No. 10-622

In The

Supreme Court of the United States

S&M BRANDS, INC., TOBACCO DISCOUNT HOUSE #1, AND MARK HEACOCK,

Petitioners,

v.

JAMES D. "BUDDY" CALDWELL, in his official capacity as Attorney General of the State of Louisiana,

Respondent.

On Petition for Writ of Certiorari
To the United States Court of Appeals for the Fifth Circuit

AMICUS CURIAE **BRIEF OF CONSTITUTIONAL LAW SCHOLARS IN SUPPORT OF THE PETITION**

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INTEREST OF *AMICI CURIAE*[1]

Amici are law professors who have taught, written about, and litigated cases involving various aspects of constitutional law.[2] They are submitting this brief in support of the petition because they believe that the lower courts in this and other similar cases have not properly understood the meaning of the Compact Clause of Article I, section 10 and have not understood its place in the federalism provisions of the Constitution. They take no position on whether the Master Settlement Agreement (MSA) being challenged in this case creates a sound public policy, but they do believe that the MSA is subject to the Compact Clause and that to allow States and private companies to enter an agreement of this type and with this massive impact, without approval of Congress, threatens to create an imbalance in our federal system. That imbalance can produce serious harms to both non-participating States and the Federal Government, in addition to the economic harm to competitors of the tobacco companies that are parties to the MSA and to consumers of tobacco products. The brief is being filed pursuant to a blanket consent given by all counsel and filed with this Court. Notice pursuant to Rule 37 was provided to all counsel on November 20, 2010.

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[1] No person other than the named *amici* authored this brief or provided financial support for it.

[2] Alan B. Morrison is the Lerner Family Associate Dean for Public Interest and Public Service at the George Washington University Law School; Richard Epstein is the Laurence A. Tisch Professor of Law at New York University Law School; and Kathleen M. Sullivan is the Stanley Morrison Professor of Law and Former Dean at Stanford Law School.

STATEMENT OF THE CASE

The complaint in this case challenges the legality of what is known as the Master Settlement Agreement (MSA) between the major tobacco manufacturers and 46 states, as described more fully in the petition. The legal bases for that claim are the Sherman Antitrust Act, 15 U.S.C. § 1, and the Compact Clause of Article I, section 10 of the Constitution. As the case comes to this Court, it is undisputed that the MSA violates the Sherman Act and that the petitioners would be entitled to an injunction against its continued operation unless the agreement is shielded by this Court's decision in *Parker v. Brown,* 317 U.S. 341 (1943). That decision found an implied exception to the antitrust laws for what would otherwise be a private agreement in restraint of trade, where the agreement was approved by the State, pursuant to a legislative policy that replaced competition with regulation, provided that the State actively supervised the operation of the agreement.

Petitioners argue that *Parker* does not apply to the MSA, but even if it did, the MSA would still be unlawful because it has not been submitted to, let alone approved by, Congress as required by the Compact Clause. *Amici* agree that *Parker* does not protect the MSA from antitrust scrutiny for two related reasons. The Compact Clause contains a specific method by which multi-state agreements can be lawfully implemented. Respondent's position is that, in addition to the implied exception under *Parker* for decisions of individual States to replace competition with regulation, Congress also impliedly exempted multi-state agreements that supplant competition in the agreeing States. But that argument is wholly inconsistent with the affirmative requirement in the Compact Clause that all such agreements be permitted only if approved by Congress.

Second, even if *Parker* explicitly included multi-state exceptions to the Sherman Act, the specific Compact Clause mandate of Congressional approval for agreements such as the MSA overrides any such exception, and hence would render the MSA invalid under the Compact Clause. It is common ground that not every agreement between two or more states must be approved by Congress, but only those that improperly increase the powers of the States that agreed to it. Thus, the applicability of the Compact Clause in this case depends on a proper understanding of that Clause and of the operation of the MSA.

The court of appeals below, agreeing with other courts that have heard similar challenges, found the Compact Clause inapplicable because "the MSA only increases states' power *vis-à-vis* the [manufacturers that are also parties to the MSA] and not in relation to the federal government." Pet. App. A6. That ruling, which effectively disregards the impact of the MSA on the federal government, other States, and third parties such as petitioners, is based on a serious misunderstanding of the meaning and scope of the Compact Clause. Accordingly, this brief will first establish the proper meaning of the Compact Clause and then explain why, as correctly understood, it requires that the MSA be approved by Congress.

ARGUMENT

THE LOWER COURTS, BY NARROWLY READING THIS COURT'S DECISION IN *UNITED STATES STEEL,* HAVE IMPROPERLY RELEGATED THE COMPACT CLAUSE TO A STATUS OF VIRTUAL INSIGNIFICANCE.

The Compact Clause is one of a number of provisions in the Constitution that speaks to issues of federalism by allocating powers between the States on the one hand and the Federal Government on the other. As such, it can be best understood not simply on its own, but as part of the federalism provisions.

At the time of the framing, the basic principle underlying the Constitution was that the primary lawmaking authority rested with the States and that the Congress was given the power to enact laws only as specifically authorized, mainly in Article I, section 8, and even then subject to the prohibitions of section 9 and others specified elsewhere in the Constitution. Having lived through the period when the Articles of Confederation spelled out the relations among the States, and between them and the central government, the Framers recognized that Congress needed certain powers and that the States should be forbidden from carrying out certain activities, either absolutely or without the approval of Congress. The foremost among the new congressional powers is that contained in Article I, section 8, clause 3, "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Although originally conceived as a limited power, the reach of the Commerce Clause has expanded greatly since 1789, and it now extends to activities that are wholly intra-state and not necessarily commercial, so long as Congress reasonably concluded that those activities might have a substantial impact on interstate commerce. *Gonzales v. Raich,* 545 U.S. 1 (2005). It is the Commerce Clause that is the basis for the Sherman Act relied on by petitioners for that cause of action.

This Court has also ruled that the affirmative grant of power to Congress to regulate commerce also contains in it a "dormant" or negative power that forbids States, even without Congressional action, to enact laws that substantially burden interstate commerce, often by discriminating against out of state entities. *See also* Article IV, section 2, clause 1, further preventing State-based discrimination by guaranteeing to all citizens "all Privileges and Immunities of Citizens in the several States." Moreover, if there is a conflict between the Sherman Act and/or the Compact Clause, and the laws of Louisiana that respondent is enforcing, such as the MSA, the Supremacy Clause of Article VI, section 1, clause 2, provides that the federal law "shall be the supreme Law of the Land."

Although this case involves limits on the powers of the States, it is important to keep in mind that there are also limits on the powers of the Federal Government. For instance, the President's powers are specified in Article II, as well as those delegated to him by Congress in duly enacted laws. Although he has some inherent powers not spelled out in the Constitution, they are limited in the domestic area and may not conflict with powers assigned to others. *See Youngstown Sheet & Tube Co. v. Sawyer,* 343 U.S. 579 (1952). Similarly, the federal courts are not courts of general jurisdiction, but can hear only cases in the nine categories spelled out in Article III. The Tenth and Eleventh Amendments impose further limits on the Federal

Government, and even Section 5 of the Fourteenth Amendment, which gives Congress "the power to enforce, by appropriate legislation, the provisions of this article," has been construed by this Court to limit such legislation to remedying violations of that Amendment. *United States v. Morrison,* 529 U.S. 598, 619-27 (2000).

The first eight amendments were originally made applicable only to the Federal Government, but with the enactment of the Fourteenth Amendment's Due Process and Equal Protection Clauses, and this Court's widespread incorporation of the rights in the Bill of Rights into the Fourteenth Amendment, most, although not all of those amendments, are also applicable to the States. *See McDonald v. City of Chicago,* 130 S.Ct. 3020 (2010).

The Compact Clause is one of several provisions in the original Constitution that expressly limit the powers of the States for the purpose of protecting the interests of the United States as a whole, in situations where the States and the Federal Government may have different views on those interests. Under Article I, section 4, the "Times, Places and Manner of holding elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof, but the Congress may at any time by Law make or alter such Regulations, except as to the Places of chusing Senators." Pursuant to this authority, Congress has decided that all elections for federal officials should be held on the first Tuesday after the first Monday in November, 2 U.S.C. § 7, because the national interest in having a single day for federal elections outweighs any State interest in choosing their own election days. Similarly, even though the elections for Members of Congress are done on a State by State basis, if there is dispute about who has prevailed, section 5 of Article I provides for a method of resolving those disputes: the House of Congress to which the candidates are seeking election is the final decision maker. And pursuant to the third clause of Article II, section 1, if there are disputes arising from the States' selection of Presidential electors, they are to be resolved by the House of Representatives.

The Compact Clause is set forth in the third set of prohibitions in Section 10 of Article I. *See generally,* Laurence H. Tribe, *American Constitutional Law,* 1238-42 (3rd ed., Vol. 1) (2000); Duncan B. Hollis, *Unpacking the Compact Clause*, 88 Texas L. Rev. 741, 759-66 (2010) (detailing the history and rationales for parts of section 10). The first group contains absolute bars to certain actions by the States. Some duplicate prohibitions that are applicable to Congress – no Titles of Nobility, bills of attainder, or ex post facto laws – while others are included because the functions are assigned exclusively to the National Government on the theory that these are areas where a single voice should be heard or uniformity is essential. These include the ban on entering "any Treaty, Alliance or Confederation," coining money, or making anything but gold or silver legal tender for the payment of debts. The second group deals with imports and exports, particularly the taxing thereof, but permits States to engage in otherwise prohibited activities, with the consent of Congress. However, it also provides that all net revenues shall belong to the United States Treasury and that even the laws that Congress approves are subject to congressional revision. In short, for this second group, Congress may consent, but the Clause has conditions that apply even with congressional approval.

The third group mainly contains broad prohibitions of conduct by a State, absent the consent of Congress, but with no mandatory conditions that accompany such consent. The provision at issue in this case does not apply to acts by a single State, but bars States from entering "any Agreement or Compact with another State, or with a foreign Power," again without the consent of Congress. While section 10 as a whole reverses the basic presumption of the Constitution that States are free to engage in acts normally incident to sovereignty as to the activities set forth in it, the Compact Clause in clause 3 reflects a special concern about, and dictates specially-disfavored treatment for State activities with other governments – both domestic and foreign – that constitute an "Agreement or Compact." Thus, the existence of an inter-state Compact acts as a kind of danger signal that further congressional action may be required.

But if the Compact Clause were read literally to apply to "any" agreement between two States on any subject, that could impose serious burdens and delays on States, and in some cases absurd results, any time they cooperated with a sister State. *See Virginia v. Tennessee,* 148 U.S. 503, 518 (1893) (giving examples of literal application of Compact Clause in cases in which it would be the "height of absurdity" to require approval of Congress). Rather, like the use of "any" in the Sherman Act, "any" in the Compact Clause is not read literally, and it is undisputed that many kinds of agreements are not subject to advance congressional approval, even if they meet the literal definition of an agreement for other purposes, such as contract law.

This Court has had relatively few cases in which it has opined on this distinction, the most recent being *United States Steel Corp. v. Multistate Tax Commission,* 434 U.S. 452 (1978), in which it found that the arrangement at issue there, relating to income taxation for corporations doing business in more than one State, did not fall within the strictures of the Compact Clause.[3] Several features of that multistate arrangement supported that ruling. The tax enforcement policies resulting from that agreement were advisory only since no State was obliged to adhere to them. The agreement had no impact on any federal law or program as it applied only to taxes imposed by States and localities. It did not produce adverse effects on the tax laws of States that chose not to join it, and a signatory State could withdraw at any time without cause or penalty. In short, it was a cooperative arrangement that did not produce any cause for concern for interests governed by our federal system, although it undoubtedly had some adverse effects on United States Steel and other companies whose tax issues may have been less favorably resolved as a result of the voluntary adherence, or as the Court put it, the "interstate cooperation," *id.* at 465, of the signing States.

United States Steel is significant for what kinds of agreements are outside the Compact Clause, but it does not do much to answer the question of what kinds of agreements fall within it. In the more than 32 years since then, this Court has not provided guidance on that question, although the Justice Department's Office of Legal Counsel issued a well-reasoned opinion two years after *United States Steel* that expressed its views on both which arrangements were outside the Clause and which were within it. Applicability of Compact Clause to Use of Multiple State Entities Under the Wa-

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[3] Justice White, joined by Justice Blackmun, dissented on the ground that the majority's reading of the Compact Clause was too narrow and that it allowed too many interstate compacts to escape congressional review. *Id.* at 479-96.

ter Resources Planning Act, 4B Op. Off. Legal Counsel 828 (1980). In contrast to the lower court opinion in this case and in others challenging the MSA, OLC did not limit the application of the Clause to actual harms to federal interests, but extended its reach to potential impairments to the enforcement of federal laws and policies and to the interests of States and private parties that are not signatories to an agreement. Thus, according to OLC, "[i]nterstate agreements interfere with federal power in this sense [of interfering with the supremacy of the United States] if: (1) they involve a subject matter which Congress is competent to regulate, *see Wharton v. Wise,* 153 U.S. 155, 171 (1894); and (2) they purport to impose some legal obligation or disability, s*ee United States Steel Corp. v. Multistate Tax Commission,* 434 U.S. 452, 467-71 (1978)." *Id. at 830-31.* OLC also stated that agreements among States are subject to the Compact Clause if they "impose a legal detriment on state or federal governments or private parties, *id.* at 831, and such agreements are not excluded unless "each state is free to accept or reject a [a decision made pursuant to it] or any of its provisions and has the unfettered right to withdraw" from them. *Id.*

The opinion further emphasized the need for continued State independence if an agreement is to be excluded: if the agreement "is made instead in return for reciprocal action by other states," then it would be covered by the Clause. *Id.* Moreover, consent of Congress would be required if an entity created by an agreement "possessed any legally effective authority, regulatory or otherwise, to ensure the [agreement's] implementation by state or federal governments or private parties." *Id.;* s*ee also Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System,* 472

U.S. 159, 175 (1985) (reciting similar factors in determining whether certain reciprocal State statutes fall within Compact Clause, but finding the question unnecessary to decide because State statutes that comply with specific federal legislation in this area "cannot possibly infringe federal supremacy", *id.* at 176).

As spelled out in detail in the petition, the MSA fails every one of OLC's tests for exclusion from the Compact Clause and meets every one for inclusion. It operates in an area that is not only appropriate for federal regulation, but it does so in the antitrust field in which Congress has enacted far-reaching and economically significant regulations that touch virtually every area of the country's economic life. Indeed if respondent and the lower courts are correct that the actions of the 46 States in joining the MSA constitute an absolute defense to this action, then it would equally be a defense to a similar action brought by the Department of Justice challenging it under the Sherman Act. The notion that an agreement among a group of States that authorizes price fixing and market-share divisions, as the MSA does, can stop federal enforcement of the antitrust laws in its tracks, is almost unthinkable in its own terms. But the Compact Clause takes that possibility from the unthinkable to the unconstitutional because the MSA is precisely the kind of joint State interference with federal laws that the Clause was designed to preclude by requiring congressional approval for agreements of this type. Indeed, in *Virginia v. Tennessee, supra,* this Court held that an agreement to settle a boundary dispute between two States required approval of Congress under the Compact Clause, even though the principal effects of that settlement were on the two settling States. 148 U.S. at 519-21.[4]

But even in the absence of federal antitrust laws, the MSA is forbidden because it is not the kind of cooperative arrangement excluded either in *United States Steel* or the OLC Opinion since it has all of the factors identified in those authorities as indicative of agreements requiring congressional approval. First, the 46 States that joined the MSA are bound by all of its terms and are also explicitly forbidden from withdrawing from it, in contrast to the MTC in *United States* Steel, which States did not have to follow and from which they were permitted to withdraw at any time. Second, because the payments under the MSA are determined by market share nationwide, tobacco users and sellers in the four States that are not parties to the MSA are also affected by it. Third, consumers of tobacco products (such as petitioner Mark Heacock) have seen the price of those products rise as a direct result of the obligations and authorities granted by the MSA, not by a decision of the State in which they make their purchases.

Fourth, as a result of the States' implementation of the MSA, including their own statutes required by the MSA, the competitors of the participating manufacturers (such as petitioner S&M Brands) are required to make additional payments into state-specified escrow accounts to offset the payments that the major tobacco

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[4] The Court then ruled that Congress had impliedly approved the compact by subsequent legislation regarding collection of revenues and representation in Congress by utilizing the agreed-upon boundaries as the basis for laws enacted by Congress. *Id.* at 521-22. *But see New Hampshire v. Maine,* 426 U.S. 363 (1976) (finding settlement of last vestiges of dispute under earlier decree not subject to Compact Clause).

companies agreed to pay the States to compensate them for the damages that the tobacco companies had caused. The effect of that requirement is to force those competitors to increase the price of their products to consumers in order to protect their profit margins, thereby protecting the market share of the major tobacco companies. Fifth, the MSA creates a separate legal entity, known as the Firm, that issues binding legal opinions and orders to which all States must adhere. Sixth, the State of Louisiana, whose Attorney General is the respondent in this case, has enacted these provisions into a law that cannot be amended without violating the MSA. And finally, the MSA itself makes clear that it will work only if all 46 States that had not previously settled with the tobacco defendants signed on, thus creating reciprocal rather that individual State actions. *See also United States Steel, supra,* 434 U.S. at 470, stating that even reciprocal legislation without a formal agreement might be subject to the Compact Clause if it may "present opportunities for enhancement of state power" of the kind that the Clause requires be approved by Congress.

Under the Compact Clause, an agreement to surrender State sovereignty to a reciprocal binding set of obligations or an agreement among States that adversely impacts federal interests triggers the need for approval of Congress. *United States Steel, supra,* 434 U.S. 471 ("relevant inquiry must be one of impact on our federal structure"). But in this case, the MSA meets both prongs, and therefore it presents an exceptionally strong case for Compact Clause review. All of the reasons noted above why the federal sovereignty prong is met establish that there is not merely the possibility of harm to the federal interest in enforcing the antitrust laws, but that the MSA directly replaces the federal norm of competition with a horizontal agreement to fix prices and divide markets under the direction of the major tobacco companies, with 46 State governments using the MSA to assure that competition is not restored. It is difficult to imagine any arrangement more inimical to the antitrust laws, and hence one for which a *Parker* exemption is less suited, let alone more suited for scrutiny as an "Agreement or Compact with another State," requiring congressional approval under the Compact Clause.

Despite this contrary authority, the court of appeals below, echoing the prior rulings of other courts, concluded that the Compact Clause was inapplicable because "the MSA only increases states' power *vis-à-vis* the [manufacturers that are also parties to the MSA] and not in relation to the federal government." Pet. App. A6. To be sure, the tobacco companies that are participants in the MSA are bound by it, and hence, under traditional contract law principles, their powers are limited because of their agreement with the States. But that can be said of every party to every contract, and, therefore, that conclusion either overlooks the substantial effects of the MSA on non-parties, including but not limited to the Federal Government, or it fails to understand that it is precisely those effects that the Compact Clause was designed to control by requiring approval by Congress of multistate agreements such as the MSA.

There is one other aspect of the MSA that makes it particularly pernicious. The tobacco companies included in the MSA a provision that no individual State would ever voluntarily support: the MSA had to be ratified by each State's legislature, and it had to bind not only the current State officials, but all future holders of those offices. Perhaps as a matter of some States' laws, that provision could not prevent the State from repealing its law agreeing to the MSA, but repeal would result in severe penalties imposed by the MSA for doing so. Even if withdrawal were possible as a matter of State law, current and future State officials would almost certainly claim that their hands were tied economically, if not legally, and thus they could do nothing to stop the participating tobacco companies from charging monopoly prices. It is only because 46 States joined the MSA that such a surrender of accountability and loss of democratic control by future State officials could take place, thereby providing another reason why Compact Clause approval is necessary. If Congress were to approve the MSA, at least there would be identifiable officials who would be accountable and to whom those who were being harmed by a congressionally-approved MSA could look to seek a repeal or modification of that approval. Furthermore, there would be no possibility of precluding future Congresses from repealing its approval prospectively since it is hornbook law that one Congress can not bind a future Congress, except by amending the Constitution. *United States v. Winstar Corp.,* 518 U.S. 839, 872 (1996) (quoting 1 W. Blackstone, Commentaries on the Laws of England 90 (1765)).

There is, of course, a reason why 46 States joined the MSA and agreed to eliminate competition in the pricing of cigarettes and to impose what is, in effect, a hidden tax on consumers of tobacco products: they were guaranteed to be paid billions of dollars over 25 years at a time when their budgets were in serious trouble and raising taxes would be politically hazardous to those seeking re-election. To be sure, the litigation against the major tobacco companies had produced very damaging evidence and four States had already obtained substantial monetary settlements, although none was based on anything like the MSA formula that relies on State-enforced suppressed competition to generate the funds used to make the annual payments to the States. There is nothing in the Compact Clause that would have prevented all 46 States from settling with the tobacco companies that had committed the wrongful conduct that made them responsible for the damages caused from the use of tobacco products, including a provision allocating the recovery among the States pursuant to an agreed-upon formula. Even if the parties agreed to have the payments spread over the future, so long as the amounts were calculated based on prior conduct, there would be no need for Compact Clause approval. But when States enter binding agreements to conduct themselves in certain ways in the future, that is a very different situation for Compact Clause purposes. And when there are very significant impacts on third parties and on the ability of the Federal Government to enforce the antitrust laws, approval of Congress is required.[5]

A word about the approach taken by the lower courts to the Compact Clause. Instead of the robust

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[5] An earlier settlement between various States and the major tobacco companies was submitted to Congress, but not acted on before it was withdrawn. Petition at 10. *Amici* recognize that a request to approve an agreement does not imply that the agreement is required to be submitted under the Compact Clause. *United States Steel, supra,* 434 U.S. at 458 n. 8 (submitted agreement, never approved, held not subject to Compact Clause). What is relevant about that prior submission is that the Federal Trade Commission raised serious antitrust objections to it and concluded that it would produce additional profits for the companies far in excess of the money needed to fund the settlement. *Id* .at n.6. Thus, it is far from clear that Congress would have approved the revised and much broader MSA.

provision that reverses the presumption that the States can pass whatever laws they want, unless expressly forbidden or preempted by federal law, the narrow view of the court of appeals on the Compact Clause means that it is essentially duplicative of the Supremacy Clause since nothing is required of States that wish to enter inter-state compacts except when they would be otherwise forbidden by federal law. Whatever the limits of the Compact Clause may be, it has a far larger role in assuring that agreements among States, such the MSA, do not interfere with overall federal interests and do not have significant impacts on other States and private persons.

* * *

This Court has not heard a Compact Clause case in more than 25 years since it decided *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System,* 472 U.S. 159, 162 (1985) (granting review in absence of a conflict because of importance of issues presented under the Commerce and Compact Clauses). The petition here presents a clear opportunity to consider the reach of that Clause in the context of an agreement that directly impacts and, we would argue, directly interferes with, the enforcement of the antitrust laws that are vital to maintaining free and open competition in the United States. The MSA affects a major industry and effectively permits the tobacco companies to engage in perpetual price-fixing and allocation of market shares, with the States precluded by the MSA from objecting or backing away from their agreement and by the massive annual payments on which they have become dependent. If this agreement is allowed a free pass, States will see it as a sign that they can be even more aggressive in substituting their judgments for those of Congress as to the national interest in matters that have significant consequences outside their borders. The Compact Clause reverses the basic presumption that the States are free to take whatever actions they want unless disapproved by Congress, by requiring congressional approval for significant interstate agreements. The Court should grant review in this case to make it clear that far-reaching agreements, like the MSA, must be approved by Congress and that the failure to obtain that approval here makes them unenforceable.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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