17-1993 (L)

17-2107, 17-2111 (XAP)

In the United States Court of Appeals for the Second Circuit

THE STATE OF NEW YORK, THE CITY OF NEW YORK,

Appellees/Cross-Appellants,

v.

UNITED PARCEL SERVICE, INC.,

Appellant/Cross-Appellee.

FINAL FORM RESPONSE AND REPLY BRIEF FOR APPELLANT/CROSS-APPELLEE UNITED PARCEL SERVICE, INC.

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

[*counsel listed on inside cover*]

Mark A. Perry
Counsel of Record
Aidan Taft Grano
Shannon Han
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 955-8500

Deanne E. Maynard
MORRISON & FOERSTER, LLP
2000 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 887-1500

Caitlin J. Halligan
GIBSON, DUNN & CRUTCHER LLP
200 Park Avenue
New York, NY 10166
(212) 351-4000

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.

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued) **Page**

TABLE OF AUTHORITIES

Page(s)

Cases

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF AUTHORITIES
(continued)

Page(s)

Statutes

TABLE OF AUTHORITIES
(continued)

Page(s)

Rules

Treatises

Other Authorities

TABLE OF AUTHORITIES
(continued)

Page(s)

TABLE OF ARGUMENTS

This complex appeal presents multiple issues. For the convenience of the Court, UPS has compiled the following table, which lists the principal arguments and the page ranges discussing that argument in each brief filed to date:

Issue	UPS Principal	Amici Curiae ISO UPS	NY Principal/ Response	Amici Curiae ISO NY	UPS Response/ Reply
"Honored"	27-41 (I.A.)	ATA: 2-22	54-70 (I.A.)	Cal.: 9-15	8-29 (I.A.)
AOD Penalty	42-61 (I.B.)	*N/A*	71-83 (I.B.)	*N/A*	30-52 (I.B.)
CCTA	62-68 (I.C.)	ATA: 22-31	83-92 (I.C.)	*N/A*	53-61 (I.C.)
Damages/ Penalties Sufficiency	69-104 (II.A.)	*N/A*	94-132 (II.A.-B.)	*N/A*	62-93 (II.A.)
Tax Diversion	104-106 (II.B.)	*N/A*	140-142 (II.C.2.)	*N/A*	94-97 (II.B.)
Excessive Penalties	107-125 (II.C.)	CAA: 6-9; La.: 2-8; Chamber: 6-25; WLF: 7-27	142-168 (II.D.)	CTFK: 21-29	98-114 (II.C.)
Causation	*N/A*	*N/A*	133-139 (II.C.1.)	*N/A*	115-122 (III.)

TABLE OF ABBREVIATIONS

Abbreviation	Full Name
AOD	Assurance of Discontinuance
Cal.	Brief of California et al. in Support of Plaintiffs
CAA	Brief of the Cigar Association of America, Inc. in Support of UPS
CCTA	Contraband Cigarette Trafficking Act
Chamber	Brief of the Chamber of Commerce in Support of UPS
DX	Defendant's Exhibit
Dkt.	District Court Docket Entry
JA	Joint Appendix
NCL	Non-Compliant List
NYAG	New York Attorney General
PHL	New York Public Health Law § 1399-*ll*
Pls.	Plaintiffs' Principal and Response Brief (Final Form)
PX	Plaintiffs' Exhibit
PACT Act	Prevent All Cigarette Trafficking Act
SA	Special Appendix
Tr.	Trial Transcript
UPS	United Parcel Service, Inc.
UPS Br.	UPS's Principal Brief (Final Form)
WLF	Brief of the Washington Legal Foundation in Support of UPS

INTRODUCTION

Reprising their trial strategy, Plaintiffs apparently hope that rhetoric and invective will lead the Court to ignore the legal errors they seek to perpetuate and the deficiencies of proof they never explain. This is a court of appeals, and for that reason UPS has focused on discrete errors—almost all reviewed *de novo*—committed by the district court. Plaintiffs' extensive recitation of misleading facts shows they have no adequate response on the law. UPS returns to the legal points below but makes a few preliminary observations about the factual milieu in which they arise.

First, while Plaintiffs try to paint a picture of widespread compliance failures at UPS, they admitted in closing argument that "the problem was highly localized," involving "a relative handful of those brown-truck routes" in upstate New York and "a few account executives" (low-level sales employees). JA1057-58_(Tr.1903:21-23, 1908:8). The district court made no finding that any UPS managerial employee was actually aware of or participated in transporting cigarette shipments. To the contrary, in each instance in which the court found that a managerial employee had actual knowledge of cigarette shipments, UPS immediately responded according to the procedures specified in the AOD. *See* SA260-61, 265, 287, 290-92_(Dkt.535:11-12, 16, 38, 41-43). Plaintiffs' theory of systemic corporate nonfeasance is baseless.

To call Plaintiffs' factual summary cherry-picked would be unfair to cherry-pickers. In most instances, Plaintiffs do not offer an "illustrative example"—they

offer their *only* example. *Compare*, *e.g.*, Pls. 24 (citing a single "UPS sales employee" who "could not recall a specific instance" of tobacco training), *with* JA1902-06, ¶¶52-60_(DX-600:20-24) (describing UPS's extensive training of drivers, sales employees, and customer service representatives). And in numerous cases, they complain about UPS taking the precise action to which both parties agreed in the AOD. *Compare*, *e.g.*, Pls. 24 (faulting UPS for employing "a single, annual pre-work message on tobacco compliance"), *with* SA506_(DX-23:14) (explicitly requiring a single, annual pre-work message on tobacco compliance); JA1902-03, ¶¶52-54_(DX-600:20-21) (undisputed evidence of UPS's compliance with that requirement). In still more cases, Plaintiffs misrepresent the evidence to allege facts the district court did not find. *Compare*, *e.g.*, Pls. 25 ("UPS implemented no formal audit policies for cigarette shippers"), *with* JA755_(Tr.700:1-24) ("Q. Is there a written policy for how to conduct an audit at UPS? A. Yes, there is. … For this particular case, it would be the tobacco procedures manual."); DX-22:28-36 (UPS's tobacco procedures manual).

UPS here offers only a few examples of Plaintiffs' mischaracterizations of the evidence to demonstrate the unreliability of their presentation:

- Plaintiffs assert that UPS "provided no audit training to its employees." Pls. 25. The cited source is testimony in which UPS's Director of Dangerous Goods stated that the sales department (which does not handle audits) trained sales employees (who do not handle audits) on tobacco compliance but that he was unaware of the specific details of that training. *See* JA639-40_(Tr.244:21-246:21).

- Plaintiffs recount a story in which "actual[] discover[y]" of "impermissible cigarette shipments" caused a UPS employee supposedly "to lament that UPS 'really need[ed]' to 'clarify what is acceptable and what is not,' or else 'a whole lot more "stuff" is going to hit the fan.'" Pls. 26. The cited exhibit shows that this statement concerned whether "cigars that are filterless and are wrapped in tobacco" are permissible to ship (they are). JA1773-75_(DX-274). And the statement concerns a shipper that the district court expressly found never shipped cigarettes. *See* SA315_(Dkt.535:66).

- Plaintiffs highlight a shipper, Bearclaw Unlimited, as its only example "of UPS's near-total disregard of its obligations under the AOD." Pls. 29. But UPS took precisely the steps the AOD requires, including "discuss[ing] the violation with" the shipper's management, "ask[ing] the customer to increase its [compliance] efforts" and obtaining a written action plan confirming staff training and future adherence to the policy. SA502, ¶28_(DX-23:10); *see* JA1911, ¶73_(DX-600:29); DX-115; DX-119. Plaintiffs' complaint about the lack of "further audits" or "meaningful remedial action" ignores that the AOD required no further remedial action for a first violation, nor did it require further audits *unless* a shipper's services had been "reinstated" after cancellation. SA503, ¶28_(DX-23:11). Moreover, Plaintiffs ignore that UPS later terminated Bearclaw on its own initiative and years before any hint of litigation, after the shipper failed an audit triggered by new information. *See* JA1912, ¶75_(DX-600:30).

Second, even setting aside the defects in Plaintiffs' factual recitations, Plaintiffs' case statement offers nothing new relating to UPS's three arguments on liability or to the legality of penalties (pure questions of law), no facts that bolster the gaping evidentiary deficiencies in their case (questions of the legal sufficiency of evidence on which the district court indisputably relied), and nothing supporting their cross-appeal's attempt to eliminate the basic element of causation from compensatory damages (a pure question of law). Peeling back Plaintiffs' sensationalized

dramatization reveals that, on the core issues confronting the Court, they have remarkably little to offer.

Most tellingly, Plaintiffs still have not pointed this Court to a *single* specific package, its contents, or UPS's knowledge of them. Not a single dollar of the district court's quarter-billion-dollar judgment is based on a finding that a particular package contained cigarettes and that UPS knew about it. In a case where that is the core conduct giving rise to liability under each of Plaintiffs' claims, after full discovery and a trial, this lacuna is remarkable. Plaintiffs bore the burden of proving that UPS knowingly transported cigarettes. Their brief in this Court confirms that they failed to discharge that burden. It is no wonder, then, that each liability theory and every monetary component of the judgment is riddled with reversible error.

* * *

In the end, Plaintiffs' statement of the case is a tale "full of sound and fury, signifying nothing." WILLIAM SHAKESPEARE, MACBETH, act 5, sc. 5. Both UPS's appeal and Plaintiffs' cross-appeal present fundamental issues of *law*. As described in the following pages, Plaintiffs offer no compelling defense of their tenuous legal positions, and no amount of extraneous material can obscure those deficiencies.

SUMMARY OF ARGUMENT

The judgment rests on a series of legal errors, nearly all reviewed *de novo*, which require reversal in whole or in substantial part.

I.A. To defend the $157 million award under the PACT Act and PHL, Plaintiffs must show that Congress intended the phrase "honored throughout the United States" to require a standardless compliance inquiry. Plaintiffs cannot do so because all the tools of statutory interpretation establish an objective inquiry: whether the AOD remains in effect and operates nationwide, which it undisputedly does.

I.B. To defend the $80 million award under the AOD, Plaintiffs must show *both* (1) that the stipulated penalty provision applies to every breach, no matter how minor, *and* (2) if applied to the audit provision, that the parties intended per-package penalties. Plaintiffs cannot do so because (1) the penalty provision applies only to "violations," which the AOD defines as a knowing shipment of cigarettes to an individual consumer, and (2) the audit obligation (and thus any penalty for breach) applies to shippers, not packages.

I.C. To defend the $9.4 million award under the CCTA, Plaintiffs must show *both* (1) that the CCTA permits aggregating multiple shipments to meet the threshold quantity, *and* (2) that the statute does not require UPS to know the quantity. Plaintiffs cannot do so because (1) the statutory text contemplates only single transactions and (2) Supreme Court precedent requires knowledge of each element.

II.A. To defend the entire $246 million damages and penalties award, Plaintiffs must show (1) that their adjudicated violation of Rule 26 warranted no sanction; (2) that they introduced legally sufficient evidence at trial to calculate package and carton counts from unexplained, voluminous spreadsheets; *and* (3) that the district court could lawfully base its awards on new information submitted post-trial using its own newly invented expert methodology. Plaintiffs cannot do any of these because (1) their willful disclosure failures severely prejudiced UPS, (2) their trial evidence provided no basis for package and carton counts (as the district court itself recognized), and (3) damages and penalties may not be awarded on theories a party was never allowed to rebut, information it could never confront, and a judge's *sui generis* methodology it could not cross-examine.

II.B. To defend the $9.4 million compensatory damages award, Plaintiffs must show that the record supports the district court's 50% tax diversion estimate. Plaintiffs cannot do so because they provided no trial evidence at all on this point.

II.C. To defend the district court's $237.6 million penalties award, Plaintiffs must show that it is neither disproportionate nor excessive. Plaintiffs cannot do so because that amount is wholly disproportionate to either Plaintiffs' loss (tax revenue of $9.4 million) or UPS's gain (profit of $475,000 on revenue of $5.2 million) from the challenged conduct and because it exceeds the amount permitted by the Constitution and common law under every accepted consideration.

III. To increase their recovery of compensatory damages to $18.8 million, Plaintiffs must show that the CCTA does not require any causal link between UPS's conduct and the claimed losses. Plaintiffs cannot do so because the Supreme Court has repeatedly held that claimants must prove causation to recover compensatory damages under federal statutes absent a contrary congressional directive.

ARGUMENT

Plaintiffs cannot defend the multitudinous legal errors committed by the district court, as to either liability or damages and penalties.

I. UPS Is Entitled to Judgment on Each Liability Theory.

The district court held UPS liable under two federal laws (the PACT Act and the CCTA), one state law (the PHL), and a contract with New York (the AOD). The liability judgment should be reversed because (A) Congress expressly exempted UPS from the PACT Act, and preempted the PHL; (B) Plaintiffs abandoned their claim under the only AOD provision that authorizes penalties; and (C) the CCTA imposes threshold quantity and scienter requirements that Plaintiffs never proved.

A. The PACT Act Exempts UPS and Preempts the PHL.

The PACT Act exempts UPS from its requirements, and preempts Plaintiffs' PHL claim, if the AOD is "honored throughout the United States." 15 U.S.C. § 376a(e)(3)(B)(ii)(I); *id*. § 376a(e)(5)(C)(ii). The district court acknowledged that this provision can be read in two different ways, and this Court decides *de novo* which of these two competing constructions is correct. *Compare* UPS Br. 27-41 (Argument I.A.), *with* Pls. 54-70 (Argument I.A.).

The district court initially rejected Plaintiffs' compliance-based approach, explaining in detail why that construction is inconsistent with the text, structure, history, and purpose of the PACT Act. *See* SA17-24_(Dkt.49:13-20). Later in the litigation, the district court reversed course and adopted a compliance-based approach,

ostensibly focused on whether UPS's policies "were so compromised that [they] are not in fact in place." SA391_(Dkt.535:142) (cleaned up). Then, the district court declared this standard met on the basis of conduct by "a number of different shippers"—twenty shippers (SA312-15_(Dkt.535:63-66))—"overseen by different Account Executives"—UPS's non-managerial sales employees (SA273-74_(Dkt.535:24-25))—"and serviced by different UPS drivers and Processing Centers"—four processing centers serving four Native American reservations in upstate New York (SA312_(Dkt.535:63)). SA392_(Dkt.535:143).

Thus, even though the AOD had (and continues to have) nationwide operation, the district court negated UPS's congressionally granted exemption because it found highly localized non-compliance with respect to a minute percentage of UPS's customers within a single state. Indeed, even using the district court's unsupported package count findings, this case concerns 80,468 packages transported over six years (*see* SA407_(Dkt.535:158); SA479-81_(Dkt.536:11-13))—a period of time during which UPS delivered more than 35 billion total packages (*see* JA1893, ¶24_(DX-600:11)). Likewise, the handful of sales employees and processing centers at issue are dwarfed by UPS's "350,000 employees in the United States alone" and "over 1,800 separate physical facilities." SA262_(Dkt.535:13). Unlike its previous construction, the district court made no effort to explain how its new "so compromised" standard—or how negating UPS's exemption on the basis of such localized

and low-level conduct—was at all consistent with the text, structure, history, or purpose of the PACT Act. *See* SA144_(Dkt.206:44); SA149_(Dkt.252:2); SA391-92_(Dkt.535:142-43).

The approach ultimately taken by the district court was wrong as a matter of law. In enacting the PACT Act with an exemption, Congress unequivocally chose an "on/off" switch: if the AOD is "on"—*i.e.*, operating nationwide—UPS's obligations and liability are defined solely by the AOD; if the AOD is "off," UPS's obligations and liability are defined by the PACT Act and state delivery laws. UPS Br. 27-41. Under either regime, UPS faces serious—but different—consequences for compliance failures: if the AOD is "on," UPS is subject to damages, stipulated penalties, or other contract remedies; if the AOD is "off," UPS is subject to PACT Act and state law penalties. But as with any contract, a failure to comply with AOD does not render it null or void (and thus turn the switch "off"); it merely creates a cause of action for contract remedies.

The exemption applies if the AOD operates nationwide—an objectively ascertainable fact that permits both government actors and UPS itself to know which regime governs. UPS Br. 27-41. Plaintiffs insist that Congress imposed a subjective inquiry—a standardless, backward-looking determination of whether UPS complied "enough"—that subjects common carriers to their contractual obligations *and* the additional requirements of federal and state law. *See* Pls. 3 ("mutually reinforcing"

regimes); *id.* at 54-70. The construction of this single "honored" clause determines the validity of the PACT Act and PHL awards here, which together constitute two-thirds of the penalties imposed. As Plaintiffs do not dispute, that entire amount ($157,105,000) has to be reversed outright if the Court adopts UPS's construction, as it should.

"[I]n interpreting a statute a court should always turn *first* to one, cardinal canon before all others[:] … [A] legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) (emphasis added); *see also United States v. Dauray*, 215 F.3d 257, 260 (2d Cir. 2000). In addition to the plain text, courts examine "statutory context, structure, history, and purpose" when interpreting a statute. *Abramski v. United States*, 134 S. Ct. 2259, 2267 (2014) (cleaned up); *see also*, *e.g.*, *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061, 1069-78 (2018). *All* of the traditional tools of statutory interpretation establish that the "honored" clause of the PACT Act refers to nation-wide *operation* (an objectively discernible fact), not in-state *compliance* (a subjective standard).

Text. The PACT Act does not define the term "honored," indicating that Congress intended the term to carry its ordinary meaning. *Dauray*, 215 F.3d at 260.

"Honored" should be given its primary legal definition (to accept an obligation as valid) because the primary vernacular meaning (to regard with great respect)

makes no sense in the context of the statute. UPS Br. 30-31. Thus, UPS is exempt from the Act—but remains liable for contract remedies for breach—if the AOD is operative throughout the United States, as it is. *Id.* Plaintiffs have countered this argument not by disputing the legal definition of "honored," but by putting forth a secondary vernacular definition—"to 'fulfill (an obligation) or keep (an agreement).'" Pls. 55. That the parties advance two different dictionary definitions is unsurprising, as the district court recognized that the term is susceptible to two different readings and in fact changed its interpretation from one to the other. *See* SA19_(Dkt.49:15); SA118-19_(Dkt.206:18-19).

Congress used the *legal* definition of "honored" in the PACT Act. When Congress uses a term that has accumulated a legal meaning over years of use in common-law practice, courts should presume that Congress "knows and adopts the cluster of ideas that were attached to" the term, which supports adopting the primary legal meaning. *Morissette v. United States*, 342 U.S. 246, 263 (1952). And Congress has used this term across a wide variety of statutes to indicate which agreements, offers, or judgments are accepted as valid and binding. *See*, *e.g.*, 25 U.S.C. § 1041b(b)(5) (providing that cooperative funding agreements between Native American tribes "shall be honored by Federal agencies"); 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"); *see also Poehl v. Countrywide Home Loans, Inc.*, 528 F.3d 1093, 1097 (8th Cir. 2008) (describing an offer under § 1681a(*l*) as one under which "the creditor will not deny credit to the consumer if the consumer meets the creditor's pre-selection criteria"); *Sullivan v. Greenwood Credit Union*, 520 F.3d 70, 76 (1st Cir. 2008) (same).

Plaintiffs assert that their definition—a second-level vernacular definition—should be applied instead. They devote exactly two sentences to this argument:

> To honor an agreement is to abide by it: to "honor" commonly means "to live up to or fulfill the terms of," or to "fulfill (an obligation) or keep (an agreement)." These definitions support a conclusion that UPS has "honored" the AOD under § 376a(e)(3)(B)(ii)(I) only insofar as UPS "live[s] up to," "fulfill[s]," or "keep[s]" its agreement with the State—which UPS failed to do.

Pls. 55-56 (internal citations omitted). Although they accurately recite one non-legal definition of "honor," Plaintiffs never explain *why* this Court should adopt their vernacular definition rather than the primary legal definition advanced by UPS. They cite no other federal statute in which Congress has used the term in the sense they propose. For all that appears from their brief, Plaintiffs simply selected the dictionary definition that best suited their theory of the case. That might be understandable as a matter of rank advocacy, but it is not a doctrinally proper method of statutory interpretation. Nor does their self-selected definition accord with the object of the exemption itself, since mere allegations of breach would require an exempt common

carrier to defend itself at trial with evidence that it complied with the regime from which it was exempt. Pls. 65 (arguing that "if UPS defaulted on its AOD responsibilities" it would "be subject to the PACT Act and the PHL, as well as the AOD").

Moreover, Plaintiffs' definition is internally inconsistent. Plaintiffs argue that their definition of "honored"—"to live up to or fulfill the terms of"—leads to the conclusion that the PACT Act applies to UPS if "the effectiveness of UPS's policies [is] so compromised that these policies are not in fact in place." Pls. 64 (quoting SA144-45_(Dkt.206:44-45)). But the "so compromised" standard is found neither in that definition nor the statute itself. Indeed, under the vernacular definition advanced by Plaintiffs, *any* breach of the AOD would render UPS subject to the PACT Act. *See* Pls. 67 ("an agreement fails the test of being 'honored throughout the United States' if there is any place in the United States where it is not 'honored'"). Plaintiffs never acknowledge that this absurd result renders their definition impossibly inconsistent with congressional intent; instead, they argue that they need not even provide a standard because the facts here are so egregious as to fit within any standard that could be (but was not) identified. Pls. 64. This is not sound statutory interpretation.

At the same time, Plaintiffs do not dispute that UPS's proposed definition is a reasonable reading of the statute. The principal (not "alternative," Pls. 60) definition of "honor" in *Black's Law Dictionary* is "[t]o accept or pay (a negotiable instrument) when presented." *Honor*, Black's Law Dictionary (10th ed. 2014). Plaintiffs

say that "[a] check is not 'honored' when a bank refuses to pay it." Pls. 60. But that makes UPS's point, not Plaintiffs': If the AOD were not operative nationwide because, for example, UPS declared its intent to repudiate the AOD in every state except New York (as a bank announces its intent to repudiate the check), then the AOD would no longer be "honored" because it would not be accepted as valid and binding throughout the United States. But if the AOD's terms and conditions are valid and binding throughout the United States—and thus UPS is liable in contract for breach—then the agreement is honored in the same way as a check is honored at a bank.

The legal definition of "honor" thus has a historical and textual pedigree that Plaintiffs' vernacular approach simply does not. But even if the Court were to conclude that both definitions are plausible, it would then need to apply the other tools of statutory construction. *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"); *see also FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000) (court "should not confine itself to examining a particular statutory provision in isolation"). And as even the district court recognized, Plaintiffs' proposed compliance inquiry "do[es] not accord with the context, structure or the aims sought to be achieved by the PACT Act." SA19_(Dkt.49:15 n.6). In fact, the structure, context,

and history and purpose of the statute all confirm that "honored" as used in the PACT Act does not contain a compliance component.

Structure. The PACT Act exemption applies to a carrier that is subject to an *existing* agreement if it is "honored throughout the United States," or to a *new* agreement if it "operates throughout the United States." 15 U.S.C. § 376a(e)(3)(B)(ii). It is clear from the parallel structure of the exemption that "honored" is synonymous with "operates," because the two terms perform the same function. Plaintiffs do not dispute that "honored" and "operates" are synonyms with respect to the PACT Act exemption. *See* Pls. 58-59. Nor do Plaintiffs dispute that "operates" is a variant on UPS's proposed construction ("accepted as valid"), whereas "operates" has nothing to do with Plaintiffs' proposed construction ("complied with"). Plaintiffs do not even *try* to square their proposed construction with the intrinsic evidence within the statute itself.

Instead, Plaintiffs try to shift gears by pointing to clauses in the definitional provision that say an existing agreement qualifies if it is "honored throughout the United States *to block illegal deliveries of cigarettes*" while a new agreement qualifies if it "operates throughout the United States *to ensure that no deliveries of cigarettes or smokeless tobacco shall be made to consumers*." 15 U.S.C. § 376a(e)(3)(B)(ii) (emphases added). Plaintiffs draw from these clauses the conclusion that an "agreement triggers an exemption from the PACT Act and state laws

(like the PHL) only if the agreement is *effective* at achieving the objectives of the PACT Act." Pls. 59 (emphasis added). But that is not what the statute says.

Plaintiffs argue, and the district court agreed, that these are "conditional" clauses. Pls. 56 (citing SA119_(Dkt.206:19). But as Plaintiffs' own authority indicates, a conditional clause is introduced by "*if*"—*e.g.*, if X is satisfied, then Y obtains. *Williams v. Taylor*, 529 U.S. 420, 431 (2000). To be sure, only those settlement agreements satisfying the "if" clause—*i.e.*, those that are "honored throughout the United States"—trigger the exemption. 15 U.S.C. § 376a(e)(3)(B)(ii)(I). But the remainder of the phrase is not an "if" clause but a "to" clause, which indicates a description of statutory purpose—*e.g.*, do X to achieve Y. For instance, in *Allison Engine Co., Inc. v. Sanders*, 553 U.S. 662 (2008), the Supreme Court, in interpreting a statute that prohibited knowingly making or using false records or statements "*to get* a false or fraudulent claim paid by the [g]overnment," held that "to get" "denotes purpose, and thus a person must have the purpose of getting a false or fraudulent claim"; the clause does *not* require that the person actually receive a fraudulently obtained payment. *Id*. at 668-69; *see also United States v. O'Hara*, 143 F. Supp. 2d 1039, 1041-42 (E.D. Wis. 2001) ("In this usage, 'to' plus the infinitive is equivalent to 'in order to' plus the infinitive or 'for the purpose of' plus the gerund form of the infinitive" and "indicates purpose or intention").

Plaintiffs' invoked clauses therefore express the purpose of the agreements, not conditions to the exemption. Had Congress wanted to make the exemption turn on a compliance inquiry, it would have conditioned the exemption on whether UPS "*complies with* a settlement agreement described in subparagraph (B)," rather than whether UPS "*is subject to* a settlement agreement described in subparagraph (B)." 15 U.S.C. § 376a(e)(3)(A)(i) (emphasis added); *see also Cyan*, 138 S. Ct. at 1071 ("Congress does not hide elephants in mouseholes." (cleaned up)). Rather than setting forth a condition precedent, the purposive clause identifies a reason (to block illegal deliveries of cigarettes) for the operation and scope of UPS's existing AOD (throughout the United States). And there is no doubt that the AOD has such operation and scope: the very first provision specifies that "UPS shall comply with PHL § 1399-*ll*(2), and adhere to the UPS Cigarette Policy described in Paragraph 15 prohibiting the shipment of Cigarettes to Individual Consumers in the United States." SA498-99, ¶17_(DX-23:6-7). What the PACT Act does *not* say is that a carrier loses its exemption if it breaches its agreement—because Congress deliberately ratified a contract-based system (with contract-based remedies) to regulate common carriers *in lieu of* the statutory regime applicable to carriers without an agreement.

Plaintiffs contend that UPS's construction renders the final clause of the statutory phrase ("honored throughout the United States to block illegal deliveries of cigarettes") "mere 'surplusage.'" Pls. 61. Not so. UPS's construction gives each

clause in the exemption full meaning: (1) "honored" requires that the AOD be valid and binding; (2) "throughout the United States" ensures that the AOD operates on a national level; and (3) "to block illegal deliveries of cigarettes" expresses the purpose behind that operation. When the PACT Act was enacted in 2010, the common carriers had already agreed to nationwide implementation of the AODs. Thus, Congress recognized that the AOD both served the same purpose as the PACT Act and imposed more technical procedures—and, therefore, because the AOD bound UPS nationwide, UPS should be exempt from the PACT Act.

Meanwhile, Plaintiffs themselves relegate the phrase "throughout the United States" to the dustbin. Plaintiffs contend that evidence of noncompliance as to twenty shippers—barely one thousandth of one percent of UPS's daily pick-up customers (*see* JA1893, ¶24_(DX-600:11))—along a "relative handful of those brown-truck routes" (JA1057_(Tr.1903:21-22)) somehow shows that UPS is not "honoring" the AOD "throughout the United States." That is nonsensical. Here are the four Native American reservations on which the twenty shippers at issue were located (SA312_(Dkt.535:63)):

And here is that excerpt in context of the United States as a whole:

See Bureau of Indian Affairs, Indian Lands of Federally Recognized Tribes of the United States (June 2016), *available at* http://bit.ly/indianlands.

It bends the English language past the breaking point to say that the AOD is not "honored throughout the United States" based on such low-level and highly localized conduct. Nor can Plaintiffs avoid this problem by arguing that some of the New York shippers sent cigarettes to other states. *See* Pls. 67 n.18; Cal. 14 n.18. Even if that were true, UPS's noncompliance, if any, would have occurred in the same four processing centers in New York where Plaintiffs alleged the breaches took place. There is no evidence in the record of UPS's noncompliance with any requirement or restriction of the AOD in any state other than New York.

Context. Congress knows how to make compliance an element of a common carrier's exemption: the PACT Act also exempts a carrier if its AOD or other qualifying agreement "is terminated or otherwise becomes inactive," but only if the carrier 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) (emphasis added). Thus, only when an AOD is terminated or becomes inactive does the exemption turn on an inquiry into whether a common carrier is "administering" or "enforcing" policies. *See* UPS Br. 33.

Plaintiffs argue that UPS's position leads to an absurd result in which, without an operative AOD, UPS is exempt from the PACT Act only if it is actually enforcing policies and practices "'at least as stringent' as those in the (nonexistent) AOD," but with an operative AOD, UPS is exempt "even if it does not actually enforce the

AOD's policies." Pls. 61. But that is not absurd at all. When the AOD is operative, it provides contract remedies for noncompliance, including compensatory damages or application of the penalties provision. But when the AOD is no longer operative—and thus cannot be used to recover damages or penalties for noncompliance—UPS's exemption turns on actual compliance, so that the PACT Act penalties are available in the event of a violation. Plaintiffs want to impose a compliance inquiry on top of the AOD, but Congress did not do so for the simple reason that an active AOD allows recovery through contract remedies.

Plaintiffs' reading conflicts with another "safe harbor" provision of the PACT Act that contains an express compliance component. *See* 15 U.S.C. § 377(b)(3)(B)(i) (exempting from penalties a common carrier that "has implemented and enforces *effective* policies and practices" (emphasis added)). Plaintiffs' insistence that the ordinary exemption is also conditioned on an "effectiveness" inquiry—though it, unlike § 377, makes no mention of "effectiveness"—cannot be reconciled with the statutory context. *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)). Moreover, Plaintiffs' interpretation would render the safe harbor provision superfluous: Should a common carrier comply with its settlement agreement, it would be exempt from the

PACT Act penalties and have no need of the safe harbor. But if a common carrier failed the compliance inquiry, it by definition could not be enforcing effective policies and procedures and thus could not get the benefit of the safe harbor. In either of these two mutually exclusive (and jointly exhaustive) scenarios, the safe harbor has no statutory purpose whatsoever—fatally undercutting Plaintiffs' interpretation. *See Marx v. Gen. Revenue Corp.*, 568 U.S. 371, 386 (2013) ("the canon against surplusage is strongest when an interpretation would render superfluous another part of the same statutory scheme").

History and Purpose. Plaintiffs have undoubtedly scoured the legislative history of the PACT Act, and they found nothing that supports their construction of the statute. At the same time, they entirely ignore the statements of the bill's sponsors in both the House and the Senate, which support UPS's construction.

When introducing the PACT Act in the Senate, the bill's sponsor explained that the legislation "exempted" UPS and other common carriers "provided [their agreements with the New York Attorney General] *remain[] in effect*." 155 Cong. Rec. S5853 (May 21, 2009) (emphasis added). Similarly, the member from New York who sponsored the corresponding House legislation stated that "the only one who would actually be covered by [the PACT Act] in a real practical sense is the United States Postal 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. 9 (2008) ("2008 Hearing") (emphasis added).

Plaintiffs never address these explicit statements, which are neither obscure nor ambiguous, and thus tacitly admit that their atextual, acontextual construction of the honored clause is directly contrary to legislative intent. Plaintiffs instead rely on one (and only one) clause from a committee report, which (they say) indicates that Congress meant to condition the applicability of the Act's exemption on a showing of compliance with the AOD. Pls. 57. Not so. Here is the full paragraph of the House Report from which Plaintiffs misleadingly extract a sentence fragment:

> Finally, the subsection provides a limited exception from these requirements for a common carrier with an active settlement agreement with a State, honored nationwide, to block deliveries of cigarettes and smokeless tobacco or shipments where applicable taxes have not been paid. The three major common carriers—United Parcel Service, FedEx, and DHL—all have such agreements with the New York State Attorney General's office. At the May 1, 2008, hearing on the bill, the Crime, Terrorism, and Homeland Security Subcommittee received testimony that these agreements were effective at stopping the illegal shipment of cigarettes to consumers.

H.R. Rep. 110-836, at 24 (2008). This statement, like everything else in the statute and its history, supports UPS's reading, not Plaintiffs': it demonstrates that the AODs were *already* effective as self-sufficient regulatory regimes with inherent contract-law remedies for noncompliance, and Congress therefore did not need to impose compounding PACT Act and PHL penalties.

The PACT Act's primary purpose was to prohibit the U.S. Postal Service from shipping tobacco products. *See*, *e.g.*, 155 Cong. Rec. S5853 (May 21, 2009) (noting that the PACT Act sought to address the "significant" problem of "the shipment of contraband cigarettes through the U.S. Postal Service" by "cut[ting] off access to the USPS by making tobacco products non-mailable"); 154 Cong. Rec. H7927 (Sept. 9, 2008) (noting that the PACT Act was designed to close the "largest truck-size loophole in the law" by prohibiting the U.S. Postal Service from mailing tobacco products). Simultaneously, Congress chose to leave UPS subject to the AOD regime to which it had already agreed. The district court reached these same, self-evident conclusions: "Because the ill that Congress was attempting to correct was *the USPS's refusal to halt the delivery of illegal cigarettes*, the purpose of § 376a(e)(3) was to exempt from the PACT Act the common carriers who had already pledged to act in conformity with the PACT Act's goals." SA23_(Dkt.49:19) (emphasis added).

Plaintiffs complain that applying the PACT Act according to its terms would mean that "[s]tates other than New York would be frozen out of the PACT Act's protections entirely." Pls. 62; *see also* Cal. 11-14 (similar). Plaintiffs' amici also argue that there is little chance the AOD will become "inactive" or "terminate" (15 U.S.C. § 376a(e)(3)(A)(ii))—thus allowing states to enforce their own laws—because the AOD does not have an expiration date and only terminates if repealed or

invalidated. *See* Cal. 11-12 (citing SA509-10, ¶47_(DX-23:17-18)). But when Congress enacted the PACT Act, it explicitly acknowledged that UPS and the State of New York were the only parties (*see* 15 U.S.C. § 376a(e)(3)(B)(ii)), repeating this fact throughout the legislative history. *See*, *e.g.*, 155 Cong. Rec. H5737 (May 19, 2009) ("UPS, FedEx, DHL, the big carriers have entered into an agreement *with the State of New York* that they are now following in all 50 States …." (emphasis added)); *see also* 2008 Hearing, *supra*, at 59 ("UPS … ha[s] agreed to not ship cigarettes through an agreement with the New York State Attorney General's office."). Even the other States knew of the AOD and its limited nature: for example, Maryland's chief counsel for tobacco enforcement testified that he knew of the AOD *and* expressed his belief that "it has been followed." 2008 Hearing, *supra*, at 90.

Accordingly, Plaintiffs' real objection is not to UPS's construction of the "honored" clause but to the very structure of the PACT Act itself and Congress's policy decisions in enacting that statute, including its exemption for UPS. This Court has no authority to override such legislative choices. *See Cyan*, 138 S. Ct. at 1073 ("Even if Congress could or should have done more, still it wrote the statute it wrote—meaning, a statute going so far and no further" (cleaned up)).

Plaintiffs respond that the AOD, the PHL, and the PACT Act "impose[] distinct compliance requirements" that Congress intended to apply simultaneously. Pls. 65-66. There is no support for this contention. Nowhere did Congress even hint,

much less clearly indicate, that it intended to subject UPS to three layers of penalties for a breach of the AOD; if it had, it would not have enacted an exemption at all but instead simply layered the PACT Act on top of the AOD. *See* UPS Br. 34-36. Congress's explicit choice to exempt common carriers with agreements is the clearest indication that it intended an "on/off" switch—where UPS is subject *either* to the AOD *or* to federal and state laws on cigarette deliveries.

Plaintiffs assert that there is "nothing unfair" about the multiple-punishment regime they envision because UPS can avoid statutory penalties by complying with the AOD. Pls. 65-66. But this approach (if accepted by this Court) would subject UPS to treble penalties in violation of the constitutional prohibition on imposing punishment if the standards giving rise to civil penalties are not reasonably discernible before the conduct occurs. *See*, *e.g.*, *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012); *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 158-59 (2012). The district court found the AOD "not honored" and imposed over $150 million in fines using a method it acknowledged was "not a precise exercise" (SA292_(Dkt.535:43)), framing its inquiry as whether alleged violations were "of a sufficiently large number" or sufficiently widespread to "suggest[]" that UPS had "overall" "turned a blind eye" to alleged AOD violations (SA145_(Dkt.206:45)). Imposing such substantial penalties on the basis of an unmoored and unprincipled standard does not satisfy basic due process requirements. *See* UPS Br. 37-38.

Nor is Plaintiffs' approach consistent with how the PACT Act operates. The PACT Act imposes technical compliance requirements, including the prohibition on deliveries for named sellers (15 U.S.C. § 376a(e)(2)), a prohibition on deliveries of cigarettes not appropriately labeled (*id.* § 376a(b)(2)), and recordkeeping requirements (*id.* § 376a(e)(4)(B)). Although Congress clearly intended the PACT Act exemption to provide shippers like UPS a uniform standard of compliance, UPS had no way of knowing before this trial whether it had to comply with any of these provisions. *See* UPS Br. 40-41; *id*. at 37-38. Plaintiffs' subjective inquiry would require shippers to comply with all three regulatory regimes—and to incur the costs associated with that compliance—for fear of losing their exemption without guidance on when compounded penalties may attach. Indeed, in this case, UPS has been penalized thrice, retroactively, without adequate notice.

Plaintiffs seek to avoid the unworkability of the court's standard for compliance by arguing that the "standard imposed was essentially one of good faith," mirroring the "implied covenant of good faith" in every contract. Pls. 63. The district court did not invoke this legal principle, and for good reason: The question is not how the AOD should be enforced, but rather how the PACT Act, a statute, should be interpreted. The PACT Act says *nothing* about good faith or fair dealing, and this Court should not read such subjective language into an otherwise unambiguous statute. *See 62 Cases, More or Less, Each Containing Six Jars of Jam v. United States*,

340 U.S. 593, 596 (1951) ("Congress expresses its purpose by words. It is for [courts] to ascertain—neither to add nor to subtract, neither to delete nor to distort.").

In sum, the PACT Act exemption turns on whether UPS "is subject to" its qualifying AOD. 15 U.S.C. § 376a(e)(3)(A)(i). UPS's AOD qualifies for the exemption if it is "honored throughout the United States," which requires only that it be operative (valid and binding) nationwide. *Id.* § 376a(e)(3)(B)(ii). Under this interpretation, UPS, courts, and state and federal regulators can easily discern in advance whether the exemption applies—using objectively verifiable information without a trial or any external proceeding. The contrary approach advocated by Plaintiffs and accepted by the district court has no footing in the text, structure, context, history, or purpose of the PACT Act and would force courts into a vague and standardless inquiry in every case. That is not the regime Congress enacted.

Because the AOD has at all relevant times had nationwide operation (*see*, *e.g.*, SA140_(Dkt.206:40)), UPS is exempt from the PACT Act, and the PHL is preempted. The judgment of liability under both statutes should be reversed.

B. UPS Is Not Liable Under the AOD.

Plaintiffs concede that, as a contract (SA163_(Dkt.355:7)), the AOD is subject to general principles of contract law. Pls. 72-73; *see also MBIA Inc. v. Fed. Ins. Co.*, 652 F.3d 152, 171 (2d Cir. 2011). Several are particularly important in this case:

- The terms of a contract are given their plain meaning.
- The construction of a contractual term must make sense in context of the entire contract, and must not render the contract illegal, illogical, or commercially unreasonable.
- The default remedy for a breach of contract is damages.
- Penalties are disfavored in the law of contracts and will be imposed by a court only where expressly agreed to by the parties.

See UPS Br. 42-46. Plaintiffs do not take issue with *any* of these statements of law, or dispute that they apply to the AOD here. Yet the district court's imposition of AOD penalties—and Plaintiffs' defense of that decision—cannot be reconciled with these bedrock doctrines.

To sustain the $80 million in penalties awarded under the AOD, this Court would have to decide, on *de novo* review, that the contract can and should be interpreted to (1) extend the penalty provision beyond its express scope (*i.e.*, knowing shipments of cigarettes to consumers) to encompass breaches of the audit provision, *and* (2) extend the audit provision beyond its express scope (*i.e.*, shippers) to apply

to each of tens of thousands of individual packages regardless of content. *Compare* UPS Br. 46-61 (Argument I.B.2.), *with* Pls. 71-83 (Argument I.B.).

1. The AOD Penalty Provision Applies Only to Knowing Shipments.

The default remedy for a breach of contract is compensatory damages. *See* UPS Br. 45. The AOD parties bargained for one departure from that standard remedy in Paragraph 42, which imposes a stipulated penalty of $1,000 on UPS for "violations" of the AOD, *i.e.*, knowing shipments of cigarettes to individual consumers and the core conduct at which the AOD (like the PHL) was aimed. Paragraph 42 states:

> 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.

SA508, ¶42_(DX-23:16). The single sentence that comprises this paragraph twice states, in so many words, that "violation" means the "shipment of Cigarettes"; and it nowhere suggests that "violation" encompasses breach of any other requirement of the AOD.

The operative complaint in this action sought penalties under Paragraph 42 for the knowing shipment of cigarettes. JA156-57_(Dkt.86:42-43). By the time the case reached trial, however, Plaintiffs realized that they could not prove that UPS had engaged in any knowing shipments (and, in fact, they proved no such thing). Unable to prove liability under the only provision of the AOD that provides for penalties, or to prove damages resulting from UPS's alleged breach of any other provision, Plaintiffs argued at trial that UPS's alleged failure to audit the 20 shippers at issue constituted a "violation" of the AOD within the meaning of the penalty provision. Because this was the *sole* basis for penalties asserted by Plaintiffs at trial, Plaintiffs therefore *abandoned* their "knowing shipments" theory, as the district court recognized. SA386_(Dkt.535:137) ("plaintiffs are not seeking the imposition of AOD penalties for knowing shipments").

In letting Plaintiffs shoehorn the audit obligation into the penalty provision, the district court contravened the principle that courts may not interpret a contract "to implicitly expand whatever ... rights are provided." *Unif. Firefighters of Cohoes, Local 2562 v. City of Cohoes*, 94 N.Y.2d 686, 694 (2000) (cleaned up). Because Paragraph 42, and the AOD as a whole, authorizes penalties *only* for knowing shipments—a theory that Plaintiffs abandoned at trial—the imposition of punitive liability under the AOD should be reversed.

Text of the AOD. The AOD consistently uses the term "violation" to refer to knowing cigarette shipments that would violate the PHL. UPS Br. 50-51. By contrast, Plaintiffs assert that "violation," as used in Paragraph 42, refers to a breach of any provision of the AOD because Paragraph 42 contains a "sweeping reference to 'each and every violation.'" Pls. 73-74. The district court agreed. SA383_(Dkt.535:134).

According to Plaintiffs, "[t]he familiar word 'violation' means '[a]n infraction or breach,' or 'the contravention of a right or duty.'" Pls. 73 (quoting *Black's Law Dictionary*). What Plaintiffs omit is the qualifier set forth in the very definition they selectively quote: "*violation*, n. (15c) 1. An infraction or breach *of the law*; a transgression. See *infraction*. 2. The act of breaking or dishonoring *the law*; the contravention of a right or duty." *Violation*, Black's Law Dictionary (10th ed. 2014) (emphases added). Plaintiffs' sole authority defines a violation as a "breach of the *law*," not of a contract, and nothing in the AOD equates "violation" with breach of contract. Indeed, "violation" is not a "familiar" word at all in the law of contracts; it is a creature of the criminal law and, as used in the AOD, refers to the same conduct that violates the PHL: knowing shipment of cigarettes.

Every time the AOD refers to a "violation" with reference specifically to UPS, the context makes clear that the conduct at issue is a knowing shipment of cigarettes. For example, 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, ¶8_(DX-23:3). The AOD describes "Potential Violations" only as shipments. *See* SA496-97, ¶15_(DX-23:4-5). Moreover, Paragraph 43 provides that evidence of a "violation of this Assurance of Discontinuance"—the exact wording used in Paragraph 42—"shall also constitute *prima facie* proof of a violation of [the] PHL." SA508, ¶43_(DX-23:16). Under Plaintiffs' interpretation, the lack of a required telephone number in UPS's cigarette database would constitute prima facie proof of a substantive cigarette shipment—a patently absurd result.

The AOD also discusses "violations" in the provisions dealing with shipper discipline, and again the context clearly indicates that, every time the term is used, it refers to cigarette shipments. *See* SA502-05, ¶¶26-33_(DX-23:10-13). Plaintiffs argue that these references are distinguishable because the other provisions of the AOD apply to UPS only, not shippers, and so UPS is able to commit varied "violations," while shippers are "likely to commit" only knowing shipment violations. Pls. 74-75. This argument is nonresponsive to the fact that the AOD's use of the disputed term—"violation"—consistently refers only to cigarette shipments.

Amazingly, Plaintiffs do not address in their brief any of the other UPS-specific references to "violations" in the AOD, or attempt to explain how the district court's construction can be squared with the plain language that actually appears in

the parties' agreement. Reading the AOD as a whole makes clear that the term "violation"—which appears more than 40 times in the AOD—consistently and exclusively applies to cigarette shipments. Perhaps that is why Plaintiffs chose to append to their brief only two paragraphs of the AOD, rather than the entire agreement. *See* Pls. ADD1. This Court's task, however, is not to read a word in isolation but to make sense of the entire contract to which the parties agreed.

The exemptions in the AOD's penalty provision further refute Plaintiffs' reading by excluding cigarette shipments made out of state or for which UPS establishes lack of knowledge. *See* SA508, ¶42_(DX-23:16). The necessary corollary is that a "violation" of the AOD is a knowing shipment of cigarettes within New York—and only such a shipment. This makes sense because knowing shipment of cigarettes to New York consumers is exactly what is prohibited by the PHL. *See Sayers v. Rochester Tel. Corp. Supplemental Mgmt. Pension Plan*, 7 F.3d 1091, 1095 (2d Cir. 1993) (where the parties dispute contractual meaning, the task of the court "is to determine whether such clauses are ambiguous when read in the context of the entire agreement" (cleaned up)).

Plaintiffs respond that "[b]ecause the drafters of the AOD plainly knew how to exempt certain violations from the penalty provision, the AOD's silence on any exemption" for breaches of other provisions means that penalties apply to such breaches "without exception." Pls. 74. This is circular because Plaintiffs assume

their own premise—that any breach of the AOD is a "violation" and thus would require explicit exclusion to be exempt from Paragraph 42. But it also defies reasonable contract drafting: under Plaintiffs' interpretation, every contractual penalty provision would apply to every breach of every provision of the contract, *except* the ones it explicitly exempts. No drafter writes such a contract.

Underscoring the absurdity of this reasoning, Plaintiffs' reading would have UPS pay no penalty for delivering a package actually containing cigarettes if UPS did not have the requisite knowledge but would require UPS to pay for delivering a package *not* containing cigarettes simply because the shipper had not been audited. *Contra In re Lipper Holdings, LLC*, 1 A.D.3d 170, 171 (N.Y. 1st Dep't 2003) ("A contract should not be interpreted to produce a result that is absurd, commercially unreasonable, or contrary to the reasonable expectations of the parties" (cleaned up)). Other provisions lead to similarly absurd penalties under Plaintiffs' theory. For example, because Paragraph 22 requires internet searches for tobacco shippers every 90 days for a limited time, Plaintiffs' theory would award them $1,000 if UPS only conducted internet searches every 91 days. And because Paragraph 23 requires UPS's communications with a cigarette retailer about the company cigarette policy to be in writing, Plaintiffs' theory again would demand $1,000 if UPS communicated by phone or in person. Or because Paragraph 25 requires UPS to list the name of a contact person for each shipper in its database of tobacco shippers, UPS would have

to pay another $1,000 if it included all other relevant information and inadvertently left out the name of the contact person.

Plaintiffs argue that "[i]t was reasonable for the State to give teeth to these additional compliance obligations by providing for incremental penalties" for the additional provisions. Pls. 75. The district court similarly concluded that limiting the penalty provision to knowing shipments "would mean that UPS could fail to comply with any of the host of other obligations without consequence." SA381_(Dkt.535:132). But the AOD is a *contract*, with default remedies for breach: compensatory damages (*U.S. Naval Inst. v. Charter Commc'ns, Inc.*, 936 F.2d 692, 696 (2d Cir. 1991)), and appropriate non-monetary relief (such as a declaration or an injunction) by which courts can regulate the parties' conduct. Thus, construing the penalties provision as limited to knowing shipments would not leave Plaintiffs without means to enforce the AOD. Plaintiffs, like the court below, simply ignore this basic point.

Context. In their attempt to rewrite the contract, Plaintiffs attempt to rewrite history as well. When the NYAG originally sought to enforce the PHL against UPS, UPS asserted a total defense: a federal law that broadly preempted 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), 41713(b)(4); *see* UPS Br. 5-7. The resulting AOD is not only a release of claims; it is the product of negotiations to achieve a

cooperative resolution of that dispute. UPS received a release of past claims and a reduced negotiated penalty, while the NYAG received procedural mechanisms to reduce cigarette trafficking and a non-preempted recovery for knowing shipments of cigarettes. Notably, the AOD expressly preserves UPS's right to assert federal preemption should the NYAG decide to claim recovery under the PHL and its higher penalty amounts. SA508-09, ¶45_(DX-23:16-17).

Plaintiffs never mention this potential federal preemption, which motivated them to bargain for the AOD to reduce the risk that UPS's defense would eviscerate the PHL. Nor do Plaintiffs dispute that UPS had the better of the preemption argument, as the Supreme Court subsequently held that an analogous state law was preempted. *Rowe v. N.H. Motor Transp. Ass'n*, 552 U.S. 364, 368-69 (2008). And because Plaintiffs studiously ignore that the parties bargained in the shadow of federal preemption, they do not dispute that 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*, 512 U.S. 219, 233 (1995).

This undisputed history further confirms that the only "violations" punishable under the AOD penalty provision are equivalent to a "violation" of the PHL—*i.e.*, knowing shipment of cigarettes. The NYAG gave up the right to proceed directly under the PHL (to avoid a judicial determination that it was preempted), and received

in exchange a contractual (and thus not preempted) promise that UPS would not knowingly ship cigarettes to individual consumers (SA498-99, ¶17_(DX-23:6-7)). UPS, in turn, could pay a lower penalty for knowing shipment violations without the need to litigate ($1,000 under the AOD vs. $5,000 under the PHL). SA508, ¶42_(DX-23:16). Both the NYAG and UPS thus contractually lessened their exposure to litigation risk.

In addition, the NYAG received contractual promises from UPS to implement procedural mechanisms designed to minimize the risk of cigarette shipments (SA499-508, ¶¶21-41_(DX-23:7-16)). These procedures are not required by the PHL and could not have been imposed by a court, absent agreement, even if the PHL had not been preempted. If, as Plaintiffs now contend, the penalty provision applies to breaches of the *procedural* mechanisms, it would expose UPS to liability far exceeding that which it faced under the PHL alone, absent the agreement. Plaintiffs have no explanation for why UPS would have acted in such an irrational manner. *US Airways, Inc. v. McCutchen*, 569 U.S. 88, 105 (2013) (finding that a contract interpretation that would make a party "worse off" would produce "strange results … [and thus] militates against" such a reading).

Put simply, UPS would never have traded its complete (meritorious) defense of federal preemption for a contractual regime in which it could be punished substantially more for actions that were not even addressed by the state law at issue.

Plaintiffs cannot, and do not, explain why UPS would have accepted such a lopsided bargain. Plaintiffs' contention that "the State entered into an AOD with UPS specifically to impose heighted compliance obligations … since the preexisting statute had proven ineffective at cigarette trafficking" (Pls. 75) is mere *ipse dixit*—it has no support in the AOD or its negotiating history. The AOD's recitals and the context of its negotiations make clear the bargain that was actually struck: UPS voluntarily agreed to abide by a prohibition that was preempted by federal law and adopt certain procedural mechanisms to lower the risk of cigarette shipments in exchange for a lower cooperative penalty than the statutory regime would have imposed. *See Red Ball Interior Demolition Corp. v. Palmadessa*, 173 F.3d 481, 484 (2d Cir. 1999) ("If a contract is clear, courts must take care not to alter or go beyond the express terms of the agreement, or to impose obligations on the parties that are not mandated by the unambiguous terms of the agreement itself.").

Unconscionability. Although Plaintiffs characterize Paragraph 42 as a "stipulated damages provision" (Pls. 76), that is wrong. Paragraph 42 is expressly punitive—it supplies a "stipulated penalty"—and the law of contracts in New York does not allow for a broad application of a punitive provision to contractual breaches. In any event, liquidated damages provisions that apply to the breach of any obligation under the agreement are, by definition, unconscionable under New York law. *John T. Brady & Co. v. Form-Eze Sys., Inc.*, 623 F.2d 261, 263 (2d Cir. 1980); *see also*

Seidlitz v. Auerbach, 230 N.Y. 167, 173 (1920). As a result, to avoid negating a party's negotiated bargain, New York courts presume that such provisions apply only to material breaches 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); *see also 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)).

A penalty clause applicable to every contractual breach "would be unconscionable by definition." UPS Br. 54. Plaintiffs respond with double-talk. They first argue that "the [penalty] provision's sweeping reference to 'each and every violation' plainly envisions penalties for violations 'of whatever type.'" Pls. 73. But just two pages later they argue that "there is no merit to UPS's suggestion that applying the AOD's penalty provision to audit violations would be 'unconscionable'" because, according to Plaintiffs, only breach of the audit provision is a "material" breach—and thus, by their logic, a "violation." Pls. 75-76. Plaintiffs are trying to have their cake and eat it, too.

Nothing in the AOD distinguishes the audit provision from any of the other procedural requirements. Plaintiffs offer no support for the conclusion that breach of the audit obligation constitutes a material breach of the entire agreement, *i.e.*, one that "go[es] to the root or essence of the agreement between the parties, or … one which touches the fundamental purpose of the contract and defeats the object of the

parties in entering into the contract." *New Windsor Vol. Ambul. Corps, Inc. v. Meyers*, 442 F.3d 101, 117 (2d Cir. 2006) (quoting 23 WILLISTON ON CONTRACTS § 63:3 (4th ed. 2002)). Indeed, for over a century, New York's highest court has allowed rescission of a contract—a remedy reserved for a material breach, *New Windsor*, 442 F.3d at 117—only where the breach is "material and willful, or, if not willful, so substantial and fundamental as to strongly tend to defeat the object of the parties in making the contract." *Septembertide Pub., B.V. v. Stein & Day, Inc.*, 884 F.2d 675, 678 (2d Cir. 1989) (quoting *Callanan v. Powers*, 199 N.Y. 268, 284 (1910)).

The alleged breach of the AOD's audit provision does not remotely meet this standard. The parties did not enter into the AOD for the "fundamental purpose" of performing audits. *New Windsor*, 442 F.3d at 117. They entered into the AOD with the fundamental purpose of obtaining a contractual guarantee from UPS of compliance with the core prohibition of the PHL. *See* SA495-99, ¶¶8, 15, 17_(DX-23:3-7). Notably, the parties are expressly required to "meet to discuss whether any changes or alterations to [the AOD] are warranted" under only one circumstance: the PHL becomes inapplicable to UPS, either because of legislative repeal or court order. SA509, ¶47_(DX-23:17). The parties therefore contemplated that the "root of the agreement between the parties" (*Process Am.*, 839 F.3d at 136 (cleaned up)) was the substantive prohibition of the PHL, not the attendant procedural mechanisms UPS agreed to implement. Because the audit obligation is not the "root or essence of the

agreement between the parties," breach of that obligation is not "material." *New Windsor*, 442 F.3d at 117.

Plaintiffs' newly minted suggestion that the audit requirement is "the core compliance mechanism of the AOD" (Pls. 76) has no basis in the agreement itself. The AOD provides that UPS has a duty to audit only when it has *already* obtained "a reasonable basis to believe" a shipper is tendering cigarettes for delivery. SA501, ¶24_(DX-23:9). Had Plaintiffs wanted audits as a pure enforcement mechanism, they could have bargained for periodic or random audits. Instead, the AOD audits serve an explicitly confirmatory purpose: "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, ¶24_(DX-23:9) (emphasis added). As this Court has pointed out, even where the breached provision may be "important" to "the special purpose of the contract" and requires "close adherence," it is not necessarily material if the object of the parties in contracting is not defeated. *Frank Felix Assocs., Ltd. v. Austin Drugs*, 111 F.3d 284, 289-90 (2d Cir. 1997). UPS's failure to comply with one confirmatory mechanism does not undermine the "root or essence" of the AOD, *New Windsor*, 442 F.3d at 117, or constitute a breach "so substantial and fundamental" as to "defeat the object of the parties in making the contract." *Septembertide*, 884 F.2d at 678.

Plaintiffs contend that the district court "found" that the audit provision "is the core compliance mechanism of the AOD, breach of which imperils 'other aspects of the overall compliance scheme.'" Pls. 76 (quoting SA380_(Dkt.535:131)). This mischaracterizes the district court's opinion. The district court concluded that because the AOD's various provisions work together, "[a] failure to abide by any one obligation—for instance, employee training—places at risk other aspects of the overall compliance scheme" and that "[a]ny failure to comply with a contractual obligation constitutes a separate violation of the AOD." SA380_(Dkt.535:131). So, to the extent the district court "found" the audit provision to be material, it did so in the context of finding every provision material. But under New York law, a penalties provision that applies to the breach of any obligation is per se unconscionable. *John T. Brady & Co.*, 623 F.2d at 263.

Plaintiffs argue in this Court, for the first time, that UPS's failure to audit rendered them impotent to combat cigarette trafficking. *See* Pls. 76-77. That is specious. The AOD itself provides for audits only when UPS already "has reason to believe" a shipper is tendering cigarettes (which therefore must have arisen outside of an audit) and expressly contemplates audits after notification by the NYAG. *See* SA501, ¶24_(DX-23:9), SA507, ¶¶39-40_(DX-23:15). The idea that the NYAG relied on UPS to monitor cigarette trafficking in its stead has no basis in the actual

agreement. What's more, Plaintiffs are *governments* with police powers, law enforcement agencies, investigators, prosecutors, revenue officials, substantial resources, and broad powers to compel testimony or documents. *See*, *e.g.*, N.Y. Exec. L. § 63(8). Nevertheless, for many years, Plaintiffs have shown themselves unable or unwilling to enforce their tax laws against Native American businesses. *See* UPS Br. 11-12. Plaintiffs are attempting to dragoon private corporations to serve as foot soldiers in a governmental conflict with another sovereign, rather than exercising their own police powers.

Abandoned Theory. On appeal, Plaintiffs contend that, even if this Court determines that Paragraph 42 applies only to knowing shipments (which it does), this Court "may uphold AOD penalties" by simply deeming each package on which the district court awarded audit penalties to have been proven a "violation" under the proper meaning. Pls. 82. They suggest that proceeding under the audit provision rather than the knowing shipment prohibition was merely to avoid a "double recovery," and that this Court may "affirm on any basis for which there is a record sufficient to permit conclusions of law." Pls. 82-83 (quoting *Bertin v. United States*, 478 F.3d 489, 491 (2d Cir. 2007)).

Plaintiffs failed to meet their burden of proof that UPS knowingly transported prohibited shipments of cigarettes to individual consumers, and the district court's findings of "knowledge" cannot sustain any penalties on a knowing shipment theory.

Although Plaintiffs suggest that these are factual findings unreviewable on appeal (Pls. 82-83), the district court itself recognized that "[t]he questions of whether UPS 'knew' packages included cigarettes and, if so, when, are mixed questions of law and fact." SA313_(Dkt.535:64 n.56). Such issues are reviewed *de novo*. UPS Br. 55.

The district court conducted a shipper-level, not a package-level, analysis of knowing shipments. UPS Br. 55. Plaintiffs admit as much when they note that "the district court found that UPS knowingly shipped cigarettes for seventeen *shippers*." Pls. 82 (emphasis added). But the AOD's penalty provision requires a package-level analysis, as it turns on "Prohibited Shipments"—a defined term under the contract. UPS Br. 55-56. Plaintiffs have absolutely no response to this *legal* argument. Similarly, the $80 million AOD penalty expressly includes packages for which Plaintiffs could not recover under a knowing shipment theory, including, for example, packages for shippers that the district court concluded were not shipping cigarettes (*see* SA358-65_(Dkt.535:109-16)) or that were tendered to UPS but shipped outside of New York (*see* SA384_(Dkt.535:135)). And Plaintiffs to this day have not identified any particular package (a) that contained cigarettes and (b) that UPS knew contained cigarettes. The district court's conclusions as to package contents are that some "percentage" (extrapolated using a statistically unsound and untested methodology) of a shipper's total shipped packages (assessed in some unexplained manner from 83.5 million cells across eleven spreadsheets) contained cigarettes. There are simply no

package-level findings *at all* in this record, and no finding supporting penalties for knowing shipments under the AOD.

Plaintiffs' failure of proof as to knowing shipments is not surprising, since they abandoned this claim at trial, which precludes appellate review. *See United States v. Olano*, 507 U.S. 725, 733 (1993); *accord United States v. Brown*, 843 F.3d 74, 81 (2d Cir. 2016) ("A true waiver will extinguish an error in the district court, precluding appellate review" (cleaned up)). The district court noted three times in as many pages that Plaintiffs were "not seeking penalties" for knowing shipments under the AOD. *See* SA384-86_(Dkt.535:135-37) (emphasis added); *see also* SA369, 392, 462_(Dkt.535:120, 143, 213) (same); Pls. 83; UPS Br. 54-55. Where a party "failed to pursue [a claim] at trial," it cannot recover on that theory on appeal. *Broadway Delivery Corp. v. United Parcel Serv. of Am., Inc.*, 651 F.2d 122, 126 (2d Cir. 1981). Such a "strategic, deliberate decision[]" is the paradigmatic example of waiver. *See Brown*, 843 F.3d at 81 (quoting *United States v. Dantzler*, 771 F.3d 137, 146 n.5 (2d Cir. 2014)).

2. The AOD Audit Provision Applies to Shippers, Not Packages.

Even if this Court could conclude that a breach of the audit provision constitutes a "violation" for purposes of Paragraph 42, the AOD requires UPS to audit shippers, not every package a shipper ships. Indeed, Plaintiffs' attempt to extract

per-package penalties out of a clause written in terms of "shippers" further demonstrates that an AOD "violation" refers only to package-level cigarette shipments. The district court found that UPS breached its obligation with respect to twenty shippers; the maximum penalty under the AOD therefore cannot exceed $20,000.

On its face, the AOD's audit provision requires UPS to "audit shippers," not "packages"—a term it never uses. The audit provision must be "enforced according to the plain meaning of its terms." *Lockheed Martin Corp. v. Retail Holdings, N.V.*, 639 F.3d 63, 69 (2d Cir. 2011); *see ACE Sec. Corp., Home Equity Loan Tr., Series 2006-SL2 v. DB Structured Prods., Inc.*, 25 N.Y.3d 581, 597 (2015). Throughout the AOD, UPS's audit obligations are *only* framed in terms of auditing shippers, and "all [such] provisions of a contract [must] be read together as a harmonious whole, if possible." *Kinek v. Paramount Commc'ns, Inc.*, 22 F.3d 503, 509 (2d Cir. 1994). Plaintiffs have no answer to UPS's straightforward application of the default principles of contract law, instead choosing wholly to ignore the text of the audit provision and the other instances of the use of the term "audit" throughout the AOD. Pls. 77-83. Indeed, Plaintiffs' reading necessitates ignoring these principles.

Plaintiffs argue that the "AOD mandates for suspicious shippers" very "close oversight" of each of those shippers' packages. Pls. 78-79. But no provision of the AOD contains such a requirement, and Plaintiffs can point to none. Rather, as outlined above, the audit provision has a confirmatory purpose: to determine whether

particular shippers should be subjected to the progressive discipline of the AOD. *See* SA501, ¶24_(DX-23:9).

The rest of the AOD confirms the plain meaning of the audit provision. *See Levy v. Southbrook Int'l Invs., Ltd.*, 263 F.3d 10, 17 (2d Cir. 2001) ("The intention of the parties is not derived from sentences or clauses read in isolation, but from the instrument as a whole" (cleaned up)). For example, Paragraph 26 requires UPS to "make and maintain a record of the shipper" if it ever "discovers a shipment of Cigarettes to Individual Consumers," which demonstrates that the drafters did *not* use "shippers" and "shipments" interchangeably. SA502, ¶26_(DX-23:10). Similarly, UPS undertook an obligation to audit any shipper as to whom "the Attorney General or any other governmental authority represents … is shipping Cigarettes to Individual Consumers." SA507, ¶40_(DX-23:15). UPS must "discipline" those shippers "found to be shipping Cigarettes to Individual Consumers" pursuant to the AOD's progressive discipline process. *Id.; see also* SA502-05, ¶¶27-32_(DX-23:10-13).

Plaintiffs seek to justify a per-package penalty on the ground that the "express purpose of an audit under the AOD is to uncover unlawful cigarette deliveries" and prevent them. Pls. 79. This reading is again contrary to the text of the provision, which explicitly specifies its purpose: "to determine whether the *shippers* are in fact" tendering Cigarettes for delivery to Individual Consumers. SA501, ¶24_(DX-23:9) (emphasis added). Nor are shipper-level audits remotely inconsistent with the goal

of uncovering unlawful cigarette deliveries. Perhaps, in hindsight, New York might prefer to have bargained for more specific procedures—or for per-package penalties—but "such lack of foresight does not create rights or obligations." *Rowe v. Great Atl. & Pac. Tea Co.*, 46 N.Y.2d 62, 72 (1978). Put simply, the parties never intended the audit provision to impose on UPS an active investigatory role; it was a reactive way to determine whether to subject a particular shipper to the disciplinary process of the AOD.

Plaintiffs also argue that an audit is "necessarily 'conducted with regard to packages,'" Pls. 78 (quoting SA384_(Dkt.535:135)), and that because UPS conducted certain audits on a per-package basis in the past, it makes sense to impose penalties on a per-package basis. These arguments again ask the Court to read into four words—"UPS shall audit shippers"—specific obligations that the contract does not include. *See Great Atl. & Pac. Tea Co.*, 46 N.Y.2d at 72 ("[C]ourts should be extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include"). The AOD does not identify any specific procedures for audits. UPS could choose to audit a suspected shipper by opening every other package or every *n*th package—not, as the district court assumed, every package. Indeed, the AOD does not require package-level audits at all: UPS could, for example, physically inspect shippers' warehouses. The district court erred in "mak[ing] a new contract for the parties under the guise of interpreting the

writing." *Vt. Teddy Bear Co. v. 538 Madison Rlty. Co.*, 1 N.Y.3d 470, 475 (2004) (cleaned up).

Plaintiffs' true motives appear when they complain that applying the penalty provision on a per-shipper basis would not result in enough money to fill their coffers. Pls. 81. While Plaintiffs contend that a per-shipper penalty would "render the AOD's audit requirement … toothless," they have no basis for making that contention. *Id*. Plaintiffs again ignore the numerous remedies available to them under contract law. If Plaintiffs had alleged and proven compensatory damages arising out of UPS's alleged breach, they would be entitled to them; they did not even try. Plaintiffs have never previously sought to enforce the audit requirement, and they were unable to prove *any* damages resulting from UPS's supposed breach. Moreover, even absent proof of damages, the NYAG could seek a declaratory judgment on the procedures for the audit requirement, which, if successful, would bind UPS to implement those procedures. *See United States v. United Mine Workers of Am.*, 330 U.S. 258, 293 (1947) ("an order issued by a court with jurisdiction over the subject matter and person must be obeyed by the parties"). What Plaintiffs cannot do, however, is impose *penalties* on UPS for conduct not addressed by the terms of the AOD's penalty provision. *See ACE Sec.*, 25 N.Y.3d at 597. Plaintiffs are entitled to the benefit of the bargain; they are not entitled to the benefit of a bargain they did not negotiate.

* * *

In short, the district court erred as a matter of law in interpreting the AOD—which all parties agree is a contract—to contain requirements and impose obligations beyond the scope of the parties' bargain. Not only did the district court expand a negotiated penalties provision far beyond its narrow scope, it then doubled-down by reading into the plain language of the audit obligation a dramatic expansion of punitive liability. These interpretations are contrary to fundamental principles of contract law and the plain meaning of the AOD.

This Court should reverse the AOD penalties in their entirety or, at most, remand with instructions to impose AOD penalties of $20,000.

C. UPS Is Not Liable Under the CCTA.

The final liability issue is whether the district court erroneously construed the CCTA to (1) permit aggregation of cigarette shipments to meet the threshold quantity requirement and (2) relieve Plaintiffs of the burden of proving that UPS had the requisite knowledge. *Compare* UPS Br. 62-68 (Argument I.C.), *with* Pls. 83-93 (Argument I.C.). Both rulings are reviewed *de novo*, and both were wrong. The CCTA liability judgment should be reversed.

1. Aggregation Is Impermissible.

The CCTA criminalizes "transport[ing] … contraband cigarettes" (18 U.S.C. § 2342(a)), specifically defined as "a quantity in excess of 10,000 cigarettes" that lack required tax stamps and "are in the possession of" an unauthorized person. *Id.* § 2341(2). The first question under this statute is whether the 10,000 cigarettes must be in a single transaction, as UPS contends, or whether multiple smaller transactions can be aggregated, as the district court ruled. *See* SA16-17_(Dkt.49:12-13).

Plaintiffs admit that the district court's construction would permit imposition of CCTA liability against "a person who transports a carton of untaxed cigarettes every week for a year, thus exceeding 10,000 cigarettes in a year." Pls. 88. At the same time, they do not dispute that Congress adopted the threshold quantity requirement to limit the statutory prohibition to "large scale operations of interstate cigarette bootlegging" rather than "casual smuggler[s]" of "small quantities of cigarettes for

themselves or their friends." S. Rep. No. 95-962, at 3, 6 (1978). Thus, both Plaintiffs' and the district court's construction run directly against legislative intent.

In response to UPS's argument that the statute's use of "a quantity" in the singular denotes a single transaction, Plaintiffs state that "use of the indefinite article in the definition does not ... preclude aggregation: it makes perfect sense to say that a shipper who makes more than ten 1,000-cigarette deliveries has delivered 'a quantity' of more than 10,000 cigarettes." Pls. 86. That is not grammatically correct. The shipper in Plaintiffs' example has delivered ten quantities of a thousand cigarettes each, just as our hypothetical casual smuggler has carried 52 quantities of 200 cigarettes each. Neither has met the statutory prerequisite of transporting "*a* quantity in excess of 10,000 cigarettes." *Cf. United States v. Winston*, 37 F.3d 235, 240 (6th Cir. 1994).

Moreover, the statute expressly contains an element of contemporaneous possession that Plaintiffs ignore. Contraband cigarettes are "*a quantity in excess of 10,000 cigarettes*, which bear no evidence of the payment of applicable State or local cigarette taxes … *and which are in the possession of any person other than*" a defined list of authorized individuals. 18 U.S.C. § 2341(2) (emphases added). The statute's use of the present tense "are" shows that Congress was concerned with the number of cigarettes *presently* in a person's possession—not with those he *previously* possessed at any given time. This reading is reinforced by the familiar principle

of criminal law that where an individual possesses the same contraband at the same time and place, it constitutes one act of possession, while possession at different places or times may be charged as multiple acts of possession. *See*, *e.g.*, *United States v. Olmeda*, 461 F.3d 271, 280 (2d Cir. 2006) (distinguishing felons who obtained multiple firearms at one time from those who kept multiple firearms at different times or places); *see also, e.g.*, *United States v. Johnson*, 909 F.2d 1517, 1518-19 (D.C. Cir. 1990) (citing cases); *United States v. Acosta*, 763 F.2d 671, 690 (5th Cir. 1985). Plaintiffs' examples—ten shipments of 1,000 cigarettes, or 50 deliveries of 200 cigarettes—do not account for the "possession" clause of the statute.

The structure of the CCTA and the language of nearby provisions bolster the plain text's requirement that a single shipment must meet the quantity threshold. In three other provisions, Congress enacted regulations covering *all* cigarettes, not just unstamped cigarettes. First, Congress criminalized the making of a "false statement or representation" in required records by anyone who "ships, sells, or distributes any quantity of cigarettes in excess of 10,000 in a single transaction." 18 U.S.C. § 2342(b). Second, Congress required "[a]ny person who ships, sells, or distributes any quantity of cigarettes in excess of 10,000 … in a single transaction" to maintain certain records about the transaction. *Id.* § 2343(a). Third, Congress required "[a]ny person … who ships, sells, or distributes any quantity in excess of 10,000 cigarettes … within a single month" to maintain records of cigarette inventory and customer

purchase information. *Id.* § 2343(b). Plaintiffs point to the first two provisions and argue that Congress's choice not to include the "in a single transaction" limitation in the definition of contraband cigarettes is an implicit authorization of aggregation. Pls. 86. But the *third* provision is inconsistent with this position, and the district court's construction, because it contains an explicit aggregation provision, showing that Congress knows how to define quantity by aggregation when it so desires.

UPS has offered the only consistent reading: each of the three provisions concern not contraband cigarettes (a defined term) but "*any* quantity in excess of 10,000" lawful or unlawful cigarettes. UPS Br. 64-65. Thus, Congress necessarily had to specify whether that quantity was in a single transaction or aggregated across a time period, based on the purposes behind each provision. By contrast, the definition of contraband cigarettes uses unique, inherently single-transaction language—"*a* quantity in excess of 10,000 [unlawfully unstamped] cigarettes … which are *in the possession of*" an unauthorized person (18 U.S.C. § 2341(2) (emphasis added))—and thus, including "in a single transaction" in § 2342(a) would have been redundant. In fact, the only other provision for which criminal penalties exist—the false statement prohibition—expressly includes the single-transaction language, reinforcing the idea that Congress intended to target only these particular shippers.

Compare id. § 2344(b) (imposing three years' imprisonment or fine for false statements under § 2342(b)), *with id.* § 2343(c)(3) (imposing $10,000 civil penalty only for refusals to permit federal inspection of records).

Plaintiffs cannot sidestep a plain reading of § 2342(a) out of concern that "parties [would] evade CCTA liability" by shipping less than 10,000 cigarettes at a time. Pls. 89. Congress is necessarily in the business of line drawing, "and the fact the line might have been drawn differently at some points is a matter for legislative, rather than judicial, consideration." *U.S. R.R. Ret. Bd. v. Fritz*, 449 U.S. 166, 179 (1980). Congress chose to draw the line here at 10,000 cigarettes, and this Court must respect that boundary. After all, the very provisions on which Plaintiffs rely to support their argument can be evaded in the *exact same way*: as long as a party handles 10,000 or fewer cigarettes "in a single transaction," neither § 2342(b)'s false statement provision nor § 2343(a)'s record-keeping requirement applies. Plaintiffs offer no explanation for why the potential for evasion is different with respect to § 2342(a), than for these other provisions.

Even if both readings were plausible, the rule of lenity requires ambiguous criminal statutes to be interpreted in favor of defendants to ensure fair warning. *See Liparota v. United States*, 471 U.S. 419, 427 (1985) ("Application of the rule of lenity ensures that criminal statutes will provide fair warning concerning conduct

rendered illegal"); *see also FCC v. Am. Broad. Co.*, 347 U.S. 284, 296 (1954) (applying the rule of lenity to statutes that have both criminal and civil enforcement applications). Since the CCTA prohibition *can* be read as applicable only to single shipments of more than 10,000 unstamped cigarettes, as even Plaintiffs admit, it *must* be so read.

2. The Knowledge Requirement Is Not Satisfied.

The CCTA makes it "unlawful for any person knowingly to ... transport ... contraband cigarettes," *i.e.*, "a quantity in excess of 10,000 cigarettes" without tax stamps that "are in the possession of" an unauthorized person. 18 U.S.C. §§ 2341(2), 2342(a). The second question under this statute is whether the statute requires proof that UPS knew it was transporting more than 10,000 cigarettes, as UPS contends; or whether, "[a]s the district court concluded, it is enough for CCTA liability that UPS knew that certain shippers were regularly shipping unstamped cigarettes and that UPS transported those shippers' packages anyway." Pls. 92.

Plaintiffs make no effort to reconcile the district court's ruling with the Supreme Court's repeated admonition that 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); *see also* UPS Br. 67 (citing cases). Nor do Plaintiffs dispute that "a quantity in excess of 10,000 cigarettes" is an element of the offense.

Plaintiffs primarily rely on *United States v. Elshenawy*, 801 F.2d 856, 859 (6th Cir. 1986), which (they say) holds that the CCTA's knowledge requirement is "satisfied by defendant's knowledge of 'the physical nature of what he possessed,' i.e., unstamped cigarettes." Pls. 92. But the "element" at issue in *Elshenawy* was the *tax status* of cigarettes, *i.e.*, the defendant's knowledge that the law required him to pay taxes on the cigarettes (801 F.2d at 857); the Sixth Circuit deemed him to have constructive knowledge of that requirement because he knew he was dealing in "very large quantities of cigarettes," which is a highly regulated business. *Id*. at 859. "Thus, the government [t]here [was] only required to show that Elshenawy knew the physical nature of what he possessed, *a quantity in excess of 60,000 cigarettes* which bore no evidence of the payment of applicable state cigarette taxes." *Id*. at 859 (cleaned up) (emphasis added). The defendant in *Elshenawy*, in other words, had knowledge of the quantity—the element that Plaintiffs failed to prove here.

Plaintiffs also argue that, consistent with penalties for drug possession cases, UPS should be liable for possession of any amount of contraband cigarettes "irrespective of [its] knowledge of the precise quantity possessed." Pls. 92 (citing *United States v. King*, 345 F.3d 149, 152 (2d Cir. 2003) and *United States v. Collado-Gomez*, 834 F.2d 280, 281 (2d Cir. 1987)). But these cases are wholly inapposite. Under 21 U.S.C. § 841, which these cases apply, it is "unlawful" to distribute or possess with intent to distribute "a controlled substance," regardless of quantity. *Id.*

§ 841(a)(1). Once a defendant is convicted, however, quantity determines the penalty. *See id.* § 841(b). *King* itself is replete with references to drug quantity as a "sentencing factor[]" and expressly rejects the argument that it is one of the "substantive elements of the offense." 345 F.3d at 152-53. These cases therefore have no application where Congress expressly made quantity an element of the offense.

According to Plaintiffs, "UPS knew that certain on-reservation shippers for which UPS provided delivery services regularly shipped cigarettes" and "UPS knew that cigarettes sold on Indian reservations were virtually always sold without tax stamps." Pls. 91 (cleaned up). "These facts," Plaintiffs insist, "more than sufficed to establish the culpable knowledge required under the CCTA." *Id.* at 91-92. This is false. Plaintiffs themselves admit that they have no evidence of any single transaction for Jacobs Tobacco "in excess of 10,000 cigarettes," (Pls. 89), and for Mohawk Spring Water—the only other shipper Plaintiffs claim exceeded the 10,000-cigarette threshold (Pls. 41)—none of Plaintiffs' cited sources identifies any specific shipment (or, indeed, even a total number of shipments) exceeding 10,000 cigarettes. *See*, *e.g.*, JA869_(Tr.1153:2-1154:6); JA1184_(PX-49:7). Tellingly, nowhere in their CCTA argument do Plaintiffs identify a single transaction exceeding 10,000 cigarettes—much less evidence that UPS knew that any transactions exceeded that quantity. Pls. 83-93.

Because the CCTA requires such evidence as a matter of law, the CCTA liability judgment should be reversed outright.

II. The Damages and Penalties Awards Cannot Stand.

Even if any aspect of the liability judgment could survive appellate review, the damages and penalties awards would have to be reversed because (A) the district court did not hold Plaintiffs to their burden of proof before, during, or after trial; (B) the compensatory damages were miscalculated; and (C) the district court violated the Constitution in imposing excessive punishment that is both triple-counted and wildly disproportionate to the conduct at issue, whether measured in terms of Plaintiffs' loss or UPS's gain.

A. The Court Erred in Relieving Plaintiffs of Their Evidentiary Burden.

"The ostrich is a noble animal, but not a proper model for an appellate advocate." *Gonzalez-Servin v. Ford Motor Co.*, 662 F.3d 931, 934 (7th Cir. 2011). In an apparent attempt to bury their heads in the sand, Plaintiffs pretend that the trial in this case proceeded in the ordinary course, that the rulings below should be reviewed with deference, and that any shortcomings in the evidentiary record should be laid at UPS's feet. *See*, *e.g.*, Pls. 93-95, 112-13, 129-32. Nothing could be further from the truth, as an examination of the actual trial proceedings reveals.

What really happened is that after the district court excluded Plaintiffs' damages and penalties expert, Plaintiffs took the risk of proceeding without any expert witness; but they could not—and did not—provide legally sufficient evidence of damages or penalties. *Before trial*, Plaintiffs refused to inform UPS of either the

amount or the process by which they would calculate their damages/penalties claims, yet the district court allowed them to proceed anyway. *During trial*, Plaintiffs' lawyers advanced various and untested theories of damages and penalties but never proved any of them—as the district court acknowledged after the close of evidence. *After trial*, Plaintiffs were allowed to submit inadmissible and unsupported information (without cross-examination) on which the district court relied, along with an untested methodology of its own invention, to award massive damages and penalties.

Each stage of this unorthodox proceeding warrants reversal. Together, the district court's errors in mismanaging this proceeding deprived UPS of its due process right to a fair adversarial proceeding presided over by an impartial adjudicator. *Compare* UPS Br. 69-103 (Argument II.A.), *with* Pls. 94-132 (Argument II.A.-B.).

1. Before Trial: Disclosure Deficiencies.

Plaintiffs do not contest UPS's recitation of the facts related to their pretrial disclosures. *See* UPS Br. 18-20, 77-78. Plaintiffs' initial Rule 26(a) disclosures were vague and offered no computation. *See* JA275_(Dkt.367-1:5), JA281_(Dkt.367-2:4). In response to UPS's interrogatories asking expressly for package and carton counts, Plaintiffs again produced no computation of package or carton counts and merely alluded to generic documents or forthcoming testimony or discovery. *See* JA131-34_(Dkt.72:9-12). (The State's response was particularly egregious, not even including references to any specific shipper at issue. *See* JA144-47_(Dkt.73:4-7)).

UPS then filed its motion to compel Plaintiffs to respond to its interrogatories on damage calculations, which the district court denied, instead ordering Plaintiffs to provide certain limited disclosures for a single shipper. SA27-33_(Dkt.169). In their responsive Arrowhawk Letter—supposedly meant to "show their cards for this shipper," SA32_(Dkt.169:6 & n.5)—Plaintiffs identified a set of spreadsheets from which they claimed they would derive package counts but provided no explanation of how. JA359-60_(Dkt.367-4). And even in that letter, the exemplar damages and penalties amounts rested entirely on an arbitrary *assumption*, not derived from any documents, of 8,000 packages at five cartons per package. *See* JA361_(Dkt.367-4:3).

Plaintiffs harp on the fact that UPS did not request reconsideration of the district court's decision to deny its motion to compel after Plaintiffs' third insufficient damages calculation (Pls. 100-01), but there is "absolutely no authority that creates an obligation to raise a motion to reconsider in order to preserve the argument for appeal." *Walker v. Abbott Labs.*, 340 F.3d 471, 475 (7th Cir. 2003). UPS relied, as it was entitled to do, on Plaintiffs' obligation to supplement their disclosures and provide final pre-trial disclosures (*see* Fed. R. Civ. P. 26(a)(3), 26(e)); and when those contained only a single paragraph that identified *no* shippers, *no* package counts, *no* carton counts, or anything remotely constituting a computation (*see*

JA299-300_(Dkt.367-3:16-17)), UPS promptly filed a motion to exclude Plaintiffs' damages evidence. *See* Dkt.365.

a. These undisputed facts make out more than what Plaintiffs repeatedly call a "purported" violation of Rule 26. Pls. 94. Despite Plaintiffs' attempt to appeal to the "gravamen" of the district court's decision (Pls. 101), the district court expressly found Plaintiffs had failed "to provide a robust pre-trial damage computation pursuant to Federal Rule of Civil Procedure 26" as they "should have" done (SA433-34_(Dkt.535:184-85)).

Plaintiffs' facially deficient disclosures come nowhere close to satisfying *Design Strategy, Inc. v. Davis*, 469 F.3d 284 (2d Cir. 2006), this Court's most robust explication of Rules 26 and 37. Plaintiffs argue that UPS "reasonably could have … anticipated" an indefinite (but substantial) amount of claims (Pls. 107) and that neither Rule 26 nor *Design Strategy* requires an exact amount or explanation of how "documents serve to prove the plaintiff's case" (Pls. 105). But Rule 26 requires "by its very terms … a '*computation*,' supported by documents" and does not permit a plaintiff to provide documents "*without any explanation*." *Design Strategy*, 469 F.3d at 295 (emphases added). Plaintiffs' attempt to shift the burden of computation to UPS ignores that they never disclosed *how* they intended to convert voluminous spreadsheets into a damages and penalties case, and UPS had no obligation to do their work for them.

Yet despite finding a Rule 26 violation, the district court refused to sanction Plaintiffs, even though Rule 37 makes preclusion automatic *unless* the court exercises its discretion to impose an alternate sanction "instead of" or "in addition to" preclusion. *See* UPS Br. 72. Contrary to Plaintiffs' assertion (Pls. 108), this Court in *Design Strategy* held only that the district court had "discretion to impose *other, less drastic* sanctions." 469 F.3d at 298 (emphasis added). Neither the text of Rule 37 nor *Design Strategy* permits doing away with sanctions altogether. Preclusion was warranted here because Plaintiffs to this day have presented only shifting, speculative package and carton counts from undisclosed methodologies. *See Weiss v. Chrysler Motors Corp.*, 515 F.2d 449, 457 (2d Cir. 1975).

b. Plaintiffs' fallback position is that their failure should be excused as either "substantially justified" or "harmless." Pls. 101-02, 109. But the four factors identified by this Court in *Patterson v. Balsamico*, 440 F.3d 104 (2d Cir. 2006), preclude this conclusion. Plaintiffs assert that the justification-or-harmlessness inquiry precedes consideration of the *Patterson* factors. Pls. 109. That is incorrect. *See Patterson*, 440 F.3d at 117; *see also*, *e.g.*, *Agence France Presse v. Morel*, 293 F.R.D. 682, 685 n.5 (S.D.N.Y. 2013) (interpreting *Design Strategy* this way). The district court improperly considered only one factor—prejudice, on which it erroneously shifted the burden of proof—while ignoring the other three: an explanation, the importance of the evidence, and the possibility of a continuance. Its conclusion is therefore

premised on legal errors and is "necessarily" an abuse of discretion. *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405 (1990); *see also Gasperini v. Ctr. for Humanities, Inc.*, 149 F.3d 137, 142 (2d Cir. 1998) (noting that a district court abuses its discretion when it "fail[s] to consider all relevant factors").

Explanation. Plaintiffs have no acceptable explanation for failing to make the required disclosures. Plaintiffs rely heavily on the district court's February 1 order (*cf.* Pls. 109-10), which did no more than deny UPS's motion to compel additional interrogatory responses "*at this stage, and in the current posture*." SA31_(Dkt.169:5) (emphasis added). It certainly did not—explicitly or implicitly—exempt Plaintiffs from Rule 26(e)'s requirement to supplement their Rule 26(a)(1) or interrogatory responses or from Rule 26(a)(3)'s final pretrial disclosures. *E.g.*, *Design Strategy*, 469 F.3d at 295 ("[Rule 26] anticipates supplemental disclosures with ever-greater level of detail as discovery progresses.").

Importance. Many courts have concluded that even dispositive evidence should be excluded where it was not properly disclosed, "particularly where [the dilatory party] alone is to blame for creating the situation." *MicroStrategy Inc. v. Bus. Objects, S.A.*, 429 F.3d 1344, 1357 (Fed. Cir. 2005); *see also* UPS Br. 73-74. Plaintiffs complain of being left without a remedy—but that is a consequence solely of Plaintiffs' dereliction of their disclosure obligations and ensuing failures of proof. *See Agence France Presse*, 293 F.R.D. at 687 ("To permit entirely unexplained Rule

26 violations to go unsanctioned whenever the evidence at issue is sufficiently important would give parties the perverse incentive to spring especially large and surprising disclosures on their adversaries on the eve of trial").

Continuance. Plaintiffs' "blame the victim" insinuation that UPS *intentionally* avoided learning about the full amount of its exposure at trial on the *chance* that the district court *might* decide to strike Plaintiffs' entire damages case (Pls. 111-12) has no support in the evidentiary record. UPS specifically and repeatedly sought disclosure of the evidence underlying Plaintiffs' package and carton counts. *See*, *e.g.*, JA131-35_(Dkt.72:9-13), JA14546_(Dkt.73:5-6). Both Plaintiffs and the district court were on notice that UPS lacked adequate information about the damages and penalties case, yet proceeded to trial anyway.

Plaintiffs ask the Court to ignore all of UPS's efforts on the ground that UPS, in the context of settlement discussions, declined some sort of proffer. Pls. 111-12. No such proffer was made. *See* JA716_(Tr.544:17-23) (explaining that Plaintiffs' description of a "proffer" of a full damages calculation "is a gross mischaracterization"). In any event, a computation provided in settlement discussions neither comports with Rule 26 nor can it be "considered a reliable indicator of the damages plaintiff is seeking," given the "mere puffery or posturing" that occurs in settlement negotiations. *Richmond v. Gen. Nutrition Ctrs. Inc.*, 2012 WL 762307, at *7 (S.D.N.Y. Mar. 9, 2012) (cleaned up) (citing cases). Indeed, UPS has challenged the

district court's reversal of itself without explanation on these purported discussions (UPS Br. 78), yet Plaintiffs repeat the error without discussing it.

Prejudice. The standard for harmlessness is a high one, clearly elucidated in the advisory committee's notes to Rule 37(c): "inadvertent omission," not listing "a person so listed by another party," or "the lack of knowledge of a pro se litigant." Fed. R. Civ. P. 37(c)(1) advisory committee's note (1993). This commentary "strongly suggest[s] that 'harmless' involves an honest mistake on the part of a party coupled with sufficient knowledge on the part of the other party." *Howe v. City of Akron*, 801 F.3d 718, 747 (6th Cir. 2015) (cleaned up). These examples are *worlds* away from Plaintiffs' wholesale failures. Indeed, in *Howe*, plaintiffs intended to use "Excel simple math" to calculate damages, disclosed all underlying documents, and proffered two experts who authored reports and were deposed on methodology. In light of these substantial disclosures, the Sixth Circuit concluded that minor changes to final calculations—not methodology—of damages were harmless. 801 F.3d at 748. Here, Plaintiffs provided no qualified expert or witness, repeatedly provided facially deficient disclosures, consistently obstructed UPS's attempts to obtain the information that Rule 26 required, and presented no calculation in evidentiary form that UPS could cross-examine or subject to testing. Such a deprivation of the oppor-

tunity to confront the lynchpin evidence is anything but "harmless." *See*, *e.g.*, *Salgado ex rel. Salgado v. Gen. Motors Corp.*, 150 F.3d 735, 741-42, 741 n.6 (7th Cir. 1998).

Plaintiffs insist in response that (1) "UPS could not have suffered any prejudice—let alone substantial prejudice—from allegedly not being told sooner about the contents of its own business records" and that (2) "UPS knew early on *that* its delivery and billing spreadsheets would play a major role in calculating damages and penalties." Pls. 103 (emphasis added). But prejudice results neither from the contents of the documents nor *that* they would be used. It was *how* Plaintiffs would derive an actual number from the spreadsheets' contents that Plaintiffs needed to disclose, including what evidence Plaintiffs would rely on to explain and interpret the data as well as the statistical and mathematical methods used to derive damages and penalties from multimillion-cell spreadsheets. These are "the parameters of the dispute in a highly technical case," and Plaintiffs' disclosure failures thus redrew "the boundaries" and "prejudiced [UPS's] ability to meet [Plaintiffs'] attack," warranting preclusion. *Softel, Inc. v. Dragon Med. & Sci. Commc'ns, Inc.*, 118 F.3d 955, 962 (2d Cir. 1997).

Rather than holding Plaintiffs to their burden, the district court instead shifted the burden to UPS to disprove prejudice, reasoning that UPS "could have called a witness" if it thought the spreadsheets "were being relied upon in an inappropriate

manner." SA436-38_(Dkt.535:187-89). But of course, a rebuttal witness would have had nothing to *rebut* without an explanation of Plaintiffs' methodology. Indeed, contrary to Plaintiffs' and the district court's assertions, UPS could not "'identify any rebuttal witnesses' regarding the Arrowhawk disclosure" (Pls. 101 (quoting SA438_(Dkt.535:189))) because it contained only an "assumption" and presented no actual computation nor methodology (JA361_(Dkt.367-4:4). Moreover, "to characterize the issue" with Plaintiffs' nondisclosure "as being determined by a lack of 'surprise' distorts the essential problem." *Weiss*, 515 F.2d at 456. Civil discovery rules in federal court were "not merely [intended] for convenience of the court and the parties" but were to promote "an orderly presentation of complex issues of fact." *Id.* at 457. As the subsequent trial revealed, Plaintiffs' disclosure failures not only prejudiced UPS's defense, they prejudiced the judicial process by destroying any chance of a sufficient presentation on this critical evidence at trial.

2. During Trial: Evidentiary Deficiencies.

Plaintiffs contend that they "maintained a consistent theory of damages and penalties" throughout this proceeding. Pls. 96. That is simply false, as the following chart graphically illustrates:

Disclosure	Amount	Detail	Cited Source
Initial Complaint (Feb. 18, 2015)	Over $180 million	No package count; 683,000 cartons	Unspecified delivery data
Disclosures (Apr. 6, 2015)	None	None	None
Third Compl. (Feb. 24, 2016)	Millions of dollars	No package count; 683,000 cartons	Unspecified delivery data
Disclosures (Aug. 8, 2016)	None	None	None
Proposed Findings (Sept. 9, 2016)	None	109,470 packages; no carton count	PXs 67, 70, 73, 76-79, 188, 194, 195, 220-223, 227, 254, 276, 277, 409, 411, 412, 415, 416, 419, 421, 425, 426, 428-431, 433-435, 437-439, 551-553, 555-560
Trial Statements (Sept. 19, 2016)	Over $872 million	None	None
Court Exhibit 1 (Sept. 20, 2016)	$876 million	109,470 packages; 766,290 cartons	Unspecified spreadsheets
Post-Trial Brief (Oct. 24, 2016)	Over $1 billion	104,893 packages; 639,847 cartons	PXs 70, 71, 222, 433, 434, 436, 552, 554-557, 559, 560
Damages Letter (Apr. 7, 2017)	None	80,468 packages; 399,068 cartons	PXs 70, 71, 222, 433, 434, 552, 554, 555, 556, 559, 560.

From the outset of the litigation to its conclusion, Plaintiffs' damages and penalties claim mushroomed from less than $200 million to more than a billion dollars, even as the number of cartons on which that claim was based dropped by more than 275,000. After avoiding mandatory disclosures for more than a year, on the second day of trial Plaintiffs claimed damages and penalties on 109,470 packages and 766,290 cartons; this unexplained proffer added nearly $700 million to their only previously disclosed demand (their complaint's $180 million), constituting an increase of over 500%. *See* JA451-55_(Dkt.440-2:1-5). Remarkably, in their post-trial briefing, Plaintiffs' total recovery went up by $125 million, even while the package count went down by 5,000 and the carton count by 125,000. *See* JA484-92_(Dkt.491-1:2-10). By the time the district court issued its damages order—without any evidentiary testing—Plaintiffs' numbers had fallen by nearly 30,000 packages and 370,000 cartons (*see* JA507-18_(Dkt.530:1-12)), which alone would reduce the AOD penalties by $30 million (or the PACT Act or PHL maximums by $150 million each) and the compensatory damages by at least $15.6 million. Consistency, this is not.

Plaintiffs purported to reach these inherently speculative figures from a shifting array of spreadsheets produced from various UPS shipping and billing databases. Plaintiffs introduced these spreadsheets into evidence without any witness, lay or expert, to testify as to their use, meaning, contents, significance to UPS's operation,

or any other myriad facts necessary to interpret over 83.5 million cells of data contained within. After advancing only non-evidentiary attorney proffers advocating what they believed the datasets to mean, Plaintiffs then sat back and asked UPS to disprove their (inconsistent) speculation. That's just not how trials work.

Plaintiffs have no answer to this fundamental error, nor do they respond to UPS's detailed arguments pointing out the massive shifts in Plaintiffs' package- and carton-count theories. *See* UPS Br. 77-79, 82-85. Plaintiffs' oft-invoked Arrowhawk Letter contains no explanation for how Plaintiffs intended to derive a package count from any spreadsheet (nor did it even purport to, providing only an unexplained "assumption" of 8,000 packages). *See* JA359, 361_(Dkt.367-4:1, 3). Plaintiffs also never explain the shift from using "testimony and shipping invoices" to show package contents (Pls. 100), to advocating at trial that the district court infer "that a tobacco seller in the United States sells tobacco in proportion to what's the national market for tobacco." JA1066-67_(Tr.1942:24-1943:2). And although Plaintiffs complain that "direct testimony was not legally required" (Pls. 124), they ignore that the only thing remotely approaching a pre-trial disclosure expressly represented that "testimony from Philip Christ regarding the nature of the Arrowhawk Enterprise as a cigarette dealer, and shipping invoices listing the contents of packages shipped by UPS" would be the evidentiary bases for package contents. JA360_(Dkt.367-4). Nor

do Plaintiffs even mention that they expressly disavowed extrapolations from anecdotal evidence, which eventually become the only basis for the district court's findings. *See* JA1061_(Tr.1922:12-16). Even their brief to this Court offers only a two-page, glancing summary of cigarette shipments, most of which relies on citations to their post-trial briefing, not evidence, for findings the district court did not make. *See* Pls. 40-41.

In an effort to sidestep the morass of confusion their trial presentation created, Plaintiffs assert essentially two defenses of their case: (a) UPS produced the spreadsheets, and so cannot dispute that they mean what Plaintiffs say they mean, and (b) if there are gaps in proof, UPS bears the responsibility to disprove their existence. Neither of these arguments is consistent with law, the Constitution, or the adversarial system.

a. Plaintiffs admit that "the spreadsheets may have been large, and the required computations time-consuming." Pls. 119. Yet UPS has never seen—let alone cross-examined a witness on—those "computations." As even the district court recognized at trial, these calculations were performed by "the data guy at the A.G.'s Office" who "may be fantastic but … a quasiexpert who's not here in court." JA710_(Tr.526:8-10). And notably, Plaintiffs' attorneys have admitted that they manipulated the actual spreadsheets to make damages calculations (*see*, *e.g.*, JA474_(Dkt.491-1:8) (identifying Excel function Plaintiffs' counsel wrote into the

spreadsheet to count rows)), and made judgment calls about which numbers to include and which to exclude. *See* JA473_(Dkt.491-1:7 n.3). Plaintiffs even changed their methodology where "[s]ome spreadsheets contained no package weight data" and therefore "required a slightly different process than the calculations discussed above." JA477_(Dkt.491-1:11). Not one of these supporting data manipulations or assumptions was put in evidence through a witness who could be cross-examined.

Plaintiffs claim that the district court's order permitting them to introduce the spreadsheets without an authenticating witness means that the documents' importance and meaning are somehow incontrovertible, as are all inferences or calculations that might be derived from them. But the district court's order on authenticity has nothing to do with providing sufficient evidence to allow conclusions to be drawn from the raw data or testing the reliability of that process. *See*, *e.g.*, *Last Atlantis Capital LLC v. AGS Specialist Partners*, 262 F. Supp. 3d 641, 673 (N.D. Ill. 2017) ("The probative value (and indeed relevance) of [plaintiff's] spreadsheets … depends upon the extent to which these exhibits actually demonstrate or tend to prove the mishandling of orders. Yet no witness was able to say that the spreadsheets actually showed mishandled orders.").

Plaintiffs fail to acknowledge that business records may be admissible as such, but inferences (and especially calculations) derived from voluminous electronic data need additional support. In this case—as in any case involving large organizations,

including governments, with extensive electronic databases—the spreadsheets were, as Judge Forrest recognized, "just chockablock full of all kinds of fields that I can't make head nor tail of." JA708_(Tr.518:10-12). (Indeed, in discovery, Plaintiffs called the spreadsheet fields full of "indecipherable shorthand and unknown acronyms" and the spreadsheets themselves "in large part indecipherable" and "practically unusable." Dkt.82:3.) Just the 11 different spreadsheets on which the district court based its final damages and penalties awards (and not the thirty-five others to which Plaintiffs cited at various times) comprise 542,418 rows, 154 columns, and 83.5 million cells of data as to which no witness testified. *See* UPS Br. 92.

Translating "inherently voluminous" and unexplained data into an *actual* package and carton count is a "highly technical" process requiring expert testimony—and especially cross-examination. *Iacobelli Constr., Inc. v. County of Monroe*, 32 F.3d 19, 25 (2d Cir. 1994). Any witness purporting to offer a conclusion from this dataset would need to explain how she selected dates, shippers, fields, and so forth; why she believed the cells on which she relied were proper; and how she performed the calculations and other manipulations of the data (such as de-duplication, arithmetic, and higher-level statistics and mathematics)—and be subject to deposition, *Daubert* challenge, cross-examination, and rebuttal on every aspect. In other words, the witness would need to "show her work." *See Salgado*, 150 F.3d at 741 n.6 (noting that Rule 26(a) expert reports "must include 'how' and 'why' the expert

reached a particular result, not merely the expert's conclusory opinions"). Plaintiffs skipped over every single one of these mandatory steps.

The unreliability of Plaintiffs' methods is demonstrated in their own post-trial briefing: According to Plaintiffs' unexplained "spreadsheet" calculations, the Arrowhawk Group shipped 38,665 cartons (Dkt.491:154)—but seven pages later, Plaintiffs provide their count of "the packing slips produced by Arrowhawk," which show that "Arrowhawk shipped *14,731* cartons of cigarettes through UPS" (Dkt.491:161 (emphasis added)). In other words, Plaintiffs' unsupported, black-box spreadsheet method produces an unexplained *24,000 more cartons* than the documentary record shows, changing potential damages by over a million dollars for Arrowhawk alone.

In fact, Plaintiffs' theories of package and carton counts change even now. According to Plaintiffs' post-trial submission, only 819 packages shipped by Jacobs Tobacco weighed over one pound, the minimum possible weight for a package to contain a carton of 200 cigarettes. JA510-11_(Dkt.530:4-5) (citing JA1381_(PX-434); *see also* SA461_(Dkt.535:212); SA482_(Dkt.536:14). On appeal, Plaintiffs assert—relying on yet *another* spreadsheet not relied on below—that Jacobs shipped through UPS "more than 3,000 deliveries … mostly comprising cases of 10,000 unstamped cigarettes each." Pls. 41 (citing JA1325_(PX-281)). But there is no way that

most of "more than 3,000 deliveries" contained a fifty-pound case of 10,000 cigarettes when only 819 packages weighed over one pound. Even before this Court, Plaintiffs *still* cannot decide which spreadsheets provide the basis for what they call "easy math." Pls. 116.

Plaintiffs' suggestion that this is an acceptable way to present a damages and penalties case—with hundreds of millions of dollars at stake—is mind-boggling in its implications. By parity of reasoning, a plaintiff alleging securities fraud could simply submit into evidence all the trading records for the class period and assert a conclusory damages number without providing an expert to show any repeatable process or methodology that connects the data to the claimed damages. The named plaintiff in an employment class action—perhaps against a New York state municipality or agency—could simply submit into evidence all the pay records and employment histories, and then claim a damages amount in some black-box attorney proffer. The government in a tax fraud case could simply introduce the defendants' tax returns and claim damages and penalties based on the information recited therein without ever disclosing the how or why of the calculations. This approach is unacceptable when offered through an expert. *See Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146 (1997) ("nothing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert"). It is even more unacceptable when done without one.

b. Plaintiffs mistake UPS's objections to the damages/penalties process as an admission of error in UPS's document productions, or as a challenge to the order permitting admission without an authenticating witness, or as an argument as to the veracity of the actual data on the spreadsheets. *See* Pls. 116-18. These are red herrings. UPS's objection is that even though the spreadsheets are in evidence, they do not show what Plaintiffs claim they show—nor does UPS even know how Plaintiffs manipulated them to produce their unreplicable numbers. Plaintiffs argue "the spreadsheets and data dictionaries were the critical evidence, and they were both authentic and relevant." Pls. 118. UPS disputes neither authenticity nor relevance—but the critical missing evidence is the process by which the raw data contained in these spreadsheets were converted into package and carton counts supporting *$246 million* in damages and penalties.

Plaintiffs insist that their damages and penalties estimates are the product of "easy math" (Pls. 116), but no actual math has been shown. UPS (and, for that matter, both this Court and the district court) have no way of knowing whether the "math" is easy or hard, or whether it was done correctly, because it does not appear any place in the record. Plaintiffs' numerous proffers—during trial, in post-trial briefing, and in post-liability submissions—have been opaque, ad hoc, often unexplained, and entirely unreproducible (even by Plaintiffs themselves). *See*, *e.g.*, JA451-55_(Dkt.440-2:1-5), JA468-82_(Dkt.491-1:2-16), JA507-18_(Dkt.530:1-

12). As Plaintiffs acknowledge, the only basis for their calculations—the "[a]dditional charts and proffers that UPS complains about"—"were never admitted into evidence," and "[t]he district court disclaimed reliance on" them. Pls. 118-19. In other words, no explanation of any of the shifting calculations Plaintiffs put forward is in evidence, much less been subject to cross-examination by UPS. These features distinguish Plaintiffs' cited case, in which a district court "cross-check[ed]" each line of a summarizing spreadsheet against the actual documentary record. *Gamero v. Koodo Sushi Corp.*, 272 F. Supp. 3d 481, 506 (S.D.N.Y. 2017). Nowhere in either of the district court's opinions here does a similar (or any) level of scrutiny appear.

Plaintiffs' repeated contention that UPS should have introduced a witness to explain Plaintiffs' evidence for them (Pls. 115, 116, 118) inverts the trial process and admits their failure to meet the burden of proof. In essence, Plaintiffs treat their introduction of voluminous spreadsheets without supporting testimony as establishing a burden-shifting presumption, compelling UPS to disprove Plaintiffs' unexplained proffers. But only a fact "which in common experience leads naturally and logically to" the asserted conclusion can create presumptive proof, and Plaintiffs' attorney arguments come nowhere near that standard. *Wilkins v. Am. Exp. Isbrandtsen Lines, Inc.*, 446 F.2d 480, 484 (2d Cir. 1971). Plaintiffs did not propose a method for computing damages, did not explain the data they now say support damages, and, before trial, did not even provide an aggregate sum of damages

sought. If UPS had called an expert, she would have had no methodology to address, no interpretation of data to dispute, and no way to engage with Plaintiffs' undisclosed theory of how they arrived at their damages calculation.

When called to account in this Court, Plaintiffs rely solely on "[t]he data contained in UPS's spreadsheets themselves, in conjunction with the UPS data dictionaries" (Pls. 115)—but can cite no evidence establishing what any of those entries mean, or how they translate into damages. Plaintiffs' failure to discuss the details of the evidence is hardly surprising, because if the spreadsheets were printed out, they would be taller than an 11-story building. For Plaintiffs to point vaguely to "the spreadsheets" as substantiating their factual claim is like a lawyer pointing generally to "the United States Reports" as supporting his legal claim. Neither will suffice.

A plaintiff that ends its case without sufficient evidence to support an essential element of its claim loses, because such "a complete failure of proof … necessarily renders all other facts immaterial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986). The district court erred in not granting judgment after trial to UPS based on Plaintiffs' complete failure of proof with respect to damages and penalties.

3. After Trial: Decisional Deficiencies.

In its liability opinion, issued almost five months after closing arguments, the district court recognized that Plaintiffs had failed to provide it with the evidence it needed to assess damages and penalties. The case should have ended there. Instead,

the court stepped outside the judicial role in two ways: first, it reopened the record to receive inadmissible information in violation of accepted procedure and UPS's due process rights; then, the court applied its own statistical methodology for extrapolating package contents from anecdotal evidence (an approach Plaintiffs expressly disclaimed at trial). Both of these rulings constitute reversible error.

a. The district court could not find the number of packages or cartons actually shipped on the basis of the trial evidence and so after trial "direct[ed] the parties to determine the number of Packages that fall within" certain parameters (SA463_(Dkt.535:214)) and to "jointly confer on the number of such Packages" (SA462_(Dkt.535:213)). This order violated this Court's precedents on grounds for reopening the record, the principle of party presentation, and UPS's due process rights. *See* UPS Br. 87-103.

Plaintiffs insist that they "met their burden of proof on damages" at trial, and "[w]hat remained was to plug in the damage and penalty calculations based on information in the record." Pls. 132. Wrong. The district court's liability opinion could not determine from the trial evidence which packages UPS transported in breach of any regulatory regime, how many cartons were involved, or how much tax revenue Plaintiffs supposedly lost due to UPS's conduct. *See* SA252_(Dkt.535:3), SA456_(Dkt.535:207 & n.144), SA461-64_(Dkt.535:212-15). The post-trial "damages and penalties calculations" *were* the still-speculative "proof of damages" that

Plaintiffs had not put in evidence during trial. Even had these post-trial numbers been properly calculated by an expert who could then testify, Plaintiffs had every opportunity to present their methodology and calculations at trial and did not do so. UPS Br. 88-89. Plaintiffs cite no precedent or justification that permits submitting new mathematical calculations for damages after the record has closed. It grossly exceeded the district court's discretion to re-open the record to provide Plaintiffs with their "second bite at the apple." *Sequa Corp. v. GBJ Corp.*, 156 F.3d 136, 144 (2d Cir. 1998).

In response, Plaintiffs contend that "[t]he record was never reopened"—but then go on to admit that they submitted "charts with shipper-by-shipper package counts," corrected the formula for "the number of shipped cartons," and proposed the use of "billed weight" for "four shippers for which actual package weights were not listed." Pls. 130-31. No matter how Plaintiffs attempt to characterize their post-trial submission, they presented numbers that were "obviously the product of calculation" for which there was no "proper foundation … connecting the numbers on the chart with the underlying evidence." *United States v. Citron*, 783 F.2d 307, 316-17 (2d Cir. 1986). It is undeniable that the district court awarded nearly a quarter-billion dollars on the basis of summary charts prepared after trial by unknown individuals—who were not witnesses, had never been cross-examined or subjected to *Daubert*

challenges, and did not testify at trial—running unknown functions on Excel spreadsheets, interpreting what particular fields represented without a basis in evidence, and presenting final package and carton counts based on mathematical computations and judgments about methodology that were never disclosed.

Although Plaintiffs claim to have "listed the exact spreadsheets they relied on" (Pls. 130), their actual citations are far less illuminating. *See* JA509-10_(Dkt.530:3-4 table 1). For example, as support for their purported AOD package count of 22,523 for Shipping Services, Plaintiffs' citation is, in full, "PX 433." JA510-11_(Dkt.530:4-5). PX 433 is a 123-megabyte Excel spreadsheet containing 235,614 rows and 154 columns for a total of 36,284,556 cells. JA1380_(PX-433). No witness—or even proffer—described how any set or subset of those 36 million cells became 22,253 packages (or which of the entries in the spreadsheet were the *actual* 22,253 packages).

Compounding its errors, the district court ordered UPS to submit its own calculations simultaneously—in other words, to provide evidence against itself without the opportunity to present a rebuttal case to Plaintiffs' calculations. Plaintiffs never address the principle of party presentation, which squarely holds that courts must be the "neutral arbiters of matters the parties present" and that "'the parties know what is best for them, and are responsible for advancing the facts and arguments entitling them to relief.'" *Greenlaw v. United States*, 554 U.S. 237, 243-44 (2008) (quoting

Castro v. United States, 540 U.S. 375, 386 (2003) (Scalia, J., concurring in part and concurring in judgment)). District courts do not "have authority to force the parties" to alter their presentations of evidence. *Oliveri v. Delta S.S. Lines, Inc.*, 849 F.2d 742, 748 (2d Cir. 1988); *see also* Fed. R. Evid. 611(a) (granting the court "reasonable control over the mode and order" of evidence presentation but not listing content). Likewise, it is reversible error to deprive a party of the opportunity to cross-examine critical evidence against it—nor can that error "be cured by having the fact-finder subsequently examine the material." *Reilly v. Pinkus*, 338 U.S. 269, 275-76 (1949).

Plaintiffs characterize UPS's post-trial submission as a calculation "based on its *own interpretation* of the evidence." Pls. 129. This misses the point entirely. UPS's post-trial submission did not purport to interpret any evidence; it simply identified the only actual evidence in the record "from which the number of 'Packages' (as defined in the Opinion) could potentially be derived" (JA520-21_(Dkt.531:1-2))—*i.e.*, the "testimony or shipping invoices" of the three shipper groups for which Plaintiffs presented such evidence at trial (as they had represented they would in the Arrowhawk Letter). *See* UPS Br. 82. Though UPS contends that Plaintiffs failed to meet their burden of persuasion as to all damages and penalties—whether through disclosure failures, prejudice to UPS's due process rights, or the district court's improper methodology—UPS can distinguish between conclusions for which Plaintiffs presented *some* evidence and those for which Plaintiffs presented *no* evidence.

Upon receiving the post-trial calculations, the district court first accepted Plaintiffs' figures without any indication that it had independently satisfied itself of their accuracy, an impermissible result even after default judgment. *See Transatl. Marine Claims Agency, Inc. v. Ace Shipping Corp.*, 109 F.3d 105, 111 (2d Cir. 1997). Then it expressly took UPS's fidelity to the trial record as an indication of "UPS's lack of acceptance of responsibility for their [*sic*] actions" and announced it would impose "a significant award" on that basis. SA472-73_(Dkt.536:4-5). In other words, the district court punished UPS for standing on its rights and holding Plaintiffs to their proof. We have no Star Chamber in this country, and the government may not punish a citizen for insisting on a fair trial—particularly where, as here, a sovereign is the adversary.

b. Despite chastising Plaintiffs both during trial and in its liability opinion for failing to present expert testimony on package and carton counts, the district court took it upon itself to rectify this fatal deficiency by inventing an expert methodology long after the trial concluded. Specifically, the district court improperly created its own unreliable statistical analysis—based on a non-random, anecdotal, and unrepresentative sample—to make findings about the *fact* of damages. UPS Br. 93-102. Plaintiffs' primary response—as ever—is to blame UPS, arguing that the "wrongdoer rule" prevents UPS from challenging the sufficiency of the proof and that

UPS's failures to audit should be blamed for the lack of proof of package contents. Pls. 120-21. These arguments are legally bankrupt.

Plaintiffs argue that "[t]he court did not purport to engage in sampling or technical extrapolation, and was not required to do so to make factual findings about package contents." Pls. 127. This is unavailing. Regardless of what the district court termed it, the court took a subset of a population—a sample—and, based on its composition, did not find that *specific packages* contained cigarettes but instead "found" that some *percentage* of the entire population did. That is the "essence of the science of inferential statistics": "that one may confidently draw inferences about the whole from a representative sample." *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) (statistical evidence includes "sampling to generate data about a population so the data will be verified or declared true"). Plaintiffs have no response to UPS's argument that statistical inferences must be drawn by an expert and supported by proper testimony about the reliability of the sampling and methodology used. *See* UPS Br. 99-100. The Supreme Court has been explicit that "[r]epresentative evidence that is statistically inadequate" cannot be deemed "reliable in proving or disproving the elements of the relevant cause of action." *Tyson Foods, Inc. v. Bouaphakeo*, 136 S. Ct. 1036, 1048 (2016). A statistical analysis "[w]ithout a sound rep-

resentative sample" renders the factual finding on which it was based "clearly erroneous." *United States v. Jones*, 641 F.3d 706, 712-13 (6th Cir. 2011). In this case, neither Plaintiffs' "math" deriving package counts nor the district court's extrapolation of package contents has been subjected to evidentiary testing, much less shown to be reproducible. *See* NAT'L ACADS. OF SCIS., ENG'G & MED., STATISTICAL CHALLENGES IN ASSESSING AND FOSTERING THE REPRODUCIBILITY OF SCIENTIFIC RESULTS 4 (2016) ("Reproducibility is a minimum necessary condition for a finding to be believable and informative").

Moreover, Plaintiffs ignore entirely that the district court's methodology was expressly disclaimed by *both* Plaintiffs *and* the district court at trial: "[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_(Tr.1922:12-16); *see also* JA1061-62_(Tr.1922:24-1923:4) (The Court: "[Y]ou can't do a calculation off of these"); JA1062_(Tr.1924:15-16) (The Court: "[I'm not suggesting] that you can do anything mathematical with this"). Instead, they argue that UPS had "every opportunity to challenge" the underlying evidence (Pls. 128), which is irrelevant when the concern is about the unrepresentativeness of the sample. *See Chevron*, 109 F.3d at 1019. The district court cannot step out of the adjudicatory role, create an untested and *sui generis* method of proving Plaintiffs' case for them, and deny UPS cross-examination and rebuttal of the methods

that are the sole basis for nearly a quarter-billion dollars in damages and penalties. *See Carter v. Morehouse Parish Sch. Bd.*, 441 F.2d 380, 382 (5th Cir. 1971) ("A ruling based on evidence which a party has not been allowed to confront or rebut is one which denies due process").

Plaintiffs claim that "UPS contests none" of the district court's "shipper-specific" factual findings and that these findings "established the existence of damages as to each of these shippers." Pls. 121-22. But UPS challenges the entire basis for the district court's package and carton findings as to *every* shipper: no evidence supports Plaintiffs' interpretations of the spreadsheets or the erroneous methodology used by the district judge, who was never cross-examined by UPS. *See* UPS Br. 93-102. And Plaintiffs again elide the distinction between *liability* as to a shipper and the *fact* that a package on which they claim damages and penalties warrants any recovery.

This Court has squarely rejected a district court's attempt to make findings that conflate liability and per-violation penalties. *See Landy v. FAA*, 635 F.2d 143, 147 (2d Cir. 1980). There, as here, a federal statute imposed per-violation penalties for failure to comply with aviation regulations. *Id.* at 144. Although a jury found the airline had violated the regulations, this Court reversed the district court's penalties because the jury had not "determine[d] as a question of fact which violations, if any, occurred during which flights." *Id.* at 147. The Court expressly held that "[w]hen a

court is permitted to impose a fine of up to $1,000 for *each violation*, proof of *the violation* should not be a matter of inference or conjecture." *Id.* (emphases added). The Court rejected the district court's inference, for example, that an inspection revealing no "life vests in the plane in August" had established "that there were no life vests aboard when a flight was made in May." *Id.* Likewise, Plaintiffs and the district court here attempt to transform their belief that UPS violated the law at some point into a specific number of violations aggregating a quarter-billion dollars in damages and penalties. This alchemy is the same attempted transmutation of liability into the *fact* of damages (per-package penalties) that *Landy* squarely precludes. The Court's closing words to the government in *Landy* echo in this case: "Instead of 'throwing the book' at appellants, the Government should limit its claims … to those it is prepared to prove." *Id.*

In this case, Plaintiffs demanded (and the district court imposed) *per-package penalties* without *per-package proof*. Plaintiffs failed to prove both the number of packages actually transported for any shipper (because of their reliance on unsupported and voluminous spreadsheets) and which packages actually contained cigarettes. Thus, they cannot invoke the wrongdoer rule to claim recovery on a per-package basis, because they have proven neither the number of packages constituting "a violation," *Landy*, 635 F.2d at 147, nor the packages to which damages "are defi-

nitely attributable … and only uncertain in respect of their amount," *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931). As this Court explained, the "more liberalized standard of proof" applies "to situations in which the amount of damages, although not specifically ascertainable because of misconduct by the defendant, falls within a certain range." *Raishevich v. Foster*, 247 F.3d 337, 343 (2d Cir. 2001). For every package on which the district court awarded damages or penalties, Plaintiffs failed to prove that range was, at least, above zero—and thus never proved the fact of damages. Because Plaintiffs have not made this necessary first showing, they cannot invoke the wrongdoer rule. *See J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 568 n.5 (1981).

It is incredible that the State and City of New York claim they lacked the capacity to obtain the proof necessary to bring this suit because "it is difficult to compel on-reservation tobacco shippers to comply with discovery requests" (Pls. 124). Even nongovernmental plaintiffs have access to the power of the federal courts to issue subpoenas and require compliance. *E.g.*, Fed. R. Civ. P. 45; *see also* N.Y. Exec. Law § 63(8) (conferring broad subpoena powers on NYAG with criminal contempt sanctions). Indeed, Plaintiffs' own citations confirm that when they experienced difficulty with third-party discovery, they "anticipate[d] requiring the Court's assistance in enforcement" (JA217_(Dkt.116:2)) and expressly informed the district court that "there is no problem" with its subpoena power on the reservations

(JA174_(Dkt.87:17)). Plaintiffs' argument is (yet again) a bare-faced attempt to shift the consequences of their inability to prove their case to UPS. At the end of the day, it matters not why Plaintiffs were unable to discharge their evidentiary burden on an element of their claim; because they didn't, they lose.

* * *

Plaintiffs ultimately ask the Court to ignore the forest for the trees: They contend that UPS "offers almost no specific challenge to any" of the findings of percentages of packages containing cigarettes (Pls. 125), while ignoring that UPS is challenging the entire method the district court used to reach all of those findings. If that challenge is accepted—as it should be—then all the findings as to package and carton counts have to be vacated, and the damages and penalties awards reversed *in toto*. At minimum, the Court should vacate the awards and remand with instructions to calculate damages and penalties only on the actual documentary and testimonial evidence submitted at trial for the three shippers for which Plaintiffs adduced any evidence at trial regarding actual cigarette shipments. *See* UPS Br. 15, 82.

B. The District Court Erred in Calculating Compensatory Damages.

The premise of Plaintiffs' compensatory damages claim is that if UPS transported a carton of untaxed cigarettes from a Native American reservation to a New York consumer, then Plaintiffs "lost" the tax revenue that the consumer otherwise would have paid on a New York-taxed carton. However, Plaintiffs cannot claim compensatory damages if that consumer would have instead purchased a carton of cigarettes in New Jersey; in that case, there would be no "lost" taxes. *See* SA441_(Dkt.535:192). The district court admitted that it "cannot arrive at a precise number of [New York-taxed] cigarette cartons consumers would have purchased," but stated—without citing any evidence—that "50% is a reasonable number based on the totality of facts." SA442_(Dkt.535:193). UPS challenged that conclusion as unsupported by legally sufficient evidence, pointing out that the only estimate of tax diversion was the zero to 5.4% range provided by UPS's expert, Dr. Nevo. *Compare* UPS Br. 104-06 (Argument II.B.), *with* Pls. 140-42 (Argument II.C.2.).

In the single paragraph that Plaintiffs devote to defending the district court's unsupported 50% figure, they assert that "Nevo acknowledged that, based on 'market-wide averages' of cigarette consumption, up to 56% of tax-free cigarette sales would have been replaced by taxable sales if UPS had followed the law." Pls. 141 (citing JA2042_(DX-613:48)). The cited paragraph in Dr. Nevo's report indicated that the diversion rate would be 56% *if* one assumes that the consumers at issue

"have tastes that are consistent with market-wide averages," but immediately explains that this "assumption … is incorrect" because purchasers "of the cigarettes at issue have systematically different tastes than 'average' consumers and have a much greater propensity to purchase untaxed cigarettes than has an 'average' consumer." JA2042_(DX-613:48). Dr. Nevo's extensive research pointed out that these purchasers are in fact exactly the demographic that most changes purchasing behavior to obtain lower prices:

> Compared to all other smokers, mail order purchasers are…
>
> - 76% more likely to make a special effort to obtain low-priced cigarettes
>
> -308% more likely to report that cigarette prices influenced their use of other non-cigarette tobacco products
>
> -28% more likely to purchase cigarettes from a Native American reservation
>
> -132% more likely to purchase cigarettes from an out-of-state or out-of-country supplier
>
> -52% as likely to attempt quitting in the preceding 12 months

JA2044_(DX-613 table 5); *see also id.* JA2043-44_(DX-613:52-56). The maximum diversion figure for this group is 5.4%, not 56%. *See* JA2050_(DX-613:73). Plaintiffs offered no contrary evidence, and the district court identified none.

Plaintiffs' rejoinder is that "UPS seems to believe that because plaintiffs introduced no evidence on diversion, the court was *required* to accept Nevo's diversion figures." Pls. 140 (cleaned up). That misses UPS's point. While the district court was not required to accept any evidence, its findings must be based on some evidence. *See Wu Lin v. Lynch*, 813 F.3d 122, 127 (2d Cir. 2016). And Plaintiffs cannot avoid the glaring absence of evidentiary support for the district court's diversion rate by claiming that the court actually relied on Dr. Nevo's 56% "starting point." Pls. 142. Not only did the district court never reference the 56% figure, it dedicated its entire discussion of Dr. Nevo's report to criticizing his methodology and explicitly based its 50% estimate on "the totality of the facts"—nothing more. SA441-42_(Dkt.535:192-93 & n.140). Thus, because Plaintiffs concededly introduced no evidence on diversion, the only alternative figure supported by the evidentiary record is zero. That is why UPS has consistently maintained that the diversion rate is "*at most* 5.4%." UPS Br. 106 (emphasis added).

Under one of the most fundamental principles of our adversarial system, "if the evidence is evenly balanced, the party that bears the burden of persuasion *must lose*." *Director, Office of Workers' Comp. Programs v. Greenwich Collieries*, 512 U.S. 267, 272 (1994) (emphasis added). Plaintiffs—not UPS—had the burden of proving that UPS's conduct caused their claimed tax losses. *See DeFalco v. Bernas*, 244 F.3d 286, 329 (2d Cir. 2001) (when causation is an element, plaintiffs must show

that their injury was "both factually and proximately caused by a defendant's violation"). Plaintiffs' brief in this Court does not cite an iota of evidence related to tax diversion offered at trial by either the State or the City. *See* Pls. 140-42. That is because they submitted none. Dr. Nevo's conclusion is as consistent with 0% diversion as with 5.4% diversion; thus, if his opinions were given no weight at all, there would be no proof on this point in the evidentiary record—period. The diversion rate in that scenario is 0% (not 50%), and the compensatory damages are $0.

The compensatory damages award should be reversed or, in the alternative, reduced to reflect a diversion rate of no more than 5.4%. *See* UPS Br. 103 table.

C. The Court Erred in Assessing Penalties.

The award of $237.6 million in penalties is wholly disproportionate to either Plaintiffs' loss from the challenged conduct (found to be $9.4 million) or UPS's gain from it (profit of $475,000 on revenue of $5.2 million). Plaintiffs never acknowledge this disproportionality, nor dispute these amounts, nor do they meaningfully contest UPS's showing that this massive and unprecedented punitive exaction contravenes the Due Process Clause, the Excessive Fines Clause, and federal common law. *Compare* UPS Br. 107-25 (Argument II.C.), *with* Pls. 142-68 (Argument II.D.). This Court should therefore vacate the penalties in their entirety, or, at minimum, reduce them to an amount equal to or less than the (reduced or remitted) compensatory damages award.

1. The Penalties Are Subject to Exacting Scrutiny.

Plaintiffs repeatedly attempt to sidestep the proportionality analysis compelled by both the Constitution and common law. *E.g.*, Pls. 148-49, 164-68. But whether under the Due Process Clause or the Excessive Fines Clause, the Supreme Court has repeatedly emphasized that the "grossly disproportional" standard used in all constitutional excessiveness review focuses on "the same general criteria." *Cooper Indus., Inc. v. Leatherman Tool Grp.*, 532 U.S. 424, 434-35 (2001) (citing *United States v. Bajakajian*, 524 U.S. 321, 337 (1998) and *BMW of N. Am., Inc. v.*

Gore, 517 U.S. 559, 575-80 (1996)); *see also* Chamber 6-8, 15-16. And proportionality between punishment and conduct is a bedrock principle whenever a federal court imposes a punitive exaction. *See Exxon Shipping Co. v. Baker*, 554 U.S. 471, 499-515 (2008) (discussing constitutional and common-law limits on judge-imposed punitive awards under federal law); *see also* WLF 11-14 (noting federal common law limits penalties to 1:1 ratio in similar cases). These constraints are directly applicable to the punishments imposed here, despite Plaintiffs' attempts to evade scrutiny.

Excessive Fines Clause. Plaintiffs take the position that the Excessive Fines Clause imposes no limit on punishment so long as a penalty "remains within the dollar ranges specifically provided by the controlling statutes." Pls. 150-51. Next, they assert another categorical rule that a statute authorizing per-violation penalties can never violate the Excessive Fines Clause because the aggregate amount is "directly proportionate to the offense." Pls. 151.

Both arguments are foreclosed by Circuit precedent. The Excessive Fines Clause inquiry "does not begin and end with the maximum penalties authorized by statute." *Von Hofe v. United States*, 492 F.3d 175, 187 (2d Cir. 2007). In *von Hofe*, this Court rejected Plaintiffs' first argument when it deemed excessive a $124,000 penalty—less than an eighth of the statutory maximum—for conduct "best described as turning a blind eye" to illegal activity. *Id.* at 189. Likewise, the Court rejected

Plaintiffs' second argument when it ruled that proportionality review must "include[] consideration of the federal Sentencing Guidelines" (*id.* at 187), which specifically reject per-violation calculations that result in punishment disproportionate to the actual harm caused. *See* U.S. SENTENCING GUIDELINES MANUAL § 1A1.4(e) (U.S. SENTENCING COMM'N 2016) (discussing policy of "grouping" for certain offenses). Notably, the Guidelines explicitly list cigarette trafficking as an offense susceptible to this disproportionality. *Id.* § 3D1.2 (requiring grouping of CCTA violations under § 2E4.1). *Von Hofe* therefore requires courts, when considering the Guidelines, to take into consideration whether the aggregate amount of per-violation penalties are actually proportional to the harm caused by the conduct.

Due Process Clause. Plaintiffs boldly assert that the Due Process Clause does not constrain statutory penalties at all. Pls. 164-65. This argument is historically inaccurate and legally flawed. The Supreme Court's earliest excessiveness precedents applied the Due Process Clause directly to statutory penalties. *See Waters-Pierce Oil Co. v. Texas*, 212 U.S. 86, 111 (1909) (addressing challenge under the Due Process Clause to fines issued under state antitrust law). Plaintiffs characterize *St. Louis I.M. & S. Railway Co.*, 251 U.S. 63 (1919), as a mere "private suit" (Pls. 165) without acknowledging the Court's express holding: the punishment was imposed "for the violation of a public law," not a "private injury" (thus allowing more than merely compensatory recovery), and the Court "fully recognized" that the Due Process

Clause "places a limitation upon the power of the states to prescribe penalties for violations of their laws." *Id.* at 66-67. Plaintiffs appear to believe that the Due Process Clause constrains a statutorily prescribed penalty when a private actor brings the suit but not when a sovereign does so. Pls. 166. That is nonsense. Due process is exclusively a check on the power of the government. *See United States v. Harris*, 106 U.S. 629, 639 (1883).

Nor can Plaintiffs claim the Excessive Fines Clause precludes application of the Due Process Clause or dismiss *Cooper Industries* as merely recognizing that both clauses "share[] the same goal." Pls. 165. There, the Court expressly held that *both* the Excessive Fines Clause *and* the Due Process Clause "of its own force" prohibit "grossly excessive punishments." 532 U.S. at 433-34. Moreover, it described the "grossly disproportional" standard as the "relevant constitutional line" under both clauses, "focused on the same general criteria." *Id.* at 434-35. Thus, the Supreme Court has expressly stated that the guideposts of due process analysis are equally applicable to statutory penalties.

And as with the Excessive Fines Clause, Plaintiffs' argument is foreclosed by Circuit precedent. This Court has recognized that "the potential for a devastatingly large damages award, out of all reasonable proportion to the actual harm suffered ... may raise due process issues." *Parker v. Time Warner Entm't Co.*, 331 F.3d 13, 22

(2d Cir. 2003). In particular, the Court concluded that "statutory damages so far beyond the actual damages suffered" would "come to resemble punitive damages" subject to the Due Process Clause. *Id*. Although Plaintiffs dismiss *Parker* because the Court there did not actually apply the Due Process Clause to the statutory penalties (Pls. 167 n.40), that was because the question arose at the class certification stage. 331 F.3d at 22. Plaintiffs have no rejoinder to the Court's observation that "in a sufficiently serious case the due process clause might be invoked ... [to] reduce the aggregate damage award." *Id.* (citing *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 416 (2003), and *Gore*, 517 U.S. at 580). This is just such a case.

Plaintiffs claim that because a statute identifies the maximum possible penalty, the due process concern for "notice" is satisfied. Pls. 167-68. But notice of the outermost boundary does not obviate all due process concerns. A legislature could not insulate punishment from judicial review by authorizing a theoretical "maximum" penalty of a zillion dollars for every regulatory offense. *Cf. Bajakajian*, 524 U.S. at 336. In any event, while lack of notice may highlight the egregiousness of a punitive measure, it is not a prerequisite to the Due Process Clause's substantive restrictions on excessive penalties. *See* Chamber 18-19.

Plaintiffs contend that *Gore*'s consideration of the ratio of punitive-to-compensatory damages is inapplicable because statutory penalties are aimed at "deterrence" and involve "considerations broader than merely the magnitude of the injuries

in an individual case." Pls. 166-67. But punitive damages also function as both deterrent and punishment. *See Gore*, 517 U.S. at 568 ("Punitive damages may properly be imposed to further a State's legitimate interests in punishing unlawful conduct and deterring its repetition"); *Tull v. United States*, 481 U.S. 412, 422 n.7 (1987) ("[T]he remedy of civil penalties is similar to the remedy of punitive damages, another legal remedy that is not a fixed fine").

Compensatory damages measure the harm actually caused to the claimant by the conduct at issue. The punishment for that same conduct must bear some reasonable relationship to that harm; otherwise, it is merely arbitrary governmental action. *See Sw. Tel. & Tel. Co. v. Danaher*, 238 U.S. 482, 486, 491 (1915) (finding $6,300 statutory civil penalty based on overcharging a customer $0.50 per day to be "so plainly arbitrary and oppressive as to be nothing short of a taking of [the defendant's] property without due process of law"). Plaintiffs never explain why the penalties here are proportionate to their losses, instead contending that the legislature's determinations of statutory penalties should not be subjected to Due Process scrutiny. Pls. 167. But "despite the broad discretion that States possess" in setting both penalties and punitive damages, due process "imposes substantive limits on that discretion." *Cooper Indus.*, 532 U.S. at 433.

Federal Common Law. A federal court imposing punishment must comply with the common law as well as the Constitution. *See*, *e.g.*, *Exxon Shipping*, 554

U.S. at 505-15; *Advance Pharm., Inc. v. United States*, 391 F.3d 377, 398-99 (2d Cir. 2004). Plaintiffs argue in a footnote that federal common law limitations on excessive penalties are "irrelevant" because they "pertain to review of jury awards of punitive damages." Pls. 164 n.38. But a statutory penalty range and punitive damages both require discretionary judgments about the appropriate level of punishment (*see Tull*, 481 U.S. at 422 n.7), and in federal court, that discretion is bounded by federal common law. *See Exxon Shipping*, 554 U.S. at 505-15.

Plaintiffs similarly err in suggesting that the AOD penalties are irrelevant because UPS agreed to the AOD. Pls. 144-45. Not so. Because the $80 million awarded under the AOD is explicitly punitive (*see* SA508, ¶42_(DX-23:16)), it constitutes part of the total punishment imposed and is relevant to excessiveness review. Although the Constitution and common law may not limit the AOD penalties themselves, they *do* prohibit punishing a defendant disproportionately: if this Court finds penalties here may not exceed a single-digit modifier of compensatory damages, for example, that conclusion necessarily precludes statutory penalties that would exceed that amount when combined with the $80 million AOD penalty.

More generally, Plaintiffs' efforts to compartmentalize the monetary awards (*see* Pls. 144-46) are misguided. Appellate review necessarily, and properly, focuses on the total punishment imposed. *See*, *e.g.*, *State Farm*, 538 U.S. at 426; *Bajakajian*,

524 U.S. at 334; *Danaher*, 238 U.S. at 490. The $237.6 million of penalties imposed—both statutory and contractual—are undeniably meant to punish UPS for the same alleged misconduct. The Constitution's limits on the power of the government to impose punishments that are "wholly disproportioned to the offense" cannot be bypassed by artificially segmenting an excessive penalty into smaller pieces. *St. Louis, I.M. & S. Ry. Co.*, 251 U.S. at 66-67.

2. The Penalties Are Unconstitutional.

UPS provided a chart that identifies the criteria courts consider to evaluate the excessiveness of penalties under the Due Process Clause, the Excessive Fines Clause, and federal common law. UPS Br. 110. Plaintiffs do not dispute that these criteria are relevant to assessing the lawfulness of penalties. *See* Pls. 151-52 (applying similar factors under *Bajakajian*). Under these non-exclusive and overlapping factors, the district court's $237.6 million penalty award—representing ratios to compensatory damages of 18:1 (State) and 111:1 (City)—grossly exceeded any appropriate amount, and none of Plaintiffs' speculative arguments to the contrary justify sustaining the overinflated penalties.

Culpability. Plaintiffs contend that UPS's "high level of culpability" justifies the $237.6 million of penalties. Pls. 152. Like every corporation, UPS can only act through its agents—both low-level employees or high-level officials. *See Daimler AG v. Bauman*, 134 S. Ct. 746, 759 n.13 (2014) ("A corporation is a distinct legal

entity that can act only through its agents"). Any assessment of UPS's culpability must therefore account for *who* within UPS was responsible for the alleged wrongdoing. As to that question, the district court did not make (and Plaintiffs do not reference) a single finding that any high-level official at UPS knowingly engaged in (or even had actual knowledge of) prohibited conduct. *See* UPS Br. 111-12.

To the contrary, Plaintiffs conceded that the trial evidence concerned only "a relative handful of those brown-truck routes" and "a few account executives" from UPS's non-managerial sales team. JA1057_(Tr.1903:21-23). Indeed, the district court concluded that UPS as an enterprise "bears a lower level of culpability." SA476_(Dkt.536:8). Nonetheless, it found "knowledge," and imposed punishment, by imputing the actions of low-level employees to UPS based on agency principles of *respondeat superior*. *See* SA403-04_(Dkt.535:154-55); SA400_(Dkt.535:151) ("It is true that certain facts upon which the Court has relied for its finding of knowledge were known only to one or a limited number of employees within UPS").

Common law principles of agency prohibit courts from awarding penalties solely on the basis of such imputed liability. UPS Br. 113-14. Plaintiffs never dispute this statement of agency law or that federal statutes are presumed to incorporate common-law principles absent specific statements from Congress to the contrary. UPS Br. 113. Instead, they seek to dismiss the Supreme Court's decision in *Kolstad*

v. American Dental Ass'n, 527 U.S. 526 (1999), as turning on "statutory interpretation." Pls. 154. But while *Kolstad* involved a statutory scheme, the Court actually applied the "long recognized" and "historically … endorsed" common-law rule "that agency principles limit vicarious liability for punitive awards." 527 U.S. at 541.

To be sure, the PACT Act and the PHL do not "require[] a showing that a high-level corporate employee ratified other employees' wrongful acts" (Pls. 154) for *compensatory* liability—but neither did Title VII in *Kolstad*. Nonetheless (and in the absence of explicit statutory language to this effect), the Supreme Court declined to impute low-level employee conduct to the employer for purposes of imposing *punishment* without proof that managers directed, knew of, or ratified that conduct. *Kolstad*, 527 U.S. at 540-46. And like Title VII, none of the relevant statutes here indicate any congressional intent to displace this common-law rule; to the contrary, the PACT Act expressly embraces the principle that low-level offenses should not lead to civil penalties. *See* 15 U.S.C. § 377(b)(3)(B)(ii); *cf. Morissette*, 342 U.S. at 263 ("[A]bsence of contrary direction may be taken as satisfaction with widely accepted definitions, not as a departure from them").

Harm. Plaintiffs make no effort to defend the award's gross disproportionality to the only actual harm identified by the district court ($9.4 million in lost tax revenue). *Cf.* Pls. 145-47, 159-61. Nor could they. The compensatory damages award is a tiny fraction of the $237.6-million penalty imposed, resulting in double-

and triple-digit ratios of penalties to damages. UPS Br. 116 (noting penalties to damages ratios of up to 111:1). This gross disparity is an unmistakable indicator of excessiveness and far exceeds any penalty/damage ratio upheld by this Circuit or any other. *See Gore*, 517 U.S. at 580 (noting that the ratio between harm and penalty is "[t]he second and perhaps most commonly cited indicium" of constitutional excessiveness); *see also* Chamber 11-13 (surveying decisions by the courts of appeals invalidating penalty/damage ratios of 18:1 and 13:1 and requiring single-digit ratios in order to pass constitutional muster); WLF 11-17 (discussing federal common law authority limiting ratio of punitive/compensatory damages to low, single digits).

Plaintiffs try to sidestep this point by asserting that there is "powerful evidence" to show that cigarettes and smoking are tied to "damaged public health." Pls. 159; *see also* Pls. 147-48. But as even the district court acknowledged, it is entirely "unclear" whether UPS's transportation of plain brown boxes here had *any* effect on public health, and drawing that conclusion would constitute "speculat[ion]." SA476_(Dkt.536:8). While Plaintiffs point out penalties are intended to compensate for harms that are not "readily quantifiable" (Pls. 159), the question is not whether this harm is quantifiable but whether it has any connection to UPS's conduct. The fact that the PACT Act and the PHL were passed with "[p]ublic health concerns" in mind does not get Plaintiffs past the district court's express finding that they had not

proved any causal relationship between UPS's alleged conduct and an impact on public health.

The harms Plaintiffs identify are, without exception, the product of choices by independent third parties, whether the delivery sellers' choices to break New York cigarette taxation laws or consumers' decisions to smoke. UPS is a common carrier providing shipping services to the general public, not a manufacturer or seller or consumer of cigarettes, and it is, at best, an ancillary or tangential participant with deep pockets caught in the middle of a long-running tax war between a State and Native American businesses. Any penalty must be proportionate to the harm actually attributable to UPS, not the bogeymen now paraded by Plaintiffs.

Comparable Sanctions. Plaintiffs argue that the Sentencing Guidelines are irrelevant because they "cannot override explicit legislative judgments on permissible sanctions." *See* Pls. 159; *id*. at 148-49. This argument echoes the dissent in *Bajakajian*, which cited the statutory maximum as evidence that Congress "did not view the reporting offense as a trivial one." 524 U.S. at 338 n.14. But the majority expressly rejected this argument: because the Guidelines suggested only "a fraction of the penalties authorized," they indicated that the "respondent's culpability relative to other potential violators of the reporting provision ... is small indeed." *Id.*; *see also von Hofe*, 492 F.3d at 187. Likewise, in the due process context, the Supreme Court

has repeatedly compared the penalty imposed to those authorized in similar legislative contexts to determine whether an exaction is unconstitutional. *See*, *e.g.*, *State Farm*, 538 U.S. at 428; *accord Turley v. ISG Lackawanna, Inc.*, 774 F.3d 140, 166 (2d Cir. 2014).

Plaintiffs want this Court to ignore the Sentencing Guidelines because the penalties here dramatically exceed the available penalties for similar conduct under the Guidelines. *See* UPS Br. 117-18 (noting that Sentencing Guidelines impose a maximum 2:1 penalties-to-tax-losses ratio for similar offenses). They also far exceed penalties recommended by Plaintiffs in a prior case under the PACT Act involving far more culpable conduct than alleged here. *See City of New York v. Milhelm Attea & Bros.*, No. 06-cv-3620, 2012 WL 3579568 (E.D.N.Y. Aug. 17, 2012). The defendants in *Milhelm* were responsible for intentionally shipping *over 10 million* cartons of cigarettes (*id*. at *8-9)—more than twenty-five times the district court's finding of fewer than 400,000 cartons at issue in this case. UPS Br. 119. And yet, "because the defendants [were] liable for an enormous number of individual CCTA violations," Plaintiffs conceded that a "per violation measure [for PACT Act penalties]" would be "excessive" and recommended only $7.3-$7.4 million in penalties. *Milhelm Attea & Bros.*, 2012 WL 3579568, at *32. Plaintiffs make no effort to explain why they—as government actors with the obligation to treat all persons equally before the law—take such a radically different view with respect to UPS.

Worse still, the district court imposed these grossly excessive penalties even though UPS is not the PACT Act's primary target. UPS Br. 118-20. Plaintiffs' argument that UPS is subject to the PACT Act (Pls. 156-57) conflates whether a statute *regulates* a class of persons with whether the statute was "principally designed" for that class. *United States v. Viloski*, 814 F.3d 104, 110-11 (2d Cir. 2016) (cleaned up); *Bajakajian*, 524 U.S. at 338. While the PACT Act and the PHL do regulate common carriers, that fact does not automatically render those carriers the principal target of the legislation. In fact, the PACT Act itself specifically identifies its targets: terrorists, cigarette traffickers, tax evaders, and individuals who sell cigarettes to minors. *See* Pub. L. 111-154, § 1(b), 124 Stat. 1087, 1087-88; *see also* Act of Aug. 16, 2000, 2000 N.Y. Sess. Laws, ch. 262, sec. 1 (targeting cigarette bootleggers). UPS is none of these things.

Deterrence. Plaintiffs contend that the exorbitant penalties here are necessary to deter future violations (Pls. 162-63), but nowhere do they even address the district court's conclusion that UPS put considerable resources into boosting compliance more than 18 months before this lawsuit was even filed, nor that it has continued to focus on enhanced compliance thereafter. *See* SA263_(Dkt.535:14) ("from the fall of 2013 onwards, [UPS's Director of Dangerous Goods] dedicated himself to 'righting the ship' with regards to UPS's compliance efforts"); SA476_(Dkt.536:8) ("UPS now approaches compliance with the AOD and the various statutory schemes with

renewed vigor and additional processes and procedures"); *see also* UPS Br. 121-22. Indeed, the court found that by February 2015, UPS was in full compliance with the AOD's requirements. SA392-93_(Dkt.535:143-44). Plaintiffs provide no coherent explanation for why $237.6 million in penalties was necessary, or even plausibly necessary, to "capture the attention" of UPS when it had been focusing on compliance before suit was filed. Pls. 163.

In any event, the compensatory damages alone exceed the gross revenue UPS received for the conduct at issue. *See* UPS Br. 107 (identifying $5.2 million in revenues and $475,000 in profits for all shippers alleged in complaint). Economics principles indicate that these damages make it irrational for a corporation to engage in such activity in the future. *See* CAA 8 ("[T]he compensatory damages alone create incentives for UPS to avoid the conduct alleged in this case"); WLF 16 (same). An additional penalty award is unnecessary to incentivize UPS, and is also likely to have a negative impact on how other businesses operate—chilling commerce and "creating incentives for economically inefficient activities." WLF 16; *see also* CAA 8-9 (same); Chamber 21 (same).

Wealth. Plaintiffs do not dispute that, in assessing the amount of a penalty, courts should not rely on the defendant's wealth. *See 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"); *see also* WLF 24-27 (discussing prohibition on use of wealth to inflate a monetary award). But the district court did precisely that here. It first observed that UPS's profits from the violations "suggest[] a low amount of penalties." SA476_(Dkt.536:8). But the court then pivoted and focused on UPS as a "large company with significant assets" capable of "handl[ing] a hefty fine." SA477_(Dkt.536:9). And next, the district court went a step further to conclude that "only a hefty fine will impact such a large entity"—*i.e.*, a "large company with significant assets." *Id*. Thus, the district court unabashedly relied on UPS's financial strength—the only factor that pointed to a "hefty," as opposed to a "low," penalty—as reason to impose these massive penalties. *Id*. That is like imposing a more severe punishment for speeding on a driver who happens to be wealthy. As a result of this unconstitutional consideration, the district court imposed penalties 500 times the profits UPS earned from the allegedly unlawful conduct. *See* UPS Br. 125. UPS is not "distort[ing] the court's decision," as Plaintiffs claim (Pls. 161), but reading it for what it says.

* * *

The bottom line is that our Constitution does not countenance penalties that are "grossly disproportional to the gravity" of an offense. *Cooper Indus.*, 532 U.S.

at 434 (cleaned up). The district court's award of a quarter-billion dollars of penalties—for conduct that resulted in (at most) a $9.4 million loss to Plaintiffs, and (at most) $5.2 million in revenue and $475,000 in profit to UPS—fails this standard. Accordingly, the Court should vacate the penalties awarded in their entirety, or, alternatively, reduce them to a ratio in conformity with constitutional limits, *i.e.*, equal to or less than the remitted compensatory damages award. *See* UPS Br. 103 table.

III. A Causal Connection Is Required Between UPS's Conduct and Compensatory Damages.

Plaintiffs have cross-appealed from the district court's ruling that their compensatory damages are limited to the amount of tax revenue allegedly lost as a result of UPS's conduct as distinguished from some other factor. *See* Pls. 133-39 (Argument II.C.1.). This is an issue of *causation*—as the district court's liability opinion makes abundantly clear:

> Defendants argue that to prove entitlement to such damages, plaintiffs bear the burden of proving a *causal connection* between UPS's transport of cigarettes and lost tax revenues. Plaintiffs argue that such a *causal connection* is not required but that, in any event, they have shown one.
>
> Plaintiffs are incorrect; a *causal connection* is required. As described above, lost tax revenues are a type of compensatory damages. Compensatory damages are intended to put a plaintiff back into "a position substantially equivalent to the one that he or she would have enjoyed had no tort been committed." *Anderson Grp., LLC v. City of Saratoga Springs*, 805 F.3d 34, 52 (2d Cir. 2015). Plaintiffs "bear[] the burden of proving damages with reasonable certainty[.]" *Raishevich v. Foster*, 9 F. Supp. 2d 415, 417 (S.D.N.Y. 1998); *see also Norcia v. Dieber's Castle Tavern, Ltd.*, 980 F. Supp. 2d 492, 500 (S.D.N.Y. 2013). Courts "will not permit recovery when the connection between the claimed loss and the tortious act is speculative or uncertain." *Anderson*, 805 F.3d at 52.

SA439-40_(Dkt.535:190-91) (emphases added).

The district court awarded compensatory damages under the CCTA, which permits States to recover "civil penalties, money damages, and injunctive or other

equitable relief." 18 U.S.C. § 2346(b)(2). Plaintiffs also sought compensatory damages under the PACT Act, which provides for "damages, equitable relief, or injunctive relief," "including the payment of any unpaid taxes to the appropriate Federal, State, local, or tribal governments." 15 U.S.C. § 377(b)(2) (emphasis added). Because the district court awarded Plaintiffs "compensatory damages under the CCTA," it did "not award … compensatory damages under the PACT Act." SA484_(Dkt.536:16).*

Plaintiffs concede that the scope of compensatory damages under both statutes "is a question of statutory interpretation" (Pls. 134) but barely engage with the statutes at issue. In sum, they argue only that the PACT Act refers to recovery of "unpaid taxes" and posit that the CCTA's "core objective" would be served by doing away with causation. Pls. 135. These arguments—for which they cite no authority—have

---

* Plaintiffs scatter their brief with footnoted requests for expansion of other portions of the judgment, including awarding PACT Act damages if the Court reverses the CCTA liability judgment (*see, e.g*, Pls. 93 n.26; *id.* at 139 n.36) and reopening the district court's decision to award only nominal penalties under the CCTA if any other penalties are reversed (Pls. 142 n.37). But arguments presented only in footnotes are "inadequately raised for appellate review," particularly when "stating an issue without advancing an argument" that shows a legal basis for the claim. *Norton v. Sam's Club*, 145 F.3d 114, 117 (2d Cir. 1998). Nevertheless, for the sake of completeness, UPS will address Plaintiffs' claims to compensatory damages under both the CCTA and the PACT Act in responding to Plaintiffs' cross-appeal. Given that Plaintiffs' cross-appeal is limited to compensatory damages, any issues related to liability or penalties are beyond the scope of the cross-appeal and may not be addressed by Plaintiffs in their final reply brief. *See* Fed. R. App. P. 28.1(c)(4).

no merit. The single reference to "unpaid taxes" in the PACT Act comes after the word "including," plainly indicating that unpaid taxes are a subset of "damages." 15 U.S.C. § 377(b)(2). Read as a whole, the clause does not permit the recovery of unpaid taxes *simpliciter*; it merely provides that a damages award may include unpaid taxes. The CCTA is even less forgiving of Plaintiffs' interpretation: it provides for "money damages" without further exposition. 18 U.S.C. § 2346(b)(2).

Although Plaintiffs complain that "the district court accepted a faulty analogy to tort principles" (Pls. 138), the district court correctly applied the presumption that statutes using common-law terms "adopt[] the cluster of ideas that were attached to each borrowed word" in the "absence of contrary direction." *Morissette*, 342 U.S. at 263. Money damages—the "traditional form of relief offered in the courts of law"—are such a term. *Curtis v. Loether*, 415 U.S. 189, 196 (1974).

The common law has long required proof of causation to recover damages, which are "intended to redress the concrete loss that the plaintiff has suffered *by reason of* the defendant's wrongful conduct." *Cooper Indus.*, 532 U.S. at 432 (emphasis added); *cf. Paroline v. United States*, 134 S. Ct. 1710, 1720 (2014) ("The words 'as a result of' plainly suggest causation"). Accordingly, the Supreme Court has repeatedly held that federal statutes authorizing damages require proof of causation. For example, even though a "literal reading" of the Clayton Act "is broad enough to encompass every harm that can be attributed directly or indirectly" to a

violation, the Supreme Court concluded that Congress intended to subject antitrust damages "to constraints comparable to well-accepted common-law rules applied in comparable litigation." *Assoc. Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters*, 459 U.S. 519, 529, 533 (1983). One of the "central elements" of these rules was "a demand for some direct relation between the injury asserted and the injurious conduct alleged." *Holmes v. Sec. Inv. Prot. Corp.*, 503 U.S. 258, 268-69 (1992). Accordingly, the Court imposed the same common law requirements on RICO damages actions. *Id.* at 266.

The Supreme Court made this point again in *Hemi Group v. City of New York*, 559 U.S. 1 (2010), which involved both New York and cigarette taxes. When the City filed a civil RICO action seeking to recover unpaid taxes after a cigarette retailer failed to file required reports with the NYAG, a plurality of the Supreme Court expressly declined to "stretch[] the causal chain … so far." 559 U.S. at 11. Quoting *Holmes*, Chief Justice Roberts observed that "the general tendency of the law, in regard to damages at least, is not to go beyond the first [causal] step." *Id.* at 10 (cleaned up). Critically, the five Justices who rejected New York's arguments agreed that federal law should not be converted into a state "tax collection statute" against an entity with "no obligation to collect, remit, or pay" the taxes in question in order "to substitute for or complement a governing body's uncertain ability or desire to collect taxes directly from those who owe them." *Id.* at 16 n.2, 17; *see also id.* at 18-

19 (Ginsburg, J., concurring in part and concurring in judgment). "Put simply, ... the City's harm was directly caused by the customers, not [the retailer]." *Id.* at 11 (plurality opinion).

The sole appellate case Plaintiffs cite in support of their cross-appeal (*see* Pls. 139) confirms that causation is an implicit requirement of federal compensatory damages unless Congress provides otherwise. In *SEC v. Apuzzo*, 689 F.3d 204 (2d Cir. 2012), this Court held that where a plaintiff is "seeking *compensation*," he must "show his injury was proximately caused by the defendant's actions." *Id.* at 212 (emphasis added). By contrast, SEC enforcement actions had no such requirement, because Congress had specifically amended the statute in question to authorize the SEC to reach actors who had *not* "proximately caused the plaintiffs' injuries." *Id*. at 213. Plaintiffs seek compensatory damages under the CCTA and the PACT Act, and nothing in either statute indicates that Congress intended to eliminate the basic requirement of causation.

Plaintiffs have not shown (and cannot show) causation on this record. As in *Hemi Group*, Plaintiffs' allegedly "lost" tax revenue results from the conduct of third parties, not UPS. New York law provides that cigarette taxes "be advanced and paid by the [licensed cigarette] agent" and then collected by an agent or cigarette dealer "from the purchaser or consumer" "as part of the sales price of the cigarettes." N.Y. Tax L. § 471(2)-(3). UPS has neither a duty to pay New York cigarettes taxes, nor

any obligation to participate in its tax collection activities. Plaintiffs' two district court cases are inapposite for this reason. Pls. 140-41. In both cases, the district courts addressed the liability of the parties directly obligated by New York state law to pay and collect cigarette taxes for distributing untaxed cigarettes. *See Milhelm Attea & Bros., Inc.*, 2012 WL 3579568, at *1 ("cigarette wholesalers who are state-licensed cigarette stamping agents"); *United States v. Morrison*, 685 F. Supp. 2d 339, 341 (E.D.N.Y. 2010) ("cigarette on-reservation retailer"). These defendants obviously meet the common law's causation standard: they caused the tax losses by not paying them. Here, by contrast, New York's losses necessarily result not from UPS's conduct but from "separate actions carried out by separate parties" (*Hemi Group*, 559 U.S. at 11 (cleaned up)) and therefore lack the "direct relation" that the common law requires for compensatory damages (*Holmes*, 503 U.S. at 268).

Plaintiffs also invoke Justice Thomas's concurrence in *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 467 (2006), to argue that a "causation defense" should not be available here. Pls. 138 & n.35. Plaintiffs are confusing the tort defense of intervening or superseding cause once causation is shown (which defeats liability) with the requirement to prove causation for compensatory damages in the first place. Unsurprisingly, Justice Thomas endorsed the latter point, which is the one applicable here: "Certainly the plaintiff in this case, as in all tort cases involving damage to business, must demonstrate that he suffered a harm *caused by the tort*, and not

merely by external market conditions." *Anza*, 547 U.S. at 467 (Thomas, J., concurring in part and dissenting in part) (emphasis added) (citing *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 342 (2005)). Where a claimant cannot prove such a causal connection, an essential element of damages is missing. *See Holmes*, 503 U.S. at 266-69; *see also Univ. of Tex. Sw. Med. Ctr. v. Nassar*, 570 U.S. 338, 347 (2013) ("It is thus textbook tort law that an action 'is not regarded as a cause of an event if the particular event would have occurred without it.'" (citing PROSSER & KEETON ON LAW OF TORTS 265 (5th ed. 1984))).

Contrary to Plaintiffs' assertions, it makes no difference that "Congress intended the CCTA and, decades later, the PACT Act to stop the widespread evasion of cigarette taxes." Pls. 135-36. The Supreme Court has long rejected the notion that "whatever furthers the statute's primary objective must be the law." *Rodriguez v. United States*, 480 U.S. 522, 526 (1987) (per curiam) (cleaned up). Regardless of the purposes of these statutes writ large, Plaintiffs cite absolutely nothing in the statute to signify that Congress intended to dispense with traditional causation principles to allow state governments to use the federal courts as engines to maximize their tax revenues.

Plaintiffs' theory that they can recover compensatory damages without proving that their losses resulted from UPS's conduct finds no basis in the text of the relevant statutes nor in the centuries of common-law principles incorporated into

them; their theory cannot be reconciled with the Supreme Court's approach to this issue and is supported by literally zero authority; and their vague invocations of statutory purpose cannot substitute for legal reasoning.

Plaintiffs' cross-appeal should therefore be rejected.

CONCLUSION

For the foregoing reasons, UPS respectfully requests that this Court grant the relief requested in UPS's appeal (*see* UPS Br. 126) and deny Plaintiffs' cross-appeal.

Dated: April 23, 2018

Respectfully submitted.

/s/ Mark A. Perry
Mark A. Perry
Counsel of Record
Aidan Taft Grano
Shannon Han
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 955-8500

Deanne E. Maynard
MORRISON & FOERSTER, LLP
2000 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 887-1500

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

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.

CERTIFICATE OF COMPLIANCE

I hereby certify that:

1. This brief complies with the type-volume limitation of Second Circuit Rules 28.1.1(a) and 32.1(a)(4)(A), which are authorized by Federal Rule of Appellate Procedure 32(e), and with this Court's order of August 28, 2017 (ECF No. 92) because, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(f), it contains 27,942 words, as determined by the word-count function of Microsoft Word 2016.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionately spaced typeface using Microsoft Word 2016 in 14-point Times New Roman font.

Dated: April 23, 2018

/s/ Mark A. Perry

CERTIFICATE OF SERVICE

I hereby certify that on April 23, 2018, an electronic copy of the foregoing was filed with the Clerk of Court for the United States Court of Appeals for the Second Circuit using the appellate CM/ECF system.

I further certify that all participants in the case are registered CM/ECF users and that service will be accomplished on the following by the appellate CM/ECF system:

Steven Wu
Eric Del Pozo
NEW YORK STATE OFFICE OF THE ATTORNEY GENERAL
25th Floor
120 Broadway
New York, NY 10271
(212) 416-6167
Steven.Wu@ag.ny.gov
Eric.DelPozo@ag.ny.gov

Jeremy W. Shweder
NEW YORK CITY LAW DEPARTMENT
100 Church Street
New York, NY 10007
(212) 356-2611
jshweder@law.nyc.gov

Counsel for Appellees/Cross-Appellants

/s/ Mark A. Perry