

**UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT**

GRAND RIVER ENTERPRISES SIX)	Civil Action No. 3:16-cv-01087-WWE
NATIONS, LTD.,)	
)	
Plaintiff,)	
)	
v.)	
)	
KEVIN B. SULLIVAN, Commissioner of)	
Revenue Services of the State of)	
Connecticut,)	
)	
Defendant.)	MARCH 19, 2018

**PLAINTIFF’S SUR-REPLY TO DEFENDANT’S REPLY MEMORANDUM IN
SUPPORT OF MOTION TO DISMISS SECOND AMENDED COMPLAINT**

Plaintiff Grand River Enterprises Six Nations, LTD (“GRE”) submits this sur-reply in response to Defendant Commissioner of Revenue Services Kevin B. Sullivan’s (the “Commissioner”) Reply Memorandum in Support of his Motion to Dismiss the Second Amended Complaint (“Reply”). ECF No. 95. The Reply cites additional cases and raises new arguments; however, none support the Commissioner’s motion to dismiss.

In the introduction to the Reply, the Commissioner tries to conflate GRE’s constitutional challenge to Conn. Gen. Stat. § 4-28m(a)(3)(C) with unsuccessful, broadside challenges to the Master Settlement Agreement (“MSA”) and statutes implementing the MSA, *i.e.*, the Escrow and Contraband Statutes, or the Allocable Share Amendment Statute.¹ The Commissioner is,

¹ GRE’s challenge to Section 4-28m(a)(3)(C) is not analogous to the cases cited in footnote 1 of the Commissioner’s Reply. *Freedom Holdings, Inc. v. Cuomo*, 624 F.3d 38, 41 (2d Cir. 2010) (challenging New York’s Escrow and Contraband Statutes); *S&M Brands, Inc. v. Caldwell*, 614 F.3d 172, 174 (5th Cir. 2010) (challenging the MSA and Louisiana’s Escrow Statute); *Grand River Enters. Six Nations, Ltd. v. Beebe*, 574 F.3d 929, 932 (8th Cir. 2009) (challenging Arkansas’ Allocable Share Amendment); *KT & G Corp. v. Attorney Gen. of State of Okla.*, 535 F.3d 1114, 1118 (10th Cir. 2008) (challenging Kansas and Oklahoma’s Allocable Share Amendments); *Star Sci., Inc. v. Beales*, 278 F.3d 339, 343 (4th Cir. 2002) (challenging the

however, unable to cite to a single case in which a court considered a statute that is akin to Section 4-28m(a)(3)(C). In fact, the reconciliation requirement of Section 4-28m(a)(3)(C) is unique to Connecticut and only a few other states have enacted a similar requirement.² This action is a targeted challenge to a discrete, onerous provision of Connecticut's regulatory scheme, a provision that is contrary to federal law and serves no legitimate governmental purpose. GRE is otherwise not seeking to unravel Connecticut's scheme (with which GRE has fully complied), and the Commissioner's efforts to sway the Court with such statements should be rejected.

I. GRE Has Standing.

The Commissioner argues that GRE has not alleged economic injuries that are fairly traceable to complying with Section 4-28m(a)(3)(C) to establish standing. Def.'s Reply Mem. at 2–3. Significantly, though, the Commissioner does not dispute that allegations of such compliance costs are sufficient to establish standing. And, the Commissioner is splitting hairs in arguing that the compliance costs alleged in paragraphs 9 and 32 of the Second Amended Complaint (“SAC”) are not traceable to Section 4-28m(a)(3)(C). The complaint alleges compliance costs, violation of constitutional rights, and a threat of substantial injury if GRE were to be delisted—all of these, whether considered alone or together, establish standing.

At the pleading stage, the Court presumes that “general allegations embrace those specific facts that are necessary to support the claim.” *Lujan v. Defs. of Wildlife*, 504 U.S. 555,

MSA and Virginia's qualifying statutes); *Grand River Enters. Six Nations, Ltd. v. King*, 783 F. Supp. 2d 516, 525 (S.D.N.Y. 2011) (challenging the MSA and the implementing legislation); *Int'l Tobacco Partners, Ltd. v. Kline*, 475 F. Supp. 2d 1078, 1080 (D. Kan. 2007) (challenging Kansas' Escrow and Contraband Statutes).

² *E.g.*, Arkansas, Nebraska, and Nevada have enacted a similar requirement. See Ark. Code Ann. § 26-57-1303(b)(3)(C); Neb. Rev. Stat. § 69-2709(14); Nev. Rev. Stat. Ann. § 370.698(2)(g).

561 (1992) (quoting *Lujan v. Nat'l Wildlife Fed'n*, 497 U.S. 871, 899 (1990)); *see also WC Capital Mgmt., LLC v. UBS Sec., LLC*, 711 F.3d 322, 329 (2d Cir. 2013) (“When we assess a lack-of-standing argument on the basis of the pleadings . . . we take as true the factual allegations contained in the complaint.”). GRE alleges that Section 4-28m(a)(3)(C), as implemented by the Department of Revenue Service (“DRS”) and interpreted by the Commissioner, imposes requirements beyond what is permissible. SAC ¶¶ 62–71. Specifically, Section 4-28m(a)(3)(C), requires, as a condition to remaining on the Directory, GRE to submit documentation that DRS has no right to obtain because the data comes from cigarette importers that do no business in Connecticut. SAC ¶ 56, 61. GRE further alleges that it has expended a considerable amount of money “in seeking and obtaining approval to be listed on the Tobacco Directory.” SAC ¶ 9. It also alleges that it has “incurred and invested over \$1 million to comply with the Conn. Gen. Stat. § 4-28l and its related legislation” SAC ¶ 32 (emphasis added). A fair reading of the SAC is that GRE’s compliance costs include the costs of providing the voluminous records that DRS requires for GRE to remain on the Directory. Because the Court must presume that GRE’s allegations embrace those specific facts that are necessary to support its claims, GRE sufficiently alleges that its economic injuries are fairly traceable to complying with Section 4-28m(a)(3)(C). Accordingly, the Court should reject the Commissioner’s argument that traceable compliance costs have not been alleged. GRE’s allegations are also sufficient to meet the injury-in-fact requirement. *See Carter v. HealthPort Techs., LLC*, 822 F.3d 47, 55 (2d Cir. 2016) (“Any monetary loss suffered by the plaintiff satisfies [the injury-in-fact] element; ‘[e]ven a small financial loss’ suffices.”); *Anderson Grp., LLC v. City of Saratoga Springs*, 805 F.3d 34, 46 (2d Cir. 2015) (plaintiff’s “actual expenditures” used to develop residential project proposal was concrete and particularized economic injury for standing purposes).

In addition to alleging compliance costs that already have been incurred, and will continue to be incurred during each compliance period, GRE alleges that it will suffer irreparable harm if it is delisted. SAC ¶¶ 9, 32, 58, 59. These allegations are sufficient to establish the threat of future injury. Thus, in addition to alleging past injury, GRE also sufficiently alleges future injury. For these reasons, GRE has standing.

II. GRE Sufficiently Alleges that Section 4-28m(a)(3)(C) Violates Substantive Due Process.

The Commissioner's arguments that GRE has not alleged a violation of substantive due process mirror the arguments that the Commissioner made when moving to dismiss the First Amended Complaint. The Court necessarily rejected those arguments in denying the first motion to dismiss. *See* ECF No. 65. The Commissioner has not presented any reason for the Court to change its decision.

A. GRE has a Constitutionally-Protected Property Interest.

The Commissioner's Reply on this issue focuses on his purported discretionary power to decide which manufacturers are listed on the Tobacco Directory, and he claims that his discretion undermines GRE's property interest claim. Def.'s Reply Mem. at 6–7. Importantly, the only discretionary power that the Commissioner can point to is the part of Section 4-28m(a)(3)(C)—the statute being challenged by GRE—that provides a nonparticipating manufacturer (“NPM”) with an opportunity to “satisfactorily explain” a discrepancy in excess of two and one-half percent. *Id.* at 6. If Section 4-28m(a)(3)(C) is unconstitutional, as claimed by GRE, the Commissioner must concede that he has no discretionary power. He cannot establish discretionary power by relying on the very provision that is being challenged in this case.

The Commissioner also ignores the important fact that GRE already holds a license and indeed held the license before the Commissioner sought to impose the new requirements of

Section 4-28m(a)(3)(C). As explained in more detail in GRE's opposition brief, State law gives rise to a constitutionally-protected interest in a license "when the discretion of the issuing agency is so narrowly circumscribed that **approval** of a proper application is virtually assured." *RRI Realty Corp. v. Inc. Vill. of Southampton*, 870 F.2d 911, 918 (2d Cir. 1989) (emphasis added). The analysis, however, differs once the State has granted a license, *i.e.*, a constitutionally-protected property interest, as it has done so here with GRE. When the plaintiff already holds the license, "the government cannot 'depriv[e] [the individual of] such an interest . . . without [due process].'" *Spinelli v. City of N.Y.*, 579 F.3d 160, 169 (2d Cir. 2009); *cf. id.* ("Where a license can be 'suspended only upon a satisfactory showing' of misconduct, the licensee has 'a property interest in his license sufficient to invoke the protection of the Due Process Clause.'") (quoting *Barry v. Barchi*, 443 U.S. 55, 64 (1979)). The Commissioner fails to appreciate that GRE already has a protected property interest.

Once the Commissioner placed GRE on the Directory, GRE was granted a constitutionally-protected property interest in remaining on it. The Commissioner cannot revoke this right unless GRE fails to comply with statutory requirements. *See* SAC ¶¶ 9, 11, 23, 32, 58. Accepting the factual allegations as true, GRE has alleged a cognizable property interest in remaining on the Directory.³

B. GRE Alleges Sufficient Facts to Support a Claim that Section 4-28m(a)(3)(C) is Not Rationally Related to a Legitimate State Interest.

The Commissioner's reply argument concerning GRE's claim that Section 4-28m(a)(3)(C) is rationally related to a legitimate state interest relies heavily on *Star Scientific*,

³ The Commissioner asserts that GRE made certain misrepresentations with respect to the course of conduct regarding Indian Country sales. Def.'s Reply Mem. at 7. To the contrary, in its opposition brief, GRE accurately described the Commissioner's position and the problems that remain, specifically with how the "exemption" of Indian Country sales can be applied. ECF No. 86, at 22–23.

Inc. v. Beales, 278 F.3d 339 (4th Cir. 2002), and, to a lesser extent, *KT & G Corp. v. Attorney Gen. of the State of Okla.*, 535 F.3d 1114 (10th Cir. 2008). Neither case was cited in the Commissioner’s opening brief, and neither case supports his arguments.

The plaintiff in *Star Scientific* challenged the MSA and Virginia’s qualifying statutes *in their entirety*. 278 F.3d at 343. Similarly, the plaintiffs in *KT & G Corp.* challenged Kansas and Oklahoma’s Allocable Share Amendments. 535 F.3d at 1118. This statute, which concerns the release of escrowed funds, is not at issue in this case. Once again, GRE is not asserting a broadside challenge to Connecticut’s regulatory scheme for tobacco products or the statutes that implement the MSA. Whether courts have held that those broader statutes pass muster under the rational basis test is of no moment here. The Commissioner has not articulated any rational relationship between the specific reporting requirements of Section 4-28m(a)(3)(C) and a legitimate government interest. For the reasons set forth in GRE’s opposition brief, the compliance requirement is arbitrary and irrational. *See* ECF No. 86, at 19–26.

III. Section 4-28m(a)(3)(C) Violates the Supremacy Clause.

The Commissioner acknowledges that his arguments for dismissal of GRE’s Supremacy Clause claim were presented in connection with his previous unsuccessful motion to dismiss. The Court should once again reject these arguments.

One point raised in the Reply does warrant a response. The Commissioner argues that GRE’s continued listing on the Directory and compliance with the Prevent All Cigarette Trafficking (“PACT”) Act undermines the Supremacy Clause claim. Def.’s Reply Mem. at 9–10. The Commissioner misunderstands GRE’s claim.

GRE’s Supremacy Clause claim is that Section 4-28m(a)(3)(C) creates an onerous reporting requirement that is in conflict with the PACT Act. Section 4-28m(a)(3)(C) purports to require cigarette manufacturers to reconcile within two and one-half percent of cigarettes

reported for federal excise tax purposes with the number reported, in effect, under the PACT Act. SAC ¶¶ 2–4, 22–24. Stated differently, the reporting requirement forces GRE to compare apples (the number of cigarettes reported for excise tax purposes) to oranges (the number of cigarettes reported for PACT Act purposes). The PACT Act makes this reconciliation impossible in certain circumstances because certain sales and shipments of cigarettes are exempt from the reporting requirements. SAC ¶¶ 37–39, 50. For example, importers that distribute cigarettes in purely intrastate sales are not required to file PACT Act report. *See* SAC ¶¶ 37–39. Therefore, although GRE can and does meet its PACT Act reporting obligations, it cannot meet the Section 4-28m(a)(3)(C) reporting requirement as implemented by the DRS and interpreted by the Commissioner. There are importers that import and sell GRE cigarettes wholly in intrastate sales, which are not subject to PACT Act reporting requirements. SAC ¶ 39. Hence, because the PACT Act does not require reports on those sales, GRE should not be forced to reconcile the importers’ federal excise tax returns with the number of cigarettes subsequently shipped or sold in “Interstate Commerce” as reported in the PACT Act report of these importers within a margin of two and half percent.

The fact that GRE has remained on the Directory does not cure the problem. As the law is written, GRE is forced to comply with an arbitrary and irrational reporting requirement that conflicts with federal law or face the prospect of being delisted. As stated above, the mere fact that GRE is compelled to submit to this process hurts GRE. It is of little comfort, and, for purposes of the Commissioner’s motion, irrelevant that the DRS has—for now—not delisted GRE.⁴

⁴ The Commissioner references two other NPMs that are listed on the Directory. Def.’s Reply Mem. at 9 n.6. This is improper extrinsic evidence because it is neither integral to GRE’s complaint nor subject to judicial notice. *See Estate of Axelrod v. Flannery*, 476 F. Supp. 2d 188,

IV. Section 4-28m(a)(3)(C) is an Extraterritorial Regulation in Violation of the Commerce Clause.

The Commissioner's claim that GRE has "belatedly" raised an extraterritorial Commerce Clause challenge to Section 4-28m(a)(3)(C), *see* Def.'s Reply Mem. at 11, has no basis. Not only has GRE raised the issue of extraterritoriality in its complaints and in its briefs on the motions to dismiss,⁵ the Commissioner addressed the extraterritorial argument, ECF No. 42, at 22–23, in connection with the motion that the Court previously denied.

The Commissioner again relies heavily on *Star Scientific*. Unlike the present action, in *Star Scientific* the challenged statutes were the MSA and Virginia's qualifying statutes. 278 F.3d at 343. As only one part of a multilayered Commerce Clause argument, the plaintiff argued that "because the escrow payments are imposed on cigarettes sold not only by it, but also by its distributors, even when the distributors purchased the cigarettes outside of the State, Star Scientific is required to 'police interstate sales or channel those sales into contractual forms that may be more burdensome to commerce.'" *Id.*, 357. The Fourth Circuit, however, was persuaded by Virginia's argument that "*distributors in Virginia* are already *required to record* the number of cigarettes they stamp with the Virginia excise stamp and *report that information to the Commonwealth*." *Id.* (emphasis added). The Commissioner mistakenly views this as an analogous situation.

199 (D. Conn. 2007). Such factual issues are best explored during discovery and play no role in a motion to dismiss.

⁵ *See* ECF No. 38, ¶ 85 (First Amended Complaint); ECF No. 42, at 25 (Section III, entitled "GRE Stated A Claim That Conn. Gen. Stat. § 4-28m(a)(3)(C) Is An Extraterritorial Regulation In Violation Of The Commerce Clause"); ECF No. 74, ¶ 92 (SAC); ECF No. 86, at 31 (Section IV, entitled "Conn. Gen. Stat. § 4-28m(a)(3)(C) is an Extraterritorial Regulation in Violation of the Commerce Clause.").

Section 4-28m(a)(3)(C) has the practical affect of forcing importers *outside* Connecticut, which have *no connection* to Connecticut, to report information to Connecticut. To achieve this end, Section 4-28m(a)(3)(C) requires GRE to force importers with no connection to Connecticut to bend to the DRS and the Commissioner's reporting requirement. *See* ECF No. 38, Ex. C (letter from Marc Papandrea, Tax Unit Manager of the Audit Division-Excise Unit in the DRS to Attorney Leonard Violi, dated July 6, 2016, stating that GRE "could require its importers to submit to the DRS the document equivalent of PACT Act reports."). Thus, *Star Scientific* is not analogous and it offers limited, if any, analytical value because Virginia was not requiring the plaintiff-manufacturer to force its distributors to submit to Virginia law, which is exactly what the DRS and the Commissioner seek to do here. Unlike *Star Scientific* where the distributors were already required to submit certain reports to Virginia, the importers at issue that import GRE's cigarettes into the United States conduct wholly intrastate sales in Florida and South Carolina. SAC ¶ 39. Therefore, those importers have no reporting requirement to Connecticut, which is a key distinguishing aspect to *Star Scientific*.

Likewise, the remaining cases relied upon by the Commissioner to counter GRE's Commerce Clause claim are unavailing. *See supra* text accompanying note 1. The Commissioner's reliance on *Freedom Holdings, Inc. v. Spitzer* is particularly inapposite. In *Freedom Holdings*, the cigarette importer focused its extraterritoriality argument on price-regulation. 357 F. 3d 205, 219 (2d Cir. 2004). GRE, by contrast, focuses its argument on the Commissioner's attempts to exert extraterritorial regulation by forcing GRE, as condition to having its products sold in Connecticut, either to refrain from selling its products to parties that conduct business exclusively within the boundaries of another State, or to require such out-of-

state importers to submit to the Commissioner's regulatory authority. Either way, the statute's impact is extraterritorial.

CONCLUSION

For the reasons set forth herein and in GRE's opposition brief, the Court should deny the Commissioner's Motion to Dismiss the Second Amended Complaint.

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CERTIFICATE OF SERVICE

I hereby certify that on March 19, 2018, the foregoing was filed electronically. Notice of this filing will be sent by e-mail to all parties by operation of the Court's electronic filing system. Parties may access this filing through the Court's CM/ECF system.

/s/ Rosendo Garza, Jr.
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