10-4265-cv(L),
10-4272-cv(CON), 10-4758-cv(CON), 10-4477-cv(XAP), 10-4598-cv(XAP), 10-4976-cv(XAP), 10-4981-cv(XAP)

United States Court of Appeals

for the

Second Circuit

ONEIDA NATION OF NEW YORK,

Plaintiff-Appellee,

SENECA NATION OF INDIANS, ST. REGIS MOHAWK TRIBE, UNKECHAUGE INDIAN NATION,

Plaintiffs-Appellees-Cross-Appellants,

v.

DAVID A. PATERSON, in his official capacity as Governor of New York, JAMIE WOODWARD, in his official capacity as Acting Commissioner of the N.Y. Department of Taxation & Finance, WILLIAM J. COMISKEY, in his official capacity as Deputy Commissioner for the Office of Tax Enforcement for the N.Y. Department of Taxation & Finance,

Defendants-Appellants,

(For Continuation of Caption See Inside Cover)

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

BRIEF FOR *AMICUS CURIAE* NEW YORK ASSOCIATION OF CONVENIENCE STORES IN SUPPORT OF DEFENDANTS-APPELLANTS-CROSS-APPELLEES

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DISCLOSURE STATEMENT

Amicus New York Association of Convenience Stores ["NYACS"] has no parent corporation. No publicly held corporation owns more than ten percent of its stock.[1]

[1] No party's counsel authored this brief in whole or in part. No party or party's counsel contributed money that was intended to fund preparing or submitting this brief. In preparing this brief, NYACS' counsel consulted with and received assistance from counsel for Altria Client Services, Inc., a wholly owned subsidiary of publicly held Altria Group, Inc., on behalf of Philip Morris USA Inc.

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IDENTITY AND INTERESTS OF *AMICUS*

NYACS is a not-for-profit trade association representing over 250 companies that operate more than 1,500 convenience stores throughout New York State. It has a critical stake in these appeals and offers a unique perspective. It supported enactment of the challenged tax law amendments, participated extensively in the litigation below, and submits this brief in support of the state defendants-appellants-cross-appellees.

Cigarette sales are a crucial part of NYACS' members' businesses. For years, however, those members have faced unfair and predatory competition from retailers on Native American reservations who sell cigarettes to non-tribal members without collecting state taxes or complying with other applicable state and federal cigarette laws. By offering untaxed cigarettes, these reservation retailers—some owned and operated by tribes themselves, others by individual tribal members—have drastically undercut NYACS' members' prices. NYACS' members and other retailers have suffered enormous lost sales to these outlets in recent years, which now account for over *one-third* of all cigarette sales in the State.[2]

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[2] Written Testimony of William Comiskey, Oct. 27, 2009, before the N.Y.S. Standing Comm. on Investigations and Gov't Operations, at 3, included as Ex. C to Affirmation of Richard T. Sullivan in Appeal No. 10-4272-cv (Dkt. 28-1) ["Sullivan Aff."].

These injuries have become dramatically worse in recent months. The challenged amendments were part of a legislative package that raised cigarette taxes by 58%—from $2.75 to $4.35 per pack—while finally closing the reservation tax loophole. The first half of this package—the massive tax increase—took effect last July, but the second half has been judicially restrained since August. The net effect has been predictable: higher taxes and the lower courts' stays and injunction have actually *enlarged* the stream of untaxed cigarettes gushing through the reservations into New York and beyond, quite contrary to what the State intended. New York retail stores on average have lost an additional 25-35% of their unit sales of cigarettes since last July, on top of what they already had lost. *See* Sullivan Aff. ¶ 12.

NYACS files this brief pursuant to this Court's December 9, 2010 order (Dkt. 83) granting NYACS leave to appear as an *amicus*.

BACKGROUND

These appeals involve an effort by five Native American tribes to prevent New York State from closing the reservation loophole through which a tiny fraction of cigarette outlets sells more than one-third of all cigarettes in the State without collecting applicable state taxes. This torrent of untaxed, unstamped cigarettes has robbed the State of enormous tax revenues—an estimated $8 *billion* over the past 15 years—and exacerbated a broad range of other harms within the

State.[3] It also has wreaked economic and law enforcement havoc throughout the United States. New York's tax law amendments simply seek to achieve what so many other States accomplished long ago—the collection of all applicable state taxes on cigarettes sold through reservation outlets to non-tribal members, while respecting the rights of individual tribal members to have access to tax-free cigarettes for their own consumption.

Let there be no ambiguity about what the five tribes are attempting to accomplish here. They want to continue engaging in *precisely* the unfair business conduct the Supreme Court *repeatedly* has condemned: "market[ing] an exemption from state taxation to persons" not entitled to such an exemption, thereby seizing an unfair "artificial competitive advantage over all other businesses in [the] State." *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134, 155 (1980); *see also Department of Tax. & Fin. of N.Y. v. Milhelm Attea & Bros.*, 512 U.S. 61, 71-72 (1994). In their business dealings with non-tribal consumers, tribal entrepreneurs are not entitled to "supersovereign" immunity from state tax, stamping, licensing, and distribution laws that apply to everyone else. *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 466 (1995); *see also*

[3] N.Y.S. Senate Standing Comm. on Investigations & Gov't Operations, *Executive Refusal: Why the State Has Failed to Collect Cigarette Taxes on Native American Reservations*, at 15 (June 2010) ["*Executive Refusal*"], attached as Ex. F to Sullivan Aff.

Rice v. Rehner, 463 U.S. 713, 734 (1983) (tribes cannot "trade in a traditionally regulated substance free from all but self-imposed regulations"). There is no basis for the federal courts to enjoin New York's universal tax precollection system—the same kind of system that has been adopted in many other States and *consistently* upheld by the federal courts.

A. The Tribes' "External" and "Internal" Cigarette Economies

Each of the challenging tribes has two distinct "cigarette economies." The first—constituting over 99% of the New York tribal cigarette trade—caters solely to "external" smokers who are not tribal members and live off-reservation. The second—accounting for less than 1% of New York tribal cigarette volume—is for "internal" on-reservation consumption by tribal members. *See* chart attached as Add. 1. The disparity between the tribes' "external" and "internal" cigarette economies is even more pronounced on the highest-volume Seneca and Poospatuck Reservations. *See* Add. 2-4.[4]

Although these two distinct economies are subject to entirely separate rules of federal Indian law, the tribes repeatedly seek to confuse and conflate them. In particular, the tribes are attempting to use various objections to how the State's prior approval and coupon systems *might* affect their *internal* cigarette economies

[4] The data in the attached charts and discussed above are derived from Appendices A-8 and A-9 to the Comiskey testimony cited in n.2 *supra*.

to obtain sweeping injunctive relief against state taxation of their *external* sales to nonmembers.

B. The Nature of the Tribes' "External" Cigarette Economies.

The tribes all admit they are attempting to take competitive advantage of high state taxes by selling untaxed cigarettes to nonmembers for off-reservation consumption. In its evidentiary case-in-chief, the Seneca called Jason Franco, operator of the Black Bear Smoke Shop and Internet website, as an example of a typical tribal retailer. Mr. Franco's website prominently offers "tax free" tobacco products and announces that "[w]e have no tax collection obligation to any State," "do not in any way support or adhere to the Jenkins Act," and will not "abide by legislation set forth by any foreign government." http://www.blackbearsmokes.com/links (last visited Jan. 17, 2011); *see* Add. 5-6.[5]

Unkechauge retailers operating from Long Island's Poospatuck Reservation also have resisted complying with governing state and federal laws. In August 2009, the Eastern District enjoined numerous Unkechauge "bootleggers" from selling untaxed cigarettes to nonmembers. *See City of New York v. Golden Feather*

[5] Internet websites' claims that "cigarettes are 'tax free,' that their customers do not have to pay taxes, and/or that defendants did not have to file Jenkins Act" reports are "untrue," materially deceptive, and "actual and intentional misrepresentation[s]." *City of New York v. Smokes-Spirits.Com, Inc.*, 541 F.3d 425, 456 (2d Cir. 2008), *rev'd on other grounds sub nom. Hemi Group, LLC v. City of N.Y.*, 130 S. Ct. 983 (2010).

Smoke Shop, Inc., No. 08-CV-3966 (CBA), 2009 WL 2612345, ** 6, 43 (E.D.N.Y. Aug. 25, 2009). The Eastern District held that the "business model" of Unkechauge cigarette merchants—which is functionally no different from any of the other challenging tribes' models—violates the Contraband Cigarette Trafficking Act, 18 U.S.C. § 2341 *et seq.*, and the New York Cigarette Marketing Standards Act, N.Y. Tax Law § 483 *et seq.* *See Golden Feather*, 2009 WL 2612345, ** 1, 6, 26-37, 43. Some Unkechauge cigarette outlets literally have "drive-thru window[s]" for "big customers," who line up in minivans and trucks to be loaded with hundreds of cartons of untaxed cigarettes for daily runs into New York City. *Id.* **12, 14. In some instances "'[t]hey would take [the cigarettes] off the delivery truck, and put [them] right . . . into people's cars.'" *Id.* *18. These contraband cigarettes are then sold and often resold in convenience stores, bars, apartment buildings, back alleys, and on street corners, often to teenagers. *See generally id.* **6-22.

The Eastern District recently held several Unkechauge retailers in civil contempt of the August 2009 injunction, finding "clear and convincing evidence" that they have "contrived" with others "to evade the Injunction's mandates," "violate[] the terms of the Injunction," and in some instances "actually t[ake] positive steps to *increase* sales of unstamped cigarettes." 2010 WL 2653369, ** 8, 18 (E.D.N.Y. June 25, 2010) (emphasis added); *see also id.* ** 8-20. The

staggering volume of contraband cigarette smuggling through the Poospatuck Reservation into surrounding urban markets continues unabated.

Members of other New York tribes also are involved in wide-ranging efforts to leverage their access to unlimited quantities of untaxed cigarettes into thriving distribution networks. Many federal and state contraband cases throughout the country, for example, involve Seneca retailers and wholesalers operating from Seneca lands.[6] The Bureau of Alcohol, Tobacco, Firearms, and Explosives ["ATFE"] recently explained that "most Seneca Internet and mail order cigarette

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[6] *See, e.g.*, *United States v. Kaid*, 241 Fed. App'x 747, 753 (2d Cir. 2007) (affirming conviction for smuggling contraband cigarettes from Seneca reservation into New York City and Michigan); Stipulated Criminal Judgment in *United States v. Native Wholesale Supply*, No. CR09-0214MJP (W.D. Wash. Sept. 10, 2010) (imposing $1,000,000 administrative forfeiture and other penalties against Seneca distributor NWS for its shipments of contraband cigarettes into Washington); *Muscogee (Creek) Nation v. Henry*, No. Civ. 10-019-JHP, 2010 WL 1078438, **3-4 (E.D. Okla. Mar. 18, 2010) (*re* contraband cigarettes distributed by Seneca-based NWS); *Idaho ex rel. Wasden v. Native Wholesale Supply Co.*, No. 08-CV-396-S-EJL, 2009 WL 940731, *1 (D. Idaho Apr. 6, 2009) (*re* alleged sales of "over 90 million cigarettes in Idaho" by Seneca-based NWS); *Idaho ex rel. Wasden v. Maybee*, 148 Idaho 520, 526, 224 P.3d 1109, 1115 (*re* Internet sales by Seneca retailer of over 2.5 million contraband cigarettes to Idaho consumers), *cert. denied*, 131 S. Ct. 150 (2010); *Department of Health & Human Servs. v. Maybee*, 2009 Me. 15, 965 A.2d 55, 56-57 (2009) (affirming penalties and fines against Seneca retailer for Internet sales to Maine consumers); *Oklahoma ex rel. Edmondson v. Native Wholesale Supply*, 2010 Okla. 58, 237 P.3d 199, 208 (*re* allegations that Seneca-based NWS arranged for sale and distribution "over a fifteen-month period [of] more than one hundred million cigarettes … into the Oklahoma market"), *pet. for cert. filed*, 79 USLW 3370 (Dec. 3, 2010); *Oregon v. Maybee*, 235 Or. App. 292, 306, 232 P.3d 970, 977 (2010) (affirming injunction against Seneca retailer prohibiting Internet sales of contraband cigarettes to Oregon consumers).

businesses are still involved in activities which deprive the States of substantial amounts of tobacco tax revenue; these activities are not conducted in accordance with the provisions of Federal law in that these sales are generally not reported to state taxation authorities as is required by the Jenkins Act."[7]

According to the U.S. Department of Justice, the Senecas' cigarette economy depends "near exclusively [on] the evasion of State excise taxes and the refusal to affirmatively report . . . tax-free sales as required by law."[8] DOJ also believes that Seneca cigarette retailers "are conducting their business in violation of the mail and wire fraud statutes, in that [such retailers] utilize[] the instrumentalities of interstate commerce—the mails and the wires—in furtherance of a scheme or artifice to defraud the states of excise tax revenues."[9]

[7] Declaration of ATFE Special Agent Ronald B. Turk ¶ 10 (filed in *Red Earth, LLC, et al. v. United States*, No. 10-CV-530 (W.D.N.Y. Jul. 6, 2010)), included as Ex. D to Sullivan Aff.

[8] U.S. Memorandum In Opposition to Plaintiffs' Motion for a Preliminary Injunction, at 11, in *Red Earth* (filed Jul. 1, 2010), included as Ex. E to Sullivan Aff.

[9] *Id.* at 10.

ARGUMENT

I. New York's Cigarette Tax Precollection System May Lawfully Be Applied to Tribal Sales to Nonmembers.

The Supreme Court has held *five times* since 1976 that States may tax and regulate *all* tribal cigarette sales to nonmembers.[10] The Court also repeatedly has held that States may require tribes and tribal retailers to assist in tracking, collecting, remitting, and reporting all such taxes, and may take a variety of enforcement measures if tribes refuse to cooperate.

Acting pursuant to these well-settled principles, the New York tax law amendments establish a universal tax "precollection" system, in which state-licensed wholesalers must "prepay" the state tax and "prestamp" all cigarette packages before distribution to retailers in the State for resale to individual consumers. The wholesalers pass the cost of the tax along in the prices they charge retailers, who in turn pass the cost along to consumers, who bear the ultimate "incidence" of the tax. *See* N.Y. Tax Law § 471(2). The "precollection" system applies universally to tribal as well as nontribal retailers. *Id.* The system prevents tribal retailers from "market[ing] an exemption from state taxation" to nonmembers, *Colville*, 447 U.S. at 155, for the simple reason that the tax already

[10] In addition to the *Moe*, *Colville*, *Potawatomi*, and *Milhelm Attea* decisions discussed in text, *see California State Bd. of Equalization v. Chemehuevi Indian Tribe*, 474 U.S. 9, 12 (1985).

has been precollected "upstream" and is now part of the retailers' cost. Tribal outlets can receive untaxed cigarettes for sale to tribal smokers for their own consumption through two options, the "coupon" system and the "prior approval" system, discussed in Part II *infra*.

The tribes claim it is unlawful to require them to purchase only pretaxed, prestamped cigarettes for resale to *nontribal* members, even though all other retailers must follow the same rules. Their arguments fail under well-settled principles of federal Indian law.

A. Courts Repeatedly Have Upheld Precollection Systems.

As the Western District emphasized in upholding New York's precollection system in its entirety, the Supreme Court and lower federal courts have *consistently* upheld the application of such "upstream" measures—many far more burdensome than New York's—so long as they are applied in a nondiscriminatory manner to tribal and nontribal merchants alike. *See Seneca Nation of Indians v. Paterson*, No. 10-CV-687A, 2010 WL 4027796, **10-12 (W.D.N.Y. Oct. 14, 2010) ("*Seneca I*"). Tribes and their members have no rights under federal Indian law to special treatment in this respect.

Indeed, the Supreme Court has held that the "interest-balancing" analysis that applies to state regulation of *on-reservation* transactions between tribal retailers and nonmembers does not even apply to "upstream" taxes collected at the

off-reservation manufacturing or wholesale levels and then passed along through the distribution chain. *Wagnon v. Prairie Band Potawatomi Nation*, 546 U.S. 95, 112-14 (2005). *Wagnon* involved a state motor fuel excise tax that was imposed at the distributor level and then passed along to retail customers. A tribally owned retailer challenged the negative "downstream economic consequences" of the tax on the tribe's sales (most of which were to non-tribal members), arguing that it was entitled "to increase [its] revenues by purchasing untaxed fuel" for resale to members and nonmembers alike. *Id.* at 114.

The Supreme Court upheld this tax collection mechanism. To begin, "interest-balancing" does not even apply where the tax is imposed on a non-Indian who is "upstream" in the distribution chain and "outside of Indian country." *Id.* at 111-14. "In these circumstances, the interest-balancing test … is inapplicable," and the only requirement is that the tax be nondiscriminatory and applied even-handedly. *Id.* at 113 (citations omitted). Nor may a tribal retailer in these circumstances complain about adverse "downstream economic consequences" caused by having to incur the same costs borne by its non-Indian competitors. *Id.* at 114.

Even if an interest-balancing analysis applied here, the Supreme Court has repeatedly upheld tax prepayment obligations imposed on tribal retailers with respect to cigarettes destined for resale to nonmembers. The Court's very first

tribal cigarette taxation case upheld a "statutory scheme [that] contemplate[d] *advance payment or 'precollection' of the sales tax by the [tribal] retailer when he purchases his inventory from the wholesaler*"—precisely the system adopted by New York. *Moe v. Confederated Salish & Kootenai Tribes of the Flathead Reservation*, 425 U.S. 463, 468 n.6 (1976) (emphasis added).[11]

The Supreme Court subsequently has reiterated that "States may *of course* collect the sales tax from cigarette wholesalers" prior to distribution to retailers. *Oklahoma Tax Comm'n v. Citizen Band Potawatomi Tribe of Okla.*, 498 U.S. 505, 514 (1991) (emphasis added). Indeed, the Court upheld on its face New York's previous version of the precollection system, reiterating that States may "'of course'" collect taxes from wholesalers on cigarettes destined for purchase by tribal retailers and resale to nonmembers and holding that "New York's decision to stanch the illicit flow of tax-free cigarettes early in the distribution stream" by collecting taxes at the wholesale level "is a 'reasonably necessary' method of 'preventing fraudulent transactions,' one that 'polices against wholesale evasion of

[11] The Northern District was simply wrong in its reading of *Moe* as a case that did not "involve[] a state tax scheme that required a tribe to pre-pay taxes on cigarettes sold to non-members." *Oneida Nation of N.Y. v. Paterson*, No. 6:10-CV-1071, 2010 WL 4053080, *10 (N.D.N.Y. Oct. 14, 2010). That is exactly what *Moe* "involved" and upheld, and what *Potawatomi* and *Milhelm Attea* subsequently upheld as well.

[New York's] own valid taxes without unnecessarily intruding on core tribal interests.'" *Milhelm Attea*, 512 U.S. at 72, 75 (citations omitted).

Many States have adopted far more burdensome prepayment systems than New York's, and those systems have consistently been upheld. Michigan, for example, has adopted a system in which *all* cigarettes purchased by tribal retailers must be tax-prepaid and prestamped, subject to a mechanism for tax refunds on all documented sales to tribal members. In *Keweenaw Bay Indian Cmty. v. Rising*, 477 F.3d 881, 890-95 (6th Cir. 2007), the Sixth Circuit upheld this wholesaler precollection/retailer refund system, even with respect to cigarettes destined for internal tribal consumption. *See also Muscogee (Creek) Nation v. Henry*, Civ. No. 10-019-JHP, 2010 WL 1078438, *1 (E.D. Okla. Mar. 18, 2010) (denying preliminary injunction against Oklahoma's universal state stamping and tax-prepayment requirements); *Confederated Tribes & Bands of the Yakama Nation v. Gregoire*, 680 F. Supp. 2d 1258, 1263-64 (E.D. Wash. 2010) (dismissing objections to Washington's universal state-stamping and tax-prepayment requirements).

New York's precollection system is much less onerous than the Michigan, Oklahoma, and Washington systems because it provides tribes with their "probable demand" of tax-free cigarettes through either the prior approval or coupon systems

rather than requiring tribal retailers to carry the interest costs while they seek tax refunds on documented sales of prestamped cigarettes to qualified tribal smokers.

B. There Is No Basis For a Different Outcome Here.

None of the tribes' objections justifies a departure from this unbroken line of authority.

Increased inventory costs. The Oneida and Cayuga complain that requiring them to purchase only prestamped cigarettes and then recoup their costs through the prices they charge nonmembers impermissibly increases their inventory carrying costs. The Northern District accepted the Oneida's estimate that the lost time-value of the prepaid tax money tied up in tribal inventory is "at least $208,000 per year," and held that it is "*unconstitutional*" to impose such a carrying charge on the tribe *qua* retailer even though all other retailers bear the *identical* carrying charges. *Oneida*, 2010 WL 4053080, **8-9 (emphasis added).

But as the Western District emphasized in rejecting the Cayuga's identical argument, there is no such exemption for tribally owned retailers. *See Seneca I*, 2010 WL 4027796, **10-12. The inventory and interest expenses that the Oneida and Cayuga complain about are an inherent part of *any* precollection system in which the tax is collected "upstream" and then passed down through the chain of distribution; there *always* will be a period of time between a retailer's purchase of prestamped inventory and its resale of that inventory when it could have been

earning interest on the money invested in the inventory. That was true of the precollection systems upheld in *Wagnon*, *Moe*, *Potawatomi*, *Milhelm Attea*, *Keweenaw Bay*, and the other decisions discussed above. New York's tribes have no rights to special treatment in this respect, which would merely give them an "artificial competitive advantage over all other business in [the] State" that must bear these carrying charges. *Colville*, 447 U.S. at 155.[12]

Tax increases. Some of the tribes contend, and the Northern District agreed, that the outcome should be different here because cigarette taxes have increased dramatically in recent years and now impose much greater economic burdens than before. *See Oneida*, 2010 WL 4053080, *10. But the right to impose "pass along and collect" obligations does not turn on the amount of the tax. One federal court has recently rejected a similar argument that *Colville* and other decisions no longer control given that "the [State of Washington] tax rate has

[12] The Northern District cited *Colville* for the proposition that, "where there is an untaxable entity such as an Indian tribe in the distribution chain, the transaction is not taxable prior to the point of sale" by the retailer to the nonmember consumer. *Oneida*, 2010 WL 4053080, *8, citing *Colville*, 447 U.S. at 142 n.9. The cited footnote does not stand for this proposition. It set forth the basis for the lower court's finding in *Colville* that, under state law, "the legal incidence of the tax is on the purchaser in transactions between an Indian seller and a non-Indian buyer." 447 U.S. at 142 (footnote omitted). This "legal incidence" analysis does not imply that the tax cannot be collected prior to the point of sale to the ultimate consumer, a conclusion that would run counter to *Moe* and subsequent decisions holding that States may "of course" collect the tax at the wholesale level prior to sale to tribal retailers.

increased at least 500% since *Colville*, placing a much more onerous burden on retailers." *Gregoire*, 680 F. Supp. 2d at 1263. As that court explained, "the increase in the amount of the tax itself has no bearing on the legal question of incidence because it has no effect on the burdens and responsibilities of each party in the distribution chain. Yakama retailers must prepay the tax and collect it from non-Yakama purchasers whether the tax is $.001 per pack or $1 per pack." *Id.* at 1264. That conclusion does not change simply because the tax in these cases is now $4.35 per pack.

The "use tax" alternative. The Northern District also held that "the new law is *unnecessary*" because, rather than collecting the tax from wholesalers or retailers, the State could simply require non-Indian smokers who purchase untaxed cigarettes from reservation retailers (either in person or over the Internet, by phone, or through other means) to self-report themselves and tender all unpaid use taxes pursuant to N.Y. Tax Law § 471-a. *See* 2010 WL 4053080, *9 (emphasis added). This reasoning is plain error. The first Supreme Court decision to address tribal cigarette sales to nonmembers emphasized that taxes realistically *must* be collected at the tribal retailer level or higher, not through enforcement of the use tax on a consumer-by-consumer basis. "Without the simple expedient of having the [tribal] 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." *Moe*, 425

U.S. at 482; *see also Milhelm Attea*, 512 U.S. at 71 (same). Subsequent experience has simply reconfirmed this prediction. There is no reason to believe that non-Indian purchasers seeking to avoid state taxes will voluntarily report themselves to the State.

Refunds for out-of-state sales. Several tribes also challenge the application of New York's precollection system to cigarettes that they or their members say they intend to sell out of State, beyond the reach of New York's taxing powers. But under New York law, tribes and their members who want to ship tax-free cigarettes out of state have two avenues for doing so, just like everyone else. *First*, they may become state-licensed stamping agents authorized to deal in untaxed, unstamped cigarettes within the State. Licensed stamping agents may purchase untaxed cigarettes and then either apply tax stamps to product destined for sale in New York or resell the cigarettes untaxed and unstamped to entities located outside the State for out-of-state consumption. *See* N.Y. Tax Law §§ 472-73; 20 NYCRR §§ 74.3, 76.1(a)(2), 76.1(a)(3).

Second, any seller that does not—for whatever reason—wish to obtain a New York stamping license can still obtain a full tax refund for stamped cigarettes sold to out-of-state purchasers within two years of when the stamps were affixed. *See* N.Y. Tax Law § 476; 20 NYCRR § 77.1(a). The State repeatedly has made clear that it interprets § 476 as allowing a non-state licensed tribal distributor or

retailer to obtain a full refund for any New York-stamped cigarettes sold to out-of-state consumers (subject to proper verification). *See Seneca I*, 2010 WL 4027796, *13 & n.9.

These are all the options to which tribes and their members are entitled. *Every* federal court considering the issue has upheld state requirements that all cigarettes be tax-prepaid and state-stamped, even where destined for eventual tax-free sale, where tribal retailers may obtain prompt tax refunds on all qualified sales. *See, e.g.*, *Keweenaw Bay*, 477 F.3d at 890-95; *Muscogee (Creek) Nation*, 2010 WL 1078438, *1; *Gregoire*, 680 F. Supp. 2d at 1263. The State should be given an opportunity to implement the § 476 refund mechanism and demonstrate it can be administered in a fair and timely manner.[13]

Equal protection objections. The St. Regis Mohawk Tribe argues that, under equal protection guarantees, "the State cannot impose any cigarette tax collection system on Indian tribes when it has not imposed a similar system on other tax-exempt entities, such as the U.S. military and diplomatic missions." *Unkechauge Indian Nation v. Paterson*, Nos. 10-CV-711A and 10-CV-811A, 2010 WL 4486565, *4 (W.D.N.Y. Nov. 9, 2010). The reason for the different treatment

[13] There is no such thing as an "intertribal" immunity from state taxation and regulation of goods moving from one tribe's reservation to another's. *See, e.g.*, *Rice v. Rehner*, 463 U.S. at 720; *Colville*, 447 U.S. at 160-61; *Muscogee (Creek) Nation*, 2010 WL 1078438, *3 (intertribal tax and regulatory immunities for commerce among tribes "would truly be unprecedented").

is manifest: under federal Indian law, States may tax tribal sales to nonmembers, but under other bodies of federal law they are categorically barred from taxing federal instrumentalities (such as military base stores where cigarettes are sold) without Congressional consent. *See, e.g.*, *United States v. Baker*, 63 F.3d 1478, 1490-91 (9th Cir. 1995); *United States v. Brigman*, No. CR-08-029 (JLQ), 2008 WL 4330315, *4 (E.D. Wash. Sept. 15, 2008). Similarly, qualified diplomats enjoy tax immunity because of treaties between their countries and the United States. *See, e.g.*, 20 NYCRR § 76.4; http://www.state.gov/ofm/tax/ (last visited Jan. 17, 2011).

And even if the State had tax collection authority over these sales, it would not violate equal protection principles by focusing first on the most egregious loophole—the one that has allowed *billions* of dollars in untaxed tribal sales to non-tribal members to escape collection—before turning to other potential abuses. "[T]he Equal Protection Clause 'does not compel … [l]egislatures to prohibit all like evils, or none. A legislature may hit at an abuse which it has found, even though it has failed to strike at another.'" *Unkechauge*, 2010 WL 4486565, *5 (quoting *United States v. Carolene Prods. Co.*, 304 U.S. 144, 151 (1938)).

II. New York's Coupon and Prior Approval Systems For Allocating Tax-Free Cigarettes to Qualified Tribal Smokers Are Lawful.

States have adopted a variety of mechanisms to ensure that tribal members have access to sufficient quantities of untaxed cigarettes for their personal consumption, as required under principles of federal Indian law. Rather than adopting a single mechanism, New York's tax law amendments offer tribes their choice between two—the "Indian tax exemption coupon system" and the "prior approval system." N.Y. Tax Law §§ 471-e, 471(5). Under the coupon system, a tribe can choose to obtain a quarterly allotment of "tax exemption coupons" for distribution as it sees fit so that tribal members can obtain tax-free cigarettes of their choice. If a tribe does not want to participate in that system, the alternative "prior approval" system will govern. Under that mechanism, state wholesalers may obtain prior DTF approval to sell tax-exempt cigarettes to tribal retailers, up to each tribe's quarterly "probable demand," for the use of tribal smokers. The cigarettes must bear state tax stamps, but wholesalers can secure refunds of all taxes upon submission of proper documentation. N.Y. Tax Law § 471(5)(b).

Each of these systems is entirely lawful, and together they provide New York tribal members with a much broader range of options for obtaining tax-free cigarettes than in most States. As the Western District emphasized, the Supreme Court in *Milhelm Attea* upheld the prior version of New York's quota and coupon system against a facial challenge, concluding that the system was fully consistent

with "principles of tribal sovereignty." *Seneca I*, 2010 WL 4027796, **9-10. Moreover, as applied to a tribe like the Cayuga Nation that owns and operates all reservation retail outlets, the new quota and coupon system can be "easily" implemented with "only a minimal burden." *Id.* *13 ("The Nation can easily implement a system whereby it uses all the coupons to redeem whatever inventory of cigarettes it needs, leaving it to individual members to present evidence of Nation membership . . . to obtain the tax-free cigarettes."). Even on reservations that have mixed tribal/private retail economies, which may present more "complex" challenges in allocating tax-free product among retail outlets, any additional burdens will be borne only if a tribe voluntarily *chooses* the coupon system. Thus, so long as the fallback prior approval system is lawful—as the Western District correctly ruled it is—New York's quota system must be sustained. *See id.* **14-15.

The Northern District, however, believed the "prior approval" system imposes undue burdens because it "does not assure adequate availability of untaxed cigarettes for consumption by members and the Oneida Nation." 2010 WL 4053080, *9. That court reasoned there is nothing in the new law to prevent a wholesaler from claiming the tribe's entire quarterly allotment of untaxed cigarettes "*without a sale to the plaintiff, thereby preventing the Oneida Nation from obtaining tax-free cigarettes for its and its members use*." *Id.* (emphasis

added). The court further speculated that, "*fueled by anti-Indian sentiments*," one or more wholesalers might "monopolize" the Oneida's allotments so as "to prevent tax-free sales" to tribal members. *Id.* (emphasis added).

This reasoning rests on pure speculation and completely misapprehends New York's prior approval system. To obtain a tax refund on qualified sales to a tribe or its members, the wholesaler using the prior approval system must present *proof* that it actually sold the cigarettes to the designated tribe or its members. Absent such proof, a wholesaler receives no tax refund, derives no economic benefit from having obtained cigarettes through the prior approval system, and thus will have no incentive to sell product to unqualified consumers. *See* TSB-M-10(6)M, at 6-7 (Jul. 29, 2010).

The Northern District also gave credence to speculation that, even if a wholesaler actually sells the allotted amounts to the intended tribal beneficiaries, it *might* be able to "monopolize" and hoard allotments "in order to leverage for a higher sales price." 2010 WL 4053080, *9. All of the tribes rely heavily on the affidavit of Peter Day, a federally, state, and tribally licensed wholesaler who claims he is going to attempt to obtain several tribes' entire allocated quotas of tax-exempt cigarettes and then charge them monopoly prices—even though he is licensed and regulated by those tribes and the BIA and must remain on good terms with them in order to receive continued tribal and federal permission to be able to

do business with tribal retailers. *See* Affidavit of Peter Day ¶¶ 28-36 (Sept. 21, 2010), attached as Ex. G to Sullivan Aff.

The price-gouging and market manipulation that Mr. Day claims he will undertake would clearly violate the duties and obligations of a federally licensed Indian trader. His proposed sharp practices would be subject to federal, state, and tribal sanctions, including license revocation. *See generally* 25 U.S.C. §§ 261-64 (federal Indian Trader Statutes); 25 C.F.R. Part 140 (Indian trader implementing regulations), esp. § 140.22 ("prices charged by licensed traders [must be] fair and reasonable"); *Milhelm Attea*, 512 U.S. at 70-75 (regulation and duties of federal Indian traders); N.Y. Tax Law § 480; 20 NYCRR §§ 72.1-72.4.

As the Western District emphasized in rejecting this same argument, there is no basis in law or equity to enjoin the enforcement of tax laws simply because private actors like Mr. Day might attempt to abuse those laws, especially where they will be subject to appropriate sanction by federal, state, and/or tribal regulators. *See Seneca I*, 2010 WL 4027796, **15-17. The tribes argue, however, that by analogy to the Fourteenth Amendment's "state action doctrine," Mr. Day's threatened abuses of the new law should be attributed to the law *itself* and serve as a basis for striking down the *entire* law. That completely misconstrues the state action doctrine, in which private conduct may in certain circumstances appropriately be attributed to a state or local government, where that government

or its agents have commanded, encouraged, jointly participated in, or otherwise been "pervasive[ly] entwine[d]" with the challenged private conduct. *Brentwood Acad. v. Tennessee Secondary Sch. Athletic Ass'n*, 531 U.S. 288, 295-98 (2001).

"[A] finding of state action must be premised upon the fact that 'the State is *responsible* for the *specific conduct* of which the plaintiff complains.'" *Horvath v. Westport Library Ass'n*, 362 F.3d 147, 154 (2d Cir. 2004) (emphasis in original) (quoting *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982)). A State is not "responsible" for a private party's abuse of the State's laws, particularly where there are remedies and "judicial relief against abuse." *Flagg Bros., Inc. v. Brooks*, 436 U.S. 149, 161 n.11 (1978); *see also id.* at 160-63; *Blum*, 457 U.S. at 1004-05.

Far from "pervasive entwinement" between DTF and Mr. Day, they are in diametric opposition. The Department has in good faith designed a prior approval system to ensure that tribal members have access to their fair share of tax-free cigarettes. Mr. Day claims he plans to abuse that system so as to monopolize the provision of tax-free cigarettes to tribes and their members, thereby jacking up the prices he is able to charge them. Although the tax law amendments by themselves might not *prevent* such sharp practices, they certainly would be *abused* by such practices. That is not a basis for holding that the amendments *themselves* are unlawful, but rather that Mr. Day's proposed abuse of them would be unlawful and justify revocation of his trading privileges.

The State should be given the opportunity to demonstrate that it can make the prior approval and coupon systems work in their day-to-day administration and enforcement. *See Milhelm Attea*, 512 U.S. at 75-76, 77 ("possibility" of implementation problems "may provide the basis for a future challenge," but courts should not "assume" that such problems will occur; potential problems "are now purely hypothetical" and "can be addressed if and when they arise") (footnote omitted); *Keweenaw Bay*, 477 F.3d at 893 (tribe could seek relief in future if "problems continue" and the State "refuses" to address legitimate tribal concerns).

III. The Many Public Interests Served By the Tax Law Amendments Substantially Outweigh the Tribes' Interest in Marketing a Nonexistent Tax Exemption to Nontribal Consumers.

In granting the stays and injunction below, the Western and Northern Districts abused their discretion by ignoring many important state and public interests while giving weight to the protection of contraband profits.

Tax losses. Although estimates vary, the State's tax losses concededly have been enormous. The N.Y.S. Senate Standing Committee on Investigations and Government Operations found in June 2010 that, "[s]ince 1996, the State has failed to collect approximately $8 billion in cigarette taxes," with current lost revenues running at about $1 billion annually. *Executive Refusal*, at 8, 15, attached as Ex. F to Sullivan Aff. Some estimates place the annual tax losses much higher. *Id.* at 8. The Northern District discounted the public interest in collecting lawful taxes

given the State's prior "forbearance" policy, reasoning that "[t]he State has been depriving itself of these revenues for many years and cannot now use revenues as a 'public interest weapon' to prevent injunctive relief[.]" *Oneida*, 2010 WL 4053080, *11 (footnote omitted). The Western District similarly gave "heav[y]" weight to "the State's lengthy prior history of forebearance." *Seneca Nation of Indians v. Paterson*, No. 10-CV-687A, 2010 WL 4027795, *3 (W.D.N.Y. Oct. 14, 2010) ("*Seneca II*").

NYACS agrees that the forbearance policy was misguided and that the State waited far too long to begin effective enforcement of its cigarette tax and distribution laws. But that is no reason to allow *continued* unchecked tribal "tax free" sales to nonmembers even though the State clearly has the right and power to tax such sales. Under this logic, the enforcement of *any* new law should be stayed pending the exhaustion of all appeals since the challenged law *could* have been enacted and enforced sooner than now.

Breadth of additional public interest considerations. Although the Northern District believed the only purpose of the tax law amendments was "to raise revenue," 2010 WL 4053080, *11 n.6, extensive legislative history demonstrates otherwise. The State's decision last June to close the reservation loophole was intended to combat a broad range of grave and mounting harms, including:

- serious and irreparable loss of business for non-tribal retailers like NYACS' members due to unfair, predatory, and unlawful price competition;

- rampant illegal conduct (including violence) associated with the trafficking of contraband cigarettes in New York and beyond—activities that repeatedly have been condemned by federal and state courts throughout the country, by the U.S. Department of Justice, by ATFE, and by state and local prosecutors and law enforcement officials; and

- the undermining of youth access prevention laws that often occurs when cigarettes are sold through unregulated distribution channels.

See Executive Refusal, at 1-2, 7-9, 11-16, attached as Ex. F to Sullivan Aff; *Muscogee (Creek) Nation*, 2010 WL 1078438, *6 (refusing to enjoin a universal precollection system similar to New York's because an injunction "could damage public interest and fiscal soundness, foster usage of cigarettes, and increase health and healthcare costs"). The courts below abused their discretion in failing to consider these important factors in their interest-balancing analyses.

Protecting those who profit from the "false tax exemption." The courts below placed great weight on the potential harms to tribal economies resulting from enforcement of the tax law amendments—even while recognizing that "the State has the right to impose a tax scheme that eliminates the *false tax exemption.*" *Seneca II*, 2010 WL 4027795, *2 (emphasis added). The State either has the right to eliminate that "false tax exemption" or it does not. The Supreme Court and lower federal courts have repeatedly emphasized that States may tax and regulate

tribal sales to nonmembers "even if [the result] seriously disadvantages or eliminates the Indian retailer's business with non-Indians." *Colville*, 447 U.S. at 151 (footnote omitted); *see also Muscogee (Creek) Nation v. Oklahoma Tax Comm'n*, 611 F.3d 1222, 1237 (10th Cir. 2010); *Squaxin Island Tribe v. Washington*, 781 F.2d 715, 720 (9th Cir. 1986).

Moreover, "a federal court should not … lend its judicial power to a plaintiff who seeks to invoke that power for the purpose of consummating a transaction in clear violation of law." *Johnson v. Yellow Cab Transit Co.*, 321 U.S. 383, 387 (1944) (footnote omitted). The current stays and preliminary injunction are not simply maintaining the status quo, but enabling various tribal cigarette merchants to continue supplying downstream contraband activity that violates numerous federal and state laws. *See* pp. 5-8 *supra*. The challenging tribes and their members "ha[ve] been acting at [their] own peril" in marketing a "false tax exemption," and "[a] court of equity is under no 'duty to protect illegitimate profits or advance business which is conducted (illegally).'" *Commodity Futures Trading Comm'n v. British Am. Commodity Options*, 560 F.2d 135, 143 (2d Cir. 1977) (citation omitted); *see United States v. Diapulse Corp. of Am.*, 457 F.2d 25, 29 (2d Cir. 1972).

Tribes' refusals to cooperate. A tribal government cannot refuse to assist the State in collecting applicable state cigarette taxes then turn around and

complain about the resulting burdens and inconveniences to *its* members caused by *its* failure to cooperate. The tribes' "consistent refusal to cooperate with the state only serves to make the collection process more burdensome on both parties," and "force[s] the state to take a more aggressive approach to the collection of tobacco taxes." *Keweenaw Bay*, 477 F.3d at 892.

Other equitable considerations. Even if there were potential problems with the *internal* tribal quota mechanisms—which apply to fewer than 1% of the untaxed cigarettes now flowing to tribal outlets—the proper remedy would be to impose conditions on the operation of those mechanisms so as to ensure that tribal smokers can obtain the untaxed cigarettes to which they are entitled, not enjoin the application of the entire tax precollection system with respect to *external* sales to nonmembers having nothing to do with the prior approval or coupon systems. Enjoining the provisions governing sales to nonmembers based on potential problems with *internal* tribal allocation would violate basic principles of equity, which require that any injunctive relief be "*narrowly tailored* to fit *specific* violations" and avoid "unnecessary burdens on lawful activity." *Waldman Pub. Corp. v. Landoll, Inc.*, 43 F.3d 775, 785 (2d Cir. 1994) (emphasis added, citation omitted); *see also Association of Surrogates and Supreme Court Reporters v. New York*, 966 F.2d 75, 79 (2d Cir. 1992) ("considerations of federalism" require

avoidance of broad injunctive relief "that intrude[s] unnecessarily on a state's governance of its own affairs"), *modified*, 969 F.2d 1416 (2d Cir. 1992).

CONCLUSION

This Court should affirm the Western District's orders denying preliminary injunctive relief and lift the stays pending appeal that were entered by that court. This Court should reverse the Northern District's order granting the Oneida preliminary injunctive relief and vacate the injunction. The Court should remand the cases for further proceedings consistent with its decision.

Dated: January 21, 2011

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

The undersigned respectfully certifies that:

1. This brief contains 6,955 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii); and

2. This brief complies with the typeface requirements of Fed R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it was prepared in a proportionately spaced typeface using Microsoft Word in 14-point Times New Roman font.

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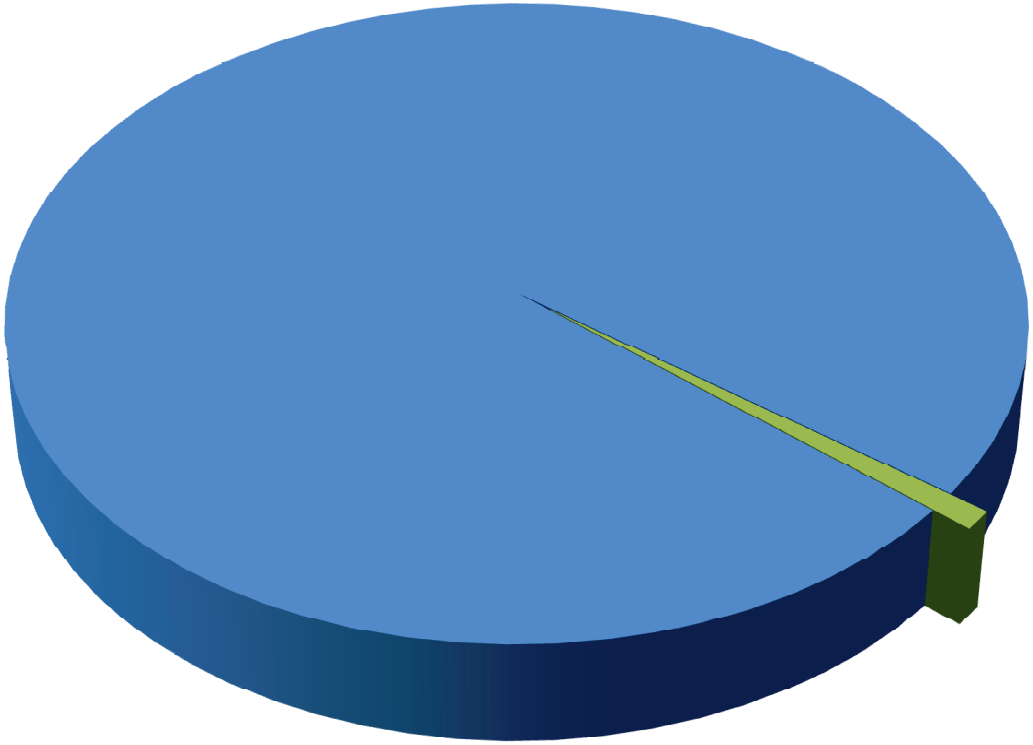
Addendum

TWO CIGARETTE ECONOMIES: NEW YORK TRIBES COMBINED*



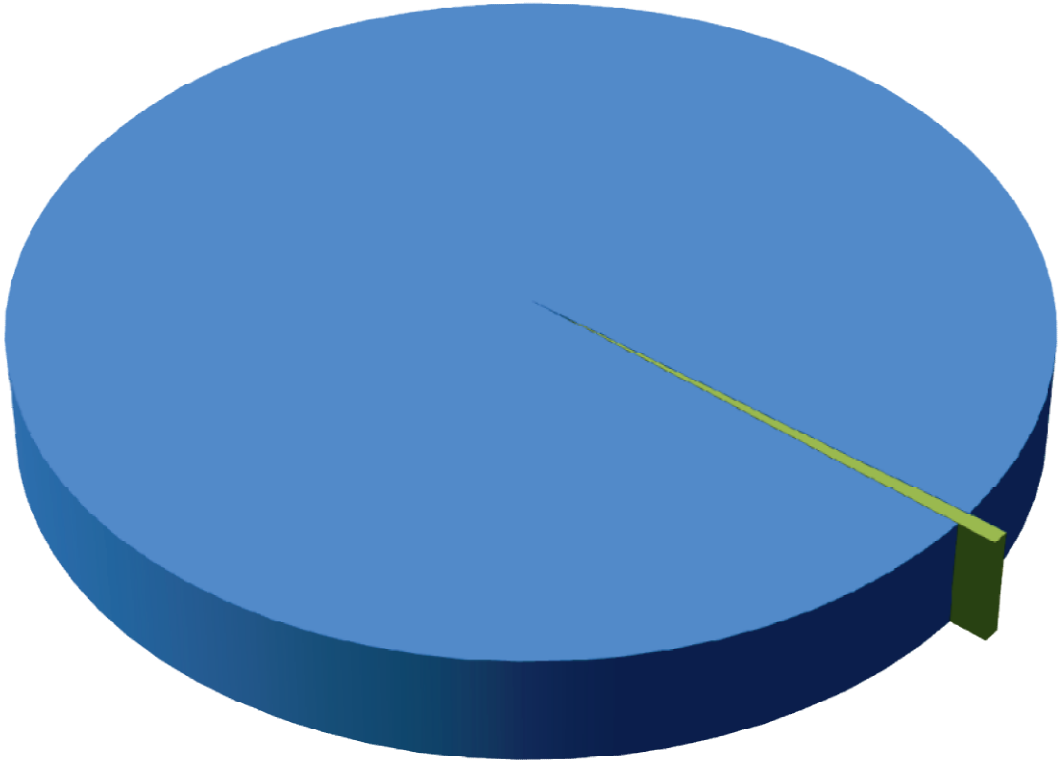
January 2008 through June 2009 Sales of Untaxed Cigarettes to New York Tribes' Combined Reservation Sellers in Excess of Probable Demand for Tribal Use (39,557,235 Cartons)

January 2008 through June 2009 Sales of Untaxed Cigarettes to New York Tribes' Combined Reservation Sellers That Equate to Probable Demand for Tribal Use (376,920 Cartons per 1.5 Years, based on 628,200 Packs per Quarter for Tribal Members) [.95% of Total Sales]

* Excluding Cayuga Indian Nation retailers, for which Department of Taxation & Finance data was not available.

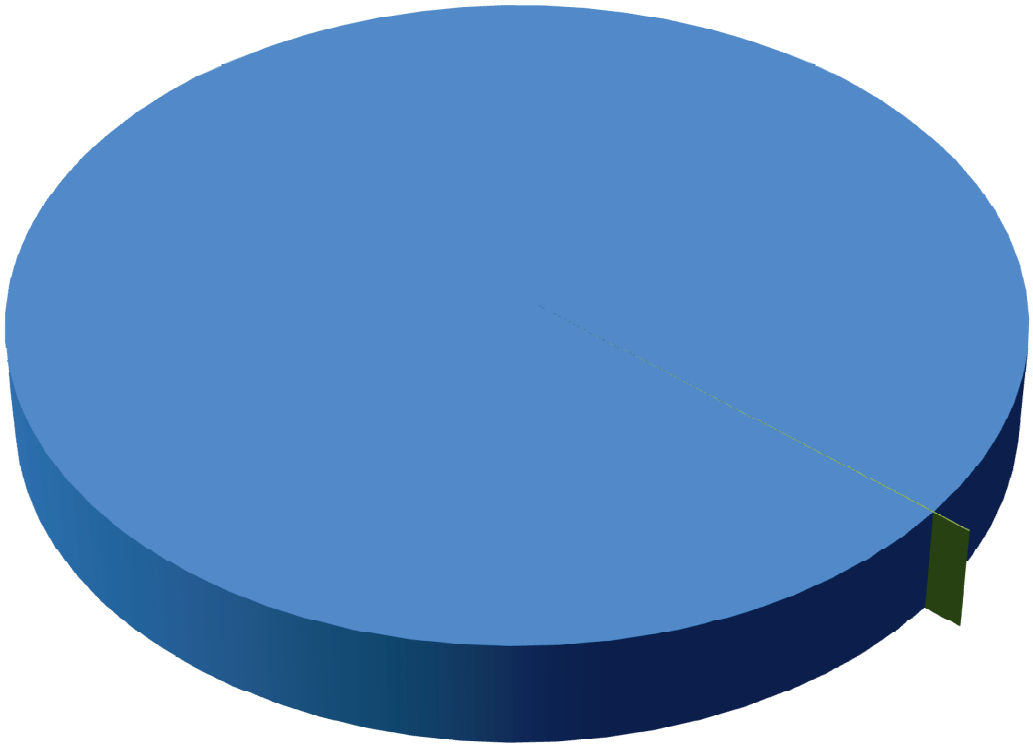
Add-1

TWO CIGARETTE ECONOMIES: SENECA NATION



- January 2008 through June 2009 Sales of Untaxed Cigarettes to Seneca Reservation Sellers in Excess of Probable Demand for Tribal Use (17,769,712 Cartons)
- January 2008 through June 2009 Sales of Untaxed Cigarettes to Seneca Reservation Sellers That Equate to Probable Demand for Tribal Use (101,160 Cartons per 1.5 Years, based on 8,100 Packs per Quarter for Tribal Members) [0.57% of Total Sales]

TWO CIGARETTE ECONOMIES: UNKECHAUGE NATION



Add-3

- January 2008 through June 2009 Sales of Untaxed Cigarettes to Unkechauge Reservation Sellers in Excess of Probable Demand for Tribal Use (10,878,385 Cartons)
- January 2008 through June 2009 Sales of Untaxed Cigarettes to Unkechauge Reservation Sellers That Equate to Probable Demand for Tribal Use (4,860 Cartons per 1.5 Years, based on 8,100 Packs per Quarter for Tribal Members) [0.044% of Total Sales]

Data For New York Tribes Combined*

Tribe	Total Sales to Reservation Sellers for January 2008 to June 2009*	Quarterly Tribal Probable Demand (in packs/cartons)	Tribal Probable Demand Quota Converted to Equivalent for January 2008-June 2009 (in Cartons)	Sales Exceeding Tribal Probable Demand Quota	Percentage of Sales Representing Legitimate Tribal Probable Demand
Seneca	17,870,872	168,600/ 16,860	101,160	17,769,712	0.57%
Unkechauge	10,883,245	8,100/ 810	4,860	10,878,385	0.04%
Tonawanda	3,332,478	5,700/ 570	3,420	3,329,058	0.10%
Tuscarora	2,107,425	21,900/ 2,190	13,140	2,094,285	0.63%
Oneida	2,269,279	31,200/ 3,120	18,720	2,250,559	0.83%
Shinnecock	366,670	40,500/ 4,050	24,300	342,370	7.10%
Onondaga	1,710,181	60,600/ 6,060	36,360	1,673,821	2.17%
Mohawk	1,394,005	291,600/ 29,160	174,960	1,219,045	14.35%
Totals	**39,934,155**	**628,200/ 62,820**	**376,920**	**39,557,235**	**0.95%**

* See Appendix A-8, A-9 to Written Testimony of William Comisky, October 27, 2009, before New York Senate Standing Committee on Investigations and Government Operations, attached as Exhibit E to Affidavit of James Calvin (filed August 26, 2010); data on sales to Cayuga Indian Nation sellers not available.

Black Bear Smoke Shop

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and many others...

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About Us

Black Bear Smoke Shop operates solely on the sovereign Territory of the Seneca Nation of Indians. The point of sale for all transactions is within the borders of Seneca Nation Territory. We have no tax collection obligation to any State because we have no physical presence outside of Seneca Nation territory. However, we do incorporate Federal tax into our prices, so the price you see is the price you pay. Black Bear Smoke Shop, a wholly owned Seneca Nation licensed business, has no further obligation to abide by legislation set forth by any foreign government. As such, we do not in any way support or adhere to the Jenkins Act. Black Bear Smoke Shop does not report any information pertaining to our customers' private information, nor do we report their purchases to any State agency. We do suggest that you check with the laws of the State in which you reside to determine your responsibility to report your tobacco purchases.

"Black Bear Smoke Shop's super low prices **smokes** the competion!"

- Chris O.

Add-6

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

AFFIDAVIT OF CM/ECF SERVICE

I, Natasha S. Johnson, being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age.

On January 21, 2011

deponent served the within: **Brief for Amicus Curiae New York Association of Convenience Stores in Support of Defendants-Appellants-Cross-Appellee**

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Sworn to before me on January 21, 2011

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