DENNIS JACOBS, *Circuit Judge*, concurring in part and dissenting in part:

The majority opinion admirably recounts the history of this case and the dizzying contractual and statutory provisions that govern. I recount only what is necessary to understand my positions in dissent.

To collect revenue and reduce public health costs, New York State and the City of New York impose taxes on cigarettes, amounting (currently) to $43.50 per carton--doing well while doing good. Of course, those taxes are only effective insofar as they are actually collected, and both New York State and the federal government have passed statutes intended to curb tax evasion, including by the imposition of damages and penalties on common carriers that deliver cigarettes, of which UPS is one. The regulation of UPS is enforced, variously, by four potential sources of liability.

I

Enacted in 2000, New York's Public Health Law § 1399-*ll* makes it "unlawful for any common or contract carrier to knowingly transport cigarettes to any person in this state reasonably believed by such carrier" to be unauthorized to receive untaxed cigarettes. § 1399-*ll*(2). Delivery to a home or residence creates a presumption of unauthorized delivery. *Id.* The PHL

authorizes penalties "not to exceed the greater of (a) five thousand dollars for each . . . violation; or (b) one hundred dollars for each pack of cigarettes shipped, caused to be shipped or transported in violation of [the PHL]." *Id.* § 1399-*ll*(5).

In 2004, the New York State Attorney General investigated UPS's compliance with PHL § 1399-*ll*, and found regular instances of violation. To settle the resulting dispute, in October 2005, UPS entered into an Assurance of Discontinuance (the "AOD") with New York. Broadly, the AOD forbids UPS from knowingly shipping untaxed cigarettes to consumers in New York State, and specifies certain compliance measures to be taken by UPS, including, for example, auditing suspect shippers and maintaining a list of shippers who have been caught selling untaxed cigarettes. The stipulated penalty is "$1,000 for each and every violation." S. App'x at 508.

Five years later, the Prevent All Cigarette Trafficking Act (the "PACT Act"), 15 U.S.C. § 375 *et seq.*, banned the mailing of cigarettes through the United States Postal Service, and placed further restrictions and reporting requirements on common carriers. Among other prohibitions, common carriers are forbidden from accepting any packages from shippers on a "Non-Compliant List" that is maintained by the U.S. Attorney General. 15 U.S.C. § 376a(e)(1). The PACT Act

authorizes penalties "in an amount not to exceed . . . $2,500 in the case of a first violation, or $5,000 for any violation within 1 year of a prior violation." 15 U.S.C. § 377. Critical here, the PACT Act has an exemption from its penalties--and preempts any damages or penalties available under state laws--if "the Assurance of Discontinuance [AOD] entered into by the Attorney General of New York and United Parcel Service, Inc. . . . is honored throughout the United States to block illegal deliveries of cigarettes or smokeless tobacco to consumers." 15 U.S.C. § 376a(e)(3)(B)(ii)(I).

The shipment of cigarettes is regulated by yet another statute. The Contraband Cigarette Trafficking Act (the "CCTA"), enacted in 1978, makes it illegal "for any person knowingly to ship, transport, receive, possess, sell, distribute, or purchase contraband cigarettes," 18 U.S.C. § 2342(a), and defines "contraband cigarettes" as "a quantity in excess of 10,000 cigarettes, which bear no evidence of the payment of applicable State or local cigarette taxes in the State or locality where such cigarettes are found." *Id.* § 2342(2). The CCTA provides that "[w]hoever knowingly violates [the CCTA] shall be fined," but gives no guidance as to amount. *Id.* § 2344.

In this case, filed in February 2015, New York State and the City of New York (together, the "plaintiffs") allege that, from 2010 to 2015, UPS violated the PHL, the AOD, the PACT Act, and the CCTA by knowingly shipping untaxed cigarettes to consumers in New York. The district court found after a bench trial that UPS had violated each of the statutes, and awarded the following damages and penalties:

- $78.4 million in penalties for accepting packages from shippers on the Non-Compliant List, in violation of the PACT Act;
- $78.8 million in penalties for the knowing shipment of untaxed cigarettes, in violation of the PHL;
- $9.4 million in damages for the recovery of unpaid taxes on cigarettes shipped in violation of the CCTA;
- $1,000 in nominal penalties for violating the CCTA;
- $80.5 million in penalties for violating the auditing provision of the AOD.

The total combined award was a colossal $246.9 million.

II

I concur in part with the majority opinion, because I agree with the majority's navigation of many of these difficult issues. Specifically, I agree that:

- the district court properly concluded that the AOD authorizes penalties for auditing violations;
- the district court erred in concluding that the AOD authorized per-package penalties for auditing violations, amounting to an $80 million award, and that the proper award is $20,000;
- the district court did not abuse its discretion in denying UPS's motion for Rule 26 sanctions;
- the district court did not clearly err in finding the package quantity and contents for the purposes of calculating damages and penalties; and
- the district court did not err by ordering the parties to submit post-trial damages calculations.

These conclusions by the majority are sound and well-reasoned.

I part company with the majority on two issues, and to that extent I respectfully dissent. *First*, I believe that UPS is exempted from the PACT Act, and that the PHL is preempted, because UPS has "honored" the AOD nationwide (within the meaning of the statute) by subjecting itself (implicitly and explicitly) to the AOD nationwide, and I therefore conclude that the district court erred in awarding damages and penalties under the PACT Act and the PHL. *Second*, I believe that the CCTA's definition of "contraband cigarettes" does not

permit aggregation of packages with fewer cigarettes to arrive at "a quantity in excess of 10,000 cigarettes"; and I further conclude that the district court erred in awarding damages under the CCTA without sufficient evidence to support the award.

The PACT Act and the PHL

It is a close question whether UPS is exempted from the PACT Act and the PHL is preempted. The wording of the statute offers little help. Nevertheless, the majority's proposed solution raises so many knotty problems that it cannot be right.

As the majority opinion explains, UPS is exempted from the PACT Act, and the PHL is preempted, if the AOD is "honored throughout the United States to block illegal deliveries of cigarettes or smokeless tobacco to consumers." 15 U.S.C. § 376a(e)(3)(B)(ii)(I) (PACT Act exemption); 15 U.S.C. § 376a(e)(5)(C)(ii) (preemption of state laws). According to the majority opinion, UPS would "honor" its undertaking only by exercising sufficient care to prevent illicit trafficking. In my view, UPS "honors" the AOD so long as it subjects itself to the terms of the AOD throughout the nation.[1] *See* Black's Law Dictionary (defining

[1] The majority cites the phrase "to block illegal deliveries of cigarettes or smokeless tobacco to consumers" as evidence that the "honored" clause was

"to honor" as to accept an obligation as valid, such as when a bank honors a check). Thus one does not dishonor a contract by subjecting oneself to its terms of liquidated damages.

This interpretation of the statute achieves straightforward application of a nebulous term, as follows. If a state or locality other than New York sues UPS under the PACT Act, UPS is not obliged to invoke the exemption; but if it does, the plaintiff cannot obtain remedies under the PACT Act, and is limited to the somewhat lesser remedies under the AOD. The condition is that UPS can invoke the exemption only if it "honors" the AOD in any enforcement suits brought by any State or locality. It does so by forgoing certain potent defenses that would otherwise defeat such a claim: that states other than New York lack privity with UPS; that other states did not agree to be bound by the AOD; that the wording of the AOD references cigarette distribution in New York only; and that the AOD grants no "rights or privileges to any" non-party. In that way, the New York-centric terms of the AOD do not defeat or complicate the exemption term of the PACT Act, which post-dated the AOD by five years. Nor can UPS back out of its

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intended to involve a compliance inquiry. But "to" clauses are more commonly understood as statements of statutory *purpose*, not directives. *See Allison Engine Co. v. Sanders*, 553 U.S. 662, 668 (2008) (concluding that "to get a false or fraudulent claim paid by the government" is a purpose clause, not a condition).

obligation to honor the AOD nationwide: UPS's invocation of the PACT Act exemption in any single forum would operate to estop its invocation of defenses against the AOD in any other forum. And the undertaking expressly made in this case--to honor the AOD nationwide--has similar estoppel effect. *Pace* the majority's misconception that UPS would thus have a case-by-case power of election in every state.

Thus UPS honors the AOD nationwide by subjecting itself to the AOD's penalty provision. And at this point having already done so in New York, it has no other option but to honor it nationwide. Up *until* that point, UPS was subjected to *either* (i) the AOD or (ii) the PACT Act and local state laws--but not all three. This is a common-sense result that seems contemplated by the exemption in the PACT Act. The manifest design of the PACT Act is to allow and ensure the imposition of one penalty or another, not to stack penalty upon penalty based on whether the company devoted a sufficient (though undefined) level of care and attention to weeding out untaxed-cigarette parcels from the millions of parcels it delivers every day.

The majority's interpretation is that to "honor" means to conduct sufficient oversight to the interdiction of cigarette traffic, and to devote sufficient resources

to that effort. That interpretation is unworkable for several reasons. First, if the applicability of the exemption were to turn on success of its interdiction measures, no one (courts, common carriers, states, or municipalities) could know whether the exemption is applicable until vexed questions were sorted out in litigation. The exemption would then become ineffective, because UPS could not rely on it: UPS could only know after trial whether it had sufficiently "honored" the AOD to qualify. And if UPS is found to be out of compliance with the AOD (say, in Rabbit County), triplicative penalties pile up under two statutes and a contract, all of which regulate the same conduct. This is untenable; worse, it is unconvincing.

The statute provides no standard for deciding whether UPS honored the AOD in the way posited by the majority. Would a single breach of a reporting requirement caused by management indifference (or other priorities) render the exemption inapplicable? Given the millions of packages delivered each day, would a hundred failures of compliance a month render the exemption inapplicable? What if the common carrier materially breaches the AOD in one state, but complies in the other forty-nine? How likely is it that Congress intended the applicability of the exemption to turn on such baffling questions, or

that Congress intended hundreds of millions of dollars of penalties to be rendered based on open issues? With no statutory guidance (or useful help from the parties), the district court created its own standard.[2]

The majority's preferred approach is internally inconsistent. If, as the majority sees it, Congress intended UPS to lose its exemption if it breached the AOD, one must infer that Congress also intended the assessment of penalties from three sources for the same conduct in the event of noncompliance. But, as the majority concludes, that result cannot be sustained: for that very reason, the majority has sharply reduced the judgment of $247 million. To avoid stacking of penalties under the PHL, the AOD, and the PACT Act, the majority simply chooses one statute's penalties to apply (the PHL), and writes off the penalties under the PACT Act and the AOD.

The majority alludes to a problem of "announcement"--how will other States know whether UPS has agreed to subject itself to the AOD nationwide, so that those States can therefore look to penalties under the AOD? But UPS has

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[2] The district court concluded that the exemption is unavailable if "the effectiveness of UPS's policies [is] so compromised that these policies are not in fact in place." S. App'x at 144. This invention is nowhere in the statute; it is subjective and vague; and it would require a trial to decide what contract and what statutes govern the case.

made that very announcement here. When UPS invoked the exemption in the PACT Act in this case, and advocated for preemption of the PHL, it became bound by the AOD nationwide by virtue of judicial estoppel. Thus, if Idaho now sues, UPS will be bound by its representation in this lawsuit that the AOD is effective nationwide and therefore will lose the ability to interpose defenses to claims under the AOD; and Idaho will seek penalties under the AOD because it will be unable to seek penalties elsewhere. Problem solved.

As to penalties under the AOD, the district court awarded $80 million for auditing violations (reduced by the majority opinion to $20,000) and imposed no penalties for the knowing shipment of untaxed cigarettes. The only penalties awarded by the majority for that unlawful conduct fall under the PACT Act and the PHL, which (in my view) are subject to UPS's exemption and to federal preemption, respectively. The plaintiffs argue that, if (as I think) the penalty awards under the PACT Act and PHL cannot be sustained, substitute penalties must be levied under the AOD for the knowing shipments of untaxed cigarettes. UPS argues waiver, because the plaintiffs did not seek those penalties under the AOD at trial. *See* S. App'x at 385 ("Plaintiffs are not seeking penalties [for knowing shipments]--they seek penalties only for violations of the audit

obligation in ¶ 24 [of the AOD].”). The plaintiffs explain, however, that they were willing to forgo collection under the AOD only because it would result in a duplicative award, and that it did not waive its right to seek those penalties if they were *not* duplicative.

The waiver, if there was one, should be overlooked. UPS does not challenge the district court’s findings that it knowingly shipped some untaxed cigarettes; and UPS admits that it should be bound by *either* the AOD or the PHL/PACT Act. Accordingly, I would vacate the awards under the PACT Act and the PHL, and remand with instructions to consider whether penalties are appropriate under the AOD for the knowing shipment of untaxed cigarettes. Based on the district court’s findings of the number of untaxed cartons of cigarettes knowingly shipped by UPS, the penalties would amount to about $30 million--a quite considerable penalty for failure to monitor a minute fraction of the parcels shipped by UPS.

The CCTA

I dissent from the majority's award of damages under the CCTA because: (1) the district court erred in concluding that the CCTA permits aggregation of small shipments to reach the 10,000-cigarette threshold in the definition of "contraband cigarettes", and (2) the district court erred in awarding any damages under the CCTA because there was insufficient evidence to sustain the award.

The CCTA outlaws the knowing shipment of "contraband cigarettes," 18 U.S.C. § 2342(a), defined as "a quantity in excess of 10,000 cigarettes, which bear no evidence of the payment of applicable State or local cigarette taxes." 18 U.S.C. § 2341(2). The district court ruled (and the majority agrees) that the CCTA permits aggregation of smaller quantities to meet the 10,000-cigarette threshold. That is a misreading. "A quantity," a singular noun, is read naturally to reference a single shipment of more than 10,000 cigarettes, which amounts to 50 cartons. This interpretation fits the express purpose of the statute, to address "the serious problem of organized crime and other large scale operations of interstate cigarette bootlegging." S. Rep. No. 95-962, at *3 (1978).

If aggregation is permitted (as my colleagues conclude), courts will be left to resolve difficult questions, starting with time period. The plaintiffs argue that aggregation should be permitted over the entire four-year period of the statute of limitations. Such aggregation would impose a penalty for shipping about one carton a month. This quick calculation tells us something about what Congress likely intended. Surely, organized crime has something better to do.

As to the calculation of damages under the CCTA, the majority concludes that the plaintiffs are entitled to recover the taxes they would have collected for each and every carton of untaxed cigarettes shipped by UPS. I disagree.

The issue is resolved by general principles of damages. In order to recover compensatory money damages, the plaintiffs must demonstrate that their loss of tax revenue was caused by the defendant's actions. *See Anderson Grp., LLC v. City of Saratoga Springs*, 805 F.3d 34, 52 (2d Cir. 2015) ("Compensatory damages are designed to place the plaintiff in a position substantially equivalent to the one that he or she would have enjoyed had no tort been committed."); *see also Cooper Indus., Inc. v. Leatherman Tool Grp., Inc.*, 532 U.S. 424, 432 (2001) ("[Compensatory damages are] intended to redress the concrete loss that the plaintiff has suffered by reason of the defendant's wrongful conduct.").

Unlike the *sellers* of the cigarettes, who are directly responsible for remitting the taxes to the state, UPS never had an obligation to pay the cigarette taxes. The damages theory relies on UPS's role as a conduit--incidental to its useful and legitimate business. No damages were caused by UPS failing to pay the tax (it never owed any); any damage was caused by UPS transporting cigarettes for sellers who did owe the taxes but failed to pay.

The intuitive point--that UPS was never responsible for paying the taxes on the cigarettes--is critical in light of the Supreme Court's decision in *Hemi Group, LLC v. City of New York, N.Y.*, 559 U.S. 1 (2010). The City of New York sued an online cigarette seller in New Mexico that shipped untaxed cigarettes to consumers in New York City. Because it was an out-of-state seller, defendant Hemi Group was under no obligation to charge, collect, or remit the City's tax on those sales. The City argued under RICO that Hemi was liable nevertheless because it failed to comply with a federal statute that required it to report customer information to the state. The Court concluded that the alleged acts of racketeering (violations of the federal reporting requirement) were attenuated from the alleged damages (unpaid City taxes), and therefore could not justify

RICO recovery for the unpaid taxes. What matters for us is the Court's observation in dismissing the City's claims:

> It bears remembering what this case is about. It is about the RICO liability of a company for lost taxes it had no obligation to collect, remit, or pay, which harmed a party to whom it owed no duty. It is about imposing such liability to substitute for or complement a governing body's uncertain ability or desire to collect taxes directly from those who owe them.

Id. at 17. We are thus cautioned against allowing the collection of unpaid taxes from defendants who, like UPS, were never responsible for paying them in the first place. True, *Hemi* was a RICO case; but the Supreme Court's teaching transcends the context.[3]

The plaintiffs here are entitled to recover no more than the cigarette taxes that would have been collected in the absence of UPS's illegal conduct. That depends (as the district court ruled) on the "diversion rate," *i.e.* the percentage of smokers who would have purchased tax-stamped cigarettes if UPS complied with the law.

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[3] The majority deems *Hemi* inapplicable to this context because the *Hemi* principle "surely cannot apply where Congress has authorized such relief." Majority Op. at 101 n.33. But Congress did not: the majority's preceding sentence asserts no more than that Congress did so "implicitly." In any event, the PACT Act does not apply for the reasons I set out above, and, as to the CCTA, the majority posits the payment of "unpaid taxes" only as it may be "encompasse[d]" in "money damages." Majority Op. at 100.

As UPS contends, the plaintiffs failed to sustain their burden of proving damages because they failed to offer any evidence of a diversion rate.

The district court's finding--that the diversion rate is 50 percent--comes from mid-air. The only testimony at trial on the proper diversion rate came from UPS's expert, Dr. Nevo; he opined that 5.4 percent was appropriate. The district court rejected Dr. Nevo's testimony (on a questionable basis), and then simply made up another rate:

> On balance, the Court cannot arrive at a precise number of cigarette cartons consumers would have purchased, but 50% is a reasonable number based on the totality of facts. The Court therefore finds plaintiffs are entitled to compensatory damages in the amount of 50% of Cartons . . . shipped by the Liability Shippers.

S. App'x at 442. In its entirety, that is the district court's analysis of the diversion rate. There is no citation to precedent or the record. And the plaintiffs offered no evidence at trial to support a 50 percent rate.

The plaintiffs argue that the 50 percent diversion rate is supported (more or less) by Dr. Nevo's opinion that 56 percent of all cigarette sales in New York State are taxed sales. But the district court did not predicate its 50 percent finding on Dr. Nevo's 56 percent estimate. In any event, Dr. Nevo's testimony--that 56 percent of New York smokers buy taxed cigarettes--does not mean that

smokers who buy *untaxed* cigarettes shipped by UPS would buy *taxed* cigarettes in the same proportion as all other New Yorkers if their smokes could not be shipped by UPS. The premise is untenable, given that many of those consumers are financially marginal, are likely to be price sensitive, and are unlikely to have an extra $3,000 a year for a carton-per-week habit.

Therefore, because the plaintiffs did not offer sufficient evidence to support its damages calculation, I would reverse the damages award under the CCTA.

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In sum, I vote to: vacate the penalty awards imposed under the PACT Act and the PHL; vacate the award of damages under the CCTA; reduce to $20,000 the penalty for auditing violations under the AOD; and remand to the district court with directions to calculate the reasonable penalties under the AOD for the knowing shipment of untaxed cigarettes.