

17-1993 (L)

17-2107, 17-2111 (XAP)

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

THE STATE OF NEW YORK AND THE CITY OF NEW YORK,
Plaintiffs–Appellees–Cross-Appellants,

v.

UNITED PARCEL SERVICE, INC.,
Defendant–Appellant–Cross-Appellee.

On Appeal from the United States District Court
for the Southern District of New York, No. 1:15-cv-1136
Honorable Katherine B. Forrest

**BRIEF OF THE STATES OF CALIFORNIA, CONNECTICUT, HAWAII,
ILLINOIS, INDIANA, IOWA, MARYLAND, MASSACHUSETTS, MICHIGAN,
NEW JERSEY, OREGON, PENNSYLVANIA, SOUTH CAROLINA, UTAH,
VERMONT, VIRGINIA, WASHINGTON, AND WYOMING, THE DISTRICT OF
COLUMBIA, AND PUERTO RICO AS AMICUS CURIAE IN SUPPORT OF
PLAINTIFFS–APPELLEES–CROSS-APPELLANTS THE STATE OF NEW
YORK AND THE CITY OF NEW YORK**

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INTEREST OF AMICI AND SUMMARY OF ARGUMENT

Pursuant to Federal Rule of Appellate Procedure 29(a)(2), the States of California, Connecticut, Hawai'i, Illinois, Indiana, Iowa, Maryland, Massachusetts, Michigan, New Jersey, Oregon, Pennsylvania, South Carolina, Utah, Vermont, Virginia, Washington, and Wyoming, and the District of Columbia and Puerto Rico submit this brief in support of Plaintiffs–Appellees–Cross-Appellants the State of New York and the City of New York. The amici States have a special interest in ensuring that the Prevent All Cigarette Trafficking (PACT) Act's exemption for certain carriers, including Defendant–Appellant–Cross-Appellee United Parcel Service, Inc. (UPS), is narrowly construed, and write in support of the plaintiffs' position on that issue.¹

Amici States take seriously their duty to protect their residents' health, safety, and welfare, and have a particularly strong interest in preventing contraband cigarettes and smokeless tobacco products from entering their borders. Tobacco use “poses perhaps the single most significant threat to public health in the United States.” *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 161 (2000). Schemes to evade state and local tobacco taxes are especially detrimental to the States' efforts to discourage tobacco use and ameliorate the harms it causes.

¹ The amici States take no position on any of the other issues at dispute in this appeal.

Selling tobacco products tax-free both encourages consumption and deprives state and local governments of an important source of revenue that, in many jurisdictions, is specifically dedicated to combating the myriad health issues caused by tobacco use. These considerations led 47 States, the District of Columbia, and three territories to support the PACT Act's adoption.²

As the PACT Act recognizes, establishing ground rules for common carriers is vital to the effort to control illegal tobacco shipments. *See* 15 U.S.C. § 376a(b)(2), (e). Before the PACT Act, some carriers were already subject to agreements with the New York Attorney General's office that established tobacco shipping rules. In an effort to lessen the regulatory burden on those carriers, Congress exempted them from the PACT Act's requirements based on those prior agreements. *Id.* § 376a(e)(3). But Congress also placed an important limitation on that exemption: it applies only as long as the agreements are "*honored* throughout the United States to block illegal deliveries of cigarettes or smokeless tobacco to consumers." *Id.* § 376a(e)(3)(B)(ii)(I) (emphasis added).

² Letter from the National Association of Attorneys General to All Members of the U. S. Senate (March 9, 2010) (available at http://www.naag.org/assets/files/pdf/signons/PACT_Final.pdf); Letter from the National Association of Attorneys General to All Members of U. S. House of Representatives (Mar. 12, 2010) (available at <http://www.naag.org/assets/files/pdf/signons/PACTFinal%20Final%20House%20Letter%20031210.pdf>).

UPS argues that because its agreement is “active and operates nationwide,” it remains eligible for the PACT Act’s exemption—even though UPS violated that agreement for nearly four years. Brief for Defendant–Appellant–Cross-Appellee United Parcel Service, Inc. (UPS Br.) 24, 39. In essence, UPS seeks blanket immunity from the PACT Act until some undefined time when its agreement with the New York Attorney General’s office is either “terminated” or no longer “remains in effect.” UPS Br. 36.

As the State of New York and the City of New York explain, this interpretation cannot be squared with the text, history, or structure of the PACT Act. Brief for Plaintiffs–Appellees–Cross-Appellants the State of New York and the City of New York (NY Br.) 55-72.

The amici States write separately to emphasize the absurd and deleterious effects of UPS’s position. If accepted, UPS’s interpretation would prevent the States from bringing civil actions against UPS and other similarly situated carriers for violations of the PACT Act. It would also prevent States from suing those carriers for violations of state-law analogues to the PACT Act, due to the Act’s express preemption provision. And it would leave New York as the only State that could seek damages against these carriers for completing deliveries of untaxed cigarettes or smokeless tobacco products, and only for deliveries to New York residents. This result directly contravenes the purposes of the PACT Act, which

was meant to aid the States in the fight against illicit tobacco products. UPS's interpretation should be rejected.

ARGUMENT

I. TOBACCO USE IMPOSES SIGNIFICANT HUMAN, FISCAL, AND ECONOMIC COSTS ON THE STATES AND THEIR RESIDENTS

Tobacco use continues to exact a heavy toll on the States and their residents.

Smoking is the number-one cause of preventable deaths in the United States.

Centers for Disease Control, *Health Effects of Cigarette Smoking* (last updated 2017).³ Smokers suffer from a litany of debilitating diseases, including several forms of cancer, coronary heart disease, stroke, and chronic obstructive pulmonary disease. *Id.* Similarly, smokeless tobacco use causes cancer of the mouth, esophagus, and pancreas, heart disease and stroke, as well as gum disease, tooth decay, and tooth loss. Centers for Disease Control, *Smokeless Tobacco: Health Effects* (last updated 2016).⁴ About 480,000 people in this country die each year because of cigarette smoking or exposure to secondhand smoke. *Health Effects of Cigarette Smoking, supra.* Those fatalities account for one out of every five

³ Available at https://www.cdc.gov/tobacco/data_statistics/fact_sheets/health_effects/effects_cig_smoking/index.htm.

⁴ Available at https://www.cdc.gov/tobacco/data_statistics/fact_sheets/smokeless/health_effects/index.htm.

American deaths. *Id.*

In addition to causing enormous human suffering, smoking-related illnesses impose a heavy financial burden. Each year, smoking costs the United States more than \$300 billion, with nearly \$170 billion spent on direct medical care and over \$156 billion in lost productivity. Centers for Disease Control, *Economic Trends in Tobacco* (last updated 2017).⁵ And the States shoulder a significant portion of these expenses. Nationwide, state Medicaid programs spend \$17.0 billion each year treating smoking-related diseases. Campaign for Tobacco-Free Kids, *The Toll of Tobacco in the United States* (last updated 2018).⁶ California alone expends 3.58 billion in Medicaid dollars annually for that purpose. Campaign for Tobacco-Free Kids, *The Toll of Tobacco in California* (last updated 2017).⁷ And each year, smoking costs California's health care system \$13.29 billion and drains \$10.35 billion from its economy in lost productivity. *Id.* The costs of smokeless tobacco use, while not as large, are still significant: the American health care system spends \$3.4 billion annually treating diseases caused by smokeless tobacco use.

⁵ Available at https://www.cdc.gov/tobacco/data_statistics/fact_sheets/economics/econ_facts/index.htm.

⁶ Available at <https://www.tobaccofreekids.org/problem/toll-us>.

⁷ Available at <https://www.tobaccofreekids.org/problem/toll-us/california>.

Campaign for Tobacco-Free Kids, *Smokeless Tobacco in the United States* (last updated 2017).⁸

II. THE STATES HAVE PLAYED A LEADING ROLE IN THE FIGHT AGAINST TOBACCO, AND IMPOSING EXCISE TAXES HAS BEEN A PARTICULARLY IMPORTANT TOOL IN THAT EFFORT

The States have been at the forefront of the battle against the public health effects of tobacco use. In 1998, a coalition of 46 States, the District of Columbia, and five territories negotiated the Master Settlement Agreement (MSA) with Brown & Williamson, Lorillard, Philip Morris, and R.J. Reynolds. Tobacco Control Legal Consortium, *The Master Settlement Agreement: An Overview* (2015).⁹ That agreement remains the largest civil litigation settlement in U.S. history. *Id.* Among other things, the MSA restricts participating tobacco companies from marketing cigarettes to youth and requires them to make annual payments to the States in perpetuity for the damages the States incur in treating smoking-relating illnesses. *Id.* The MSA also set aside money for the creation of a

⁸ Available at <https://www.tobaccofreekids.org/assets/factsheets/0231.pdf>.

⁹ Available at <http://www.publichealthlawcenter.org/sites/default/files/resources/tclc-fs-msa-overview-2015.pdf>. The only States that did not sign the MSA were Florida, Minnesota, Mississippi, and Texas; each of those States had agreed to prior settlements with tobacco companies.

national foundation, the Truth Initiative, which runs youth anti-smoking campaigns nationwide. The Truth Initiative, *Who We Are and What We Do*.¹⁰

In addition to these public education and litigation efforts, many States have sought to discourage tobacco use by imposing excise taxes on the sale of cigarettes and smokeless tobacco. And those taxes can be considerable: on average, state and federal taxes account for nearly 44% of the cost to consumers of cigarettes nationwide. Orzechowski and Walker, *The Tax Burden on Tobacco* iv (2016). Imposing excise taxes on tobacco products is a doubly effective way for the States to address the health risks of tobacco use. Taxes increase the cost of buying cigarettes and smokeless tobacco, thereby discouraging their use. That disincentive is significant: according to the CDC, a 10% increase in the cost of cigarettes reduces consumption by 3% to 5%. Centers for Disease Control, *Economic Trends in Tobacco* (last updated 2017).¹¹ That is especially true among young smokers, who are two to three times more price sensitive than adults. *Id.* State and local tobacco taxes also help fund these jurisdictions' anti-tobacco campaigns. In fiscal year 2016, cigarette sales generated over \$16.5 billion in

¹⁰ Available at <https://truthinitiative.org/about-us/warner-series/fifteen-years-after-the-master-settlement-agreement-msa-successes-and-challenges?page=6> (last visited Feb. 27, 2018).

¹¹ Available at https://www.cdc.gov/tobacco/data_statistics/fact_sheets/economics/econ_facts/index.htm.

gross state excise tax revenues and \$4 billion in general sales tax revenues.

Orzechowski and Walker at iv. And several States dedicate at least a portion of these funds to tobacco prevention and education programs. *E.g.*, Cal. Rev. & Tax. Code, § 30130.55 (setting aside tobacco excise tax revenue for treatment of tobacco-related diseases, tobacco prevention and control programs, and youth tobacco education); Cal. Rev. & Tax. Code, § 30122 (setting aside tobacco excise tax revenue for tobacco-related education and disease research).

As tobacco taxes have increased, so has tax evasion. *See* National Research Council, *Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from International Experiences* 23 (2015). And the rise of e-commerce has made it even easier for sellers to evade these taxes. *See, e.g., id.* at 117 (in 2007, 78% of internet cigarette vendors advertised that they sold cigarettes “tax free”). Each year, state and local governments lose between \$2.95 and \$6.92 billion in tax revenue due to illicit cigarette sales. *Id.* at 4.¹² This loss of funds deprives these jurisdictions of an important revenue stream, and consumers’ ability

¹² As of 2013, the five States with the highest tobacco tax revenue loss due to tax avoidance and evasion were New York, Washington, Arizona, Rhode Island, and Kansas. National Research Council, *supra*, at 105. California’s Board of Equalization estimated it lost approximately \$172 million in cigarette and tobacco products excise tax due to evasion in fiscal year 2015-2016. Cal. Board of Equalization, *Revenue Estimate: Cigarette and Tobacco Products Tax Evasion* (Oct. 3, 2016) (available at <https://www.boe.ca.gov/legdiv/pdf/Evasion-10-2016F.pdf>).

to easily procure tax-free cigarettes and smokeless tobacco products has led to greater consumption—which has, in turn, contributed to an increase in smoking- and tobacco-related disease. *Id.* at 26-27.

III. THE PACT ACT WAS ADOPTED TO PREVENT EVASION OF STATE AND LOCAL CIGARETTE TAXES; THE EXEMPTION SHOULD BE READ TO SERVE THAT SAME PURPOSE

The PACT Act was adopted to stem this growing tide of illicit internet cigarette and smokeless tobacco sales. *See Gordon v. Holder*, 632 F.3d 722, 723 (D.C. Cir. 2011). Its provisions were designed to give federal, state, and local law enforcement officials new “tools to combat illegal remote sales of cigarettes, such as those conducted over the Internet.” H.R. Rep. No. 110-836, at 22 (2008); *see also* 156 Cong. Rec. H1526, 1534 (Mar. 17, 2010) (statement of Rep. Weiner) (PACT Act designed “to make it very, very difficult, if not impossible, for Internet tobacco sales to continue”). Among other things, the Act strictly limits the circumstances in which a person or corporation may sell cigarettes directly to consumers over the internet. 15 U.S.C. § 376a(d). It also imposes certain obligations on common carriers. Common carriers may not “knowingly complete” a delivery for any person or organization listed on a Non-Compliant List compiled by the U.S. Attorney General. *Id.* § 376a(e)(2). They are also prohibited from shipping packages that contain cigarettes or smokeless tobacco, if the packages do

not include a statutorily required label reminding consumers that they must pay all applicable excise taxes. *Id.* § 376a(b)(1)-(2).

At the same time, Congress expressly exempted UPS (and two other carriers, DHL and FedEx) from the obligations imposed on other common carriers by the PACT Act. 15 U.S.C. § 376a(e)(3). But it did so only because these carriers had entered into agreements with the New York Attorney General’s Office that foreshadowed what would later become the PACT Act’s requirements before the PACT Act became law. H.R. Rep. No. 110-836, at 24 (2008); Dkt.49:4-5.¹³ In order to lessen the regulatory burden on these carriers, Congress exempted them from liability under the PACT Act. Dkt.49:18-19. Importantly, however, these carriers are entitled to the exemption only as long as the agreements are “honored throughout the United States to block illegal deliveries of cigarettes or smokeless tobacco to consumers.” 15 U.S.C. § 376a(e)(3)(B)(ii)(I).¹⁴

¹³ Like the plaintiffs’ brief, this brief uses Dkt. to refer to district court docket entries in this case, No. 15-cv-1136 (S.D.N.Y.).

¹⁴ The PACT Act also includes a generic exemption for common carriers that have “active agreement[s]” with a State that “operates throughout the United States to ensure that no deliveries of cigarettes or smokeless tobacco shall be made to consumers or illegally operating Internet or mail-order sellers.” 15 U.S.C. § 376a(e)(3)(B)(ii)(II).

IV. UPS’S INTERPRETATION OF THE PACT ACT’S EXEMPTION WOULD LEAVE EVERY STATE EXCEPT NEW YORK WITHOUT LEGAL RECOURSE, AN ABSURD RESULT THAT CONGRESS DID NOT INTEND

In this appeal, UPS maintains that it is entitled to the protections of the PACT Act’s common carrier exemption because its settlement agreement with New York *applies* nationwide. UPS Br. 36. In UPS’s view, it is irrelevant whether UPS *complies* with its terms throughout the country. *See also* UPS Br. 34 (“Congress intended to exempt carriers with agreements that operate nationwide...*with no compliance inquiry.*”) (emphasis added). But as the plaintiffs explain, this interpretation cannot be squared with either the text or the purpose of the PACT Act. NY Br. 55-72. The plain meaning of “honor” is “to live up to or fulfill the terms of” an obligation or commitment. *Merriam Webster’s Collegiate Dictionary* 597 (10th ed. 1994); *see also* NY Br. 56-57. Interpreting that word in a way that would allow carriers who violate their agreements to continue to benefit from the PACT Act’s exemption would undermine the law’s principal purpose: to stem the flow of illegal and untaxed cigarettes. *See* NY Br. 56-60.

Indeed, UPS’s proposed reading of the common carrier exemption would create a gaping loophole in the PACT Act. Under UPS’s proffered interpretation, its agreement remains ““honored throughout the United States”” until the undefined time when the agreement is ““terminated”” or no longer ““remains in effect.”” UPS Br. 36. But that trigger is unlikely to ever be reached: the agreement can only be

terminated if the New York State Legislature repeals or amends that State’s PACT Act equivalent (New York Public Health Law § 1399-*ll*), or if a court finds § 1399-*ll* invalid. DX-23:17, ¶ 47.¹⁵ And even then, UPS retains discretion to determine whether the agreement should be terminated. *Id.* The result of UPS’s interpretation would be to grant it—along with DHL and FedEx—indefinite immunity from the PACT Act’s significant criminal and civil penalties.¹⁶

Nor do the adverse consequences of UPS’s proffered interpretation end there. If adopted, UPS’s position would also inoculate it (and, by extension, other common carriers) from liability under a wide range of state laws intended to interdict illicit shipments of cigarettes and smokeless tobacco products. The PACT Act expressly preempts state and local laws “that restrict[] deliveries of cigarettes or smokeless tobacco to consumers by common carriers” by, among other things, requiring common carriers to verify that all applicable taxes have been paid or requiring common carriers to verify the age or identity of the recipient. 15 U.S.C. § 376a(e)(5)(A). And although the PACT Act allows States to ban the delivery of

¹⁵ Like the plaintiffs’ brief, this brief uses DX to refer to the defendant’s trial exhibits and PX to refer to the plaintiffs’ trial exhibits.

¹⁶ *See* 15 U.S.C. § 377(a) (common carriers and their employees can be imprisoned for up to three years or criminally fined for violating the PACT Act); *id.* § 377(b)(1)(B) (providing for civil penalties against common carriers of up to \$2,500 for the first violation and \$5,000 for each subsequent violation committed within one year).

cigarettes and smokeless tobacco products directly to individual consumers or personal residences, it forbids States from enforcing such laws against common carriers *unless* the State first proves that the common carrier is not entitled to the PACT Act’s exemption. 15 U.S.C. § 376a(e)(5)(C)(ii).¹⁷ Under UPS’s interpretation, then, States would be unable to bring suit against UPS or other similarly situated common carriers for shipping illicit tobacco products under either state or federal law.

Indeed, UPS’s interpretation is perhaps of even greater consequence to the other 49 States (and territories) than it is to New York. The PACT Act’s exemption does not shield UPS from liability for its violations of its agreement

¹⁷ Several States have adopted these bans on remote cigarette sales. *See* Ariz. Rev. Stat. Ann. § 36-798.06; Ark. Code Ann. § 26-57-203(31); *Arkansas Tobacco Control Bd. v. Santa Fe Nat. Tobacco Co.*, 360 Ark. 32, 41 (2004) (“[A]ny sale of cigarettes in the state of Arkansas must be made in a face-to-face transaction at a physical location.”); Conn. Gen. Stat. Ann. § 12-285c; Me. Rev. Stat. tit. 22, § 1555-D (as limited by *Rowe v. New Hampshire Motor Transp. Ass’n*, 552 U.S. 364, 371 (2008)); Me. Rev. Stat. tit. 22, § 1555-F; Or. Rev. Stat. 180.441; S.D. Codified Laws § 10-50-99; Utah Code Ann. §§ 59-14-509, 76-10-105.1; Vt. Stat. Ann. tit. 7, § 1010; Wash. Rev. Code Ann. § 70.155.140. Others have severely restricted, but not entirely banned, remote sales to consumers. *See* Ohio Rev. Code Ann. § 5743.71 (remote sales to consumers only permissible if consumer has procured consent from tax commissioner prior to purchase); Md. Code Ann., Bus. Reg. §§ 16-223(b)(2); 16.5-217(b)(3) (remote consumer sales limited to two cartons of cigarettes and two packages of other tobacco products at a time); Ind. Code Ann. § 24-3-5-4.5 (merchants may not directly ship cigarettes to non-distributor consumers, but can ship tobacco products to consumers if sale is billed through a distributor).

with New York. DX-23:16, ¶ 42. But New York is the only State that has an agreement of this kind with UPS, and it is the only State that can file suit should UPS breach it. *See* DX-23:19 ¶ 52 (agreement does “not grant any rights or privileges to any person or entity who is not a party to” it). Moreover, New York can file suit against UPS under that agreement only for shipments of cigarettes and other tobacco products to individual consumers who reside in *New York*. DX-23:16, ¶ 42.¹⁸

¹⁸ Although UPS contends that it “perfect[ly] compli[ed]” with its agreement in every State other than New York, UPS Br. 39, the record contains ample evidence that UPS shipped cigarettes to consumers nationwide. Between 2010 and 2015, UPS delivered more than 5,700 packages containing untaxed cigarettes to California residents. PX-433; PX-435; PX-439; PX-551; PX-552; PX-554; PX-555; PX-556; PX-559. (The figures recited in this brief count only packages weighing one pound or more, consistent with the methodology adopted by the district court. *See* Dkt.536:14.) During the same five-year period, UPS also shipped a large number of cigarettes to residents of States that ban remote sales of cigarettes, including over 6,100 packages to Arizonans, 6,400 to Connecticuters, 700 to Indianians, 700 to Mainers, 2,500 to Marylanders, 7,800 to Ohioans, 190 to South Dakotans, 240 to Utahans, 600 to Vermonters, and 2,600 to Washingtonians. *Id.* Tracer evidence (that is, inquiries from customers about lost or damaged packages) also shows that UPS accepted packages of cigarettes destined for residents in Arizona, Illinois, Massachusetts, Michigan, New Jersey, Ohio, Pennsylvania, Rhode Island, Texas, and Wisconsin. PX-113; PX-190; PX-191; PX-211; PX-213; PX-214; PX-403; PX-405; PX-468; PX-469.

This cannot be the result Congress intended when it adopted the PACT Act. The PACT Act was designed to help the States prevent contraband cigarettes and tobacco products from reaching their residents. That is why the law specifically affords the States a right of action to bring civil suits against violators. 15 U.S.C. § 378(c); *see also* H.R. Rep. No. 111-117, at 23 (2009) (PACT Act would “benefit State, local, and tribal governments by ... allow[ing] State attorneys general ... to file charges in U.S. district courts against sellers or deliverers who violate this law”). UPS’s interpretation, however, would give it—and other similarly situated common carriers—free rein to ship untaxed cigarettes and smokeless tobacco products to residents of every State and territory except New York, and immunize them from any legal action by the States. This Court should reject this absurd interpretation. *See United States v. Messina*, 806 F.3d 55, 70 (2d Cir. 2015) (“[I]nterpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available.”).

CONCLUSION

The district court's interpretation of 15 U.S.C. § 376a(e)(3)(B)(ii)(I) should be affirmed.

Dated: February 28, 2018

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the requirements of Federal Rule of Appellate Procedure 29(a)(5), because it contains 3,439 words, according to the count of Microsoft Word. I further certify that this brief complies with typeface requirements of Rule 32(a)(5) because it has been prepared in 14-point Times New Roman font.

February 28, 2018

/s/ Nora Flum
Nora Flum

CERTIFICATE OF SERVICE

I certify that on February 28, 2018, the foregoing Brief of the States of California, Connecticut, Hawai'i, Illinois, Indiana, Iowa, Maryland, Massachusetts, Michigan, New Jersey, Oregon, Pennsylvania, South Carolina, Utah, Vermont, Virginia, Washington, and Wyoming and the District of Columbia and Puerto Rico as Amicus Curiae in Support of Plaintiffs–Appellees–Cross-Appellants the State of New York and the City of New York was served electronically via the Court's CM/ECF system upon all counsel of record.

February 28, 2018

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