Indiana's Vapor Act:

An Unprecedented Reach, Overturned

In January 2017, a federal appeals court held that Indiana's Vapor Pens and E-Liquid Act unconstitutionally regulated out-of-state e-liquid manufacturers and warned about protectionist purposes.

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On May 12, 2015, Indiana passed a law known as the Vapor Pens and E-Liquid Act. Overall, it covered the manufacture and distribution of vapor pens and e-liquids with the intent of protecting public safety. But beyond what the title might suggest, the act also addressed the minutia of on-site security and manufacturing practices. Further, the act applied not only in Indiana, but it also reached out-of-state e-liquid manufacturers and distributors. Those out-of-staters were even required to consent to auditing by Indiana and, to that end, Indiana officials' inspection of their premises.

On January 30, 2017, the U.S. Court of Appeals for the Seventh Circuit held, in *Legato Vapors, LLC, et al. v. Cook, et al.*, that these security, manufacturing, and auditing laws were unconstitutional insofar as they applied to out-of-state manufacturers.

THE SEVENTH CIRCUIT'S DECISION

Spearheading the constitutional challenge were Legato Vapors, Rocky Mountain E Cigs, and Derb E Cigs. Each manufactures e-liquids outside of Indiana. They sued relevant Indiana officials and the State of Indiana in the U.S. District Court for the Southern District of Indiana, which upheld the Vapor Pens and E-Liquid Act. On appeal, the vapor manufacturers won, and the reasoning for the Seventh Circuit's decision is important.

The Seventh Circuit held that the Act's security, cleaning, and auditing laws—insofar as they reached out-of-state manufacturers—violated the U.S. Constitution's Commerce Clause. The particular doctrine, known as the Dormant Commerce Clause, prevents states from burdening or obstructing interstate trade. Here, the vapor manufacturers argued that the Vapor Pens and E-Liquid Act directly regulated out-of-state commercial activity. They also raised concerns that the Act might impose standards inconsistent with those of the manufacturers' home states. The State of Indiana countered that the Act regulated activity not entirely outside of Indiana and that the Act applied as equally to Indiana manufacturers as it did to the out-of-staters.

The Court characterized the Act's security laws as "extraordinary," "at least as applied to out-of-state manufacturers." Among them were requirements to:

- plan a specific facility design;
- enter into a five-year, renewable service agreement with a security firm meeting "astoundingly specific" qualifications;
- ensure that only authorized personnel could access areas where e-liquids were stored;
- have a remotely-monitored security system, a high-security key system, and twenty-four hour video surveillance; and
- keep samples from e-liquid batches for three years.

These laws violated the Commerce Clause "as extraterritorial legislation, governing the services and commer-

cial relationships between out-of-state manufacturers and their employees and contractors." Moreover, they raised concerns that such a manufacturer might confront an inconsistent duty to comply with different laws in its home state. All in all, "[w]ith two hundred years of Commerce Clause precedents to draw from," the Indiana parties "offered no authority supporting such extraterritorial legislation."

In an interesting aside from the Commerce Clause analysis, the Seventh Circuit spoke of the Act's favoritism for Indiana vapor manufacturers. "Before the Act went into effect, 90 percent of e-liquid revenue in Indiana came from e-liquids manufactured out-of-state." After, "only six manufacturers—compared to the more than one hundred selling in Indiana before the Act—supply e-liquids to Indiana retailers. Four of those six are in-state companies." Although not necessary as a basis for its decision, the Seventh Circuit stated in strong terms the "obvious concerns about protectionist purposes."

The Seventh Circuit next addressed the cleaning laws. They required vapor manufacturers to:

- plan a clean-room space, in which all mixing and bottling would occur, and
- clean and maintain cleaning equipment according to Indiana standards for commercial kitchens.

The referenced standards for commercial kitchens went so far as to detail the allowed "type of sinks and required cleaning equipment" as well as "types of cleansers and utensils used." As with the security laws, the cleaning laws directly regulated out-of-state manufacturers and threatened regulation inconsistent with that of the manufacturers' home states. This was unconstitutional.

Finishing up with the challenged laws, the Seventh Circuit addressed a "loose category of 'audits.'" They required vapor manufacturers to:

- consent to Indiana officials' entry into, and inspection of, their facilities for auditing purposes;
- consent to certain state and federal criminal background checks;
- prohibit vapor manufacturers from listing on a permit application anyone convicted of a felony or controlled-substance offense; and
- inform of each manufacturing facility's projected output.

Again, the Act impermissibly imposed direct regulations on out-of-state manufacturers, although the Court left room for other challenges to sampling or other inspection requirements "not relating as directly to manufacturing facilities and production processes."

Finally, the Court observed that the Act would even reach commercial transactions wholly outside of Indiana if products were to eventually reach the State for sale. This only confirmed the Act's unconstitutionality.

THE SIGNIFICANCE OF THE COURTS RULING OUTSIDE OF INDIANA

To be sure, the Seventh Circuit's decision is binding only in the federal courts of the three states composing it (Indiana, Illinois, and Wisconsin), and assuredly, out-of-state vapor manufacturers have much to celebrate if they wish to see their products sold in Indiana. On the whole, however, vapor manufacturers everywhere won an important victory.

The Seventh Circuit's decision is an important precedent. Other states will second-guess legislating to directly regulate out-of-state manufacturers. If they pass such legislation, it likely will be tested in court, and challengers will have a strong precedent on their side. The opinion twice refers to the Act's extraterritorial reach as "unprecedented" and four times describes its problems as "obvious." In addition, the Court's strong language against the Act's "protectionist purposes" is a welcome signal of the federal courts' concern over legislative efforts to treat out-of-state manufacturers unfairly. The well-reasoned analysis and strong holdings in Legato Vapors, LLC, et al. v. Cook, et al., likely would lead the decisions of other federal and state courts if similar laws are challenged.

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Indiana's Vapor Pens & E-Liquid Act: Nothing Else Like it Ever, Says Court

- "With almost two hundred years of precedents to consider, our review of prior dormant Commerce Clause decisions has not revealed a single appellate case permitting any direct regulation of out-of-state manufacturing processes and facilities comparable to the Indiana Act."
- "In remarkably specific provisions, [the Act] requires an applicant for a manufacturing permit to provide "verified documents" demonstrating that the "security firm has continuously employed" for not less than one year at least one employee certified by the Door and Hardware Institute and at least one employee certified as a Rolling Steel Fire Door Technician. The security firm must also have at least one year of commercial experience with "video surveillance system design and installation with remote viewing capability from a secure facility," owning and operating a security monitoring system with redundant offsite backup, and operating "a facility that modifies commercial hollow metal doors, frames, and borrowed lights with authorization to apply the Underwriters Laboratories label."
- "Another district court decision in Indiana recently found that only one company in the entire United States, located not so coincidentally in Indiana, satisfied the criteria of the Indiana Act and has the approval of the Indiana Alcohol and Tobacco Commission... In fact, prior to a [2016] amendment to the bill that became the Act, not even that favored company would have met the Act's requirements.
- "We don't need that much regulation to ensure safety. We don't do it for food, we don't do it for the coffee we all had this morning," said state Sen. Randy Head, R-Logansport, who is sponsoring an overhaul of the law. "The permitting process should be up to the government. We shouldn't relegate that to a private business."