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THE CONSTITUTION AND THE CATHEDRAL: PROHIBITING, PURCHASING, AND POSSIBLY CONDEMNING TOBACCO ADVERTISING

Thomas W. Merrill*

INTRODUCTION

This Article has both theoretical and practical objectives, which are closely interrelated. The theoretical objective is to develop a framework for understanding the "transaction structure" of constitutional rights. By this, I refer to the different rules that determine when the government may purchase, condemn, or otherwise extinguish constitutional rights. The practical objective is to consider different options that may be available to the government, as part of a broader effort to reduce the incidence of smoking, to curtail tobacco advertising that would otherwise be protected under the First Amendment. It is my hope that the theoretical framework will illuminate the practical problem. Conversely, however, I also anticipate that consideration of the practical problem will suggest refinements in or limitations on the theoretical framework.

The transaction structure that applies to constitutional rights includes four principal options. Sometimes constitutional rights are deemed non-waivable. Thus, when the courts apply the unconstitutional conditions doctrine to strike down an arrangement in which a constitutional right is given up in exchange for some government benefit, this may mean that the right cannot be waived under any circumstances. In other settings—for example, with respect to plea bargaining—the courts have been quite willing to permit persons to waive their constitutional rights in return for some quid pro quo like a reduced sentence. In still other settings, most prominently where contract and property rights are concerned, the government is permitted to condemn constitutionally protected interests without the right-holder's consent upon payment of judicially determined compensation. Finally, there are many circumstances where courts have concluded that the

* John Paul Stevens Professor of Law, Northwestern University. I am grateful for comments received from Jim Speta and from the participants in Free Speech and Economic Power: A Symposium.


2 The analysis could no doubt be refined to include other options. See Saul Levmore, Unifying Remedies: Property Rules, Liability Rules, and Startling Rules, 106 YALE L.J. 2149, 2173 (1997) (listing sixteen possible transaction structure rules).
government has such a strong interest in preventing certain harms that constitutional rights can be overcome by legislative action without consent and without paying any compensation at all. This is what happens when a right is said to be trumped by the government’s police power.

This typology of transfer rules can be redescribed in terms of the vocabulary introduced by Guido Calabresi and A. Douglas Melamed (hereinafter C&M) to explain different degrees of protection given to common-law entitlements. The first circumstance, where all transfers are prohibited, reflects what C&M call an “inalienability” rule. The second, where rights may be sold by the rightsholder but cannot be involuntarily taken, tracks what C&M label a “property” rule. The third, in which the government can take rights without the rightsholder’s consent upon payment of ex post compensation, is what C&M call a “liability” rule. Finally, the fourth circumstance, in which the right is extinguished upon a finding that it is trumped by the police power, would under the C&M framework be a situation of “no entitlement.”

In some circumstances, the transactional rules that apply to constitutional rights are reasonably well established. Thus, for example, it is clear that government employees cannot waive their free speech rights, at least as to matters unrelated to their government responsibilities; that is, the First Amendment in these circumstances is protected by an inalienability rule. Similarly, we know that criminal defendants can waive their right to a public trial; the Sixth Amendment is in these circumstances protected by a property rule. Likewise, there is no doubt that owners of real estate can have their property condemned by the government for virtually any plausible reason as long as the government compensates them; the Fifth Amendment here is protected by a liability rule. And we know that in certain circumstances, like shouting fire in a crowded theater or using one’s property to commit a nuisance, rights can be trumped without either consent or compensation; that is, the right gives way to the supervening claims of the police power.

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3 See Guido Calabresi & A. Douglas Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 HARV. L. REV. 1089 (1972). As more recent commentary has suggested, the different modes of protecting rights should not be regarded as different “remedies” for the violation of entitlements, but rather as different specifications of the content of entitlements with respect to the domain of transfer. See Jules L. Coleman & Jody Kraus, Rethinking the Theory of Legal Rights, 95 YALE L.J. 1335, 1345 (1986); Dale A. Nance, Guidance Rules and Enforcement Rules: A Better View of the Cathedral, 83 VA. L. REV. 837 (1997).


7 See Nollan v. California Coastal Comm’n, 483 U.S. 825, 837 (1987) (“a ban on shouting fire can be a core exercise of the State’s police power to protect the public safety, and can thus meet even our stringent standards for regulation of speech.”) (dictum); Keystone Bituminous Coal Ass’n v. De-Benedictis, 480 U.S. 470 (1987) (a state may prohibit nuisances and thereby impair the value of property without violating the Takings Clause).
But there are other settings—such as the right to engage in commercial speech—where the appropriate transactional rule or rules is highly uncertain. In filling such gaps or lacunae in the transaction structure, it would be useful to have a general theoretical framework that would help judges and other actors identify the relevant variables for determining which transaction rule is appropriate. My first objective in this Article is to contribute to the development of such a framework.

The second and more practical objective is to consider various options available to the government in controlling commercial advertising by tobacco companies. The issue has been brought to the fore by a series of unusual efforts outside the normal legislative process to impose new restrictions on tobacco advertising. These efforts commenced when the federal Food and Drug Administration (FDA) proposed and then adopted tough regulations limiting tobacco advertising. The FDA had never before in its long history sought to regulate tobacco advertising. Not surprisingly, the tobacco companies challenged the FDA’s advertising regulations in federal district court in North Carolina as exceeding the FDA’s jurisdiction and as violating the tobacco companies’ First Amendment rights.

Without reaching the First Amendment question, both the district court and the Fourth Circuit Court of Appeals held that the FDA had no statutory authority to regulate tobacco advertising. The Supreme Court has recently granted the government’s petition for certiorari seeking review of this decision. If the Court upholds the FDA’s jurisdiction over tobacco advertising, then the First Amendment issue would be ripe for consideration by the lower courts. Alternatively, if the Court holds that the FDA lacks authority over tobacco, Congress conceivably could respond by enacting legislation that would confer such authority on the FDA or another federal agency, in which case federal limitations on tobacco advertising could return either as part of the legislation or as new or readopted administrative regulations. Thus, it is not unlikely that courts sometime in the not-too-distant future will have to decide whether the federal government’s interest in discouraging smoking is sufficiently compelling to justify significant curtailments on tobacco advertising, in other words, whether the right to engage in tobacco advertising is trumped by the police power.

In June 1997, while the legal challenges to the FDA’s authority were pending before the Fourth Circuit, a startling development was announced: the major tobacco companies and many of their adversaries, including state


attorneys general, plaintiffs' lawyers, and certain public health groups, had entered into a settlement agreement calling for payments totaling $368.5 billion by the tobacco companies over twenty-five years.\(^\text{10}\) This so-called "Global Settlement" also provided for the enactment of federal legislation that would resolve the scope of the FDA's authority over tobacco,\(^\text{11}\) impose limits on the companies' annual tort liability from all sources, and impose significant new advertising and marketing restrictions on the companies. Recognizing that the advertising restrictions might be vulnerable to a First Amendment challenge, the settlement also called for the adoption of consent decrees in which the tobacco companies promised to abide by the advertising restrictions to be included in legislation.\(^\text{12}\) To further protect against First Amendment interference, the Global Settlement then provided that the tobacco companies entering into the consent decrees would "expressly waive" any claim that these restrictions violate the federal or state constitutions.\(^\text{13}\) In short, the Global Settlement presupposed that commercial advertising of tobacco products is protected at most by a property rule, that is, by a right that the tobacco companies are free to bargain away by contract in return for offsetting benefits that they regard as more valuable, such as limitations on their tort liability.

The requirement of implementing federal legislation proved to be the Global Settlement's undoing. Legislators sought to rework the settlement into something more to their liking; specifically, they sought to increase the payments required of the tobacco companies while reducing the degree of tort immunity granted to the companies. In April 1998, the tobacco companies responded by withdrawing their support from the Global Settlement and launching a public relations campaign to defeat the legislation.\(^\text{14}\) By June, the publicity campaign began to take effect and the tobacco bill was killed by the Senate leadership.\(^\text{15}\)

Nevertheless, the prime movers behind the Global Settlement—the state attorneys general and the tobacco companies—did not give up. Almost immediately, a new effort commenced to reach a settlement that would not require federal legislation.\(^\text{16}\) In November 1998, a stripped-down

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\(^\text{10}\) See Memorandum of Understanding and Proposed Resolution (visited May 18, 1999) <http://stic.neu.edu/settlement/6-20-settle.htm> [hereinafter Global Settlement].

\(^\text{11}\) The Global Settlement did not resolve the litigation in the Fourth Circuit over the FDA's proposed regulations, but it did call for the enactment of new federal legislation that would have effectively mooted the FDA controversy. See id.

\(^\text{12}\) Id. at tit. III.B.

\(^\text{13}\) Id.


settlement agreement calling for payments totaling $206 billion was unveiled.\(^\text{17}\) This "AG Settlement" rapidly received the assent of all forty-six attorneys general who had not previously settled with the tobacco companies, as well as the approval of most trial courts overseeing the attorneys general’s suits against the tobacco companies.\(^\text{18}\) The AG Settlement appears to be well on its way to final approval in all states.

Although it does not require the enactment of federal legislation, the AG Settlement provides for the entry of consent decrees in which the tobacco companies agree to significant restrictions on advertising, albeit more modest ones than those set forth in the Global Settlement. Thus, under the AG Settlement the consent decrees move from a role of "backstopping" legislated regulations on advertising to a role of serving as the primary mechanism for controlling advertising. Moreover, the AG Settlement, like the Global Settlement, includes a "waiver of rights" provision as insurance against judicial invalidation of these advertising restrictions.\(^\text{19}\) Therefore the AG Settlement, in a fashion even more dramatic than the Global Settlement, presupposes that commercial speech rights may be waived by negotiated contracts.

In sum, recent events have suggested that commercial advertising of tobacco products conceivably could be governed by three of the four major transactional rules: a police power rule, a property rule, or, if the FDA’s regulations are declared unconstitutional and the tobacco companies’ waivers of rights are invalidated or ignored, an inalienability rule. The only missing possibility is the liability rule. But it is not too hard to envision how this too might eventually become a live option. First, suppose that the courts rule that additional restrictions on tobacco advertising beyond those contained in the AG Settlement are unconstitutional. Then, assume that it proves impossible to secure a waiver of rights from the tobacco companies with respect to these additional advertising restrictions, perhaps because the federal government fails to secure such a waiver as part of a future settlement of its recently proposed lawsuit against the tobacco companies.\(^\text{20}\)


\(^{18}\) As of this writing, 44 of the 46 trial courts have approved the AG Settlement and associated consent decrees. See NAAG, States with Approval (visited Feb. 28, 1999) <http://www.naag.org/consent.htm>. Four states (Mississippi, Florida, Minnesota, and Texas) had previously entered into individual settlements with the tobacco companies and are not included in the AG Settlement.

\(^{19}\) Specifically, the AG Settlement contains a provision in which each participating tobacco company: acknowledges that it understands that certain provisions of this Agreement may require it to act or refrain from acting in a manner that could otherwise give rise to state or federal constitutional challenges and that, by voluntarily consenting to this Agreement, it ... waives for purposes of performance of this Agreement any and all claims that the provisions of this Agreement violate the state or federal constitutions. Supra note 17, art. XV.

\(^{20}\) In his State of the Union address on January 19, 1999, President Clinton announced that the federal government would file its own civil damages action against the major tobacco companies, seeking to
Should these events come to pass, then Congress might be impelled to consider the possibility of condemning the commercial advertising rights of the tobacco companies. The question would then be presented whether commercial speech rights—like property and contract rights—are the type of constitutional right subject to forced exchange upon the payment of *ex post* compensation. In other words, the liability rule solution.

This Article begins in Part I by considering the transaction structure of constitutional rights from a theoretical perspective. The pioneering work of Calabresi and Melamed serves as the central inspiration here, but it is given a different explication than is commonly found in discussions of the transactional rules that apply in the private law context. Part II provides a summary of the Supreme Court's evolving jurisprudence of commercial speech, and of the advertising restrictions contained in the FDA regulations, the Global Settlement, and the AG Settlement. Part III then applies the theory developed in Part I to transaction structure issues likely to be presented by these new cigarette advertising regimes. I conclude that efforts to restrict cigarette advertising similar to those contained in the FDA regulations, the Global Settlement, and the AG Settlement should be upheld by courts under a police power rule. However, if the courts reject this conclusion, waivers of commercial speech rights by the tobacco companies, such as the one contained in the AG Settlement, should be enforced. Finally, if the courts hold that tobacco advertising restrictions beyond those in the AG Settlement are unconstitutional, and if a waiver of rights cannot be secured with respect to these additional restrictions, then I argue that condemnation of the commercial speech rights of tobacco companies should be permitted.

I. THEORETICAL FRAMEWORK

In this Part, I offer a sketch of a theoretical framework for resolving questions that arise concerning the transaction structure of constitutional law. The framework is derived from the "view of the cathedral" presented by Calabresi and Melamed in their famous article, which is usually applied in discussing the transaction structure for common-law entitlements. But I will give the C&M framework a somewhat different spin than is usually encountered, in part because of differences between constitutional law and recover tobacco-related costs incurred by the Medicare program and other federal programs besides Medicare. Remarks as Prepared for Delivery by President William Jefferson Clinton: State of the Union Address (last modified Jan. 19, 1999) <http://www.pub.whitehouse.gov/uri-res/l2R?um:pdi/oma.eop.gov.us/1999/1/19/20.text.l>. It would appear to be the federal government's objective, following the lead of the state attorneys general, to survive motions to dismiss such a suit, and then to try to enter into an additional multibillion dollar settlement with the tobacco companies. Whether the federal government will in fact survive motions to dismiss, whether there will be an additional settlement, and whether the settlement would include a new waiver of rights with respect to more draconian advertising restrictions, are all of course extremely conjectural possibilities at this point in time.

common law, and in part because of what I regard as shortcomings in the conventional explication of this seminal work.

A. The Constitution's Cathedral

The conventional elaboration of the C&M framework in law-and-economics literature starts by developing a two-by-two matrix describing some kind of land-use dispute. On one axis, the initial entitlement is given either to the plaintiffs (e.g., residents) or the defendants (e.g., polluters). On the other axis, the entitlement is protected either with a property rule or a liability rule. As shown by Table 1, this generates four possibilities: the plaintiffs get the entitlement protected by an injunction ("Rule One"); the plaintiffs get the entitlement protected by an award of damages ("Rule Two"); the defendants get an unrestricted entitlement to pollute ("Rule Three"); or the defendants get the entitlement but the plaintiff can buy it out at a judicially-determined price ("Rule Four"):  

<table>
<thead>
<tr>
<th>INITIAL ENTITLEMENT</th>
<th>METHOD OF PROTECTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residents</td>
<td>Injunction / Property Rule</td>
</tr>
<tr>
<td></td>
<td>Rule 1</td>
</tr>
<tr>
<td>Polluters</td>
<td>Rule 3</td>
</tr>
</tbody>
</table>

Table 1

Typically, this matrix is deployed in an analysis inspired by Coasean transaction-cost economics. The central question is how the initial assignment of entitlements and transactional rules will affect private bargaining among the parties. If transaction costs are low for both the plaintiffs

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23 Adopted from Krier & Schwab, supra note 22, at 444.

and the defendants, all four options will presumably lead to efficient outcomes. Property rules (Rule One or Rule Three) may be favored here because they reduce judicial costs—there is no need to hold a hearing to set damages—or because they protect non-market values (e.g., subjective valuations or "other justice reasons"\textsuperscript{25}). If transaction costs are asymmetric—high for one side, low for the other—then the options become more constrained. Property rules may frustrate private bargaining because of holdout or free-rider problems associated with the side having high transaction costs. This may limit the court's choices if efficiency is desired. Finally, if transaction costs are high for both sides, then choices are constrained even further, because property rules can never be modified by private bargaining. Thus, if the court is uncertain of the right result and wants to promote efficiency, it is assumed that recourse must be had to liability rules.

This conventional explication of the C&M framework has no doubt generated valuable insights, but there are reasons to believe that it is not the only fruitful interpretation. One evident shortcoming is that inalienability rules are completely ignored in the conventional account. Inalienability is treated as a fringe concept relevant only to phenomena like slavery contracts, sales of body parts, and other marginal issues where we have reason to doubt the rationality of the participants or where nonmarket "moralisms" dominate the usual concern with efficiency.\textsuperscript{26} It is curious that the concept of inalienability, which plays a central part in the original C&M article, is implicitly dismissed in the conventional account as being of little intrinsic interest to a theory of transaction structures.

A second shortcoming—in my view at least—is that the conventional explication leads to a rather obsessive concern with the possible utility of C&M's "discovery" of Rule Four. Rule Four is in effect a private right of eminent domain: the plaintiff is empowered to take the entitlement without the defendant's consent, but must provide just compensation to the defendant for doing so. Rule Four was serendipitously invoked by one court about the same time the C&M article was published.\textsuperscript{27} Yet, notwithstanding the strenuous efforts of tort and property teachers to promote Rule Four as an option of equal dignity with Rules One to Three, it has rarely been seen before or since.\textsuperscript{28} The usual combination of factors said to justify the

\textsuperscript{25} Calabresi & Melamed, supra note 3, at 1102-05. "Other justice reasons" can refer to considerations such as who established their land use first—the "coming to the nuisance" problem.

\textsuperscript{26} See, e.g., Kaplow & Shavell, supra note 24, at 715 n.1. This is not to say that the phenomenon of inalienability has been ignored by legal scholars. See, e.g., Richard A. Epstein, Why Restrain Alienation?, 85 COLUM. L. REV. 970 (1985); Margaret Jane Radin, Market-Inalienability, 100 HARV. L. REV. 1849 (1987); Susan Rose-Ackerman, Inalienability and the Theory of Property Rights, 85 COLUM. L. REV. 931 (1985). But the phenomenon has been treated more as a challenge to the economic perspective associated with the C&M framework, rather than an integral part of it.


application of Rule Four is that efficiency favors the plaintiffs, "other justice reasons" favor the defendant, and yet because the plaintiffs are numerous or otherwise face high transaction costs, there can be no assurance that Rule Three (requiring the more efficient plaintiffs to buy out the more deserving defendant) will work. The basic problem with this Rule Four scenario, however, is that if the plaintiffs face high transaction costs, they will have no more success assembling a fund to pay just compensation to the defendant than they would have in putting together a negotiated buyout of the defendant.29 Given its lack of relevance to the real world of positive transaction costs, Rule Four probably does not deserve the prominence it receives in the standard account.

This specific critique of Rule Four reflects a more general problem with the conventional explication, namely, that it implicitly adopts an overly narrow conception of transaction costs. In the conventional account, transaction costs are often implicitly assumed to mean the costs of market exchange. But litigation is also costly. If we define transaction costs more broadly to include all costs of organizing for effective collective action, then it is clear that filing a lawsuit to obtain a judgment from a court establishing entitlements and transaction rules may also fail in the face of high transaction costs.30 Thus, liability rules—Rules Two and Four—do not represent the cure-all for high transaction costs occasionally suggested in the literature. Just as low transaction costs on both sides can render all four rules largely irrelevant—efficient outcomes will prevail no matter what initial allocation of entitlement and transaction rule we select—so high transaction costs on both sides can render all four rules largely irrelevant—the entitlement will stay where it is initially allocated no matter what transaction rule we select.

For these and other reasons, I will depart from the conventional explication and instead offer a different view of the C&M cathedral. My interpretation is based not on a two-by-two matrix but rather on four possible outcomes, ranked hierarchically in terms of the degree of difficulty they pose for transfers away from the initial allocation of entitlements (see Table 2). Thus, at the top of the hierarchy we find an entitlement protected by an inalienability rule, that is, the situation where no transfers of the entitlement are permitted. This is followed by an entitlement protected by a property rule, meaning that the entitlement may be transferred only with the consent of the entitlement holder, presumably in return for consideration that the entitlement holder values more than the entitlement. This is followed by an entitlement protected by a liability rule, meaning that the entitlement can be taken without the entitlement holder's consent, but only upon payment of just compensation. And bringing up the rear we find an entitlement that can

29 See Krier & Schwab, supra note 22.
be trumped by the police power, meaning that the entitlement can be taken without the entitlement holder’s consent and without the payment of just compensation.

<table>
<thead>
<tr>
<th>FOUR TRANSACTIONAL RULES</th>
<th>INALIENABILITY RULE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Property Rule &gt;</td>
</tr>
<tr>
<td></td>
<td>Liability Rule &gt;</td>
</tr>
<tr>
<td></td>
<td>Police Power</td>
</tr>
</tbody>
</table>

Table 2

There are several advantages to this explication of the C&M framework in the context of considering different protections of constitutional rights. First, it places the emphasis on the transactional rule rather than on the assignment of entitlements. In the common law context, it may be plausible (at least to some) to assume that courts have freewheeling authority to allocate entitlements to plaintiffs or defendants according to some ad hoc economic analysis. But this assumption makes no sense in considering constitutional entitlements, where the authoritative constitutional text itself establishes the menu of entitlements and who gets them—generally private persons who are subject to government regulatory power. The only significant issue in constitutional law, in the language of the C&M framework, is the determination of which transactional rule should apply to these entitlements in any particular context. Thus, an analysis that downplays the question of who gets the entitlement makes more sense here.

Second, unlike the conventional explication, my treatment incorporates the missing inalienability rules directly into the analysis. This addition is important for an analysis of constitutional rights, where the unconstitutional conditions doctrine plays such a large and often puzzling role. The unconstitutional conditions doctrine demarcates a sphere where inalienability rules reign, and this sphere undoubtedly covers a larger area of constitutional law than inalienability rules occupy in the common law.

Third, my explication includes the three outcomes that are found most commonly in common law litigation. Rule One in the conventional treatment corresponds to my “property rule,” Rule Two to my “liability rule,”

and Rule Three to my "police power rule." What drops out in my version is Rule Four. As previously suggested, this would not be much of a loss in the explication of common law rules because this rule turns out to be of little practical relevance in that context. But it is even more of an unnecessary appendage in the constitutional realm. Rule Four in the constitutional context would imply a situation in which an individual can acquire a constitutional right against the government, but only by paying the government for the costs associated with its exercise. Although it may be possible to imagine such rules, if any actually exist they are rare.

Finally, and most importantly, I rely less heavily on transaction cost considerations in developing the relevant considerations in choosing among these outcomes. Transaction costs will enter the picture, but in a more secondary fashion than is typical under the conventional analysis. Instead, I will deploy my hierarchy of outcomes in light of an older economic tradition—that associated with the concept of externalities. Only after this basic assessment is undertaken will I turn to transaction cost economics. In this sense, I will give the C&M framework a more "Pigouvian" spin than is customarily found in the conventional explication, which is purely "Coasean."33

**B. The External Benefits and Costs of Constitutional Rights**

My proposed explication of the transaction structure of constitutional rights is based on the external benefits and external costs associated with the exercise of different constitutional rights.34 Presumably, most constitutional rights provide private benefits to the rightsholder, whether it be the self-expression guarded by the First Amendment, the privacy protected by the Fourth Amendment, or the freedom from egregious punishments barred by the Eighth Amendment. In addition, however, the exercise of constitutional rights in many circumstances generates external benefits and external costs for third parties.

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32 One possibility is suggested by cases involving access to traditional public forums to engage in speech-protected activities. A rule that permitted groups to obtain access to the public streets to conduct a demonstration, but only on condition that they agree to pay the costs of policing and litter removal, might qualify as an illustration of a Rule Four constitutional entitlement. Whether such a rule would be permissible under current law is uncertain. See Forsyth County, Georgia v. Nationalist Movement, 505 U.S. 123 (1992) (invalidating discretionary advance fee of $100 for demonstration justified in part by anticipated costs of police protection).


It is easy to think of examples of constitutional rights that generate external benefits. Free speech rights are probably the most commonly recognized illustration. Information is a public good which can be consumed by an unlimited number of persons. Thus, protecting A's right to disseminate information to B will often generate benefits in the form of additional information for C, D, E, F, etc. as well. Separation of powers provisions offer another example. Individual defendants typically invoke separation of powers defenses (e.g., that the suit cannot be heard by an Article III court) not because these rights necessarily have any intrinsic value to the litigant, but primarily for strategic reasons. Nevertheless, the general public benefits by the enforcement of these principles because this preserves our system of checks and balances among the branches.

It is also not hard to think of examples of constitutional rights that generate external costs. The Fourth Amendment, to the extent it is protected by the exclusionary rule, is one example. If the Fourth Amendment requires the suppression of evidence that allows a career criminal to go free, then the exercise of this constitutional right may result in external costs being imposed on third persons. Even rights that ordinarily generate external benefits can on occasion lead to large external costs. If the First Amendment is applied so as to permit self-styled Nazis to march in Skokie, Illinois, the anguish imposed on local residents who remember death camps run by real Nazis is an external cost of this exercise of First Amendment rights.

My basic theory is that the transactional rule applied to any particular constitutional right will depend primarily on whether the exercise of that right generates significant net external benefits or significant net external costs. Constitutional rights that generate significant net external benefits above and beyond the value of the private right will be protected with inalienability rules, because the individual valuation of the right will fail to take into account the external benefits generated by the exercise of the right. Thus, permitting individuals to waive these rights in exchange for quid pro quos they value more highly would deprive society of valuable external benefits associated with the rights' exercise. An example would be applicants for government employment asked to waive their rights to publish books in return for a government job. The job applicants would weigh the offer against their private assessment of the likely benefits they will gain from future book publication. But this ignores the external benefits to the public from increased information—a classic public good. Consequently, there is reason to believe that permitting individual waivers by job applicants, particularly on a mass scale, would lead to inefficient outcomes.

At the other extreme, where the exercise of constitutional rights generates net external costs that exceed the private value of the right, those rights are subject to being trumped by the police power. This is because the individual valuation of the right is more than offset by the external costs generated by the exercise of the right, making enforcement of the right socially inefficient. An example would be a police request to enter a home in pursuit of a fleeing suspect. The homeowner is likely to weigh the costs and benefits of waiving Fourth Amendment rights and consenting to police entry solely in terms of his or her valuation of the intrusion of the search, and may not factor in the external costs to third parties if the felon is allowed to escape. To protect society’s interest in preventing the imposition of large external costs in these situations, we allow the government’s police power to trump the Fourth Amendment right by carving out of the warrant requirement an exception for arrests made in “hot pursuit.”

The intermediate case between these two poles is where a constitutional right has no significant net external benefits or costs, either because there are no appreciable external effects or because the external benefits and external costs more or less cancel each other out. In these situations, we typically allow the individual rightsholder to determine whether to invoke the right or to waive the right in exchange for government benefits that have a higher value.

Plea bargaining is an example where the exercise of a constitutional right has both positive and negative external effects and where waivers are routinely enforced. The right in question is the Sixth Amendment’s guarantee of a public criminal trial. Exercise of this right surely gives rise to external benefits, such as greater public information about law enforcement and criminal behavior, opportunities for civic participation in government, and so forth. But exercise of the right also generates external costs, given that the expense of public trials is heavily subsidized by the state and thus borne by taxpayers. If every accused criminal received a full-blown trial, we would have to expand the judicial system many times over. Different commentators have placed different values on the marginal benefits of additional trials versus the marginal costs of additional trials. But it is not implausible that on balance the external benefits and costs here are a toss-up, or at least that the relative valuation of the external benefits and costs is indeterminate, making a property rule the correct choice.

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38 This analysis assumes, of course, that all external benefits and costs are capable of valuation under a common metric, such as dollars. Many will question this assumption, especially where the external benefits or costs are long-term and systemic or structural in nature. Nevertheless, I will not explore these problems here, for fear of digressing too far from explication of the basic theoretical framework.
40 Cf. Owen M. Fiss, Against Settlement, 93 YALE L.J. 1073 (1984) (criticizing settlement of litigation on the ground that it vitiates the “public values” associated with public trials).
In short, the key variable in choosing among these three transactional options—inalienability rules, property rules, and police power rules—is the "public goods value" of the exercise of a constitutional right in a given circumstance, or PGV_{cr} for short. This public goods value is simply the net value of the external benefits of the exercise of the right (EB_{cr}), and the external costs of the exercise of the right (EC_{cr}). Thus,

\[ \text{PGV}_{cr} = \text{EB}_{cr} - \text{EC}_{cr}. \]

What this says is that every invocation of a constitutional right will have a certain public goods component, and that this component is made up of any external benefits associated with the exercise of that right minus any external costs associated with the exercise of that right.

In addition to its public goods value, constitutional rights have (in most cases) a private value to the rightsholder (PV_{cr}). Putting together the PV_{cr} and the PGV_{cr}, we obtain the following conditions for applying inalienability rules (IR), property rules (PR), and police power rules (PPR):

\begin{align*}
(1) & \quad \text{IR}, \quad \text{PGV}_{cr} + \text{PV}_{cr} > \text{PV}_{cr} \text{ or } \text{PGV}_{cr} > 0 \\
(2) & \quad \text{PR}, \quad \text{PGV}_{cr} + \text{PV}_{cr} = \text{PV}_{cr} \text{ or } \text{PGV}_{cr} = 0 \\
(3) & \quad \text{PPR}, \quad \text{PGV}_{cr} + \text{PV}_{cr} < 0 \text{ or } \text{PGV}_{cr} < -\text{PV}_{cr}
\end{align*}

Equation One tells us that inalienability rules should apply when the public goods value of the exercise of a right is positive (because EB_{cr} > EC_{cr}) and consequently the total value of the exercise of the right (PGV_{cr} + PV_{cr}) is greater than the private value alone. In these circumstances, the individual valuation of the right diverges from the social valuation of the right, giving rise to a danger that the individual will waive the right even though it is socially inefficient to do so. The solution is to bar waivers of such rights, that is, to make them inalienable. We can do this either by prohibiting contracts to sell the right (e.g., slavery contracts or contracts to sell votes) or, more commonly, by allowing the entitlement holder to keep both the right and the consideration that the government previously paid in attempting to induce waiver of the right (e.g., the government employee gets to keep her First
Amendment rights and the government job that was supposedly conditioned on her waiver of these rights).

Equation Two tells us that property rules should apply when the public goods value of the exercise of the right is zero, a result that occurs when $EB_{cr}$ and $EC_{cr}$ are both zero or when $EB_{cr} = EC_{cr}$. In these circumstances, the total value of the right exactly equals the private value, and there is no significant divergence between the individual valuation of the right and the social valuation of the right. Permitting the entitlement holder to waive her rights in these circumstances is thus consistent with social efficiency, subject to the usual caveats about the absence of fraud, duress, and so forth.

Equation Three tells us that the police power rule should apply when the public goods value of the exercise of the right is negative (because $EB_{cr} < EC_{cr}$) and this negative social value more than wipes out the presumed positive private value of the right to the entitlement holder. In these circumstances, the total value of the exercise of the right is negative, and social welfare is improved if the right is trumped by the exercise of the police power. This is consistent with the traditional understanding that the police power concept entails, first, an assessment of the government interest in regulation (aimed at eliminating or avoiding a negative $PGV_{cr}$ associated with the exercise of the right) and, second, a finding that the government interest outweighs the private interest.

C. The Role of Liability Rules

So far, my Pigouvian explication of the C&M framework based on external costs and benefits has considered only three types of rules—inalienability rules, property rules, and police power rules. What is the rationale for adding a fourth type—liability rules? Liability rules pose a degree of difficulty for transfers away from the initial allocation of entitlements that is intermediate between property rules and police power rules. They are less restrictive of transfers than property rules, because they do not require that the government obtain the consent of the entitlement holder before a transfer may take place. On the other hand, they are more constraining than police power rules, because under a liability rule the government is required to compensate for the loss of the entitlement, whereas under a police power rule the government overrides the entitlement without any need to pay compensation.

The case for liability rules in the constitutional context is somewhat complex, and entails three subsidiary questions. First, why do we need compelled transfers as opposed to voluntary waivers of rights? This question demands a justification for reducing the barriers to transfer below those associated with property rules. Second, why do we provide compensation as opposed to simply declaring that the government interest trumps the private right? This question demands a justification for the practice of providing compensation in the case of some compelled transfers but not those
associated with exercises of the police power. Third, does the compensation requirement impose other limitations on the domain of liability rules? Here, we have to face the difficulty that not all constitutional rights are equally amenable to being valued in monetary terms.

1. Why Compelled Transfers? The basic explanation for shifting from property rules to liability rules is one that will be highly familiar to those conversant with the C&M literature—high transaction costs. The analysis here reverts to the standard C&M explication reflected in Table 1. In other words, we start with the standard hypothetical world of residents and polluters—or here, rightsholders and the government—with the usual assumptions of low transaction costs, no external effects beyond the parties to the dispute, full information, and rationality. In such a situation, constitutional rights should be protected by property rules. If the individual values the right more than the government values its abrogation, the individual will refuse the government’s entreaty to waive her rights. If the individual values the right less than the government values its abrogation, the individual will waive her rights in return for some payment offered by the government having greater value to her. Either way, the result is socially efficient.

In many constitutional contexts, this stylized set of circumstances may be a fair approximation of reality. With respect to plea bargaining, for example, it is plausible to regard the negotiations over the waiver of the right as taking place in a relatively low transaction cost setting. There are only two parties to the negotiations—the government and the accused. Each side

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42 In the discussion so far, I have implicitly assumed away all concern with transaction costs. With respect to rights that generate significant net external benefits or net external costs, I have assumed that private bargaining cannot supply the external benefits or avoid the external costs because of high transaction costs. If we were talking about external benefits and costs associated with private property and contract rights, this would be a questionable assumption, and some discussion of the various mechanisms that the common law has devised for generating small scale public goods and overcoming small scale public bads would be in order. Cf. Robert C. Ellickson, Property in Land, 102 YALE L.J. 1315, 1322-35 (1993) (discussing ways in which parcelization of land contributes to finding contractual solutions to “small events” and “medium events”). Where the external benefits and external costs of the exercise of constitutional rights are concerned, however, it is reasonable to assume that bargaining is not going to be the solution. If the exercise of a right generates external benefits—as for example with the exercise of free speech rights in many contexts—those benefits are likely to be spread very widely among a disparate group of persons, including members of future generations, who cannot realistically bargain to preserve those benefits. Similarly, if the exercise of the right generates external costs—as where the Fourth Amendment is used to free persons who otherwise would be convicted of crimes—the external costs may be disbursed very widely, also making negotiations among affected parties an unrealistic option for eliminating these costs. I have also implicitly assumed that where there are no significant external benefits or external costs, that is, where PGV = 0, either because EB, or EC, are zero, or because EB, = EC, that private bargaining will always function smoothly to handle transfers of constitutional rights. This is also a simplifying assumption that will not be borne out in every case. I do not deal with this complication here, other than to note that the liability rule solution can handle bargaining breakdowns from any source, whether it be transactions costs generated by large numbers of affected parties, or simple bilateral monopoly.
is represented by counsel and hence is presumably informed of the relevant options and their consequences. There may be some room for strategic behavior, but each side has a viable alternative to reaching a deal—each can insist on going forward with the public trial.\textsuperscript{43} No doubt there are in some cases problems of duress, incompetence, and conflict of interest. But it would seem that these problems can be handled by application of ordinary contract law principles.\textsuperscript{44} Thus, there is no obvious reason to depart from property rules in this situation and permit the government to condemn an accused’s right to a public trial in return for \textit{ex post} compensation, or, for “Rule Four” aficionados, to permit the accused to buy his way out of a public trial upon payment to the government.

In other situations, however, negotiations over the transfer of a right may break down or be too costly. The primary cause of high transaction costs in the exchange of constitutional rights is probably the presence of monopoly power on the entitlement holder’s side. If the government can accomplish its objectives by dealing in a competitive market of rightsholders, then it is unlikely that transaction costs will stand in the way of exchange. However, if the rightsholder has a degree of monopoly power over the right that the government wants to acquire, then the holdout potential becomes acute, and with it the danger of spiraling transaction costs.

The classic illustration of this phenomenon comes from the law of eminent domain. If the government’s desire for land is not site-dependent—for example, if it wants to acquire land to build a new prison in a rural area—then there is no need to shift from property rules to liability rules. The government has many options to choose from, and it can strike a mutually satisfactory deal with one or more sellers of vacant rural land. However, if the government’s needs are site-dependent—say, it wants to acquire hundreds of contiguous parcels of land for a new highway—then it is likely that one or more landowners will hold out or bargain strategically. This will substantially raise the transaction costs of acquiring the desired land. The power of eminent domain has been explained as a device for overcoming these transaction costs.\textsuperscript{45}

Whether the government faces a thick market of rights-sellers or a monopolist will often depend on how the government defines its objectives. Suppose that as part of a “beautification” program, a city concludes that there are too many push-cart vendors on downtown sidewalks.\textsuperscript{46} Suppose further that the push-cart vendors have licenses from the city that are re-

\textsuperscript{43} See Gannett Co. v. DePasquale, 443 U.S. 368, 382-83 n.11 (1979) (either defendant or prosecution can demand a public trial); Singer v. United States, 380 U.S. 24, 35-37 (1965) (either defendant or prosecution can demand a jury trial).

\textsuperscript{44} See Scott & Stuntz, \textit{supra} note 5.


\textsuperscript{46} Cf. City of New Orleans v. Dukes, 427 U.S. 297 (1976) (equal protection challenge to program to eliminate most of push-cart vendors from French Quarter of city).
garded as obligations protected under the Contract Clause. If the city wants to reduce the number of push-cart vendors by half, there is probably no reason why it cannot simply buy out the licenses of half of the existing vendors. If one vendor is stubborn and refuses to deal, the city can just go to the next one until it reaches its quota. However, if the city decides that it wants to eliminate all licensed push-cart vendors, every rightsholder becomes a potential monopolist holding the last license. Thus, just one stubborn hold-out could foil the plan, and the government needs the trump card of forced exchange. This explains why contractual obligations, like property rights, are subject to the power of eminent domain.47

2. Why Compensation? If high transaction costs are the explanation for shifting from property rules to liability rules, then what is the explanation for not shifting further and simply replacing property rules with police power rules? If the rightsholder has a monopoly on a right that the government wants to acquire and this causes the transaction costs of exchange to rise precipitously, those transaction costs can be seen as a type of “externality” associated with the exercise of the right. The framework adopted in this Article suggests that where the exercise of constitutional rights generates external costs in excess of the private value of the right, the principal solution is simply to shift to a police power rule.

The shift from a property rule to a police power rule has in fact happened fairly frequently throughout our history, as the history of the Contract Clause reveals.48 In Stone v. Mississippi,49 for example, the state legislature granted a twenty-five-year charter to a company to conduct a lottery. Two years later, the state rescinded the charter and prohibited further operation of the lottery. Although prior precedent indicated that such charters create contractual obligations protected under the Contract Clause,50 the Supreme Court upheld the state’s elimination of the lottery without compensation as a proper exercise of its police power. As the Court put it, “Any one . . . who accepts a lottery charter does so with the implied understanding that the people, in their sovereign capacity, and through their properly constituted agencies, may resume [the charter] at any time when the public good shall require, whether it be paid for or not.”51 In so ruling, the Court emphasized the “inherent vices” and “demoralizing . . . effects” of lotteries.52

49 101 U.S. 814 (1880).
51 Stone, 101 U.S. at 821.
52 Id. at 818.
That is to say, the Court endorsed this use of the police power because of the perceived external costs it associated with lotteries.\(^5\)

In other circumstances, however, the police power solution to the problem of monopoly and high transaction costs has been rejected, and the courts have required that the government pay just compensation for a coerced transfer of property or contract rights. The reason why compensation is required in some cases but not in others leads us into the regulatory takings puzzle—when does an exercise of the police power go "too far" and hence require compensation?\(^4\) Without purporting to offer a complete answer to that puzzle, we can say for present purposes that compensation is typically required when the entitlement holder is perceived as being blameless for the externalities that the government is trying to either eliminate or produce through a coerced exchange of property rights.\(^5\) Thus, the owner of land impressed into service for a new highway or courthouse is entitled to compensation because the owner is not perceived as being the cause of any externality that the project is designed to eliminate or produce. In contrast, an owner of a printing press used to make counterfeit bills or a chemical lab used to make illegal drugs is not entitled to compensation when the government seizes these assets,\(^5\) because in these cases the owner is identi-

\(^5\) See also Mugler v. Kansas, 123 U.S. 623, 662 (1887) (upholding state law prohibiting the use of property for manufacturing alcoholic beverages on the ground “that the idleness, disorder, pauperism, and crime existing in this country are, in some degree at least, traceable to this evil”).


\(^5\) This is captured in the often-quoted statement that the purpose of the compensation requirement is “to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.” Armstrong v. United States, 364 U.S. 40, 49 (1960). Generally speaking, two conditions must be established to make out a claim for compensation under the Takings Clause. First, the government must be coercing an exchange of property rights, not merely limiting the class of permissible uses of property. See Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1017 (1992) (compensation required for regulation that is “the equivalent of a physical appropriation”); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 435 (1982) (compensation required when the government “chops through” the owner’s bundle of rights, “taking a slice of every strand”). Second, the purpose of the coerced exchange must be for a purpose other than stopping an activity that is regarded as imposing harm on others. See Bennis v. Michigan, 516 U.S. 442 (1996) (civil forfeiture of automobile used in assignation with prostitute did not constitute a compensable taking); Keystone Bituminous Coal Ass’n v. DeBenedictis, 480 U.S. 470, 492 n.22 (1987) (“a State need not provide compensation when it diminishes or destroys the value of property by stopping illegal activity or abating a public nuisance”); Miller v. Schoene, 276 U.S. 272 (1928) (upholding statute requiring destruction of cedar trees infected with cedar rust without compensation in order to preserve apple orchards having a higher social value). See generally Andrea L. Peterson, The Takings Clause: In Search of Underlying Principles, Part II—Takings as Intentional Deprivations of Property Without Moral Jus-

\(^5\) See generally Mugler v. Kansas, 123 U.S. 623, 662 (1887) (upholding state law prohibiting the use of property for manufacturing alcoholic beverages on the ground “that the idleness, disorder, pauperism, and crime existing in this country are, in some degree at least, traceable to this evil”).


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\(^5\) See Bennis, 516 U.S. at 442.
fied as the source of the negative externalities that the government is seeking to overcome.

One clear case for compensation rather than police power rules is where PGV<sub>cr</sub> is negative and more than wipes out PV<sub>cr</sub>, but prior precedent compels the conclusion that the regulated party has a constitutionally protected right. In *United States Trust Co. v. New Jersey*,<sup>57</sup> for example, the Court held that, under longstanding precedent, holders of government bonds secured by specific revenues have an entitlement protected by the Contract Clause that renders a proposed governmental diversion of the revenues to other worthy purposes unconstitutional. The Court acknowledged that the diversion of revenues might produce public benefits greater than the loss in value suffered by the bondholders.<sup>58</sup> But it declined to “engage in a utilitarian comparison of public benefit and private loss”<sup>59</sup> and suggested that if the government wanted to repeal the pledge, it would have to pay the bondholders just compensation.<sup>60</sup> Similarly, your standard eminent domain case can be seen as a situation where a coerced transfer of property would produce public benefits that exceed the private value of the right, but there is no doubt under established law that the property owner’s interest is constitutionally protected. It may be that we always require compensation in these cases in order to preserve the “bright-line” rule that real estate is a form of constitutionally protected property.

The “hard cases” that fall in between the drug lab case and the standard eminent domain case often involve situations in which public perceptions of what kinds of uses of property are blameworthy are undergoing change. Consider in this regard the disquiet over the government power to declare private land a critical habitat for endangered species of plants and animals.<sup>61</sup> A government order banning development of private land in order to protect an endangered species may make sense from the perspective of external benefits and costs. If development goes forward, some species of immense potential value may be lost, and thousands of persons around the world concerned with preservation of biodiversity will experience a measure of unhappiness. Thus, the external costs of development, once the discounted probability of losing valuable species and the aggregated unhappiness to the very large and diffuse group of biodiversity advocates are factored in, may well exceed the loss in value to the landowner.

Nevertheless, many observers think it is unduly arbitrary to impose the costs of preservation entirely on the shoulders of a single landowner, who may have had no knowledge of the existence of the species when the property was purchased, and who is not proposing to do anything with the prop-

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<sup>57</sup> 431 U.S. 1 (1977).
<sup>58</sup> See *id.* at 29.
<sup>59</sup> *Id.*
<sup>60</sup> See *id.* at 19.
erty that other landowners are not permitted to do. Given the widespread perception that the landowner is "innocent" of any antisocial behavior, the use of a liability rule—forced exchange with compensation—may appear more appropriate here than the shift all the way to a police power rule.

As the lottery and the endangered species examples suggest, public perceptions about what sort of conduct is blameworthy can shift over time, sometimes quite rapidly. It may be, therefore, that liability rules function in part as transitional relief that applies to individuals during changeover from a situation where an entitlement is protected by a property rule, or conceivably even a rule of inalienability, to a police power rule. Today, many people regard property owners who resist the imposition of preservation orders designed to protect endangered species with sympathy. Tomorrow, they may be regarded as lottery promoters were in the late nineteenth century, thus making a police power rule seem more appropriate.

3. Objective Measures of Compensation. Even if high transaction costs cause us to abandon property rules, and sympathy for the rightsholder or prior determinations of constitutional protection cause us to resist moving all the way to a police power rule, there is a third constraint that limits the domain of liability rules: the need for an objective basis for calculating ex post compensation. One reason why liability rules work in the context of property and contract rights is that objective benchmarks are available to value these rights when taken by the government. Property rights usually have a market value. As the Supreme Court has made clear, this market value—what a willing buyer would pay a willing seller for the property in question—serves as the presumptive measure of just compensation for takings of property. Similarly, commercial contract rights usually have an objectively determinable value, established, again, with reference to the difference between the contract price and the market value of that which is the subject of the contract. This established basis for valuing contract rights again serves as the measure for computing ex post damages for takings of contractual rights.

The importance of having some objectively determinable measure of compensation can be seen by considering the problems that would emerge in the absence of such a measure. For these purposes, it may be useful to reflect on why we do not use liability rules to protect Fourth Amendment

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65 See generally 3 E. ALLAN FARNsworth, Farnsworth ON Contracts §12.9 (1990).
rights. In many respects, the Fourth Amendment’s prohibition on unreasonable searches would seem to be a good candidate for the use of liability rules. Indeed, one of the nation’s leading commentators on the Amendment, Akhil Amar, has argued that ex post damages is both the original understanding of how the Fourth Amendment should be enforced and the preferred measure of protection today.66

In terms of the framework deployed here, the current regime of protection afforded to Fourth Amendment rights can be described as a foundational property rule subject to numerous exceptions where we follow what amounts to a police power rule. The foundational rule is a property rule because rightsholders are permitted to consent to government searches, that is, to waive their right.67 This property rule is enforced via the mechanism of the exclusionary rule, which can be viewed as a penalty-default rule68 imposed on the government for engaging in unconsented searches. However, because of the high external costs associated with the exclusionary rule, namely, that guilty criminals may go free, the Fourth Amendment is laced with numerous exceptions in which a police power rule applies. The most important of these, at least in doctrinal terms, is the warrant requirement: a search may proceed without consent if the police obtain a warrant in an ex parte hearing before a magistrate in which they show probable cause that the search will yield evidence of a crime, contraband, or a fugitive.

Liability rules would seem to make more sense than this patchwork of property rules and police power exceptions. The argument for liability rules in the Fourth Amendment context would begin by noting that the government will often face high transaction costs in negotiating consents to searches. The problem is essentially one of adverse selection. Innocent owners might agree readily enough to waive their rights and consent to government searches of their property; but owners harboring inculpatory evidence, contraband, or fugitives, would not. In effect, the owners of the properties the government is most anxious to search would have monopoly power that would raise transaction cost barriers to negotiation. On the other hand, shifting to a police power rule across the board would effectively negate the constitutional right. Specifically, it would deprive innocent owners subjected to unreasonable searches of any remedy for these intrusions on their privacy. A liability rule appears to strike the right compromise: the government would be able to conduct reasonable searches without fear of monopoly holdouts by the guilty, while the requirement of ex post compensation for unreasonable searches would protect the innocent.

The liability rule proposal, however, would pose a serious problem in terms of determining the amount of compensation that should be paid *ex post* for unreasonable government searches. There is no established market price or other financial benchmark for unreasonable government searches. Thus, advocates like Amar are forced to say that the matter should be left to the discretion of the jury.\(^6\) The difficulty with this solution is that another adverse selection problem would emerge under a regime of *ex post* actions for damages. Given jury discretion and the elasticity of the concept of an "unreasonable" search, it is likely that only innocent owners would sue. For the same reasons, it is likely that they would usually win. Armed with the wisdom of hindsight that the search turned up nothing, juries would be strongly inclined to award some measure of damages as compensation for the inconvenience and embarrassment of the intrusion. But with no available benchmark for establishing the size of the award, the magnitude of verdicts would vary tremendously. The insurance costs of all governmental entities with police forces would rise, perhaps dramatically.

The objection that *ex post* compensation would increase the costs of government, and hence would require increases in taxes, is not necessarily a fatal one. But at least it helps explain why the Supreme Court has instinctively shied away from the liability rule solution in this context. With respect to takings of property and contract rights, jury awards of compensation are constrained by the existence of well-established formulas, grounded in market values, for computing compensation. Using liability rules to remedy Fourth Amendment violations, in contrast, would operate more like an open-ended regime of punitive damages.\(^7\) Governmental entities at all levels would howl with indignation if subjected to such uncertain liabilities. Knowing this, the Court has stuck to the messy patchwork of a foundational property rule subject to a myriad of exceptions. If there is a way to escape this doctrinal mess and enter the simpler world of liability rules, it would almost certainly require a legislated solution, including a fixed schedule of administrative penalties for defined categories of improper searches.

**D. The Generality of Analysis**

A final point that has been touched upon but deserves more explicit comment concerns the generality with which we apply the transaction structure analysis. Constitutional law in general consists of a mix of "categorical rules" and "balancing tests,"\(^7\) analogous to the use of *per se* rules

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\(^6\) See AMAR, supra note 66, at 44-45.


and the rule of reason in antitrust law or to rules and standards more generally. Categorical rules are said to apply when the Court is confident of the result that should obtain in virtually all cases. Case-by-case balancing tests are used when the Court intuits that a more intensive examination of the facts should be undertaken in each case before deciding on the result.

There is no reason why analysis of the transaction structure should not proceed the same way. Indeed, as noted in the introduction, there are several areas of the law where repeated exposure to the issue has resulted in relatively categorical rules. Waivers of the right to engage in future political speech are almost never enforced; plea bargaining agreements are always enforced absent some defect in the bargaining process; government regulation of nuisances never gives rise to a right of compensation. In terms of the framework developed here, these rules reflect a judgment that in the general run of the cases falling within each of these categories, the PGVcr of the exercise of the right is either large and positive, approximately zero, or large and negative. This does not mean that there will not be exceptional cases in each category. But the judicial judgment has been that the administrative costs and error costs of permitting courts to ferret out the exceptions do not justify the gains from fine-tuning.

Where constitutional law has not fixed on categorical rules, the Court often prescribes some kind of formulaic multiprong "test" to structure the inquiry. Examples are the three-part formula for assessing restrictions on symbolic speech, the four-part formula for considering regulations of commercial speech, the three-part cost-benefit test for determining the procedures required by due process, and the three-part formula for evaluating regulatory takings claims. Although presented by the Court as imposing a law-like constraint, in practice these formulas permit a good deal of variation in outcomes, depending on how courts assess the facts relevant to each "prong" of the formula. Predictability is rarely achieved through subsequent refinements in the language used to describe the formulas. Numerous intermediate constitutional themes, see James G. Wilson, Surveying the Forms of Doctrine on the Bright Line-Balancing Test Continuum, 27 ARIZ. ST. L.J. 773 (1995).


See supra notes 4-7 and accompanying text.


stead, it is the accumulation of precedent that provides points of reference from which lower courts and litigants can reason by analogy.

Similarly, the framework offered above would presumably be applied in a case-by-case fashion in situations where the correct transactional rule was a matter of doubt. Moreover, my manner of expressing the relevant variables would not offer any escape from the frustrating unpredictability associated with the multipart tests used by the Court in determining the scope of substantive constitutional rights. Asking courts to consider the "external benefits" and "external costs" of constitutional rights—not to mention the "transaction costs" of acquisition of the right and other variables—would not eliminate the potential for significant disagreements over the facts of each case. The primary justification for considering the transaction structure in terms of the proposed economic framework thus is not that it would substitute objectivity and certainty for mush. Instead, the justification lies in the unifying perspective that this vocabulary brings to a wide range of constitutional issues, and in its identification of common variables that might otherwise be overlooked under alternative approaches.

II. TOBACCO ADVERTISING: CURRENT LAW AND EMERGING ISSUES

Before applying the proposed transaction structure to tobacco advertising, it is useful to consider both current First Amendment doctrine as it applies to commercial speech\(^8\) and the controls on advertising that are most likely to be adopted in the future.\(^8\) The doctrine and regulation of tobacco advertising are in a state of flux—and headed on a collision course.

A. The Current State of the Commercial Speech Doctrine

As is well known, before the mid-1970s restrictions on commercial advertising were regarded as regulations of commerce, not speech, and hence were not thought to raise any issue under the First Amendment.\(^8\) In trans-

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\(^8\) To simplify matters, I will not discuss federalism and separation of powers issues that might be presented by tobacco advertising controls. The federalism issues include questions about the limits on federal commandeering of states, which might be presented by federal legislation directing the states to adopt advertising or marketing controls as proposed in the Global Settlement (compare with, e.g., Printz v. United States, 521 U.S. 898 (1997)); issues of federal preemption of state advertising regulations (see Cipollone v. Liggett Group, Inc., 505 U.S. 504 (1992)); and possible issues under the Commerce Clause raised by state regulations that have extraterritorial effects (compare with Healy v. The Beer Inst., 491 U.S. 324, 336 (1989)). Separation of powers questions may be presented by the use of consent decrees in lieu of legislation to establish a comprehensive regime of tobacco advertising controls, as in the AG Settlement. See Michael W. McConnell, Why Hold Elections? Using Consent Decrees to Insulate Policies from Political Change, 1987 U. CHI. LEGAL F. 295 (1987).

\(^8\) Readers who are already up to speed on the current state of the Supreme Court's commercial speech doctrine may wish to skip Part II.A. Those familiar with the recent struggles over the FDA's regulations and the tobacco settlements may wish to skip Part II.B.

\(^8\) See Valentine v. Chrestensen, 316 U.S. 52 (1942); see generally Alex Kozinski & Stuart Banner, The Anti-History and Pre-History of Commercial Speech, 71 TEx. L. REV. 747 (1993); Martin H.
action structure terms, the purveyors of advertising were subject to a universal police power rule. In the mid-1970s, however, the Court reconsidered this understanding and began subjecting advertising restrictions to a kind of intermediate standard of scrutiny under the First Amendment. This approach eventually crystallized into one of those “multiprong” formulas of which the Burger Court was so fond, in this case the four-step Central Hudson test.

In commercial speech cases . . . a four-part analysis has developed. At the outset, we must determine whether the expression is protected by the First Amendment. [1] For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask [2] whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine [3] whether the regulation directly advances the governmental interest asserted, and [4] whether it is not more extensive than is necessary to serve that interest.

The first prong of Central Hudson’s four-part test creates what are in effect two categorical police power rules within the universe of commercial speech regulation: advertising for activities that are illegal and advertising that is false or misleading continue to enjoy no First Amendment protection. These exceptions make sense, in that both advertising for illegal products and false or misleading advertising would seem to generate significant external costs while conferring few or no offsetting benefits.

The remaining three prongs implicitly recognize that there are other circumstances besides advertising for illegal transactions and false advertising in which the external costs associated with advertising may exceed its benefits. These prongs can be read as a series of screens designed to identify such advertising. The external costs must be significant, that is, the government interest being asserted must be “substantial.” The regulation must be effective in reducing those costs, that is, it must “directly advance” this government interest. Finally, there must be no alternative non-speech-related regulation that would achieve the reduction in costs as effectively, that is, the regulation must not be “more extensive than necessary.”

When it was first announced, the Central Hudson formula was regarded as a moderately conservative restatement of the Court’s commercial


Id. The numbers were helpfully inserted by Justice White in United States v. Edge Broad. Co., 509 U.S. 418, 424 (1993).
speech doctrine. More recently, support for the Central Hudson approach appears to be crumbling, among conservative as well as liberal Justices, in favor of an even more speech-protective standard. If the current Court can agree on little else, it is consistently well disposed toward free-speech interests. A newly reinforced block of traditional free-speech liberals, Justices Stevens, Souter, Ginsburg, and Breyer, has joined with a block of libertarian conservatives, Justices Scalia, Thomas, and Kennedy, to produce seven reasonably solid votes for pro-First Amendment outcomes. This coalition is threatening to jettison Central Hudson in favor of an approach that would adopt a special commercial speech standard only with respect to advertising for illegal transactions and advertising that is false or deceptive.

All other advertising regulations would be subjected to the same demanding standards that apply in assessing regulations of political speech.

Two recent cases reveal the shift in judicial attitudes and define the terrain over which regulations of tobacco advertising will be fought. United States v. Edge Broadcasting Co. is the last case decided by the Court to uphold a content-based regulation of truthful, nondeceptive advertising of a commercial product or service. At issue was the validity of a federal statute that prohibited broadcasters from carrying advertisements for state lotteries if the broadcaster's antenna was physically located in a state that did not have such a lottery. The statute created anomalies for radio stations, like Edge Broadcasting Company, that operated in a state where lotteries were illegal (North Carolina) but near the border of a state which had a lottery (Virginia). Indeed, ninety percent of Edge's listeners lived in Virginia, where lotteries were legal and vigorously promoted.

The Court, in an opinion by Justice White, applied the Central Hudson test and upheld the statute. The federal interest was not described as controlling advertising for an illegal transaction. The advertising Edge wanted to run was for the Virginia state lottery—a legal lottery—and residents of

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86 See, e.g., Archibald Cox, Foreword: Freedom of Expression in the Burger Court, 94 HARV. L. REV. 1, 34-35 (1980) (noting that although Central Hudson is "less solicitous" of commercial speech than some other decisions, "[t]he most striking aspects of the case are the weight of the burden put upon the state and the degree to which judicial opinion is substituted for state regulatory authority").


90 In Florida Bar v. Went for It, Inc., 515 U.S. 618 (1995), the Court, by a vote of five to four, upheld a thirty day ban on direct solicitation of accident victims by personal injury lawyers. See id. at 619. In addition to being a type of time, place and manner restriction, this regulation obviously affected only advertising by the legal profession. Restrictions on advertising by professionals have always been treated somewhat more sympathetically by the Court than restrictions on purely commercial advertising controls. See generally, Daniel Halberstam, Commercial Speech, Professional Speech, and the Constitutional Status of Social Institutions, 147 U. PA. L. REV. 771 (1999).
North Carolina were free to travel to Virginia and purchase tickets there. Consequently, the interest was described as accommodating the policies of states having lotteries and states that regard lotteries as undesirable. With little analysis, the Court deemed this interest in accommodating state policies to be “substantial” under *Central Hudson’s* second prong.91

The Court then went on to consider the “fit” between the regulatory scheme and this postulated interest—addressed by prongs three and four. With respect to whether the statute directly advanced the asserted interest, Justice White concluded that it was not appropriate to look solely at the peculiar circumstances of one broadcaster; instead, the Court had to consider the overall operation of the statute. As to broadcasters in general, the prohibition advanced the interest in accommodation. Moreover, even looking solely at the respondent’s unique situation, the statute resulted in some reduction in lottery advertising reaching North Carolinians, and this was enough of an impact to find that the statute “directly advanced” the asserted interest.92 Turning to the question of whether the prohibition was more extensive than necessary, Justice White appeared to apply a rather relaxed standard, requiring only a “reasonable” connection between means and end.93 No inquiry was made as to whether there was a less burdensome policy that would have accommodated the conflicting state policies with less intrusion on commercial speech.

*Edge Broadcasting* is relevant to tobacco advertising controls, because it addresses a situation in which advertising promotes a legal transaction but also encourages similar transactions that would be illegal. It is unlawful in all states for persons under the age of eighteen to purchase tobacco. Thus, even though tobacco advertising proposes a transaction that is lawful for those over eighteen, and presumably no tobacco company would adopt advertising overtly directed at those under eighteen, it is arguably appropriate to curtail advertising likely to reach a significant number of underage persons in order to avoid promoting what is in fact an illegal transaction.94 *Edge Broadcasting* can be cited for the proposition that it is only necessary that advertising reach a relatively small percentage of persons for whom the transaction is illegal in order to justify regulation under this rationale.

Only three years later, in *44 Liquormart, Inc. v. Rhode Island*,95 the Court embraced a much more speech-protective attitude toward commercial advertising.96 The Court ruled unanimously that a Rhode Island statute

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91 See *Edge Broad.*, 509 U.S. at 426.
92 See *id.* at 431-35.
93 *Id.* at 429.
94 Indeed, the FDA drew upon this rationale in its Final Regulations. See *supra* note 8 and accompanying text.
96 This shift was foreshadowed by *Rubin v. Coors Brewing Co.*, 514 U.S. 476, 478 (1995), where the Court unanimously struck down a federal statute that prohibited labels on beer cans and bottles from displaying the alcoholic content of the beer. The Court found that although the government’s interest—preventing “strength wars”—may be substantial, the regulation did not directly advance the interest, and
banning the advertisement of liquor prices in that state, other than in point-of-sale displays, violated the First Amendment. The state argued that the purpose of the statute was to reduce consumption of alcoholic beverages. It reasoned that the ban on price advertising would limit price competition, which in turn would increase the price of liquor, which would depress demand and consumption. Not a single Justice agreed that this justification was sufficient to sustain the statute. All agreed that if Rhode Island wanted to suppress demand for liquor, it could easily adopt alternative regulations less burdensome on commercial speech, such as increasing state liquor taxes or imposing minimum price controls.

Although the bottom line in 44 Liquormart was unanimous, the Court was badly fragmented as to the rationale. Indeed, no opinion captured a majority on the crucial issues. Justice Stevens wrote the lead opinion, joined in part by all Justices, in part by two different combinations of three other Justices, and in part by only two other Justices. Justice Scalia concurred in the judgment on the ground that longstanding historical practice rather than the Central Hudson test should govern in this area; but since none of the briefs contained enough information about historical practice regarding price advertising to permit him to resolve the issue on that basis, he simply deferred to the judgment of his colleagues.97 Justice Thomas concurred in the judgment, in an opinion that would have rejected Central Hudson outright by limiting commercial speech regulations to illegal transactions and false advertising.98 Justice O’Connor, joined by three other Justices, concurred in the judgment in an opinion that said the issue should be resolved by applying Central Hudson, which she regarded as being implicitly abandoned by Justice Stevens’s opinion.99 Justice Souter’s position is somewhat perplexing. He joined all of Justice O’Connor's opinion—the least speech-protective—but also joined selective parts of Justice Stevens’s opinion that O’Connor and her other compatriots declined to join.100

The precise holding of 44 Liquormart should have no direct impact on proposed cigarette advertising restrictions because none of those initiatives single out price advertising for proscription. The case is nevertheless significant for the fate of cigarette advertising restrictions, for three reasons.

First, 44 Liquormart creates uncertainty about the status of the Central Hudson test, and in particular about whether a majority of the Court may conclude that truthful advertising for a lawful product like liquor or cigarettes is subject to the same protection as political speech under the First
Amendment. Justice Thomas is already committed to this position. Justice Stevens did not quite say that *Central Hudson* should be abandoned, but he has in effect adopted this position in prior separate opinions, making him a reasonably certain second vote. And Justices Kennedy, Souter, and Ginsburg joined the portion of Stevens's plurality opinion which appeared to recast *Central Hudson* as imposing a standard of strict scrutiny where prohibitions against truthful, nonmisleading commercial speech for a lawful product are at issue.

Second, all Justices appeared to agree that the Rhode Island ban on price advertising should be struck down because "less burdensome" alternatives were available. This may signal an invigoration of the fourth prong of the *Central Hudson* test into something approximating the "least restrictive alternative" requirement imposed elsewhere under First Amendment law. As Justice Thomas astutely observed, such an understanding of prong four, "if applied consistently in future cases," could result in outcomes indistinguishable from those reached under his preferred approach of limiting permissible commercial speech regulations to illegal transactions and misleading speech. As he explained, the Stevens and O'Connor opinions would appear to commit the courts to striking down restrictions on speech whenever a direct regulation (i.e., a regulation involving no restriction on speech regarding lawful activity at all) would be an equally effective method of dampening demand by legal users. But it would seem that directly banning a product (or rationing it, taxing it, controlling its price, or otherwise restricting its sale in specific ways) would virtually always be at least as effective in discouraging consumption as merely restricting advertising regarding the product would be, and thus virtually all restrictions with such a purpose would fail the fourth prong of the *Central Hudson* test.

Third, in Part VI of his opinion, Justice Stevens considered and rejected two arguments in support of liquor advertising restrictions that the Court had endorsed in the 1986 case *Posadas de Puerto Rico v. Tourism Company of Puerto Rico*. Both of these arguments would almost certainly be relied upon in justifying controls on tobacco advertising. Part VI was joined by Justice Thomas but not Justice Souter. Thus, the vote on this part was four to four, with Justice Scalia a scratch.

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101 See Edge Broch., 509 U.S. at 437 (Stevens, J., dissenting).
102 The Stevens opinion stated that such restrictions must be reviewed with "special care" under *Central Hudson*, and that such speech prohibitions will "rarely survive constitutional review." 44 Liquormart, 517 U.S. at 504.
103 The Court expressly rejected application of the "least restrictive means" test in commercial speech cases in *Board of Trustees, State Univ. v. Fox*, 492 U.S. 469, 476-81 (1989) and *Florida Bar v. Went For It, Inc.*, 515 U.S. 618, 632 (1995). The Court was concerned that this formulation would be interpreted as imposing "a heavy burden on the State." *Board of Trustees*, 492 U.S. at 471 (citing, *Inter alia*, Shelton v. Buckner, 364 U.S. 479, 488 (1960)).
104 See 44 Liquormart, 517 U.S. at 524 (Thomas, J., concurring).
The first of the two arguments rejected by Stevens is the so-called greater-includes-the-lesser idea. At issue in *Posadas* was a Puerto Rican statute that permitted gambling casinos—a lawful enterprise in Puerto Rico—to be advertised in other states, but not in Puerto Rico itself. In upholding this scheme, the Court majority stated that there was no doubt that Puerto Rico had the greater power to ban casinos altogether. Thus, there should be no objection if it took the lesser step of banning advertising for casinos within Puerto Rico.106

Justice Stevens would have overruled this aspect of *Posadas* if he had the votes,107 and in all likelihood the greater-includes-the-lesser notion is dead. Although she did not specifically mention the argument, Justice O'Connor conceded in her concurring opinion in *44 Liquormart* that *Posadas* is out of line with other recent decisions applying the *Central Hudson* test, and she appeared to acquiesce in confining the decision to its facts. In any event, the greater-includes-the-lesser theory of *Posadas* ought to be rejected as a premise for commercial speech regulation.108 The government can ban virtually any commercial product as long as it has a plausible reason—even oleomargarine was banned at one time, and this was upheld by the Supreme Court.109 Thus, the greater-includes-the-lesser idea would permit the government to ban truthful advertising for virtually any product that is not itself protected by the Constitution. This is surely overkill, for it would permit the prohibition of commercial advertising where the benefits of the speech far outweigh any external costs associated with it.

106 See id. at 345-47.
107 See 517 U.S. at 509-12.
108 Justice Stevens cited two homely examples in support of the proposition that the greater does not always include the lesser, at least when the lesser involves the transmission of information. With all due respect, I find neither example especially persuasive. The first is drawn from an old proverb: "Give a man a fish, and you feed him for a day. Teach a man to fish, and you feed him for a lifetime." *44 Liquormart*, 517 U.S. at 511 n.19. Based on this, Justice Stevens observed, "it may prove more injurious to prevent people from teaching others how to fish than to prevent fish from being sold." *Id.* at 511. But it is far from obvious that teaching people how to do things themselves is more important than giving them access to a market where those things can be bought and sold. Suppose we substitute brain surgery for fishing in Justice Stevens's sentence. The sentence would now read: "it may prove more injurious to prevent people from teaching others how to perform brain surgery than to prevent them from acquiring the services of a brain surgeon." Admittedly, a ban on educating brain surgeons would be bad. But as long as we could import brain surgeons from abroad, it would probably be better than having everyone engage in do-it-yourself brain surgery. Justice Stevens's second example involves bicycles: "Similarly," he says, "a local ordinance banning bicycle lessons may curtail freedom far more than one that prohibits bicycle riding within city limits." *Id.* This example seems to turn on the notion that riding is prohibited only within one municipality; thus, if you can teach someone how to ride, he can always take the bicycle to another locality and ride there. But what if bicycle riding is banned everywhere? If bicycle riding is banned everywhere, teaching someone to ride a bike does little good. On the other hand, since presumably most people who want to ride a bike could teach themselves how to do it after some trial and error, the ban on instruction would be less intrusive.

The second argument rejected by Part VI of Justice Stevens’s opinion—also derived from the decision in *Posadas*—is that a special exception should be recognized for advertising that pertains to “vice activity.” The problem with this argument, according to Justice Stevens, is that it is hard to define what constitutes a “vice.” Because “[a]ll most any product that poses some threat to public health or public morals might reasonably be characterized by a state legislature as relating to ‘vice activity,’” recognizing such an exception would have one of two unfortunate consequences. It would allow “state legislatures to justify censorship by the simple expedient of placing the ‘vice’ label on selected lawful activities,” or it would require “the federal courts to establish a federal common law of vice.”

Whether Justice Stevens has the votes ultimately to inter the “vice exception” is less clear. The Court made some sympathetic noises about the vice exception in *Edge Broadcasting* (although it did not reach the issue of whether such an exception would have justified a complete ban on lottery advertising). Furthermore, it is not clear that the definitional problems are as insuperable as Justice Stevens suggests. For example, we could take a cue from poor Justice Scalia, sitting there on the sidelines, and adopt an historical test for vice activity. If something has a reasonably long history of regulation in a majority of jurisdictions—for example, if sales to minors are prohibited or other significant restrictions on access are imposed—then it would be reasonable for the State to regard it as a vice. This sort of test would suggest that liquor, cigarettes, and gambling are vices, but eating steak and eggs and thereby endangering your cholesterol level is not. Alternatively, we could at least recognize a separate category for advertising “addictive” substances, and borrow medical definitions of addiction. The FDA, for example, has stated that substances are addictive if (1) they are mood altering; (2) they result in regular and compulsive use; (3) they cause physical dependence characterized by withdrawal symptoms; and (4) the body develops a tolerance toward them. The Court could simply recognize a special category of addictive substances and defer to the FDA’s definition of what that means.

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110 See *Posadas*, 478 U.S. at 346.
111 *44 Liquormart*, 517 U.S. at 514.
112 Id.
113 See *Edge Broad.*, 509 U.S. at 426.
In short, after 44 Liquormart restrictions on nondeceptive tobacco advertising will be much more difficult to justify than before. Most significantly, support on the Court for the Central Hudson test appears to be eroding. That test, whatever its other merits and demerits, implicitly recognizes that advertising may generate net external costs in situations other than the promotion of illegal transactions or consumer deception. At least some Justices, however, are anxious to endorse a stronger bright-line test that would block the government from controlling these other types of external costs through commercial speech restrictions. Even if Central Hudson is not jettisoned outright, 44 Liquormart may signal a new skepticism on the part of the Court toward any use of commercial speech restrictions to curtail demand for lawful products where other strategies for controlling demand such as price increases, taxes, or other rationing mechanisms have not been fully exploited. Finally, the greater-includes-the-less argument of Posadas is almost certainly dead, as may be the argument that there is a special exception for vices or addictive products.

The Court has not been steadfast in its attitude toward commercial speech. Ever since Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc. was decided in 1976, the Justices have tacked back and forth in the degree of value they attribute to commercial advertising and in their willingness to defer to legislative and regulatory bodies that propose commercial speech regulations. Recent decisions culminating in 44 Liquormart suggest that the Court is currently tacking strongly toward the pro-commercial speech position, and that it is inclined not to give much deference to those who believe less speech will benefit consumers and society more generally. This new tack is taking place just as new types of advertising regulations on tobacco advertising are being put in place, with further regulations likely to follow.

B. Proposals to Regulate Tobacco Advertising

The nation is moving inexorably toward a new regime of tobacco advertising controls. The minimum content of those controls is established by the recent AG Settlement between the state attorneys general and the tobacco companies. Further restrictions could come from several sources: a Supreme Court decision upholding the FDA's jurisdiction over tobacco, which would revive the FDA's 1996 regulations concerning tobacco advertising; new federal legislation imposing additional controls; or a settlement between the tobacco companies and the federal government in the federal government's promised cost-recovery action against the tobacco companies. Whatever the future may hold, it is doubtful that the AG Settlement

117 See supra note 17.
118 See supra note 9.
119 See supra note 20.
will represent the last word on tobacco advertising restrictions. Public support for aggressive regulation of tobacco products remains very high, and it seems reasonable to assume that some type of strong controls on tobacco advertising will emerge in the near future.

Thus, it is worth taking a brief look at the regulatory regimes established by the FDA's regulations, the Global Settlement, and the AG Settlement in order to gain a sense of the types of advertising controls that are likely to be adopted. I will start with the FDA regulations because they have received the most complete public justification. I will then provide briefer descriptions of the restrictions contained in the Global Settlement and the AG Settlement, which can be viewed as maximal and minimal variations on the basic structure put in place by the FDA regulations.

1. The FDA Regulations. The advertising restrictions contained in the 1996 FDA regulations are designed to reduce the “product appeal” of tobacco for youths under eighteen. No government interest in suppressing demand among adults is asserted as part of the justification for the regulations. As the FDA explained, its restrictions are formulated “to preserve the informational components of advertising and labeling which can provide useful information for adult smokers, while eliminating the imagery and color that make advertising appealing and compelling to children and adolescents under 18 years of age.”

The FDA’s strategy for reducing the exposure of youths to alluring tobacco advertising includes seven principal restrictions. First, tobacco advertising is limited to FDA-approved media, including print publications, billboards, direct mail, and point-of-sale displays. Second, tobacco advertising in these approved media is restricted to black text on white background (i.e., “tombstone” advertising), unless the advertising appears in an adult publication, defined as one with no more than fifteen percent youth readership or total youth readership of two million, or appears in an establishment restricted to adults, such as a bar. Use of color and images continues to be permitted in adult publications and in adults-only commercial establishments. Third, no billboard may advertise tobacco products within one thousand feet of schools or public playgrounds. Fourth, all tobacco advertising must include, in addition to the Surgeon General’s warnings, the label “Nicotine-Delivery Device for Persons 18 or Older.” Fifth, tobacco

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brand names may not be used in connection with promotional merchandise, such as t-shirts or ashtrays. Sixth, tobacco companies may not offer promotional gifts, with or without brand names, in return for proof of purchase of tobacco products. Finally, tobacco brand names or symbols may not be used in connection with sponsoring of concerts or sporting events, such as the Virginia Slims Tennis Tournament.

In its statement of basis and purposes accompanying the final rules, the FDA argued that these restrictions were warranted because tobacco advertising, if it does not propose an illegal transaction, is at least related to an illegal transaction, that is, the sale of tobacco to minors, now prohibited in all fifty states. The FDA also sought to demonstrate that its restrictions were consistent with the Supreme Court’s Central Hudson test. The government’s interest, protecting the health of individuals under the age of eighteen, is clearly substantial. As to whether the restrictions would “directly advance” that interest, the FDA summarized a wide range of evidence—including expert opinion, advertising theory, survey data, empirical studies drawing on international experience, anecdotal evidence (e.g., the Joe Camel campaign), industry statements, and consensus reports—in an effort to show that advertising may influence the decision of teens to smoke, and that restrictions on advertising reduce the incidence of teen smoking.

Finally, with respect to each of its proposed regulations, the FDA argued that its restrictions were narrowly tailored to reach only those media and aspects of advertising that would have the greatest effect on youngsters:

FDA is not banning outdoor advertising; it is restricting it so that it does not unavoidably confront children at play. It is not banning print advertising. It is restricting the use of images and color, which are particularly appealing to children, in publications that have a large number of young readers under the age of 18 . . . . [FDA] is permitting companies to sponsor [events] in the corporate name in order to engender good will, but preventing them from using the brand specific attractive imagery that is influential with young people. Finally, it is prohibiting the use of branded promotional items because it is the young who find particular value in these items.

The tobacco industry vigorously disputed the FDA’s constitutional analysis in comments filed with the agency before it promulgated its final rules. Moreover, the industry filed suit in federal district court in North Carolina seeking to invalidate the advertising restrictions. The litigation resulted in a judgment that the FDA lacks jurisdiction over tobacco, though neither the district court nor the court of appeals reached the merits of the industry’s First Amendment claims.

125 See id. at 44,488-89 (summarizing types of evidence).
126 Id. at 44,497.
2. The Global Settlement. The proposed global settlement announced in June 1997 took the FDA advertising regulations as a baseline and upped the ante. The public health groups that participated in the negotiations have long been committed to strong restraints on tobacco advertising. Evidently, the tobacco companies were willing to make additional concessions on the advertising front in return for securing the public health groups’ endorsement of legislated liability limitations for big tobacco.

The Global Settlement basically took the FDA’s advertising restrictions as a template and added some new twists in the direction of further limitations. Thus, rather than requiring FDA approval of advertising in new media, the settlement would have expressly banned any tobacco advertising on the Internet. In addition to the requirement of black-on-white tombstone ads in all newspapers and magazines with a substantial youth audience, the settlement would have prohibited any use of human images, such as the Marlboro Man, or cartoon characters, such as Joe Camel, in any advertising. Rather than ban billboards within one thousand feet of schools and playgrounds, the settlement would have prohibited all billboard advertising of tobacco products. Beyond prohibiting the use of tobacco brand names in connection with the sponsorship of concerts and sporting events, the settlement would also have prohibited all indirect payments to movie or music video producers to glamorize smoking. Beyond requiring the label “nicotine-delivery device” on all advertising, the settlement would have mandated even more emphatic warning labels (e.g., “WARNING: Smoking can kill you”) covering twenty-five percent of the front panels of packages. The Global Settlement would also have imposed severe restrictions on point-of-sale advertising and displays.

The Global Settlement was not promulgated pursuant to the Administrative Procedure Act, and hence the negotiators did not favor us with a comprehensive statement of basis and purpose such as accompanies the FDA’s rules. We thus have no authoritative explanation for why the negotiators selected the particular package of upward “ratchets” in advertising restrictions that we find in the settlement document. In general, the modifications seem either to reflect particular bugaboos of the public health community—Joe Camel and the Marlboro Man—or to undo certain compromises that the FDA made in formulating its regulations, such as limiting the billboard ban to those near schools and playgrounds and dropping the proposed regulation’s requirement of additional and more emphatic warnings, or to legislate proposals that the public health community had

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127 See Global Settlement at 8-10.
128 The “Preamble” to the Global Settlement states that the “new regime” to be enacted into law would “go beyond FDA’s current regulations to ban all outdoor tobacco advertising and to eliminate cartoon characters and human figures, such as Joe Camel and the Marlboro Man, two tobacco icons which the public health community has long assailed as advertising appealing to our nation’s youth.” Global Settlement at 2.
urged in the FDA rulemaking process without success, such as an express ban on advertising in the Internet.

The Global Settlement called for federal legislation to be enacted incorporating its proposed package of advertising restrictions. In addition, the parties agreed that, once the legislation was signed into law, the tobacco companies would enter into consent decrees containing identical restrictions. The Global Settlement explained the need for adoption of parallel provisions in the consent decrees in the following revealing paragraph:

[T]he parties recognize that certain provisions of the consent decrees and the agreement may require them to act (or refrain from acting) in a manner that they otherwise might claim would violate the federal or state constitutions. They will therefore in the consent decrees expressly waive any claim that the provisions of the consent decrees or the agreement violate the federal or state constitutions. The consent decrees will also state that if a provision of the Act covered by the decrees is subsequently declared unconstitutional, the provision remains an enforceable term of the consent decrees.

In other words, the consent decrees were to function as a backstop if, as the parties thought not unlikely, the legislated advertising restrictions were declared unconstitutional. By signing the consent decrees and waiving any constitutional objections to the advertising restrictions in the consent decrees, the tobacco companies would, as a matter of contract, guarantee what might not be achievable by way of direct regulation.

3. The AG Settlement. The provisions of the AG Settlement—which, unlike the FDA regulations and the Global Settlement provisions, are almost certain to take effect in the near future—represent a further evolution in the basic template established in the FDA regulations. Now, however, the ratchet has moved downward somewhat, back toward and in some respects below the FDA regulations.

The AG Settlement, like the Global Settlement, prohibits any use of cartoon characters such as Joe Camel in any advertising. But it does not follow the Global Settlement in banning human images, nor does it follow the FDA in allowing only black-on-white tombstone ads in all newspaper and magazines with a substantial youth audience. Thus, the Marlboro Man will live on—in full color—in magazine advertising. On the other hand, the AG Settlement, like the Global Settlement, bans virtually all tobacco ad-
vertising on billboards or in transit advertising. Moreover, like the FDA regulations and the Global Settlement, under the AG Settlement the use of tobacco brand name merchandise is prohibited, sponsorships of concerts and athletic events are phased out, except for certain dispensations to Brown & Williamson Corporation, and payments to movie or music video producers to promote tobacco products are banned. Unlike the Global Settlement, however, the AG Settlement makes no effort to impose new warning labels on tobacco products. Nor does it contain any restrictions on advertising on the Internet, or on point-of-sale advertising or displays.

Because the AG Settlement, unlike the Global Settlement, forswears any reliance on federal legislation, the advertising restrictions are adopted only as consent decree provisions. Nevertheless, the AG Settlement contemplates that the States may enact future legislation that further restricts the marketing of tobacco products. The settlement attempts to pave the way for these future legislative enactments by including a provision in which the tobacco companies promise not to lobby against, or otherwise oppose, the adoption of an enumerated list of future types of state statutory restrictions. In other words, the AG Settlement includes not only a waiver of commercial speech rights, but also a partial waiver of political speech rights by the tobacco companies.

Overall, both the Global Settlement's and the AG Settlement's restrictions remain comfortably within the general rationale of the FDA's rules: protecting children from advertising likely to glamorize smoking or at least make it seem like a broadly acceptable adult activity. Thus, there is no attempt in either of the settlements to ban "hard" information about tobacco products, such as information about prices, new products, or relative safety claims. The focus throughout is on "soft" information—cartoon imagery, billboards, brand name merchandise, sponsorship of concerts and sporting events. And there is no effort to end all advertising in print media, direct mail solicitation, or point-of-sale displays, where hard information about prices or new products would most likely be disseminated.

In general, it would seem that both settlements give up something relative to the FDA rules on the narrow tailoring front. For example, certain forms of advertising (e.g., cartoons) are banned in all media without regard to the percentage of youth readership, and all billboard advertising is banned, not simply advertising in the proximity of schools and playgrounds. On the other hand, the settlement provisions arguably gain

134 Id. § (d) (eliminating outdoor advertising and transit advertisements).
135 Id. § (c) (limiting tobacco brand name sponsorships); id. § (f) (banning tobacco brand name merchandise); id. § (e) (prohibiting payments related to tobacco products and media).
136 See id. § (m) (limiting lobbying). See infra note 184-85 and accompanying text for a further description of this interesting provision.
137 In this light, it is interesting to think of the Global Settlement and the AG Settlement as examples of "negotiated rulemaking," and to consider what light this sheds on the FDA's mandatory rules. See generally Jody Freeman, Collaborative Governance in the Administrative State, 41 UCLA L. Rev. 1

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something in return in terms of directly advancing the government interest in discouraging youth smoking: a universal ban on cartoons and billboards is likely to be more effective than a selective ban. The AG Settlement, by giving up on requiring tombstone advertising in magazines, probably eliminates the single most contentious First Amendment issue and goes a long way toward increasing the odds of securing judicial approval. But as noted earlier, the AG Settlement is probably just the floor in terms of new advertising restrictions: more far-reaching efforts are surely around the corner.

III. THE TRANSACTION STRUCTURE APPLIED TO TOBACCO ADVERTISING

We are now in a position to consider more fully the transaction structure that should apply to tobacco advertising. The logical progression of the issues would seem to be as follows: (1) Are tobacco advertising restrictions of the sort adopted by the FDA and contained in the Global Settlement and the AG Settlement examples of regulations as to which the government's police power trumps the tobacco companies' First Amendment rights? (2) If not, are the First Amendment rights of the tobacco companies in this context subject to waiver in negotiated agreements like the Global Settlement and the AG Settlement; that is, are these rights protected by a property rule as opposed to an inalienability rule? (3) If the First Amendment rights of the tobacco companies are alienable, but for some reason an agreement satisfactory to all sides cannot be reached (for example, if the federal government and big tobacco cannot reach a satisfactory settlement agreement in the federal government's projected cost-recovery suit), is the government permitted to condemn the tobacco companies' First Amendment rights in return for the payment of just compensation; that is, are those rights protected by a liability rule?

In considering these questions, I will assume that the regulation of tobacco advertising takes approximately the form reflected in the FDA regulations and the two settlements. These are fairly draconian regulations relative to the status quo ante: all advertising is banned in certain media—billboards and merchandise—and content restrictions are imposed—no cartoons and possibly no color or image advertising. It is possible, of course, to imagine even more draconian regulations, such as the total ban on tobacco advertising adopted by the Canadian Parliament. But I will assume that the restrictions contained in the FDA regulations and in the two settlements most closely approximate the type of restraints that are likely to be adopted in the near future.

(1997) (reviewing experience with negotiated rulemaking). Left to their own devices, the parties negotiated advertising restrictions that tend to be more bright-line and simpler to administer than those contained in the FDA regulations. This suggests perhaps that regulated parties place a higher value on comprehensibility and ease of administration and a lower value on fine tuning of policy than do agencies. But the total ban was struck down on free speech grounds by the Canadian Supreme Court. See RJR-MacDonald, Inc. v. Canada (Attorney General) [1995] S.C.R. 199.
A. A Police Power Rule?

The first question that must be confronted is whether the proposed restrictions on tobacco advertising would violate the First Amendment at all; in other words, whether such advertising would be subject to a police power rule. If a police power rule applies, then all other questions about the transaction structure become moot. Any decision by the government to purchase tobacco advertising rights, or to pay just compensation for taking such rights, would be an act of gratuitous generosity, not something compelled by the transaction structure.

Under the general theory of the transaction structure set forth in Part I, the tobacco advertising prohibited by recent initiatives would be governed by a police power rule if we conclude that the public goods value of the right is negative (because $EB_{cr} < EC_{cr}$) and exceeds in absolute magnitude the private value of the right (assumed to be positive). Given these conclusions, in other words, tobacco advertising would fall under Equation Three:

$$\text{(3) PPR, } PGV_{cr} + PV_{cr} < 0 \text{ or } PGV_{cr} < -PV_{cr}$$

This requires, in turn, that we consider the external benefits and external costs associated with tobacco advertising and compare the resulting $PGV_{cr}$ to the private value of tobacco advertising to the tobacco companies.

1. The External Benefits of Tobacco Advertising. As a general matter, the external benefits of commercial advertising are probably small. This is not to say that commercial advertising does not contain valuable information, especially for consumers. But it is in the very nature of commercial speech that to the extent it conveys valuable information to consumers, that value is largely internalized by the purveyor of the information and the recipient of the information through the commercial transaction that the information is designed to promote. As Professor Farber has explained:

Most of the benefit of product advertising is captured by the producer itself in the form of increased sales. Consequently, we would not expect severe underproduction of commercial speech. Even casual exposure to the American media is enough to convince most people that advertising is already produced at an ample level.\(^\text{139}\)

To illustrate, suppose convenience store A sells a pack of cigarettes for $3.00, and convenience store B sells the same pack for $2.75. Convenience store B will have an incentive to advertise the existence of its lower price to

\(^{\text{139}}\) Farber, supra note 35, at 565. See also Posner, supra note 35, at 22.
the extent that the advertising generates additional sales and profits that exceed the costs of the advertising. Consumers will benefit from the information to the extent it permits them to save $0.25 per pack of cigarettes. But every consumer who benefits from the information by saving this amount of money will also be generating additional sales and presumably profits for convenience store B. Thus, every consumer who benefits from the information also generates parallel gains for the purveyor of information. The value of the information is thus internalized, at least in large part, through the commercial transaction that the information is designed to promote.

It is important not to exaggerate this point by suggesting that commercial advertising generates no external benefits. Unless the seller of the advertised product is able to engage in perfect price discrimination among consumers, consumers as a group will enjoy a "consumer surplus" from the transaction that is not recaptured by the seller. Consumer surplus can be regarded as a type of external benefit of the advertising that stimulates these transactions. Moreover, as Judge Posner has observed, some advertising will contain general information about products and services which may lead to higher sales for other sellers of similar products—an external benefit for the rivals of the purveyor of the information. But these kinds of external benefits associated with advertising are thought to be relatively small, at least relative to the external benefits associated with other kinds of speech such as political speech, scientific speech, or artistic expression.

Notice further that the clearest examples of external benefits from commercial advertising, such as consumer surplus, are generated largely by "hard" information like price advertising or information about new products or product features. The advertising restrictions in the FDA regulations and the two settlements contain no prohibition on the communication of this kind of information. Instead, they interdict the flow of certain "soft" information, such as cartoon images, and the dissemination of information through visual media, such as billboards, where emotional content tends to predominate over hard information.

The argument has been made that without vivid imagery, it may be more difficult for tobacco companies to draw attention to important hard information, like lower prices or safer cigarettes. But this claim is questionable. After all, information about retail prices of consumer products is typically conveyed in black-on-white printed ads, such as the grocery and drug store ads that fill up the inner pages of weekday newspapers. And advertisements for new products, such as new drugs, are often placed in print media, where the features can be explained in a more satisfactory fashion than would be the case on a billboard or a television or radio spot.

140 Consumer surplus is a measure of the value that consumers as a group attach to a product above the price they pay for it. For a concise exposition of the concept, see Posner, supra note 45, at 277.
141 See Posner, supra note 35, at 22.
Thus, it is probably safe to conclude that although the advertising prohibited by the proposed settlement would generate some external benefits, primarily by alerting consumers to better prices or superior tobacco products being offered by some manufacturers or retailers relative to others, those external benefits are not large. Most of the consumer surplus that advertising helps consumers to obtain will not be extinguished by the proposed regulations. And there is little danger that tobacco companies and retailers will stop generating information valuable to consumers altogether.

2. The External Costs of Tobacco Advertising. At first blush, it might seem that the external costs of tobacco advertising must be extremely large. It turns out, however, that the magnitude of external costs associated with such advertising is highly debatable. There is no doubt that, as a general matter, the costs of smoking are high. Consider the following factual summary in the FDA’s Notice of Proposed Rulemaking:

Approximately 50 million Americans currently smoke cigarettes and another 6 million use smokeless tobacco products. These tobacco products are responsible for more than 400,000 deaths each year due to cancer, respiratory illnesses, heart disease, and other health problems. Cigarettes kill more Americans each year than acquired immune deficiency syndrome (AIDS), alcohol, car accidents, murders, suicides, illegal drugs, and fires combined. On average, smokers who die from a disease caused by smoking lose 12 to 15 years of life because of tobacco use.143

Indeed, on a straight cost-benefit basis, the FDA was able to show that its proposed regulations were among the most cost-effective social regulations ever proposed, even assuming relatively low effectiveness rates. For example, assuming that the FDA’s regulations reduced youth smoking by 25%, and using the Office of Management and Budget’s current recommended discount rate of 7%, the cost per life saved was estimated to be only about $52,000.144 Even on a worst-case scenario, assuming that the regulations reduced youth smoking by only 2.5%, the cost per life saved was estimated to be about $525,000—a much lower cost per life saved than associated with many environmental and safety regulations.145

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143 FDA NOPR, 60 Fed. Reg. at 41,314.
144 See FDA Final Reg., 61 Fed. Reg. at 44,599.
145 See id.
146 Environmental and safety regulations are often criticized on the ground that they reflect widely varying costs per life saved. See generally Lisa Heinzerling, Regulatory Costs of Mythic Proportions, 107 YALE L.J. 1981 (1998) (providing an overview and critique of this literature). One commonly referenced table shows costs per life saved ranging from a low of $100,000 to a high of $72 billion. See id. at 1988-89. Within this range, where exactly the benchmark for regulatory expenditure should be fixed is, of course, highly debatable. One approach would rely upon so-called “risk-risk” assessment, which attempts to determine the point at which additional expenditures on regulation would
The key question posed by the proposed transaction structure, however, is not whether the costs of smoking are high, or whether the benefits of smoking reduction exceed the compliance and regulatory costs of getting people to stop smoking. Rather, the question is whether the external costs associated with smoking are high. That question has no simple answer. The vast preponderance of the costs of smoking are borne by smokers themselves or their families, and policy analysts disagree sharply about whether it is proper to classify these costs as "externalities."

a. The External Costs of Smoking.—The conceptual and normative problems surrounding the question of whether smoking produces significant external costs can be illustrated by the accompanying table, which is reproduced from a recent article by Jon Hansen and Kyle Logue (see Table 3). The first column reflects an estimate of the external costs and benefits of smoking developed by Willard Manning and a team of economists in 1991. The table shows external costs as having a positive sign and external benefits as having a negative sign. Using a discount rate of five percent, Manning and his colleagues found that the external costs of smoking were small, from thirty-one to fifty-two cents per pack. Specifically, they concluded that nonsmokers subsidize smokers' medical care because smokers use up disproportionately large portions of the pool of health insurance premiums. On the other hand, smokers subsidize the costs of providing pensions and insured coverage of nursing home care to nonsmokers because smokers die earlier. The noninsurance externalities referenced on the table include things like lives lost in fires caused by smoking, fetal deaths due to women smoking while pregnant, and neonatal intensive care costs of infants borne to women who smoke while pregnant.

The second column reflects an estimate of the external costs of smoking developed in 1995 by another economist, Kip Viscusi, largely following the Manning methodology but using a lower discount rate—three percent—and updated figures. Viscusi found even smaller external costs; indeed, the lower end of his range suggests that smoking produces external benefits of eighteen cents per pack. This conclusion was generated largely by restat-
## Estimated External Costs per Pack of Cigarettes

<table>
<thead>
<tr>
<th>Costs</th>
<th>Manning et al.</th>
<th>Viscusi</th>
<th>Hanson &amp; Logue's Alternative Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical Care</td>
<td>$0.26</td>
<td>$0.50</td>
<td>$0.50</td>
</tr>
<tr>
<td>Sick Leave</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>Group Life Insurance</td>
<td>0.05</td>
<td>0.13</td>
<td>0.013</td>
</tr>
<tr>
<td>Nursing Home Care</td>
<td>-0.03</td>
<td>-0.22</td>
<td>—</td>
</tr>
<tr>
<td>Retirement Pension</td>
<td>-0.24</td>
<td>-1.10</td>
<td>—</td>
</tr>
<tr>
<td>Fire Insurance</td>
<td>0.02</td>
<td>0.02</td>
<td>0.02</td>
</tr>
<tr>
<td>Taxes on Earnings</td>
<td>0.09</td>
<td>0.35</td>
<td>—</td>
</tr>
<tr>
<td>Total Insurance</td>
<td>0.15</td>
<td>-0.32</td>
<td>0.66</td>
</tr>
<tr>
<td>Costs to Smoker</td>
<td>—</td>
<td>—</td>
<td>5.93</td>
</tr>
<tr>
<td>ETS</td>
<td>—</td>
<td>—</td>
<td>0.14</td>
</tr>
<tr>
<td>Other</td>
<td>—</td>
<td>—</td>
<td>0.25</td>
</tr>
<tr>
<td>Total Noninsurance</td>
<td>0.16 to 0.37</td>
<td>0.14 to 0.73</td>
<td>6.32</td>
</tr>
<tr>
<td>Total</td>
<td>0.31 to 0.52</td>
<td>-0.18 to 0.41</td>
<td>6.98</td>
</tr>
</tbody>
</table>

**Table 3**
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ing the analysis of insurance externalities, in particular by adjusting upward the estimate of savings in pension, social security, and nursing home benefits due to premature deaths.

The third column shows Hansen and Logue's own estimation of the external costs of smoking. Although they adopted most of Viscusi's numbers and his discount rate, they concluded that smoking generates external costs of a staggering seven dollars per pack. The largest source of this extreme divergence is that Hansen and Logue include nearly six dollars per pack of costs to the individual smoker and his or her family, including medical expenses not covered by insurance, wages not received because of illness and early death, and the monetized value of early death and disability. In addition, on policy grounds Hansen and Logue reject any savings in pension, social security, and nursing home costs associated with early death. They also add in the costs of second-hand smoke exposure, although the estimated external costs here may be small.\(^{150}\)

The huge disparity in external cost estimates derived by Manning and Viscusi, on the one hand, and by Hansen and Logue, on the other, is primarily attributable to conceptual and normative disagreements, not to disagreements about the facts. The biggest single issue concerns whether additional lifetime costs to smokers, such as lost wages, unreimbursed medical expenditures, and the monetized value of premature death and disability, should be counted as external costs. Manning and Viscusi assume that because these costs are eventually borne by the smoker or the smoker's family, they are fully internalized when the smoker makes the decision whether to continue smoking or to quit. Hansen and Logue, in contrast, argue that because of informational imperfections and distorted decision-making associated with addictive behaviors, smokers do not properly evaluate these costs and the impact of these costs on family members when they decide to continue smoking or to quit.\(^{151}\) In effect, Hansen and Logue argue that the risk of illness and early death that the "future self" and family members incur because of smoking should be regarded as an external cost to the "present self" who decides whether to light another cigarette.\(^{152}\)

The second issue, which accounts for slightly less than one dollar of external costs, concerns whether the lower costs that the government and private pensions incur because of the premature deaths of smokers should be counted as an external benefit. Manning and Viscusi assume that if the higher medical insurance costs borne by nonsmokers because of the ill-
nesses of smokers are to be treated as an external cost of smoking, then the lower Social Security and Medicare costs attributable to the early deaths of smokers should be counted as an external benefit of smoking. Hansen and Logue, in contrast, argue that no early-death pension saving "credit" should be included in the calculus. Although they again rely on informational imperfections in making this argument, their most forceful argument here is a moral one. They contend that it is inappropriate to consider early death a "social benefit" in any effort to determine correct social policy because, for example, "we do not hear polluters urging policymakers to take into account the many pension-saving deaths that would result if Congress would only leave polluters unregulated."

I will not attempt here to arbitrate between these competing positions regarding the magnitude of the external costs of smoking, at least with respect to adult smokers. Resolution of this debate would require the exploration of a number of extremely difficult questions, such as whether people suffer from cognitive biases that prevent them from making correct assessments of distant and uncertain costs, and in particular whether addictive substances like tobacco distort the processes of individual decision making in ways that prevent rational assessments of future benefits and costs. These issues cannot be resolved by applying a single "correct" definition of externalities to the facts as we know them. Either the definition of what constitutes an externality is contestable or, if one wants to insist on a single definition, there is a contestable claim that the definition should be modified in favor of an alternative measure of benefits and costs. At its core, the dispute centers on whether we insist on a model of individual decision making that adheres to the rational choice assumptions on which all economic analysis and cost-benefit analysis rests, or whether we are willing to make adjustments to that model in particular cases based on arguments that the model produces distorted results or results that are incompatible with widely shared moral intuitions. Either way, the choice of model is debatable and cannot be resolved dogmatically.

In the context of the current debate over cigarette advertising, however, it seems that there is a way to side-step these conundrums, and that is to recall that the sole objective of the regulations is to discourage children from smoking. The question may therefore be restated as follows: whether the future medical costs, lost wages, and lost years of life associated with smoking should be regarded as being fully internalized by the child when he or she decides to take up smoking. The answer should be a self-confident "yes" only if one is prepared to maintain that children have the

\[153\] Id. at 1247-54.
\[154\] Id. at 1256.
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same capacities for rationally weighing future costs and benefits that we ordi-
narily attribute to adults. Few would defend such a position. As the FDA
notes, "[e]ven steadfast defenders of individual choice acknowledge the dif-
culty of applying the 'market failure' criterion to non-adults."\(^{156}\) Thus, in
assessing an advertising policy designed to influence the behavior of chil-
dren, future costs of the sort included by Hansen and Logue are properly
considered external costs.

The conceptual and normative disagreements about what constitutes an
external cost of smoking nevertheless provide an important caveat about the
utility of the general theoretical framework set forth in Part I. No one
should suppose that deeply controversial normative judgments are avoided
by casting the inquiry in terms of "external benefits" and "external costs." They just emerge at a different point in the analysis. As my colleague
Marty Redish has observed, the Supreme Court's commercial speech cases
have alternated between "paternalistic" and "anti-paternalistic" assumptions
about consumer behavior.\(^{157}\) Under the proposed framework discussed
here, the same conflict emerges, this time in connection with a debate over
the magnitude of the "external costs" attributable to smoking. Paternalistic
assumptions about consumer behavior yield large external costs. Assump-
tions ground in rugged individualism yield much smaller and perhaps even
negative external costs.

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b. The Role of Advertising.—Even if we conclude that smok-
ing is associated with significant external costs, perhaps even of the mag-
nitude of seven dollars per pack, it is still necessary to demonstrate that
advertising is responsible for increasing the incidence of this externality-
producing activity and, conversely, that restricting advertising would cause
incidence of the externality-producing activity to decline. Public health ad-
vocates who crusade against smoking find it self-evident that the huge ad-
vvertising budgets of tobacco companies are largely responsible for the
persistence of tobacco use, especially among teens.\(^{158}\) But when the FDA

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\(^{156}\) FDA Final Reg., 61 Fed. Reg. at 44,571. The FDA cited two types of evidence in support of
this common sense conclusion. The first consists of studies showing that the implicit time discount rate
used by children falls as they mature. "Infants and young children tend to live very much for the pres-
ent; the prospect of something only a week in the future usually has little influence over their behavior.
As children get older their time horizons lengthen, but once adult status is reached there seems to be lit-
tle correlation between time discount and age." \textit{Id.} (quoting \textit{VICTOR R. FUCHS, HOW WE LIVE} 228-29
(1983)). The second was a study by economist Frank Chaloupka showing that the pattern of "rational
addiction" thought to exist in the general population, whereby current consumption is a function of both
past and future consumption, does not hold for younger persons, for whom current consumption is a
function only of past but not future consumption. \textit{Id.} at 44,572 (citing Frank Chaloupka, \textit{Rational Ad-
ddictive Behavior and Cigarette Smoking}, 99 J. POL. ECON. 740 (1991)).


\(^{158}\) See, \textit{e.g.}, \textit{Tobacco Advertising and Promotion, in GROWING UP TOBACCO FREE} 105-35
(1995). For a review and assessment of the empirical literature on the impact of tobacco advertising on
sought to demonstrate that its proposed advertising restrictions would "directly advance" the interest in reducing teen smoking within the meaning of the Central Hudson test, proof of this proposition was hard to come by.\footnote{159} Here, the disagreements are largely empirical rather than conceptual or normative. Either advertising influences kids to smoke or it does not. The reason it is so hard to demonstrate what kind of effect it has is that it is impossible to conduct controlled experiments that would isolate the influence of advertising from other variables. To take just one example, the FDA relied in its rule making on sampling data from Norway computing the percentages of teenage boys and girls who were daily smokers before and after that nation imposed strict limits on all forms of tobacco advertising and promotion.\footnote{160} In 1975, before advertising was restricted, twenty-three percent of fifteen-year-old boys and twenty-eight percent of fifteen-year-old girls were daily smokers.\footnote{161} In 1986, after the restrictions had been fully implemented, the percentage of daily smokers had fallen to sixteen percent and seventeen percent respectively.\footnote{162} Standing alone, this would suggest that tight limits on advertising can reduce the incidence of teen smoking by as much as twenty-five to forty percent.

But, of course, other cultural and legal changes were taking place in Norway at the same time as the ban on tobacco advertising was put in place. In particular, Norway imposed a large excise tax increase on cigarettes in 1980.\footnote{163} Policy analysts, especially those with an economics orientation rather than a public health background, tend to believe that price increases have a more dramatic effect on smoking behavior than do advertising restrictions.\footnote{164} It is therefore quite likely that these other changes in Norway were at least partially responsible for the decline in underage smoking. Thus, because it is not possible to run a controlled experiment that holds these other changes constant while examining only the effect of advertising restrictions, we have no way of calibrating how much impact advertising restrictions actually have on teen smoking.

Notwithstanding the great difficulties in proving causality with any precision, I think a persuasive case can be made that at least some causal connection exists. A key fact about the tobacco market is that very few individuals take up smoking as adults. It is estimated that about ninety per-

\footnote{159} FDA Final Reg., 61 Fed. Reg. at 44,474-95.
\footnote{160} FDA Final Reg., 61 Fed. Reg. at 44,490-91.
\footnote{161} See id. at 44,491.
\footnote{162} See id.
\footnote{163} See id.
cent of adult smokers started smoking before the age of eighteen.\textsuperscript{165} This means that the future market shares of the tobacco companies—and their future profitability—are critically dependent on the number of persons who start using their products as teens.

Teen behavior is notoriously driven by peer pressure and by a desire to experience adult "rites of passage."\textsuperscript{166} Thus, there would no doubt be substantial teen tobacco use in a world without tobacco advertising, just as there is substantial teen use of marijuana in a world without marijuana advertising. Yet the tobacco companies are not run by fools. Those companies spend a staggering six billion dollars per year on marketing activities in the U.S.\textsuperscript{167} In an oligopolistic market for a product that attracts very few new adult users, where brand loyalty is high, and where demand among established users is highly inelastic,\textsuperscript{168} it is reasonable to assume that the great bulk of this money is being spent to attract new teenage users. The fact that teens overwhelmingly prefer to smoke the most heavily advertised products tends to confirm this supposition.\textsuperscript{169}

Thus, there is reason to believe that there is at least some causal connection between advertising and smoking behavior. It is not the sole cause, it is perhaps not the dominant cause, and the degree of causal influence probably cannot be quantified. Still, curtailing the exposure of teens to cartoon advertising, billboards, and promotional merchandise would probably contribute, in some measure, to a reduction in teen smoking. Whether the courts will agree with this assessment will depend on what standard of proof they apply, and on how willing they are to defer to the judgment of entities like the FDA, which are convinced that there is such a connection.

3. The Private Value of Tobacco Advertising. The external benefits and costs of tobacco advertising should be compared to the private value of this advertising to the rightsholders, the tobacco companies. Here, there would seem to be few conceptual difficulties, although informational shortcomings prevent any exact assessment. The private value to the tobacco companies should be measured by their willingness to pay for such a right.

\textsuperscript{165} See FDA Final Reg., 61 Fed. Reg. at 44,573 (reporting survey data that 92\% of 20-year-old smokers started before age 18); id. at 44,574 (reporting finding that 82\% of smokers aged 30 to 39 began to smoke before age 18).

\textsuperscript{166} See FDA NOPR, 60 Fed. Reg. at 41,329.

\textsuperscript{167} See FDA Final Reg., 61 Fed. Reg. at 44,601.

\textsuperscript{168} On price elasticity, see \textsc{Federal Trade Commission, Competit\,ion and the Financial Impact of the Proposed Tobacco Industry Settlement} 4-5 (1997) (demand for cigarettes is relatively insensitive to price, with price elasticity generally reported to be -0.4); on brand loyalty, see Jon D. Hanson et al., \textit{Smokers' Compensation: Toward a Blueprint for Federal Regulation of Cigarette Manufacturers}, 22 S. Ill. U. L.J. 519, 534 n.48 (1998) (cigarettes have the highest known brand loyalty of any consumer product).

Tobacco companies pay an astonishing amount for advertising—currently six billion dollars per year. But this is not the correct measure of the private value of the right. Advertising is valued not according to what it costs but according to the profits it brings in—the additional revenues net of costs. Thus, the correct measure of the PV$_{cr}$ of advertising is the profits the tobacco companies would lose if such advertising were banned. This is presumably just slightly more than what the companies would be willing to pay to preserve the right to continue to engage in such advertising.\footnote{A complete analysis should perhaps also include in PV$_{cr}$ any returns earned by providers of inputs to tobacco advertising in excess of their opportunity costs. Thus, for example, if advertising agencies can earn $(X + Y)$ creating ads to induce smoking, but only $(X)$ creating antismoking ads, then $(Y)$—the forgone economic rents of the advertising agencies from not being able to produce ads for cigarettes—should be added as an element of PV$_{cr}$. I have ignored this complication here because I have no way of knowing if there are such forgone opportunity costs and, if so, how large they might be. Also, the addition of this refinement would not change the bottom line, given that PGV$_{cr}$ exceeds PV$_{cr}$ by such a large magnitude.} In assessing this PV$_{cr}$, it is also important to remember that neither the Global Settlement nor the AG Settlement bans all tobacco advertising; both focus on cartoons, billboards, and promotions most likely to appeal to teens.

One way to measure the private value of the prohibited advertising would be to estimate the decline in profits that would occur once the advertising is banned. The lost profits would equal the private value of the advertising. This approach, of course, takes us back to the vexing issue of what effect advertising restrictions will have on demand for cigarettes, as to which we do not have very good data. A second method of valuation might be to determine the internal benchmark rate of return on investment in the tobacco industry, and apply this rate to investment in advertising, on the assumption that tobacco companies will demand that all investments realize the benchmark rate of return. This approach would require that we estimate the reduction in advertising investment that will occur as a result of the new restrictions, as opposed to the reduction in smoking, as well as the companies’ benchmark internal rate of return.\footnote{The five-year average rate of return on investment in the tobacco industry is reported to be 17.01%. \textit{See} Market Guide, \textit{Comparison Report for Philip Morris Companies} (visited March 4, 1999) <http://yahoo.marketguide.com/mgi/ratio/7043N.html>.}

4. \textit{A Police Power Rule: The Final Accounting.} What then is the bottom line with respect to whether tobacco advertising should be constitutionally protected under the proposed framework? The answer, obviously, is that we do not know. For sake of illustration, however, let us start with some numbers taken from the FDA’s cost-benefit analysis.\footnote{\textit{See} FDA Final Reg., 61 Fed. Reg. at 44,568-99. Agencies such as FDA are required to perform a cost-benefit analysis of major rulemaking initiatives under Executive Order 12,866, the Clinton Administration’s version of Executive Order 12,291 issued by President Reagan.} The FDA computed the costs and benefits of its proposed advertising and marketing restrictions using a variety of assumptions as to their effectiveness. The
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agency argued that its proposed package of marketing restrictions would reduce teen smoking by fifty percent, and that fifty percent of these teenagers would continue to refrain from smoking as adults.\textsuperscript{173} This is probably optimistic. Moreover, the advertising restrictions actually adopted by the AG Settlement are significantly less restrictive overall than the FDA's restrictions. To be conservative, let us assume that the advertising restrictions actually adopted will deter only ten percent of the teens in each age group from smoking and that fifty percent of these teenagers will continue to refrain from smoking as adults. Under these assumptions, the FDA computed that 12,000 smoking-related deaths would be avoided and 181,100 years of life saved.\textsuperscript{174} After subtracting compliance and administrative costs, the agency placed the monetized net present value of these benefits (using the OMB's discount rate of seven percent) at between $3.5 and $4.0 billion.\textsuperscript{175}

In order to compute the $PGV_{cr}$ associated with the extinction of advertising rights, we should also take into account any external benefits to consumers from cigarette advertising which will be lost because of the restrictions. Given that hard information is not restricted and that magazine and direct mail advertising is not restricted (except insofar as cartoon characters are banned), these external benefits are probably small. To err on the side of generosity, let us assume that the advertising restricted by regulations would eliminate some consumer surplus. We can perhaps account for this by selecting the low end of the FDA’s estimate of the benefits of the restrictions. This yields a $PGV_{cr}$ of negative $3.5 billion for the tobacco advertising banned by the proposed settlement.

Under the formula for determining whether to apply a police power rule ($PGV_{cr} + PV_{cr} < 0$ or $PGV_{cr} < -PV_{cr}$), it is necessary that this negative $PGV_{cr}$ more than offset the private value of the exercise of the right to the tobacco companies ($PV_{cr}$). Again, the uncertainties in determining $PV_{cr}$ are considerable. Let us again borrow from the FDA’s analysis, however, and attempt to derive a value for $PV_{cr}$ based on the predicted decline in sales, assuming that the FDA’s advertising restrictions deter ten percent of teenagers from starting to smoke, and fifty percent of those teenagers continue not to smoke as adults. The FDA’s cost-benefit analysis indicates that these assumptions would translate into lost sales of 31.6 million packs of cigarettes in the first year, 56.4 million packs in the second year, 81.2 million packs in the third year, 106 million packs in the fourth year, and so on.\textsuperscript{176} Using the current industry-average profitability of five cents per pack,\textsuperscript{177}

\textsuperscript{173} See FDA Final Reg., 61 Fed. Reg. at 44,569.

\textsuperscript{174} See id.

\textsuperscript{175} See id. at 44,598.

\textsuperscript{176} See FDA Final Reg., 61 Fed. Reg. at 44599. This assumes a 10% deterrence of teens rather than the optimistic 50% taken by the FDA. See id.

\textsuperscript{177} See FEDERAL TRADE COMMISSION, supra note 168, at 45 (table showing operating profits of tobacco companies without settlement). 1193
this represents a profit loss of $1.58 million in the first year, $2.82 million in the second year, $4.06 million the third year, and so forth. The discounted present value of this stream of lost profits, again using OMB’s seven percent discount rate, is about $113 million.\footnote{The discounted present value of the lost profits due to FDA-type advertising restrictions was derived as follows:}

Clearly, the external costs associated with the restricted tobacco advertising, $3.5 billion, far exceed the private benefits of that advertising, $113 million. Indeed, under the above assumptions, it is not even close: the external costs are greater than the private benefits by a ratio of more than twenty-five to one. The cause of this disparity has little to do with the assumptions about the effectiveness of the advertising restrictions. Instead, it derives primarily from the fact that cigarettes are a product that is uniquely devastating to people’s health. Consequently, virtually any regulatory pol-

\begin{table}
\begin{center}
\begin{tabular}{|c|c|c|c|c|c|}
\hline
Year & Lost Sales assuming 50\% effective (million packs) & Lost Sales assuming 10\% effective (million packs) & Profit per pack (FTC) & Lost Profit (column 3 x column 4) ($ million) & PV (using 7\% discount rate) \\
\hline
1 & 158 & 31.6 & $0.05 & 1.58 & 1.48 \\
2 & 282 & 56.4 & $0.05 & 2.82 & 2.46 \\
3 & 406 & 81.2 & $0.05 & 4.06 & 3.31 \\
4 & 530 & 106.0 & $0.05 & 5.30 & 4.04 \\
5 & 654 & 130.8 & $0.05 & 6.54 & 4.66 \\
6 & 778 & 155.6 & $0.05 & 7.78 & 5.18 \\
7 & 902 & 180.4 & $0.05 & 9.02 & 5.62 \\
8 & 1026 & 205.4 & $0.05 & 10.27 & 5.98 \\
9 & 1150 & 230.2 & $0.05 & 11.51 & 6.26 \\
10 & 1274 & 255.0 & $0.05 & 12.75 & 6.48 \\
11 & 1398 & 279.8 & $0.05 & 13.99 & 6.65 \\
12 & 1582 & 304.6 & $0.05 & 15.23 & 6.76 \\
13 & 1646 & 329.4 & $0.05 & 16.47 & 6.83 \\
14 & 1770 & 354.2 & $0.05 & 17.71 & 6.87 \\
15 & 1894 & 379.0 & $0.05 & 18.95 & 6.87 \\
16 & 2018 & 403.8 & $0.05 & 21.19 & 6.78 \\
17 & 2142 & 428.6 & $0.05 & 21.43 & 6.78 \\
18 & 2266 & 453.4 & $0.05 & 22.67 & 6.71 \\
19 & 2390 & 478.2 & $0.05 & 23.91 & 6.61 \\
20 & 2514 & 503.0 & $0.05 & 25.15 & 6.50 \\
\hline
TPV & & & & & 112.85 \\
\hline
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icy that reduces the incidence of smoking even to a modest degree will be cost-justified compared to the profits that can be derived from advertising the product. Thus, I would submit that a police power rule is fully justified.

This analysis, of course, is subject to many objections about the choice of assumptions and relative magnitudes. No doubt, if we were to re-do the analysis and substitute Viscusi’s estimate of the external costs of smoking for the FDA’s estimate of the costs of smoking to teens, which assumes that future medical costs and lost years of life are externalities to the immature teen, the estimate of the PGVcr of tobacco advertising would be much smaller. Also, if we assume that the advertising restrictions will be highly effective in discouraging smokers, then the PVcr would be much larger because the tobacco companies would lose more profits. With enough adjustments, conceivably the case could be made that a police power rule is not justified here. Additional data would reduce the uncertainties in this exercise to a degree. But as noted earlier, the conceptual and normative issues that divide the FDA and Hansen and Logue from the economists Manning and Viscusi are the largest source of the variance in outcomes.

Clearly, therefore, the case for a police power rule for tobacco advertising is contestable. On assumptions that I regard as reasonable, the framework would suggest that this is the correct solution—advertising restrictions limited to demand-inducing features likely to influence teens should be deemed constitutional under the First Amendment. On other assumptions that cannot be dispositively rejected, however, the framework conceivably could suggest that tobacco advertising should be constitutionally protected.

B. A Property Rule?

Regardless of what the framework indicates about the propriety of a police power solution, there are reasons to press ahead with the analysis of other aspects of the transaction structure. The courts will most likely assess advertising restrictions under the case-by-case Central Hudson test, and the question of whether tobacco advertising restrictions can be sustained under that test is highly uncertain. The FDA has vigorously argued both in its rule-making and in court that its advertising regulations are constitutional under Central Hudson. But the consensus of the legal commentators seems to be that these restrictions cannot survive scrutiny under Central Hudson,179 or at least that they cannot survive under Central Hudson as reinterpreted by 44 Liquormart.180

Moreover, the disquiet about the *Central Hudson* test on display in *44 Liquormart* may reflect a growing consensus among the Justices in favor of a more "categorical" and a less case-by-case approach to commercial speech restrictions. Specifically, the Court may limit permissible commercial speech restrictions to those designed to curb false or misleading advertising and advertising for illegal products or services. I would argue that the example of demand-inducing cigarette advertising demonstrates the un-wisdom of such a limited rule. But the Court may conclude that other considerations—such as desire for more easily administered and predictable rules—outweigh the advantages of case-by-case weighing of external costs and benefits. Such a jurisprudential commitment on the part of the Court would render advertising restrictions of the type adopted by the FDA and contained in the AG Settlement unconstitutional. Thus, there is ample reason to proceed to a consideration of transactional options other than the police power rule.

Which brings us then to our next question: whether the tobacco companies should be allowed to waive their right to engage in tobacco advertising. This inquiry is more easily answered than the question of whether tobacco advertising should be subject to a police power rule.

Under current constitutional law, the answer to the waiver question would be governed by the unconstitutional conditions doctrine. A common understanding of the doctrine is that it protects individuals against entering into improvident or unfair contracts to waive their constitutional rights. In other words, the unconstitutional conditions doctrine is designed to invalidate contracts that do not reflect a genuine exercise of individual consent. If we regard the waiver issue in this light, there would seem to be no reason to invalidate the waiver of commercial speech rights by the major tobacco companies. These companies are perhaps endowed with more legal advice...
about their constitutional rights than any other entities in the world. If they decide that it makes sense to waive their First Amendment rights in return for relief from tort liability or other benefits, it cannot be because they do not understand their rights or the implications of waiving those rights, or because the government has exerted "undue influence" on their decisionmaking. Indeed, few corporate actions were more carefully deliberated than the decision of the major tobacco companies to enter into the proposed Global Settlement and, when that failed, the AG Settlement. The same will presumably be true of any future settlement or other agreement, perhaps with the federal government, in which the companies agree to waive their commercial speech rights.

As I have argued elsewhere, however, the unconstitutional conditions doctrine should not be understood as being grounded in a concern about volitional consent. The reason why consent should not be dispositive can be illustrated by considering waivers of political speech rights by tobacco companies. This is not a hypothetical. As part of the recent AG Settlement, the tobacco companies agreed not only to waive their First Amendment commercial speech rights insofar as they apply to the advertising restrictions included in the agreement. They also agreed to waive their First Amendment rights to object to certain types of legislation that may be proposed in the future. With respect to an enumerated list of legislative proposals, the tobacco companies pledged not to "oppose, or cause to be opposed (including through any third party or Affiliate), the passage by such Settling State (or any political subdivision thereof) of those state or local legislative proposals or administrative rules." This proposal is, un-

183 See Frankel, supra note 16 (tobacco companies were represented in settlement negotiations by high-powered litigation and settlement specialists).
184 See Merrill, supra note 34.
185 The types of legislation covered by the waiver are listed in the AG Settlement, Exhibit F, which reads as follows:

EXHIBIT F

POTENTIAL LEGISLATION NOT TO BE OPPOSED

Limitations on Youth access to vending machines.
Inclusion of cigars within the definition of tobacco products.
Enhancement of enforcement efforts to identify and prosecute violations of laws prohibiting retail sales to Youth.
Encouraging or supporting use of technology to increase effectiveness of age-of-purchase laws, such as, without limitation, the use of programmable scanners, scanners to read drivers' licenses, or use of other age/ID data banks.
Limitations on promotional programs for non-tobacco products as prizes or giveaways.
Enforcement of access restrictions through penalties on Youth possession or use.
Limitations on tobacco product advertising in or on school facilities, or wearing of tobacco logo merchandise in or on school property.
Limitations on non-tobacco products which are designed to look like tobacco products, such as bubble gum cigars, candy cigarettes, etc.
186 Id. art. III(m).
abashedly, a partial waiver of core First Amendment rights to engage in future political speech.

Obviously, there can be no argument that the tobacco companies' waiver of political speech rights was not "knowingly and intelligently" consented to by the tobacco companies. The political speech waiver, like the commercial speech waiver, was made on advice of counsel and after extensive deliberation. Clearly, the tobacco companies concluded that it was in their best interest to waive their political speech rights to oppose the enumerated categories of legislation as part of a package of *quid pro quos* that included the AG's agreement to drop all pending and future cost-recovery litigation against the tobacco companies.

Nevertheless, I think a compelling argument can be made that such political speech waivers should not be enforced. As the Supreme Court noted in *First National Bank of Boston v. Belotti*,187 "[t]he inherent worth of the speech in terms of its capacity for informing the public does not depend upon the identity of its source, whether corporation, association, union, or individual."188 Indeed, one can readily imagine how the purchased silence of the tobacco companies with respect to future legislative proposals could deprive the public of important input about such proposals. For example, a proposed law mandating the use of "programmable scanners" to read drivers's licenses or other types of identification before cigarettes may be purchased189 might raise troubling privacy questions. If tobacco companies had not waived their political speech rights, they might raise such concerns in public debate over whether to adopt such a measure. However, with the tobacco companies sitting silently on the sidelines, it is not clear that other organizations would have sufficient resources or incentives to stimulate public awareness of these issues.

Under the transaction structure theory proposed herein, the question whether a constitutional right is protected by an inalienability rule or a property rule turns on whether the exercise of the right has a large and positive $PGV_r$. For reasons already canvassed, there is reason to believe that political speech in the aggregate provides important benefits to third parties. Moreover, it is clear that such speech is entitled to a high level of protection on a categorical basis. This suggests that it would be inappropriate to engage in an inquiry into whether the $PGV_r$ of such speech in any particular case is sufficiently small that a waiver should be permitted. Political speech, including political speech by tobacco companies, should be governed by an inalienability rule.

With respect to commercial speech, however, it is less likely that waivers of speech rights would deprive consumers of important information. For the reasons previously given, the external benefits of commercial ad-

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188 *Id.* at 777.
189 See supra note 185.
vertising are, as a general matter, low. Moreover, the proposed regulations do not interfere with the dissemination of price information, new product information, and comparative safety claims—advertising most likely to entail external benefits. Thus, any external benefits associated with the restricted tobacco advertising are likely to be insignificant. In determining the overall magnitude of $PGV_{cr}$, it is necessary to subtract the external costs of the exercise of the right from the external benefits. The magnitude of the external costs of tobacco advertising, as we have seen, is highly uncertain. But on almost any reckoning, those costs are likely to be at least as large as the external benefits. As long as $EB_{cr} \leq EC_{cr}$, then $PGV_{cr}$ is either zero or negative, making property rule protection, rather than an inalienability rule, appropriate.\footnote{In advocating the use of an inalienability rule with respect to political speech rights, I am obviously advocating a "categorical" rule for all types of political speech. Similarly, I am inclined to take the categorical position that constitutionally protected commercial speech should always be subject to a property rule, if not a liability rule, because the external benefits of such speech will likely be small. This is in contrast to the case-by-case approach I have advocated for determining whether commercial speech regulations are justified under a police power rule. There is no contradiction in these positions, however. My advocacy of categorical rules simply reflects my belief that most cases within the category would be decided the same way if case-by-case inquiries were undertaken. In contrast, where the outcomes of individual cases within a category are likely to differ, a case-by-case approach makes greater sense.}

It follows that there is no reason why the tobacco companies should be prohibited from waiving their commercial speech rights, as opposed to their political speech rights. Those rights should be at most protected by a property rule, which the tobacco companies would be free to sell to government at a mutually satisfactory negotiated price.

C. A Liability Rule?

Suppose that the proposed advertising restrictions are found to be unconstitutional, and suppose further that the tobacco companies are permitted to waive their right to challenge those restrictions. What happens if the tobacco companies cannot be induced to execute further waivers beyond the waiver already achieved in the AG Settlement? If further regulation of tobacco advertising is desired, it would seem that we are left with only one option: condemnation of the tobacco companies' advertising rights. As suggested in Part I, a liability rule should be available if the following three conditions are met: (1) the rightsholder has a monopoly over something that the government needs to acquire to fulfill its objectives; (2) compensation rather than a police power rule is appropriate, either because the rightsholder is blameless or because the rightsholder has already been determined to have a constitutionally protected right; and (3) the right in question can be objectively valued in monetary terms. Let us briefly consider whether tobacco advertising satisfies each of these conditions.
1. The Presence of Monopoly. The governmental objective reflected in the FDA rules and the two settlements is to reduce the incidence of underage smoking. No one anticipates that the level will be driven to zero. It might seem, therefore, that the governmental objective could be pursued by achieving a reduction in advertising rather than an elimination of advertising. This, in turn, suggests that the government could purchase advertising waivers from different manufacturers without having to worry about acquiring the rights from every manufacturer. In other words, tobacco advertising might be viewed like too many push-cart vendors in the downtown area. There is no monopoly holdout problem, since it does not matter which push-cart vendors sell their rights. Without any monopoly holdout problem, there is no need to move from property rules to liability rules.

Unfortunately, given the dynamics of the tobacco market, the strategy of purchasing the advertising rights of only some tobacco companies is unlikely to work. As noted earlier, the basic marketing strategy of the tobacco companies is to try to snare as large a share of the teenage market as possible, because this is the age at which individuals begin to smoke and form brand loyalties. Thus, if the government secures a preliminary agreement from four tobacco companies to curb advertising designed to appeal to teens but a fifth company refuses to go along, the first four companies will almost certainly bail out of the deal. This is because the prospect of one company being able to use color and image advertising would give that company an unfair advantage in capturing future market share. It follows that purchasing less than all the rights in the market will not do. The government will have to achieve unanimous consent among the companies in order to eliminate tobacco advertising through voluntary agreement.

The requirement of obtaining the unanimous consent of all rightsholders means that the first condition for utilizing liability rules rather than property rules has been satisfied. Because all must consent, each tobacco company has the power to hold out and frustrate the government's objective by raising the transaction costs of achieving a voluntary exchange of rights to unacceptably high levels. The presence of such high transaction costs, in turn, justifies recourse to liability rules in order to achieve the desired end.

2. Whether Compensation Should be Required. Although the presence of high transaction costs justifies shifting from a property rule to a liability rule, it is also necessary to explain why a shift all the way to a rule of no entitlement is not the appropriate solution. I earlier suggested the following reasons why such a shift might be regarded as improper: (1) although exercise of the constitutional right generates external costs in excess of external benefits and private benefits, the rightsholder is perceived as being blameless for these external costs; or (2) the rightsholder has already been

191 See supra note 46 and accompanying text.
192 See supra notes 55-59 and accompanying text.
determined to have a protected constitutional right, perhaps because the courts have committed to a categorical rule of constitutional protection. The first reason is unlikely to strike much of a responsive chord in this context. Few objective observers would characterize the tobacco companies as innocent purveyors of innocuous commercial messages that, through no fault of their own, just happen to induce teenagers to start smoking.

The second reason, however, could easily become relevant if the Supreme Court adopts the position of Justices Stevens and Thomas that commercial speech, with the exception of deceptive advertising and advertising for illegal products and services, is entitled to full constitutional protection. Such a bright-line categorical rule might be justified on the grounds that it covers the principal examples of advertising that generates external costs in excess of its benefits, and the administrative costs and error costs of permitting judges to try to identify other examples through case-by-case inquiry are too high. The erection of such a doctrinal regime would place the police power solution to restriction of nondeceptive advertising off limits, even if in individual cases like tobacco advertising the social costs of a particular type of advertising far exceed its benefits. The only options that would remain for dealing with the problem would be a government purchase of a waiver of rights or, failing unanimous agreement, government condemnation of advertising rights.

The previous discussion of the external costs and benefits of cigarette advertising suggests an additional reason, not anticipated in the initial presentation of the general framework, why a liability rule might be preferred to a police power rule. If the courts are very uncertain about the correct analysis of external costs and benefits, a liability rule provides a mechanism for assuring that the correct conclusion has been drawn. Under a liability rule, the government must compensate the rightsholder for the private value of exercising the constitutional right. Insofar as the government seeks to obtain the maximum benefit from its expenditure of public funds, the government will condemn and compensate only if the social benefits of extinguishing the right exceed the private value of the right. Thus, the government will condemn and compensate only when it is socially efficient to do so. In this sense, the liability rule solution can be justified for reasons that parallel the arguments found in the conventional explication of the C&M framework about why a rule of strict liability in tort may be superior to a rule that requires the court to enjoin the defendant to operate in a socially efficient manner.

Thus, our consideration of the problem of tobacco advertising uncovers another qualification to the basic framework, in the form of an additional

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193 See supra note 101 and accompanying text.
194 See supra notes 147-68 and accompanying text.
195 In the takings literature, this is referred to as the "fiscal illusion" argument for compensation. See Merrill, supra note 34, at 882-86.
reason to use liability rules: those rules may be particularly appropriate where there is a high level of uncertainty about whether a police power rule should apply. Making the government pay for the extinction of rights provides an additional assurance that the government is not overusing its police power in socially undesirable ways.

3. Objective Measurement in Money. Perhaps the most difficult hurdle to overcome in justifying the use of a liability rule to acquire the commercial speech rights of tobacco companies is the requirement that the right be susceptible to objective valuation in monetary terms. Real estate, the most common subject of the power of eminent domain, nearly always has an ascertainable market value, and this acts as a constraint on jury discretion in making ex post awards of damages. Other property rights and contract rights may also be amenable to valuation using market values as a benchmark. The right to advertise, in contrast, is not a recognized property right, and does not have a readily determinable market value.

This is not necessarily a fatal objection, however. There are instances where holders of property rights with no market value have been held to be entitled to just compensation upon a taking of those rights by the government. For instance, the Supreme Court has held that trade secrets taken by the government through a regulatory scheme mandating disclosure are entitled to compensation even though such secrets have no readily available market value. When the government takes rights that do not have an established market value, it has been suggested that compensation can be determined in other ways, such as the income capitalization method, which "estimates the value of a stream of income that property produces over its useful economic life by capitalizing that stream in terms of its present value." In principle, it should be possible to deploy such techniques to place a value on a tobacco company's right to advertise. To be sure, it would be necessary to obtain proprietary information about each company's return on investment in advertising, or on the profits it has lost because of the imposition of certain advertising restrictions. But in a condemnation proceeding, it would be appropriate to place the burden on each company to produce such information as a condition of obtaining compensation. Thus, the objective valuation hurdle can perhaps be overcome in this context, even without established market values for the right in question.

The ability to put a monetary value on commercial speech rights reminds us that commercial advertising has always had a dual nature: part commerce and part speech, or really both at once. The Supreme Court of late has been stressing the speech part and insisting on greater measures of

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constitutional protection for advertising, thereby frustrating government attempts at regulation. But the fact that commercial speech is susceptible to valuation in money terms reflects the fact that it remains a part of commerce. The commerce side of commercial speech renders it, unlike many other constitutional rights, subject to government condemnation.198

CONCLUSION

Virtually every nation in the world is free to adopt, as one element of its strategy for combating tobacco use, regulations designed to restrict demand-inducing advertising. A construction of the First Amendment that permits restrictions only of deceptive advertising and advertising for illegal products—as proposed by Justice Thomas and perhaps Justice Stevens—would, in effect, remove this as a regulatory option in the United States. The government would be forced into one of two polar positions: either making tobacco use illegal and thereby permitting restrictions of nondeceptive tobacco advertising, or continuing to allow adults to use tobacco products legally and thereby permitting unrestricted promotion of tobacco products.

Forcing the government to choose between these two extremes eliminates the obvious intermediate option: legalizing tobacco products but restricting their promotion. Perhaps the most intuitive way to make the argument in favor of permitting regulation of demand-inducing advertising for tobacco products is to consider the case of narcotics. Many thoughtful people have urged at least a partial deregulation of these substances. But under the commercial speech regime proposed by Justices Thomas and Stevens, such a move would mean that the purveyors of legalized marijuana or heroin would have the right to put up color billboards in inner city neighborhoods, run ads using cartoon characters in magazines, and otherwise tout the use of narcotics. Similar points could be made about a policy of legalizing prostitution, as in Nevada, or decriminalizing other traditional types of "vice activity."

From a policy perspective, this regulatory straightjacket makes little sense. If cigarettes were introduced today, knowing what we know about them as a product, there is little doubt that they would be banned. And any

198 One danger of using condemnation in the context of advertising for a product like cigarettes having a high demand inelasticity is that the government may turn around and impose a tax on the activity in order to pay the "just compensation" for the extinction of the speech right. Clearly, it would be inappropriate for the government to condemn half of someone's land for a highway and then raise property taxes on the remainder of the land to pay for the taking. This would be an end run around the requirement of just compensation. Similarly, it might be inappropriate for the government to raise excise taxes on cigarettes by the exact amount needed to pay just compensation for the extinction of tobacco advertising rights. Given the courts' reluctance to engage in much analysis of tax incidences, however, the government might be able to do something closely approximating this through step transactions, i.e., by first adopting a general increase in the excise tax with the proceeds payable to the Treasury, then condemning the advertising rights and paying just compensation out of general appropriations. As long as the government was not too blatant about what it was doing, courts might be reluctant to police against this.
advertising for them would thus also be banned, and this would be constitutional under the Thomas/Stevens commercial speech theory. Unfortunately, because smoking is so deeply entrenched in our society—there are so many millions of people who cannot kick the habit—there is no prospect in the foreseeable future that the sale of cigarettes will be banned. But this quirk of history should not require us to tie our hands in taking reasonable steps to minimize smoking and reduce the number of future smokers. Reasonable regulation of advertising such as the prohibition on cartoons and billboards adopted in the AG Settlement can play a constructive role in this process. Further regulation, including restricting all print advertising to black-on-white tombstone formats, should also be considered.

Moreover, outside the world of First Amendment theology, it is not necessarily true, as Justice Thomas has argued, that alternatives less burdensome on commercial speech are always preferable to advertising restrictions. The obvious “less burdensome” option for tobacco products is a steep excise tax increase, which would depress demand and consumption, especially among youth. But such an option would impose severe hardships on many poor adults, including large numbers of elderly smokers who live on fixed pensions. For many of these persons, raising the price of cigarettes a dollar a pack is not going to change a lifetime of behavior. What it will mean, instead, is something on the order of a one thousand dollar annual tax increase, which will be adsorbed by purchasing less food or prescription medicines. Given the choice between a one thousand dollar tax increase and not being able to see Joe Camel on billboards, I have no doubt what most of these hopelessly addicted elderly smokers would choose.

Fortunately, even if the Supreme Court blocks the door to direct prohibition of demand-inducing tobacco advertising, our constitutional structure is sufficiently flexible that there may be other avenues to achieving sensible results. One permissible possibility is to regulate tobacco advertising as part of a settlement between tobacco companies and other affected parties, in which the tobacco companies contractually pledge to waive their First Amendment rights. Another possibility, which is more daring but I think also justifiable, is to condemn the tobacco companies’ right to advertise in return for the payment of just compensation. The Constitution, it turns out, is a cathedral of many dimensions. Its offers us not only protected and unprotected activities, but also inalienability rules, property rules, and liability rules. Property rules and liability rules may be called upon for new service in the years ahead.