2018 WL 1672606 (C.A.2) (Appellate Brief)
United States Court of Appeals, Second Circuit.

THE STATE OF NEW YORK, The City of New York, Appellees/Cross-Appellants,
v.
UNITED PARCEL SERVICE, INC., Appellant/Cross-Appellee.

Nos. 17-1993, 17-2107, 17-2111.
March 28, 2018.

On Appeal from the United States District Court for the Southern District of New York
Case No. 15-cv-1136

Brief for Appellant/Cross-Appellee United Parcel Service, Inc. (Final Form)

Mark A. Perry, Counsel of Record, Christopher J. Baum, Aidan Taft Grano, Gibson, Dunn & Crutcher LLP, 1050 Connecticut Avenue, N.W., Washington, D.C. 20036, (202) 955-8500.

Caitlin J. Halligan, Gibson, Dunn & Crutcher LLP, 200 Park Avenue, New York, NY 10166, (212) 351-4000, Counsel for appellant/cross-appellee, United Parcel Service, Inc.

Deanne E. Maynard, Morrison & Foerster, LLP, 2000 Pennsylvania Avenue, N.W., Suite 6000, Washington, D.C. 20006, (202) 887-1500.

Paul T. Friedman, Morrison & Foerster, LLP, 425 Market Street, San Francisco, CA 94105, (415) 268-7000.

*I CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, the undersigned counsel for Appellant/Cross-Appellee United Parcel Service, Inc. states that:

Appellant/Cross-Appellee United Parcel Service, Inc. has no parent corporation and no person or entity owns more than 10% of the outstanding stock of United Parcel Service, Inc.

*ii TABLE OF CONTENTS

*iv TABLE OF AUTHORITIES

Cases

*v

*XVIII TABLE OF ABBREVIATIONS

Abbreviation	Full Name
2016.06.07.Tr.	Transcript of June 7, 2016 District Court Hearing
AOD	Assurance of Discontinuance
CCTA	Contraband Cigarette Trafficking Act
DX	Defendant's Exhibit
Dkt.	District Court Docket Entry
FAAAA	Federal Aviation Administration Authorization Act
JA	Joint Appendix
MCL 4th	Manual for Complex Litigation (Fourth)
NCL	Non-Compliant List
NYAG	New York Attorney General
PHL	New York Public Health Law § 1399-*ll*
PX	Plaintiffs' Exhibit
PACT Act	Prevent All Cigarette Trafficking Act
SA	Special Appendix
TrialTr.	Trial Transcript
UPS	United Parcel Service, Inc.

*1 INTRODUCTION

A cavalcade of errors committed by the court below culminated in an unsupported and unlawful judgment of almost a quarter-billion dollars. The State and City of New York alleged that plain brown boxes transported by United Parcel Service, Inc. from retailers on Indian reservations contained untaxed cigarettes. The court agreed and awarded damages of $9.4 million and penalties of $237.6 million. The proceedings that led to these rulings were procedurally and substantively deficient from start to finish.

In holding UPS liable, the district court grievously misapprehended the governing regulatory regime. As just one example, the court imposed liability under two statutes from which Congress exempted UPS *by name*. As another, New York abandoned its

claim under the only contractual provision that authorizes per-shipment penalties, yet the court ruled that UPS was liable for such penalties anyway. For these reasons and others, UPS is not liable as a matter of law on any of Plaintiffs' four theories.

Even though the district court acknowledged that Plaintiffs' trial evidence was insufficient to support a monetary award, the court relied on additional information it ordered the parties to provide after trial to assess damages and penalties using an untested methodology *of its own invention* - all without a single witness, cross-examination, or even response. The court also punished UPS not once, not twice, but ***2** three times for the same conduct - each $80 million whack at least an order of magnitude greater than either New York's loss or UPS's gain and otherwise excessive. For these reasons and others, the damages and penalties awards cannot stand.

The litany of prejudicial errors made by the district court is chronicled in hundreds of pages of orders entered below. This Court now gets to write the next chapter. For the reasons explained below and in the briefs for *amici curiae*, UPS respectfully submits that it should end with *reversed*.

*3 STATEMENT OF JURISDICTION

The district court had jurisdiction under 28 U.S.C. §§ 1331 (federal claims) & 1367(a) (state-law claims). The court entered final judgment on May 26, 2017. UPS timely filed a notice of appeal on June 23, 2017 (JA528_ (Dkt.539)); Plaintiffs have each cross-appealed. This Court has jurisdiction under 28 U.S.C. § 1291.

*4 STATEMENT OF THE ISSUES PRESENTED

I. Whether the *liability* judgment should be reversed because the district court erred -

A. In interpreting the PACT Act's "honored" provision to conclude that UPS is not exempt from that Act and that the PHL is not preempted;

B. In construing the provisions of the AOD addressing violations and audits to conclude that UPS is liable for per-shipment penalties; and

C. In failing to apply the CCTA's threshold quantity and scienter requirements to conclude that UPS transported contraband.

II. Whether the *monetary* judgment should be reversed because the district court erred -

A. In disregarding fatal defects in Plaintiffs' damages and penalties submissions before, during, and after trial, rendering all findings on package and carton counts legally insufficient;

B. In awarding compensatory damages without legally sufficient evidence regarding the tax diversion rate; and

C. In imposing disproportionate and excessive penalties.

*5 STATEMENT OF THE CASE

After a bench trial, the district court (Forrest, J.) entered an order holding UPS liable under its Assurance of Discontinuance ("AOD") with the New York Attorney General ("NYAG"), the Prevent All Cigarette Trafficking Act, 15 U.S.C. §§ 375-78 ("PACT Act"), the Contraband Cigarette Trafficking Act, 18 U.S.C. §§ 2341-46 ("CCTA"), and Section 1399-*ll* of the

New York Public Health Law ("PHL"). *State of New York v. United Parcel Serv., Inc.*, No. 15-cv-1136, 2017 WL 2305380 (S.D.N.Y. May 25, 2017). The court subsequently entered an order requiring UPS to pay $9.4 million in compensatory damages and $237.6 million in total penalties. *State of New York v. United Parcel Serv., Inc.*, No. 15-cv-1136, 2017 WL 2303525 (S.D.N.Y. May 25, 2017).

1.a. In 2000, New York enacted the PHL in an effort to prevent consumers from avoiding the notoriously high taxes imposed on cigarettes in New York. As relevant here, the PHL prohibits common carriers from "knowingly transport[ing] cigarettes to any person in this state reasonably believed by such carrier to be" unauthorized to receive them; deliveries to "a home or residence" are presumed to be to unauthorized persons. N.Y. Pub. Health L. § 1399-*ll*(1) & (2). Thus, the PHL essentially prohibits UPS from knowingly delivering cigarettes to individual consumers.

***6** Soon after the PHL became effective in 2003, UPS voluntarily "adopted revised policies governing the transportation of tobacco products … meant to ensure that UPS does not knowingly deliver cigarettes to unauthorized recipients." SA495_(DX-23:3); *see also* SA269_(Dkt.535:20). Among other things, UPS revised its Tariff and Terms and Conditions to prohibit "shipments of cigarettes to consumers under any circumstances." *E.g.*, JA1486, 1515_(DX-35:10, DX-35:39); *see also* SA495-96_(DX-23:3-4). UPS also provided formal training on its revised Cigarette Policy to employees and advised approximately 400 shippers that UPS would no longer accept prohibited packages. SA496_(DX-23:4).

When the NYAG nonetheless questioned whether UPS was in compliance with the PHL, UPS defended the adequacy of its Cigarette Policy and pointed out that the PHL was preempted by a federal law prohibiting the enforcement of state laws "related to a price, route, or service of any motor carrier … with respect to the transportation of property." 49 U.S.C. § 14501(c)(1) ("FAAAA"); *see also id.* § 41713(b)(4). This provision prevents the States from interfering with the common carriers' federal obligation to pick up and transport packages on reasonable request from any customer. *See id.* § 14101(a).

Following negotiations, to "promote further and ongoing cooperation" and "in lieu of" the NYAG's "commencing a civil action against UPS," UPS and the NYAG entered into the AOD on October 21, 2005. SA497_(DX-23:5). An assurance of ***7** discontinuance is a statutorily authorized settlement agreement. *See* N.Y. Exec. L. § 63(15).

The AOD resolved the dispute over the PHL by formalizing UPS's Cigarette Policy. SA497-99_(DX-23:5-7). UPS agreed to limited steps aimed at identifying cigarette shippers, such as maintaining its own database of potential cigarette shippers (SA499-501_(DX-23:7-9)) and conducting internet searches for a limited period of time to identify customers shipping cigarettes (SA500_(DX-23:8)). UPS also undertook certain shipper-oriented obligations, including notifying cigarette shippers of its policy (SA500_(DX-23:8)); auditing shippers it has reason to believe are shipping cigarettes (SA501_(DX-23:9)); and imposing progressive disciplinary measures on shippers that UPS discovers do ship cigarettes (SA502-05_(DX-23:10-13)). Finally, UPS undertook internal compliance obligations, such as training its employees regarding its Cigarette Policy (SA505-06_(DX-23:13-14)); responding to NYAG inquiries by auditing or disciplining shippers as appropriate (SA507_(DX-23:15)); retaining and providing information to the NYAG upon request (SA507-08_(DX-23:15-16)); and verifying its compliance as needed (SA510_(DX-23:18)).

Along with these procedural obligations, the AOD provides that if UPS *knowingly* delivers cigarettes to an individual consumer within New York State (a "violation" of the AOD), UPS "shall pay to the State of New York a stipulated penalty of $1,000 for each and every violation." SA508_(DX-23:16). UPS also ***8** expressly reserved the right to challenge the PHL as "unconstitutional, preempted by federal law, or otherwise unenforceable as applied against UPS." SA508-09_(DX-23:16-17). In a 2005 report submitted to the NYAG, UPS "confirmed that it would give nationwide effect to the AOD and that it no longer shipped cigarettes to consumers." SA9_(Dkt.49:5).

b. The enforceability of the PHL was called into serious question when the Supreme Court held that Maine's tobacco-delivery law - which similarly prohibited the knowing transport of tobacco products to unauthorized individuals - was preempted. *Rowe v. N.H. Motor Transp. Ass'n*, 552 U.S. 364, 368-69 (2008). In addition, the States could not constitutionally regulate deliveries through the Postal Service and Congress had not yet addressed the mailing of cigarettes. *See*, *e.g.*, 156 Cong. Rec. H1526-01, 2010 WL 956208, at * 27 (Mar. 17, 2010) (statement of House sponsor).

Congress responded by enacting the PACT Act in 2010, making cigarettes non-mailable matter and imposing shipping, labeling, and recordkeeping requirements on delivery sellers. 15 U.S.C. § 376a(a)-(d); 18 U.S.C. § 1716E. The PACT Act also requires the U.S. Attorney General to create a "Non-Compliant List" ("NCL") of delivery sellers of cigarettes, and to update and distribute that list on a regular basis to the U.S. Postal Service, state attorneys general, and others. *Id.* § 376a(e)(1). The statute prohibits a person who is subject to the Act and receives ***9** the NCL from "knowingly complet[ing] … a delivery of any package for any person whose name and address are on the list." *Id.* § 376a(e)(2); *see also* Pub. L. 111-154, sec. 3, 124 Stat. 1087, 1103-09.

Congress enacted the PACT Act only after "careful negotiat[ion] with the common carriers, including UPS, to ensure that [it would] not place any unreasonable burdens on those businesses." 155 Cong. Rec. S5853 (daily ed. May 21, 2009) (statement of Senate sponsor). UPS, FedEx, and DHL had each entered into contracts with the NYAG and, pursuant to those agreements, had adopted nationwide policies regarding tobacco shipments. "In recognition of UPS and other common carriers' agreements to not deliver cigarettes to individual consumers on a nationwide basis, pursuant to agreements with the State of New York, [Congress] *exempted them from the bill provided this agreement remains in effect*." *Id.* (emphasis added).

The PACT Act exempts from its requirements any "common carrier that is subject to a settlement agreement" with state regulators - including, explicitly, UPS's agreement with New York - if the agreement "is honored throughout the United States." *Id.* § 376a(e)(3)(A), (B)(ii)(I). The Act also exempted common carriers that enter into "any other active agreement" that similarly "operates throughout the United States." *Id.* § 376a(e)(3)(B)(ii)(II). The PACT Act also provides that States may not enforce prohibitions on tobacco shipments or deliveries ***10** against common carriers that are exempt from the PACT Act itself. *Id.* § 376a(e)(5)(C)(ii).

Another federal statute, the CCTA, was enacted in 1978 "with the aim of reducing evasion of state cigarette taxes." *Att'y Gen. of Can. v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 129 (2d Cir. 2001). As relevant here, the CCTA makes it unlawful for any person "knowingly to ship, transport, receive, possess, sell, distribute, or purchase contraband cigarettes." 18 U.S.C. § 2342(1). "Contraband cigarettes" are defined as "a quantity in excess of 10,000 cigarettes" without legally required tax stamps "in the possession of any person other than" authorized personnel. The CCTA empowers state and local governments to seek civil penalties for violations. *Id.* § 2346(b).

2. For a decade, both UPS and New York followed the procedures set forth in the AOD. New York periodically inquired as to compliance issues, including whether identified shipments were proscribed; UPS responded with the requested information, including its lack of knowledge as to particular shipments. *See*, *e.g.*, SA261_(Dkt.535:12). For example, in April 2011, UPS became aware that certain shippers might be shipping cigarettes and consulted New York State law enforcement. SA261, 282_(Dkt.535:12, Dkt.535:33). A state trooper (Officer Nitti) instructed UPS to continue picking up packages from those shippers because of an ongoing "sting" operation. SA261, 283_(Dkt.535:12, Dkt.535:34). In August 2011, ***11** UPS related

this series of events to the NYAG and provided delivery information regarding those shippers; the NYAG took no action at that time. SA261, 283_(Dkt.535:12, Dkt.535:34).

UPS also conducted extensive efforts to advise its customer base of its Cigarette Policy (JA1897-1900, 1907-08_(DX-600:15-18, DX-600:25-26)); engaged in extensive training and specific enhancement of compliance efforts across New York State in 2011 when cigarette shipments were identified on one reservation (JA1900-06, 1915-22_(DX-600:18-24, DX-600:33-40)); repeatedly terminated shippers upon discovering suspected cigarette shipments (JA1910-12, 1915, 1920, 1922, 1929, 1931_(DX-600:28-30, DX-600:33, DX-600:38, DX-600:40, DX-600:47, DX-600:49)); and cooperated with governmental agencies every time UPS was presented with a suspected cigarette shipper (JA1911, 1913-14, 1934_(DX-600:29, DX-600:31-32, DX-600:52)).

By contrast, the relationship between the State and the Native American tribes has been anything but cooperative. For three decades, New York and retailers on Native American reservations have disputed the enforcement of cigarette taxes. *See*, *e.g.*, *Oneida Nation of N.Y. v. Cuomo*, 645 F.3d 154, 158-60 (2d Cir. 2011). Even after the Supreme Court upheld regulations designed to permit taxation of on-reservation sales to non-Indian consumers (*see* *Dep't of Taxation & Fin. of N.Y. v. Milhelm Attea & Bros., Inc.*, 512 U.S. 61 (1994)), New York "never implemented ***12** the regulations … due to additional litigation, civil unrest, and failed negotiations." *Oneida*, 645 F.3d at 159. The Department of Taxation and Finance adopted a formal "forbearance" policy in 1998 - declining to enforce the tax against wholesalers selling to reservation retailers - that, by the time it was revoked in 2010, cost the State an estimated $110 million in annual tax revenue. *Id.*

Apparently frustrated by its own unwillingness, or inability, to tax Indian cigarette sales directly, New York trained its sights on secondary actors with deeper pockets. Despite UPS's longstanding cooperation with government enforcement efforts, New York State and New York City sued UPS on February 18, 2015 for "violating" the AOD *and* the PACT Act, the PHL, and the CCTA. Dkt.1; *see also* JA219_(Dkt.189) (operative Third Amended Complaint). After trial, the district court found UPS liable for transporting packages from twenty individual shippers, organized into fifteen shipper "groups," all located on tribal lands in upstate New York. SA248, 312-15_(Dkt.535:ii, 63-66). UPS thus became a casualty of New York's ongoing dispute with the Native Americans over cigarette taxes.

a. As pertinent to the issues presented in UPS's appeal, the district court allowed all of Plaintiffs' liability and damages/penalties theories to proceed to trial:

PACT Act exemption and PHL preemption. On summary judgment, the court determined that Plaintiffs had raised a triable issue of fact regarding whether the ***13** AOD was being "honored" nationwide by proffering evidence regarding UPS's purported non-compliance with the AOD. SA149_(Dkt.252:2).

AOD. The court ruled on summary judgment that Plaintiffs would have to prove at trial "whether UPS had a reasonable basis to believe that it was transporting cigarettes to unlawful recipients." SA164-65_(Dkt.355:8-9).

CCTA. The court denied UPS's motion to dismiss Plaintiffs' CCTA claims, holding that the CCTA "allow[s] aggregation of multiple cigarette shipments to meet the CCTA's threshold quantity." SA17_(Dkt.49:13).

Damages/penalties. The court granted UPS's motion to preclude Plaintiffs' expert, Dr. Erath, from offering opinion testimony on the percentage of shipments containing unstamped cigarettes, based on statistical analysis applied to a survey he designed. SA200_(Dkt.405:31). The court held that Dr. Erath "lack[ed] the qualifications to design and conduct the survey," that his "training and experience f[e]ll well short of the basic requirements set forth in *Daubert*," and that he "rendered opinions that

[we]re demonstrably unreliable." SA186-87_(Dkt.405:17-18). Accordingly, Dr. Erath was not permitted to testify, and Plaintiffs had no other witness to testify on this subject - which, it turned out, was central to Plaintiffs' monetary claims.

Notwithstanding the mandatory requirements of Rule 26(a), Plaintiffs' initial disclosures contained no total amount of damages or penalties sought; offered no ***14** methodology for computing such an amount; and identified no underlying documents supporting damages or penalties. JA271_(Dkt.367-1); JA278_ (Dkt.367-2). After UPS propounded interrogatories, the district court ordered Plaintiffs to submit a letter detailing evidence of shipments, package contents, and a calculation of damages for a single "exemplar" shipper group of their choosing. SA32_(Dkt.169:6). On March 3, 2016, Plaintiffs submitted a letter with estimations only for the Arrowhawk shipper group. JA359_(Dkt.367-4:4). Yet Plaintiffs' final supplemental disclosures did not include similar information for any other shippers. JA299-300_(Dkt.367-3:17-18). UPS accordingly moved to preclude Plaintiffs' damages and penalties claims. *See* Dkt.365. The district court denied UPS's motion, explaining that it "view[ed] the overall record as sufficiently placing UPS on notice as to the damage theory, and while there are open factual issues, those largely go to calculations and not methodology." JA443_(Dkt.413:1).

b. The district court presided over a bench trial in September 2016. In their opening statement, Plaintiffs disclosed for the first time that they sought $38 million in damages and $825 million in penalties. JA596-97_(TrialTr.72:9-74:3). Plaintiffs introduced into evidence voluminous spreadsheets from several internal UPS shipping and billing databases - so voluminous that they are being filed in native format on DVD because printing them out to include in the Joint Appendix would create a stack of paper *hundreds* of feet high. *See* JA1203-07_ (PX-67–PX-71); ***15** JA1209-16_(PX-73–PX-80); JA1282_(PX-188); JA1295-1300_ (PX-220–PX-225); JA1317_(PX-227); JA1321_(PX-254); JA1322-24_(PX-276–PX-278); JA1355_(PX-404); JA1357-79_(PX-409–PX-431); JA1380-87_(PX-433–PX-440); JA1421_(PX-535); JA1422-31_(PX-539–PX-548); JA1432-41_(PX-551–PX-560); JA1444_(PX-591); JA1447-62_(PX-605–PX-620). Although Plaintiffs initially informed the court that they intended to ask UPS witnesses questions about these spreadsheets (JA613-14_(TrialTr.140:23-141:8)), they never did. By the time the trial ended, Plaintiffs had adduced no testimonial evidence regarding the spreadsheets, including the significance or even meaning of their contents. SA456_(Dkt.535:207).

For three shipper groups (Arrowhawk, Jacobs, and Smokes & Spirits), Plaintiffs introduced evidence - through testimony by the shippers or documents such as shipping invoices - that some (but not all) packages contained cigarettes. *See*, *e.g.*, JA809_(TrialTr.914:25-915:2); *see also* JA1107_(PX-8B); JA1198_(PX-55); JA1217_(PX-87); JA1241_(PX-90); JA1243_(PX-92); JA1245_(PX-93); JA1260_(PX-96). For the other twelve shipper groups as to which liability was imposed, Plaintiffs presented no evidence showing package contents and instead, as UPS explained at closing, assumed that "everything is 100 percent cigarettes." JA1083_(TrialTr.2010:16-17); *see also* JA1066_(TrialTr.1942:4-7); JA1084-85_(TrialTr.2014:24-2015:2); JA1085_(TrialTr.2016:21-2017:4).

***16** UPS questioned Plaintiffs' unwarranted, and stereotyped, assumption that the shippers at issue were shipping cigarettes (and only cigarettes) simply because they were located on Indian reservations and some of them were called "smoke shops." UPS introduced photographic evidence that most of these shippers actually shipped other items, such as Native American crafts or lawful tobacco products like "little cigars," rather than cigarettes. *E.g.*, JA1838_ (DX-500); JA1913-22, 1925-26, 1936-39, 1943_(DX-600:31-40, DX-600:43-44, DX-600:54-57, DX-600:61). UPS also adduced evidence that these little cigars were "total substitute[s]" for cigarettes but not subject to cigarette taxes or the delivery prohibitions at issue here. JA977_(TrialTr.1584:16-25). Little cigars are sold in "cartons weighing approximately one pound" that are "similar in size, shape, and color to those of cigarettes" and often under "quite similar" brand names. SA298_(Dkt.535:49).

c. In its post-trial liability order, the district court found UPS liable on each of Plaintiffs' claims that proceeded to trial, and rejected each of UPS's defenses. SA247_(Dkt.535) (corrected order); *see also* Dkt.526 (original order). For each of the fifteen shipper groups, the court found "(1) the date not later than which there was a reasonable basis to believe that such shipper may have been tendering cigarettes [for delivery] to [consumers]; (2) (if applicable) the date not later than which the shipper was in

fact shipping cigarettes; and (3) (if applicable) the date not later than which UPS knew [the shipper] was shipping cigarettes." ***17** SA313_(Dkt.535:64). The court also reached a number of conclusions of law, summarized below as relevant to this appeal.

PACT Act and PHL. Reiterating its summary judgment ruling, the district court held that UPS could lose its PACT Act exemption and PHL preemption if "[p]ersistent or widespread violations wherever located can indicate that the AOD is not being honored," even if they "originate only in New York." SA391_ (Dkt.535:142). The court found that "UPS was not honoring the AOD" between December 1, 2010 (when the court found that UPS "was not taking appropriate action" after having a reasonable basis to believe that some shippers were shipping cigarettes) and February 18, 2015 (when the court found UPS had returned to full compliance with the AOD's requirements). SA392-93_ (Dkt.535:143-44). During that period, the court ruled that UPS was liable for violating both the PACT Act and the PHL. SA408-15_(Dkt.535:159-66).

AOD. Although the State initially sought penalties under Paragraph 42 of the AOD only for the knowing delivery of cigarettes to consumers (JA156-57_ (Dkt.86:42-43)), at trial New York abandoned that theory and argued that it was entitled to penalties for UPS's alleged failure to comply with the audit obligation in Paragraph 24. SA384_(Dkt.535:135). The district court held that, "[o]n its face, ¶ 42 does not limit 'violations' for which penalties may be imposed solely to any one type of obligation"; that "there [wa]s no reason for this Court to separate one type of ***18** contractual obligation that UPS assumed in the AOD from another when determining what constitutes a 'violation' under ¶ 42"; and that "[a]ny failure to comply with a contractual obligation constitutes a separate violation of the AOD," subject to a $1,000 penalty. SA380_(Dkt.535:131). Accordingly, the district court determined the date when UPS was first required to audit a shipper and assessed a $1,000 penalty for *every* package that was sent after that date while the shipper remained unaudited, regardless of package contents. SA384-85_(Dkt.535:135-36). This included packages from the shippers that UPS was specifically directed by New York law enforcement to continue transporting. SA428-32_(Dkt.535:179-83).

CCTA. The district court held that the statutory quantity requirement of 10,000 cigarettes could be met by aggregating multiple shipments, and that the statutory knowledge requirement was met by testimony from two shippers that they had shipped cigarettes in lots of 10,000 or more. SA415-21_(Dkt.535:166-72).

Package counts. The court ruled that Plaintiffs had violated Rule 26 by failing to disclose damages and penalties computations before trial, but imposed no sanction because the court was "not convinced that UPS lacked adequate pre-trial notice to counter Plaintiffs' damages claims, nor [wa]s it convinced that UPS suffered any real prejudice." SA433-39_(Dkt.535:184-90).

After trial, the district court invented its own methodology to estimate the number of packages containing cigarettes, and the number of cigarette cartons per ***19** package, for which UPS would be held liable and ordered to pay damages and penalties. SA456-58, 456.n.144_(Dkt.535:207-09, Dkt.535:207.n.144); *see also* JA710_(TrialTr.526:8-10). First, using spreadsheets from UPS's internal databases - about which "[n]either the Plaintiffs nor UPS presented witness testimony" SA456_(Dkt.535:207) - the court held that total packages could be counted using proffered account numbers of the shippers at issue. Then, the court examined anecdotal evidence, such as the results of audits and consumer inquiries regarding lost packages ("tracers"), and treated these as a "sample" of the entire population of packages for each shipper, "extrapolating" the percentage of packages that might contain cigarettes for the entire population of packages tendered by that shipper. *E.g.*, SA336 & n.77_ (Dkt.535:87 & n.77) (Shipping Services). The court found that a cigarette carton weighs a pound on average; to estimate cartons, the court summed the weights of all packages weighing over a pound, multiplied that sum by its speculative percentage of cigarette shipments, and divided by one pound - thus assuming that if a package contained any cigarettes, it contained 100% cigarettes. SA461_(Dkt.535:212).

Plaintiffs had not introduced evidence of the number or contents of packages and cartons - only a demonstrative upon which the district court did not rely and an expert excluded as unreliable and unqualified. *See* SA456.n.144_ (Dkt.535:207.n.144); SA200_(Dkt.405:31). Nonetheless, the court ***20** ordered the parties to submit additional information

post-trial - specifically, to "simply add up the packages at issue consistent with the instructions provided by the Court herein" SA456.n.144_(Dkt.535:207.n.144) - to enable it "to make a final determination as to the quantum of compensatory damages and penalties." SA258_(Dkt.535:9).

UPS objected that, even under the court's newly announced methodology, "the trial record contains evidence from which the number of 'Packages' … could potentially be derived for *only* three shippers," and that Plaintiffs had introduced no "evidence of shipments that UPS had an opportunity to test at trial" regarding *any* of the other shippers. JA520-21_(Dkt.531:1-2) (emphasis added). Accordingly, UPS provided the requested information as to those three shipper groups. JA521-22_(Dkt.531:2-3). Plaintiffs, in contrast, submitted purported package counts for each shipper, including a sum of package weights, without explaining how they derived these numbers from the eleven spreadsheets they cited. JA507_(Dkt.530). UPS had no opportunity to test, challenge, or respond to the information that Plaintiffs submitted after the trial's conclusion.

Compensatory damages. In assessing compensatory damages - *i.e.*, "lost" tax revenue - the district court held that Plaintiffs were required to show a causal connection between UPS's conduct and Plaintiffs' purported tax losses. SA440_(Dkt.535:191). Although Plaintiffs introduced no evidence on the issue and ***21** UPS's expert testified without contradiction that the tax diversion rate (the rate of tax loss caused by sale of contraband cigarettes) was at most 5.4%, the court held that a 50% rate was appropriate. SA440-42_(Dkt.535:191-93).

Penalties. Although the court recognized that "UPS now approaches compliance with the AOD and the various statutory schemes with renewed vigor and additional processes and procedures," it found that a "hefty fine" was necessary to "cause changes in practices and procedures to be strictly maintained." SA446-47_(Dkt.535:197-98). Even though the court had not yet established the amount of damages or penalties (and, indeed, had insufficient evidence on which to do so), the court opined that the "hefty fine" it contemplated would not be unlawfully or unconstitutionally excessive. SA447-55_ (Dkt.535:198-206).

d. The district court subsequently entered a damages and penalties order, accepting Plaintiffs' submission regarding package counts *in toto*. SA469_ (Dkt.536). The court deemed UPS to have waived any challenge to Plaintiffs' post-trial package and carton counts based on its characterization of UPS's simultaneous submission as "demonstrat[ing] a lack of cooperation and, frankly, odd abrasiveness." SA472_(Dkt.536:4). In the court's view, UPS's insistence that the trial record contained no evidence to support an award of damages or penalties as to twelve of the fifteen shipper groups was "consistent with UPS's ***22** lack of acceptance of responsibility," which "further inform[ed] the Court's views on the need for a significant award to deter future conduct." SA473_(Dkt.536:5).

PACT Act and PHL Penalties. The district court calculated the maximum PHL penalty by multiplying its estimated package count by the statutory amount ($5,000). SA478_(Dkt.536:10). Likewise, the court calculated the maximum PACT Act penalty by multiplying the estimated package counts for shippers listed on the NCL by the statutory amount ($2,500 for the first package, and $5,000 for each subsequent package). SA484-85_(Dkt.536:16-17). The court awarded 50% of these amounts, resulting in PACT Act penalties of $35,258,750 to New York State and $43,091,250 to New York City, SA485_(Dkt.536:17), and PHL penalties of $41,410,000 to New York State and $37,345,000 to New York City, SA487_ (Dkt.536:19). The court did not analyze whether the maximum penalties (as thus calculated) or its award of 50% of those maximums was disproportionate to New York's loss or UPS's gain.

AOD Penalties. The district court counted the number of packages (regardless of contents) shipped to New York addresses after the date on which it found sufficient knowledge to trigger UPS's audit obligation for each shipper and multiplied that figure by $1,000, awarding New York State a total of $80,468,000. SA479-81_(Dkt.536:11-13). The court also did not analyze whether this award was disproportionate. The City is not a party to the AOD and thus cannot recover penalties under it. *See* SA511_(DX-23:19).

***23** *CCTA Damages*. Based on its methodology for approximating package and carton counts and its 50% tax diversion rate ruling, the court awarded compensatory damages of $8,679,729 to New York State and $720,885 to New York City. SA488-89_(Dkt.536:20-21). The court also awarded nominal penalties of $2,000 under the CCTA. SA490_(Dkt.536:22).

All told, the district court awarded Plaintiffs almost $250 million:

Theory	State	City	Total
PACT Act Penalties	$35,258,750	$43,091,250	**$78,350,000**
PHL Penalties	$41,410,000	$37,345,000	**$78,755,000**
AOD Penalties	$80,468,000	N/A	**$80,468,000**
CCTA Damages	$8,679,729	$720,885	**$9,400,614**
CCTA Penalties	$1,000	$1,000	**$2,000**
TOTAL	$165,817,479	$81,158,135	**$246,975,614**

*24 SUMMARY OF ARGUMENT

I. The district court erred as a matter of law in concluding that UPS is liable under each theory advanced by Plaintiffs at trial.

A. UPS is exempt under the PACT Act, and the PHL is preempted, because its AOD is "honored throughout the United States" under a correct interpretation of the PACT Act. Congress provided a readily verifiable standard - whether the AOD is active and operates nationwide - that is satisfied here. *Either* UPS is subject to the AOD *or* it is subject to the PACT Act and the PHL; in no event is it subject to all three. In concluding otherwise, the district court ignored the statute's text, structure, context, and history, adopting a rudderless compliance inquiry that defies both due process and common sense.

B. UPS is not liable under the AOD because New York abandoned its claim under the provision authorizing per-shipment penalties for the knowing transportation of cigarettes to consumers within New York. The AOD's audit provision, under which New York elected to proceed instead, does not authorize penalties - or if it does, permits only per-shipper, not per-shipment, penalties. In concluding otherwise, the court impermissibly rewrote the parties' agreement.

C. UPS is not liable under the CCTA because Plaintiffs failed to establish the threshold quantity and scienter elements. In concluding otherwise, the district court failed to apply the statutory terms as written and as construed in analogous cases.

***25 II.** The district court erred as a matter of law in awarding damages and penalties to Plaintiffs.

A. Before trial, Plaintiffs failed to disclose either the amount of damages and penalties or the methodology for computing them, but the district court allowed Plaintiffs to proceed. At trial, Plaintiffs failed to submit adequate evidence to support an award of damages or penalties under either of their two new theories. After trial, the district court relieved Plaintiffs of their evidentiary burden, re-opened the record to receive unsworn submissions without cross-examination, and invented its own untested and unsupported methodology to estimate the number of packages and cartons containing cigarettes supposedly transported by UPS. The resulting awards of damages and penalties are not supported by legally sufficient evidence.

B. The district court adopted a 50% tax diversion rate even though the trial record establishes that the diversion rate is at most 5.4%. The resulting compensatory damages award is not supported by legally sufficient evidence.

C. The district court imposed aggregate penalties of nearly $240 million, improperly punishing UPS thrice for the same conduct. Combined or separately, the penalty awards are grossly disproportionate to the loss suffered by Plaintiffs and the gains received by UPS for the conduct at issue, and they are excessive under the pertinent common-law and constitutional factors. The penalties cannot withstand review under these substantive constraints on government-imposed punishment.

*26 STANDARDS OF REVIEW

This Court reviews *de novo* the interpretation of federal statutes and the AOD, as well as the district court's legal conclusions and its application of law to facts. *See* *Olin Corp. v. Ins. Co. of N. Am.*, 221 F.3d 307, 320 (2d Cir. 2000); *Cofacredit, S.A. v. Windsor Plumbing Supply Co.*, 187 F.3d 229, 238 (2d Cir. 1999).

The Court reviews findings of fact for clear error. *Mobil Shipping & Transp. Co. v. Wonsild Liquid Carriers Ltd.*, 190 F.3d 64, 67 (2d Cir. 1999).

The Court reviews for abuse of discretion the district court's refusal to award sanctions; its decision to re-open the record after trial; and its penalty calculations (except to the extent that the penalties are unconstitutional or unlawfully excessive). *See* *Dart Cherokee Basin Operating Co. v. Owens*, 135 S. Ct. 547, 555 (2014); *Bradford Tr. Co. of Bos. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 805 F.2d 49, 53 (2d Cir. 1986). Discretionary determinations based on "an erroneous view of the law" - which this Court reviews *de novo* - "necessarily" constitute an abuse of discretion. *Dart Cherokee*, 135 S. Ct. at 555.

*27 ARGUMENT

The liability rulings, as well as the damages and penalties awards, are infested with legal error. Correcting those errors requires reversing the judgment in its entirety or, at minimum, dramatically reducing the monetary awards.

I. UPS Is Entitled To Judgment On Each Liability Theory.

Plaintiffs' four theories of liability fail, in their entirety, for three legal reasons: (A) UPS is exempt under the PACT Act, and the PHL is preempted, because its AOD is "honored throughout the United States"; (B) UPS is not liable under the AOD because New York abandoned its claim under the knowing shipment provision and the audit provision does not authorize per-shipment penalties; and (C) UPS is not liable under the CCTA because Plaintiffs failed to establish the threshold quantity and scienter requirements.

A. The PACT Act Exempts UPS And Preempts The PHL.

Two-thirds of the penalties in this case (approximately $157 million) were awarded under two statutes - the PACT Act and the PHL - as to which federal law expressly makes UPS *not* liable. The district court's contrary conclusion depends entirely upon its misinterpretation of a single phrase in the PACT Act, which this Court reviews *de novo*.

The PACT Act exempts UPS from its requirements, and preempts Plaintiffs' New York PHL claims, if the AOD is "honored throughout the United States." 15 U.S.C. § 376a(e)(3)(B)(ii)(I), 376a(e)(5)(C)(ii). Under the PACT Act, UPS is ***28** subject *either* to the requirements of its AOD *or* to the requirements of federal and state law - not both. The "honored" provision operates as an "on/off" switch, turning on a readily discernible fact: If UPS's AOD applies nationwide, UPS is exempt from the PACT Act and the PHL is preempted (and UPS may be liable under the AOD); but if the AOD ceases to apply nationwide, UPS is subject to the PACT Act and the PHL (and UPS is not liable under the AOD) unless UPS fits within another exemption.

The PACT Act necessarily contemplates that a contract can be "honored" even if it is breached. The district court, however, held that the AOD was not "honored throughout the United States" from December 1, 2010 to February 18, 2015, because the court found that during that period UPS breached several obligations imposed by the AOD as to fifteen shipper groups located on three of the nine Indian reservations within New York State, out of the millions of shippers that UPS serves nationwide. On this basis, the court held UPS liable under the AOD *and* the PACT Act *and* the PHL - thus contravening the either/or regulatory structure enacted by Congress.

1. The AOD Is Honored Throughout The United States.

The ordinary tools of statutory construction - the statutory text, structure, and context, as well as legislative history and purpose - establish that "honored throughout the United States" means that the agreement must have nationwide ***29** operation. Because it is undisputed that UPS's AOD has applied nationwide since its inception (*see*, *e.g.*, SA9_(Dkt.49:5)), the PACT Act exempts UPS from its reach and preempts the PHL.

Text. Statutory construction begins with the text of the statute. *United States v. Dauray*, 215 F.3d 257, 260 (2d Cir. 2000). Here, verbatim, is the critical language in the PACT Act (with added emphasis):

(3) Exemptions

(A) In general *** requirements or restrictions *** shall not apply to a common carrier that -
(i) is subject to a settlement agreement described in subparagraph (B); or

(ii) if a settlement agreement described in subparagraph (B) to which the common carrier is a party **is terminated or otherwise becomes inactive**, is **administering and enforcing policies and practices throughout the United States** that are at least as stringent as the agreement.

(B) Settlement agreement A settlement agreement described in this subparagraph -

(i) is a settlement agreement relating to tobacco product deliveries to consumers; and

(ii) includes -

(I) the Assurance of Discontinuance entered into by the Attorney General of New York and DHL Holdings USA, Inc. and DHL Express (USA), Inc. on or about July 1, 2005, the Assurance of Discontinuance entered into by the Attorney General of New York and United Parcel Service, Inc. on or about October 21, 2005, and the Assurance of ***30** Compliance entered into by the Attorney General of New York and Federal Express Corporation and FedEx Ground Package Systems, Inc. on or about February 3, 2006, if each of those agreements is **honored throughout the United States** to block illegal deliveries of cigarettes or smokeless tobacco to consumers; and

(II) any other active agreement between a common carrier and 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 and that any such deliveries to consumers shall not be made to minors or without payment to the States and localities where the consumers are located of all taxes on the tobacco products.

***

(5) Preemption

(C) State laws prohibiting delivery sales
***

(ii) Exemptions No State may enforce against a common carrier a law prohibiting the delivery of cigarettes or other tobacco products to individual consumers or personal residences without proof that the common carrier is not exempt under paragraph (3) of this subsection.

The PACT Act does not define the term "honored" or use it elsewhere, and therefore it should be given its ordinary meaning. *Dauray*, 215 F.3d at 260; *see also* *United States v. Patel*, 778 F.3d 607, 613 (7th Cir. 2015). The most common vernacular meaning of the verb "honor" is to pay respect (honor thy father and mother). *E.g.*, *Honor*, Webster's Third New Int'l Dictionary (3d ed. 2002); ***31** 31 U.S.C. § 5112(n)(4)(A). That meaning does not make sense in the context of the PACT Act. But the primary *legal* definition of "honor" is to accept an obligation as valid (honor a check). *See Honor*, Black's Law Dictionary (10th ed. 2014); *see also* 15 U.S.C. § 1681a(l) ("any offer of credit or insurance to a consumer that will be honored"); 18 U.S.C. app. 2 § 2 ("before the request be honored"); 48 U.S.C. § 1921d(*o*) (providing that certain judgments not "be honored by the United States"). This meaning makes perfect sense in the PACT Act - *UPS is exempt from the Act if UPS's obligations under the AOD are accepted as valid throughout the United States*, even though UPS contracted only with New York.

Structure. The exemption at issue provides that the PACT Act's requirements "shall not apply to a common carrier that is *subject to* a settlement agreement described in subparagraph (B)." 15 U.S.C. § 376a(e)(3)(A)(i) (emphasis added). In subparagraph (B), Congress described two types of agreements that qualify a common carrier for the exemption: the existing agreements between UPS, FedEx, and DHL and New York, and unspecified "other" agreements that might arise in the future. *Id.* § 376a(e)(3)(B)(ii)(I), (II). An existing agreement qualifies for the exemption if it is "honored throughout the United States," while a new agreement qualifies if it "operates throughout the United States." *Id.* For purposes of this exemption, "honored" is synonymous with "operates."

***32** Although different terms within a statute generally have different meanings, that is "no more than a rule of thumb that can tip the scales when a statute could be read in multiple ways." *Sebelius v. Auburn Reg'l Med. Ctr.*, 568 U.S. 145, 156 (2013) (cleaned up). There is no "canon of interpretation that forbids interpreting different words used in different parts of the same statute to mean roughly the same thing." *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519, 540 (2013). Here, "honored" and "operates" perform the same function. Congress was describing two similar but not identical sets of agreements - a set of three identified contracts with the NYAG, which at the time of the PACT Act's passage applied nationwide and came within

the exemption if they continued to be "honored" nationwide; and a set of future contracts, which did not yet exist so Congress required them to "operate" nationwide, just like the existing agreements did (and do). It would make no sense to construe the PACT Act as making the exemption for *future* agreements turn on their "operat[ion]" (effect) while requiring a compliance inquiry for *existing* agreements.

The exemption makes no reference to whether a carrier is in compliance with its agreement (existing or future); rather, a carrier secures the exemption by being "subject to" an agreement that is "honored," or "operates," "nationwide." The exemption turns on the applicability of the agreement, not the carrier's compliance with that agreement as to a specific shipper or in a particular locale.

***33** *Context*. The "honored" clause must, of course, be harmonized with the rest of the statute in which it appears - including the surrounding subparts of the exemption provision. *See* *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015) (courts must read words in statutes "with a view to their place in the overall statutory scheme"); *Abramski v. United States*, 134 S. Ct. 2259, 2267 (2014) (courts must interpret statutes "with reference to the statutory context, structure, history, and purpose" (cleaned up)).

A separate exemption provides contextual confirmation that the "honored" clause does not encompass a compliance inquiry. If an AOD or other qualifying agreement "is terminated or becomes inactive," then the carrier becomes subject to the PACT Act (and state law) *unless* it is "administering and enforcing policies and practices throughout the United States that are at least as stringent as the agreement." 15 U.S.C. § 376a(e)(3)(A)(ii). Thus, only when the AOD is inactive (*i.e.*, UPS is no longer "subject to" it) does UPS's exemption turn on whether it is "administering" or "enforcing" policies or whether those policies are sufficiently "stringent." When (as here) the AOD is active, the PACT Act neither requires nor authorizes any inquiry into the company's administration or enforcement of its policies (or their stringency) because penalties for noncompliance are built into the agreement.

Yet another provision of the PACT Act exempts carriers who are otherwise subject to the Act from penalties for violating the Act's delivery requirements if they ***34** have "implemented and [are] enforc[ing] *effective* policies and practices for complying with that section [§ 376a(e)]," pretermitting any strict liability. 15 U.S.C. § 377(b)(3)(B)(i) (emphasis added). Congress's decision not to include a similar compliance inquiry in the exemption provision at issue here must be respected by the courts. *See* *Bates v. United States*, 522 U.S. 23, 29-30 (1997) ("Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion" (cleaned up)). By reading the exemption here to require an inquiry into UPS's implementation and enforcement of the AOD procedures, the district court disrupted the statutory structure.

History and purpose. The drafting history of the PACT Act provides further confirmation that Congress intended to exempt carriers with agreements that operate nationwide - including UPS's AOD - with no compliance inquiry.

An early draft of the Act contained no exemption for carriers with agreements. S. Rep. No. 110-153, at 26-30 (2007). The exemption was added following a hearing at which the bill's proponents made clear that its purpose was to prevent the Postal Service from shipping cigarettes, recognizing that UPS, FedEx, and DHL all had existing procedures set forth in contracts with the NYAG. H.R. Rep. No. 110-836, at 7 (2008). The bill's House sponsor explained that "the only [entity that] would actually be covered by this in a real practical sense is the United States Postal ***35** Service. Everyone else would already be following their status quo operations." Hearing on H.R. 4081 & H.R. 3689 Before the Subcomm. on Crime, Terrorism, & Homeland Sec. of the H. Comm. on the Judiciary, 110th Cong., at 9 (May 1, 2008).

The Senate sponsor of the PACT Act explained that, because Congress deemed the procedures set forth in the contracts to be sufficient, "this bill has been carefully negotiated with the common carriers, including UPS, to ensure that it does not place any unreasonable burdens on these businesses." 155 Cong. Rec. S5853 (daily ed. May 21, 2009). This lawsuit - in which UPS has been held liable under its AOD *and* the PACT Act *and* the PHL - is a prime example of such an "unreasonable burden." To avoid precisely this outcome for carriers with an active agreement, Congress "exempted them from the bill provided this agreement *remains in effect*." *Id.* (emphasis added).

Congress intended to exempt common carriers subject to active agreements, old or new, from the PACT Act's requirements (and from state-law requirements) if their agreements continue to have nationwide operation. To that end, Congress provided that the three carriers identified in the PACT Act itself - UPS, FedEx, and DHL - would be governed by their agreements with the NYAG rather than the PACT Act or state laws such as the PHL; that is the entire purpose of the company-specific exemption provision. Nowhere in the history of the legislation is there any indication that Congress intended a compliance inquiry as a precondition to applying ***36** the exemption to those carriers. There is no dispute that UPS remains "subject to" its AOD (which has not been "terminated" and thus "remains in effect" to this day) within the meaning of the PACT Act. Nor is there any dispute that the AOD imposes nationwide obligations on UPS, and thus applies in all 50 States. *See* SA493_(DX-23); JA1477_(DX-35). No more is required for the PACT Act's exemption and preemption provisions to apply.

2. The District Court's Contrary Construction Is Wrong.

The district court recognized that, standing alone, the phrase "honored throughout the United States" could have two meanings. SA2-3_(Dkt.37:2-3); *see also* SA19_(Dkt.49:15.n.6). It could require *either* a determination whether the AOD applies nationwide, *or* a determination whether UPS has sufficiently complied with the AOD.

At the outset, the district court correctly chose the first meaning, following a detailed analysis of the Act's text, structural context, and legislative history. The court ruled that "UPS is exempt from the PACT Act" and Plaintiffs' state-law claims are preempted "if the AOD has appropriate breadth" - *i.e.*, "if and only if the agreement has nationwide effect." SA19.n.6_(Dkt.49:15); *see also* SA1_(Dkt.37). The court stressed that the exemption "*does not purport to reach questions of compliance or non-compliance with obligations assumed under any particular agreement*." SA18_(Dkt.49:14) (emphasis added); *see also* SA19, 20_(Dkt.49:15 & ***37** n.6, Dkt.49:16). As explained above, under this approach UPS is exempt from the PACT Act and the PHL is preempted, because the AOD indisputably has nationwide operation.

On summary judgment, however, the district court reversed course and chose the second possible meaning of the "honored" clause. Without addressing the statutory text, structure, history, or purpose, the court ruled that if "the effectiveness of UPS's policies is so compromised that these policies are not in fact in place, that would be sufficient" to deprive UPS of the exemption. SA144-45_(Dkt.206:44-45); *see also* SA142, 144, 145_(Dkt.206:42, Dkt.206:44, Dkt.206:45). Subsequently, the court ruled that "if there was an absence of the AOD [only] in New York, that would be a lack of nationwide effect." JA577_(2016.06.07.Tr.77:7-9); *see* SA148_(Dkt.252). Ultimately, the court ruled that the exemption would be lost by "[p]ersistent or widespread violations wherever located." SA391_(Dkt.535:142). This line of reasoning led the court to the rudderless inquiry it conducted at trial: "[W]hen was UPS's conduct persistent *enough* and widespread *enough*?" SA392_(Dkt.535:143) (emphases added).

To satisfy due process, the standards of conduct giving rise to civil penalties must be reasonably discernible *before* the conduct giving rise to punishment occurs. *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012); *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 156 (2012). The court's construction does ***38** not comport with that command because a common carrier will know only in retrospect whether it has engaged in "enough" conduct to forfeit the exemption. The court ruled that liability would attach if "plaintiffs could present evidence of a sufficiently large number of instances of shipments

of contraband cigarettes that it suggests that UPS is, overall, turning a blind eye towards such unlawful shipments" or "evidence showing that UPS policymakers have in fact turned a blind eye to shipments of contraband cigarettes." SA145_(Dkt.206:45); *see also* SA391_(Dkt.535:142). By the court's own lights, however, this is "not a precise exercise" (SA292_ (Dkt.535:43), which is reason enough to condemn the approach.

Ironically, earlier in the litigation the district court recognized the fundamental flaw in the approach it eventually adopted, which renders it "doubtful that a carrier could ever successfully invoke the exemption at any stage prior to trial." SA144_(Dkt.206:44). The district court admitted that, without a trial, it was unable to provide *either* a factual *or* legal standard for determining whether UPS was entitled to the exemption. SA145_ (Dkt.206:45) (the court "cannot determine in the abstract precisely how much evidence of non-adherence is necessary to raise a genuine issue as to whether UPS maintains a nationwide policy in name only"). But the statutory text and history contain no hint that Congress expected that a trial on compliance would be needed to determine whether a carrier was required to follow the PACT Act.

***39** Additionally, the district court received no evidence and made no findings regarding UPS's purported non-compliance in any jurisdiction besides New York. The court thus erased the words "throughout the United States" from the exemption. § 376a(e)(3)(B)(i)(I). And although the court stated that "the mere fact of a single violation - or even several - in any state … is insufficient to demonstrate that UPS is not honoring [the] AOD" (SA392_ (Dkt.535:143)), it did not quantify what degree of non-compliance in a single State would establish that UPS was not "honor[ing]" the AOD "throughout the United States." Moreover, if UPS has achieved perfect compliance in forty-nine States (and the record here does not suggest otherwise), UPS cannot lose its exemption based on isolated incidents of non-compliance in only one State. Yet, as New York *admitted* during closing argument, "the problem was highly localized." JA1058, 1066_(TrialTr.1908:8, 1941:4-5).

At most, Plaintiffs showed that out of more than 4,000 tobacco shippers nationwide (JA1892_(DX-600:10)) - and 1.6 million daily pick-up accounts nationwide (JA1893_(DX-600:11)) - a mere *fifteen* shipper groups, all within discrete areas of upstate New York on Native American reservations, managed to ship an unknown number of cigarettes in violation of UPS's Cigarette Policy. That is 0.5% of all tobacco shippers nationwide and 0.00125% of all daily pick-up accounts nationwide, or *one shipper out of every 80,000*, all in a single state. Moreover, even this figure betrays inherent selection bias: Plaintiffs ***40** "initially … sought discovery with regard to fifty or so shippers" in New York, and "[o]ver the course of the litigation, that number was reduced." SA286.n.39_(Dkt.535:37.n.39). Given that Plaintiffs offered no evidence regarding *at least* 99.99875% of UPS's customers nationwide, the court's conclusion that the AOD is not being honored throughout the United States beggars belief even if some inquiry into compliance were warranted. *Cf.* *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 358 (2011) (testimony from one out of every 12,500 class members insufficient to even allege unlawful companywide pattern).

The district court said that "UPS's lack of commitment to … AOD compliance pervaded its corporate culture." SA265_(Dkt.535:16). The court's *sole* support for this statement was the fact that UPS did not rely on the PACT Act NCL (*id.*) - which, according to the court, was a "useful tool[] to ensure that its AOD was being 'honored.'" SA267_(Dkt.535:18); *see also* SA304_(Dkt.535:55). But the NCL is not mentioned in the AOD, which was entered into five years before the PACT Act was even enacted, and UPS was not required to follow the NCL precisely because it was exempt from the PACT Act.

As the judgment entered in this case establishes, under the district court's reading of the "honored" clause, the carriers identified by name in the PACT Act - UPS, FedEx, and DHL - could be subjected to the PACT Act and state laws such as the PHL based on isolated breaches of contractual obligations. If that construction ***41** were to be sustained, carriers with agreements would be forced to comply with the PACT Act and the PHL, in addition to their agreements, or face the kind of triple-counted, gargantuan penalties imposed by the court here. That reality establishes that the district court's construction has to be wrong, because the PACT Act was obviously designed to subject carriers *either* to their agreements *or* to the requirements of federal and state statutes.

The PACT Act exemption for common carriers subject to nationwide agreements is an on/off switch. But the district court destroyed this structure, subjecting carriers (in contravention of Congress's design) to all three liability and penalty regimes. This problem is averted by construing the "honored" clause pursuant to its plain meaning, context, and history, which makes UPS's exemption turn on a readily discernible fact: whether the agreement has nationwide operation. Because it is undisputed that the AOD operates nationwide, UPS is exempt from the PACT Act and the PHL is preempted. The liability judgment (and associated penalties) on both theories must perforce be reversed.

*42 B. UPS Is Not Liable Under The AOD.

The district court found that UPS failed to conduct audits of twenty individual shippers that UPS had reason to believe were shipping cigarettes, and on that basis alone imposed penalties of $80 million under the AOD. For each shipper, the district court found a date by which UPS should have conducted an audit, and then assessed a penalty of $1,000 for *every package* shipped by that shipper after that date (regardless of contents).

In so doing, the court misconstrued the AOD in two respects. *First*, the court erred in ruling that the AOD's penalty provision, which specifies a $1,000 penalty for each "violation," applies to UPS's breach of the audit provision, rather than only to UPS's knowing shipment of cigarettes to consumers in New York. *Second*, even if the penalty provision applies to a breach of the audit provision, the district court erred in applying the penalty to each *shipment* rather than each *shipper*.

1. The AOD Is Generally Governed By Contract Principles.

Although the court posited without further explanation that the AOD is "distinguishable in important respects from an ordinary commercial contract" (SA78.n.14_(Dkt.177:45.n.14)), the only such departure relevant to this appeal concerns the statute of limitations. The district court held that Plaintiffs' AOD claims are subject to the six-year statute of limitations applicable to contract claims, rather than the three-year limit for liabilities created or imposed by statute. ***43** SA407_(Dkt.535:158); *compare* N.Y.C.P.L.R. § 213(2) *with* N.Y.C.P.L.R. § 214(2). But the three-year limitations period in Section 214(2) applies "where liability would not exist but for a statute." *Gaidon v. Guardian Life Ins. Co. of Am.*, 96 N.Y.2d 201, 208 (2001) (cleaned up). And because N.Y. Exec. L. § 63(15) and N.Y. Exec. L. § 63(12) granted New York the authority to enter into the AOD based wholly on purported violations of the PHL, the AOD - and UPS's purported liability thereunder - would not exist but for those statutes. SA493_(DX-23:1); *see also* SA250.n.3_ (Dkt.535:1.n.3). The New York Court of Appeals is currently considering which limitations period governs claims under N.Y. Exec. L. § 63(12). *See People v. Credit Suisse Sec. (USA) LLC*, No. APL-2017-00056 (N.Y. 2017). Under Section 214(2)'s three-year limitations period, New York's claims for shipments before September 18, 2011 are time-barred.

Otherwise, the district court correctly recognized that "the AOD functions as a contract." SA167_(Dkt.355:11); *see also* SA67_(Dkt.177:34) ("[t]he State's position in asserting its AOD claim is akin to that of a private contracting party"); SA407_(Dkt.535:158). General contract principles apply to assurances of discontinuance under New York law. *See* *MBIA Inc. v. Fed. Ins. Co.*, 652 F.3d 152, 171 (2d Cir. 2011); *Whitehaven S.F., LLC v. Spangler*, 633 F. App'x 544, 547 (2d Cir. 2015) (summary order). Several such principles are pertinent here.

***44** *First*, "[c]ourts may not by construction add or excise terms, nor distort the meaning of those used and thereby make a new contract for the parties under the guise of interpreting the writing." *ACE Sec. Corp. v. DB Structured Prods., Inc.*, 25

N.Y.3d 581, 597 (2015) (cleaned up). Relatedly, contracts "should not be interpreted to render them illegal and unenforceable where the wording lends itself to a logically acceptable construction that renders them legal and enforceable." *NLRB v. Local 32B-32J Serv. Emps. Int'l Union*, 353 F.3d 197, 202 (2d Cir. 2003) (cleaned up). A court is "not free to alter the contract to reflect its personal notions of fairness and equity." *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 570 (2002).

Because New York entered into the AOD to avoid federal preemption of the PHL, the overlay of federal law "confine[s]" the agreement "to the parties' bargain, with no enlargement or enhancement based on state laws or policies external to the agreement." *Am. Airlines, Inc. v. Wolens*, 513 U.S. 219, 233 (1995). Thus, UPS's liability under the AOD is limited to the AOD's express terms as a matter of both New York contract law and federal law. This preemptive limit is particularly important because of UPS's federal obligation to transport packages on reasonable request from any customer (49 U.S.C. § 14101(a)) - including those located on Native American reservations. (In other words, the district court's not-so-subtle suggestion that UPS should simply decline to pick up packages from Indian retailers ***45** (*e.g.*, SA226_(Dkt.406:26)), not only condones discrimination but contravenes UPS's federal service obligation.)

Second, the generally applicable default contract rules apply to this dispute, unless a statute specifies otherwise or the parties expressly agreed to depart from those rules. *See*, *e.g.*, *Whitehaven*, 633 F. App'x at 546-47; *see also Dolman v. U.S. Tr. Co. of N.Y.*, 2 N.Y.2d 110, 116 (1956); Restatement (Second) of Contracts § 5 (1981). In particular, the default remedy for a breach of a contract's obligations is the aggrieved party's actual damages (or in appropriate circumstances non-damages remedies such as a declaration or specific performance), obtained through a breach-of-contract action. *U.S. Naval Inst. v. Charter Commc'ns, Inc.*, 936 F.2d 692, 696 (2d Cir. 1991); *see* Williston on Contracts § 64:1 (4th ed.) ("the disappointed promisee is generally entitled to an award of money damages in an amount reasonably calculated to make him or her whole and neither more nor less; any greater sum operates to punish the breaching promisor and results in an unwarranted windfall to the promisee").

"The parties to a contract are not free to provide a penalty for its breach." Restatement (Second) of Contracts § 356. Under New York law, liquidated damages provisions that apply to the breach of any obligation under the agreement are *by definition* unconscionable. *John T. Brady & Co. v. Form-Eze Sys., Inc.*, 623 F.2d 261, 263 (2d Cir. 1980); *see also* ***46** *NewCSI, Inc. v. Staffing 360 Sols., Inc.*, 865 F.3d 251, 261 (5th Cir. 2017) (applying New York law); *Seidlitz v. Auerbach*, 230 N.Y. 167, 173 (1920). Courts therefore presume that penalty provisions apply only to specified acts that go to "the root of the agreement between the parties," *Process Am., Inc. v. Cynergy Holdings, LLC*, 839 F.3d 125, 136 (2d Cir. 2016) (cleaned up), not to "trivial breaches," *United Air Lines, Inc. v. Austin Travel Corp.*, 867 F.2d 737, 741 (2d Cir. 1989) (citing *Hackenheimer v. Kurtzmann*, 235 N.Y. 57, 66 (1923)). That is because "punitive awards are not part of the law of contract damages." *U.S. Naval Inst.*, 936 F.2d at 696. Yet, as explained below, the district court read the AOD as imposing a $1,000 stipulated penalty for any breach of any provision, no matter how technical or ministerial.

Finally, the construction of unambiguous contract terms is reviewed *de novo*. *Olin*, 187 F.3d at 320. The district court found "the relevant provisions of the AOD to be unambiguous." SA379_(Dkt.535:130).

2. The District Court Misconstrued The AOD In Two Critical Respects.

Given the nature of UPS's business - transporting plain, brown boxes, SA278_ (Dkt.535:29) - UPS and New York carefully negotiated a complex agreement with procedural requirements designed to minimize cigarette shipments. The AOD requires UPS to enforce its Cigarette Policy (SA498-99_(DX-23:6-7)); notify shippers of that policy (SA500_(DX-23:8)); maintain a database of potential cigarette shippers (SA499-501_(DX-23:7-9)); audit shippers that it has reason to ***47**

believe are shipping cigarettes (SA501, 507_(DX-23:9, DX-23:15)); discipline shippers that UPS learns do ship cigarettes (SA502-05_(DX-23:10-13); train its employees (SA505-06_(DX-23:13-14); and provide the NYAG with information about its compliance upon request (SA507-08_(DX-23:15-16). *The AOD is silent as to the consequences for a breach of these provisions*. Therefore, the default rules of contract law apply: New York's remedy in the event of breach is to seek compensatory damages or non-monetary relief. Here, however, New York never sought common-law contract remedies - and thus forfeited any claim to such remedies.

a. The Penalty Provision Applies Only To The Knowing Shipment Of Cigarettes To Individual Consumers.

The AOD contains a single departure from standard breach-of-contract remedies, Paragraph 42, in which UPS and New York agreed that a stipulated penalty of $1,000 would apply to knowing shipments of cigarettes, the core conduct at which the AOD - like the PHL - was aimed. It provides:

> UPS shall pay to the State of New York a stipulated penalty of $1,000 for each and every violation of this Assurance of Discontinuance occurring after the Effective Date; provided, however, that no penalty shall be imposed if (a) the violation involves the shipment of Cigarettes to an Individual Consumer outside the State of New York, or (b) the violation involves the shipment of Cigarettes to an Individual Consumer within the State of New York, but UPS establishes to the reasonable satisfaction of the Attorney General that UPS did not know and had no reason to know that the shipment was a Prohibited Shipment.

***48** SA508_(DX-23:16).

As the district court explained, however, Plaintiffs "*seek penalties only for violations of the audit obligation* in ¶ 24." SA385_(Dkt.535:136) (emphasis added). Therefore, because the $1,000 stipulated penalty for "violations" is limited to knowing shipments under Paragraph 42 - as UPS has maintained throughout this proceeding - UPS is not liable under the AOD. *Broadway Delivery Corp. v. United Parcel Serv. of Am., Inc.*, 651 F.2d 122, 126 (2d Cir. 1981) (plaintiffs abandoned claim by "fail[ing] to pursue it at trial," and this Court "will not relieve a party of the effect of its procedural default, except in the most extraordinary circumstances to prevent a miscarriage of justice").

i. Paragraph 42 provides a stipulated $1,000 penalty for "violation[s]," and divides those "violations" into two categories that cover the universe of "shipment[s] of Cigarettes to an Individual Consumer": shipments to a consumer "outside the State of New York" and shipments to a consumer "within the State of New York." SA508_(DX-23:16). Penalties are available only for the latter violations. UPS can avoid any penalty if New York is satisfied that UPS did not know or have reason to know that the shipment was a Prohibited Shipment (SA508_ (DX-23:16)) - defined as "any package containing Cigarettes tendered to UPS where the shipment, delivery or packaging of such Cigarettes would violate Public Health Law § 1399-*ll*." SA498_(DX-23:6).

***49** The context of the AOD's negotiation confirms that the penalty was limited to the knowing transportation of cigarettes to consumers. The PHL provides penalties only for the knowing transportation of cigarettes within New York to a person that UPS reasonably believes is unauthorized to receive them. § 1399-*ll*(2). New York agreed to the AOD in light of the looming threat of federal preemption of the PHL, receiving a contractual agreement that UPS would pay a penalty for identical conduct. As a matter of *federal* law, that agreement must be strictly limited to its terms. *Wolens*, 513 U.S. at 233.

Other provisions are consistent. The AOD provides that UPS and New York entered into the agreement to ensure "UPS's compliance with [the] PHL." SA496-97_(DX-23:4-5). New York accepted the AOD "in lieu of commencing a civil action against UPS for the Alleged Past Violations" of the PHL. SA497_(DX-23:5). UPS may describe the AOD as a "voluntar[y] agree[ment] … to prohibit the shipment of Cigarettes to Individual Consumers in the United States." SA510-11_(DX-23:18-19). And if UPS terminates the agreement because the PHL is amended or repealed, New York has the right to seek relief for "violations of [the AOD] … that occurred during the period in which [the AOD] was in effect." Put differently, if New York loses the ability to seek remedies for PHL violations, AOD violations are *substitutes* for those violations, which makes sense only if AOD violations are knowing shipments. SA509-10_(DX-23:17-18).

***50** Throughout the AOD, the term "violation" describes knowing cigarette shipments. The agreement defines "Alleged Past Violations" - the obverse of a future "violation" - as UPS's delivery of "packages containing cigarettes to persons who were not authorized to receive them pursuant to PHL § 1399-*ll* in violation of PHL § 1399-*ll*(2)." SA495_(DX-23:3). The AOD defines "Potential Violations" only as shipments. SA507_(DX-23:15) (if New York presents "evidence that a UPS customer is shipping Cigarettes to Individual Consumers," UPS shall discipline the shipper); SA507_(DX-23:15) (if New York represents that "a UPS customer is shipping Cigarettes to Individual Consumers," UPS shall audit the shipper).

If UPS did not know that a particular shipment was a "Prohibited Shipment," equated to "violation" in the penalty provision itself, *no penalty applies*. SA508_(DX-23:16). Similarly, under the heading "Restrictions," the AOD provides that "UPS shall comply with PHL § 1399-*ll*(2), and adhere to the UPS Cigarette Policy … prohibiting the shipment of Cigarettes to Individual Consumers in the United States." SA498-99_(DX-23:6-7). The only non-shipment requirements listed under the heading "Restrictions" are that UPS must promulgate its Cigarette Policy, refrain from amending it to be inconsistent with the AOD, and revise and maintain its delivery policies and procedures in accordance with the AOD. SA499_(DX-23:7).

***51** The AOD also sets forth a progressive mechanism for disciplining shippers. SA502-05_(DX-23:10-13). In this context, the term "violation" refers exclusively to the knowing shipment of cigarettes: "The violations found to have occurred pursuant to [the AOD] … shall be applied both to the shipper committing the violation, and to any other shipper … that UPS has a reasonable basis to believe" is shipping for a suspended shipper. SA504-05_(DX-23:12-13). Attributing to a shipper a so-called "violation" of some other obligation that the AOD imposes on UPS would be a *non sequitur*. And the AOD repeatedly uses the term "violation" to refer to "violation[s] of the UPS Cigarette Policy": shipments of cigarettes to individual consumers. *E.g.*, SA505_(DX-23:13).

Still more provisions reinforce this point. UPS's Cigarette Policy is described as "expressly prohibiting the shipment of cigarettes to individual consumers in the United States." SA496-97_(DX-23:4-5). The AOD explains that UPS educated its drivers about the PHL's "delivery restrictions" and instructed them "not to load for delivery, or deliver, packages in violation of [the] PHL." SA496_(DX-23:4). The entire focus of the AOD is prohibiting the knowing shipment or transportation of cigarettes; the various obligations it imposes are means to that end, not ends in themselves.

ii. Abjuring the text and structure of the AOD, the district court ruled that the AOD allows New York to recover the stipulated $1,000 penalty for *any* breach of ***52** *any* obligation in the contract, and in particular the AOD's audit obligation, whatever the gravity of the breach or UPS's scienter. SA380-83_ (Dkt.535:131-34). In the court's view, "the parties could have limited monetary penalties to only shipments of cigarettes by agreeing that violations of certain AOD obligations would be treated differently from violations of other AOD obligations … [b]ut they did not." SA383_(Dkt.535:134). That is exactly backwards as a matter of contract interpretation. Standard contractual remedies apply *unless* the parties make an express exception. *Whitehaven*, 633 F. App'x at 546-47; *Dolman*, 2 N.Y.2d at 116. Here, the parties provided stipulated penalties only for the

knowing transportation of cigarettes to consumers in New York. For all the other provisions, standard contract remedies are available.

The district court rejected the plain-language construction because the court believed that it "would mean that UPS could fail to comply with any of the host of other obligations *without consequence*." SA381_(Dkt.535:132) (emphasis added). But the penalty provision is not - as the district court believed - "a method to ensure compliance with all of the AOD obligations" (SA381_ (Dkt.535:132)); that is the role of *contract law itself*, which is why the AOD reserves all other rights of the NYAG and requires UPS to apprise the NYAG of its performance under the agreement. *See* SA507-08, 510-11_(DX-23:15-16, DX-23:18-19). The consequence for a breach of contract is an action for breach, with the attendant contract-law ***53** remedies - compensatory damages and appropriate non-monetary relief. *U.S. Naval Inst.*, 936 F.2d at 696. In concluding that the penalty provision provides New York's exclusive remedy under the AOD, therefore, the district court brushed aside centuries of contract jurisprudence as well as the plain language of the AOD itself.

The district court said that the penalty provision "*expressly equates* a 'violation' to a failure by UPS to fulfill its obligations under the AOD." SA380_(Dkt.535:131) (emphasis added). But there is no such "equat[ion]" in the AOD, express or implied. To the contrary, both the express terms of the penalty provision (SA508_(DX-23:16)) and the clear implications from context "equate []" a violation with a knowing shipment of cigarettes, as explained above. The various other obligations under the AOD have no scienter requirement and any departure from those obligations leads to ordinary contract remedies, not the stipulated penalty. *E.g.*, SA499-501_(DX-23:7-9) (requiring UPS to maintain records and a database of potential cigarette shippers). This reading, unlike the district court's, is consistent with New York law requiring that contractual penalties reasonably approximate the damages resulting from the breach. *JMD Holding Corp. v. Congress Fin. Corp.*, 4 N.Y.3d 373, 380 (2005).

Permitting a $1,000 penalty for any breach, no matter how minor, would have perverse consequences. Many of the AOD's requirements are ministerial. For example, the AOD requires UPS to record the contact person for a shipper it ***54** identifies as a Cigarette Retailer. SA501_(DX-23:9). If, however inadvertently, UPS neglected to include a contact name, UPS would be subject (under the court's interpretation) to a $1,000 penalty for each package transported from that shipper. No commercially reasonable contracting party - and certainly not one with UPS's massive scope of nationwide operations (SA262-63_(Dkt.535:13-14)) - would ever agree to a $1,000 penalty for every foot-fault, *even if unintentional*, particularly when the background state law contains a scienter requirement. That would be unconscionable by definition. *See Form-Eze*, 623 F.2d at 263; *NewCSI*, 865 F.3d at 261; *Seidlitz*, 230 N.Y. at 173. At the same time, New York agreed to allow UPS to avoid penalties for actual cigarette shipments if it could prove that it lacked the requisite scienter. SA508_(DX-23:16). It would defy reason for the parties to have agreed to strict liability for recordkeeping violations but a good-faith defense to the substantive conduct at which the entire agreement (like the PHL) is aimed: knowing cigarette shipments.

iii. As the district court repeatedly noted, "Plaintiffs seek penalties only for violations of the AOD's audit obligation. In other words, plaintiffs seek penalties only for violations of ¶ 24 and not … [¶ 42]." SA384_(Dkt.535:135); *see also* SA386_(Dkt.535:137) ("plaintiffs are not seeking the imposition of AOD penalties for knowing shipments"); SA369, 385, 392, 462_(Dkt.535:120, Dkt.535:136, Dkt.535:143, Dkt.535:213). New York's unequivocal abandonment renders ***55** irrelevant the district court's statement that "[o]n numerous occasions, UPS knowingly transported shipments containing cigarettes to Individual Consumers, in violation of ¶ 42." SA382_(Dkt.535:133). Even if this statement were correct, New York could not collect any penalties under the AOD; but the court's statement is wrong as a matter of law.

As the district court acknowledged, "[t]he questions of whether UPS 'knew' packages included cigarettes and, if so, when, are mixed questions of law and fact." SA313.n.56_(Dkt.535:64.n.56). Such mixed questions are reviewed *de novo* by this Court. *Kreisler v. Second Ave. Diner Corp.*, 731 F.3d 184, 187 n.2 (2d Cir. 2013). The district court further acknowledged that its

"knowledge" findings "specifically incorporat[e] and apply[]" the "legal principles" set forth elsewhere in the liability order. SA313.n.56_(Dkt.535:64.n.56). Those legal principles are also reviewed *de novo*. *Olin*, 221 F.3d at 320.

The district court assessed knowledge only at the shipper level: "The knowledge at issue in this case concerns UPS's knowledge that certain shippers were tendering packages containing cigarettes." SA399_(Dkt.535:150); *see id.* (making "findings" "[a]s to each shipper"); SA403_ (Dkt.535:154) (imputing "knowledge" of facts "vis-à-vis the Liability Shippers"); SA405_ (Dkt.535:156) (imputing "knowledge" "that certain of [UPS's] clients were shipping cigarettes"). But in marked contrast to the PACT Act, which prohibits transportation of packages from ***56** shippers on the NCL, Paragraph 42 of the AOD requires knowledge at a shipment level, providing for penalties for knowingly transporting "Prohibited Shipments" - defined with reference to "package[s]," not shippers. SA508_(DX-23:16); *see id.* (allowing UPS to avoid penalties for a package if it did not know that "*the* shipment was *a* Prohibited Shipment" (emphasis added)). Indeed, as discussed above, the AOD consistently refers to "violations" in terms of shipments, not shippers.

The district court made no finding that any of the 80,468 packages for which it awarded penalties under the AOD's audit provision constituted "Prohibited Shipments" under Paragraph 42. As an obvious example, the district court awarded audit penalties for three shippers (Native Outlet, A.J.'s Cigars, and RJESS) while ruling that there was insufficient evidence to establish that they actually shipped cigarettes - meaning that *none* of the packages from those shippers for which the court awarded AOD penalties were Prohibited Shipments. *See* SA359-65_(Dkt.535:110-16). And many of the packages shipped by the other shippers did not contain cigarettes at all, so they could not have been "Prohibited Shipments" for which UPS was liable for penalties under the AOD. *See* SA508_(DX-23:16). New York certainly did not prove, and the court did not find, the total number of packages (if any) containing cigarettes that UPS knowingly delivered to individual consumers in New York. Therefore, even had New York not abandoned its claim, as a matter of law New York could not recover any penalties under Paragraph 42.

***57 b. The Audit Provision Requires UPS To Audit Shippers, Not Shipments.**

"Plaintiffs seek penalties *only* for violations of the AOD's audit obligation." SA384_(Dkt.535:135) (emphasis added). As just explained, the $1,000 stipulated penalty is limited to knowing shipments; it does not apply to the audit obligation. But *even if* UPS's failure to audit could be considered a "violation" of the AOD, the district court also misconstrued the audit provision itself, leading to massively overinflated penalties. Paragraph 24 provides:

> UPS shall audit shippers where there is a reasonable basis to believe that such shippers may be tendering Cigarettes for delivery to Individual Consumers, in order to determine whether the shippers are in fact doing so.

SA501_(DX-23:9). At most, UPS breached this provision only once per shipper, meaning that the *maximum* available penalty is $20,000 (based on the twenty individual shippers for which the district court found AOD liability). The $80 million penalty imposed by the district court - *4,000 times greater* - is based on a legally erroneous rewriting of the contract to give New York something it never bargained for (and UPS never agreed to).

i. On its face, the AOD's audit provision imposes a per-*shipper* obligation. UPS must "audit shippers," not shipments - indeed, Paragraph 24 uses the term "shippers" twice, and the term "shipments" not at all. The audit provision must be "enforced according to the plain meaning of its terms." *Lockheed Martin Corp. v.* ***58** *Retail Holdings, N.V.*, 639 F.3d 63, 69 (2d Cir.

2011); *see* *ACE Sec.*, 25 N.Y.3d at 597. The AOD does not contain specific procedures for conducting an audit and "audit" is not a defined term, nor does the AOD require UPS to open every package tendered by a shipper that UPS is required to audit.

As a whole, the AOD shows that UPS's audit obligations are shipper-oriented, as it consistently lays out UPS's responsibilities with reference to "shippers." *See* *Kinek v. Paramount Commc'ns, Inc.*, 22 F.3d 503, 509 (2d Cir. 1994) ("all provisions of a contract [must] be read together as a harmonious whole, if possible"). For example, UPS must investigate shippers on the internet "to determine whether these shippers in fact ship Cigarettes," and "conduct audits of such shippers to the extent required by Paragraph 24." SA500_(DX-23:8); *see also* SA499-500_(DX-23:7-8). UPS must maintain records of "the results of audits of any Cigarette Retailers." SA501_(DX-23:9). Upon the State's representation of a Potential Violation, UPS "shall conduct an audit of that shipper." SA507_(DX-23:15). *See also* SA496_(DX-23:4) (UPS conducted an unannounced audit of ten shippers); SA500_(DX-23:8) (UPS must correspond with suspected cigarette shippers); SA501_(DX-23:9) (UPS must maintain cigarette shipper database); SA502-05_(DX-23:10-13) (UPS must discipline cigarette shippers); SA502_(DX-23:10) (UPS must suspend delivery services for willful cigarette shippers). Thus, a failure ***59** to audit a shipper would (if penalties applied) result in only one penalty - a penalty for failing to audit that shipper.

ii. The district court held that interpreting the audit provision as imposing a requirement to audit shippers, not shipments, would be "unreasonable." SA384_ (Dkt.535:135). But the district court had no power, under state or federal law, to substitute its own notions of "reasonableness" for the parties' agreement. Whether or not the district court thought it reasonable, the contract limits the audit obligation to shippers, and it *must* be enforced according to its terms. Indeed, the court's reliance on what it viewed as "reasonable," rather than what the contract says, shows that the court impermissibly rewrote the AOD. (The court made this error repeatedly. As another example, the AOD requires UPS to provide annual training on the Cigarette Policy to drivers (SA506_(DX-23:14)); but the district court ruled that UPS "breached" this obligation because, even though annual training was provided, the court did not think it sufficiently effective. SA270-71_ (Dkt.535:21-22).)

In departing from the contractual language, the district court held that UPS agreed to pay a $1,000 penalty for *every shipment* from a shipper that UPS was obligated to audit, until UPS audited that shipper, *regardless of the package's contents*. Of course, the AOD does not say that, and UPS would never have agreed to it. *See* *ACE Sec.*, 25 N.Y.3d at 597 (New York courts are "extremely reluctant to ***60** interpret an agreement as impliedly stating something which the parties have neglected to specifically include"). The court reasoned, however, that interpreting the AOD as requiring UPS to audit shippers, not shipments, would create a perverse incentive not to audit because "the penalty UPS would incur would be the same on day one as on day 300 ($1,000)." SA384-85_ (Dkt.535:135-36). But nothing supports the court's premise that a $1,000 per-shipper penalty would not adequately incentivize UPS to comply with its audit obligation. Moreover, a contract's incentives are entirely a function of the parties' agreement; a court may not blue-pencil contract terms to change that agreement after the fact. *See* *ACE Sec.*, 25 N.Y.3d at 597; *Greenfield*, 98 N.Y.2d at 570.

The district court's revisions to the AOD's terms would, bizarrely, mean that UPS has a good-faith defense to penalties for the AOD's core prohibition - knowingly transporting cigarettes - but no good-faith defense for purported breaches of the audit obligation. And while UPS could avoid a penalty by showing that it did not know that a particular shipment contained cigarettes, UPS would have no opportunity to persuade New York that it had no reason to suspect, and thus audit, a particular shipper. Given that UPS negotiated these defenses to the knowing shipment prohibition, it is not conceivable that UPS would have agreed to penalties, regardless of package contents, in the context of the audit provision.

***61** Simply put, UPS did not agree to a $1,000 penalty for every shipment in settlement of a dispute about a statute (the PHL) that penalized *only* the knowing transport of packages containing cigarettes. Nor would any reasonable common carrier make such a deal. Even apportioning the nationwide revenue and profit amounts for all alleged shippers to the packages on which the

court found liability (which grossly overstates the numbers), UPS earned less than $65 dollars in revenue and $6 in profit on average. Thus, agreeing to pay $1,000 per unaudited package would make no commercial sense. New York cannot recover more than it bargained for - particularly where it could not prove that UPS knowingly transported cigarettes and made the strategic decision not to seek breach-of-contract damages under the AOD.

iii. The district court found that UPS breached the audit obligation as to twenty shippers, who (by the court's count) collectively shipped 80,468 packages within New York after the dates on which the court found that UPS should have audited each shipper. SA481_(Dkt.536:13). The court then multiplied this package count by $1,000 to arrive at $80,468,000 in AOD penalties. SA481_ (Dkt.536:13). But those 80,468 packages (whatever their contents) were shipped by only twenty individual shippers (SA316-63_Dkt.535:67-114) and, thus, even if UPS breached the audit obligation with respect to each of those shippers, the maximum penalty under the AOD is $20,000.

*62 C. UPS Is Not Liable Under The CCTA Because The Threshold Quantity And Scienter Requirements Were Not Met.

The final basis on which the district court found UPS liable was the CCTA, which provides that it is unlawful "knowingly to ship, transport, receive, possess, sell, distribute, or purchase contraband cigarettes." 18 U.S.C. § 2342(a). The CCTA defines "contraband cigarettes" as "a quantity in excess of 10,000 cigarettes" that lack tax stamps and "which are in the possession of any person" that is unauthorized. *Id.* § 2341(2). Congress enacted the CCTA to address "the serious problem of organized crime and other large scale operations of interstate cigarette bootlegging." S. Rep. No. 95-962 (1978), at *3. The threshold quantity requirement was intended to ensure that liability was limited to major traffickers, rather than "casual smuggler[s]" of "small quantities of cigarettes for themselves or their friends." *Id.* at *6; *see also id.* at *8.

The district court committed two legal errors: (1) aggregating separate shipments of cigarettes to meet the CCTA's quantity requirement; and (2) failing to apply the CCTA's knowledge requirement to each element of the offense. Correcting these errors requires reversal of the judgment under the CCTA, because Plaintiffs did not establish an essential element of their claims - the knowing transportation of a quantity in excess of 10,000 unstamped cigarettes.

*63 1. Aggregation Is Impermissible.

The CCTA does not criminalize 50 shipments of a carton of cigarettes (or 500 shipments of a pack of cigarettes, or 10,000 shipments of one cigarette), but, rather, a single act of transporting 10,000 cigarettes. *United States v. Spears*, 697 F.3d 592, 600 (7th Cir. 2012) ("where a statute imposes a quantity threshold for a possession offense, the government must prove that the defendant possessed the minimum quantity at a particular time").

Congress's use of the term "*a quantity*" - singular - "in excess of 10,000 cigarettes" demonstrates that a single shipment must meet the quantity threshold. *Cf.* *United States v. Winston*, 37 F.3d 235, 240 (6th Cir. 1994) (interpreting possession statute and holding that it was "obvious … from its use of the phrase '*a* violation' - that this section refers to a *single* violation," precluding aggregation). That requirement ensures that the provision will reach large-scale traffickers but not "casual smugglers." Just as a consumer does not violate the CCTA by transporting a carton of unstamped cigarettes, that consumer does not violate the CCTA by doing so every week for a year (thereby transporting 52 cartons, or 10,400 cigarettes over time). *See*, *e.g.*, *City of New York v. Tavares*, No. 15-cv-5089, 2016 WL 7912006, at *3 (E.D.N.Y. Dec. 23, 2016) (on "each of the twenty-seven occasions" when defendant "purchased more than 50 cartons of untaxed cigarettes … and transported them … , his conduct fell within the scope of the CCTA" (citation omitted)), *rept.* ***64** *& rec. adopted sub nom. City of New York v. Khashman*, No. 15-cv-5089, 2017

WL 325250 (E.D.N.Y. Jan. 20, 2017); *cf.* *Winston*, 37 F.3d at 241 (aggregation under possession statute would contravene Congress's intent by allowing prosecution of "small-time dealers or users who never possess more than a few grams at a time").

The district court, however, ruled that UPS violated the CCTA because it transported more than 10,000 cigarettes *in the aggregate*, and then assessed damages based on the total number of cartons purportedly transported. SA16-17_ (Dkt.49:12-13); SA97_(Dkt.177:64); SA420_(Dkt.535:171). The court followed a line of district court cases holding that such aggregation is permitted because "other provisions of the CCTA … contain an explicit per-transaction requirement." *City of New York v. Gordon*, 1 F. Supp. 3d 94, 103 (S.D.N.Y. 2013). But each of those other provisions imposes obligations (recordkeeping, reporting, etc.) on shippers, sellers, and distributors of cigarettes who lawfully deal in sufficiently large quantities of cigarettes. §§ 2342(b), 2343(a). Because regulated entities must keep records and submit reports of stamped cigarettes, not "contraband cigarettes," Congress had to repeat the per-transaction requirement in each of these provisions (*e.g.*, "in a single transaction," § 2343(a)), rather than incorporate it through use of the term "contraband cigarettes."

Moreover, the district court (like the decisions on which it relied) failed to recognize that the CCTA specifically "include[s] aggregation" in another section, ***65** which "indicat[es] that Congress specifically excluded aggregation" from the definition of "contraband cigarettes." *United States v. Farkas*, 935 F.2d 962, 966 (8th Cir. 1991). In § 2343(b), the CCTA imposes a reporting requirement on any person "who engages in a delivery sale, and who ships, sells, or distributes *any* quantity in excess of 10,000 cigarettes … *within a single month*." *Id.* (emphases added). Had Congress intended to allow similar aggregation as to the threshold quantity, it would have defined "contraband cigarettes" as the transport of "any quantity" (instead of "a quantity") in excess of 10,000 cigarettes "within a single month" or "within a single year." *Cf.* *United States v. Russell*, 908 F.2d 405, 407 (8th Cir. 1990) ("separate and distinct instances of possession cannot be combined in order to meet the minimum numerical threshold"); *United States v. Lee*, 317 F.3d 26, 39 (1st Cir. 2003) (where a quantity limitation "defines the scope of a single crime," it "cannot coherently be read as an attempt to aggregate separate crimes").

This Court has not yet weighed in on the aggregation issue (*see* SA98_ (Dkt.177:65)), but other courts of appeals recognize that by prohibiting transactions in "contraband cigarettes," the CCTA makes quantity a threshold element of the offense. *See United States v. Khan*, 771 F.3d 367, 376-77 (7th Cir. 2014); *Grey Poplars Inc. v. One Million Three Hundred Seventy One Thousand One Hundred (1,371,100) Assorted Brands of Cigarettes*, 282 F.3d 1175, 1178 (9th Cir. 2002); *United States v. Elshenawy*, 801 F.2d 856, 857 (6th Cir. 1986); *cf.* *United* ***66** *States v. Hasan*, 718 F.3d 338, 344 (4th Cir. 2013). Because Plaintiffs did not prove as to each shipment for which the court held UPS liable that UPS transported more than 10,000 unstamped cigarettes, and because the court made no such finding, the CCTA judgment must be reversed.

2. Plaintiffs Failed To Establish UPS's Knowledge.

The district court ruled in the alternative that the "'10,000 cigarette' quantity requirement" was met based on testimony from two shipper groups that they shipped more than 10,000 cigarettes. SA419_(Dkt.535:170); *see* JA869_ (TrialTr.1152:23-1153:11) (Mohawk); JA1001_(TrialTr.1680:8-22) (Jacobs). The court ruled that "[t]his is alone sufficient to establish this element of a CCTA violation" *with respect to all shipments from all shippers.* SA419_ (Dkt.535:170). But Plaintiffs did not prove - and the court did not find - that UPS *knew* it was transporting unstamped cigarettes *in excess of 10,000 at a time* in shipments from those two shippers. And there was no proof at all that UPS actually transported shipments containing in excess of 10,000 cigarettes for any of the other thirteen shipper groups, let alone that UPS *knowingly* did so.

"[D]espite the legal cliché 'ignorance of the law is no excuse,'" courts "ordinarily read a phrase in a criminal statute that introduces the elements of a crime with the word 'knowingly' as applying that word to each element." *Flores-Figueroa v. United States*, 556 U.S. 646, 652 (2009). This Court is "require[d]" to read the ***67** mens rea provided in the CCTA, "knowingly," to apply to each element that "is necessary to separate wrongful conduct from 'otherwise innocent conduct.'" *Carter v. United States*, 530 U.S. 255, 269 (2000); *see United States v. X-Citement Video, Inc.*, 513 U.S. 64 (1994); *Staples v. United States*, 511 U.S. 600 (1994); *Liparota v. United States*, 471 U.S. 419 (1985); *Morrissette v. United States*, 342 U.S. 246 (1952). Thus, a defendant "must 'know the facts that make [its] conduct fit the definition of the offense,' even if [it] does not know that those facts give rise to a crime." *Elonis v. United States*, 135 S. Ct. 2001, 2009 (2015) (quoting *Staples*, 511 U.S. at 608 n.3). Contrary to Plaintiffs' position below, the glancing reference to "knowledge" in *United States v. Morrison*, 686 F.3d 94, 107 (2d Cir. 2012), does not resolve the issue presented in this appeal.

To make UPS's conduct "fit the definition of the offense" (*Elonis*, 135 S. Ct. at 2009), and to establish each violation of the CCTA, Plaintiffs had to prove that UPS *knew* that a particular shipment contained a quantity in excess of 10,000 unstamped cigarettes, not simply - as the district court held - that "UPS[] kn[ew] that certain shippers were tendering packages containing cigarettes." SA399_(Dkt.535:150). Plaintiffs did not prove as much, even as to shipments from the two shippers who testified about shipments in excess of 10,000 cigarettes. (And even if they had, CCTA liability would be limited to those shipments that exceeded 10,000 cigarettes; but the district court made no finding regarding which, if any, ***68** particular shipments cleared that hurdle.) As to the other thirteen shippers, Plaintiffs provided no evidence even to establish that UPS transported packages containing more than 10,000 cigarettes from those shippers - and no evidence that UPS knew that it did so. Without such proof, there is no legally sufficient evidence on which to base a conclusion that UPS "knowingly … transport[ed] … contraband cigarettes." § 2342(a). The CCTA judgment therefore must be reversed.

***

For the reasons set forth above, each of Plaintiffs' claims that proceeded to trial fails as a matter of law:
• UPS is exempt from the PACT Act because the AOD has at all times been "honored" throughout the United States, and the PHL is preempted for the same reason;

• The AOD's stipulated penalty provision does not apply to audit failures, and if it does the penalty can only be assessed on a per-shipper basis; and

• The CCTA's threshold quantity and knowledge requirements were not met.

***69 II. The Damages And Penalties Awards Cannot Stand.**

Even if one or more liability theories could be sustained, this Court should reverse the damages and penalties awards because (A) Plaintiffs' damages and penalties requests were plagued by fatal substantive and procedural errors before, during, and after trial, resulting in factually and legally deficient monetary awards; (B) the compensatory damages award is not supported by legally sufficient evidence; and (C) the penalty awards are multiplicative, disproportionate, and excessive.

A. The Court Erred In Relieving Plaintiffs Of Their Evidentiary Burden Before, During, And After Trial.

Flouting Rule 26(a)'s mandatory disclosure requirements, Plaintiffs withheld their damages and penalties calculations, methodologies, and evidentiary bases from UPS before trial. After the district court refused to preclude their claims for monetary relief, Plaintiffs repeatedly shifted methodologies at trial, forcing UPS to aim at an ever-moving damages and penalties target. Then, despite acknowledging that the evidence at trial did not permit any calculation of damages and penalties, the district court ordered both parties to submit additional, untested information after trial and used that information to assess damages and penalties based on its own unsupported expert methodology. This Court should make clear that this is not an appropriate way for civil litigation to proceed in our federal courts.

***70 1. Before Trial, Plaintiffs Failed To Disclose Their Damages And Penalties Case.**

Even though Plaintiffs did not disclose any damages or penalties "calculations" before trial, JA443_(Dkt.413:1), the district court permitted Plaintiffs to proceed because UPS knew that damages and penalties were potentially of high "magnitude," SA438_(Dkt.535:189). The result was a trial by ambush.

a. Plaintiffs were *required* to disclose, before trial, each particular "'category' of 'damages' sought" and also "a 'computation,' supported by documents." *Design Strategy, Inc. v. Davis*, 469 F.3d 284, 295 (2d Cir. 2006); *see* Fed. R. Civ. P. 26(a)(1)(A)(iii). This mandatory disclosure requirement applies both to "damages" and "other monetary relief" like penalties. *Design Strategy*, 469 F.3d at 296.

Rule 26 intentionally limits a claimant's theory of monetary recovery so that "[t]he opposing party may then prepare to meet that evidence via cross examination and via evidence in its rebuttal case." *Silicon Knights, Inc. v. Epic Games, Inc.*, No. 07-cv-275, 2012 WL 1596722, at *7 (E.D.N.C. May 7, 2012). Late disclosures "surprise[] [defendants] on the eve of trial," "prejudice [] any response," and cannot be cured "without postponing trial and reopening discovery," thus warranting preclusion. *MicroStrategy Inc. v. Bus. Objects, S.A.*, 429 F.3d 1344, 1357 (Fed. Cir. 2005); *see also CQ, Inc. v. TXU Mining Co.*, 565 F.3d 268, 280 (5th Cir. 2009); *Hoffman v. Constr. Prot. Servs., Inc.*, 541 F.3d 1175, 1180 (9th Cir. 2008). Defective disclosures regularly result in preclusion, *see Am. Realty Tr., Inc. v. Matisse* ***71** *Partners, LLC*, No. 00-cv-1801, 2002 WL 1489543, at *4, *6 (N.D. Tex. July 10, 2002); *see also Silicon Knights*, 2012 WL 1596722, at *7; *24/7 Records, Inc. v. Sony Music Entm't, Inc.*, 566 F. Supp. 2d 305, 318 (S.D.N.Y. 2008), even when preclusion results in the absence of any damages evidence, *e.g.*, *MicroStrategy*, 429 F.3d 1358; *Colombini v. Bd. of Dirs. of the Empire College Sch. of Law*, No. 97-cv-4500, 2001 WL 1006785, at *8 (N.D. Cal. Aug. 17, 2001); *see also Gould Paper Corp. v. Madisen Corp.*, 614 F. Supp. 2d 485, 490-91 (S.D.N.Y. 2009) (Chin, J.).

A litigant may not shift the burden of computation by, for example, providing financial statements but no actual calculation of lost profits, and this Court has rejected the argument that a defendant merely had to engage in the "simple arithmetic" of "taking [plaintiff's] revenue and deducting the cost of operations from the financial statements." *Design Strategy*, 469 F.3d at 295 (cleaned up). Failure to disclose "both a calculation of damages *and* the documents supporting that calculation" is a violation of Rule 26, which "by its terms does not require a showing of bad faith" or disobedience to a court order, and warrants preclusion of the undisclosed evidence. *Id.* at 295-96.

b. Here, the district court held that Plaintiffs violated Rule 26 and, in fact, recognized that UPS's "motion to preclude all damages was quite a serious one." SA433.n.138, 434_(Dkt.535:184.n.138, Dkt.535:185). Nevertheless, reasoning that the "determination

to impose preclusion [as a sanction] for a failure to comply is ***72** discretionary," the court found that "preclusion of damages [wa]s unwarranted" and imposed *no* sanction. *See* SA434_(Dkt.535:185).

Although Rule 37 authorizes a district court to select among available sanctions, the rule does not permit inaction in the circumstances here presented. A party's failure to disclose information required by Rule 26(a) results in *automatic* preclusion of that evidence, "unless the failure was substantially justified or is harmless." Fed. R. Civ. P. 37(c)(1). To be sure, "the court does have discretion to impose other, less drastic, sanctions," *Design Strategy*, 469 F.3d at 298 - but only "[i]n addition to" (*i.e.*, as additional sanctions to) "or instead of" (*i.e.*, as replacement sanctions for) preclusion. Fed. R. Civ. P. 37(c)(1). Where a Rule 26(a) violation is neither substantially justified nor harmless, Rule 37 requires the imposition of *some* sanction. *See* *Roadway Exp., Inc. v. Piper*, 447 U.S. 752, 763-64 (1980) ("Rule 37 sanctions must be applied diligently both to penalize … and to deter" (cleaned up)). The district court had no discretion to give Plaintiffs a pass for their blatant disregard of the mandatory disclosure requirement.

Moreover, the district court "fail[ed] to consider all relevant factors" in reaching its decision and thereby abused its discretion. *Gasperini v. Ctr. for Humanities, Inc.*, 149 F.3d 137, 142 (2d Cir. 1998); *accord* *Hapag-Lloyd Aktiengesellschaft v. U.S. Oil Trading LLC*, 814 F.3d 146, 155 (2d Cir. 2016). The district court's conclusion was not guided by the Rule 37 factors identified by this ***73** Court: "(1) the party's explanation for the failure to comply with the [disclosure requirement]; (2) the importance of the testimony of the precluded witness[es]; (3) the prejudice suffered by the opposing party as a result of having to prepare to meet the new testimony; and (4) the possibility of a continuance." *Patterson v. Balsamico*, 440 F.3d 104, 117 (2d Cir. 2006); *accord* *Design Strategy*, 469 F.3d at 296. The district court did not even consider factors one, two, or four, and it erred in its consideration of the prejudice factor.

Explanation. Plaintiffs *never* offered any explanation for their failure to disclose either the total amount of damages and penalties or the underlying computations. Nor did the district court even suggest that a possible explanation existed. *See* SA434_(Dkt.535:185) ("[P]laintiffs could have had a more robust Rule 26 disclosure - and indeed, should have"). Failure to offer compelling justifications regularly results in preclusion, *e.g.*, *Design Strategy*, 469 F.3d at 297; *Silicon Knights*, 2012 WL 1596722, at *8, particularly when the plaintiffs "had all the necessary facts to disclose their damage theory months ago," *Am. Realty Tr.*, 2002 WL 1489543, at *6.

Importance. In every case, evidence that supports calculating damages and penalties is unquestionably important. But precluding such evidence is warranted when "all of the other factors weigh heavily in favor of exclusion." *Design Strategy*, 469 F.3d at 297. Courts preclude even remedy-dispositive evidence where the ***74** defendant would suffer prejudice and the plaintiff offered no explanation, "particularly where [the dilatory party] alone is to blame for creating this situation." *E.g.*, *MicroStrategy*, 429 F.3d at 1357; *accord* *Silicon Knights*, 2012 WL 1596722, at *8; *Am. Realty Tr.*, 2002 WL 1489543, at *5-6. And the importance *to UPS* is enormous: Plaintiffs sought nearly a billion dollars, and the court awarded hundreds of millions. A case of such magnitude requires more scrupulous adherence to procedural requirements, not less.

Continuance. Plaintiffs first disclosed the total amount of damages and penalties sought in their opening statement. *See* JA596-97_(TrialTr.71:20-74:3). At such a late stage, the burdensome alternative of postponing trial and re-opening discovery weighs in favor of preclusion. *Hoffman*, 541 F.3d at 1180; *accord* *MicroStrategy*, 429 F.3d at 1357; *Silicon Knights*, 2012 WL 1596722, at * 8.

Prejudice. The court concluded that sanctions were unwarranted solely because it was "not convinced that UPS lacked adequate pre-trial notice to counter plaintiffs' damages claim, nor is it convinced that UPS suffered any real prejudice." SA439_(Dkt.535:190); *see also* JA443_(Dkt.413:1). Multiple errors render the court's determination untenable.

First, the district court placed the burden on UPS to prove that preclusion was appropriate after Plaintiffs' failure to disclose. *See* SA439_(Dkt.535:190). This approach violates both the text and purpose of Rule 26. *See* 8B Wright & Miller, ***75** Federal Practice & Procedure - Civil Procedure § 2289.1, at 608 (3d ed. 2010) ("[T]he burden is on the party seeking to escape exclusion to show that these factors justify excusing its failure to disclose at the proper time"). District courts in this Circuit have consistently held that the burden rests with the violator to prove that preclusion is not warranted. *See*, *e.g.*, *Design Strategies, Inc. v. Davis*, 367 F. Supp. 2d 630, 635 (S.D.N.Y. 2005), *aff'd*, 469 F.3d 284. At least six other courts of appeals have reached the same conclusion. *Wilkins v. Montgomery*, 751 F.3d 214, 222 (4th Cir. 2014); *Rembrandt Vision Techs., L.P. v. Johnson & Johnson Vision Care, Inc.*, 725 F.3d 1377, 1381 (Fed. Cir. 2013); *R.C. Olmstead, Inc. v. CU Interface, LLC*, 606 F.3d 262, 272 (6th Cir. 2010); *Torres v. City of Los Angeles*, 548 F.3d 1197, 1213 (9th Cir. 2008); *Wilson v. Bradlees of New England, Inc.*, 250 F.3d 10, 21 (1st Cir. 2001); *Salgado by Salgado v. Gen. Motors Corp.*, 150 F.3d 735, 742 (7th Cir. 1998). Erroneous allocation of the burden of proof is a "legal error," vitiating the deference normally owed to the district court's discretion. *Balliu v. Gonzales*, 467 F.3d 609, 613 (7th Cir. 2006).

Second, the district court's narrow focus on the existence of specific prejudice contravenes this Court's precedent, which has "consistently rejected the 'no harm, no foul' standard for evaluating discovery sanctions." *S. New England Tel. Co. v. Global NAPs Inc.*, 624 F.3d 123, 148-49 (2d Cir. 2010); *see also Moran Towing Corp. v. Young*, 597 F. App'x 33, 34 (2d Cir. 2015) (summary order). Rule 37 ***76** sanctions serve "other functions unrelated to the prejudice suffered by individual litigants," including preventing the non-compliant party from benefiting from its transgression, specific deterrence, and general deterrence. *S. New England*, 624 F.3d at 149. All of these are implicated here, yet the district court addressed none of them.

Third, contrary to the district court's conclusion, the prejudice to UPS was substantial. The number of packages, and the derivative number of packages containing unstamped cigarette cartons, transported by UPS constituted the determinative measure of both compensatory damages and penalties. SA456, 461_ (Dkt.535:207, Dkt.535:212). Thus, disclosure of the methodology and evidence supporting those calculations was critical to UPS's defense, as it determined the areas on which UPS could have focused in discovery as well as its presentation of a defense case, including rebutting evidence or witnesses, such as an expert. When certain evidence forms "the parameters of the dispute in a highly technical case," late disclosure of that evidence "redraw[s] the boundaries of the case and almost certainly … prejudice[s] [defendant's] ability to meet [plaintiff's] attack," making preclusion the appropriate remedy. *Softel, Inc. v. Dragon Med. & Sci. Commc'ns, Inc.*, 118 F.3d 955, 962 (2d Cir. 1997). Defendants cannot be "forced, at a very late date in the discovery process, to accommodate potentially significant shifts in the theories being offered against it." *Id.*

***77 c.** Before trial (and in response to a court order), Plaintiffs identified a single "exemplar" shipper group, Arrowhawk, and submitted a letter purporting to calculate damages and penalties based on an assumption of 8,000 packages and five cartons of cigarettes per package. JA361_(Dkt.367-4:3). In denying UPS's pre-trial motion to preclude, the district court acknowledged that the "open factual issues … go to calculations" yet held that the Arrowhawk Letter put UPS "sufficiently … on notice" about an unspecified but gargantuan amount of damages. *E.g.*, JA443_(Dkt.413:1). But Rule 26 does not require simply that UPS be put on notice that a case is of high "magnitude" or that additional bases for liability "would add significantly" to a single figure provided. SA437-38_(Dkt.535:188-89). Rule 26 "requires a 'computation,' supported by documents." *Design*

Strategy, 469 F.3d at 295. It also "anticipates supplemental disclosures with ever-greater level of detail as discovery progresses." *Id.* (citing *City & Cty. of San Francisco v. Tutor-Saliba Corp.*, 218 F.R.D. 219 (N.D. Cal. 2003)). Conveying a general sense that monetary awards may be high, particularly without identification of the evidence from which UPS could derive actual computations, satisfies neither Rule 26(a) nor *Design Strategy.*

In their final (and necessarily determinative) pre-trial disclosure, *see* Fed. R. Civ. P. 26(a)(3)(B), Plaintiffs again offered no total amount of relief sought, no computation of packages containing cigarettes, and no computations of cartons. ***78** JA299-300_(Dkt.367-3:16-17). And even though the district court's pre-trial order stated that the "open factual issues" did not involve "methodology," JA443_(Dkt.413:1), this proved false. As discussed below, no pre-trial disclosure came remotely close to disclosing *either* the methodologies on which Plaintiffs relied at trial *or* the methodology on which the district court ultimately found damages and penalties.

When UPS renewed its Rule 26 objection following trial, the district court faulted UPS for "declin[ing]" to receive "a full calculation for each shipper … several weeks prior to trial." SA437_(Dkt.535:188). Although the court provided no citation, it could only have been referring to cursory, non-substantive *settlement discussions. See* JA715_(TrialTr.542:16-25). The court ruled during trial that "a proffer of a calculation or not, in the context of settlement discussion" was "not ultimately a critical point here" and accepted "that [UPS] did not receive that notice." JA716_(TrialTr.545:13-24). In light of this ruling, as well as the irrelevance of settlement negotiations generally, the court's post-trial suggestion that UPS "declined" to receive any information is inexplicable (and wrong).

Relying on the Arrowhawk Letter, the district court also said after trial that "[t]here is no doubt that UPS possessed the information to replicate this same calculation for each shipper at issue: It knew the shippers, it could easily locate the same types of documents for each, and it knew plaintiffs' general methodology." ***79** SA435-36_(Dkt.535:186-87). This statement is, first, simply inaccurate: Plaintiffs did not rely on that methodology at trial. More importantly, if UPS could have "replicated" the information for all shippers, Plaintiffs could also have done so; and the failure of proof at trial means that Plaintiffs lose, not UPS - indeed, that is the definition of the burden of proof. The district court repeatedly overlooked the fact that the defendant, dragged into court against its will, has no obligation to help prove issues that the claimant, who chose to bring the lawsuit, bears the burden of proving. *Sims v. Kia Motors of Am., Inc.*, 839 F.3d 393, 409 (5th Cir. 2016).

The remedy for Plaintiffs' blatant violation of Rule 26, and the district court's refusal to enforce Rule 37, is reversal of the damages and penalties awards *in toto* or, at minimum, for all shippers other than the Arrowhawk group.

2. At Trial, Plaintiffs Failed To Prove Damages And Penalties.

On the first day of trial, the district court was forced to ask "exactly what dollars the plaintiffs are looking for with regard to each and every claim." JA580_(TrialTr.5:5-7). That question alone shows why the case should not have gone to trial, much less judgment, on damages and penalties. Yet because the district court did not hold Plaintiffs responsible for their violation of Rule 26, by the time the record closed, Plaintiffs had *never* presented any witness - fact or expert - to testify about its damages and penalties case and had instead substituted shifting attorney proffers for evidence. *See* *Softel*, 118 F.3d at 962 (pre-trial disclosure ***80** prevents the defendant from having to "accommodate potentially significant shifts in the theories being offered against it").

In their opening statement, Plaintiffs requested only a total amount of damages and penalties without reference to supporting documents or other evidence, causing the district court to ask for a detailed chart "so that we know exactly the target that's being shot at." JA580_(TrialTr.5:19-6:8). The next day, Plaintiffs submitted Court Exhibit 1, which contained - for the first time - a

shipper-by-shipper breakdown of damages and penalties based on package count, average weight, and varying assumptions of package contents. *See* JA451_ (Dkt.440-2); *see also* JA647-48_(TrialTr.272:1-277:17). The following day, Plaintiffs submitted an attorney proffer, purporting to explain the process behind Court Exhibit 1, which was prepared by an unknown and unsworn "technical research employee" of the State. JA709, 718_(TrialTr.519:19-520:4, 552:9-20); *see* JA456_(Dkt.441). But, of course, "counsel's statements are not admissible evidence," *United States v. Roberts*, 660 F.3d 149, at 158 (2d Cir. 2011), and, as the district court noted, these exhibits were prepared by "a quasiexpert who's not here in court." JA710_(TrialTr.526:8-10). Both Court Exhibit 1 and the explanatory proffer contained mathematical inaccuracies and assumptions about package contents wholly inconsistent with any prior disclosure. *E.g.*, JA455_(Dkt.440-2:5.n.5).

***81** At trial, Plaintiffs' lawyers purported to base their counts on a number of spreadsheets generated from internal UPS billing and shipping databases. But as the district court recognized, "neither the plaintiffs nor UPS presented witness testimony" about these spreadsheets at trial. SA456_ (Dkt.535:207). In fact, during discovery, Plaintiffs never even asked a single UPS witness one question about them. In other words, *no foundational witness* testified about how the spreadsheets are generated, what role they perform in UPS's internal systems, or whether any information contained therein formed a reliable basis for counting packages, much less their contents. As early as the second day of trial, the court itself pointed out this lack of foundation: "So, in the spreadsheets, there are just - it's just chockablock full of all kinds of fields that I can't make head nor tail of." JA708_(TrialTr.518:10-12); *see also* JA708_(TrialTr.516:4-8) (questioning how account numbers used "were the right account numbers"); JA708_(TrialTr.516:21-25) (questioning "which fields you were certain corresponded to a shipper number … [b]ecause the columns don't necessarily always have English language"); JA708_(TrialTr.518:13-22) (questioning "how do we know that that package was, in fact, a package versus a billing or a rebilling for something else"); JA709_(TrialTr.522:8-16) (The Court: "I thought originally … that there would be something in the spreadsheets that would give me sort of literally like a list of numbers where you add it up .... [B]ased on my review of the spreadsheets, it's far more complex than that, … frankly, I know some ***82** of Excel. I could not do the exercise. I physically could not accomplish it."). These are questions for witnesses with knowledge and expertise, not a party's attorneys.

Plaintiffs' pre-trial Arrowhawk Letter had identified two types of evidence that could prove which packages contained cigarettes: "testimony from [the shipper] regarding the nature of the [business] as a cigarette dealer, and shipping invoices listing the contents of packages shipped by UPS." JA360_ (Dkt.367-4:2); *see also* SA435_(Dkt.535:186). But at trial Plaintiffs presented testimony or shipping invoices for only three of fifteen shipper groups - Arrowhawk, Jacobs, and Smokes & Spirits. *See* JA519_(Dkt.531). And one of those (Jacobs) shipped cigarettes only to retailers on Indian reservations, which UPS understood to be permissible under the State's tax forbearance policy, under court injunctions blocking the enforcement of New York's tax laws at the time, and pursuant to the explicit instructions of a state law enforcement officer. SA351_(Dkt.535:102). For the remaining shippers, Plaintiffs presented *no* evidence of package contents but rather assumed package contents based on national cigarette *consumption* statistics. *See* JA1066-67_(TrialTr.1942:22-1943:2).

Plaintiffs' mid-trial shift from direct evidence of cigarettes through testimony and invoices to unsupported inferences about package contents was the definition of a trial by ambush. Importantly, Plaintiffs had proffered Dr. Erath before trial to estimate the percentage of packages that contained cigarettes, but the district court ***83** excluded his opinions under *Daubert* for lack of qualifications and an unreliable methodology. *See* SA186-87_ (Dkt.405:17-18). During trial, Plaintiffs' lawyers substituted their own speculation for the excluded expert, providing no supporting documentation or witness from which to infer percentages of package contents. *See* JA647-48, 709, 718, 1067_(TrialTr.272:1-277:17, 519:19-520:4, 552:9-20, 1942:22-1943:2); *see also* JA451_(Dkt.440-2); JA456_(Dkt.441).

When it became clear that Plaintiffs were not presenting actual evidence of package contents for most shippers, UPS had to shift its defense repeatedly to counter Plaintiffs' numerous end-runs around their proof deficiency, including attempted "attorney proffers" and theories, *see*, *e.g.*, JA456_(Dkt.441), and the attempted submission of exhibits without authenticating witnesses, supporting documentation, or the opportunity for cross-examination as to methodology, *see*, *e.g.*,

JA451_(Dkt.440-2); JA467_(Dkt.491-1). For example, after Plaintiffs proffered package weights (and therefore number of cartons) based on the "billed weight" columns from one (or possibly several) of a list of undifferentiated spreadsheets (JA438-41, 458_(Dkt.399:47-50, Dkt.441:3)), UPS had to point out that "'[b]illed' or '[b]illable' weight is an industry term … which cannot be relied upon across the board to establish the actual weight of a package." *See* Dkt.446:6. In fact, the *only* witness testimony at trial explained that the "billable weight is actually the larger of the actual weight or the dimensional weight," which is where ***84** "the product is lightweight in nature, [and] [UPS] might charge by the amount of space it takes up" (JA782_(TrialTr.809:20-810:7)) - meaning that Plaintiffs' calculations undoubtedly included large boxes that nonetheless had lower actual weights.

Although Plaintiffs initially attempted to support Court Exhibit 1 by group-citing "between eight and 21" spreadsheets for each alleged shipper group, JA438-41_(Dkt.399:47-50), their methodology changed again after trial. In their post-trial briefing, Plaintiffs submitted *more* calculations applying new methodologies as Appendices A and B - now making clear their exclusive reliance on one UPS database (the "On Demand" spreadsheets) different from the myriad databases used to create Court Exhibit 1, and adopting a *new* (but still unsupported) assumption that over 90% of all packages contained cigarettes. *See* JA468_(Dkt.491-1:2). UPS's first opportunity to confront this new methodology was in closing statements, where UPS pointed out that "On Demand" "was a billing system that doesn't include whether the package was actually delivered." JA1094_(TrialTr.2052:12-2054:4). UPS further explained, "[t]his isn't a question of putting in a couple of spreadsheets and asking your Honor to sum up the bottom number … [T]hese aren't just reasonable inferences; this is a methodology with assumptions, with choices, with a need to understand the documents and the data." JA1095_(TrialTr.2055:14-24).

***85** Even where cross-examination is available, figures that are "obviously the product of calculation" *must* be accompanied by an evidentiary "explanation, either in the form of worksheets, testimony, or other methods of elucidation, showing how [the proffering party] derived the figure," and the district court *must* consider whether the figures are fairly based on the evidence. *United States v. Citron*, 783 F.2d 307, 316-17 (2d Cir. 1986). Just one of the "On Demand" spreadsheets admitted into evidence contains *110,320 rows* and *154 columns*; when printed to PDF, that one exhibit spans *73,710 pages. E.g.*, JA1206_(PX-70). Translating the meaning of *millions* of data points into a claim for monetary relief is a complex exercise affected by assumptions and variables about which the parties and the court were wholly in the dark, because Plaintiffs never adduced evidence to support their presentation and UPS never had a chance to cross-examine the creators of their attorney proffers.

New York presented no witness - fact or expert - to testify about its damages and penalties theory. The methodology, calculations, and conclusions advanced at trial came entirely from the *lawyers*, not a person testifying under oath and subject to cross-examination. UPS is aware of no case in which a federal court of appeals has sustained a substantial damages or penalties judgment in similar circumstances. Every time UPS tried to identify Plaintiffs' approach to damages and penalties, Plaintiffs produced new computations. *See*, *e.g.*, JA359_(Dkt.367-4); JA597_(TrialTr.73:24-74:3); JA455_(Dkt.440-2:5 & n.5); JA467_(Dkt.491-1) ***86** (varying computations proffered by Plaintiffs before, at, and after trial). Recognizing the flaws in Plaintiffs' numerous non-evidentiary submissions, the district court ultimately declined to rely on them in calculating damages and penalties. SA456.n.144_(Dkt.535:207.n.144). Once again, Plaintiffs' failures of proof should have ended the proceeding in UPS's favor and did not. This error warrants reversal of the damages and penalties awards on appeal, either outright or at minimum as to all shipper groups other than the three (Arrowhawk, Jacobs, and Smokes & Spirits) about which Plaintiffs adduced evidence at trial.

3. After Trial, The District Court Abdicated Its Role As Neutral Arbiter.

After trial, UPS suffered one more prejudicial shift in theories - this time, at the hands of Judge Forrest. The total number of packages, the number of packages containing cigarettes, and the number of cartons transported for each shipper were the

central (and essential) predicates for the awards of damages and penalties. Faced with Plaintiffs' insufficient proof at trial on the meaning and significance of the various spreadsheets, the court announced during closing arguments that it intended to do Plaintiffs' work for them. *See* JA1096_(TrialTr.2059:2-7).

In response to the district court's announcement, UPS had to take "the uncomfortable position of saying the problem is that we don't get a chance to challenge you":

> ***87** And this isn't just adding up columns; this is going to require to [sic] you to make some determinations as to which numbers to use and what calculations make sense, which consignees should be excluded, which package type should be excluded. … [N]one of that is appropriate for the Court to be doing post trial, with absolutely no evidence to back it up, other than the underlying data, which we submit isn't enough for you to reach that.

JA1096_(TrialTr.2059:8-17). Unfortunately, that was exactly what the court did.

Five months after the record closed (JA1046_(TrialTr.1859:6-8)), the district court acknowledged in its liability opinion that it could not award damages and penalties on the basis of the trial record. *See* SA455, 462-64_(Dkt.535:206, Dkt.535:213-15). Under our adversarial system, the failure of a party to produce evidence sufficient to support an essential element of its claim results in judgment in favor of the other party - case closed. *See*, *e.g.*, *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Plaintiffs' adjudicated failure to prove package counts and contents at trial should have led, as night follows day, to a judgment of zero.

In spite of this principle and its acknowledgment of the deficiency of proof, the district court chose to re-open the record *sua sponte* to demand additional (inadmissible) information from Plaintiffs and UPS. *See* SA468_(Dkt.535:219). The court then stepped into the role of expert witness and created a previously undisclosed, untested, and unsupported methodology on which to base damages and penalties. The ensuing awards were the culmination of the district court's refusal to ***88** hold Plaintiffs accountable for their evidentiary failures at every stage of the proceeding.

a. The district court repeatedly recognized that Plaintiffs had not produced sufficient evidence from which it could derive a damages or penalties calculation. *See*, *e.g.*, SA455_(Dkt.535:206); SA462_(Dkt.535:213). The lack of sufficient evidence prevents the court from, as it did, re-opening the record *sua sponte* and "direct[ing] the parties to determine the number of Packages that fall within" a methodology devised by the court in its post-trial order. *See* SA463, 465, 468_(Dkt.535:214, Dkt.535:216, Dkt.535:219).

This Court has made clear that re-opening the record "is not a vehicle for relitigating old issues, presenting the case under new theories, securing a rehearing on the merits, or otherwise taking a 'second bite at the apple.'" *Sequa Corp. v. GBJ Corp.*, 156 F.3d 136, 144 (2d Cir. 1998). Re-opening the record should not benefit a party "where it has not carried its burden of establishing" that the evidentiary deficiency "was not the result of its own lack of diligence." *Bradford Tr. Co. of Bos. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 622 F. Supp. 208, 214 (S.D.N.Y. 1985), *aff'd*, 805 F.2d 49. Particularly where a party is aware of evidence and failed to take steps to introduce it at trial, re-opening the record is not warranted. *See Air et Chaleur, S.A. v. Janeway,* 757 F.2d 489, 495 (2d Cir. 1985); *Romeo v. Sherry*, 308 F. Supp. 2d 128, 138-41 (E.D.N.Y. 2004). Yet the

district court's re-opening of the ***89** record served no purpose *but* to give Plaintiffs a second (or third or fourth) bite at the apple under a new theory.

Plaintiffs had every opportunity to present the evidence underlying their own theory of damages. Plaintiffs' deficiencies of proof on the number and contents of packages were indisputably "discussed at length throughout the trial" and before. *Janeway*, 757 F.2d at 495; *see*, *e.g.*, JA597_(TrialTr.74:22-75:22); Dkt.366; Dkt.437; JA456_(Dkt.441); Dkt.442; Dkt.445; Dkt.446 (motions concerning exclusion of Plaintiffs' damages case). Plaintiffs also had every opportunity to present additional evidence through shipper testimony or invoices; they did not. And Plaintiffs had every opportunity to put forward competent witness or statistical evidence concerning packages reflected in UPS's delivery spreadsheets or other records; they did not. *See* SA433.n.138_ (Dkt.535:184 & n.138). Accordingly, the district court had no discretion to give Plaintiffs a mulligan (or two or three) on their burden of proof. *See* *Romeo*, 308 F. Supp. 2d at 138-41.

Even worse, the district court ordered UPS to conduct and submit a calculation of the packages containing cigarettes using the court's untested methodology - information that would be used to *punish* UPS financially - violating the principle of party presentation and shifting the burden of proof. *See*, *e.g.*, *Greenlaw v. United States*, 554 U.S. 237, 243-44 (2008); *Sims*, 839 F.3d at 409. Moreover, the district court ordered both Plaintiffs and UPS to submit their calculations simultaneously, ***90** without an evidentiary hearing or opportunity for UPS to cross-examine or even respond to Plaintiffs' submission. *See* SA468_(Dkt.535:219); *see also* *Reilly v. Pinkus*, 338 U.S. 269, 275 (1949) (finding "undue restriction" on cross-examination where a party could not cross-examine expert witness on the underlying data).

As a result of this unorthodox order, UPS found itself in a Catch-22: It could either furnish speculative calculations and risk being deemed to have admitted (or waived objections to) findings based on those calculations, or it could refuse to comply and risk the ire of the court. In a good-faith effort to comply with the order in view of the evidence actually adduced at trial, UPS submitted estimated package counts for the three shipper groups as to which Plaintiffs had introduced evidence of actual shipments and contents at trial (Arrowhawk, Jacobs, and Smokes & Spirits). *See* JA521-22_(Dkt.531:2-3). Conversely, UPS did not submit package counts for the twelve shipper groups for which Plaintiffs did not present direct evidence at trial, while expressly objecting to any such submission by Plaintiffs.

UPS's fears were justified. The district court rebuked UPS for its "lack of cooperation," held that it had "waived arguments relating to the calculations submitted by plaintiffs," and - stunningly - used this submission as proof of "UPS's lack of acceptance of responsibility for their actions," the district court's principal basis for imposing significant penalties. SA472-73_ (Dkt.536:4-5); *see* SA470_(Dkt.536:2). The district court also faulted UPS for not "provid[ing] any ***91** explanation of how it calculated the figures provided," SA473.n.6_(Dkt.536:5.n.6), a puzzling statement given its willingness to permit Plaintiffs - who bore the burden of proof - to recover damages and penalties without *ever* disclosing or providing reliable explanation of the evidence or methodology used to calculate the number of packages that, they said, contained cigarettes.

The district court had already held that, as a common carrier, UPS had "imputed knowledge" of the contents of every package it ever ships (SA404-05_ (Dkt.535:155-56)), but that has never been the law - as demonstrated by the court's reliance on a dissenting opinion. The court also ruled that UPS "bears the responsibility for [the] lack of information" "regarding the contents of the Relevant Shippers packages," obviating Plaintiffs' burden to prove that any package actually contained cigarettes (SA289, 460_(Dkt.535:40, 211)); but the uncertainty principle provides that after "a *proven invasion* of the plaintiff's rights," a wrongdoer cannot demand exacting proof of indefinite harms caused by his actions. *Bigelow v. RKO Pictures*, 327 U.S. 251, 265-66 (1946) (emphasis added). It does not allow the claimant (or a court) to shift the burden of disestablishing wrongdoing to the defendant, but that is exactly what happened here.

Plaintiffs' post-trial submission contained general citations to eleven spreadsheets and no evidence or explanation supporting the manner in which they obtained their counts from those spreadsheets. JA509_(Dkt.530:tbl.1). As the chart ***92** below demonstrates, these spreadsheets contain over 540,000 unique rows of data, each containing 154 columns, for a total of *83.5 million cells.*

Exhibit	Rows	Columns	Cells
PX-70	110,321	154	16,989,434
PX-71	8,163	154	1,257,102
PX-222	10,671	154	1,643,334
PX-433	235,614	154	36,284,556
PX-434	11,292	154	1,738,968
PX-552	41,132	154	6,334,328
PX-554	10,501	154	1,617,154
PX-555	11,194	154	1,723,876
PX-556	3,268	154	503,272
PX-559	53,848	154	8,292,592
PX-560	46,414	154	7,147,756
Total	**542,418**	**154**	**83,532,372**

If these spreadsheets were printed as exhibits, they would comprise over 350,000 pages - ten times the length of the entire Encyclopedia Britannica and, if stacked, almost three times the height of the columns at the front of 40 Foley. Deriving damages and penalties from the volume and complexity of such a data set is not "simply counting packages" - especially since Plaintiffs never introduced foundational testimony about what any particular row, column, or cell signified, nor ***93** presented any witness to explain the process by which their package counts were generated. Yet after recognizing during trial regarding a similar proffer that "the data guy at the A.G.'s office may be fantastic but he may be a quasiexpert who's not here in court" (JA710_ (TrialTr.526:8-10)), the district court accepted *in toto* Plaintiffs' unsupported post-trial package counts, with no witness or cross-examination and to which UPS never got a chance to respond. The court then awarded substantial damages and penalties based on a self-generated methodology, which as explained next was itself wholly untested in the crucible of the adversary process.

b. After recognizing that Plaintiffs had taken "a risk not worth taking" in declining to present expert testimony (JA1069_(TrialTr.1954:8-11); *see also* JA1070_(TrialTr.1955:6-7); SA433 & n.138_(Dkt.535:184 & n.138)), the court overstepped the judicial role in volunteering to serve as Plaintiffs' expert.

Rejecting both of the approaches Plaintiffs had advanced at trial, the district court adopted a methodology of its own devise: For each shipper group, the district court guessed as to the number of packages containing cigarettes throughout an entire shipping

period. *See*, *e.g.*, SA334_(Dkt.535:85). The court speculated as to a percentage of packages that might have contained cigarettes based on "evidence of tracer inquiries, driver reports, … and the audits that were conducted" (SA460_(Dkt.535:211)) - an unreliable approach never advanced by Plaintiffs at trial.

***94** For example, as to the shipper group Shipping Services, the district court found that "25% of customer inquiries related to cigarettes, that [one audit conducted on January 2, 2014] revealed that 40% of shipments were for cigarettes, and that it operated out of a storefront that sold other items, along with the totality of the evidence." SA334.n.76_(Dkt.535:85.n.76). Yet without any further explanation, it selected 40% as its "reasonable approximation of the percentage of packages shipped by this group with UPS that contained cigarettes." SA334_(Dkt.535:85). And the exhibits cited by the district court in support - DX-499 and DX-500 (SA332_(Dkt.535:83)) - show that far less than 25% of tracers related to cigarettes. *See* JA1791_(DX-499) ("Package Details" tab, showing only 1 clear tracer for cigarettes out of 29 in account #XXXXXX); JA1838_(DX-500) (same); JA1920_(TrialTr.1920:21-23) (The Court: "for Shipping Services, 90 percent that's referenced here are cigars, not cigarettes"). For the shipper Indian Smokes, the district court was even more transparent about its guesswork: "In the absence of precise evidence, the Court uses 50% as a conservative view of an even split between cigarette and non-cigarette products." SA336.n.77_(Dkt.535:87 & n.77).

After reaching its percentages for each shipper group, the district court then calculated the number of transported cartons - necessary for its assessment of compensatory damages - by summing the "total actual weight for all Packages" and dividing "by one (based on the Court's finding that a Carton of cigarettes weigh[s] ***95** exactly one pound)." SA461_(Dkt.535:212). Not only does this calculation assume actual weight may be inferred (again without testimony) from the unsupported spreadsheets, but it also assumes that each package contained *only* cigarettes when the district court found facts inconsistent with that assumption. For example, the court found that "[a]ll but one of the Relevant Shippers … sold a variety of tobacco products and, in certain instances, other items as well." SA295_(Dkt.535:46). More specifically, the court found that "[a]ll but one of the Relevant Shippers … sold little cigars and shipped them via UPS," that "[t]he boxes in which [little cigars] were shipped were the same as those used to ship cigarettes" and little cigar cartons weighed "approximately one pound," and that it was "very difficult to distinguish between packs of little cigars and those of cigarettes." SA298_(Dkt.535:49).

At no time - before, during, or after trial - was UPS given notice that approximate extrapolations derived from anecdotal evidence would form the only basis for findings about the number and contents of shipped packages and cartons. In fact, *Plaintiffs had expressly disclaimed this methodology*: "[W]e don't believe … the proportion of claims or tracers somehow gives you an accurate perspective on what was the actual content by percentage basis of the shippers' shipments." JA1061_(TrialTr.1922:12-16). Seemingly, so had the court: "[Y]ou can't do a calculation off of these" anecdotal bits of evidence. JA1061-62_(TrialTr.1922:24-1923:4); *see also* JA1062_(TrialTr.1924:15-16) (The Court: ***96** "[I'm not suggesting] that you can do anything mathematical with this"). Unsurprisingly, neither Plaintiffs nor UPS pursued this line of inquiry during trial. Yet the district court's post-trial damages and penalties calculations are based entirely on these approximations. "A ruling based on evidence which a party has not been allowed to confront or rebut is one which denies due process." *Carter v. Morehouse Parish Sch. Bd.*, 441 F.2d 380, 382 (5th Cir. 1971); *see also* *United States v. Robin*, 553 F.2d 8, 10 (2d Cir. 1977) (en banc) (reassignment in a bench trial may be appropriate "[w]here a judge has made detailed findings based on evidence erroneously admitted or factors erroneously considered").

UPS had no opportunity to cross-examine any witness, much less Judge Forrest, on the assumptions she used after trial to calculate damages and penalties. *See N.V. Maatschappij Voor Industriele Waarden v. A.O. Smith Corp.*, 590 F.2d 415, 421 (2d Cir. 1978) ("limitation on cross-examination of a key expert witness can amount to prejudicial error"); *see also* *Wiseman v. Sinclair Ref. Co.*, 290 F.2d 818, 820 (2d Cir. 1961) (reversing judgment for failure to permit expert cross-examination "especially in view of the importance of the [expert's] testimony"). Cross-examination is, of course, the engine of truth in our

adversary system and is essential to due process "[i]n almost every setting where important decisions turn on questions of fact." *Goldberg v. Kelly*, 397 U.S. 254, 269 (1970). Deprivation of "the right to cross-examine" an expert cannot be cured even "by having the fact-finder ***97** subsequently review" adverse materials. *Reilly*, 338 U.S. at 275-76. For this reason, the Federal Rules empower a court to "call a witness on its own," including an expert, but expressly provide that "[e]ach party is *entitled* to cross-examine the witness." Fed. R. Evid. 614(a) (emphasis added).

The district court's invention of a damages and penalties methodology violates "the principle of party presentation," which "rel[ies] on the parties to frame the issues for decision" and "assign[s] to courts the role of neutral arbiter of matters of the parties present." *Greenlaw*, 554 U.S. at 243. "[A]s a general rule, our adversary system is designed around the premise that the parties know what is best for them, and are responsible for advancing the facts and arguments entitling them to relief." *Id.* at 244 (internal quotation marks and alterations omitted). Federal law prohibits a judge's participation as a witness in a trial over which she presides, *see* Fed. R. Evid. 605; 28 U.S.C. § 455; and judges may not take steps to obtain extrajudicial information through their own or their agents' investigations, *see*, *e.g.*, *Price Bros. Co. v. Phila. Gear Corp.*, 629 F.2d 444 (6th Cir. 1980). Firmly rejecting the suggestion that a judge may investigate evidence in her own case, then-Chief Judge Cardozo observed that "[c]enturies of common-law tradition warn us with echoing impressiveness that this is not a judge's work." *In re Richardson*, 247 N.Y. 401, 412 (1928).

***98** Appellate courts have disqualified district judges who have solicited expert testimony *ex parte* and without cross-examination, because that testimony was "extrajudicial" and had not "enter[ed] the record and [been] controverted or tested by the tools of the adversary process." *Edgar v. K.L.*, 93 F.3d 256, 259 (7th Cir. 1996) (citing *Liteky v. United States*, 510 U.S. 540 (1994)); *see also* *United States v. Craven*, 239 F.3d 91, 102-03 (1st Cir. 2001). Here, rather than receiving testimony from an expert *ex parte*, Judge Forrest created her own methodology after Plaintiffs had fallen short, transforming an adversarial process into an inquisitorial one.

Critically, the methodology actually adopted by the district court was itself erroneous. As the court recognized, there is a difference between evidence "to support the fact that packages contained cigarettes" and evidence "as to the particular percentage of [a shipper's] shipments that contained cigarettes versus something else." SA459_(Dkt.535:210). Plaintiffs provided actual evidence of the number of packages containing cigarettes for only three shipper groups: Arrowhawk, Jacobs, and Smokes & Spirits. *See*, *e.g.*, JA1107_(PX-8B); JA1198_(PX-55); JA1217_(PX-87); JA1241_(PX-90); JA1243_(PX-92); JA1245_(PX-93); JA1260_(PX-96). But for *all* shippers - even those three - the district court made a "reasonable approximation" as to the percentage of packages containing cigarettes based on extrapolation from the results of anecdotal "audits" and "tracer inquiries." SA289, 460_(Dkt.535:40, Dkt.535:211); *see also* JA1061_ (TrialTr.1920:7-10) (The Court: ***99** "I've printed out some pages and taped them together from the spreadsheet"). *But see* JA1061-62_(TrialTr.1922:24-1923:4); JA1062_(TrialTr.1924:15-16). This extrapolation is quintessentially statistical in nature - *i.e.*, an inference about a population from a sample. *See* *In re Chevron U.S.A., Inc.*, 109 F.3d 1016, 1019-20 (5th Cir. 1997); *see also* Manual for Complex Litigation (Fourth) § 11.493 (2004) ("MCL 4th") (statistical evidence includes "sampling to generate data about a population so the data will be verified or declared true"). However, the court's extrapolations lack supporting evidence of reliability, rendering them untenable.

As the Supreme Court has made clear, whether a representative sample may be used to find liability turns on "the degree to which the evidence is reliable in proving or disproving the elements of the relevant cause of action." *Tyson Foods, Inc. v. Bouaphakeo*, 136 S. Ct. 1036, 1046 (2016). "Representative evidence that is statistically inadequate or based on implausible

assumptions could not lead to a fair and accurate estimate" of the population as a whole. *Id.* at 1048. To be representative, "the sample must be a randomly selected one of sufficient size so as to achieve statistical significance to the desired level of confidence in the result obtained." *Chevron*, 109 F.3d at 1019; *see also* MCL 4th § 11.493 (sampling methods must conform to "generally recognized statistical standards," including "properly chosen and defined" population, "representative" sample, "accurately reported" data, and analysis "in accordance with accepted statistical principles"). ***100** Had the district court's unsupported approach been offered through an expert witness, it would have been excluded under *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993). In fact, the district court excluded Plaintiffs' expert for similar reasons. *See* SA170_ (Dkt.405). But UPS had no opportunity to make a *Daubert* challenge to Judge Forrest.

Because no party presented the theory on which the district court extrapolated package contents, no evidence demonstrated that audits and tracers constituted a random sample of sufficient reliability or size. *See*, *e.g.*, *Akerman v. Oryx Commc'ns*, 810 F.2d 336, 343 (2d Cir. 1987) ("Statistical analyses must control for relevant variables to permit reliable inferences"). And because no expert had conducted (or been cross-examined on) the statistical inferences the district court ultimately drew, no evidence supported the conclusion that this analysis met the standard for expert evidence. Fed. R. Evid. 702; *see* MCL 4th § 11.493 (laying foundation for statistical evidence "will ordinarily involve expert testimony" and "disclosure of the underlying data and documentation"). Findings of fact that are extrapolated from an unreliable sample are "clearly erroneous." *United States v. Jones*, 641 F.3d 706, 712-13 (6th Cir. 2011). In fact, comparing the actual invoices in evidence (for three shipper groups) to the district court's extrapolations (for those same groups) reveals that the court's untested methodology *doubled* or *quadrupled* the number of packages that ostensibly contained cigarettes.

***101** The district court invoked the principle that "once the existence of damages is determined, a factfinder may make a reasonable approximation of their amount," and stated that "[t]he reasonable approximation of package contents here is done for this purpose." SA459_(Dkt.535:210) (citing *Tractebel Energy Mktg. v. AEP Power Mktg., Inc.*, 487 F.3d 89, 110 (2d Cir. 2007)). This is yet another legal error. Without "approximat[ing]" the number of packages in violation of the relevant legal rule, the *existence* of damages has not been proven. As the Supreme Court said in the seminal case on this subject, "[t]he rule which precludes the recovery of uncertain damages *applies to such as are not the certain result of the wrong*, not to those damages which are definitely attributable to the wrong and only uncertain in respect of their amount." *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931) (emphasis added). The district court used its untested and unsupported approximations to establish whether UPS is liable for a package at all - *i.e.*, the *fact* of damages, not merely their amount. This proof deficiency is laid squarely at Plaintiffs' feet, not UPS's, and precludes recovery. *See* *J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 568 (1981).

Neither the damages award nor the penalties awards can stand in light of the district court's unforced errors. To estimate the number of cartons shipped for compensatory damages purposes, the court applied a speculative percentage to a weight summed from voluminous, unsupported spreadsheets - assuming, contrary ***102** to its other findings, that every pound of weight was cigarettes. Likewise, for penalties, the court based each of the penalty calculations on unsupported package count findings. First, each un-audited package received a $1,000 penalty under the AOD. Next, the court calculated the statutory maximums for the PACT Act and the PHL, treating each package as a violation warranting up to $5,000 each; it reached its final penalty awards by simply taking 50% of this maximum, tying each award inextricably to the court's erroneous findings. Without the proper foundation for *any* of these steps, these calculations are irreparably flawed, unsupported by legally sufficient evidence, and clearly erroneous. Because the awards are wholly grounded on the unsupported assumptions of the district court, which UPS never had the opportunity to rebut, the awards cannot stand. *See* *Carter*, 441 F.2d at 382.

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In short, the district court's findings on damages and penalties are the result of cascading, cumulative errors - before, during, and after trial. The awards result from computations and methodologies that were never even proposed by Plaintiffs, much less disclosed before trial. No record evidence supports the reliability of the calculations, and UPS had no opportunity to question any witness about them. Plaintiffs' failure to disclose or prove damages and penalties means they lose; the district court erred in trying to rescue Plaintiffs from their failures. The remedy for this series of errors is outright reversal of the damages and penalties awards.

***103** At minimum, Plaintiffs' monetary recovery should be limited to the one shipper group (Arrowhawk) as to which they made *any* pre-trial disclosure, or the three shipper groups (Arrowhawk, Jacobs, and Smokes & Spirits) as to which they adduced evidence of package contents at trial. The following chart provides estimates of the amount of damages available for the relevant shipper groups, under both the district court's erroneous extrapolations (although it is impossible to replicate Judge Forrest's figures exactly) and the invoice evidence of cigarette shipments adduced at trial; each column also includes a further adjustment to a 5.4% tax diversion rate, required to correct for a separate error addressed below.

Shipper Groups	District Court's Extrapolations		Actual Invoices Reflecting Cigarette Shipments	
	50% Diversion	5.4% Diversion	50% Diversion	5.4% Diversion
All	$9.4 million	$1 million	N/A	N/A
Arrowhawk Jacobs Smokes & Spirits	$2 million	$220,000	$1 million	$110,000
Arrowhawk	$1 million	$110,000	$250,000	$27,000
None	$0	$0	$0	$0

The penalties for the AOD, PACT Act, and PHL (to the extent liability could be sustained under any of those theories) would also have to be reduced commensurately, because they are premised on the same erroneous package counts.

*104 B. The District Court Erred In Calculating Compensatory Damages.

As the district court recognized, compensatory damages in this case equal the amount of "tax diversion," the extent to which purchasers of untaxed cigarettes would have purchased New York-taxed cigarettes if the former were not available through UPS. *See* SA440-41_(Dkt.535:191-92). Tax revenue "lost" from consumers who would not have purchased taxed cigarettes anyway has not been "suffered by reason of the defendant's wrongful conduct." *Cooper Indus., Inc. v. Leatherman Tool Grp.*, 532 U.S. 424, 432 (2001). The district court found the tax diversion rate to be 50%, but there is not legally sufficient evidence to support that conclusion.

UPS's expert, Dr. Aviv Nevo, presented the only evidence at trial on diversion, concluding that, at most, 5.4% of unstamped cartons would be diverted to taxed cartons instead of lower-cost alternatives, like non-cigarette tobacco products (*e.g.*, little cigars), non-tobacco products (*e.g.*, nicotine gum), or quitting smoking altogether. *See* JA2029, 2047, 2051, 2056_ (DX-613:4,

DX-613:22, DX-613:26, DX-613:31). Plaintiffs introduced no evidence on diversion at all, much less evidence indicating a diversion rate exceeding 5.4%, and instead presented only *legal* challenges to causation. *See* JA464-65_ (Dkt.491:232-33).

Without identifying any evidence in the record, the district court arbitrarily set the diversion rate at 50%. The court's only explanation consisted of three unsupported assumptions. *See* SA442_(Dkt.535:193).

***105** *Representativeness*. The court concluded that one component of Dr. Nevo's analysis - the New York Adult Tobacco Survey - "was not representative of the consumer base at issue" and considered it "to be weak evidence." SA441.n.140_(Dkt.535:192.n.140). But the court did not explain why it was not representative - nor could it have. Dr. Nevo's analysis expressly identified the subset of individuals in the survey "most comparable to the buyers at issue with respect to purchasing behavior." JA2043-45_(DX-613:18-20).

Addiction. The court found that Dr. Nevo's 5.4% diversion rate was "unduly low," because "seizures of packages occur without prior notice" such that "consumers … would not be able to quickly take the various actions necessary to immediately replace them." SA442_(Dkt.535:193). But no party presented evidence suggesting that these (or any) cigarette purchasers would need *immediate* replacement tobacco products. The proper but-for analysis, moreover, assumes a world in which untaxed cigarettes were not available *at all* through UPS - not a sudden interruption in delivery.

Transportation. The court also faulted Dr. Nevo for not "consider[ing] the transportation limitations of New York City dwellers in accessing cars to drive out of state." SA442_(Dkt.535:193). But no party introduced evidence as to transportation limitations of New York City dwellers or their effect on diversion - and not all of the consumers at issue live in New York City. For those that do, across ***106** the Hudson in New Jersey, consumers pay only $2.70 per pack in state tax, compared with New York's $4.35. *Compare* N.J. Stat. Ann. 54:40A-8 (twenty-cigarette pack), *with* N.Y. Tax L. § 471(1). And the district court apparently overlooked the multiple public transportation options available to New Yorkers, even though the PATH terminal - with direct trains to New Jersey - is within walking distance of the courthouse.

Plaintiffs failed to introduce any evidence contradicting Dr. Nevo's conclusions, and the district court could identify no contrary evidence. *See Wu Lin v. Lynch*, 813 F.3d 122, 127 (2d Cir. 2016) (clear error includes where there is "no evidence at all to support a finding of fact"); *NAACP v. Town of East Haven*, 70 F.3d 219, 224 (2d Cir. 1995) ("An assumption cannot pass for a factual finding"). The record therefore supports, at most, a 5.4% diversion rate.

Accordingly, any compensatory damages have to be further reduced from a 50% diversion rate to at most 5.4% - an additional 90% reduction in the amount of recoverable damages - as reflected in the chart above.

***107 C. The Penalties Are Disproportionate And Excessive.**

By any objective standard, the conduct at issue in this tax dispute - UPS's transportation of packages from fifteen shipper groups located on Indian reservations in upstate New York - does not merit the $237.6 million in penalties imposed by the district court. The district court assessed substantial penalties for the same conduct under each of three penal regimes: The district court first assessed a penalty under the AOD, *see* SA479-81_ (Dkt.536:11-13), then it assessed a penalty under the PACT Act, *see* SA481-85_ (Dkt.536:13-17), and it then assessed *another* penalty under the PHL, *see* SA485-87_(Dkt.536:17-19). This triple-counting was itself improper and served to propel the combined penalties far beyond acceptable boundaries.

Whether considered individually (*i.e.*, $80 million each) or collectively (*i.e.*, $240 million), the penalty awards here are disproportionate to both Plaintiffs' loss and UPS's gain. The compensatory damages award is $9.4 million, and the tax diversion actually proven at trial, if any, was a tenth of that. Moreover, UPS's gain from the conduct at issue was likewise minimal: It

earned $5.2 million in revenue and $475,000 in total profit on every package sent by any shipper as to whom Plaintiffs alleged liability - *whatever* the contents, *wherever* shipped, and *no matter whether* that shipper was one for which the district court found UPS liable. *See* JA1881, 1953-54_(DX-545, DX-601:8-9). The penalties imposed by the district ***108** court are many multiples of these figures, and as such are unlawfully and unconstitutionally disproportionate. They are also excessive under the familiar frameworks for reviewing punitive exactions.

As a matter of *federal common law*, "the degree of discretion enjoyed by trial courts in these matters is relatively narrow" where there are a lack of "objective standards" to guide punitive awards. *Turley v. ISG Lackawanna, Inc.*, 774 F.3d 140, 164 (2d Cir. 2014) (internal quotation marks omitted) (citing *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 499 (2008)). This Court has an independent "obligation to ensure that such awards for intangibles be fair, reasonable, predictable, and proportionate," particularly because penalties "are imposed in civil proceedings in which the defendants do not receive the protections afforded to criminal defendants." *Payne v. Jones*, 711 F.3d 85, 93-94 (2d Cir. 2013). Moreover, courts applying civil penalties must ensure their awards are proportionate to considerations of "retribution and deterrence." *Tull v. United States*, 481 U.S. 412, 422-23 (1987).

Statutory civil penalties violate the *Due Process Clause* when they are "so excessive as to constitute a taking of the defendant's property without due process of law." *Waters-Pierce Oil Co. v. State of Texas*, 212 U.S. 86, 111 (1909). Punitive damages are subject to the same due process constraints. *See* *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 575 (1996). Although the district court said that *Gore* applies only to punitive damages awards, not statutory penalties (SA452_(Dkt.535:203)), ***109** the relevant considerations are hallmarks of all due process excessiveness analyses and are derived from the statutory penalty context. *Cooper Indus.*, 532 U.S. at 432-35; *see* *Parker v. Time Entm't Co.*, 331 F.3d 13, 22 (2d Cir. 2003) (recognizing that statutory penalties may raise due process concerns).

The *Excessive Fines Clause* "limits the government's power to extract payments, whether in cash or in kind, 'as punishment for some offense.'" *Austin v. United States*, 509 U.S. 602, 610 (1993) (emphasis omitted) (quoting *Browning-Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 265 (1989)). A penalty violates the Eighth Amendment if it is "grossly disproportional to the gravity of the defendant's offense." *United States v. Bajakajian*, 524 U.S. 321, 337 (1998).

To channel and guide judicial review, courts have identified several factors against which punishment must be compared. *See* *Advance Pharm., Inc. v. United States*, 391 F.3d 377, 399 (2d Cir. 2004) (common law) ("(1) the level of defendant's culpability, (2) the public harm caused by the violations, (3) defendant's profits from the violations, and (4) defendant's ability to pay a penalty"); *Gore*, 517 U.S. at 575 (Due Process Clause) ((1) reprehensibility of the defendant's conduct, (2) ratio of the punitive award to actual harm, and (3) penalties available for comparable conduct); *United States v. Viloski*, 814 F.3d 104, 110-11 (2d Cir. 2016) (Excessive Fines Clause) ((1) the "essence of the crime"; (2) "whether the defendant fits into the class of persons for whom the statute was principally designed"; (3) "the ***110** maximum sentence and fine"; (4) "the nature of the harm caused"; and (5) "whether a forfeiture would deprive an offender of his livelihood.").

Because there is some overlap among these factors, UPS discusses them below in five categories as indicated in the chart below.

Brief	Common Law	Due Process Clause	Excessive Fines Clause

Culpability	Retribution; Culpability	Reprehensibility	Essence of Offense
Harm	Public Harm	Ratio to Actual Harm	Nature of Harm
Comparable Sanctions	-	Comparable Sanctions	Class of Persons; Max Sentence
Deterrence	Deterrence	-	-
Wealth	Profits; Ability to Pay	-	Livelihood

1. UPS's Culpability Does Not Warrant Penalties.

The district court concluded that "the facts demonstrate a high level of culpability by UPS." SA475_(Dkt.536:7). On the very next page, the court then acknowledged that UPS "bears a lower level of culpability" than the principal bad actors at which the statutes were aimed. SA476_(Dkt.536:8). The court's conflicting, impressionistic conclusions are no substitute for the factors courts have adopted to conduct excessiveness review - all of which show that UPS's conduct does not warrant punishment at all, much less punishment of this magnitude.

***111** "Perhaps the most important indicium" of excessiveness is "the degree of reprehensibility of the defendant's conduct." *Gore*, 517 U.S. at 575. The Supreme Court has identified a number of factors indicating higher culpability: (1) physical, as opposed to economic, harm; (2) indifference to or reckless disregard of the health or safety of others; (3) the target's financial vulnerability; (4) repeated actions, rather than an isolated incident; and (5) intentional malice, trickery, or deceit, or mere accident. *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 419 (2003). This Court has held that a punitive damages award may not be "in significant excess of [the] compensatory damages award" for conduct that did not "not result in physical injury, nor … evince an indifference to or reckless disregard for the health or safety of others" - even where it might have involved "intentional discrimination," was "more than merely negligent," and "did not arise from a single discrete act, but occurred over a period of time." *Thomas v. iStar Fin., Inc.*, 652 F.3d 141, 148 (2d Cir. 2011) (per curiam) (cleaned up). UPS's conduct falls far short of even *Thomas*'s "moderate level of reprehensibility," 652 F.3d at 149. Plaintiffs suffered only economic harm, in the form of lost tax revenue, and neither the State nor the City of New York could possibly be deemed financially vulnerable victims.

As even the district court acknowledged, UPS's "knowledge" of cigarette shipments was - at best - constructive. The court imputed low-level knowledge to the corporation through agency principles; and even this imputation supported only ***112** conscious avoidance, not actual knowledge. *See* SA395-404_(Dkt.535:146-55); *see also* SA265, 280-81_(Dkt.535:16, Dkt.535:31-32). And the district court found only that UPS consciously avoided the possibility that the liability shippers were shipping cigarettes - *not* that UPS knew any particular package actually contained cigarettes. SA398-400_(Dkt.535:149-51). The "essence" of UPS's conduct, even under the district court's findings, is confined to reporting and regulatory compliance failures. *See* *Bajakajian*, 524 U.S. at 337. This Court has previously rejected substantial penalties where the defendant's conduct was "best described as turning a blind eye," not intentional criminality. *Von Hofe v. United States*, 492 F.3d 175, 189 (2d Cir. 2007). *Cf.* SA391, 399-400_(Dkt.535:142, 150-51).

New York conceded in closing argument that "we're talking about a relative handful of those brown-truck routes" and "a few account executives." JA1057_ (TrialTr.1903:21-23). The district court never made *any* finding that any UPS employee above a driver or field-level account executive had actual knowledge of cigarette shipments. Tellingly, the district court found that when high-level officers had such knowledge, they took appropriate action. *See* SA260-61, 265, 269, 287, 290-92_(Dkt.535:11-12, 16, 20, 38, 41-43). Yet the district court simply ignored in its penalty analysis undisputed evidence of UPS's good-faith compliance efforts. For example, when a driver informed a shipping center supervisor of his belief that certain shippers were tendering cigarettes, security personnel called ***113** Officer Nitti of the New York State Police and received instructions from him to continue carrying the packages so as not to disrupt an ongoing investigation. *See* SA282-84_(Dkt.535:33-35). Yet those very packages are included in the district court's penalty calculations. That is not a rational approach to government-sponsored punishment.

Although imputed corporate knowledge can lead to corporate liability, it cannot support the imposition of punitive sanctions without evidence that managerial employees directly participated in or ratified low-level unlawful conduct. *See*, *e.g.*, *Kolstad v. Am. Dental Ass'n*, 527 U.S. 526, 541 (1999) ("The common law has long recognized that agency principles place limits on vicarious liability for punitive damages"); *see also* *Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 108 (1991) (holding that courts "may take [common law principles] as a given … except when a statutory purpose to the contrary is evident" (cleaned up)). Although UPS raised this point below, *see* JA495-98_ (Dkt.492:229-32), the district court had no answer for it.

Under federal common law, a principal cannot be liable for punitive or exemplary damages (beyond compensatory damages) when the necessary scienter is not directly attributable to it. *See*, *e.g.*, *Lake Shore & Mich. S. Ry. Co. v. Prentice*, 147 U.S. 101, 112 (1893); *The Amiable Nancy*, 16 U.S. 546, 559 (1818); *see also* *Roginsky v. Richardson-Merrell, Inc.*, 378 F.2d 832, 842 & n.18 (2d Cir. 1967) ***114** (noting New York's similar "complicity rule"). More recently, the Supreme Court has applied this principle to Title VII, permitting punitive damages only where managerial employees (a) authorized the act, (b) recklessly employed an unfit agent, (c) participated in the act itself, or (d) ratified the act. *Kolstad*, 527 U.S. at 542-43 (citing Restatement (Second) of Agency § 217C (1957)). And far from expressing statutory intent to the contrary, the PACT Act *itself* expressly adopts a limitation that the common carriers will not be liable for acts committed solely by low-level employees. *See* 15 U.S.C. § 377(b)(3)(B)(ii). As a result, under governing common-law principles, imputed knowledge cannot be used to impose inherently punitive sanctions like civil penalties - which serve the same remedial goals as punitive damages, *see* *Tull*, 481 U.S. at 422 n.7 - where the only evidence of scienter is limited to low-level or non-managerial employees.

Thus, even accepting the district court's findings regarding UPS's "knowledge" for liability purposes and an award of compensatory damages, those findings do not approach the "high degree of culpability that warrants a substantial [penalties] award." *Gore*, 517 U.S. at 580.

2. Any Economic Harm Is Remedied By Compensatory Damages.

The harm caused by UPS's conduct was purely economic in nature (*i.e.*, "lost" tax revenues), which warrants lower penalties than offenses causing physical injury. *See* *Gore*, 517 U.S. at 583. The district court acknowledged that "it is unclear ***115** whether, in the absence of UPS's transport of cigarettes, the same public health effects would still be felt" and specifically found "it could not speculate as to this." SA476_(Dkt.536:8). It nonetheless concluded "significant penalties are appropriate" (SA470_(Dkt.536:2) because of "UPS's unlawful enablement of a public health impact that the political branches

have proscribed and the costs of which New Yorkers must bear" (SA476_(Dkt.536:8)). But the impact of *smoking* on public health is distinct from an impact of *UPS's conduct* on public health, and neither Plaintiffs nor the district court identified any evidence that UPS's conduct had *any* such discernible impact.

Accordingly, the only harm that the district court found UPS to have caused is quantifiable as lost tax revenue, which is fully remedied by an award of compensatory damages at the correct tax-diversion rate. But because the damages as calculated by the court far exceed the revenue - let alone profit - UPS received for the conduct at issue, the "compensatory" award already contains a punitive component. The court's decision to impose additional "significant penalties" on public harm grounds (SA470_(Dkt.536:2)) without any causal findings constitutes an abuse of discretion. *See* *Gasperini*, 149 F.3d at 142 (finding abuse of discretion where determinations are "unsupported by the facts").

As well as being unsupported by evidence of public harm, the penalties far exceed permissible ratios between a penalty and "the actual harm inflicted on the ***116** plaintiff," which is "[t]he second and perhaps most commonly cited indicium" of constitutional excessiveness. *Gore*, 517 U.S. at 580. Although the Supreme Court has declined to establish a concrete mathematical calculation, it has held that "single-digit multipliers are more likely to comport with due process, while achieving the State's goals of deterrence and retribution." *State Farm*, 538 U.S. at 425; *accord* *Pac. Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 23-24 (1991) (noting that a 4:1 ratio is "wide and, indeed, may be close to the line"); *Turley*, 774 F.3d at 165 (same). "[W]hen a compensatory award is particularly high, a 1:1 ratio between compensation and punishment may be the maximum award permitted by the Constitution." *Turley*, 774 F.3d at 167 (citing *State Farm*, 538 U.S. at 425); *see also* *Thomas*, 652 F.3d at 149 (where compensatory damages are "very substantial," this factor "weighs heavily in favor of a punitive damages award equal to or less than the remitted compensatory damage award").

Here, the district court assessed compensatory damages of $8,679,729 to the State and $720,885 to the City. *See* SA489_(Dkt.536:21). The AOD penalties alone exceed an 8:1 ratio - more than double *Haslip*'s "line." 499 U.S. at 24. The State's total $157,137,750 in statutory and AOD penalties exceed an *18:1* ratio of penalties to compensatory damages, and the City's total $80,437,250 statutory penalties exceed a jaw-dropping *111:1* ratio. (Correcting the tax-diversion-rate error discussed above would explode the ratios to 167:1 for the State and 1,033:1 for the City.) ***117** Compounding that punishment by imposing double- and triple-digit ratios in penalties "furthers no legitimate purpose and constitutes an arbitrary deprivation of property." *State Farm*, 538 U.S. at 417. Any punishment in this case must be proportional to the actual harm sustained by Plaintiffs as well as the gains to UPS.

3. The Penalties Dwarf Comparable Sanctions.

In analyzing comparable sanctions, the Supreme Court has historically looked to civil and criminal statutes addressing comparable conduct. *See*, *e.g.*, *State Farm*, 538 U.S. at 428; *Gore*, 517 U.S. at 583-84. This Court has also looked to other cases involving similar conduct. *See*, *e.g.*, *Turley*, 774 F.3d at 166.

A closely analogous penalty is the federal Sentencing Guidelines' range of sentences for trafficking cigarettes under the CCTA. *See* U.S.S.G. § 2E4.1 (Nov. 1, 2014); *cf.* *Bajakajian*, 524 U.S. at 338 (looking to the Sentencing Guidelines for comparable conduct). As the Guidelines make clear, tax evasion is the principal conduct at which these statutes are directed, not the transportation of unmarked packages for which UPS was punished. U.S.S.G. § 2E4.1; *see also* *R.J. Reynolds*, 268 F.3d at 129. The Guidelines are particularly relevant, because they are designed specifically to avoid hypertechnical, per-violation

penalty calculations where the conduct at issue "involv[es] substantially the same harm." U.S.S.G. § 3D1.2 (specifically identifying cigarette trafficking as offense conduct that should be grouped); *see also id.* § 1A1.4(e) (discussing policy reasons for grouping offense ***118** conduct, including "minimiz[ing] the possibility that an arbitrary casting of a single transaction into several counts will produce a longer sentence").

The operative Guidelines establish the appropriate fine for more culpable conduct as equal to or double the amount of pecuniary loss caused (*i.e.*, a 1:1 or 2:1 ratio). *See* U.S.S.G. §§ 2E4.1, 2T4.1, 8C2.4(d), 8C2.6 (Nov. 1, 2014). Under the Guidelines - even if the district court's inflated compensatory damages award were sustained - the court could have awarded only an *aggregate* penalty between $9.4 million and $18.8 million. Instead, the district court awarded more than four times the maximum end of that range in AOD penalties *alone* ($80.4 million) - and *twelve* times that in total penalties ($237.6 million). By comparison, this Court in *Von Hofe* struck down a forfeiture that tripled the Guidelines range and that was a mere eighth of the statutory maximum. 492 F.3d at 189.

What's more, the principal bad actors here were the shippers that made delivery sales of untaxed cigarettes, "acting contrary to law and UPS policy" (SA279_(Dkt.535:30)) - the same shippers to whom the government offered leniency if they cooperated against UPS. *See*, *e.g.*, JA847, 871, 872, 1005_ (TrialTr.1068:12-1069:16, 1160:19-21, 1163:2-17, 1696:8-1697:20); JA387-91, 1463_(DX-701, ¶¶ 7-8; PX-627). In passing the PACT Act, Congress expressly identified the classes of persons the statute was principally designed to punish: cigarette traffickers, tax evaders, and individuals who sold cigarettes to minors. *See* ***119** Pub. L. 111-154, sec. 1(c), 124 Stat. at 1087-88. UPS is none of these. Likewise, New York identified delivery sellers of cigarettes (particularly to minors) and cigarette bootleggers as the principal focus of its new delivery sales regime. *See* Act of August 16, 2000, 2000 N.Y. Sess. Laws, ch. 262, sec. 1. The only mention of common carriers in the PHL is in one subsection, *id.* sec. 2, §1399-*ll*(2), while the rest of the Act focuses on licensed cigarette dealers, retail entities, and their agents.

The penalties awarded against UPS as a secondary actor are plainly excessive when compared to penalty awards against primary actors. *See*, *e.g.*, JA836_ (TrialTr.1024:17-25) (one shipper at issue was never ordered to pay $1 million restitution). For example, in a case in which actual sellers of untaxed cigarettes faced statutory penalties, the City "concede[d]" that "the per violation measure" of damages under the PACT Act would "suggest an excessive penalty" and argued instead for "a penalty up to 2% of each defendant's gross sales of unstamped cigarettes." *City of New York v. Milhelm Attea & Bros., Inc.*, No. 06-cv-3620, 2012 WL 3579568, at *32 (E.D.N.Y. Aug. 17, 2012). The court noted that such a penalty would approximate $7.3–7.4 million per defendant, each of whom had sold over *10 million cartons* of unstamped cigarettes over a three-year period. *See id.* at *8-9. By contrast, the district court here imposed $237.6 million in penalties on UPS not for selling but for transporting fewer than *400,000 cartons* - ***120** even under the court's flawed package counts. This disparity cannot be characterized as anything but excessive.

The relevant legal regimes also suggest lower penalties. The AOD establishes a $1,000 penalty for the knowing transportation of cigarettes by UPS. *See* SA508_(DX-23:16). The PHL authorizes a maximum of $5,000 per knowing shipment by delivery sellers *or* common carriers. PHL § 1399-*ll*(5). The PACT Act sets civil penalties for common carriers at half the maximum imposed on delivery sellers and does not impose penalties for the misconduct of low-level employees. 15 U.S.C. § 377(b)(1)(B), (3)(B)(ii). And, as noted above, the PACT Act contemplates penalties equaling 2% of a delivery seller's gross revenue from cigarettes and smokeless tobacco. *See* 15 U.S.C. § 377(b)(1)(A)(ii); *see also Milhelm Attea*, 2012 WL 3579568, at *32 (applying the 2% metric to avoid "an excessive penalty amount if the per violation measure were used"). By contrast, the penalties here completely invert that ratio: UPS's *revenue* from every shipper Plaintiffs alleged to have shipped cigarettes (not all of which were even presented at trial) is 2% of the *penalties.* And numerous States with prohibitions and penalties for delivery sales do not impose *any* penalties on common carriers. *See*, *e.g.*, Cal. Bus. & Prof. Code § 22963(d). Others impose far lower

penalties on common carriers than on shippers. *See*, *e.g.*, Ind. Code § 24-3-5-5(b). A multi-million dollar penalty cannot be reconciled with these legislative determinations regarding the appropriate level of punishment.

***121 4. Further Deterrence Is Not Warranted.**

The district court made contradictory findings on deterrence. The court expressly denied injunctive relief on several factual findings: (1) "UPS has implemented oversight processes that should prevent repetition" of non-compliance; (2) "UPS has demonstrated that it is more likely than not that it is far more capable today of affirmatively working to identify and take action to ensure it honors the AOD"; (3) UPS "has shown by a preponderance of the evidence that a sufficient number of future violations are unlikely to support the rather harsh imposition of injunctive relief or a monitor"; and (4) "it is likely that this lawsuit, including the resulting reputational and financial costs, provide standalone economic motivation for UPS to proceed more carefully in the future." SA467_(Dkt.535:218). The district court similarly found that UPS is currently complying with the AOD and relevant statutory regimes - and that this enhanced focus on compliance began more than eighteen months before the litigation. *See* SA263_(Dkt.535:14); *see also* SA476_(Dkt.536:8). These findings do not support the imposition of any penalties.

Elsewhere, however, the district court concluded that "only a hefty fine will impact such a large entity sufficient to capture the attention of the highest executives of the company - executives who then, in a rational economic move, will cause changes in practice and procedures to be strictly maintained." SA447_(Dkt.535:198).

***122** Civil penalties serve the purposes of both "retribution and deterrence, in addition to restitution." *Tull*, 481 U.S. at 422. But even accepting the district court's conclusions that UPS's procedures did not comport with every jot and tittle of the AOD, its opinions are replete with uncontroverted findings that UPS *did* pursue more aggressive compliance with the AOD as early as 2013. *E.g.*, SA263_(Dkt.535:14). And not only did UPS consistently implement good-faith compliance efforts, the district court found that "as of February 18, 2015, UPS was again honoring the AOD." SA393_ (Dkt.535:144). Thus, the district court's emphasis on specific deterrence in its penalties calculation is internally inconsistent because UPS was *already* in compliance before the trial even began, before any "hefty fine" was levied. *See* SA477_(Dkt.536:9).

The district court also made no findings on general deterrence - nor could it. UPS is one of only four major carriers, and none of the others would be deterred by the penalty here. The Postal Service is a government entity that cannot transport cigarettes. *See* 18 U.S.C. § 1716E. FedEx's conduct is the subject of a similar suit brought by Plaintiffs, *see City of New York v. Fedex Ground Package Sys., Inc.*, No. 13-cv-9173 (S.D.N.Y.), and DHL ceased its domestic delivery service within the United States in 2009, *see* Aaron Smith, *DHL to Cut 9,500 Jobs*, CNNMoney.com (Nov. 10, 2008), http://money.cnn.com/2008/11/10/news/companies/dhl/index.htm. ***123** Penalizing UPS cannot be rationalized in terms of influencing other carriers' conduct.

5. UPS Cannot Be Penalized For Its Success.

The district court misapplied the law governing its consideration of UPS's financial condition in assessing penalties, first by using UPS's wealth to inflate penalties and second by relying on erroneous assumptions about UPS's gain from the relevant conduct.

When assessing a defendant's ability to pay a penalty, courts must assess whether the defendant is unable to pay the penalty, not whether its financial health warrants increasing the penalty. *Advance Pharm.*, 391 F.3d at 400; *accord United States v. Global Distribs., Inc.*, 498 F.3d 613, 621 (7th Cir. 2007) (examining whether defendant's financial condition "would allow

[it] to pay a $200,000 fine"); *see also* *Viloski*, 814 F.3d at 114 (asking "whether the challenged forfeiture would deprive Viloski of his livelihood").

This is an inescapable outgrowth of our constitutional tradition, which does not countenance punishing a rich defendant more harshly than a poor one. *Cf.* *State Farm*, 538 U.S. at 427 ("The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award"); 28 U.S.C. § 994(d) (requiring the Guidelines to be "entirely neutral as to the … socioeconomic status of offenders"). The district court's reliance on UPS's financial health to *increase* penalties, ***124** SA477_(Dkt.536:9), was legal error and thus "necessarily" constituted an abuse of discretion. *See* *Dart Cherokee*, 135 S. Ct. at 555.

Nor does UPS's gain from the relevant conduct indicate that high penalties are warranted. The district court acknowledged that UPS's relatively small profits "suggests a low amount of penalties" but identified additional, purportedly "relevant metrics." SA476_(Dkt.536:8). It concluded that "maintaining customers helps UPS's overall competitive position" and that "it is reasonable to infer that this assists the acquisition of business through network effects and economies of scale." SA476_(Dkt.536:8). No evidence supported either of these conclusions, nor did the district court identify any. And the conclusions constitute legal error: Courts must look only to the "gross" and "net profits" of the defendant's conduct, not to attenuated economic concepts. *Advance Pharm.*, 391 F.3d at 400; *accord Global Distribs.*, 498 F.3d at 621 (applying *Advance Pharmaceutical* and looking only to actual revenue and profit).

Indeed, the $237.6 million total penalties dwarf the losses, if any, sustained by Plaintiffs (as demonstrated by comparison to the chart at the conclusion of Part II.A.), as well as the money UPS actually received for all packages shipped by the shippers in this case, not just those encompassed by the judgment (as demonstrated in the chart below). *See* JA1881, 1953-54_(DX-545, DX-601:8-9). Such a significant gap far exceeds permissible limits and "cannot be located within the ***125** range of permissible decisions." *Zervos v. Verizon N.Y., Inc.*, 252 F.3d 163, 169 (2d Cir. 2001); *see also Global Distribs.*, 498 F.3d at 621.

Comparator	Amount	Penalties as Multiple of Comparator
UPS *Revenue* from Any Alleged Shipper for Any Shipment Delivered Nationwide	$5,200,000	50x
UPS *Profit* from Any Alleged Shipper for Any Shipment Delivered Nationwide	$475,000	500x

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The district court's penalty awards are unlawfully disproportionate and grossly excessive. An $80 million punishment under any liability theory *alone* cannot be sustained under the pertinent factors, much less the *triple-dipping* that the court engaged in by repeatedly punishing UPS for the same conduct. This Court should vacate the penalties entirely or, at minimum, reduce them to an amount "equal to or less than the remitted compensatory damages award." *Thomas*, 652 F.3d at 149; *see also id.* at 147 n.6. If any penalties are available here, they should not exceed either the actual harm to Plaintiffs (properly calculated) or UPS's profits - both of which are in the hundreds of thousands, not the hundreds of millions, of dollars.

***126 CONCLUSION**

For the foregoing reasons, UPS respectfully requests that this Court -
• REVERSE the judgment of liability and attendant penalties under the PACT Act and PHL (Part I.A.);

• REVERSE the judgment of liability and attendant penalties under the AOD or, in the alternative, REDUCE the penalty award to $20,000 (Part I.B.);

• REVERSE the judgment of liability and attendant damages and penalties under the CCTA (Part I.C.);

• REVERSE any remaining awards of damages and penalties in their entirety; or, at minimum, VACATE the awards except as limited to the Arrowhawk group (or, in the alternative, the Arrowhawk, Jacobs, and Smokes & Spirits groups) and as limited to the actual evidence adduced at trial (Part II.A.);

• REDUCE any remaining compensatory damages to reflect a 5.4% tax diversion rate (Part II.B.); and

• REVERSE the awards of penalties or, in the alternative, REDUCE any penalty award to at most a 1:1 ratio to compensatory damages as otherwise reduced (Part II.C.).

***127** Dated: March 28, 2018

Respectfully submitted.

/s/ Mark A. Perry

Mark A. Perry

Counsel of Record

Christopher J. Baum

Aidan Taft Grano

GIBSON, DUNN & CRUTCHER LLP

1050 Connecticut Avenue, N.W.

Washington, D.C. 20036

(202) 955-8500

Caitlin J. Halligan

GIBSON, DUNN & CRUTCHER LLP

200 Park Avenue

New York, NY 10166

(212) 351-4000

Deanne E. Maynard

MORRISON & FOERSTER, LLP

2000 Pennsylvania Avenue, N.W.

Suite 6000

Washington, D.C. 20006

(202) 887-1500

Paul T. Friedman

MORRISON & FOERSTER, LLP

425 Market Street

San Francisco, CA 94105

(415) 268-7000

Counsel for Appellant/Cross-Appellee

United Parcel Service, Inc.

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