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MUNICIPAL LAW

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Cigarettes, Firearms, and Foreign Missions

In a previous article, I described the work of the Law Department's affirmative litigation division, which is unique among the divisions of the Law Department in focusing on advancing the interests of the city and its residents through affirmative legal action in which the city assumes the role of plaintiff.

The division's role is essentially twofold: to protect public health and safety and advance the city's substantive agenda by instituting appropriate claims and proceedings, and to pursue claims of monies due to the city. Recently, the division has been assigned the task of working with the Department of Investigation to recover damages for false claims made against the city, utilizing authority granted under the New York City False Claims Act.

The division has been instrumental in furthering the efforts of the Bloomberg administration to promote public health and safety by eliminating illegal handguns from the streets of the city and to stop cigarette bootlegging, which not only deprives the city of revenues due to it but also abets smoking addiction by reducing the price of cigarettes.

I will discuss these efforts and provide an update on the division's work to ensure that foreign missions located in New York City pay the taxes they owe the city.

Firearms Litigation

In 2000, the city filed suit against a large group of firearms manufacturers, who the lawsuit alleged caused, created or contributed to a public nuisance by supplying the market for illegally possessed handguns in the city. *City of New York v. B.L. Jennings Inc.*, 219 FRD 255 (E.D.N.Y. 2004). That suit, in which the city was assisted by pro bono counsel Pillsbury Winthrop Shaw Pittman, has followed an interesting trajectory that provides an example of both the effect that litigation brought by the city can have on a national level and the ability of the gun industry to promote legislative initiatives favorable to it.

The city's case was days from trial when, in November 2005, President George W. Bush signed into law the so-called Protection of Lawful Commerce in Arms Act (PLCAA), Pub. L. No. 109-92, 119 Stat. 2095 (2005) (codified at 15 U.S.C. §§7901-7903), which barred the commencement or continuation of litigation against firearms sellers where a third party was alleged to be jointly liable for the plaintiffs' injury. 15 U.S.C. §7903(5)(A). When the defendant firearms manufacturers sought dismissal of the city's action pursuant to the act, the city argued that its action came within one of the few exemptions from dismissal set forth in the act, which



applied to lawsuits alleging that the defendant had violated a state or federal law "applicable to" the sale or marketing of firearms. 15 U.S.C. §7903(5)(A)(iii). Because the city's complaint alleged violations of the New York's criminal nuisance statute (Criminal Procedure Law §240.45), division attorneys argued that it came within that exemption on the ground that the public nuisance law was "applicable to" the sale of marketing and firearms, according to numerous dictionary definitions of that term adopted by the case law. The defendants, citing to the PLCAA's legislative history which they asserted identified the city's lawsuit as one barred by the act, argued that, for purposes of the act, only statutes that specifically addressed firearms sales were "applicable to" the sale and marketing of firearms. See *City of New York v. Beretta U.S.A. Corp.*, 524 F.3d 384 (2d Cir. 2008). Although the district court agreed with the city's argument, it found sufficient room for difference of opinion to certify its determination to the U.S. Court of Appeals for the Second Circuit. The Second Circuit, over Judge Robert A. Katzmann's dissent, rejected arguments of both sides, holding that, although the PLCAA exemption did not require an alleged violation of a statute expressly regulating the firearms industry, the dictionary meaning of the term "applicable" did not give sufficient weight to the surrounding language of the statute and would not accurately reflect the intent of Congress. 524 F.3d at 400.

In the absence of the New York Court of Appeals having addressed the question, the Second Circuit, which also rejected the city's alternative argument that the statute was unconstitutional, dismissed the city's action as outside the exemption. *Id.* The corporation counsel must now determine whether to petition for certiorari to the U.S. Supreme Court.

While its suit against firearms manufacturers was pending, the city again teamed up with Pillsbury Winthrop Shaw Pittman, serving as pro bono counsel, and began a series of legal actions against other defendants to address the problem of illegally possessed firearms. See *A-1 Jewelry & Pawn*, 501 F.Supp.2d 369 (E.D.N.Y. 2007); *City of New York v. Bob Moates' Sport Shop Inc.*, 2008 U.S. Dist. LEXIS 11699, (E.D.N.Y. 2008). Investigations had shown that a relatively small number of retail firearms dealers in Southeastern and Midwestern states were responsible for a disproportionate number of the illegal firearms recovered in the city. After assembling both statistical and analytical data indicating that the sales practices of certain dealers contributed disproportionately to the flow of illegal guns into the city, investigators obtained direct evidence of those practices

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through undercover operations that tested a dealer's willingness to sell a gun during a simulated "straw purchase," in which a person legally entitled to acquire a firearm (a "straw buyer")—seeks to purchase a gun on behalf of a person not so entitled. The dozens of purchases simulated by city investigators replicated all the characteristics of a typical straw purchase, as described in both law enforcement and industry publications. Gun sales made under those circumstances were captured on videotape, and attorneys for the city filed lawsuits against the dealers, alleging that their sales practices facilitated the trafficking of guns into the city, giving rise to a public nuisance.

An initial issue raised by the litigation was whether a New York court could assert personal jurisdiction over these out-of-state defendants. The city contended that the defendants were subject to personal jurisdiction under New York state law because they did business in interstate commerce and their out-of-state tortious conduct caused injury in New York. The district court held that jurisdiction was proper, where "[a]lleged and thus far prove[d] with abundant factual confirmation are facts that the defendant engaged in straw sales, knew, or should have known, that the apparent purchaser was acting on behalf of a prohibited purchaser, and knew, or should have known, that many of the guns it was selling illegally would be trafficked to New York and used in crimes committed in *New York City*." *City v. Bob Moates*, 2008 U.S. Dist. LEXIS 75578, *8.

The city did not seek money damages against the dealers, but instead sought a practical method of compelling them to reform their sales practices. The relief proposed by the city, and ultimately agreed to in settlements by most of the dealers, was supervision by a court-appointed special master, who would monitor the dealers' sales practices and provide educational and logistical support in order to assure that their sales conformed to best practices guidelines. To date, 20 of the original 27 dealers sued have been under monitorship for varying periods of time, and preliminary results have shown that the number of guns recovered in the city traceable to monitored dealers has declined by approximately 75 percent since the monitoring began. Moreover, the overall number of guns traceable to other dealers in the states covered by the city's suit also declined according to data collected by the Bureau of Alcohol, Tobacco, Firearms and Explosives.

Cigarette Bootlegging

Several years ago, the city was among the first jurisdictions in the United States to commence litigation against Internet-based cigarette businesses that exploit the significant differences in cigarette prices created by variations in local, state and foreign cigarette taxation. Those differences among jurisdictions enable smokers within the city to pay less for cigarettes by buying them over the Internet from sellers situated in places with lower cigarette taxes. Such purchases

are not illegal, but the buyer owes taxes on them pursuant to state and city "use" taxes.

The city's lawsuits alleged that Internet cigarette sellers actively concealed from the state sales to New York residents, despite a reporting requirement under the federal Jenkins Act, thereby depriving the city of the opportunity to collect lawfully due taxes. See, e.g., *City of New York v. Nexicon Inc.*, 2006 U.S. Dist. LEXIS 10295 (S.D.N.Y. March 13, 2006); *City of New York v. Cyco.net Inc.*, 383 F.Supp. 2d 526 (S.D.N.Y. 2005). The city alleged that the Internet cigarette business amounted to a mail and wire fraud scheme intended to defraud the city of taxes and that the defendants were civilly liable for those losses under the RICO statute. The city's four lawsuits were rejected by the district court, which, while agreeing with the underlying theory that the defendants' businesses practices could amount to mail and wire fraud violations, twice dismissed the RICO claims on pleading technicalities. *Cyco.net*, 383 F.Supp.2d at 526.

This month, however, the Second Circuit reversed and reinstated the four complaints. *City of New York v. Smokes-Spirits*, 2008 U.S. App. LEXIS 18930 (2d Cir. 2008). Consistent with recent U.S. Supreme Court decisions, the Second Circuit decision rejected defendants' argument that a RICO plaintiff could not allege a predicate offense of mail and wire fraud in the absence of misrepresentations made directly to the plaintiff. 2008 U.S. App. LEXIS 18930 at *34. The decision also expressly laid to rest a previous dictum in which the Second Circuit had suggested that municipal revenue losses might not qualify as "injury to business or property" under RICO, holding that allegations of lost taxes qualified as injury to a municipal property for RICO purposes. The circuit further certified sua sponte two questions raised by the city's state law claims to the New York Court of Appeals. 2008 U.S. App. LEXIS 18930 at *80-81.

In its original investigation of Internet cigarette sales, the city learned of significant sources of bootlegged cigarettes being sold within New York state itself. New York's American Indian reservations have become a major source of "unstamped" bootlegged cigarettes on which New York city taxes, as well as taxes due to other jurisdictions, have not been prepaid. According to the city's findings, state-licensed cigarette wholesalers sell large quantities of "unstamped" cigarettes to cigarette sellers located on American Indian reservations. These unstamped cigarettes do not include in their selling price New York state and local excise taxes, enabling steeply discounted, although illegal, sales to be made profitably, while depriving the city and state of tax revenues.

The affirmative litigation division commenced litigation to address the significant injuries to city and state tax revenue caused by the in-state cigarette trafficking that emanates from New York's American Indian reservations and which has been estimated to result in a billion dollars a year in combined revenue losses for the city and the state. In March 2006, the federal Contraband Cigarette Trafficking Act (CCTA), a

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criminal statute previously available only to federal prosecutors, had been amended by Congress to provide state and local governments with standing to bring civil actions for injunctive relief, damages and penalties. See 18 U.S.C. §2341 et seq. In what we believe is the first suit filed by a state or local government under the newly amended statute, the city brought claims against a group of cigarette wholesalers who are the principal suppliers of unstamped cigarettes to New York's America Indian tribes. The wholesalers' principal defense was that because the state does not enforce its laws regulating sales of unstamped cigarettes, there could be no violation of the CCTA, the language of which requires that there be an "applicable" state tax. Judge Carol B. Amon of the U.S. District Court for the Eastern District of New York rejected this argument, holding that the language of the New York state tax law was determinative of whether there was an "applicable tax," not whether a state agency undertook to enforce the law. *City of New York v. Milhelm Attea & Bros. Inc.*, 2008 U.S. Dist. LEXIS 35465 (E.D.N.Y. 2008).

Just two weeks ago, the city filed another cigarette lawsuit, this time against an estimated 19 individuals and businesses located on the Poospatuck reservation in Mastic, N.Y. *City of New York v. Golden Feather Cigarette Express Inc. et al.*, 08-cv-3966 (E.D.N.Y.). Investigators have identified that reservation as a major supplier of bootlegged cigarettes to the city. Although American Indians are permitted to possess and sell unstamped cigarettes sufficient for their personal use, sales by them to the public are taxable transactions, and the cigarettes must bear tax stamps. Based on figures provided by cigarette wholesalers, the city learned that sales of unstamped cigarettes by reservation cigarette sellers greatly exceed anything that could be consumed by reservation residents. To account for these sales, each man, woman and child residing on the reservation would have to smoke an estimated 966 packs of cigarettes per day. Other evidence obtained by the city demonstrated that the bulk of reservation cigarette sales were made to the public, including sales in which van loads of cigarettes are trucked into the city. The city suit alleges CCTA violations against a number of reservation businesses and their owners and operators for trafficking in unstamped cigarettes. *City of New York v. Golden Feather Cigarette Express Inc. et al.*, 08-cv-3966 (E.D.N.Y.).

Foreign Missions

Last February, the city prevailed in the district court in what have become known as the foreign mission tax cases, in which the city sued to recover unpaid property taxes on certain properties owned by India, Mongolia, and the Philippines. *City of New York v. Permanent Mission of India to the U.N.*, 533 F.Supp.2d 457 (S.D.N.Y. 2008).

The cases against India and Mongolia raised the question whether portions of Manhattan properties owned by those governments and used to house nonambassadorial staff of

their United Nations missions and consular staff are subject to property taxation, as the city claimed, or are exempt as integral parts of the mission or consular premises, as India and Mongolia claimed.

The case against the Philippines turned on whether certain government-related entities—a bank, an airline (which was, however, private for some of the period in question), and a restaurant—are exempt from property taxation as part of the diplomatic premises. India and Mongolia further contended that they were immune from suit under the Foreign Sovereign Immunities Act, 28 U.S.C. §§1602 et seq. In June 2007, in a case argued for the city by Corporation Counsel Michael A. Cardozo, the city prevailed on the jurisdictional question in the U.S. Supreme Court. In its 7-2 ruling, the Court affirmed the Second Circuit and district courts, holding that the city's claims could proceed because they fell within the "immovable property" exception to the immunity otherwise afforded to foreign governments under the act.

Following the Supreme Court's ruling, all three cases moved forward in the U.S. District Court. On cross motions for summary judgment, Judge Jed. S. Rakoff ruled in February that under the Vienna Conventions on Diplomatic and Consular Relations and New York state law, India and Mongolia must pay taxes on properties being used to house consular and mission staff, and the Philippines must pay tax on portions of its building being used by its national bank and airlines, although not on that portion used as a restaurant.

With respect to staff residences, the court held that the applicable provisions of law limit the residential tax exemption to the residences of each country's consul general and ambassador to the United Nations. In the case of the Philippines, the court further held that portions of property leased to the Philippines National Bank and the Philippines Airlines were commercial uses subject to the city's tax, but that a restaurant formerly operated on the property served consular purposes and was therefore tax exempt. The district court determined that India owed \$42.4 million in real property taxes, Mongolia owed \$4.3 million, and the Philippines owed \$10.9 million, for a total of \$57.6 million owed to the city. All three countries have appealed the district court's decision to the Second Circuit.

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