

## States' Rights on Steroids

By Michael S. Greve

*State attorneys general have discovered a new target for a coordinated litigation campaign: the pharmaceutical industry. The Federalism Outlook has devoted much ink and attention to state attorneys general activism, and another issue on the subject may tax the patience of even the most faithful reader. Each new campaign, though, holds new lessons. The states' antipharmaceuticals crusade, when viewed in the context of earlier campaigns against the tobacco industry and brokerage houses, suggests that litigation and collusive settlements may become a principal vehicle for regulating many major American industries.*

No drug or medical device is perfectly safe. Every vaccine will result in some deaths and injuries. Beginning in the 1970s, the residual risks of pharmaceutical products prompted extravagant liability verdicts and, eventually, a liability crisis. Useful drugs disappeared from the market. Companies pulled entire product lines; all but four companies have left the vaccine market.

Those were the good old days of American tort law. While the consequences—such as an inordinately fragile vaccine supply system<sup>1</sup>—are still with us, the pharmaceutical industry now faces an additional, entirely new set of legal challenges. The new attacks differ from the old, Bendectin-style products liability lawsuits in several salient and menacing ways.

First, traditional products liability lawsuits presupposed some actual injury. Even when that requirement became increasingly attenuated (for example, through awards of “phobic” damages for plaintiffs’ fear of future illness), it still imposed some boundary on the number of plaintiffs. The modern tort cases, in contrast, very nearly dispense with the injury requirement. They are based on open-ended

theories of fraud, misrepresentation, and the like. They have to do not with the safety of the product, but with the ways in which it is priced, marketed, and sold. The alleged tort is suffered by tens of millions of (potential) consumers.

Second, the drug industry’s foes in the old liability cases were specialized plaintiffs’ lawyers. While those guys were smart, they have been replaced with a still more potent force—a highly coordinated and well-financed trial bar, working hand-in-glove with an equally tight-knit and sophisticated coalition of state attorneys general. Plaintiffs’ firms have learned to divvy up market shares and to reduce production costs through collusion—for example, by sharing discovery materials. The firms and state attorneys general have developed personal and professional relationships in earlier campaigns (notably against the tobacco industry), and the parties’ tight cooperation is built on a perfect congruence of interest: the trial lawyers’ money gets attorneys general elected, and the attorneys general return the favor by hiring plaintiffs’ firms as counsel in state-sponsored litigation (often before state judges who were also elected with the trial lawyers’ money).

Third, the liability lawyers of old could be bought, though often at an exorbitant price. The new litigation industry wants money—and the industry’s assent to a comprehensive regulatory

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program governing the sale and marketing of pharmaceutical products. If the litigation industry has its way, the pharmaceutical industry will, under the threat of financial ruin, turn itself into a public utility. It will, in that entirely possible event, have all the innovative oomph of, say, Pacific Gas & Electric. We will have the pharmaceutical equivalent of windmills and solar panels—phony remedies for politically favored maladies and body parts.

## Double Fun

Pharmaceutical products have a funny pricing behavior.<sup>2</sup> The first pill may cost upwards of \$500 million in R&D costs; the second costs next to nothing. This makes the industry highly susceptible to price controls. Advocacy groups, state officials, and plaintiffs' lawyers have caught on to this. Over the past two years, the industry has been hit with a fusillade of price control initiatives.

State legislatures are experimenting with a great variety of "rebate" and price control programs, typically to bring spiraling Medicaid costs under control. (One of those programs is the subject of a pending Supreme Court case, *PhRMA v. Concannon*.)<sup>3</sup> At the same time, the industry confronts a torrent of state and class action lawsuits. Most of the cases involve one of two issues: drug manufacturers' allegedly fraudulent efforts to extend their patents and the companies' pricing practices under Medicare and Medicaid.

**Patents.** In the 1984 Hatch-Waxman Act, Congress attempted to ease generic drugs into the market after the expiration of the patent for the original product (for example, by streamlining the Food and Drug Administration's approval process for generic substitutes). The statute is not all it could be. It provides the original patent holder with procedural means to extend the life of the patent and to delay introduction of the generics, and drug companies have predictably availed themselves of those opportunities—sometimes on rather questionable grounds. While the transition from patented products to generics has gone smoothly in the great majority of cases, a number of highly profitable drugs have generated high-stakes litigation between patent holders and generic producers.<sup>4</sup>

In well over a dozen enormous class actions, involving a variety of drugs and companies, plaintiffs' groups have attacked pharmaceutical firms' patent extensions as fraudulent, profiteering, conspiratorial, and otherwise

unlawful. The suits typically seek disgorgement of the "excess" profits the firms exacted from customers who would otherwise have been able to purchase cheaper generics; punitive damages; and other types of relief. One such lawsuit has been filed by a coalition of twenty-nine state attorneys general, led by Michigan attorney general and governor-in-waiting Jennifer Granholm. Many other cases have been engineered by an outfit called Prescription Access Litigation, an umbrella group of some seventy-plus advocacy groups invariably representing that terminal plight on the body politic, "concerned citizens." In several cases, PAL has been joined by AARP (Angry Advocates for Rapacious Pensioners).

**Prices.** Both Medicaid and Medicare (Part B) use an external reference price to determine reimbursement rates. Medicare uses an "average wholesale price." With the assistance of plaintiffs' firms, Nevada and Montana have filed suits against twenty-plus leading manufacturers. The states allege that the firms' average wholesale prices are higher than the actual transaction prices charged to doctors and pharmacists. The aforementioned PAL has filed a similar suit.

The allegation that average wholesale prices do not represent transaction prices is true and has been known to regulators and legislators since at least 1967. Nonetheless, as recently as 1997, Congress rejected a Clinton administration proposal to reform average wholesale pricing. Since reimbursements go not to producers but to providers, doctors and pharmacists pocket the difference between the average wholesale price and the actual lower price. Doctors stand to benefit from prescribing drugs with a high price spread, which in turn gives manufacturers a perverse incentive to quote a high average wholesale price. Still, Congress has deemed the practice essential to sustain the providers' participation in the program.

The state suits seek relief for manufacturers' deception, fraud, racketeering, breach of contract, and Medicaid fraud, as well as punitive damages for the defendants' malicious and oppressive conduct. PAL's lawsuit contains additional charges of antitrust violations.

## Who's Zooming Whom?

Although the pharmaceutical litigation market looks somewhat chaotic, we have seen its like before—twice. The prototype of the pending cases and, in particular, the average wholesale price litigation, is the attorneys

general—trial lawyers campaign against the tobacco industry that terminated in a 1998 “Master Settlement Agreement” that imposed a quarter-trillion-dollar national sales tax and a massive regulatory regime governing the sale and marketing of tobacco products. A variation on the tobacco theme is the state crusade, led by New York attorney general Eliot Spitzer, against brokerage firms accused of touting stocks to an allegedly unsuspecting public. That initiative has so far produced a \$100 million settlement with Merrill Lynch; it is continuing as we write and you read.

We have even seen the same people before. The National Association of Attorneys General—which helped engineer the MSA and, under its terms, functions as the nation’s cigarette czar—is again playing a coordinating role in the pharmaceutical cases. The plaintiffs’ groups in the patent and average wholesale price cases are represented by, among other firms, San Francisco’s Lieff Cabraser, veterans of the tobacco wars. Nevada’s and Montana’s counsel in the average wholesale price litigation include Seattle’s Hagen Berman, also of tobacco fame. (The question where the plaintiffs’ bar would invest the billions earned in the tobacco litigation has been partially answered.) A creative genius named William Novelli ran, in the heady days leading up to the MSA, a group called Campaign for Tobacco-Free Kids, which agitated for tobacco regulation through litigation. Novelli now serves as director of AARP, in which capacity he lends plaintiffs and financial and organizational support to the litigation against the pharmaceutical industry.

Nothing is *exactly* the same the second or third time around. The fee agreements between attorneys general and plaintiffs’ firms in the tobacco litigation generated exorbitant contingency fees for the lawyers. Chastened by the ensuing public relations debacle, trial lawyers have in the average wholesale price litigation accepted more modest fee-sharing arrangements. Some colorful and voracious tobacco lawyers—notably, Mississippi’s Richard Scruggs—have expressed interest in the pharmaceutical cases but have for now been sidelined.

Attorneys general have learned. The tobacco campaign was instigated by Mississippi’s Michael Moore, whose fanatical, hard-left ways ultimately proved a liability. The MSA was eventually hammered out by a smaller group of attorneys general under the leadership of Colorado’s Gale Norton, a Republican who is now secretary of the interior. For the antipharmaceutical campaign, the attorneys general have rolled out a respectable, responsible,

Republican, female poster child at the front end: Ohio attorney general Betty Montgomery heads a task force of forty attorneys general to investigate and implement pharmaceutical price control strategies.<sup>5</sup>

Advocacy groups too have learned. Novelli, for one, views the tobacco settlement as a sellout. While the agreement produced monopoly profits for tobacco firms and a general revenue stream for the states, the ostensible purpose of reducing smoking was essentially forgotten. (Only a small fraction of the settlement proceeds is put to that purpose.) Novelli’s AARP has taken an active cocounsel role in the average wholesale price litigation that makes clear that the lawsuits are about “system change” rather than mere dollars.<sup>6</sup>

The major change is on the defense side, and the direction of that change is a bit of a puzzle. Widespread speculation that the tobacco settlement might generate copycat campaigns against other industries focused on industries that shared tobacco’s injury-inducing characteristics and its ill repute, meaning that no *New York Times* reporter would go near the products—guns, for example, and fast foods. Both industries, however, have suffered only a few wildcatter lawsuits by cities and private plaintiffs. No organized assault has materialized.

Instead, the litigation industry has zeroed in on financial brokerage houses and pharmaceutical firms—both of which service the intelligentsia, and the latter of which actually save lives. Neither cultural explanations nor product characteristics appear to explain the litigation industry’s choice of targets. Nor does the targeted industries’ conduct explain that choice. Like tobacco firms, fast food companies market an addictive product to children (and lie about it); still, the industry has been spared. Pharmaceutical firms market life-saving products in conformance with FDA instructions; they have been targeted. For an explanation, and for a prediction concerning next-on-deck industries, one must look to the political economy of the matter. First, targeted industries will typically be unable to differentiate their products along jurisdictional lines and to control cross-border arbitrage (meaning the unauthorized sale of products from one jurisdiction into another, with much of the proceeds going to middlemen). Second, targeted industries will tend to be highly concentrated.

## No Exit

The fifty states encompass large variations in political culture and interest. They vary on every dimension

pertinent to the ambitions of the pharmaceutical cases—demographics, taxes, insurance regulation, and geography. (The spectacle of U.S. citizens boarding Canada-bound buses to purchase price-controlled drugs in that country explains why border states such as Michigan and Maine have played a leading role in the push for domestic price controls.) How can Florida and Mississippi and Colorado hope to agree on a concerted litigation campaign? The answer lies in interstate exploitation.

Suppose that business firms can respond to state regulation by taking their business to another state: even if all fifty states agreed on a need for stricter regulation, they could never agree on a uniform scheme (by litigation or otherwise). A single free-rider state would attract all the mobile industries and the benefits they convey. The costs of regulation would accrue to the regulating states' citizens.

Suppose, however, that a company cannot escape the regulatory imposition of any state, and suppose further that it cannot tailor the price or the characteristics of its product to the laws and regulations of an individual state: in that case, the most regulation-minded state will be able to export the costs of its policies to the company's customers, shareholders, and workers across the nation. The benefits, meanwhile, accrue entirely inside the state. Under those conditions, a single state's unilateral action may produce a concerted state campaign—even if *no other state actually agrees with the first-moving state's policy*. Real-life examples illustrate the point.

Many and perhaps most state attorneys general agree that greenhouse gas emissions should be drastically curtailed. Some stand ready to pursue that objective by means of litigation. The costs of additional controls, however, would hit mostly the states' own citizens and put the implementing states at a disadvantage vis-à-vis more lenient states. State cooperation in that venue has therefore failed to produce, and will not produce, a coordinated litigation campaign. It has instead produced a petulant letter from twelve attorneys general to President Bush that demanded that he regulate them and other states. While the attorneys general make threatening noises about state litigation and regulation on greenhouse gases, they also "make it clear that state-by-state action is not [their] preferred option."<sup>7</sup> When the threat of corporate or civic exit disciplines regulation-minded states, the sovereign states shout: "Come govern us!"

Tobacco exemplifies the opposite scenario. The costs of initial settlements with four states (Texas, Florida, Minnesota, and Massachusetts) were distributed across the country. The defendant companies had no way of charging the cost to the states' consumers; any attempt to do so would only have generated a gray cross-border market. Once the first-moving states had obtained their benefits, the attorneys general of other states had no choice but to follow suit: their citizens were paying a portion of the cost without reaping the benefits, and that inequity rose with every additional state's hop on the bandwagon. In the end, even the most recalcitrant state—Alabama—signed the settlement.

A similar dynamic drives the campaign against the investment industry. Since New York can reach every firm with a single customer in the state, Merrill Lynch cannot escape Eliot Spitzer's clutches by moving to another state. The same is true, *mutatis mutandis*, of all other firms and states. Seeing that first-litigating state reap attractive rewards, all attorneys general—even those favorably disposed toward the industry—have joined the crowd.

In the pharmaceutical cases, the products' pricing behavior generates a race toward unanimity. Since the "second pill" costs next to nothing, manufacturers will continue to sell their products in price-controlling states, just as they continue to sell them in Canada. As more states file for single-purpose accession to Canada by controlling prices, citizens in the remaining United States will increasingly feel like chumps. Politicians will heed the local demand that their state should also join the free-rider parade.

To summarize: organized litigation campaigns threaten the producers of nondifferentiable consumer products that may easily cross state lines. Among service providers, the risk affects banks (which cannot easily differentiate their products) but not hotel chains (which can). Among air polluters, the risk affects car manufacturers but not utilities.

## Concentrate!

As noted, multistate settlements and settlement demands encompass both monetary transfers and regulatory impositions. "We're not in the litigation simply for the money," Ohio attorney general Betty Montgomery has stated on behalf of the attorneys general pharmaceuticals task force.<sup>8</sup> To everyone's great relief, the attorneys general are in litigation mostly for price

controls. The monetary aspect requires, on the part of the states, consensus on the division of the spoils. The regulatory ambitions imply that the states and the targeted industry as a whole must be able to reach an agreement.

That ability rises in proportion to industry concentration. At the time of the tobacco settlement, the four major manufacturers supplied 99 percent of the American market. That enormous concentration made it possible to bring the industry to the bargaining table and to monitor the firms' compliance with the agreement. At the other extreme, the fragmentation of the fast food and snack food industry explains why that otherwise vulnerable sector has so far escaped an organized attack. McDonald's and Wendy's can deal and comply. Thousands of smaller competitors do not, and the business is not amenable to entry controls.<sup>9</sup> The litigation industry's attacks on investment and pharmaceutical firms are effectively a bet that those sectors are sufficiently cohesive and concentrated to cut a deal.

## I Want My Oligopoly

The tobacco agreement is a state-administered cartel. It provides for penalties for states that fail to suppress new market entrants and thus enlists the states in the defense of the four manufacturers' market position. The agreement also guarantees the market participants price increases sufficient to pay the costs of the settlement and, moreover, monopoly profits above that level.

Bargains along those lines are the most likely outcome of all organized state litigation campaigns. The targeted industries are already concentrated and already used to cartelization at the national level. The litigation industry's initiatives present a new set of players, and they require a replacement of Beltway lobbyists with lawyers who pretend to be litigators. The idea of cutting a deal, though, is nothing new.

The average wholesale price cases will likely produce a deal between state attorneys general and the industry that provides for pricing "reform," harsh penalties for noncompliance with the reformed regime, and several billions for "recoupment" of excessive state payments and individual copayments. The deal will not go down in a courtroom, just as none of the state tobacco cases went to a verdict. It will go down in a hotel room in Carson City or Helena.

## Full Retreat, Full Surrender

When monopolies and cartels are being organized on a national scale, we ought to undertake the enterprise through national institutions that are at some level accountable to a national electorate. That function, however, is now drifting to the states, which means plaintiffs' lawyers, attorneys general, and state courts.

The perversity of that enterprise should by now be obvious. The imposition of a quarter-trillion-dollar national sales tax on a single consumer product (cigarettes) ought to involve more than a bunch of lawyers. Political pressures may eventually overwhelm good sense and generate price controls on pharmaceutical products. Most certainly, however, we want that fateful decision to be made after an open debate and vote in Congress—as opposed to insider negotiations among plaintiffs' lawyers, industry flaks, and the self-appointed custodians of "concerned citizens." But that is what is going to happen.

The only organized interest with a tangible incentive to fight the litigation industry is corporate America. Business must effectively serve as a public interest proxy in resisting rent seeking and redistribution through litigation. Never heartening, that observation is particularly depressing in the present context.

First, corporate leaders have yet to comprehend the challenge posed by the litigation industry. The average CEO's response to the tort crisis is a tirade about ambulance-chasing plaintiffs' lawyers and "hellhole jurisdictions." Those beasts exist, but they are no longer the sole problem. The leaders—or at least the figureheads—of the litigation industry now include public officials from the Chamber of Commerce's playbook. Recall the central roles played by then-Colorado attorney general Gale Norton, Republican and near Libertarian; and by Ohio attorney general Betty Montgomery, whose political beliefs are a standard deviation to the right of the industry leaders'. Eliot Spitzer is the toast of Wall Street and *Fortune*. (As he has quipped, he has only two kinds of personal friends: investment bankers and lawyers for investment banks.)<sup>10</sup> The first average wholesale price cases have come not from some collectivist haven but from Nevada and Montana.

Second, trial lawyers know their playing field in advance. Their incentive is to buy their home state judges and their home state attorney general. Corporations, in contrast, can be sued anywhere. That reduces their incentives to counter the trial bar's efforts. As noted, moreover,

unanimous state support for a litigation campaign is often a foregone conclusion once the first state has made its move. Thus, the trial bar needs to own only one or a few states. Industry, in contrast, must stop the first mover. To accomplish that feat, it would have to “own” all fifty state attorneys general and state courts.

Third, corporations face acute coordination problems in organizing a united front against the litigation industry. Gun makers, liquor producers, fast food companies, and (we now know) brokerage and pharmaceutical firms all had good reasons to ally themselves with the tobacco industry. But they had better reasons to *distance* themselves, lest they be next in line. Merrill Lynch was mowed down for a “conflict of interest” between its analysis and investment banking activities. Since every corporation has conflicts of interests (for example, among shareholders, employees, and customers), Eliot Spitzer’s creative translation of intrafirm conflicts into a common law cause of action and a statutory crime should have served as a rallying cry for corporate America. What prevailed instead was absolute silence. Now, the pharmaceutical industry is at bat—and a corporate alliance called Business for Affordable Medicine (which also includes states) is cheering the multiple pitchers to deliver a price control fastball straight in the industry’s face. (The reason is that companies often serve as third-party health care and insurance payers.)

In light of such massive impediments, corporate America cannot mount serious, coherent resistance to the litigation industry. Individual industries will fight, sometimes aggressively, in the early stage of a campaign. But they will be alone, and they will cease to fight when the contours of an acceptable bargain emerge. (The tobacco industry fought *for* the state settlement—not against it.) There simply is no effective interest group resistance to the litigation industry.

To make matters worse, no institutional resistance exists either.

## Nothing Doing

One might think that Congress and regulatory agencies have an institutional incentive to defend their turf against state attempts to regulate the same subject matter through litigation, in derogation of the federal schemes. That thought, however, is wrong. The national government may assist a state attorneys general–trial bar campaign in its initial stages, or it may use the resulting bargain as a springboard for yet more intrusive interventions. But it

will not arrest a continuing campaign or unravel a bargain between the litigation industry and its targets.

Recall the state-federal interaction in the tobacco crusade, described in an earlier *Outlook*: the states initially thought, correctly, that their proposed deal with the industry required congressional assent and legislation. When Congress failed to consent, the states proceeded on their own. No federal legislator, however, said a peep about the states’ arrogation of federal authority. Subsequently, Congress has legislated on the tobacco deal only once. On the states’ own theory, the tobacco payments constitute a recoupment of Medicaid expenses—half of which had been paid by the federal government. Congress surrendered its claims on those funds.

In June 2002, when Eliot Spitzer’s campaign against New York brokers hit its zenith and his diatribes against the industry’s undue influence with the Securities and Exchange Commission and Congress received daily news coverage, industry leaders boarded their jets, descended upon Washington, and insisted that the SEC, or Congress, or *somebody* preempt Mr. Spitzer and prevent the impending “balkanization” of the securities markets. Unbeknownst to the PR genius who advised that brilliant move (though unbeknownst to every newspaper reader), the Beltway was having a nervous breakdown over the plight of investors. Instead of the desired preemption, the CEOs received (1) the usual assurance (“We will do what we can. Please leave your check at the door.”); (2) another scathing Spitzer press release and its reprint in the *New York Times*; and (3) federal laws and regulations on top of those contemplated by Spitzer and his fellow attorneys generals—but without preemptive force.<sup>11</sup>

The states’ pharmaceutical price control crusade has been aided and abetted by the federal government. Part of the Clinton administration’s initiative to reform average wholesale pricing (which, as mentioned, failed in Congress) was a criminal prosecution against a pharmaceutical joint venture called TAP over the pricing and marketing of a single drug (called Lupron). The prosecution included credible allegations that TAP had sought to enhance sales and prescriptions of Lupron by illegal means, such as financial kickbacks to doctors. Confronted with the prospect of complete financial ruin, the defendants settled for \$800 million—and something close to an admission that “inflated” average wholesale pricing itself amounts to fraud. The TAP settlement is Exhibit A in the pending state average wholesale price proceedings.

If Congress has an institutional incentive to protect any programs against state “reform,” Medicare and Medicaid fit the bill. Those programs make up an enormous chunk of federal outlays. They rank high on the voters’ list of political priorities, and they embody difficult compromises among countless contending interests. They are the subjects of virtually permanent federal reform efforts, from prescription benefits to eligibility criteria. Congress knows that average wholesale pricing needs reform, and it knows that Hatch-Waxman is not working as intended. Bills to reform Medicare and Hatch-Waxman are pending in both chambers. The state campaigns threaten to preempt the federal reform efforts.

Yet nobody in Washington is thinking to preempt state price controls. Secretary Tommy Thompson of the Department of Health and Human Services is handing out waivers for states that wish to impose otherwise prohibited Medicaid price controls—before Congress makes him do so and on the misunderstanding that anything the states want to do must therefore be federalism. (He made his career obtaining waivers to reform Wisconsin’s welfare system.) The leading congressional contender for Hatch-Waxman reform would deal with the mass of cases against patent-holding companies—by creating another cause of action against them. Congress may eventually reform average wholesale pricing—but only by augmenting whatever bargain the states may exact. The pharmaceutical industry, in another masterpiece of corporate PR, is agitating for a national prescription drug benefit program as a preemptive solution to the states’ price control efforts. It may achieve that outcome—on some other planet.

## Institutional Impotence

All regulation is cartelization. When Congress regulates, it establishes and funds state cartels. That need arises because states often confront a coordination or holdout problem. Recall the greenhouse gas letter from the attorneys general: states A–M wish to regulate, while states N–Z have little taste for the program. Often, they will hope to benefit from its imposition by other states, since A–M companies or taxpayers may come to find the dissident states relatively more attractive. (Such healthy jurisdictional competition is often called a “race to the bottom.”) States A–M must bribe or coerce N–Z into compliance with their preferred scheme, and Congress is the only institution with the power to do so.

In the litigation industry’s venues, in contrast, no central coordination is required. When the extraterritorial application of state law prevents producers from escaping to another state, there can be no state holdout problem against regulation. In fact, the holdout problem arises in reverse: the first-moving state reaps benefits, and the costs are incurred in all states. Interstate exploitation solves the states’ coordination problem and obviates the need for central intervention. Antiregulation states might seek to prevail upon Congress to preempt the proregulation (that is, prolitigation states), but they are unlikely to succeed. Those states will at best be conflicted, since they can always reap benefits through the simple device of joining the litigating states. Moreover, federal legislation effectively requires supermajorities. When the states have a holdout problem, the proregulation states must mobilize those majorities. In the reverse holdout case, antiregulation states must mobilize majorities to stop a speeding train. Good luck! When states can couch regulatory demands as a common law cause of action and impose their demands on an extraterritorial basis, Congress might as well go home. It cannot break up or curtail a spontaneous state cartel after the fact—when all states and, typically, the regulated industries have locked themselves into a mutually satisfactory arrangement. Going home would actually be the best thing to do lest Congress legislate on top of the states’ regime.

## Same Old, Same Old

Contrary to a still prevailing, convenient belief, the contemporary tort crisis has expanded well beyond ambulance chasers and hellhole jurisdictions. The crisis now is the operation of a sophisticated, resourceful litigation industry that operates in all jurisdictions.

Contrary to an equally widespread, convenient, and false belief, the threat of state regulation through litigation is not regulatory “balkanization.” We *have* uniform tobacco regulation—except it is not the national government’s. Eliot Spitzer has no intent to balkanize the securities industry; he wants to unify it under a regulatory framework that bears his signature. When Nevada and other states are through with the pharmaceutical industry, we *will have* uniform pharmaceutical price controls for Medicare and Medicaid—but they will be sanctioned by a state cartel, not the U.S. Congress. The danger, in other words, is not

balkanization but collusion—a series of regulatory cartels under the sponsorship of the National Association of Attorneys General and its principal constituency, the trial bar. Those agencies will increasingly perform the function that Congress and federal regulatory agencies are supposed to perform.

Congress cannot arrest that development. State-based regulation by litigation will always move faster than Congress—because attorneys general are more mobile and energetic than a fractious legislature and because the “process” they have invented reduces the range of interest group conflict to two or three constituencies—trial lawyers, regulated industries, and perhaps advocacy organizations. The congressional failure to enjoin or preempt unilateral state “reforms” of federal regimes, moreover, is not an institutional failure. It indicates that the system is working as intended, more or less: Congress is supposed to be cumbersome and slow.

What is *not* working as intended is state law. States can afford to dispense with congressional intervention when and where they have managed to solve the coordination problem. They have solved that problem when and where the extraterritorial reach of state law leaves regulated industries no escape and, at the same time, permits first-moving states to exploit their neighbors—until the inexorable logic of interstate exploitation generates unanimity, and something approximating proportional exploitation, among the states.

The root of our parallel National Association of Attorneys General Constitution, of states’ rights on steroids, is the unbounded reach of state law. The actual Constitution and real federalism presuppose rules that limit states to experimenting on their own citizens and their own corporations. The enforcement of those rules is the business of the federal courts.

A half-dozen *Outlooks* have drawn that inescapable conclusion. If a handful of federal judges were to arrive at that same destination, American business could go back to business.

## Notes

1. On the continuing liability-induced shortages of childhood vaccines, see Robert Pear, “States Ration Low Supplies of 5 Vaccines for Children,” *New York Times*, September 16, 2002.

2. I have stolen the title of this section from Robert Palmer and its content from my colleague Jack Calfee,

who bears no responsibility for mistakes and carefully cast aspersions.

3. For a brief description of the case, see “The Supreme Court Term That Was, and the One That Will Be,” *Federalism Outlook* No. 13 (July/August 2002) (available at <http://www.aei.org/fo/fo14236.htm>). For up-to-date descriptions of the mind-boggling flurry of state initiatives in this area, see the Web site of the National Council of State Legislatures, <http://www.204.131.235./67/programs/health/drugdisc02.htm>.

4. The policy question is whether the generics can be brought to market during the pendency of the litigation. They usually are not because sales of the replacement product expose the generic firm to financial ruin if the patent holder eventually wins the case.

5. The alternative candidate with the requisite characteristics, Carla Stovall of Kansas, is intensely occupied with putting a patina of respectability on the states’ continued antitrust campaign to enact Silicon Valley’s business plan against Microsoft.

6. Russell Gold and Andrew Caffrey, “States Suing Drug Makers Spurn ex-Allies on Tobacco,” *Wall Street Journal*, May 29, 2002 (quoting AARP representative).

7. The July 17, 2002, letter was signed by the attorneys general of Alaska, California, and ten Northeastern states. It is available at [http://www.ago.state.ma.us/press\\_rel/climate.pdf](http://www.ago.state.ma.us/press_rel/climate.pdf).

8. Gold and Caffrey, “States Suing Drug Makers.”

9. The problem is not insurmountable. The litigation industry may be able to identify a sufficiently concentrated food industry sector—and a “problem” unique to that sector—to render a litigation campaign feasible. The ostentatious display of carbonated soft drinks in supermarkets and convenience stores, for example, may be said to induce excessive and unhealthful consumer demand. It surely constitutes some common law cause of action (such as deceptive trade practice), and the affected industries may be sufficiently cohesive to permit a state litigation campaign.

10. See *Fortune*’s multipage puff piece on Spitzer: Mark Gimein, “The Enforcer,” *Fortune*, September 16, 2002 (available at [www.fortune.com/indexw.jhtml?channel=artcol.jhtml&doc\\_id=209347](http://www.fortune.com/indexw.jhtml?channel=artcol.jhtml&doc_id=209347)).

11. Section 501 of the Sarbanes-Oxley Act of 2002, enacted by overwhelming majorities as an amendment to the 1934 Securities and Exchange Act, commands the SEC to issue regulations governing not only the internal organization of integrated financial service firms—the subject matter of Spitzer’s Merrill Lynch settlement—but also analyst disclosures in public appearances. With respect to the settlement issues, the SEC has indicated its intent to promulgate rules that are “at least as strict” as those agreed to by Merrill Lynch. See Kathleen Day, “SEC Rules to Target Analysts, Officials Say,” *Washington Post*, September 10, 2002.