UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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THE CITY OF NEW YORK,

Plaintiff,

vs.

Civil Action No. 10 cv 5783 (LDW)

KING MOUNTAIN TOBACCO COMPANY, INC., and DELBERT WHEELER, SR.,

Defendants.

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DEFENDANTS' REPLY IN SUPPORT OF ITS MOTION TO DISMISS

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I. INTRODUCTION

The City's Complaint should be dismissed because there is no legal basis for the relief it seeks. The City's claims rely upon unenforceable New York State tax provisions, §§ 471 and 471-e. (Compl. ¶¶ 25-26.) These provisions have never been enforced, either in their current or prior versions, on cigarette sales occurring on qualified Indian Reservations.[1] The deliveries alleged in the Complaint were made to the Poospatuck Indian Reservation – a "qualified Indian Reservation." N.Y. Tax Law § 470(16)(c). During the period contemplated in the Complaint, these provisions were found unenforceable with respect to on-reservation cigarette sales. The Second Circuit recognized the unresolved enforceability of §§ 471 and 471-e, and looked to the New York State Court of Appeals to resolve the enforceability question which definitively answered "no." Like the State, the City possessed no authority to impose its taxes on the subject cigarettes. There was no obligation on King Mountain to stamp the cigarettes at issue here and, as such, the City's claims must be dismissed.

II. LAW AND ARGUMENT

A. The City has failed to establish that New York State Tax Law required stamps

During the period contemplated in the Complaint, New York State had no valid/enforceable provision for requiring tax stamps on cigarettes destined for sale on a qualified Indian Reservation. The City's suggestion that the Defendants are subject to liability, regardless of the enforceability of §§ 471 and 471-e, lacks merit and contradicts case law.

In March 2010, the Second Circuit, in a case brought by the City, certified the following questions to the New York Court of Appeals regarding the effect of §§ 471 and 471-e on cigarette sales on Native American reservation land:

[1] *See Oneida Nation v. Cuomo*, 2011 U.S. App. LEXIS 9497 * 7-11, 56-58 (2d Cir. May 9, 2011).

> (1) Does N.Y. Tax Law § 471-e, either by itself or in combination with the provisions of § 471, impose a tax on cigarettes sold on Native American reservations when some or all of those cigarettes may be sold to persons other than members of the reservation's nation or tribe?
>
> (2) If the answer to Question 1 is "no," does N.Y. Tax Law § 471 alone impose a tax on cigarettes sold on native American reservations when some or all of those cigarettes may be sold to persons other than members of the reservation's nation or tribe? *City of New York v. Golden Feather Smoke Shop*, 597 F.3d 115, 127 (2d Cir. 2010) (emphasis added).

As of March 2010, even the Second Circuit questioned the enforceability of §§ 471 and 471-e with regards to the State's ability to impose a tax on cigarettes sold on reservations regardless of whether the purchaser was a member of the reservation's nation or tribe. *Id.* Specifically, the unresolved question was "whether cigarette vendors on the Poospatuck Reservation violate state and federal law by selling untaxed cigarettes to people who are not members of the Unkechauge Nation?" *Id.* at 122 (emphasis added).

Like here, that case involved CCTA claims based on the failure to affix New York State cigarette tax stamps and the enforceability of §§ 471 and 471-e in regards to these deliveries is directly relevant to the City's claims.[2] *Id.* at 121-22. As noted by the Second Circuit, "if §§ 471 and 471-e, individually or in combination, do not impose a tax on cigarettes sold by reservation vendors, then there would be no basis on which the City could pursue in federal court an injunction under either the CCTA or the CMSA." *Id.* at 127. In other words, there would be no violation of the CCTA.

A month later, in April 2010, this Court found that § 471 "lacked sufficient clarity" and vacated that defendant's RICO conspiracy conviction based on a conspiracy to sell unstamped cigarettes violation of N.Y. Tax Law § 471. *United States v. Morrison*, 706 F. Supp.2d 304, 306,

[2] All of the cases cited by the City for the proposition that it can sustain a CCTA claim based on § 471 regardless of enforceability were issued prior to *Golden Feather*, 597 F. 3d 115 (March 4, 2010) and *Cayuga*, 14 N.Y.3d 614 (May 11, 2010).

313 (E.D.N.Y. 2010). As this Court noted, the Second Circuit's certification of the questions (discussed above) "compels the conclusion that the [Second] Circuit perceives the applicability of § 471 to on-reservation sales as unsettled and ambiguous, *i.e.*, not self-evident nor predictable from a simple reading of the section." *Id.* at 312-13.

In May 2010, the New York Court of Appeals answered the questions certified by the Second Circuit in an unrelated case. *Cayuga Indian Nation v. Gould*, 14 N.Y.3d 614, 930 N.E.2d 233 (N.Y. Ct. App. 2010). There, like the City here, the District Attorneys argued that "§ 471 imposes a sales tax on cigarettes sold by Indian retailers to non-Indians and this can be enforced against the Nation, notwithstanding the fact that the tax exemption coupon system devised by the Legislature in Tax Law § 471-e is not in effect." *Id.* at 646. The Court of Appeals *rejected* this argument holding that Indian retailers could not be sanctioned for failing to collect taxes from non-Indian consumers, because State law lacked a methodology for calculating and collecting this tax. *Id.* at 648.

The City's claims here strike at the heart of the question answered in *Cayuga Nation* because there can be no liability where there is no existing mechanism to assess the validity of refund claims for tax exempt cigarettes that already occurred. *See Id.* at 650-51. Regardless of whether the sanction(s) contemplated are criminal or civil[3] (CCTA, PACT Act, and RICO), *Cayuga Nation* applies. As noted by the Court of Appeals, "[e]ven outside of the context of Indian relations, taxpayers are not ordinarily required to guess what they need to do to comply with the Tax Law." *Id.* at 651. Therefore, King Mountain and Delbert Wheeler cannot be sanctioned for failing to comply with §§ 471 and 471-e for the period prior to the September 1,

[3] The City itself prevented the New York Court of Appeals from deciding the enforceability of §§ 471 and 471-e in the civil context by moving to withdraw the questions certified in *Golden Feather*. *See* Second Circuit Docket 09-3942-cv, Motion, on behalf of Appellee City of New York, to recall certified questions (6/25/10).

2010, the effective date of the amendments or after that date because their enforceability remains questionable.

While the City attempts to limit the applicability of *Cayuga*, its holding does apply here. According to the Complaint the subject cigarettes were delivered to the "Watkins Sellers" that the City claims "sell cigarettes through sole proprietorships, with places of business of business located on the Poospatuck Indian Reservation in Mastic, New York." (Compl. ¶ 14.) As noted above, the Watkins Sellers' liability under the CCTA liability is directly linked to the enforceability of the prior versions of §§ 471 and 471-e, as recognized by the Second Circuit in certifying the questions to the New York Court of Appeals. *Golden Feather*, 597 F.3d at 127. There is no allegation that the Watkins Sellers "intended to resell [the cigarettes] off the reservation." *See Cayuga Indian Nation*, 14 N.Y.2d at 653 (emphasis added). Speculation that some of the subject cigarettes were eventually sold to non-Indians on the reservation does not contradict application of the *Cayuga Indian Nation* holding here because it specifically contemplated on-reservation sales to non-Native Americans.

Likewise, the enforceability of the amended §§ 471 and 471-e continues to percolate in New York State Court. On June 10, 2011, the Appellate Division of the New York Supreme Court entered an order temporarily restraining and enjoining the State from "implementing, administering, and enforcing N.Y. Tax Law §§ 471(1), (2) , (5) related to the taxation of cigarettes on Indian territory, N.Y. Tax Law § 471-e, and 20 N.Y.C.R.R. § 74.6, pending further order of [the] Court." *Seneca Nation of Indians v. State of New York*, Amended Order to Show Cause, Erie County Index No. 2011-000714 (*see* Appendix). Accordingly, §§ 471 and 471-e provide no basis for the City's attempt to assert civil and RICO liability on King Mountain and Delbert Wheeler, Sr. *See Morrison*, 706 F. Supp.2d at 312.

The City argues that there are no allegations in the Complaint that the Watkins Sellers "are members of Native American tribes." (Pl. Br. at 5.) However, according to the Complaint deliveries contemplated in this lawsuit were delivered to the Poospatuck Indian Reservation in Mastic, New York, not to New York City. (Compl. ¶¶ 14, 22.) The Poospatuck Reservation is Indian Territory pursuant to New York tax law. N.Y. Tax Law § 470(16)(c) ("Qualified reservation"). Likewise, the "Watkins Sellers" sell cigarettes through businesses located on the Poospatuck Indian Reservation. (Compl. ¶ 14.) So it is undisputed that the subject cigarettes were destined for sale on a qualified reservation and therefore no State tax stamps were required to be affixed by King Mountain, an exempt manufacturer transporting its product.

B. The City had no authority to tax cigarettes destined for the Poospatuck Reservation

The City's authority to tax does not extend to sales of cigarettes where the State lacks authority to impose such a tax and has no application outside its territorial limits. N.Y. Unconsol. Laws §§ 9436(3),) (5). The City's argument that it has authority to tax cigarettes destined for the Poospatuck Reservation contradicts its prior representations to this Court.

In *United States v. Morrison* the City admitted that it had no authority to tax cigarettes sold at the Peace Pipe Smoke Shop located on the Poospatuck Reservation. 685 F. Supp.2d 399, 344 n.5 (2010); *see also City of New York v. Golden Feather Smoke Shop*, 2009 U.S. Dist. LEXIS 76306 *31-32 (E.D.N.Y. 2009) (Peace Pipe Smoke Shop located on the Poospatuck Reservation). There the City represented that "City tax stamps … applied only to cigarettes that are to be sold at retail within the confines of New York City…. That is, cigarettes sold to Peace Pipe would never have borne City tax stamps because, ostensibly at least, they were not sold to a City retailer." *Morrison*, 685 F. Supp.2d at 344 n. 5 (quoting City's brief).

Furthermore, the City's refund provision provides a tacit admission that the City lacks authority to assess a tax on the cigarettes here. The refund provision - "the commissioner of

finance **shall**" refund any tax erroneously paid and the dealer "**shall** be entitled to a refund," less the applicable commission, of the amount of tax paid on cigarettes "sold and shipped to a **dealer outside the City** for sale there." N.Y.C. Admin. Code § 11-1311 (emphasis added). Section 11-1311's refund provisions are absolute, and without the limits suggested by the City. If the cigarettes are sold and shipped to a dealer outside the City for sale there, then the dealer "shall" be entitled to a refund. King Mountain bears no burden in this case to prove that the subject cigarettes were not delivered to a dealer or retailer within the City and *the City admits as much in its Complaint*. (Compl. ¶¶ 14, 22, 24.) Accordingly, the cigarettes were not subject to City tax, and the City would have been required to refund any tax collected. Likewise, any "presumption" included in the City's tax code that King Mountain "is a dealer of cigarettes in the city" is overcome by the admission in the City's Complaint that all of the subject deliveries were made to retail sellers outside the City. Finally, the City's reliance on *United States v. Boggs* fails to establish the City's right to tax cigarettes as they pass through town due to multiple factual distinctions. The *Boggs* defendant was not a exempt under the CCTA and West Virginia law applied in part because the cigarettes were "available for sale within the State of West Virginia" at the time they were seized. *Boggs*, 775 F.2d 582, 584 n.4 (4th Cir. 1985). Here, there is no question that the subject cigarettes were bound for sale on a Qualified Indian Reservation.

C. The subject cigarettes were not "Contraband Cigarettes" Under the CCTA

The City cannot prove its CCTA claim against King Mountain because by express statutory definition, the subject cigarettes were not "contraband" while they were in King Mountain's possession. The CCTA's prohibitions apply only to "contraband cigarettes" as defined by statute at 18 U.S.C. § 2341(2). 18 U.S.C. § 2342(a). The "contraband" status is based on the status of the possessor. As noted in the *Boggs* case, cited by the City, "Section 2341(2) [of the CCTA] also contains a series of excepted individuals who may possess otherwise

contraband cigarettes without the cigarettes coming within the statutory definition [of "contraband cigarettes]." 775 F.2d at 584 n. 3 (4th Cir. 1985) (emphasis added). The CCTA provides no provision to support the City's claim that it loses its exempted status once the cigarettes change hands. The CCTA's burden of compliance falls on the person in possession, not prior-possessors. And here, King Mountain is a permitted manufacturer falling within the CCTA's express exemption.

The City admits that the subject cigarettes were not contraband while in King Mountain's possession and provides no authority for its "reach-back" claim that a permitted tobacco product manufacturer can somehow become liable under the CCTA if the subject cigarettes later land in the possession of a non-exempt entity. (Pl.s Mem. p. 13-14.) Instead, the City relies upon a Complaint from an unrelated case, a completely unrelated criminal indictment, and guilty plea. (Pl. Br. at 14-15.) These documents have **no** precedential value and could only have been submitted in an inflammatory attempt to prejudice the Defendants and should be struck or at a bare minimum should not be considered.

Furthermore, as discussed above, there was no enforceable New York State law during the relevant time period in the Complaint (November 11, 2009 – July 23, 2010) requiring on-reservation vendors to purchase stamped cigarettes for resale. Accordingly, even if the City's reach-back argument was supported by law, there was no State obligation to place tax stamps on the subject cigarettes so they would not be "contraband" under the CCTA. 18 U.S.C. § 2341(2). As noted above, the cases cited by the City for the proposition that § 471 provided the basis for CCTA violation, regardless of its enforceability, are inapplicable because they were issued prior to the *Cayuga Indian Nation* case.

Finally, the City challenges King Mountain's status as a permitted tobacco product manufacturer on the pure speculation that the permit may have been revoked, in an attempt to avoid the motion to dismiss. The City did not plead this in its Complaint, has offered nothing to support a claim that the permit has been revoked, because it cannot, and should not be allowed to attempt to create factual questions based purely on speculation raised in response to a motion to dismiss. *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1949 (2009) (requiring that the Complaint contain sufficient factual matter to survive motion to dismiss). Likewise, any suggestion that the permit may have expired is contradicted by the fact that the permit is not issued for a particular period and the regulations provide for amended permits in circumstances such as a change in the name of the tobacco product manufacturer. *See* 27 C.F.R. §§ 40.75-.76, 40.91-.114. The regulations do not require periodic renewal. *Id.* Because King Mountain was permitted during relevant time-frame the City's speculative argument fails.

D. The City's PACT ACT claim rests on unenforceable State tax provisions

The City incorrectly states that the delivery destination was New York State, because the delivery destination was the Poospatuck Reservation. Furthermore, as stated above, since *Cayuga Indian Nation* found that §§ 471 and 471-e were unenforceable during the time period relevant to the deliveries alleged in the City's Complaint, the City's allegations that the Watkins Sellers sold unstamped cigarettes on the Poospatuck Reservation are insufficient to support the conclusory suggestion that they were not "lawfully" operating Reservation Retailers. The City claims that the Watkins Sellers sell unstamped/untaxed cigarettes in violation of the CCTA and are therefore not lawfully operating. New York State law did not impose an obligation on the Watkins Sellers to place stamps on the cigarettes sold on the reservation during the relevant period, accordingly, this claim lacks basis in light of the *Cayuga* case. As such, they fail to meet the PACT Act's "consumer" definition. *See* 15 U.S.C. § 375(4). Likewise, any case or decision

regarding alleged CCTA violations by the Watkins Sellers based on violation of §§ 471 or 471-e involving on-reservation sales of unstamped cigarettes pre-dating the *Cayuga* decision is of little or no value. (Pl.'s Mem. at 18 (citing *Golden Feather*, 2009 U.S. Dist. LEXIS 76306 at 25-30 (issued almost nine months prior to *Cayuga* and seven months prior to the Second Circuit's certification of questions regarding the enforceability of §§ 471 and 471-e in the very same case).

E. The City Has Failed to Meet its Burden to Survive Dismissal of its RICO Claim

The City's citation to a search warrant, illegally executed, in February highlights the defamatory intent of its RICO claim against Delbert Wheeler. As discussed above, the City as a matter of law had no authority to collect City taxes on the deliveries alleged in the Complaint. If the City had no right to collect the tax in the first place, then it has suffered no damages for King Mountain's alleged failure to pay City taxes the City was not entitled to collect.

Furthermore, as noted above, to the extent that the City's RICO Conspiracy Claim is based on the on-reservation sales of unstamped cigarettes by the Watkins Sellers, these sales did not violate the CCTA, because neither the City nor the State of New York had the authority to require tax stamps on these cigarettes.

The City's RICO claim may only survive if it can prove damages as a direct result of the alleged claims. Since the City lacked authority to tax the subject cigarettes, it has suffered no damages and its RICO claims must be dismissed. Accordingly, the City must rely on a "distribution theory" of causation. The very case the City relies upon rejects the distribution theory. (Pl.'s Mem. at 22-23 (citing *United States v. Morrison*, 685 F. Supp.2d 339.) In *Morrison*, this Court rejected, as "far too attenuated," the same basic causation arguments the City makes here. 685 F. Supp.2d at 345-46 (relying on *Hemi Group, LLC v. City of New York*, 130 S. Ct. 983, 990-91 (2010) (cited by Defendants in Support of Motion to Dismiss at 19, 21, and 22). As noted by this Court, "the City's claimed injury 'rests not just on separate *actions*,

but separate actions carried out by separate *parties*.'" *Id.* at 346 (quoting *Hemi Group*, 130 S. Ct. at 990) (emphasis in original). The Defendants here are even another step removed from the alleged injury because, based on the City's allegations, the Defendants sold to the Reservation Retailer, whereas the sales in *Morrison* initiated with the Reservation Retailer.

III. CONCLUSION

The City has failed to establish that it has stated a claim for which relief can be granted. As such, the Defendants are entitled to dismissal, with prejudice, of the City's Complaint.

Dated: Spokane WA

June 22, 2011

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned certifies this 22nd day of June, 2011 that a true and correct copy of the foregoing ***DEFENDANTS' REPLY IN SUPPORT OF ITS MOTION TO DISMISS*** was served by way of the Court's ECF system upon all counsel of record.

/s Theresa L. Keyes
Theresa L. Keyes

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APPENDIX

SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION FOURTH DEPARTMENT

SENECA NATION OF INDIANS,

PLAINTIFF,

v.

THE STATE OF NEW YORK,
THE NEW YORK STATE DEPARTMENT OF
TAXATION AND FINANCE,
THOMAS H. MATTOX,
ACTING COMMISSIONER OF THE
DEPARTMENT OF TAXATION
AND FINANCE, ERIC T. SCHNEIDERMAN,
NEW YORK STATE ATTORNEY GENERAL,

DEFENDANTS.

Amended

ORDER TO SHOW CAUSE

ERIE COUNTY INDEX NO.
2011-000714

PRESENT: Hon. JEROME GORSKI Justice of the Supreme Court, Appellate Division for the Fourth Judicial Department.

UPON the annexed Affirmation of Carol E. Heckman, Esq., with exhibits, dated June 8, 2011 and submitted by Plaintiff-Appellant the Seneca Nation of Indians ("the Nation" or "Plaintiff"), it is hereby

ORDERED that Defendants-Respondents THE STATE OF NEW YORK, THE NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, THOMAS H. MATTOX, Acting Commissioner of the Department of Taxation and Finance, and ERIC T. SCHNEIDERMAN, New York State Attorney General, ("Defendants") shall **SHOW CAUSE** before a Special Term of the Supreme Court of the State of New York, Appellate Division, Fourth Department, to be held at the M. Dolores Denman Courthouse, 50 East Avenue, Rochester, New York on the 20 day of June, 2011 at 10:00 o'clock in the ~~fore~~ noon of that day, ~~or as soon thereafter as counsel may be heard~~, why an Order should not be made and entered pursuant to CPLR § 5518, granting Plaintiff's motion for a preliminary injunction pending the appeal of the order of Hon. Donna M. Siwek, J.S.C., dated

June 8, 2011, denying the Nation's Motion for Summary Judgment; finding that the Nation's Motion for Preliminary Injunction enjoining Defendants from implementing, administering, or enforcing N.Y. Tax Law §§471(l), (2), (5) related to the taxation of cigarettes on Indian territory, N.Y. Tax Law §47 1-e, and 20 N.Y.C.R.R. §74.6 was moot; and granting Defendants' Cross-Motion for Summary Judgment; and it is hereby

ORDERED, that pending a hearing on this order to show cause, and until further order of this Court, Defendants are temporarily restrained and enjoined from implementing, administering, and enforcing N.Y. Tax Law §§471(l), (2), (5) related to the taxation of cigarettes on Indian territory, N.Y. Tax Law §47 1-e, and 20 N.Y.C.R.R. §74.6, pending further order of this Court,

SUFFICIENT REASON APPEARING THEREFOR, let service of a copy of this Order and of the above-listed papers upon which the same is granted, made upon counsel for the Defendants, Darren Longo, Esq., by hand-delivery, fax, or e-mail, on or before the 10 day of June, 2011 at 5:00 o'clock in the afternoon, be deemed good and sufficient service; and it is further

ORDERED, that any responsive papers shall be filed with the Court and delivered to counsel for the Plaintiff no later than the 14 day of June, 2011 at 5:00 o'clock in the afternoon, and Plaintiff's reply papers, if any, shall be filed with the Court and delivered to counsel for Defendants no later than the 16 day of June, 2011 at 5:00 o'clock in the afternoon.

Hon. _____, J.S.C.

ENTER: 6/9/11

6/10/11