

# 20-1044

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In the  
**United States Court of Appeals**  
**For the Second Circuit**

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**GRAND RIVER ENTERPRISES SIX NATIONS, LTD.,**  
*Plaintiff-Appellant,*

v.

**JOHN BIELLO, ACTING COMMISSIONER, CONNECTICUT**  
**DEPARTMENT OF REVENUE SERVICES,**  
*Defendant-Appellee.*

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**On Appeal from the United States District Court**  
**for the District of Connecticut**

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**BRIEF OF PLAINTIFF-APPELLANT**  
**GRAND RIVER ENTERPRISES SIX NATIONS, LTD.**

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## **CORPORATE DISCLOSURE STATEMENT**

Pursuant to Federal Rule of Appellate Procedure 26.1, counsel certifies that Appellant Grand River Enterprises Six Nations, Ltd. has no parent corporation and that no publicly held corporation owns 10% or more of Grand River Enterprises Six Nations, Ltd.'s stock.

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**STATEMENT OF JURISDICTION**

The district court had subject matter jurisdiction pursuant to 28 U.S.C. § 1331 because the claims alleged in this lawsuit arise under the Constitution of the United States. The district court had supplemental jurisdiction over Plaintiff's claim arising under the Connecticut State Constitution pursuant to 28 U.S.C. § 1367.

The district court granted defendant's motion to dismiss plaintiff's second amended complaint on September 26, 2018, and entered judgment in favor of defendant on September 27, 2018. JA120-30. On October 3, 2018, Plaintiff moved for reconsideration. JA131-32. On March 3, 2020, the District Court denied plaintiff's motion for reconsideration. JA188-99. Plaintiff filed a timely notice of appeal on March 20, 2020. JA200-01.

This Court has appellate jurisdiction pursuant to 28 U.S.C. § 1291.

### **STATEMENT OF THE ISSUES**

Conn. Gen. Stat. § 4-28m(a)(3)(C), the “Reconciliation Requirement,” imposes a condition on Grand River Enterprises Six Nations, Ltd. (“GRE”) before the cigarettes it manufactures can be sold in Connecticut. GRE must prove that all the cigarettes it makes in Canada and imported by independent, unaffiliated importers throughout the United States (as measured by the federal excise tax paid by the importers) match the number of cigarettes reflected in interstate and intrastate shipping reports of these importers within a margin of 2.5%, including importers that have no nexus with Connecticut, do not import, sell, or ship into Connecticut, and otherwise have no contacts or business dealings at all with Connecticut businesses or residents. The issues presented on appeal are:

1. Did GRE’s Second Amended Complaint sufficiently state a claim that defendant’s enforcement of the Reconciliation Requirement of Conn. Gen. Stat. § 4-28m(a)(3)(C) violates the Due Process Clause of the U.S. Constitution and the Connecticut Constitution?

2. Did GRE’s Second Amended Complaint sufficiently state a claim that defendant’s enforcement of the Reconciliation Requirement of Conn. Gen. Stat. § 4-28m(a)(3)(C) violates the Commerce Clause of the U.S. Constitution?

3. Did GRE's Second Amended Complaint sufficiently state a claim that defendant's enforcement of the Reconciliation Requirement of Conn. Gen. Stat. § 4-28m(a)(3)(C) violates the Supremacy Clause of the U.S. Constitution?

4. Did GRE's Second Amended Complaint sufficiently state a claim that GRE is entitled to a declaration that it has complied with the Reconciliation Requirement of Conn. Gen. Stat. § 4-28m(a)(3)(C)?

**STATEMENT OF THE CASE**

**I. CONNECTICUT’S REQUIREMENT THAT GRE RECONCILE THE FEDERAL EXCISE TAX RETURNS OF INDEPENDENT, UNAFFILIATED IMPORTERS OF ITS CIGARETTES WITH ALL INTERSTATE AND INTRASTATE SHIPPING REPORTS OF THESE IMPORTERS NATIONWIDE**

In 1998, the country’s major tobacco companies negotiated a global settlement with representatives of forty-six states, including Connecticut, to resolve pending lawsuits related to the sales and marketing practices of these major manufacturers. *See Grand River Enters. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 162 (2d Cir. 2005). The result was the Master Settlement Agreement (the “MSA”), which resolved the states’ pending claims and released any future claims related to cigarette sales.

After the MSA’s execution, tobacco companies that had not been accused of any wrongdoing or sued were (and remain) invited to join the MSA. *Id.* at 163. Tobacco companies that have not joined the MSA are known as Nonparticipating Manufacturers (“NPMs”). *Id.* Plaintiff-Appellant Grand River Enterprises Six Nations, Ltd. (“Grand River Enterprises” or “GRE”) is an NPM. JA98, ¶ 16.

Connecticut has enacted enabling legislation to implement many of the provisions of the MSA. As relevant here, Connecticut, like other states, presents

GRE and other NPMs with two options in order for their cigarettes to be sold in the state. NPMs may either join and make annual settlement payments under the MSA or they may deposit funds into an escrow account roughly equivalent to what the NPM would be required to pay if it were a party to the MSA. *See* Conn. Gen. Stat. § 4-28i. The escrow obligation is calculated based on the volume of sales of its cigarettes in Connecticut. Conn. Gen. Stat. § 4-28i(a)(1). The funds held in escrow are used to fund judgments or settlements arising out of claims that may be asserted in the future by the state. Conn. Gen. Stat. § 4-28i(b). The deposited funds are released to the NPM after twenty-five years, to the extent not used to fund such judgments or settlements. *Id.* GRE must certify on an annual basis that it is in compliance with this and other applicable state requirements. Conn. Gen. Stat. § 4-28l.

Like other states, Connecticut has enacted legislation directing its Commissioner of the Department of Revenue Services (the “Commissioner”) to develop a directory listing all tobacco product manufacturers that have provided “current and accurate certifications” establishing an NPM’s compliance with Connecticut law, including its escrow payment obligations and reporting requirements. Conn. Gen. Stat. § 4-28m(a) (hereafter, the “Directory Law”). The

statute authorizes the Commissioner to update this directory—which is known as the Connecticut Tobacco Directory or just the Tobacco Directory—as necessary to correct mistakes and to add or remove tobacco product manufacturers. Conn. Gen. Stat. § 4-28m(a)(1). If a tobacco manufacturer or its products are not listed on the Tobacco Directory, its cigarettes cannot be sold in the state. Conn. Gen. Stat. § 4-28m(b).

In 2014, Connecticut amended the Directory Law to add a condition that is at issue in this appeal, Conn. Gen. Stat. § 4-28m(a)(3)(C), which GRE will refer to as the Reconciliation Requirement. Following further amendment in 2017, the Reconciliation Requirement now provides in relevant part:

(3) The commissioner shall not include or retain in the directory any brand family of a nonparticipating manufacturer if the commissioner concludes ... (C) a nonparticipating manufacturer's total nation-wide reported sales of cigarettes on which federal excise tax is paid exceeds the sum of (i) its total interstate sales, as reported under 15 USC 375 et seq., as from time to time amended, or those made by its importer, and (ii) its total intrastate sales, by more than two and one-half per cent of its total nation-wide sales during any calendar year, unless the nonparticipating manufacturer cures or satisfactorily explains the discrepancy not later than ten days after receiving notice of the discrepancy.

Conn. Gen. Stat. § 4-28m(a)(3)(C).

The Reconciliation Requirement provides that the Commissioner can exclude an NPM from the Tobacco Directory if the NPM fails to reconcile two figures: the total number of cigarettes imported by companies that import the NPM's cigarettes nationwide (as evidenced by the importers' federal excise tax returns) and the number of cigarettes those importers report as being sold in interstate commerce throughout the United States under federal law, as well as intrastate sales anywhere in the United States. Significantly, Connecticut imposes this Reconciliation Requirement on GRE with respect to importers that make no sales in or into Connecticut, do no business in Connecticut or with Connecticut residents or entities, and otherwise have no nexus or connection with Connecticut.

The first figure required by the Reconciliation Requirement is taken from amounts reported on federal excise tax returns. All cigarettes manufactured in or imported into the United States are subject to a federal excise tax. *See* 26 U.S.C. § 5701(b). The entities responsible for paying this federal excise tax file monthly reports with the Department of the Treasury called Form 5220.6 reports. U.S. DEP'T OF TREAS. ALCOHOL AND TOBACCO TAX AND TRADE BUREAU, Form 5220.6 (Feb. 28, 2013), <https://www.ttb.gov/images/pdfs/forms/f52206.pdf>. For cigarettes produced domestically, U.S. manufacturers file the reports and pay the excise tax.

For cigarettes produced outside the U.S., federally licensed importers that import the product into the U.S. pay the excise tax.<sup>1</sup>

The second figure is the total number of interstate and intrastate sales of the NPM's cigarettes nationwide. For purposes of interstate sales, the Reconciliation Requirement relies on reports filed by importers under a federal law known as the Jenkins Act, as amended by the Prevent All Cigarette Trafficking Act ("PACT Act"). *See* 15 U.S.C. § 375 *et seq.* The PACT Act was enacted to target illegal sales of cigarettes. *See* Prevent All Cigarette Trafficking Act of 2009 § 1, Pub. L. No. 111-154, 124 Stat. 1087 (Mar. 31, 2010). It requires "[a]ny person who sells, transfers, or ships" cigarettes in interstate commerce to report to the Tax Administrator of a State on a monthly basis the number of cigarettes shipped or sold into that State. 15 U.S.C. § 376(a). Interstate commerce is defined as commerce "between a State and any place outside the State, commerce between a State and any Indian country in the State, or commerce between points in the same State but through any place outside the State or through any Indian country." 15 U.S.C. § 375(9). Because the PACT Act only applies to interstate shipments of

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<sup>1</sup> GRE is a foreign manufacturer whose tobacco products were imported into the United States from Canada by five independent and unaffiliated U.S. importers—each of which possessed a valid, federal license to import tobacco products.

tobacco products, reports filed under the PACT Act do not reflect intrastate shipments of tobacco products. With respect to intrastate sales, the Reconciliation Requirement does not identify what records will be considered to determine the volume of such sales.

The Reconciliation Requirement is unique to Connecticut and a small minority of other states with similar provisions. *See* Ark. Code Ann. § 26-57-1303(b)(3)(C); Neb. Rev. Stat. § 69-2709(14); Nev. Rev. Stat. Ann. § 370.698(2)(g). In the vast majority of other states, NPMs such as GRE do not face a similar requirement.

## **II. IMPACT OF THE RECONCILIATION REQUIREMENT ON GRAND RIVER ENTERPRISES**

GRE is a Canadian corporation owned by members of First Nations that comprise the Six Nations of Indians (also known as the Iroquois Confederacy) and is in the business of manufacturing cigarettes. JA97, ¶ 11.<sup>2</sup> GRE manufactures its cigarettes at its facility on the Six Nations of the Grand River Reserve, in Ohsweken, Ontario, Canada. Cigarettes manufactured by GRE, including its

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<sup>2</sup> Unless otherwise stated, the following facts are taken from the Second Amended Complaint, JA94-117, which is the operative complaint for purposes of this appeal.

Seneca® brand cigarettes, are approved for sale in Connecticut and have been listed on the Tobacco Directory for the past six years. *Id.*

GRE does not sell its products directly into Connecticut, nor to Connecticut consumers, nor to any Connecticut business or entity, nor to any other consumers in the United States. Rather, GRE sells to several U.S.-based importers—none of which are located in Connecticut—that import the products into the United States. The importers then sell the GRE-manufactured cigarettes to tobacco wholesalers, some of which are located in states different from the importer’s state and some of which are located in the same state as the importer. At all times through the present, there has been only one importer of GRE products that has sold GRE products to cigarette wholesalers in Connecticut. JA104, ¶ 39.

Like domestic cigarette manufacturers, the importers of GRE’s cigarettes are responsible for paying federal excise tax for each GRE cigarette they import into the United States and filing the Federal Form 5220.6 reports. JA43.<sup>3</sup> The importers are also responsible for filing PACT Act reports with tax administrators of the respective States into which the importers sell or ship GRE products in

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<sup>3</sup> GRE attached four exhibits to its First Amended Complaint. JA37-59. These exhibits were discussed and incorporated by reference in the Second Amended Complaint. JA103, ¶¶ 34-35 (Exhibits A and B); JA105, ¶ 46 (Exhibit C); JA106, ¶ 53 (Exhibit D).

interstate commerce after importation. JA44. GRE does not file federal excise tax reports or make excise payments of its own, is not subject to the PACT Act, and makes no PACT Act filings because it does not sell or ship its products itself in interstate commerce. JA43-44.

In April 2016, GRE submitted its annual certification for the 2015 calendar year to the Connecticut Department of Revenue Services (“DRS”). JA102, ¶ 33. DRS informed GRE that its certification had been reviewed, but requested additional information and documents related to, among other things, GRE’s compliance with the Reconciliation Requirement. *Id.* ¶ 34. DRS claimed that GRE had failed to explain how its compliance with the Reconciliation Requirement had been verified through the Form 5220.6 and PACT Act reports filed by U.S. importers of GRE cigarettes. *Id.* DRS threatened that if GRE did not provide the requested information, it could result in exclusion from the Tobacco Directory effective as of July 1, 2016. *Id.*

As GRE explained in its response to DRS, only one importer of GRE’s products had any nexus or connection with Connecticut—*i.e.*, the importer that transacted business with Connecticut wholesalers. JA44. The remaining importers neither sold nor shipped GRE products in, into, or within Connecticut, nor had any

business or nexus with the State of Connecticut. GRE did not submit copies of the Form 5220.6 and PACT Act reports filed by its importers, because it did not possess its importers' records—these were federal excise tax returns and PACT Act records created and filed by the importers—which contained confidential federal tax and related information that could not be demanded by GRE or the state. JA43-44.<sup>4</sup> But in an effort to cooperate and address the concerns of DRS without prejudice and under a reservation of rights, GRE requested and obtained copies of the Form 5220.6 and PACT Act reports from its importers on a voluntary and confidential basis and provided the reports to DRS. *Id.*

GRE likewise explained to DRS that the figures from PACT Act reports (which exclude intrastate shipments) would not capture all of the GRE products that are distributed in the United States and, as a result, the two figures subject to the Reconciliation Requirement necessarily would not reconcile within the margin required by the statute. JA103, ¶ 36. During this period, there were five importers

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<sup>4</sup> Form 5220.6 reports are confidential federal tax returns of the importers. *See* 26 U.S.C. § 6103. Moreover, the PACT Act specifically states that its reports are confidential under federal law and may only be used for purposes of determining compliance with the PACT Act's reporting requirements—not for the purposes DRS is pursuing, *i.e.*, reconciling the federal tax paid on a manufacturer's cigarettes imported nationwide and determining compliance with Connecticut's Tobacco Directory laws. *See* 15 U.S.C. § 376(c).

of GRE products into the United States. Three of these importers did not file PACT Act reports b they distributed exclusively within Indian Country, as that term is defined in the PACT Act. *Id.* ¶ 37.<sup>5</sup> While the two remaining importers did file PACT Act reports for cigarettes distributed in interstate commerce, the PACT Act did not (and does not) provide for reporting of intrastate transactions. JA104, ¶ 39. As noted, some of the importers' sales to cigarettes wholesalers take place within a single state (including the original state into which their imports landed from Canada), and thus are not subject to PACT Act reporting. In 2015 alone, over one million GRE cigarettes were sold by these importers in purely intrastate sales. *Id.* Finally, a number of GRE cigarettes are held by importers in inventory that carries over from prior years or is carried over until the next calendar year. JA95, ¶ 5. These cigarettes would be reflected on the importers' federal excise tax returns, but not on the PACT Act reports for the same year.

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<sup>5</sup> During the course of this litigation, this Court held that the PACT Act applies to certain shipments to Indian Country that cross state lines. *New York v. Mountain Tobacco Co.*, 942 F.3d 536, 547 (2d Cir. 2019). In that case, the PACT Act was held to apply to a shipment from the Yakama reservation in Washington State to Indian reservations in New York. *Id.* Shipments within and among Indian Country that do not cross state lines—for example, a shipment from one reservation in New York to another reservation in New York—would still not be covered by the PACT Act as it would be entirely within a state.

In sum, a substantial number of GRE cigarettes are either sold by importers in transactions that are not subject to the PACT Act reporting requirements or held in inventory. As a result, the total number of cigarettes reported on PACT Act reports of the importers could never be reconciled with the total number of cigarettes reported on federal excise tax returns within the margin required by the State of Connecticut's Reconciliation Requirement. JA103, ¶ 36. GRE explained that DRS was forcing GRE to reconcile separate reports required under two unrelated federal laws in ways that not even those federal laws—or any other federal law—required. Indeed, federal law does not require companies to reconcile federal excise tax returns with PACT Act reports; yet Connecticut imposes the Reconciliation Requirement, on a nationwide basis, as a condition to GRE's products being sold in Connecticut. Nevertheless, DRS took the position that it would remove GRE from the Tobacco Directory and ban the sale of its products in Connecticut if GRE refused to obtain and produce the federal reports of its importers and reconciled their figures in accordance with the Reconciliation Requirement under Connecticut law.

### III. PROCEDURAL HISTORY

GRE filed this lawsuit in response to the Commissioner's imminent threat to remove GRE's products from the Tobacco Directory. If DRS were to remove GRE's products from the Tobacco Directory, it would become illegal to sell GRE brand cigarettes in Connecticut. JA107, ¶ 58. This would irreparably harm GRE and its brands. Distributors and customers in Connecticut would immediately turn to an alternative source of supply or substitute brand. *Id.* ¶ 59. Outside of Connecticut, the delisting would harm the confidence of GRE's distributors and retailers and potentially expose GRE to delisting in other States (as the laws of many states purport to authorize a state to ban GRE's products if GRE has been taken off the Tobacco Directory of any other state). JA108, ¶ 59.

As part of the lawsuit, GRE sought a declaration that its removal from the Tobacco Directory, as threatened by the Commissioner, would be unconstitutional. In the original complaint, GRE alleged that its removal would violate GRE's rights to procedural and substantive due process as required by the Fourteenth Amendment to the U.S. Constitution and Article First, Section 10 of the Connecticut Constitution, the Commerce Clause of the U.S. Constitution, and the Supremacy Clause of the U.S. Constitution. GRE also sought a declaration that it

had complied with the Reconciliation Requirement based on its explanation of why the number of cigarettes reported on its importers' federal excise tax returns could not be reconciled with the number of cigarettes reported by them under the PACT Act.<sup>6</sup>

GRE also separately moved for a temporary restraining order and preliminary injunction to prevent DRS from removing it from the Tobacco Directory. JA3, #3, #4. The district court granted GRE's motion for a temporary restraining order on July 1, 2016, and enjoined the Commissioner from removing GRE from the Tobacco Directory. JA5, #21.

A few days after the district court entered its temporary restraining order, DRS formally notified GRE of its decision to not include GRE in the Tobacco Directory. JA105, ¶ 46. DRS maintained that GRE had failed to cure or satisfactorily explain the discrepancy between the number of cigarettes reported by importers of its products nationwide on their federal excise tax forms and the number of cigarettes reported by those importers as shipped nationwide under the PACT Act. *Id.* ¶ 47. This was despite GRE's explanation to DRS that a reconciliation of these two figures was impossible. JA103-04, ¶¶ 36-39. DRS's

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<sup>6</sup> GRE later filed a First Amended Complaint raising the same claims with the exception of procedural due process. JA29-33.

only response was that GRE could stop doing business with importers which do not file PACT Act reports or force the importers to prepare and submit the documentary equivalent of PACT Act reports to DRS. JA54 (“Grand River Enterprises could utilize other importers or could require its importers to submit to DRS the documentary equivalent of PACT Act reports.”).<sup>7</sup> GRE filed a written protest and requested a hearing with the agency. JA106, ¶¶ 52-53.

In February 2017, the Commissioner moved to dismiss the First Amended Complaint, arguing that GRE had failed to state any viable claim for relief. JA60. The Commissioner also moved to vacate the temporary restraining order. JA8, #51. The Commissioner wished to terminate the temporary restraining order because in April 2017—almost one year after GRE had submitted its annual certification—DRS reversed course and informed GRE that it was in compliance with the Reconciliation Requirement for the 2015 calendar year and would remain on the Tobacco Directory for the remainder of the period. JA106, ¶ 54.

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<sup>7</sup> DRS later notified GRE that it would not require GRE to demonstrate compliance with the Reconciliation Requirement with respect to its importers that distribute exclusively within Indian Country. JA62-63. GRE would still have to demonstrate compliance with respect to the other importers, including the importers with no nexus to Connecticut. The Commissioner has not advised GRE if he will continue to exempt reporting for distribution entirely within Indian Country, particularly given this Court’s decision in *New York v. Mountain Tobacco Co.*, 942 F.3d 536 (2d Cir. 2019).

In the interim, GRE had filed its annual certification for the 2016 calendar year. JA106, ¶ 55. Again, DRS demanded that GRE gather from its importers and produce to DRS all PACT Act Reports, federal excise tax returns, monthly Form 5220.6 reports, and documentation of intrastate sales. JA107, ¶ 56. GRE was thus in the exact same position as it was when it first filed this lawsuit—facing the threat of removal from the Tobacco Directory because it had not satisfactorily demonstrated compliance with a state law that, for the reasons explained below, lacks any rational basis, directly controls interstate commerce that has no nexus to Connecticut, and conflicts with federal law.

After a June 2017 hearing, the district court granted the motion to vacate the temporary restraining and denied the Commissioner’s first motion to dismiss. JA8, #63; JA9, #65. The motion to dismiss was denied without a written opinion, but at the hearing the district court observed that GRE had very likely stated viable claims for relief. JA66 (“So with that in mind, we looked at all the papers. And it seems to use that there is enough there to put this matter to a jury and not grant the motion to dismiss. There’s a lot of issues raised.”).

Before the deadline for the Commissioner to file its answer, the district court granted GRE leave to file a Second Amended Complaint—the complaint at issue

in this appeal—in order to plead additional facts that had occurred since December 2016. *See* JA9, #72; JA10, #73. As noted, DRS had notified GRE that it was in compliance for purposes of the 2016 version of the Tobacco Directory, but GRE’s status for the 2017 version of the Tobacco Directory was uncertain. JA106-07, ¶¶ 54-57; JA108, ¶ 61. GRE’s claims for relief remained the same: the Reconciliation Requirement violated the Due Process Clause (and the Connecticut equivalent), the Commerce Clause, and the Supremacy Clause. JA110-13, ¶¶ 72-94. GRE also sought a declaration that it had complied with the provision. JA113-14, ¶¶ 95-99.

Although the district court had just denied a motion to dismiss these very same claims, the Commissioner again moved to dismiss the Second Amended Complaint. JA118. This time the district court granted the motion to dismiss, concluding that GRE had failed to state any viable constitutional claims and that its request for declaratory judgment was moot. JA120-29.

***Substantive Due Process.*** GRE’s substantive due process claim alleged that the Reconciliation Requirement was an arbitrary and irrational infringement of GRE’s protected interest in remaining on the Tobacco Directory. JA110-11, ¶¶ 72-78. In particular, the Reconciliation Requirement did not rationally relate to any legitimate state interests concerning the identification of illicit cigarette sales (in

Connecticut or otherwise) because the two figures at issue cannot be reconciled (for any purpose), even if importers of GRE cigarettes fully complied with federal excise tax and PACT Act reporting requirements. Indeed, not even federal law requires the reconciliation imposed by Connecticut. Moreover, the State of Connecticut was regulating GRE's conduct outside the jurisdiction of the State, by requiring GRE to impose conditions on GRE's dealings with importers that have no nexus with Connecticut. The DRS letter identified above spelled out those unconstitutional conditions: if GRE wished to remain on the Tobacco Directory, GRE should discontinue doing business with importers that refused to supply their nationwide federal tax and shipment information to Connecticut. JA54. The district court found that GRE had failed to plausibly allege a substantive due process violation, reasoning that the provision could be viewed as a rational means of rooting out illicit sales because, even if the figures at issue did not reconcile, a manufacturer could explain (or fail to explain) the discrepancy. JA124-25.

*Commerce Clause.* GRE alleged that the Reconciliation Requirement violated the dormant Commerce Clause because it had the practical effect of regulating commerce wholly outside of Connecticut. JA112-13, ¶¶ 89-94. The provision forced NPMs like GRE to obtain and report federal excise tax returns of

importers who neither sold in or into, nor had any nexus with, the State of Connecticut whatsoever—under pain and sanction of having GRE’s products banned from sale in Connecticut. GRE could not comply with the provision without obtaining and submitting confidential tax and shipping records from unaffiliated importers that have no connection to Connecticut. The district court rejected the dormant Commerce Clause claim, reasoning that the provision operated as an after-the-fact reporting requirement and thus did not directly regulate out-of-state commerce. JA127-28.

***Supremacy Clause.*** GRE alleged that the Reporting Requirement violated the Supremacy Clause because it was impossible for GRE to comply with the state law and the PACT Act. JA111-12, ¶¶ 79-88. In addition, the PACT Act specifically states that its reporting was subject to confidentiality under federal law and could be used only for purposes of determining compliance with the PACT Act itself—not a State’s separate enabling statute under the MSA or any other state law. *See* 15 U.S.C. § 376(c). DRS, however, refused to acknowledge or abide by the federal confidentiality and instead claimed that DRS was only subject to Connecticut’s confidentiality laws. In addition, DRS claimed that there was no limitation on its ability to demand or use any PACT Act reports, including PACT

Act reports containing information about shipments of tobacco products taking place completely outside of Connecticut by buyers and sellers located in other States and having no nexus with the State of Connecticut. The district court concluded that GRE had failed to state a claim because GRE has remained on the Tobacco Directory, JA126, even though it has never been able to comply with the statutory provision by reconciling its nationwide sales figures based on tax and shipping records.

***Declaratory Judgment Claim.*** Finally, GRE sought a declaratory judgment that, notwithstanding the constitutional issues with the Reporting Requirement, GRE had complied with the provision. JA113-14, ¶¶ 95-99. The district court dismissed this claim as moot because DRS had informed GRE that it was in compliance for the 2015 and 2016 calendar years. JA129. GRE had argued that its claim was not moot because DRS could unilaterally change its mind for any future calendar years. *Id.* The district court disagreed, stating that the non-constitutional claim had not evaded review in light of the decision to dismiss GRE's constitutional claims. *Id.*

Following the district court's order, GRE moved for reconsideration of the dismissal of the Commerce Clause and Supremacy Clause claims, while also

reserving its rights to appeal the dismissal of its other claims. JA131-32. GRE argued that the district court had misapplied this Court's decision in *VIZIO, Inc. v. Klee*, 886 F.3d 249 (2d Cir. 2018), in dismissing the Commerce Clause claim. GRE also argued that the district court had considered impermissible extrinsic evidence in dismissing the Supremacy Clause claim. The district court denied the motion for reconsideration and this appeal followed. JA188-99; JA200-01.

### **SUMMARY OF THE ARGUMENT**

Connecticut's legitimate interests in regulating the sale of tobacco products within its borders and enforcing its tax laws with respect to such sales is not at issue in this appeal. GRE's constitutional challenges raise issues only with respect to Connecticut's Reconciliation Requirement, which is an irrational statutory requirement that does not further any legitimate state interest, conflicts with applicable federal law, and regulates commerce and conduct occurring wholly beyond its borders. GRE has alleged plausible constitutional and non-constitutional claims for relief, and the district court's decision dismissing GRE's claims in their entirety should be reversed.

First, GRE sufficiently alleged a substantive due process claim, as the Reconciliation Requirement is an arbitrary and irrational interference with GRE's

constitutionally-protected interest in remaining on the Tobacco Directory and doing business outside the State of Connecticut on terms that are not regulated by DRS or any other Connecticut agency. The Commissioner claims that the provision is designed to discover sales of cigarettes that evade state taxation and threaten public health. The reality is that the Reconciliation Requirement does not advance, in accordance with constitutional limits, any of the State's purported interests in the black market for cigarettes.

As illustrated by GRE's efforts to comply, the "discrepancy" scrutinized under the Reconciliation Requirement pertains solely to reporting requirements under federal law and has no bearing whatsoever on whether GRE's cigarettes were diverted to the illicit market. Moreover, the Reconciliation Requirement inexplicably applies only to those manufacturers such as GRE that have not joined the MSA, and not the manufacturers that have joined the MSA and account for the vast majority of cigarettes sold in Connecticut.

Second, GRE has sufficiently alleged a violation of the Commerce Clause based on the Reconciliation Requirement's direct impact on out-of-state transactions. If the Commerce Clause means anything with respect to state economic regulation, it means that one State cannot regulate commerce outside of

its borders. Yet this is precisely what Connecticut has done in this case. GRE does not assert that Connecticut lacks authority to regulate importers conducting business with or into Connecticut. But the Reconciliation Requirement demands that GRE obtain confidential tax and business records from unaffiliated, independent importers of GRE cigarettes that have no nexus at all with the State of Connecticut, for purposes of submission to and review by DRS. These confidential tax and business records relate exclusively to sales taking place outside of the State. This assertion of state authority over out-of-state economic transactions conducted by out-of-state parties cannot be reconciled with the limits on state power embodied in the Commerce Clause.

Third, GRE adequately alleged a Supremacy Clause claim in light of the conflict between the state Reconciliation Requirement and the federal PACT Act. GRE's importers can be in full compliance with the PACT Act, yet GRE will be unable to comply with the Reconciliation Requirement when the shipment figures reflected in PACT Act reports filed by importers doing no business in Connecticut or having any nexus with Connecticut do not match (to the satisfaction of DRS) the figures reflected in the importers' federal excise tax returns. Moreover, the Reconciliation Requirement requires the submission of PACT Act reports to

comply with the Directory Law. The PACT Act, however, expressly states that these reports must be kept confidential and cannot be used for any purposes other than determining compliance with the PACT Act. Any of these grounds are sufficient to state a claim of impossibility preemption.

Fourth and finally, GRE adequately alleged a declaratory judgment claim for a ruling that GRE has complied with the Reconciliation Requirement by providing a sufficient explanation for any discrepancy. The Commissioner's decision to continue listing GRE on the Tobacco Directory does not render this claim for declaratory relief moot. So long as the Reconciliation Requirement remains in place, GRE will face the same compliance burdens and threat of removal each year. This is therefore a textbook example of a claim of future harm that is not moot because it is capable of repetition yet evading review. Moreover, contrary to the district court's conclusion, GRE's claim for declaratory relief has never been reviewed by *any* court.

### **STANDARD OF REVIEW**

“Whether a complaint alleges sufficient facts to state a claim on which relief can be granted is a question of law, which [the Court] consider[s] *de novo*.”

*Anderson News, L.L.C. v. Am. Media, Inc.*, 680 F.3d 162, 185 (2d Cir. 2012) (citation omitted).

### **ARGUMENT**

The district court erred in granting the Commissioner’s motion to dismiss and dismissing each of GRE’s claims for relief. At the motion to dismiss stage, the Court applies the familiar pleading standards articulated in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). In order to satisfy Rule 8, GRE must allege “enough facts to state a claim to relief that is plausible on its face.” *Twombly*, 550 U.S. at 570. A claim is plausible “when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.” *Iqbal*, 556 U.S. at 678. The factual allegations in the Second Amended Complaint stated plausible constitutional and non-constitutional claims for relief related to the Reconciliation Requirement and its enforcement by the Commissioner.

#### **I. THE RECONCILIATION REQUIREMENT VIOLATES SUBSTANTIVE DUE PROCESS**

The Due Process Clause of the Fourteenth Amendment prohibits a state from depriving any person of life, liberty, or property without due process of law. U.S. Const. amend. XIV, § 1. While the Due Process Clause undoubtedly has a

procedural component, it has an equally important substantive component that guarantees “more than fair process.” *Washington v. Glucksberg*, 521 U.S. 702, 719 (1997). In particular, the substantive component of the Due Process Clause bars certain state action “regardless of the fairness of the procedures.” *Daniels v. Williams*, 474 U.S. 327, 331 (1986). When a State enacts an economic regulation like the Reconciliation Requirement that is “arbitrary and irrational,” it violates substantive due process. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976).<sup>8</sup> Due process also requires some definite link, some minimum connection, between a state and the transaction it seeks to regulate. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2093 (2018) (“[D]ue process require[s] that there be ‘some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.’”) (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345 (1954)).

In order to state a substantive due process claim, GRE must allege that it has a protected interest in remaining on the Tobacco Directory and that the

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<sup>8</sup> The requirements to state a violation of substantive due process under the Connecticut Constitution are substantially the same. *See Ramos v. Town of Vernon*, 254 Conn. 799, 837 (2000). Accordingly, to the extent that GRE stated a plausible substantive due process claim under the U.S. Constitution, it has likewise stated a plausible claim under the Connecticut Constitution.

Reconciliation Requirement is not rationally related to a legitimate government interest. *See Winston v. City of Syracuse*, 887 F.3d 553, 566 (2d Cir. 2018). GRE has done so, and the district court decision's dismissing the substantive due process claim should be reversed.

**A. GRE Has a Protected Interest in Remaining on the Tobacco Directory**

The Tobacco Directory contains a list of manufacturers and tobacco products that are approved for sale in the state. JA99, ¶ 20. GRE must submit an annual certification of compliance in accordance with applicable state laws and regulations in order to remain on the Tobacco Directory. *Id.* If GRE and its products were removed from the Tobacco Directory, it would become illegal to sell GRE's products in Connecticut. JA102, ¶ 31. In effect, the Tobacco Directory operates as a license for GRE to continue having its tobacco products sold in Connecticut.<sup>9</sup>

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<sup>9</sup> Connecticut also demanded that GRE obtain a Connecticut Tobacco Manufacturer license (costing \$10,000 per year) pursuant to Conn. Gen. Stat. § 12-285b. GRE obliged the state's demand although GRE does not engage in any manufacturing in Connecticut. JA96, ¶ 9. Connecticut does not require GRE to reconcile importers' tax returns with their PACT Act reports for GRE to maintain its manufacturing license, but does require GRE to make that reconciliation as a condition of having GRE's cigarettes approved for sale in Connecticut.

GRE's interest in this license is constitutionally protected because the circumstances in which the license can be taken away are limited by statute. In the context of a licensing scheme like the Tobacco Directory, a party has a protected interest so long as it has a "legitimate claim of entitlement" to the license. *See RRI Realty Corp. v. Inc. Vill. of Southampton*, 870 F.2d 911, 915-17 (2d Cir. 1989) (internal quotation marks and citation omitted); *Mordukhaev v. Daus*, 457 F. App'x 16, 18-19 (2d Cir. 2012). GRE's entitlement to its license turns on the level of discretion granted to the issuing agency—in this case the Commissioner—and the requirement that the Commissioner issue the license to GRE in accordance with due process and all other constitutional requirements and protections. *See RRI Realty Corp.*, 870 F.2d at 917-18.

In other words, the less discretion the Commissioner has in granting or denying the license, the stronger GRE's claim of entitlement to the license. *See id.*; *Jones-Soderman v. Exec. Sec'y of the State Bd. for Psychology*, No. 08-4716, 2010 WL 3800908, at \*6 (E.D.N.Y. May 21, 2010). For example, this Court has held that an applicant sitting for a psychology licensure examination had a protected interest because the state agency lacked broad discretion to accept or reject the application. *Charry v. Hall*, 709 F.2d 139, 144 (2d Cir. 1983). On the

other hand, where the application for a taxicab license involved subjective criteria such as “good moral character,” “physical condition,” and “knowledge,” this Court held that the plaintiff had failed to allege a legitimate claim of entitlement. *Mordukhaev*, 457 F. App’x at 19-20.

As relevant here, the Connecticut legislature has severely limited the discretion of the Commissioner to remove GRE from the Tobacco Directory. Specifically, the Commissioner “shall not include or retain” a manufacturer on the Tobacco Directory in limited circumstances, including when the manufacturer fails to provide its annual certification or when the certification does not comply with the requirements in the statute. Conn. Gen. Stat. § 4-28m(a)(2). In addition, the Commissioner “shall not include or retain” a NPM in the Tobacco Directory if the Commissioner concludes that the NPM failed to make its escrow payments or failed to satisfy a state judgment related to its escrow payments. Conn. Gen. Stat. § 4-28m(a)(3). The Commissioner has not claimed that GRE has failed to make an escrow payment or failed to satisfy any judgment.

Each of the grounds listed in the statute are objective and have little in common with the sort of subjective criteria that might call into question GRE’s entitlement to a license. *See Mordukhaev*, 457 F. App’x at 19-20. Accordingly,

the Commissioner lacks broad discretion to revoke GRE's license, and GRE has a protected interest in remaining on the Tobacco Directory. *See RRI Realty Corp.*, 870 F.2d at 918; *Charry*, 709 F.2d at 144.

**B. The Reconciliation Requirement is Arbitrary and Irrational**

In connection with its substantive due process claim, GRE likewise adequately alleged that the Reconciliation Requirement fails the rational basis test. Under that test, the Reconciliation Requirement must be rationally related to a legitimate government interest in order to pass constitutional muster. *See Pension Ben. Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 729 (1984); *Beatie v. City of N.Y.*, 123 F.3d 707, 711 (2d Cir. 1997). “[W]hile rational basis review is indulgent and respectful, it is not meant to be ‘toothless.’” *Winston*, 887 F.3d at 560 (quoting *Windsor v. United States*, 699 F.3d 169, 180 (2d Cir. 2012), *aff'd*, 570 U.S. 744 (2013)). For example, this Court reinstated a substantive due process claim at the pleading stage when the plaintiff plausibly alleged that a city ordinance that would shut off water service for tenants did not rationally advance legitimate interests in collecting payments from landlords. *Winston*, 887 F.3d at 563.

In this case, GRE plausibly alleged that the Reconciliation Requirement fails the rational basis test because it does not reasonably advance any legitimate state

interests related to the illicit market for cigarettes, tax compliance, or public health. In the district court, the Commissioner claimed that the Reconciliation Requirement would reduce state tax evasion, increase compliance with the escrow statute, and promote public health. JA123-24. Yet the Commissioner failed to explain how any of those interests are furthered by requiring reconciliation from manufacturers who did not join the MSA, while leaving those manufacturers that did join the MSA (and accounting for over 90% of the cigarettes sold nationwide and in Connecticut) completely exempt from that requirement. In addition, Congress itself stated its purposes for adopting the federal tax code provisions applicable to cigarettes produced or imported into the United States, as well as the separate congressional purpose for adopting the PACT Act, *i.e.* reducing the illicit cigarette trade. However, neither the federal statutes nor any federal agency require, or have ever required, that the separate reports filed pursuant to these codes be reconciled in any respect.

Each of the state's claimed interests are premised on the purported ability of the Reconciliation Requirement to identify cigarettes that have been diverted from the legal market to the illegal market. As noted, the Reconciliation Requirement compares the total number of cigarettes reported on federal excise tax returns with

the total number of interstate and intrastate sales of cigarettes. According to the Commissioner, the difference between these two numbers represents the probable diversion of cigarettes to the illegal market where, among other things, the cigarettes are sold without paying applicable state taxes.

As an initial matter, the Commissioner's claims regarding the state interests at stake are not credible in light of the scope of the Reconciliation Requirement. There is nothing unique about NPMs that make their products especially susceptible to diversion to the illicit market, yet this provision applies *only* to NPMs like GRE. Participating manufacturers are exempt, despite the fact that such manufacturers represent the bulk of the overall market. *See Grand River Enters. Six Nations, Ltd.*, 425 F.3d at 162 (major manufacturers who originally joined MSA represented 98% of cigarette sales in 1998). If the Connecticut legislature truly believed that this provision furthered state interests related to the detection of cigarettes sold on the black market, it would have drafted a law that applied to *all* manufacturers.<sup>10</sup>

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<sup>10</sup> Indeed, the sanction for failing to meet the Reconciliation Requirement is not the imposition or collection of any tax or penalty for diversion. The only sanction is a ban on the sale of GRE's brands in the state. It is arbitrary and irrational for a state to ban the sale of a manufacturer's products based on whether downstream distributors keep satisfactory business records or can otherwise

Perhaps even more obvious and important, the claim that the Reconciliation Requirement furthers the state's interest in having NPMs comply with the escrow requirements is belied by the fact that the escrow obligation is based on *statewide* sales when the Reconciliation Requirement is based on *nationwide* sales. *See* Conn. Gen. Stat. § 4-28i. GRE's escrow obligations in Connecticut are not in any way triggered or dependent on any discrepancy between the number of cigarettes reported by independent importers for tax or shipping purposes on a nationwide basis. In fact, Connecticut has no legitimate interest in seeking to police sales that take place outside of its borders. *See Bigelow v. Virginia*, 421 U.S. 809, 827-28 (1975) (holding that, for First Amendment purposes, Virginia's interest in shielding citizens from information about activities outside Virginia's borders was entitled to little, if any, weight because Virginia's police powers did not reach such activities); *see also Am. Charities for Reasonable Fundraising Regulation, Inc. v. Pinella Cty.*, 221 F.3d 1211, 1216 (11th Cir. 2000) ("There must be at least some minimal contact between a State and the regulated subject before it can, consistently with the requirements of due process, exercise legislative

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explain their conduct. This would be akin to a state banning the sale of products made by a PPE device manufacturer simply because a downstream distributor engaged in price gouging in selling the manufacturer's products anywhere in the country during a pandemic.

jurisdiction.”) (quoting *Hellenic Lines Ltd. v. Rhoditis*, 398 U.S. 306, 315 n.2 (1970) (Harlan, J., dissenting)).<sup>11</sup>

Turning back to the Commissioner’s core premise regarding the Reconciliation Requirement—that it is a proxy for identifying illicit sales—this too completely collapses upon scrutiny, rendering the provision arbitrary and irrational. Despite not being limited to the proper subject of Connecticut’s police powers, *i.e.* illicit sales in Connecticut, in order to identify illicit sales of cigarettes, the state would need to compare two consistent data points to observe whether cigarettes are “falling out” of the nationwide market and finding their way to Connecticut. However, nothing in the reports that must be produced under the Reconciliation Requirement purports to tie any “falling out” with the State of Connecticut. Even before attempting to make such a tie, it is, as GRE alleged in detail and argued below, impossible in the first instance to reconcile the number of cigarettes reflected in annual excise tax filings and shipping records of its

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<sup>11</sup> Indeed, those companies that have joined the MSA make payments to Connecticut based on allocated percentages tied to nationwide sales measured by federal excise taxes paid by those companies. However, those companies are exempt from the Reconciliation Requirement and are not required to reconcile their federal tax payments with their PACT Act shipping reports or reports of intrastate shipments and sales. *See Master Settlement Agreement, available at <https://www.naag.org/assets/redesign/files/msa-tobacco/MSA.pdf>* (§ II(z) (definition of market share); § IX (MSA payments) (last visited May 27, 2020).

importers. *E.g.*, JA103-04, ¶¶ 36-39. The starting point for the Reconciliation Requirement is an NPM's "total nation-wide reported sales of cigarettes on which federal excise tax is paid." Conn. Gen. Stat. § 4-28m(a)(3)(C). Excise taxes are paid on *all* cigarettes "manufactured in or imported into the United States." 26 U.S.C. § 5701(b). But this baseline figure is not tied in any way under federal law or otherwise to the sum of "total interstate sales, as reported under [the PACT Act]" and "total intrastate sales." Conn. Gen. Stat § 4-28m(a)(3)(C).

For example, the PACT Act requires reporting of cigarettes shipped in "interstate commerce," 15 U.S.C. § 376(a), which is defined as commerce "between a State and any place outside the State, commerce between a State and any Indian country in the State, or commerce between points in the same State but through any place outside the State or through any Indian country." 15 U.S.C. § 375(9). Intrastate shipments and shipments within Indian country that do not cross state lines do not fall within the PACT Act's definition of "interstate commerce." As GRE explained to the Commissioner, well over one million of its cigarettes fell into this category for 2015. JA103-04, ¶¶ 37-39. Moreover, even reports of "total intrastate sales" will not be able to account for cigarettes that are held in inventory that carries over from prior years or is carried over until the next calendar year.

JA95 ¶ 5. These cigarettes would be reflected on an importer's federal excise tax returns, but not on the PACT Act reports for that year.

Accordingly, any discrepancy between the figures reported in connection with the Reconciliation Requirement is attributable to the fact that the state is comparing apples and oranges, not to the diversion of cigarettes into the illicit market. The Reconciliation Requirement does not yield *any* reliable information about illicit sales of GRE cigarettes and provides no basis to conclude that either GRE or any importer of its cigarettes are engaging in illicit sales in or into Connecticut.<sup>12</sup> For this reason, the provision is not rationally related to a legitimate state interest and GRE has plausibly alleged a violation of substantive due process.

### **C. The District Court Erred in Dismissing the Due Process Claim**

The district court concluded that the Reconciliation Requirement can be viewed as a rational means to identify illicit sales. JA124-25. The district court appeared to accept that the statutory provision will always result in a discrepancy

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<sup>12</sup> If these reports did or were intended to provide Connecticut with such information, the PACT Act—federal legislation intended to stop illicit trade—would not limit a reporting company to filing PACT Act reports *only* in the state into which the company makes its shipments. For example, the PACT Act does not require or provide that an importer shipping cigarettes into California must file a report of such shipment with Connecticut; the report is filed only with California. Connecticut essentially has transformed PACT Act reporting into a nationwide requirement, contrary to the plain text of the PACT Act itself.

between the figures reported on tax records and sales records, but minimized that concern because manufactures will either explain or fail to explain the discrepancies in reported sales. *Id.* The district court thus assumed that to the extent *some* manufacturers lack a satisfactory explanation for the discrepancy in records maintained by importers of its products, the Reconciliation Requirement will have served its purpose of identifying illicit sales.

Such a conclusion is based on pure speculation, as there is no indication in the record that the Commissioner or DRS have rooted out illicit sales in this fashion. Moreover, the fact that independent, unaffiliated importers cannot, for whatever reasons, reconcile their tax returns and shipping reports (for imports and distribution taking place completely outside the State of Connecticut) to within a margin of 2.5% provides no rational basis to prohibit the sale of GRE's cigarettes in Connecticut.

In short, the district court's conclusion is inconsistent with the pleading requirements applicable at this stage of the case. Accepting GRE's factual allegations as true, GRE has *plausibly alleged* that the Reconciliation Requirement bears no rational relation to a legitimate state interest. *Winston*, 887 F.3d at 566-67; *see also Dias v. City & Cty. of Denver*, 567 F.3d 1169, 1184 (10th Cir. 2009)

(reversing dismissal of substantive due process claim where plaintiffs plausibly alleged that pit bull ban would not improve public safety). At some later date, the Commissioner might come forward with evidence showing that the Reconciliation Requirement is a legitimate compliance tool. For its part, GRE would be able to present its own evidence as to why that is not the case. But for now, GRE's well-pleaded allegations control and state a plausible substantive due process claim.

## **II. THE RECONCILIATION REQUIREMENT VIOLATES THE COMMERCE CLAUSE**

The Commerce Clause is most often cited as an affirmative grant of power to Congress “[t]o regulate Commerce ... among the several States.” U.S. Const. art. I, § 8, cl. 3. But the Commerce Clause has also long been construed as an implicit restraint on state power over interstate commerce. *See, e.g., Healy v. Beer Inst., Inc.*, 491 U.S. 324, 326 n.1 (1989). Commonly referred to as the “dormant Commerce Clause,” this restraint on state power limits “the authority of the States to enact legislation affecting interstate commerce,” *id.*, and it has invalidated a variety of state laws that control, burden, or discriminate against interstate commerce.

Among other limitations, the Commerce Clause “precludes the application of a state [law] to commerce that takes place wholly outside of the State’s borders,

whether or not the commerce has effects within the State.” *Id.* at 336 (quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982)). It is well-established that such laws are virtually *per se* invalid under the Commerce Clause. *See Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573, 579 (1986); *Am. Booksellers Found. v. Dean*, 342 F.3d 96, 104 (2d Cir. 2003).

The Reconciliation Requirement violates the Commerce Clause because it regulates the sale of cigarette products from GRE to its importers, as well as sales by those importers, which have no connection to Connecticut. As alleged in the Second Amended Complaint, Connecticut’s extraterritorial application of state law is *per se* invalid and the district court’s dismissal of GRE’s Commerce Clause claim should be reversed.

**A. The Commerce Clause Prohibits the Extraterritorial Application of State Economic Regulations**

For well over a century, it has been clear that “[n]o State can legislate except with reference to its own jurisdiction.” *Bonaparte v. Tax Court*, 104 U.S. 592, 594 (1881). “Laws have no force of themselves beyond the jurisdiction of the state which enacts them, and can have extraterritorial effect only by the comity of other states.” *Huntington v. Attrill*, 146 U.S. 657, 669 (1892).

In the context of the Commerce Clause, the extraterritoriality principle means that one state cannot regulate commerce occurring wholly outside of the state. *Healy*, 491 U.S. at 336. This limitation on state power is a necessary and important feature of our constitutional structure. A “central concern of the Framers” was “the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.” *Comptroller of Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1794 (2015) (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979)). The application of the Commerce Clause to invalidate extraterritorial regulations of commerce directly addresses this concern by “prevent[ing] the States from adopting protectionist measures and thus preserv[ing] a national market for goods and services.” *Tenn. Wine & Spirits Retailers Ass’n v. Thomas*, 139 S. Ct. 2449, 2459 (2019). At the same time, rigorous application of the extraterritoriality principle also preserves state sovereignty and “the autonomy of the individual States within their respective spheres.” *Healy*, 491 U.S. at 336.

Under the rubric of extraterritoriality, the Supreme Court has invalidated a variety of state laws that regulated out-of-state commerce. For example, the

Supreme Court has twice struck down state laws prohibiting the importation of out-of-state goods unless the importer affirmed that it did not offer those same goods for a lower price in another state. *Healy*, 491 U.S. at 337; *Brown-Forman Distillers Corp.*, 476 U.S. at 579. Along the same lines, the Supreme Court had previously struck down similar state laws that restricted the interstate shipment of goods based on out-of-state prices. *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935); *Lemke v. Farmers' Grain Co.*, 258 U.S. 50, 61 (1922). It similarly invalidated a state law that granted state officials the authority to block corporate takeovers where all of the corporate shareholders were residents of other states. *Edgar*, 457 U.S. at 642-43.

The same holds true in this Court, which has found violations of the dormant Commerce Clause when a state requires that out-of-state commerce conform to in-state requirements. For example, in *American Booksellers Foundation v. Dean*, 342 F.3d at 103-04, this Court held that a Vermont law prohibiting the distribution of explicit materials via the Internet violated the dormant Commerce Clause. Because persons outside Vermont sharing information on the Internet could not prevent someone in Vermont from accessing the material, the practical effect of the state law was that those outside Vermont had to comply with the law or risk

prosecution. *Id.* This projection of state law onto out-of-state commerce presented a *per se* violation of the dormant Commerce Clause. *Id.* at 104.

**B. The Reconciliation Requirement Regulates Out-of-State Commerce**

The unifying theme of the Commerce Clause cases addressing extraterritoriality is that courts will invalidate state laws when their “practical effect ... is to control conduct beyond the boundaries of the state.” *Healy*, 491 U.S. at 336. The Reconciliation Requirement violates this core principle because its practical effect is to require that any importer conducting business with GRE for distribution of GRE products completely outside Connecticut must consent and submit to Connecticut’s demands for federal tax returns and shipment records, in addition to Connecticut law that requires GRE to reconcile those records within a margin of 2.5%—all as a condition to GRE having its products sold in Connecticut.

As noted, GRE must obtain and submit to the Commissioner nationwide records showing and reconciling the number of cigarettes for which importers of GRE cigarettes have paid federal excise tax in a given year and the number of cigarettes sold interstate and intrastate by those importers in that same year. *See* Conn. Gen. Stat. § 4-28m(a)(3)(C). This provision is drafted without regard to

whether the cigarettes at issue originated in Connecticut, were sold in Connecticut, passed through Connecticut, or, for that matter, had any connection to the state. As the record reflects, all but one of the importers that import GRE cigarettes into the U.S. have absolutely no nexus with Connecticut. They have neither offices, assets, nor personnel in Connecticut, nor have they engaged in any business in, with, or among Connecticut residents or entities. In addition, they have never shipped GRE products in or into Connecticut. Statutes with such nationwide reach invariably present Commerce Clause concerns. *See Am. Booksellers Found.*, 342 F.3d at 103-04; *see also Healthcare Distribution All. v. Zucker*, 353 F. Supp. 3d 235, 261 (S.D.N.Y. 2018) (striking down New York law that prohibited opioid manufacturers from passing on a state surcharge to consumers, regardless of the location of the sale). And each step of the calculation in the Reconciliation Requirement confirms that Connecticut has impermissibly extended its regulatory authority beyond its own borders.

Beginning with the federal excise tax figures, Connecticut requires GRE to obtain and report the total number of cigarettes imported by all importers of GRE products into the United States, as measured by the federal excise taxes paid by these importers. Conn. Gen. Stat. § 4-28m(a)(3)(C). GRE does not pay federal

excise taxes or file the corresponding Form 5220.6 reports. JA43. These tax records are prepared and only filed with the federal government by the third-party importers of GRE's cigarettes. *Id.* GRE has no right to obtain or produce third-party tax records, which contain the importers' confidential tax information. *Id.* Moreover, for all but one importer, these records would not reflect the importation of cigarettes that ultimately are sold in Connecticut. JA104, ¶ 39.

In a good faith effort to comply with the statute, GRE submitted all of *its* invoices to the U.S. importers reflecting the number of cigarettes imported into the United States. JA43. The Commissioner rejected GRE's invoices as insufficient documentation. *Id.* GRE was therefore forced to obtain and produce the Federal Form 5220.6 reports filed by each of its importers. *Id.* As noted, GRE was compelled to produce the reports of importers with no connection or nexus to Connecticut. The Commissioner has no authority or jurisdiction to compel the production of records of out-of-state transactions made by out-of-state actors. Yet the Commissioner has required GRE to repeat this exercise every year while this litigation has been pending in order for GRE to comply with the Reconciliation Requirement and remain on the Tobacco Directory.

As a result, if GRE and a certain importer wish to continue to do business with each other—business which has no nexus to Connecticut—the Connecticut statute compels GRE to secure the importer’s agreement to provide to GRE, and ultimately the Commissioner, the importer’s confidential federal excise tax reports. That constitutes direct regulation of entirely out-of-state transactions.

The story is much the same with the second step in the calculation, where GRE must obtain and provide the Commissioner with the total interstate sales of importers (as reported under the PACT Act) and total intrastate sales made by those importers. Conn. Gen. Stat. § 4-28m(a)(3)(C). As with the federal excise tax records, the Commissioner demands PACT Act reports and reports of intrastate sales from importers with no connection or nexus to Connecticut. JA104, ¶ 39. The Commissioner has demanded that GRE obtain and produce these records in order to comply with the Reconciliation Requirement and remain on the Tobacco Directory. Indeed, the Commissioner has even suggested that GRE stop doing business with certain importers who do not file PACT Act reports (regardless of whether the PACT Act requires the filings) or force these importers to prepare and submit the equivalent of PACT Act reports. JA54 (“Grand River Enterprises could

utilize other importers or could require its importers to submit to DRS the documentary equivalent of PACT Act reports.”).

Here too, the Connecticut statute directly regulates out-of-state transactions between GRE and its importers: as a condition of doing business with each other, the importer must agree to turn over to GRE, and ultimately the Commissioner, its confidential PACT Act reports, “equivalents” of PACT Act reports, records of intrastate sales, and inventory records, even if the importer’s records do not pertain to a single sale in Connecticut.

In sum, the Reconciliation Requirement conditions GRE’s participation in the state marketplace on requiring its out-of-state importers engaged in out-of-state transactions to provide confidential records and submit to the regulatory authority of DRS and the Commissioner. This type of condition precedent to GRE’s participation in the marketplace presents a clear violation of the dormant Commerce Clause.

One state cannot control conduct beyond its borders and cannot “force an out-of-state merchant to seek regulatory approval in one State before undertaking a transaction in another.” *Healy*, 491 U.S. at 336-37; *see also Edgar*, 457 U.S. at 642-43 (striking down state law that granted state officials the authority to block

corporate takeovers involving out-of-state shareholders). Yet in similar fashion, Connecticut is requiring out-of-state importers of GRE's products to submit confidential records of all of their out-of-state sales. While the Reconciliation Requirement forces the importers to produce these records after they are generated and filed with the U.S. Treasury or other states' taxing authorities, the timing of when they are filed and must later be produced to the Commissioner does not insulate the Commissioner's requirements from scrutiny under the Commerce Clause.

Moreover, the Supreme Court has made clear that the analysis under the dormant Commerce Clause focuses on the *practical effect* of the state law and is not bound by formalism. *Healy*, 491 U.S. at 336. Indeed, the Commissioner's statements present no practical resolution for GRE: If the importer refuses to produce its reports and filings pertaining to the previous year's sales, GRE could refuse to do future business with the importer. This does not solve GRE's compliance dilemma, however, because the Commissioner has already told GRE that GRE *must* obtain and produce those records or GRE's products will be banned from the state. Thus, GRE's only means of compliance (in accordance with the Commissioner's direction) is to require importers to agree at the outset to provide

their federal tax returns and PACT Act filings to GRE, and to provide those documents on a real-time basis, for subsequent filing and submission to the Commissioner. Not even the federal tax laws or the PACT Act place such demands on GRE, nor do they entitle GRE or any state to such records. With respect to the PACT Act, as noted above, the only PACT Act report to be filed with a state is that which corresponds to a shipment into that state.

**C. The District Court Misapplied Circuit Precedent in Dismissing GRE's Commerce Clause Claim**

The district court misapplied this Court's decision in *VIZIO, Inc. v. Klee*, 886 F.3d 249 (2d Cir. 2018), when it concluded that the Reconciliation Requirement operated as a mere recordkeeping requirement. JA127-28. The facts of that case were quite different and it was error for the district court to rely on its holding. In *Vizio*, the plaintiff argued that a state law that assessed an electronic device recycling fee based on the plaintiff's national market share impermissibly regulated interstate commerce. *VIZIO, Inc.*, 886 F.3d at 254. Noting that state laws that have the practical effect of controlling extraterritorial conduct violate the Commerce Clause, this Court held that it was not a violation of this principle to merely consider out-of-state activity when calculating and imposing in-state charges. *Id.* at 255-56.

The statutory provision at issue in this case does far more than consider out-of-state activity. Connecticut compels third-parties with no economic connection to the state to produce to GRE, and ultimately to DRS, confidential business records reflecting wholly out-of-state transactions involving GRE's products. The analysis of this case under the *VIZIO* framework may have been different if the Reconciliation Requirement required only the submission of GRE's invoices to importers, which GRE is capable of providing on its own and, in fact, voluntarily provided to the Commissioner. However, the statute requires, and DRS has insisted upon, the production of third-party excise tax forms and shipping records. GRE must, therefore, negotiate arrangements to obtain the importers' documents even if the importer does no business related to Connecticut. This is not the case, as in *Vizio*, where the state imposes a fee on a manufacturer doing business in Connecticut based on the manufacturer's nationwide market share.

In other words, the Commerce Clause violation in this case is not merely attributable to the fact that the Commissioner considers out-of-state activity in deciding whether GRE will remain on the Tobacco Directory. Rather, it is the fact that the Commissioner compels GRE's out-of-state importers and distributors to submit documentation of that activity and reconcile documentation of their

nationwide and out-of-state transactions that leads to a violation of the Commerce Clause. For this reason, *VIZIO* is distinguishable.

### **III. THE RECONCILIATION REQUIREMENT VIOLATES THE SUPREMACY CLAUSE**

The Supremacy Clause restricts the power of states to enact legislation that conflicts with federal law. U.S. Const. art. VI, cl. 2. A state law is preempted by federal law when there is an actual conflict between the two, which occurs when it is impossible for a private party to comply with both state and federal law. *See PLIVA, Inc. v. Mensing*, 564 U.S. 604, 618 (2011); *United States v. Locke*, 529 U.S. 89, 115 (2000). That is exactly the case here.

#### **A. GRE Cannot Comply With the PACT Act and the Reconciliation Requirement**

GRE alleged and argued below that the Reconciliation Requirement is preempted by the PACT Act because it is impossible to comply with both the federal and state requirements. JA111, ¶¶ 79-88. This is true for two independent reasons.

First, as discussed, it is impossible for GRE to reconcile nationwide sales of cigarettes of importers as reported on their federal excise tax returns with the total nationwide interstate sales reported by them under the PACT Act and intrastate

sales. *See supra* at 36-38. In other words, GRE's importers can fully comply with the PACT Act and file all necessary PACT Act reports, but GRE will still be in violation of the Reconciliation Requirement. This is therefore a case where the Reconciliation Requirement is preempted by the PACT Act because "state law penalizes what federal law requires." *In re Methyl Tertiary Butyl Ether (MTBE) Prods. Liab. Litig.*, 725 F.3d 65, 97 (2d Cir. 2013) (quoting *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 873 (2000)).

Second, the Reconciliation Requirements purports to rely on PACT Act reports in a manner that violates federal law. The PACT Act is clear that the reports submitted to tobacco tax administrators and chief law enforcement officers are to be used "solely for the purposes of the enforcement of [the PACT Act] and the collection of any taxes owed on related sales of cigarettes and smokeless tobacco." 15 U.S.C. § 376(c). The Commissioner is thus explicitly prohibited by statute from compelling the importers of GRE cigarettes to submit federal PACT Act reports as a condition to GRE remaining on the Tobacco Directory and determining GRE's compliance with the Directory Law.

Both of these arguments are further bolstered by the fact that Connecticut is regulating conduct at the outer reaches of its power. While courts generally

assume that state laws relating to a field the states have traditionally occupied are not preempted, that assumption does not apply when a state regulates in an area not typically within its powers. *See Locke*, 529 U.S. at 107-08; *N.Y. SMSA Ltd. P'ship v. Town of Clarkstown*, 612 F.3d 97, 104 (2d Cir. 2010). In this case, the Reconciliation Requirements has nationwide reach and applies to all sales of GRE cigarettes, regardless of any nexus to Connecticut.

**B. The District Court Erred in Dismissing the Supremacy Clause Claim**

As grounds for dismissing GRE's claim, the district court relied on the fact that GRE remained on the Tobacco Directory during the course of this litigation. JA126. That is irrelevant. GRE has only remained on the Tobacco Directory by explaining why it cannot possibly comply with the Reconciliation Requirement as drafted and by obtaining on a voluntary basis the confidential records of its importers—records which Connecticut is not entitled to receive under federal law. *See* JA103, ¶¶ 36-39. Accordingly, it was incorrect for the district court to conclude that GRE's placement on the Tobacco Directory necessarily defeats its claim of impossibility preemption.

#### **IV. GRE COMPLIED WITH THE RECONCILIATION REQUIREMENT**

In the event the Reconciliation Requirement was not set aside as unconstitutional, GRE sought a declaratory judgment that its explanations of the reasons for the discrepancy found under Reconciliation Requirement must be deemed satisfactory under the statute. JA113-14, ¶¶ 95-99.

The district court dismissed this request as moot. JA129. At the time GRE filed this lawsuit, the Commissioner took the position that GRE had failed to satisfactorily explain the discrepancy and therefore threatened to remove GRE from the Tobacco Directory. JA102 ¶ 34; JA105 ¶ 46. During the course of the litigation, the Commissioner reversed course and announced that it would not remove GRE from the Tobacco Directory. JA106, ¶ 54. But as GRE argued in the district court, the Commissioner's decision does not render GRE's declaratory judgment claim moot. On the contrary, there is little doubt that GRE remains subject to the same requirement each year, and each year is compelled under penalty of delisting to obtain and produce the subject tax returns and records of importers that import its products. Indeed, this is exactly the process that already twice unfolded with GRE's 2015 and 2016 annual certification. JA102, ¶ 34; JA107, ¶ 56. This is therefore a case where the subject of GRE's declaratory

judgment is “capable of repetition, yet evading review.” *Murphy v. Hunt*, 455 U.S. 478, 482 (1982) (internal quotation marks and citation omitted).

Moreover, the Commissioner reversed course only because of the voluminous confidential documents that GRE was able to obtain from its importers and produce to the Commissioner without prejudice and pursuant to a reservation of rights. The Commissioner’s continued demand for this production remains unconstitutional, as the Commissioner continues to insist that GRE obtain and produce such records during each annual certification period. GRE will therefore continue to be at the mercy of its third-party importers unless the requirement is either stricken as unconstitutional or GRE obtains declaratory relief that its explanation of the inevitable discrepancy is satisfactory under the statute, *i.e.* GRE cannot be compelled to reconcile importers’ federal tax returns with their federal PACT Act filings, under any discretionary standard adopted by the Commissioner.

The district court concluded that GRE’s request had “not evaded review” in light of the district court’s resolution of GRE’s constitutional claims. JA129. But this misses the entire point of GRE’s request for declaratory relief, which assumes that the Reconciliation Requirement is not struck down as unconstitutional. Simply put, there was no review of GRE’s request for a declaratory judgment that

assuming the provision is enforceable, GRE has complied. Accordingly, the district court erred in dismissing GRE's request for declaratory relief.

**CONCLUSION**

The decision of the district court dismissing GRE's claims should be reversed in its entirety.

Respectfully submitted,

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**CERTIFICATE OF COMPLIANCE**

The foregoing brief is in 14-point Times New Roman proportional font and contains 11,933 words as determined by Microsoft Word, excluding the parts of the brief exempted by Rule 32(f) of the Federal Rules of Appellate Procedure, and thus complies with the typeface, typestyle, and type-volume requirements set forth in Rule 32(a)(5)-(7)(B) of the Federal Rules of Appellate Procedure, as modified by Local Rule 32.

/s/ Erick M. Sandler  
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**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that on this 1<sup>st</sup> day of June, 2020, a copy of foregoing was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent by e-mail to all parties by operation of the Court's electronic filing system or by mail to anyone unable to accept electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the Court's CM/ECF System.

/s/ Erick M. Sandler

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