U.S. Department of Justice

Civil Division

Washington, D.C. 20530

MEMORANDUM

To: Robert D. McCallum
Associate Attorney General

From: Sharon Y. Eubanks
Director, Tobacco Litigation Team

Stephen D. Brody
Deputy Director, Tobacco Litigation Team

Date: May 30, 2005

Re: Smoking Cessation Remedy to be sought by United States in United States v. Philip Morris USA, No. 99-cv-2496 (GK)(D.D.C.)

Timetable: Closing arguments are tentatively scheduled for June 7-9, 2005

Introduction

This past Thursday evening, May 26, we met with you, Jeff Senger, Peter Keisler, Dan Meron, and Frank Marine for approximately two and one half hours. The meeting was set up after Dan Meron informed me that you wanted to weigh in, in particular, on the remedies we would ask the district court to impose. The main focus of that meeting was for the trial team to obtain your approval regarding precisely what remedies we would ask the district court to impose, assuming a finding of liability. In particular, and most extensively, we addressed the smoking cessation remedy. At the close of the meeting, although we discussed the matter at length, we had not resolved the extent or duration of the smoking cessation remedy. When we suggested that you simply tell us what we are authorized to request, rather than do that, you suggested another meeting; we scheduled that meeting for today, Memorial Day.

After a series of emails following our meeting on Thursday, today we met with you, Dan Meron, Frank Marine, and Jeff Senger (by phone) to continue the discussion. During this meeting,

you made it clear that the trial team may not make the argument in closing supporting a remedy that would include a 25-year cessation program. Without reviewing the evidence that supports our factual and legal arguments, you indicated that such a program would not in your view "prevent and restrain" future misconduct and further, should Judge Kessler impose such a remedy, it would result in a "sure-fire reversal on appeal." You expressed the view that "a reasonable cessation program for a particular reasonable dollar amount is necessary." Much of the discussion that followed centered around how we might make the evidence we have adduced at trial fit this new approach–a real challenge--since our plan had been to rely upon the Fiore/Bazerman Model (discussed further below). You told us that you did not find persuasive our arguments and that we "should not let perfect be the enemy of good enough." You made it clear that any effort that "reduced" the benefits to be realized by defendants from future fraud would be sufficient in your view, even if it did not fully "prevent" the fraud.

As you are well aware, we recommend that we ask the district court to adopt the cessation program largely as set forth in the testimony of Dr. Michael Fiore, which includes a duration of 25 years. During our meeting, you argued against that approach, suggesting that the trial court would not appear reasonable because 25 years was too long and also, that such a determination likely would be rejected on appeal to the District of Columbia Circuit.

Analysis

The major components of the smoking cessation remedy we propose include (1) a national tobacco quitline network that will provide universal, barrier-free access to evidence-based counseling and medications for tobacco cessation; (2) an extensive paid media campaign to encourage all smokers in the United States to quit using tobacco; (3) training and education to ensure that all clinicians in the United States have the knowledge, skills, and support systems necessary to help their patients quit tobacco use; and (4) a research component in order to develop therapies for hard to reach populations in order to achieve the 25-year goal. Dr. Michael Fiore, perhaps the foremost authority in the world on smoking cessation, has testified that a cessation program should be in place for 25 years in order to effectively allow all addicted smokers who wish to quit to do so successfully and to remove that portion of the market.

The legal argument in favor of a lengthy and sustained period for the cessation remedy can be explained succinctly here. The district court has received voluminous evidence, much of it in the form of defendants' own documents and the testimony of defendants' own executives, showing that defendants have long sought to develop and market cigarettes in order to keep smokers who want to quit from doing so. By way of example, the evidence admitted shows that defendants have long known that light cigarettes were viewed by smokers as an excuse not to quit and that defendants designed cigarettes and marketing campaigns to intercept quitters.[1/] The fact that Dr. Fiore, a well-respected expert in the treatment of tobacco dependence, did not specifically testify

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[1/]Philip Morris views smokers who want to quit as "a textbook example of a market opportunity." U.S.Ex. 38763. Furthermore, defendants specifically designed cigarettes in a way that would make it easy for addicted smokers to obtain a minimum dose of nicotine. See, e.g., U.S. Ex. 21829; 26072; 85075; direct testimony of William Farone at 84:16-86; 114:2-7; 124:4-125:3.

about how a national smoking cessation program will prevent and restrain the defendants' misconduct in the future simply does not bear upon the appropriateness of the remedy. Indeed, the evidence before the Court from the liability phase of the trial is sufficient for the Court to conclude that the program described by Dr. Fiore is both forward-looking and aimed at future violations.[2/] The factual record before the court demonstrates that eliminating the population of smokers who want to quit removes a market opportunity that has led to past and continuing fraudulent conduct by defendants. In particular, Dr. Max Bazerman, a Harvard Business School professor and expert in the field of behavioral decision research, gave testimony about the cessation program remedy that was unchallenged by defendants on cross-examination and has not been addressed by any of defendants' remedies witnesses.[3/] As Dr. Bazerman explained:

> Presently in the market place, there are smokers who want to quit and smokers who have quit that want to abstain from smoking. I have assumed that defendants are aware of this population of consumers of their products and defendants design and market light and low tar cigarettes to address this population. To the extent that effective cessation programs eliminate this population in the long term, or immunize this population against defendants' misleading marketing campaigns, they will also eliminate the incentives that encourage defendants to design and market cigarettes in ways intended to appeal to this population.

Bazerman direct at 65:7-14. Dr. Bazerman compared the effect of a cessation program on defendants' future behavior to recently enacted rules governing auditors:

> **Q: Among the recommendations for the court interventions you make in this case, are there any parallels to the recommendations you made in the context of the auditing industry?**
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> A: Yes, the first recommendation we made to the SEC, that auditing firms be prohibited from selling non-auditing services to their clients, was designed to address a market opportunity that provided an incentive for misconduct by auditing firms. There are two recommendations I have made in this case that are designed to

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[2/]The suggestion made at the meeting last Thursday that Dr. Fiore (and Dr. Bazerman) failed to address the requirements of RICO suggests a lack of understanding of evidence presentation at this trial. None of the witnesses for either side was called to the stand to recite case precedent or enforcement policies or practices regarding our use of RICO, nor would that have been proper or permitted by the district court.

[3/]Defendants have three witnesses on remedies remaining. We have received and reviewed the written direct testimony of each witness remaining and it appears unlikely that any remaining witness will address these issues and challenge the testimony of Dr. Bazerman on this point.

> address market opportunities that provide incentives for misconduct by defendants. Specifically, those incentives are eliminating the incentive to market to young people and requiring the defendants to fund counter-marketing and cessation programs. In the auditor context, the market opportunity for accounting forms was selling consulting services to their clients. In this case, the market incentive is selling cigarettes to children and to individuals who want to quit.

Id. at 39:19-40:6.

While some flexibility on our part may be warranted in order to address the concerns raised at our meeting, it is critical that we not abandon our strong evidence by supporting a watered-down approach to remedies. Supporting any approach to remedies which appears less than vigorous suggests to the district court a weakness in our evidence and wholly undermines our case. Any discussion of the cessation remedy that fails to even mention a 25-year program will send the message that we believe that our evidence is weak and that Dr. Fiore is not credible on this point. Moreover, there is nothing in the record, that is, there is no competing evidence, suggesting a shorter period. Stated simply, if we are to urge any period less than 25 years we need to do so with reason–citing to the record and making those arguments.

At the meeting today, we provided a one page summary of the smoking cessation remedy that the evidence supports that is a compromise, and that the trial team could easily support with evidence in the record and reference in closing arguments. We attempted to focus your attention to that document, which is attached (Attachment A); however, because you would not review the one page or discuss it with us at the meeting, it is presented here. To summarize what we proposed and which has been overruled without review: Any remedy that we propose must take into account whether defendants will act unlawfully in the future, noting that the district court has the power to impose reasonable restrictions that prevent and restrain violations of RICO. We could emphasize at closing that a 25-year program, as discussed by Dr. Fiore, eliminates a significant incentive for future fraudulent conduct. We could suggest a periodic review of defendants' conduct to assess the need for the program to continue to its full 25-year term. Accordingly, we could recommend to the court that the court or a court appointed monitor assess defendants' conduct after a period of 10 or 15 years in order to make a determination as to whether defendants should be required to continue funding the program. The assessment will be particularly appropriate if a judgment entered by the court prohibits defendants from using brand descriptors such as light, medium, and mild, or descriptors that are found similarly to convey health benefits where none exist. If the court or monitor find after 10 (or 15) years that, contrary to their past history of finding ways to circumvent laws, regulations, judgments, decrees, or agreements, defendants are not engaged in deceptive marketing and design practices, a recommendation and decision can be made that the program need not continue.

In bringing this proposal to the table, we honestly felt that it addressed many of the concerns raised last week; it is regrettable that no one would even review it on the spot and tell us where it went wrong. That said, we understand that it has been rejected and that we may not pursue it further.

To be defensible, any solution on remedies must be evidence based. What we represent to the court in terms of remedies should not be based in any way upon what happened or what was learned in settlement negotiations; this is a legitimate concern.[4] This concern arises because much of the discussion at our meeting last week focused on "sticker shock" in terms of the amount of money which would be needed to implement our smoking cessation program, and much of what was discussed clearly was derived from information that those present[5] at the settlement table received from the other side. To be clear: that is not evidence that has been introduced in our proceedings. Moreover, the comments from the bench and the interim rulings from the court addressing our cessation remedy indicate that Judge Kessler is at least receptive to, not put off by, a substantial remedy.

Our discussions last Thursday also were indicative of a departure from what we understood (and what notes taken at the meeting indicate) we discussed the last time that we met to address the status of settlement. Specifically, given the fact that defendants' settlement proposal was much lower than any amount that we felt appropriate, we agreed to pursue the litigation vigorously, obtaining a judgment if possible and then using that judgment to negotiate a settlement **before** an appeals court ruling. To be sure, this was one scenario discussed approvingly. The more recent conversations seem to ignore that strategy, instead focusing upon what might happen at the court of appeals. More to the point, if we have a substantial judgment, any settlement is likely to be more substantial. A decision to seek less substantial remedies when we have a record to support those remedies might suggest that our motivation is not proper, and that is a charge that we should avoid. We do not want politics to be perceived as the underlying motivation, and that is certainly a risk if we make adjustments in our remedies presentation that are not evidence based.

Because the court will give deference to the Department of Justice position – albeit acting independently[6] as the court must – we have an obligation to ensure that we urge remedies in this fully litigated case that are supported by the evidence in the record as a whole. All of this evidence we have fought very hard to get in, and we fought particularly hard to get the evidence

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[4]Notably, Frank Marine's May 25, 2005 memorandum references those negotiations when discussing what position we should take on a pharmacotherapy program. Even more alarming, however, was the comment today by Jeff Senger that "public opinion" would make it impossible for us to "drop that far" if Judge Kessler were to order too substantial a cessation remedy because it would interfere with the potential for settlement. The Tobacco Litigation Team has not to date proceeded with its prosecution of this case or repressed its advocacy in such a way as to leave open the hypothetical possibility of settlement. Based upon Mr. Senger's comment, it does not appear that we have all proceeded in the same manner, and this is of significant concern.

[5]No trial team representatives were present at the most recent discussions with the mediator.

[6]It is conceivable that the court will not order a remedy that it considers inadequate; however, we should not put forth one that we consider inadequate based upon the record evidence. The court of appeals has no authority to substitute its findings of fact for those of the trial court where the evidence is without conflict.

submitted through Dr. Fiore into the record. Although it is true that the Department of Justice has the right to dismiss a complaint or to negotiate a settlement, the right of prosecutorial discretion certainly lessens and arguably ends when a case such as this one, with almost nine months of testimony, is submitted for final judgment. The role of the court upon a finding of liability is to determine if the remedies we propose are appropriate, and one of our jobs is the assist the court in properly interpreting the decision of the D.C. Circuit.

The issues surrounding these remedies and what we proposed with Dr. Fiore's testimony were reviewed and approved in advance by management, and we were allowed to proffer his testimony without changes. In fact, during the same process, when it was suggested that we not alter Dr. Eriksen's testimony to reflect only what we would seek, that suggestion was rejected and we were informed that we would look "silly" proffering testimony from an expert that included remedies that we had no interest in adopting.[7] Dan Meron informed us that you insisted upon our making certain changes to conform Dr. Eriksen's testimony, and we did so. With no substantive changes suggested for Dr. Fiore, we have been proceeding with the expectation that we would ask the court to impose a 25-year cessation program, along the lines of what Dr. Fiore proposed. With closing arguments just a few days away, to now suggest these massive structural changes in our remedies case is unrealistic and jeopardizes our ability to present a coherent approach; we do not view it as supportive of our efforts or of the case, and it is not necessary as a matter of RICO law. Because of the timing and the significant changes imposed, it is our intent to ask the district court to delay the schedule for closing arguments. A postponement until the week of June 20 will allow for additional time to implement your directed changes to our remedies presentation.

As to those directed changes, the cessation remedy you have proposed will create an incentive for defendants to engage in future misconduct by making the misconduct profitable. Specifically, you have suggested that we ask the Court to order defendants to pay for a cessation program that will allow one quit attempt for each smoker found in ensuing years after district court judgment to have: (1) started smoking as an adolescent due to defendants' fraudulent conduct; or (2) switched from regular cigarettes to light cigarettes due to defendants' fraudulent conduct. Scientific evidence, which is in the record before the Court and has been cited as persuasive by Dr. Fiore, suggests that approximately 20% of those smokers who participate in a program will quit successfully. Therefore, defendants will realize profits from the remaining 80% of all smokers they are able to fraudulently induce to begin or continue smoking. Assuming that 3 million smokers fall into the categories of smokers identified above, defendants will have to pay approximately $2 to $2.5 billion for cessation services, which will result in 600,000 successful

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[7]Attachment B is an email transmission from Dan Meron, rejecting the suggestion of the trial team Director that written direct testimony of an expert be proffered as drafted even if it contained proposed remedies that the United States would not necessarily request the court to impose. Mr. Meron noted that you had rejected that approach "because we feel that having the witness testify about it in his prepared, for us to then disown it, in effect, in our legal briefs, just is **embarrassing and calls more attention to the problem.**" Attachment B (emphasis added). On the same day, the trial team Deputy Director submitted the proposed testimony of Dr. Fiore, which we were allowed to file as prepared. The note back from Mr. Meron indicated "this is very strong" and contained no criticisms or suggestions for change. Attachment C.

cessation attempts. Defendants will realize $18 billion over a 15-year period from the remaining 2.4 million smokers who are smoking due to defendants' fraud. Accordingly, if we are to recommend the cessation remedy as you have formulated it, we will create a $15-16 billion incentive for defendants to engage in fraudulent activity by making it profitable to do so.

Unfortunately, addressing the foregoing problem by coupling the proposed cessation program with fines for findings of continued misconduct merely highlights the failure of the cessation program to prevent and restrain future wrongdoing by divorcing it from any impact on defendants' conduct. Indeed, if contempt sanctions are necessary to account for the failure of the cessation remedy to prevent and restrain future unlawful activity, appellate review will focus on the inadequacy of the cessation component and reversal on appeal will be likely. That is, the Court of Appeals will ask whether the cessation component prevents and restrains unlawful conduct. The answer to that question will be a resounding "no," made all the more apparent by the need to impose fines to counter the fact that the cessation program will increase the incentive for defendants to commit fraud. As Judge Williams observed in his concurring opinion, "the court must try to draw lines between equitable remedies that merely 'hurt' the defendant and ones that have a genuine tendency to 'prevent and restrain' his future violations." 396 F.3d at 1204.

Another difficulty is supporting the idea that all switchers change cigarettes due to the mistaken belief that lower tar levels are associated with lesser disease risks. The Court must therefore determine – or ask a monitor to determine – a reasonable approximation of the number of smokers who switch for such reasons. The Court must then make a determination of the number of those smokers who held their mistaken belief that light cigarettes offered health benefits as a result of defendants' fraudulent conduct. There is not evidence in the record to support such determinations. Moreover, the Court has expressed its strong aversion to any remedy that requires extensive, continued monitoring, such as the annual trials on the issue of the number of new smokers and switchers attributable to defendants' fraud that would be required if your proposal were adopted by the Court.

Conclusion

In the end, we do not believe it is possible to argue convincingly that the cessation remedy as you have proposed it is designed to prevent future unlawful activity, but we will follow your ultimate direction in our presentation. In that these sweeping changes are being imposed by you after the close of our evidence, it will take some time to locate what record evidentiary support we have for what we must now argue. Within 48 hours, we will provide you with a draft structure that we believe you want us to present at closing, based upon our recent discussions.

/s/ Sharon Y. Eubanks
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/s/ Stephen D. Brody
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