

# FROM THE SWORD TO THE PEN: A HISTORY AND CURRENT ANALYSIS OF U.S. TOBACCO MARKETING REGULATIONS

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## I. INTRODUCTION

In Henry County, Virginia, a place where generations have grown flue-cured tobacco, there is a noticeable difference these days when one looks into the

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curing barns. Darrell Jackson, 43, is now attempting to settle into these dynamic times. He along with other farmers now operating in the free market have changed types of tobacco from the flue-cured, as was required under the federal tobacco program for their area. They have instead chosen burley tobacco, as it has potential to sell more in a direct marketing contract and is an easier harvest on the grower.<sup>1</sup> The reason that burley is a more attractive alternative is due to its production nearly dropping in half after the buyout, as many family farms simply left the business.<sup>2</sup>

This is a newfound concept for Mr. Jackson and his brethren. As the farmers are now forced to respond to the free market instead of taking their direction from the Secretary of Agriculture through the law and regulations of the federal tobacco program. Gone are the days of the bustle of the auction warehouse, as the only thing left of the American tobacco auction would be the nostalgic diatribes of those intimate with such settings.<sup>3</sup> The new industrialized system has set upon the tobacco fields in sheer 1984-style, similar to the business organization that has created a stripped down streamline market in the chicken and hog industry. The cry of the auctioneer has been replaced with the sound of a scribe swaying his pen upon a contract. This departure from the more traditional ways, at least the way it has been done since the 1930s, is mostly due to the changing attitude of Americans toward tobacco and farm subsidies as a whole.

America was historically enamored with tobacco and this can be felt in some areas of the foothills of the Mid-Atlantic Appalachian Trail region where the last relics of domestic tobacco still hold to the soil. However, the popular cultural tide as a whole has seemed to go against the historical golden leaf with the recent development of the new term "nonsmokers' rights."<sup>4</sup> This term, along with expanded research into Environmental Tobacco Smoke ("ETS" or second-hand smoke), has led to smoke-free airplanes, airports, restaurants, nightclubs, and workplaces.<sup>5</sup> This comes in the midst of contemptuous flurry over tobacco

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1. Christina Rogers, *Smoking Out a New Venture*, DAILY PRESS (Newport News, Va.), Oct. 30, 2006, at C2.

2. *Id.*

3. See *Review of the Impact of the Proposed Tobacco Settlement on Producers: Hearing Before the Subcomm. on Risk Mgmt. and Specialty Crops*, 105th Cong. 45 (1998) (statement of the Honorable Dane Perkins, Superior Court Judge from Nashville, Georgia speaking of the time when he was little growing up at the tobacco auction and about the abundance of people that would gather at the auction warehouse).

4. STANTON A. GLANTZ ET AL., *THE CIGARETTE PAPERS* 391 (1998) (detailing the nonsmokers' rights movement).

5. See Institute of Medicine, *Clearing the Smoke: Assessing the Science Base for the Tobacco Harm Reduction* 1 (2001). This was distributed to all new Philip Morris U.S.A. interns

rising to the level of the asbestos and lead paint scares of recent decades, as even tobacco growing states enact laws curbing smoking and place burdensome sin taxes upon the product.<sup>6</sup> As in any situation in which there are non-mutually exclusive categories, there will be a balance that is shifted. Therefore, the rise of “non-smokers’ rights” and the dissipation of locales to smoke have led to a decrease in the social acceptability of tobacco smoke and positively correlated a drop in demand for tobacco. This has created an aftershock that travels down the domestic tobacco production line, where the high of the wave crashes heavily on the tobacco farmer and those dependent entities and communities.

This article will examine the historical significance of the economics of tobacco in America and an effort to keep the market afloat despite contentious moments in our nation’s history, both in general and specifically with regard to the tobacco industry. The journey will start with the first settlers in the New World, to the rise of cigarette manufacturers, to the regulating of the tobacco industry, to the Master Settlement agreement and the cracks in the federal tobacco program that led to the tobacco quota buyout. The article will be concluded with a look to the future of the domestic tobacco market and its producers as well as former producers.

## II. THE CIGARETTE TOBACCO

As an introductory matter, the defining of varieties of tobacco will lead to an effective focusing of this paper. Historically, the Department of Agriculture has defined seven foreign-grown tobacco classes: “flue-cured, fire-cured, air-cured, cigar-filler, cigar-binder, cigar-wrapper, and miscellaneous domestic.”<sup>7</sup> Cigarettes became the most popular use of domestically-produced tobacco since the turn of the 20th Century, which generated increased production in flue-cured and air-cured tobacco within Kentucky, Tennessee, and Mid-Atlantic region states.<sup>8</sup> The bulk of tobacco produced under the program was of the flue-cured

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during orientation in summer of 2004, which was the same summer that this author worked in the law department as an intern.

6. See Smoke Free World, Smoke-Free USA, <http://www.smokefreeworld.com/usa.shtml> (last visited Oct. 21, 2008); see also Non-Smoker Protection Act, TENN. CODE ANN. 39-17-1801, 1802 (2007) (mandating that all restaurant and bar establishments will go smoke-free as of October 2007, unless they are establishments that only admit those twenty-one or older at all times of operation).

7. HAROLD B. ROWE, TOBACCO UNDER THE AAA 29 (1935).

8. CHARLES KELLOGG MANN, TOBACCO: THE ANTS AND THE ELEPHANTS 27 (1975) (explaining that the tobacco harvest is heavily concentrated amongst seven states).

and air-cured burley tobacco variety to meet the demand of tobacco companies,<sup>9</sup> so the bulk of this analysis will cover these specific types.

Flue-cured tobacco derives its name from the curing process that is involved.<sup>10</sup> The leaves are primed or individually removed from the stalk, stored in a barn with a furnace or heat source, and the leaves are cured as the smoke through an "iron flue" in the roof, thereby giving the leaf a distinctive bright gold hue.<sup>11</sup> This has also given the flue-cured tobacco the more common industry name of "bright."<sup>12</sup> In recent years, the bulk of the flue-cured tobacco is derived from North Carolina.<sup>13</sup>

The other tobacco type mostly focused on in this paper, air-cured tobacco, was mostly harvested in Kentucky.<sup>14</sup> The particular type of air-cured tobacco that is used in cigarettes is Burley, type 31, which is one of two types of light air-cured tobacco.<sup>15</sup> In comparison to the flue-cured tobacco, Burley is cut by the entire stalk and hung in a flue barn, where it is not aided by an artificial heat source.<sup>16</sup>

Flue-cured and fire-cured<sup>17</sup> have shaped prominent parts of our American legislative history through their use in cigarettes. The bulk of this paper will deal with the history associated with the production of bright flue-cured tobacco and the darker air-cured burley type. As noted from the story that opened this article, the traditional regions for the various types of tobacco were based on geographic boundaries created by the federal tobacco program, which are both now non-existent.

### III. "ANCIENT" HISTORY OF UNITED STATES TOBACCO

This is a tale of America's first cash crop.<sup>18</sup> Just a short one-hour drive down from the current Philip Morris U.S.A. headquarters in the west end of

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9. JASPER WOMACH, CONG. RESEARCH SERV., TOBACCO PRICE SUPPORT: AN OVERVIEW OF THE PROGRAM 12 (2005) (hereinafter "TOBACCO PRICE SUPPORT") (citing about ninety-four percent of U.S. Tobacco Production is one of the two defined types).

10. ROWE, *supra* note 7, at 30.

11. *Id.*

12. JOSEPH C. ROBERT, THE STORY OF TOBACCO IN AMERICA 183 (1949).

13. TOBACCO PRICE SUPPORT, *supra* note 9, at 2, 4.

14. *Id.* at 2.

15. ROWE, *supra* note 7, at 31. The other type of light air-cured tobacco is Southern Maryland or Type 32. In addition, there are other types of dark air-cured tobacco.

16. *Id.* at 31-32.

17. *Id.* at 31. The other type of tobacco is fire-cured, which is mostly made in Kentucky and Tennessee and is mostly used in cigar and snuff.

18. See WILLARD W. COCHRANE, THE DEVELOPMENT OF AMERICAN AGRICULTURE: A HISTORICAL ANALYSIS 14 (2d ed. 1993).

Richmond, Virginia is Jamestown, where tobacco became the much sought-after crop of a burgeoning nation. In 1607, a group of Englishmen led by Captain Christopher Newport,<sup>19</sup> commissioned by the Virginia Company, dropped their anchors in the James River and landed in a heavily wooded area with only an instruction to create a settlement.<sup>20</sup> The idea of a settlement quickly turned into a more rustic version of any late night infomercial, get-rich-quick scheme. The settlers had visions of great profits, so they raked the area for gold or other treasures, and completely neglected the idea of creating agricultural and settlement stability.<sup>21</sup> The first years of the “settlement” led to many dashed dreams as settlers were either starving, being killed by the native people of the area, or just returning home with empty pockets and heavy heads.<sup>22</sup> The only thing that held the settlement together was the constant influx of new settlers with more resources that came to participate in the “treasure hunt.”<sup>23</sup>

It was during this desperate time, that our now vilified hero came onto the American scene. A young settler by name of John Rolfe created a hybrid form of tobacco from a Spanish type of tobacco and the native tobacco, which he helped cultivate by placing dead fish in the soil where the tobacco grew.<sup>24</sup> The first sampling of the new tobacco or the “golden weed” was sent back to England in 1614.<sup>25</sup> In the following years, the settlers as a group became more cognizant of the need for agriculture. They had gained great insight from the local Native American tribe in planting corn to avoid starvation, and tobacco, which could be exported back to England to provide a fluid economy in the settlement.<sup>26</sup> The prospects of great wealth were in tobacco, not corn, and this became apparent in the planting habits of many of the colonists. Tobacco was planted at hysterical rates, virtually being grown everywhere that was moderately feasible, even planting in the streets and the cemeteries. Tobacco was so popular at the time that it was actually used as a form of currency, where one could even purchase a bride

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19. Newport News, Virginia, the author’s hometown, was named after Captain Christopher Newport. See Newport News Tourism Development Office, <http://www.newport-news.org/about-our-city/faqs.html> (last visited Nov. 18, 2008). There is also a Commonwealth of Virginia public university named after the captain in Newport News, Virginia, aptly named Christopher Newport University (CNU).

20. COCHRANE, *supra* note 18, at 13.

21. *Id.* at 14.

22. *Id.* at 13-14.

23. *Id.* at 13.

24. See generally RICHARD KLUGER, *ASHES TO ASHES: AMERICA’S HUNDRED-YEAR CIGARETTE WAR, THE PUBLIC HEALTH, AND THE UNABASHED TRIUMPH OF PHILIP MORRIS* 11 (1996).

25. Jamestown Settlement and Yorktown Victory Center, <http://www.historyisfun.org/jamestown-chrono.htm> (last visited Nov. 18, 2008); see *id.* at 8-11 (for an intricate working of the Rolfe story).

26. COCHRANE, *supra* note 18, at 14.

by tendering one hundred and twenty pounds of Virginia leaf.<sup>27</sup> In response to the crazed planting, Thomas Dale, the Deputy-Governor, ordered that no man could plant tobacco in a season, unless he planted and maintained two acres of corn for sustenance in that same season.<sup>28</sup> Deputy-Governor Dale placed the first production control on tobacco, not as a measure of price support, but rather for fear of a similar starvation period that occurred during the infancy of the Jamestown settlement.<sup>29</sup>

Across the Atlantic, tobacco was already quite popular in England when shipments began coming from Jamestown, due to the Spanish Colonies' previous imports from the "New World."<sup>30</sup> Therefore it was extremely profitable for the settlers and the Virginia Company; however it became cumbersome and dangerous to ship out of the Jamestown settlement due to Native American attacks.<sup>31</sup> In order to protect its popular investment, King James I<sup>32</sup> revoked the company's charter that funded the Virginia expedition and made the settlement a royal colony subject to direct control of the Crown.<sup>33</sup> The new found control in the Crown spun the reckless wheels of supply and demand into a mono-market with complete vertical integration. The English government gave a monopoly on growing tobacco to the newly formed Virginia Colony by prohibiting tobacco cultivation within England, giving generous land grants to "gentry and yeoman" and London merchants gave supplies on credit for tobacco cultivation.<sup>34</sup> The growers, through the "subsidized" programs set up by the English government, exploited and exhausted the land and exploited the new slave labor as it continuously cropped tobacco.<sup>35</sup> It was obvious that the Jamestown settlers and England found its long

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27. ROBERT, *supra* note 12, at 35. A controversy over a person's payment in tobacco and the royal veto in 1758 allowed a young patriot in the middle of Virginia named Patrick Henry to rise to prominence and defend American rights.

28. See COCHRANE, *supra* note 18, at 22.

29. ROBERT, *supra* note 12, at 8.

30. COCHRANE, *supra* note 18, at 22.

31. *Id.* at 14.

32. Interestingly, James I was one of the first anti-smoking advocates as he referred to smoking as "[a] custome lothsome to the eye, hatefull to the Nose, harmefull to the braine, dangerous to the Lungs, and the blacke stinking fume thereof, nearest resembling the horrible Stigian smoke of the pit that is bottomlesse," in his manifesto. See JAMES I, A COUNTER-BLASTE TO TOBACCO (1604), available at [http://worldlibrary.net/eBooks/Renascence\\_Editions/James1.html](http://worldlibrary.net/eBooks/Renascence_Editions/James1.html).

33. COCHRANE, *supra* note 18, at 14.

34. KLUGER, *supra*, note 24, at 11. In exchange for the monopoly, the growers were required to ship the crop to Great Britain exclusively and on a ship flying the British flag; this gave the merchants in London a monopoly on the reshipment.

35. See COCHRANE, *supra* note 18, at 22-23. Due to the limited agricultural methods of the time, most harvesting was done by hand, which increased the demand for labor. It was this push that helped set up the slave trade – suggesting that the newly imported slaves kept labor costs down. "The first black men were sold in Jamestown, Virginia by a Dutch Slaver in 1619."

sought treasure in the “golden weed,” which was being shipped into London at about 1.4 million pounds annually by 1640.<sup>36</sup>

The promise of economic prosperity led to a virtual exhaustion of the land and its resources, and an abundance of tobacco. The over-production of the crop was one reason that led to a severe depression in tobacco country between the years 1660 through 1680.<sup>37</sup> Another factor that created this depression was the enforcement of the Navigation Acts that were created in the 1620s, which restricted the shipment of tobacco and other “enumerated articles” to England and its dominion.<sup>38</sup> Therefore, the producers had nowhere to send the tobacco, unless they surreptitiously shipped products.<sup>39</sup> The tobacco colonies abided by the Navigation Acts and seemed to accept a more adolescent economic theory that one just needs to produce more tobacco to sell more. The “plant more” mindset fostered an environment that allowed further devastation of the land, importation of a greater number of slaves, and an increase in debt from more credit being extended.<sup>40</sup>

The depression in the tobacco colonies of Virginia, Maryland, and Carolina prompted the first formal attempt to control production, supplying the first semblance of an attempted marketing order<sup>41</sup> for tobacco.<sup>42</sup> The three colonies agreed not to cultivate tobacco for one year beginning February 1, 1667.<sup>43</sup> This strategy was chosen to lower the supply, thereby inversely increasing the demand

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36. ROBERT, *supra* note 12, at 10.

37. *Id.*

38. *Id.* at 10-11. The shutdown of the British market was devastating mostly due to the previous monopoly terms that required such dependence on the British market.

39. *See id.* at 11-12. New England and New York shippers were the brazen few who deviated from the obedience to the Navigation Acts as they shipped to other ports in England after keeping crop back in their own warehouses, thereby by-passing English customs. In an effort to halt this method, Parliament passed a tax of one penny on all “enumerated articles” shipped between colonies.

40. KLUGER, *supra*, note 24, at 12. Some historians believe that a more silent, however compelling, reason for the American Revolution was to avoid the debts owed to British creditors since tobacco accounted for seventy-five percent of the total value of goods exported from Maryland and Virginia in recent years prior to the Revolutionary War. *See also* ROBERT, *supra* note 12, at 44.

41. *See* Inst. for Trade & Com. Dipl., [http://www.itcdonline.com/introduction/glossary/1\\_klmn.html](http://www.itcdonline.com/introduction/glossary/1_klmn.html) (last visited Nov. 18, 2008) (explaining that Marketing Orders are an agreed-upon guidance within an industry to regulate quality of the product, and timing of marketing to enable consistency within the market and to maintain prices at high levels while restricting supply).

42. National Commission on Marihuana and Drug Abuse, History of Tobacco Regulation, [http://www.druglibrary.org/schaffer/library/studies/nc/nc2b\\_2.htm](http://www.druglibrary.org/schaffer/library/studies/nc/nc2b_2.htm) (last visited Nov. 18, 2008).

43. ROBERT, *supra* note 12, at 11.

of tobacco and the price.<sup>44</sup> Lord Baltimore opposed the measure, which led to its failure, as he felt it was discriminatory of Maryland's northerly location, the poorer farmers, and the direction of the Crown.<sup>45</sup> Far from a trained economist, Lord Baltimore had an ill-informed view of the social and economic trends that led to the tobacco country depression.<sup>46</sup> He stated, "it is not from the low price of [t]obacco, but from their owne sloth, ill husbandry, and profusely spending their crops in Brandewine, and other liquors."<sup>47</sup> As future events ironically show, perhaps if the tobacco farmer had spent more time with the drink and less time with the crop, all may have benefited.<sup>48</sup> In 1682, the Virginia General Assembly failed to implement any production control methods, so local farmers destroyed their own crops and the crop of their neighbors.<sup>49</sup> This was one of many plant-cutting riots by the "[p]luckers and [c]utters,"<sup>50</sup> which continued until some of its leaders were arrested.<sup>51</sup> This terrorist method actually helped to increase prices, as their slashing weapons crudely exemplified the classic supply and demand curve.<sup>52</sup>

A forced migration of many English and Scotch-Irish pioneers into North Carolina in the middle of the eighteenth century occurred due to the land depleting effect of a tobacco crop.<sup>53</sup> However, land was thought to be plentiful and expendable, and the relentless cropping did not cease upon the entrance into

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44. *See id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *See id.* at 14-15. It was around this time, in 1673, that a penny-per-pound tax was assessed to all tobacco to be exported from Maryland and Virginia to another colony for the benefit of college that was chartered by England to be opened in the Virginia Colony, which was the College of William and Mary. According to Benjamin Franklin, one proponent of the tobacco tax said that the school would be for the ministry, and that Virginia had souls that needed to be saved, which prompted a rebuttal from his rival, "Souls! [d]amn your [s]ouls. Make [t]obacco!"

49. *Id.* at 11. Maryland also had a significant plant-cutting riot that was result of a satisfactory tobacco inspection act not being passed. Additionally, there were other rebellions, such as Bacon's Rebellion and Culpeper's Rebellion, which were not directly linked to tobacco price, but were rather a by-product of depressed regions.

50. *Id.* at 11. This was the title given by William Fitzhugh, an extremely successful tobacco planter in the tidewater region of Virginia in the late 1600s, to the group that practiced these non-traditional methods of production control.

51. *Id.* at 12 (These groups operated in various Virginia colony counties and were quite successful as they eliminated about 10,000 hogsheads, which is the shipping unit of tobacco that is used even in the present day).

52. *Id.*

53. JOHN K. WINKLER, TOBACCO TYCOON: THE STORY OF JAMES BUCHANAN DUKE 5 (1942); *see also* COCHRANE, *supra* note 18, at 74 (explaining that tobacco cannot be produced for more than three or four years in a row because of the damaging effect the crop has on the soil.).

North Carolina.<sup>54</sup> This trend continued into the Revolutionary War era until much of the Virginia and North Carolina countryside and tobacco crop was destroyed by the British soldiers as they marched the land.<sup>55</sup> An example of this is shown in the time period of 1780-81, referred to by many as “the tobacco war”, when General Cornwallis torched over ten thousand hogsheads in the area around Petersburg, Virginia.<sup>56</sup>

Tobacco caused even more controversy in the years immediately following the Revolutionary War. Following the Treaty of Paris, Britain demanded immediate payment upon all debts due and owing associated with tobacco production and exportation in the years preceding the Revolutionary War.<sup>57</sup> Many of the Virginian farmers, mostly growing tobacco, felt that debts did not have to be paid in light of the destruction done to their countryside by the British troops.<sup>58</sup> This became a bone of contention in the Constitutional Convention regarding the possible ratification because many farmers wanted there to be a provision prohibiting enforcement of the debts.<sup>59</sup> There was no forgiveness provision included in the Constitution, and the debts were reaffirmed in *Ware v. Hylton*, 3 U.S. 199 (1796).<sup>60</sup> This domestic concern regarding the payment of British debts coincided with the bottom falling out of the world tobacco market in the early 1800s, which also became a domestic concern as U.S. tobacco farmers were over-cropping the lands once again.<sup>61</sup>

The downward turn of the tobacco market made room for cotton to be “king.” Additionally, as more and more land was being exhausted, the pioneers were preparing for the inevitable nomadic travels into the Deep South. The migration of settlers, the steadily growing importation of slaves, and the advances in technology, such as the cotton gin, created more profit in such labor-laden crops

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54. COCHRANE, *supra* note 18, at 50, 75. Some pioneers, became “farmers” and stewards of the land when they tried to conserve the land by developing crop rotation with grains and clover to put nitrogen back in the soil, using lime and guano fertilizer, plowing deeper, and introducing animal agriculture.

55. *See* ROBERT, *supra* note 12, at 43-44.

56. *Id.* at 44.

57. *Id.* at 44-45.

58. *Id.* at 46 (Thomas Jefferson presumably had his entire debt written off due to state sequestration laws and Cornwallis’ destruction of his Elk Island tobacco plantation.).

59. *Ware v. Hylton*, 3 U.S. 199 (1796); *see also id.* at 47.

60. *See id.* at 47-48. John Marshall argued on behalf of the Virginia farmers in a losing effort as the Court interpreted the Virginia sequestration law as invalid in light of the treaty with Britain.

61. COCHRANE, *supra* note 18, at 50; *see also id.* at 48 (citing that evidence suggests the U.S. tobacco farmers were over-cropping to pay for the old debts to Britain that were being enforced as federal courts were ruling in favor of British creditors which led to the bankrupting of traditional aristocratic families).

as cotton.<sup>62</sup> Tobacco had lost its favor amongst the pioneer farmers during this time as it lost its main incentive of providing a profit.<sup>63</sup> In addition, there was a resurgence of the anti-tobacco movement amongst the youth in the cities, which culminated in an essay entitled *A New Counterblast* published in *The Atlantic Monthly* in 1861, that was more cautious in tone and spoke to everyone in a straight-forward manner.<sup>64</sup>

Tobacco may have lost its popular favor, but it was far from extinct in the new America that was formed during the years preceding the Civil War. Much of the tobacco during mid-nineteenth century was marketed through factors or agents in port cities such as New York City, where it was sold to wholesalers, then to retailers and finally to the consumer.<sup>65</sup> This set up a system where fifty percent (50%) of all tobacco produced and eventually manufactured in the tobacco heavy states of North Carolina and Virginia was to be transported and sold through New York City.<sup>66</sup> This was the North/South interdependence that could have proved fatal for tobacco farmers during the impending Civil War.<sup>67</sup> The producers got a glimpse of this during the Panic of 1857 when a factor from New York returned unpaid acceptances drawn by Southern manufacturers.<sup>68</sup> The farmers accused the factor of boondoggling and held a convention in Richmond that allowed a more calm response of reforming the transactions with the factors and lower commissions, while withdrawing the initial imputations of fraud.<sup>69</sup>

#### IV. NOT YOUR FATHER'S ANTEBELLUM TOBACCO FARM

Tobacco farmers were stricken to poverty within the southern heat following the Civil War, as they were at the mercy of creditors.<sup>70</sup> This was mainly due to the heavy subject of the gold standard falling the way of the creditor in the

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62. See COCHRANE, *supra* note 18, at 50 (“[t]he invention of the cotton gin by Eli Whitney made it possible for a slave to clean as much as fifty pounds of cotton a day instead of just a few pounds.”).

63. See *id.* at 71. Tobacco farmers adapted to the situation of the tobacco market waning by supplementing the farm income with the exportation of slaves into the Deep South to work on the cotton farm.

64. ROBERT, *supra* note 12, at 111-112. This was a major issue with children in New York City, who could often be found mastering the arts of chewing and smoking at a young age.

65. *Id.* at 93.

66. *Id.*

67. See *id.* at 94.

68. *Id.*

69. *Id.*

70. See TRACY CAMPBELL, *THE POLITICS OF DESPAIR: POWER AND RESISTANCE IN THE TOBACCO WARS* 6 (1993).

subsequent years of the Civil War.<sup>71</sup> Congress funded the war from 1861 to 1865 by issuing greenbacks, which was currency that was not backed by gold.<sup>72</sup> It was simply money created by legislative fiat that possessed no intrinsic value, which heightened susceptibility to inflation.<sup>73</sup> This led to a volatile and urgent situation that the legislators had to settle. On one hand there were debtors, mostly farmers, desiring to expand currency to allow prices to catch up with inflation, and on the other hand were banks, creditors, who wanted to constrict the nation's money supply in order to get a hold of the bucking inflation.<sup>74</sup>

The moral to this story is that the farmer does not win when big money is at issue. Congress agreed with the creditors and tightened the flow of currency by discontinuing the greenbacks, thereby reinstating the gold standard and sending the farmers into a whirlwind of mounted debt and literally pieces of paper from which to pay for it.<sup>75</sup> Most farmers responded to this crisis in the only plausible means by which they could pay off anything – by planting and harvesting more of their crop.<sup>76</sup> This only greased the heavily tilted slide that commodity prices were experiencing following the congressional action of terminating the acceptance of greenbacks.<sup>77</sup> Tobacco prices dropped from \$0.116 per pound for tobacco in 1866 to \$0.054 per pound in 1877, which was a downfall from which many farmers were not able to recover, thereby forcing the forfeiture of many farms to creditors during the end of the nineteenth century.<sup>78</sup> The larger farms that maintained through the crisis bought most of the smaller farms that were foreclosed upon through auction.

However, despite the consolidation of ownership of the tobacco farms, during these times the marketing of the tobacco was still open to various viable channels. A producer could either take the tobacco to a shipper in order to get the product to a bigger city in the vicinity, or direct sell to buyers either at a local

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71. *See id.* at 7.

72. *Id.* at 6-7.

73. *Id.* at 7 (inflation rate rose seventy-nine percent between 1861-1865).

74. *Id.*

75. *Id.* The currency rate was set to pre-war levels in order to counter inflation and align with the supply of gold, which is a method to base the value of the currency.

76. *Id.* at 19.

77. *Id.* at 7, 8. Campbell also explains that another reason for farmer's plight during these times was the lack of financing options since there were few banks in the South due to restrictions established in the National Bank Act (NBA) of 1863 that limited state-chartered banks in the South. In addition, only 69 of the 1,545 national banks were located in the Southern States. This led to a rise of "furnish merchants," Southern shopkeepers funded by Northern interests, who would take advantage of the potentially monopolistic opportunity by charging steep interest rates.

78. *Id.* at 18-20.

warehouse<sup>79</sup> or his barn.<sup>80</sup> These marketing options were to go to the wayside in the wake of the big tobacco companies dictating the producer market through the manufacturing industry power jostle.

#### V. WELCOME BIG TOBACCO

The creditors in the tobacco farming states would have owned the majority of the tobacco farms in the respective areas, but there was no incentive in owning farms that were not profiting due to all of the issues affecting tobacco growers in the late nineteenth century. This scenario left a gap for an opportunistic individual or entity to make money if they had the investment funds. In stepped the American Tobacco Company<sup>81</sup> from New York City in the year 1889 to take over the bulk of the tobacco industry, as it eventually controlled eighty-six percent of all domestic cigarette manufacturing.<sup>82</sup> Led by one of its prominent members, James Buchanan Duke from Durham, North Carolina who took over the successful W. Duke and Sons firm from his father in the 1880s, the goal of the American Tobacco Company was to convert the primary usage of tobacco into cigarette production and to virtually control all aspects of the tobacco industry.<sup>83</sup> The foresighted cigarette production goal of James B. Duke was even more viable since W. Duke and Sons secured the patent on James A. Bonsack's mass-producing cigarette machine<sup>84</sup> before entering into the American Tobacco Company merger.<sup>85</sup> As for the other goal, Duke worked in very shrewd ways to push out over 250 tobacco manufacturers in just a few short years.<sup>86</sup> He created an agreement with the Imperial Tobacco Company to control export tobacco in the

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79. ANTHONY J. BADGER, *PROSPERITY ROAD: THE NEW DEAL, TOBACCO, AND NORTH CAROLINA* 15 (1980); *see also* ROBERT, *supra* note 12, at 68-69. The auction system began in Virginia in the early nineteenth century because of the need for inspections because of questions regarding the quality of tobacco that was being transacted. In addition, this seemed like a new improvement on marketing tobacco as buyers began noticing subtle differences in type and quality of the leaf.

80. BADGER, *supra* note 79, at 10.

81. ROBERT, *supra* note 12, at 145-46. An agreement in 1889 merged W. Duke & Sons Company, Kinney Tobacco Company, Allen and Ginter, W. S. Kimball & Company, and Goodwin & Company into the American Tobacco Corporation.

82. CAMPBELL, *supra* note 70, at 23.

83. *Id.* at 21-22. W. Duke & Sons specialized in plug and chewing tobacco until James B. Duke took over the leadership of the company.

84. KLUGER, *supra*, note 24, at 20.

85. CAMPBELL, *supra* note 70, at 22-23, 73.

86. Duke's methods of purchasing stocks in other companies and concentrating power were ingenious and unrelenting. A detailed summary of these dealings can be found in the case brought by the U.S. government against the tobacco industry of the day. *See U.S. v. Am. Tobacco Co.*, 221 U.S. 106, 156-61 (1911).

U.S., which led to the formation of the British-American Tobacco Company to eliminate all major international competitors.<sup>87</sup> After many acquisitions, Duke's companies accounted for "86% . . . of all the cigarettes produced in the United States, above 26% of all the smoking tobacco, more than 22% of all plug tobacco, 51% of all little cigars, 6% each of all snuff and fine cut tobacco, and over 2% of all cigars and cheroots."<sup>88</sup>

One of the largest acquisitions for James B. Duke was the takeover of a company created by a Southern tobacco businessman named Richard Joshua Reynolds that was the major player in the plug and twist chewing tobacco market.<sup>89</sup> R.J. Reynolds was located in the "bright belt"<sup>90</sup> city of Winston,<sup>91</sup> North Carolina, which was in close proximity to Duke's American Tobacco Company in Durham, North Carolina.<sup>92</sup> Forty percent of all flue-cured tobacco was produced between the three North Carolina cities of Winston, Kinston, and Greenville, which created the "new belt."<sup>93</sup> The success and location of the company caught the ever opportunistic eye of Duke, who was then in New York.<sup>94</sup> Due to R.J. Reynolds' need for northern capital and the strength of Duke's monopoly that mimicked Rockefeller's Standard Oil Company, R.J. Reynolds was forced to succumb to the American Tobacco Company.<sup>95</sup> This was a major hit to the farming community as R.J. Reynolds did not stomp on the farmers who were getting lower leaf prices, as opposed to Duke and the American Tobacco Company.<sup>96</sup> Duke took a controlling share in the Winston-based company and re-organized it in New Jersey thereby allowing many of American Tobacco Company's directors to sit on R.J. Reynolds' board.<sup>97</sup> It was certain that Duke controlled the tobacco

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87. See CAMPBELL, *supra* note 70, at 25-26.

88. *Am. Tobacco Co.*, 221 U.S. 106, 162 (1911). Duke also had controlling stock in the Continental Company that performed similar actions to the American Tobacco Company after its creation, spawned by multiple acquisitions.

89. See WINKLER, *supra* note 53, at 110-12. See also ROBERT, *supra* note 12, at 127-28.

90. ROBERT RODGERS KORSTAD, CIVIL RIGHTS UNIONISM: TOBACCO WORKERS AND THE STRUGGLE FOR DEMOCRACY IN THE MID-TWENTIETH-CENTURY SOUTH 42 (2003).

91. America's Most Livable Communities, <http://www.mostlivable.org/general/winston-salem-city-home.html> (last visited Nov. 18, 2008) (detailing that the town was joined with another local city named Salem, North Carolina in 1913, which gives the "twin city" its current name of Winston-Salem, North Carolina).

92. See KORSTAD, *supra* note 90, at 41, 44.

93. BADGER, *supra* note 79, at 3.

94. See KLUGER, *supra*, note 24, at 36.

95. KORSTAD, *supra* note 90, at 45.

96. See KLUGER, *supra*, note 24, at 35.

97. KORSTAD, *supra* note 90, at 45 (explaining that the profits moved to New York, but R.J. Reynolds kept its corporate identity, its president and headquarters in North Carolina).

world by the early 1900s in the same way that his New York colleague, John D. Rockefeller, controlled the oil business.<sup>98</sup>

The monopolization of the American Tobacco Company had a great effect on the marketing of the tobacco. Duke colluded with the remaining tobacco companies in an attempt to set up boundaries in tobacco counties in an effort to eliminate all meaningful competition amongst the buyers.<sup>99</sup> Tobacco producers would be informed by various company representatives that they could not purchase their tobacco because they were on the wrong side of the stream and the territory was controlled by another company.<sup>100</sup> Some farmers even concluded that the international arrangement between the American Tobacco Company and Imperial Tobacco wiped out competition in the export market; therefore the tobacco producers were left with no free market on which to place their tobacco and battle for a fair price.<sup>101</sup> Much of the power that the producers possessed was usurped by monopolization techniques by Duke's companies and transactions.<sup>102</sup>

Eventually, Theodore Roosevelt's "trustbusters" turned their attention away from Standard Oil Company and invoked the wrath of the Sherman Anti-trust Act of 1890 against the restraint on trade created by the American Tobacco Company.<sup>103</sup> The high Court complained that they violated the first and second sections of the anti-trust act because of the extent of their stock ownership and to the extent that they became co-operators by contract.<sup>104</sup> The Court through Chief Justice Edward Douglass White further stated:

[t]he history of the combination is so replete with the doing of acts which it was the obvious purpose of the statute to forbid, so demonstrative of the existence from the beginning of a purpose to acquire dominion and control of the tobacco trade, not by the mere exertion of the ordinary right to contract and to trade, but by methods devised in order to monopolize the trade by driving competitors out of the business, which were ruthlessly carried out upon the assumption that to work upon the fears or play upon the cupidity of competitors would make success possible.<sup>105</sup>

The formal dissolution occurred in the Southern District of New York on November 16, 1911 when the Court entered a decree requiring branches of the company to become separate entities pursuant to the six-month old finding of the

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98. ROBERT, *supra* note 12, at 145.

99. CAMPBELL, *supra* note 70, at 27.

100. *Id.* A representative buyer of the Italian Regie Company once informed a producer that he would give \$0.07 per pound, but first had to see if the producer was within his boundary. It was discovered that he was not within the boundary, therefore the deal was not finalized.

101. *Id.* at 28.

102. *Id.*

103. *See generally* United States v. Am. Tobacco Co., 221 U.S. 106 (1911).

104. *Id.* at 184.

105. *Id.* at 181-82.

Supreme Court.<sup>106</sup> The four largest independent companies that came from the dissolution of the American Tobacco Company were American, Liggett & Myers, P. Lorillard, and R.J. Reynolds.<sup>107</sup>

#### VI. EX UNUS UT PLURES (“FROM ONE TO MANY”)

Many could assume that the dissolution of the large monopoly on manufacturing would allow the tobacco farmers of the South to breathe again and market their tobacco with less artificial restrictions. However, the dissolution merely created competition within the manufacturing market, not within tobacco production.<sup>108</sup> Prior to the dissolution of the tobacco trust, one-twentieth of all tobacco was used for cigarettes,<sup>109</sup> however, by 1929, 53.6% of all domestically-produced tobacco went into cigarette manufacturing.<sup>110</sup> This was due to all the companies that spun out of American Tobacco Company, using the heavy advertising techniques to create a cigarette brand.<sup>111</sup> In 1913, following the dissolution of the American Tobacco Company monopoly, R.J. Reynolds entered the cigarette market based on the strength of a new blend of Turkish and domestic burley tobacco, which sold under the name of Camel cigarettes.<sup>112</sup> This market reconfiguration ushered in the “age of the cigarette” in America that catered to the demanding market following World War I.<sup>113</sup> The “big three” cigarette manufac-

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106. See *People’s Tobacco Co. v. Am. Tobacco Co.*, 246 U.S. 79, 84 (1918) (regarding proper service upon a former agent of the American Tobacco Company following the company’s dissolution).

107. KORSTAD, *supra* note 90, at 45. R.J. Reynolds put up a billboard featuring “King Edward VII in his Prince Albert jacket, with the brand’s slogan ‘The Nation’s Joy Smoke’” in the Manhattan skyline. In addition, R.J. Reynolds wanted to “give Buck Duke [h]ell,” so he included a prideful statement on the billboard that simply stated “R.J. Reynolds Tobacco Company, Winston-Salem, N.C.” See *Lorillard Tobacco Company, Lorillard at a Glance*, <http://www.lorillard.com/index.php?id=33> (last visited Nov. 18, 2008). Currently, Lorillard Tobacco Company is the third largest U.S. cigarette manufacturer with the prominent brand of Newport cigarettes.

108. See KORSTAD, *supra* note 90, at 48.

109. BADGER, *supra* note 79, at 17. According to early European explorers, South America, especially Brazil, was one of the first places cigarettes, called *papelitos*, were found in the middle of the eighteenth century. Cigarettes became more popular in Europe following the Crimean War in 1856. COUNT CORTI, *A HISTORY OF SMOKING* 252 (1931).

110. BADGER, *supra* note 79, at 17.

111. *Id.*

112. KORSTAD, *supra* note 90, at 45-46.; see also, *id.* at 17 (explaining how Liggett & Myers developed Chesterfields, American Tobacco created the very popular Lucky Strikes brand soon after the dissolution of the tobacco trust in 1911, and Lorillard came in later with the marketing of Old Gold’s in the 1920s).

113. BADGER, *supra* note 79, at 17 (stating that the U.S. government purchased domestic tobacco cigarettes for the troops serving during World War I and that there was an increased demand by women following the war).

turers, American, Liggett & Myers, and R.J. Reynolds, constituted ninety percent of the cigarette market by the 1930s.<sup>114</sup>

As previously mentioned, tobacco producers were still at the whim of the companies as they were still producing a highly perishable crop that was secretly graded by the companies.<sup>115</sup> The grading of tobacco by the buyers determined the price given to the supplier, however, the reticent nature of the system did not allow farmers to know if they were getting a fair price or which grade provided the highest market price.<sup>116</sup> Another market factor that affected the producers' position was that the manufacturers kept a stock of two to three years for proper blending, so the demand of tobacco was not always immediate, thereby allowing the price to drop to suitable levels for the manufacturer.<sup>117</sup> The governor of Georgia, Richard Russell, even stated in 1932 that the tobacco manufacturers "have as complete a monopoly and combine as this [n]ation has ever seen," despite there being a disbanding of the American Tobacco Company monopoly two decades prior.<sup>118</sup> Another commentator of the era, Josephus Daniels,<sup>119</sup> claimed that there had been no real competition in years and "[the manufacturers] have been paying the farmers just enough to encourage them to grow the weed."<sup>120</sup> This would eventually lead to another antitrust case in the tobacco industry in 1946.<sup>121</sup>

The Great Depression was looming heavily upon the farm communities that were at the mercy of the companies. This had an extreme effect on the economically vulnerable tobacco farmers of the South, as flue-cured tobacco dropped below \$0.20 per pound for the first time in eight years in 1928.<sup>122</sup> Many tobacco farmers solely produced tobacco to be sold in auction, therefore the non-

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114. *Id.* (stating that the "big three" raised their prices in the 1930s, and created an inroads into the market for the cheaper cigarette brands manufactured by tobacco companies like Axton-Fisher and Brown & Williamson).

115. *Id.* at 19.

116. *Id.*

117. *Id.*

118. *Id.*

119. Josephus Daniels was a newspaper publisher in Raleigh, North Carolina, the Secretary of Navy, and the Ambassador to Mexico under Franklin D. Roosevelt. *See* Josephus Daniels, <http://www.usjosephusdaniels.com/history.htm> (last visited Nov. 18, 2008).

120. *See* BADGER, *supra* note 79, at 19-20.

121. *See* *Am. Tobacco Co. v. U.S.*, 328 U.S. 781 (1946) (charging American Tobacco Company, Liggett & Myers Tobacco Company, and R.J. Reynolds with (1) conspiracy in restraint of trade, (2) monopolization, (3) attempt to monopolize, and (4) conspiracy to monopolize. The Supreme Court affirmed the convictions of the companies under Count 1, 2, and 4, as Count 3 was merged into Count 2.) *See also* BADGER, *supra* note 79, at 209 (stating that there were no discernible differences in leaf buying practices following the 1946 antitrust case).

122. BADGER, *supra* note 79, at 21 (citing price per pound dropped to an extreme low of \$0.084 in 1931).

diversification of farms in the tobacco regions made these areas particularly susceptible to the extreme price decrease.<sup>123</sup> In addition, any effort in diversification during the Great Depression era was met with despair in other crop prices.<sup>124</sup> The farmers' condition worsened in regard to tobacco as they became heavily cash strapped, thereby forcing farmers to pay a full year's interest charges on credit that was only needed for a six-month period.<sup>125</sup> This created interest rates between 27% and 37% for fertilizer and supplies, which crippled the tobacco dependent farming communities.<sup>126</sup> In 1930 the North Carolina governor, O. Max Gardner, exclaimed, "the whole structure of industry is in a desperate state and agriculture is beyond description."<sup>127</sup> It was obvious that the whole agricultural system, including tobacco, would have to be revamped in order to save a failing economy.

There were a few different approaches to increase the bargaining power and economic status of the producers taken in the years 1917-1933.<sup>128</sup> The Tri-State Growers' Cooperative attempted to improve marketing of the tobacco by paying the contracted-member producers for depositing the tobacco for storage and re-drying, and a second installment when the various graded tobacco was sold.<sup>129</sup> This would allow for a pooling of resources to make the crop less perishable at the production level and the ability to hold tobacco back until a suitable price is determined in the market.<sup>130</sup> This cooperative effort failed in 1926 due to the entrenched interests of the manufacturers and warehousemen in combination with mismanagement and conflicts of interest within the higher ranks of the cooperative.<sup>131</sup>

Another approach was North Carolina Governor O. Max Gardner's "Live at Home" program that encouraged diversification of farms and subsistence farming.<sup>132</sup> Ideally, this program would have reduced dependence on tobacco and cotton as the farms were diversified with crops to be used by the growers' family,

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123. *Id.* at 18-19.

124. *Id.* at 22 (explaining that the collapse in tobacco prices was accompanied with a downturn in the price for cotton).

125. KLUGER, *supra*, note 24, at 84.

126. *See id.*

127. BADGER, *supra* note 79, at 22 (also referring to the rapid unemployment rate in North Carolina as many individuals were laid off at the factories and textile mills during that time period).

128. *See id.* at 23.

129. *Id.* at 24.

130. *Id.*

131. *Id.* at 24-25 (describing how warehousemen led a full opposition to the forming of the cooperative, as they saw it as an organization that would make farmers less dependent on them for credit).

132. *Id.* at 26.

lessening the money flowing outside North Carolina for imported food.<sup>133</sup> Also, the decreased planting of cotton and tobacco would raise the prices for the cash crops.<sup>134</sup> This approach only appealed to the small family farmer and not to the large commercial enterprises; therefore the program had limited effect.<sup>135</sup>

Some state legislators in the respective tobacco-growing states, with aid of warehousemen who were opposed to cooperative efforts, advocated acreage and production cutbacks to ensure better crop prices.<sup>136</sup> Many politicians in the grower states would not back the compulsory acreage reduction, as these pundits did not want to risk votes from the tobacco counties, especially when most farmers would not voluntarily reduce their acreage without assurance of an across-the-board cutback on production.<sup>137</sup> There was a momentary cutback in North Carolina tobacco production in 1932; however, this was followed by a dramatic increase in production in 1933, which illuminated the fact that the federal government would have to make the necessary changes to the tobacco production industry to keep it afloat.<sup>138</sup>

## VII. LIFE ANEW UNDER THE FEDERAL TOBACCO PROGRAM

Legislators in Washington, D.C. began their protection of tobacco farmers in the early twentieth century through passage of the Warehouse Act of 1916.<sup>139</sup> This authorized the creation of a standard grading measure to be calculated by an inspection service.<sup>140</sup> Unfortunately, however, this standard grading was not implemented until 1929, and was only implemented in a limited number of counties in tobacco growing states.<sup>141</sup> In addition, many farmers did not use the service as it was not always recognized by the buyer, and the farmer had to pay the service to grade his tobacco.<sup>142</sup> There was also a promising effort to assist with the formation of a growers' cooperative with the Federal Farm Board that

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133. *Id.*

134. *Id.*

135. *Id.* at 27.

136. *Id.* at 31.

137. *Id.* at 31-32. Tobacco warehousemen in North Carolina would have farmers sign "morally bound" contracts in combination with a radio propaganda campaign in effort to reduce tobacco acreage in 1931, which ultimately failed. Another proposal from growers' representatives was to create a refund to growers upon the reduction of the federal cigarette tax, which proved ineffectual.

138. *Id.* at 37.

139. *See id.* at 19.

140. *Id.*

141. *Id.*

142. *Id.*

was established in the Agricultural Marketing Act of 1929.<sup>143</sup> Also in 1929, Congress passed the Tobacco Stocks and Standards Act, which allowed the Secretary to collect and publish statistics and established standards to assist in data collection.<sup>144</sup> Once again, the hostility of warehousemen and the autonomous nature of farmers in the grower states proved the end of talks of cooperative movements. This set the stage for more comprehensive legislation to be passed.

It is not clear that tobacco was originally intended to be considered a commodity. It was not included the McNary-Haugen bills<sup>145</sup> of the mid-1920s, but was only placed in the 1927 draft of a farm relief bill to broaden its political support with the tobacco growing states.<sup>146</sup> The 1932 Hope-Norbeck bill, the first significant legislation proposed, featured tobacco in addition to the widely supported wheat and cotton.<sup>147</sup> Once it became part of the legislative landscape, the players needed to come to a form of political consensus in order to aid the farmers.

The Roosevelt administration and its forceful Secretary of Agriculture, Henry A. Wallace, threatened manufacturers with the possibility of governmental price control of tobacco and an order to open the industry books if they did not fall in line with the recognition of the plight of the tobacco farmers.<sup>148</sup> Led by the efforts of Samuel Clay Williams, who was the hand-picked successor of R.J. Reynolds, the major cigarette manufacturers agreed to pay \$0.17 per pound of leaf tobacco, up from \$0.10 the prior year.<sup>149</sup> “[T]he manufacturers . . . agreed to advise the Department of Agriculture of their approximate supply needs in advance of the planting season so government administrators could better gauge where to set the guaranteed support level.”<sup>150</sup> This was combined with the proposals discussing voluntary reduction in acreage or production to form the basis to an effective federal tobacco program.<sup>151</sup>

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143. *Id.* at 27.

144. *See* Freeman v. Brown, 342 F.2d 205, 208 (5th Cir. 1965) (addressing whether the Secretary used the most up-to-date statistics to arrive at a quota allotment).

145. *See* ROWE, *supra* note 7, at 6-8 (domestic price for exportable farm products was to remain above the price of foreign markets by approximately the amount of the imposed tariff through the use of an “equalization fee” funded by the producers directly; supporters of this approach opposed the use of production curtailment).

146. BADGER, *supra* note 79, at 39.

147. *Id.*

148. KLUGER, *supra*, note 24, at 85.

149. *Id.*; *see generally* Midway Man, TIME, Feb. 25, 1935, available at <http://www.time.com/time/magazine/article/0,9171,754529-1,00.html> (portrait of S. Clay Williams and his role as a liaison between the industry and the Roosevelt administration).

150. KLUGER, *supra*, note 24, at 85.

151. *Id.*

Congress sought to continue its protection of America's agricultural sector, including the tobacco farmers, during the Great Depression through the passage of the Agricultural Adjustment Act of 1933 (AAA).<sup>152</sup> The AAA was intended to be temporary,<sup>153</sup> but eventually formed the basis of the popular "Farm Bill" that is currently in debate every five to seven years in Congress.<sup>154</sup> There was no direction regarding the regulation of each commodity within the AAA, as it was more of a basis of policy that was given to the Secretary of Agriculture to assist in the preparation of various programs to regulate the basic agricultural commodities.<sup>155</sup> This led to varied approaches and methods of price support regarding specific commodities.

The bill that would become the AAA was finally submitted to Congress in March of 1933 and included a combination of many earlier tobacco program proposals.<sup>156</sup> The bill featured: "(1) payments to farmers; (2) a processing tax to raise revenue; (3) commodity programs aimed at reducing production; (4) marketing orders directed at managing supplies of milk and specialty crops [including tobacco]; (5) price support to farmers through the use of nonrecourse loans; [and] (6) commodity storage."<sup>157</sup> The combination of these six separate approaches was to be discussed among the government, farmers, warehousemen, and manufacturers to balance and create an optimal program.<sup>158</sup> The main tool discussed by all groups was production control, which is similar to the basic economics concept of supply and demand: if supply decreases while demand remains steady or increases, there will be a price increase.

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152. ROWE, *supra* note 7, at 1.

153. *See id.* at 12-13 (asserting that Congress viewed the AAA as "emergency legislation" and noting that the Act provides: "[t]his title shall cease to be in effect whenever the President finds and proclaims that the national economic emergency in relation to agriculture has been ended. . . .").

154. United States Congress Major Acts, Agricultural Adjustment Act (1933), *available at* <http://lawsandacts.com/agricultural-adjustment-act>. The Farm Bill of 2002 expired at the end of the 2007 fiscal year. Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171, 116 Stat. 134 (2002) (repealed 2007). In June of 2008 the most recent Farm Bill was enacted into law. If the 2008 Bill had not been created, the market would have resorted back to the AAA parity pricing. *See* JIM MONKE ET AL., CONG. RESEARCH SERV., POSSIBLE EXPIRATION (OR EXTENSION) OF THE 2002 FARM BILL 4 (2008).

155. ROWE, *supra* note 7, at 8 (stating that there are six basic agricultural commodities under the AAA).

156. *Id.* at 6.

157. COCHRANE, *supra* note 18, at 317. One distinction between tobacco and other commodities is that the parity period is different. The other commodities use a five-year period pre-World War I, while tobacco used the time period between 1919 and 1929 to establish parity prices which aligned with the post-World War I higher prices due to the demands of soldiers and their families. ROWE, *supra* note 7, at 17-18.

158. *See* BADGER, *supra* note 79, at 46.

However, all the production reduction measures were voluntary in nature, which required a consensus amongst the growing communities. The Agricultural Adjustment Administration conducted meetings throughout the grower states to encourage discussion regarding production cuts and imposition of taxes on the manufacturers.<sup>159</sup> The main focus in the first year of the AAA was on cigar-leaf and burley, with flue-cured sitting favorably until the following year when a long-term plan could be created.<sup>160</sup> Flue-cured tobacco farmers were not satisfied with this approach, and expedited the production reduction provisions pertaining to tobacco in the AAA. As a result, ninety-five percent of all flue-cured producers agreed to reduce their respective plantings by thirty percent the following year.<sup>161</sup> This was positive news for John B. Hutson, the head of the tobacco section of the Agricultural Adjustment Administration, as he had to urgently fix the market of the cigar-type dark tobacco in the Northeast and create different programs for each subtly different variety of tobacco.<sup>162</sup> This referendum approach was a keystone of the AAA.<sup>163</sup>

This led to a contract sign-up between the individual producers and the Agricultural Adjustment Administration to promise a reduced individualized acreage and/or production in a bargained-for-exchange of a rental payment, benefit payments, or both.<sup>164</sup> The sign-ups were pushed by propaganda and even veiled threats of future crop destruction, similar to the pre-regulated market.<sup>165</sup> Overall, the sign-up period was a success and prompted Congress to determine the best approach to heighten the 1933 crop prices.<sup>166</sup> This prompted the marketing agreement previously mentioned that required domestic buyers, the manufacturers, to purchase at \$0.17 per pound, while export buyers informed the Agricultural Adjustment Administration that they could not sign a marketing agreement, but would conform to the agreement.<sup>167</sup> This combined the two parts of the earlier proposals requiring acreage reduction and a guaranteed price to assist the farmers, however, a new problem occurred with individuals who did not sign the contracts, effectively free-riding the price increase.

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159. See generally *id.* at 46 (noting “that programs would only be implemented after consultation with the interested parties. . .”).

160. *Id.* at 45-46.

161. ROBERT, *supra* note 12, at 208-09. (Groups of advocates also requested the North Carolina governor to close down tobacco auctions under martial law until tobacco had reached \$0.20 per pound once again); see *id.* at 50-54 (detailed account of the meeting that lead the growers to unilaterally and voluntarily reduce the crop production rates for the 1933 crop).

162. See BADGER, *supra* note 79, at 44-46.

163. *See id.* at 44.

164. *Id.* at 54.

165. *Id.* at 55.

166. *Id.* at 57.

167. *Id.* at 63.

Congress enacted the Kerr-Smith Act in 1934 to deal with the non-signers by imposing a sales tax on all tobacco sold by those farmers who did not sign the acreage reduction contracts.<sup>168</sup> This measure was to decrease the incentive of overproduction by these individuals who were not contractually bound.<sup>169</sup> The tax was between one-fourth and one-third of the sale price of the tobacco above the contractual level of non-contractually bound tobacco, pursuant to the Secretary's discretion.<sup>170</sup> This seemed to be a plausible solution, but it moved a voluntary reduction into the realm of compulsion as the price was to be determined either by contract reductions or taxes imposed by Congress. Following the Kerr-Smith Act, the Agricultural Adjustment Administration reached a record of 369,465 signers on the grower contracts.<sup>171</sup> These measures and the continued support of the producers lead to a doubling of leaf prices from pre-AAA prices in 1936.<sup>172</sup> However, there were bound to be dissenters following the outright governmental control through the taxing power.

#### VIII. THE *BUTLER* CASE AND DEMISE OF THE AAA

In January 1936, the Supreme Court declared the AAA of 1933 unconstitutional in *United States v. Butler*, because the Bankhead Acts, which controlled cotton, similar to the Kerr-Smith Act for tobacco, and the production controls violated the states' reserved powers found in the Tenth Amendment of the U.S. Constitution.<sup>173</sup> The original action was brought by the receivers of a defunct cotton-based corporation, Hoosac Mills Corporation, regarding their level of a processing tax; however, the heart of the case struck to all the commodities under the AAA as Justice Roberts saw the use of the taxing power as a way to an unconstitutional end.<sup>174</sup> This prompted an immediate response by the Roosevelt administration and Congress to repeal the Kerr-Smith Act and Bankhead Acts.<sup>175</sup>

Roosevelt sought an act from Congress that would survive the outright attack on New Deal legislation by the U.S. Supreme Court. The Soil Conversa-

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168. ROWE, *supra* note 7, at 23.

169. *Id.* at 24.

170. *Id.* at 25.

171. ROBERT, *supra* note 12, at 210.

172. KLUGER, *supra*, note 24, at 85.

173. ROBERT, *supra* note 12, at 210; *see generally* *United States v. Butler (Hoosac Mills)*, 297 U.S. 1 (1936).

174. *Hoosac Mills*, 297 U.S. at 57.

175. ROBERT, *supra* note 12, at 210; BADGER, *supra* note 79, at 122, 126-27 (explaining that Congressman Kerr from North Carolina sought a private tobacco compact to enforce the voluntary production controls and the Kerr-Smith Act within the state of North Carolina until the repeal of the Act in *Butler* made this impossible).

tion and Domestic Allotment Act garnered support in the tobacco states as a substitute to the AAA of 1933 because many farmers and tobacco related organizations feared the worst.<sup>176</sup> This legislation can be likened to the current Conservation Reserve Program payments which compensate the farmer for not planting soil-depleting plants like tobacco.<sup>177</sup> Unfortunately, this Act did not have the desired effect, as tobacco production in 1937 shot up to the highest levels since 1931 due to fear accompanied by a particularly dry year and bad harvest the previous year.<sup>178</sup> A new measure had to be enacted to fix the production concerns in the tobacco producer market. Luckily for tobacco farmers, in 1937, there was the, now infamous, court-packing bill announcement and “the switch in time that saved nine”<sup>179</sup> by the same Justice Roberts who wrote the opinion in *Butler*.

#### IX. BACK TO THE DRAWING BOARD

Following the increased production levels of the 1937 crop year, growers’ organizations were looking to get back on track with the success they had under the AAA of 1933.<sup>180</sup> This led to the formation of groups, like the North Carolina Farm Bureau, for the sole purpose of assisting the American Farm Bureau with tasks such as lobbying for a new farm bill containing enhanced production controls.<sup>181</sup> These concerted efforts in combination with the changing opinion of the Supreme Court allowed Congress to put forth another comprehensive farm bill in 1938.<sup>182</sup>

In February of 1938, Congress passed the second incarnation of the Agricultural Adjustment Act<sup>183</sup> to create a ceiling on the harvest and a floor under the price for tobacco and other commodities.<sup>184</sup> The major change between the 1938 version and the 1933 version was the inclusion of compulsory production controls through marketing quotas.<sup>185</sup> These were to be applied to tobacco types that so warranted, at the discretion of the Secretary, dependent on a two-third

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176. See BADGER, *supra* note 79, at 124.

177. *Id.* at 123.

178. ROBERT, *supra* note 12, at 210-11.

179. See *W. Coast Hotel Co. v. Parrish*, 300 U.S. 379, 400 (1937). Justice Roberts switched his steady conservative vote in favor of the freedom to contract with the more favorable to New Deal Legislation liberal view, thereby opening the gate for governmental control and an expanded interpretation of the Commerce Clause.

180. See BADGER, *supra* note 79, at 136.

181. See *id.* at 136-40.

182. See *id.* at 142-43.

183. 7 U.S.C. §§ 1311-1316, 1445 (1938); BADGER, *supra* note 79, at 144.

184. ROBERT, *supra* note 12, at 210.

185. See *id.*

ratification referendum by the effected growers.<sup>186</sup> Under this program, the grower would be guaranteed a price up to their set poundage level and were granted nonrecourse loans by the Commodity Credit Corporation (CCC) at 85%-90% of parity if cooperating with the quota.<sup>187</sup> Any sales above the quota level would be accompanied by a heavy penalty.<sup>188</sup>

The marketing quotas were not continuous, but rather solely at the discretion of the Secretary and subject to a referendum by the growers thirty days after the Secretary's determination.<sup>189</sup> The quota determination typically occurred if the total supply of tobacco at July 1 exceeded the reserve supply level that was defined in the AAA of 1938.<sup>190</sup> If the Secretary so found, a marketing quota would be implemented by December 1 and enforced for a year, commencing on the following July 1 date.<sup>191</sup> This schedule led to a slew of problems for the AAA of 1938, because it was not passed until February of 1938 thereby allowing a maximum of 15 days to derive a quota after the passage of the statute.<sup>192</sup>

The farmers overwhelmingly voted for the quotas in March of 1938 to begin July 1, 1938.<sup>193</sup> However, the reduced timeline allowed for the quota resulted in a lack of confidence by the growers.<sup>194</sup> In addition, the farmers were not pleased with the acreage allotments that were handed out at the beginning of the season, which did not allow farmers time to arrange the crop.<sup>195</sup> The discontent resulted from the confusion between acreage allotments under the conservation program, the quota resulting from the timing issue, and the price the farmers received due to the reduced supply.<sup>196</sup> Because the growers sold less tobacco than in previous years, there was a \$24.8 million cumulative reduction from 1937.<sup>197</sup> This led to an onslaught of complaints by the producers who roundly rejected the next quota through referendum in December 1938 for the 1939 crop year, which led to another dramatic production increase.<sup>198</sup> Despite all of its promise, things were unraveling quickly for the AAA of 1938.

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186. *Id.*

187. *Id.* at 211.

188. *Id.*

189. *Mulford v. Smith*, 307 U.S. 38, 42-43 (1939).

190. *Id.* at 42.

191. *Id.* at 42-43.

192. *BADGER*, *supra* note 79, at 150.

193. *Id.*

194. *Id.* at 151. This resulted in the quota being based on allotment made under the acreage conservation program, which was only intended to be a guideline.

195. *Id.* at 150.

196. *Id.* at 162-63.

197. *Id.* at 164.

198. *Id.* at 169. (stating that only 56.8% of all flue-cured farmers voted for production control, which fell short of the two-thirds requirement).

A chance to kick the AAA of 1938 when it was down on the ground came when there was a constitutional challenge upon its inception. In *Mulford v. Smith*, flue-cured tobacco producers challenged the quota system in the same fashion that the tax method of production control was challenged in *Butler*.<sup>199</sup> However, the AAA of 1938 withstood the constitutional challenge as the Court interpreted the Congressional Commerce Clause power broadly, and looked to the statute and its application to determine that it was not ambiguous, vague, or applied retroactively.<sup>200</sup> The expanded Commerce Clause was reinforced in the 1942 decision of *Wickard v. Filburn* by the U.S. Supreme Court when it held that wheat on the farm for personal use “affected” interstate commerce and was under the purview of congressional power.<sup>201</sup>

The validity of the Act was intact following the bouts in the Supreme Court, which left its practical application to still be conquered. The Agricultural Adjustment Administration needed to repair the tobacco producer market following a record-breaking production year in 1939 as a result of the quota being rejected during referendum.<sup>202</sup> Due to the concerns regarding allotment size, the 1940 quota proposal by the Secretary was accompanied by a provision that added ten thousand acres of flue-cured tobacco and twenty-five thousand acres of burley tobacco to be distributed to “inadequate” sized farms.<sup>203</sup> In an effort to get the quota passed through referendum, there was a promise by the CCC to purchase all tobacco that was intended for Britain, but this promise was duly canceled due to the impending World War II.<sup>204</sup> The 1940 quota proposal survived the farmer vote.<sup>205</sup> This changed the arrangement of the quota system as the measurement turned from poundage to acreage, and refocused the administration of the program on crop yield.<sup>206</sup>

Another string of legislation from the New Deal era was affecting the tobacco producers through the control of the warehousemen. The *Magna Carta* of the warehouse was the Tobacco Inspection Act of 1935, which sought to extend

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199. See *Mulford v. Smith*, 307 U.S. 38 (1939).

200. *Id.* at 47-51.

201. *Wickard v. Filburn*, 317 U.S. 111, 125 (1942).

202. MANN, *supra* note 8, at 54.

203. *Id.*

204. *Id.* This deal by the government was presupposing that the British buyers would soon return.

205. See BADGER, *supra* note 79, at 191-92.

206. See *id.* at 185-86, 194. (explaining that the First Federal Savings and Loan Association in Greenville, North Carolina took out a full page advertisement the week before the referendum stating, “Would you refuse to be rescued? Face Saving or Shirt Saving. Would you lose your shirt to save your face? Restricted production or financial disaster, which will you choose? Vote for control October 5. A vote for the financial safety of yourself and the community in which you live. Hoovercats or Automobiles? You must decide.”).

the provisions of the Warehouse Act of 1916.<sup>207</sup> The Act authorized the Secretary of Agriculture to create an inspection system on any leaf market pending the two-thirds ratification by the growers utilizing that market, and the Secretary was to publish the findings and information regarding supply, demand, and market prices.<sup>208</sup> All fees associated with the inspection system were collected by the warehousemen with no compensation to the farmer, thereby formalizing the interlocking of the warehousemen and the tobacco growers.<sup>209</sup> The 1935 Act added transparency to the once cloaked market, thereby giving the necessary information to the growers to make informed transactions in the auction warehouses.<sup>210</sup> These were important measures of the time, as ninety percent of all tobacco was taken in burlap sacks to centralized barns to be sold at warehouse auctions in the late 1930s.<sup>211</sup>

As stated earlier, the federal tobacco program matured quickly in 1940 as it was beginning to create a solid foundation to handle issues with exports to war-ready Europe, the quota system was switched over to acreage from the poundage system, the auction process was relatively transparent, and the allotments were redistributed to assist smaller farms. The further allocation of apportionments to smaller growers continued in a three-year quota proposal from 1941-1943 thereby increasing farm size, and the minimum allotment was created.<sup>212</sup> The minimum allotment provision was included in quota proposals until 1973, and protected those with smaller allotments from having their allotment cut if they fell under the size requirement.<sup>213</sup>

By 1948, tobacco was the only commodity from the AAA of 1938 to remain under crop control.<sup>214</sup> In addition, the CCC took more than two billion pounds of tobacco which failed to bring parity-basing price on the market due

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207. See ROBERT, *supra* note 12, at 212 (explaining how Act was upheld in *Currin v. Wallace*, 306 U.S. 1 (1939) despite being invalidated at the district court level).

208. *Id.* at 212-14 (grading of the tobacco was based on breaking the tobacco into classes and types within the classes, where flue-cured was in class one, and burley was in class three).

209. See *Review the Impact of the Proposed Tobacco Settlement on Producers: Hearing Before the Subcomm. on Risk Mgmt., and Specialty Crops of the Comm. on Agric.*, 105th Cong. 48 (1998) (testimony of Carson Dane Perkins Sr., Superior Court Judge, on behalf of Tobacco Quota Warehouse Alliance).

210. This changes aspects of the warehouse auctions, however, the cynic would easily point out that there are still arms-length transactions and small town politics that go into the sale of the tobacco.

211. ROBERT, *supra* note 12, at 193-94.

212. See MANN, *supra* note 8, at 54.

213. *Id.* at 54-57 (noting that scrapping of the minimum allotment was due to the increased ownership of smaller allotments and in 1955, sixty-four of allotments were under the minimum allotment of 7/10 of an acre).

214. ROBERT, *supra* note 12, at 279.

mostly to the change from poundage quota based system to the acreage based system under the 1938 act.<sup>215</sup> The focus on yield, led to increased technology, degradation of the quality of the tobacco in hopes of an increased quantity to place on the market.<sup>216</sup>

#### X. FARMERS RECEIVE MONEY TO LIMIT GROWING

To stop the metaphorical bleeding, Congress acted by guaranteeing tobacco growers a minimum price per pound in exchange for a limiting of the production under a federal price support program as introduced by the Agricultural Act of 1949.<sup>217</sup> This ushered in the commodity price support for tobacco, and took it from the traditional marketing quota that rules in the fruit and vegetable markets presently.<sup>218</sup> The price support was to be the inducement for voting on the marketing quota proposed by the Secretary.<sup>219</sup> However, this measure did not have the desired long-term effect, as the average yield for the years 1955-60 was sixty percent higher than that of the years 1940-45.<sup>220</sup> During this period there was progressive reduction in acreage allotments due to the abundance of poor quality tobacco flooding the market, thereby culminating in the switch in 1965 from acreage to the original measure of poundage quotas or a hybrid for many of the highly produced forms of tobacco.<sup>221</sup> There were civil and market penalties

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215. *Id.*; See BADGER, *supra* note 79, at 194.

216. See MANN, *supra* note 8, at 58.

217. David G. Altman & Adam O. Goldstein, *The Federal Tobacco Price Support Program and Public Health*, in 10 SOUTHERN RESEARCH REP., TOBACCO FARMING: CURRENT CHALLENGES AND FUTURE ALTERNATIVES 67-100 (1998).

218. *Id.*

219. Christopher R. Kelley, *Recent Federal Farm Program Developments*, 4 DRAKE J. AGRIC. L. 93, 114 (1999).

220. E.C. PASOUR, JR. & RANDAL R. RUCKER, PLOWSHARES AND PORK BARRELS: THE POLITICAL ECONOMY OF AGRICULTURE 142 (2005).

221. *Id.* Whether to measure by acreage, poundage, or an acreage-poundage combination is determined by the type of tobacco being examined. Burley was measured by poundage, which the Secretary apportioned the quota to individual farms based on yield established for the farm multiplied by the acreage allotment for the farm before the enactment of the poundage quota. See 7 U.S.C. § 1314c (h) (1994) (repealed 2004). The acreage-poundage allotment was used for flue-cured tobacco, where the national marketing quota was divided by the “national average yield goal,” or the amount of flue-cured tobacco that needs to be farmed on each-quota possessing farm by acre to insure stability in the market, and then allocated to each farm based on last year’s acreage allotments. 7 U.S.C. § 1314c (a)(2)-(4)(1994) (repealed 2004). The marketing quota for individual farms, by pounds, is determined by multiplying the individual farm’s established yield by the farm’s adjusted acreage allotment. 7 U.S.C. § 1314c (a)(7)-(8) (1994) (repealed 2004).

for those farmers who exceeded the marketing quota for their various forms of tobacco.<sup>222</sup>

As the federal price support program was being threatened, Congress passed the No-Net Cost Tobacco Program of 1982. This program imposed an assessment, which was to be held in escrow for the benefit of the government, on every pound of tobacco marketed so that the cost of the program was borne by the producers, rather than by the taxpayers.<sup>223</sup> This shift of the financial burden to the growers encouraged a reduction in support prices, which was done in 1985.<sup>224</sup> The 1982 act was supplemented by the Consolidated Omnibus Budget Reconciliation Act of 1985, which required purchasers and producers to share equally in the no-net cost assessment, and the Omnibus Budget Reconciliation Act of 1993 that posed assessments on importers of burley and flue-cured tobacco.<sup>225</sup> There were penalties similar to marketing quotas for those responsible individuals who failed to pay the assessments for the program to operate at a no-net cost.<sup>226</sup>

Aligning with the other fundamental changes to the tobacco program during the 1980s, the Tobacco Improvement Act of 1985 and the Tobacco Reform Act of 1986 granted the Secretary the authority to set the computation method of the marketing quota from a pure prices paid index to a more market-oriented formula.<sup>227</sup> The Secretary demanded the major domestic buyers estimate purchases for the upcoming crop year in the spring prior in order to set the average poundage quota.<sup>228</sup> Despite the new computation method leading to an approximate twenty percent reduction in price support levels, the Tobacco Reform Act of 1986 was considered producer-friendly for the most part as it was seen as a savior of the no-net-cost tobacco program by allowing the CCC to suffer a loss

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222. 7 U.S.C. § 1314c (g)(1994) (repealed 2004) (mandating that farmers who market more than 103% of their flue-cured marketing quota are subject to financial penalties); *see also* Cole v. U.S.D.A., 133 F.3d 803, 809 (11th Cir. 1998) (upholding the constitutionality of the civil penalty of the national marketing quota). For those farmers still operating under the acreage allotment, any tobacco sold over the quota was penalized and sold at roughly seventy-five percent of the support price. *See* PASOUR & RUCKER, *supra* note 220, at 142.

223. TOBACCO PRICE SUPPORT, *supra* note 9, at 4 (the 2004 assessments were \$0.02 for pound of burley and \$0.10 per pound of flue-cured).

224. *Id.*

225. Altman, *supra* note 217, at 72.

226. *See* Kelley, *supra* note 219, at 115.

227. PASOUR & RUCKER, *supra* note 220, at 142; *Review of the Federal Tobacco Program: Hearing before the Subcomm. on Risk Mgmt, Research, and Specialty Crops of the Comm. on Ag.*, 106th Cong. 32 (2000) (statement of Will Snell, Agricultural Economics Research Professor at the University of Kentucky, who also contributed to the marketing contract summary mentioned in this article).

228. PASOUR & RUCKER, *supra* note 220, at 142-43.

as a result of selling unsold stabilization inventories at a greatly discounted price.<sup>229</sup>

The tobacco producers began to feel even greater strain by the 1990s due to overwhelming anti-tobacco sentiment amongst the general population. Times were changing as massive tort litigation associated with the deleterious health effects of cigarette smoke,<sup>230</sup> not only in the user, but those in the immediate environment, rained over the landscape. It culminated in a landmark settlement that forced an entire industry to change the way they did business. This could be considered the most restrictive document to be applied to an industry outside of the application of antitrust legislation, as it controlled nearly every aspect of the way the manufacturers' conducted business.

#### XI. GENERAL OVERVIEW OF THE MASTER SETTLEMENT AGREEMENT

The Master Settlement Agreement (MSA) of November 1998 narrowed the U.S. domestic tobacco market even further, as the industry was squeezed from the top, solidifying the top four spots for the four largest tobacco companies Philip Morris USA, R.J. Reynolds, Brown & Williamson, and Lorillard.<sup>231</sup>

The MSA was the ultimate result of decades of public health litigation flowing from the Attorney's General offices in many states and select U.S. territories, restriction on "assumption of risk" defenses to torts by many state legislatures, and a failed settlement in 1997.<sup>232</sup> Ultimately, the settlement was amongst forty-six states and the Commonwealth of Puerto Rico, Guam, the Virgin Islands, American Samoa, and the Northern Marianas as other states came to terms with the tobacco industry individually prior to the November date of the MSA.<sup>233</sup>

229. *Id.* at 142. The Flue-Cured Tobacco Cooperative Stabilization Corporation (stabilization) was just one of the grower owned cooperatives that purchased the tobacco stock through CCC loans and re-sold the tobacco to private buyers.

230. It is well known that the Mississippi trial lawyer Dickie Scruggs earned nearly \$1 billion in fees from his work in tort litigation that led to the Master Settlement Agreement. He is now facing up to seventy-five years for possibly bribing a state judge. Terry Carter, *Long Live the King of Torts?*, A.B.A. J. (Apr. 2008).

231. See MARTHA A. DERTHICK, UP IN SMOKE: FROM LEGISLATION TO LITIGATION IN TOBACCO POLITICS 3 (2002) (explaining the MSA regulation of the tobacco industry); Reynolds American, Inc., Investor Fact Sheet, <http://www.reynoldsamerican.com/investors/factsheet.aspx?mp=investor> (last visited Nov. 18, 2008) (explaining that R.J. Reynolds and Brown & Williamson merged in 2004 to form the second largest domestic tobacco company).

232. See DERTHICK, *supra* note 231, at 118-46 (for a more in-depth look on the eventual demise of the proposed 1997 settlement).

233. Master Settlement Agreement, art. II, sec. (qq)-(rr), Off. Of Cal. Att'y Gen. (1998), available at <http://ag.ca.gov/tobacco/pdf/1msa.pdf> (stating that the four states not included in the MSA were Florida, Mississippi, Texas, and Minnesota, as they made individual deals with participating manufacturers).

Generally, the MSA was a tool for the Attorneys General to place restrictions on the tobacco industry on the marketing and lobbying, and in return the tobacco industry received immunity from suit by the states.<sup>234</sup> However, to understand the effects the agreement had on the industry and the farmers, one must delve into the specifics of the agreement as well as how it was formed.

The formation of the MSA was a top-down venture in that the elites of the tobacco industry were to make decisions that would cause ripples through the entire industry, including smaller tobacco companies, wholesalers, consumers, farmers and auction warehousemen. On the other side were a small number of elected individuals from a collective of states that were making decisions that would weigh on the judiciary, legislature, and respective executive branches, as well as the constituents. This scheme was the ultimate homage to Weberian elitism controlling the state.<sup>235</sup> However, no matter how much one may support or detest the way the rules of the tobacco game were made, one must understand them in order to cooperate within the new system.

There was a checklist of activities that the Attorneys General wanted to limit or prohibit, which would have effect across the board for all the signatories of the MSA. All the provisions applied to the Original Participating Manufacturers (OPMs), who were the biggest four tobacco companies previously mentioned. Many of the provisions<sup>236</sup> also applied to smaller companies that signed onto the MSA at a later date, donning them the title Subsequent Participating Manufacturers (SPM).<sup>237</sup> Last, but not least, there were some very controversial provisions that only applied to the Non-Participating Manufacturers (NPMs) or those that were not signatories to the MSA.<sup>238</sup> These provisions will be examined in the next section of the paper, as I will examine the adverse market effects of the MSA.<sup>239</sup>

Lobbying was a direct target for the Attorneys General of many states as it would be a formidable foe to a sustainable agreement, because the tobacco industry has a substantial amount of money and influence to shift the political winds back in their favor. Therefore, the MSA had provisions to disband the

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234. *Id.* at sec. I, III (a)-(j) (explaining that the suits were normally based on theories of tort and were premised on the idea that the tobacco industry was externalizing the cost of the deleterious health effects onto the state, and, in turn, should be liable to reimburse the medical expenses that the state was paying on behalf of its citizens).

235. C. WRIGHT MILLS, *THE POWER ELITE* 4 (1956). Max Weber was a German political economist whose theories can be found in C. Wright Mills' *Power Elite* that argued much of governmental policy is created by an elite class of professional politicians.

236. The provisions that did not apply to the SPMs will be explained in the next section.

237. *See* Master Settlement Agreement, *supra* note 233 at art. II, sec. (tt).

238. *See id.* at art. II, sec. (cc).

239. *See id.* at art. II, sec. (cc), (jj), (tt).

largest lobbying arms of the industry, the aptly named Tobacco Institute and Council for Tobacco Research.<sup>240</sup> Also, the industry was prohibited from challenging certain categories of bills, mostly those including youth access to smoking and provisions of pseudo-tobacco products such as bubble gum cigarettes or other candy products resembling tobacco leaf derivatives.<sup>241</sup> In addition to the proverbial tying of the hands in legislative matters, the National Association of Attorneys General (NAAG) prevented judicial actions by barring constitutional challenges of the MSA, through the agreement, in the Courts of the United States.<sup>242</sup>

The collective Attorneys General also focused on marketing and advertising restrictions, which limited a tobacco company to one public sponsorship per year within specific guidelines,<sup>243</sup> limited direct advertising to “adult-only facilit[ies]” or those reasonably considered to admit only those eighteen years of age and older at all times of operation, and limited print advertisements to those magazines with readership that is of legal age to purchase cigarettes.<sup>244</sup> These specific provisions were encased in the general concept of limited youth access to smoking, and spurred the demise of Joe Camel and spawned the proliferation of Youth Smoking Prevention (YSP) departments in the respective tobacco companies.<sup>245</sup>

All these provisions should naturally cause a decrease in demand and a subsequent price hike to compensate. Therefore, the true cost of these measures would be passed onto the consumer, creating immunity for the manufacturer, and passing the risk on the side back to the producers, warehousemen, and wholesalers. However, the more controversial provisions that caused an anticompetitive hue on the entire agreement worried the left side of the economic equation, as producers had less market options to sell their harvested tobacco, thereby giving way to the contract-sales of tobacco.

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240. *Id.* at art. III, sec. (o).

241. *See* DERTHICK, *supra* note 231, at 175-76.

242. *See id.* at 3; *see also* Master Settlement Agreement, *supra* note 233, at art. III, sec. (m).

243. *See* DERTHICK, *supra* note 231, at 3 (explaining that participating manufacturers could not sponsor any event which could be considered a concert, where the majority of participants are youth, or any football, baseball, basketball, hockey, or soccer league; this was designed with the intention for the Winston brand to still be attached to the NASCAR series, however, NEXTEL now sponsors the racing championship series); *see also* Master Settlement Agreement, *supra* note 233, at art. III, sec. (j).

244. *See* Master Settlement Agreement, *supra* note 233, at art. III §§ (a)-(j).

245. *See* DERTHICK, *supra* note 231, at 3.

## XII. THE MASTER SETTLEMENT AGREEMENT "MONEY" PROVISIONS

According to Dan Morales, the Texas Attorney General, on March 28, 1996, the idea behind the public health litigation that spurred the MSA was "to change how [the tobacco] industry does business[.]"<sup>246</sup> A major effort to change the way the industry did business was done by financial penalty. The tobacco companies were required to distribute roughly \$246 billion to the individual states over twenty-five years.<sup>247</sup> These payments were broken down over seven categories: \$12.742 billion in up-front payments following the approval of the MSA by the courts, the annual payments over the twenty-five year period, \$8.61 billion into a strategic contribution fund, which can be linked to attorneys' fees,<sup>248</sup> \$250 million into the "national foundation," which were various charitable foundations related to curbing smoking and its deleterious effects, \$1.45 billion to the "national public education fund" that is used for anti-tobacco advertising,<sup>249</sup> \$50 million to the individual attorneys general for implementation and enforcement of the MSA, and \$1.5 million in payments over ten years to the National Association of Attorneys General.<sup>250</sup>

These payments were meant to affect the domestic cigarette market, and can be looked at as a form of neo-prohibitionism through consent decree, rather than legislative mandate.<sup>251</sup> At first blush, this may seem like a major blow to the

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246. Mark Curriden, *Up in Smoke: How Greed, Hubris and High-Stakes Lobbying Laid Waste to the \$246 Billion Tobacco Settlement*, A.B.A. J., (Mar. 2007).

247. *Id.* The original settlement was for the mind-boggling amount of \$369 billion was later reduced to the \$246 billion sum. Of note, some tobacco producing states used portions of this money to enact a state-sponsored buyout prior to the federal tobacco buyout.

248. *See id.* This is in addition to actual attorneys' fees that were paid by the tobacco companies to the Attorneys' General offices who hired a large number of outside private lawyers to assist in the resolution of the case.

249. This money is the source of the popular "Truth" campaign that created guerilla commercials set on city streets. *See* American Legacy Foundation, <http://www.americanlegacy.org/25.aspx> (last visited Oct. 21, 2008). *See also* American Legacy Foundation, <http://www.americanlegacy.org/28.aspx> (last visited Oct. 21, 2008) (explaining the purpose behind the American Legacy Foundation's "Truth" ad campaign). Such advertisements include a commercial where they put hundreds of filled body-bags on a New York City Street outside a busy office building to demonstrate the amount of deaths per day associated with smoking cigarettes. *Is Thetruth.com Too Truthful?* (CBS News July 3, 2000), <http://www.cbsnews.com/stories/2000/07/03/tech/main211877.shtml>.

250. DERTHICK, *supra* note 231, at 173-74 (A critique by many anti-smoking critics of these payments is that they are on a floating scale that would increase or decrease based on market share and cigarettes shipped, as well as inflation, so as not to "bankrupt" the companies).

251. *See* Curriden, *supra* note 246 (revealing that contrary to the original intent of the MSA and its effort to change the industry, the article is dedicated to how after even ten years of the MSA that business is "as usual" for the tobacco companies as they still have record-setting profits, the industry is still unregulated, and youth still make up a major portion of daily smokers).

profits of the tobacco companies. However, the true brunt of the MSA payments were going to be passed down the supply line as the cigarette companies would charge more for the cigarettes and recoup the money from the consumers.<sup>252</sup> Tobacco producing leaders feared the worst as they realized that the tobacco producers as a whole were facing “drastically reduced production opportunities or quotas.”<sup>253</sup> Some growers even saw the eventual reality that would lead to the end of the family farm and tobacco communities, which would be the contract farming.<sup>254</sup> In addition, tobacco dependent businessmen, such as the tobacco auction warehousemen, set out their fears regarding the then proposed settlement to a congressional subcommittee in 1998, and expressed how the tobacco communities as a whole would be effected by the downturn in production, the eventual push to contract farming, and the deviation from the traditional auction style tobacco sales.<sup>255</sup> The Phase II payments to tobacco farmers were meant to be a remedy for the amount of money that was going to be lost by the historical quota holders and the tobacco community as a whole due to the restrictive measures of the MSA.<sup>256</sup>

### XIII. “THE FIX” – PHASE II PAYMENTS

The elites that masterminded the MSA sought a “fix” for the relatively silent producers as they feared the worst regarding the new agreement that had potential to put an end to the domestic tobacco market, which included their towns, livelihood, and living history. The tool that the drafters of the agreement determined was the optimal solution for the producers was a \$5.15 billion trust that would be paid out over twelve years to all tobacco quota holders in the fourteen tobacco growing states to compensate the loss of equity in their quota allocation.<sup>257</sup> The allocation was based on the state’s proportionate level of tobacco production during the 1998 growing season, which provided North Carolina with 37.95%, Kentucky with 29.66%, Tennessee with 7.57%, South Carolina with 6.94%, Virginia with 6.58%, and varying amounts between the remaining nine

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252. *See id.*

253. *Review the Impact of the Proposed Tobacco Settlement on Producers: Hearing Before the Subcomm. on Risk Mgmt. and Specialty Crops of the Comm. on Agric., 105th Cong.* 29 (1998) (testimony of Wayne Ashworth, President, Va. Farm Bureau Federation).

254. *Id.* at 31-32.

255. *Id.* at 29-31.

256. Kentucky Governor’s Office of Agricultural Policy, National Tobacco Growers Settlement Trust History, [http://www.agpolicy.ky.gov/phase\\_ii/ktstc\\_trust\\_history.shtml](http://www.agpolicy.ky.gov/phase_ii/ktstc_trust_history.shtml) (last visited Nov. 18, 2008).

257. *Id.*

tobacco producing states.<sup>258</sup> These payments were to be distributed by trustees within the state.<sup>259</sup> The Phase II payments were meant to put the worries of the producers to rest as they would be given time to diversify their crop to include other commodities separate from tobacco, or to allow the quota holders to cease planting tobacco altogether.<sup>260</sup>

This was the saving grace for the producers as they virtually had no say in the MSA, even as a collective group because the main thrust of the negotiations focused on advertising and youth access to tobacco, which are areas that tobacco producers do not fancy their time. However, was this remedy adequate for producers that held a license, given to them by the U.S. government years before, that allowed them to plant an allotted amount and receive a pre-determined price that would ensure their family's livelihood?

There are a few different levels upon which to examine this inquiry depending on the expected outcome. The health advocate that wants smoking eradicated may see no issue with the bottlenecking of domestically produced tobacco as it may mean less tobacco in the market. In addition, they may see the payments as just a gratuity that does not necessarily have to be paid since it is the choice of the farmer to produce a "deadly" product.

On the other hand, you may be a farm advocate whose main concern is the livelihood of the family farm. The family farm in America is typically heavily dependent upon the subsidies provided by the government in order to maintain a manageable quality of life, and quota allocation is significant to the quality of life of that farm family. Therefore, a farm advocate may be in favor of compensation for lost sales due to the adverse effect on demand created by the provisions of the MSA.

On the extreme end would be the individuals who would want to keep the status quo, where the major "defense" to tobacco sales is consumer choice. This is where the simple decision not to buy a pack of cigarettes or continue to buy cigarettes dictates the free flow of the tobacco market. These individuals would more than likely continue the federal tobacco program as it were in 1997 in order to align with precedent, or would perhaps ask for a buyout to allow a complete free flow of the market.

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258. *See id.* (explaining that the schedule was for the four OPMs to pay \$380,000,000 in 1999, \$280,000,000 in 2000, \$400,000,000 in 2001, \$500,000,000 per year between and including 2002 to 2008, and \$295,000,000 in the years 2009 and 2010).

259. *Growers Optimistic of Payments*, GAZETTEVIRGINIAN, Oct. 29, 1999, available at <http://www.gazettevirginian.com/archivesfolder.html/10-29-1999.html>.

260. JASPER WOMACH, CONG. RESEARCH SERV., U.S. TOBACCO PRODUCTION, CONSUMPTION, AND EXPORT TRENDS 3 (2003) (hereinafter U.S. TOBACCO PRODUCTION).

These are merely three possible groups of many that have differing opinions regarding the complex system of tobacco sales and the tradeoffs that must occur between all levels of the tobacco market economy. These same issues and groups are involved in the debate over the tobacco transition payments that are associated with the 2004 Tobacco Quota Buyout.

#### XIV. ECONOMIC REALITIES FOR TOBACCO AT THE TURN OF THE CENTURY

The MSA was the foreground that shined a light on an economic issue regarding domestic tobacco that had been an ongoing problem for about twenty years at that point. Utilization of U.S. grown tobacco has been on a consistent decline since 1975, and its artificial pricing through the quota system along with increased quality in foreign-based tobacco has led to a rapid decline in the years preceding the quota buyout.<sup>261</sup> In 1999 there was a 28.8% cut in quota demand with an additional 45.3% cut in 2000.<sup>262</sup> Congress was forced to pass the Agriculture Risk and Protection Act of 2000 to deal with the dramatic cuts in quota by distributing \$340 million to tobacco farmers.<sup>263</sup> However, Congress could not continue to bail out the farmers that were already guaranteed sales by the federal tobacco program.

The quota decrease was partially due to direct marketing implemented by Philip Morris U.S.A. around the turn of the century, which was slowly eliminating the use of auctions that would create the market.<sup>264</sup> Instead, growers were signing contracts directly with individual manufacturers, thereby eliminating the power that growers had by a concerted effort of selling their products in a common marketplace and allowing the market to be defined through negotiation. Now the market has fixed prices and a reduction of demand from the major manufacturers during the auctions, as they already have their suppliers on contract producing tobacco specifically for them.<sup>265</sup>

In addition, manufacturers were heavily importing non-program foreign tobacco as it was cheaper. In 2004, 12.662 billion pounds of tobacco were pro-

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261. *Id.* at 12.

262. *Review of the Federal Tobacco Program: Hearing Before the Subcomm. on Risk Mgmt. and Specialty Crops of the Comm. on Agric.*, 106th Cong. 16 (2000) (statement of Billy Ray Smith, Comm'r, Ky. Dep't Agric.).

263. JASPER WOMACH, CONG. RESEARCH SERV., TOBACCO FARMER ASSISTANCE 4 (2005).

264. *See DeLoach v. Philip Morris Cos.*, No. 1:00CV01235, 2001 WL 1301221, at \*2 (M.D.N.C. July, 24, 2001).

265. *See* STEVE ISAACS ET AL., UNIV. OF KY., SUMMARY OF FOUR 2005 BURLEY TOBACCO MARKETING CONTRACTS (2005), [http://www.uky.edu/Ag/TobaccoEcon/publications/buyout\\_contract\\_comp.pdf](http://www.uky.edu/Ag/TobaccoEcon/publications/buyout_contract_comp.pdf) (University of Kentucky Cooperative Extension Service "side-by-side summary of marketing contracts" as an aid to tobacco farmers in the region).

duced, with only 788 million pounds coming from the United States.<sup>266</sup> This declining production capacity of domestic tobacco is grossly contrasted to the U.S. being the number one exporter of manufactured tobacco products.<sup>267</sup> Also, in the international context, there has been increased tension with the elimination of governmental subsidies to comply with the World Trade Organization (WTO) compliance regulations.

A statement by Larry Wooten of the North Carolina Farm Bureau, before a congressional subcommittee, examined the current application of the price support program in 2004 when he explained that the price support program was never meant to be applied to the current state of tobacco because large-scale operations were never contemplated by New Deal legislators, contract-farming was not anticipated, nor was there near the fierce worldwide competition that is currently dominating the market.<sup>268</sup> Statements like these are a harsh economic reality as it is a twist of irony that the program that was originally brought in to stabilize the market for the farmer, must be removed as it is the catalyst of instability in that same market.

#### XV. GROWERS ATTEMPT TO FIGHT BACK THROUGH LITIGATION

The “economic realities” mentioned in the previous section spawned a class action suit in which the growers blamed most of the economic downfalls on the manufacturers through claims of violation of the Sherman Antitrust Act.<sup>269</sup> The growers, as a class, accused the manufacturers and representative buyers (defendants) of manipulating the market and dropping the quota between forty-five and sixty-five percent since 1997 through the passage of the MSA and price fixing at the auction warehouses.<sup>270</sup> The complaint stated that Philip Morris would not purchase at the minimum auction price, and would wait for the tobacco to be bought by the grower cooperatives, where Philip Morris would purchase from the cooperatives at a roughly thirty-four percent discount, and the growers were left with little recourse, as any tobacco left unsold would lower the quota

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266. TOBACCO PRICE SUPPORT, *supra* note 9, at 4 (citing 2004 assessments as \$0.02 for pound of burley and \$0.10 per pound of flue-cured; China, Brazil, and India produced more tobacco than the United States).

267. *Id.* at 2.

268. *The Necessity of a Tobacco Quota Buyout: Why it is Crucial to Rural Communities and the U.S. Tobacco Industry: Hearing Before the Subcomm. on Prod. and Price Competitiveness of the Comm. on Agric., Nutrition, and Forestry*, 108th Cong. 41 (2004) (statement of Larry B. Wooten, President, North Carolina Farm Bureau).

269. *Philip Morris*, 2001 WL 1301221, at \*1.

270. *Id.* at \*1-\*2.

the following year.<sup>271</sup> In addition, the complaint stated that the manufacturers submitted lower purchase intentions that skewed the quota downward as the defendants were attempting to replace the quota system with direct contract farming with anticompetitive terms.<sup>272</sup> The plaintiffs survived the motions to dismiss at the district court level, which led to some form of settlement negotiations with all defendants except R.J. Reynolds.<sup>273</sup> The first settlement, which was untouched by an appeal, consisted of a \$135 million first installment, a \$65 million conditional installment, and commitment from all signatories to buy an allotted amount of U.S. grown tobacco during certain years.<sup>274</sup>

However, by the time most of the settlement provisions of this case applied, the effort for the tobacco quota buyout was at full steam.<sup>275</sup> Despite the victory in the form of a settlement, the merits of the case were never heard, and were the underlying “economic realities” that led to the tobacco quota buyout and the full onslaught of contract farming that the plaintiffs feared as shown by their complaint.<sup>276</sup>

#### XVI. REGULATORS ARE PUSHED BACK FOR GOOD AND ALL

While the other winds of change in the tobacco market occurred such as the MSA and contract farming, there was a reinvigorated movement within the industry and government to regulate cigarettes through the Food and Drug Administration (FDA). There have always been grumblings within Congress over whether tobacco should be regulated, despite it being exempted in the Food Drug

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271. *Id.* at \*2.

272. *Id.* (plaintiffs stating that the manufacturers retaliated against growers who challenged the contract terms through litigation).

273. *DeLoach v. Lorillard Tobacco Co.*, 391 F.3d 551, 554-55 (4th Cir. 2004) (regarding an appeal of a second settlement with R.J. Reynolds).

274. *Id.* (subjecting the \$65 million settlement to a proportionate reduction if the plaintiffs settled with R.J. Reynolds “on or before the day before the first day of trial,” which was the subject of the continued litigation).

275. Howrey L.L.P., Private Antitrust Litigation, [http://howrey.com/practices/practices\\_Detail.aspx?service=45e73399-0543-41d9-9f65-d6559b20d228&op=experience](http://howrey.com/practices/practices_Detail.aspx?service=45e73399-0543-41d9-9f65-d6559b20d228&op=experience) (last visited Nov. 18, 2008) (stating that settlement money was completely distributed in 2006, and all unclaimed funds were donated to land grant universities for the benefit of children and grandchildren of tobacco farmers; the 10-year purchase commitment would seem moot as there is no auction market anymore).

276. *See In re Reams*, No. 01-70935-LMK, 2005 WL 3273708, at \*1 (Bankr. N.D. Fla. Nov. 7, 2005) (Case alluded to the class action leading to the tobacco quota buyout that was the underlying issue in the bankruptcy decision regarding the right to the tobacco transitional program payments.).

and Cosmetic Act of 1938 (FDCA).<sup>277</sup> In addition, the Court of Appeals in the District of Columbia stated that the FDA lacked jurisdiction to regulate the tobacco in 1977 as “drugs.”<sup>278</sup> However, this did not squelch the concept of having the cigarette industry under the regulatory control of a governmental entity.

In 1996, the FDA declared it had jurisdiction to regulate cigarettes as a “drug” and a “device” that delivers the drug nicotine with the intention to “affect the structure or any function of the body,” which would squarely place cigarettes in the purview of the FDCA.<sup>279</sup> After solidifying the position through statutory definitions that the agency can regulate, the FDA began imposing many of the regulations that were imposed upon the industry in the MSA, including provisions regarding promotion, labeling, and youth accessibility. This authority was challenged by many in the tobacco industry, including advertisers, manufacturers, and retailers in the Middle District of North Carolina where the plaintiffs lost on all aspects of the suit except the ability of the FDA to regulate advertising and promotions of the cigarettes.<sup>280</sup> This decision was expeditiously appealed, and reversed by a divided panel in the similar vigor.<sup>281</sup> A basis of the Fourth Circuit decision was the determination that insofar as the FDA finds cigarettes to be unsafe, the FDCA would require the agency to ban the sale of cigarettes and run counter to congressional intent.<sup>282</sup> The question over whether the FDA possessed the authority to regulate cigarettes was then ripe for the Supreme Court.<sup>283</sup>

The Supreme Court ultimately concluded through a Sandra Day O’Connor written opinion and a 5-4 decision, that the FDA lacked authority to regulate tobacco products.<sup>284</sup> The Court followed the same logic in its affirmation of the Fourth Circuit by stating that Congress intended to exclude the controversial tobacco products from the FDCA, as it was never intended to ban the sale of those tobacco products, which is the logical extension of placing them under the FDA regulations.<sup>285</sup> In addition, the Court looked at six separate pieces of legis-

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277. See *Coyne Beahm, Inc. v. U.S. FDA*, 966 F. Supp. 1374, 1381-82 (M.D.N.C. 1997); *Action on Smoking & Health v. Harris*, 655 F.2d 236, 241 (D.C. Cir. 1980).

278. See *Action on Smoking & Health*, 655 F.2d. at 241. See also *Coyne Beahm, Inc.*, 966 F. Supp. at 1381-82 (illustrating how one year later, the FDA rejected the plaintiff’s position that tobacco should be regulated as “devices”).

279. See *Coyne Beahm, Inc.*, 966 F.Supp. at 1380-81. See also 21 U.S.C. §§ 321(g)(1), (h) (2007).

280. *Coyne Beahm, Inc.*, 966 F. Supp. at 1399-1400 (imposing the negated provisions through the MSA).

281. *Brown & Williamson Tobacco Corp. v. FDA*, 153 F.3d 155, 176 (4th Cir. 1998).

282. *Id.* at 166.

283. *FDA v. Brown & Williamson Tobacco Corp.*, 153 F.3d 155 (4th Cir. 1999), cert. granted, 67 U.S.L.W. 3484 (U.S. Feb. 2, 1999) (No. 98-1152).

284. *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125-26 (2000).

285. *Id.* at 130-31.

lation that had been passed since 1965 to conclude that Congress has a continued intent to not ban tobacco products or place authority in the hands of the FDA to regulate the industry.<sup>286</sup>

This was an effective end to the regulatory argument, but it was only short-lived as the movement gained a large ally shortly after the decision. Philip Morris U.S.A. backed effective FDA regulation, as it was one of the most accepting of the fate of the tobacco industry and the scrutiny that has been placed on it since the fateful day that the heads of the major tobacco companies raised their hands in Congress and admitted that cigarettes were addictive.<sup>287</sup> Philip Morris U.S.A. supported the proposed H.R. 3940, which was a combined federal tobacco quota buyout and FDA regulation bill in 2002, as an effort to create market stability and a more efficient market by centralizing any regulation of the industry.<sup>288</sup> Philip Morris U.S.A. was under the impression that the tobacco quota buyout could not be done in the then-current political climate without a submission to the FDA regulatory control, therefore the company aided in the drafting of proposed FDA regulations and aligned its business plan with those possible provisions in order to garner more of the market upon the occurrence of regulatory control.<sup>289</sup>

As is now known, the buyout went through without a turnover of regulatory control to the FDA. However, the discussion of regulatory control in combination with the operation of the industry under the MSA, the economic downturn in demand for domestic tobacco, and in turn, the profits of domestic tobacco farmers led to the passing of a comprehensive quota buyout.

## XVII. TOBACCO QUOTA BUYOUT

In a relative short use of the English language with respect to Governmental documents, Congress repealed the tobacco marketing quota as set out in the American Agricultural Adjustment Act of 1938 through the Fair and Equita-

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286. *Id.* at 143-44 (noting the restrictions require health warnings, prohibition of advertisement through “any medium of electronic communication” . . . require secretary of [Health and Human Services ] to report” on the addictive properties of cigarettes every three years, and require states to comply with the age limit through its Spending Clause power).

287. *See Review of Tobacco Buyout Proposals: Hearing Before the Subcomm. on Specialty Crops and Foreign Agric. Programs, 107th Cong. 88-89 (2002)* (statement of Mike Szymanczyk, Chairman and CEO, Phillip Morris U.S.A.).

288. *Id.* An interesting note is that Philip Morris U.S.A. made a major point of not wanting the FDA to regulate down to the farm level.

289. The author of this note aided in reviewing some of the proposed regulations during an internship in the Summer of 2004 at Philip Morris U.S.A. headquarters in Richmond, Virginia.

ble Tobacco Reform Act<sup>290</sup> (FETRA), codified at 7 U.S.C. § 518 (2008), located in the Jobs Creation Act of 2004.<sup>291</sup> The repeal of the quota was positively correlative to the operational purpose of the Act, which was to allow domestic tobacco price to float in a free market in order to compete with the cheaper imported tobacco.<sup>292</sup> The by-products are obvious: the diminution of the price of the domestic tobacco, some researchers suggest a twenty-five percent decline from previous program influenced levels, combined with the elimination of federal farm program payments will equal less people making money in the business of domestic tobacco production.<sup>293</sup> This will result in less small-scale generational farmers, and more large-scale corporate farmers who can deal with the increase of production.<sup>294</sup>

Congress did have the foresight to realize these eventual occurrences, therefore it set up a transitional program that would pay former quota owners of the next ten years. The payments, which are funded by manufacturers and importers, are to cushion the former quota holders from the initial shock of rapid price plummet as a rite of passage into the free market, and help compensate the Commodity Credit Corporation (CCC) for loan losses contributed to the devaluing of the tobacco, otherwise known as loan collateral.<sup>295</sup> The regulations use the parity price of seven dollars per pound, or three dollars per pound to active

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290. Subtitle A of the FETRA ("Act") caused Congress essentially to go back in time and erased tobacco from its scrolls in relation to federal farm programs, thereby thrusting tobacco into the free market. These words, from American Jobs Creation Act of 2004, Pub. L. No. 108-357 § 611, 118 stat. 1418 (Oct. 22, 2004), in Subtitle A "Termination of Federal Tobacco Quota and Price Support Programs," section 611, states "[t]ermination of tobacco quota program and related provisions," therefore pulling back 66 years of how business is done in the domestic tobacco production market. 7 U.S.C. § 518 (2008). Other Acts were repealed in subtitle A to effectuate Congress' goal, which include: Section 213 of the Tobacco Adjustment Act, the Tobacco Control Act, an Act pertaining to acreage-poundage quotas, and two Acts pertaining to Burley Tobacco allotments and import review. In addition, Congress amended numerous other Acts in order to remove tobacco from each law's respective purview.

Section 612 furthered the mission of § 611 by terminating tobacco price support and no net cost provisions by outright repeal and the striking of definitions from basic agricultural commodities and removing the power of the Commodity Credit Corporation (CCC). The Act does allow for a continuation of liability for any actions regarding crop year 2004 and prior. Within two and a half pages of actual text, we are given a blank slate with regards to tobacco marketing. Congress was not to leave tobacco farmers utterly naked, as they intended to ease the transition through the buyout provisions which will be analyzed in the section below.

291. See Scott Sanford, *Fair and Equitable Tobacco Reform Act of 2004: Cost Benefit Analysis* (Feb. 1, 2005), [http://www.fsa.usda.gov/Internet/FSA\\_File/cbattppassmtreg020105.pdf](http://www.fsa.usda.gov/Internet/FSA_File/cbattppassmtreg020105.pdf).

292. *Id.*

293. *Id.*

294. *Id.* (stating that some university researchers also propose that production costs will be reduced as quota rent will be eliminated).

295. *Id.*

producers of flue-cured and burley, at the 2002 quota level to determine proportioning of tobacco transitional program payments (TTPPs).<sup>296</sup> This program is anticipated to rack up a bill of \$10.14 billion dollars of the ten-year life of the payments, which most of it is assumed to be passed on to the consumer in gradual sales price increases.<sup>297</sup>

Possible effects of an elimination of the tobacco program would have very little effect on the retail prices because there would be higher excise taxes associated with the settlement.<sup>298</sup> Despite a possible twenty to forty percent decrease in domestic leaf price in the market, there would be a consolidation of tobacco farms or simple eradication of small to mid-size farms due to a lower profit margin, and there would be a redistribution of resources from the farmer to the manufacturer as domestic unprocessed leaf will be substantially cheaper.<sup>299</sup> This redistribution will also be seen in the power shift that will usher in complete contract farming, as the general stability of farming under a program is no longer present.

#### XVIII. THE ECONOMICS OF THE BUYOUT

The Tobacco Transitional Payment Program creates a payout for each quota holder with acreage allotments at seven dollars per pound on the basic quota level established during the 2002 marketing year.<sup>300</sup> The payments by the CCC would be made in ten equal installments of \$0.70 per pound or could be made in a lump sum through an arrangement with a participating financial institution.<sup>301</sup> Active tobacco producers, all the burley and flue-cured producers, received a contract obligating the CCC to pay \$3.00/lb. on the effective farm marketing quota for 2002, with those producing quota tobacco from 2002-2004 receiving the full \$3.00/lb. or \$0.30/lb. in a yearly installment over a ten year period, or the lump sum option that was extended to the tobacco quota holder.<sup>302</sup> The money in

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296. *Id.*; see also Tobacco Transition Payment Program, 70 Fed. Reg. 17,150, 17,150 (April 4, 2005) (to be codified at 7 C.F.R. § 1463).

297. Sanford, *supra* note 291.

298. Altman & Goldstein, *supra* note 217, at 86-90 (1998) (the other possible effects dealt directly with the disarming of the tobacco lobby in regards to public health advocacy).

299. *Id.*

300. Sanford, *supra* note 291.

301. JASPER WOMACH, CONG. RESEARCH SERV., TOBACCO QUOTA BUYOUT 2 (2005) [hereinafter "TOBACCO QUOTA BUYOUT"] (citing 2002 national basic quota amounted to about 959 million pounds, which would translate to about \$6.7 billion in TTPPs); Tobacco Transitional Payment Program, 70 Fed. Reg. 17,150, 17,150 (Apr. 4, 2005) (to be codified at 7 C.F.R. § 1463).

302. TOBACCO QUOTA BUYOUT, *supra* note 301, at 2, 5 (stating that the lump sum would come from financial institutions that operate under a maximum allowable discount rate of the prime

the CCC's tobacco trust fund, that is to pay out the contract amounts, will also be used to pay out any losses that exceed the no-net cost assessments that were collected in previous years, which will shrink the pie from which the producers are paid.<sup>303</sup> In addition, an important note that may change the amount of payments actually distributed is that the producers have to sign-up in order to verify their quota entitlement and receive any payments.<sup>304</sup>

The CCC is reimbursed through assessments on tobacco product manufacturers and importers, which the price would be passed onto the consumer at the retail level. These assessments are to be collected quarterly over the ten year period beginning with the 2005 fiscal year, which the yearly amount would equal out to about one billion dollars.<sup>305</sup> The assessments are apportioned to gross domestic volume share of the market held by each class of tobacco product.<sup>306</sup> The amount to be paid by the cigarette manufacturer could be roughly \$0.05 per pack if the market share remains similar for cigarettes to the 2004 market year.<sup>307</sup> In addition, as assistance to the manufacturers, the assessments for the tobacco quota buyout will offset the MSA's phase II payments.<sup>308</sup> The unfortunate aspect is that these numbers are not as high per farmer as the payout from the manufacturers suggest. The top one percent of recipients will receive a fourth of the pay-

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rate on the first workday of each money plus two percent rounded to the nearest number and if the financial institution follows this guideline then it can have the annual payments assigned to it).

303. *Id.* at 6.

304. *See* Press Release, Farm Serv. Agency, USDA Reminds Tobacco Quota Holders and Producers of Sign-up Deadline for 2007 Payment (Nov. 1, 2006), *available at* [http://www.fsa.usda.gov/FSA/newsReleases?area=newsroom&subject=landing&topic=ner&newstype=newsrel&type=detail&item=nr\\_20061013\\_rel\\_1542.html](http://www.fsa.usda.gov/FSA/newsReleases?area=newsroom&subject=landing&topic=ner&newstype=newsrel&type=detail&item=nr_20061013_rel_1542.html). Also of note, for tax purposes, the buyout payments regarding quota owner payments (\$7.00/lb.) will be treated as capital gains, and the grower payments (\$3.00/lb) will be treated as ordinary income. *See* KELLY TILLER, ET AL., TOBACCO QUOTA BUYOUT PROVISIONS: FAIR AND EQUITABLE TOBACCO REFORM ACT OF 2004 (2004), <http://www.uky.edu/Ag/TobaccoEcon/publications/buyoutprov.pdf>; I.R.S. Notice 2005-51 (Dec. 19, 2005) (question and answer format to supply answers regarding tax treatment of buyout proceeds).

305. *See* Press Release, *supra* note 304. *See* TILLER, *supra* note 304. *See* I.R.S. Notice, *supra* note 304 (question and answer format to supply answers regarding tax treatment of buyout proceeds).

306. TOBACCO QUOTA BUYOUT, *supra* note 301, at 3; *see also* 7 C.F.R. § 1463.5 (2008) (for fiscal year 2005: cigarettes 96.331%, cigars 2.783%, snuff 0.539%, roll-your-own tobacco 0.171%, chewing tobacco 0.111%, pipe tobacco 0.066%).

307. *Id.*

308. *Id.* (Pennsylvania, \$9.3 million in Phase II payments, and Maryland, \$13.5 million in Phase II payments, lost the most in the offset as the tobacco producers of those states opted out of the federal subsidy program); *see also* State v. Philip Morris USA, Inc., No. 98 CVS 14377, 2005 WL 2672042, at \*1 (N.C. Oct. 19, 2005) (holding that the tobacco manufacturers had to begin the FETRA obligations prior to relieving themselves of the Phase II payments, therefore, the defendants were liable for the \$106 million owed for the fourth quarter 2004 payment and cannot take a tax offset for that amount).

ments, equaling about \$600,000 average over the ten years, while the bottom eighty percent will receive about \$5,000 over the ten year period.<sup>309</sup>

This legislation has wiped the regulations of yesteryear away, including the compromises, litigation, auction deals, and all of the flavor that created a rather complex federal program that was constantly a focal point of political turmoil. However, there are still issues on the horizon that our domestic producers will encounter, including, but not limited to, contract farming, receiving payments, technology, and free market.

#### XIX. A BATTLE-TESTED LEGISLATION HOLDS

A challenge to regulations promulgated under the authority of FETRA has arisen in West Virginia.<sup>310</sup> Neese, and other plaintiffs, argued that the buyout regulations,<sup>311</sup> promulgated on April 4, 2005, are a far departure from the statutory language guaranteeing active producers \$3.00/lb., and Neese suffered damages in the amount of \$373,359 through sub-standard payments.<sup>312</sup> Neese sued the Secretary and the CCC regarding the payment formula regulated, which prompted Philip Morris USA to intervene and move to dismiss the lawsuit for lack of standing as the plaintiffs had already assigned their contract rights in exchange for a lump sum payment.<sup>313</sup> The District Court granted the motion to dismiss, but also added that it would have denied the equitable relief sought by the plaintiffs as the plaintiffs came to the cause with “unclean hands” by entering into producer contracts and creating more of the chaos that was the center of their complaint.<sup>314</sup> The Fourth Circuit affirmed the District Court of West Virginia, thereby effectively ending the *Neese* litigation.<sup>315</sup>

The FETRA and resulting regulations have also been challenged through the buyer/manufacturer side of the issue.<sup>316</sup> The mentioned litigation was started by a buyer who felt the quarterly assessment that was imposed in the regulations stemming from the passage of FETRA, 7 U.S.C. § 518 et. seq. (2008), was a violation of the takings clause, due process, equal protection, and the very passage was a violation of the Administrative Procedure Act (APA).<sup>317</sup> Swisher<sup>318</sup> felt that

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309. PASOUR & RUCKER, *supra* note 220, at 146.

310. *See generally* Neese v. Johanns, 450 F. Supp. 2d 632 (W.D. Va. 2006).

311. *See generally* 7 C.F.R. § 1463 (2008).

312. *Neese*, 450 F. Supp. 2d at 636.

313. *Id.*

314. *Id.* at 637-38.

315. *Neese v. Johanns*, 518 F.3d 215, 219 (4th Cir. 2008).

316. *See Swisher Int'l v. Johanns*, No. 3:05-cv-871-J16-TEM, 2007 U.S. Dist. LEXIS 88738 (M.D. Fla., Nov. 27, 2007).

317. *Swisher*, 2007 U.S. Dist. LEXIS 88738, at \*3.

the Act or regulations did not take into account the amount of participation the company had in the old quota system.<sup>319</sup> Swisher, in particular, purchased 99% of its tobacco outside the U.S. over the last ten years, but will be forced to pay nearly \$100 million in assessments over the ten year period.<sup>320</sup> The Court examined the record and first determined that, as the Act was mainly regulatory, the quarterly assessment was a “fee,” not a tax.<sup>321</sup> Because this fee is for the benefit of the tobacco producers within the same market as the buyer/manufacturer, there is no takings clause applicability.<sup>322</sup> Due process was also not offended because Swisher was a member of the past market and can be held liable for its correction.<sup>323</sup> Finally, the court held that the regulations were rationally related to a legitimate government interest, thereby surviving an equal protection analysis.<sup>324</sup> The District Court, after enumerating its findings in a relatively lengthy opinion, granted the Secretary’s summary judgment motion on all counts.<sup>325</sup>

There have also been grumblings in the academic community of an unjust compensation argument being brought by producers as the \$7.00/lb. for quota owners is merely partial compensation for an entitled \$12.60/lb. that the owner should be receiving according to the author.<sup>326</sup> The *Swisher* case is a judicial recognition of the political and economic compromise that was to be hammered out by many interests, and would be a testament to the Act being able to withstand these challenges from either side claiming unfairness in the amount that they need to contribute or receive.

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318. A 147-year-old company manufacturing cigars and smokeless tobacco. Swisher Int’l Inc., <http://www.swisher.com/main/history.cfm> (last visited Nov. 18, 2008).

319. *Swisher*, 2007 U.S. Dist. LEXIS 88738, at \*14-15.

320. *Id.*, at \*14.

321. *Id.*, at \*24.

322. *Id.*, at \*33-\*34.

323. *Id.*, at \*40-\*43.

324. *Id.*, at \*43-\*52.

325. *Id.*, at \*52.

326. Matthew Nis Leerberg, *Takings and Statutory Entitlements: Does the Tobacco Buyout Take Quota Rights Without Just Compensation?*, 55 DUKE L.J. 865, 890-91 (2006) (arguing that the tobacco quota buyout is a violation of the 5<sup>th</sup> Amendment takings clause due to only partial just compensation being offered).

XX. A THEORY ON THE FUTURE OF THE DOMESTIC TOBACCO MARKET<sup>327</sup>

Many tobacco farmers will move on to other ventures as the free market and/or contracting may not give enough income potential or security.<sup>328</sup> In 2002, imported cigarette tobacco was delivered to the United States at about forty percent of the cost of U.S. grown tobacco.<sup>329</sup> Most farmers will not feel it profitable to compete in a market that includes foreign countries that may not have to pay as much in capital contributions and labor,<sup>330</sup> especially in combination with the ever-increasing domestic energy prices. This means larger, but fewer, farms in the U.S. growing tobacco, but it will also mean many tobacco farmers either selling their land or turning to other crops and farming practices.<sup>331</sup> As mentioned, the majority of the buyout recipients will not receive the lump sum amount that many expect; therefore, a majority of these new farming ideas will have to be financed through loans. This system opens the producers up to all of the risks that come with agricultural loans.

For those farmers choosing to continue to grow the golden leaf, the end of the tobacco program ushered in the free market and formalized the marketing

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327. As a preliminary matter the charting of the tobacco market will be transformed. The USDA was specifically prohibited from spending research funds on the production, processing or marketing of tobacco, and from promoting the export of tobacco or tobacco products. TOBACCO PRICE SUPPORT, *supra* note 9, at 6. (The prohibitions can be found in the USDA appropriations law). The industry and land-grant institutions have filled this void, with the creation of entities such as the Center for Tobacco Grower Research at the University of Tennessee. See Jim Miller, *Uniting Growers: Philip Morris-funded UT Center Will Help Tobacco Farmers*, KNOXVILLE NEWS SENTINEL, Dec. 15, 2007, available at <http://www.knoxnews.com/news/2007dec/15/uniting-growers/> (stating that Philip Morris spent \$445,000 to create the Center for Tobacco Grower Research at the University of Tennessee's Institute of Agriculture, which will team up with the University of Kentucky to gather data from 14 tobacco growing states).

328. See Cecil H. Yancy Jr., *Buyout Brings Changes to Maryland Farm Landscape*, SOUTHWEST FARM PRESS, April 9, 2004, available at <http://southwestfarmpress.com/news/maryland-tobacco-buyout/>. One Maryland generational tobacco farmer went on to farm geraniums and cannot be happier. Maryland actually offered its farmers a buyout with some of the MSA payments in 2001. See Cecil H. Yancy Jr., *Buyout Brings Changes to Maryland Farm Landscape*, SOUTHWEST FARM PRESS, April 9, 2004, <http://southwestfarmpress.com/news/maryland-tobacco-buyout/>.

329. U.S. TOBACCO PRODUCTION, *supra* note 260, at summary.

330. See A. Blake Brown & Dewitt T. Gooden, *Tobacco Situation and Outlook for 2008*, 2008 SOUTH CAROLINA TOBACCO GROWERS GUIDE, Dec. 2007, available at <http://www.clemson.edu/peedeerec/Tobacco/2008tobguidesects/2008tobguide.pdf>.

331. For example, some former tobacco farmers are using the time that they receive payments to bring the farm within the U.S.D.A. organic standards to take advantage of niche market. See Brian Halweil, *The Smoke Clears: Ex-Tobacco Farmers Kick the Habit and Go Organic*, E: THE ENVTL. MAG., July/Aug. 2003, available at [http://findarticles.com/p/articles/mi\\_m1594/is\\_ai\\_105367817](http://findarticles.com/p/articles/mi_m1594/is_ai_105367817).

and production contracts as the most utilized tool in tobacco marketing.<sup>332</sup> Most tobacco is now sold by direct contracting with the manufacturers, which allows the buyer power to dictate the market that has not been wielded by the manufacturers since the times of James B. Duke. Beyond just acquiescing the power to price by concerted effort in an auction, there are other dangers that the grower faces by entering marketing and production contracts. Professor Neil Hamilton explains some of these in a draft of a report to the USDA in 2000: (1) the writer of the contract, the tobacco manufacturer in our case, benefits the most; (2) many farmers may not read or understand the contract and its language; (3) the farmer must fulfill the requirements before he can get paid; and other additional pitfalls associated with contracting.<sup>333</sup> The main concern is that many farmers are not going to seek legal counsel prior to signing the contracts, nor are there an abundance of attorneys that specialize in this area or understand the market enough to lend sound legal advice if their counsel was sought.<sup>334</sup>

Benefits of contract farming can include reducing financial risk by providing a guaranteed source of cash flow, thereby reducing the need to seek loans; however, if a loan is necessary, you will be more likely to get a line of credit with the guaranteed money from the contract.<sup>335</sup> In addition, the grower may have access to new technologies as provided by the manufacturer, or the ability to get better premiums on specialty types of tobacco based upon needs of the buyer.<sup>336</sup> The drawbacks can be increased production costs for the grower that may not be financed by the buyer, less flexibility in the farming, the manufacturer having greater access to the grower's fields, and the risk of not being paid at all if the manufacturer makes the final determination on the quality standards.<sup>337</sup> Also, growers will switch gears to grow the best selling product in order to attract the manufacturer buyers and maximize the proceeds received from their land. This will lead to lower prices for all buyers as there will be an abundance of supply, less variety as producers respond to the market, similar to the story of Darrell Jackson in the beginning of this article, as well as the continued consolidation of tobacco farms into mega-farms.<sup>338</sup>

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332. See Brown & Gooden, *supra* note 330. Experts also point to the possibility of flue-cured stabilization, and possibly leaf dealers offering contracts. However, the bulk of the contracts are going to come from the more powerful manufacturers, even if other groups are creating their own contractual relationships with the producer.

333. NEIL HAMILTON, A FARMER'S LEGAL GUIDE TO PRODUCTION CONTRACTS 3 (1995).

334. See ISAACS ET AL., *supra* note 265, at 1-6. (explaining the differences in and the right to inspect the individual farms).

335. See *id.* at 4.

336. See Rogers, *supra* note 1, at C2.

337. ISAACS ET AL., *supra* note 265, at 1-6.

338. See Rogers, *supra* note 1, at C2.

The idea of a family farm and the once festive nature of the auction barn are forever gone in tobacco, as well as Americans' affinity for tobacco.<sup>339</sup> The grower side will rival the manufacturer side in terms of size and relative power in the domestic tobacco market as small farmers leave the market,<sup>340</sup> farms merge, and technology increases to meet the production costs of overseas ventures. This could be a promising time for those producers who have the money to stick around during the shakedown of the market. However, for the majority of producers, it is an eerie repeat of history and perhaps the end of an era.

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339. See Dionne Walker, *Philip Morris Closing North Carolina Plant*, USA TODAY, June 26, 2007. This is even more pronounced with the amount of cities and states curbing smoking in public places increasing. This trend has caused major manufacturers to readjust their production methods and costs, as shown by Philip Morris U.S.A. (now known as "Altria") closing down its Cabarrus County, North Carolina plant and consolidating its domestic production in Richmond over the coming years.

340. Editorial, *Some Small Farmers Will Take Their Leave*, ALL BUSINESS, Feb. 1, 2005, available at <http://www.allbusiness.com/north-america/united-states-north-carolina/962257-1.html>.