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UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF NEW YORK

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THE EUROPEAN COMMUNITY

Plaintiff,

(00-CV-06617) (NGG) (VVP)

v.

RJR NABISCO, INC., et al.,

Defendants.

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DEPARTMENT OF AMAZONAS, et al.

Plaintiffs,

(00-CV-02881) (NGG) (VVP)

v.

PHILIP MORRIS COMPANIES, INC., et al.,

Defendants.

MEMORANDUM AND ORDER

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GARAUFIS, U.S. District Judge

Now before this court are Defendants' motions to dismiss the complaints in the above-captioned cases, and to deconsolidate those cases; and a motion by the European Community to amend its complaint. For the reasons set forth below, Defendants' motion to de-consolidate the cases is granted; Defendants' motion to dismiss the complaint filed by the European Community is granted; Japan Tobacco, Inc.'s motion to dismiss is denied as moot; and the European Community's motion to amend its complaint is denied. The Defendants' motion to dismiss the complaint filed by the Departments of the Republic of Colombia will be decided in a separate memorandum and order, to be issued at a later date.

## I. Introduction

The above-captioned cases, which are distinct and have been consolidated for administrative purposes including the resolution of the motions now before this court, have been brought by the European Community<sup>1</sup> (the "EC Case") and by numerous political subdivisions of the Republic of Colombia<sup>2</sup> (the "Amazonas Case") against major tobacco product manufacturers. The Defendants in the EC Case include Philip Morris Companies, Inc. and several of its affiliates<sup>3</sup> (collectively "Philip Morris"), RJR Nabisco, Inc.,<sup>4</sup> several companies related to R.J. Reynolds Tobacco Company,<sup>5</sup> and Japan Tobacco, Inc. (collectively "RJR").<sup>6</sup> The Defendants in the Amazonas case include Philip Morris Companies, Inc. and several of its affiliates<sup>7</sup>

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<sup>1</sup> The European Community is "a governmental body created as a result of collaboration among the majority of the nations of Western Europe, more specifically, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom." (EC Compl. ¶ 6.) The EC brings this case "acting on its own behalf and on behalf of the Member States it has power to represent." (*Id.* at 1.)

<sup>2</sup> Plaintiffs in the Amazonas case include, in addition to the Santa Fe De Bogotá Capital District, the Departments of Amazonas, Antioquia, Atlantico, Bolivar, Boyaca, Caqueta, Casanare, Cesar, Choco, Cordoba, Cundinamarca, Huila, La Guajira, Magdalena, Meta, Nariño, Norte de Santander, Putumayo, Quindio, Risaralda, Santander, Sucre, Tolima, Valle del Cauca and Vaupes. (2d Am. Amazonas Compl. ¶ 6.) The Departments are autonomous from the Republic and each "has rights and responsibilities comparable to that of a state of the United States." (*Id.*) The Republic of Colombia is not a party to this action.

<sup>3</sup> (See EC Compl. ¶¶ 16-20.)

<sup>4</sup> (See EC Compl. ¶ 7.)

<sup>5</sup> (See EC Compl. ¶¶ 8-13.)

<sup>6</sup> (See EC Compl. ¶¶ 14-15.)

<sup>7</sup> (See 2d Am. Amazonas Compl. ¶¶ 7-15.)

(collectively "Philip Morris"), BAT Industries P.L.C. and several of its affiliates,<sup>8</sup> and Brown & Williamson Tobacco Corporation<sup>9</sup> (collectively "BAT").

Plaintiffs in these cases seek recovery against major tobacco product manufacturers and related entities for damages sustained as a result of three separate conspiracies, all related to the smuggling of contraband cigarettes into the EC and Colombia, as follows:

1. a conspiracy involving, in the EC Case, RJR and various co-conspirators, including RJR's distributors, shippers, currency dealers, smugglers, lobbyists, customers, agents, consultants and others to smuggle RJR's tobacco products into the EC and the territories of various EC Member States and to launder the proceeds of drug trafficking; BAT is alleged to head a similar conspiracy with the same objective in the Amazonas Case.
2. a conspiracy involving, in the EC Case, Philip Morris and various co-conspirators, including Philip Morris's distributors, shippers, currency dealers, smugglers, lobbyists, customers, agents, consultants and others, to smuggle Philip Morris's tobacco products into the EC and the territories of various EC Member States and to launder the proceeds of drug trafficking; Philip Morris is alleged to head a similar conspiracy with the same objective in the Amazonas Case.
3. a conspiracy, in the EC Case, among RJR and Philip Morris employing various means, including fixing the price of smuggled cigarettes, to implement and conceal the first two conspiracies; BAT and Philip Morris are alleged to have launched a similar conspiracy with the same objective in the Amazonas Case.

In each case, Plaintiffs' claim that they are entitled to recover under both the Federal Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961 *et seq.*, and under various state common law causes of action, including fraud, public nuisance, unjust enrichment, negligence and negligent misrepresentation.

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<sup>8</sup> (See 2d Am. Amazonas Compl. ¶¶ 16-25.)

<sup>9</sup> (See 2d Am. Amazonas Compl. ¶¶ 19-20.)

Plaintiffs in both cases allege that the conspiracies described above resulted in the following damages:

1. lost tax revenues derived from the sale of cigarettes that would have been paid if the smuggled cigarettes had entered Plaintiffs' territories legally;
2. money and property that Plaintiffs would have obtained with revenues derived from the lawful sale of cigarettes;
3. money spent by Plaintiffs to recover funds lost as a result of Defendants' illegal activities, including money spent to combat cigarette smuggling;
4. illegal profits resulting from Defendants' illegal sale of contraband cigarettes and participation in illegal money laundering;
5. damages resulting from Defendants' creation of a public nuisance.

## II. Deconsolidation

This memorandum and order dismissing the EC Complaint disposes of the EC Case only, which was consolidated with the Amazonas Case pursuant to Fed. R. Civ. P. 44(a) on November 27, 2000. (See Nov. 27, 2001 Tr. at 39.) On that date, I explained that the purpose of consolidation was to simplify this complex litigation to the fullest extent practicable; I further emphasized that my decision to consolidate the Amazonas and EC Cases was not final, and that I would revisit the issue as appropriate. (*Id.*) “[T]he decision to consolidate is discretionary with the court and turns essentially on balancing the time that might be saved against the possible delay or prejudice involved in consolidation.” Transeastern Shipping Corp. v. India Supply Mission, 53 F.R.D. 204, 206 (S.D.N.Y. 1971); see also Kelly v. Kelly, 911 F. Supp. 66, 69 (N.D.N.Y. 1996). Consolidation promoted the fair and efficient resolution of various motions and housekeeping issues that have come up concerning these cases, including the motions to dismiss now before this court. Continued consolidation, however, will delay the resolution of these cases unnecessarily, and the cost of such delay is not outweighed by the fact that the EC and Amazonas Cases to some extent share common legal and factual issues. Defendants' motion

for deconsolidation is therefore granted. The Amazonas Case shall re-acquire its original docket number, 00-CV-02881; the EC Case shall retain docket number 00-CV-06617.

### **III. Standard of Review**

In reviewing a motion brought pursuant to Fed. R. Civ. P. 12(b)(6), the Court must accept all factual allegations in the complaint as true and draw all reasonable inferences from those allegations in the light most favorable to the plaintiff.<sup>10</sup> See Allbright v. Oliver, 510 U.S. 266, 268 (1994); Burnette v. Carothers, 192 F.3d 52, 56 (2d Cir. 1999). The complaint may be dismissed only if “it appears beyond doubt, even when the complaint is liberally construed, that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.” Hoover v. Ronwin, 466 U.S. 558, 587 (1984) (citing Conley v. Gibson, 355 U.S. 41, 45-46 (1957)). In deciding such a motion, the “issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims.” Bernheim v. Litt, 79 F.3d 318, 321 (2d Cir. 1996) (internal quotation marks and citations omitted).

### **IV. The EC Complaint**

#### **A. RJR’s Involvement in Smuggling**

Plaintiff alleges, in general terms, that RJR has been actively involved in smuggling contraband cigarettes into the EC and numerous countries outside of the EC for many years; that RJR’s smuggling activity spans the globe, and includes conduct and effects in the Eastern District of New York and throughout New York State; that RJR entered into an agreement with its distributors, customers, agents, consultants and other co-conspirators to participate in a

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<sup>10</sup> This court’s obligation to accept plaintiff’s allegations as true and to draw all reasonable inferences in plaintiff’s favor is identical under Fed. R. Civ. P. 12(b)(1). See, e.g., Jaghory v. N.Y. State Dep’t of Educ., 131 F.3d 326, 329 (2d Cir. 1997).

common scheme to smuggle contraband cigarettes into the EC; that RJR conspired with Philip Morris to promote and conceal its and Philip Morris's smuggling activities by means including, inter alia, fixing the price of contraband cigarettes; and that RJR agreed with its co-conspirators to commit tortious acts in order to conduct its smuggling scheme. Plaintiff further alleges that it has suffered economic harm, in the forms described supra, as a result of Defendants' participation in cigarette smuggling.

Plaintiff alleges that each of the named RJR Defendants participated in the conception and execution of RJR's conspiracy to smuggle cigarettes into the EC. At all relevant times, RJR and its co-conspirators communicated using both interstate and international wires and mail, on many occasions, in order to carry out nearly every aspect of the alleged scheme. The mail and wires were used in connection with, inter alia, the following conspiratorial activities: arranging for the sale, shipment, billing, payment and accounting of contraband cigarettes; arranging for the return of smuggling proceeds to the United States; preparing and transmitting documents intentionally misstating to authorities of the United States, the EC and the Member States the ultimate destination of cigarettes.

The following is a summary of the Plaintiff's specific factual allegations concerning RJR and Philip Morris's conduct of the conspiracies described above.

**1. RJR's Participation in Smuggling Cigarettes into Spain**

Plaintiff alleges that RJR established the routes and mechanisms by which its cigarettes were (and in some instances continue to be) smuggled into Europe. RJR employees, motivated to some extent by the promise of large bonuses, helped to establish this network. The efforts of

one such employee, named Richard Larocca,<sup>11</sup> are described in some detail.

Larocca was involved principally with the smuggling of RJR cigarettes into Spain. RJR recruited Larocca on the basis of his knowledge of the Spanish cigarette market. RJR directed him to increase market share by any means, including smuggling. Larocca provided RJR with information concerning the marketing potential for Winston cigarettes in Spain. He also provided marketing and other information to cigarette smugglers in order to ensure the efficiency of their operations.

Through employees such as Larocca, RJR maintained control over smuggling by, for example, requiring smugglers to keep logs indicating the amount, destination, and price ultimately paid for illegal cigarette shipments. RJR indicated that if any smuggler did not keep adequate records of shipments, RJR would discontinue its relationship with that smuggler. According to an RJR policy, implemented in the mid- to late 1990s, RJR would refuse to deal with any distributor who failed to verify to RJR the identity of the final customer. By means of these practices, RJR should have been able to ascertain whether or not its cigarettes had reached their intended destination, and by extension, whether or not its cigarettes had ultimately been sold legally.

RJR went to considerable lengths to ensure control over cigarette smuggling. When, for example, RJR detected that large volumes of unauthorized cigarettes had been smuggled into Spain, without RJR's "authorization," RJR purchased such cigarettes and subsequently required the distributor of these cigarettes to repurchase them from RJR. The rogue distributor, thus

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<sup>11</sup> Plaintiff alleges that Larocca is currently an employee of Japan Tobacco, Inc. and at that company "fulfills much the same role . . . that he fulfilled for [RJR] prior to 1999." (EC Compl. ¶ 32x.)

disciplined, then sold the cigarettes to another purchaser for resale into an "authorized" market.

RJR had a separate method for addressing situations in which "unauthorized" smuggled cigarettes were seized by Spanish authorities. In such instances, RJR purchased the seized cigarettes at auction, and then required the smugglers to reimburse RJR for one-half of the price paid at auction. RJR then sold these cigarettes in Spain through legitimate vendors. If the "unauthorized" smuggler refused to reimburse RJR, RJR cut off the smuggler's supply of cigarettes.

As part of its effort to maintain control over smugglers by protecting "authorized" smugglers against their "unauthorized" counterparts, RJR developed a special marketing presentation for Winston cigarettes. Cigarettes marketed with this presentation became known to Spanish consumers as "patanegra." RJR used the patanegra marketing presentation to ensure that "approved" smugglers could maintain their competitive edge over "unauthorized" smugglers who did not have access to, and thus could not sell, patanegra Winstons.

Throughout the 1990s until at least 1999, patanegra Winstons were smuggled into Spain in an elaborate shipping scheme. First, RJR sold them in large quantities in Miami, Florida. Next, they were shipped from RJR's North Carolina production facility to customers located in Panama. These cigarettes were then re-shipped from Panama to Rotterdam, Holland. From Rotterdam, the cigarettes were delivered by truck to Barcelona, Spain.

Because cigarettes cannot be shipped legally from Rotterdam to locations within the EC, smugglers were required to obtain fraudulent transit documents indicating an ultimate destination outside of the EC. Typically, these fraudulent documents indicated the Canary Islands as the cigarettes' ultimate destination. In time, as additional requirements, such as the posting of large

bonds, were imposed upon shippers of cigarettes to guard against smuggling, forged shipping documents indicated Eastern European destinations rather than the Canary Islands as the ultimate destination.

Cigarettes shipped by truck from Rotterdam were then unloaded in Barcelona and sold illegally; other goods, accompanied by the fraudulent transit documents, were then shipped in place of the cigarettes to destinations in Eastern Europe. Upon arrival, smugglers processed the transit documents as if the shipments had contained the cigarettes originally sent from North Carolina via Rotterdam.

Plaintiff claims that RJR executives charged a kickback of five to fifteen dollars per case of cigarettes in exchange for selling patanegra Winston cigarettes into the smuggling network. These executives further encouraged smugglers and their associates to buy more cigarettes by offering "discounts" on the kickbacks in exchange for purchasing larger quantities of cigarettes. In addition, Plaintiff alleges that certain smugglers paid RJR executives to protect their territories from infringement by other smugglers.

Plaintiff claims that the smuggling of patanegra Winstons could not have occurred except with RJR's complicity. The creation of the patanegra presentation for Winston cigarettes sold in Spain is alleged to be a "but-for" cause of smuggling RJR cigarettes into the EC, as is RJR's providing large quantities of cigarettes for sale through its Miami, Florida office.

RJR allegedly also participated in smuggling cigarettes into Spain from the United Kingdom. Through intermediary distributors located in Panama and elsewhere, RJR supplied large volumes of cigarettes manufactured in the United States to a group of six related companies in the United Kingdom (the "UK Group"), including a business known as Entire Warehousing,

that smuggled RJR cigarettes into Spain. RJR's involvement with the UK Group extended from at least October, 1995 through April, 1997. Plaintiff alleges that RJR supplied cigarettes to these companies through distributors in Panama in order to evade detection.

The UK Group falsified European customs documents to indicate that cigarette shipments were destined for locations outside of the EC. RJR was aware that large volumes of cigarettes sold to the distributors in connection with this scheme did not reach the markets for which the cigarettes were purportedly destined, but rather ended up sold on the black market in Spain. RJR nevertheless continued to supply these distributors with large numbers of cigarettes.

RJR employed additional smuggling channels originating in Charleston, South Carolina and Savannah, Georgia. In or about November, 1997 RJR prepared a shipment of eighty million of its cigarettes from Charleston and Savannah to Europe. RJR prepared shipping documents falsely indicating that the cigarettes were destined for a particular company in Greece. Plaintiff alleges that RJR either knew or should have known that this company had neither the capability nor the intention to receive such a large shipment. RJR prepared bills of lading in connection with the shipment instructing that no reference be made to, inter alia, the number of the cigarettes contained in the shipment or the brand name of the cigarettes shipped. RJR or its agents filed documents with the U.S. Bureau of Alcohol, Tobacco and Firearms (the "ATF") that intentionally misstated the intended destination of the shipment in order to mislead the ATF.

## **2. RJR's Awareness of Cigarette Smuggling**

Plaintiff imputes awareness of the smuggling to RJR by virtue of RJR's refusal to discontinue selling to individuals known to participate in cigarette smuggling. For example, RJR continues to supply cigarettes to Michael Haenggi, even though Haenggi has stated that he

frequently supplied Winston cigarettes to smugglers, who then illegally introduced those cigarettes into the Spanish market. Haenggi has also stated that in one instance he sold 160 million cigarettes, mostly manufactured by RJR, to a company in Panama, which in turn smuggled those cigarettes into Spain. Haenggi has also stated that on a separate occasion he sold 220 million cigarettes, again mostly manufactured by RJR, to a Caribbean company, which in turn smuggled those cigarettes into Spain.

RJR has also declined to curtail shipments to specific customers even though one of its distributors expressly informed RJR that these customers were smuggling cigarettes into the EC. On May 26, 1997 Belgium Pakhoed N.V. ("Pakhoed"), one of RJR's primary agents for the storage and handling of cigarettes in the EC, notified RJR that numerous RJR customers were smuggling cigarettes and were "involved in major EC-fraud." Pakhoed thus refused to load cigarettes onto ships operated by such customers. Rather than curtailing further sales to such customers, RJR responded by redirecting its supply to these customers through Cyprus. RJR continues to supply these customers, despite Pakhoed's warning.

In another such example, Spanish customs authorities in April, 1997 seized a shipment of twenty-two million cigarettes, purportedly destined for locations outside of the EC. When EC officials requested information from RJR, RJR refused to comply with the request, arguing that such disclosures would violate Swiss secrecy laws.

Reports of the activities of an unnamed major customer of RJR (responsible for smuggling large quantities of cigarettes into Spain), further indicates RJR's knowledge of, and tacit support for, its customers' cigarette smuggling. During all or part of the time that this customer was engaged in smuggling, he was also suspected by Spanish authorities of narcotics

trafficking. In October, 1999 he eluded Spanish authorities just as they were planning to arrest him on charges of hashish smuggling. Because several of his encounters with Spanish authorities drew publicity, RJR knew or should have known of this customer's alleged involvement in narcotics trafficking.

Finally, RJR's own shareholders, in 1998 and 1999, allegedly proposed resolutions at the RJR annual meeting that put the RJR board of directors on actual notice that RJR was doing business with notorious cigarette smugglers. Plaintiff alleges that through these and other events RJR is on notice that its cigarette customers are involved in illegal smuggling.

### **3. Steps Taken By RJR to Facilitate Cigarette Smuggling**

Moreover, Plaintiff alleges RJR took affirmative steps to facilitate cigarette smuggling. For example, RJR regularly packaged cigarettes specifically to meet the needs of smugglers. RJR also routinely attached tax stamps or counterfeit tax stamps to cigarette shipments at the factory. Without these stamps, the cigarettes could not be shipped to certain destinations. RJR also affixed certain labels and health warnings to ensure the value of the cigarettes at their ultimate destination and designed special cigarette packaging to prevent customs officials from identifying smuggled cigarettes.

Plaintiff further alleges, in addition to the means just described, that RJR provided smugglers with direct assistance in the form of marketing information, including pricing information, specifications concerning which products were in demand, and the volume of cigarettes needed to meet clients' requirements.

According to Plaintiff, RJR also routinely invokes Swiss secrecy laws to thwart detection of its participation in cigarette smuggling. Plaintiff alleges that RJR executives have arranged for

payment to smugglers from accounts located in Switzerland. Plaintiff further alleges that RJR re-located records concerning nearly all of its illegal activities worldwide to Geneva, Switzerland in order to evade the efforts of law enforcement to detect cigarette smuggling.

**4. RJR Conspired With Other Tobacco Producers to Obstruct EC Efforts to Combat Cigarette Smuggling**

In addition to ignoring, on the one hand, ample indications that it transacts business with cigarette smugglers and facilitating, on the other hand, the efforts of cigarette smugglers, RJR also acted in concert with Philip Morris and other tobacco producers to conceal its participation in cigarette smuggling through the formation and manipulation of numerous industry groups and associations. RJR and Philip Morris formed, managed and directed the affairs of industry groups including the International Committee on Smoking Issues, the EEC Task Force on Consumerism (the "EECTF"), the International Duty Free Confederation, the Confederation of European Community Cigarette Manufacturers Ltd. ("CECCM") and CECCM's Duty Free Study Group.

The EECTF was formed by Philip Morris and other tobacco companies on January 19 and 20, 1978. The objective of the EECTF is to thwart EC efforts to regulate tobacco advertising and distribution, and to address the health effects of smoking. Likewise, RJR has utilized the CECCM to conceal the true causes of cigarette smuggling. The CECCM asserted in a 1995 publication that high cigarette taxes had created an enormous black market for cigarettes. The CECCM publication did not, however, disclose RJR's or any other tobacco producer's involvement in this black market.

Plaintiff alleges that RJR's use of tobacco industry groups and their false representations obstructed government oversight and misled the public into believing that high taxes cause the black market for contraband cigarettes, when in fact RJR, Philip Morris and other tobacco producers had conspired to generate and maintain cigarette smuggling operations. The EC reasonably relied on the tobacco industry groups' misrepresentations in accounting for the cigarettes in question and assessing customs duties on cigarettes entering the EC.

#### **5. RJR's Involvement in Money Laundering**

Plaintiff alleges that RJR executives and employees, and in particular Richard Larocca, traveled to locations in the Caribbean and Central America for the purpose of meeting and negotiating business agreements with companies and individuals that RJR knew or should have known were money launderers. RJR's employees and agents also developed business relationships with individuals in Colombia that RJR knew or should have known were directly involved in narcotics trafficking.

In or about the early 1990s, U.S. authorities froze bank accounts in Miami, Florida owned by various distributors of RJR cigarettes because funds credited to those accounts represented laundered drug money. RJR was thus on notice that its distributors had been involved in laundering narcotics proceeds.

Plaintiff alleges that RJR overlooked its distributors' ties to money launderers and actively developed such relationships in order to continue selling large volumes of cigarettes to money launderers. Plaintiff further alleges that cigarettes sold to money launderers were ultimately smuggled into the European Union.

RJR's awareness of the link between its distributors and money launderers and drug

traffickers was furthered by the August 15, 1994 report of the Coalition Against Crime and Tobacco Contraband, a group funded in part by RJR. The report concluded that drug traffickers purchased cigarettes for sale in Colombia as a means of laundering their illegal profits.

**B. Philip Morris's Involvement in Smuggling**

Plaintiff alleges in general terms that Philip Morris, like RJR, has been actively involved in smuggling contraband cigarettes into the EC and numerous countries outside of the EC for many years; that Philip Morris's smuggling activity spans the globe, and includes conduct and effects in the Eastern District of New York and throughout New York State; that Philip Morris entered into an agreement with its distributors, customers, agents, consultants and other co-conspirators to participate in a common scheme to smuggle contraband cigarettes into the EC; that Philip Morris conspired with RJR to promote and conceal its and RJR's smuggling activities by means including, inter alia, fixing the price of contraband cigarettes; and that Philip Morris agreed with its co-conspirators to commit tortious acts in order to conduct its smuggling scheme. Plaintiff further alleges that it has suffered economic harm, in the forms described supra, as a result of Defendants' participation in cigarette smuggling; and that Philip Morris agreed with its co-conspirators to commit tortious acts in order to conduct its smuggling scheme.

Plaintiff alleges that each of the named RJR Defendants participated in the conception and execution of RJR's conspiracy to smuggle cigarettes into the EC. At all relevant times, Philip Morris and its co-conspirators communicated using both interstate and international wires and mail, on many occasions, in order to carry out nearly every aspect of the alleged scheme. The mail and wires were used in connection with, inter alia, the same conspiratorial activities as those listed above in connection with the RJR use of the mail and wires.

The following is a summary of the Plaintiff's specific factual allegations concerning Philip Morris's participation in cigarette smuggling.

**1. Philip Morris's Participation in Smuggling Cigarettes into the EC**

Plaintiff describes Philip Morris's creation of a circuitous distribution chain through which it conducts the majority of its sales in Europe and South America. The ultimate purpose of these convoluted arrangements is to conceal the sale of cigarettes to distributors known to be associated with cigarette smugglers in the EC. These evasive distribution methods also serve to increase market penetration and market share by introducing billions of contraband Philip Morris cigarettes into the EC at prices substantially below those paid for legitimate imports.

Philip Morris has long maintained relationships with various agents and distributors in Central America and the Caribbean who have been investigated, and in some cases indicted, by U.S. authorities for money laundering. Rather than sever these relationships, Philip Morris established a covert arrangement for selling cigarettes to such entities. According to Philip Morris policy, certain customers are required to purchase cigarettes through offices in remote locations, such as Paraguay. Philip Morris prohibits written purchase orders at these offices, presumably to avoid leaving a paper trail. The offices then forward the orders to Maraval, a company based in Basel, Switzerland. A second Basel company, Weitnauer Services, Ltd. ("Weitnauer"), then arranges for delivery of the cigarettes. Plaintiff alleges that the sole purpose of this complex procedure for ordering, payment and delivery of cigarettes was to conceal from authorities Philip Morris's involvement in the sale of cigarettes into smuggling channels reaching, among other places, the EC. Plaintiff further alleges that Philip Morris controlled the sale of all cigarettes sold by the various agents and distributors involved in this chain.

Like RJR, from at least October, 1995 through April, 1997, Philip Morris supplied large volumes of cigarettes to a U.K. smuggling group that included Entire Warehousing. This smuggling group created false documents so as to defraud customs officials and create the appearance that Philip Morris cigarettes would be exported to destinations outside of the EC, such as Morocco, Mozambique and Angola, when in fact the cigarettes were smuggled to EC countries, such as Portugal. Philip Morris sold its cigarettes to intermediary distributors knowing that they would be purchased by this smuggling group and also that they would not reach the markets for which the distributors had indicated to Philip Morris they were intended. The cigarettes smuggled by this group were manufactured in the United States, and orders for these cigarettes were placed with Philip Morris in the United States.

Throughout the 1990s, Philip Morris shipped large volumes of cigarettes to smugglers located in certain free trade zones, such as the Colon Free Trade Zone (the "CFTZ") in Panama. A substantial percentage of the cigarettes shipped to such destinations was ultimately smuggled into the EC. Philip Morris' purpose in shipping cigarettes through free trade zones such as the CFTZ was, as in the case of the distribution route described supra, to take advantage of secrecy laws (such as those of Panama) and thus to prevent scrutiny of cigarette shipments by law-enforcement.

On several occasions in 1999 and 2000, Philip Morris notified prosecutors and customs officials within the government of Panama that it had no authorized dealer in the CFTZ. Philip Morris nevertheless continued the clandestine sale of its products to smugglers in the CFTZ.

For example, Philip Morris World Trade S.A. sold 440 cases of its cigarettes to Weitnauer on January 17, 2000. Philip Morris claims to have no knowledge of the ultimate

destination of these cigarettes. The delivery note, however, reflecting the delivery of the cigarettes sold to Weitnauer, was faxed to Marco Shrem, in the CFTZ. Shrem owns Marksman Latin America S.A. ("Marksman"), a company in the CFTZ. In spite of the fact that confirmation of the sale was sent to Shrem, Weitnauer apparently did not sell the cigarettes to Shrem or to any company of which Shrem is an officer. Rather, Weitnauer purportedly sold the cigarettes to a company called Interduty Free Tulcan ("Tulcan") for delivery to a warehouse in Antwerp, Belgium. Tulcan ostensibly shipped the cigarettes to Interduty Free Panama Inc. ("IFP"), located in Panama. Notice of that shipment included notification to a company known as J.F. Hillebrand, U.S.A., Inc., located in Hollywood, Florida. The bills of lading and other pertinent documents relative to this shipment were delivered to Hillebrand on or about February 17, 2000.

These cigarettes were purportedly destined for Ecuador, and the declarations of commercial movement indicated that the cigarettes should have been shipped through the Panama Canal and delivered directly to Ecuador, without being offloaded. When the cigarettes arrived in Panama, however, they were offloaded and placed in a warehouse. Panamanian customs authorities seized the cigarettes because they lacked proper documentation. At the time of seizure, Panamanian authorities discovered Shrem's employees removing the numbers and markings from the cases of Marlboro cigarettes. Even though all documents indicate that the cigarettes are the property of IFP, Shrem has appeared before the Panamanian customs authorities with documentary proof from Philip Morris that the cigarettes belong to him and to his company, Marksman. The cigarettes were released to Marksman, and sold to individuals who allegedly took them to Colombia. Plaintiff alleges that because Philip Morris sent the pertinent

delivery documents to Shrem, Philip Morris knows the identity of the true ultimate purchaser of these cigarettes. Plaintiff further alleges that Marksman's shipping records show that Marksman's buyers smuggle the bulk of the cigarettes into the EC.

## **2. Philip Morris's Awareness of Cigarette Smuggling**

Plaintiff alleges that Philip Morris has sold, and continues to sell, Marlboro brand cigarettes to known smugglers. For example, Philip Morris has sold, and continues to sell, cigarettes to a purchaser named Corado Baianchi, despite Baianchi's public statements that he has acted as a conduit between Philip Morris and smugglers for the distribution and sale of contraband cigarettes into Western Europe, and that he sold Philip Morris cigarettes to smugglers so that those cigarettes could be sold illegally in Italy. Andrew Reitman, a Philip Morris employee in Europe, has acknowledged that Philip Morris knows that smugglers illegally sell its cigarettes in the EC.

Plaintiff additionally claims that Philip Morris has destroyed documents concerning its participation in cigarette smuggling. In the 1990s Philip Morris destroyed documents relating to its so-called "tax-free customers," thereby concealing its involvement in cigarette smuggling. Between November 29, 1988 and December 3, 1988 Geoffrey Bible of Philip Morris convened a series of meetings in Boca Raton, Florida. A key component of the plan allegedly formulated at this meeting was a policy according to which Philip Morris's international legal staff destroyed many boxes of documents related to entities that Philip Morris has described as "tax-free customers." Pursuant to this policy, on January 8, 1991 alone, Philip Morris destroyed at least 43 cartons of documents related to export sales. Plaintiff alleges that Philip Morris arranged for such document destruction through the use of interstate and international wires, and that the

policies are evidence of Philip Morris's direct involvement with smugglers and attempts to conceal such involvement. Plaintiff complains that the destruction of documents has impeded its ability to plead the full extent of the fraudulent scheme.

**3. Steps Taken By Philip Morris to Facilitate Smuggling**

In October, 1990 Philip Morris invited its major customers, including those involved in smuggling, to a conference in Scottsdale, Arizona. Senior Philip Morris executives coordinated and attended the conference using interstate and foreign wires and mails. At this conference, Philip Morris actively promoted the actions of smugglers by providing them with detailed information concerning Philip Morris's marketing and product initiatives.

Philip Morris further facilitated cigarette smuggling by routinely packaging cigarettes specifically to meet the needs of smugglers. Plaintiff alleges that Philip Morris routinely and improperly attached tax stamps or counterfeit tax stamps to cigarette shipments at the factory, and affixed certain labels and health warnings to ensure the value of the cigarettes at their ultimate destination. Philip Morris also designed cigarette packaging in order to make it difficult for customs officials in various countries to identify smuggled cigarettes.

**4. Philip Morris Conspired with other Tobacco Producers to Obstruct EC Efforts to Combat Cigarette Smuggling**

Like, and in concert with, RJR, Philip Morris engaged in a public relations campaign condemning high taxes as the root cause of smuggling. This campaign continues to be a part of a long-term corporate policy carried out by, among others, Philip Morris's External Affairs Group, which sought to minimize excise taxes on cigarettes and to reduce government oversight of the tobacco products business. It is unnecessary to repeat the details of the conspiracy between

Philip Morris and RJR, which have been summarized supra; it is sufficient to note here that Philip Morris, like RJR, is alleged to have falsely represented, through CECCM, EECTF and other, similar industry groups to various governmental authorities that the tobacco producers were attempting to combat smuggling when, in fact, these companies controlled, directed, encouraged, supported and facilitated smuggling.

Plaintiff does allege certain facts particular to Philip Morris in connection with the conspiracy among tobacco producers. In approximately 1999, Philip Morris entered into written agreements with one or more Member States wherein Philip Morris promised to take a variety of steps to combat smuggling into the EC. Plaintiff alleges that Philip Morris executed these agreements to deceive the EC and its Member States into believing that Philip Morris would help combat smuggling. The EC relied upon Philip Morris's misrepresentations that Philip Morris would help combat smuggling.

Plaintiff also sets forth specific facts regarding Philip Morris's involvement in facilitating and controlling cigarette smuggling by fixing the prices of smuggled cigarettes throughout the world. Plaintiff argues that fixing the price of contraband cigarettes is necessary to prevent undercutting sales of the relatively small amounts of Philip Morris's legally imported cigarettes by unrestrained distribution of low-cost contraband. Philip Morris and another tobacco manufacturer launched a conspiracy to fix prices on smuggled cigarettes on February 14, 1992. On that date, Philip Morris representatives met for the first time with another cigarette manufacturer at John F. Kennedy International Airport in Queens, New York, in order to set forth a strategy to coordinate price-fixing and smuggling of their respective brands. The parties to the initial meeting agreed to conduct further meetings. At a second meeting, on August 5, 1992,

Philip Morris representatives discussed price-fixing schemes for both legally sold and smuggled cigarettes.

Agreements between Philip Morris and other manufacturers to fix cigarette prices continued throughout the 1990s, and continue to exist to control the price of smuggled cigarettes throughout the world. Plaintiff alleges that such price-fixing agreements had the effect of fixing prices for cigarettes ultimately smuggled into the EC, because a substantial percentage of cigarettes sold to distributors and smugglers in Central and South America is ultimately smuggled into the EC.

#### **5. Philip Morris's Involvement in Money Laundering**

Since at least 1991, Philip Morris has sold cigarettes to individuals whom Philip Morris knew to be reputed drug smugglers. At least one such individual stated to U.S. government informants that he was involved in the so-called "pool system" of drug trafficking, whereby he would combine his drug shipments with those of other drug traffickers into a single shipment destined for the United States; he further explained that individual drug traffickers in the United States received the drugs and, having sold them in exchange for U.S. currency, delivered that currency to couriers, approved by drug lords, who would convert the cash into cashier's checks made payable to specific businesses, identified by name in court documents.

In or about the early 1990s, U.S. authorities froze bank accounts in Miami, Florida owned by various distributors of Philip Morris cigarettes because funds credited to those accounts represented laundered drug money. Philip Morris was thus on notice that its distributors had been involved in handling laundered narcotics proceeds.

## V. Subject-Matter Jurisdiction

The Supreme Court has recently admonished the federal courts to refrain from exercising “hypothetical jurisdiction,” and to address jurisdictional questions as a “threshold issue.” Steel Co. v. Citizens for a Better Env’t, 523 U.S. 83, 94-95, 101 (1998). The Court in Steel Co. noted:

[t]he statutory and (especially) constitutional elements of jurisdiction are an essential ingredient of separation and equilibration of powers, restraining the courts from acting at certain times, and even restraining them from acting permanently regarding certain subjects . . . . For a court to pronounce upon the meaning or the constitutionality of a state or federal law when it has not jurisdiction to do so is, by very definition, for a court to act ultra vires.

Id. at 101-02. Because Defendants argue that the revenue rule deprives this court of subject matter jurisdiction to hear Plaintiff’s claims, (see, e.g., Defs.’ Mem. in Support of Mot. to Dismiss Departments’ Compl. Under 12(b)(1) and (b)(7) at 26),<sup>12</sup> I address this argument first. Having concluded that the revenue rule is not implicated in this case, I then address the Defendants’ arguments concerning Plaintiff’s lack of standing under the federal civil RICO statute, 18 U.S.C. § 1964(c).

### A. The Revenue Rule

Defendants argue that this court is bound to dismiss the EC Complaint under the common-law doctrine known as the revenue rule. Defendants claim that this doctrine is an “international rule” that is “absolute,” “categorical,” and “jurisdictional.” (Philip Morris’s Mem. in Support of Mot. to Dismiss EC Compl. Under 12(b)(1) and (b)(7) at 33-34; May 1, 2001 Tr. at

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<sup>12</sup> The arguments made in support of dismissing the EC and Amazonas Complaints on the basis of the revenue rule are substantially similar, and the memorandum in support of dismissing the EC Complaint under Fed. R. Civ. P. 12(b)(1) and (b)(7) incorporates by reference “relevant portions” of the memorandum in support of dismissing the Amazonas Complaint. (Defs.’ Mem in Support of Mot. to Dismiss EC Compl. Under 12(b)(1) and (b)(7) at 26 n.13.)

151.) Plaintiff responds that the revenue rule has been repudiated. (Plfs.' Mem. in Opp. to Mot. to Dismiss Departments' Compl. Under 12(b)(1) and (b)(7) at 44.) In the alternative, Plaintiff contends that the rule is discretionary, and that its application is limited to actions brought by foreign sovereigns seeking to enforce tax judgments entered in foreign tribunals. (*Id.* at 52.) For the reasons set forth below, I conclude that whatever the collective impact of the many attacks leveled against the doctrine, its applicability in this case is doubtful; and that in light of recent Second Circuit decisions discussing the inapplicability of the revenue rule in the context of criminal prosecutions under the federal mail and wire fraud statutes, such doubt must be resolved against invoking the rule as a basis for declining jurisdiction over Plaintiff's civil RICO claims in the EC Case.

**1. What is the Revenue Rule? – Comparison to Related Doctrines**

Under the common law revenue rule, courts in this country “customarily refuse” to enforce the revenue laws of foreign sovereigns. *Banco National de Cuba v. Sabbatino*, 376 U.S. 398, 448 (1964) (White, J., dissenting). In often-cited *dicta*, Judge Learned Hand explained the policy considerations supposedly underlying the rule, which include separation of powers concerns and judicial hesitancy in the face of adjudicating claims presenting issues of foreign public law:

While the origin of the [rule that a foreign state will not enforce the penal laws of another state] does not appear in the books, a sound basis for it exists, in my judgment, which includes liabilities for taxes as well . . . . To pass upon the provisions for the public order of another state is, or at any rate should be, beyond the powers of a court; it involves the relations between the states themselves, with which courts are incompetent to deal, and which are intrusted to other authorities. It may commit the domestic state to a position that would seriously embarrass its neighbor. Revenue laws fall within the same reasoning; they affect a state in matters as vital to its existence as its criminal laws.

Moore v. Mitchell, 30 F.2d 600, 604 (2d Cir. 1929) (Hand, J., concurring), aff'd, 281 U.S. 18 (1930); see also U.S. v. Trapilo, 130 F.3d 547, 550 (2d Cir. 1997) (“[T]he rationale for [the revenue rule] is that issues of foreign relations are assigned to, and better handled by, the legislative and executive branches of the government.”), cert. denied, 525 U.S. 812 (1998); City of Phila. v. Cohen, 11 N.Y.2d 401, 406 (1962) (noting comity concerns and concluding that to act as “collectors of taxes for another State . . . would be an intrusion into the public affairs of another State”); Her Majesty the Queen v. Gilbertson, 433 F. Supp. 410, 412 (D. Or. 1977) (“Selectively refusing to enforce a specific tax suit for reasons of public policy might well be taken as an affront to the taxing foreign government . . . [which] could put the United States in an embarrassing position and upset the sometimes delicate relationship between the United States and other nations.”), aff'd, 597 F.2d 1161 (9th Cir. 1979).

Separation of powers and the traditional reluctance of U.S. courts to adjudicate claims presenting questions of foreign law whose resolution would implicate foreign policy concerns justify other common law doctrines as well, including the act of state, international comity and political question doctrines. My conclusion concerning the proper scope and application of the revenue rule is informed by the role played by the separation of powers doctrine in courts’ and commentators’ analysis of these related jurisprudential doctrines.

**(a) Act of State**

The Supreme Court provided the classic formulation of the act of state doctrine more than 100 years ago:

Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances

by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.

Underhill v. Hernandez, 168 U.S. 250, 252 (1897); cf. The Schooner Exchange v. McFadden, 11 U.S. (7 Cranch) 116, 136 (1812) (Marshall, J.) (“The jurisdiction of the nation within its territory is necessarily exclusive and absolute . . . . Any restriction upon it, deriving validity from an external source, would imply a diminution of its sovereignty . . . .”). “The act of state doctrine in its traditional formulation precludes the courts of this country from inquiring into the validity of the public acts of a recognized foreign sovereign power committed within its own territory.” Sabbatino, 376 U.S. at 401. The Second Circuit has noted that the act of state doctrine “is not jurisdictional.” Bigio v. Coca-Cola Co., 239 F.3d 440, 451 (2d Cir. 2001) (quoting Allied Bank Int’l v. Banco Credito Agricola de Cartago, 757 F.2d 516, 520 (2d Cir. 1985)). Rather, the doctrine states a “principle of decision binding on federal and state courts alike.” W.S. Kirkpatrick & Co., Inc. v. Env’tl Tectonics Corp., Int’l, 493 U.S. 400, 406 (1990) (quoting Sabbatino, 376 U.S. at 427). Under the act of state doctrine, “the act within its own boundaries of one sovereign State . . . becomes . . . a rule of decision for the courts of this country.” Id. (quoting Ricaud v. Am. Metal Co., 246 U.S. 304, 310 (1918)). Finally, “[a]ct of state issues only arise when a court must decide – that is, when the outcome of the case turns upon – the effect of official action by a foreign sovereign. When that question is not in the case, neither is the act of state doctrine.” Id. (emphasis in original). In order to avoid overstepping the limitations imposed upon the judiciary in matters of foreign relations, application of the act of state doctrine entails, of necessity, an assessment of whether or not “the relief sought or the defense interposed would . . . require[] a court in the United States to declare invalid the official act of a foreign

sovereign performed within its own territory.”<sup>13</sup> Id. at 405.

As with the revenue rule, the policy rationale underlying the act of state doctrine emerges from the traditional concern of U.S. courts to ensure an adequate separation of powers between itself and its coordinate political branches in matters touching upon foreign affairs. Id. at 404 (noting that act of state doctrine is “a consequence of domestic separation of powers”). The doctrine “embodies the purely prudential concern that judicial inquiry into the validity of a foreign nation’s sovereign acts may interfere with Executive and Congressional policy efforts.” Roe v. Unocal Corp., 70 F. Supp. 2d 1073, 1076 (C.D. Cal. 1999); see also First Nat’l City Bank v. Banco Nacional de Cuba, 406 U.S. 759, 765 (1972) (holding the act of state doctrine justified “primarily on the basis that juridical review of acts of state of a foreign power could embarrass the conduct of foreign relations by the political branches of the government”); Braka v. Bancomer, S.N.C., 762 F.2d 222, 224 (2d Cir. 1985) (“[T]he policy concerns underlying the doctrine require that the political branches be preeminent in the realm of foreign relations.”).

**(b) International Comity**

Justice Gray gave the doctrine of comity its classic formulation in Hilton v. Guyot, 159 U.S. 113 (1895):

‘Comity,’ in the legal sense, is neither a matter of absolute obligation . . . nor of

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<sup>13</sup> The act of state doctrine does not, however, completely deprive the courts of jurisdiction to examine the validity of a foreign state’s acts. The Supreme Court has noted that “sometimes, even though the validity of the act of a foreign sovereign within its own territory is called into question, the policies underlying the act of state doctrine may not justify its application.” W.S. Kirkpatrick & Co., 493 U.S. at 409. Absent such extraordinary circumstances, however, courts in the United States have the power, and ordinarily the obligation, to decide cases and controversies properly presented to them,” id., even when the outcome of the case turns upon the effect of a foreign sovereign’s acts taken within its own territory.

mere courtesy and good will . . . But it is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard to both international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws.<sup>14</sup>

Hilton, 159 U.S. at 163-64. “Comity protects decisions of a foreign sovereign that cannot be completed within the sovereign's realm. In such cases, a foreign sovereign will request the assistance of United States courts, which is forthcoming absent some infringement upon United States public policy.” Hon. Marianne D. Short & Charles H. Brower, The Taming of the Shrew: May the Act of State Doctrine and Foreign Sovereign Immunity Eat and Drink as Friends?, 20 Hamline L. Rev. 723, 725 (1997) (citing cases).

As is also true regarding the revenue rule and the act of state doctrine, separation of powers concerns inform application of the doctrine of international comity: “comity in the international context (in conjunction with separation of powers principles) requires deference to international and executive branch processes and efforts to establish coherent policies on matters of substantial public concern.” 767 Third Ave. Assocs. v. Consulate Gen., 60 F. Supp. 2d 267, 280 (S.D.N.Y. 1999), aff'd in part and vacated in part, 218 F.3d 152 (2d Cir. 2000). Thus, U.S. courts “ordinarily refuse to review acts of foreign governments and defer to proceedings taking place in foreign countries, allowing those acts and proceedings to have extraterritorial effect in the United States.” Pravin Banker Assocs., Ltd. v. Banco Popular Del Peru, 109 F.3d 850, 854 (2d Cir. 1997). Comity “is best understood as a guide where the issues to be resolved are entangled in international relations.” In re Maxwell Communication Corp., 93 F.3d 1036, 1047

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<sup>14</sup> According to the Court's formulation of the principle in Hilton, comity describes the broader principle to which the revenue rule arguably provides an exception. In other words, absent the revenue rule, the effect to be given by a U.S. court to a foreign tax judgment or another sovereign's tax legislation would be decided according to principles of comity.

(2d Cir. 1996).

International comity does not describe a limitation upon the subject matter jurisdiction of the federal courts. The Second Circuit has explained that “[w]hen a court dismisses a complaint in favor of a foreign forum pursuant to the doctrine of international comity, it declines to exercise jurisdiction it admittedly has.” Bigio, 239 F.3d at 454 (citing cases).

**(c) Political Question**

The Supreme Court set forth the well-known analysis for determining whether or not an issue is non-justiciable under the political question doctrine in Baker v. Carr, 369 U.S. 186 (1962):

Prominent on the surface of any case held to involve a political question is found [1] a textually demonstrable constitutional commitment of the issue to a coordinate political department; or [2] a lack of judicially discoverable and manageable standards for resolving it; or [3] the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion; or [4] the impossibility of a court’s undertaking independent resolution without expressing lack of the respect due coordinate branches of government; or [5] an unusual need for unquestioning adherence to a political decision already made; or [6] the potentiality of embarrassment from multifarious pronouncements by various departments on one question.

Baker, 369 U.S. at 217. Although the relative weight and usefulness of these criteria have been the subject of debate,<sup>15</sup> it is clear that most, if not all, reflect a concern to minimize the intrusion of the judiciary into those areas, including foreign affairs, traditionally held to be the exclusive concern of the political branches of government.

As with the doctrine of comity, the political question doctrine counsels caution in the face of adjudications whose international relations implications are pronounced. See Baker, 369 U.S.

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<sup>15</sup> See, e.g., Erwin Chemerinsky, Federal Jurisdiction § 2.6.1 (3d ed. 1999) (“[T]hese criteria seem useless in identifying what constitutes a political question.”).

at 211-12 (“Our cases in [the field of foreign relations] seem invariably to show a discriminating analysis of the particular question posed, in terms of the history of its management by the political branches, of its susceptibility to handling in the light of its nature and posture in the specific case, and of the possible consequences of judicial action.”). And like the act of state doctrine, the political question doctrine “is a function of the constitutional framework of the separation of powers.” 767 Third Ave. Assocs. v. Consulate Gen. of Socialist Fed. Republic of Yugoslavia, 218 F.3d 152, 164 (2d Cir. 2000); see also Kadic v. Karadzic, 70 F.3d 232, 248 (2d Cir. 1996) (noting that the political question and act of state doctrines “reflect the judiciary’s concerns regarding separation of powers”). Applying the Baker factors, the Second Circuit in 767 Third Avenue Associates concluded that the exercise of jurisdiction in that case was inappropriate on the grounds that “[a] determination by this court of the allocation of debt among the successor[ states to the former Socialist Federal Republic of Yugoslavia] might hinder or prejudice the future resolution of this issue through negotiations or another determination by the Executive [branch of the U.S. Government],” and because “[s]uch an outcome would directly ‘interfere with executive foreign policy prerogatives.’” 767 Third Ave. Assocs., 218 F.3d at 160 (quoting Canada v. United States, 14 F.3d 160, 163 (2d Cir. 1994)). In conclusion, the court noted the constitutional underpinnings of the political question doctrine: “Just as ‘Congress may not confer jurisdiction on Art. III federal courts to render advisory opinions, or to entertain friendly suits,’ it may not require courts ‘to resolve political questions,’ because suits of this character are inconsistent with the judicial function under Art. III.” Id. at 164 (quoting Sierra Club v. Morton, 405 U.S. 727, 732 n.3 (1972)).

This brief excursus illustrates the uncontroversial conclusion that the policies underlying

the revenue rule also inform the act of state, international comity and political question doctrines. These doctrines, together with the revenue rule, provide the federal courts with tools for assessing, under varying circumstances, whether or not the exercise of jurisdiction is proper in a case presenting a question of foreign law. Under none of these doctrines is the exercise of jurisdiction improper in the absence of an issue whose adjudication would likely result in improper judicial encroachment upon the foreign relations power committed to the coordinate political branches.

As discussed infra, the rule of decision in this case is provided by U.S. federal and state law. Although questions of foreign law are likely to arise during the course of this litigation (should it proceed beyond the motion to dismiss stage), these questions are ancillary to the domestic causes of action giving rise to liability. Nor is it at all likely that the resolution of foreign law issues in this case would offend the interests of the coordinate, political branches of government. The act of state doctrine does not apply, because liability does not turn on this court's interpretation of the effect of a foreign sovereign's official act; international comity is not at issue because there is no need for this court to defer to the legislative or judicial acts of a foreign sovereign; and the political question doctrine is not implicated because the principal questions presented for decision in these cases, namely whether or not Plaintiff can demonstrate liability under federal and state law causes of action, are quintessentially the province of the judiciary to decide.

Although liability does not turn upon the resolution of any question of foreign law, and notwithstanding the fact that no separation of powers concerns are meaningfully implicated, Defendants nonetheless maintain that the revenue rule, which is justified primarily on separation

of powers grounds, presents an insuperable bar to the exercise of subject matter jurisdiction in these cases. This argument lacks merit. To side with Defendants on this issue would be contrary to Second Circuit precedent and would endow the revenue rule with much greater force than any other common law doctrine based on similar policies. Such policies do not constitute “a doctrine unto themselves.” W.S. Kirkpatrick & Co., 493 U.S. at 409. In the absence of circumstances justifying its application, invocation of the revenue rule as a bar to jurisdiction in this case would amount to nothing more than an unwarranted “expan[sion of] judicial incapacities.” Id.

## 2. The Revenue Rule Is Discretionary

The revenue rule is discretionary rather than jurisdictional. “Jurisdiction is the power to declare the law.” Ex parte McCardle, 74 U.S. (7 Wall.) 506, 514 (1868). The common law doctrine affording this court discretion to decline enforcement of foreign tax judgments is a function of, rather than an exception to, its constitutional authority to adjudicate cases and controversies arising under the Constitution and laws of the United States. The policy concerns that give rise to and justify the revenue rule do not warrant elevating the doctrine to a categorical limitation upon the powers conferred upon the federal courts by the Constitution. Neither does any authoritative articulation of the rule suggest such a limitation: “a court need not give effect to the penal or revenue laws of foreign countries.” Sabbatino, 376 U.S. at 413-14 (emphasis added); accord Trapilo, 130 F.3d at 550 (“our courts will normally not enforce foreign tax judgments”) (emphasis added); United States v. Boots, 80 F.3d 580, 587 (1996) (“our courts have traditionally been reluctant to enforce foreign revenue laws”) (emphasis added); Restatement (Third) of Foreign Relations Law § 483 (1987) (“Courts in the United States are not required to recognize or to enforce judgments for the collection of taxes, fines, or penalties

rendered by the courts of other states.”) (emphasis added).

The clearest indication that the rule is not jurisdictional is the Supreme Court’s statement to this effect in Milwaukee County v. M.E. White Co., 296 U.S. 268 (1935). There the Court observed, on its way to concluding that the Full Faith and Credit clause requires federal district courts in one state to recognize tax judgments rendered by the courts of another state, that the revenue rule imposes no limitation upon the jurisdiction of the federal courts:

The objection that the courts in one state will not entertain a suit to recover taxes due to another or upon a judgment for such taxes is not rightly addressed to any want of judicial power in courts which are authorized to entertain civil suits at law. It goes not to jurisdiction, but to the merits, and raises a question which District Courts are competent to decide.

Milwaukee County, 296 U.S. at 272 (citations omitted). It is thus clear to me that the revenue rule does not deprive this court of the power, as a constitutional matter, to adjudicate cases and controversies properly before it simply because to do so may implicate a foreign tax law.

Instead, the revenue rule is in the nature of a doctrine of abstention. Like the related doctrines discussed supra, it describes juridical principles which indicate when it may be appropriate for a court to decline to exercise its jurisdiction. See Bigio, 239 F.3d at 451 (“Even when a district court has jurisdiction over a case, it may choose not to exercise that jurisdiction if principles of abstention are applicable.”). Thus, in order for the revenue rule to serve in any sense as a bar to a lawsuit, it can only be where, in accordance with the doctrine, a court has recognized “an exception to a [court’s] normal duty to adjudicate a controversy properly before it.” Hachamovitch v. DeBuono, 159 F.3d 687, 693 (2d Cir. 1998) (citation omitted). As when courts undertake analyses pursuant to the other, related jurisprudential doctrines, discretion under the revenue rule “must be exercised within the narrow and specific limits prescribed by the

particular abstention doctrine involved.” Id. (citation omitted). A decision in this or any other case to abstain pursuant to the revenue rule would therefore constitute an exception to the “virtually unflagging obligation of the federal courts to exercise the jurisdiction given them.” Colo. River Water Conserv. Dist. v. United States, 424 U.S. 800, 817 (1976).

### 3. Historical Origins of the Revenue Rule

The revenue rule provides no basis for abstention in this case. As discussed infra, abstention under the revenue rule is never warranted in the absence of genuine separation of powers concerns. A review of the early revenue rule cases, and of the cases in which something approaching a contemporary rationale for the rule is set forth, demonstrates that separation of powers is the only remaining legitimate basis for invoking the doctrine. None of the ancient rationales retain sufficient force, in the absence of a real threat of judicial encroachment upon the authority of the political branches, to justify an exception to the otherwise “unflagging obligation” of the federal courts to exercise jurisdiction to adjudicate properly presented cases. This is especially true, as discussed infra, with respect to cases arising under U.S. law.

The common law ancestry of the revenue rule extends back more than two centuries. The fact that the rule has been invoked continuously since well before the American Revolution does not, however, guarantee its continued applicability. There is little reason to expect that courts today would see fit to invoke the rule, as did British courts in the eighteenth century, without greater justification than was stated in the early cases. See Oliver Wendell Holmes, The Path of the Law, 10 Harv. L. Rev. 457, 469 (1897) (“It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds

upon which it was laid down have vanished long since, and the rule simply persists from blind imitations of the past." Courts' understanding of the policy bases for the rule has been greatly refined since its inception; the Second Circuit, in particular, has all but eliminated at least one major rationale for reliance upon the rule.

The origin of the revenue rule is nearly always traced to Lord Mansfield's often-repeated and conclusory dictum in Holman v. Johnson, 1 Cowp. 341, 98 Eng. Rep. 1120 (K.B. 1775), that "no country ever takes notice of the revenue laws of another." The first case applying the rule that "one state will not enforce the revenue measures of another" is attributed not to Lord Mansfield, however, but to Lord Hardwicke in Boucher v. Lawson, 1734, Cases Temp. Hardwicke 85, 95 Eng. Reprint 53. Boucher was a case brought against the master of a vessel transporting gold from Portugal to England, who refused to deliver the cargo to the plaintiff upon the ship's arrival in London. The defendant argued that no remedy was available because the underlying contract was illegal under the law of Portugal. Lord Hardwicke rejected the defense on the ground that to recognize it would "cut off all benefit of such trade from this kingdom, which would be of very bad consequence to the principal and most beneficial branches of our trade."

The famous Holman case, decided over forty years later, was brought by a French seller against his English purchaser who withheld payment on a shipment of tea. The English purchaser argued that the contract was illegal because it had been made for the purpose of smuggling the goods into England without paying English duties. Noting that even though "[t]here are a great many cases which every country says shall be determined by the laws of

foreign countries where they arise,” Lord Mansfield declined to apply the choice of law principle that “with regard to contracts legally made abroad, the laws of the country where the cause of action arose shall govern,” on the grounds that “no country ever takes notice of the revenue laws of another.” Holman, 98 Eng. Rep. at 1121. Lord Mansfield essentially amended the traditional conflicts of law rule to include an exception pertaining only to contract cases in which the agreement at issue was (1) made abroad, and (2) reached with the purpose of violating British revenue laws.

Lord Mansfield also decided Planche v. Fletcher (1779) 1 Doug. K.B. 251. In Planche, an insurer of cargo had declined coverage on the ground that the policy, which specified travel from London to Ostend, Belgium, and from there to Nantz, France, was unenforceable because the ship had actually traveled directly to Nantz. The insurer claimed that the cargo’s origin had been fraudulently indicated as Ostend in order to avoid higher French duties on English goods. Lord Mansfield concluded that no fraud had been committed, because “[w]hat had been practiced in this case was proved to be the constant course of trade, and notoriously so to every body.” Ruling against the insurer, he added, “[b]ut, at any rate, this was no fraud in this country. One nation does not take notice of the revenue laws of another.” The justification for referring to the revenue rule seems even weaker in Planche than in Holman, not least of all because the enforceability of the insurance contract did not turn on a question of foreign law. On balance, the decision says more about the willingness of the court to countenance what appears to have been an accepted practice in the shipping industry than it does concerning the policy basis for the revenue rule.

These early British cases, long considered the fons et origo of the revenue rule, provide

little explicit justification for the rule's emergence. Courts have noted, moreover, the tenuous connection between the context in which the rule was first articulated and the uses to which it has since been put in modern cases:

[i]n none of the[se early cases] was an attempt made to collect a tax due to a foreign state, but in each case the question presented was whether a contract made to evade a foreign revenue law or which did not comply with the revenue laws of the locus contractus was enforceable in England; and, in each case, the ruling was based upon a desire to promote commercial convenience.

State ex rel. Okla. Tax Comm'n, 193 S.W.2d 919, 922 (Mo. Ct. App. 1946) (emphasis added) (upholding a suit by Oklahoma for income tax incurred by former Oklahoma residents and concluding that there is "no valid justification for not permitting a suit in this state for a tax lawfully levied by another"); see also Buckley v. Huston, 60 N.J. 472, 474, 291 A.2d 129, 130 (N.J. 1972) (holding that the taxing authority of the City of Philadelphia had a common law right to proceed in the courts of New Jersey to recover wage taxes due to Philadelphia and noting that "[t]he English cases which gave rise to the early American common law notion that one state would not enforce the revenue laws of another, arose in international commercial contexts which have no relation whatever to the context at hand"). In none of the early British cases, moreover, did the revenue rule provide the basis of decision. See, e.g., Kovatch, Recognizing Foreign Tax Judgments, 22 Hous. J. Int'l L. 265, 273-78 (2000).

#### **4. The Rationales Underlying the Revenue Rule Have Been Called Into Doubt**

The early cases provide insufficient justification to support the revenue rule, and no court today could rely upon these decisions, without more, as sufficient justification for withholding jurisdiction. Modern courts have sought to place the rule on a more secure footing. Even modern justifications, however, have been strongly resisted. See, e.g., Trapilo, 130 F.3d at 550

n.4 (2d Cir. 1997); see also generally Barbara A. Silver, Modernizing the Revenue Rule: The Enforcement of Foreign Tax Judgments, 22 Ga. J. Int'l & Comp. L. 609 (1992); Kovatch, supra.

Such criticism is hardly new. Justice Story first expressed doubts concerning the soundness of the revenue rule in The Anne, 1 F. Cas. 955, 1 Mason 508, No. 412 (C.C.D. Mass. 1818), a maritime case brought in federal district court to recover for pilotage services.

Observing that the facts of the case strongly suggested that the ship's passengers and crew, originally destined for Quebec, then a British colony, had staged a mutiny and hired a local pilot in order to evade British laws restricting the number of passengers on board a ship destined for the United States, Justice Story criticized, in passing, the policy basis for the refusal of courts to enforce foreign municipal regulations:

I confess that I have always been a good deal staggered by this doctrine. It has appeared to me more consonant with national comity, sound morals, and public justice, that courts of all countries should lend their aid to discountenance frauds upon the revenue laws of other countries, and decline to enforce any agreements entered into for the purpose of evading those laws. An exception might very properly apply, where those laws were in direct hostility to our own policy or laws, or were inconsistent with the principles of general justice. But the rule is now too stubborn to be controlled . . . .

Id. at 956.

Justice Story's criticism anticipated by more than a century broader attacks leveled by numerous jurists upon the legitimacy of the revenue rule. Modern attacks proceed against every rationale traditionally thought to support the doctrine. For example, the revenue rule has been justified on the grounds that revenue laws, like penal laws, are "provisions for the public order," and that to pass on such provisions "should be, beyond the powers of a court; it involves the relations between the states themselves, with which courts are incompetent to deal, and which are

intrusted to other authorities.” Moore, 30 F.2d at 604 (2d Cir. 1929) (Hand, J., concurring). Several years later, however, the Supreme Court took a different view, stating that “the obligation to pay taxes is not penal. It is a statutory liability, quasi contractual in nature, enforceable, if there is no exclusive statutory remedy, in the civil courts . . .” Milwaukee County, 296 U.S. at 271; see also City of Phila. v. Cohen, 222 N.Y.S.2d 226, 228 (N.Y. App. Div. 1961) (“[T]ax laws and penal laws are not the same and considerations valid against enforcing the one are pointless as against the other.”), aff’d, 230 N.Y.S.2d 226 (1961). Guided by the Supreme Court’s unequivocal dissociation of penal and revenue laws in Milwaukee County, this court must regard foreign revenue laws in the same light as foreign civil judgments and non-penal enactments, which U.S. courts routinely enforce regardless of whether the propounding court is domestic or foreign.

Apart from the discredited analogy of revenue enactments to penal laws, courts have found support for the revenue rule in the traditional deference that federal courts accord to the political branches in matters of foreign policy. See, e.g., Trapilo, 130 F.3d at 550. As discussed, supra, however, the federal courts are hardly under an obligation to decline jurisdiction in the face of every decision implicating foreign affairs concerns, and “it is ‘error to suppose that every case or controversy which touches foreign relations lies beyond judicial cognizance.’” Baker v. Carr, 369 U.S. at 211. Proponents of the revenue rule have come under criticism for advocating a heavy-handed approach where a more sensitive analysis is warranted. For example, whereas defenders of the revenue rule contend that enforcement of foreign tax judgments will cause embarrassment to foreign sovereigns, opponents argue that the judiciary is unlikely to cause offense to a foreign sovereign that has availed itself of this country’s courts. The Missouri Court

of Appeals criticized the rule on this ground in Oklahoma Tax Commision, in which the court commented as follows on Judge Hand's dictum in Moore:

We fail to see that this is a valid objection to accepting jurisdiction in such cases. The foreign state would not be likely to object or to be offended over such procedure because it is the one seeking relief and is asking the court to scrutinize those relations.

Okla. Tax Comm'n, 193 S.W.2d at 924; see also Note, 77 Harv. L. Rev. 1327, 1328 (1964)

("[The argument against enforcing foreign revenue laws based on the fear of embarrassing foreign sovereigns] is not seriously offered when the foreign government sues in its own name to enforce a contract to which it is a party despite the possibility that the forum government will not recognize the claim for reasons of public policy.").

Courts in this and other countries are accustomed to entertaining public policy challenges to the enforcement of foreign judgments, despite the potential for embarrassment to the foreign nation. See Kovatch, supra, at 279 (noting the codification of the public policy exception to the enforcement of foreign judgments in international conventions); see also Ackerman v. Levine, 788 F.2d 830, 841 (2d Cir. 1986) ("A judgment is unenforceable as against public policy to the extent that it is repugnant to fundamental notions of what is decent and just in the state where enforcement is sought.") (internal quotation marks and citation omitted); Matusevitch v. Telnikoff, 877 F. Supp. 1 (D.D.C. 1995) (declining to recognize a British libel judgment as repugnant to the public policies of Maryland and the United States). There seems scant basis for assuming that tax enactments implicate sovereign dignity more thoroughly than other categories of legal enactment.

Courts and commentators have criticized the revenue rule on the ground that the