IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

R.J. REYNOLDS TOBACCO CO., *et al*.,

Plaintiffs,

v.

UNITED STATES DEPARTMENT OF AGRICULTURE, *et al*.,

Defendants.

Civil Action No. 1:14-cv-01388 (KBJ)

PLAINTIFFS' MEMORANDUM IN OPPOSITION TO
DEFENDANTS' MOTION TO DISMISS

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INTRODUCTION

When Congress directed the Department of Agriculture ("USDA") to collect more than $10 billion from U.S. manufacturers and importers of tobacco products to fund the Tobacco Transition Payment Program, it gave USDA clear instructions on how to apportion that burden. The guiding principles are fairness and proportionality. The Fair and Equitable Tobacco Reform Act ("FETRA") requires USDA to impose assessments "on a pro rata basis . . . based on each manufacturer's or importer's share" of the domestic tobacco market and bars any charges "in excess of the manufacturer's or importer's" market share. 7 U.S.C. § 518d(e). To ensure the accuracy of the market share determination, the statute directs USDA to account for "total gross domestic volume from all sources" for which "relevant information" is available. *Id.* § 518d(i)(4), (g)(1). The central question in this case is whether FETRA permits USDA to force law-abiding cigarette manufacturers to pay more than their fair share to make up for the delinquencies of identified, law-breaking manufacturers.

The action challenges two sets of tobacco transition assessments that USDA imposed on Plaintiffs R.J. Reynolds Tobacco Company ("RJRT") and Santa Fe Natural Tobacco Company ("Santa Fe") in 2013. It is undisputed that the challenged assessments were based on determinations of plaintiffs' market share by USDA that excluded an entire segment of the domestic cigarette industry: manufacturers that fail to self-report their sales, also known as non-reporting manufacturers. As a result of that exclusion, USDA overcharged plaintiffs.

In their administrative challenge, plaintiffs asked USDA to correct these overcharges by complying with the statute and taking reasonable steps to account for unreported cigarette production. To aid USDA, plaintiffs submitted relevant information in the form of concrete evidence, collected through an extensive investigation, of unreported production by two unlicensed cigarette manufacturers that are openly doing business in New York. In addition, plaintiffs pointed to multiple government reports indicating that unreported cigarette production comprises a significant share of domestic cigarette volume — as much as 5% of the domestic cigarette market, according to a congressional report. *See* Compl. ¶¶ 69–75. USDA did not dispute or criticize the quality of the information showing massive unreported cigarette production at any stage of the administrative process. Nonetheless, USDA refused to adjust RJRT's and Santa Fe's assessments to remedy the charges made in excess of their share of domestic volume. That choice violates both FETRA and USDA's duty to "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (internal quotation marks omitted).

USDA is not free to stick its "head in the sand" when information relevant to statutory considerations mandated by Congress is available. *National Ass'n of Regulatory Util. Comm'rs v. Dep't of Energy*, 680 F.3d 819, 824 (D.C. Cir. 2012). Instead, as FETRA directs, when presented with "relevant" evidence of non-reporting manufacturers' contribution to "total gross domestic volume from all sources," USDA must reasonably account for that information by making appropriate adjustments to its determination of domestic volume. Plaintiffs do not question the government's discretion to decide whether to take enforcement action against non-reporting manufacturers that are not paying their fair share. But plaintiffs do object to USDA's imposition of assessments in excess of plaintiffs' own "correct pro rata share[s]" to make up the deficit, in violation of FETRA. 7 U.S.C. §§ 518d(i)(4), 518d(e)(2).

None of USDA's excuses for refusing to adopt a reasonable estimate of sales volume attributable to identified, non-reporting cigarette manufacturers holds up. USDA's suggestion that information cannot be "relevant" within the meaning of FETRA unless it has been "substantiated" by other federal agencies cannot be reconciled with the statutory directive to base market share determinations on excise tax and customs forms "as well as any other relevant information" available. *Id.* § 518d(g)(1). Nor is there anything to USDA's assertion that its "lack of investigatory and law enforcement powers" justifies its wholesale failure to account for non-reporting manufacturers. USDA Br. 8. No one is asking USDA to pick up a badge and gun to pursue illicit cigarette manufacturers for violations of laws that USDA is not charged with administering. This suit seeks only to compel USDA to comply with FETRA, the statute that it *is* charged with administering. FETRA requires that, when presented with "relevant" evidence of non-reporting manufacturers' contribution to "total gross domestic volume from all sources," USDA must reasonably account for that information. No matter how the government may choose to exercise its enforcement prerogatives against those who fail to pay their share of FETRA payments, USDA has no authority to make up the difference by forcing law-abiding manufacturers or importers to pay assessments substantially "in excess of the manufacturer's or importer's." 7 U.S.C. § 518d(e)(2).

BACKGROUND

A. Statutory and Regulatory Background

For nearly 70 years, USDA administered a system of price supports and marketing quotas to aid domestic tobacco farmers. In 2004, Congress enacted the Fair and Equitable Tobacco Reform Act, 7 U.S.C. §§ 518 *et seq.*, to phase out that old regime of subsidies. To ease the transition for current beneficiaries, FETRA created the Tobacco Transition Payment Program, a temporary system of periodic payments to tobacco growers and other holders of tobacco quotas. Compl. ¶ 36. FETRA designated USDA to administer the program in conjunction with the Commodities Credit Corporation ("CCC") and the Farm Services Agency ("FSA"), two entities within USDA. 7 U.S.C. §§ 518–519a. (For simplicity, this brief refers generally to USDA as the administering agency, except where a distinction is relevant.)

FETRA directs USDA to fund the transition payment program largely through assessments collected from manufacturers and importers of tobacco products. *Id.* § 518e; Compl. ¶¶ 38–39. Those assessments must be imposed on "each tobacco product manufacturer and tobacco product importer that sells tobacco products in domestic commerce in the United States during [a] fiscal year." *Id.* § 518d(b)(1). Over the 10-year life of the program, which expired in 2014, USDA collected more than $10 billion in assessments from manufacturers and importers and distributed them to program beneficiaries. *See* USDA, *Tobacco Transition Payment Program; Cigar and Cigarette Per Unit Assessments*, 76 Fed. Reg. 15,859 (Mar. 22, 2011).

Congress prescribed a specific statutory formula to govern USDA's calculation of quarterly assessments. The purpose of that formula is to allocate transition payment costs *pro rata* among manufacturers and importers based on each entity's market share. *Id.* § 518d(a)(3); Compl. ¶ 39.

First, the total yearly assessment is divided among six classes of tobacco products — cigarettes, cigars, snuff, roll-your-own, chewing tobacco, and pipe tobacco — based on each class's share of the overall U.S. tobacco market in the preceding quarter. *Id.* § 518d(b)(1), (e)(1). For example, because cigarettes represented 88.499% of total tobacco sales in the second quarter of 2013, cigarette manufacturers and importers were required collectively to contribute 88.499% of the aggregate third quarter 2013 assessments imposed on all manufacturers and importers of the specified classes of tobacco products. Compl. ¶¶ 40–41.

Second, USDA determines each manufacturer's or importer's individual "market share" within each class of tobacco products. *See* Compl. ¶¶ 42–48. FETRA requires USDA to calculate market share by dividing each individual manufacturer's and importer's tobacco volume of domestic sales by the "the total volume of domestic sales of the class of tobacco product." 7 U.S.C. § 518d(a)(3).

Because market share is a fraction, its accuracy depends on both the numerator and denominator. The numerator is the individual company's contribution to domestic cigarette sales. *Id.* § 518d(a)(3), (g)(1). The denominator — "total volume of domestic sales" for each product class, *id.* § 518d(a)(3) — is "calculated based on gross domestic volume." *Id.* § 518d(g)(2). The term "gross domestic volume" means all non-tax-exempt tobacco products that are "removed" into domestic commerce. *Id.* § 518d(a)(2)(A). The term "removed" as used in FETRA incorporates the definition from the Internal Revenue Code, which broadly includes any means of placing tobacco products in the stream of commerce, whether by removing domestically manufactured products "from the factory," or by "releas[ing] [imported products] from customs custody," or even by employing unlawful means. 26 U.S.C. § 5702(j). The statute is clear that both individual company sales volume and total volume of domestic sales must be calculated based not only on excise tax and customs forms but also on "any other relevant information provided to or obtained by the Secretary." 7 U.S.C. § 518d(g)(1).

Based on the determinations of individual market shares and class-by-class allocations, USDA calculates quarterly assessments "by multiplying (1) the market share of the manufacturer or importer, as calculated with respect to that payment period, of the class of tobacco product; by (2) the total amount of the assessment for that quarterly payment period . . . for the class of tobacco product." *Id.* § 518d(f).

The statute unequivocally forbids USDA from imposing an assessment on any manufacturer or importer that is disproportionate to its market share: "No manufacturer or importer shall be required to pay an assessment that is based on a share that is in excess of the manufacturer's or importer's share of domestic volume." *Id.* § 518d(e)(2). Instead, "[t]he assessment for each class of tobacco product . . . shall be allocated on a pro rata basis among manufacturers and importers based on each manufacturer's or importer's share of gross domestic volume." *Id.* § 518d(e)(1); Compl. ¶ 49.

This pro rata limitation is backed by a process for appealing erroneous assessments. *See* Compl. ¶ 50. A manufacturer or importer may contest its assessment by filing an appeal with the Secretary. *Id.* § 518d(i). The statute specifically permits a manufacturer to rely on a broader universe of information than government reports to pursue such an appeal: "In challenging the assessment, the manufacturer or importer may use any information that is available, including third party data on industry or individual company sales volumes." *Id.* § 518d(i)(2). After receiving notice of a manufacturer's or importer's challenge, the Secretary must "decide whether the information provided to the Secretary . . . and any other information that the Secretary determines is appropriate, is sufficient to establish that the original assessment was incorrect; and

. . . make any revisions necessary to ensure that each manufacturer and importer pays only its correct pro rata share of [the] total gross domestic volume from all sources." *id.* § 518d(i)(4).

Even though the Tobacco Transition Payment Program expired in 2014, the FETRA methodology has continued relevance because it informs the calculation of "user fees" paid by manufacturers or importers of regulated tobacco products to the Food and Drug Administration to fund the exercise of its newly conferred jurisdiction to regulate tobacco products. Compl. ¶¶ 55–59.

B. Licensing and Taxation of Cigarette Production and Sales

The U.S. Alcohol and Tobacco Tax and Trade Bureau ("TTB") is responsible for federal licensing and taxation of cigarette manufacturers. Compl. ¶¶ 60–63. Under federal law, cigarette manufacturers are required to obtain an operating permit from, and remit excise taxes to, TTB. Like most federal taxes, the tobacco excise tax depends primarily on self-reporting. Federal law requires manufacturers and importers to file an excise tax return reporting cigarette removals during the relevant tax period and remit the excise taxes owed. Unlicensed cigarette manufacturers — that is, those operating illegally without a TTB permit — evade federal excise tax liability. A licensed manufacturer's underreporting (or failure to report) cigarettes produced and removed from its factory also results in evasion of federal excise taxes. Compl. ¶¶ 64–65.

Federal excise tax laws apply to virtually all cigarettes manufactured and sold in the United States, including cigarettes manufactured by Native American tribes and sold outside a Native American reservation or to a purchaser who is not a reservation member. Compl. ¶ 67. Only cigarettes sold on a Native American reservation to reservation members are exempt from federal excise taxes. Compl. ¶ 68. Similarly, state sales and excise tobacco tax laws generally apply to cigarettes manufactured by Native American tribes and sold outside a reservation or to non-member. Compl. ¶ 67.

C. Non-reporting Cigarette Manufacturers

The unreported manufacture of cigarettes, distributed and sold tax-free in violation of state and federal law, is a multibillion-dollar business in the United States. Compl. ¶ 69. In connection with the administrative challenge that gave rise to this action, plaintiffs presented USDA with extensive information concerning the prevalence of illicit cigarette manufacturing in general, as well as evidence and estimates of unlawful production by two identified large-scale cigarette manufacturers operating in New York. Compl. ¶¶ 129–40.

1. The Extent Of The Problem

Unreported production and sale of cigarettes is a widely recognized problem. A 2007 report prepared by staff for the U.S. House Committee on Homeland Security estimated that 5% of the annual domestic cigarette market — approximately 414 billion cigarettes — was unreported and untaxed. Compl. ¶ 70. According to the U.S. Government Accountability Office ("GAO"), there are "two primary illicit manufacturing schemes used to evade taxes on domestically produced cigarettes" — (1) unlicensed manufacturing, and (2) underreported production. GAO, Illicit Tobacco: Various Schemes Are Used to Evade Taxes and Fees 19 (GAO-11-313) (Mar. 2011); Compl. ¶ 71. Unlicensed manufacturing is production by manufacturers that have no TTB permit and consequently do not report any production at all to government authorities. Underreporting production is the submission of false excise tax returns by licensed manufacturers. Because excise taxes are assessed based on volume, underreporting the number of cigarettes that leave a manufacturing facility results in tax evasion. Compl. ¶ 71(b).

Non-reporting and under-reporting manufacturers cost state and federal governments large sums in lost tax revenue. A 2009 report by the Inspector General of the U.S. Department of Justice estimates that tobacco diversion costs the federal and state governments over $5 billion in revenue from unpaid excise taxes each year. Compl. ¶ 72.

The state of New York is an epicenter of unlicensed and non-reporting cigarette manufacturing. According to GAO, most unlicensed cigarette manufacturing occurs in northern New York among an estimated 15 to 18 unlicensed cigarette manufacturers. Those manufacturers alone have cost New York approximately $1 billion in lost tax revenues per year. Compl. ¶ 73. Recently, unreported cigarette manufacturing by Native American tribes has been on the rise in response to recent court approval of New York's renewed effort to enforce its tobacco excise tax. Compl. ¶ 74. In 2011, the U.S. Court of Appeals for the Second Circuit held that New York has authority to collect state excise taxes from tobacco product wholesalers that supply cigarettes to Natives American tribes for resale to non-reservation members. *Oneida Nation of N.Y. v. Cuomo*, 645 F.3d 154 (2d Cir. 2011). As the *New York Times* reported, Native American tribes responded to the decision by "resolv[ing] . . . to stock the shelves of their convenience stores with their own cigarettes." Compl. ¶ 74.

There is ample evidence that non-reporting Native American cigarette manufacturers and tobacco retail shops sell cigarettes in substantial volumes to non-reservation members. Compl. ¶ 74(a). In 2013, for example, a Brooklyn federal judge ordered three Indian smoke shops linked to the Poospatuck Reservation to pay New York $10 million for trafficking untaxed cigarettes to non-reservation members. Each member of the Poospatuck Reservation would have had to smoke 960 packs a day to reach the number of cigarettes that were being sold on the reservation before the lawsuit. Compl. ¶ 75(a). Another report prepared by the Tobacco Control Legal

Consortium estimates that "the number of cigarettes imported by some tribes would be enough for every reservation resident, including children and infants, to smoke hundreds of packs a day. For example, a tiny Long Island reservation with 283 residents imported 90 million cigarettes in 2000 and more than 2 billion in 2007." Compl. ¶ 75(b). And in *Oneida*, the Second Circuit recognized that "non-[reservation] member evasion of the [New York] cigarette tax [has] proliferated." Compl. ¶ 75(c). The court noted that based on cigarette sales by the Unkechauge Nation, "[i]f only Unkechauge members had consumed these cigarettes, every man, woman, and child would have smoked 364 packs per day in 2009." *Oneida*, 645 F.3d at 159.

In addition, plaintiffs provided USDA with evidence showing that the reported decline in consumer demand for cigarettes did not coincide with any reported decline in the sales volume of cigarettes that flowed through established wholesale-retail distribution channels in New York. The explanation for that gap is unreported manufacturing. By analyzing the difference between the reported decline in sales volume through established distribution channels and consumer demand, plaintiffs calculated that the gap in volume constitutes between 2.6 billion and 4 billion cigarettes per year, representing between 0.9% and 1.4% of the total U.S. cigarette industry volume. In other words, non-reporting manufacturers in New York alone are responsible for as much as 1.4% of U.S. cigarette industry volume. Compl. ¶¶ 78–81.

2. GlobalSource's Investigation

Due to the lack of visibility into unlicensed and non-reporting cigarette manufacturing, and concerned that they were being forced to pay significantly more than their lawful share of FETRA assessments, plaintiffs retained GlobalSource LLC, a respected business investigations firm. Beginning in 2012, GlobalSource conducted a rigorous investigation and survey of the production and distribution of untaxed cigarettes in New York. Compl. ¶ 76. GlobalSource's investigation focused on two non-reporting, unlicensed Native American cigarette manufacturers based in New York — the Onondaga Nation Cigarette Factory ("Onondaga") and T&D Enterprises. Neither Onondaga nor T&D Enterprises reports its production volumes to USDA as required under FETRA, and USDA does not account for production by those entities in calculating total volume of domestic sales. Compl. ¶¶ 11, 129.

GlobalSource investigators use a number of accepted investigational methods to gather information on cigarette production, and law enforcement and regulatory agencies have routinely relied on information developed in GlobalSource's investigations to initiate enforcement action or as a lead for further investigation resulting in civil or criminal action. Compl. ¶¶ 131–35. To conduct its investigation of Onondaga and T&D Enterprises, GlobalSource researched public records; conducted targeted surveillance (including on-the-ground surveillance) of manufacturing facilities; consulted confidential sources and others knowledgeable of the factories' operations and production equipment used; performed in-person and telephone interviews; conducted surveys of retail cigarette shops that sell cigarettes made by Onondaga and T&D Enterprises. Compl. ¶¶ 141, 155.

GlobalSource was able to ascertain or reliably estimate the key indicia of production levels at Onondaga and T&D Enterprises, including the specific types of equipment used, number of production lines, number of employees on each shift, duration and frequency of production shifts, and the size of factories. Compl. ¶ 146. Based on the results of its extensive investigation, GlobalSource estimated in July 2013 that Onondaga manufactures approximately 1.092 million cartons of cigarettes per year and that T&D Enterprises manufactures approximately 2.5 million cartons per year. Compl. ¶¶ 10, 148, 163. GlobalSource's investigation also produced ample evidence that Onondaga and T&D Enterprises distribute their cigarettes for retail sale off the reservation. *See* Compl. ¶¶ 149–50, 159, 163

In December 2013, GlobalSource conducted a follow-up investigation to confirm its earlier production estimates. Compl. ¶¶ 168–74. That follow-up investigation confirmed its 2012 estimate of Onondaga's volumes, but GlobalSource revised its initial findings concerning T&D Enterprises. Compl. ¶ 169. Among other new findings, GlobalSource concluded that T&D Enterprises operates more shifts and maintains more employees on each shift than initially estimated. Compl. ¶¶ 171–72. Based on these updated findings, GlobalSource revised its earlier figures and estimated that T&D Enterprises manufactures approximately 6.435 million cartons of cigarettes annually. Compl. ¶ 173.

D. The September 2013 and December 2013 Assessments

This action involves a challenge to two sets of quarterly assessments charged to plaintiffs. On September 1, 2013, USDA imposed second-quarter assessments of $49.073 million on RJRT and $2.746 million on Santa Fe. Compl. ¶ 82. On December 1, 2013, USDA imposed third-quarter assessments of $49.301 million on RJRT and $3.069 million on Santa Fe. Compl. ¶ 101. The assessments were supposed to be based on USDA's calculation of RJRT's and Santa Fe's market shares of the total volume of domestic cigarette sales during the assessment period. In calculating total volume, however, USDA failed to take into account the volume of production by Onondaga, T&D Enterprises, or any other non-reporting cigarette manufacturers that failed to file federal excise tax returns. Compl. ¶ 130.

1. Plaintiffs' Administrative Challenge

Plaintiffs promptly challenged both their September and December 2013 assessments on the ground that they exceeded each company's pro rata share of total volume. Compl. ¶ 7. Plaintiffs explained in detail that, by failing to account for unreported production by Onondaga and T&D Enterprises (or other non-reporting cigarette manufacturers), USDA had understated the total volume of domestic sales — the market share denominator. As a result, USDA overstated plaintiffs' respective market shares and charged them excessive assessments in violation of FETRA. Compl. ¶ 7.

Using estimates supplied by GlobalSource's investigations, plaintiffs calculated a corrected total volume of domestic sales to account for unreported production by Onondaga and T&D Enterprises. Compl. ¶¶ 88, 109. Based on that adjusted total volume, plaintiffs demonstrated that USDA's exclusion of these two non-reporting manufacturers alone caused USDA to overcharge plaintiffs. Compl. ¶ 54. Detailed recalculations submitted by plaintiffs showed that the September assessments overcharged RJRT by at least $119,004 and Santa Fe by at least $6,543; the December assessments overcharged RJRT by at least $257,148 and Santa Fe by at least $15,836. Compl. ¶¶ 84, 103. Plaintiffs asked USDA to award adjustments in those amounts and to refrain from further overcharges.

On November 15, 2013, USDA (through CCC) rejected the September assessment challenge. USDA determined that "no revisions are warranted to [RJRT's and Santa Fe's] assessment of September 1, 2013" because the challenge did not "allege that [USDA] has miscalculated the assessment *as a function of the tax and custom forms it has received* . . . . The allegation that [plaintiffs] raise[d] as a basis for [their] appeal is an allegation of tax evasion." Compl. ¶ 120 (emphasis added); *see* Ex. C.

On December 9, 2013, plaintiffs appealed that determination and requested a hearing to provide evidence establishing that the determination was erroneous, arbitrary and capricious, and not in accordance with law. The hearing was scheduled for February 26, 2014. Compl. ¶¶ 121–22. Although USDA did not directly respond to plaintiffs' challenge to the December 31, 2013 assessment, USDA and plaintiffs agreed to combine the challenges at the February 2014 hearing. Compl. ¶ 123.

For the purpose of the hearing, Steve Gentry, Senior Director of Regulatory Taxes for plaintiffs, provided a declaration regarding the calculations behind plaintiffs' challenged assessment amounts for September and December 2013. Richard Hynes, case manager for GlobalSource, provided a declaration with testimony on GlobalSource's investigation of cigarette manufacturers in New York that do not report their sales volumes to USDA or pay the taxes or fees associated with those volumes. Compl. ¶ 124. USDA did not cross-examine or otherwise challenge either of plaintiffs' witnesses. Nor did USDA present any evidence contradicting plaintiffs' estimates of unreported cigarette production. Compl. ¶ 125.

2. USDA's Final Decision

In a March 27, 2014 letter, USDA denied plaintiffs' joint appeals of both their September 2013 assessment and their December 2013 assessment. Compl. ¶ 177. The agency recognized its obligation to ensure that "each manufacturer's or importer's assessment is proportional to its market share within [each] class" of tobacco products. Compl. ¶¶ 178–79; Final Decision 2 (Ex. H).[1] The agency also recognized that it is statutorily forbidden from charging any manufacturer or importer "'an assessment that is based on a share that is in excess of the manufacturer's or importer's share of domestic volume,'" Compl. ¶ 179 (quoting 7 U.S.C. § 518d(e)(2)), and that it is required to base its calculation of domestic volume on not only excise tax and customs documents but also "'any other relevant information provided to or obtained by the Secretary,'" *id.* (quoting 7 U.S.C. § 518d(g)(1)); Final Decision 2 (Ex. H).

[1] USDA has not fulfilled its obligation to file the administrative record in this case. *See* LCvR. 7(n)(1) ("In cases involving the judicial review of administrative agency actions, unless otherwise ordered by the Court, the agency must file a certified list of the contents of the administrative record with the Court within 30 days following service of the answer to the complaint or simultaneously with the filing of a dispositive motion, whichever occurs first."). For the Court's convenience, selected portions of the administrative record are attached as exhibits to this brief.

USDA did not dispute that it is required by FETRA to account for "gross domestic volume from all sources." 7 U.S.C. § 518d(i)(4)(B). Nor did it dispute that non-reporting cigarette manufacturers, including Onondaga and T&D Enterprises, are responsible for a significant share of domestic sales of cigarettes. The agency neither presented nor cited any evidence that contradicts or conflicts with the relevant information provided by plaintiffs concerning Onondaga and T&D Enterprises specifically or non-reporting cigarette manufacturers generally. Compl. ¶ 181.

USDA nevertheless denied in full plaintiffs' challenges. Compl. ¶ 182. As noted above, USDA did not dispute plaintiffs' detailed evidence of unreported cigarette production and sales by Onondaga and T&D Enterprises. But USDA brushed aside that evidence on the ground that it came from plaintiffs and had not been verified by other federal agencies. Final Decision 5 (Ex. H.). Specifically, USDA suggested that information can never be "relevant" within the meaning of FETRA unless it is "substantiated by the U.S. Department of the Treasury, the U.S. Department of Homeland Security, or the U.S. Department of Justice (Bureau of Alcohol, Tobacco, and Firearms)." *Id*. USDA cited no statutory or other authority for that limitation. Compl. ¶ 185.

Without offering any justification for its *de facto* estimate of zero, USDA contended that any estimate concerning the volume of unreported production by Onondaga and T&D Enterprises "would necessarily be arbitrary." Compl. ¶ 184; Final Decision 5 (Ex. H). USDA did not address plaintiffs' alternative argument that the agency should, at a minimum, make adjustments to their quarterly assessments based on a reasonable nationwide estimate of all unreported sales. Instead, USDA chose to ignore all the evidence of unreported sales. Compl. ¶¶ 186–87.

This action asserting claims under FETRA and the APA followed.

SUMMARY OF ARGUMENT

I. An agency must follow a statutorily mandated methodology where "Congress has not provided for an agency override of its methodology." *South Coast Air Quality Mgmt. Dist. v. EPA*, 472 F.3d 882, 894 (D.C. Cir. 2006). In FETRA, Congress directed USDA to ensure that an individual company's tobacco transition assessments are proportionate to that company's share of "total gross domestic volume from all sources," 7 U.S.C. § 518d(i)(4)(B), based on any "relevant information" provided to or obtained by USDA, *id.* § 518d(g)(1); *see also id*. § 518d(i)(2). The assessments imposed on plaintiffs violate those requirements because they rest on USDA's categorical exclusion of a significant "source[]" of domestic volume — non-reporting cigarette manufacturers — despite plaintiffs' submission of highly relevant, uncontroverted information concerning volume produced by those manufacturers. That carve-out of all illicit production erroneously inflated the market share ascribed to plaintiffs, in violation of FETRA's clear prohibition on disproportionate assessments.

II. USDA's shifting justifications for disregarding available evidence of unreported tobacco production are inconsistent with both FETRA and the agency's duty of reasoned decisionmaking under the APA.

A. FETRA provides that USDA "shall" base its market share determinations on "information provided by the manufacturers and importers pursuant to subsection (h) [excise tax and customs documents] *as well as any other relevant information* provided to or obtained by the Secretary." *Id.* § 518d(g)(1) (emphasis added); *see also Single Stick, Inc. v. Johanns*, 601 F. Supp. 2d 307, 314 (D.D.C. 2009). USDA's contention that only excise tax and customs documents qualify as "relevant information" reads the latter clause out of existence; conflicts with the ordinary meaning of the term "relevant"; and renders the contemplated submission of "third party data on industry or individual company sales volumes" in assessment challenges a pointless exercise. *Id.* § 518d(i)(2). To the contrary, the unambiguous meaning of sections 518d(g)(1) and 518d(i) is that USDA not only *may* but *must* consider information beyond excise tax and customs forms if that information is "relevant."

B. The government's argument that USDA regulations bar consideration of anything other than "data reported on customs forms and excise tax forms" (USDA Br. 11) fails for two reasons: (1) it is an impermissible post hoc rationalization, and (2) it rests on an untenable regulatory interpretation that would put USDA's rules at war with the plain language of the statute.

C. Nor does USDA's impossibility defense withstand scrutiny. "[A]n agency may not shirk a statutory responsibility simply because it may be difficult," *NetCoalition v. SEC*, 615 F.3d 525, 539 (D.C. Cir. 2010), but USDA has done exactly that by refusing to adopt a reasonable estimate of unreported cigarette production based on relevant information available to the agency. Regardless of how USDA chooses to deal with manufacturers that fail to pay their fair share of FETRA payments, the agency is forbidden from charging plaintiffs more than their "correct pro rata share" to make up for the delinquencies of others. 7 U.S.C. § 518d(i)(4)(B).

LEGAL STANDARDS

On a motion to dismiss under Rule 12(b)(6), the court "must view the complaint in a light most favorable to the plaintiff and must accept as true all reasonable factual inferences drawn from well-pleaded factual allegations.'" *Tefera v. OneWest Bank, FSB*, 19 F. Supp. 3d 215, 216 (D.D.C. 2014) (internal quotation marks omitted). "'So long as the pleadings suggest a 'plausible' scenario to 'show that the pleader is entitled to relief,' a court may not dismiss.'" *Atherton v. D.C. Office of Mayor*, 567 F.3d 672, 681 (D.C. Cir. 2009) (citation omitted).

Under the Administrative Procedure Act, "a court must set aside agency action it finds to be 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.'" *Tourus Records, Inc. v. DEA*, 259 F.3d 731, 736 (D.C. Cir. 2001) (quoting 5 U.S.C. § 706(2)). The failure to "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made" is paradigmatic arbitrary and capricious action. *State Farm*, 463 U.S. at 43. When reviewing the validity of an agency's interpretation of a statute, the court must "give effect to the unambiguously expressed intent of Congress" over a conflicting agency interpretation. *Chevron, USA., Inc. v. NRDC*, 467 U.S. 837, 842–43 (1984). If the statute is silent or ambiguous on the question at issue, the agency's interpretation is entitled to deference only if it is "reasonable." *Id.*

ARGUMENT

I. USDA Violated Its Statutory Obligation To Assess Market Share Based On Cigarette Production From "All Sources" Using All "Relevant Information."

Some statutory schemes set forth "broad standards and leave[] much to [an agency's] discretion." *NRDC v. Hodel*, 865 F.2d 288, 302 (D.C. Cir. 1988). Not FETRA. Congress prescribed a clear and comprehensive methodology to distribute the multibillion-dollar burden of FETRA among *all* tobacco product manufacturers and importers on a fair and equal basis. Consistent with constitutional constraints on regulatory schemes that impose massive financial burdens on private parties, *see Eastern Enters. v. Apfel*, 524 U.S. 498, 538 (1998), FETRA demands that assessments must be proportionate to each company's market share. Specifically, "[n]o manufacturer or importer shall be required to pay an assessment that is based on a share that is in excess of the manufacturer's or importer's share of domestic volume." 7 U.S.C. § 518d(e)(2). In other words, an individual company's assessments must be proportionate to its market share. *See id*. § 518d(f)(1). This "pro-rata-basis limitation . . . ensures that *no company would be forced to make up any shortfall caused by delinquent manufacturers* or importers." *Prime Time Int'l Co. v. Vilsack*, 930 F. Supp. 2d 240, 257 (D.D.C. 2013) (emphasis added). In this case, USDA has forced plaintiffs to do just that by unreasonably excluding *all* unreported cigarette manufacturers and thereby erroneously inflating plaintiff's market share and concomitant assessments.

A. "All Sources" Unambiguously Includes Non-Reporting Cigarette Manufacturers.

One way a manufacturer can be charged more than its pro rata share is when USDA excludes other manufacturers from its calculation of the denominator — "total volume of domestic sales." That is what happened here. USDA does not dispute that cigarettes are manufactured and introduced into domestic commerce by manufacturers that do not pay excise taxes or file custom forms, and it further acknowledges that its assessment calculations in no way account for that segment of the domestic market. USDA Br. 2. That categorical exclusion of unreported manufacturing, in the face of relevant evidence of significant contributions to total domestic volume, violates Congress's plain command to account for "total gross domestic volume from all sources," 7 U.S.C. § 518d(i)(4)(B), using all "relevant information" available, *id.* § 518d(g)(1); *see also id.* § 518(d)(i)(2), (4)**.**

Pointing to no authority, USDA suggests that accounting for unreported cigarette manufacturing is a "responsibility . . . that Congress never intended" USDA to bear. USDA Br. 10. If USDA means that FETRA permits it to ignore unreported cigarette manufacturing *about which it has relevant information*, that interpretation would be impermissible because the statute clearly provides otherwise. *See Chevron*, 467 U.S. at 842–43.

By its plain terms, FETRA requires USDA to account for both lawful and unlawful sources of cigarette manufacturing or importation in its calculation of total volume of domestic sales, provided that "relevant information" is available. 7 U.S.C. § 518d(g)(1). The statute directs that a manufacturer cannot be charged more than its "correct pro rata share of *total gross* domestic volume from *all sources*." *Id.* § 518d(i)(4)(B) (emphasis added). That language is all-inclusive in triplicate. The world "total" means "relating to, or constituting the whole amount"; "gross" means "[e]xclusive of deductions; total"; and "all" means "[b]eing or representing the entire or total number, amount, or quantity." AMERICAN HERITAGE DICTIONARY (5th ed. 2014), *available at* www.ahdictionary.com; *see generally Reves v. Ernst & Young*, 507 U.S. 170, 179 (1993) (using dictionary as tool of statutory construction). Congress was clear bordering on redundant that an assessment must be proportionate to a manufacturer's share of the *entire* market for the relevant tobacco product.

FETRA's definition of the term "gross domestic volume" — on which "volume of domestic sales" is based (§ 518d(g)(2)) — further confirms the broad scope of the market share determination. That term is defined as "the volume of tobacco products — (A) removed (as defined by [the Internal Revenue Code]); and (B) not exempt from tax." 7 U.S.C. § 518d(a)(2). Congress's use of the term "removed" is significant because removal includes *any* means of placing tobacco products in the stream of commerce, including unlawful means such as "unlawful importation." 26 U.S.C. § 5702(j). In short, FETRA cannot be reasonably construed to carve out unlawful or unreported cigarette production from the scope of "total volume of domestic sales."

It is not surprising that Congress went to great lengths to guide USDA's distribution of $10 billion in liabilities in light of the constitutional problems that a disproportionate approach would raise. The Supreme Court has recognized that imposition of massive, unforeseen liabilities on private parties must be proportionate to their relevant experience. In *Eastern Enterprises*, for example, the Court held that that the Coal Industry Retiree Health Benefit Act, which imposed multimillion-dollar liabilities on coal companies to fund lifetime health benefits for coal workers, was unconstitutional as applied to a former coal operator. 524 U.S. 498. Both the plurality (which decided the case under the Takings Clause) and Justice Kennedy (who decided the case under the Due Process Clause) emphasized that the "disproportionate" extent of the statutory liabilities imposed was central to the law's constitutional infirmity. *Id.* at 536 ("[T]he Constitution does not permit a solution to the problem of funding miners' benefits that imposes such a disproportionate and severely retroactive burden upon [the plaintiff]"); *id.* at 549 (Kennedy, J., concurring in the judgment) (noting the disconnect between the plaintiff's past operations in the coal industry and the financial responsibility the statute imposed on it).

Conversely, in upholding similar statutes that impose significant financial liabilities, the Court has recognized the crucial role of proportionality in *avoiding* constitutional defects. *See, e.g.*, *Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Trust for S. Cal*., 508 U.S. 602, 641–47 (1993) (upholding statutory scheme that imposed pension withdrawal liability on employers in part because the employer had not shown that its liability was "'out of proportion to its experience with the [pension] plan'") (citation omitted); *Connolly v. PBGC*, 475 U.S. 211, 226 (1986) (same, where there was "nothing to show that the withdrawal liability actually imposed on an employer w[ould] always be out of proportion to its experience with the plan"). When Congress enacted FETRA, it avoided the same constitutional pitfalls by requiring an accurate pro rata distribution of the tobacco transition assessments.

B. USDA Cannot Ignore Relevant Evidence of Cigarettes Removed By Non-Reporting Manufacturers.

Agencies are not free to take an "ostrich-like" approach when information relevant to statutory considerations mandated by Congress is available. *Portland Cement Ass'n v. EPA*, 665 F.3d 177, 185 n.2 (D.C. Cir. 2011) (per curiam); *National Ass'n of Regulatory Util. Comm'rs*, 680 F.3d at 824 (rejecting as "farfetched, almost absurd" the argument that an agency can decline to make a required adjustment to an agency fee structure "so long as [the agency] is unaware of any information" that would necessitate the adjustment); *Sindicato Puertorriqueno De Trabajadores v. Brennan*, 530 F.2d 1023, 1032 (D.C. Cir. 1976) ("[A]dministrative law is not generally hospitable to an ostrich approach."). FETRA makes that settled background principle explicit by providing that USDA "shall" base its determination of both individual volume and total domestic volume on any "relevant information provided to or obtained by the Secretary." 7 U.S.C. § 518d(g)(1); *see also id*. § 518d(i) (establishing a process for challenging and revising assessments when "information" submitted by a manufacturer or importer demonstrates that the assessment is "incorrect"). Accordingly, when presented with relevant information of cigarette removals by non-reporting manufacturers, USDA is obligated to reasonably account for that illicit production in its calculation of total domestic volume to ensure that law-abiding manufacturers are not required to pay more than their lawful pro rata share.

USDA relies on *Single Stick, Inc. v. Johanns*, 601 F. Supp. 2d 307, to support its refusal to consider available evidence of unreported cigarette volumes, USDA Br. 11, but that case recognizes exactly the opposite: While FETRA does not necessarily require USDA to "affirmatively seek information about" tobacco products that enter domestic commerce by unlawful means, USDA *is* "required to incorporate this information if it is available." 601 F. Supp. at 314–15.

In *Single Stick*, a cigar manufacturer challenged its FETRA assessment on several grounds, including on the theory that USDA failed to account for "smuggled or unlawfully imported tobacco products." *Id.* at 314. The court rejected the government's sweeping argument that FETRA does not apply to smuggled or unlawfully imported cigars. *Id.* (noting that "removal" as used in FETRA includes unlawful means). Instead, the court identified two reasonable, alternative interpretations of USDA's statutory duty with respect to information about unreported tobacco volumes: Either "the Secretary is required to *affirmatively seek* information about smuggled or unlawfully imported tobacco products in determining the volume of domestic sales, or . . . the Secretary is simply required to incorporate this information *if it is available*." *Id.* (emphasis added). The court agreed with USDA that the former interpretation is not required by the statute. But the court recognized that USDA must, at a minimum, incorporate relevant information concerning unlawful importation when it is provided to USDA by a manufacturer or importer or when it is otherwise "available." *Id.* Unlike RJRT and Santa

Fe, the cigar manufacturer in *Single Stick* submitted *no* information concerning unreported volumes. On that record, the court agreed with USDA that FETRA could be permissibly interpreted to excuse USDA from accounting for "smuggled or unlawfully imported cigars in the USDA's calculation of volume of domestic sales *where that information had not been provided* by manufacturers or importers." *Id.* (emphasis added).[2]

By contrast, plaintiffs here presented USDA with ample relevant information concerning unreported cigarette manufacturing by two Native American manufacturers in particular and of the market effects of the illicit cigarette trade generally. Under any reasonable interpretation, the information submitted by plaintiffs is clearly "relevant" to USDA's determination of total volume and market share, and USDA's failure to adjust the challenged assessment to reasonably account for that information violated FETRA and, by extension, the APA.[3]

II. USDA's Shifting Justifications For Excluding Unreported Cigarette Production Fail.

USDA offers three justifications for its decision not to account for production by non-reporting manufacturers generally or Onondaga and T&D Enterprises specifically in its evaluation of "total gross domestic volume from all sources." None of those explanations

[2] Although the D.C. Circuit partially reversed the district court's decision in *Single Stick*, the plaintiff did not appeal the district court's ruling with respect to USDA's failure to account for smuggled cigars. *See Prime Time Int'l Co. v. Vilsack*, 599 F.3d 678 (D.C. Cir. 2010) (affirming in part and reversing in part).

[3] Plaintiffs assert a claim under FETRA and an alternative claim under the APA. Compl. ¶¶ 190–209. USDA notes that FETRA provides a complete remedy here — a refund of past overcharges and injunction against future overcharges. USDA Br. 12–13. The parties agree on that point and, for that reason, this case could be fully resolved on the FETRA claim alone. But that is no basis for dismissing the APA claim at this stage. *See Weyrich v. New Republic, Inc.*, 235 F.3d 617, 628 (D.C. Cir. 2001) (holding that plaintiffs may plead similar but mutually exclusive claims in the alternative). In any event, whether the court decides the FETRA claim or APA claim has no practical implication on the substantive analysis. USDA does not and cannot deny that the APA requirement of reasoned decisionmaking applies to the agency's implementation of FETRA. *See Lockhart v. United States*, 546 U.S. 142, 148–49 (2005) (Scalia, J., concurring) (exemptions from reasoned decisionmaking requirements are "not lightly to be presumed").

excuses the agency's violation of FETRA's clear command and failure to reasonably account for relevant factors mandated by Congress.

A. Information Need Not Be Substantiated By Other Federal Agencies To Be "Relevant" Under FETRA.

In its denial letter, the agency argued that plaintiffs' information concerning production by Onondaga and T&D Enterprises is not "relevant" because it has not been "substantiated" by other federal agencies. Final Denial 5 (Ex. H) ("The information and evidence presented by the [plaintiffs] must be substantiated by the U.S. Department of the Treasury, the U.S. Department of Homeland Security, or the U.S. Department of Justice (Bureau of Alcohol, Tobacco, and Firearms) as appropriate, before the Secretary can rely upon it when determining individual assessments pursuant to Section 625 of FETRA."). In a variation on this argument, the government's motion to dismiss argues that USDA was permitted, or perhaps required, to limit its consideration exclusively to "official government documents" — *i.e.*, tobacco excise tax returns and customs forms. USDA Br. 6; *id.* at 10, 11. These two limitations on what qualifies as "relevant" cannot be reconciled with the language of the statute or Congress's goal of ensuring that law-abiding manufacturers are not forced to shoulder the delinquencies of others.

FETRA clearly mandates consideration of information beyond the government documents that USDA has exclusively relied on. Subsection (h) requires manufacturers and reporters to submit copies of excise tax returns and customs forms to USDA. 7 U.S.C. § 518d(h). But FETRA directs that the market share determination "shall be made by the Secretary based on information provided by the manufacturers and importers pursuant to subsection (h), *as well as any other relevant information* provided to or obtained by the Secretary." *Id.* § 518d(g)(1) (emphasis added). USDA's interpretation would render the "any other relevant information" clause a nullity, in violation of normal rules of construction. *See*

Corley v. United States, 556 U.S. 303, 314 (2009) ("[A] statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous"). The plain import of section 518d(g)(1) is that USDA not only *may* consider information beyond excise tax and customs forms — it *must* ("shall") base its market share determination on such information if it is available and "relevant." *F.T.C. v. Tarriff*, 584 F.3d 1088, 1090 (D.C. Cir. 2009) ("It is . . . fixed usage that 'shall' means something on the order of 'must' or 'will.'"). Indeed, the statute further provides that, in challenging the correctness of an assessment, manufacturers "may use any information that is available, including third party data on industry or individual company sales volumes," 7 U.S.C. § 518d(i)(2) — a process that would be pointless if non-governmental information were per se *irrelevant* to USDA's assessment calculation.

More broadly, nothing in the statute permits USDA to categorically exclude information just because it has not been verified or corroborated by other government agencies. To the contrary, under section 518d(g)(1), it is *USDA's* responsibility to make a reasonable determination whether information provided by plaintiffs is "relevant" and hence to make adjustments to ensure that assessments are reasonably accurate. *Single Stick*, 601 F. Supp. 2d at 314 (recognizing that USDA is "required to incorporate" relevant information concerning unreported tobacco volumes "if it is available"). USDA's attempt to equate third-party substantiation with relevance is unreasonable and at odds with the ordinary meaning of the term "relevant" — which Congress is presumed to have intended. *In re North (Gadd Fee Application)*, 12 F.3d 252, 255 (D.C. Cir. 1994) (per curiam) ("Congress is normally presumed to afford an undefined term its ordinary meeting."). Information is "relevant" if it is "[l]ogically connected and tending to prove or disprove a matter in issue; having appreciable probative value — that is, rationally tending to persuade people of the probability or possibility of some alleged fact." BLACK'S LAW DICTIONARY 1404 (9th ed. 2009). Accordingly, information tending to prove the existence of unreported cigarette production is "relevant" to determining gross domestic volume. USDA does not explain how plaintiffs' proffered information fails to meet that or any other reasonable standard of relevance. *National Mar. Safety Ass'n v. OSHA*, 649 F.3d 743, 752 (D.C. Cir. 2011) (an agency must "identify the evidence upon which it relies . . . and to provide its reasons for rejecting contrary evidence and arguments").

In short, FETRA cannot be reasonably construed to limit USDA's consideration to government documents or information substantiated by other agencies. Based on this legal error alone, USDA's decision denying plaintiffs' challenges to the assessments must be reversed. *SEC v. Chenery Corp.*, 318 U.S. 80, 94 (1943) ("[A]n order may not stand if the agency has misconceived the law."); *see also Prill v. NLRB*, 755 F.2d 941, 956–57 (D.C. Cir. 1985) (holding that when an agency incorrectly concludes that Congress mandated a particular interpretation of a statute, the reviewing court must remand).

B. USDA Regulations Do Not And Cannot Bar Consideration Of Non-governmental Data.

In its motion to dismiss, the government for the first time argues that USDA's refusal to consider non-governmental information showing unreported production was not merely permissible but actually *required* by agency regulations. USDA Br. 11. That justification is both wrong and procedurally deficient.

As a threshold matter, the government's suggestion that USDA regulations — specifically, 7 C.F.R. § 1463.7(b) — bar consideration of anything other than "data reported on customs forms and excise tax forms" is a post hoc rationalization. For that reason alone it fails. *West Deptford Energy, LLC v. FERC*, 766 F.3d 10, 25 (D.C. Cir. 2014) (reviewing courts "need not—and indeed cannot—consider appellate counsel's post hoc rationalizations") (internal quotation marks and citation omitted). USDA *never* argued that its regulations confine its evaluation of market share to excise tax and customs documents. To the contrary, USDA relied on the statute itself to conclude that there was "insufficient evidence that the information offered by [Plaintiffs] is relevant for the purpose of Section 625(g)(1)" and did not even cite the regulatory provision now seized upon by the government. Final Denial 5. Plaintiffs were under no obligation to challenge a regulation that the agency did not rely on, and this Court cannot uphold USDA's actions based on the government's new regulatory argument. *See State Farm*, 463 U.S. at 50 ("It is well-established that an agency's action must be upheld, if at all, on the basis articulated by the agency itself.").

In any event, even if the government's post hoc interpretation of USDA's regulation were admissible as a basis to uphold USDA's action, that interpretation is untenable. The provision at issue states that calculation of domestic sales volume "shall be based upon reports filed by domestic manufacturers and importers of tobacco with the Department of Treasury and the Department of Homeland Security." 7 C.F.R. § 1463.7(b). The government now wants to rewrite that regulation by inserting the word "only." *Cf. Adirondack Med. Ctr. v. Sebelius*, 740 F.3d 692, 699–700 (D.C. Cir. 2014) (cautioning against "rewrit[ing]" statutes by "insert[ing] the word 'only' here and there"). That limitation is atextual and unreasonable, and in any event it is not entitled to deference because of its post hoc nature. *See Martin v. Occupational Safety & Health Review Comm'n*, 499 U.S. 144, 156 (1991) ("[A]gency 'litigating positions' are not entitled to deference when they are merely appellate counsel's 'post hoc rationalizations' for agency action, advanced for the first time in the reviewing court.").

Even more fundamentally, the government's new, made-for-litigation interpretation of section 1463.7(b) is directly at odds with FETRA's clear command to consider excise tax and customs documents "as well as any other relevant information." 7 U.S.C. § 518d(g)(1); *see also Hazardous Waste Treatment Council v. Reilly*, 938 F.2d 1390, 1395 (D.C. Cir. 1991) (an agency's interpretation of its own regulations must "meet the test of consistency with the underlying statute"). While it is certainly appropriate for USDA to promulgate regulations explaining how assessments will generally be calculated based on information that USDA knows will be available to it — reports filed by law-abiding domestic manufacturers and importers — the government has no authority to interpret its regulations as rewriting the statute to exclude other sources of relevant information. *See, e.g., Utility Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2446 (2014) (agency may not rewrite "clear statutory terms to suit its own sense of how the statute should operate"). To the contrary, FETRA requires USDA to base its market share determinations on "any . . . relevant information" provided to the agency concerning reported or unreported cigarette volumes. 7 U.S.C. § 518d(g)(1); *id.* § 518(i)(4)(B) (directing USDA to "ensure that each manufacturer and importer pays only its correct pro rata share of total gross domestic volume from all sources"); *see also Single Stick*, 601 F. Supp. 2d at 314. The government does not even attempt to square its regulatory argument with the text of the statute, and "a valid statute always prevails over a conflicting regulation," *National Family Planning & Reproductive Health Ass'n v. Gonzales*, 468 F.3d 826, 829 (D.C. Cir. 2006).

C. USDA's Asserted Lack Of Competence Does Not Excuse Its Failure To Comply With FETRA.

USDA argues that because it lacks "investigatory [or] law enforcement powers," it was "rational" to categorically exclude non-reporting cigarette manufacturers. USDA Br. 8. This argument both exaggerates the challenge of complying with FETRA and shrugs off USDA's legal duty to make a reasonable determination concerning factors prescribed by Congress.

"[A]n agency may not shirk a statutory responsibility simply because it may be difficult." *NetCoalition*, 615 F.3d at 539 (superseded on unrelated grounds by statute); *see also Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005). The D.C. Circuit has repeatedly recognized that when Congress directs an agency to make particular factual determinations in carrying out a regulatory scheme, the agency's self-professed incompetence is no excuse for noncompliance.

In *Chamber of Commerce*, for example, the Securities and Exchange Commission ("SEC") issued a rule imposing two restrictions on mutual funds pursuant to a statute that requires the SEC to evaluate the cost of new rules. *Id.* at 135. Plaintiffs argued that the SEC violated the statute by failing to estimate the costs of the first restriction. Much like USDA, the SEC defended its failure on the ground that it had no "reliable basis" for making that statutorily mandated determination. Rejecting that argument, the court explained that the "difficulty" of assessing the full cost of the rule did "not excuse the Commission from its statutory obligation to determine as best it can the economic implications of the rule it has proposed." *Id*. at 143.

So too here. Whatever the difficulty, FETRA requires USDA to make a determination of domestic volume attributable to any "source[]" for which "[relevant] information [has been] provided to the Secretary." 7 U.S.C. § 518d(i)(4); *see also Cobell v. Salazar*, 573 F.3d 808, 813 (D.C. Cir. 2009) (holding that where Congress directed the Department of the Interior to undertake an extremely complex accounting of a federal Native American trust fund, the agency was not free to "throw up its hands and stop the accounting" but rather must "provide[] the best accounting it can"); *see also id*. ("The district court's holding of impossibility contradicts the [statutory] requirement of an equitable accounting — one that makes most efficient use of limited government resources.").

Moreover, USDA has mischaracterized the difficulty of the task before it. The agency suggests that plaintiffs would have USDA step into the shoes of law enforcement, USDA Br. 1, 8–10, but FETRA does not require USDA to pursue or prosecute non-reporting cigarette manufacturers any more than the Census Act requires the U.S. Census Bureau to deport undocumented residents. The requirement is simply to *count* them. Making reasonable estimates based on information delivered to USDA's doorstep does not require vast "law enforcement or investigatory powers." USDA Br. 10. To the contrary, agencies are routinely required to adopt reasonable estimates of statutorily mandated factual considerations subject to significant uncertainty. *See, e.g.*, *Am. Iron & Steel Inst. v. EPA*, 115 F.3d 979, 1004–05 (D.C. Cir. 1997) (per curiam) (upholding the agency's reliance on a reasonable model to estimate results where no field data were available); *Bluewater Network v. EPA*, 370 F.3d 1, 24 (D.C. Cir. 2004) (upholding agency's reliance on best available data to estimate emissions from engines for which no direct emission data was available).

To support its plea of impossibility, USDA relies exclusively on two government reports. USDA Br. 8–10. Neither report remotely supports the claim that reasonably accounting for some or all non-reporting manufacturers would be the Sisyphean undertaking USDA imagines. The first report, a 2004 GAO study, does not even address non-reporting cigarette manufacturers in the United States. *See* GAO, Cigarette Smuggling: Federal Law Enforcement Efforts and Seizures Increasing (GAO-04-641) (May 2004) ("GAO, Cigarette Smuggling"). As its title suggests, the GAO report focuses on "smuggling of counterfeit cigarettes manufactured overseas" and "smuggling of genuine cigarettes manufactured overseas but diverted to the illicit market." *Id.* at 6. The report explains that smuggling is difficult to estimate due to its cross-border, "clandestine nature." *Id.* at 2. But it says nothing about the relative ease or difficulty of estimating production by non-reporting domestic cigarette manufacturers — much less manufacturers like T&D Enterprises and Onondaga who ply their illicit trade in broad daylight on a massive scale. *See* Compl. ¶¶ 140–73.

The second report, issued by TTB, is equally unavailing. *See* Dep't of Treasury, Rept. to Congress on Fed. Tobacco Receipts Lost Due To Illicit Trade and Recommendations for Increased Enforcement (Feb. 4, 2010). To be sure, TTB describes the challenges of sizing up the *entire* "illicit cigarette trade" (including all forms of smuggling). *See id* at 1. But plaintiffs ask for a far more modest accounting, based on detailed information about two specific manufacturers that they provided to USDA. USDA also fails to mention that the TTB report actually *does* provide a range of estimates of cigarette volumes attributable to the illicit trade, using a "tax gap" analysis. *See id.*, Appendix. Specifically, based on excise tax data and a national survey of tobacco consumers conducted by the U.S. Centers for Disease Control, TTB compared "[a]ctual tax receipts" to "tax receipts expected if all cigarettes that are consumed were taxed" to estimate the tobacco product volume not reported on excise tax returns. *Id.*, Appendix at 2. USDA, by contrast, has thrown up its hands despite its statutory duty to consider domestic volume from "all sources." *Cf., e.g., Utah Power & Light Co. v. ICC*, 747 F.2d 721, 741 (D.C. Cir. 1984) (agency "cannot simply throw up its hands on what may be a crucial inquiry").

Significantly, USDA has never disputed the accuracy of the multiple government reports submitted and cited by plaintiffs indicating that unreported cigarette production comprises a significant share of domestic cigarette volume — as much as 5% of the domestic cigarette market, according to one congressional report. *See* Compl. ¶¶ 69–75. Nor has it disputed the claim that Onondaga and T&D Enterprises are each responsible for a significant volume of unreported cigarettes. Instead, USDA ignored that information on the ground that any attempt to derive an estimate from it "would necessarily be arbitrary." Compl. ¶ 47 (quoting Final Decision 5 (Ex. H)).[4] But USDA makes no attempt to defend the reasonableness of the estimate of unreported cigarette production that it *has* adopted. By excluding all unreported cigarette production from its determination of total domestic volume, USDA has effectively assigned that production a value of zero. That *de facto* estimate cannot be squared with the undisputed facts in the administrative record, and for that reason alone the challenged assessments must be set aside. *See County of L.A. v. Shalala*, 192 F.3d 1005, 1021 (D.C. Cir. 1999) ("[W]here the record belies the agency's conclusion, [the court] must undo its action.").

Plaintiffs never claimed to have "solved the accounting problem for illicitly traded cigarettes," USDA Br. 9, but they do claim to have presented USDA with relevant estimates and evidence of cigarette production by two specific non-reporting manufacturers operating in New York. Under FETRA and the APA, USDA's duty is to make a *reasonable* determination, based on plaintiffs' unchallenged submissions and any other relevant information available to it, of unreported contributions to "volume of domestic sales" and to make necessary adjustments to assessments to ensure that manufacturers and importers are paying no more than their lawful share. *See* 7 U.S.C. § 518d(g)(1); *id.* § 518d(i)(4)(B) ("The Secretary *shall* . . . make any revisions necessary to ensure that each manufacturer and importer pays only its correct pro rata share of total gross domestic volume from all sources.") (emphasis added).

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[4] For the first time in its brief, USDA questions the adequacy of GlobalSource's investigative methods on the theory that "'cigarette investigations take 12 to 24 months.'" USDA Br. 9 (quoting GAO, Cigarette Smuggling 20). That post hoc objection is invalid because a reviewing court "must rely only upon the reasons given by the agency." *EchoStar Satellite v. F.C.C.*, 457 F.3d 31, 36 (D.C. Cir. 2006). It is also irrational. USDA's sole authority is a GAO report that describes criminal investigations of clandestine smuggling networks, including "larger investigations to identify and dismantle entire organizations responsible for cigarette smuggling, including investigating the potential for ties to terrorist groups." GAO, Cigarette Smuggling 17; *id.* at 18–20. It is manifestly unreasonable to assume the investigation of far more limited scope and purpose undertaken by GlobalSource would have required the same time and resources as those described by GAO. *See Mississippi v. E.P.A.*, 744 F.3d 1334, 1343 n.1 (D.C. Cir. 2013) (per curiam) ("logic rejects comparisons of apples and oranges").

Faced with undisputed evidence of unreported cigarette production in the record, USDA had a range of choices, but valuing unreported cigarette manufacturing at zero and forcing plaintiffs to "make up [the] shortfall" was not one of them. *Prime Time Int'l*, 930 F. Supp. at 257. Among other responses, USDA could have developed its own reasonable estimate of production by Onondaga and T&D Enterprises based on plaintiffs' submissions. It could have derived a reasonable estimate from the existing governmental estimates of unreported cigarette volumes. Or it could have conducted its own analysis. There is no reason USDA could not have developed a rational estimate here — whether with respect to T&D Enterprises and Onondaga specifically, or non-reporting cigarette manufacturers generally.

* * *

Congress instructed USDA to allocate the $10 billion burden of tobacco transition assessments in a manner proportionate to each manufacturer's and importer's "correct pro rata share of total gross domestic volume from all sources." 7 U.S.C. § 518d(i)(4)(B). No matter how the government exercises its enforcement prerogatives against those who fail to report domestic cigarette manufacturing, USDA cannot pretend that unreported manufacturing does not exist — especially when plaintiffs presented overwhelming evidence of it, including reliable estimates of unreported production by two identified manufacturers. USDA violated both FETRA and the APA by assigning unreported production an obviously incorrect value of zero in its calculation of "total gross domestic volume from all sources" and saddling law-abiding manufacturers with assessments that plainly overstate their "correct pro rata share."

CONCLUSION

The Court should deny USDA's motion to dismiss.

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Respectfully submitted,

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INDEX OF EXHIBITS*

* Because USDA has not fulfilled its obligation to file the administrative record in this case, *see* LCvR. 7(n)(1), plaintiffs have submitted selected portions of the administrative record for the Court's reference. This submission is not intended to serve as the complete administrative record.