

Federal Government Aggressively Enforces State Tobacco Laws

States are leaving no stone unturned in their desperate attempt to plug budget holes. >BY TROUTMAN SANDERS TOBACCO TEAM

In recent months, the federal government has initiated significant enforcement actions targeting cigarette distribution and manufacturing companies in what has traditionally been the province of state governments. A number of these enforcement actions have been conducted by a federal task force comprised of federal, state, and local law enforcement agencies, including the Federal Bureau of Investigation (FBI), the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF), and various state agencies and local authorities. Federal prosecutors have also become involved in efforts to seize money from cigarette distributors based upon alleged violations of tobacco laws, thereby turning ostensibly state civil matters into federal criminal violations.

MANUFACTURER AND DISTRIBUTOR RAIDS

In April, May, and June of 2009, federal authorities raided four cigarette distribution and manufacturing companies as part of a two-year investigation into an alleged tobacco black market. During these raids, the authorities also discovered a warehouse containing millions of dollars worth of cigarettes. According to an FBI statement released on June 5, 2009, the black market network is believed to have ties to South Carolina, Kentucky, Mississippi, and other states.

ATF officials report that the federal task force involved in the raids was formed specifically to prevent criminal networks from profiting and flourishing from tax evasion through the interstate transportation and sales of contraband cigarettes. ATF officials added that the best way to address the illegal transport and sale of contraband cigarettes is by attacking the entire black market network.

According to federal authorities, this

investigation is ongoing and all resources of the federal, state, and local agencies involved are being utilized. Although no arrests have been made, a number of individual subjects have been interviewed by the federal task force.

TARGET: \$1.3 SEIZURE FROM CIGARETTE DISTRIBUTORS

In May 2009, federal prosecutors filed a Verified Complaint for Forfeiture in the U.S. District Court for the Eastern District of Tennessee. In the Complaint, the U.S. government seeks to seize \$1,377,365 from two cigarette distribution companies in Tennessee and South Carolina. The seizure is based on unpaid cigarette excise taxes from a purported scheme to underreport cigarette sales in Tennessee, resulting in underpayments not by distributors but rather by the manufacturer, into the Master Settlement Agreement (MSA) escrow account. The criminal violations cited in the complaint are of the mail and wire fraud statutes and the Contraband Cigarette Trafficking Act.

The Tennessee complaint alleges that, through the use of the U.S. mail and various wire transmissions, the distributors underreported the amount of cigarettes sold in Tennessee, thereby indirectly depriving the state of deposits into the MSA escrow fund. The MSA requires, among other things, that tobacco manufacturers (not parties to the MSA) make annual payments to escrow accounts based on annual cigarette sales in each state. The escrow accounts were established to pay future health care costs for the citizens of the States if a nonparticipating manufacturer ("NPM") were found liable for such costs due to the use of its product, but the accounts belong to the NPM unless certain conditions are met after 25 years.

In the complaint, the government

claims that the distributors' scheme to underreport their cigarette sales in Tennessee resulted in an NPM failing to meet its obligation to make payments into the MSA escrow fund. The government's attempt to seize money from tobacco distributors based on an NPM's separate payment obligation to the MSA escrow fund is unprecedented.

BROAD EXPANSION OF FEDERAL AUTHORITY OVER TOBACCO

These recent developments represent a significant increase in the federal government's effort to investigate interstate cigarette trafficking and to obtain funds from cigarette distributors and manufacturers. The federal task force is focused on long-term investigations, covering large geographical areas, and crossing a multitude of jurisdictional boundaries. The recent raids are an indication of what is most certainly a large-scale initiative by the task force. As a result, even manufacturers or distributors who are not the target or subject of an investigation by the federal task force may receive subpoenas for documents or testimony related to an investigation. A company that is contacted by a representative of any federal or state law enforcement agency should contact legal counsel immediately for advice on how to respond.

Moreover, the government's unprecedented attempt to seize money from cigarette distributors based on an NPM's separate payment obligation to a state MSA escrow fund, all under the guise of alleged violations of the federal mail and wire fraud statutes, raises important and novel legal issues. As such, distributors and manufacturers alike must be ever more diligent in implementing their internal compliance measures, in structuring relationships between distributors and manufacturers, and in reporting their financial statements to state revenue agencies. Once again, it is critical that a company confronted with such issues contact legal counsel immediately for guidance on how to comply with federal and state law. ■

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