

In the wake of the four state settlements and the failed legislation, the tobacco companies and the states began another attempt to settle all state claims. Negotiations grew out of an attempted mediation in the lawsuit that the state of Washington brought against the industry; officials from other states with pending lawsuits were brought in to the secret talks.⁷⁵ In November 1998, the states and the tobacco industry made a deal to be offered to each of the remaining states implemented through consent decrees in each state's court.⁷⁶ This Master Settlement Agreement (Settlement) was released on November 14, 1998, and all forty-six states speedily approved it.⁷⁷

Currently, most small states have already developed disbursement programs, while interest groups in large states continue to wrangle over the pot.⁷⁸ Most states seem to be allocating a small part of the Settlement to antismoking advertising and the like.⁷⁹ Many allo-

pect of Big Damage Award, Wall St. J., Oct. 21, 1999, at B19. Recently, the Florida Supreme Court has decided to review a request by tobacco companies to block the punitive damage award in this case. See Gordon Fairclough, Florida High Court is Reviewing Request to Block Tobacco-Case Punitive Award, Wall St. J., Nov. 4, 1999, at A4.

⁷³ See Sandra Torry & Ceci Connolly, Tobacco Firms Set to Pay Texas \$14.5 Billion, Wash. Post, Jan. 16, 1998, at A1.

⁷⁴ See John Schwartz, Tobacco Settles Minnesota Suit, Wash. Post, May 9, 1998, at A1. Minnesota's case benefited from first rate plaintiffs' counsel and a judge hostile to the cigarette manufacturers. See *id.* (discussing judge's jury instructions and state's largest ever compilation of internal industry documents for case, as well as compelling witnesses and arguments).

⁷⁵ See Sandra Torry, Tobacco Giants Try to Settle with States, Wash. Post, July 10, 1998, at A1 (discussing meetings between industry negotiators and states' lawyers).

⁷⁶ See Master Settlement Agreement, Nov. 14, 1998, exh. L (visited Mar. 2, 2000) <www.tobacco.net/Extra/multistate_settlement.htm>.

⁷⁷ See Barry Meier, Remaining States Approve the Pact on Tobacco Suits, N.Y. Times, Nov. 21, 1998, at A1.

⁷⁸ See Shailagh Murray, Most States to Spend Tobacco Settlement on Improving Health Care, Survey Says, Wall St. J., Mar. 8, 2000, at B6; Richard Pérez-Peña, State Efforts to Cut Smoking Leave New York Far Behind, N.Y. Times, May 30, 1999, at A1 (describing New York as laggard in combating smoking). While politicians are stating that they are spending much of this money for health care, in fact, as in California, much of it is being dumped into the general fund without any specific assurance that it will ever find its way into health care or any other form that would directly benefit smokers as a group. See Shirley Leung, So Far, California Is Being General on Tobacco Cash, Wall St. J. (Cal. ed.), Mar. 8, 2000, at CA2, available in Westlaw, WSJ database.

⁷⁹ For example, Florida has already spent \$100 million of its tobacco settlement funds to combat smoking. See Conrad deFiebre, Tobacco Cash Flowing In, but So Far, Not Out, Star Tribune (Minneapolis, Minn.), May 2, 1999, at A1. In Iowa, Attorney General Tom Miller has stated that he would like to see some of Iowa's \$1.7 billion award, possibly 10%, to be spent on efforts to counter tobacco ads and to enforce laws banning the sale of tobacco to minors. See Jane Norman, Iowa Payout Is \$1.7 Billion, Des Moines Register,

cate some part of the money to health care in some form that is not necessarily associated with tobacco-related disease.⁸⁰ But in many states, some overtly and (we suspect) others covertly, the money is going into the general treasury for uses completely unrelated to health care or smoking. For example, Rhode Island and New York intend to balance their budgets, and Oklahoma will pay down a \$1 billion bond issue.⁸¹ Because the amounts allocated to health care in states that make such allocations do not appear to absorb the entire payment, we suspect that even in those states a large residue will find its way into the states' general funds.

The Settlement preserves few of the protections for the tobacco industry that were present in the AG Agreement. It does not prohibit class actions or punitive damages, nor does it cap the industry's potential liability for each year. The deal totals \$206 billion through the year 2025,⁸² the biggest portions of which are the annual payments to

Nov. 17, 1998, at 1A. The Maryland General Assembly has decided that a part of the tobacco settlement money will be spent on smoking prevention programs. See Scott Shane, *Curran Weighs Tobacco Gamble*, *The Sun* (Baltimore), Nov. 17, 1998, at 1A. Most of the members of Utah's legislature have already agreed that a large portion of the state's settlement funds should go toward youth tobacco intervention programs. See Bob Bernick Jr., *\$157 Million Additional Tobacco Money*, *The Deseret News* (Salt Lake City), May 25, 1999, at B5.

⁸⁰ Mississippi has set aside funds of \$4.1 billion to create a health care trust fund for its citizens. See deFiebre, *supra* note 79. Nebraska has already allocated its \$1.17 billion award toward a health trust fund for the purposes of hiring school nurses, immunizing children, and testing for breast cancer and cholesterol. See Robynn Tysver, *State Accepts Tobacco Deal*, *Omaha World-Herald*, Nov. 17, 1998, at 1. Texas has appropriated some \$180 million to a health insurance program for low-income children. See Clay Robinson, *So Much Money, and So Much Controversy*, *Hous. Chron.*, May 30, 1999, Outlook, at 2, available in 1999 WL 3993228.

⁸¹ In Rhode Island, Governor Lincoln Almond's budget proposal requires the state to spend its entire \$63 million first settlement installment (to be paid in 2000) to balance the budget. See Christopher Rowland, *Let's Not Count Tobacco Money Until It's Here, Pires Cautions*, *Providence J.*, Apr. 14, 1999, at B5. New York Governor George Pataki has proposed using a large portion of the settlement funds to reduce the state's debt. See Richard Pérez-Peña, *New York Politics May Hold Up Most of Nation's Tobacco Cash*, *N.Y. Times*, Apr. 11, 1999, at A1 (stating that governor "is counting on the first \$63 million to help balance next year's budget"). Oklahoma legislative leaders and Governor Frank Keating are pushing for a "\$1 billion bond issue to be repaid from Oklahoma's anticipated tobacco industry settlement windfall." Ken Neal, *The Tobacco Settlement: How About a \$10-Billion Endowment for Oklahoma*, *Tulsa World*, May 16, 1999, available in 1999 WL 5400642.

⁸² The tobacco industry is to transfer \$2.4 billion as an initial payment to the states. Although it is less than the \$10 billion contemplated by the AG Agreement, the initial payment to the states will eventually total \$12.74 billion over 5 years. The base amount in 2000 is \$4.5 billion; it gradually increases to \$9 billion in 2018 and for every year thereafter. See *Master Settlement Agreement*, *supra* note 76, § IX(c)(1). Other payments include \$250 million over 10 years to help fund a foundation whose goals are reduction of youth smoking and prevention of tobacco-related illnesses. See *id.* § VI(b). This foundation will receive an additional \$300 million per year starting in 2004 if the market share of the

be made by the industry and distributed to the states.⁸³ Unlike the AG Agreement, which only vaguely indicated that money was to go to the states, the Settlement clearly delineates the percentage of the Settlement funds that each state will receive.⁸⁴ Its provisions touch upon restrictions on marketing and advertising,⁸⁵ restrictions on lobbying,⁸⁶ reduction of tobacco use by minors,⁸⁷ and elimination of actions brought against the tobacco industry by state or local government entities.⁸⁸ It also contains certain provisions, which we analyze below, that keep out competing cigarette manufacturers.

C. *Explaining the Settlement*

By their separate agreements with four states and the Settlement with the remaining forty-six, the tobacco manufacturers have made agreements that will cause them to pay more than \$240 billion to the fifty states by the year 2025.⁸⁹ We believe that the states had only one meritorious claim against the tobacco manufacturers,⁹⁰ namely subro-

Participating Manufacturers exceeds 99.05% and continues to do so. See *id.* § IX. A public education fund run by the foundation will receive \$1.45 billion over the course of five years. See *id.*

⁸³ See *id.*

⁸⁴ See *id.* exh. A (listing percentage of funds to be allocated to each state).

⁸⁵ See *id.* § III(a)-(j).

⁸⁶ See *id.* § III(m), exh. F.

⁸⁷ See *id.* § III(a).

⁸⁸ See *id.* § II(pp)(1) (releasing past, present, and future claims of any "Settling State's" subdivisions).

⁸⁹ In the Settlement, the tobacco companies agreed to pay roughly \$206 billion by 2025 to the 46 states. See *id.* § IX(a)-(c). This payout was in addition to the separate agreements with Mississippi, Florida, Texas, and Minnesota (totaling \$40 billion). See Milo Geyelin, *Top Tobacco Firms Agree to Pay States Up to \$206 Billion in 25-Year Settlement*, *Wall St. J.*, Nov. 16, 1998, at A3.

⁹⁰ Because subrogation allows the tobacco industry to use the same defenses against the government that it could use against individual smokers, see, e.g., *Iron Workers Local Union No. 17 Ins. Fund v. Philip Morris Inc.*, 23 F. Supp. 2d 771, 778 (N.D. Ohio 1998) (discussing individual and subrogation claims); see also *infra* Part II.E, states prefer to bring direct claims. However, most of the states' other causes of action against the tobacco industry are either subrogation claims in disguise or are invalid. See, e.g., *Minnesota v. Philip Morris Inc.*, 551 N.W.2d 490, 495 (Minn. 1996) (rejecting all direct tort claims as too remote); see also *Massachusetts Laborers' Health & Welfare Fund v. Philip Morris, Inc.*, 62 F. Supp. 2d 236, 239 (D. Mass. 1999) (dismissing all nonsubrogation claims). Typical common law causes of action asserted by various states included indemnity, voluntary assumption of a special duty, and unjust enrichment; statutory claims were based either on consumer protection statutes or state and federal antitrust law. Although the Settlement mooted these claims, before the Settlement several courts dismissed states' complaints for failure to state causes of action. In short, few of the nonsubrogation claims were successful. This footnote discusses these claims.

First, states' indemnity claims are invalid. Indemnity arises in cases where a wrongful act of one party creates vicarious liability for the other, and the other pays that liability. The passive wrongdoer who discharges the duty is generally entitled to indemnity. See

Douglas Laycock, *Modern American Remedies* 646-47 (2d ed. 1994). Indemnity is not available to a plaintiff who does not share a common liability with the party from whom indemnity is sought. See, e.g., *In re Air Crash Disaster*, 86 F.3d 498, 547-49 (6th Cir. 1996) (holding that indemnity is unavailable to plaintiff who cannot establish common liability); *Stephenson v. McClure*, 606 S.W.2d 208, 213-14 (Mo. Ct. App. 1980) (same). Although only Iowa has ruled on indemnity in the smoking litigation, see *Iowa v. R.J. Reynolds*, No. CL 71048 (Iowa Dist. Ct. Aug. 26, 1997) (visited Sept. 19, 1999) <<http://stic.neu.edu/In/dec8-26.htm>>, *aff'd sub nom.*, *Iowa ex rel. Miller v. Philip Morris Inc.*, 577 N.W.2d 401 (Iowa 1998), the United States Supreme Court denied indemnity to the federal government in similar circumstances in 1947. See *United States v. Standard Oil Co.*, 332 U.S. 301, 313 (1947) (holding that indemnity claim is matter for Congress, not Court); see also *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258, 268-69 (1992) (citing difficulties establishing proximate cause for similar indemnity claim). The Iowa court dismissed the state's indemnity claim because injuries suffered by the state were too indirect to satisfy proximate cause. See *Iowa v. R.J. Reynolds*, No. CL 71048, at 4-5. The court noted that the state could state a cause of action under Iowa's subrogation statute. See *id.* at 3-4.

Second, states' claims for breach of a special duty of care lack merit, both because the states cannot satisfy the physical injury requirement of that cause of action, and because the tobacco industry has not breached any duty to the states, as noted in the Restatement:

One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of the other's person or things, is subject to liability to the other for *physical harm* resulting from his failure to exercise reasonable care to perform his undertaking, if (a) his failure to exercise such care increases the risk of such harm, or (b) the harm is suffered because of the other's reliance upon the undertaking.

Restatement (Second) of Torts § 323 (1965) (emphasis added). Section 324A continues:

One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person for *physical harm* resulting from his failure to exercise reasonable care to protect his undertaking, if (a) his failure to exercise reasonable care increases the risk of such harm, or (b) he has undertaken to perform a duty owed by the other to the third person, or (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.

Id. § 324A (emphasis added). States alleged that the tobacco industry voluntarily assumed a duty of care when it undertook to monitor and study the health effects of tobacco use, and that the industry breached this duty when it manipulated its findings. By and large, courts have rejected this claim. See *Texas v. American Tobacco Co.*, 14 F. Supp. 2d 956, 973 (E.D. Tex. 1997) (refusing to extend liability under § 323 to create duty undertaken by corporate advertising); *Iowa v. R.J. Reynolds*, No. CL 71048, at 6-7 (dismissing claim alleging breach of duty voluntarily assumed because plaintiff failed to show physical harm); *Washington v. American Tobacco, Inc.*, No. 96-2-15056-8 SEA, 1997 WL 714842, at *1-*4 (Wash. Super. Ct. June 6, 1997) (same). This claim is also vulnerable because of the "economic loss doctrine." See *id.* (noting well-established rule that if only loss due to negligence is economic one, it is not legally cognizable). Courts have also rejected similar claims by nongovernmental insurers. See, e.g., *Laborers' & Operating Engineers' Utility Agreement Health & Welfare Trust Fund v. Philip Morris, Inc.*, 42 F. Supp. 2d 943, 951 (D. Ariz. 1999) (finding no breach of assumed duty under §§ 323 and 324A when there was no physical injury to plaintiff); *Oregon Laborers-Employers Health & Welfare Trust Fund v. Philip Morris, Inc.*, 17 F. Supp. 2d 1170, 1182-83 (D. Or. 1998) (same).

Additionally, many states claimed recovery for unjust enrichment. The courts' analysis of these claims has been inconsistent, but the courts have dismissed them nonetheless. Some courts hold that unjust enrichment is not available if any other remedy is available. See *Iowa v. R.J. Reynolds*, No. CL 71048, at 7-8; *Maryland v. Philip Morris Inc.*, No.

96122017, 1997 WL 540913, at *215 (Md. Cir. Ct. May 21, 1997) (holding that plaintiff had no right to recover at common law); *Washington v. American Tobacco Co., Inc.*, No. 96-2-15056-8 SEA, 1996 WL 931316, at *9 (Super. Ct. Wash. Nov. 19, 1996) (holding that Washington Product Liability Act preempts unjust enrichment claim); *McGraw v. American Tobacco Co.*, No. 94C-1707, 1995 WL 569618, at *2 (W. Va. Cir. Ct. June 6, 1995) (holding that attorney general of West Virginia has no common law authority). We do not agree with these cases. See Hanoch Dagan, *Unjust Enrichment: A Study of Private Law and Public Values* 5-6 (1997) (explaining that claims based on restitution for unjust enrichment stand independent of claims based on tort); see also *infra* Part II.B. A federal district court in Pennsylvania did provide the correct analysis of this claim, that the plaintiff's unjust enrichment cause of action was really just a badly stated subrogation claim. See *Steamfitters Local Union No. 420 Welfare Fund v. Philip Morris, Inc.*, No. Civ.A.97-5344, 1998 WL 212846, at *4 (E.D. Pa. Apr. 22, 1998). Part II.B elaborates on this issue, explaining that legal subrogation is a subspecies of unjust enrichment, a restitutionary recovery for the unsolicited conferral of benefits.

Courts also assert that the alleged benefit conferred by the states does not satisfy any duty of the tobacco industry and is too attenuated to be actionable. See *Iowa v. R.J. Reynolds*, No. CL 71048, at 8; *Maryland v. Philip Morris*, 1997 WL 540913, at *17; *Washington v. American Tobacco*, 1996 WL 931316, at *9; *McGraw*, 1995 WL 569618, at *1-2. We disagree. See *infra* Part II.D.

That the federal government has not alleged any of these or similar common law causes of action against the tobacco industry in its lawsuit is telling. The United States pursues relief under two federal subrogation statutes and the Racketeer Influenced and Corrupt Organizations (RICO) Act. See Plaintiff's Compl., *United States v. Philip Morris, Inc.* (D.D.C. Sept. 22, 1999) (No. 99-213). Even the smart and expensive folks working for the United States place little faith in the merits of these common law claims. See David S. Cloud et al., *Justice Reverses: Lobbying Effort Wins Turnabout on Tobacco Suit*, Wall St. J., Sept. 24, 1999, at B1.

The states' statutory claims are also tenuous. Claims based on consumer protection statutes survived the tobacco manufacturers' motion to dismiss in Iowa, Maryland, Minnesota, and West Virginia. See, e.g., *Maryland v. Philip Morris*, 1997 WL 540913, at *17. Many of the states appear to state causes of action under the broad language of some of the state statutes. For example,

[t]he State must merely allege that [the state] has sustained an injury or loss as a result of Defendants' prohibitive conduct which, despite the difficulties of proof that may arise at trial, it has properly done in claiming that it lost millions of dollars due to the tortious acts of Defendants.

Id. at *18. Under these statutes some of the states may have been entitled to injunctive relief and possibly even to civil penalties. Whether states could ever recover for "tortious acts" that cost the states money (e.g., Medicaid payments) but are not compensable torts against the injured citizens is doubtful. For example, the state of California might be able to demonstrate that it suffered specific medical costs because of automobile accidents involving automobiles manufactured by the Ford Motor Company. Could California have a claim against Ford under the consumer statutes where Ford had committed no tort? No.

Similarly, most of the state antitrust claims survived the tobacco manufacturers' motions. See, e.g., *id.*; *Washington v. American Tobacco*, 1996 WL 931316, at *6. But see *Texas v. American Tobacco*, 14 F. Supp. 2d at 969-70 (holding that "State has not suffered the type of injury the antitrust laws were designed to prevent"). Despite this initial success, we doubt that the states would have prevailed at trial on these issues. First consider the allegation concerning the tobacco industry's conspiracy to fail to develop a safer cigarette. It is contrary to the interest of a cigarette company to forego the bonanza awaiting the company that makes a cigarette that has all of the beneficial and none of the deleterious effects of current tobacco cigarettes. Such a cigarette would capture a huge market share instantaneously. Why then should one company conspire with another to fail to

gation to the claims of their citizens against the tobacco manufacturers in tort, to be discussed in Part II below. Since in subrogation actions the manufacturers could raise all defenses that they could have raised against the subrogors (assumption of risk, causation, and the like)—given the current record of individual suits—it is likely that less than half of the state suits would have been successful.⁹¹

make such a cigarette? An additional response to this theory is that it is incorrect as a historical and factual matter; in the 1970s, RJR developed and test marketed a “safe cigarette” in Japan. The cigarette was a flop, according to Bryan Burrough and John Helyar in *Barbarians at the Gate*; the principal consequence of the test marketing was to require Americans to learn the Japanese term meaning “tastes like shit.” See Bryan Burrough & John Helyar, *Barbarians at the Gate* 112 (1990). A final barrier that stands in the way of recovery is that it is unlikely that any such cigarette can be developed and a conspiracy to do what is impossible could not cause damage.

Other states claimed that the manufacturers violated their antitrust laws by conspiring to fix prices. This claim was made in the face of public evidence of intense competition among the major cigarette manufacturers. See Suein L. Hwang, *Cigarette Makers in Discount War to Lock in Share*, *Wall St. J.*, Sept. 23, 1998, at B1. We wonder what proof of price fixing the states would have produced at trial. Note too, this claim is more than a little ironic. The principal injury that the states assert in all of these cases arises from their additional expenditure for health care costs caused by smoking. By hypothesis, a conspiracy to fix prices would raise prices and reduce the number of smokers who would otherwise have been injured in a free market (with lower prices and more extensive use), so the states in making these claims are talking out of both sides of their mouths. On the one hand they complain that cigarettes cause added health costs but on the other hand they complain because the cigarette companies have sold too few cigarettes.

Some proponents of the tobacco litigation justify states’ claims on the basis of “lost productivity of the citizenry.” See *Iowa v. R.J. Reynolds*, No. CL 71048, at 2; see also *Texas v. American Tobacco Co.*, 14 F. Supp. 2d at 962 (justifying direct common law claims based on state’s “quasi-sovereign” interest in “the well-being of its populace”). But “loss of productivity” is not a cause of action recognized under the common law. As the Supreme Court noted in *United States v. Standard Oil*, entirely new causes of action require explicit legislative approval. See 332 U.S. at 313-14 (refusing to create new cause of action from heightened legal duty). In other words, democratic principles require more accountability in the establishment of new tort claims. See *infra* Part IV. Second, this proposed cause of action is problematic on its merits because it would open every “nonproductive” but addictive activity to legal liability, such as loafing, recreational sex, and gluttony. For example, would the government have a cause of action against the National Football League for diverting thousands of citizens’ hours from “productive” to “nonproductive” ends?

As Part II explains in detail, we believe that the restitutionary claim of subrogation (with appropriate limits) remains an actionable claim. As the Maryland court remarked,

[a]t common law a plaintiff had no right to recover damages from a defendant tortfeasor as a result of the defendant’s injuries, harm, or lack of care to a third person, regardless of the fact that the defendant’s actions may have put the plaintiff to what otherwise would have been unnecessary or increased expense.

Maryland v. Philip Morris, 1997 WL 540913, at *9. However, “in some instances, the plaintiff can recover from the defendant if the plaintiff has a legal right, under equitable principles of subrogation, to assert the legal claims of the injured third party in the name of the injured third party.” *Id.* at *12; see also *Standard Oil*, 332 U.S. at 313 (noting that state courts have greater freedom to create new common law liabilities).

⁹¹ In individual suits against the tobacco manufacturers concluded in 1999, less than half of the plaintiffs won. See *supra* note 25. If one assumes that the states would have

Even if the states could have won on behalf of every injured smoker, the settlement would still greatly exceed the expended costs. Because the states pay no part of Medicare and approximately one-half of Medicaid costs, and because private insurance companies and the smokers themselves pay most health care costs associated with smoking, the part of the total cost actually borne by the states is small. A state's additional medical expenses attributable to a decedent's smoking are approximately \$557.⁹² Multiplying the number of deaths from smoking by the \$557 figure produces an annual cost to all of the states of approximately \$223 million.⁹³

An alternative estimate is to apply \$557 to each of the forty-six million adult smokers.⁹⁴ This calculation suggests that the states' total Medicaid liability for all living adult smokers is no more than \$32 billion. Adding a payment for all smokers who have died in the last five years (as a proxy for those for whom statute of limitations has not run) would increase the amount by $\$557 \times 5 \times 400,000 = \1.1 billion.

done no better, 25 or more of the states would have lost their suits. For example, before the settlement was reached, Iowa's claim was rejected on appeal by its own supreme court. See *Iowa ex rel. Miller*, 577 N.W.2d 401. Similarly, after the tobacco manufacturers' motion to dismiss was granted as to Washington's most promising causes of action (restitution and unjust enrichment), the state's case was on the ropes. See *Washington v. American Tobacco*, 1996 WL 931316. The dismal record of unions and private insurance companies as plaintiffs suggests that the states might have fared even worse. See *supra* note 43.

⁹² This figure is derived from the Manning Study published in 1991. See Willard G. Manning et al., *The Costs of Poor Health Habits 67-85* (1991). In 1986 dollars, that study determined that a smoker will incur \$6,000 more in lifetime medical costs than a non-smoker. However, most of this expense is not assumed by the individual states. The Centers for Disease Control (CDC) estimate that Medicaid only covers 10.2% of these smoking-related expenditures. See *Medical-Care Expenditures Attributable to Cigarette Smoking—United States, 1993*, 43 *Morbidity & Mortality Wkly. Rep.* 468, 471 (1994). Furthermore, not all Medicaid expenses are borne by the individual state. For instance, the federal government matched an average of 60.47% of state Medicaid funds in 1995. See *Congressional Info. Serv., Health Care State Rankings, in 1995: Health Care in the 50 United States 287* (May 1995). Therefore, if Medicaid covers roughly 10% of the medical costs associated with smoking, and of that 10% only half is paid by the individual state, then the total lifetime medical costs a smoker will impose on his respective state in 1986 dollars equals \$300. The present value of \$300 in medical costs in 1986 equals approximately \$557 in 1999. See Bureau of Labor Statistics Data, *Consumer Price Index—All Urban Consumers* (visited Aug. 2, 1999) <<http://www.bls.gov/top20.html>>. The annual average value of 122.0 was used for 1986, and the June value of 250.2 was used for 1999. See *id.*

⁹³ The 400,000 deaths per year estimated here is slightly lower than the CDC's 1990 estimates. See *Mortality Trends for Selected Smoking-Related Cancers and Breast Cancer—United States, 1950-1990*, 42 *Morbidity & Mortality Wkly. Rep.* 857, 857 (1993) (estimating that 419,000 deaths in United States during 1990 were attributable to smoking).

⁹⁴ This 1993 estimate defined current cigarette smokers as those who had smoked at least 100 cigarettes and who reported that they smoke every day or some days. See *Cigarette Smoking Among Adults—United States, 1993*, 43 *Morbidity & Mortality Wkly. Rep.* 925 (1994).

The manufacturers could satisfy their entire potential liability to the states for all adults currently smoking and for those who have died within the last five years for about \$30 to \$35 billion, a fraction of the amount they have agreed to make to the states. This amount assumes a charge for every single smoker and assumes it is paid at once even though many of the costs for living smokers will be incurred far in the future.

In agreeing to the Settlement, the tobacco companies have thus probably agreed to pay the states a much larger amount than the states could have expected to recover had every case gone to judgment (even if we assume some additional, unidentified costs attributed to legitimately subrogated preventative and ameliorative costs). Yet, the tobacco companies have received no direct protection from bankruptcy. While it would take many large recoveries to bankrupt even the weakest companies, recall that plaintiffs' asbestos suits went from certain defeats to routine victories in the blink of an eye.⁹⁵ Past victories give little comfort, particularly to an industry that sees new evidence of its pariah status everywhere it turns.⁹⁶

Why would an industry agree to pay far more than the present value of its probable liability and agree to a settlement that does not give it what it most needs—protection from bankruptcy? We see several reasons, some plain, some subtle and speculative. First, the tobacco manufacturers did gain important indirect protections from bankruptcy. Second, the tobacco manufacturers achieved explicit provisions that minimize competition from new tobacco manufacturers who did not sign the Settlement.

1. *Safety from Bankruptcy*

We believe the holy grail for the tobacco manufacturers is federal protection from bankruptcy.

The financial stakes in the state suits were particularly great because the tobacco manufacturers faced a queue of state plaintiffs

⁹⁵ In 1964, a significant link was acknowledged between lung cancer and mesothelioma and exposure to asbestos. See Sandra Friedman, Note, *Manville: Good Faith Reorganization or "Insulated" Bankruptcy*, 12 Hofstra L. Rev. 121, 124-25 (1983). This resulted in a floodgate of litigation beginning in the late 1960s against asbestos-producing companies such as Manville, which at one point "boast[ed] annual sales of approximately two billion dollars." *Id.* at 121. Overnight, Manville tumbled from Fortune 500 status into bankruptcy. See *id.*

⁹⁶ Certainly the market sees this risk. Prior to its spinoff in 1999, the market valued RJR's domestic tobacco subsidiary at less than zero. See Andrew Bary, *Unfazed by Rates, Stocks Roar Ahead at Week's End*, Barron's Bus. Wk., June 7, 1999, at MW3. The presence of certain specific terms (especially the \$5 billion annual cap) in the AG Agreement and in the original McCain bill shows that the tobacco manufacturers also appreciate the risk.

thirty or forty deep, each of whom could observe earlier trials and learn from the mistakes of each prior plaintiff by bringing their suits in seriatim fashion.⁹⁷ Since any judgment would be due and owing in full on the exhaustion of the defendants' appeals, the amount of the judgment would have to be booked as a liquidated liability and, absent an agreement with the plaintiff, would have to be paid at once, not over twenty-five years out of future earnings.

Tobacco manufacturers would have faced financial dangers from any large jury verdict even if the companies were eventually successful on appeal. The prospect of obtaining a bond to cover such a judgment, which might include punitive damages and treble damages, posed a formidable threat.⁹⁸ The cost of a bond would be enormous,⁹⁹ and bonding companies might no longer be willing to write such bonds for defendants facing thirty or forty more suits.

Given the risks of large judgments, seriatim suits, and the costs of bonds, bankruptcy loomed as a real danger. At least one of the largest three tobacco manufacturers carried a burden of hard debt balanced against soft assets.¹⁰⁰ And bankruptcy for a tobacco

⁹⁷ The prospect of a long line of plaintiffs with ever-increasing strength would have been an unattractive prospect even if a tobacco manufacturer had no bankruptcy concerns.

⁹⁸ On the last day of the trial, the tobacco companies settled with the state of Minnesota for \$6.6 billion. See Milo Geyelin, *Minnesota, Tobacco Firms in Settlement*, Wall St. J., May 11, 1998, at A3 (discussing Minnesota's \$6.6 billion settlement for smoking health care costs). Given some of the theories advanced by the plaintiff, the defendants reasonably could have feared a judgment as high as \$10 or \$15 billion. Texaco's experience in its case against Pennzoil is also instructive: On November 17, 1985, a Harris County (Houston) civil jury awarded Pennzoil a judgment of \$10.53 billion against the multinational oil company, Texaco. See Matt Moffett, *Pennzoil Wins \$10.53 Billion in Suit Against Texaco; Verdict Is Called Highest Civil Judgment in History*, Wall St. J., Nov. 20, 1985, at 3. Under Texas law, Texaco was required to post a supersedeas bond equal to the amount of judgment plus interests and costs, in order to stay the enforcement of the judgment pending appeal. See *Texaco, Inc. v. Pennzoil Co.*, 626 F. Supp. 250, 257 (S.D.N.Y. 1986). After Texaco's challenges to the bond requirement were rejected, see *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 33 (1987), Texaco filed for Chapter 11 bankruptcy and settled with Pennzoil for \$3 billion under a reorganization plan. See Robert H. Mnookin & Robert B. Wilson, *Rational Bargaining and Market Efficiency: Understanding Pennzoil v. Texaco*, 75 Va. L. Rev. 295, 296 (1989).

⁹⁹ To appeal a \$10 billion judgment under Minnesota law, the defendants would have had to post a bond equal to at least the amount of the lower court judgment. Minnesota civil provisions concerning supersedeas bonds state that:

[i]f the appeal is from a judgment directing the payment of money, the condition of the bond shall be the payment of the judgment or that part of the judgment which is affirmed and all damages awarded against the appellant upon the appeal if the judgment or any part of it is affirmed or if the appeal is dismissed.

Minn. R. App. P. 108.01(3).

¹⁰⁰ Of RJR's \$29 billion assets in 1998, trademarks made up roughly \$7 billion and an additional \$11.5 billion were attributable to goodwill. See RJR Nabisco Holding Corp., Form 10-K: Annual Report, tbl.F-3 (1998).

manufacturer would not be the momentary unpleasantness it might be for a defendant faced with a single plaintiff. Thousands of tobacco plaintiffs might appear in the bankruptcy court with their unliquidated claims. Some might ask the court to estimate the value of their claims and to give them a large chunk of the company; others might find the bankruptcy court to be a convenient forum to challenge the manufacturers' payment of dividends or other transfers of corporate assets as fraudulent conveyances. Asymptomatic smokers could claim a share of the estate based on asbestos bankruptcy precedents.¹⁰¹

Although the Settlement did not provide the kind of explicit protections from bankruptcy that the AG Agreement would have, it staved off threats of insolvency in two important ways. First, insofar as states' claims are concerned, the Settlement completely forestalled the possibility of a lucky hit that would have knocked all of the companies into bankruptcy. It enabled the tobacco companies to pay over many years, to book the liability piecemeal, and, perhaps, even to reduce the discounted cost of the total stream of payments.

Second, the Settlement will enlist the states and beneficiaries of the payments to the states as new lobbying allies of the tobacco companies in Congress in favor of liability-limiting bills. If the tobacco companies filed a petition in Chapter 11, their payments under the Settlement would be indefinitely postponed.¹⁰² Since the payments have been negotiated and characterized as payments by a tortfeasor to the states (as the injured party or as a subrogee to the injured party) and not as taxes, the states would not enjoy the benefits that the Bankruptcy Code confers on some state tax claims.¹⁰³ It seems likely that the states' claims would be treated as mine-run unsecured claims, requiring the states to compete with individual smokers. No state would relish a fight with victims suffering debilitating and deadly diseases over limited funds.

Bankruptcy would thus threaten the fortunes of many powerful beneficiaries in the states, beneficiaries who are likely to come from

¹⁰¹ In *In re Joint E. & S. Dist. Asbestos Lit. (In re Johns-Manville Corp.)*, 982 F.2d 721 (2d Cir. 1992), modified, 993 F.2d 7, 11 (2d Cir. 1993), those exposed to asbestos but not yet sick had to compete with conventional creditors and with persons already suffering asbestos diseases. Although the courts were hesitant to recognize the former as "creditors" under the Bankruptcy Code, the courts frequently provided for them by making them beneficiaries of trusts that held the debtor's assets, or by other means. See, e.g., *id.* at 725-32 (describing plight of Manville Trust). See generally Mark J. Roe, *Bankruptcy and Mass Tort*, 84 Colum. L. Rev. 846, 864-92 (1984) (describing payment devices to manage uncertainty regarding aggregate claims liability).

¹⁰² See Master Settlement Agreement, *supra* note 76, § 549. In addition, § 362 would automatically stay any attempt outside of the bankruptcy court to collect the amounts under the Settlement. See *id.* § 362.

¹⁰³ See 11 U.S.C. §§ 507(a)(8), 523(a) (1994).

all parts of the political spectrum: from teachers unions on the left (who benefit from use of the tobacco money for education), to municipalities in the middle, to businesses and individuals on the right (who will face increased taxes if the tobacco money dries up). When a manufacturer suffers the first threatening judgment and turns to the states, municipalities, unions, and others requesting they use their influence with Congress, we predict the various beneficiaries will spring to action—just as any well paid lobbyist should.¹⁰⁴

2. *Protection Against Competition*

To meet its payments under the Settlement, the tobacco companies would have to raise the price per pack of cigarettes.¹⁰⁵ At some point new manufacturers (who, by hypothesis, have committed no torts) might be able to enter the market and undersell the existing manufacturers. The agreement with the states contains a diabolically clever set of provisions to insulate the cigarette manufacturers from such competition.

Section IX(d), titled “nonparticipating manufacturer adjustment,” adjusts the principal payments (particularly the “base amount” which rises from \$5 billion in 2001 to \$9 billion in the year 2018 and thereafter) downward if “nonparticipating manufacturers”—new tobacco manufacturers—take market share from the participating manufacturers. A particular state’s share of the payments is not merely reduced dollar for dollar for the loss of share; it is reduced by a multiple of the sales lost to the new entrants. If, for example, the participating tobacco manufacturers lose 10% of their market share to new entrants, they will have a right under subsection (d) to reduce their payments to the states by as much as 24%.¹⁰⁶

Any state that passes the Settlement’s model statute is freed from any adjustment.¹⁰⁷ The model statute imposes a tax on new tobacco entrants equal to approximately twenty cents per package in the year 2000, rising to thirty-six cents in the year 2007. If new entrants make inroads on the signing manufacturers’ market share, the nonparticipating adjustment attributable to those inroads is spread among states who have not adopted a similar tax. For example, if California adopts

¹⁰⁴ That such a possibility would be on the minds of the tobacco manufacturers is shown by the terms in the AG Agreement where an express part of the deal was that the attorneys general would lobby Congress for a federal annual cap and for other restrictions on individual suits. See AG Agreement, *supra* note 46, tit. VIII.

¹⁰⁵ This of course is the appropriate fate of a tortfeasor, to internalize the cost of its bad act and so insure that its product truly reflects the risks.

¹⁰⁶ See Master Settlement Agreement, *supra* note 76, § XI(d).

¹⁰⁷ See *id.* exh. T.

the model tax on new entrants but half of the states do not, and a new entrant takes 10% of the signers' market share in California, California will receive its regular base payment while the states who have not adopted a similar tax will suffer a reduction in their base payment (amounting to as much as 24% of California's share). So a failure to tax new entrants can cost a state not only an exponential reduction of payments that it would otherwise have received, but also an additional reduction for inroads by new entrants in states that did adopt a tax.¹⁰⁸

If, as we suspect, the new entrant tax and nonparticipating manufacturers' reduction will effectively exclude new entrants, the only loss that will be suffered by the manufacturers' shareholders will come from the reduction in demand caused by increased price. How elastic cigarette demand is remains to be seen. If it is completely inelastic and if new competition does not erupt among the existing manufacturers, the entire cost of the deal is thrown on the backs of future smokers. If, on the other hand, the settlement drives the cost of cigarettes over some invisible tipping point—where their cost exceeds the pleasure conferred for many smokers—the shareholders will bear a significant part of the cost.

II

GOVERNMENTS VS. INJURIOUS INDUSTRIES: SUBROGATION

As mentioned in Part I, the states' litigation against the tobacco industry focused on reimbursement of tobacco-related health care costs.¹⁰⁹ The causes of action actually brought by the states, however, were invalid bases on which to make such claims.¹¹⁰ The states' complaints neglected their true remedy: subrogation. This Part considers how the states' claims fit into the scope of subrogation, a task requiring an explanation of the underlying premises of restitution for unsolicited benefits. We then discuss how the states' claims in subrogation against injurious industries diverge from traditional insurance subrogation and explore how the peculiarities of the states' claims test the scope and outer limits of the law of subrogation. Another question, which we take up only in the last section of this Part, relates to the

¹⁰⁸ The tax is justified in the Settlement in the most pious terms: "To protect the public health gains achieved by this Agreement." *Id.* § XI(d). If the states had really wished to have the tort system work as it should, however, they could have refused to agree to the nonparticipating manufacturers' adjustment and could have applied a prospective tax to all cigarettes. That would have made the tortfeasors bear the cost of their injuries while avoiding punishing new entrants who have committed no torts.

¹⁰⁹ See *supra* notes 36-38 and accompanying text.

¹¹⁰ See *supra* note 90.

interaction of common law subrogation with specific statutory interventions.

A. Subrogation Defined

Subrogation is substitution.¹¹¹ It arises where one person (the subrogee) pays another (the subrogor) to cover a loss or a debt for which a third party is primarily liable.¹¹² The subrogee then enforces the rights of the subrogor against that third party (the party primarily responsible for the loss) for its own benefit.¹¹³ Subrogation has two forms: contractual (also called conventional), and legal (also called equitable).¹¹⁴ Contractual subrogation (the most typical example is insurance) exists by virtue of explicit agreement between the subrogee and the subrogor,¹¹⁵ while legal subrogation arises by law following unsolicited conferral of benefits by one person on another.¹¹⁶ The

¹¹¹ See Henry N. Sheldon, *The Law of Subrogation* § 1, at 1-2 (1893) (“[Subrogation] is a substitution, ordinarily the substitution of another person in the place of a creditor, so that the person in whose favor it is exercised succeeds to the rights of the creditor in relation to the debt.”); see also, e.g., S.F. Dixon, *Substituted Liabilities: A Treatise on the Law of Subrogation* 7 (1862); Ronald C. Horn, *Subrogation in Insurance Theory and Practice* 12 (1964) (“‘Subrogation’ is . . . derived from the Latin *subrogare*, which means . . . to substitute.”).

¹¹² See Horn, *supra* note 111, at 13-14; see also Restatement (Third) of Suretyship and Guaranty § 27 cmt. a (1995).

¹¹³ See A.S. Burrows, *The Law of Restitution* 76 (1992); G.H.L. Fridman, *Restitution* 398 (2d ed. 1992); F. Joseph Du Bray, *A Response to the Anti-Subrogation Argument: What Really Emerged from Pandora’s Box*, 41 S.D. L. Rev. 264, 265 (1996) (explaining principle of enforcement of rights by subrogee against third party); Keith E. Edeus, Jr., *Comment, Subrogation of Personal Injury Claims: Toward Ending an Inequitable Practice*, 17 N. Ill. U. L. Rev. 509, 511 (1997) (same); Jeffrey A. Greenblatt, *Comment, Insurance and Subrogation: When the Pie Isn’t Big Enough, Who Eats Last?*, 64 U. Chi. L. Rev. 1337, 1338 (1997) (same). For a general discussion, see Lord Goff of Chieveley & Gareth Jones, *The Law of Restitution*, 120-69 (Gareth Jones ed., 5th ed. 1998); see also Restatement (Third) of Suretyship and Guaranty § 28 (1996).

¹¹⁴ See Dixon, *supra* note 111, at 7 (identifying two types of subrogation); Horn, *supra* note 111, at 22 (same); see also Burrows, *supra* note 113, at 207-11; Sheldon, *supra* note 111, § 5, at 6-7 (explaining two types of subrogation in Louisiana).

¹¹⁵ See Dixon, *supra* note 111, at 7 (distinguishing contractual subrogation from legal subrogation); Horn, *supra* note 111, at 22 (same); see also Sheldon, *supra* note 111, § 5, at 7 (noting requirement in Louisiana that conventional subrogation be formally expressed).

¹¹⁶ See Burrows, *supra* note 113, at 207-11; Horn, *supra* note 111, at 22 (describing legal subrogation); see also Sheldon, *supra* note 111, § 6, at 7 (same). An insurer’s right to recover against a responsible third party or tortfeasor for money that the insurer has already paid out to the insured victim is an example of legal subrogation. See Horn, *supra* note 111, at 7 n.47 (using fire insurance as example where legal subrogation would be permitted). Other examples include an insurer’s right to recoupment of an insured victim’s winnings in a lawsuit or settlement against the responsible third party or tortfeasor, see Thomas C. Homburger & Kimberly Harper, *Insurance Law Overlay or Title Insurance, in Title Insurance: Handling Critical Issues Facing Buyers, Sellers and Lenders*, at 1201, 1218 (PLI Real Estate Law & Practice Course Handbook Series No. N4-4607, 1997), available in Westlaw, PLI-Real database, and a tortfeasor’s right to contribution against another

task of this Part is to delineate the scope of legal subrogation, and, more particularly, to demonstrate how governments claiming expanded preventative and ameliorative costs fall within this restitutionary claim.

It is often maintained that legal subrogation is a remedy that seeks to rectify unjust enrichment.¹¹⁷ This rationale, unfortunately, is not helpful:¹¹⁸ To say that legal subrogation should be allowed if “it would be unjust for the person enriched to retain the benefit . . . is to analyze the complex in terms of the obscure.”¹¹⁹ Pointing to the principle of prevention of unjust enrichment cannot be very helpful since it does not tell us when the third party’s (or the purported subrogor’s) enrichment is “unjust.” Not every conferral of a benefit on someone else—which, by definition, leads to someone’s enrichment—triggers legal subrogation. If the benefactor is considered a “volunteer” whose conduct is officious, the retention of the benefit is not deemed unjust and the beneficiary does not have a right to legal subrogation.¹²⁰

The scope of legal subrogation, the distinction between payments that should be deemed unjust enrichment and payments that fall

tortfeasor when the first tortfeasor has already paid money to a victim who is injured by both, see Stewart A. Estes, *The Short Happy Life of Litigation Between Tortfeasors: Contribution, Indemnification and Subrogation After Washington’s Tort Reform Acts*, 21 *Seattle U. L. Rev.* 69, 88-89 (1997) (describing right of contribution); see also Restatement of Restitution § 104 (1937) (discussing right of subrogation for satisfaction of lien).

¹¹⁷ See Peter Birks, *An Introduction to the Law of Restitution* 95-96 (rev. ed. 1989) (describing subrogation as remedy for unjust enrichment); Burrows, *supra* note 113, at 82; John P. Dawson & George E. Palmer, *Cases on Restitution* 59-60 (2d ed. 1969) (same); 1 Dan B. Dobbs, *Law of Remedies* § 4.3(4), at 604-05 (2d ed. 1993) (same); Charles Mitchell, *The Law of Subrogation* 4, 9 (1994) (same); 1 George E. Palmer, *The Law of Restitution* § 1.5(b), at 23-24 (1978 & Supp. 1996) (same); John F. Dolan, *A Study of Subrogation Mostly in Letter of Credit and Other Abstract Obligation Transactions*, 64 *Mo. L. Rev.* 789, 791-92 (1999). But see Horn, *supra* note 111, at 24 (“It seems to this writer, however, that *the* general purpose of subrogation is to facilitate placement of the financial consequences of loss on the party primarily responsible in law for such loss.”).

¹¹⁸ For a general critique of the justificatory power of the concept of unjust enrichment, see Hanoch Dagan, *Restitutionary Damages for Breach of Contract: An Exercise in Private Law Theory*, 1 *Theoretical Inquiries L.* 115 (2000) (stating that unjust enrichment is conclusion in need of supportive normative arguments).

¹¹⁹ Michael Sean Quinn, *Subrogation, Restitution, and Indemnity*, 74 *Tex. L. Rev.* 1361, 1367 (1996) (book review).

¹²⁰ Sheldon has noted:

The doctrine of subrogation is not applied for the mere stranger or volunteer, who has paid the debt of another, without any assignment or agreement for subrogation, being under no legal obligation to make the payment, and not being compelled to do so for the preservation of any rights or property of his own.

Sheldon, *supra* note 111, § 240, at 360; see Greenblatt, *supra* note 113, at 1340 (stating requirement for subrogation claim that debt being paid not be voluntary); Quinn, *supra* note 119, at 1380 (“It is often said that volunteers do not have any rights of subrogation.”); see also, e.g., Fridman, *supra* note 113, at 401; 1 Palmer, *supra* note 117, § 1.5(b), at 23.

under the volunteer rule, must derive from the considerations that guide our private law—more particularly, the law of restitution—in cases of the conferral of unsolicited benefits. Legal subrogation, as one subspecies of restitution for unsolicited benefits, must be shaped by the same framework.¹²¹ This framework provides a principled distinction between those unsolicited benefits which justify the granting of this remedy, when we would say that it would be unjust for the third party (or the subrogor) to retain the benefit, and other unsolicited benefits that are not thus privileged, in which case we will label the payor volunteer (and the payment officious) and refuse to allow its legal subrogation claim.

B. *Restitution for Unsolicited Benefits*

Typical unsolicited benefits (positive externalities) arise where the parties' interests are "locked in" together.¹²² The law of restitution is frequently used to overcome the resulting free-riding difficulties, as long as such intervention will not unduly interfere with the defendant's liberty or create negative externalities.¹²³ Examples include a class action member who pays the lawyer's fee, one of several tortfeasors who settles with a victim discharging the entire liability,¹²⁴

¹²¹ This Article does not discuss issues raised by altruistic interventions by "good samaritans." On recovery for good samaritans, see generally Hanoch Dagan, *In Defense of the Good Samaritan*, 97 Mich. L. Rev. 1152 (1999).

¹²² See Daniel Friedmann & Nili Cohen, *Payment of Another's Debt*, in *International Encyclopedia of Comparative Law*, ch. 10, at 42 (1991) ("Broadly speaking, all legal systems considered in this work contain rules that strengthen the position of the payor who in order to protect his own interest, pays the debt owed (or also owed) by another."); see also, e.g., John Dawson, *Unjust Enrichment: A Comparative Analysis* 36, 138-41 (1951) (discussing development of protections for those who pay debts of others under various legal regimes); Sheldon, *supra* note 111, § 3, at 4-5 (same).

¹²³ Our analysis below triggers legal subrogation. With contractual subrogation (e.g., insurance cases), there is no need to examine whether the parties' interests are "locked in" because they have explicitly agreed to unite their interests, and their agreement is enforceable by law. It is only in cases of legal subrogation that courts enforce a duty for which the parties did *not* contract; thus, examining the parties' interests becomes necessary to ensure that one is not getting a free ride at the expense of the other.

A similar analysis applies to what at first might seem to be (and technically is) legal subrogation. For instance, courts enforce subrogation when a mortgagor pays a mortgagee's taxes to prevent foreclosure, even though the parties did not expressly bargain for that arrangement. Although this technically is an example of legal subrogation, in reality, it better resembles contractual subrogation because the mortgagor is simply filling in a "gap" in the contract that the parties would have agreed to at the time of contract formation, had the issue come to the table. Our analysis also does not extend to cases like these, which instead are resolved under general contract principles.

¹²⁴ See 2 Palmer, *supra* note 117, § 10.6(c), at 410-11 (describing indemnity between tortfeasors). The case of a joint tortfeasor who settles only its share is more complex. See *McDermott, Inc. v. AmClyde*, 511 U.S. 202, 216-17 (1994) (noting difficulties of such approach).

or an insurer who compensates the victim of a tort with its own funds.¹²⁵

Restitutionary awards for unsolicited benefits seem easily justified in such cases if three conditions are satisfied. First, the benefit involved must be collective with respect to the members of a group, causing the parties' interests to be locked together.¹²⁶ Because it is impossible or infeasible to exclude any of the relevant actors from benefiting from the other's payment (or performance), free riding may occur: Individuals may refuse to pay their share, motivated solely by the expectation that others' efforts will generate the very same good free of charge (or more cheaply).¹²⁷ Free riding may frustrate the possibility of achieving the collective good itself if no single member of the group is likely to derive sufficient benefits from that good to justify paying the entire cost of supplying it alone, and no coalition of members can feasibly divide the costs among members.¹²⁸ Under such circumstances, a restitution recovery forces the parties involved to pay their proportionate share of the collective good, overcoming the free-rider problems that otherwise might cause the collective benefit to be underproduced.¹²⁹ Restitution of unsolicited benefits will be awarded, in other words, where it is a necessary form of "mutual coercion"¹³⁰ for solving a collective action problem.¹³¹

The second and third conditions respond to possible legitimate objections of defendants, even where the parties' interests are locked

¹²⁵ See 1 Palmer, *supra* note 117, § 1.5(b), at 23.

¹²⁶ See John P. Dawson, *The Self-Serving Intermeddler*, 87 Harv. L. Rev. 1409, 1418 (1974) (describing unjust enrichment rationale in instances of interlocked interests); see also Richard J. Arneson, *The Principle of Fairness and Free-Rider Problems*, 92 Ethics 616, 618 (1982) (defining public good by its jointness, nonexcludability, and equal consumption among group members).

¹²⁷ See Arneson, *supra* note 126, at 621 (noting possibility of free riding when exclusion from benefits is impossible).

¹²⁸ See Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* 41 (2d ed. 1971) (noting how free riders may deprive collusive organizations from any benefit of collective action). Free riding also creates distributive difficulties since the free rider pays less than her proportionate share in the collective endeavor.

¹²⁹ See Arneson, *supra* note 126, at 621 (explaining when voluntary acceptance of benefits is sufficient to create obligation to repay).

¹³⁰ Cf. Garrett Hardin, *The Tragedy of the Commons*, 162 Science 1243, 1247 (1968) (explaining idea of agreed upon "mutual coercion" to produce individual responsibility).

¹³¹ Free riding is one species of a collective action problem. Collective action is a generic term describing the difficulty faced by a group of self-interested individuals where the promotion of their self-interest requires cooperation. Even if they all agree on both their collective purpose and the best means to promote it, they will still face difficulties in achieving it, since for each and every one of them the individual interest supersedes their collective good. See, e.g., Olson, *supra* note 128, at 2, 8, 10-11, 21, 51, 60-61 (discussing problems of private individual interests versus collective interests).

in, that make restitution problematic.¹³² The first objection revolves around the difficulties of valuing the benefit received. Where the benefit involved is easily reducible to money, valuation is unproblematic. Difficulties may arise, however, where noncash benefits are involved, so that wealth or taste dependencies create significant variations in people's subjective valuations. As Saul Levmore explains, people's valuations are idiosyncratic because they depend both on varying abilities to pay for a good and on personal tastes. Levmore gives three exceptions where the phenomenon of subjective devaluation would not occur: (1) the recipient has infinite wealth, (2) the recipient is a profit-making enterprise where subjective preferences have little role, or (3) the nonbargained benefit is easily translated into wealth. Unless those exceptions apply, one cannot easily refute the recipient's claim that the recipient preferred to invest money in the acquisition of some other benefit more clearly to the recipient's liking.¹³³

Where valuations are subjective, restitution may not be appropriate. First, these cases raise the notorious difficulty of interpersonal comparisons of utility, and thus reduce the confidence that restitution would maximize utility.¹³⁴ Furthermore, even where we are relatively certain that, all in all, the collective benefit is value enhancing, these are still harder cases since awarding restitution may insult the liberal commitment to individual free choice.¹³⁵ The concern for individual

¹³² Indeed the law may (justifiably, in our view) perceive certain objections as illegitimate, and thus ignore them. Where one tortfeasor believes it is worse off by the other's settlement with the victim due to the information the settling tortfeasor releases to the victim, for example, no set off of the harm caused by this information to the other tortfeasor is allowed. Another way to put the same point may be that in such cases, third party effects justify some leniency respecting the locked-in inquiry. See *infra* text accompanying notes 154-62.

¹³³ See Saul Levmore, *Explaining Restitution*, 71 *Va. L. Rev.* 65, 74-79 (1985) (noting wealth-dependency problems in valuation); see also Birks, *supra* note 117, at 109 (discussing problem of subjective devaluation); Burrows, *supra* note 113, at 9-11 (stating that borderline of incontrovertible benefits may be open to dispute); Peter Birks, *In Defense of Free Acceptance*, in *Essays on the Law of Restitution* 105, 127 (Andrew Burrows ed., 1991).

¹³⁴ Clearly, this is Levmore's concern. See Levmore, *supra* note 133, at 74-79 (discussing wealth dependency).

¹³⁵ See Birks, *supra* note 117, at 109-10, 228 (noting right of individual choice as important factor in restitution decisions); 1 Dobbs, *supra* note 117, § 4.9(2), at 683 (same); Dawson, *supra* note 126, at 1417 (same); John D. McCamus, *The Self-Serving Intermeddler and the Law of Restitution*, 16 *Osgoode Hall L.J.* 515, 520, 575 (1978) (same); Mitchell McInnes, *Incontrovertible Benefits in the Supreme Court of Canada: Peel (Regional Municipality) v. Canada; Peel (Regional Municipality) v. Ontario*, 23 *Can. Bus. L.J.* 122, 123, 128 (1994) (same). Another concern that may make restitution for unsolicited benefits problematic is negative externalities. Thus, in some cases, allowing restitution to intervening providers hinders well-developed or "thick" markets composed of many active buyers and sellers. If bypassing the market mechanism would still allow providers of services—through the availability of restitutionary claims—to receive some prevailing price for their

freedom is stronger insofar as we believe that the revealed idiosyncratic preferences of the other beneficiaries are genuine, rather than strategic.¹³⁶

The case of *Board of Directors v. Western National Bank*¹³⁷ illustrates the difficulties of divergent valuations. In that case, apartment owners in a residential development that combined both single family homes and apartments protested having to participate in the costs of maintaining the development's common areas.¹³⁸ Although there was no doubt that this maintenance positively affected the value of the apartments, the court ruled that the apartment owners were not obligated to contribute.¹³⁹ The homeowners who conferred an unsolicited benefit on the apartment owners were deemed pure volunteers. This result, in our view, stems from the rationale that the apartment owners may have preferred different expenditures from the homeowners. Because the family homes were likely to be occupied on a relatively long-term basis by their owners, whereas the apartments were leased out and for shorter periods, the apartment owners may well have had "cheaper tastes" even if the maintenance added undisputed value to the property.

Indeed, in types of cases where problems of subjective valuation typically arise, restitution is usually awarded only if no beneficiary who has a disinterested motive for not contributing to the collective good is required to contribute, and as long as the defendant's proportionate benefit exceeds the cost to him or her of contributing the proportionate share of the costs of supplying the benefit.¹⁴⁰ These

services, up-front bids will be discouraged. When some suppliers have the capacity of being more efficient than others, this would be an unfortunate result. Hence, the law's tendency to deny—in cases where this last condition applies—restitutionary relief to providers of nonbargained benefits, even if there is no real difficulty from the point of view of the desirability of such benefit to the recipient, can be seen as "market encouraging." See Levmore, *supra* note 133, at 79-80 (explaining market encouragement through denial of restitution).

¹³⁶ For an example of strategic idiosyncratic preferences, see *Cox v. Wooten Bros. Farms, Inc.*, 610 S.W.2d 278 (Ark. Ct. App. 1981). In *Cox*, Wooten had a subsequent interest in the property and agreed to assume its assignors' obligations on a note to a bank. It paid off the entire debt—both the part assigned to it and the part which represents the pro rata responsibility of Cox—in order to be able to refinance its operation and obtain an additional loan from the bank. See *id.* at 279. As the court noted, it was only at that time that "Cox decided she was no longer indebted to anyone." *Id.* at 280. The court appropriately allowed Wooten's subrogation claim. See *id.* at 281.

¹³⁷ 487 N.E.2d 974 (Ill. App. Ct. 1985).

¹³⁸ See *id.* at 976.

¹³⁹ See *id.* at 978-79.

¹⁴⁰ See Charles Silver, *A Restitutionary Theory of Attorneys' Fees in Class Actions*, 76 *Cornell L. Rev.* 656, 664-65 (1991) (outlining conditions for requiring absent class members to pay attorneys' fees).

requirements ensure that the beneficiary of the unsolicited benefit cannot legitimately object to its restitutionary obligation.

The second objection of defendants arises from potential "agency costs" of the benefactors. In addition to benefiting the locked-in group, the benefactor may have incentives to act in ways that advance only its own interests or, at least, in ways that are more committed to its own interests than to those of its purported beneficiary.¹⁴¹ A defendant may be rightly concerned that the restitutionary claim partially seeks compensation for benefits conferred only upon the benefactor agent. In cases that raise such concerns, restitution for unsolicited benefits may not be forthcoming.

The case of *McNeilab, Inc. v. North River Insurance Co.*¹⁴² nicely illustrates this dilemma. In *McNeilab*, an insured pharmaceutical company sought restitution from its own liability insurer for a recall undertaken after product-tampering incidents.¹⁴³ Its theory, based on a celebrated Pennsylvania case,¹⁴⁴ was that the recall was expected to benefit the insurer by preventing third party damages for which the insurer would be liable. The agency cost problem explains the court's denial of the claim.¹⁴⁵ The court noted that the insured undertook the recall in the most expensive manner possible and had thus achieved far more than limiting the insurer's potential liability to tort victims. Instead, the recall had increased the company's profitability by substantially promoting goodwill and an image of the firm as committed to product safety.¹⁴⁶ Recall efforts typically involve such moral hazards due to the intrinsic mixture of collective benefits in the form

¹⁴¹ This "agency costs" objection is conceptually related to our previous locked-in analysis. Where agency costs exist, it usually indicates that the parties' interests are not identical, so that although they partly converge, there is also a significant divergence. If the conflicting interests overwhelm the converging interests, imposing subrogation on the parties would actually *create* inefficient free rider problems because the "benefactors'" interests are then subsidized at the expense of the locked-in group.

¹⁴² 645 F. Supp. 525 (D.N.J. 1986).

¹⁴³ See *id.* at 527-28.

¹⁴⁴ *Leebov v. United States Fidelity & Guar. Co.*, 165 A.2d 82 (Pa. 1960).

¹⁴⁵ The court's explicit holding relied on its view that recall costs were not covered as part of the insured's liability policy given that the manufacturer had not actually been held liable for any of the drug tampering deaths. See *McNeilab*, 645 F. Supp. at 536. Saul Levmore has argued that the court's denial of coverage stems from the law's policy to allow restitution for unsolicited benefits only if the intervention turns out to be *ex post* efficient. See Saul Levmore, *Obligation or Restitution for Best Efforts*, 67 S. Cal. L. Rev. 1411, 1433-34 (1994). A requirement of *ex post* success, however, is indefensible. See Dagan, *supra* note 121, at 1179-83 (arguing against requirement of *ex post* success because it creates disincentive for altruistic interventions).

¹⁴⁶ See *McNeilab*, 645 F. Supp. at 527 (discussing safety measures and consumers' positive response).

of liability reduction and goodwill promotion to the insured.¹⁴⁷ In such situations, where we might have particular reason to believe that the benefits provided contain such a mixture, restitution should be strictly limited to the collective aspect of the benefit. In cases where such a sorting is infeasible, a restitutionary remedy should not be available.

* * *

We now have a principled delineation of the core and the periphery of restitutionary claims following the conferral of unsolicited benefits. At the core, we find cases in which the parties' interests are locked together and there are no expected differences between their preferences based on taste, wealth, or conflicts of interest. Where there may be such differences or where the interaction between their interests is more equivocal, difficulties arise.

C. *The Scope of Subrogation*

Consider the garden variety cases of liability insurers who pay an insured's loss and turn to the tortfeasor for subrogation. Using our discussion of restitutionary claims for unsolicited benefits, it is easy to see why this is a core subrogation case.¹⁴⁸ The interests of the insurer and the tortfeasor are locked together. If the insurer's coverage would have been considered "voluntary"—that is, if we would have concluded that the tortfeasor has not been unjustly enriched—then, assuming we would not allow victims to recover twice,¹⁴⁹ both the tortfeasors and the insurers would have an incentive to refuse to pay, since the first who would pay will carry the burden irrespective of their substantive rights.¹⁵⁰ Allowing insurers to seek subrogation from

¹⁴⁷ Such moral hazards may help explain the high cost of recall insurance, which the plaintiff in *McNeilab* had at one time carried but had decided by the time of the recall was prohibitively expensive. See *id.* at 528.

¹⁴⁸ See Friedmann & Cohen, *supra* note 122, at 21 (“[S]ubrogation is used extensively [in the Anglo-American legal system] in favour of an indemnity insurer who paid a loss covered by the policy.”).

¹⁴⁹ As a default rule, allowing victims to recover twice simply results in insurers transferring their higher costs to insureds in the form of higher premiums. See Horn, *supra* note 111, at 25:

In the first place subrogation recoveries *do* enter the rate structure, by serving as a reduction in incurred losses; hence the insurer is not paid to take the risk of negligent losses . . . but rather the risk of negligent losses *less net subrogation* recoveries. Regardless of what specific class of insurance or actuarial technique is in question, the net losses (net of subrogation) will in some way be used as a basis for the premium structure.

¹⁵⁰ A similar reasoning of locked-in interests applies in the context of contribution claims of a joint tortfeasor who discharges the entire liability by settlement and seeks con-

tortfeasors removes this incentive. Subrogation, a subspecies of restitution for unsolicited benefits, is the way to solve the collective action problem of insurers and tortfeasors.

As long as the right of tortfeasors to contest liability and damages is preserved in the subrogation suit (with the same procedural advantages—e.g., burden of proof—as they had in the original suit),¹⁵¹ they have no legitimate reason to complain because this paradigmatic insurance case raises neither of the objections of defendants discussed above. First, no difficulty of wealth or taste dependency arises because the nonbargained benefit is already in monetary terms and satisfies an expense that is nondiscretionary to the tortfeasor.¹⁵² Second, payment by the insurer appears to provide few benefits to the insurer apart from the collective benefit of satisfying the duty to pay the victim.¹⁵³ Hence, no systemic concern of conflict of interests justifies a denial of restitution.

Not all legal subrogation cases are as easy. A typical hard case in legal subrogation arises where the parties' interests are not as clearly locked in. In the setting of subrogation, however, award may be justified even in such peripheral cases if there are third parties affected by the subrogee's decision whether to provide the benefit. A good example comes from the recent Sixth Circuit case *In re Air Crash Disas-*

tribution. Plaintiffs are much more likely to settle, or to settle on more lenient terms, if they settle their entire claim (the advantage to plaintiffs, in terms of litigation costs, of such settlements over partial settlements which leave part of their claim against other defendants pending is obvious).

¹⁵¹ See 2 Palmer, *supra* note 117, § 10.6(a), at 402-03 (arguing that where one party settles with third-party victim, tortfeasor should have opportunity to challenge reasonableness of settlement); see also Stephenson v. McClure, 606 S.W.2d 208, 212 (Mo. Ct. App. 1980) (involving contribution claims of joint tortfeasor who discharged entire liability by settlement and thereafter sought contribution).

¹⁵² See Dawson, *supra* note 122, at 141 ("It will be very rarely indeed that a substitution of the plaintiff for the paid-off creditor can in any way prejudice the debtor. The modern recognition of assignability of contract rights greatly weakens the objection to involuntary assignments by means of subrogation."); 1 Dobbs, *supra* note 117, § 4.9(2), at 685 ("When the defendant's choice is limited by law or fact, restitution may not interfere with any choice he legally or practically has."); Keith Mason & J.W. Carter, *Restitution Law in Australia* 48 (1995) (noting that saving of necessary expense is uncontroversial form of incontrovertible benefit); Mayo Moran, *Rethinking Winnipeg Condominium: Restitution, Economic Loss, and Anticipatory Repairs*, 47 U. Toronto L.J. 115, 135 n.54 (1997) ("[S]ubjective devaluation is simply not available when the law stipulates that the benefit is one which the defendant was required to choose."); see also J. Beatson, *The Use and Abuse of Unjust Enrichment* 32-33 (1991) (describing necessary expenditures and monetary benefits as incontrovertible benefits); Birks, *supra* note 117, at 117 (same); Burrows, *supra* note 113, at 11 (same); Goff & Jones, *supra* note 113, at 22-25 (same); McInnes, *supra* note 135, at 124, 128 (same).

¹⁵³ One additional benefit is the goodwill benefit of being recognized as someone with whom it is easy to do business.

ter.¹⁵⁴ On August 16, 1987, Northwest Flight 255 crashed and killed 156 people. A jury found the airline, Northwest, liable for one hundred percent of injuries and death caused by the crash, and exonerated McDonnell Douglas, the manufacturer of the airplane. McDonnell Douglas had previously paid considerable amounts of money to settle certain claims arising out of the incident. After the verdict, it sought recovery from Northwest under a theory of equitable subrogation. The court of appeals accepted the theory of recovery.¹⁵⁵

The court noted that “[e]quitable subrogation is especially well-suited to allow recovery by an innocent settling party from the actual wrongdoer,”¹⁵⁶ as long as it can demonstrate that it was not “a mere volunteer.”¹⁵⁷ The volunteer issue here frequently implies the question of how closely the payor’s and tortfeasor’s interests were tied together. In this case, it would have been possible for McDonnell Douglas to have protected its own interests without conferring the unsolicited benefits on Northwest. In response to McDonnell Douglas’s volunteer problem, the court noted that the money McDonnell Douglas paid was “in response to the threat of litigation.”¹⁵⁸ Given McDonnell Douglas’s ultimate lack of liability, this reason, however, might seem a flimsy basis on which to conclude that McDonnell Douglas and Northwest were sufficiently bound together to justify a subrogation recovery.

The result of *In re Air Crash Disaster* is correct, but for reasons beyond the relationship between the two parties. The court praised McDonnell Douglas’s “strategy” to “compensate the injured parties and focus the controversy between Northwest and McDonnell Douglas,” a strategy which “provided prompt payments for the special plaintiffs and reduced their legal expenses.” Preventing McDonnell Douglas “from recovering after it has been exonerated,” explained the court, would have deterred “parties harboring any hope of innocence from settling,” thus undermining public policy.¹⁵⁹

The court’s concern for third-party effects explains why this borderline case is justifiably covered by legal subrogation. Between a payor and a tortfeasor, cases of payments to victims by nonliable original defendants are on the periphery of subrogation. But in the context of nonbargained coverage of harm inflicted by someone else’s

¹⁵⁴ 86 F.3d 498 (6th Cir. 1996).

¹⁵⁵ See *id.* at 511-13, 549-50.

¹⁵⁶ *Id.* at 550.

¹⁵⁷ *Id.* at 549-50. Recall that in the context of legal subrogation, “volunteer” stands for officious and refers to a duty undertaken by a purported subrogee for its own interests.

¹⁵⁸ *Id.* at 550; see also *id.* at 552 (referring to Restatement of Restitution § 71(2) (1937)).

¹⁵⁹ *Id.* at 552.

wrong, the law must also consider possible third-party effects. These effects should allow subrogation claims to succeed especially where (as in the case at hand) no serious concerns from either subjective valuation or conflicts of interests arise.

This attention to third parties is also favored in the realm of insurance subrogation. Insurance subrogation is available for payments which are "favored by public policy," even if they are not in performance of a legal duty.¹⁶⁰ Thus, the "volunteer rule" rarely influences insurance subrogation cases.¹⁶¹ As long as the nature of the loss is within the basic scope of the policy coverage, an insurer who pays a claim should not be treated as a volunteer, even if it acts in the face of judicial authority suggesting that applicable exclusion would enable it to deny liability.¹⁶² The reason for this expansion of subrogation should be clear: If insurers would not have been permitted to "recover by subrogation colorable claims paid, even if, in the end, these claims were not, strictly speaking, covered," they would have been more hesitant in accepting claims, whereas "sound social policy" should encourage them "to err on the side of caution when rejecting claims."¹⁶³

The premises guiding legal subrogation thus track our analysis of restitution for unsolicited benefits, but with a twist: Subrogation should be allowed even where the parties' interests are not strongly enough locked in to present a core case if there are substantial concerns for third party effects and as long as there are no significant concerns regarding subjective devaluation or conflict of interests.

D. *The Governments' Subrogation Claim*

Having established the theoretical premise for delineating the borders of legal subrogation, we can now evaluate the governments' subrogation claim against industries such as the tobacco and gun industries. The governments' claims are unconventional in three impor-

¹⁶⁰ *State Farm Fire & Cas. Co. v. East Bay Mun. Util. Dist.*, 62 Cal. Rptr. 2d 72, 75 (Ct. App. 1997); see also *Continental Ins. Co. v. Federal Ins. Co.*, 266 S.E.2d 351, 352 (Ga. Ct. App. 1981) (stating that good public policy encourages prompt settlement of insureds' claims).

¹⁶¹ See Quinn, *supra* note 119, at 1381; see also Robert E. Keeton & Alan I. Widiss, *Insurance Law* § 3.10(d)(3), at 249 (1988) (stating that volunteer doctrine is not recognized by many American courts and almost never applied where liability of insurer was open to dispute); Friedmann & Cohen, *supra* note 122, at 13-14, 43, 47 (comparing American law, where concept of volunteer has often been narrowly construed, with English law, which remains rather strict); cf. Fridman, *supra* note 113, at 402 (noting that use of subrogation in Canada is wider than in England).

¹⁶² See *State Farm Fire & Cas. Co.*, 62 Cal. Rptr. 2d at 77.

¹⁶³ Quinn, *supra* note 119, at 1380; see also *State Farm Fire & Cas. Co.*, 62 Cal. Rptr. 2d at 76-77.

tant respects. First, the payments for which subrogation is sought—such as the additional health care costs governments have incurred as a result of smoking-related illnesses—are not based on the payor's private duty. Second, the claims are not based on direct payments to the alleged subrogors, but rather on expenditures made in preventing and ameliorating their harms. Third, parts of the claims refer to costs which have not yet been incurred by the governments. The alleged subrogors of the future health care costs are still healthy (indeed, some are yet to be born). The first two features call into question how closely the governments' and industries' interests are locked together and the future-oriented nature of part of these expenditures raises the objection of agency costs. Should any of these features make legal subrogation inapplicable?

In this section we answer this question using the analysis developed in the previous section. First, we ask whether the interests of the governments and the industries are locked together. Second, we look at the possible objections of the industry, which did not bargain for the unsolicited benefits conferred (indirectly) on it. Finally, if we reach the conclusion that these two tests classify this case as peripheral, we inquire into the third party effects of the decision whether to classify it within legal subrogation.

At first blush, the locked-in investigation seems simple. The states' health care costs in our case study, preventative and ameliorative, benefit the tobacco industry by limiting the detrimental consequences to citizens, thus diminishing the extent and amount of potential damages that could be suffered by the industry through the injured citizens' suits¹⁶⁴ (which we assume throughout to be legally valid). The indirectness of the government payments, however, illustrates that the locked-in effect is not as strong as it is in more typical subrogation cases, where the subrogee is legally required to pay. Just as in *In re Air Disaster* and in cases of insurers' coverage of uninsured harms, part of the states' costs were discretionary.¹⁶⁵

Next, we turn to the legitimate objections of the defendants. First, it is difficult to think of any complaint arising from subjective devaluation concerns. The situation of the tobacco and gun industries

¹⁶⁴ See *City of New York v. Lead Indus. Ass'n*, 644 N.Y.S.2d 919, 924-25 (App. Div. 1996) (stating same claim respecting costs expended by plaintiff as landlord to relieve hazardous conditions resulting from use of lead-based paint in city-owned buildings); see also Moran, *supra* note 152, at 135 (“[T]here will be a benefit to the defendant where he has avoided and consequently shifted the cost of performing his duty to another.”).

¹⁶⁵ While the states must pay for a percentage of Medicaid, see *supra* text accompanying note 92, other preventative and ameliorative costs they have incurred, such as the anti-smoking programs undertaken in California and Florida, are discretionary.

in this respect is analogous to that of tortfeasors in garden variety insurance subrogation claims. As long as their right to contest their liability and the reasonableness of the amount spent by the states is preserved,¹⁶⁶ and provided the states would have borne the burden of proof on both issues, no legitimate interests of the industry have been impaired. The nonbargained benefit indirectly conferred on the tobacco and gun manufacturers is, from their perspective, already in monetary terms, and it reduces (we assume) an expense which is not discretionary to them.¹⁶⁷

The second objection, that of agency costs, may be a valid concern regarding that part of the governments' claim that refers to costs which they have not yet incurred, the third distinguishing characteristic of our triangular paradigm. When a government recovers for costs to be incurred at some time in the future, it may have significant incentives to pursue benefits that would not accrue to the injurious industry as much as to the government—money free from political costs. This concern is mitigated by basic principles of legal subrogation, which limits "the subrogee's recovery . . . to the amount of the performance [it] actually rendered."¹⁶⁸ The law prohibits recovery in advance.¹⁶⁹ Correspondingly, governments should be limited to a judgment of liability with actual payments being made periodically and to the extent of their actual additional (strictly preventative or ameliorative) costs.¹⁷⁰

¹⁶⁶ See *supra* note 151; *infra* note 184 and accompanying text. To recover against the tobacco industry, the government must show that its preventative and ameliorative measures actually reduced the industry's liability.

¹⁶⁷ See *supra* text accompanying note 152 (explaining why no taste or wealth dependencies exist in typical insurance subrogation cases). Notice that no difficult question of imposing an unsolicited benefit arises insofar as the injured citizens are concerned since the preventative and ameliorative costs sought do not reduce the industry's liability to them (but rather the harms for which it is liable). For this very reason, the industry cannot raise any concerns of being doubly liable (as can some debtors in other cases of unrequested payments of another's debt; see generally Beatson, *supra* note 152, at 177-205).

¹⁶⁸ Saul Litvinoff, *Subrogation*, 50 La. L. Rev. 1143, 1176 (1990); see also *United States v. P/B STCO 213*, 756 F.2d 364, 370 (5th Cir. 1985) (allowing United States to recover only those costs actually incurred for clean-up of oil spill).

¹⁶⁹ See, e.g., Peter D. Maddaugh & John D. McCamus, *The Law of Restitution* 165 (1990). Although the majority rule prohibits the subrogee *any recovery at all* until it has made the entire payment, see, e.g., *Shelter Ins. Cos. v. Frohlich*, 498 N.W.2d 74, 78 (Neb. 1993); *Westendorf v. Stasson*, 330 N.W.2d 699, 703 (Minn. 1983), this rule is impractical when applied to the states' claims against the tobacco industry because it would be difficult to determine what constitutes full or partial payment. Therefore, courts should apply the minority rule and permit the government *pro tanto* subrogation based on partial payment. See Quinn, *supra* note 119, at 1387; see also Keeton & Widiss, *supra* note 161, § 3.10(b)(1), at 233-37 (discussing alternative approaches to allocation of payments between subrogor and subrogee).

¹⁷⁰ Discussing rules of recovery for situations where insureds have not been fully paid

But even if we set aside the concern of agency costs, the governments' subrogation claim still looks peripheral given the relatively tenuous locked-in nature of the governments and industries indicated above.¹⁷¹ Third-party effects should therefore determine whether to allow or disallow a claim to recover those costs in legal subrogation. These effects, more specifically, justify a relatively generous attitude to legal subrogation.

The significance of such effects has been recently considered in a similar context in *City of New York v. Lead Industries Ass'n*.¹⁷² In that case, New York City sued five major manufacturers of lead-based paint and their trade association to recover costs expended in inspecting, testing, monitoring, and abating the hazard arising from the use of the lead paint; in testing children at risk of lead poisoning; and in treating the victims of such poisoning.¹⁷³ The defendants moved for dismissal of these claims, but the appellate court refused to grant dismissal, deciding that these claims set forth viable causes of action.¹⁷⁴

for an injury, Quinn says that rules vary as to whether the insurer may recover only after the insured has been fully reimbursed, or for sums already outlaid even if some payments remain to be made. Quinn claims that insurers should not be reimbursed for amounts not yet paid to the insured. See Quinn, *supra* note 119, at 1384-87.

We have been assuming throughout that the government's claims for money spent to treat those who are actually already sick (past injuries) would take priority over its claims for ameliorative costs (present injuries), and that both of these would take priority over the government's claims for preventative costs (future injuries). Periodic claims for actual payments will also make sure that this priority is not upset.

¹⁷¹ See *supra* text accompanying note 152.

¹⁷² 644 N.Y.S.2d 919 (App. Div. 1996).

¹⁷³ See *id.* at 921. Under New York statute, the government was required to alleviate hazards caused by lead pigments the defendants manufactured. See *id.* at 924-25. The court specifically noted, however, that a plaintiff seeking restitution need not have been under a duty to perform but rather took action to protect the public health and safety. See *id.* at 923.

¹⁷⁴ It is doubtful whether the particular restitutionary cause of action which the court allowed, indemnity, should have been available. As Andrew Kull noted in criticizing this opinion, "[t]he required nexus for indemnity is the existence of a joint liability to a third party [whereas] the paint manufacturers were not . . . under any liability to anyone." Andrew Kull, *Regional Digest—U.S.A.*, 5 *Restitution L. Rev.* 198, 203 (1997). This is not merely a matter of legal formalities, since the classification of a claim between indemnity and subrogation entails substantive differences. Unlike cases of indemnity, where—for limitation purposes—liability attaches only when the loss is suffered by the party seeking indemnity, subrogees are held subject to any valid defenses against their subrogors, including to the same counting of time for the purposes of the statute of limitations. See Laycock, *supra* note 90, at 647. This defense, however, would probably not have been relevant regarding the city's case had it been brought as a subrogation claim since, in passing, the court mentions that "individual children suffer injury from continuing exposure to paint," implying that, unlike the city's direct claim, the inhabitants' suits are not time barred. See *Lead Indus. Ass'n*, 644 N.Y.S.2d at 925. Because the city would substitute for the direct plaintiffs, the city's subrogation claim would not be dismissed on limitations grounds.

In its opinion, the court relied heavily on Section 115 of the Restatement of Restitution, which provides that performance of another's duty where there is an immediate necessity "to protect 'public decency, health or safety'" gives rise to restitution, notwithstanding the plaintiff's lack of liability.¹⁷⁵ "The thrust of the complaint," said the court, "is that plaintiffs took the immediate action necessary to protect the health and safety of the residents of their buildings, particularly children, from the well recognized hazards of lead paint which had been manufactured and marketed by defendants."¹⁷⁶ The court decided that the reasonable costs of the plaintiffs' preventative and ameliorative measures are recoverable, emphasizing that "the salutary goals" of the restitutionary remedy—which are "particularly relevant" for abatement costs—"are furthered when preventative and ameliorative steps to abate the hazards at the earliest opportunity are immediately taken to limit the disastrous consequences to children that would ensue from continued exposure to lead paint."¹⁷⁷

City of New York illustrates how the public duty owed to third parties by governments in responding to harms should be as compelling a ground for subrogation recovery as the policy in favor of encouraging insurers to pay claims to tort victims. The court generously interpreted the "immediacy" language of Section 115 of the Restatement and did not require short-term emergency to justify the government's action. A government may recover as long as the action was taken to promote public health and welfare.¹⁷⁸

We reach the same conclusion with respect to government claims regarding the preventative and ameliorative costs for our general discussion of the triangular case under consideration.¹⁷⁹ Even if, in our

In short, we endorse *City of New York*, although we agree that (1) indemnity is not the right heading, (2) the limitation question should have been explicitly addressed and resolved, and (3) the court should have emphasized the derivative nature of the city's claim. Regarding those parts of the court's opinion that deviate from these premises, we concur in Professor Kull's critique.

¹⁷⁵ *Lead Indus. Ass'n*, 644 N.Y.S.2d at 923 (citing Restatement of Restitution Proposed Final Draft § 115 (1936)).

¹⁷⁶ *Id.* at 924.

¹⁷⁷ *Id.* at 925. For other cases, in the context of asbestos abatement, that adopted (and at times declined to adopt) a similar approach, see Rendelman, *supra* note 6, at 910 & n.305.

¹⁷⁸ See *United States v. P/B STCO* 213, 756 F.2d 364, 371 (5th Cir. 1985) (concluding that obligation to reimburse government arises especially where duty was "necessary to preserve the public's welfare and safety").

¹⁷⁹ The need to hold an industry responsible for the consequences of its tortious conduct may not be immediately obvious, since government already has a duty, and therefore needs no incentive, to provide preventative and ameliorative care to injured citizens. However, failing to make manufacturers internalize the cost of their negligence is inefficient as well as unjust, and although we assert that the governments do have an interest in

terminology, the bilateral relationship between the governments and the industries is set at the periphery of subrogation, the interests of an untold number of third party beneficiaries¹⁸⁰ require the availability of such restitutionary claims. Public authorities should be able to respond in an efficient manner to any threat to the public health or safety, without worrying that the provision of services would insulate those who are responsible to these threats from liability and unjustifiably shift the burden of their wrongdoing to the public purse.¹⁸¹

E. Defenses and Limitations

The governments' status as subrogees, according to our analysis, makes their rights derivative of those of the direct victims, due to and to the extent of the unsolicited benefits conferred. As such, the subrogee's rights can be no greater than the rights of the subrogor.¹⁸² Thus, the industry's original liability to injured citizens caps its exposure to subrogation.¹⁸³ Beyond the industry's original liability, its putative objection based on subjective devaluation should preclude recovery. The governments are also subject to whatever defenses the industry would have had against the injured citizens,¹⁸⁴ most prominently as-

providing these services, preventative and ameliorative care for citizens is still to some extent discretionary, such that concern about the adequacy of resources is legitimate.

¹⁸⁰ *Lead Indus. Ass'n*, 644 N.Y.S.2d at 925 (referring to interests of "untold number of children").

¹⁸¹ See *id.* at 925; see also *Wyandotte Transp. Co. v. U.S.*, 389 U.S. 191, 205 (1967). In *Wyandotte*, the federal government removed a sunken barge and its cargo and brought suit against the parties responsible for the allegedly negligent sinking for reimbursement of the costs of removal. See *id.* at 193. The Supreme Court allowed recovery, holding that the government's exercise of its right of removal "should not relieve negligent parties of the responsibility for removal," and adding that any other result would penalize the government "for the correct performance of its duty." *Id.* at 205.

¹⁸² See John Dwight Ingram, *Priority Between Insurer and Insured in Subrogation Recoveries*, 3 *Conn. Ins. L.J.* 105, 107 (1996) (exploring options to reduce dispute about allocation of subrogation recoveries). The pay-as-you-go nature of subrogation obviates arguments about whether the states have, on the whole, actually saved money through the early deaths of smoking citizens. For conflicting views respecting the net benefit argument, compare Willard G. Manning et al., *The Costs of Poor Health Habits 27-28* (1991) (claiming that society saves money overall from smokers' deaths), and David A. Hyman, *Tobacco Litigation's Third-Wave: Has Justice Gone Up in Smoke?*, 2 *J. Health Care L. & Pol'y* 34, 38 (1998) (same), with Hanson & Logue, *supra* note 4, at 1247-60 (rejecting argument both in economic and normative terms).

¹⁸³ See Quinn, *supra* note 119, at 1374.

¹⁸⁴ One criticism leveled against the idea of allowing individual citizen plaintiffs to recover from the government in this manner is that this may indirectly create a new cause of action in which plaintiffs' burden of proving causation is diminished: Plaintiffs would no longer need to establish specific damages resulting from the specific negligent acts of specific defendants. However, we do not believe that this constitutes an end run around causation. Tort law has already adopted mechanisms such as burden shifting, market share and enterprise liability, and alternative tort liability to force tortfeasors to internalize the

sumption of risk, causation, and statutes of limitations.¹⁸⁵ Moreover, as per the concern from agency costs, governments are entitled only to the damages attributable to the loss which they have covered¹⁸⁶ (and they carry the burden of proving that these costs were indeed incurred in a way that benefits the injured citizens). Governments are not entitled to damages for pain and suffering, punitive damages, or statutory penalties to which the injured citizens might have been entitled from the industries.¹⁸⁷

A further problem arises where the resources of alleged tortfeasors are limited. If the subrogor and the subrogee cannot both recover in full, the subrogor—the injured party—takes first.¹⁸⁸ This points to a potential competition between the governments who seek to recover their ameliorative and preventative costs and the citizens who seek remedy for their direct harms. This aspect of the triangular relation between governments, citizens, and injurious industries is the focus of Part III.¹⁸⁹

costs of negligence in cases where liability would otherwise be very difficult to prove. See, e.g., Ariel Porat & Alex Stein, *Liability for Uncertainty: Making Evidential Damage Actionable*, 18 *Cardozo L. Rev.* 1891, 1895-96 (1997) (citing ways that tort law deals with defendants who cause factual ambiguity to plaintiffs' cases against them, making them more difficult to prove, and ultimately advocating creation of separate tort of "evidential damage"). These mechanisms help plaintiffs where proving their cases against particular defendants is difficult because "the [negligent] conduct of multiple defendants is simultaneous but does not combine." Richard Delgado, *Beyond Sindell: Relaxation of Cause-in-Fact Rules for Indeterminate Plaintiffs*, 70 *Cal. L. Rev.* 881, 881 (1982). Had the tobacco settlement never occurred, for example, it is likely that individual citizen plaintiffs would have succeeded in this matter and recovered the proportional share of their damages, given the likelihood that smoking was the cause of their injury.

¹⁸⁵ See Robert H. Jerry, II, *Understanding Insurance Law* § 96(g)(1), at 613 (2d ed. 1996) ("[A]ny defense that the third party has which is good against the subrogor, such as laches, the statute of limitations, immunity, unclean hands, or illegality, is good against the subrogee."); Sheldon, *supra* note 111, § 6, at 8 ("[T]he party for whose benefit the doctrine of subrogation is exercised can acquire no greater rights than those of the party for whom he is substituted; if the latter had not a right of recovery, the former can acquire none." (footnote omitted)); Quinn, *supra* note 119, at 1363 (same); Greenblatt, *supra* note 113, at 1346 (same). Recall that subrogees are held subject to the same counting of time for the purposes of the statute of limitations as their subrogors. See *supra* note 174.

¹⁸⁶ See *supra* note 169 and accompanying text.

¹⁸⁷ If the government covered losses from pain and suffering, it would be entitled to subrogation. See Quinn, *supra* note 119, at 1375, 1376 n.51.

¹⁸⁸ See Greenblatt, *supra* note 113, at 1346, 1351. This issue may be particularly relevant regarding government suits against gun manufacturers, whose resources available to pay a judgment are a fraction of those of the tobacco industry. See David E. Rosenbaum, *Echoes of Tobacco Suit in Gun Battle*, *N.Y. Times*, Mar. 21, 1999, at A32 (noting that annual sales of gun makers in United States are \$1.5 billion compared to \$45 billion of cigarette companies); see also Fox Butterfield, *Lawsuits Lead Gun Maker to File for Bankruptcy*, *N.Y. Times*, June 24, 1999, at A14 (discussing bankruptcy filings as response to municipal suits).

¹⁸⁹ In other words, we do not think that a defendant in a subrogation suit has standing to

F. A Note on Statutory Interventions

Having defined the possible liability of industries such as the tobacco or gun manufacturers to governments under a common law cause of action in subrogation, we must also consider the possible impact of specific statutory interventions. Statutory interventions raise complex questions that cannot be addressed adequately here. This section is only a roadmap to the way in which these general questions manifest in our triangular paradigm.

There are two types of statutory intervention that may affect a government common law cause of action in subrogation against an injurious industry.¹⁹⁰ The first involves a statutory subrogation provision whose scope does not coincide with the scope we ascribed to common law subrogation. In several states, legislatures have passed statutes that allow the relevant state government to proceed with a subrogation free of one or more of the industries' traditional defenses,¹⁹¹ or at least to create a lien in favor of the government.¹⁹² The second type involves a more aggressive mode of state government intervention against municipal actors. Several states have recently enacted statutes that prohibited (with the threat of criminal sanctions) city officials from pursuing any municipal claim against the gun industry.¹⁹³

These statutory interventions raise a host of difficult questions. The first type of intervention raises the complicated issue of the relationship between statutory rules and pre-existing common law: whether the new statute should be read as a clean slate that erases any

raise the claim that it is not liable to the subrogee since—given its limited resources—the subrogor must take precedence. It can admit liability and ask the court to instruct it as to whom it should pay. This, however, brings us back to the competition between governments and citizens, which is the subject of Part III.

¹⁹⁰ This question should be distinguished from the problem of a court's determining when a statutory cause of action should be read to allow contribution among violating parties. See *Musick, Peeler & Garrett v. Employers Ins.*, 508 U.S. 286, 288, 293-94 (1993) (allowing contribution in 10b-5 case and discussing precedents under other statutes).

¹⁹¹ See Fla. Stat. Ann. § 409.910 (West Supp. 2000) (abrogating affirmative defenses, common law causation and damages, and creating special class action rules); Mass. Gen. Laws Ann. ch. 118E, § 22 (West 1993 & Supp. 1999) (creating independent cause of action against tobacco manufacturers); see also Elizabeth A. Frohlich, Note, *Statutes Aiding States' Recovery of Medicaid Costs from Tobacco Companies: A Better Strategy for Redressing an Identifiable Harm?*, 21 *Am. J.L. & Med.* 445 (1995) (discussing statutory provisions). On the defenses relevant to a subrogation action, see *supra* Part II.E.

¹⁹² See Iowa Code Ann. § 249A.6 (West Supp. 1999) (creating lien in favor of government regarding claims of state assistance recipients); Md. Code. Ann., Health-Gen. I § 15-120 (1994 & Supp. 1999) (same).

¹⁹³ See *Bush Signs Bill Banning Anti-Gun Lawsuits*, *N.Y. Times*, June 19, 1999, at A11. With the signing of the bill by Governor and presidential candidate George W. Bush, 14 states have passed legislation banning suits. See *id.*

prior common law rules, if the language of the text seems to suggest so;¹⁹⁴ or whether it should be read with these rules at the background, trying to accommodate its content to a “chain novel” understanding of legal evolution.¹⁹⁵ Courts have interpreted these interventions into the common law variously,¹⁹⁶ and given the jurisprudential stakes, we do not try to resolve this general question. Still, whatever one’s views, we believe that a statutory enactment that changes the common law rules in favor of the state should be interpreted narrowly, presuming no preemption, particularly when the amended rules go to the heart of the premises of subrogation.

The second type of intervention—where states try to bar cities’ subrogation claims—raises questions as to whether such statutes run afoul of the state’s particular home rule view. Depending on whether a municipality’s suit is styled as a “local” or “statewide” matter, views would vary as to whether municipalities are empowered to undertake such litigation in the first place.¹⁹⁷ Assuming that the municipality’s suit would otherwise have been permissible, its immunity from the state’s statutory intervention would turn on whether the state had a home rule provision in its constitution. Given such a provision, the question of how “local” the initiative is arises again,¹⁹⁸ with some states’ constitutions protecting the municipality from preemption only regarding “local” initiatives,¹⁹⁹ and others protecting the local govern-

¹⁹⁴ See Antonin Scalia, *A Matter of Interpretation* 24 (1997) (“Words do have a limited range of meaning, and no interpretation that goes beyond that range is permissible.”); cf. *State ex rel. Miller v. Philip Morris Inc.*, 577 N.W.2d 401, 404-05 (Iowa 1998) (holding that statute granting lien in favor of state was Iowa’s exclusive remedy because there had been no right to recover Medicaid costs from third parties at common law).

¹⁹⁵ See Ronald Dworkin, *Law’s Empire* 313, 338 (1986) (“[The judge should] treat Congress as an author earlier than himself in the chain of law . . . and he will see his own role as fundamentally the creative one of a partner continuing to develop, in what he believes is the best way, the statutory scheme Congress began. . . . [H]is account must justify the story as a whole, not just its ending.”).

¹⁹⁶ See, e.g., James J. White, *Rights of Subrogation in Letters of Credit Transactions*, 41 *St. Louis U. L.J.* 47, 54 (1996) (discussing equitable right to subrogation recognized by courts in bankruptcy cases apart from statutory right specified in Bankruptcy Code).

¹⁹⁷ Compare Ga. Const. art. III, § 6, ¶ 4(a) (allowing initiative only over local affairs), with National League of Cities, *Model Constitutional Provisions* 19, cited and discussed in Kenneth Vanlandingham, *Constitutional Municipal Home Rule Since the AMA (NLC) Model*, 17 *Wm. & Mary L. Rev.* 1, 6 (1975) (allowing initiatives over all matters on which state could have legislated).

¹⁹⁸ See generally Terrance Sandalow, *The Limits of Municipal Power Under Home Rule: A Role for the Courts*, 48 *Minn. L. Rev.* 643, 650-51 (1964) (arguing that meaning of “local” for purposes of understanding municipality’s power of initiative may be different than for purposes of determining when state statute preempts local rule).

¹⁹⁹ Compare *State ex rel. Haynes v. Bonem*, 845 P.2d 150, 155 (N.M. 1992) (“A home-rule city’s ordinance will supersede a conflicting state statute on the same subject matter in areas of strictly local concern. Conversely, a state statute will supersede a conflicting municipal charter or ordinance on a matter of [exclusively] statewide concern.” (quoting 2

ment more broadly.²⁰⁰

In any event, absent statutory intervention of one of these types, we believe that subrogation should be a viable cause of action for governments that have spent public funds on the prevention or amelioration of citizens' injuries caused by a defendant industry. Subrogation supplies the proper doctrinal home for these claims as it is tailored to address cases in which the law needs to facilitate legitimate unsolicited conferrals of benefits. The traditional defenses and limitations of subrogation help overcome any possible complaint of the industry from subjective devaluation or conflicts of interest. The significant third party effects in our triangular case justify our generous approach respecting the scope of subrogation, namely our assertion that these government claims should be upheld notwithstanding the attenuated degree to which the government's and the industry's interests are locked in together.²⁰¹

Eugene McQuillin, *The Law of Municipal Corporations* § 4.80, at 175 (3d ed. 1988), with Colo. Const. art. XX, § 6 (providing that home-rule authority may supersede conflicting law of state within city's territorial limits).

²⁰⁰ The second type of statute may also raise democratic and institutional competence concerns. If governments have brought suits as a way around instances of capture by strong industries, the subsequent prohibition of such suits by legislation—probably lobbied for by the industries or their supporters, see James Dao & Don Van Natta Jr., *N.R.A. Is Using Adversity to Its Advantage*, *N.Y. Times*, June 12, 1999, at A10 (stating that National Rifle Association's lobbying for litigation bars was "its major effort of the past year")—may defeat the possibility of allowing courts to serve as a forum for a more democratic discourse. Alternatively, if we are of the view that courts are an inappropriate arena for such discourse, we might applaud legislation that forbids such "political" litigation. It may well be that the difficult doctrinal line drawings sketched in the text turn upon these important questions.

²⁰¹ The federal government's suit to recoup medical costs from the tobacco industry is a particularly rich example of the interplay between statutes and common law in a government's assertion of its rights. The bases for the federal claims are the Federal Medical Care Recovery Act (MCRA), 42 U.S.C. §§ 2651-2653 (1994), the Medicare Secondary Payer Program of the Social Security Act, 42 U.S.C. § 1395y(b)(2)(B)(ii) & (iii) (1994), and the civil provisions of the Federal Racketeer Influenced and Corrupt Organizations (RICO) Act, 18 U.S.C. §§ 1961-1968 (1994 & Supp. III 1997). We are doubtful about the merits of the first and third causes of action. We disagree between ourselves whether the second can be the doctrinal home for the federal government's subrogation claim.

Both MCRA and the Medicare Secondary Payer Program are essentially subrogation statutes. MCRA authorizes the federal government to recoup medical costs paid by the federal government that resulted from a tortious injury to a covered person. See 42 U.S.C. § 2651(a). (The United States is alleging that the tobacco industry is liable to smokers for fraud, negligent performance of a voluntary undertaking, civil conspiracy, and state consumer protection violations. See *Plaintiff's Complaint* at 49-62, *United States v. Philip Morris, Inc.* (D.D.C. Sept. 22, 1999) (No. 99-213).) The claim under MCRA is not strictly subrogation, for the Act creates an independent right of recovery on the part of the federal government. See, e.g., *United States v. Merrigan*, 389 F.2d 21, 26 (3d Cir. 1968). But under the Act, the United States, like any subrogee, remains subject to all defenses (except statute of limitations) available against the injured party. See *United States v. Studivant*, 529 F.2d 673, 675 (3d Cir. 1976) (noting rule that state statute of limitations is not binding

on United States under MCRA); *United States v. Theriaque*, 674 F. Supp. 395, 399 (D. Mass. 1987) (noting that United States is bound by state law defenses affecting creation of third person tort liability).

The Medicare Secondary Payer Program allows the federal government to recoup medical payments that should have been covered by a beneficiary's primary insurer. It too permits an independent right of action, see *Zinman v. Shalala*, 67 F.3d 841, 844-45 (9th Cir. 1995), but also subjects the government's claim to the same defenses available against the alleged beneficiary, see *Lamb v. Quincy*, 636 N.E.2d 412 (Ohio Ct. App. 1993) (finding statute did not abrogate Ohio's collateral source rule).

The problem with MCRA is that it was designed to allow the government to recoup medical costs for the treatment of *military personnel* who were injured by tortious conduct. This is clear from the history of the Act. See S. Rep. No. 87-1945, at 1-4 (1962); see also *United States v. United Servs. Auto. Ass'n*, 5 F.3d 204, 207 (7th Cir. 1993). Congress enacted MCRA following the Supreme Court's refusal in *United States v. Standard Oil Co.*, 332 U.S. 301, 311-17 (1947), to create a federal common law right for this type of recovery. See S. Rep. No. 87-1945, at 1-3. Congress found that, "in the 30 months ending June 30, 1959, an average of \$10.5 million was spent annually for hospital and medical care to military personnel as the result of accidents involving privately owned motor vehicles." *Id.* at 4.

The language of MCRA itself supports the conclusion that it is limited to costs of treatment for military personnel. References to military personnel permeate the Act. For example, in describing the third-party beneficiary status of the United States, the Act reads:

If, pursuant to the laws of a State that are applicable in a case of a *member of the uniformed services* who is injured or contracts a disease as a result of tortious conduct of a third person, there is in effect for such a case . . . a system of compensation or reimbursement for expenses of hospital, medical, surgical, or dental care and treatment or for lost pay pursuant to a policy of insurance . . . the United States shall be deemed to be a third-party beneficiary of such a policy

42 U.S.C. § 2651(c)(1) (Supp. III 1997) (emphasis added).

The language of the Act almost uniformly describes it exclusively in terms of its application to servicepeople (although it is clear from the case law that the United States may also recover on behalf of family members of military personnel, see, e.g., *Thomas v. Shelton*, 740 F.2d 478, 481 (7th Cir. 1984) (sustaining cause of action on behalf of serviceperson's son)). The first paragraph of the Act reads:

In any case in which the United States is authorized or required by law to furnish or pay for . . . medical . . . care and treatment . . . to a person who is injured or suffers a disease . . . under circumstances creating a tort liability upon some third person (other than or in addition to the United States and except employers of seamen treated under the provisions of section 249 of this title) to pay damages therefor, the United States shall have a right to recover . . . from said third person, or that person's insurer, the reasonable value of the care and treatment so furnished

42 U.S.C. § 2651(a) (Supp. III 1997).

Sections 42 U.S.C. § 2651(b) and (c) then clarify that these provisions apply to "member[s] of the uniformed services." The Act also delineates cases where tortious third parties should also be liable for the lost wages of injured persons in a manner that refers only to military personnel:

If a member of the uniformed services is injured, or contracts a disease, under circumstances creating a tort liability upon a third person . . . for damages for such injury or disease and the member is unable to perform the member's regular military duties as a result of the injury or disease, the United States shall have a right (independent of the rights of the member) to recover from the

third person . . . the amount equal to the total amount of the pay that accrues and is to accrue to the member for the period for which the member is unable to perform such duties as a result of the injury or disease and is not assigned to perform other military duties.”

42 U.S.C. § 2651(b) (Supp. III 1997).

Finally, it is clear that the Act was intended to apply only to servicepeople also because the Act describes the procedure by which any money recovered by the United States under the Act is to be credited to the appropriate military medical treatment facility, “as determined under regulations prescribed by the Secretary of Defense.” 42 U.S.C. § 2651(f)(1) (Supp. III 1997).

Furthermore, even if the federal courts’ interpretation of MCRA has broadened its coverage, see, e.g., *United Servs. Auto. Ass’n v. Perry*, 102 F.3d 144, 146 (5th Cir. 1996) (holding for first time that no-fault carriers can be substituted for actual tortfeasor), expanded recovery has never meant recovery for expenses associated with persons other than military personnel and their families. Cf. *United States v. Wall*, 670 F.2d 469, 470 (4th Cir. 1982) (supporting claim that Act is designed for servicepeople).

The Medicare Secondary Payer Program allows the United States to recover Medicare payments from third parties who are required or responsible to pay for medical costs. Congress enacted these provisions to give the United States a right, as a secondary insurer, to demand reimbursement from primary insurers who have a duty to pay for medical treatment. “The Medicare Secondary Payer Program is intended to help the Medicare Program identify situations where another health care plan should be, or should have been, the primary payer for a beneficiary’s health services.” H.R. Rep. No. 104-87(I), at 4 (1995); see also *Blue Cross & Blue Shield of Tex., Inc. v. Shalala*, 995 F.2d 70, 71-72 (5th Cir. 1993) (stating that purpose of program is to prevent group health plans from providing that plan will be secondary payer if Medicare coverage exists). The legislative history also notes that Medicare is a secondary insurer with respect to employer group health plans, as well as “workers’ compensation, automobile, no-fault, and liability insurance.” H.R. Conf. Rep. No. 101-386, at 818 (1989).

The Medicare Secondary Payer Program itself provides that it is directed towards “group health plan[s],” and that “[a] large group health plan . . . may not take into account that an active individual . . . is entitled to benefits under this subchapter under Section 426(b) of this title [Medicare].” 42 U.S.C. § 1395y(b)(1)(A)(i), (B)(i). In other words, the Program seeks to prevent primary insurers from refusing to pay medical expenses because those who are insured under their plans are also eligible for Medicare. The government is so committed to pursuing this goal in fact, that it also prohibits employers from offering financial incentives to keep employees out of a group health plan. “It is unlawful for an employer or other entity to offer any financial or other incentive for an individual entitled to benefits under this subchapter not to enroll (or to terminate enrollment) under . . . a primary plan” *Id.* § 1395y(b)(3)(C).

Do these provisions give the United States a right to demand recovery from anyone other than a primary insurer? Do they apply to subrogation claims against injurious industries, such as the tobacco companies? Only with some interpretive effort. Subsection (iii) states that the federal government’s right of subrogation is limited to “item[s] or service[s] [provided for] under a primary plan.” *Id.* § 1395y(b)(2)(B)(iii). On the other hand, subsection (ii) says that the United States “may join or intervene in any action related to the events that gave rise to [a] need for [an] item or service.” *Id.* § 1395y(b)(2)(B)(ii). Although it is reasonably clear from the language of the subsection taken as a whole that this authorization applies only “with respect to such item or service . . . under a primary plan,” *id.*, the language of that subsection is less clear. The federal government’s best hope is here.

The government also seeks recovery under the federal RICO statute, claiming that the tobacco industry deceived consumers about the health effects of its products, conspired to suppress the development of a safer cigarette, and deliberately marketed its products to

children in violation of federal law. The RICO statute is not a subrogation statute, and appellate courts have already uniformly held that third-party health care providers have no standing to sue directly under RICO. See *Laborers Local 17 Health & Benefit Fund v. Philip Morris, Inc.*, 191 F.3d 229 (2d Cir. 1999) (holding that third party had no standing to sue under RICO); *Oregon Laborers-Employers Health & Welfare Trust Fund v. Philip Morris, Inc.*, 185 F.3d 957, 963-64 (9th Cir. 1999) (same); *Steamfitters Local Union No. 420 Welfare Fund v. Philip Morris, Inc.*, 171 F.3d 912 (3d Cir. 1999) (same).

The circuit courts derive their standing principles for RICO claims from *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992), in which the Supreme Court held that the standing analyses for antitrust and RICO claims are drawn from the common-law principles of proximate cause and remoteness of injury. See *id.* at 268-69. As the Third Circuit noted:

By subsuming the proximate cause requirement under the concept of standing, the Supreme Court has acknowledged that a private plaintiff might validly plead (and even prove) that a defendant has committed an antitrust violation, but still lack standing to enjoin or remedy this violation if his own injury is too remotely connected to it.

Steamfitters Local Union, 171 F.3d at 921.

The circuit courts have denied standing to sue health care insurers under the federal RICO statute based on three *Holmes* principles:

- (1) the more indirect the injury, "the more difficult it becomes to ascertain the amount of a plaintiff's damages attributable to [defendant's wrongdoing] . . . ;"
- (2) allowing recovery by indirectly injured parties would require complicated rules for apportioning damages; and (3) direct victims could generally be counted on to vindicate the policies underlying the relevant law.

Id. at 932 (alteration in original) (quoting *Holmes*, 503 U.S. at 269-70). First, injury is too indirect when plaintiffs suffer a loss because of the harm that the defendants brought upon a third party. See *id.* Because the funds are only "injured" by virtue of the injury to individual smokers, they are too remote to satisfy the proximate cause standing analysis. See *id.* Second, the damage apportionment calculus required to distribute damages between smokers and health care funds was overly complicated, and no relevant or workable standards existed to provide a framework for establishing such a system. See *id.* at 933. Finally, smokers are capable of vindicating these claims without the tenuous claims of health care providers. See *id.*

The arguments used against the RICO standing of health care providers apply with equal force to the federal government. Just as insurers are harmed only by virtue of injury to smokers, the federal government sustains injury only on this basis. The same damage apportionment calculus between smokers and health care providers that the courts deem to be prohibitively complicated is applied when the United States becomes a plaintiff. Finally, if smokers are deemed capable to litigate RICO policies over general funds, there is no reason to allow the federal government to litigate these claims as well.

We agree on this doctrinal analysis, but—corresponding to our more general disagreement regarding statutory interpretation—we draw different conclusions as to the viability of the federal government's second cause of action. Dagan believes it may well be viable; White is doubtful.

Dagan believes that judges interpreting statutes should see themselves as partners to Congress "continuing to develop, in what [they] believe is the best way, the statutory scheme Congress began." Dworkin, *supra* note 195, at 313. Therefore, every effort should be made in order to find a doctrinal home for the important subrogation claim delineated in this Part in triangular cases where the federal government is involved. This can be done in one of two ways. One way is to build on the ambiguity we have found in § 1395y(b)(2)(B)(ii) in order to interpret the Medicare Secondary Payer Program broadly, as directed not only against primary insurers, but also against injurious industries. An alternative—probably more secure way—is to find a cause of action by analogy to the

III

CITIZENS VS. GOVERNMENTS: TAKINGS

When two parties to a three party transaction negotiate a settlement, there is always a temptation to take assets from and pass costs on to the absent third party. In our triangle, the government's temptation to eat the citizens' lunch may be irresistible. Such externalities may occur when government settlements with defendant industries include provisions limiting the settling defendants' future tort liability to private litigants. In the tobacco context, the McCain bill would have explicitly capped injured smokers' compensatory claims and barred punitive damages awards and class actions.²⁰² Similar limitations may be reintroduced once the tobacco industry returns to Congress.²⁰³ Citizens thus help pay for the governments' winnings through reduced opportunities to pursue their private claims against the injurious industries.

Indirect evidence for the same phenomenon is the receipt by a government of funds in excess of spent costs and their spending of such funds on causes that have nothing to do with the injured citizens' interests. To be sure, some general purpose expenses may set off past preventative and ameliorative costs that were unjustifiably borne by the public. But insofar as these states' expenditures exceed those past costs (with the remainder not preserved by the governments for the benefit of future injured citizens), they may point out the fact that even with no explicit sacrifice of the injured smokers' interests, the states received—and are now spending—money in excess of what they deserve as subrogees. This fact seems especially problematic given that subrogation law explicitly gives priority to subrogees' interests over those of subrogees where the resources of the alleged tortfeasor are limited.²⁰⁴

Do injured citizens have any legal remedy if these concerns turn out to be true? Can they invoke the Fifth and Fourteenth Amend-

Program. Such analogy is required because judges must develop federal law for the better. In our context this means that they must follow the logic of subrogation underlying the Medicare Secondary Payer Program, and find the distinction between primary insurers and injurious industries unprincipled, and thus irrelevant.

White disagrees. He disapproves of this method of statutory interpretation, favoring a more textualist and intentionalist interpretive approach. Thus, he insists that we should not make such strenuous efforts to find a doctrinal home for a federal subrogation claim. Either one exists in the federal common law (but the Justice Department lawyers seem to think otherwise), or the federal government can go to Congress to get a statute to permit subrogation. New rights, in his view, should be created by the legislatures. Thus, White is not optimistic about the federal government's prospects of success.

²⁰² See *supra* text accompanying note 65.

²⁰³ See *supra* text accompanying note 104.

²⁰⁴ See *supra* text accompanying note 181.

ments against a legislative attempt to cap their claims against an injurious industry or to preclude them from filing class actions? Is the government's receipt and use of industry payments in excess of its preventative and ameliorative costs tantamount to the taking of the injured citizens' property? These questions are complicated and require an inquiry into both the underlying foundations of takings law and the question of people's entitlement to various components of the remedial and procedural aspects of our tort law.

In order to simplify discussion, we focus on the government's interference with expected monetary awards (via its receipt of more money than it has spent on preventative and ameliorative measures and/or the enactment of caps). The takings question regarding a triangular paradigm analogous to ours—where the government's settlement with another sovereign limits a citizen's claim against that sovereign—is unsettled. While the Supreme Court in *Dames & Moore v. Regan*²⁰⁵ left open as unripe the question of whether such a settlement constituted a taking,²⁰⁶ Justice Powell noted in concurrence that “[t]he Government must pay just compensation when it furthers the Nation's foreign policy goals by using as ‘bargaining chips’ claims lawfully held by a relatively few persons and subject to the jurisdiction of our courts.”²⁰⁷ Lower courts have followed this proposition by scrutinizing the constitutionality of such governmental interference.²⁰⁸

By exploring the foundations of takings law, we will show that a government's interference with its citizens' compensatory claims beyond its role as a legitimate subrogee does justify compensation.²⁰⁹ In other words, insofar as the citizen's expected awards are compensatory, and the government spends the money it receives from the industry on programs that do not benefit the injured citizens, the citizen's takings claim should be successful.²¹⁰ Governmental interfer-

²⁰⁵ 453 U.S. 654 (1981).

²⁰⁶ See *id.* at 688-89.

²⁰⁷ *Id.* at 691 (Powell, J., concurring).

²⁰⁸ See *infra* text accompanying notes 226-29 (discussing *Belk v. United States*, 12 Cl. Ct. 732 (1987)); text accompanying notes 243-45 (discussing *Shanghai Power Co. v. United States*, 4 Cl. Ct. 237 (1983)); text accompanying note 247 (discussing precedents establishing that claim is property right).

²⁰⁹ For an opposite conclusion using the same cases we use but not our theoretical analysis, see Maria Gabriela Bianchini, Comment, *The Tobacco Agreement that Went Up in Smoke: Defining the Limits of Congressional Intervention into Ongoing Mass Tort Litigation*, 87 Cal. L. Rev. 703, 735-39 (1999). For an early discussion that agrees with our conclusion, see Note, *The U.S.-Iran Accords and the Taking Clause of the Fifth Amendment*, 68 Va. L. Rev. 1537 (1982).

²¹⁰ Insofar as the preclusion of the pursuit of the citizens' claims against the industry via class actions reduces significantly their ability to collect their compensatory awards, this may also be characterized as a taking. Resolving the empirical assumption of this proposition is beyond the scope of this Article.

ences with citizens' punitive damages awards present a more complex case. All we can do here respecting this component of the citizens' expected awards is to set the parameters for the resolution of this difficult case.

A. *Premises of Takings Law*

Takings doctrine is complex and multifaceted; some say chaotic.²¹¹ If there is some measure of coherence or consensus in this vast and diverse body of judicial opinions and scholarly commentary, it is that the purposes of just compensation are essentially two: efficiency and distributive justice.²¹² Efficiency seeks to make sure that resource allocation maximizes the size of the social pie. Distributive justice is concerned with the equitable distribution of the costs and benefits resulting from such resource allocation.

1. *Efficiency*

The economic analysis of takings law focuses on the incentive effects of various compensatory regimes on the behavior of the pertinent actors. Lawyer-economists discuss, more particularly, the incentive effect of different compensation rules on the decisions of private individuals and of public officials.

When discussing takings doctrine in the land use context, lawyer-economists point to two conflicting considerations respecting landowners' investment decisions. On the one hand, compensation is needed in order to prevent the underinvestment of risk-averse landowners in their property.²¹³ On the other hand, if the law guarantees the full value of landowners' investments, even where they could have foreseen the prospect of a loss in value if their land would be subjected to public use, they may inefficiently overinvest.²¹⁴

The second focus of the economic analysis of takings law, and the one more pertinent for our current purposes, studies the incentives that influence the public officials who actually make the crucial tak-

²¹¹ See generally Andrea L. Peterson, *The Takings Clause: In Search of Underlying Principles*, Part I, 77 Cal. L. Rev. 1299 (1989) (describing current state of takings doctrine as in chaos).

²¹² See Michael A. Heller & James E. Krier, *Deterrence and Distribution in the Law of Takings*, 112 Harv. L. Rev. 997, 998-99 (1999) (defining efficiency and justice in takings context).

²¹³ See, e.g., Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 Cal. L. Rev. 569, 584-99 (1984) (describing effects on land value when investors consider governmental actions).

²¹⁴ See, e.g., Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 Harv. L. Rev. 509, 529 (1986) ("[E]ncouragement resulting from the assurance that compensation . . . will be provided in the event of change results in overinvestment.").

ings decisions. In this context, it has been suggested that compensation provides the appropriate incentive for these decisionmakers.²¹⁵ When the public authority does not need to pay compensation for its takings, its officials may disregard the costs their decisions impose upon private resource holders, a phenomenon frequently described as “fiscal illusion.”²¹⁶ Compensation creates a budgetary effect which (assuming that democratic mechanisms make public officials accountable for their budget management) forces governments to internalize these costs. Compensation is tantamount to a built-in mechanism that verifies the efficiency of public decisions that affect private property.

This consideration applies especially where the injured parties are part of the nonorganized public—where they are “occasional individuals”—or members of a marginal group with little political influence. In these cases, where there is an acute risk that public officials will be dismissive of private costs, compensation may be the only feasible tool for mitigation.²¹⁷

2. *Distributive Justice*

It is widely acknowledged that the “Fifth Amendment’s guarantee . . . [is] designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.”²¹⁸ The question of when fairness and justice require that a burden should be borne publicly, however, is much debated. Theories relating takings doctrine to principles of distributive justice fall into two camps: the libertarian approach and the progressive approach.

a. The Libertarian Approach. The libertarian conception of property focuses on shielding the individual from claims of other per-

²¹⁵ See, e.g., Margaret Jane Radin, *Reinterpreting Property* 158 (1993) (describing how losses in transaction are balanced by gains elsewhere); Saul Levmore, *Just Compensation and Just Politics*, 22 Conn. L. Rev. 285, 306-08 (1990) [hereinafter Levmore, *Just Compensation and Just Politics*] (discussing how individuals who cannot effectively participate in political arena are protected by Takings Clause); Saul Levmore, *Takings, Torts, and Special Interests*, 77 Va. L. Rev. 1333, 1344-48 (1991) (arguing that compensable taking is found when government singles out private parties); Marc R. Porier, *Takings and Natural Hazards Policy: Public Choice on the Beachfront*, 46 Rutgers L. Rev. 243, 260-83 (1993) (arguing same premise in beachfront context).

²¹⁶ Thomas W. Merrill, *Rent Seeking and the Compensation Principle*, 80 Nw. U. L. Rev. 1561, 1583 (1987).

²¹⁷ See Levmore, *Just Compensation and Just Politics*, supra note 215, at 305-19.

²¹⁸ *Armstrong v. United States*, 364 U.S. 40, 49 (1960). For the wide endorsement of this general proposition, see William Michael Treanor, *The Armstrong Principle, The Narratives of Takings, and Compensation Statutes*, 38 Wm. & Mary L. Rev. 1151, 1153-54 (1997).

sons and from the power of the public authority²¹⁹ and preserving an untouchable private sphere, which is a prerequisite to personal development and autonomy.²²⁰ Private property and the constitutionalization of its protection from governmental interference seek, according to this conception, to decentralize the ownership of resources in order to diminish the power of governments or any single private entity: They endow individuals, rather than any collective bureaucracy, with control over resources and thus preserve personal freedom, security, and independence.²²¹

For the libertarian, compensation should be required every time a taking's impact on one owner is disproportionate to the burden (if any) carried by other beneficiaries of that public use.²²² This rule of proportionality dictates that the claimant not sustain a burden that is disproportionately heavy in comparison to that sustained by other beneficiaries of the public action, taking into account the respective benefit to all parties involved.²²³ It bars any public actions that would make some owners worse off by transferring some of their economic value to the public or to other individuals.²²⁴ Assuming that the public action is welfare promoting, or at least not welfare impoverishing, this rule safeguards against any government action that results in private owners suffering a net loss of economic value. The proportional-

²¹⁹ See Bruce A. Ackerman, *Private Property and the Constitution* 71-74 (1977) (explaining Kantian philosophy as concerned with assuring that no individual is used as means to satisfaction of another); Jennifer Nedelsky, *Private Property and the Limits of American Constitutionalism* 207-08 (1990) (defining property as tension between individual and collective rights).

²²⁰ See Isaiah Berlin, *Two Concepts of Liberty*, in *Four Essays on Liberty* 118, 122, 124 (1970) (arguing that man needs minimum areas of personal freedom for minimum development); John Rawls, *Political Liberalism* 298 (1993) (describing property as building block of personal independence and self-respect).

²²¹ See Randy E. Barnett, *The Structure of Liberty* 139-42, 238 (1998) (detailing benefits of decentralization of property-related rights); Milton Friedman, *Capitalism and Freedom* 7-21 (1962) (analyzing relationship between economic and political freedom); Bernard H. Siegan, *Property and Freedom: The Constitution, the Courts, and Land-Use Regulation* 10 (1997) ("People whose property is not secure from government are extremely limited in their freedom . . ."); Charles A. Reich, *The New Property*, 73 *Yale L.J.* 733, 771 (1964) ("[P]roperty performs the function of maintaining independence, dignity and pluralism . . ."); Cass R. Sunstein, *On Property and Constitutionalism*, 14 *Cardozo L. Rev.* 907, 914-15 (1993) ("[Property] create[s] a realm of private autonomy in which the citizenry can operate without fear of public intrusion."). The relationship between private property and freedom is not, of course, as simple as the text may imply, see Gerald F. Gaus, *Property, Rights, and Freedom*, in *Property Rights* 209 (Ellen F. Paul et al. eds., 1994), but further complications are not required for current purposes.

²²² See Richard A. Epstein, *Takings: Private Property and the Power of Eminent Domain* 207 (1985) (arguing that explicit transfers of compensation are required for nonproportionate takings).

²²³ See *id.* at 205.

²²⁴ See *id.* at 204-09.

ity rule thereby preserves the prevailing distribution of assets, legal rules, and wealth (although it may still “translate” people’s assets or other entitlements into wealth without their consent).²²⁵

In the field of government settlements and extinguished claims, the case of *Belk v. United States*²²⁶ illustrates how such proportionality precludes takings concerns. In *Belk*, former hostages of Iran alleged that the President’s settlement with Iran, which had secured their release, constituted a government taking requiring compensation because it extinguished their claims against Iran.²²⁷ The court rejected the claim. Although the public incidentally benefited through the resolution of a source of conflict between its country and another sovereign,²²⁸ the plaintiffs (whose freedom was achieved as part of the bargain) were the chief beneficiaries of the President’s action. Moreover, even though the former hostages bore a greater burden for the governmental action than other American citizens, their benefit was correspondingly much more substantial.²²⁹

b. The Progressive Approach. These theories start with the premise that ownership is not merely a bundle of rights, but also a social institution that creates bonds of commitment and responsibility among owners and others who live, work, or are otherwise affected by the owner’s properties.²³⁰ Furthermore, property is an expression of a cluster of values—primarily privacy, security, and independence²³¹—

²²⁵ See Richard A. Epstein, Takings, Exclusivity and Speech: The Legacy of *PruneYard v. Robins*, 64 U. Chi. L. Rev. 21, 27-28 (1997) (explaining how rule maximizes value of personal use and protection); Molly S. McUsic, The Ghost of *Lochner*: Modern Takings Doctrine and Its Impact on Economic Legislation, 76 B.U. L. Rev. 605, 645, 647 (1996) (arguing that rule blocks redistribution efforts and inhibits government services).

²²⁶ 12 Cl. Ct. 732 (1987).

²²⁷ See *id.* at 732-33 (noting that plaintiffs claimed they would have pursued claims against Iran for false imprisonment, assault and battery, intentional infliction of emotional distress, loss of consortium, and invasion of other rights, immunities, and privileges had claims not been extinguished).

²²⁸ See *id.* at 734 (stating that all Americans received incidental benefit from President’s actions).

²²⁹ For another example, see *Abraham-Youri v. United States*, 139 F.3d 1462, 1463 (Fed. Cir. 1997), cert. denied, 118 S. Ct. 2366 (1998) (holding that settling plaintiffs’ claims against government of Iran for full principal but for less than full amount of claimed interest is not compensable taking since result produced by this settlement was “as favorable to plaintiffs as could reasonably be expected . . . [as] [p]laintiffs have not shown that they sustained losses that were avoidable under the circumstances”).

²³⁰ See Hanoch Dagan, Takings and Distributive Justice, 85 Va. L. Rev. 741, 772-73 (1999) (describing conception of property that views ownership as source of community responsibility).

²³¹ See Frank Michelman, Tutelary Jurisprudence and Constitutional Property, in *Liberty, Property and the Future of Constitutional Development* 127, 149-50, 154 (Ellen Frankel Paul & Howard Dickman eds., 1990).

that always involve the distribution as well as the retention of wealth.²³² Property must entail distribution since ownership is a source of economic, and therefore also social, political, and cultural, rights and powers; the correlative of which is other people's duties and liabilities.²³³

A progressive takings doctrine, committed to social responsibility and to "the ongoing normative commitment to dispersal of access"²³⁴ must not—contrary to some conventional wisdom²³⁵—be too oblivious to the imposition of disproportionate burdens in the pursuit of public actions.²³⁶ A relaxed takings doctrine, one that gives compensation only in extreme cases, harms property holders of all sorts, rich and poor. More precisely, at times (or even typically), a no compensation regime might lead to systematic exploitation of small and relatively less well-off owners, who by hypothesis have no other way to protect themselves.²³⁷

This does not mean that progressives subscribe to the libertarian rule of proportionality. Strict proportionality would bar any reconfiguration of the distribution of the aggregate of resources, wealth, and legal rules.²³⁸ Strict proportionality also would undermine social

²³² See *id.* at 150; see also Frank I. Michelman, *Possession vs. Distribution in the Constitutional Idea of Property*, 72 *Iowa L. Rev.* 1319, 1319 (1987) (stating that private property is not merely "possessive proprietary principle" or "antiredistributive principle").

²³³ See Morris R. Cohen, *Property and Sovereignty*, 13 *Cornell L.Q.* 8, 11-14 (1927) (arguing that dominion over things is also *imperium* over fellow human beings); Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 *Pol. Sci. Q.* 470, 470-79 (1923) (noting that inequalities in distribution of income and power are direct result of legal allocation of background rules); Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 *Yale L.J.* 16 (1913) (arguing that legal rights, privileges, powers, and immunities are jural relations, advantageous to their holders to extent they are disadvantageous to those subject to their correlatives); see also Barbara H. Fried, *The Progressive Assault on Laissez Faire: Robert Hale and the First Law and Economics Movement 71-107* (1998) (presenting Hale's attack on theory of natural property rights).

²³⁴ Joseph William Singer & Jack M. Beerman, *The Social Origins of Property*, 6 *Can. J.L. & Jurisprudence* 217, 245 (1993).

²³⁵ See C. Edwin Baker, *Property and Its Relation to Constitutionally Protected Liberty*, 134 *U. Pa. L. Rev.* 741, 764-65 (1986) (arguing that protection against exploitation may not be best guide for property jurisprudence because ban on unjust individual exploitation would necessarily be so broad that it would also prevent desirable government actions); Frank Michelman, *The Common Law Baseline and Restitution for the Lost Commons: A Reply to Professor Epstein*, 64 *U. Chi. L. Rev.* 57, 69 (1997) (arguing that most regulatory restrictions of land use should be perceived as ordinary examples of background risks and opportunities against which we take our chances as owners of property).

²³⁶ The remainder of this section builds on Dagan, *supra* note 230.

²³⁷ See Barton H. Thompson, Jr., *The Endangered Species Act: A Case Study in Takings and Incentives*, 49 *Stan. L. Rev.* 305, 361, 367 (1997) (stating that, within context of Endangered Species Act, no compensation rule will not achieve horizontal or vertical equity within various interest groups and results in unjust distribution of burdens).

²³⁸ See Baker, *supra* note 235, at 748 (stating that rigid formulation of property rules

responsibility by insisting that our mutual obligations as citizens should be derived solely from either consent or self-advantage, thus underplaying the significance of belonging, membership, and citizenship.²³⁹

A takings doctrine attuned to the virtues of social responsibility and equality must therefore avoid both of these extreme positions. Instead, it should start with a rule of long-term reciprocity of advantage. This regime prescribes that a public action imposing a disproportionate burden is not a taking as long as two conditions are met: The immediate burden on the claimant is not extreme, and the claimant stands to enjoy benefits of similar magnitude from other public actions, even if those benefits are not contemporaneous.²⁴⁰ This conception of reciprocity of advantage attempts to recognize, preserve, and foster the significance of membership and citizenship. At the same time, it is still sufficiently cautious not to be too utopian about citizenship, acknowledging the detrimental consequences of a no compensation regime in our nonideal world and, thus, requiring long-term rough equivalence of burdens and advantages.²⁴¹

A further refinement is necessary. More caution is needed where disproportionate contributions to the community's well-being are required from owners who are either politically weak or economically disadvantaged. A government's claim of social responsibility is not credible if it targets the weaker sectors of society. This concern is especially warranted when the public action's direct beneficiaries enjoy significant political or economic power.²⁴²

The leading case of *Shanghai Power Co. v. United States*²⁴³ demonstrates this long-term reciprocity test in the context of government

would often have effect of stopping nonexploitive practices); Jed Rubenfeld, *Usings*, 102 *Yale L.J.* 1077, 1135 (1993) (critiquing strong antiredistributive view in part because it seems to invalidate such measures as progressive taxation, rent control, and social security programs).

²³⁹ See Charles Taylor, *Atomism*, in 2 *Philosophy and the Human Sciences: Philosophical Papers* 187, 187-88 (1985) (describing theories of primacy of rights as promoting individual rights and assigning less importance to principles of belonging and obligation); see also Robert Nozick, *Anarchy, State, and Utopia* 171-72 (1974) (claiming that giving each citizen enforceable claim to some portion of total social product is tantamount to infringing people's self-ownership).

²⁴⁰ This conception of reciprocity corresponds to Robert Ellickson's influential study of reciprocal norms in neighborly settings. See Robert C. Ellickson, *Order Without Law: How Neighbors Settle Disputes* 56, 234-36, 274-75 (1991).

²⁴¹ Cf. Margaret Jane Radin, *Contested Commodities* 5, 118 (1996) (noting that regime of strict proportionality defines our obligations as citizens and community members as exchanges for monetizable gains).

²⁴² See Radin, *supra* note 215, at 59 (describing past state actions which benefited landlords over poor tenants as in tension with personhood perspective).

²⁴³ 4 Cl. Ct. 237 (1983).

settlements and extinguished claims. In *Shanghai Power*, an American corporation sought compensation for its lost claim against China regarding China's confiscation of the company's power plant in Shanghai. The President had extinguished all outstanding claims against China in the process of establishing diplomatic relations, and plaintiff's portion of the settlement, about \$20 million, was far less than the claimed value of \$144 million.²⁴⁴ Judge Kozinski concluded that there was no compensable taking. First, although the plaintiff did bear a disproportionate loss in the short term, there was no radical disproportionality. Plaintiff did recover some amount of its losses. Second, the court noted that the President's ability to establish good relations with foreign nations was what made foreign trade and travel for Americans such as the plaintiff possible.²⁴⁵ The plaintiff stood to benefit as a long-term trader, and thus no compensation was necessary notwithstanding its short-term disproportionate loss. The case also did not present any egalitarian concerns as plaintiff was a strong business entity able to fend for itself in negotiating with the government.

B. *Barring Citizens' Compensatory Awards*

We now consider whether efficiency and distributive justice support the injured citizens' takings claims respecting a government's receipt and use of injured citizens' compensatory damages in excess of its preventative and ameliorative costs. We conclude that both efficiency and distributive justice, including the latter's libertarian and progressive approaches, lead to the very same conclusion: that governmental interference with the compensatory awards of injured citizens in the name of the public good cannot be deemed just unless it is accompanied by compensation.

Courts have consistently followed Justice Powell's theory²⁴⁶ that compensatory claims with which a government has interfered are "property interests" for takings purposes.²⁴⁷ Admittedly, as we have

²⁴⁴ See *id.* at 239.

²⁴⁵ See *id.* at 244-45.

²⁴⁶ See *supra* text accompanying note 207.

²⁴⁷ See *Langenegger v. United States*, 756 F.2d 1565, 1569 (Fed. Cir. 1985) (holding that plaintiff's expropriation claim against El Salvador was property right for takings purposes); *In re Aircrash in Bali, Indonesia* on Apr. 22, 1974, 684 F.2d 1301, 1312-13 (9th Cir. 1982) (holding that plaintiffs could have takings claim if Warsaw Convention's limitations on damages limited their recovery); see also Robert L. Muse, A Public International Law Critique of the Extraterritorial Jurisdiction of the Helms-Burton Act (Cuban Liberty and Democratic Solidarity (Libertad) Act of 1996), 30 *Geo. Wash. J. Int'l. L. & Econ.* 207, 207, 229-31 (1996-97) (criticizing Helms-Burton Act, which creates cause of action for Americans to sue Cuba for property taken under Castro regime, because it could create massive takings claims against U.S. government if United States normalized relations with Cuba).

seen, plaintiffs in such cases have not succeeded in obtaining compensation from the government because the plaintiffs reaped either immediate²⁴⁸ or long-term²⁴⁹ benefits as a result of the governmental action. In the triangular case under consideration, however, the benefits accruing to the injured citizens through settlements such as the tobacco case may be too attenuated to satisfy any distributive theory of takings law. Moreover, allowing governmental interference in the victim's compensatory claims beyond the government's preventative and ameliorative costs without compensation is bound to generate inefficiencies.²⁵⁰

From the standpoint of efficiency, our triangular paradigm presents a strong example of fiscal illusion. The injured citizens are typically of the "occasional individual" type, part of the nonorganized public with no specific political influence. Without a strong constitutional guarantee, their interests may easily be disregarded, and public officials may use their compensatory damages for more politically visible purposes. The current proposals for the distribution of the tobacco settlement proceeds are a vivid demonstration of this phenomenon.²⁵¹

From the standpoint of distributive justice, consider first the libertarian approach. Even advocates of a strict proportionality rule might acknowledge the need for governmental interference for solving the collective action difficulties discussed in Part II.²⁵² A proportionality rule would undoubtedly insist, however, that the government should not be allowed to take any part of the money it has collected from the injurious industry for purposes other than its preventative and ameliorative costs. Any amount in excess of these costs should be distributed among the injured citizens in proportion to their injuries.

Interestingly enough, the progressive long-term reciprocity rule—the ideological rival of the libertarian proportionality rule—arrives at the very same conclusion. Long-term reciprocity, as may be recalled, insists that probable, and not merely theoretical, reciprocity takes place; the mere fact of the owner's membership in the benefited com-

²⁴⁸ See *supra* discussion of *Belk v. United States* at text accompanying notes 226-29.

²⁴⁹ See *supra* discussion of *Shanghai Power Co. v. United States* at text accompanying notes 243-45.

²⁵⁰ Furthermore, in these past failed takings claims, the government typically settled a claim on behalf of an injured party who later (unsuccessfully) second guessed the amount of the settlement. Individual tobacco claims present a completely different factual scenario because in these cases, the state is actually trading a plaintiff's claim to obtain money for itself.

²⁵¹ See *supra* text accompanying notes 77-81.

²⁵² See, e.g., Richard A. Epstein, *Bargaining with the State* 76 (1993) (stating that social prisoner's dilemma game can only be overcome through use of collective coercion).

munity cannot be enough of an advantage to offset a tangible disproportionate loss. The doctrine further safeguards against too extreme a transient imbalance by disallowing overly excessive private burdens. In our triangular paradigm, it is hard to see what future probable benefits could offset the very significant harm of injured citizens whose compensatory awards from the injurious industry are taken by the government. As we have seen, many of the programs states are planning to undertake with their tobacco settlement funds are unrelated to the prevention or amelioration of tobacco related injuries.²⁵³ The conclusion that compensation is required seems even stronger in light of the egalitarian concerns of the long-term reciprocity regime because the injured citizens in the paradigmatic triangular case are typically part of the nonorganized public. Hence, a progressive takings regime would join forces with its libertarian counterpart, concluding that insofar as a government receives and uses injured citizens' compensatory damages in excess of its own preventative and ameliorative costs, the injured citizens should have valid takings claims.

Such claims, of course, would arise only to the extent that the government fails to benefit the injured citizens with settlement funds beyond the expended costs. Thus, if the funds were held in trust for use by injured citizens, no taking demanding compensation would occur.²⁵⁴

C. *The Uneasy Case of Punitive Damages*

1. *The Difficulty*

On the face of it, punitive damages are easy. As subrogees, the states are entitled only to the damages attributable to the loss which they had covered or will cover,²⁵⁵ and are thus not entitled to the citizens' expected punitive damages.²⁵⁶ Before we reach this easy conclusion, however, a preliminary question must be addressed: Are punitive damages part of the citizen's entitlement? If the answer to this question is affirmative, our takings analysis does apply. If the citizen's expected punitive damages award is purely a windfall, however, then the government's interference cannot be deemed a taking.

Several state supreme courts have recently addressed a similar

²⁵³ See *supra* text accompanying notes 78-81.

²⁵⁴ Indeed, we would have no complaint had the government sought through injunctive remedy the creation of a disgorgement fund that would be available to victorious private plaintiffs. The Federal Trade Commission is currently attempting this tack in antitrust litigation. See Dick Thornburgh, *FTC Seeks Precedent Only a Trial Lawyer Could Love*, *Wall St. J.*, May 10, 1999, at A23.

²⁵⁵ See *supra* Part II.C.

²⁵⁶ See *supra* note 187 and accompanying text.

question in conjunction with statutory provisions that give states some significant portion of punitive damage awards.²⁵⁷ Those courts are divided as to whether such provisions, which force plaintiffs to hand over part of their punitive damage awards to the state, effect a taking. The majority view insists that plaintiffs have no vested property rights in punitive damages and thus take any punitive awards subject to the allocation conditions set by the legislature.²⁵⁸ These courts emphasize that punitive damages are mere windfall to the individual plaintiff,²⁵⁹ who is the “fortuitous beneficiary . . . simply because there is no one else to receive [the punitive damage].”²⁶⁰

One court has expressed a dissenting view, ruling that a potential judgment for punitive damages does constitute a property interest.²⁶¹ This court was careful to emphasize that the punitive damages statute at issue repudiated any state interest in the litigation or in the judgment itself and that the state’s interest attached only after judgment.²⁶² This reasoning suggests that a legislature can avoid takings claims through more carefully worded legislation.²⁶³

²⁵⁷ Eight states have enacted such legislation. See Fla. Stat. Ann. § 768.73 (West Supp. 2000); Ga. Code Ann. § 51-12-5.1 (Supp. 1999); 735 Ill. Comp. Stat. Ann. 5/2-1207 (West Supp. 1999); Ind. Code Ann. § 34-51-3-6 (West 1999); Iowa Code Ann. § 668A.1(2)(b) (West 1998); Mo. Rev. Stat. § 537.675 (Supp. 1998); Or. Rev. Stat. § 18.540 (1997); Utah Code Ann. § 78-18-1(3) (1996). One justification for such statutes is that they may ameliorate the negative popular image of punitive damages by using the funds to support plaintiffs’ suits more generally or to promote product safety in some area of law. See Edward L. Rubin, *Punitive Damages: Reconceptualizing the Runcible Remedies of Common Law*, 1998 Wis. L. Rev. 131, 153-54 (1998) (stating that excess damages could be used to support plaintiffs’ suits or special purpose institutions related to issues of lawsuit).

²⁵⁸ See *Gordon v. State*, 608 So. 2d 800, 801 (Fla. 1992) (holding that plaintiff had no cognizable right to recovery of punitive damages and that legislature may place conditions on such recovery even to point of abolishment); *Mack Trucks, Inc. v. Conkle*, 436 S.E.2d 635, 639 (Ga. 1993) (same); *State v. Moseley*, 436 S.E.2d 632, 634 (Ga. 1993) (upholding Georgia statute mandating payment to state of portion of punitive damages awards in product liability actions); *Shepherd Components, Inc. v. Brice Petrides-Donohue & Assocs.*, 473 N.W.2d 612, 619 (Iowa 1991) (stating that plaintiff has no vested right in punitive damages and statutes regulating such damages are generally constitutional). For discussion of cases, see Matthew J. Klaben, Note, *Split-Recovery Statutes: The Interplay of the Takings and Excessive Fines Clauses*, 80 Cornell L. Rev. 104, 119-24 (1994).

²⁵⁹ See *Mack Trucks*, 436 S.E.2d at 638 (stating that purpose of punitive damages statute at issue was not to provide windfall to plaintiff); Janet Malloy Link, *When a Sting Is Overkill: An Argument for the Discharge of Punitive Damages in Bankruptcy*, 94 Colum. L. Rev. 2724, 2739-40 (1994) (presenting how courts generally describe punitive damages as windfalls for plaintiff).

²⁶⁰ *Shepherd Components*, 473 N.W.2d at 619.

²⁶¹ See *Kirk v. Denver Publ’g Co.*, 818 P.2d 262, 264 (Colo. 1991) (holding that Colorado statute requiring judgment creditor to pay one-third of exemplary damages award into state general fund effected unconstitutional taking).

²⁶² See *id.* at 272.

²⁶³ See Gerald W. Boston, *Punitive Damages in Tort Law* § 4:21, at 4-99 to 4-100 (1993) (explaining that Colorado Supreme Court’s decision in *Kirk* seems to have relied on time

Determining whether punitive damages are an entitlement based on the time at which the state's interest attaches to the award is not helpful for our purposes. Our concern is not whether the legislature can change doctrines governing remedies, or even liability, across the board, but rather what are the constitutional limits of governmental interference with private recoveries of only a particular group of plaintiffs.²⁶⁴ Those limits should not be set according to any temporal distinction. Instead, in order to identify what part, if any, of the expected punitive damage awards of citizens' claims should be subjected to our takings analysis, we need to distinguish between the portion, if any, of the punitive damage award that can be deemed part of the plaintiff's entitlement²⁶⁵ based on a "jurisprudence of damages."²⁶⁶ This section thus undertakes an investigation of the three broad rationales offered for punitive damages—compensation, deterrence, and retribution—and explores the implications of each rationale for our takings inquiry.

2. *Punitive Damages for Compensation*

Commentators have suggested that punitive damage awards serve, at least in part, a compensatory function. They allow plaintiffs to recover "for losses not ordinarily recoverable as compensatory damages, such as actual losses the plaintiff is unable to prove or for which the rules of damages do not provide relief, including and most importantly, the expenses of bringing suit."²⁶⁷ Bridging the gap be-

at which statute attached sharing mechanism to judgment); Paul F. Kirgis, Note, The Constitutionality of State Allocation of Punitive Damage Awards, 50 Wash. & Lee L. Rev. 843, 869 (1993) (same).

²⁶⁴ We readily concede that a state could cap damages awards (even compensatory damages) or could limit the availability of punitive damages to, say, only retributive purposes. The Atomic Energy Act of 1954, 42 U.S.C. § 2012(i) (1994), for example, limits the liability of some nuclear electrical generating facilities in the event of accidents, and its constitutionality was justifiably upheld in *Duke Power Co. v. Carolina Env'tl. Study Group, Inc.*, 438 U.S. 59, 68 (1978). Rather, we are concerned here with the extent to which the government may single out specific groups to limit liability and confiscate the proceeds.

²⁶⁵ See David G. Owen, *A Punitive Damages Overview: Functions, Problems and Reform*, 39 Vill. L. Rev. 363, 392-93, 410-11 (1994) (distinguishing between portion of punitive damages that achieves educative, retributive, deterrent, compensatory, and law enforcement functions, and that which is excess).

²⁶⁶ Aaron B. Twerski, *Introduction: Punitive Damages: Through the Five Prisms*, 39 Vill. L. Rev. 353, 355 (1994).

²⁶⁷ Owen, *supra* note 265, at 378-79; see also, e.g., 1 Linda L. Schlueter & Kenneth R. Redder, *Punitive Damages* § 2.2(B)(1), at 33-35 (3d ed. 1995) (referring to courts' endorsement of compensatory justification for punitive damages). Some reference has also been made to losses falling on persons other than the victim, but the significance of this consideration is decreasing with the increasing recognition of the independent claims of such third parties. See Dorsey D. Ellis, Jr., *Fairness and Efficiency in the Law of Punitive Damages*, 56 S. Cal. L. Rev. 1, 28-29 (1982).

tween allowed compensation and perfect compensation—fully accounting for the plaintiff's consequential damages, remote damages, economic losses, exposure to risk, emotional distress, or pain and suffering—appears to have been one of the original inspirations for awarding punitive damages at common law.²⁶⁸

We concede that the tort system may well be undercompensatory,²⁶⁹ and undercompensation, as well as the typical contingency fee arrangements that frequently give one-third of the recovery to plaintiff's lawyer, are genuine challenges for a tort system that purports to compensate fully victims for their losses. However, we believe that punitive damages are probably a poor mechanism for bridging this gap.²⁷⁰ First, they are underinclusive with regard to all plaintiffs in the tort system because punitive damages do not apply to all cases, and second, they are also overinclusive with regard to plaintiffs who do receive punitive damages because, often, their awards are excessive.²⁷¹ Therefore, "remedies for missing components of harm would best be pursued through revision of the rules used to calculate compensatory damages" rather than by employing punitive damages to achieve this purpose.²⁷² Viewing punitive damages as compensatory would only exacerbate the already existing irrationality of the current system by inconsistently correcting these deficiencies, and not correcting others at all.²⁷³ Hence, we assume that punitive damages do not include any compensatory component, and focus instead on the two "official" purposes of punitive damages: deterrence and retribution.²⁷⁴

²⁶⁸ See Robert D. Cooter, *Punitive Damages, Social Norms, and Economic Analysis*, 60 *Law & Contemp. Probs.* 73, 80-81 (1997). Other accounts focus on the expressive functions of punitive damages. For more complete historical discussions, see generally 1 Theodore Sedgwick, *A Treatise on the Measure of Damages* §§ 348-352, at 687-98 (9th ed. 1912); Ellis, *supra* note 267, at 12-20.

²⁶⁹ See generally Steven P. Croley & Jon D. Hanson, *The Nonpecuniary Costs of Accidents: Pain-and-Suffering Damages in Tort Law*, 108 *Harv. L. Rev.* 1785 (1995) (evaluating nonpecuniary damages on basis of consumer demand).

²⁷⁰ See generally Cooter, *supra* note 268 (criticizing use of "punitive" to describe gap-filling damages).

²⁷¹ See James A. Breslo, *Comment, Taking the Punitive Damage Windfall Away from the Plaintiff: An Analysis*, 86 *Nw. L. Rev.* 1130, 1133, 1138-39 (1992).

²⁷² A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 *Harv. L. Rev.* 869, 939 (1998).

²⁷³ See Cooter, *supra* note 268, at 75-76 (discussing inconsistencies inherent in punitive damage awards); Polinsky & Shavell, *supra* note 272, at 942 (arguing that punitive damages should not be used to correct inadequate compensatory damages).

²⁷⁴ See Restatement (Second) of Torts § 908(1) (1979) ("Punitive damages are damages, other than compensatory or nominal damages, awarded against a person to punish him for his outrageous conduct and to deter him and others like him from similar conduct in the future.").

3. *Punitive Damages for Deterrence*

Courts and commentators alike have most frequently considered deterrence to be the predominant purpose of punitive damages.²⁷⁵ On its face, deterrence—the prevention of similar misconduct in the future—seems to be extrinsic to the relationship between specific plaintiff and specific defendant, and thus any measure of recovery based on deterrence must be beyond the entitlement of the plaintiff.²⁷⁶ Therefore, there seems to be no difficulty in shifting part of deterrence-oriented punitive damages to the state.²⁷⁷

Deterrence, however, is not *necessarily* extrinsic to the bilateral private relationship, and, therefore, a measure of recovery that guarantees deterrence is not necessarily beyond the plaintiff's entitlement.²⁷⁸ A legal regime that effectively deters may well be aimed at vindicating the resource holder's control over the infringed resource. This goal makes deterrence part and parcel of the content and meaning of that person's entitlement. In other words, there may be cases in which we would opt for structuring the entitlement of people around a model of libertarian rights, a model that discourages potential invaders from circumventing the bargaining process and bypassing the entitlement holder's consent. In cases where deterrence serves as part of the entitlement to control, it defines the parties' relationship and thus cannot be deemed extrinsic. It is only when we decide to structure the entitlement on a utilitarian model, which seeks merely to preserve the entitlement holders' welfare as embodied in their resources, that a compensatory damage award that restores the entitlement holder's objective level of utility is the plaintiff's only legitimate claim.

Insofar as cases of punitive damages are aimed at vindicating the

²⁷⁵ See, e.g., Owen, *supra* note 265, at 377-78. For the claim that deterrence is adequately secured by incentives provided by the market, government regulation, and compensatory damages, and that punitive damages have no significant deterrent effect, see W. Kip Viscusi, *The Social Costs of Punitive Damages Against Corporations in Environmental and Safety Torts*, 87 *Geo. L.J.* 285 (1998). This proposition is debated. Compare Theodore Eisenberg, *Measuring the Deterrent Effect of Punitive Damages*, 87 *Geo. L.J.* 347 (1998) (questioning Viscusi's empirical premises about punitive damages, understanding of applicable legal rules, and statistical methodology), and David Luban, *A Flawed Case Against Punitive Damages*, 87 *Geo. L.J.* 359 (1998) (asserting Viscusi's analysis contains at least 13 significant errors), with W. Kip Viscusi, *Why There Is No Defense of Punitive Damages*, 87 *Geo. L.J.* 381 (1998) (defending original critique of punitive damages by arguing that they play no constructive role in society and their costs are too high).

²⁷⁶ See Eric Kades, *Windfalls*, 108 *Yale L.J.* 1489, 1562 (1999); Ernest J. Weinrib, *Restitutionary Damages as Corrective Justice*, 1 *Theoretical Inquiries L.* 1 (2000).

²⁷⁷ Cf. Polinsky & Shavell, *supra* note 272, at 923.

²⁷⁸ The argument that follows builds on Hanoch Dagan, *Encroachment: Between Private and Public*, in *The Comparative Law of Unjustified Enrichment* (David Johnston & Reinhard Zimmermann eds., forthcoming 2000).

plaintiff's control, we should inquire which specific measure of recovery actually discourages potential invaders from any boundary crossing consistent with this libertarian ideal.²⁷⁹ Usually, the most suitable measure of recovery would be the defendant's profits. This removal of the "possibility of profit takes the bite out of the forced transfer, and apparently deters . . . the invader" from embarking on a "useless adventure" at the outset.²⁸⁰ A profits measure of recovery thus vindicates the plaintiffs' liberty to control the entitlement as part of their private sphere.²⁸¹

There are, however, cases in which even such profit-based remedies would not effectively deter interferences and where additional measures must be undertaken. For example, where the defendant is the plaintiff's fiduciary, deterrence is compromised by severe difficulties of asymmetric information between the fiduciary and the beneficiary. The law vindicates the beneficiary's entitlement to the fiduciary's loyalty by "reinforcing" the profit remedy with a cluster of rules that facilitate proof of wrongdoing.²⁸²

Likewise, and more pertinent for our purposes, there may be types of cases in which an injurer has a particularly good chance of escaping liability for the harm it caused. Where this risk is high enough, raising significant dangers that deterrence will be diluted, the appropriate measure of recovery should be increased so that the defendant's average damages will equal its profit. Technically, this would require that the level of damages imposed should equal the defendant's profits divided by the probability of liability.²⁸³ This solu-

²⁷⁹ See Nozick, *supra* note 239, at 57, 71-73.

²⁸⁰ Dagan, *supra* note 90, at 18; see also Cooter, *supra* note 268, at 77 ("[A]n injurer who faces certain liability for extra-disgorging damages prefers not to cause the injury. When the liability system works perfectly, liability for extra-disgorging damages deters intentional wrongdoing."); Dan B. Dobbs, Ending Punishment in "Punitive" Damages: Deterrence-Measured Remedies, 40 Ala. L. Rev. 831, 874 (1989) ("[T]he most obvious measurement for [an extracompensatory] award would be the amount of profit the defendant has earned or will earn from the misconduct."); Bailey Kuklin, Punishment: The Civil Perspective of Punitive Damages, 37 Clev. St. L. Rev. 1, 12 (1989) ("Deterrence occurs when a rational person perceives that the risk of liability for his proscribed act, along with the other costs, exceeds the probable gains.");

²⁸¹ Whether a profit measure of recovery is efficient is subject to some economic dispute. See Keith N. Hylton, Punitive Damages and the Economic Theory of Penalties, 87 Geo. L.J. 421, 423 (1998) (suggesting that where defendant's gain is probably less than or equal to victim's loss, then punitive award should aim to eliminate prospect of gain on part of offender); Polinsky & Shavell, *supra* note 272, at 918-20, 945-47 (discussing instances in which policy of removing defendant's gain may result in overdeterrence).

²⁸² See Robert Cooter & Bradley J. Freedman, The Fiduciary Relationship: Its Economic Character and Legal Consequences, 66 N.Y.U. L. Rev. 1045, 1046-47, 1051-54 (1991) (stating that rules accompanying fiduciary duty include shifting balance of proof to fiduciary or applying conclusive presumption of appropriation).

²⁸³ See Polinsky & Shavell, *supra* note 272, at 889, 895-96; see also Robert D. Cooter,

tion seems especially pertinent in the case of citizen suits against injurious industries: The victim may have difficulty establishing causation; she might not be able to ascertain which polluter is responsible for her harms (analogous to smokers who have smoked many brands of cigarettes); and she might not even bring suit given such expected problems of proof.²⁸⁴

Applying this analysis to our context would require the citizens who challenge the government interference with their punitive damage awards to convince a court that the awards were indeed aimed at vindicating their control respecting the entitlement infringed upon by the injurious industry. Furthermore, they would also need to demonstrate that the amounts awarded to them are equal (or at least approximate) to the industry's profit, or, in appropriate cases, the profit divided by the enforcement probability.²⁸⁵ Given the open-ended, discretionary authority for juries to award punitive damages, it may well be very difficult to carry the burden of proof.²⁸⁶

4. *Punitive Damages for Retribution*

Finally, as the term may suggest, punitive damages are sometimes justified by reference to retribution.²⁸⁷ There seem to be two basic

Punitive Damages for Deterrence: When and How Much?, 40 Ala. L. Rev. 1143, 1148 (1997) (“[T]he punitive multiple should equal the reciprocal of the enforcement error for the sake of deterrence”); cf. Hylton, *supra* note 281, at 422-24 (applying Polinsky’s and Shavell’s formula only as minimum punitive damages when offender’s gain is equal to or less than victim’s loss). Where the likelihood of escaping liability is not especially high, this refinement is not especially needed for vindicating control, at least where the defendant’s expected gain is greater than the plaintiff’s harm. The plaintiff’s opportunity to recover such excess gain creates an appropriate incentive actually to detect infringement, thus further diminishing the significance of the defendant’s escaping liability.

²⁸⁴ Cf. Richard Craswell, *Deterrence and Damages: The Multiplier Principle and its Alternatives*, 97 Mich. L. Rev. 2185, 2237 (1999) (discussing multiplier principle as it relates to enforcement); Polinsky & Shavell, *supra* note 272, at 888 (discussing difficulty of proof as one reason why injurers at times escape liability).

²⁸⁵ It is especially difficult to prove that the damage awards equal this sum because not all smokers—or their claims—are alike. The spectrum of potential claimants encompasses those who began smoking during the period of severe underenforcement of laws against the tobacco industry to those who began smoking relatively recently, when enforcement has become relatively comprehensive.

²⁸⁶ The difficulty addressed by the text is but one disadvantage of the open-ended nature of punitive damages in contemporary doctrine. See Cass R. Sunstein et al., *Assessing Punitive Damages (with Notes on Cognition and Valuation in Law)*, 107 Yale L.J. 2071, 2078-79 (1998) (finding that judges, not juries, should decide amounts of punitive damage awards).

²⁸⁷ See Boston, *supra* note 263, § 2:6, at 11 (“[M]ost jurisdictions recognize the dual objectives of punishing the defendant for its wrongful conduct and deterring the defendant and others from repetition of the same or similar conduct in the future.”); Cooter, *supra* note 283, at 1146 (“A consensus among legal scholars holds that deterrence, along with punishment, is the goal of punitive damages.”). For skeptical views as to the punishment

accounts of this retribution idea. They lead to different results respecting the plaintiff's entitlement to the punitive damage award.

On one account, the award of punitive damages "serves as a voice of outrage for the body politic."²⁸⁸ It is an opportunity to speak to the conscience of the country; a part of "the American judicial theatre [which] plays a role . . . that has no parallel in any other country"; a measure of "creative government" which produces "a cathartic effect."²⁸⁹ This understanding of the retribution function of punitive damages does not even attempt to include a role for the plaintiff in the retribution drama. Hence, it would tend to perceive the award as a windfall for the plaintiff²⁹⁰ and correspondingly to see the government's interference with such a windfall as unproblematic.

This view, however, is not the only available understanding of the retribution idea of punitive damages. Others believe punitive damages are "the expression of an intellectual judgment about justice and desert."²⁹¹ Against a wrongdoer who "has implicitly asserted a kind of undeserved mastery and superiority over the victim," punitive damages "reassert the truth about the relative value of wrongdoer and victim by inflicting a publicly visible defeat on the wrongdoer."²⁹² Punitive damages send a message by inflicting an expressive defeat on the wrongdoer. "A more heinous act on the part of the wrongdoer expresses a greater level of contempt for the victim, and so the expressive defeat must be correspondingly more decisive; hence the principle that greater wickedness deserves greater punishment."²⁹³

This second understanding of the retribution idea of punitive damages suggests that the plaintiff—the injured citizen in our triangular scenario—does have an entitlement in a punitive damage award.

objective, in general and respecting firms, correspondingly, see Ellis, *supra* note 267, at 4-8; Polinsky & Shavell, *supra* note 272, at 948-54.

²⁸⁸ Twerski, *supra* note 266, at 361; see also Angela P. Harris, *Rereading Punitive Damages: Beyond the Public/Private Distinction*, 40 Ala. L. Rev. 1079, 1110 (1989) ("[T]he doctrine of punitive damages draws on the preliberal notion of a jury as representing the collective morality of a community.").

²⁸⁹ Twerski, *supra* note 266, at 360; see also Owen, *supra* note 265, at 374-76.

²⁹⁰ See Schlueter & Redder, *supra* note 267, § 2.2(A)(2), at 32 ("Because the plaintiff already received full compensation, any additional award is merely an unjustified windfall for the plaintiff. Thus, punitive damages are not awarded as matter of right but are within discretion of the jury and with certain prerequisites.").

²⁹¹ Luban, *supra* note 275, at 378.

²⁹² Marc Galanter & David Luban, *Poetic Justice: Punitive Damages and Legal Pluralism*, 42 Am. U. L. Rev. 1393, 1432 (1993); see also David G. Owen, *The Moral Foundations of Punitive Damages*, 40 Ala. L. Rev. 705, 711 (1989) ("If autonomy thefts—intentional 'border crossings' into other persons' zones of rights—were not subjected to penalties in addition to the restoration of the stolen goods (compensatory damages), the rectification of the transaction would be incomplete." (footnote omitted)).

²⁹³ Luban, *supra* note 275, at 378.

The wrongdoer's punishment should not be, in this view, "too lenient" since if it is, it implies that society as a whole "ratifies the view that the victim is the sort of person it is all right to treat badly."²⁹⁴ It may be difficult, however, to measure such an entitlement for purposes of takings law. Such expressive retribution can hardly produce the kind of clear calibration of punitive damage that is required in order to determine whether the government's interference with the award constitutes a taking.²⁹⁵

* * *

In sum, the case of barring punitive damages as part of a government-industry settlement derives complexity from the unsettled nature of punitive damages. We doubt that citizens can claim any entitlement for punitive damages for retribution. But insofar as punitive damages are aimed at deterring the defendant's infringement of the plaintiff's entitlement, thus vindicating the latter's control over the infringed resource, plaintiffs may well have valid takings claims even respecting punitive damage. As long as punitive damages for deterrence will not be disentangled from punitive damages for retribution, these claims would probably remain theoretical. On the other hand, we have no doubt that governmental interference with citizens' compensatory awards should be regarded as a violation of their Fifth and Fourteenth Amendment rights. As this Part has demonstrated, a strict takings doctrine is the only viable protection for citizens from the dangers inherent in governmental interference with their claims against injurious industries.

IV PUBLIC POLICY

As we demonstrate in Part III, there is considerable risk that governmental interference in the resolution of mass tort claims will violate the legal rights of the individual victims. Our case study of the tobacco settlement highlights an additional disadvantage, that such interference is also bad public policy even where it might not violate the legal rights of the individual victims. This is true whether one considers the settlement to be merely an agreed resolution of a tort subrogation claim or a state imposed tax.

²⁹⁴ Galanter & Luban, *supra* note 292, at 1433.

²⁹⁵ See Cooter, *supra* note 268, at 74 ("Courts should not ask juries to determine the extent of punishment without providing instructions for its computation from the facts of the case."); Owen, *supra* note 292, at 732-33 (finding that restitution for stolen freedom is "highly metaphorical, indeterminate, and hence incapable of principled measurement" and that "[t]here is no good resolution").

We acknowledge that the states are proper subrogees for their ameliorative and preventative costs and we see no reason why their claim for those costs could not be resolved by agreement with the manufacturers. But the settlement is unlike a garden variety subrogation recovery; as true subrogees, the states would surely not have won judgments with a value equal to the amount that the tobacco manufacturers have agreed to pay.²⁹⁶ The states reached such a favorable settlement only by colluding with the tobacco manufacturers to put a disproportionate share of the cost on their citizen smokers.

Our principal quarrel with the Settlement as an agreed resolution of a tort claim is that some of the terms—reducing payments by the participating manufacturers if they lose market share to outsiders and inviting the states to enact a tax that deters new market entrants²⁹⁷—improperly redistribute costs from the tobacco companies' shareholders to their consumers.²⁹⁸ If the agreements in the Settlement had been reached between private parties, they would have violated federal antitrust laws.²⁹⁹ Although states' agreements are immune from federal antitrust prosecution,³⁰⁰ the anticompetitive provisions of the Settlement will have exactly the same effect as if private parties had conspired to exclude competitors. If the agreement with the manufacturers hinders the entry of new competitors, the price of cigarettes will be higher than in a freely competitive market.

The higher price has two effects. First, it frees the companies' shareholders from having to internalize the costs of their tort liability; they can pass on the costs to consumers without a loss in market share.³⁰¹ Second, it facilitates the inclusion of additional payments in the Settlement (e.g., payments for lobbying) without fear that new entrants to the market will undercut the cigarette prices of the partici-

²⁹⁶ See *supra* Part I.C.

²⁹⁷ See *supra* Part I.C.2.

²⁹⁸ Some might claim that the shareholders could avoid this loss by selling their shares. Because of the speed with which the market has responded to litigation and other factors in the cigarette business, it would have taken a particularly adroit shareholder to escape the loss. In the past two-and-a-half years, Philip Morris's shares have fluctuated between about \$19 and \$57. During 1999, Philip Morris's share value declined more than 55% as more and more threatening clouds appeared.

²⁹⁹ See Sherman Act, 15 U.S.C. § 1 (1994) ("Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States . . . is declared to be illegal.").

³⁰⁰ See *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 136 (1961) ("[W]here a restraint upon trade or monopolization is the result of valid governmental action, as opposed to private action, no violation of the [Sherman] Act can be made out." (citing *Parker v. Brown*, 317 U.S. 341 (1943))).

³⁰¹ The manufacturers raised the price of cigarettes in unison about \$0.45 per pack in the fall of 1998. See Vanessa O'Connell, Philip Morris, RJR Lift Wholesale Price for Cigarettes 45 Cents a Pack Today, *Wall St. J.*, Nov. 24, 1998, at A2.

pating manufacturers. If demand for cigarettes is relatively inelastic, if price competition among the participating manufacturers is muted, and if outsiders are barred, the cost of any "bribe" to the state governments can be passed through to purchasers without cost to the manufacturers.³⁰²

The Settlement may be even more offensive to public policy if it is considered to be a tax imposed by quasi-judicial action. The payments have many of the attributes of a tax: They are made to the states; continue indefinitely; are only imperfectly related to past tort injuries; and in many states will go directly into the treasury and be expended in just the same way as conventional tax revenues would be.³⁰³ As a tax, the Settlement is undemocratic and regressive.

The first and most powerful objection is that as a tax the Settlement violates the democratic principles that are built into the tax laws of every state. If a state were to enact a multibillion dollar tax equal to the revenues that it will receive under the Settlement, it would have to follow elaborate legislative procedures. Typically, these measures would include legislative hearings, debate, and passage by both houses of the state legislature, and signature by the governor.³⁰⁴ In contrast, a state's adoption of the Settlement required only the agreement of a state official such as the attorney general and the adoption of the settlement in a judgement dismissing the state's suit against the manufacturers.³⁰⁵ The Settlement's bypassing of the traditional safety mechanisms for the passage of new taxes reduces the visibility of the Settlement's provisions. No advocate for cigarette consumers has ever had the opportunity to express the arguments that we consider here. No attorney general has had to respond to questions about the Settlement's anticompetitive provisions. No antitax governor has had to explain why he or she is proposing a huge new tax.

This lack of public participation becomes even more troubling when we consider that in modern America smokers are drawn dispro-

³⁰² Of course, it is true that imposing a high tax on existing manufacturers and erecting barriers to others' entry could serve a state goal of reducing smoking. Because there are more principled ways to accomplish that result that are not subject to the criticism elaborated in this Article, we do not believe that the current regime can be justified as a way to reduce smoking. After all, a legislature might conclude that a larger or smaller tax is appropriate. Since no legislature was asked how large its tax should be, we do not know what answer it would give in the face of conflicting claims by smokers and nonsmokers.

³⁰³ See *When Lawyers Inhale*, *Economist*, May 22, 1999, at 88.

³⁰⁴ See, e.g., *How a Bill Becomes a Law in Minnesota* (visited March 30, 2000) <<http://www.leg.state.mn.us/leg/howbill/htm>> (emphasizing that bill must pass both houses of Minnesota's legislative branch).

³⁰⁵ "Final approval" of the Settlement requires "State-Specific Finality." Master Settlement Agreement, *supra* note 76, § II(u). "State-Specific Finality" in turn requires approval and entry by a court. See *id.* § II(ss).

portionately from classes with limited education and low incomes.³⁰⁶ The tobacco manufacturers' ability to pass on the costs of the Settlement means that the costs will be imposed primarily on working-class smokers. This concern would be alleviated if a disproportionately large share of the tax revenues were to go to the working class, particularly to the smokers, but we see no evidence of that happening.³⁰⁷

Consider one final consequence of this unusual tax. Every excise tax on a potentially injurious product is, of course, a bargain with the devil, for more sales mean both more tax revenue and more injuries. But the peculiar nature of this tax ties the states even more closely to current members of the tobacco industry than would be true of a conventional tax. Because the tax arises from an agreement between each state and specific tobacco manufacturers, the tax revenues depend upon the continued existence and solvency of the participating manufacturers. If Philip Morris or RJR goes into bankruptcy and liquidates, and their market share is taken over by a new entrant, every state's tax revenues will decline accordingly. Each state will thus have an incentive to keep these particular taxpayers healthy. If our analysis is correct, the states have made covert, implied promises about lobbying and covert, express promises about erecting barriers to new entrants that the states would probably not make to anyone openly, certainly not to specific members of a particular industry.³⁰⁸

Because the Settlement revenues go to identifiable beneficiaries in most states, persons in every state will shortly regard these benefits as an entitlement. The incentive of state officials to maintain the revenues will be correspondingly enhanced by the knowledge that particular, local voters depend on this revenue.

We see much that is bad and little that is good from enacting such a tax by a quasi-judicial process. The absence of the legislature from

³⁰⁶ See Robert D. Tollison & Richard E. Wagner, *Smoking and the State* 8 (1988) (noting that regressivity of cigarette taxes is strengthened because "the use of tobacco products declines as income rises").

³⁰⁷ See *supra* text accompanying notes 75-81.

³⁰⁸ If the states had entered into an agreement with the tobacco manufacturers that required the manufacturers to pay only the proper value of the states' subrogation claims (taking into account the defenses that could properly be asserted by the tobacco companies), the states' incentive to lobby for restrictions on their citizens' potential recovery from the tobacco manufacturers would have been much smaller than it will be under the existing agreement. First, the states would lose proportionally less (by way of agreed payments) from any tobacco manufacturer's bankruptcy because the total payments would be smaller. Second, any state's need for revenue from the sale of cigarettes would be met by a tax applicable to all sales that would be insensitive to the failure of existing manufacturers. If one assumes that there is a relatively fixed demand for cigarettes, the bankruptcy of one or all existing manufacturers would not reduce any state's revenues because other manufacturers, including new entrants, could be expected to come into the market to replace any failed manufacturer.

the adoption process stills the public's voice and facilitates collusive bargains. Characterizing the payments as tort recoveries frees public officials from the pain that they would suffer for enacting new taxes, particularly regressive ones. Finally, the exclusion of smokers from the private bargaining table facilitates other parties' taking assets that should belong to the excluded players.

CONCLUSION

We do not claim that every bargain struck in settlement of a state or federal suit against weapons manufacturers, sellers of fatty foods, brewers, or distillers will have all of the same characteristics as the tobacco settlement. But we believe that when the government asserts a claim that could be asserted by an individual citizen, it will almost always be presented with the same temptation to collusion and conversion. The industry under attack will always want protection from the private suits; that may be its only hope for survival. Invariably, therefore, these industries will seek payment out of the resources of the individual plaintiffs. Because these bargains are negotiations for the settlement of suits to which, by hypothesis, the individuals are not parties, the individual plaintiffs will be excluded. But as we demonstrate in Part II, government interference is also beneficial, for it allows governments to pursue their public responsibilities in preventing and ameliorating injuries to their citizens without fear that the public will bear more than its fair share of the cost. Properly asserted, government legal subrogation claims insure the correct internalization of the true costs of an industry's products.

As we claim throughout, government's legal subrogation claims are both salutary and dangerous. Only a generous approach to subrogation accompanied by a strict takings inquiry can capture the advantages of government involvement without opening the door to abuse.