



## UPS Untaxed Cigarette Trafficking Liability: Increased Scrutiny on Tobacco Companies

*A U.S. district court held that UPS unlawfully transported untaxed cigarettes in the past and must pay damages to New York City and New York state, but determined that current compliance efforts are adequate.*

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In a March 24, 2017 opinion, Judge Katherine B. Forrest of the U.S. District Court for the Southern District of New York found United Parcel Service (UPS) to be liable to the plaintiffs—New York City and New York state—under state law prohibiting the trafficking of untaxed cigarettes, a 2005 settlement with the State, the federal Prevent All Cigarette Trafficking Act, and the federal Contraband Cigarettes

Trafficking Act. The bench trial in *The State of New York and the City of New York v. United Parcel Service, Inc.* lasted from Sept. 19 through Sept. 29, 2016. The trial included 38 witnesses and more than 1,000 documents.

### THE CASE AGAINST UPS

The gist of the plaintiffs' case was that UPS had delivered untaxed cigarettes to consumers. The shipments came from

Native American reservations, where purchases generally are not subject to state cigarette taxes. With those untaxed cigarettes, some shippers made remote sales to consumers (non-tribal members among them) throughout the state. UPS delivered these cigarettes, on which taxes were neither paid nor collected. This conduct had been investigated through much of the 2000s.

Among the various issues addressed in the opinion and order (UPS raised various defenses), the most central was UPS's knowledge of the activity. Each of the plaintiffs' claims "require[d] UPS's 'knowing' transport of cigarettes," specifically, "UPS's knowledge that certain shippers were tendering packages containing cigarettes, and that in the face of such knowledge, UPS nonetheless stood down in various ways, including by not probing further, not conducting audits, and ultimately agreeing to transport such packages." The court found the totality of the evidence to support a finding of UPS's knowledge.

Among other things, this evidence included:

- UPS's "past history with the shipper;"
- UPS's "knowledge of activity from [the shipper's] address;"
- shippers' inquiries to UPS about lost or damaged packages of cigarettes;
- shippers' identification in non-compliant lists maintained by the federal Bureau of Alcohol, Tobacco, and Firearms;
- a 2010 tobacco watchdog letter to UPS addressing known or suspected shippers of untaxed cigarettes;
- "The wares a shipper sold;"
- shippers' "signage;"
- a shipper's warehouse inventory, visible to UPS personnel;
- "the use of the terms 'cigar,' 'tobacco,' or 'cigarette' in a name or URL" of the shipper;
- a shipper's "use of multiple [UPS] accounts;"
- a shipper's "business acquisition or significant increase after the passage of the [Prevent All Cigarette Trafficking Act];"
- A shipper's "proximity to a reserva-

tion with a prior history of cigarette shipping;" and

- "high-volume shipments from residential addresses."

Although the court acknowledged that certain of these facts "were known only to one or a limited number of employees within UPS," "[a]s a corporate defendant, UPS acts only through its employees and agents." The court considered there to be circumstantial proof of these facts' widespread knowledge at UPS.

UPS's knowledge was also supported "through 'regulatory' imputation," a presumption of "knowledge of a regulatory violation if the means were present by which the company could have detected the infractions." Supporting this finding, according to the court, were UPS's rights to audit or to open packaging, its knowledge of certain "high risk" customers, its own tobacco policy (which "specifically prohibited shipments of cigarettes to consumers on a nationwide basis"), and its access to non-compliant lists.

The Court concluded that there was "no doubt that UPS could have and should have done more to identify shippers likely to be tendering cigarettes." None of UPS's defenses availing, the court entered judgment for the plaintiffs.

Not to be overlooked, UPS did successfully defend against a claim for injunctive relief. The plaintiffs had sought injunctive relief to appoint an independent monitor so as to prevent UPS from committing further violations. The court denied the claim. UPS's more-recent compliance efforts—namely, over the past two years—allayed any real concern justifying such an extraordinary remedy.

#### MORE TO COME IN THE CASE

At the time of the opinion and order's issuance, the court desired more information for its rulings on the damages and penalties to award to the plaintiffs. The parties have since provided the requested information, and they await a further ruling from the court. Additional post-trial motions might follow, and the parties will have the opportunity to pursue appeals should they wish to do so.

#### THE CASE'S DOWNSTREAM SIGNIFICANCE TO TOBACCO

Although UPS's compliance efforts came too late to avoid liability, the court's discussion provides a glimpse into the increased scrutiny UPS has focused on tobacco companies.

- Where UPS audits or inspections have uncovered shipments of tobacco products, UPS has terminated the shippers' accounts.
- UPS has "changed its account-opening process to increase screening of tobacco shippers in New York State."
- "Each account opened on an Indian reservation is investigated to determine if it might be shipping tobacco products."
- "Additionally, UPS monitors the volume of shipments from reservation-based shippers on a weekly

basis to identify red flags in volume patterns."

In light of the plaintiffs' claims and their successes at trial, one can certainly understand UPS "ramping up" its compliance efforts. Nonetheless, the result has been, effectively, to conscript UPS as a vigilant partner in law enforcement. The added scrutiny, meanwhile, affects tobacco firms who are compliant shippers and who still have accounts with UPS. Should UPS further ramp up scrutiny, such firms may be confronted with serious questions about how to ship at all. **S**

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#### UPS Tobacco Shipping Policy

Shipments containing tobacco or tobacco products, as those terms are variously defined under applicable state law ("Tobacco Product Shipments"), are accepted for transportation only from shippers who are licensed and authorized to ship tobacco and tobacco products pursuant to applicable laws. UPS does not provide pick-up service from any person or entity included in the Bureau of Alcohol, Tobacco, Firearms and Explosives PACT Act - Non-Compliant List. Tobacco Product Shipments shipped to a consumer will only be accepted for transportation as a contractual service.

However, because UPS prohibits shipments of cigarettes to consumers under any circumstances, UPS does not offer a contractual service for the delivery of cigarettes to consumers. To receive service for Tobacco Product Shipments shipped to a consumer, the shipper must sign and agree to the provisions set forth in an approved UPS agreement for the transportation of tobacco products. For all other service for Tobacco Product Shipments, the receiver must be licensed and authorized to receive tobacco or tobacco products pursuant to all applicable federal, state, provincial, or local laws or regulations, and the shipment must conform to the terms, conditions, restrictions, and prohibitions set forth at [www.ups.com/tobacco](http://www.ups.com/tobacco) at the time of shipping. It is the responsibility of the shipper to ensure that a shipment tendered to UPS, including a Tobacco Product Shipment, does not violate any federal, state, provincial, or local laws or regulations applicable to the shipment.

UPS reserves the right to refuse to accept, transport, or deliver any Tobacco Product Shipment that UPS, in its sole and unlimited discretion, determines does not comply with UPS requirements for the shipment or any applicable law or regulation, and to discontinue any or all service to any shipper for, among other reasons, tendering such a shipment. UPS reserves the right to dispose of any Tobacco Product Shipment that shippers are prohibited from shipping, that UPS is not authorized to accept, that UPS states that it will not accept, or that UPS has a right to refuse. —[ups.com/tobacco](http://ups.com/tobacco)