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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

THE CITY OF NEW YORK,

Plaintiff,

-against-

MILHELM ATTEA & BROS., INC., DAY WHOLESALE, INC., GUTLOVE & SHIRVINT, INC., MAURO PENNISI, INC., JACOB KERN & SONS, INC., WINDWARD TOBACCO, INC. and CAPITAL CANDY COMPANY, INC.

Defendants.

Civil Action No. 06-CV-3620 (CBA)

MEMORANDUM OF LAW SUBMITTED BY DEFENDANT DAY WHOLESALE, INC. IN SUPPORT OF ITS MOTION TO DISMISS PURSUANT TO RULE 12 (B) OF THE FEDERAL RULES OF CIVIL PROCEDURE

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PRELIMINARY STATEMENT

Since 1939, the State of New York (the "State") has authorized the collection of excise taxes on cigarettes sold at retail in the State, but has exercised no authority to collect these taxes from "reservation sellers."[1] L. 1939, c. 940. Starting with Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation, 425 U.S. 463, 483 (1976), the United States Supreme Court has reaffirmed in a series of cases that states may collect these "concededly lawful taxes" on reservation sales to non-Indians. Despite these rulings, the State has adhered to a policy of forbearance, permitting the sale of unstamped cigarettes from reservation sellers.

Political and legal debates have surrounded the State's long-standing policy of forbearance. The State has explored several legislative and administrative proposals requiring the pre-collection of cigarette taxes on reservation sales to non-Indians. These controversial proposals have sometimes polarized elected officials within the State, strained relationships between the State and tribal nations, and lead to civil unrest.

Political and public policy debates cannot be resolved in the courts. Yet, in the last year, Day Wholesale, Inc. ("Day Wholesale") and other State stamping agents have been placed in the middle of this political and legal debate. In 2006, two lawsuits filed in state courts challenged the State's current policy of forbearance and named Day Wholesale and others as respondents. These state lawsuits were properly dismissed on threshold issues.

After the Department of Taxation and Finance ("Tax Department") issued an advisory opinion reaffirming the State's long-standing policy of forbearance, Day Wholesale sought further clarification of its legal tax obligations by commencing a State action for declaratory

[1] A "reservation seller" is defined as an Indian tribe or nation, one or more members of such tribe, or an entity wholly owned by either or both, which operates a retail cigarette business within the boundaries of a qualified reservation. N.Y. Tax Law § 470 (17).

judgment. In response, the State Supreme Court has enjoined the State from pre-collecting cigarette taxes from reservation sellers until the State has taken the necessary administrative steps to implement its legislative initiatives.

Although Day Wholesale has conducted its wholesale business in accordance with State laws and policies, it finds itself a party to yet another frivolous lawsuit. Without constitutional, statutory, or regulatory authority, the City of New York (the "City") has chosen to ignore all state court precedence and has turned to the federal courts for relief. By exploiting local federal rules that permit discovery prior to joinder of issue, a practice not permitted in state courts, the City has achieved its primary objective – the opportunity to review the business records of state stamping agents.

This memorandum of law is submitted in support of Day Wholesale's motion to dismiss. The grounds for this motion includes the City's lack of capacity and standing to sue state agents who act in accordance with State laws and policies (Points I and II, respectively), its failure to join the State as a necessary and indispensable party to these proceedings (Point III), its failure to state a claim or raise a federal question necessary to invoke the Court' subject matter jurisdiction (Point IV), and its failure to state any other cognizable statutory or common law claims under state law (Point V). For the reasons stated below, Day Wholesale requests an Order dismissing the City's amended complaint with prejudice.

STATEMENT OF FACTS

Defendants, Day Wholesale, Milhelm Attea & Bros., Inc. ("Milhelm Attea"), Gutlove & Shirvint, Inc., Mauro Pennisi, Inc., Jacob Kern & Sons, Inc., Windward Tobacco, Inc. and Capital Candy Company, Inc. ("Capital Candy") (collectively, "Defendants"), are licensed

wholesale cigarette dealers. (Am. Compl. ¶ 2). With the exception of Capital Candy, each defendant is a domestic corporation organized and existing under the laws of the State of New York. (Am. Compl. ¶¶ 8 -13). Capital Candy is a Vermont corporation, but is authorized to do business in the State of New York. (Am. Compl. ¶ 14).

Pursuant to New York Tax Law § 472, the State Tax Department has designated and appointed Defendants as state agents to pre-collect state cigarette taxes and to affix tax stamps on cigarettes sold at retail in the State. (Am. Compl. ¶ 2, ¶¶ 8-14). As licensed state agents, Defendants are permitted to sell tax-stamped cigarettes and other tobacco products to licensed New York wholesalers and registered New York retailers. (Am. Compl. ¶ 18). Defendants also sell unstamped cigarettes to reservation sellers who re-sell these unstamped cigarettes to State residents, including City residents. (Am. Compl. ¶¶29, 31-35, 38-43, 50).

The City is a municipal corporation organized under the laws of the State of New York (the "State"). (Am. Compl. ¶ 7). As authorized by State law, the City imposes its own local excise tax on all cigarettes sold or used in its municipal boundaries. (Am. Compl. ¶ 17). State and local cigarette taxes constitute as much as half of the retail price of cigarettes sold in the City. (Am. Compl. ¶¶ 3, 22). The combined State and local taxes, including excise, sales and compensating use taxes, for cigarettes sold or used in the City total $33.30 per carton. (Am. Compl. ¶ 17).

In its Amended Complaint, the City seeks to enjoin Defendants from selling, transporting, distributing and shipping unstamped cigarettes to reservation sellers. (Am. Compl. ¶1). The City contends that large quantities of unstamped cigarettes purchased by City residents from reservation sellers result in "enormous tax loss for the City." (Am. Compl. ¶ 44). The City has acknowledged however, that the Amended Complaint is "not at all premised on the non-

collection of City taxes, or on the Administrative Code, but on violation of ***State*** law." (Letter from Proshansky to Judge Amon of 3/26/07, at 5-6). (Am. Compl. ¶¶ 49-65).

RELEVANT LEGAL AUTHORITY

A. State Cigarette Taxes

The New York State Constitution reserves to the State Legislature the exclusive power to tax. N.Y. Const. art. III, § 22; N.Y. Const. art. XVI, §1. U.S. Steel Corp. v. Gerosa, 7 N.Y.2d 454, 459, 166 N.E.2d 489, 491, 199 N.Y.S.2d 475, 478 (1960); Sonmax, Inc. v. City of New York, 43 N.Y.2d 253, 257, 372 N.E.2d 9, 11, 401 N.Y.S.2d 173, 175 (1977). Article III, § 22 of the State Constitution states that "[e]very law which imposes, continues or revives a tax shall distinctly state the tax and the object to which it is to be applied." The State's power of taxation, therefore, includes the power to determine the class of persons to be taxed, the object to be taxed, and the method of tax collection. Accord Gerosa, 7 N.Y.2d at 459, 166 N.E.2d at 491, 199 N.Y.S.2d at 478.

The State Legislature has authorized the collection of taxes on cigarettes sold at retail or used in the State. State cigarette taxes include sale excise and use excise taxes collected pursuant to Article 20, §§ 471 and 471-a of the New York Tax Law and sales and compensating use taxes collected pursuant to Article 28, §§ 1105 and 1110 of the Tax Law. State stamping agents pre-collect cigarette taxes by purchasing and affixing tax stamps on cigarettes to be sold at retail in the State pursuant to Tax Law § 471 (2) and §1111(h). Although these state excise and sales taxes are pre-collected by state stamping agents prior to any retail sale in the State, consumers are ultimately responsible for the payment of these state cigarette taxes. N.Y. Tax Law § 471 (2).

Cigarettes purchased outside of the State, but used in the State are also subject to state excise and use taxes pursuant to §§ 471-a and 1110. Even though State tax stamps are not affixed to cigarettes purchased outside of the State, if these cigarettes are intended to be used in the State, consumers have 24 hours to report and remit the excise and use taxes to the State Tax Department. N.Y. Tax Law §§ 471-a, 1111 (h). Notwithstanding these provisions, consumers are authorized under State law to possess and use a limited number of unstamped cigarettes in the State without tax liability. The State does not require the reporting or collection of cigarette taxes on two or less cartons of unstamped cigarettes brought into the State and possessed by a consumer. N.Y. Tax Law §§471-a. Consumers, however, must report and remit taxes on cigarettes possessed in excess of this two-carton limit. 20 N.Y.C.R.R. § 75.3.

As an agent for the Tax Department, Day Wholesale is required to file monthly tax reports that account for affixed and unaffixed tax stamps and for the sale and distribution of unstamped and stamped cigarettes. N.Y. Tax Law § 475; 20 N.Y.C.R.R. § 75.1. On forms provided by the Tax Departments, Day Wholesale accounts for all cigarette sales and other transactions from the previous month including: (1) sales of unstamped cigarettes to agencies of the United States; (2) sales of unstamped cigarettes to persons or business locations outside of the State; (3) sales of unstamped cigarettes to persons located within the State, and (4) sales of unstamped cigarettes to dealers/vendors on Indian reservations or territories located within the State. 20 N.Y.C.R.R. § 75.1. In its Amended Complaint, the City does not (and could not) allege that Day Wholesale or the other Defendants have failed to file these monthly reports. Failure to file monthly reports is a ground for revoking an agent's license. N.Y. Tax Law § § 472 (1), 480 (3) (a) (ii); 20 N.Y.C.R.R. § 76.3.

The State's power to collect state cigarette taxes is not without limits. The State's tax laws and regulations specifically provide that "no tax shall be imposed on cigarettes sold under such circumstances that this state is without power to impose such tax. . . ." See, e.g., N.Y. Tax Law §§ 471, 471-b, 1116; N.Y. Unconsol. Law § 9436; 20 N.Y.C.R.R. § 76.1. Regulations adopted by the State Tax Department set forth some, but not all, areas exempted from state taxation.

Article 20, Part 76 of the New York Codes of Rules and Regulations sets forth the general exemption for "circumstances that the State is without the power to tax" and four specific exemptions. 20 N.Y.C.R.R. §§ 76.1 (general exemption), 76.2 (sales to governmental entities), 76.3 (out-of-state sales), 76.4 (diplomatic sales), 76.5 (sales to the United Nation). These specific exemptions illustrate the State's jurisdictional limitations on its power to tax.

The United States Constitution also limits the State's power of taxation.

> The Constitution of the United States prohibits any state from imposing a tax which directly burdens or unduly impedes interstate or foreign commerce and from attempting to impose a tax on any person, property or privilege which is not within such state's jurisdiction. While it is axiomatic that New York State is without power to impose the cigarette tax under any such circumstances, a licensed cigarette agent may, pursuant to this section, sell cigarettes upon which the tax has not been prepaid and precollected but which are within this State's taxing authority to out-of-state purchasers without incurring any tax liability pursuant to article 20 of the Tax Law.

20 N.Y.C.R.R. § 76.3. Consequently, state stamping agents may sell unstamped cigarettes at wholesale if these cigarettes are intended for resale and use in another state.

The federal constitution places other limits on the State's authority to collect state taxes. For example, an out-of-state retailer who has no physical presence within a state, but who merely ships goods by a common carrier or by mail to state residents cannot be required under State law to collect or remit state taxes. Quill Corp. v. North Dakota, 504 U.S. 298, 309-12 (1992). The

State also lacks the authority to impose or collect state taxes on tribal land, income earned on tribal land or on reservation sales to tribal members. McClanahan v. State Tax Comm'n, 411 U.S. 164, 181 (1973) ("the State is totally lacking in jurisdiction over both the people and the lands it seeks to tax. In such a situation, the State has no more jurisdiction to reach income generated on reservation lands than to tax the land itself."); Dep't of Taxation and Finance v. Milhelm Attea & Bros., Inc., 512 U.S. 61 (1994) (enrolled tribal members who purchase cigarettes on Indian reservations are exempt from state cigarette taxes). On the other hand, reservation sales to non-Indians are generally not subject to this constitutional limitation. Id.

1. Reservation sales to non-Indians

In 1976, the United States Supreme Court first ruled that states could impose a "minimal burden" on reservation sellers to collect state cigarette taxes attributable to on-reservation sales to non-Indians. Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation, 425 U.S. 463, 483 (1976). The Court observed that:

> the competitive advantage which the Indian seller doing business on tribal land enjoys over all other cigarette retailers, within and without the reservation, is dependent on the extent to which the non-Indian purchaser is willing to flout his legal obligation to pay the tax. Without the simple expedient of having the retailer collect the sales tax from non-Indian purchasers, it is clear that wholesale violations of the law by the latter class will go virtually unchecked.

Id. at 482. The Court, therefore, concluded that the State's interest in collecting "a concededly lawful tax" imposed on non-Indian taxpayers justified the "minimal burden" place on reservation sellers. Id. at 483. The Court reiterated this same view four years later in Washington v. Confederated Tribes of Colville Indian Reservation, 447 U.S. 134 (1980).

Fifteen years after the Moe decision, the Supreme Court acknowledged the conflict between the doctrine of tribal sovereign immunity and its holdings in Moe and Colville. Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe of Oklahoma, 498 U.S. 505

(1991). The doctrine of tribal sovereign immunity does not preclude the state from imposing its taxes on reservation sales to non-Indians. Id. at 512. Tribal immunity, however, bars the State from suing tribal retailers to enforce these tax assessments. Id. at 514.

> Congress has always been at liberty to dispense with such tribal immunity or to limit it. Although Congress has occasionally authorized limited classes of suits against Indian tribes, it has never authorized suits to enforce tax assessments. Instead, Congress has consistently reiterated its approval of the immunity doctrine. See, *e.g.,* Indian Financing Act of 1974, 88 Stat. 77, 25 U.S.C. § 1451 *et seq.,* and the Indian Self-Determination and Education Assistance Act, 88 Stat. 2203, 25 U.S.C. § 450 *et seq.* These Acts reflect Congress' desire to promote the "goal of Indian self-government, including its 'overriding goal' of encouraging tribal self-sufficiency and economic development." California v. Cabazon Band of Mission Indians, 480 U.S. 202, 216 . . . (1987). Under these circumstances, we are not disposed to modify the long-established principle of tribal sovereign immunity.

Id. at 510. Accord New York Ass'n of Convenience Stores v. Urbach, 181 Misc. 2d 589, 694 N.Y.S.2d 885 (Sup. Ct. 1999) ("Indian tribes have immunity from suit and cannot be sued to accomplish tax collection. This immunity extends to tribal retailers."), aff'd, 275 A.D.2d 520, 712 N.Y.S.2d 220 (3d Dept.) ("The record here . . . makes plain that the statutes cannot effectively be enforced without the cooperation of the Indian tribes. Because of tribal immunity, the retailers cannot be sued for their failure to collect the taxes in question, and State auditors cannot go on the reservations to examine the retailers' records."), appeal dismissed, 95 N.Y.2d 931, 744 N.E.2d 142, 721 N.Y.S.2d 606 (2000), appeal denied, 96 N.Y.2d 717, 756 N.E.2d 78, 730 N.Y.S.2d 790, cert. denied, 534 U.S. 1056 (2001).

Although tribal immunity bars a state from seeking its "most efficient remedy," the Court in Potawatomi was not persuaded that states lack "any adequate alternatives." Potawatomi, 498 U.S. at 514. The Court posed three viable means to enforce these state tax obligations. Id. First, the State could direct wholesalers to pre-collect these cigarette taxes from reservation sellers

during the wholesale transaction. Id. Second, the State could conduct off-reservation seizures of unstamped cigarettes being shipped to reservations sellers. Id. Finally, the State and tribal nations could enter into tax compacts that set forth a mutually acceptable regime for the tax collection. Id.

In 1988, the State Tax Department promulgated tax regulations requiring the collection of cigarettes taxes on reservation sales to non-Indians (the "1988 Regulations"). The adoption of the 1988 Regulations was the first time that the State ever asserted taxing authority over reservation sales. The Tax Department, however, was precluded from implementing the 1988 Regulations during the pendency of the litigation that culminated in an appeal to the United States Supreme Court in Dept. of Taxation and Finance v. Milhelm Attea & Bros., Inc., 512 U.S. 61 (1994).

In Attea, the Supreme Court specifically stated that its review was "limited by the nature of [the] challenge." Id. at 69. Milhelm Attea, who is one of the defendants in this case, brought a facial challenge to the 1988 Regulations on the grounds of federal pre-exemption. Id. at 64.

> Their claim is that the New York scheme interferes with their federally protected activities as Indian traders who sell goods at wholesale to reservation Indians. While the effect of the New York scheme on Indian retailers and consumers may be relevant to that inquiry, [cite omitted] this case ***does not require us to assess for all purposes each feature of New York's tax enforcement scheme that might affect tribal self-government or federal authority over Indian affairs.*** Here we confront the narrower question whether the New York scheme is inconsistent with the Indian Trader Statutes.

Id. at 69-70 (emphasis added). The Court found that the 1988 Regulations were not pre-exempted, on their face, by the Indian Trader Statutes. Id. at 78. The Court expressly cautioned the State that it could not unreasonably restrict wholesale shipment of cigarettes to reservation sellers who have the right to acquire and possess "sufficiently generous" quantities of tax-free

cigarettes for tax-exempt sales. Id. at 69, 75-76. The Supreme Court warned that underestimating "the legitimate demand for tax-free cigarettes" could "provide the basis for a future challenge to the *application* of the regulations." Id. at 75 -76.

In New York, the Attea case raised as many legal and political questions as it resolved. A mere three years after the Attea decision was decided, former Governor George Pataki stated that "[v]arious Supreme Court and other court rulings have only added to the confusion and polarized entire communities." (Murphy Aff. ¶ 10, Ex. H). On May 22, 1997, Governor George Pataki announced his decision to repeal these tax regulations.

2. State's policy of forbearance

Since the repeal of the 1988 Regulations, the State has failed to take the necessary steps to legally assert its authority to collect cigarette taxes on reservation sales to non-Indians. Instead, the State Tax Department has continued to follow "a long-standing policy of allowing untaxed cigarettes to be sold from licensed stamping agents to recognized Indian Nations and reservation-based retailers making sales from qualified Indian reservations." Advisory Opinion TSB-A-06(2)(M) (Murphy Aff. ¶ 4, Ex. B).

In 2005, the State Legislature enacted amendments to Articles 20 and 28 of the New York Tax Law requiring the pre-collection of taxes on all sales to non-Indians made on qualified reservations ("2005 Tax Amendments"). L. 2005, c. 61, pt. K, as amended by L. 2005, c. 63, pt. A. The 2005 Tax Amendments only authorized the collection of state cigarette taxes on reservation sales to non-Indians. Id. Although duly enacted, the 2005 Tax Amendments have not taken effect pursuant to terms of the legislation. Day Wholesale, Inc. v. State, Index No. 2006-7668, Mem. Decision (N.Y. Sup. Ct., Erie Co. filed Jan. 2, 2007) (Murphy Aff. ¶ 7, Ex. E).

In adopting the 2005 Tax Amendments, the State Legislature inserted the following relevant language:

> This act shall take effect March 1, 2006, ***provided that*** any actions, rules and regulations necessary to implement the provisions of this act on its effective date are authorized and directed to be complete on or before such date.

L. 2005, c. 61, pt. K, § 7, as amended by L. 2005, c. 63, pt. A, § 4 (emphasis added). The Tax Department has publicly stated that, despite the 2005 Tax Amendments, it "has no intention to alter its long-standing policy" that permits state stamping agents to sell unstamped cigarettes to reservation sellers. Advisory Opinion TSB-A-06(2)(M). Currently, a State Supreme Court has preliminarily enjoined the State from enforcing the 2005 Tax Amendments:

> until such time as the New York State Department of Taxation and Finance (the "Tax Department") has adopted the necessary rules and regulations to implement the Indian Tax Exemption Coupon System; and has distributed Indian tax exemption coupons to the recognized governing bodies of the Cayuga Indian Nation of New York, Oneida Indian Nation of New York, Onondaga Nation of Indians, Poospatuck or Unkechauge Nation, St. Regis Mohawk, Seneca Nation of Indians, Shinnecock Tribe, Tonawanda Band of Seneca Indians, Tuscarora Nation of Indians.

Day Wholesale, Inc. v. State, Index No. 2006-7668, Order (N.Y. Sup. Ct., Erie Co. filed Feb. 20, 2007) (Murphy Aff ¶ 8, Ex. F). To this date, the State has not issued Indian tax exemption coupons or begun the rulemaking process.

Although the State has both a new governor and new attorney general, this "long-standing policy" has not changed. In a recent lawsuit filed on February 5, 2007, the State's new Attorney General, Andrew Cuomo, asserted in a complaint that the State does "not tax sales of cigarettes (and certain other commodities) from Native American lands" based on a "policy of recognizing the sovereignty" of Indian Nations. See State v. Philip Morris Inc., Index No. 400440/07, Compl. (N.Y. Sup. Ct., N.Y. Co. filed Feb. 5, 2007) (Murphy Aff. ¶ 9, Ex. G). The complaint further suggests that the collection of cigarette taxes from such sales would alter "the

relationship between the State of New York and Native American Tribes in New York." (Murphy Aff. ¶ 9, Ex. G, ¶ 8).

In an administrative decision issued by the State Division of Tax Appeals, the policy of forbearance has been described as a "political decision by the State to cease its attempts to enforce the collection of tobacco product and motor fuel excise and sales taxes connected to sales of such commodities by Indian retailer to non-Indian consumers,' based upon its fears of violence and public unrest." In the Matter of the Petition of John H. Davis, DTA No. 820262, 2006 WL 2106182 (N.Y. Div. Tax Appeals July 20, 2006). This action is only one in a series of legal challenges seeking to overturn the State's "political decision" by compelling the pre-collection of state taxes on cigarettes sold on Indian reservation to non-Indians. Urbach, 181 Misc. 2d 589, 694 N.Y.S.2d 885 (Sup. Ct., Albany Co. 1999), aff'd, 275 A.D.2d 520, 712 N.Y.S.2d 220 (3d Dep't 2000); County of Seneca v. Eristoff, Index No. 3172-06, slip op. (N.Y. Sup. Ct., Albany Co. Nov. 16, 2006) (Murphy Aff. ¶ 5, Ex. C); New York Ass'n of Convenience Stores v. Pataki, Index No. 2915-06, slip. op. (N.Y. Sup. Ct., Albany Co. Nov. 17, 2006) (Murphy Aff. ¶ 6, Ex. D). In its Amended Complaint, the City has stated that the sales of unstamped cigarettes to reservation sellers have "been the subject of numerous litigation in which some or all of the defendants have been made parties." (Am. Compl. ¶ 33). The Amended Complaint, however, fails to mention that these prior actions, brought in State courts, have been unsuccessful.

In New York Ass'n of Convenience Stores v. Urbach, a trade association of in-state retailers brought an Article 78 proceeding seeking a judgment based on mandamus to compel the State Tax Commissioner and the Tax Department to determine, assess, collect and enforce the cigarette and motor fuel taxes pertaining to reservation sales to non-Indians. 81 Misc. 2d at 590,

694 N.Y.S.2d at 886-87. The trade association alleged that the State had failed to enforce its tax laws and regulations against reservation sellers who sold unstamped cigarettes to non-Indians. Id. It claimed that the failure to enforce these tax laws and regulations caused them to suffer economic injury by diminishing their ability to compete with reservation sellers. Id. It further alleged that the State's failure to collect these taxes deprived the State and its taxpayers of substantial public revenue. New York Ass'n of Convenience Stores v. Urbach, 169 Misc. 2d 906, 908, 646 N.Y.S.2d 918, 920 (Sup. Ct., Albany Co. 1996).

The State Supreme Court first denied the State's motion to dismiss. New York Ass'n of Convenience Stores v. Urbach, 170 Misc. 2d 445, 648 N.Y.S.2d 890 (Sup. Ct., Albany Co. 1996). On appeal, the State Appellate Division, with two Justices dissenting, concluded that the petitioners had established that the State's failure to enforce these tax laws and regulations constituted discriminatory tax enforcement based on race in violation of the Equal Protection Clause. New York Ass'n of Convenience Stores v. Urbach, 230 A.D.2d 338, 344, 658 N.Y.S.2d 468, 472 (3d Dep't 1997). The New York Court of Appeals, however, remanded the matter to the trial court for further record development after the State repealed the 1988 Regulations in favor of a policy that amounted to "withholding active enforcement on a long-term basis." Urbach, 92 N.Y. 2d 204, 214, 699 N.E.2d 904, 909, 677 N.Y.S.2d 280, 285 (1998)

On remand, both the State Supreme Court and the Appellate Division applied the rational basis standard of review that the Court of Appeals had found applicable to the State's actions, and held that the Tax Department's long-term policy of forbearance was rational. Urbach, 181 Misc. 2d at 594, 694 N.Y.S.2d at 889, aff'd, 275 A.D.2d at 522-23, 712 N.Y.S.2d at 222. The State Supreme Court found that the remedy of mandamus did not lie because the State

maintained discretion in its manner of enforcing the tax laws considering the unique circumstances involved in dealing with Indian nations or tribes. Such discretion was based upon:

> a recognition by the Court of Appeals that there are circumstances under which there can be a rational basis for even a "long-term" policy of nonenforcement. . . . If this Court were to grant the requested relief in the circumstances here presented, the Court, in violation of familiar principle, would wrongfully substitute its judgment for that of the Respondents who are charged with the obligation of administering the tax laws of this State. Moreover, even if the Petitioners were to possess a strict right to the relief of mandamus, such relief should not be granted if, as has been here shown, the granting of the relief would cause public disorder. . . .

181 Misc. 2d at 594, 694 N.Y.S.2d at 889.

In affirming this decision, the Appellate Division similarly reasoned that the State's policy of forbearance was rational because:

> The record here . . . makes plain that the statutes cannot effectively be enforced without the cooperation of the Indian tribes. Because of tribal immunity, the retailers cannot be sued for their failure to collect the taxes in question, and State auditors cannot go on the reservations to examine the retailers' records.
>
> Additionally, the Department cannot compel the retailers to attend audits off the reservations or compel production of their books and records for the purpose of assessing taxes. In that regard, representatives of the Department engaged in extensive negotiations with the tribes in an effort to arrive at an acceptable agreement. Those efforts were largely unsuccessful and the vast majority of the Indian retailers refused to register with the Department. In further efforts to enforce the statute, the State attempted interdiction, i.e., interception of tobacco and motor fuel shipments and seizure of those shipments that were found to be in noncompliance with the Tax Law. That strategy resulted in civil unrest, personal injuries and significant interference with public transportation on the State highways. In our view, all of these factors provide a rational basis for the differential treatment of the parties and we, therefore, affirm the judgment of Supreme Court.

275 A.D.2d at 522-23, 712 N.Y.S.2d at 222. Once this determination was made, both the New York Court of Appeals and the United States Supreme Court rejected petitions to hear any further appeals on the matter. Urbach, 275 A.D.2d 520, 712 N.Y.S.2d 220, appeal dismissed, 95

N.Y.2d 931, 744 N.E.2d 142, 721 N.Y.S.2d 606 (2000), appeal denied, 96 N.Y.2d 717, 756 N.E.2d 78, 730 N.Y.S.2d 790, cert. denied, 534 U.S. 1056 (2001).

In 2006, this same trade association brought another Article 78 proceeding against the State seeking mandamus to compel the Tax Department to collect taxes on reservation sales to non-Indians. Pataki, Index No. 2915-06, slip. op. at 3. In that proceeding, four of the seven Defendants in this lawsuit were named as respondents. Id. at 2. The State Supreme Court dismissed the petition on the grounds that the petitioners' economic and competitive injuries were not within the zone of interest protected by the State's tax laws, which allowed them to assert standing. Id. at 11.

In a recent similar case, the County of Seneca brought an Article 78 proceeding seeking mandamus to compel the State Tax Commissioner and stamping agents to enforce Articles 20 and 29 of the Tax Law. Eristoff, Index No. 3172-06, slip op. at 2. Again, four of the seven Defendants in this lawsuit were named as respondents. The County sought to challenge the long-standing policy that does not apply or enforce these tax provisions to sales made to non-Indians on tribal lands. Id. Similar to the allegation in this case, the County asserted that sales of unstamped cigarettes from Indian reservations deprived the County of local sales tax revenues. The State Supreme Court rejected these allegations in rulling that the County did not have the capacity to maintain the proceedings and dismissed the petition against all respondents.

B. Local Cigarettes Taxes

A municipal corporation does not possess the inherent power to assess and levy taxes. Society of Plastics Indus. Inc. v. City of New York, 68 Misc. 2d 366, 371, 326 N.Y.S.2d 788, 793-94 (Sup. Ct., N.Y. Co. 1971), citing, County Securities v. Seacord, 278 N.Y. 34, 15 N.E.2d 179 (1938). Its power to tax is derived solely from State legislative enactment that specifically

designates the tax that can be imposed. Id.; N.Y. Const. art. XVI, §1 ("Any laws which delegate the taxing power shall specify the types of taxes which may be imposed thereunder and provide for their review."). See also Gerosa, 7 N.Y.2d at 459, 166 N.E.2d at 491, 199 N.Y.S.2d at 478. In Gerosa, the New York Court of Appeals stated that:

> the State Legislature has the exclusive power to tax, including the power to determine the class of persons to be taxed (citations omitted) which it may delegate to its municipal subdivisions, including the City of New York. But any taxes imposed by the latter must be within the expressed limitations (citation omitted) and unless authorized, a tax so levied is constitutionally invalid (citation omitted).

Id.

The State Legislature has enacted legislation that permits the City to impose its own local excise, sales and use taxes on cigarettes sold at retail from a City vendor or used in the City by a consumer. N.Y. Unconsol. Law § 9436

> (1) Notwithstanding any other provision of law to the contrary, any city of the state having a population of one million or more inhabitants, acting through its local legislative body, is hereby authorized and empowered to adopt and amend local laws imposing in any such city taxes on cigarettes, cigars or smoking tobacco such as the legislature has or would have power and authority to impose . . . . The taxes may be imposed on the use, sale, exchange, transfer, storage, withdrawal, possession or retention of cigarettes, cigars or smoking tobacco, provided, however, that nothing in this act shall authorize the imposition of a tax on the use, possession or retention (otherwise than for sale) of two hundred cigarettes or less, of fifty cigars or less or of two pounds of smoking tobacco or less brought into the city on, or in possession of, any person. . . .
>
> (3) A tax imposed hereunder shall have application only within the territorial limits of any such city and shall be in addition to any and all other taxes. The method of collecting any tax imposed hereunder, either with or without adhesive or meter stamps, shall be subject to the approval of the state tax commission[2].

Id.; see, also, N.Y.C. Admin. Code § 11-1302.

[2] The State Tax Commission "in all matters pertaining to the administration of the division of tax appeals, means the tax appeals tribunal and in all other matters means the commissioner of taxation and finance." N.Y. Tax Law § 2. The reference used in this quotation means the Tax Commissioner.

Consistent with this State enabling legislation, the New York City Administrative Code only requires stamping agents to affix State/City joint tax stamps to cigarettes "prior to delivery of such cigarettes ***to any dealer in the city***." N.Y.C. Admin. Code § 11-1305 (a) (emphasis added). In its Amended Complaint, the City does not accuse Defendants of failing to affix joint tax stamps on cigarettes sold to City retailers. The Amended Complaint only alleges that Defendants have failed to affix tax stamps to cigarettes sold to reservation sellers. (Am. Compl. ¶¶ 29, 34, 41, 42, 44, 50). The Court can take judicial notice of the fact that there are no Indian reservations or territories within the City's borders. Consequently, the City has not alleged that any Defendant has committed a single act in violation of its Administrative Code.

STANDARD OF REVIEW

The standard of review for a motion to dismiss is the same in both federal and state courts. In considering a motion to dismiss, a court must presume that all well-pleaded allegations are true, resolve all doubts and inferences in the plaintiff's favor, and view the pleadings in the light most favorable to the non-moving party. Gryl ex rel. Shire Pharms., Group PLC v. Shire Pharms. Group PLC, 298 F.3d 136, 140 (2d Cir. 2002); Conley v. Gibson, 355 U.S. 41, 45-46 (1957) ("a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief"). Accord Leon v. Martinez, 84 N.Y.2d 83, 87-88, 683 N.E.2d 511, 513, 614 N.Y.S.2d 972, 974 (1994).

Day Wholesale's motion to dismiss focuses on issues of State tax laws and policies, issues that are at the crux of the City's Amended Complaint. Although the City could have brought their Amended Complaint in the State Supreme Court, it chose to bring its claims before

the United States District Court. State courts have reviewed and dismissed at the pleading stage similar claims involving these same state law issues. The City cannot avoid the holdings of these state cases by seeking relief in a federal court. Under the Erie Doctrine, this Court must apply the State's common law when the interpretation of state statutes is at issue.

ARGUMENT

POINT I

THE CITY LACKS THE CAPACITY TO SUE STATE AGENTS WHO ACT IN ACCORDANCE WITH STATE POLICY

Before reaching the merits of the City's claims, the Court must first determine the threshold issue of capacity. The capacity to sue is a state law issue. Yonkers Comm'n on Human Rights v. City of Yonkers, 654 F. Supp. 544, 551 (S.D.N.Y. 1987). Under FRCP Rule 17 (b), "[t]he capacity of a corporation to sue or be sued shall be determined by the law under which it was organized." Because the City is "a municipal corporation organized under the laws of the State of New York," the laws of the State will determine the City's capacity to sue the State in a federal court. (Am. Compl. ¶ 7).

As a general rule, municipal corporations, as political subdivisions of the State, cannot contest the actions of the State which affect them in their governmental capacity or as representatives of their inhabitants. County of Oswego v. Travis, 16 A.D.3d 733, 735, 791 N.Y.S. 2d 189, 192 (3d Dep't 2005), citing, City of New York v. State, 86 N.Y.2d 286, 289-90, 655 N.E.2d 649, 651, 631 N.Y.S.2d 553, 555 (1995); see also Town of Riverhead v. New York State Board of Real Prop. Servs., 7 A.D.3d 934, 935, 777 N.Y.S.2d 533, 534-35 (3d. Dep't 2004), aff'd, 5 N.Y.3d 36, 832 N.E.2d 1169, 799 N.Y.S.2d 753 (2005). This limitation stems from the political relationship between the State and these political subdivisions. City of New

York v. State, 86 N.Y.2d at 289-90, 655 N.E.2d at 651, 631 N.Y.S.2d at 555. Local governments are created to carry out the governmental powers and duties of the State subject to the State's direction and control. Id. The New York Court Appeals has opined:

> [t]he lack of capacity of municipalities to sue the State is a necessary outgrowth of separation of powers doctrine: it expresses the extreme reluctance of courts to intrude in the political relationship between the Legislature, the State and its governmental subdivisions.

Id. at 295-96, 655 N.E.2d at 654, 631 N.Y.S.2d at 558.

In this case, the Court cannot grant the relief being sought by the City without intervening in a political dispute between the City and the State. The City seeks an order enjoining Defendants from selling unstamped cigarettes to reservation sellers. So long as these sales are made and reported by state stamping agents, such sales are authorized under the State's policy of forbearance. Whether this policy continues or changes is a matter for the State, not the City or the Court, to decide.

The issue of capacity cannot be side-stepped simply because the City has not named the State or the Tax Department in this action. Albany County v. Hooker, 204 N.Y. 1, 10 (1912) (local governments "cannot maintain an action against the state, of whose sovereign power they are a part, or against state officers who are expressly charged with the performance of sovereign power.") Capacity concerns the power to appear and bring a grievance before a court. Town of Riverhead, 7 A.D.3d at 935, 777 N.Y.S.2d at 534, quoting Community Bd. 7 of Borough of Manhattan v. Schaffer, 84 N.Y.2d 148, 155, 639 N.E.2d 1, 4, 615 N.Y.S.2d 644, 647 (1994). At the center of the City's grievance is the State's policy of forbearance. This policy is carried out by the State through its stamping agents. By challenging the actions of Defendants who act in accordance with this policy, the City seeks to challenge the actions of the State.

The fact that this policy may affect the City's ability to collect local taxes or may displace sales by City vendors does not alter the analysis. As the courts have noted, municipal corporations, as political subdivisions, "cannot contest *actions* of the state which affect them in their governmental capacity or as representatives of their inhabitants." County of Oswego, 16 A.D.3d at 735, 791 N.Y.S. 2d at 192; Eristoff, Index No. 3172-06, slip op. at 4.

The only exceptions to the general rule barring a municipal corporation from suing the State which have been identified in State case law are: (1) the express statutory authorization to bring such a suit, (2) where the State action adversely affects a municipality's propriety interest in a special fund of moneys, (3) where the State action infringes upon the powers of Home Rule guaranteed to local governments by the State Constitution, and (4) where the municipality asserts that if it were obligated to comply with the State statute (or policy) it would by that very compliance be forced to violate a constitutional proscription. City of New York v. State, 86 N.Y.2d at 291-92, 655 N.E.2d at 652, 631 N.Y.S.2d at 556. The third and fourth exceptions clearly have no applicability to this case. In its Amended Complaint, the City does not allege any violations of its local laws; therefore, it cannot claim that the State's policy of forbearance infringes upon its right to Home Rule. The City also does not assert any constitutional infinity to the State's policy of forbearance. More importantly, the State is authorized under its Constitution to withhold or restrict a municipality's power to tax. Therefore, neither the third or fourth exception would apply to this case. Gerosa, 7 N.Y.2d at 459, 166 N.E.2d at 491, 199 N.Y.S.2d at 478 ("taxes imposed by [a municipality] must be within the expressed limitations . . . and unless authorized, a tax so levied is constitutionally invalid. . . .).

The City has no statutory basis to claim that it has express authority to commence this action. The first sentence of paragraph 1 of the Amended Complaint reads:

> This is a civil action under the Contraband Cigarette Trafficking Act (18 U.S.C. § 2341 *et seq.*), the Cigarette Marketing Standards Act (N.Y. Tax L. § 483 *et seq.*) and common law.

Neither the Contraband Cigarette Trafficking Act ("CCTA") nor the Cigarette Marketing Standards Act ("CMSA") expressly authorizes lawsuits challenging either the State or its policies.

Although the CMSA may authorize an action against a state stamping agent, the City has not pled sufficient facts to support a CMSA violation. The CMSA provides:

> Notwithstanding any other provision of law, it shall be unlawful and a violation of this article:
>
> 1. For any agent, wholesale dealer or retail dealer, ***with intent*** to injure competitors or destroy or substantially lessen competition, or with intent to avoid the collection or paying over of such taxes ***as may be required by law***, to advertise, offer to sell, or sell cigarettes at less than cost of such agent wholesale dealer or retail dealer, as the case may be.

N.Y. Tax Law § 484 (1) (emphasis added). The City cannot claim that Defendants' sales show an intent to injure competitors (who could also chose to make such sales) or to avoid the payment of taxes for the simple reason that the State's policy of forbearance permits the sales of unstamped cigarettes to reservation sellers. If Defendants intended to avoid the collection or payment of cigarette taxes, then they would not report such sales each month to the State Tax Department. More importantly, the CMSA speaks of "taxes as may be required by law." In Urbach, the courts ruled that the policy of forbearance was a rational exercise of State authority. Urbach, 181 Misc. 2d at 594, 694 N.Y.S.2d at 889, aff'd, 275 A.D.2d at 522-23, 712 N.Y.S.2d at 222. Therefore, although the State may have the authority to tax reservation sales to non-Indians, it is not required to pre-collect taxes prior to a retail sale. The Court may not intrude into policy matters involving the discretionary exercise of governmental power. Accord City of New York v. State of New York, 86 N.Y.2d at 295-96, 655 N.E.2d at 654, 631 N.Y.S.2d at 558.

Since the issue of capacity is a matter of state law, it would be imprudent to suggest that the CCTA has given the City the express authority to legally challenge the State or its taxing policies. First, a federal law that would permit a political subdivision of a State to challenge the State's exclusive taxing authority would violate the Tenth Amendment of the United States Constitution. New York v. U.S., 505 U.S. 144, 166 (1992) ("the Framers explicitly chose a Constitution that confers upon Congress the power to regulate individuals, not States."); Metcalf & Eddy v. Mitchell, 269 U.S. 514, 523-24 (1926) ("neither [federal or state] government may destroy the other nor curtail in any substantial manner the exercise of its powers. Hence the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax (cites omitted) or the appropriate exercise of the functions of the government affected by it"); 16A Am. Jur. 2d Constitutional Law § 236 (""Congress may not settle the public policy of any state as to intrastate matters."); 81A C.J.S. States § 53 ("The federal government may not encroach on the reserved powers of the states or interfere with the states within the limits of state sovereignty."). Second, the CCTA expressly contradicts any such assertions by stating that it does not "restrict, expand or modify any sovereign immunity of a State." 18 U.S.C. § 2346 (b)(2). Therefore, there is no express authority given in the CCTA that allows the City to challenge State policy. Gregory v. Ashcroft, 501 U.S. 452, 463-64 (1991) (Congressional interference with state's decision to establish qualifications for judges upsets usual constitutional balance of federal and state powers, and thus Congress must make its intention to do so unmistakably clear in the language of the federal statute.).

The "propriety interest in a special fund" exception also does not apply to this case. In Eristoff , the State Supreme Court stated that:

> [i]n order for such exception to apply, there must be a specific fund of money in existence (see *County of Albany v. Hooker*, 204 NY 1, 18 [1912]; *see also City of New York v. State of New York, supra* at 294) to which the petitioner has an immediate right to possession (*see Matter of Town of Moreau v. Saratoga County*, 142 AD2d 864, 865 [3d Dept 1988]). Petitioner does not contend that these tax revenues have been collected or contest how they have been allocated. Instead, petitioner seeks to compel [the State Tax Commissioner] to create a fund of money by collecting sales taxes and than distribute it. This is an administrative process which is not subject to such a challenge.

Eristoff, Index No. 3172-06, slip op. at 5. The same reasons that this exception did not apply in the County of Seneca apply here.

In its pre-motion letter dated March 26, 2007, the City incorrectly asserts that:

> Defendants uncritically adopted the "capacity" argument from *County of Seneca v. Eristoff et al,* Index No. 3172-06 (Sup. Ct., Albany Co. 2006) which merely held that Seneca County does not have the capacity to bring an action against the [Tax Department] to compel enforcement of the tax laws. *County of Seneca* was an Article 78 action seeking mandamus against the State Tax Commissioner. Just as surely as the present suit is not against Indians, it is not against the State Tax Commissioner.

The County of Seneca did not seek mandamus against the State Tax Commissioner alone. Mandamus was sought against four of the seven Defendants named in this action. The State Supreme Court dismissed the petition against all respondents by only addressing the issue of capacity. Eristoff, Index No. 3172-06, slip op. at 5. The court ruled that the County did "not have capacity to maintain the . . . proceedings" and granted the "respondents' motions to dismiss on ***that*** ground." Id. (emphasis added). The County of Seneca brought the same grievance to the State Supreme Court that the City brings to this Court. Since capacity is an issue of state law, the same result should be imposed by this Court. The City's Amended Complaint should be dismissed.

POINT II

THE CITY LACKS STANDING BECAUSE IT HAS SUFFERED NO COGNIZABLE INJURY

The question of standing "involves both constitutional limitations on federal-court jurisdiction and prudential limitations on its exercise." Warth v. Seldin, 422 U.S. 490, 498 (1975) (citing Barrows v. Jackson, 346 U.S. 249 (1953). The party invoking federal jurisdiction bears the burden of establishing elements of standing. Lujan v. Defenders of Wildlife, 504 U.S. 555, 561 (1992).

> Since they are not mere pleading requirements but rather an indispensable part of the plaintiff's case, each element must be supported in the same way as any other matter on which the plaintiff bears the burden of proof, *i.e.,* with the manner and degree of evidence required at the successive stages of the litigation.

Id. On motion to dismiss for want of standing, the Court must construe the complaint in favor of the complaining party. Warth, 422 U.S. at 502. The pleading must state at least general factual allegations of injury caused by defendant's conduct to establish standing. Lujan, 504 U.S. 555 at 561.

A. The City Has No Injury in Fact Traceable to Defendants' Conduct, Which Is Necessary to Invoke the Court's Jurisdiction under Article III.

To satisfy the "case" or "controversy" requirement of Article III, which is the "irreducible constitutional minimum" of standing, a plaintiff must, generally speaking, demonstrate that he has suffered "injury in fact," that the injury is "fairly traceable" to the actions of the defendant, and that the injury will likely be redressed by a favorable decision. Lujan, 504 U.S. at 560-61; Valley Forge Christian Coll. v. Americans United for Separation of Church and State, Inc., 454 U.S. 464, 471-72 (1982). Separation of powers which largely depends upon the common understanding of what activities are appropriate to legislatures, to executives, and to courts, is at the core of Article III powers. Lujan, 504 U.S. at 559-560. Article III limits the federal judicial

power "to those disputes which confine federal courts to a role consistent with a system of separation of powers and which are traditionally thought to be capable of resolution through the judicial process." Valley, 454 U.S. at 471. Without a showing of an injury in fact fairly traceable to a defendant's actions, a federal court is without jurisdiction under Article III to hear the case.

In its Amended Complaint, the City claims "an enormous tax loss" due to Defendants' sale of unstamped cigarettes to reservation sellers. (Am. Compl. ¶44). The Amended Complaint alleges that:

> [t]he vast majority of sales of unstamped cigarettes replace sales that would otherwise generate tax revenue for the State, and, in significant part, for the City. Sales of unstamped cigarette annually cost New York City millions of dollars in tax revenues.

(Am. Compl. ¶ 5; see, also, Am. Compl. ¶¶1, 3-5, 22, 44, 51, 57).

In 2005, the State Legislature enacted amendments to the State tax law that specifically directed the pre-collection of state cigarette taxes on reservation sales to non-Indians. Currently, however, the State is enjoined from enforcing these provisions until the State Tax Department has promulgated the rules and regulations and taken other actions necessary to implement the amended changes. Day Wholesale, Index No. 2006-7668, Order (N.Y. Sup. Ct., Erie Co. Feb. 20, 2007). Until these steps or other actions have been taken by the State, the State Tax Department has continued its policy of forbearance which allows Defendants and other stamping agents to sell unstamped cigarettes to reservation sellers.

When the State Legislature enacted the 2005 Tax Amendments, it only directed the pre-collection of state cigarette taxes on reservation sales to non-Indians. The State Legislature has never enacted legislation that authorizes the pre-collection of local cigarette taxes on such sales. The State Legislature has, nonetheless, authorized the pre-collection of City cigarette taxes on

cigarettes sold at retail or used in the City[3]. N.Y. Unconsol. Law § 9436. Consistent with its state enabling legislation, the Administrative Code only requires stamping agents to affix City tax stamps on cigarettes "prior to delivery of such cigarettes to any dealer in the city." N.Y.C. Admin. Code § 11-1305(a). Since Day Wholesale only sell unstamped cigarettes to reservation sellers, all of whom are located outside of the City, the Amended Complaint does not allege a single violation of City's laws or regulations.

The City makes only the insufficient claim that its damages flow from Defendants' failure to pre-collect state cigarette taxes. According to the City's pre-motion letter to the Court:

> The Defendants all unaccountably raise issues related to the New York City Administrative Code and the "City taxes." But, as shown above, the City's claims are not at all premised on the non-collection of City taxes, or on the Administrative Code, but on violation of ***State*** tax law.

(Letter from Proshansky to Judge Amon of 3/26/07, at 5-6).

Under Articles 20 and 28 of the New York Tax Law, Defendants are directed to pre-collect state taxes on cigarettes to be sold at retail in the State. As a matter of public policy, the State Tax Department does not currently require Defendants to pre-collect state taxes on cigarettes sold at retail from an Indian reservation. The City's grievance, therefore, stems from the State's policy of forbearance which permits state stamping agents to sell unstamped cigarettes to reservation sellers. Although the State may have the authority to pre-collect these taxes on reservation sales, it also has the discretion not to pre-collect these taxes as a matter of

[3] Additionally, there is a question whether the State could authorized, as a matter of law, the pre-collection of local cigarette taxes on reservation sales. The United States Supreme Court has on several occasions addressed whether state taxes may be collected on cigarettes sold on an Indian reservation to non-Indians. Moe, 425 U.S. 463; Colville, 447 U.S. 134; Potawantomi, 498 U.S. 505; Attea, 512 U.S. 61. In each of these cases, the Court weighed state interests against federal and tribal interests. However, the Supreme Court has never ruled that local taxes may be collected on cigarettes sold on an Indian reservation to non-Indians. Since City taxes are not pre-collected on sales made by vendors of adjacent counties to City residents, any requirements to pre-collect City taxes only on reservation sales would not be viewed as even-handed or nondiscriminatory. However, this question is not ripe for judicial review since the State Legislature has not enacted such legislation.

public policy. Urbach, 181 Misc. 2d at 594, 694 N.Y.S.2d at 889, aff'd, 275 A.D.2d at 522-23, 712 N.Y.S.2d at 222.

The City characterizes this policy as a "violation of ***State*** tax law." (Letter from Proshansky to Judge Amon of 3/26/07, at 6). Yet, Articles 20 and 28 do not define whether cigarettes sold at retail in the State include reservation sales. Such gaps in the legislation can be clarified through the state rulemaking process. However, the Tax Department has thus far declined to adopt regulations relating to the collection of state cigarette taxes on reservation sales to non-Indians. More importantly, the State is currently enjoined from enforcing the provisions of the 2005 Tax Amendments until the Tax Department has adopted the necessary rules and regulations. Therefore, Defendants' sales cannot be classified as unlawful.

Based upon the foregoing facts, the City cannot assert Article III standing in this case. The City has failed to allege sufficient facts from which this Court could draw the legal conclusion that Day Wholesale or any of the other Defendants, as a matter of state law, are conducting illegal sales. Assuming that the City could show that its lost tax revenues were due to the State's non-enforcement of its own tax laws, the United States Supreme Court has repeatedly ruled that an asserted right to have the government act in accordance with the law is not sufficient alone to confer jurisdiction on a federal court. Allen v. Wright, 468 U.S. 737, 754 (1984). See, e.g., Schlesinger v. Reservists Comm.to Stop the War, 418 U.S. 208 (1974); United States v. Richardson, 418 U.S. 166 (1974); Valley Forge, 454 U.S. 464. The City has no standing to complain simply that the Defendants are violating a state law.

Article III standing requires the plaintiff to show (1) an injury in fact, which is an invasion of a legally protected interest which is concrete and particularized and actual or imminent rather than conjectural or hypothetical; (2) a causal connection between the injury and

conduct complained of so that the injury is fairly traceable to the challenged action of the defendant and not the result of the independent action of some third party who is not before the court; and (3) that it is likely, as opposed to merely speculative, that injury will be redressed by a favorable decision. Lujan, 504 U.S. at 560-61.

The City does not dispute that Defendants are not required under state or local law to pre-collect City taxes on cigarettes sold to reservation sellers. The City does not allege that Defendants sell unstamped cigarettes to City retailers in violation of state and local laws. In fact, the City attributes the loss of its revenue to the independent acts of third parties who are not parties to this action, namely the sales between reservation sellers and City residents.

Even if Defendants were required to pre-collect state cigarette taxes on reservation sales, cigarette sales would still be diverted to vendors located outside of the city. As the City noted in its Amended Complaint, the City collects excise taxes in the amount of $15.00 per carton for cigarettes sold by City vendors. City residents would still be induced to purchase their cigarettes outside of the City to avoid this local excise tax. Additionally, both State and City laws allow City residents to possess two cartons of unstamped cigarettes without any tax liability. Thus, the City cannot claim that its injuries would be redressed by a favorable decision in this matter. N.Y. Tax Law §§471-a; N.Y. Unconsol. Law § 9436; N.Y.C. Admin. Code § 11-1302(b). For these reasons, the City has failed meet the minimum standards for Article III standing. The City's Amended Complaint must, therefore, be dismissed.

B. Since Neither Congress Nor the City Can Usurp the State's Taxing Authority, the City's Grievance Is Not Within the Zone of Interest Protected by the CCTA

Even if the Court were to find that the City has Article III standing, this does not conclude the analysis. In addition to the immutable requirements of Article III, "the federal judiciary has also adhered to a set of prudential principles that bear on the question of standing."

Id. at 474-75. Like their constitutional counterparts, these "judicially self-imposed limits on the exercise of federal jurisdiction," are "founded in concern about the proper--and properly limited--role of the courts in a democratic society." Allen, 468 U.S. at 751; Warth, 422 U.S at 501. However, unlike their constitutional counterparts, these prudential principles can be modified or abrogated by Congress. Numbered among these prudential principles are doctrines of particular concern in this case.

First, the federal courts are constrained to hear cases when the asserted harm is a "generalized grievance" shared in substantially equal measure by all or a large class of citizens; such harm alone normally does not warrant exercise of jurisdiction. Id. at 499 (citing, e.g., Schlesinger, 418 U.S. 208; Richardson, 418 U.S. 166. For example, the City's assertion that the State's policy of forbearance deprives the State of state revenues is a "generalized grievance." The City cannot claim a right to the revenues collected by state cigarette taxes. The loss of state revenue is a grievance which any member of the public could claim injury. Nonetheless, such a "generalized grievance" does not permit the exercise of jurisdiction under the prudential principles of standing.

Second, even when the plaintiff has alleged injury sufficient to meet the 'case or controversy' requirement, this Court has held that the plaintiff generally must assert his own legal rights or interests, and cannot rest his claims to relief on the legal rights or interests of third parties. Id. In this case, the City asserts the right to determine the collection method for state cigarette taxes. The State Constitution confirms that the authority to impose state cigarette taxes, and the manner in which such taxes are collected and administered, are exclusively State functions. N.Y. Const. art. III, § 22; N.Y. Const., art. XVI, §1. The State has given no delegated authority to the City to enforce any provisions under Articles 20 and 28 of the New

York Tax Law. Under the State's policy of forbearance, state and local taxes on reservation sales to non-Indians can only be collected from the non-Indians. Although the State may assert the authority to pre-collect the state portion of these taxes, as a matter of public policy, the State has not asserted such authority. Under the State Constitution, the State has the exclusive power of taxation, which includes the power and discretion to tax or not to tax. The City's claim that it has the right to ignore the State's tax policies constitutes the exercise of rights that the City does not possess under the State Constitution.

Finally, a plaintiff's grievance must arguably fall within the zone of interests protected or regulated by the statutory provision or constitutional guarantee invoked in the suit. Allen, 468 U.S. at 751; Valley Forge, 454 U.S. at 474-75. In this case, the City asserts that the:

> CCTA now provides the City (and others) with the enforcement powers that the Commissioner of the State's Department of Taxation & Finance ("DTF") previously chose not to exercise . . . . Under the CCTA, the power to enforce existing, but ignored, State tax statutes is now shared with the City (and others). DTF's prior exercise of discretion is now only of historical interest, where the City chooses to enforce the dictates of duly-enacted State statutes.

(Letter from Proshansky to Judge Amon of 3/26/07, at 2). The City's assertions suggest that the CCTA has the ability to augment the powers of the City, despite constitutional and statutory limitations imposed by the State. Such assertions ignore the principles of dual-sovereignty between federal and state governments protected by the Tenth Amendment of the United States Constitution. New York v. U.S., 505 U.S. at 166; Metcalf & Eddy, 269 U.S. at 523-24; 16A Am. Jur. 2d Constitutional Law § 236 81A C.J.S. States § 53.

Despite the City's assertions, a plain reading of the CCTA shows that Congress respected the principles of dual-sovereignty and the authority of the State to determine its own tax laws. Nothing in the provisions of the CCTA suggests that Congress intended to augment the powers of municipalities beyond those already given by state law.

The application of the CCTA is only triggered when there is a clear violation of state tax laws. The CCTA prohibits the possession of 10,000 or more cigarettes (i.e. 50 cartons), "which bears no evidence of the payment of applicable State or local cigarette taxes in the State or locality where such cigarettes are found, ***if the State or local government requires a stamp, impression, or other indication to be place on packages or other containers . . . "*** 18 U.S.C. § 2341(2) (emphasis added). While State and local cigarettes taxes are applicable to all cigarettes sold or used in the State, tax stamps are only required to be affixed to cigarettes sold by registered in-state "retail dealers," not by "reservation cigarette sellers." Under New York Tax Law, "reservation cigarette sellers" are distinguished from "retail dealers." See N.Y. Tax Law § 470(9), (17). As a matter of public policy, the State continues to permit stamping agents to sell unstamped cigarettes to "reservation cigarette sellers," while prohibiting such sales to registered in-state "retail dealers." The New York courts have already ruled that distinguishing "reservation cigarette sellers" from in-state "retail dealers" is rational and within the State's discretionary authority to make. Urbach, 181 Misc. 2d at 594, 694 N.Y.S.2d at 889, aff'd, 275 A.D.2d at 522-23, 712 N.Y.S.2d at 222.

The CCTA does not give the federal courts exclusive jurisdiction to hear CCTA claims. Therefore, the City is free to pursue such claims through the state courts. However, the City is not free to ignore those State tax laws or policies and may not ask this Court to intrude into public policy matters of the State – areas not within the zone of interest protected by the CCTA. For these reasons, the Court should dismiss the Amended Complaint based on the City's lack of standing.

POINT III

THE STATE IS A NECESSARY AND INDISPENSABLE PARTY IN THIS ACTION BECAUSE THE CITY'S AMENDED COMPLAINT CHALLENGES THE EXCLUSIVE CONSTITUTIONAL AUTHORITY OF THE STATE TO ENFORCE ITS OWN TAX LAWS AND POLICIES

Although the City lacks the capacity to sue the State or its Tax Department, the State would still be considered a necessary and indispensable party under FRCP Rule 19. In considering a motion to dismiss, a court is required under Rule 19 to conduct a three-part inquiry. Part one requires the court to determine whether the absent party is "necessary" to the action. FRCP Rule 19 (a). Part two, then, requires the court to determine whether joining the necessary party is feasible. FRCP Rule 19 (b). Finally, if joinder is not feasible, the court must decide whether the necessary, but absent, party is indispensable to the case. FRCP Rule 19 (b). If the party is indispensable, the court must dismiss the complaint. A federal court will deem a party to be necessary and indispensable if the party's "interest is such that a decree cannot be rendered that will not affect [the party's] interest, or if such party's absence leave the controversy in such a condition that its final determination is wholly inconsistent with equity and good conscience." Grace v. Carroll, 219 F. Supp. 270, 273 (S.D.N.Y. 1963), citing 3 Moore, Federal Practice, 2150 (2d ed. 1948).

In Grace, the United State District Court for Southern District of New York found that the State Attorney General was an "indispensable party" in a case involving the inter vivos charitable trust. Under state trust laws, the Attorney General is required to represent beneficiaries of charitable trusts. In that case, the court held that the indispensability of a party is a matter of federal law, but state law determines the interests of the party. 219 F. Supp. at 272. Since the Attorney General's interest was protected under the state trust laws, the court

concluded that he was an indispensable party in a case seeking judicial settlement of a trust. Id. at 273.

The determination of whether or not a party is indispensable is based on the pleadings. Associated Dry Goods Corp. v. Towers Fin. Corp., 920 F.2d 1121, 1124 (2d Cir. 1990). In its Amended Complaint, the City asserts that, "each year, defendants knowingly sell [to reservation sellers] millions of cartons of unstamped cigarettes under circumstances in which cigarette tax imposed under N.Y. Tax L. § 471(1) – (2) apply." (Am. Compl. ¶ 30). Although the State Legislature clearly intended all cigarettes used in the State to be subject to state cigarettes taxes, the State Legislature has not made clear whether the pre-collection of these taxes are required on reservation sales to non-Indians prior to its enactment of the 2005 Tax Amendments. The City ignores the provisions of § 471(2) which states that the Tax Commissioner "may by regulation provide that the tax on cigarettes imposed by this article shall be collected without the use of stamps."

Pursuant to Article 8 of the New York Taw Law, the State Tax Department is charged with the responsibility to carry-out and enforce all State tax laws. Among its enforcement powers, the Tax Department, through its Commissioner, may "make such reasonable rules and regulations, not inconsistent with law, as may be necessary for the exercise of its powers and the performance of its duties" under New York Tax Law. N.Y. Tax Law § 171.

In the absence of such regulations, the Tax Commissioner may advise its stamping agents, as well as taxpayers, tax practitioners, department personnel and the general public, as to its policies and interpretation of the State tax laws. N.Y. Tax Law § 171. Consequently, the pronouncement of State's taxing policies may be executive in nature, but must be based upon, and not inconsistent with, legislative authorization.

With regards to reservation sales to non-Indians, the Tax Department's policy of forbearance does not eliminate the payment obligations under Articles 20 and 28. The policy still mandates that the collection of these concededly lawful taxes from the State consumers, in the same manner in which such taxes are collected from State consumers on out-of-state purchases. Therefore, the policy is not inconsistent with the legislative mandates.

The State Legislature has directed that state taxes be imposed on all cigarettes sold at retail or used in the State and intended that the State consumers be ultimately responsible for the payment of these taxes[4]. N.Y. Tax Law §§ 471, 471-a, 1105, 1110. However, the State Legislature has only directed the pre-collection of state cigarette taxes to cigarettes possessed for sale in the State. N.Y. Tax Law § 471. The State Legislature has not indicated in Articles 20 or 28 whether cigarettes sold at retail from an Indian reservation located within the State's exterior boundaries are considered to be retail sales in the State. This gap still exists even with the enactment of the 2005 Tax Amendments.

The State has had several opportunities to plug this gap. The State, through general legislation or rulemaking, could have simply stated that sales in the State included sales on recognized Indian reservations. The Tax Department has declined to adopt such regulations. The State Legislature also failed to enact a legislation that has plugged this gap. In any event, such a legislative enactment would have undoubtedly increased tensions between the State and

[4] In its pre-motion letter, the City quotes the New York Court of Appeals in the Urbach case. The Court of Appeals described the Tax Department's "newly minted long-term policy" as "abstaining from taking active measures to enforce the legislatively mandated excise and sales taxes on motor fuel and cigarettes destined for sale on Indian reservations. Urbach, 92 N.Y.2d at 215, 699 N.E.2d at 909, 677 N.Y.S.2d at 285. The City misinterprets the meaning of this passage. State cigarette taxes are legislatively mandated, but the pre-collection of these taxes on reservation sales to non-Indians has not been mandated by the State Legislature prior the 2005 Tax Amendments. The Court of Appeals would never have authorized a policy of forbearance if that policy was in direct conflict with state general law. In any case, the City should seek a clarification from a state court that is subject to the subsequent appellate review of the New York Court of Appeals. By urging this Court to render an opinion as to the meaning of this passage from the New York Court of Appeals, such an interpretation would not be reviewed by the New York's high court.

tribal nations. The State Legislature has also failed to pass bills that would have delegated some of the Tax Department's enforcement powers to the State Attorney General and the City's Corporation Counsel. See, e.g., A. 10859-A, 229th Session (N.Y. 2006) (same as S. 7568-A) (failed to pass after Governor's veto).

Instead, the State's policy has been to exempt reservations sellers from the general provisions of Articles 20 and 28 of the Tax Law. In Urbach, the New York Court of Appeals held that State laws and policies could single out reservation sellers for special treatment and exempt them from provisions generally applicable to other retail dealers, if the State could show a rational basis for the distinction. 92 N.Y.2d at 213, 699 N.E.2d at 908, 677 N.Y.S.2d at 284. Specifically, the Court of Appeals stated that the State may:

> adopt laws and policies to reflect or effectuate [preferences given under] Federal laws designed "to readjust the allocation of jurisdiction over Indians" without opening themselves to the charge that they have engaged in race-based discrimination (*Washington v. Yakima Indian Nation*, [439 U.S. 463] supra, at 501). The Tax Department's specialized treatment of on-reservation cigarette and motor fuel sales is clearly such a policy, since it is predicated on the Department's sensitivity to both tribal sovereignty issues and the complex restrictions imposed by the Indian Trader Laws.

Id. After the case was remanded, both the Supreme Court and the Appellate Division found that the policy of forbearance was a rational exercise of State authority. Urbach, 181 Misc. 2d at 594, 694 N.Y.S.2d at 889, aff'd, 275 A.D.2d at 522-23, 712 N.Y.S.2d at 222. Both the New York Court of Appeals and the United States Supreme Court rejected petitions to hear any further appeals in the matter. Urbach, 275 A.D.2d 520, 712 N.Y.S.2d 220, appeal dismissed, 95 N.Y.2d 931, 744 N.E.2d 142, 721 N.Y.S.2d 606 (2000), appeal denied, 96 N.Y.2d 717, 756 N.E.2d 78, 730 N.Y.S.2d 790, cert. denied, 534 U.S. 1056 (2001).

In the 2005 Tax Amendments, the State Legislature made special provisions regarding the reservation sales to non-Indians, including making a distinction between a "reservation

cigarette seller" and other "retail dealer." Additionally, the State Legislature delayed the effective date for implementation of the 2005 Tax Amendments until "any actions, rules and regulations necessary to implement the provisions" of the 2005 Tax Amendments have been "authorized and directed to be complete" by the State Tax Department. Currently, the State has been enjoined from enforcing the 2005 Tax Amendments until the Tax Department has promulgated the necessary rules and regulations to implement these amendments. See Day Wholesale, Index No. 2006-7668, Order.

The City seeks to hold the Defendants accountable for acting in accordance with the Tax Department's policy and interpretation of the State tax laws. In its prayer for relief, the City requests that Defendants be enjoined from selling unstamped cigarettes to reservations sellers. If this Court were to grant such an order, the State's policy of forbearance would be rendered meaningless. This long-standing policy can only be carried out through the assistance of the stamping agents who, like Defendants, have been designated by the Tax Department. If this Court were to imprudently grant the relief sought by the City, such an order could have devastating effects upon the State's relationship with tribal nations, could lead to public unrest in areas of the State outside of the City and could frustrate efforts by the State to reach a compromise with these tribal nations.

In its pre-motion letter, the City states that:

> [t]he Court can take judicial notice of a new administration in place in Albany, so that the "current" policy is simply unknown, and subject for discovery. . . The only means of understanding the scope of the "policy," and whether it was intended to immunize Defendants under the CCTA, is by discovery of the State.

(Letter from Proshansky to Judge Amon of 3/26/07, at 5). If the City believes it necessary to seek "discovery of the State," then it must recognize that the State is at least a necessary party to these proceedings. The City cannot simply subpoena Tax Department personnel whom it

believes shares its viewpoint to ascertain the current status and scope of the policy of forbearance. Under state law, only the Tax Commissioner has the authority to communicate the Tax Department's policies and interpretation of Articles 20 and 28. N.Y. Tax Law § 171.

As a stamping agent for the Tax Department, Milhelm Attea has sought an advisory opinion from the Tax Commissioner regarding the current status of its policy of forbearance. Advisory Opinion TSB-A-06(2)(M). In footnote 5 of its pre-motion letter, the City asserts that since its Amended Complaint makes no reference to this advisory opinion, the Court cannot consider it since it would constitute facts outside of the pleadings. The City is mistaken in its legal conclusion.

An advisory opinion issued by the Tax Department is legal authority. Although such an opinion has no binding effect upon a court, it may be considered by a court as permissive authority. Goyer v. New York State Dep't of Env't Conservation, 12 Misc. 3d 261, 270, 813 N.Y.S.2d 628, 636 (Albany Co. Sup. Ct. 2005). The New York Court of Appeals has also stated that "the construction given statutes and regulations by the agency responsible for their administration, if not irrational or unreasonable, should be upheld" by the courts. Howard v. Wyman, 28 N.Y.2d 434, 438, 271 N.E.2d 528, 530, 322 N.Y.S.2d 683, 686 (1971).

In its petition for advisory opinion, Milhelm Attea posed three questions to the Tax Commissioner: (1) what is the Tax Department's current policy regarding sales by stamping agents to reservation sellers; (2) had the Tax Department altered its long-standing policy of forbearance as a result of the 2005 Tax Amendments; and (3) will the Tax Department issue tax assessments against stamping agents after the 2005 Tax Amendments take effect on March 1, 2006? Advisory Opinion TSB-A-06(2)(M). In response to these questions, the Tax Commissioner advised *inter alia*, that (1) the State has a "long-standing policy of allowing

unstamped cigarettes to be sold from licensed stamping agents to recognized Indian Nations and reservation based retailers making sales from qualified Indian reservations;"(2) "the [Tax] Department has no intention to alter its long-standing policy until [deficiencies in the 2005 Tax Amendments] are fully addressed and considered;" and (iii) "the [Tax] Department will not issue assessments with respect to transactions occurring during the period of forbearance as that would be inconsistent with the State's long-standing policy." Advisory Opinion TSB-A-06(2)(M). Finally, the advisory opinion stated that "if the Department decides to revise its policy in the future, it will provide adequate notice to all affected stamping agents." Nothing has since been issued to revoke or modify the Tax Department's confirmation of the State's policy, articulated in the advisory opinion.

The State and its Tax Department have more than a passing interest in the issues presented in the case. The State, not the City, has been vested with the exclusive power of taxation. The Tax Commissioner, not the Corporation Counsel, has the authority to enforce the State's tax laws and policies and to render opinions as to the interpretation of the state tax laws.

Pursuant to a preliminary injunction, the State is enjoined from enforcing the 2005 Tax Amendments until the Tax Department has promulgated rules and regulations necessary to implement these amendments. Day Wholesale, Index No. 2006-7668, Order. If the Court were to grant the relief sought by the City, the State would have no mechanism currently available under the tax laws and regulations to supply reservation sellers with tax-exempt cigarettes for sales to tribal members or out-of-state purchases. The United States Supreme Court in Attea cautioned the State that limiting "sufficiently generous" quantities of tax-free cigarettes for legitimate tax-exempt sales could "provide the basis for a future [constitutional] challenge." 512 U.S. at 69, 75-76.

In litigation involving the Master Settlement Agreement ("MSA"), the State has sought a declaratory judgment that its policy of forbearance does not breach the terms of the MSA or jeopardize the payments received by the State under the MSA. Philip Morris Inc., Index No. 400440/07. A decision in this case as to whether reservation sales are considered under Article 20 to be sales that take place in the State could affect the State's interest in the outcome of that pending case.

Neither the City nor this Court can set public policy for the State. Nor can the City seek a judgment against Defendants who act in accordance with the State's policy of forbearance. For these reasons, the Court must find, based in equity and good conscience, that the State is a necessary and indispensable party that is not subject to joinder. Therefore, Rule 19 provides the Court with an additional ground to dismiss the City's Amended Complaint.

POINT IV

THE COURT LACKS SUBJECT MATTER JURISDICTION BECAUSE THE CITY HAS FAILED TO RAISE A FEDERAL QUESTION UNDER THE CCTA

In its Amended Complaint, the City has sought to invoke the Court's subject matter jurisdiction based upon a federal question. (Am. Compl. ¶¶ 1, 15). The Amended Complaint set forth three causes of action. Only the City's first cause of action alleges a federal question. The City alleges that Day Wholesale is in violation of the Contraband Cigarette Trafficking Act, 18 U.S.C. § 2341 *et seq.* ("CCTA").

To state a cause of action under the CCTA, the City must prove that Defendants "knowingly" shipped, transported, received, possessed, sold, distributed or purchased "contraband cigarettes." 18 U.S.C. § 2342(a). There are three reasons the City cannot state a cause of action based upon the CCTA. First, cigarettes are only contraband under the CCTA, if

they "bear ***no evidence of the payment*** of applicable State or local taxes in the . . . locality where such cigarettes are found" and "the State and local governments ***require a stamp*** . . . to be placed on packages or other containers of cigarettes ***to evidence payment***. . . ." 18 U.S.C. § 2341 (2) (emphasis added). Second, Day Wholesale cannot be sued under CCTA since it is "licensed or otherwise authorized by the State . . . to account for and pay cigarette taxes imposed by the State" and complies with the monthly reporting and accounting procedures set forth by the State's Tax Department. 18 U.S.C. § 2341(2)(C). Finally, the City cannot hold Defendants accountable for the independent acts of third parties who may or may not be in violation of the CCTA. There is no such cause of action or violation under the CCTA, which permits such civil liabililty. 18 U.S.C. § 2342.

A. <u>The Cigarettes at Issue Are Not Contraband.</u>

The City alleges that Defendants have violated the CCTA by distributing contraband cigarettes "that do not possess the State cigarette tax stamps required by N.Y. Tax L. § 471(1)-(2) under circumstances in which the State requires that they bear stamps." (Am. Compl. at ¶ 49). The core premise of the City's claim that Defendants' sales of unstamped cigarettes to reservation sellers violate Article 20 is erroneous as a matter of law. Any CCTA violation is depended on the violation of a state tax law. Without a state tax law violation, the City's claim under 18 U.S.C. § 2346 of the CCTA must be dismissed.

Section 2341(2) of the CCTA provides that:

> [T] he term "contraband cigarettes" means a quantity in excess of 10,000 cigarettes, which bear no evidence of the payment of applicable State or local cigarette taxes in the State or locality where such cigarettes are found, if the State or local government requires a stamp, impression, or other indication to be placed on packages or other containers of cigarettes to evidence payment of the cigarette taxes …

In this instance, the operative term is whether State or local law "requires" a stamp.

The 2005 Tax Amendments are the only State or local laws that would require state tax stamps to be affixed to cigarettes sold to reservation sellers. The State is currently enjoined from enforcing the 2005 Tax Amendments until the Tax Department has directed and completed the necessary administrative steps to implement the amended provisions, including the adoption of rules and regulations and the distribution of Indian tax exemption coupons to recognized tribal nations. To this date, no such rules or regulations have been promulgated and no tax coupons issued to the tribal nations or its enrolled members.

As previously stated, Article 20 only requires Defendants to affix state tax stamps on cigarettes possessed for sale in the State. No provision in Article 20 defines reservation sales as in-state sales. As a matter of public policy and consistent with the provisions of Article 20, the Tax Department has permitted Defendants to sell unstamped cigarettes to reservation sellers. Although some, but not all, reservation sales are made to State and City residents, Article 20 only requires the consumer to report and pay state taxes if the cigarettes are used, but not sold, in the State.

The State's policy allowing Defendants' sales of unstamped cigarette to reservation sellers is also consistent with the City's local laws. Under the City's Administrative Code, stamping agents are only required to affix joint tax stamps on cigarettes "prior to delivery of such cigarettes to any dealer in the city." N.Y.C. Admin. Code § 11-1305(a). In its Amended Complaint, the City does not accuse Defendants of failing to affix joint tax stamps on cigarettes sold to City retailers. The Amended Complaint only alleges that Defendants have failed to affix tax stamps to cigarettes sold to reservation sellers. (Am. Compl. ¶¶ 29, 34, 41, 42, 44, 50). Since there are no Indian reservations or territories within the City's boundaries, the City cannot

claims that Defendants are required under local law to affix joint tax stamps on cigarettes sold to reservation sellers.

Since neither the State nor the City require a tax stamp to be affixed cigarettes sold by reservation sellers, the City cannot show that Defendants possess or distribute contraband cigarettes. This fact alone proves "beyond doubt" that the City "can prove no set of facts" to support its CCTA claim. Conley, 355 U.S. at 78. For this reason, the City has failed to state a cause of action upon which the Court may grant relief. The Court, as a matter of law, must dismiss the City's first claim for relief.

B. State Stamping Agents Are "Exempt" Persons Under the CCTA

There is nothing illicit about Defendants' possession of unstamped cigarettes under the provisions of the CCTA. As agents for the Tax Department, Defendants are required to file monthly reports that account for affixed and unaffixed tax stamps and for the sale and distribution of unstamped and stamped cigarettes. N.Y. Tax Law § 475; 20 N.Y.C.R.R. § 75.1. On forms provided by the Tax Departments, Defendants account for all cigarette sales and other transactions from the previous month including all sales of unstamped cigarettes. 20 N.Y.C.R.R. § 75.1. The City is well aware that the Tax Department requires Defendants to report all sales of unstamped cigarettes to reservation sellers on a form, known as Schedule E. In its Amended Complaint, the City does not allege that Defendants have failed to file, or falsely report information in these monthly reports. Such claims would be grounds for revoking a stamping agent's license. N.Y. Tax Law § § 472(1), 480(3)(a)(ii); 20 N.Y.C.R.R. § 76.3. See, also, 18 U.S.C. § 2342(b).

The CCTA plainly provides that unstamped cigarettes are not "contraband" if they are in the possession of: "a person – (i) who is licensed or otherwise authorized by the State where the

cigarettes are found to account for and pay cigarettes taxes imposed by such State; and (ii) who has complied with the accounting and payment requirements relating to such license or authorization with respect to the cigarettes involved." 18 U.S.C. § 2341(C)(2). Each of the Defendants, as a licensed stamping agent, qualifies as an exempt "person" under the CCTA.

C. Defendants Cannot Be Held Vicariously Liable under the CCTA for the Acts of Independent Third Parties

In paragraph 50 of the Amended Complaint, the City alleges that:

> Defendants have further violated the CCTA by knowingly aiding and abetting repeated violations of the CCTA by cigarette sellers operating on Native American reservations, some or all of whom have shipped, transported, sold and distributed "contraband cigarettes" in the State, as that term is defined by 18 U.S.C. § 2341 (2). That is, defendant has shipped, transported, sold and distributed in excess of 10,000 cigarettes that do not bear the State cigarette tax stamps required by N.Y. Tax L. § 471 (1)-(2) to persons in this State knowing that such persons intend to resell such cigarettes to the public.

The wording of the above quoted paragraph leaves some doubt as to what the City is attempting to assert, but the City seemingly makes two assertions in paragraph 50. First, Defendants individually or collectively, ship, transport, sell and distributed more than 50 cartons of unstamped cigarettes to reservation sellers who intended to resell these cigarettes to the public. Second, Defendants are "knowingly" aiding and abetting reservation sellers who are in violation of the CCTA.

With regards to the City's first assertion, Day Wholesale does not dispute that it shipped, transported, sold and distributed more than 50 cartons of unstamped cigarettes to reservations sellers who intended to resell these cigarettes to the public. In fact, each month, Day Wholesale reports the quantity, brand and style of unstamped cigarettes sold to reservation sellers to the State Tax Department. Both the State and Defendants know from "the sheer quantities of cigarettes" reported each month that these unstamped cigarettes are being re-sold not only to

enrolled tribal members, but also to non-tribal members. (Am. Compl. ¶ 32). The State's policy of forbearance anticipates reservation sales to non-Indians. In fact, if the State did not permit such sales to non-Indians, it would have no need of a policy of forbearance.

In its pre-motion letter, the City suggests that the State's policy of forbearance may be limited to reservation sales of unstamped cigarettes to only tribal members. Since reservation sales to enrolled members of the same tribe are exempted from state taxation, the State is forbearing nothing in such sales. Because of the United States Supreme Court's rulings in Moe, Colville, Potawatomi and Attea, the City asserts that the State has the authority to pre-collect state cigarette taxes on reservation sales to non-Indians. Assuming this is true, the State has chosen, as matter of public policy, not to exercise of such authority over reservation sales.

The CCTA definition of "contraband" does not prohibit the possession of limitless quantities of unstamped cigarettes by either State stamping agents or reservation sellers located within the State's exterior boundaries. As discussed in the previous section, licensed stamping agents, like Defendants, qualify as an exempt "person" under the CCTA. 18 U.S.C. § 2341(2)(C). Because of the State's policy of forbearance, unstamped cigarettes found on reservations are not contraband. The CCTA looks to the "locality where such cigarettes are found" to determine whether "the State or local government requires a stamp." Neither State nor local laws require a tax stamp on cigarettes within the possession of a reservation seller.

With regards to the City's second assertions, Day Wholesale does not dispute that reservation sellers may not lawfully sell 50 or more cartons of unstamped cigarettes in a single transaction to a non-Indian. Day Wholesale does not have personal knowledge whether its reservation customers are engaging in such activities. If the City had alleged such facts in its

Amended Complaint, Day Wholesale would have denied that it had any actual knowledge of such unlawful reservation sales[5].

The City's Amended Complaint does not allege that reservation sellers are selling quantities of unstamped cigarettes that are unlawful sales under the CCTA. The Amended Complaint merely asserts that the sale of unstamped cigarettes by reservation sellers to the public is unlawful. (Am. Compl. ¶¶ 3, 29, 31, 32, 33, 34, 35, 38, 42, 50).

In paragraph 41 of the Amended Complaint, the City alleges that:

> large quantities of unstamped cigarettes sold by defendants to retailers outside of the City are routinely trucked backed into the City for subsequent resale to City residents, either at retail locations or by street-corner "buttleggers."

The City has not defined the term "large quantities" in the Amended Complaint to mean 50 cartons or more of unstamped cigarettes. If cigarette bootlegging is occurring in the City, then the City would be in a better position to know the source of these unstamped cigarettes than Defendants. Five of the seven Defendants operate their wholesale businesses in the far reaches of Vermont, and Western and Northern New York. The City needs to allege more facts for any court to conclude that these Defendants are aware of activities taking place 8 to 10 hours away from their own businesses.

But nothing in the Amended Complaint sets forth any information as to how the City has concluded that reservation sellers are the source of these contraband cigarettes. More importantly, the City has not set forth a single fact that contraband cigarettes sold in the City were originally sold by any Defendant. The City's Amended Complaint takes a giant leap from the fact that Defendants sell unstamped cigarettes to reservation sellers to Defendants are the

[5] The City also alleges that reservation sellers violate state laws prohibiting non-face-to-face sales (i.e. delivery sales) and sales to minors. Delivery sales are not illegal under the CCTA. 18 U.S.C. § 2342 (b). No provision of the CCTA addresses the issue of sales to minors. The CCTA only prohibits the trafficking of unstamped cigarettes and tobacco in interstate commerce. Therefore, the City cannot claim that reservation sellers who are alleged to make sales to minors and illegal delivery sales are in violation of the CCTA.

source of unstamped cigarette that are being bootlegged in the City. State stamping agents are not the only sources for unstamped cigarettes. Unstamped cigarettes can also be obtained from out-of-state distributor. See City of New York v. Cyco.net, Inc., 383 F. Supp. 2d 526 (S.D.N.Y. 2005) (City brought action under RICO and state law alleging that out-of-state vendors conspired to sell cigarettes to city residents via internet without paying state taxes). The Amended Complaint fails to lay out the circumstantial facts that would lead a reasonable person to reach the conclusion that Defendants are aiding and abetting the sale of contraband cigarettes.

Cigarette trafficking is a crime under the CCTA. 18 U.S.C. § 2344. For the City to allege that Defendants are aiding and abetting cigarette trafficking, it must allege in its Amended Complaint that each Defendant "knowingly [and deliberately] associated [himself] [herself] with the crime in some way as a participant—someone who wanted the crime to be committed—not as a mere spectator." 1A Fed. Jury Prac. & Instr. § 18.01 (5th ed. 2000). The City has failed to allege in its Amended Complaint any set of facts that would support such a conclusion. "[M]erely knowing that a crime is being committed or is about to be committed is not sufficient conduct for the jury to find that a defendant aided and abetted the commission of that crime." 1A Fed. Jury Prac. & Instr. § 18.01 (5th ed. 2000).

In essence, the City seeks to hold Defendants vicariously liable for the independent acts of unnamed third parties. Such a cause of action is not supported by the provisions of the CCTA. 18 U.S.C. § 2342.

The City has failed to state a cause of action under the CCTA. The City has also failed to raise a federal question that would invoke the Court's subject matter jurisdiction. For these reasons, the Court should dismiss the City's Amended Complaint.

POINT V

THE CITY HAS FAILED TO STATE A CAUSE OF ACTION ON ITS REMAINING STATE STATUTORY AND COMMON LAW CLAIMS

In its second and third claims for relief, the City has presented novel issues of first impression involving state statutory and common law. These claims again challenge the Tax Department's long-standing policy of indefinite forbearance. Absent a justiciable federal claim, this Court has discretion to dismiss the City's remaining state causes of action pursuant to 28 U.S.C. § 1367(c). The Court also has the grounds to dismiss these state claims on the merits.

A. The State's Policy of Forbearance Precludes Any CMSA Claim

There are three reasons why the City has failed to state a cause of action under the State's CMSA. First, Defendants are not selling cigarettes below the "basic cost of cigarettes." Second, the City cannot show that Defendants have formed any intent to destroy competition, an element of proof for a CMSA claim. Finally, no state or federal case has ever held that the CMSA is a state law applicable to reservation sellers. For these reasons, the City has not pled sufficient facts to support a CMSA violation

Just as the City's CCTA claim is erroneously premised on the claim that Defendants are selling "contraband" cigarettes, the City's CMSA claim is erroneously premised on the claim that Defendants are advertising, offering to sell and/or selling cigarettes for less than the "basic cost of cigarettes." (Am. Compl. at ¶ 56). The "basic cost of cigarettes, as defined in § 483 of the CMSA, "shall mean the invoice cost of cigarettes to the agent who purchases from the manufacturer, or the replacement cost of cigarettes to the agent, in the quantity last purchased . . . to which shall be added in the full face value of any stamps ***which may be required by law***." N.Y. Tax Law § 483 (emphasis added). Once again, the City simply ignores the State's policy of forbearance, which permits Defendants' sale of unstamped cigarettes to reservation sellers.

The City's claim is premised on an interpretation of state law that is plainly contrary to that of the Tax Department and employs a legally erroneous definition of "basic cost" under the CMSA. More importantly, the CMSA provides:

> Notwithstanding any other provision of law, it shall be unlawful and a violation of this article:
>
> 1. For any agent, wholesale dealer or retail dealer, ***with intent to injure competitors or destroy or substantially lessen competition***, or with intent to avoid the collection or paying over of such taxes ***as may be required by law***, to advertise, offer to sell, or sell cigarettes at less than cost of such agent wholesale dealer or retail dealer, as the case may be.

N.Y. Tax Law § 484(1) (emphasis added). Since the State's policy of forbearance permits the sales of unstamped cigarettes to reservation sellers, the City cannot claim that Defendants' sales show any intent to injure. Any state stamping agent, just Defendants, may sell unstamped cigarettes to reservation sellers. Since the State does not require stamping agents to pre-collect state cigarette taxes on reservation sales, the City cannot claim that Defendants have the intent to avoid the payment of taxes since the pre-collection of such taxes are not "required by law." The fact that these sales of unstamped cigarette to reservation sellers are meticulously documented each month by Defendants to the Tax Department also proves Defendants' lack of intent.

Finally, if the City were to suggest that the "basic cost of cigarettes" must include the value of taxes that are not collected, such an assertion would be pre-exempted under federal law. Under certain rare circumstances, federal law has permitted some nondiscriminatory state civil regulatory laws to apply to activities conducted on Indian reservations. Mescalero Apache Tribe v. Jones, 411 U.S. 145, 148-49 (1973); see also Colville, 447 U.S. at 151; Potawatomi, 498 U.S. at 511. However, the federal law pre-exempts any state law that discriminates against Indian

commerce. Id. The City's interpretation of the CMSA would indeed place discriminatory burdens upon reservation sellers.

Assuming that reservation sellers had no alternative but to accept the City's interpretation of "minimum pricing" under the CMSA, reservation sellers would actually be paying a higher wholesale cost for cigarettes than other retail dealers. Other retail dealers have value in selling cigarettes that have state taxes already collected. Reservation sellers, on the other hand, would be selling untaxed cigarettes to its non-Indian customers who would still be liable for the state taxes not collected. The actual retail cost of these cigarettes would consequently be higher for reservation sales then for in-state retail sales. Such a scheme would neither be even-handed or non-discriminatory.

State law is also pre-exempted in areas where Congress has enacted specific legislature regulating Indian commerce. Under federal law, the Commissioner of the Bureau of Indian Affairs "sole power and authority to make regulations, specifying the kind and quantity of goods ***and the prices at which such goods shall be sold to the Indians***." 25 U.S.C. § 261 (emphasis added). The Bureau of Indian Affairs, whose functions are now administered by the Secretary of the Interior, has promulgated extensive regulations recognizing and implementing his sole power and authority regulate Indian traders" 25 C.F.R. §140.1, §140.9, §140.11, §140.26. "Congress has taken the business of Indian trading on reservations so fully in hand that no room remains for state laws imposing additional burdens upon traders." Warren Trading Post Co. v. Arizona Tax Comm'n, 380 U.S. 685, 690 (1965).

In Attea, the United States Supreme Court held that the pre-collection of state cigarette taxes pursuant to the State's 1988 Regulations were not pre-exempted by the Indian Trader Statutes, cited above. Id. at 78. The Supreme Court found that the 1988 Regulations were

"designed to prevent circumvention of 'concededly lawful' taxes owed by non-Indians" and not to dictate "the kind and quantity of goods and the prices at which such goods shall be sold to the Indians." Id. at 75. The Court observed that licensed wholesalers "remain free to sell Indian tribes and retailers as many cigarettes as they wish, of any kind and at whatever price." Id.

Since the repeal of the 1988 Regulations, the State has not attempted to pre-collect the state cigarette taxes on reservations sales to non-Indians. Consequently, the State has never asserted the CMSA applies to reservation sellers. Unless the State changes its policy of forbearance, the City has no cause of action against Defendants for violations of the CMSA.

B. State Issues of Public Policy Preclude The City's Nuisance Claim

While the Court must, for the purposes of this motion, accept the City's allegations as true, it is axiomatic that "bald contentions, unsupported characterizations, and legal conclusions are not well-pleaded allegation, and will not suffice to defeat a motion to dismiss." Xerion Partners, I LLC v. Resurgence Asset Mgmt., LLC, 474 F. Supp. 2d 505, 561 (S.D.N.Y. 2007). Here, the City's allegations in support of its public nuisance claim against Defendants are little more than "unsupported characterizations" that should be dismissed by the Court.

Under New York law, a public nuisance is "conduct or omissions which offend, interfere with or cause damage to the public in the exercise of rights common to all in a manner such as to offend public morals, interfere with the use by the public of a public place or endanger or injure the property, health, safety or comfort of a considerable number of persons." Copart Indus., Inc. v. Consolidated Edison Co., 41 N.Y.2d 564, 568, 362 N.E.2d 968, 971, 394 N.Y.S.2d 169, 172 (1977). A successful claim requires the City to demonstrate:

> 1. the existence of a public nuisance-a substantial interference with a right common to the public;

> 2. negligent or intentional conduct or omissions by a defendant that create, contribute to, or maintain that public nuisance; and
>
> 3. particular harm suffered by plaintiff different in kind from that suffered by the community at large as a result of that public nuisance.

N.A.A.C.P. v. Acusport, Inc., 271 F. Supp. 2d 435, 448 (E.D.N.Y. 2003); see, also, City of New York v. Beretta U.S.A Corp., 315 F. Supp. 2d 256, 276-77 (E.D.N.Y. 2004) (The City of New York "is a proper party to bring an action to retrain a public nuisance that allegedly may be injurious to the health and safety of its citizens."). Here, even assuming that a public nuisance does exist, the City has failed to plead even the most basic facts to suggest that Defendants are causing or contributing to the existence of that nuisance.

The City's nuisance claim is premised upon alleged violations of the Public Health Law § 1399-ll by reservation sellers who purchase unstamped cigarettes from Defendants. The State Commissioner of Public Health is expressly empowered to enforce § 1399-ll. The City has no enforcement powers under the provisions of §1399-ll.

Despite its lack of enforcement powers under § 1399-ll, the City attempts to use § 1399-ll to bootstrap its public nuisance claims. Violation of the state statute does not give the City the right to bring a private civil lawsuit based on nuisance. A.E. Sales, LLC, 03 Civ. 7715 (DAB), slip op. at 3. The conduct which is the violation must constitute a public nuisance. While smoking may create a public nuisance, neither the State nor the City prohibits the sales of cigarettes. Section 1399-ll does not ban the sale of cigarettes, but merely regulates who may sell cigarettes to State consumers. Nor does the statute curtail the number of cigarettes available for sale to City residents. Since § 1399-ll is not aimed at smoking, but at sales, the City's claim does not sound so much in nuisance as in tax collection.

The City's public nuisance claim is another ploy to attack the State's policy of forbearance. As stated earlier, only the State can set public tax policy. On a matter of public policy, the State is concerned not only with the collection of taxes, but also with the preservation of public order and peace. The City cannot pursue a claim for public nuisance by setting aside a State policy aimed at avoiding other public nuisances.

Tellingly, the City has unsuccessfully pursued this theory of public nuisance several times before in federal court. In A.E. Sales, the City brought a nearly identical claim of public nuisance against cigarette sellers who were alleged to be selling their cigarettes directly to New York City residents via the Internet. A.E. Sales, 03 Civ. 7715, slip op. at 2-3. The Southern District granted those defendants' motion to dismiss, ruling that even if the State Legislature, through the legislative history of § 1399-11, correctly identified the sale of cigarettes by Internet, mail order or telephone ("delivery sales") as a public nuisance, the City had failed to plead facts necessary to demonstrate that the defendants' delivery sales were affecting a "considerable number of people" so as to satisfy the elements of a public nuisance claim at common law. A.E. Sales, 03 Civ. 7715, slip op. at 6. Further, the court stated that it was "wary of expanding the breadth of public nuisance law," noting the cautionary language issued by the State's Appellate Division in the context of a public nuisance charge against the gun industry. See A.E. Sales, 03 Civ. 7715, slip op. at 8.

In People v. Sturm, Ruger & Co., Inc., 309 A.D.2d 91, 761 N.Y.S. 2d 192 (1st Dep't), lv. denied, 100 N.Y.2d 514, 801 N.E.2d 421, 769 N.Y.S. 2d 2000 (2003), the court held that

> [W]e see on the horizon, were we to expand the reach of the common-law public nuisance tort in the way the plaintiff urges, the outpouring of an unlimited number of theories of public nuisance claims for courts to resolve and perhaps impose and enforce – some of which will inevitably be exotic and fanciful, wholly theoretical, baseless, or perhaps even politically motivated and exploitative.

Id. at 104-05, 761 N.Y.S. 2d at 202-03. Returning to this language, the A. E. Sales court noted that "[u]sing the guise of public health concerns under common law nuisance to close a tax loophole is that 'exotic and fanciful' usage that was of concern to the Sturm, Ruger court." A.E. Sales, 03 Civ. 7715, slip op. at 9.

Here, the City is once again seeking to use the pretext of public health to close a tax loophole. Indeed, its claims are, if anything, even more "fanciful" than those brought in the A. E. Sales litigation. In that matter, the City was claiming that Defendants who directly sold to consumers were creating a public nuisance. Here, the City is asking the Court to go a step further, holding Defendants liable not for their own actions, but for the actions of reservation sellers that are not parties to this litigation. Moreover, in the A. E. Sales litigation, the Court held that a claim that roughly 6% cigarette sales in New York City were occurring over the Internet was insufficient to establish that a "considerable number of persons" were being injured under the public nuisance standard. A.E. Sales, 03 Civ. 7715, slip op. at 6-7. Here, the City claims that "perhaps as much as 15 percent of all smokers in the City purchase their cigarettes from Internet sellers, street sellers and reservations sellers." (Am. Compl. ¶ 43). The Amended Complaint is silent as to what fraction of this 15% is attributable to reservation sellers – the only sellers to whom Defendants are alleged to provide wholesale cigarettes. Moreover, the Complaint is similarly devoid of any indication of what percentage of cigarettes sold by reservation sellers are provided by Defendants. Here, the City has plainly failed to plead facts adequate to establish that Defendants are causing "a public nuisance that imperils the City's very existence" or that their actions endanger "the public at large." A.E. Sales, 03 Civ. 7715, slip op.

at 9. Accordingly, Defendants respectfully submit that the City's public nuisance claim should be dismissed.

CONCLUSION

The relief requested in the City's Amended Complaint would require the Court to supplant the State's exclusive taxing authority. While the City may be unhappy with the State's policy of forbearance, it should not be permitted to usurp the State's authority. The City's interest alone cannot dictate the interest for an entire State. The City's cavalier approach to "sue first, get the facts later" should not be used to derail Defendants' lawful business practices that are in accordance with State's tax laws and policies.

Accordingly, Day Wholesale respectfully submits that the Amended Complaint be dismissed for the City's lack of capacity and standing to challenge the State's policy of forbearance. Both the City's federal claim under the Contraband Cigarette Trafficking Act, § 18 U.S.C. 2341 *et seq.*, and state claim under the Cigarette Marketing Standards Act, N.Y. Tax Law § 483 *et seq.*, are dependent on the assumption that Articles 20 and 28 of the New York Tax Law requires the pre-collection of state taxes on reservation sales to non-Indians. The assumption is plainly erroneous and in conflict with the State's policy of forbearance. Therefore, these federal and state claims must fail as a matter of law. The City seeks to further bolster its political dispute with the State with an insufficient claim that Defendants' actions contribute to a public nuisance. Finally, the City cannot join the only necessary and indispensable party whose policy is at the root of the City's grievance – the State.

Each of the City's theories of liability have been raised, considered and rejected by both federal and state courts. Day Wholesale respectfully submits that this Court should do the same.

Dated: May 10, 2007
Buffalo, New York

Respectfully Submitted,

x /s/Margaret A. Murphy x

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