UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SANTA FE NATURAL TOBACCO CO., INC. Plaintiff, -v.- ELIOT SPITZER, individually and in his official capacity as Attorney General of the State of New York, et al., Defendants.	00 Civ. 7274 (LAP)
BROWN & WILLIAMSON TOBACCO CORPORATION, and BWTDIRECT, LLC, Plaintiffs, -v.- GEORGE E. PATAKI, in his official capacity as Governor of the State of New York, et al., Defendants.	00 Civ. 7750 (LAP)

CORRECTED OPINION

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LORETTA A. PRESKA, United States District Judge:

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I. INTRODUCTION

In 1999, as part of its comprehensive program to decrease tobacco use among its citizens, New York increased its tax on cigarettes from $.56 per pack to the national high of $1.11 per pack. As expected, sales of tax-paid cigarettes decreased. As those sales decreased, so did the profits of New York's cigarette retailers, particularly those near the State's borders and near Indian reservations. Perhaps not surprisingly, those retailers complained to the Governor about "unfair competition" from those selling untaxed cigarettes, including Internet, mail order and telephone sellers. Apparently in response, the Governor proposed, the Legislature passed, and the Governor signed into law § 1399-ll of the Public Health Law, citing as its purposes, among others, promoting public health, preventing access to cigarettes by minors, funding of health care and "the economy of the state." The statute prohibits cigarette sellers from shipping or transporting cigarettes directly to New York consumers and prohibits common carriers from delivering cigarettes directly to New York consumers, thus, restricting retail sales of cigarettes in New York to face-to-face transactions at in-state retail locations. Plaintiffs, Santa Fe Natural Tobacco Co., Inc. ("Santa Fe"), Brown & Williamson Tobacco Corporation and BWTDirect, LLC (collectively "B&W") bring two related actions against officials of New York State (the "State") seeking to enjoin enforcement of § 1399-ll.

In Article I, section 8, clause 3, the Constitution gives to Congress the power "to regulate commerce . . . among the several states." The Commerce Clause

> reflected a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.

Hughes v. Oklahoma, 441 U.S. 322, 325 (1979) (citations omitted). The Supreme Court has recognized that the Commerce Clause's affirmative grant of power carries with it a "negative" or "dormant" aspect that limits the power of states to erect barriers to interstate trade. Maine v. Taylor, 477 U.S. 131, 137 (1986). This limitation imposed by the Commerce Clause "is by no means absolute," and the states retain the authority to regulate matters of "legitimate local concern." Id. at 138.

Here, there is no dispute that protecting the health of New York citizens, both adults and minors, is a legitimate, in fact, laudable, state interest. The other two major statutory purposes, funding health care in the State and aiding the economy of the State, are certainly goals intended to benefit the citizens of the State. While the statute is a reasonable -- indeed commendable -- solution by a concerned Governor and a responsive Legislature to certain pressing problems facing New Yorkers, that is not the test imposed by the Constitution. Even a wise statute, beneficial to most New Yorkers, must be

judged by the Constitutional mandate.

In evaluating statutes under the Commerce Clause, the Supreme Court has distinguished between those that affirmatively or directly burden interstate commerce and those that do so only incidentally. The former are subject to strict scrutiny and only survive if they serve a legitimate state purpose which could not be served by means less burdensome to interstate commerce. Hughes, 441 U.S. at 336. The latter are subject to a balancing test, specifically, whether the burden they impose on interstate commerce are "clearly excessive in relation to the putative local benefits." Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970). Regrettably, I am constrained to hold that § 1399-ll fails both tests prescribed by the Supreme Court under the Commerce Clause, and, therefore, must be enjoined.

II. BACKGROUND

A. PROCEDURAL HISTORY

On November 13, 2000, a temporary restraining order was issued prohibiting the enforcement of § 1399-ll.[1] The parties

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[1] The temporary restraining order was entered on a finding that plaintiffs demonstrated a likelihood of success on the merits, both under strict scrutiny and balancing test analyses. Specifically, it appeared likely that plaintiffs would be able to demonstrate that § 1399-ll would fail the strict scrutiny test because there appeared to be other means by which the State can advance its legitimate interests. Additionally, it appeared likely that plaintiffs would be able to demonstrate that the statute would fail the balancing test articulated in Pike v. Bruce Church, Inc., 397 U.S. 137 (1970), because the burden the act imposes on interstate commerce is clearly excessive in

(continued...)

engaged in extensive discovery since the imposition of the temporary restraining order, and the preliminary injunction hearing was rescheduled several times to give the parties sufficient time to complete discovery. On April 24, 2001, the trial on the merits was advanced and consolidated with the preliminary injunction hearing pursuant to Fed. R. Civ. Proc. 65(a)(2). A five-day bench trial commenced on April 30, 2001. The following constitutes the Court's findings of fact and conclusions of law.

B. LEGISLATIVE BACKGROUND

1. Federal Cigarette Laws

a. The Jenkins Act

The Jenkins Act, 15 U.S.C. §375 et seq., requires, among other things, any person who sells cigarettes in interstate commerce and ships those cigarettes into a state that taxes the sale or use of cigarettes to file a monthly report with the state tax administrator specifying the name and address of the person to whom the shipment was made, the brand of the cigarettes and the quantity purchased. 15 U.S.C. § 376(a)(2). The purpose of the Jenkins Act is to assist states in collecting cigarette taxes

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[1](...continued)
relation to the putative local benefits. See Santa Fe Natural Tobacco Co. v. Spitzer, et al., No. 00 Civ. 7274, Brown & Williamson Tobacco Corp., et al. v. Pataki, et al., No. 00 Civ. 7750, 2000 WL 1694307 (Nov. 13, 2000). By agreement of the parties, the temporary restraining order will expire at 12:01 AM on June 8, 2001.

that would otherwise be lost by interstate sales of cigarettes directly to consumers.

b. The Synar Amendment

In 1992, Congress passed the "Synar Amendment," a statute that conditions a state's receipt of certain federal aid on, among other things, (1) the state's enacting a law banning the sale of tobacco products to minors, (2) the state's effectively enforcing such a law, and (3) the state's conducting random, unannounced compliance checks to ensure that retailers are not selling tobacco to minors. States whose noncompliance rates on Synar-mandated checks are above 20% lose federal block grant dollars. 42 U.S.C. § 300x-26; 61 Fed. Reg. 1492, 1498.

2. New York Cigarette Laws

a. Adolescent Tobacco Use Prevention Act

In 1992, in response to the Synar Amendment, New York adopted the Adolescent Tobacco Use Prevention Act ("ATUPA"), which added a new Article 13-F to the Public Health Law and modified section 480-a of the Tax Law. ATUPA, among other things, requires a retailer to make a comparison between the purchaser and a government- or school-issued photo ID before selling cigarettes to a person who looked younger than 25 years old. It also requires retailers to post a conspicuous sign describing the prohibition against youth purchases and bans vending machine sales (except in adult-only establishments) and the distribution of free cigarettes and coupons. N.Y. Pub.

Health Law § 1399-aa et seq.[2]

A 1994 amendment prohibits the sale of unpackaged cigarettes. N.Y. Pub. Health Law § 1399-gg. In 1997, amendments to ATUPA authorized (1) the development of community and school-based programs to prevent and reduce tobacco use, (2) marketing and advertising initiatives to discourage tobacco use, (3) tobacco cessation programs for youths and adults, and (4) various methods of restricting youth access to tobacco products including compliance checks in retail establishments selling cigarettes. N.Y. Pub. Health Law §§ 1399-ii; 1399-hh.

The 1999 amendments include support for school-based programs, counter-advertising campaigns, tobacco cessation programs, restrictions on youth access and other activities. Funding for the comprehensive plan was to come from federal sources, the excise tax increase and tobacco settlement funds. N.Y. Pub. Health Law § 1399-ii.

In addition to imposing penalties for sales to underage smokers, one important element of ATUPA is the threat that retailers caught selling to minors could lose their registration, and be barred from selling cigarettes entirely. N.Y. Pub. Health

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[2] ATUPA did not pre-empt local governments within New York State from adopting their own regulations. For example, New York City entirely bans the sale of cigarettes in vending machines, even in adult-only establishments. (Def. Ex. 1,001 at 211). Other local governments ban free-standing displays of cigarettes and require that all cigarettes be inaccessible to consumers and, therefore, not subject to theft by children.

Law § 1399-ff.

In September 2000, the State adopted § 1399-ee, which significantly increased the penalties for in-state retailers who sell cigarettes to minors. Monetary penalties were essentially tripled; registrations to sell cigarettes were more easily revoked; retailers caught selling to minors now faced the threat of losing not only their cigarette licenses, but their licences to sell lottery tickets as well; and retailers who violated the law would find their names published in local, general circulation newspapers. N.Y. Pub. Health Law § 1399-ee.

In response to the 1997 amendment to ATUPA, the State Department of Health ("DOH") adopted a Tobacco Enforcement Program ("TEP") aimed at developing, implementing and enforcing a compliance check program at retail stores across New York State to ensure that youths do not obtain tobacco products at the retail level. Pub. Health Law § 1399-ii. Initially, TEP was funded with $2.5 million. (Def. Ex. 1,084). In conjunction with increasing the fines and penalties for selling tobacco to minors, the State increased its commitment to TEP's efforts by increasing funding to $4.2 million in 2000. (Trial Tr. at 457).

TEP distributes funding for conducting and enforcing compliance checks to 35 counties and 9 state health department district offices which cover 22 additional counties . (Id. at 457, 461). The program also provides training for officials in those locales on how to conduct the compliance checks. (Id. at

461-62). Training of county health department officials is conducted by TEP personnel; an independent contractor trains retailers on how to prevent minors from purchasing tobacco products. (Id. at 461, lines 12-25 to 462, lines 1-10).

A compliance check is conducted by the local enforcement officer who visits a registered tobacco retailer together with a minor. (Trial Tr. at 457-58). The minor, trained beforehand through role-playing scenarios, enters the establishment and tries to purchase a pack of cigarettes. (Id. at 458). The local enforcement officer enters either before or after the minor so that he or she can witness the purchase. (Id. at 459, lines 8-11). Each minor, typically 15-17 years of age, is asked to dress as he or she would normally and, so as to protect the minor's identity, instructed not to carry identification. (Id. at 458, lines 12-25; id. at 459, lines 1-22).[3]

TEP's compliance check also includes an assessment of the retailer's compliance with other legal requirements aimed at enforcing the prohibition of sales to minors. For example, at the same time the compliance check is completed, the local enforcement officer checks whether the retailer is currently registered with the Department of Taxation and Finance ("DTF") and whether the retailer maintains the required signage regarding

[3] The methodology for the Program's compliance check, including the Program's instruction that the minor portray him or herself honestly, is based on the protocol developed for compliance checks required under Synar. (Trial Tr. at 460).

the prohibition of tobacco sales to minors. (Trial Tr. 460-61; Def. Ex. 1,084; see also § 1399-ee).

Due to significantly increased enforcement efforts, training, and heightened penalties and fines, TEP has achieved significant success in improving retailer compliance rates: from 62% in 1997, to 81% in 1998, to 83% in 1999. (Def. Ex. 1,084; Trial Tr. at 362-63). From October 1, 1999 to September 30, 2000, the non-compliance rate was just 12%, well below the 20% requirement of Synar. (Def. Ex. 1,184; Trial Tr. at 471, line 9 to 472, line 14).[4]

Richard Svenson is the Director of DOH's Bureau of Community Sanitation and Food Protection ("Bureau") which coordinates, develops and monitors ATUPA enforcement. Mr. Svenson testified that the Bureau has made no effort to enforce ATUPA with regard to direct sales, whether originating in New York or elsewhere. (Trial Tr. at 267-68; see also id. at 464-65, 473-74). The

[4] Plaintiffs argue that the results of this methodology overestimate stores' compliance rates because minors who act and look older and present fake identification are more likely to obtain cigarettes than those using the TEP protocols. Therefore, they argue, TEP does not measure minors' actual access to cigarettes. This point was conceded by the State official in charge of administering TEP. "We are not asking minors if they have access to tobacco. Our objective in this program is to do compliance checks of retailers to determine that they are not breaking the law by selling to persons less than 18, that they are checking the individual's proof of age by looking at a photographic identification to determine if a person who appears less than 25 is indeed of legal age to purchase before they make a sale of tobacco to that individual." (Trial Tr. at 475, lines 18-25).

Bureau focuses its efforts on conducting compliance checks at non-Indian brick-and-mortar retail establishments. (Id. at 267-68, 457-58, 464-65). Additionally, the Bureau has been "directed" not to inspect Indian retailers on reservations or "sovereign land." (Id. at 467; see also id. at 269).

b. Health Care Reform Act of 2000

In August 1999, the Centers for Disease Control ("CDC") published its "Best Practices for Comprehensive Tobacco Control Programs" ("Best Practices"). (Def. Ex. 1,002). Modeled on the successful experiences in California and Massachusetts, and based on other research conducted by the CDC, the document provides a template for states to adopt their own comprehensive tobacco control programs. (Def. Ex. 1,002 at 3).

A comprehensive program includes several factors:

- universal licensure of tobacco outlet sources in order to enforce tobacco control laws and regulations;
- public education campaigns and training programs in order to build support among retailers for enforcing sales restrictions and to train them how not to sell tobacco to minors;
- youth access laws and signage in stores notifying the public that it is illegal to sell tobacco products to minors;
- an active compliance check program where, periodically, underage purchasers will attempt to buy tobacco products illegally ("sting" operations);
- a penalty system that includes graduated fines for those vendors who sell tobacco products, as well as revocation of license for repeat offenders;
- price increases from taxation; and

! clean indoor air laws.

(Def. Exs. 1,001 at i-ii; 1,002 at 18; 1,023; Trial Tr. at 355, line 22 to 356, line 9; id. at 360, line 18 to 362, line 19).

CDC's Best Practices is a forward-looking model; at the time of its adoption, no state was implementing all of the recommended program components fully. (Def. Ex. 1,002 at 3). In 2001, only seven states were meeting what the CDC considered a "minimal" funding level for a comprehensive plan. (Def. Ex. 1,004 at 11).

In December 1999, New York Governor George E. Pataki signed into law the Health Care Reform Act of 2000 ("HCRA"). Laws of 1999, Ch. 1, § 1. HCRA established and funded a Comprehensive Tobacco Use Prevention and Control program, modeled on successful efforts in other states.[5] N.Y. Pub. Health Law § 1399-ii. The New York program was built upon previously-existing State programs, including the State's strict regulatory system designed to deny young people commercial access to tobacco and to ensure that all New York consumers pay a high cigarette excise tax designed to discourage smoking. To that end, HCRA also increased the cigarette excise tax from $.56 per pack to $1.11 per pack. N.Y. Tax Law § 471. The increase took effect on March 1, 2000. As a result, New York currently has the highest cigarette excise

[5] Comprehensive programs have been successful in reducing smoking in states such as Massachusetts (consumption and prevalence), California (consumption), Florida (prevalence) and Oregon (consumption). See Def. Exs. 1,001 at 392-97; 1,002 at 85-86; 1,003; 1,007; 1,009; Trial Tr. at 350, lines 2-16.

tax in the United States. (Pl. Ex. 139, Tab 41 at 1).

One of the immediate effects of the near-doubling of the excise tax was a marked decrease in the sale of cigarettes by in-state brick-and-mortar retail stores. (Trial Tr. at 526, lines 2-4) (there was a 24.5% reduction in tax-paid cigarette sales in New York State from the second quarter of 1999 to the second quarter of 2000). Newspaper articles reported decreased in-state sales, retailers' concerns over the loss of business, and the switch in the locus of cigarette sales from in-state retailers to neighboring states, Indian reservations[6] and Internet sites. See e.g., Pl. Ex. 46, Tab 185; Pl. Ex. 49, Tab 26 at 1; Pl. Ex. 53, Tab 176; Pl. Ex. 139, Tab 41 at 1; Pl. Ex. 212, Tab 177 at 1; Pl. Ex. 215, Tab 30 at 2.[7] In addition, in letters contained in the bill jacket for the statute at issue here noted that "[s]ales [on Indian reservations] to non-Indians have clearly risen since the state increased the cigarette excise tax to $1.11 per pack." (Pl. Exs. 172-175, Tabs 35-38), and the "growing problem of untaxed, bootlegged cigarettes being sold by illegal vendors." (Pl. Ex. 211, Tab 32). Evidence introduced at trial shows that

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[6] As explained at length below, cigarettes sold on Indian reservations are not taxed.

[7] Both plaintiffs and defendants proffered various newspapers articles, some for their truth, e.g., Def. Exs. 1,043-45; 1,060; Pl. Ex. 28, Tab 66 at 223-37; Pl. Ex. 137, Tab 41; Pl. Ex. 215, Tab 30; Pl. Ex. 212, Tab 177; Pl. Ex. 63, Tab 27; Pl. Ex. 66, Tab 90; Pl. Ex. 17, Tab 118. Because this is a bench trial, I accept all the newspaper articles into evidence and accord them their appropriate weight.

substantial amounts of untaxed cigarettes flow into states with high excise taxes as a result of cross-border sales and bootlegging. (Pl. Ex. 306, Tab 228; Pl. Ex. 278, Tab 229; Pl. Ex. 310, Tab 213).[8] "Rising state excise taxes on cigarettes . . . encourage individuals with access to cigarettes not subject to such taxes to alter their purchasing habits. The two primary sources of such cigarettes are Native American tribal reservations and commissaries on military bases. . . . The effects of cross-border shopping have been especially pronounced along the U.S.-Canadian border." (Pl. Ex. 306, Tab 228 at 1-2) (Patrick Fleenor, The Effect of Excise Tax Differentials on the Interstate Smuggling and Cross-Border Sales of Cigarettes in the United States (October 1996)).

C. SECTION 1399-ll

In response to the concern by in-state retailers over the loss of cigarette sales to Indian reservations and direct sales channels[9] and the risk of minors' obtaining cigarettes through these means, see Pl. Exs. 211, 172-75, Tabs 32, 35-38, § 1399-ll was added to New York's Public Health Law by Chapter 262 of the

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[8] Defendants object to the admission of these articles. The objection is overruled. Plaintiffs' expert, Professor Kursh, testified about two of these articles and the third is to the same effect. See Trial Tr. at 152-55. Accordingly, I receive into evidence all three articles and accord them their appropriate weight.

[9] "Direct sales channels" include Internet, mail order and telephone sales of cigarettes.

1999-2000 New York Session Laws. The bill was introduced in the Legislature at the request of Governor Pataki on June 14, 2000,[10] passed by the Senate on June 14, 2000 and passed by the Assembly on June 15, 2000.[11] Governor Pataki signed the bill into law on August 16, 2000.

[10] Section 1399-ll was originally introduced in the New York State Senate as S7297 at the request of Governor Pataki on April 3, 2000, just a month after the HCRA tax increase went into effect. (Pl. Ex. 347, Tab 15). The purpose of the bill was to "prevent underage youths from obtaining cigarettes and, in effect require that all [cigarette] purchases be made face-to-face in retail stores where proof of age can be checked and verified [and to] ensure funding for health care as enacted by the Health Care Reform Act of 2000." (Id.).

[11] New York State Senate bill S8177 was identical to the Assembly bill A11455. After the Senate passed S8177, it delivered the bill to the Assembly where S8177 was substituted for A11455 and passed. (Pl. Ex. 202, Tab 2).

1. Legislative Background and the Statute

Both the Governor's Program Bill Memorandum and the Introducers' Memorandum[12] submitted in support of the legislation state that it has no legislative history, and there is no indication in the record that any legislative hearings or other fact-finding was conducted with respect to the bill. See Pl. Ex. 9, Tab 6 at 5; Pl. Ex. 41, Tab 1 at 4. The bill jacket, however, contains appeals from brick-and-mortar retailers urging the Governor to approve the legislation to protect them from "unfair competition" from retailers selling directly to consumers via the Internet, mail order and telephone. (Pl. Exs. 211, Tab 32; Pl. Ex. 172-75, Tabs 35-38). The letters also state that direct sales "make a mockery of the state laws against . . . sales to

[12] The Governor's Program Bill Memorandum, the Introducer's Memorandum in Support and the bill jacket constitute the legislative materials relied upon by both the parties and the Court to analyze § 1399-ll. These legislative materials, "though not conclusive, are entitled to considerable weight." Doe v. Pataki, 120 F.3d 1263, 1277 (2d Cir. 1997) (citing North Haven Board of Education v. Bell, 456 U.S. 512, 526-27 (1982) and United States v. Jackson, 805 F.2d 457, 462-63 (2d Cir. 1986)); see also Miller v. American Steamship Owners Mutual Protection and Indemnity Co., 509 F. Supp. 1047, 1049 n.2 (S.D.N.Y. 1981) (relying on the legislative history including the bill jacket to help discern the specific purpose of a statutory exception); G/C Volkswagen Corp. v. Volkswagen of America, Inc., No. 97 Civ. 8364, 1998 WL 799174 *4 (S.D.N.Y. 1998) ("to determine legislative intent, 'inquiry must be made of the spirit and purpose of the legislation, which requires examination of the statutory context of the provision as well as its legislative history'")(quoting Sutka v. Conners, 73 N.Y.2d 395, 403 (N.Y. 1989).

minors since the person receiving the product is not asked to produce proof of age." (Pl. Exs. 172-75, Tabs 35-38).

By its terms, the primary purpose of the act is to prohibit cigarette sales "via the Internet or by telephone or by mail order to residents" of New York in an effort to promote four state interests: (1) public health, (2) "funding of health care pursuant to the health care reform act of 2000," (3) "the economy of the state," and (4) improving the state's ability "to measure and monitor cigarette consumption and to better determine the public health and fiscal consequences of smoking." Ch. 262, N.Y. Pub. Health Law § 1 (legislative findings).[13] The statute

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[13] Section 1 provides that

> [t]he legislature finds and declares that the shipment of cigarettes sold via the Internet or by telephone or by mail order to residents of this state poses a serious threat to public health, safety, and welfare, to the funding of health care pursuant to the health care reform act of 2000, and to the economy of the state. The legislature also finds that when cigarettes are shipped directly to a consumer, adequate proof that the purchaser is of legal age cannot be obtained by the vendor, which enables minors to avoid the provisions of article 13-F of the public health law. It is also the legislature's finding that by preventing shipment of cigarettes directly to consumers, the State will be better able to measure and monitor cigarette consumption and to better determine the public health and fiscal consequences of smoking. The legislature further finds that existing penalties for cigarette bootlegging are inadequate. Therefore, the bill enhances existing penalties for possession of unstamped or unlawfully stamped cigarettes.

(continued...)

provides in relevant part:

> 1. It shall be unlawful for any person engaged in the business of selling cigarettes to ship or cause to be shipped any cigarettes to any person in this state who is not (a) a person licensed as a cigarette tax agent or wholesale dealer . . .; (b) an export warehouse proprietor . . . or an operator of a customs bonded warehouse . . .; or (c) a person who is an officer, employee or agent of the United States government, this state or a department, agency, instrumentality or political subdivision of the United States or this state, when such person is acting in accordance with his or her official duties. . . .[14]
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> 2. It shall be unlawful for any common or contract carrier to knowingly transport cigarettes to any person in this state reasonably believed by such carrier to be other than a person described in paragraph (a), (b) or (c) of subdivision one of this section. . . . Nothing in this subdivision shall be construed to prohibit a person other than a common or contract carrier from transporting not more than eight hundred cigarettes at any one time to any person in this state.[15]
>
> . . .
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> 5. Any person who violates the provisions of subdivision one or two of this section shall be guilty of a class A misdemeanor and for a second or subsequent violation shall be guilty of a class E felony. In addition to the criminal penalty, the commissioner may impose a civil fine not to exceed five thousand dollars for each such violation on any person who violates subdivision one or two of this section.

N.Y. Pub. Heath Law §§ 1399-ll(1), (2), (5). In essence, subdivision 1 prohibits sales of cigarettes to consumers in New

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[13](...continued)
N.Y. Pub. Health Law, ch. 262, § 1.

[14] Subdivision 1 was to become effective on November 14, 2000.

[15] Subdivision 2 was to become effective on January 1, 2001.

York via direct sales channels, and subdivision 2 prohibits common or contract carriers from transporting cigarettes directly to consumers in New York. Subdivision 2 also provides an 800-cigarette exemption from the delivery ban imposed on common and contract carriers. Thus, "with few exceptions," the law requires a face-to-face transaction between the cigarette consumer and retailer in New York. (Pl. Ex. 41, Tab 1 at 4) (Introducer's Memorandum in Support).

2. Sales by Indian Nations

Although it does not appear in the statute, a de facto exemption apparently applies to the direct sale of cigarettes by retailers on Indian reservations. Direct sellers operating from Indian reservations located within New York account for nearly half of the direct sellers retailing cigarettes to New Yorkers. (Trial Tr. at 404). The State contends that it lacks general civil and regulatory jurisdiction over Indian tribes and reservations located within the State and is unable to (and does not) take on-reservation audit, collection or enforcement actions against retailers located on such Indian reservations. (Pl. Ex. 28, Tab 66 at 197 ¶ 4).[16] Further, Indians living on-reservation

[16] Defendants object to the admission of an affidavit of Steven U. Teitelbaum, then Deputy Commissioner and Counsel for the New York State Department of Taxation and Finance ("DTF"), because, they argue, Mr. Teitelbaum cannot make admissions binding on the Legislature. This objection is overruled. The affidavit is admissible pursuant to Fed. R. Evid. 801(d)(2)(C) as a "statement by a person authorized by the party to make a (continued...)

are not subject to New York excise or sales taxes, and New York does not require retailers on Indian reservations to collect and remit to the State excise and sales taxes owed by such retailers' non-Indian customers. (Id.).

A brief history of New York's efforts to collect taxes from on-reservation sales to non-Indians is necessary to understand the State's current position with respect to regulating cigarette sales on Indian reservations. In the late 1990s, New York tried unsuccessfully to collect excise and sales taxes through regulations designed to estimate the volume of cigarettes sold from Indian reservations to non-Indian consumers. The regulations required cigarette distributors and wholesalers to include applicable taxes on cigarettes that were sold to on-reservation retailers but were expected to be purchased ultimately by consumers living off-reservation. (Id. at 200-01). Additionally, tribal governments were required to establish a system for regulating retailers on the reservation. If they did not, State DTF established the quantity of permissible tax-free

[16](...continued)
statement concerning the subject" and pursuant to Fed. R. Evid. 801(d)(2)(D) as a "statement by the party's agent or servant concerning a matter within the scope of the agency or employment, made during the existence of the relationship." The affidavit was made by Mr. Teitelbaum when he was Deputy Commissioner and Counsel of DTF in support of DTF's cross motion for summary judgment in another litigation. He was authorized to make the statement, and the statement was made within the scope of his then-current employment with DTF. Accordingly, Mr. Teitelbaum's affidavit is admitted.

product for sale by distributors and wholesalers to on-reservation retailers for sale to Indians based upon the probable demand of qualified Indian consumers. (Id. at 200-01 ¶ 9).

In April 1997, the State attempted to implement these regulations while also attempting to negotiate separate tax compacts with the Indian tribal governments. (Id. at 200, 202). On-reservation retailers, however, refused to comply with the regulatory reporting system to which their tribal governments had agreed. (Pl. Ex. 28, Tab 66 at 205). In response to the State's efforts to interdict untaxed shipments of cigarettes, Indian retailers and other tribal members resorted to "blockading of public highways, threats of violence and actual violence." (Id. at 205, 222-37).

In May 1997, Governor Pataki halted the implementation effort, directed the repeal of the regulations and proposed legislation that would allow on-reservation stores to sell tax-free cigarettes and gasoline. (Id. at 208 ¶ 27; id. at 258-59). In a press release dated May 22, 1997, the Governor stated:

> Let me make my message to all Indian Nations clear: It is your land, we respect your sovereignty and, if the Legislature acts as I am requesting, you will have the right to sell tax-free gasoline and cigarettes free from interference from New York State.

(Id. at 259). The official repeal comments stated that "[t]he decision to repeal the regulations was based on both the inability of the regulations to achieve the purposes of the Tax Law and also the State's respect for the Indian Nations'

sovereignty." (Pl. Ex. 24, Tab 67 at 3).

Upon the passage of § 1399-ll, the Indian nations made it clear that they would continue to sell and deliver tax-free cigarettes without interference, monitoring or regulation by New York State. (Id. at 4-5). In addition, Indian retailers stated that they would use the "United States Postal Service or other available means to deliver such goods." (Id. at 5; see also Pl. Ex. 158, Tab 74 ("our absolute sovereignty, jurisdiction and self-governing authority has never been relinquished and predates state and federal authority. As such, unilateral acts by the state of New York that encroach on the subsistence of indigenous nations are not legal. Therefore, we anticipate your prompt veto of [S8177].")). Thus, there is little in the record demonstrating that New York intends to or could effectively enforce § 1399-ll against Indian-owned direct sellers operating from reservations in New York, and I am persuaded that no enforcement efforts under § 1399-ll will be directed to direct sellers on Indian reservations. See Trial Tr. at 230, 319; but see Pl. Ex. 10, Tab 49 at 1 (State DTF issued a bulletin that stated that § 1399-ll applies to "shipments by Indian nations, tribes and businesses to any person other than recognized Indian nations or tribes, Indian-run businesses on reservations or Indian consumers residing on reservations in New York State").

3. Deliveries by the Postal Service

Although the statute does not provide an express exemption,

§ 1399-ll also does not and cannot prohibit shipment of cigarettes to consumers by the U.S. Postal Service. A spokesman for DTF admitted that "[t]hat has the potential to be somewhat of a loophole." (Def. Ex. 1,076; Pl. Ex. 333, Tab 156; Pl. Ex. 215, Tab 30 at 2 (criticism by United Parcel Service, a common carrier, on the grounds that § 1399-ll does not affect U.S. Postal Service and thereby gives it a competitive advantage)).

In addition, the U.S. Postal Service cannot, sua sponte, decline to handle cigarette shipments. Article I, Section 8, Clause 7 of the Constitution vests power in Congress to "make all laws which shall be necessary and proper" to run the nationwide postal system. The Supreme Court, in construing this provision, has made clear that the Postal Service, not the states, has exclusive authority to designate what can and cannot be sent through the mails and that such exclusivity is essential to maintaining a uniform postal system. See, e.g., U. S. Postal Service v. Greenburgh Civic Ass'ns, 453 U.S. 114, 121, 123 (1981); Ex parte Jackson, 96 U.S. 727, 732 (1878) (upholding authority of Congress, not the states, to determine what should and should not be carried in the mail, and noting that "[t]he right to designate what shall be carried necessarily involves the right to determine what shall be excluded"). What is "mailable" and "nonmailable" has long been a matter of federal law. See 39 U.S.C. § 3001 (setting forth Congress' determination of what is not "mailable"); Burton v. United States, 202 U.S. 344, 371

(1906) (noting "the power of the United States, by legislation, to designate what may be carried in the mails and what must be excluded therefrom; such designation and exclusion to be, however, consistent with the rights of the people as reserved by the Constitution.").

Just as individual states are without power to determine what is or is not "mailable," the Postal Service is without authority to follow state "suggestions" or "requests" that it selectively disregard applicable federal statutes and regulations governing the mailability of items through the Postal Service. The courts on a number of occasions have ruled that the Postal Service must accept as mailable commodities that federal law and regulations do not declare to be "unmailable." See, e.g., Grove Press, Inc. v. Christenberry, 276 F.2d 433 (2d Cir. 1960) (enjoining the Postal Service from refusing to transmit through the mail copies of Lady Chatterly's Lover, holding it not obscene and therefore not "nonmailable" under 18 U.S.C. § 1461); Stanford v. Lunde Arms Corp., 211 F.2d 464, 466, n.1 (9th Cir. 1954) (enjoining the Postal Service from refusing to accept for mailing

toy pistols, which were not "nonmailable" items under 18 U.S.C. § 1715).[17]

III. DISCUSSION

A. STANDARD OF REVIEW

This case arises under the Commerce Clause of the Constitution of the United States,[18] and, accordingly, the Court

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[17] Defendants concede that "State regulators are still developing enforcement plans," and that [s]uch future enforcement efforts may include . . . an attempt to enforce the law against the [U.S. Postal Service]." (Def. Proposed Findings of Fact and Conclusions of Law ¶¶ 351-352) (emphasis added). Defendants further contend that "[e]ven assuming that the State could not obtain compliance from the [Postal Service], it might still obtain enforcement by the Indians themselves. . . . At the least, sellers would need to be highly concerned that their activities might constitute not merely a misdemeanor violation, but a violation of the federal mail fraud statutes." (Id. at 353). Such speculative possibilities are entitled to little weight. Other than some brief conversations between DTF's Deputy Commissioner, Peter Farrell, and an unnamed official at the Postal Service office in New York City, the State has not developed any plan or procedure for enforcing § 1399-ll against shipments of cigarettes delivered by the Postal Service. Mr. Farrell testified at his deposition that the Postal Service official told him that Postal Service personnel "would be more than happy to sit down with [State officials] . . . and they could see if they could cooperate with [the State]." (Farrell Dep. Tr. at 131). However, before passage of § 1399-ll, there were no discussions between the State and Postal Service enforcement officials regarding direct sales of cigarettes to minors. (Id. at 132-33). I am persuaded that the Postal Service will not and cannot assist in enforcement of § 1399-ll. Additionally, with respect to Indian nations, as noted above, I am also persuaded that New York will not enforce § 1399-ll against sales on Indian reservations, both to Indian residents, where New York has no jurisdiction, and to non-Indian purchasers, because Indian reservations will not provide Jenkins Act reports.

[18] "Congress shall have power . . . to regulate commerce . . . among the several states." U.S. Const., Art. I, § 8, cl. 3.

has federal question jurisdiction. 28 U.S.C. § 1331.

The Commerce Clause is more than an affirmative grant of power to Congress. In his concurring opinion in Gibbons v. Ogden, 9 Wheat. 1, 231-32, 239, 6 L. Ed. 23 (1824), Justice Johnson recognized that the Commerce Clause has a negative sweep as well. In what commentators have come to term its "negative" or "dormant" aspect, the Commerce Clause restricts the individual states' interference with the flow of interstate commerce in two ways. It prohibits discrimination aimed directly at interstate commerce, see e.g., City of Philadelphia v. New Jersey, 437 U.S. 617 (1978), and it bars state regulations that, although facially nondiscriminatory, unduly burden interstate commerce, see e.g., Kassel v. Consolidated Freightways Corp. of Del., 450 U.S. 662 (1981). The "fundamental objective" of the dormant Commerce Clause is "preserving a national market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors." General Motors Corp. v. Tracy, 519 U.S. 278 at 299 (1996).

As a preliminary matter, defendants argue that the Commerce Clause is not implicated by the statute at all:

> In light of the predominance of New York-based Indian reservations among direct mail sellers, . . . [§] 1399-ll's effects are imposed primarily [on] businesses within New York State boundaries and, accordingly, [the statute] does not discriminate against interstate commerce.

(Def. Proposed Findings of Fact and Conclusions of Law ¶ 339).

This argument cannot be sustained. First, sovereign Indian nations are "entirely distinct" entities from states. Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 192 (1989); id. at 191 ("Indian tribes are not States within the meaning of the Commerce Clause."). Thus, for purposes of Commerce Clause analysis, Indian reservations located within New York State are not part of New York State, and, therefore, direct sales from such reservations are not "in-state" sales. Second, the fact that the statute falls predominantly on New York entities is irrelevant to determining whether a statute discriminates against interstate commerce. "The volume of commerce affected measures only the extent of discrimination; it is of no relevance to the determination whether a State has discriminated against interstate commerce." Wyoming v. Oklahoma, 502 U.S. 437, 455 (1992) (emphasis in original); New Energy Co. v. Limbach, 486 U.S. 269, 276-77 (1988) ("where discrimination is patent, . . . neither a widespread advantage to in-state interests nor a widespread disadvantage to out-of-state competitors need be shown[;] . . . the number of the in-state businesses favored or the out-of-state businesses disfavored [is not] relevant to our determination."). Thus, I find that § 1399-ll implicates and concerns interstate commerce, and the issue is whether it impermissibly and unconstitutionally discriminates against interstate commerce.

"[T]he first step in analyzing any law subject to judicial

scrutiny under the negative Commerce Clause is to determine whether it regulates evenhandedly with only incidental effects on interstate commerce, or discriminates against interstate commerce." Oregon Waste Systems, Inc. v. Department of Environmental Quality, 511 U.S. 93, 99 (1994). A statute that discriminates against interstate commerce "is virtually per se invalid. . . . By contrast, nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless 'the burden imposed on such commerce is clearly excessive in relation to the putative benefits.'" Id. (quoting Pike, 397 at 137). The Supreme Court has stated:

> When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state economic interests, we have generally struck down the statute without further inquiry. When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, we have examined whether the state's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits.

Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573, 579 (1986) (citations omitted).

Plaintiffs argue that the statute discriminates against interstate commerce by banning interstate retail cigarette sales in New York and, therefore, that strict scrutiny applies requiring defendants to demonstrate that they have no other means to advance their legitimate state interests. C&A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383, 392 (1994). Defendants

argue that the statute applies evenhandedly and, thus, that the less rigorous balancing standard articulated in Pike applies. As discussed in detail below, § 1399-ll fails both the strict scrutiny and Pike balancing analyses.

1. Strict Scrutiny

Discrimination against interstate commerce is virtually per se invalid unless the State "can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest." Carbone, 511 U.S. at 392, citing Taylor, 477 at 131. Under a strict scrutiny analysis,

> [t]he burden to show discrimination rests on the party challenging the validity of the statute, but [w]hen discrimination against commerce . . . is demonstrated, the burden falls on the State to justify it both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake.

Hughes, 441 U.S. at 336 (citation and quotation marks omitted).

A state law can discriminate against interstate commerce on its face, by its purpose, or in its effect. See Wyoming, 502 U.S. at 455 (state law discriminated on its face and in practical effect); Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 270-71 (1984) (purpose of state law was protectionist); Hunt v. Washington State Apple Adver. Comm'n, 432 U.S. 333 (1977) (state law was nonprotectionist in purpose and facially neutral, but discriminatory in effect). A state law can also discriminate against interstate commerce by seeking to accomplish its

objectives "by the illegitimate means of isolating the State from the national economy." Philadelphia, 437 U.S. at 627.

Plaintiffs argue that § 1399-ll discriminates (1) on its face, (2) in its purpose, (3) by its practical effect, and (4) by impermissibly seeking to isolate the State from the national economy. Discrimination in any one of these ways is sufficient to trigger strict scrutiny. Relying on General Motors Corp. v. Tracy, defendants argue that direct retailers and in-state brick-and-mortar retailers do not compete in the same market and, therefore, that § 1399-ll does not discriminate against interstate commerce in any respect.

In Tracy, Ohio exempted local, that is, in-state, natural gas distribution companies ("LDCs") from certain state and local sales taxes while not exempting non-LDC gas sellers, such as producers and independent marketers. Out-of-state producers and marketers challenged the tax scheme on Commerce Clause grounds. The Supreme Court began its analysis by determining whether the LDCs and the producers and independent marketers provided the same products, and thus were in competition, or different products, and thus were not similarly situated for constitutional purposes. 519 U.S. at 298-99. It noted that "in the absence of actual or prospective competition between the supposedly favored and disfavored entities in a single market there can be no local preference . . . to which the dormant Commerce Clause may apply." Id. at 300. In comparing the markets served by LDCs and non-

LDCs, the Court found that they were separate even though not geographically distinct. It found that the LDCs primarily served a captive market of low-volume residential customers who required a bundle of services, including, inter alia, delivery by pipeline system to all comers, stable rates and certainty of supply, regardless of market or weather conditions. The mostly out-of-state producers and independent marketers, on the other hand, did not serve these residential customers but rather served higher volume commercial customers who could afford the transaction costs of dealing with various individual suppliers in the open market. Thus, the Court found:

> [T]he LDCs' bundled product reflects the demand of a market neither susceptible to competition by the interstate sellers nor likely to be served except by the regulated natural monopolies that have historically served its needs. So far as this market is concerned, competition would not be served by eliminating any tax differential as between sellers, and the dormant Commerce Clause has no job to do.

Id. at 303.

Here, defendants contend that, just as in Tracy, out-of-state direct retailers like plaintiffs do not compete with the more regulated in-state brick-and-mortar retailers. To support this contention, defendants cite plaintiffs' internal documents that state that their direct sales businesses will not compete with brick-and-mortar retailers. See e.g., Def. Ex. 1,175. Defendants misapprehend these documents. I credit the testimony

of Messrs. Heironimus[19] and Sommers[20] to the effect that direct sellers do, in fact, compete with brick-and-mortar retailers and that the internal documents reflected an effort to minimize retailer discontent about plaintiffs' direct sales. See Trial Tr. at 16, lines 12-21; id. at 19, lines 19-24; id. at 64, line 18 to 65, line 4; id. at 94, line 22 to 97, line 6. Moreover, I credit the testimony of plaintiffs' expert, Dr. Frederick C. Dunbar, Senior Vice President at National Economic Research Associates, to the effect that the relevant market to be considered in evaluating § 1399-ll is the retail cigarette market in New York, including both in-state and out-of-state retailers, and that enforcement of the statute would protect in-state retailers from competition from out-of-state retailers. (Id. at 223, lines 12-22).

Also demonstrating competition are letters contained in the bill jacket for § 1399-ll in which in-state retailers urge the Governor to support the legislation, citing the "unfair competition" from direct sellers. See Pl. Ex. 211, Tab 32 ("legitimate retailers are being forced to compete with illegal vendors conducting direct mail and direct phone solicitations of

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[19] John Heironimus is President of plaintiff BWTDirect, a wholly-owned subsidiary of Brown & Williamson Tobacco Corp., that sells retail cigarettes directly to consumers. (Trial Tr. at 4, 5).

[20] Robin Sommers is the President and Chief Executive Officer of plaintiff Santa Fe Natural Tobacco Co. (Trial Tr. at 56).

untaxed product. The loss of business has been especially damaging to small independent food store operators who rely upon cigarettes to generate revenue and to build traffic for 'tie-in' sales."); Pl. Exs. 172-175, Tabs 35-38 (Internet, mail order and telephone sales "clearly have risen since the state increased the cigarette excise tax to $1.11 per pack. . . . The loss of business has been significant, involving both cigarette sales and sales of related products.").[21]

In sum, plaintiffs have proved that they and other out-of-state direct retailers are in direct competition with in-state brick-and-mortar retailers of cigarettes, and, therefore, Tracy is inapplicable. Accordingly, I must now consider whether the statute discriminates against interstate commerce in the retail cigarette market in New York in any of the ways argued by plaintiffs.

a. The statute on its face

Defendants argue that § 1399-ll treats all direct retailers -- whether in-state or out-of-state -- evenhandedly because all direct retailers are subject to the same prohibitions under the statute and "New York-based retailers comprise a large proportion of the direct mail market." (Def. Proposed Findings of Fact and Conclusions of Law ¶ 293). Therefore, defendants contend, the

[21] There is no contention that plaintiffs illegally sell cigarettes to New York consumers or fail to submit Jenkins Act reports to the State; indeed, all the evidence is to the contrary.

statute does not discriminate against interstate commerce. This argument cannot be sustained because § 1399-ll discriminates on its face against interstate commerce.[22]

A state law may be discriminatory even though it limits activities of in-state as well as out-of-state business. Carbone, 511 U.S. at 391 ("The ordinance is no less discriminatory because in-state or in-town processors are also covered by the prohibition."). While § 1399-ll's prohibitions apply to all direct sellers, the law, on its face, discriminates against interstate commerce by requiring that retail sales take place only in-state. Specifically, subdivision 1 prohibits the direct shipment of cigarettes to any person in New York who is not a licensed tax agent or wholesaler, export warehouse proprietor, operator of a customs bonded warehouse, or government official. Therefore, the only way to effect a retail sale to a New York consumer is by an in-state, face-to-face transaction. Thus, subdivision 1 shifts the interstate retail market to in-state brick-and-mortar retailers.[23] See Carbone, 511 U.S. at 389 (the law "prevents everyone except the favored local [retailers] from [effecting retail sales.] The [law] thus deprives out-of-

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[22] To the extent that this argument is meant to refer to retailers on Indian reservations within the State's boundaries, it is without merit. See Part III(A).

[23] In cases in which in-state retailers use direct sales channels to effect sales, the statute provides an exemption for the delivery of cigarettes. See N.Y. Pub. Health Law § 1399-ll(2). This exemption is discussed in detail below.

state businesses of access to a local market.").

Section 1399-ll also discriminates on its face by providing an exemption from the transportation prohibition that permits local retailers to fill telephone, mail order and Internet orders using their own delivery people. Subdivision 2 of § 1399-ll specifically provides that

> [n]othing in this subdivision shall be construed to prohibit a person other than a common or contract carrier from transporting not more than eight hundred cigarettes at any one time to any person in this state.

N.Y. Pub. Health Law § 1399-ll(2) (emphasis added). Defendants argue that the exemption does not "appear to apply to home-delivery services offered by in-State retailers through their own employees." (Def. Proposed Findings of Fact and Conclusions of Law ¶ 299). Rather, defendants contend that the exemption is "limited to the proscription of subdivision 2" and only permits consumers to transport up to four cartons of cigarettes to their homes or to other individuals. For support, defendants cite the deposition testimony of Michael Rosen, Vice President and General Counsel of the Food Industry Alliance ("FIA"),[24] who testified that he understood the original interpretation of the exemption was "to allow consumers to shop at Indian stores for personal use and then transport a de minimis amount of cigarettes." (Rosen

[24] The Food Industry Alliance is a New York trade association comprised of food retailers and wholesalers. Its function is to represent the interests of grocery stores. (Rosen Dep. Tr. at 6, lines 10-17).

Dep. Tr. at 47, lines 9-15).

Defendants further argue that under this interpretation, § 1399-ll does not discriminate on its face between in-state and out-of-state interests and that a "statute is not facially discriminatory when state courts might interpret the statute in a non-discriminatory manner." (Def. Proposed Findings of Fact and Conclusions of Law ¶ 296) (citing Tracy, 519 U.S. at 310). The flaw in this argument is that the favoritism here is not merely "hypothetical;" it is clear on the face of the statute. Assoc. Indust. of Mo. v. Lohman, 511 U.S. 641, 654 (1994). Subdivision 2 carves out an exemption for any person -- whether an individual or retailer -- to deliver up to 800 cigarettes directly to a consumer. There is nothing in the language of the statute that limits this interpretation to consumers. If the Legislature had wanted to restrict the exemption to individual consumers only, it could easily have defined the exemption accordingly. As the statute is drafted, out-of-state retailers that depend on common or contract carriers are prohibited from directly selling and delivering cigarettes to consumers, while in-state brick-and-mortar outlets that have their own delivery services are not. Thus, the statute discriminates on its face against interstate commerce by providing a delivery exemption for New York brick-and-mortar businesses with their own delivery services.

The evidence produced at trial supports the finding that this exemption is intended as a local benefit. The statute's

bill jacket contains a July 18, 2000 letter from Mr. Rosen to James M. McGuire, Counsel to the Governor, expressing FIA's "strong support" for the legislation. The letter briefly summarizes the law and states that "[a] diminimus exemption [sic] is provided for persons transporting up to 800 cigarettes." (Pl. Ex. 211, Tab 32). This "diminimus exemption" clearly refers to Mr. Rosen's understanding that FIA members could take advantage of the language in subdivision 2 for their home-delivery services.[25]

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[25] No other interpretation of the Rosen letter makes sense. FIA exists to represent the interests of grocers and would not be advocating on behalf of private individuals who purchase up to 800 cigarettes from an Indian reservation or across state lines.

Defendants object to the admission of portions of Mr. Rosen's deposition in which he testified that he received assurances from Christopher O'Brien, an assistant counsel in the Governor's counsel's office, that the statute provides an exemption for retailers to deliver cigarettes directly to the customer. Mr. Rosen testified that Mr. O'Brien advised him that FIA members could "avail themselves" of the 800-cigarette exemption in § 1399-ll(2) to make home deliveries. (Rosen Dep. Tr. at 24, lines 13-24 to 25, lines 1-5).

Mr. Rosen further testified that after the bill was signed into law, he met with Howard Herman, DTF Counsel, who stated that a "reasonable interpretation" of the 800-cigarette exemption was that it permitted groceries to make home deliveries of cigarettes. (Id. at 41, lines 15-24 to 43, lines 1-2).

Defendants also object to a letter Mr. Rosen wrote to Arthur J. Roth, Commissioner of DTF, stating that

> [i]n discussing [the bill] with counsel to the Governor's office prior to its enactment, we were advised that the bill as drafted would not affect our members' home delivery programs, wherein cigarettes along with other grocery products are ordered via fax, phone or the Internet and delivered by the retailer to the customer's home, in that the bill exempted the transport of not more than 800 cigarettes.

(continued...)

[25](...continued)
(Pl. Ex 25, Tab 31).

Defendants' objections to the admission of this portion of the testimony and to Mr. Rosen's letter to Mr. Roth are sustained because they contain inadmissible hearsay.

With respect to the letter to Mr. Roth, in particular, plaintiffs argue it is admissible as a business record under Fed. R. Evid. 803(6) because Mr. Rosen testified that he prepared it in the ordinary course of business and that it was one of his regular duties to draft such letters. See Rosen Dep. Tr. at 28. Plaintiffs further argue that the letter is admissible because Mr. O'Brien's statements contained in the letter were made in Mr. O'Brien's capacity as a representative of the Governor, and, therefore, are admissions of a party-opponent pursuant to Fed. R. Evid. 801(d)(2). Finally, plaintiffs contend that because they were not permitted to depose Mr. O'Brien because of the legislative privilege, it was understood that the statements could come in through Mr. Rosen's letter and testimony. See Pl. Response to Evidentiary Objections, dated May 24, 2001. None of these arguments has merit. While Mr. Rosen's letter may arguably be considered a business record, the third-party statements of Mr. O'Brien therein are internal hearsay not within the business records exception and not within any other hearsay exception. See United States v. Bortnovsky, 879 F.2d 30, 33 (2d Cir. 1989) (hearsay statement contained in insurance adjuster's report was not within business record exception "because there was no showing that [third-party] had a duty to report the information he was quoted as having given"); United States v. Yates, 553 F.2d 518, 521 (6th Cir. 1977) (postscript of letter containing hearsay is not properly within the business records exception as statements were made by a third party outside the scope of the business); Yates v. Bair Transport, 249 F. Supp. 681, 683 (S.D.N.Y. 1965) ("The mere fact that the recordation of the third party statements is routine, taken apart from the source of the information recorded, imports no guaranty of the truth of the statements themselves.").

Furthermore, plaintiffs have offered no evidence that Mr. O'Brien was authorized to speak on behalf of the Governor or that he is in a position to bind the Governor. Thus, his statements have not been shown to be in a representative capacity. Lastly, plaintiffs were not permitted to depose Mr. O'Brien because, as counsel to the Governor, he is protected by the legislative privilege. Therefore, plaintiffs were not able to question Mr. O'Brien about his statements to Mr. Rosen. The application of the legislative privilege, however, does not relieve the proponent of a statement of the obligation of demonstrating its

(continued...)

Finally, the Introducer's Memorandum in Support of the bill acknowledges that the requirement of in-store purchases is subject to "exceptions." (Pl. Ex. 41, Tab 1 at 4). "With few exceptions, cigarette consumers will thus have to purchase their cigarettes at a registered retail dealer's place of business." (Id.). This statement that there are exceptions to the face-to-face purchase requirement is not consistent with defendants' position that the exception in subdivision 2 applies only to consumers' delivering their own or some other consumer's cigarettes. Considering all of the evidence in the record on the 800-cigarette exemption contained in § 1399-ll(2), I am persuaded that it applies to any person, including retailers, and that it is not limited in the manner defendants suggest.[26]

Accordingly, I find that plaintiffs have carried their burden of proving that § 1399-ll discriminates on its face

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[25](...continued)
admissibility. Because no hearsay exception applies to the statements contained in Mr. Rosen's letter or his testimony repeating Mr. O'Brien's and Mr. Herman's purported statements, defendants' objections to the letter and those portions of Mr. Rosen's testimony are sustained.

[26] Defendants argue that if subdivision 2 is found to be discriminatory, it should be severed rather than striking the statute in its entirety. (Def. Proposed Findings of Fact and Conclusions of Law ¶ 310). Severing the exemption, however, would not save the statute from discriminating against interstate commerce. As discussed above, by blocking interstate businesses from entering the New York retail market, the statute discriminates on its face.

against interstate commerce.

b. The statute's purpose

As discussed above, the State asserts four interests underlying § 1399-ll: (1) health of minors and adults; (2) health care funding; (3) the economy of the State; and (4) improving the State's ability to measure and monitor cigarette consumption and determine the public health and fiscal impacts of smoking. Defendants have conceded that they are not defending § 1399-ll as a means to improve the State's ability to measure and monitor cigarette consumption. In fact, defendants presented no evidence concerning this State interest, and, accordingly, it will not be considered.

With respect to "health care funding" and the "economy of the state," the law is clear that such purposes by themselves are impermissible to justify discrimination against interstate commerce. Carbone, 511 U.S. at 393. As to "the funding of health care," the statute makes no secret of its intent to meet the revenue targets established by the Governor in his 2000-2001 Executive Budget and to maintain health care funding pursuant to HCRA. See Ch. 262, § 1 (legislative findings), Pl. Ex. 15, Tab 34; Pl. Ex. 72, Tab 11 at 6 ("This proposal is necessary to maintain the revenue estimate for cigarettes contained in the State FY 2000-2001 Executive Budget."). While the goal of funding health care is laudable, "revenue generation is not a local interest that can justify discrimination against interstate

commerce." Carbone, 511 U.S. at 393.

With respect to the "economy of the state," it was not disputed that HCRA's near-doubling of the cigarette excise tax resulted in decreases in cigarette sales among in-state brick-and-mortar establishments. As discussed above, those in-state brick-and-mortar establishments compete with direct sales retailers, including retailers located on Indian reservations. Also as discussed above, the bill jacket contains letters from various New York retailers expressing concern over "unfair competition" from direct sellers of cigarettes. (Pl. Exs. 172-175, Tabs 35-38). See also Trial Tr. at 64, lines 18 to 65, line 4; id. at 223, lines 12-22. Thus, I am persuaded that § 1399-ll was enacted in part for the purpose of protecting in-state retailers from competition from out-of-state direct sellers. Such a protectionist purpose, while welcomed by in-state retailers, is impermissible under the Commerce Clause. "Preservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits." West Lynn Creamery v. Healy, 512 U.S. 186, 205 (1994); see also Carbone, 511 U.S. at 394 ("State and local governments may not use their regulatory power to favor local enterprise by prohibiting patronage of out-of-state competitors."). This is one of those "rare instance[s] where a state artlessly discloses an avowed purpose to discriminate." Dean Milk Co. v. Madison, 340 U.S.

349, 354 (1951). Accordingly, the State's defense of the statute as a way to protect local commercial interests is constitutionally impermissible.

Defendants argue, and the relevant legislative materials confirm, that § 1399-ll was also enacted to protect the health of New York's citizens by preventing minors from obtaining cigarettes through direct sales channels and by reducing cigarette consumption through the maintenance of high cigarette prices. As will be discussed below, I find that these are legitimate goals within the traditional police power of the State. Therefore, plaintiffs have failed to prove that § 1399-ll discriminates against interstate commerce by its purpose because the statute was not solely motivated by impermissible economic concerns.

c. The statute's effect

A statute that has the practical effect of favoring in-state economic interests over out-of-state interests discriminates against interstate commerce. Oregon Waste, 511 U.S. at 99. Section 1399-ll prohibits "any person engaged in the business of selling cigarettes" from shipping cigarettes to anyone in New York who is not a licensed retailer or wholesaler. N.Y. Pub. Health Law § 1399-ll(1). In addition, common and contract carriers are prohibited from transporting cigarettes directly to consumers. N.Y. Pub. Health Law § 1399-ll(2). The only way an out-of-state seller could legally sell retail cigarettes to New

York consumers under § 1399-ll is to establish a brick-and-mortar outlet in New York. I credit plaintiffs' testimony (which defendants have not countered) to the effect that establishing in-state brick-and-mortar outlets by plaintiffs would be "unworkable" (Trial Tr. at 15-16), and "uneconomic" (id. at 73). Thus, the effect of § 1399-ll is to eliminate out-of-state direct sales retailers from the market by requiring face-to-face, in-state retail sales only.

A state may not require an out-of-state operator "to become a resident in order to compete on equal terms." Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 72 (1963). The Supreme Court views "'with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere. Even where the State is pursuing a clearly legitimate local interest, this particular burden on commerce has been declared to be virtually per se illegal.'" South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 100 (1984) (citation omitted).

The delivery exemption in subdivision 2 also has a discriminatory effect. While the exemption applies to interstate as well as intrastate retailers, I credit Mr. Sommers' testimony that it is not economically feasible for interstate businesses to make deliveries to New York customers using their own trucks. I also credit the testimony of plaintiffs' expert, Dr. Dunbar, who stated:

> [D]oing the delivery themselves just means that they are becoming a common carrier [and] economically they have to have the same [cost]-structure as a common carrier in order to compete in-state. If for some reason or another they can't deliver in the state at a cost that is similar to the common carrier, if they have to have a courier come from the retailer who is employed by the retailer, then make a face-to-face transaction at the house, that is the same as a ban because that's going to be cost-prohibitive. That's going to be, you can always get the same effect as a ban by making something so costly that nobody is going to do it.

(Trial Tr. at 257, line 16 to 258, line 2). Therefore, interstate direct sellers are effectively banned from engaging in retail cigarette sales with New York customers. "[T]he statute's consequence of raising the costs of doing business in the [New York] market for [interstate sellers], while leaving those of their [New York] counterparts unaffected, . . . has the practical effect of not only burdening interstate sales . . . but discriminating against them." Hunt, 432 U.S. at 350-351.

Accordingly, plaintiffs carried their burden of proving that the practical effect of § 1399-ll is to discriminate against interstate commerce by effectively eliminating all competition from interstate merchants for the retail sales of cigarettes. There is every reason to suspect that the gainers will be New York retail businesses and that the losers will be out-of-state retailers. Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 473 (1981).

d. Economic isolationism

"No State may attempt to isolate itself from a problem

common to the several States by erecting barriers to the free flow of interstate trade." Chemical Waste Management, Inc. v. Hunt, 504 U.S. 334, 339-40 (1992).

> Neither the power to tax nor the police power may be used by the state of destination with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of its residents. Restrictions so contrived are an unreasonable clog upon the mobility of commerce. They set up what is equivalent to a rampart of customs duties designed to neutralize advantages belonging to the place of origin. They are thus hostile in conception as well as burdensome in result.

Baldwin, 294 U.S. at 527.

Here, in its admitted attempt to force New York consumers to pay high retail prices, New York is also attempting to isolate itself from the national market. Such a purpose is irreconcilable with the goal of "preserving a national market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors." Tracy, 519 U.S. at 299. Thus, even recognizing the State's legitimate goals in reducing smoking among adults and minors, it cannot seek to achieve these otherwise legitimate goals by "the illegitimate means of isolating the State from the national economy." Philadelphia, 437 U.S. at 627 (citation and quotation marks omitted). Accordingly, plaintiffs carried their burden of proving that § 1399-ll discriminates against interstate commerce by attempting to isolate New York from the national cigarette retail market.

e. Application of Strict Scrutiny

Because plaintiffs have demonstrated that § 1399-ll discriminates against interstate commerce, the burden shifts to the State "to justify [the discrimination] in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake." Hughes, 441 U.S. at 336.

Defendants argue that § 1399-ll confers a local benefit as a part of New York's comprehensive program to reduce cigarette smoking, especially by minors. Specifically, defendants have asserted (a) that the statute will ensure age verification of purchasers by requiring face-to-face transactions, thus preventing sales to minors, and (b) that the statute will prevent untaxed sales of cigarettes, thus raising the price of cigarettes which, in turn, reduces smoking by adults and minors. Plaintiffs contend that such benefits will not accrue and that, in any case, other alternatives, less burdensome to interstate commerce, are available to effect those benefits.

i. Direct sales of cigarettes to minors

Defendants have failed to carry their burden with respect to preventing sales to minors because they have not demonstrated (1) that minors use direct sales channels to a significant degree to acquire cigarettes and, thus, that any material benefit will accrue from the statute; or (2) that the State has no less discriminatory means available to reduce smoking among minors.

While a state need not "sit idly by and wait until potentially irreversible [health] damage has occurred . . . before it acts to avoid such consequences," Taylor, 477 U.S. at 148, the potential damage must be something more than insubstantial or de minimis. Defendants have failed to demonstrate that minors use direct sales to obtain cigarettes to any significant degree or that they are likely to do so in the future. The available data, though sparse, show that direct sales channels are not a significant source of cigarettes to consumers in general. Census data produced in July 2000 show that, as of 1997, only 1.2% of all cigarette sales took place through non-store retailers, including .7% through vending machines and .3% through electronic shopping and mail order houses. (Def. Ex. 1,050 at 161). Additionally, minors constitute only 2% of the total cigarette sales in the United States, (Trial Tr. at 401), and "youth acquisition through direct sales is virtually insignificant," (id. at 232). Plaintiffs' expert, Dr. Dunbar, testified that the "Monitoring the Future"[27]

[27] In 1997, the Monitoring the Future Project surveyed eighth, tenth and twelfth graders about their use of direct mail for the purchase of cigarettes. A question on the survey asked survey participants to identify the types of transactions through which they had purchased cigarettes in the previous 30 days. The choices were: through a friend (i.e., social sources), through a vending machine, through the mail, bringing cigarettes themselves to a counter (i.e., self-service displays), or having the clerk hand them a pack. (Def. Exs. 1,221, 1,224). The Monitoring the Future data are frequently relied upon by researchers in the field. See e.g., Def. Exs. 1,003, 1,162.

survey data showed that only 1.9% of all surveyed youth smokers who purchased cigarettes did so through the mail in 1999. (Def. Ex. 1,221). The survey also found no statistically significant trend in the purchase of cigarettes through the mail from 1997-1999. (Trial Tr. at 614).[28]

Many of defendants' own witnesses, including New York State officials, were unable to identify data showing that minors in the State purchase cigarettes using direct sales channels. Richard Svenson, the New York official charged with administering ATUPA, testified that he was unaware of any reliable studies or statistics on the percentage of minors in New York who purchase cigarettes over the Internet, by mail, or by phone. (Id. at 275-76). Christopher Maylahn, Director of the Bureau of Health Risk Reduction of the Department of Health, similarly testified he was unaware of any data on the percentage of minors in New York who purchase cigarettes through direct sales channels. (Id. at 285-86).

The evidence also shows that younger minors who are only experimenting with smoking obtain cigarettes from social rather

[28] Defendants argue that these figures underestimate the volume of cigarettes minors obtain through direct sales because direct vendors typically require a one- to two-carton minimum purchase. Thus, minors need to use direct sales channels with less frequency to obtain the same number of cigarettes as they would obtain from other commercial sources. While this arithmetic is accurate, minimum purchase requirements also represent a deterrent to minors using direct sales channels, which will be discussed in detail below.

than commercial sources.[29] Plaintiffs' expert, Steven R. Kursh, Executive Professor in the College of Business Administration at Northeastern University, cited two studies supporting this view. In "How Adolescents Get Their Cigarettes: Implications for Policies on Access and Price," the authors concluded that "[f]or the vast majority of adolescent experimenters, who rely on friends with more smoking experience to supply their cigarettes, access laws likely have little impact." (Pl. Ex. 324, Tab 215). In another study of school students in grades 6, 9 and 12, the authors found that "age is negatively correlated with exclusively social access (that is, as age increases, users are more likely to buy)," and concluded that "[o]verall, friends are the most common source" for cigarettes. (Pl. Ex. 321, Tab 220 at 42, 44). See also Trial Tr. at 232 (while older adolescents tend to rely more on commercial sources, they do not use direct sales channels to any significant degree). Accordingly, defendants have not shown that a ban on direct sales of cigarettes will effect any benefit with respect to these younger minors.

The evidence also shows that "non-monetary" or "transaction" costs represent substantial obstacles for minors to overcome in order to purchase cigarettes through direct sales. These transaction costs include minimum purchase requirements; the need

[29] Social sources include obtaining cigarettes from friends or family members, taking cigarettes from the home or a friend's home and getting someone else to buy the cigarettes. (Pl. Ex. 321, Tab 220 at 43).

for a credit card; delayed delivery; the risk of detection by parents or other responsible adults; and, in the case of Internet sales, the need for unsupervised, unfiltered Internet access. (Trial Tr. at 140-47, 234).

Minimum purchase requirements are a particularly significant transaction cost. The evidence is undisputed that Internet and mail order vendors impose minimum purchase requirements of one carton or more.[30] (Id. at 144). Such requirements are a major deterrent not only because they require a significant cash outlay (id. at 388), but also because those minors who do purchase cigarettes typically buy them by the pack, as defendants' experts conceded. (Id. at 144, 387, 568-69). Cartons are more difficult to hide than packs and must be concealed for longer periods, thereby creating a risk of detection. (Id. at 569). Additionally, cartons contain more cigarettes than underage smokers, typically experimenters, need. (Id. at 144). "[T]he vast majority of underage minors are experimenters [who] consume very low quantities of cigarettes [and] obtain their cigarettes through . . . social sources or non-commercial sources." (Trial Tr. at 124, lines 14-19).

The requirement of payment by credit card, imposed by

[30] Although one of plaintiffs' experts testified that he had found a single, offshore Internet vendor that offered to sell by the half-carton, the evidence indicates that all other vendors impose at least a one-carton minimum purchase requirement. (Trial Tr. 144).

approximately 90% of Internet sites, is also a significant obstacle. (Id. at 144). Professor Kursh testified, without contradiction, that teenagers rarely have independent access to credit cards. (Id. at 145). Even if some teenagers are able to use credit cards of parents or other responsible adults, charge cards remain unattractive payment vehicles because the cigarette purchase will likely be detected by the cardholder on his or her monthly credit card statement. (Id.).[31]

Both parties' expert witnesses testified that the delay inherent in any Internet, mail order, or telephone purchase is also a significant transaction cost to underage smokers. (Id. at 146, 569).

All of the experts who addressed the issue also agreed that the risk of parental detection of delivery is a non-monetary cost to minors of purchasing through direct sales channels. (Id. at 146, 388, 596). Because a minor has no knowledge of or control over the time of delivery by the carrier, there is a substantial

[31] The Federal Communications Commission, in regulations implementing a provision of the Communications Act of 1934, 47 U.S.C. § 223(b)(2)(A), determined that "requiring prepayment by credit card effectively restricts . . . access" by minors to "dial-a-porn" messages because credit cards "are not routinely issued to minors" and, when issued, are subject to parental supervision. 50 Fed. Reg. 42699 ¶ 30 (1985); 49 Fed. Reg. 24996 ¶ 34 (1984); see Restrictions on Indecent Telephone Message Services, 47 C.F.R. § 64.201(a)(2).

risk that cigarettes ordered over the Internet, by mail order, or by telephone will be intercepted by a responsible adult. (Trial Tr. at 146). In explaining why his department does not attempt to intercept direct sales cigarettes at the point of delivery, defendants' expert, Gregory Connolly, D.D.S., Director of the Massachusetts Tobacco Control Program, explained that "guessing which day the delivery comes or doesn't come . . . would be costly and difficult." (Id. at 376).

With respect to Internet sales, the need for unsupervised, unfiltered Internet access is also a substantial transaction cost to minors. Professor Kursh testified that 70% of parents monitor the online activities of their children. (Id. at 141). In addition, parents can take advantage of filtering software that blocks access to sites inappropriate for minors. (Id.). The New York City Department of Consumer Affairs has also recommended the use of blocking software to parents to prevent their children from accessing tobacco websites. (Pl. Ex. 86, Tab 194 at 2). Other software products built into web browsers make it possible for parents to keep a log of the sites their children have visited. (Trial Tr. at 143-44). Because of the widespread parental supervision of children's Internet activities and the availability of various technological tools to assist this supervision, the need to obtain unsupervised, Internet access is a significant transaction cost to minors attempting to purchase cigarettes over the Internet.

Professor Kursh's conclusion, which I credit, was that "[e]ach of these transaction costs is significant in and of itself but in combination they create so many hurdles, particularly in contrast to obtaining cigarettes from traditional brick[]-and-mortar retailers, that underage minors would find . . . direct marketing channels an unattractive source for cigarettes." (Id. at 146-47). In sum, defendants have failed to demonstrate that use of direct sales channels by minors is significant and thus have failed to demonstrate that the statute will effect any material local benefit in reducing direct sales of cigarettes to minors.

Even if defendants had proved that direct sales channels posed a substantial health risk to minors, they have not shown that § 1399-ll will meaningfully address the problem. The law both creates and leaves open loopholes which are fatal to its effectiveness. Specifically, the 800-cigarette delivery exemption in § 1399-ll(2) permits local retailers to receive phone, Internet or mail orders and deliver those orders directly to the customer without an in-store, face-to-face transaction. In addition, § 1399-ll will not be enforced against Indian reservations and cannot be enforced against the United States Postal Service. Therefore, to the limited extent that they do so now, minors would continue to be able to obtain cigarettes by direct sales even if § 1399-ll is allowed to take effect because direct sales of cigarettes will continue to be available both

from Indian sellers and from other direct sellers using the U.S. mails. Thus, the loopholes themselves make the law ineffective in stopping minors from accessing cigarettes. See Hughes, 441 U.S. at 338 (state ban on exporting minnows could not be justified as conservation measure due to loopholes in ban).

Even if these loopholes did not exist, minors would continue to obtain cigarettes through other sources, sources through which the evidence shows they obtain the vast majority of the cigarettes they smoke. As mentioned above, young minors obtain cigarettes primarily through social sources and older minors who, in turn, use commercial sources and have relatively little problem purchasing cigarettes directly from a brick-and-mortar establishment. For example, in an investigation not in accordance with Synar requirements conducted in mid-2000, the New York State Attorney General found that minors had a 46.8% success rate of purchasing cigarettes from brick-and-mortar stores. (Trial Tr. at 147-48; Pl. Ex. 39, Tab 163 at 9).[32] "All a youth

[32] Pursuant to Synar compliance check methodology, minors who appear to be over 18 years old are specifically excluded from participating in sting operations. Minors are also instructed not to carry any form of identification in order "to protect the identity of the minors" and are told not to present false identification. (Trial Tr. at 476-77). In contrast, the State Attorney General's investigation required minors to bring proper identification into the retail establishment. If asked, the minor was required to present his or her identification and to answer truthfully if asked his or her age. "Particularly disturbing is the fact that many of the sales were effectuated even when the students show identification which revealed that they were under 18 years of age." (Pl. Ex. 39, Tab 163 at 10).
(continued...)

has to do is go to five stores and the mathematics are they have gotten a 97% chance of acquiring a pack of cigarettes." (Trial Tr. at 233, lines 21-24). In sum, I credit Dr. Dunbar's testimony and conclusion to the effect that closing down direct sales channels will not reduce smoking by minors to any cognizable degree. Accordingly, defendants have not carried their burden of demonstrating that § 1399-ll will effect any material local benefits.

Under strict scrutiny, defendants must also demonstrate that they have "no other means" to reduce youth smoking. Carbone, 511 U.S. at 392; see American Camping Assn. v. Whalen, 465 F. Supp. 327, 330 (S.D.N.Y. 1978) (discriminatory state law not shown to be "necessary" to further legitimate state interests; neither of the state goals is satisfied by the legislation). They have failed to do so. The evidence establishes that it is possible to reduce youth smoking without banning direct sales, that the model programs for reducing youth smoking do not recommend banning direct sales and that states have succeeded in reducing youth

[32](...continued)
In another study by the New York City Council, minors were instructed to respond that they were 18 if they were asked their age. If asked for identification, however, they were instructed to respond that they did not have any with them. Fifty-six percent of the 100 stores surveyed sold cigarettes to the minors. (Pl. Ex. 221, Tab 162 at 12, 16).

smoking without banning direct sales.[33] In contrast, there is no evidence in the record that New York has developed or tried any alternative less discriminatory means of preventing minors from obtaining cigarettes through direct sales channels rather than completely banning these sales. Indeed, all of the State officials who testified at trial stated that they have not yet developed a program to enforce current law against direct sellers or to enforce § 1399-ll.

Kathleen Henry of DOH's Bureau of Community Sanitation and Food Protection ("Bureau") testified that "at this point [in] time [the Bureau] do[es] not do compliance checks of facilities by mail or by the Internet or by telephone," and was not "that aware of Internet sales" prior to passage of § 1399-ll. (Trial Tr. at 472-73, 481). She further testified that "[w]e haven't truly discovered how we would proceed to do that type of compliance work. I am not sure what kind of barriers we may face at this point in time. We haven't really investigated that to see how we would conduct so I don't think I am informed enough at

[33] Two leading government reports that make recommendations for successful tobacco control programs neither mention direct sales nor recommend banning such sales in order to reduce youth smoking. As discussed above, the CDC's Best Practices sets forth a detailed set of recommended practices for controlling tobacco use. However, it does not include a ban on direct sales. (Pl. Ex. 248, Tab 235). "Reducing Tobacco Use: A Report of the Surgeon General" also makes numerous recommendations for reducing youth access to tobacco products without calling for a ban on direct sales or indicating that minors obtain cigarettes through direct sales channels. (Pl. Ex. 250, Tab 236).

this point in time to answer that question." (Id. at 481-82).

Richard Svenson, the official in charge of administering ATUPA, the statute restricting the sales of cigarettes to minors, testified that prior to the enactment of § 1399-ll, no one under his supervision considered any alternative to an outright ban on direct sales. (Id. at 267, 271-73). According to Mr. Svenson, his subordinates at DOH are only now in the process of looking at possible alternatives. (Id. at 272). Mr. Svenson further testified that his office was still in the fact-gathering stage and that it was "too early" for him to identify any specific alternatives that are being examined or forecast a date as to when a study of alternatives would be completed. (Id. at 272, 273). When questioned at trial, Mr. Svenson testified that his bureau might consider blocking software as an alternative. (Id. at 273).

With respect to Internet sales in particular, Ms. Henry admitted that the three impediments to enforcement of age-verification laws on the Internet were a lack of preparedness, a lack of funding and a lack of staffing. (Trial Tr. at 480). She conceded that there were no technological reasons for the Bureau's failure to enforce age-verification requirements on the Internet. (Id. at 481). Additionally, it was uncontradicted that it may be easier to identify vendors and perform sting operations against Internet retailers than brick-and-mortar outlets because a government agency can use a computer program

that continuously searches the Internet and collects a list of sites. (Id. at 167-68, 405-06).

Defendants' witnesses also admitted that if § 1399-ll were to take effect, they would enforce it against out-of-state retailers in the same way they enforce the current statutes against brick-and-mortar sellers. (Id. at 446). Logic dictates that if such operations against out-of-state direct sellers are available to enforce § 1399-ll, they are also available to enforce current age-verification requirements and prohibitions of sales to minors without an outright ban on interstate sales.

The evidence shows that other states have begun to enforce their existing minimum age laws against direct vendors without a ban on direct sales. For example, Michigan has filed numerous complaints against out-of-state Internet tobacco vendors alleging, among other things, violations of minimum age laws. See, e.g., Pl. Exs. 101-05, 110, Tabs 105-10; Pl. Exs. 106-09, Tabs 147-50. After the Oregon Attorney General threatened a lawsuit against out-of-state companies selling bidis[34] over the Internet and by telephone, they agreed to comply with Oregon laws governing the sale of tobacco products, including a commitment not to sell tobacco products to minors. (Pl. Ex. 235, Tab 87).

The record also includes undisputed evidence of cooperation among the states in tobacco control matters, including efforts to

[34] "Bidis" are imported, hand-rolled cigarettes that are flavored to appeal to young people.

prevent the sale of tobacco products to minors through direct sales channels. Washington State was part of a multi-state Internet sting operation that resulted in the issuance of a cease and desist order against five out-of-state bidi sellers, including a New York direct seller. (Pl. Ex. 117, Tab 152). New York itself has also cooperated with North Carolina, Virginia, Washington, DC, Maryland, Delaware, Pennsylvania and New Jersey in an effort to stop cross-border smuggling of untaxed cigarettes. (Trial Tr. at 443). No evidence has been presented indicating that New York could not similarly coordinate with other states to prevent direct sales of cigarettes to minors. (Id. at 443-44).

Another alternative to an outright ban on direct sales is requiring Internet, mail order and telephone vendors to employ age-verification procedures or other protections against underage purchasing that are tailored to direct sales. Other states have proposed or enacted legislation that would regulate the direct sale of cigarettes but would not impose an outright ban. For example, in Kansas, a bill permits the sale of cigarettes through the mail if the purchaser submits a declaration that he or she is of legal age. (Pl. Ex. 59, Tab 82). In Missouri, a bill expressly permits the sale of cigarettes by mail or through the Internet, if all other aspects of the statute are observed. (Pl. Ex. 64, Tab 84). In addition, a recent Rhode Island statute regulates direct sales without prohibiting them. A key aspect of

that statute is the requirement of an adult's signature for delivery. (Pl. Ex. 26, Tab 79). Lastly, a bill has been introduced in Congress, entitled the "Tobacco Free Internet for Kids Act," that prohibits the direct sale of cigarettes only to persons under eighteen years of age. (Pl. Ex. 197, Tab 85).

The evidence also indicates that adoption of age-verification procedures similar to those employed by plaintiff BWTDirect would be effective in reducing minors' access to cigarettes through direct sales channels. At trial, John Heironimus, President of BWTDirect, described the company's four-part procedure for verifying a purchaser's age and preventing minors from obtaining cigarettes. (Trial Tr. at 22-29). First, BWTDirect requires age verification through matching to a database of persons over 21 or submission of a government identification. When a customer seeks to place an order with BWTDirect, an attempt is made to match the name, address and date of birth provided by the customer against information contained in one of two databases of individuals whose age has been verified to be 21 years or older, one database maintained by the company and one maintained by Donnelly Marketing, a leading direct-marketing firm. (Id. at 26-27). If the name, address and date of birth provided by the customer cannot be matched with that of an age-verified individual in one of these two databases, each of which is based on public records such as driver's license and voter registration records, the customer is required to submit an age-verification kit consisting

of a signed certification that the customer is of legal age and a copy of a valid government identification (driver's license, state identification card, passport, or military identification).[35] (Trial Tr. at 24-26; Pl. Ex. 362, Tab 187).

Second, BWTDirect imposes a two-carton minimum purchase requirement. (Trial Tr. at 26). As discussed above, a minimum purchase requirement is a transaction cost of direct sales that I find deters minors from purchasing cigarettes through direct sales channels.

Third, BWTDirect requires customers to pay by personal check or credit card issued to an age-verified adult; money orders and cash are not accepted. (Id. at 26, 162). Again, the risk of parental detection is a non-monetary cost to minors of using direct sales channels. (Id. at 146, 388, 596).

Fourth, BWTDirect restricts delivery to the billing address on the check or credit card used by the customer and will not deliver to a post office box. (Id. at 27, 164-65). The policy not to deliver to post office boxes acts as a protection against minors' trying to shield receipt of cigarettes from parental detection.

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[35] Defendants dispute the efficacy of BWTDirect's requirement that a customer submit a copy of a driver's license because BWTDirect permits the customer to black out his or her driver's license number for privacy. (Trial Tr. at 49, lines 21-25). To the extent that that might decrease efficacy, an age-verification program could require that the driver's license number be provided.

In addition, like Rhode Island, New York could require an adult's signature for delivery. Defendants state on one hand that in connection with § 1399-ll they will train carriers in compliance and grant them a grace period before enforcing § 1399-ll against them. (Id. 435-36). However, defendants also argue on the other hand that they cannot require carriers to obtain an adult's signature for the delivery of cigarettes. If carriers can be trained not to deliver certain packages, although it is unclear how they will know what the packages contain, logic dictates that carriers can also be trained to obtain an adult's signature upon delivery. This would be a nondiscriminatory alternative to an outright ban on direct sales.

In sum, I credit the testimony of Professor Kursh and Dr. Dunbar to the effect that age-verification and delivery systems similar to BWTDirect's system would provide an effective barrier to cigarette purchases by minors via direct sales channels. (Id. at 140-41, 162-63, 234).[36]

Finally, another nondiscriminatory alternative to reduce youth smoking is to devote more funding to tobacco control -- a choice within the purview of the elected branches. New York State ranks 21st in the nation in per capita spending on tobacco control, according the CDC. (Pl. Ex. 252, Tab 237 at 89).

[36] Notably, BWTDirect has processed approximately 30,000 orders since its program began in October 2000, without receiving a single complaint of underage purchasing. (Trial Tr. at 33).

Christopher Maylahn, Director of the State's Bureau of Health Risk Reduction, opined that the State's tobacco-control program is insufficiently funded. Mr. Maylahn confirmed that while New York receives one billion dollars annually from cigarette manufacturers under the Master Settlement Agreement,[37] it sets aside only 40 million dollars for tobacco control. (Trial Tr. at 282-84). This amount represents only 45% of the minimum level recommended by the CDC's Best Practices and only 16% of the maximum, and, in Mr. Maylahn's view, an inadequate amount to effect a reduction in youth smoking. (Id. at 284; Pl. Ex. 252, Tab 237 at 89; Pl. Ex. 248, Tab 235 at 66).

Additionally, Kathleen Henry testified that one reason that the Bureau of Community Sanitation and Food Protection does not conduct compliance checks on direct sales channels is insufficient funding. (Trial Tr. at 480). Inadequate funding also appears to have constrained the State's efforts to ensure that brick-and-mortar retailers comply with minimum age laws. Ms. Henry testified that in the past her compliance program has had "minimal staff" and that "getting the state on board to do just retail facilities was an undertaking in itself." (Id. at

[37] The Master Settlement Agreement was the result of various states' lawsuits against the tobacco industry that sought reimbursement of public health expenditures due to smoking-related illness. The settlement provides, among other things, funding to states for anti-smoking advertising campaigns, youth smoking prevention programs and a national public education fund for tobacco control.

465).

Dr. Connolly also testified that if New York State committed "more dollars" to tobacco control, it would show a "bigger decline" in youth smoking. (Id. at 354). He noted the success of Massachusetts' tobacco control program and attributed it in part to the amount of funding the state has allocated.[38] (Id. at 384-85). Dr. Connolly confirmed the conclusion of the CDC that "the more resources you put into the program the more effect you get. . . . [G]iven the level of funding in Massachusetts they were getting larger declines than if they were spending less money." (Id. at 385).

While the choice of what measures to adopt to curb smoking by minors is one for the elected branches, defendants have not carried their burden of demonstrating that § 1399-ll's ban on direct sales will be more effective than, for example, some combination of age-verification and delivery procedures similar to those of BWTDirect, increased funding for tobacco control programs and the like. In sum, defendants have failed to carry their burden of justifying § 1399-ll as the only means available of preventing minors' access to cigarettes.[39]

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[38] As noted above, many of the components of the CDC's Best Practices were modeled on Massachusetts and California's successful anti-smoking programs. (Trial Tr. at 383). Massachusetts ranks among the top four states in terms of per capita tobacco control funding. (Id. at 384).

[39] Recently, the district court in the Southern District of (continued...)

ii. The health of minors and adults

Defendants argue that one of the purposes of § 1399-ll is to require in-state, face-to-face transactions only, thereby requiring buyers[40] to pay prices including New York's high cigarette excise tax. Defendants argue that the high price tag leads to decreased demand for cigarettes, thereby effecting the local benefit of improving the health of New Yorkers. While this is a worthy goal, defendants have not carried their burden of

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[39](...continued)
Texas scrutinized a statute similar to the one here. Dickerson v. Bailey, 87 F. Supp.2d 691, 710 (S.D. Tex. 2000). There, the court rejected a similar youth-access justification for a Texas law banning direct-to-consumer shipments of alcohol, finding that "there are reasonable, nondiscriminatory alternatives, including more narrowly drawn statutes," to a ban on such shipments. The Dickerson court held that the state's interest in protecting minors could be adequately served by enforcement of state laws prohibiting the sale of alcoholic beverages to minors. Id. The twenty-first amendment was not implicated in that portion of the court's analysis. But see Bridenbaugh v. Freeman-Wilson, 227 F.3d 848, 851 (7th Cir. 2000) ("If the product were cheese rather than wine, Indiana would not be able either to close its borders to imports or to insist that the shippers collect its taxes. . . . [T]he twenty-first amendment empowers Indiana to control alcohol in ways that it cannot control cheese.").

[40] Plaintiffs argue that there is no evidence that § 1399-ll was enacted to reduce smoking by adults. Rather, they contend that this purpose is a "post hoc rationalization" for discrimination. Hughes, 411 U.S. at 338. While the statute's legislative findings and Introducer's Memorandum do not specifically mention reduction in smoking among adults as one of the law's purposes, the legislative findings do refer to "public health" in general, and numerous exhibits were received at trial discussing the relationship between the price of cigarettes and the demand for cigarettes as to both adults and minors. Accordingly, I credit the State's legitimate interest in reducing smoking by adults as well as by minors as a purpose of the statute.

demonstrating that the statute will effect the desired benefit and that there is no less discriminatory alternative.

As a preliminary matter, the parties dispute whether minors are price sensitive, that is, whether their demand for cigarettes will be affected by a change in price. Plaintiffs contend that the studies show that young teens are insensitive to price and that conclusions regarding older teens are "contradictory and inconclusive." (Pl. Proposed Findings of Fact and Conclusions of Law ¶¶ 113-115). Defendants assert that numerous studies show that an increase in price of cigarettes reduces the "consumption" of cigarettes. The Surgeon General's report, for example, concludes that "[t]he price of tobacco has an important influence on . . . demand." (Def. Ex. 1,001 at 359). In 1993, a panel convened by the National Cancer Institute concluded that increases in cigarette prices would lead to large reductions in both adult and youth smoking. (Trial Tr. 513, line 22 to 514, line 7). In addition, a panel convened by the CDC's Office on Smoking & Health concluded that increasing cigarette taxes would be very effective in reducing youth smoking. (Id. at 516, lines 17-25). As discussed by defendants' expert, Dr. Chaloupka,[41] the

[41] Frank Chaloupka is a Professor of Economics in the College of Business Administration at the University of Illinois. (Trial Tr. at 499).

CDC "concluded that protecting youth from smoking was the best economic argument for increasing cigarette taxes." (Id. at 516, line 25 to 517, line 2).

Additionally, B&W's own internal documents support the conclusion that both minors and adults are price sensitive with respect to cigarettes and that minors are more price sensitive than adults. In 1997, B&W attempted to quantify the effect of the price increase arising from its settlement with the various states on the demand for its products. B&W reviewed data from the Monitoring the Future Project and a 1996 study by Dr. Chaloupka and Michael Grossman. That study concluded that "[t]he calculated elasticity of -1.15 [meaning that a 10% increase in price will lead to an 11.5% reduction in smoking] for the group studied suggests the effect of price increases on youth smoking is about three times as large as the impact on adult smoking." (Def. Ex. 1,162). B&W also reviewed 40 other research reports and found that "[a] common conclusion reached in these studies was that the price responsiveness of cigarette demand decreases with age." (Id.). In other words, the younger the smoker, the more sensitive to price he or she will be. Thus, I credit the testimony of defendants' expert, Dr. Chaloupka, that increases in cigarette prices will reduce smoking initiation among youth and prevent young "experimenters" from becoming "established" smokers. (Trial Tr. at 519, lines 22-24; id. at 573, lines 16-19). Accordingly, defendants have demonstrated that an increase

in the price of cigarettes will lead to a decrease in the demand for cigarettes.[42]

Defendants, however, have not demonstrated that § 1399-ll will prevent smokers from obtaining lower-priced cigarettes and thus effect a local benefit. As noted above in Part II(C)(2), Indian retailers can and will continue to sell cigarettes by direct sales to New York consumers. As noted above in Part II(C)(3), § 1399-ll cannot be enforced against the U.S. Postal Service. Because of these various loopholes in the ban § 1399-ll seeks to impose on direct sales, "[w]hatever the relation there may be between [high prices] and [a decrease in smoking] is too remote and indirect to justify obstructions to the normal flow of commerce in its movement between states." Baldwin v. G.A.F. Seelig, 294 U.S. 511, 524 (1935).[43] Accordingly, defendants have

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[42] It was not satisfactorily answered at trial whether the studies measure a change in "demand" or "consumption." The terms seem to be used interchangeably. For purposes of deciding the constitutionality of § 1399-ll, the precise word is of no moment.

[43] Baldwin involved a New York law that established a minimum price to be paid to milk producers. The law prohibited the sale in New York of milk purchased out-of-state for below the minimum. The State argued that the "the exclusion of milk paid . . . below the New York minimum will tend . . . to impose a higher standard of quality and thereby promote health." 294 U.S. at 524. Like the statute at issue here, the State attempted to dictate a price to be paid in order to protect the health of New York citizens. The Supreme Court found that the law discriminated against interstate commerce and that its benefits were too "remote" and "indirect." "[C]ommerce between the states is burdened unduly when one state regulates by indirection the prices to be paid to producers in another, in the faith that augmentation of prices will lift up the level of economic

(continued...)

not carried their burden of demonstrating that § 1399-ll will effect the benefit of reducing smoking through the maintenance of high cigarette prices.

Section 1399-ll also fails strict scrutiny because defendants have not carried their burden of proving the lack of less discriminatory alternatives to equalize the price of direct-sales and brick-and-mortar cigarettes. For example, it is undisputed that states and cities may collect the tax due on direct sales through the Jenkins Act and they may do so in state court. Angelica Co. v. Goodman, 276 N.Y.S.2d 766, 769 (N.Y. Sup. Ct. 1966). New York, however, has not attempted to use the Jenkins Act mechanism to maintain high prices. The evidence is undisputed that DTF has chosen not to make any effort to collect taxes on cigarettes sold from out-of-state to New York consumers by telephone, mail and Internet. (Farrell Dep. Tr. at 19). Peter Farrell, Deputy Commissioner of the Office of Tax Enforcement, testified that DTF has not assigned a single person to investigate telephone, mail-order or Internet sales originating out-of-state and has not conducted a single sting operation in connection with such sales. (Id. at 55, 114). "New York has not made any effort . . . to enforce its statutes against mail order sales, phone sales or Internet sales." (Id.

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[43](...continued)
welfare, and that this will stimulate the observance of sanitary requirements in the preparation of the product." Id.

at 70). In fact, DTF made a policy decision not to rely on the Jenkins Act to assist in collecting taxes due by New York consumers who purchase cigarettes directly from out-of-state vendors. (Trial Tr. at 312, 314; Pl. Ex. 157, Tab 43). This is evidenced by an internal email correspondence among the highest DTF executives: Lawrence Keeley, Director of the Transaction and Transfer Tax Bureau ("TTTB"); Charles Mills, Director of the Petroleum, Alcohol and Tobacco Bureau ("PATB"); Arthur Roth, then Deputy Commissioner for Tax Operations; Kevin Murray, then Executive Deputy Commissioner; and Michael Urbach, then DTF Commissioner. (Pl. Ex. 157, Tab 43). In this exchange, Mr. Mills informed the others that he recently received "packages of invoices" containing the names of New York consumers who did not remit use tax for untaxed cigarette purchases. He commented in the email that if New York consumers were to be contacted and advised of their tax liability the "incentive to get tax-free cigarettes disappears." (Id.; Trial Tr. at 312-15).

In addition, Deputy Commissioner Roth, Commissioner Urbach and Executive Deputy Commissioner Murray determined that no action should be taken to collect use tax by means of the Jenkins Act because they did not want "to harass individual taxpayers," and that nothing more than a monitoring system should be set up. (Trial Tr. at 314; Pl. Ex. 157, Tab 43). No such monitoring system, however, was actually established. (Trial Tr. at 314-15).

Defendants also have not shown that Jenkins Act enforcement would not be effective in maintaining New York's high prices. The record contains evidence collected from several states that are beginning to enforce the Jenkins Act that the benefits of enforcement exceed the costs. For example, in California, the Excise Taxes Division ("the Division") sent letters to out-of-state direct retailers of cigarettes advising them of their reporting obligations under the Jenkins Act. (Maciel Dep. Tr. at 78, 95-96; Pl. Ex. 337, Tab 160). Those retailers who did not respond were sent a follow-up letter demanding compliance, with a copy provided to the federal Bureau of Alcohol, Tobacco and Firearms ("ATF").[44] (Maciel Dep. Tr. at 78). In response to these letters, retailers began to provide the Division with Jenkins Act reports. (Id. at 83). The Division used the information provided in Jenkins Act reports to prepare and send mailings advising consumers that they owed excise and use taxes and providing tax forms and instructions for remittance of those taxes. (Id. at 84-85, 96-97; Pl. Ex. 337, Tab 160).

Although the California program has been in existence for

[44] The Division provided copies of the follow-up letters to ATF because ATF representatives who attended earlier meetings of the Federation of Tax Administrators "showed a willingness to work with the states" to achieve Jenkins Act compliance. (Maciel Dep. Tr. at 79). ATF assisted the Division by sending agents to visit hard-to-find retailers in other states and informing them of their reporting obligations. (Id. at 79-80). Some retailers began filing Jenkins Act reports with the Division as a result of visits by ATF agents. (Id. at 80-81).

only about one year, the Division's out-of-state sellers program has achieved a compliance rate of 60 to 65 percent, based on returns sent to California consumers identified in Jenkins Act filings. (Maciel Dep. Tr. at 114). Dennis Maciel, Chief of the Excise Taxes Division, testified that, if the program were administered with regular full-time staff rather than through overtime, it would have a "dramatic impact" in raising the rate of compliance among identified consumers. (Id. at 118). As of March 2, 2001, the Division had collected over $1.4 million in excise and use taxes from California consumers, who filed more than 40,000 excise and use tax returns in response to Division mailings. (Id. at 110; Pl. Ex. 339, Tab 120).

In addition to efforts to contact consumers directly, the Division used news releases and other publicity efforts to increase public awareness of consumers' excise and use tax obligations on purchases of cigarettes from out-of-state retailers. (Maciel Dep. Tr. at 100-02; Pl. Ex. 338, Tab 161). The "educational value" of this program helps increase compliance with the state's tax code. (Maciel Dep. Tr. at 102). Some California consumers stopped buying cigarettes online, finding that such purchases were more expensive than cigarettes bought locally once all taxes had been paid. (Id. at 102-03).

While the evidence is not entirely consistent,[45] defendants

[45] For example, Carter Mitchell, Program Manager for (continued...)

have failed to carry their burden of justifying § 1399-ll as the only means available of reducing smoking among adults or minors by attempting to force consumers to pay New York's high price for cigarettes. The evidence shows that there are other nondiscriminatory alternatives to a complete ban on the direct sale of cigarettes. Thus, Section 1399-ll fails strict scrutiny under Hughes:

> Far from choosing the least discriminatory alternative, [New York] has chosen . . . the way that most overtly discriminates against interstate commerce. . . . [Section 1399-ll] is certainly not a last ditch attempt . . . after nondiscriminatory alternatives have proved infeasible. It is rather a choice of the most discriminatory means even though nondiscriminatory alternatives would seem likely to fulfill the State's purported legitimate local purpose more effectively.

Hughes, 441 U.S. at 338. Accordingly, the statute is unconstitutional and permanently enjoined from enforcement.

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[45](...continued)
Tobacco Tax Enforcement for the Washington State Liquor Control Board testified that

> it's extremely time consuming and costly to pursue [Internet vendors], and we just don't have the revenue available to make a lot of buys to see if people are going to sell and turn in a Jenkins Report. It's not practical to do. We have monitored -- we have tried to a get a grasp on this to try to answer questions as to the overall problem in the state, and like I said, there are literally hundreds, if not a thousand sources of supply, and there is just no way that we can have a real aggressive campaign on that type of thing.

(Mitchell Dep. Tr. at 16, lines 12-25).

2. Pike Balancing Test

a. Standard

If, as defendants argue, § 1399-ll regulates direct sellers evenhandedly, it is subject to review under the less stringent Pike balancing test:

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative benefits.

Pike, 397 U.S. at 142. Defendants contend that in evaluating the putative health benefits of § 1399-ll, the Court should defer "to the judgment of the legislature that [§ 1399-ll] would reduce commercial access by youth and reduce smoking prevalence," (Def. Proposed Findings of Fact and Conclusions of Law ¶ 343), citing Justice Brennan's concurring opinion in Kassel, 450 U.S. at 680-81. In his opinion, Justice Brennan stated that

> [i]n determining [the local] benefits, a court should focus ultimately on the regulatory purposes identified by the lawmakers and on the evidence before or available to them that might have supported their judgment. . . . It is not the function of the court to decide whether in fact the regulation promotes its intended purpose, so long as an examination of the evidence before or available to the lawmaker indicates that the regulation is not wholly irrational in light of its purposes.

Id. (citation omitted). Thus, defendants ask the Court to defer to the Legislature's determination that the avowed purposes of § 1399-ll are legitimate and, without further inquiry, that § 1399-ll will meet the goals of reducing access to cigarettes

and reducing smoking. Only then, according to defendants, is the Court to engage in a balancing analysis of those goals against the burdens on interstate commerce.

Defendants' reliance on Justice Brennan's opinion is misplaced. The plurality opinion in Kassel stated that while

> regulations that touch upon safety . . . are those that the Court has been most reluctant to invalidate [and that] [t]hose who would challenge such bona fide safety regulations must overcome a strong presumption of validity, . . . the incantation of a purpose to promote the public health or safety does not insulate a state law from Commerce Clause attack. Regulations designed for the salutary purpose nevertheless may further the purpose so marginally, and interfere with commerce so substantially, as to be invalid under the Commerce Clause.

450 U.S. at 670. Additionally, Pike itself does not direct the Court to defer to the determination of the Legislature. Rather, the Supreme Court stated:

> If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Pike, 397 U.S. at 142 (emphasis added). Thus, Pike directs a review of § 1399-ll to determine, first, whether it advances legitimates goals, and, second, whether those interests could be promoted with lesser impact on interstate commerce. See Ass'n. of Int'l Auto. Mfrs., Inc. v. Abrams, 84 F.3d 602, 612-613 (2d Cir. 1996) ("the validity of the legislative assumptions . . . is debatable. . . . Since there are genuine factual issues as to

both the claimed burdens and the putative benefits . . ., we remand for further development of the record in order to permit the district court to apply the Pike v. Bruce Church balancing test.").

b. Application of Pike balancing

A law "incidentally burdens" interstate commerce when it produces "impacts on commerce beyond the borders of the state," or "burdens that fall more heavily on out-of-state interests." Sal Tinnerello & Sons, Inc. v. Town of Stonington, 141 F.3d 46, 55 n.9 (2d Cir. 1998); USA Recycling, Inc. v. Town of Babylon, 66 F.3d 1272, 1287 (2d Cir. 1995). As discussed above in Parts III(A)(1)(a), (c) and (d), § 1399-ll more than "incidentally burdens" interstate commerce; it directly and substantially burdens interstate commerce and isolates New York from the national cigarette market.

The primary legitimate purposes of § 1399-ll are to reduce minors' access to cigarettes through direct sales channels and to reduce cigarette consumption by requiring consumers to pay New York's high excise taxes. As discussed above, these purposes are legitimate state interests and easily fall within the State's traditional police powers. However, under Pike scrutiny, if § 1399-ll burdens interstate commerce to a greater extent than it will promote these interests, it cannot be upheld. As noted above in Parts III(A)(1)(e)(i) and (ii), defendants have not proved that § 1399-ll will effect those wholly laudable goals.

On balance, then, although "designed for [a] salutary purpose," § 1399-ll "further[s] the purpose so marginally, and interfere[s] with commerce so substantially, as to be invalid under the Commerce Clause." Kassel, 450 U.S. at 670. Accordingly, § 1399-ll fails the Pike balancing test.

IV. CONCLUSION

For the reasons set forth above, New York Public Health Law § 1399-ll is declared unconstitutional and permanently enjoined.

SO ORDERED:

Dated: New York, New York
June___, 2001

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LORETTA A. PRESKA, U.S.D.J.