10-4265

10-4272, 10-4598, 10-4758
10-4477, 10-4976, 10-4981

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ONEIDA NATION OF NEW YORK,
Plaintiff-Appellee

SENECA NATION OF INDIANS,
Plaintiff-Appellee-Cross-Appellant

v.

DAVID PATERSON, IN HIS OFFICIAL CAPACITY AS GOVERNOR OF NEW YORK, JAMIE WOODWARD, IN HIS OFFICIAL CAPACITY AS ACTING COMMISSIONER OF THE NEW YORK DEPARTMENT OF TAXATION AND FINANCE, WILLIAM J. COMISKEY, IN HIS OFFICIAL CAPACITY AS DEPUTY COMMISSIONER FOR THE OFFICE OF TAX ENFORCEMENT FOR THE NEW YORK DEPARTMENT OF TAXATION AND FINANCE,
Defendants-Appellants,

JOHN MELVILLE,
Defendant-Appellant-Cross-Appellee

CAYUGA INDIAN NATION OF NEW YORK,
Intervenor-Appellant

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NEW YORK

OPENING BRIEF FOR CAYUGA INDIAN NATION OF NEW YORK

[Counsel Listed on Inside Cover]

David W. DeBruin
Scott B. Wilkens
Joshua M. Segal
JENNER & BLOCK LLP
1099 New York Avenue, NW
Washington, DC 20001
(202) 639-6000

Daniel French
Lee Alcott
FRENCH-ALCOTT, PLLC
One Park Place
300 South State Street
Syracuse, NY 13202
(315) 413-4050

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JURISDICTIONAL STATEMENT

The district court had jurisdiction over this case (Court of Appeals Docket No. 10-4272; W.D.N.Y. Case No. 10-cv-687) under 28 U.S.C. §§ 1331 and 1362. On October 14, 2010, the district court issued an interlocutory order denying the Cayuga Nation's motion for a preliminary injunction. The Cayuga Nation timely filed a motion for reconsideration under Rules 59 and 60 of the Federal Rules of Civil Procedure. The district court denied the motion on November 12, 2010, and the Cayuga Nation timely filed a notice of appeal on November 18, 2010. This Court has jurisdiction under 28 U.S.C. § 1292(a)(1).[1]

ISSUE PRESENTED

Whether the Cayuga Nation was entitled to a preliminary injunction against enforcement of a state tax scheme that violates established principles of Indian sovereignty by (a) requiring Indian nations to prepay substantial state excise taxes on cigarette sales to non-tribal members; and (b) giving unaffiliated wholesalers the ability to control the Cayuga Nation's entire quota of tax-free cigarettes.

STATEMENT OF THE CASE

The Cayuga Indian Nation of New York ("Cayuga Nation" or "Nation") is a sovereign Indian nation recognized by both the United States and the State of New

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[1] This Court's jurisdiction over the other cases in these consolidated appeals is addressed in the briefs submitted by the parties to those cases.

York ("State"). For decades, out of respect for Indian sovereignty and to permit Indian tribes to engage in economic development, the State allowed the tribes to sell cigarettes on qualified reservation land to tribal members and non-members without collecting state taxes. Then, in mid-2010, in response to budget pressures, the State Legislature rushed through a new scheme for taxing on-reservation sales of cigarettes to non-members, but in thoughtless ways that needlessly infringe longstanding principles of Indian sovereignty. 2010 N.Y. Laws 134, Part D (SPA94-102).[2] The amendments to the New York Tax Law require all cigarettes sold on Indian reservations to bear state tax stamps, and limit Indian nations to a specified quantity of tax-exempt (though stamped) cigarettes that can be used by the Indian nation or sold to members of the tribe on reservation land. *See* N.Y. Tax Law §§ 471, 471-e (SPA104-10). On June 22, 2010, the day after the amendments were enacted, the Department of Taxation and Revenue issued emergency implementing regulations. *See* 20 N.Y.C.R.R. § 74.6 (2010) (SPA120-26). The new statutory and regulatory scheme was scheduled to take effect on September 1, 2010.

[2] "SPA" refers to the Special Appendix filed by the parties and is followed by the page numbers on which the cited material appears. "JA" refers to the Joint Appendix filed by the parties and is similarly followed by the page numbers where the cited material appears.

The Seneca Nation of Indians ("Seneca Nation") brought suit in the United States District Court for the Western District of New York (Arcara, J.), challenging the new tax scheme under the U.S. Constitution and seeking a preliminary injunction. The Cayuga Nation intervened and also sought a preliminary injunction. The district court issued a temporary restraining order preventing implementation of the tax scheme. After a hearing on September 14 and 15, 2010, and after supplemental argument on September 23, 2010, the district court denied a preliminary injunction. Although it held that the tribes had failed to demonstrate a likelihood of success on the merits, the court found that the tribes had raised substantial issues going to the merits of their claims and issued a stay pending appeal. *Seneca Nation of Indians v. Paterson*, No. 10-CV-687A, 2010 WL 4027796 (W.D.N.Y. Oct. 14, 2010) (order denying preliminary injunction) (SPA3-37); *Seneca Nation of Indians v. Paterson*, No. 10-CV-687A, 2010 WL 4027795 (W.D.N.Y. Oct. 14, 2010) (order granting stay pending appeal) (SPA38-45). The State moved to vacate the stay, but this Court denied the State's motion and the injunction pending appeal remains in effect. *Paterson v. Seneca Nation of Indians*, No. 10-4272 (2d Cir. Dec. 9, 2010) (order denying motion to vacate stay pending appeal).[3]

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[3] For similar reasons, Judge Arcara also denied a preliminary injunction and

[Footnote continued on next page]

While the *Seneca* case was pending before Judge Arcara in the Western District, the Oneida Nation brought a challenge to the new tax scheme in the Northern District (Hurd, J.). On the same day that Judge Arcara denied a preliminary injunction and issued a stay pending appeal in the *Seneca* case, Judge Hurd granted the Oneida Nation's motion for a preliminary injunction. Judge Hurd ruled that the State's tax scheme would impose significant burdens on the Oneida Nation and would cause irreparable harm. *Oneida Nation of New York v. Paterson*, No. 10-CV-1071, 2010 WL 4053080 (N.D.N.Y. Oct. 14, 2010) (SPA46-70).

This Court consolidated appeals by the State (from the injunction granted by Judge Hurd and the stay issued by Judge Arcara) and by the Indian nations in the cases before Judge Arcara (from the orders denying a preliminary injunction). Neither Judge Arcara nor Judge Hurd has entered a final judgment in the cases before them. Thus, in each case, further proceedings will be conducted to develop fully the burdens and harms occasioned by the new tax scheme, which is necessary

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[Footnote continued from previous page]
issued a stay pending appeal in a challenge to the New York tax scheme brought by the Unkechauge Nation and the St. Regis Mohawk Tribe. *Unkechauge Indian Nation v. Paterson*, No. 10-CV-711A, 2010 WL 4486565 (W.D.N.Y. Nov. 9, 2010) (SPA74-86).

to enable the district courts to enter a final judgment on all of the Indian nations' legal claims.

STATEMENT OF FACTS

A. The Cayuga Nation And Its Operations.

The Cayuga Nation is one of the Six Nations of the Haudenosaunee, which were the most powerful Indian tribes in the northeastern United States at the time of the American Revolution. *County of Oneida v. Oneida Indian Nation of N.Y.*, 470 U.S. 226, 230 (1985).[4] The Cayuga Nation's original treaty with the United States pre-dates the U.S. Constitution, and the United States recognizes the Cayuga Nation as a sovereign Indian tribe under federal law. *See* Fort Stanwix Treaty with the Six Nations, October 22, 1784, 7 Stat. 15; Indian Entities Recognized and Eligible to Receive Services from the United States Bureau of Indian Affairs, 73 Fed. Reg. 18,553 (Apr. 4, 2008).

In the 1794 Treaty of Canandaigua, the United States recognized the existence of a 64,015-acre reservation for the Cayuga Nation. 7 Stat. 41. New York State, however, later acquired fee title to that land in a series of transactions that failed to comply with federal law. *Cayuga Indian Nation of N.Y. v. Pataki*,

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[4] The Six Nations are the Cayugas, Mohawks, Oneidas, Onondagas, Senecas, and Tuscaroras. *New York Indians v. United States*, 170 U.S. 1, 36 (1898).

413 F.3d 266, 268-69 (2d Cir. 2005). Notwithstanding the State's purchases, Congress has never taken any steps to disestablish or diminish the Cayuga reservation. *See Solem v. Bartlett*, 465 U.S. 463, 470 (1984) (reservation status persists "until Congress explicitly indicates otherwise").

Since 2003, the Cayuga Nation has owned and operated two convenience stores – one in Seneca County, the other in Cayuga County – located on fee land purchased by the Nation within the boundaries of its reservation. *Cayuga Indian Nation of N.Y. v. Gould*, 930 N.E.2d 233, 240 (N.Y. 2010). From these stores, the Nation sells unstamped cigarettes to its members as well as to non-members, for personal consumption. *Id.*; JA224-25. Revenues from these cigarette sales represent virtually the only source of revenue for the Nation, and the profits are used to conduct tribal activities and provide tribal services. JA225. Without these revenues, the Nation may be unable to provide essential services to its citizens. *Id.*

B. The State's Efforts To Tax Cigarette Sales By Indian Tribes.

Since 1939, the State of New York has imposed an excise tax on cigarettes sold at retail within the State. The tax, codified at Section 471 of the Tax Law, is collected at the top of the distribution chain, with payment evidenced by a stamp on the package. The tax is then passed on to each successive purchaser and ultimately collected from the consumer as part of the retail price of the cigarettes. *See* N.Y. Tax Law § 471 (SPA104-06). Under state law, violation of the cigarette

tax provisions constitutes a felony or a misdemeanor, depending on the circumstances. *See* N.Y. Tax Law § 1814.

The historical context of and legal rules governing the imposition and enforcement of state tax laws on qualified Indian reservations are complex and central to this case, and are discussed further below. For purposes relevant here, New York State has at various times since 1988 sought to impose its cigarette excise tax provisions on sales made by Indian tribes on their qualified reservations. The State's legal right to do so has been upheld by the courts, but in decisions that have reserved judgment concerning the impact and legality of specific provisions of those prior tax schemes. *See generally Dep't of Taxation and Fin. of New York v. Milhelm Attea & Bros., Inc.*, 512 U.S. 61 (1994); *Gould*, 930 N.E.2d 233. However, the State then made a voluntary and formal decision to withdraw from those prior efforts, before the tax schemes were ever upheld in full, in large part because of "sensitivity to both tribal sovereignty issues and the complex restrictions imposed by the Indian Trader Laws." *New York Ass'n of Convenience Stores v. Urbach*, 699 N.E.2d 904, 908 (N.Y. 1998). This policy of "forbearance," as it came to be called, was itself challenged in the courts by non-Indian retailers and upheld. *Id.*; *Gould*, 930 N.E.2d at 237-38. The policy of forbearance persisted, and it has been the "status quo" in New York for decades. *Gould*, 930 N.E.2d at 237-38.

All this came to an abrupt change last summer. Faced with a significant budget deficit, the Legislature hurriedly enacted new legislation to require Indian nations to collect state excise taxes in connection with on-reservation sales to non-tribal members. 2010 N.Y. Laws 134, Part D (SPA94-102). At the same time, the Legislature raised the cigarette excise tax by $1.60 per pack, from $2.75 to $4.35. *Id.* § 1 (SPA94). The State's new tax scheme required the promulgation of "emergency" regulations, because, as the State has acknowledged, the statute's September 1, 2010 effective date left "insufficient time to adopt the regulations within the normal State Administrative Procedure Act time frame." JA244. The Department's "emergency" regulations in fact were promulgated on June 22, 2010, only one day following the Legislature's amendment of the Tax Law. *See* 20 N.Y.C.R.R. § 74.6 (SPA120-26).

The new scheme provides that the cigarette tax set forth in § 471 does not apply to cigarette sales to "qualified Indians for their own use and consumption on their nations' or tribes' qualified reservations," but that the tax does apply to all cigarettes sold "on an Indian reservation to non-members of the Indian nation or tribe." N.Y. Tax Law § 471(1) (SPA104). The statue makes clear that "[a]ll cigarettes sold by agents and wholesalers to Indian nations or tribes or reservation cigarette sellers located on an Indian reservation must bear a [New York State] tax stamp." N.Y. Tax Law § 471(2) (SPA105).

The new tax scheme provides two alternative mechanisms by which Indian nations and their members may obtain cigarettes for their own use that are exempt from state taxes, even though, under the new scheme, the cigarettes still must bear tax stamps. *See* N.Y. Tax Law § 471(1) (SPA104). The first mechanism is an "Indian tax exemption coupon system," in which an Indian nation must affirmatively elect to participate. N.Y. Tax. Law §§ 471(1), 471-e(1)(b) (SPA104, 107). Under this system, the Tax Department would distribute a quota of Indian tax exemption coupons to a participating Indian nation, based upon the "probable demand" for tax-exempt cigarettes by members of the nation for their own personal use and consumption, as calculated by the Department. N.Y. Tax Law § 471-e(2) (SPA108-09). Each Indian nation would then have "the obligation to determine how those coupons should be redeemed, allocated, and distributed." SPA11. Reservation cigarette sellers would provide these coupons to state-licensed stamping agents and wholesale dealers to obtain tax-exempt, albeit stamped, cigarettes for purposes of resale to nation members. N.Y. Tax Law § 471-e(3) (SPA109-10). The stamping agents and dealers in turn would submit these coupons to the Tax Department in conjunction with a refund request for taxes prepaid on stamped cigarettes that were not, in fact, subject to the state tax. N.Y. Tax Law § 471-e(4) (SPA110).

The second mechanism is the "prior approval" system, which is the default mechanism if an Indian nation does not elect to participate in the coupon system. N.Y. Tax Law § 471(5)(a) (SPA106). Under the prior approval system, the Department calculates a quota of tax-exempt cigarettes for each Indian nation based upon the same probable demand formula noted above. N.Y. Tax Law § 471(5)(b) (SPA106); 20 N.Y.C.R.R. § 74.6(e) (SPA125-26). Before selling any portion of the tax-exempt quota of cigarettes to an Indian nation or to reservation cigarette sellers on the nation's qualified reservation, a wholesaler must receive "prior approval" from the Department. *See* N.Y. Tax Law § 471(5)(b) (SPA106); (SPA124); 20 N.Y.C.R.R. § 74.6(d)(3) (SPA124).

Neither the statutory amendments nor the implementing regulations specify how the prior approval system will operate. Instead, an informal statement issued by the Tax Department purports to explain the prior approval system. TSB-M-10(6)(M), Amendment to the Tax Law Related to Sales of Cigarettes on Indian Reservations Beginning September 1, 2010 (July 29, 2010) (SPA139-46). Wholesalers wishing to make tax-free sales to Indian nations are required to have an online services account on the Tax Department's website. SPA50. The Department will post each nation's quota of tax-free cigarettes at the beginning of each quarter, and any wholesaler can then claim part or all of a tribe's quota. *Id.* The number of cigarettes claimed by a wholesaler is automatically deducted from

the nation's quota. *Id.* If there is no actual sale to the Indian nation or a reservation cigarette retailer within 48 hours, the "claim" disappears. SPA50-51. However, the wholesaler may go back to the website and again claim the tribe's allotment of tax exempt cigarettes. SPA51. If the cigarettes are actually sold to a tribe, the wholesaler must report that on the website. *Id.* The wholesaler may then request a refund from the Department for taxes prepaid on stamped cigarettes sold as tax-exempt to the Indian nation or reservation cigarette sellers. *Id.*

For all cigarettes sold by wholesalers to tribes or tribal retailers that are destined for sale to *non-tribal members*, New York's new tax scheme requires wholesalers to add the amount of the tax to the sales price of cigarettes. Thus, when an Indian nation purchases cigarettes from a wholesaler for sale to non-members, the nation pays the wholesale price for the cigarettes and also pays an additional amount that constitutes prepayment of the state excise taxes on the cigarettes in question. The current amount of the excise tax is significant – $4.35 per pack, or $43.50 for each carton purchased by the Indian nation. SPA48. For the entire time that the carton is held in inventory before it is sold, those funds essentially have been loaned by the tribe to the State, without interest. JA333. Only when the cigarettes are sold to a non-Indian consumer does the tribe collect the state taxes, thus recouping the amount that it had advanced to the State by

prepaying the tax. Even then, however, the Indian nation never recoups the interest or other financial opportunities lost for the period that the funds were advanced to the State.

C. Federal District Court Challenges To The New York Tax Scheme.

Several Indian nations filed challenges to the new scheme in the Western District and the Northern District. The Seneca Nation filed suit on August 17, 2010 in the Western District, and the Cayuga Nation subsequently intervened in that action (Case No. 10-cv-687). On August 27, 2010, the Unkechauge Indian Nation filed a separate action in the Western District (Case No. 10-cv-711). Meanwhile, the St. Regis Mohawk Tribe filed an action in the Northern District on August 24, 2010, but that action was subsequently transferred to the Western District (Case No. 10-cv-811) and consolidated with the Unkechauge suit. On September 7, 2010, the Oneida Nation filed an action in the Northern District (Case No. 6:10-cv-1071). The Western District cases were heard before Judge Arcara, while the Northern District case was heard before Judge Hurd.

In the *Seneca/Cayuga* suit before Judge Arcara, the Cayuga Nation focused on two aspects of the tax scheme that are unduly burdensome and unnecessary. These aspects of the tax scheme were also challenged by the Oneida Nation in the suit before Judge Hurd. First, the Cayuga Nation challenged the fact that the new scheme requires the Nation to prepay the State's excise taxes, often weeks or

months before the Nation sells the cigarettes in the transaction that the State is entitled to tax – the sale to a non-member of the tribe. At the evidentiary hearing below, State witness Bartlett admitted that the statutory and regulatory scheme requires the Nation to prepay an excise tax of $43.50 for every carton of cigarettes purchased by the Nation, and that these funds are held by the State, without payment of interest to the Nation. JA333. Only when (and if) the cigarettes are sold to a non-Indian consumer does the Nation recoup the amount it has advanced to the State. During this period of time, it is the Nation itself, and not any potential future purchaser, that has been taxed by the State.

In addition, if the cigarettes are *not* sold, then the Nation must apply to the Tax Department for a refund of the taxes paid, under a cumbersome refund mechanism:

> Whenever any cigarettes upon which stamps have been placed or tobacco products upon which the tax has been paid . . . have become unfit for use and consumption or unsalable . . . the agent, dealer or tobacco products distributor, as the case may be, shall be entitled to a refund of the actual amount of tax so paid, provided application therefor is filed with the commissioner of taxation and finance within two years after the stamps were affixed to such cigarettes or the tax was paid upon such tobacco products. . . .

N.Y. Tax Law § 476 (SPA111). The section goes on to state: "If the commissioner of taxation and finance is satisfied that any dealer is entitled to a refund he shall issue to such dealer stamps of sufficient value to cover the refund of the tax on cigarettes or may, subject to audit by the comptroller, make a refund

of the tax on cigarettes or on tobacco products." *Id.* Thus, an Indian nation is required to pay a tax on products it may never sell, subject only to the ability to file for a refund if the products "become unfit for use . . . or unsalable," which refund is contingent on whether the Tax Department is "satisfied that [the nation] is entitled to a refund." *Id.*

Second, the Cayuga Nation challenged an illogical and unnecessary aspect of the manner in which the new scheme permits an Indian nation to obtain cigarettes without payment of tax for its own use or for transactions with its own members. As described above, the new scheme establishes for each tribe a "quota" of cigarettes that may be purchased each quarter without tax. However, as State witness Bartlett confirmed at the evidentiary hearing, under the "prior approval" system, the regulations allow *any* wholesaler in the state – whether or not it has ever had a business relationship with an Indian nation – to "claim" some or all of that quota for sales to the tribe, without proof of an actual purchase order from the tribe.[5] JA333. As a result, the regulations deprive an Indian nation of the right to

[5] Mr. Bartlett admitted that the wholesaler then has 48 hours to complete the sale. During that period, the Nation may have no other recourse for the purchase of tax-free cigarettes to sell to its own members. Moreover, if the wholesaler does not complete the sale within 48 hours, there is nothing in the regulations or in the Tax Department's informal guidance, TSB-M-10(6)(M), to prevent that wholesaler from again claiming some or all of the Nation's quota for subsequent 48-hour periods. *See* JA334.

decide from whom it will purchase tax-free cigarettes for its own use and for transactions with members. Many Indian nations traditionally purchase cigarettes from particular wholesalers, who often have an Indian affiliation. The new regime illogically allows any wholesaler to seize a tribe's quota and essentially monopolize those sales. Such monopolistic behavior would allow a wholesaler to demand a premium for cigarettes, thereby eliminating the benefit of their tax-free status.

Although Indian nations have the option of choosing the coupon system in lieu of the default prior approval system, the coupon system is itself deeply flawed and was challenged before Judge Arcara by the Seneca and Mohawk nations. By forcing tribes to take a command-and-control approach to regulating their tobacco economies, which is incompatible with the way that many of those tribal economies operate, the coupon system rides roughshod over tribes' sovereign right of self-government. Given the need to have a permissible mechanism for imposing a state tax collection obligation on all Indian nations in the State, and not just some, the principal focus below was whether the alternative default "prior approval" system was a permissible mechanism for imposing a state tax collection obligation on tribal on-reservation sales.

On October 14, 2010, Judge Arcara denied the Cayuga and Seneca Nations' motions for a preliminary injunction, but issued a stay pending appeal. On the

same day, Judge Hurd granted the Oneida Nation's motion for a preliminary injunction. In these rulings, the district courts reached contradictory results regarding the tribes' challenges to the tax scheme's prepayment obligation and prior approval system.

While recognizing that Indian tribes have "sovereign power" over their members and territory and generally are exempt from state taxation within their own reservation, SPA15-16, Judge Arcara concluded that the tribes were unlikely to succeed on the merits of their claims that the New York tax scheme unconstitutionally burdens tribal sovereignty, SPA36. With respect to the tax scheme's precollection obligation, he acknowledged that "the tax imposed by New York is significantly higher than the amounts previously authorized by the Supreme Court," but viewed that increased burden as constitutionally permissible. SPA25. Turning to the State's prior approval system, Judge Arcara acknowledged the "very realistic possibility" of monopolistic behavior by a single wholesaler that would "eviscerate[] any tax savings to the individual member[s]" of a tribe, but viewed that risk as a permissible result. SPA33-35. With respect to the coupon system, Judge Arcara accepted that "[t]he task of allocating coupons among the [Seneca] Nation's retailers may be somewhat more onerous than the 'minimal burden' approved of by the Supreme Court in *Moe*, *Colville* and their progeny,"

but he did not decide whether the burden was impermissible because he viewed the prior approval system as a constitutionally adequate alternative. SPA30-31.

At the same time, Judge Arcara granted a stay pending appeal, finding that "[t]he Nations have raised serious legal questions going to the merits of their claims" and that "[i]t remains an open question whether the Second Circuit will agree with this Court's determination that the prior approval system imposes only a minimal burden." SPA44. Judge Arcara also found that "the Nations will suffer irreparable injury absent a stay" because "[t]he potential loss of an entire economy that currently supports many of each Nation's members and services is a harm that cannot be measured by monetary damages alone." SPA42.

In contrast, Judge Hurd granted a preliminary injunction in the suit brought by the Oneida Nation, holding that the prepayment obligation and the prior approval system unconstitutionally burdened tribal sovereignty. SPA61-65. With respect to the prepayment obligation, Judge Hurd held that "requiring the Oneida Nation to pay the tax, and be out of pocket for that amount until the retail sale is made . . . is unconstitutional." SPA60, 62. As to the prior approval system, Judge Hurd held that the threat of monopolization by a single wholesaler "further burdens plaintiff by not protecting the right to have available tax-free cigarettes for members and itself, as required by law." SPA63. Judge Hurd found that the prior approval system was "ripe for manipulation by wholesalers" and "would allow a

wholesaler . . . to monopolize the Oneida Nation's allotment to prevent tax-free sales forcing members to purchase taxed cigarettes at non-Indian retailers for their own consumption." SPA62.

On October 20, 2010, the Cayuga Nation sought reconsideration of Judge Arcara's denial of a preliminary injunction, based on Judge Hurd's contrary decision and the importance of uniform administration of the tax law. Judge Arcara denied the motion for reconsideration on November 12, 2010, and this appeal of Judge Arcara's denial of a preliminary injunction followed.

The Cayuga Nation's appeal has been consolidated with other appeals in the *Seneca/Cayuga*, *Oneida*, and *Unkechauge/St. Regis Mohawk* challenges to the New York tax scheme. As noted above, these appeals are all interlocutory, and neither Judge Arcara nor Judge Hurd has issued a final judgment in any of the underlying actions.

SUMMARY OF ARGUMENT

New York's hastily-enacted scheme to tax on-reservation cigarette sales to non-tribal members must be viewed in historical context. The doctrine of Indian sovereignty over reservation lands and the policy of leaving Indians free from state interference is deeply rooted in our Nation's history and in the law. For over 175 years, the Supreme Court has protected the sovereign authority of Indian nations over their reservations and their members. Although the Court has recognized a

narrow exception allowing States to place minimal, reasonably necessary burdens on Indian tribes to collect state taxes on cigarette sales to non-members, the New York tax scheme far exceeds that narrow exception.

The Cayuga Nation challenges aspects of the State's new scheme that impose impermissible and avoidable burdens upon the Nation, and impair the Nation's legitimate efforts to maintain tribal self-sufficiency and economic development. First, the prepayment tax obligation at issue here is far more substantial, given the huge increases in the amount of the excise tax, than anything that has been considered previously by the Supreme Court. The State effectively has imposed a significant tax directly upon an Indian nation itself, long before the transaction occurs that the State is entitled to tax. The Supreme Court has held that there is a bright-line rule against any tax imposed upon an Indian nation. *See, e.g.*, *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 148 (1973). Moreover, the prepayment obligation imposes an undue burden associated with a tribe's collection of a state tax, *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134, 159-60 (1980), which is avoidable.

Second, under the default "prior approval" system for tax-free sales, the State has illogically and impermissibly authorized any wholesaler in the State to seize the entire amount of the Nation's designated quota. Although the district court denied a preliminary injunction, it recognized that the regulations created a

risk that a "monopoly situation . . . may occur." SPA33. The regulations also deny an Indian nation the right to decide for itself from whom it will purchase cigarettes for its own use and for transactions with members. In so doing, the State has interfered with the undisputed right of an Indian nation to sell cigarettes to its own members without tax. *Moe v. Confederated Salish & Kootenai Tribes of Flathead Reservation*, 425 U.S. 425, 480-81 (1976).

Although the State has provided a "coupon system" as an ostensible alternative to the prior approval system, the coupon system is itself defective because it interferes with tribal sovereignty by requiring Indian nations to engage in command-and-control style regulation of retail tobacco economies. Although the extent of the interference may vary depending upon the size of a tribe's retail operations, the State cannot impose a tax collection scheme that works for some Indian nations but not others, and every nation has a right to expand its own on-reservation activity.

As Judge Arcara correctly concluded in granting a stay pending appeal, the Cayuga Nation would suffer irreparable harm if the new tax scheme were implemented. The scheme is a direct affront to the Nation's sovereignty over its territory and its members and threatens the Nation's economy, which is almost entirely dependent on the sale of cigarettes at the Nation's two convenience stores. Granting a preliminary injunction is in the public interest because it protects Indian

sovereignty and economic development until such time as the State formulates a lawful scheme for collecting state taxes with regard to on-reservation cigarette sales to non-tribal members.

ARGUMENT

THE CAYUGA NATION IS ENTITLED TO A PRELIMINARY INJUNCTION TO PROTECT ITS SOVEREIGN AUTHORITY OVER ON-RESERVATION ECONOMIC ACTIVITY.

This Court reviews a district court's denial of a preliminary injunction for abuse of discretion, but reviews questions of law decided in connection with the denial of a preliminary injunction de novo. *Lusk v. Vill. of Cold Spring*, 475 F.3d 480, 484-85 (2d Cir. 2007). A district court abuses its discretion in denying a preliminary injunction if it "(1) bases its ruling on an erroneous view of the law, (2) makes a clearly erroneous assessment of the evidence, or (3) renders a decision that cannot be located within the range of permissible decisions." *Monserrate v. N.Y. State Senate*, 599 F.3d 148, 154 (2d Cir. 2010) (internal quotation marks omitted).

As a general matter, this Court requires a party seeking a preliminary injunction to "show (a) irreparable harm and (b) either (1) likelihood of success on the merits or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly toward the party requesting the preliminary relief." *Citigroup Global Mkts., Inc. v. VCG*

Special Opportunities Master Fund Ltd., 598 F.3d 30, 35 (2d Cir. 2010) (internal quotation marks omitted). However, in a case such as this, "where the moving party seeks to stay government action taken in the public interest pursuant to a statutory or regulatory scheme," the "serious questions" standard is unavailable, and the moving party must establish, "along with irreparable injury, a likelihood that he will succeed on the merits of his claim." *Id.* at 35 n.4 (internal quotation marks omitted).

Judge Arcara erred in holding that New York's new tax collection scheme imposes only a minimal, reasonably necessary burden on the Cayuga Nation and its members, even though the scheme requires the Cayuga Nation to prepay state taxes on cigarette sales to non-members long before the taxable transactions occur, and even though the scheme incentivizes non-Indian wholesalers to monopolize the Cayuga Nation's entire quota of tax free cigarettes and thereby fails to protect the Nation's right to obtain such cigarettes for its members' own use. These two aspects of the tax scheme impose substantial and avoidable burdens on the Cayuga Nation in violation of the Constitution. Given the merits of the Nation's claims, the threat of irreparable harm to the Nation's financial viability, and the public interest in maintaining the status quo, the Cayuga Nation is entitled to a preliminary injunction preventing enforcement of the new tax scheme.

I. The Cayuga Nation Is Likely To Prevail On Its Claim That New York's New Tax Collection Scheme Unconstitutionally Burdens Tribal Sovereignty.

A. For Over 175 Years The Supreme Court Has Recognized That Indian Nations Have Sovereign Authority Over Their Own Reservations, Free From State Interference.

To understand the trio of Supreme Court decisions concerning state taxation of reservation cigarette sales – *Moe*, *Colville*, and *Milhelm Attea* – it is essential to view these cases in historical context. As this Court recently reaffirmed, an Indian nation's "freedom from state taxation, in the broader context of immunity from state regulation, . . . arises from a tribe's sovereign authority over its reservation lands." *Oneida Indian Nation of N.Y. v. Madison County*, 605 F.3d 149, 156 (2d Cir. 2010), *vacated and remanded*, No. 10-72, 2011 WL 55360 (U.S. Jan. 10, 2011). The doctrine of Indian sovereignty over reservation lands, and the concomitant "policy of leaving Indians free from state jurisdiction and control," is "deeply rooted in our Nation's history" and jurisprudence. *Rice v. Olson*, 324 U.S. 786, 789 (1945); *see also McClanahan v. State Tax Comm'n of Ariz.*, 411 U.S. 164, 168 (1973). The Supreme Court first articulated the doctrine of Indian sovereignty over 175 years ago in the *Cherokee Cases*, which arose from the State of Georgia's attempts "to annihilate the Cherokees as a political society." *Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1, 15 (1831).

In the first case, *Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1 (1831), the Cherokees sought to establish that they were a "foreign state" in order to bring an action against Georgia in federal court. Chief Justice Marshall, writing for the Court, accepted that the Cherokees were "a state, . . . a distinct political society, separated from others, capable of managing its own affairs and governing itself." *Id.* at 16. The Chief Justice further accepted that the Cherokees and other Indian nations "have an unquestionable, and, heretofore, unquestioned right to the lands they occupy, until that right shall be extinguished by a voluntary cession to our government." *Id.* at 17. He did not, however, accept that Indian nations are *foreign* states, and instead characterized them as "domestic, dependent nations." *Id.* at 17. Thus, the Cherokees' motion to enjoin the state of Georgia was denied. *Id.* at 20.

One year later, Chief Justice Marshall elaborated on the doctrine of Indian sovereignty in *Worcester v. Georgia*, 31 U.S. (6 Pet.) 515 (1832). That case was an appeal by two missionaries who had been convicted of violating a Georgia law requiring non-Indians residing in Cherokee territory to obtain a license from the state. After reviewing colonial history and various treaties with Indian nations, Chief Justice Marshall summarized the doctrine of Indian sovereignty as follows:

> From the commencement of our government, congress has passed acts to regulate trade and intercourse with the Indians; which treat them as nations, respect their rights, and manifest a firm purpose to afford that protection which treaties stipulate. All these acts . . . manifestly

> consider the several Indian nations as distinct political communities, having territorial boundaries, within which their authority is exclusive, and having a right to all the lands within those boundaries, which is not only acknowledged, but guaranteed by the United States.

Id. at 556-57. The logical consequence of "this concept of Indian reservations as separate, although dependent nations" was that "state law could have no role to play within the reservation boundaries." *McClanahan*, 411 U.S. at 168. Thus, Chief Justice Marshall concluded in *Worcester* that "[t]he Cherokee nation . . . is a distinct community occupying its own territory, with boundaries accurately described, in which the laws of Georgia can have no force, and which the citizens of Georgia have no right to enter, but with the assent of the Cherokees themselves, or in conformity with treaties, and with the acts of Congress." 31 U.S. (6 Pet.) at 561.

Although *Worcester* concerned a State's attempt to extend its criminal jurisdiction to reservation lands, subsequent Supreme Court cases made clear that the doctrine of Indian sovereignty also generally prevents states from levying taxes on reservations. *McClanahan*, 411 U.S. at 169. For example, in *The Kansas Indians*, 72 U.S. (5 Wall.) 737 (1867), the Supreme Court rejected a State's attempt to impose a land tax on reservation Indians: "If the tribal organization of the Shawnees is preserved intact, and recognized by the political department of the government as existing, then they are a 'people distinct from others,' capable of making treaties, separated from the jurisdiction of Kansas, and to be governed

exclusively by the government of the Union." *Id.* at 755. The Court reached a similar result in *The New York Indians*, 72 U.S. (5 Wall.) 761 (1867), decided the same day, where the State sought to tax reservation lands in order to raise money to build roads across those reservations. *Id.* at 771-72 ("Our conclusion is, that the whole of the taxes assessed upon the three reservations (Buffalo Creek, Alleghany, and Cattaraugus), are illegal, and void as in conflict with the tribal rights of the Seneca nation as guaranteed to it by treaties with the United States.").

Nearly a century later, in *Warren Trading Post Co. v. Arizona Tax Commission*, 380 U.S. 685 (1965), the Supreme Court struck down Arizona's attempt to tax the gross revenue of a trading company doing business on the Navajo reservation. In doing so, the Court noted that "from the very first days of our Government, the Federal Government has been permitting the Indians largely to govern themselves, free from state interference." *Id.* at 686-87. Subsequently, in *McClanahan v. State Tax Commission of Arizona*, 411 U.S. 164 (1973), the Court invalidated Arizona's efforts to impose its personal income tax on a reservation Indian whose entire income was derived from reservation sources. The Court reasoned that "[t]he Indian sovereignty doctrine . . . provides a backdrop against which the applicable treaties and federal statutes must be read." 411 U.S. at 172; *see id.* at 173 ("When the relevant treaty and statutes are read with this

tradition of sovereignty in mind, we think it clear that Arizona has exceeded its lawful authority by attempting to tax appellant.").

In sum, these cases establish that the federal government has "exclusive authority over relations with Indian tribes," and that "[a]s a corollary of this authority, and in recognition of the sovereignty retained by Indian tribes even after formation of the United States, Indian tribes and individuals generally are exempt from state taxation within their own territory." *Montana v. Blackfeet Tribe of Indians*, 471 U.S. 759, 764 (1985); *see also Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 455 (1995). Thus, "when a state attempts to levy a tax directly on an Indian tribe or its members inside Indian country, rather than on non-Indians," a "categorical bar prevents enforcement of the tax." *Oklahoma Tax Comm'n*, 515 U.S. at 458-59.

B. The Supreme Court Has Carved Out A Narrow Exception Allowing States To Impose Minimal, Reasonably Necessary Burdens On An Indian Nation In Collecting State Taxes On Cigarettes Sold To Non-Tribal Members.

Although the doctrine of Indian sovereignty bars States from extending their tax laws to Indian reservations absent express Congressional authorization, the Supreme Court has carved out a narrow exception when the legal incidence of the state tax falls on non-Indian consumers. In such a situation, if the balance of federal, state, and tribal interests favors the State, and federal law is not to the contrary, the State may impose its tax on non-Indian consumers and may place on

a tribe or tribal members minimal, reasonably necessary burdens in collecting the tax. *Oklahoma Tax Comm'n*, 515 U.S. at 459; *Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134, 154-57 (1980). This exception is a narrow one, and in the trio of relevant cases – *Moe*, *Colville*, and *Milhelm Attea* – the Supreme Court repeatedly has emphasized that the burdens imposed on the tribes in collecting a tax from non-members must be both "minimal" and "reasonably necessary" to further the State's legitimate interests.

In *Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation*, 425 U.S. 463 (1976), two members of the Confederated Salish and Kootenai Tribes were arrested for selling unstamped cigarettes at convenience stores located on land they leased from the tribes. The Supreme Court held that Montana's cigarette sales tax of $1.20 per carton could not be applied to on-reservation cigarette sales to tribal members.[6] However, the Court reached a different conclusion with respect to on-reservation cigarette sales to non-members, holding that "[t]he State's requirement that the Indian tribal seller collect a tax validly imposed on non-Indians is a minimal burden designed to avoid the likelihood that in its absence non-Indians purchasing from the tribal seller will avoid payment of a concededly

[6] The amount of the tax – 12 cents per pack or $1.20 per carton – is stated in the district court decision. *Confederated Salish and Kootenai Tribes of Flathead Reservation v. Moe*, 392 F. Supp. 1297, 1313 (D. Mont. 1974), *aff'd*, 425 U.S. 463 (1976).

lawful tax." *Id.* at 483. In reaching this conclusion, the Court did not have occasion to assess the actual burdens involved in distinguishing between sales to tribal members and non-members, or in the pre-collection of taxes on sales to the latter. The Montana tax scheme did not distinguish between sales to members and non-members, and the district court had recognized that drawing such a distinction "would result in 'complicated problems' of enforcement by the State." *Id.* at 468 n.6. Rather than attempt to address these enforcement problems, the district court had deferred doing so pending a ruling by the Supreme Court. The Supreme Court, in turn, "express[ed] no opinion on this question." *Id.*

Subsequently, in *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134 (1980), the Supreme Court held that Washington's cigarette sales tax of $1.60 per carton could be applied to on-reservation sales to non-members of Indian tribes, and that Indian retailers could be required to assist in the collection of the tax and to keep records of taxable and nontaxable transactions. With respect to collecting taxes on cigarette sales to non-members, the Court reasoned that "the simple collection burden imposed by Washington's cigarette tax on tribal smokeshops is legally indistinguishable from the collection burden upheld in *Moe*." *Id.* at 159. With regard to the recordkeeping requirements, the Court accepted the district court's finding that the tribes had

failed to proffer any evidence that the recordkeeping requirements were "not reasonably necessary." *Id.* at 160.

More than a decade later, in *Department of Taxation & Finance of New York v. Milhelm Attea & Bros.*, 512 U.S. 61 (1994), the Supreme Court reaffirmed the principle articulated in *Moe* and *Colville* that "States may impose on reservation retailers *minimal* burdens *reasonably tailored* to the collection of valid taxes from non-Indians." *Id.* at 73 (emphasis added). In *Milhelm*, a facial challenge to the State's tax collection scheme was brought by non-Indian wholesalers, and the Court addressed the narrow question whether New York's then-existing regulatory scheme for taxing reservation cigarette sales to non-members was pre-empted by the Indian Trader Statutes. In holding that the regulations were not preempted, the Court was careful to note that it did not "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." *Id.* at 69. With that important caveat, the Supreme Court upheld the State's "probable demand" mechanism for determining each tribe's quota of tax free cigarettes as a "reasonably necessary" method for preventing tax evasion by non-Indian consumers.[7] Furthermore, the Court held

[7] At the same time, the Court acknowledged that an "inadequate quota may provide the basis for a future challenge to the *application* of the regulations." *Id.* at 75 (emphasis in original).

that the record-keeping requirements imposed on wholesalers did not "unduly interfere with Indian trading," given that they were no more onerous than the record-keeping provisions that had been upheld in *Colville*. *Id.* at 76.

C. The State's New Tax Scheme Violates Indian Sovereignty By Requiring Indian Nations To Prepay Substantial Sums Of State Taxes On Cigarettes That Ultimately Are Sold To Non-Tribal Members.

As described above, the State's new regulatory scheme for cigarette taxation requires that tax stamps be affixed to all cigarettes sold at retail on Indian reservations. To effectuate that result, the new scheme requires wholesalers to purchase tax stamps, and then to sell only stamped packages of cigarettes. Apart from the small numbers of cigarettes sold through the "coupon" system or the "prior approval" system for tribal sales to members, the scheme requires wholesalers to add the amount of the tax to the sales price of cigarettes for all wholesale sales to Indian nations or reservations retailers for later resale to non-Indian consumers.

Thus, when a tribe purchases cigarettes from a wholesaler for sale to non-members, (1) it pays the wholesale price for the cigarettes, and (2) it also pays an additional amount, which constitutes prepayment of the state excise taxes on the cigarettes in question. The amount of the excise tax is now significant – $4.35 per pack, or $43.50 for each and every carton purchased by the tribe. For the entire time that the carton is held in inventory before it is sold, those funds essentially

have been loaned by the Indian nation to the State, without interest. Only when the cigarettes are sold to a non-Indian consumer does the tribe collect the state taxes, thus recouping the amount that it had advanced to the State by prepaying the tax.

The statutory requirement that allows the State the use of the tribe's money, before any tax actually is collected from the non-Indian consumer upon whom the incidence of the tax properly falls, obviously deprives the tribe of funds that it otherwise could put to other purposes, including the promotion of tribal self-sufficiency and economic development. *See Habitat Educ. Ctr. v. U.S. Forest Serv.*, 607 F.3d 453, 457 (7th Cir. 2010) ("Every day that a sum of money is wrongfully withheld, its rightful owner loses the time value of the money."). This avoidable aspect of the tax scheme is unlawful in two respects.

First, as noted above, it is well settled that a State may not impose a tax on Indian tribes. As the Supreme Court has held, "[i]n the special area of state taxation, absent cession of jurisdiction or other federal statutes permitting it, there has been no satisfactory authority for taxing Indian reservation lands or Indian income from activities carried on within the boundaries of the reservation. . . . [S]uch taxation is not permissible absent congressional consent." *Mescalero*, 411 U.S. at 148 (first alteration in original); *see also*, *e.g.*, *County of Yakima v. Confederated Tribes & Bands of Yakima Indian Nation*, 502 U.S. 251, 258 (1992);

Milhelm Attea, 512 U.S. at 64, 73; *Okla. Tax Comm'n*, 515 U.S. at 459; *Wagnon v. Prairie Band Potawatomi Nation*, 546 U.S. 95, 101-02 (2005).

Yet for an appreciable period of time, the State has imposed a significant tax burden directly upon an Indian nation by enjoying use of the Nation's money between the time cigarettes are purchased from a wholesaler and the time when they eventually are sold to a consumer (or when a refund is obtained, if the cigarettes are not sold). Thus, the prepayment mechanism, without any compensation for the State's use of the Indian nation's funds, constitutes a direct tax on operations of the tribe itself, independent of the tax that ultimately is collected from the non-Indian consumer. The scheme thus violates the "categorical" rule against state taxation of an Indian nation. *Okla. Tax Comm'n*, 515 U.S. at 458.

Although the tax schemes upheld in *Moe* and *Colville* involved pre-collection of taxes by tribal retailers, the taxes at issue here are more than 25 times greater per carton. Thus, Judge Arcara was simply incorrect in concluding that "[t]he Supreme Court has repeatedly upheld taxing schemes that impose prepayment obligations *like* the one at issue here." SPA23 (emphasis added). The magnitude of the State's new pre-collection obligation renders it a tax "imposed directly on the seller," *Moe*, 425 U.S. at 482.

Second, even if the prepayment obligation is not viewed as an impermissible state tax upon the on-reservation activities of an Indian nation, it still is a "burden" upon those activities, and, under *Moe*, *Colville*, and *Milhelm*, that burden must be both "minimal" and "reasonably necessary." *Colville*, 447 U.S at 151; *Moe*, 425 U.S. at 483; *Milhelm Attea*, 512 U.S. at 73. The substantial prepayment amounts required by the State's significant excise tax cannot be viewed as a minimal, reasonably necessary burden when – as here – alternatives exist. For instance, the State might consider a scheme that would allow Indian nations to possess an adequate inventory of cigarettes without prepayment of tax, with taxes paid only on replenishment inventory (i.e., after the original inventory was sold out and taxes had been collected by the Indian nation on those taxable sales). Or the State might consider a scheme in which the State paid interest on the use of the money prepaid by an Indian nation for the period that cigarettes remain in inventory before sale. *See Love v State*, 583 N.E.2d 1296, 1298 (N.Y. 1991) (requiring State of New York to pay interest as "simply the cost of having the use of another person's money"); N.Y. C.P.L.R. § 5001(a) (requiring prejudgment interest to compensate for any act "depriving or otherwise interfering with . . . possession or enjoyment" of property); N.Y. Tax Law § 1088 (interest on overpayments); *id.* § 688 (same).

With a prepayment obligation of $43.50 on every carton of cigarettes purchased and held in inventory, the financial burden on the Cayuga Nation and

other Indian nations is substantial. Judge Hurd correctly concluded that the prepayment obligation would place a more than minimal burden on the Oneida Nation. SPA61-65. Indeed, the Supreme Court has never upheld a prepayment tax collection scheme of this magnitude imposed upon an Indian nation. As noted above, the tax schemes upheld in *Moe* and *Colville* involved taxes per carton that were a small fraction of the taxes at issue in this case. And although *Milhelm Attea* involved a pre-collection scheme (at a time when the excise tax was only 56 cents per pack, as opposed to $4.35), the Supreme Court made clear that its review was limited to the "narrower question whether the New York scheme is inconsistent with the Indian Trader Statutes." 512 U.S. at 70. As noted above, the Court also emphasized that it had not "address[ed] for all purposes each feature of New York's tax enforcement scheme that might affect tribal self-government or federal authority over Indian affairs." *Id.* at 69.

Although Judge Arcara believed that "[t]he Supreme Court's holdings [in *Moe* and *Colville*] were not grounded in the *amount* of the taxes that were required to be prepaid," SPA25, nothing in *Moe* and *Colville* indicates that the Supreme Court was willing to condone a pre-collection obligation more than 25 times greater per carton, when alternatives exist. Furthermore, the Supreme Court's requirement that the state tax scheme impose only a "minimal burden" on Indian tribes is not limited to "administrative burden[s]," as Judge Arcara apparently

believed, *id.*, but rather includes any burden that a state's tax scheme imposes on a tribe, including the financial burdens associated with providing what is in essence an interest-free loan to the State.

The State has made no showing that its scheme requiring Indian nations to prepay the $43.50 per carton of state excise taxes is either "reasonably tailored" or "reasonably necessary" to the State's goal of collecting taxes on sales of cigarettes to non-Indians. At the evidentiary hearing, the State made no showing that it even considered alternative schemes that would not require prepayment of tax by Indian nations, often weeks or months before the taxable transaction at issue.

The Cayuga Nation does not contend that the State lacks the power to require tribes to collect state taxes on cigarette sales to non-members – a power that New York previously chose not to exercise. If the State does require tribes to collect state taxes on such sales, however, it must do so in a manner that neither imposes a direct tax upon the tribe nor imposes an unnecessary burden upon the tribe. There is nothing inevitable or necessary in the collection mechanism the State has chosen here.

D. The State's New Tax Scheme Also Violates Indian Sovereignty By Failing To Protect An Indian Nation's Right To Obtain Tax-Exempt Cigarettes For Its Members' Use From A Source Of The Nation's Own Choosing.

It is undisputed that the State must provide a mechanism by which each Indian nation can make tax-free sales to its own members. *See Moe*, 425 U.S. at

480-81 (invalidating "cigarette sales tax, as applied to on-reservation sales by Indians to Indians"). As explained previously, the new statutory scheme provides a default "prior approval" system under which cigarette wholesalers can claim some of all of the quota of tax-exempt cigarettes that can be sold to a particular tribe. By placing a tribe's supplies of tax-free cigarettes under the complete control of any wholesaler that manages to claim the tribe's quota, the prior approval system violates Indian sovereignty in two related respects.

First, as State witness Bartlett confirmed at the evidentiary hearing, *any* wholesaler in the state – whether or not it has ever had a business relationship with an Indian nation – can "claim" some or all of the nation's quota of tax-free cigarettes. JA333. As a result, the regulations deprive an Indian nation of the right to decide from whom it will acquire tax-free cigarettes for its own use and for transactions with members. Many tribes traditionally acquire cigarettes from particular wholesalers, who often have an Indian affiliation. The new regime illogically allows any wholesaler to seize a tribe's quota and essentially monopolize those sales. The regime does not even contain the elementary requirement that a wholesaler submit proof of an actual purchase order from the

tribe before claiming some or all of a tribe's tax-free quota.[8] Indeed, the State's 1988 tax cigarette scheme, which was upheld against a facial challenge in *Milhelm Attea*, required wholesalers to submit "evidence of valid purchase orders" from the tribe. *Milhelm Attea*, 512 U.S. at 66. In its rush to implement its new scheme, the State has run roughshod over basic principles of respect for what is supposed to be a co-equal Indian sovereign.

Second, as Judge Hurd correctly concluded in *Oneida Nation*, by allowing a single wholesaler to monopolize a tribe's supply of tax-free cigarettes, the prior approval system fails to protect the right of an Indian nation to obtain an adequate amount of tax-exempt cigarettes for its members. SPA62-63. Even the informal statement of the Tax Department does not limit the operation of the prior approval system in any logical or adequate way to protect the interests of the tribe. *Id.* Thus, the system allows a single wholesaler to monopolize a tribe's allotment in a

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[8] The prior approval system contrasts sharply with the State's approach to sales of cigarettes to members of the armed forces on military bases. Such sales are exempt from state tax – and, in effectuating the exemption, the State (a) does not require that the cigarettes in question be stamped at all, and (b) does not establish a quota. Rather, the United States simply must submit a signed government purchase order or exemption document, which must state that the unstamped cigarettes will be sold only to authorized, tax-exempt purchasers. *See* N.Y. Tax Law § 471(1) (SPA104); 20 N.Y.C.R.R. § 74.1(c)(2) (SPA113); *id.* §§ 76.1(a)(1), 76.2(d)(1).

way that effectively can "prevent tax-free sales[,] forcing members to purchase taxed cigarettes at non-Indian retailers for their own consumption." *Id.*

Although Judge Arcara found that there was "a very realistic possibility" that a single wholesaler would attempt to monopolize a tribe's entire quota of cigarettes and demand a premium that "eviscerates any tax savings to the individual member," the court inexplicably held that this risk did not apply to the Cayuga Nation because the Nation owns only two retail stores and is entitled to a relatively small quota of tax exempt cigarettes under the State's probable demand formula. SPA34. If anything, the risk that a single wholesaler will monopolize a tribe's entire quota of cigarettes is even greater for the Cayuga Nation given the relatively small size of the Nation's quota. There is no reason to believe that the risk of monopolization by a wholesaler would be any less present for the Cayuga Nation than it is for the Seneca Nation and other nations.

Compounding that error, Judge Arcara went on to hold that despite the risk of monopolization facing Indian tribes, the prior approval system is nonetheless constitutional because the tribes are not mandated to "become involved in the allocation of the tax-exempt cigarettes" and "can simply refrain from acting and let principles of the existing . . . free market economy govern the supply and distribution of the tax free cigarettes." SPA33. That approach, however, would allow a single wholesaler to distort the market by engaging in monopolistic

behavior and demanding a premium that "eviscerates any tax savings to the individual member" of the tribe. SPA34. That market distortion is a direct consequence of the State's tax scheme and is not simply the result of a private individual acting in a free market, as Judge Arcara believed. *See id.* By creating a system that "incentivizes" wholesalers to monopolize tribal quotas of tax-free cigarettes, the State has failed to protect a tribe's "right to have available tax free cigarettes for members and itself, as required by law." SPA63. If the State is going to require sovereign Indian nations to collect state excise taxes in connection with on-reservation sales (as the State is doing here by requiring Indian nations to sell cigarettes with state tax stamps), the State is entitled to invoke the limited exception of *Moe*, *Colville*, and *Milhelm* only if the tax scheme imposes burdens that are minimal and reasonably necessary. Here, the State has imposed a scheme that burdens the rights of Indian nations to chose for themselves where to purchase the tax-exempt cigarettes to which they are entitled as a matter of federal law – not only giving that power of choice to whatever wholesaler in the State is able to "seize" the tribe's quota of tax-free cigarettes, but also giving that wholesaler monopoly power that can lead to increased prices. This scheme is entirely different from that reviewed in *Milhelm*, and wholly illogical and unnecessary.

E. The Tax Scheme's Coupon System Is Not A Viable Alternative To The Prior Approval System Because It Violates The Tribes' Right To Self-Government.

Although the State's new tax scheme provides the tribes with a coupon system as an ostensible alternative to the prior approval system, the coupon system is itself defective because it interferes with tribes' right to self government. As Judge Arcara explained, the coupon system "do[es] not provide for allocation of the coupons among reservation cigarette sellers or tribal members, . . . leaving the tribe with the obligation to determine how those coupons should be redeemed, allocated and distributed." SPA11. The coupon system thus would require many tribes to change radically their involvement in the tobacco economies that exist on their reservations. As set forth in greater detail in the briefs submitted by the Seneca and Mohawk Nations, tribal governments would have to give up their role as responsible regulators of free market tobacco economies, and instead become central authorities in new "command and control" style economies. As part of that transformation, Indian nations would need to pass new regulations and assume new duties. The attempt to commandeer the tribal governments to do the State's bidding is fundamentally inconsistent with tribal sovereignty and far exceeds the minimal, reasonably necessary burdens approved by *Moe*, *Colville*, and *Milhelm Attea*. *See, e.g.*, *New Mexico v. Mescalero Apache Tribe*, 462 U.S. 324, 338 (1983) (Indian nation's sovereign authority "would have a rather hollow ring" if it

could "exercise its authority over the reservation only at the sufferance of the State."). Indeed, Judge Arcara acknowledged that "[t]he task of allocating coupons among the [Seneca] Nation's retailers may be somewhat more onerous than the 'minimal burden' approved of by the Supreme Court." SPA30. The coupon system thus interferes with a tribe's sovereign right to develop its economy and with the federal government's strong interest in tribal economic development. *See, e.g.*, *California v. Cabazon Band of Mission Indians*, 480 U.S. 202, 216 (1987).

The degree of the coupon system's interference in tribal sovereignty may vary depending on the current size of a tribe's retail operations. The validity of a state tax scheme cannot be measured, however, against the current size of a tribe's on-reservation operations, which the tribe has the inherent right to expand. Even more fundamental, the State cannot impose a scheme that might work for some sovereign Indian nations to collect state excise taxes, while failing to create a workable system that would require other sovereign nations in the State to do the same. If a State is to be allowed to require Indian nations to collect taxes for the State, it is essential for the State to have a uniform, permissible system regarding the collection of state taxes on Indian reservations. The State did not compel any tribe to participate in the coupon system, and the prior approval system is the default mechanism for all tribes, unless a tribe voluntarily chooses the coupon method. The coupon system's substantial interference in the retail operations of a

number of tribes renders it invalid as to all tribes in the State. As the New York Court of Appeals recently held in *Gould*: "Whatever methodology is ultimately used to calculate and collect sales taxes derived from on-reservation retail sales of cigarettes, we would expect that advance notice would be supplied to Indian retailers and that the system would be uniform throughout the state." *Gould*, 930 N.E.2d at 255.

II. Denying Preliminary Injunctive Relief Will Cause Irreparable Harm To The Cayuga Nation.

Although the district court did not address irreparable harm or the public interest in denying the Cayuga Nation's motion for a preliminary injunction, the district court did address these factors in granting a stay pending appeal. In any event, the record below is more than sufficient to allow this Court to address these factors in the first instance. The issues raised by the Cayuga Nation – involving the State's right to require the Cayuga Nation itself to prepay what today is a very substantial tax obligation long before a legitimately taxable transaction, and involving a scheme that allows wholesalers to dictate with whom the Nation must do business – are direct affronts to the lawful, independent sovereignty of the Cayuga Nation. As the district court correctly recognized in granting a stay pending appeal, numerous courts have found irreparable harm where enforcement of a statute or regulation threatens to infringe on a tribe's right to sovereignty. SPA41-42; *see, e.g.*, *Prairie Band of Potawatomi Indians v. Pierce*, 253 F.3d 1234,

1250-51 (10th Cir. 2001) (holding that infringement of tribal sovereignty constitutes irreparable injury because "it [can] not be adequately compensated for in the form of monetary damages"); *Kiowa Indian Tribe of Okla. v. Hoover*, 150 F.3d 1163, 1171-72 (10th Cir. 1998) (holding that irreparable injury was shown where "seizure of tribal assets" and "prohibition against full enforcement of tribal laws" interfered with "the Tribe's self-government"); *Seneca-Cayuga Tribe of Okla. v. Oklahoma*, 874 F.2d 709, 716 (10th Cir. 1989) (finding irreparable injury where threatened loss of revenues and jobs created "prospect of significant interference with [tribal] self-government"); *Winnebago Tribe of Neb. v. Stovall*, 216 F. Supp. 2d 1226, 1233 (D. Kan. 2002) (finding irreparable injury where "scope of tribal sovereignty" is threatened because such "cannot be measured in dollars"), *aff'd*, 341 F.3d 1202 (10th Cir. 2003).

Furthermore, enforcement of the State's new tax scheme will irreparably harm the Cayuga Nation by threatening the nation's economic livelihood, which depends on the sale of cigarettes. Although the State has the power to require Indian nations to assist in the collection of state excise taxes on cigarette sales to non-members, that power is limited to imposing only minimal, reasonably necessary burdens on the tribes. Until New York develops a tax scheme that respects this fundamental limitation on state power, New York's interference in the Cayuga Nation's tobacco economy is impermissible and would cause irreparable

damage. As Judge Arcara found in granting a stay pending appeal, "[t]he potential loss of an entire economy that currently supports many of each Nation's members and services is a harm that cannot be measured by monetary damages alone." SPA42. Thus, the threat of irreparable harm clearly favors granting a preliminary injunction.

III. Granting Preliminary Injunctive Relief Is In The Public Interest.

Finally, granting preliminary injunctive relief would serve the public interest. As set forth above, the Cayuga Nation does not maintain that the State of New York lacks all power to require Indian nations to assist in the collection of state excise taxes. But the State must do so in a manner that respects an Indian nation's "historic immunity from state and local control" and "Congress' overriding goal of encouraging tribal self-sufficiency and economic development." *Mescalero*, 462 U.S. at 332, 335 (internal quotation marks omitted). The evidentiary hearing conducted by the district court showed that there is nothing inevitable or necessary in the collection mechanism the State has chosen here, and that alternatives exist that would preserve vital interests of Indian sovereignty, self-sufficiency, and economic development – all critical components of the public interest. For these reasons, the Cayuga Nation respectfully submits that it is entitled to a preliminary injunction against enforcement of New York's new cigarette tax collection regime, until such time as the State promulgates a scheme

that respects the sovereignty of Indian nations and imposes only constitutionally permissible, minimal burdens upon the nations to assist in the collection of state excise taxes.

The public interest surely is disserved by the possibility that a federally recognized Indian tribe may cease to be financially viable and may no longer be able to provide vital tribal services to its members as a result of a tax scheme that far exceeds the boundaries imposed by the Supreme Court. On the other side of the balance, the State has not enforced for decades any requirement that reservation retailers collect excise taxes for the State, leaving the State to collect those taxes directly from consumers instead. Preliminary relief would merely leave in place the status quo that has existed since the cigarette tax's 1939 enactment, while the district court gives full consideration to whether the State's hasty effort to disrupt the status quo is consistent with federal law. Judge Hurd came to a similar conclusion regarding the balance of equities in granting a preliminary injunction in *Oneida Nation*: "Although New York may have an interest in obtaining revenue, injunctive relief will maintain the status quo, not reduce the State's revenue. In addition, the Oneida Nation would suffer irreparable harm should an injunction not issue, tipping the scales of equity in its favor." SPA65.

Furthermore, any claim by the State that a preliminary injunction harms its interest in protecting public health also rings hollow in light of the State's many

decades of forbearance. Indeed, the State's asserted interests in public health and raising revenue conflict with one another, as Judge Hurd explained in *Oneida Nation*:

> [T]he stated purpose of the legislation is to raise revenue. Public health is not mentioned. Moreover, the goals of raising revenue and assuring the public health by reducing cigarette use are contradictory, for if less cigarettes are used by the public fewer taxes will be paid and tax revenues will be lower.

SPA66. Thus, the public interest also favors the grant of preliminary relief.

CONCLUSION

For the foregoing reasons, the district court's October 14, 2010 order denying the Cayuga Nation's motion for a preliminary injunction should be reversed and the district court should be directed to grant the motion, pending further proceedings in this action.

Dated: January 21, 2011

Respectfully submitted,

/s/ David W. DeBruin

David DeBruin
Scott B. Wilkens
Joshua M. Segal
JENNER & BLOCK LLP
1099 New York Avenue, NW
Washington, DC 20001
(202) 639-6000

Daniel French
Lee Alcott
FRENCH-ALCOTT, PLLC
One Park Place
300 South State Street
Syracuse, NY 13202
(315) 413-4050

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I hereby certify that on this 21st day of January, 2011, a true and correct copy of the foregoing Cayuga Nation's Opening Brief was served on all counsel of record in this appeal via CM/ECF pursuant to Local Rule 25.1 (h)(1) & (2).

/s/ David W. DeBruin