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COURT OF APPEALS

STATE OF NEW YORK

PEOPLE OF THE STATE OF NEW YORK,

Respondent,

-against-

No. 127

SPRINT NEXTEL CORP.,

Appellant.

20 Eagle Street
Albany, New York 12207
September 09, 2015

Before:

CHIEF JUDGE JONATHAN LIPPMAN
ASSOCIATE JUDGE EUGENE F. PIGOTT, JR.
ASSOCIATE JUDGE SHEILA ABDUS-SALAAM
ASSOCIATE JUDGE LESLIE E. STEIN
ASSOCIATE JUDGE EUGENE M. FAHEY

Appearances:

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Sara Winkeljohn
Official Court Transcriber

1 CHIEF JUDGE LIPPMAN: We're going to start
2 with number 127, People v. Sprint.

3 Counsel.

4 MR. SHANMUGAM: Thank you, Chief Judge
5 Lippman. Kannon Shanmugam of Williams & Connolly for
6 the Sprint appellants, and I'd like to reserve three
7 minutes for rebuttal.

8 CHIEF JUDGE LIPPMAN: Okay, counsel. Go
9 ahead.

10 MR. SHANMUGAM: May it please the court.
11 The Appellate Division's order in this case - - -

12 CHIEF JUDGE LIPPMAN: Counsel, let - - -
13 let me ask you, what's the heart - - - heart of your
14 argument? Is it that your interpretation of the
15 statute is a rational one? Is that essentially what
16 it comes down to?

17 MR. SHANMUGAM: Well, yes, in two respects,
18 Chief Judge Lippman.

19 CHIEF JUDGE LIPPMAN: Go ahead. Sure.

20 MR. SHANMUGAM: The first, for purposes of
21 the substantive tax question in this case, which, of
22 course, underlies all of the claims in this case - -
23 -

24 CHIEF JUDGE LIPPMAN: Right.

25 MR. SHANMUGAM: - - - the question is

1 whether the tax law unambiguously required Sprint to
2 collect sales tax on the interstate voice portion of
3 its flat rate monthly wireless bills.

4 CHIEF JUDGE LIPPMAN: Right.

5 MR. SHANMUGAM: And we believe that the
6 ordinary canon that ambiguities in tax statutes
7 redound to the taxpayers' benefit - - -

8 CHIEF JUDGE LIPPMAN: Well, in general, you
9 believe that your interpretation, the way you view
10 it, is a reasonable view of that statute?

11 MR. SHANMUGAM: Yes. And of course we
12 believe that our interpretation is the better one.

13 JUDGE ABDUS-SALAAM: Well, is that a
14 defense, though, as opposed to port - - - whether
15 that's an element of the cause of action itself?

16 MR. SHANMUGAM: No, Judge Abdus-Salaam. It
17 is part and parcel of the interpretative question
18 before this court, which is the question of whether
19 the tax law imposes liability in the first place.
20 Now, of course, we also have our defense under the
21 federal Mobile Telecommunications Sourcing Act, and
22 that is the - - -

23 CHIEF JUDGE LIPPMAN: How does that act
24 coordinate with the - - - with the state act?

25 MR. SHANMUGAM: Sure. So if this court

1 were to conclude that the Attorney General's
2 interpretation here were unambiguously the correct
3 one, in our view that interpretation would be
4 preempted by the federal Mobile Telecommunications
5 Sourcing Act, and that is simply because the
6 taxability of the service at issue here, namely
7 interstate mobile voice service, would turn on
8 whether - - -

9 CHIEF JUDGE LIPPMAN: Counsel, were you - -
10 -

11 MR. SHANMUGAM: - - - that service is
12 bundled.

13 CHIEF JUDGE LIPPMAN: - - - were you told
14 by the State people as to what their interpretation
15 was?

16 MR. SHANMUGAM: So it is true - - -

17 CHIEF JUDGE LIPPMAN: Were you on notice
18 when - - - when you took whatever pricing steps you
19 took?

20 MR. SHANMUGAM: So it is true that at the
21 time Sprint made its decision, the Department of
22 Taxation and Finance had taken the contrary position;
23 it had done so both in a letter to the governor prior
24 to signing and in a subsequent TSB memorandum.

25 JUDGE STEIN: What - - -

1 CHIEF JUDGE LIPPMAN: You - - - were you
2 told by auditors of that?

3 MR. SHANMUGAM: There was no specific
4 communication until, it is alleged, 2009, some time
5 later, when the DTF first raised concerns with - - -

6 CHIEF JUDGE LIPPMAN: I see.

7 MR. SHANMUGAM: - - - Sprint's taxation
8 practices.

9 CHIEF JUDGE LIPPMAN: That was the first
10 time from your perspective that - - -

11 MR. SHANMUGAM: That is correct. And the
12 two critical points - - -

13 JUDGE STEIN: What would you have - - -
14 what would you have had to have done or not done in
15 order for your conduct, your decision, to be reckless
16 under the statute?

17 MR. SHANMUGAM: So in our view, we believe
18 that where an interpretation is an objectively
19 reasonable one, there can be no liability under the
20 New York False Claims Act. And so just to be clear
21 in response to the Chief Judge's - - -

22 JUDGE STEIN: Does that - - - does it - - -
23 does it matter whether or not your decision to - - -
24 not to tax that portion of - - - of your services was
25 based on your interpretation?

1 MR. SHANMUGAM: No. In our view, the
2 objective reasonableness question is a purely
3 objective question, and we of course rely on the Sup
4 - - - United States Supreme Court's decision in the
5 Safeco in the federal context which, in construing a
6 materially identical scienter requirement,
7 essentially held that the subjective state of mind of
8 the defendant is irrelevant when assessing the
9 objective reasonableness of the position.

10 Now, Judge Stein, I would just say a couple
11 more things about sort of the state of play at the
12 time Sprint adopted its interpretation. The first
13 is, of course, that the DTF's interpretation was not
14 entitled to any deference, and under ordinary
15 principles of tax law, a taxpayer has two choices:
16 the choice to pay first and litigate an issue of
17 interpretation later, or second, the choice to take
18 its position and to wait until the DTF imposes an
19 assessment and at that point litigate the issue
20 through the administrative process.

21 JUDGE STEIN: Let - - - let me - - - let me
22 get back to the - - - to the reckless question.
23 Okay. So if - - - are you saying that the only way
24 that act - - - action could be reckless would be is
25 if there is no reasonable interpretation of the

1 statute that would support your action?

2 MR. SHANMUGAM: Yes. And that is the way
3 in which federal statutes, including the federal
4 False Claims Act and the cases on which we rely, such
5 as the Hixson case but also many other federal
6 decisions, have applied the similar state of mind
7 requirement under the federal False Claims Act.

8 CHIEF JUDGE LIPPMAN: So it's of no moment
9 - - - from your perspective, it's of no moment that -
10 - - assuming you know that the State's position is
11 contrary to yours, that is of no moment in terms of
12 the issues we're dealing with?

13 MR. SHANMUGAM: It is of no moment where
14 the State's interpretation is codified in a document
15 and is entitled to no deference - - -

16 CHIEF JUDGE LIPPMAN: And you're on notice
17 - - -

18 MR. SHANMUGAM: - - - and does not - - -

19 CHIEF JUDGE LIPPMAN: And you're on notice
20 of.

21 MR. SHANMUGAM: - - - and does not have the
22 force of law. And again, to - - - to finish up my
23 answer to your earlier question, Judge Stein, I would
24 just say that I think that the Attorney General - - -
25 including most recently in his response to the amicus

1 briefs - - - has really effectively conceded, and I
2 would refer you to footnote 7, that the effect of his
3 broader view of the False Claims Act would really be
4 to swallow up the option of waiting for an assessment
5 and then litigating the validity of an
6 interpretation.

7 JUDGE PIGOTT: Well, waiting for - - -
8 waiting for an assessment I get, but I mean, if
9 you've got - - - if you've got a plan that is just
10 facially absurd, I'm not suggesting yours is or
11 isn't, you can't hide behind the fact that you - - -
12 you said, well, you know, all we were doing was
13 waiting for them to come and then in the meantime we
14 decided we're not charging - - - we're not collecting
15 any tax whatsoever on our - - - on our service.

16 MR. SHANMUGAM: Well - - - well, it is
17 certainly true that where you have an interpretation
18 that is absurd, that interpretation would not be
19 objectively reasonable, and it's important to keep -
20 - -

21 JUDGE PIGOTT: So how did you identify the
22 nontaxable components of the charge?

23 MR. SHANMUGAM: Well, that raises a
24 different issue, and let me address that issue, which
25 is the question of how we went about disaggregating

1 the taxable and nontaxable portions - - -

2 CHIEF JUDGE LIPPMAN: Wait, why would - - -
3 why don't you explain first to us why you were doing
4 it? Why did you decide to do that?

5 MR. SHANMUGAM: So Sprint, in 2005, adopted
6 a new billing system - - - and to some extent, this
7 is not in the complaint, and I realize that we're in
8 a motion to dismiss, but I think this is the
9 explanation - - -

10 CHIEF JUDGE LIPPMAN: Go ahead. From - - -
11 from a practical perspective, why did you do it?

12 MR. SHANMUGAM: The explanation for what
13 took place was that Sprint adopted a new billing
14 system and in so doing, it assessed its compliance
15 with state laws regarding sales tax, not just in New
16 York but across the country, and it determined that
17 in approximately thirteen states, the better
18 interpretation of state law was that sales tax should
19 not be collected - - -

20 CHIEF JUDGE LIPPMAN: Was that solely your
21 - - - your consideration? Are you considering what's
22 more customer-friendly? What - - - what - - - what
23 was really going on here?

24 MR. SHANMUGAM: I think that this was an
25 assessment of what tax was due, and I think it's

1 important to realize that what we're - - -

2 CHIEF JUDGE LIPPMAN: I mean, totally on
3 the basis of the law or on the product that you're
4 selling and how you sell it and what your - - - what
5 your success is with your customers? That plays into
6 this, too, doesn't it?

7 MR. SHANMUGAM: So, Chief Judge Lippman, to
8 be sure, what we're talking about here is a sales
9 tax, and I think this critically differs from other
10 tax contexts in that what we're really talking about
11 here is a tax that is owed by our customers. And so
12 the question here is, what tax should Sprint collect?
13 And so this is not at all a question concerning money
14 that we have in our possession - - -

15 CHIEF JUDGE LIPPMAN: Right. But you - - -

16 MR. SHANMUGAM: - - - whether we're going
17 to pay that or we aren't.

18 CHIEF JUDGE LIPPMAN: But you are
19 considering - - - what's best for your customers and
20 how you are perceived by your customers are all
21 issues that one would consider in this kind of issue,
22 right?

23 MR. SHANMUGAM: Certainly so. And if we
24 were to collect tax that in fact was not owed and
25 then pay it over to the State, we could be on the

1 receiving end of a consumer class action or consumers
2 would seek to get the money back.

3 JUDGE PIGOTT: That would make me think
4 that maybe I ought to talk to the tax people and see
5 if I violated the law up until this point and whether
6 or not by revising my billing system, I might be
7 violating it the other way, the other way.

8 MR. SHANMUGAM: But again, Judge Pigott, a
9 taxpayer is certainly not under any obligation to do
10 so, but yet I think it really is the position of Mr.
11 Wu and the Attorney General - - - and you can - - -

12 JUDGE PIGOTT: But - - -

13 MR. SHANMUGAM: - - - ask Mr. Wu himself
14 that if a taxpayer does not do so that is evidence of
15 recklessness, and I would respectfully submit that
16 when the legislature amended the False Claims Act to
17 extend that act to tax liability, it did not have
18 this circumstance in mind. It had in mind the
19 circumstance in which a taxpayer flagrantly flouted
20 its obligations to pay tax.

21 JUDGE STEIN: Well, that's what - - - that
22 - - -

23 MR. SHANMUGAM: And the one example - - -

24 JUDGE STEIN: That's what the Tax
25 Department says you're doing and that's what they

1 allege in the complaint, that you essentially are
2 flagrantly flouting what you understood to be the
3 official position on this and that you did not have a
4 reasonable basis to think otherwise.

5 MR. SHANMUGAM: And - - - and just to be
6 clear, where a taxpayer's position is objectively
7 unreasonable, there will still be liability,
8 including liability under the False Claims Act.

9 JUDGE ABDUS-SALAAM: So on - - - on the - -
10 -

11 MR. SHANMUGAM: Now, I would note that the
12 only example - - -

13 JUDGE ABDUS-SALAAM: I'm sorry, counsel.
14 On the issue of objective liability, you mentioned
15 that there were - - - you did this across - - -
16 Sprint did this across the board and there were
17 thirteen states that essentially support their
18 interpretation of this tax law or this tax supports
19 your position. What if there had been thirteen
20 states the other way? Would you still say that your
21 position was a reasonable interpretation of the tax
22 law?

23 MR. SHANMUGAM: Well, just to be clear,
24 Judge Abdus-Salaam, the statutes are differently
25 worded.

1 JUDGE ABDUS-SALAAM: Right.

2 MR. SHANMUGAM: And so there are states
3 that unambiguously impose tax on the interstate as
4 well as the intrastate portion of tax - - - of mobile
5 tax - - - mobile bills, and in those states, Sprint,
6 of course, collects tax. And conversely, there are
7 states that unambiguously impose tax only on the
8 intrastate portion, and in those states, Sprint
9 collects tax only on the intrastate portions. The
10 State's argument here regarding the interpretation of
11 this provision ultimately rests on one thing. It
12 ultimately rests on a comma in Section 1105(b)(2),
13 and the State argues that based on that comma, the
14 legislature intended to abrogate the decades-long
15 distinction under New York law between taxable
16 intrastate services and nontaxable interstate
17 services.

18 CHIEF JUDGE LIPPMAN: And you disagree on
19 what that comma - - - the significance of the comma?

20 MR. SHANMUGAM: I do. And the State argues
21 that you apply the rule of the last antecedent, which
22 is one of the canons of construction that is not an
23 absolute canon, in order to limit the modifying
24 phrase "that are taxable" under subset - - -
25 paragraph b of paragraph 1 - - -

1 JUDGE STEIN: Well, that's not an
2 unreasonable - - -

3 MR. SHANMUGAM: - - - to non-voice
4 services.

5 JUDGE STEIN: - - - position either, is it?

6 MR. SHANMUGAM: Well, we're not arguing
7 that the State's interpretation is objectively
8 unreasonable. We are simply arguing that our
9 interpretation is a permissible one and at a minimum,
10 an objectively reasonable one.

11 And I want to say just one word in response
12 to Judge Pigott's question concerning Sprint's books
13 and records, because I think this goes to the other
14 issue that we've touched on today, which is this
15 issue of preemption. As I said in response to the
16 Chief Judge, we believe that the Attorney General's
17 interpretation would be plainly preempted by the
18 federal MTSA, because the taxability of mobile voice
19 service would turn on whether or not it is aggregated
20 or bundled. At pages 13 to 14 of his brief, the
21 Attorney General concedes - - -

22 JUDGE STEIN: So - - - but assuming you're
23 allowed to unbundle, have you done so properly?

24 MR. SHANMUGAM: We - - -

25 JUDGE STEIN: And is that relevant?

1 MR. SHANMUGAM: We believe that we have,
2 and we further believe that the Attorney General in
3 his complaint has not separately alleged that we
4 failed to comply with the MTSA's books and records
5 requirement. And so just to be clear about how this
6 would work, if you agree with us that there is a
7 conflict between federal and state law, if in fact
8 there is such a conflict, the State could impose tax
9 on mobile voice service only where a provider failed
10 to reasonably identify the nontaxable portion of the
11 bundled charge from its books and records.

12 Now, the Attorney General has not made any
13 effort in this case to explain how state law could
14 accommodate that theory. In other words, the
15 Attorney General has not identified provisions of
16 state law that would permit such a claim to proceed.
17 But assuming that the Attorney General did so and
18 assuming further that the Attorney General did enough
19 in the complaint to allege this theory, the issue for
20 the lower courts on remand would be the question of
21 whether Sprint complied with that requirement, that
22 is to say whether Sprint in fact reasonably
23 identified the nontaxable portion of its fixed-rate
24 charge.

25 CHIEF JUDGE LIPPMAN: Okay, counsel.

1 JUDGE FAHEY: You're almost - - - you're
2 almost out of time.

3 CHIEF JUDGE LIPPMAN: Go ahead, Judge
4 Fahey.

5 JUDGE FAHEY: Yeah, I just wanted you to
6 address your ex post facto argument. Go ahead.

7 MR. SHANMUGAM: Sure. Our argument, I
8 think is a quite straightforward one. We believe
9 that as the United States Supreme Court has
10 recognized with regard to the federal False Claims
11 Act and as this court has recognized, albeit in a
12 different context with regard to the New York False
13 Claims Act, that the sanctions imposed by the FCA are
14 punitive in nature, and that goes to a number of the
15 factors under the United States Supreme Court's
16 decision in Mendoza-Martinez for determining whether
17 a law, while denominated as civil, is nevertheless so
18 punitive in nature to raise ex post facto concerns.

19 JUDGE FAHEY: You mean beyond treble
20 damages or just because of treble damages?

21 MR. SHANMUGAM: The United States Supreme
22 Court in Landgraf suggested that treble damages are
23 essentially punitive in nature, but of course the New
24 York False Claims Act does more. It imposes civil
25 penalties and it makes consequential damages

1 available as well, and we believe that this goes to
2 the question of whether the sanction has historically
3 been regarded as punishment, whether the sanction
4 will promote the traditional aims of punishment, as
5 the Attorney General seemingly recognized - - -

6 CHIEF JUDGE LIPPMAN: Okay, counsel. Let -
7 - - let's hear from your adversary and then you'll
8 have your rebuttal time.

9 MR. SHANMUGAM: Thank you.

10 MR. WU: May it please the court, Steven Wu
11 for the State. The State is entitled to proceed to
12 trial on its allegations that state - - - that Sprint
13 engaged in a multiyear effort deliberate and
14 nondisclosed - - -

15 CHIEF JUDGE LIPPMAN: Coun - - - counsel do
16 you agree with their contention that if there's a
17 reasonable interpretation along the lines that they
18 read the statute, that - - - that there's not a
19 problem here?

20 MR. WU: No. I don't agree with that. For
21 - - - for two - - -

22 CHIEF JUDGE LIPPMAN: So they could
23 reasonably believe that the statute allows them to do
24 X an - - - and what - - - what is the test if it's
25 not their reasonable - - -

1 MR. WU: Well, I'll say two things. The
2 first is, we do not agree that this is a reasonable
3 interpretation of the statute.

4 CHIEF JUDGE LIPPMAN: No. No. But assume
5 it is - - -

6 MR. WU: Putting that issue aside.

7 CHIEF JUDGE LIPPMAN: Assume it is, for the
8 sake of argument.

9 MR. WU: Putting that issue aside, for
10 False Claims Act liability, the inquiry doesn't end
11 here. The underlying test is whether the defendant
12 acted recklessly with knowledge or with deliberate
13 ignorance, and part of that might be - - -

14 CHIEF JUDGE LIPPMAN: Yeah. Yeah. But I -
15 - - but I asked you a different question. I assume
16 that - - - that reason - - - if you're reckless and
17 deliberate in doing it, that you're not reasonable in
18 your interpretation, or is that not the case, you
19 could have both - - - you could have a reasonable
20 interpretation and yet be reckless and disregard,
21 whatever? Are you saying that because your - - -
22 your contention is that they knew that your position
23 was - - -

24 MR. WU: Right.

25 CHIEF JUDGE LIPPMAN: - - - that - - - that

1 they can't do this, is that why it's - - - it's
2 reckless and deliberate, et cetera?

3 MR. WU: It's really two. One is we do
4 actually plead knowledge here, which is they knew
5 exactly what the tax law meant, they complied with
6 that interpretation for three years.

7 CHIEF JUDGE LIPPMAN: Right. But say they
8 know it but they're still doing a reasonable
9 interpretation - - -

10 MR. WU: The - - - the knowledge - - -

11 CHIEF JUDGE LIPPMAN: - - - no good?

12 MR. WU: The knowledge of it is no good,
13 and courts have recognized that before. That you
14 cannot - - -

15 CHIEF JUDGE LIPPMAN: Once they have the -
16 - - once they have the knowledge, even if their
17 interpretation is better than yours, it doesn't
18 matter, they can't do it?

19 MR. WU: Well, I wouldn't say that. I'd
20 say if they knew what the tax law meant but that
21 afterward some judge says I - - - I guess I could see
22 it the other way, that is not enough to - - -

23 CHIEF JUDGE LIPPMAN: No. No. That's not
24 what I'm asking, if they knew what it meant.

25 MR. WU: - - - exempt them from liability.

1 CHIEF JUDGE LIPPMAN: What I'm saying is
2 what if they think it means something else and you
3 think it means one thing, they may - - - they think
4 it means another, but they know what you think?

5 MR. WU: Right.

6 CHIEF JUDGE LIPPMAN: So it's deliberate in
7 a sense that they know it's a different
8 interpretation than you have. Do they have the
9 right, as your adversary says - - -

10 MR. WU: Right.

11 CHIEF JUDGE LIPPMAN: - - - to do it and
12 then wait for you to react to that or - - - or not?

13 MR. WU: The State's position is a pretty
14 straightforward one, which is the reasonableness of
15 an interpretation of a statute is one factor that
16 goes into scienter. But there are other factors that
17 underlie the defendant's conduct that are also
18 relevant, and all that we're asking for is - - -

19 CHIEF JUDGE LIPPMAN: What are those - - -

20 MR. WU: - - - to proceed to trial on that
21 quest - - - question.

22 JUDGE FAHEY: It would - - - it would have
23 to be that way, because otherwise subjective - - -
24 subjective reasonability, in other words them
25 thinking a particular thing, would be dispositive of

1 the case.

2 MR. WU: Right.

3 JUDGE FAHEY: If - - - if there wasn't a -
4 - - a third-party objective - - - objectively
5 reasonable standard outside of what they believed
6 then it - - - there could never be a False Claims
7 Act, never.

8 MR. WU: Yeah. I mean it's part - - - it's
9 certainly part of the case what they believed. It -
10 - - and there's also objective components - - -

11 JUDGE FAHEY: Of course.

12 MR. WU: - - - that are part of it as well.

13 JUDGE FAHEY: Of course.

14 MR. WU: But - - - but the thing that is -
15 - -

16 JUDGE PIGOTT: Well, but you - - - you - -
17 -

18 MR. WU: - - - striking and radical - - -
19 I'm sorry, Judge Pigott.

20 JUDGE PIGOTT: That's okay. What I was
21 going to say is you - - - you started out by saying
22 that you're entitled to go to trial on this.

23 MR. WU: Right.

24 JUDGE PIGOTT: We're at a 32.11. I mean,
25 aren't you a little ahead of that game? I mean,

1 really you're arguing you're entitled to an answer
2 and discovery - - -

3 MR. WU: Right.

4 JUDGE PIGOTT: - - - and perhaps a 32.12
5 later on may change somebody's tune.

6 MR. WU: That - - - that's right. I mean,
7 and we are entitled to additional discovery here
8 which only highlights the premature nature of the
9 argument they're making. I mean, what was really
10 radical - - -

11 CHIEF JUDGE LIPPMAN: What will discovery
12 show in this case? What particularly would be
13 helpful?

14 MR. WU: Well, I think, for example, a
15 couple of things would be helpful. We would be
16 interested in discovery as to what Sprint thought at
17 the time that the statute was enacted. The wireless
18 industry including Sprint was deeply involved in
19 commenting on and reviewing this legislation.

20 CHIEF JUDGE LIPPMAN: To show - - - to - -
21 -

22 MR. WU: And expressed their views - - -

23 CHIEF JUDGE LIPPMAN: To show that - - - to
24 show that - - - that what they were doing was - - -
25 was not based on their reasonable interpretation? Is

1 that what you're saying?

2 MR. WU: Well, that's one. They - - - to -
3 - - they expressed their views about what the statute
4 meant when it was enacted, and we think that is
5 relevant.

6 CHIEF JUDGE LIPPMAN: But - - - but you - -
7 - just - - - just one thing and then I'll let you - -
8 - you complete. But you don't accept - - - again, I
9 just want to understand the test - - - you don't
10 accept that if it was their reasonable interpretation
11 - - - or let's put it this way, if it's an
12 objectively reasonable interpretation that if I look
13 at it and you look at it and everyone on this bench
14 does and says, yeah, you could read it that way, not
15 good enough?

16 MR. WU: We don't think that's dispositive.

17 CHIEF JUDGE LIPPMAN: That's not the case?

18 MR. WU: That's is the underlying State's
19 position.

20 CHIEF JUDGE LIPPMAN: Okay.

21 MR. WU: And - - - and what this reflects
22 is the basic view that two taxpayers can have the
23 same underlying conduct and yet be differentially
24 liable - - -

25 JUDGE FAHEY: That - - - that's - - -

1 MR. WU: - - - under the False Claims Act.

2 JUDGE FAHEY: That's reflected at the
3 federal case law, isn't it?

4 MR. WU: That - - -

5 JUDGE FAHEY: You've got the Hixson case on
6 one side and the Parsons case on the other side.

7 MR. WU: That's correct. If - - -

8 JUDGE FAHEY: And that - - - that
9 distinction, not that we're necessarily bound by
10 either of them, but nonetheless that's reflected in
11 the case law.

12 MR. WU: It - - - it's reflected there.
13 And I would say even Hixson, which Sprint relies upon
14 so heavily, acknowledges that there's more than just
15 a reading of the statute that is relevant. In that
16 case, as in Safeco, the court was careful to point
17 out that there were no warning signs that would have
18 led the defendant to think otherwise. But what's
19 different about this case is that there were an
20 immense number of red flags that told Sprint that
21 what it was doing was illegal. They were
22 specifically told by the Tax Department twice to
23 collect the tax on the full price of flat rate plans.

24 CHIEF JUDGE LIPPMAN: Does that in itself
25 make it unreasonable what they're doing?

1 MR. WU: It - - - it does not, but it is
2 relevant evidence about the defendants underlying - -
3 -

4 JUDGE STEIN: Well, you used the terms - -
5 -

6 MR. WU: - - - scienter, which is all we're
7 arguing.

8 JUDGE STEIN: - - - aggressive and risky in
9 that regard because they knew about all these other
10 things, but is reckless, aggressive, or risky, are
11 they the same thing?

12 MR. WU: They're - - - they're not quite
13 the same. I will say aggressiveness and riskiness
14 play into the reckless behavior.

15 JUDGE STEIN: So - - -

16 MR. WU: The Safeco discussion - - -

17 JUDGE STEIN: So what allegations make - -
18 - make this rise to the level of knowledge as defined
19 in the - - - in the act?

20 MR. WU: Well, knowledge and recklessness,
21 the allegations that we would point to are the fact
22 that Sprint had repeated warnings from every
23 interpretative authority that showed that their
24 reading of the statute was wrong, and they not only -
25 - -

1 JUDGE STEIN: But that - - -

2 MR. WU: - - - disregarded that - - -

3 JUDGE STEIN: But isn't that just two
4 opposing interpretations, yours and theirs? How - -
5 - how - - - how does that establish for them that - -
6 - that it's reckless to think that they're right?

7 MR. WU: Because the very definition of
8 reckless behavior is to ignore red flags showing that
9 you are wrong, and here, those red flags existed in
10 multiple sources; the Tax Department's immediate
11 guidance after the enactment of the statute, the - -
12 -

13 JUDGE FAHEY: Is that the 2 - - - is that
14 the 2002?

15 MR. WU: The 2002 TSBM as well as the
16 letter to the governor that they referenced here.

17 JUDGE STEIN: It all - - - but it all came
18 in - - -

19 JUDGE FAHEY: It's - - - it's your position
20 then that - - - that after that, at least we should
21 be able to get discovery to see what they knew on
22 that. That should be your position, right?

23 MR. WU: That - - - that - - - that's
24 correct, and part of the discovery we would want to
25 obtain, to - - - to further answer the Chief Judge's

1 question, is whether in 2005 they actually did change
2 their view based upon - - -

3 CHIEF JUDGE LIPPMAN: Had they - - -

4 MR. WU: - - - a reasonable interpretation
5 of the statute.

6 CHIEF JUDGE LIPPMAN: But - - - but - - -
7 but they contend that they can test this, that they
8 can hear your view - - -

9 MR. WU: Correct.

10 CHIEF JUDGE LIPPMAN: - - - disagree with
11 it, and that basically the law allows them to test it
12 and then if you disagree, you take whatever steps - -
13 -

14 MR. WU: I mean, let - - - let me take a
15 step back - - -

16 CHIEF JUDGE LIPPMAN: Why is that not a
17 rational position?

18 MR. WU: Let me take a step back. That
19 might be a story that they can tell. For the first
20 time they've given a story here about comparing
21 multiple states' laws and coming to some reasonable
22 judgment about what New York said. But that's a fact
23 question and we have disputed, and we have alleged
24 otherwise, that they did not act either with that
25 motive or with that practice in 2005, and it's

1 supported by allegations that they never disclosed
2 this scheme to any tax authority that we are aware
3 of. That it was not until 2011, six years after they
4 adopted this practice, that they finally told the tax
5 authorities for the first time that they had a legal
6 interpretation, and that for the course of all those
7 years, it's - - -

8 CHIEF JUDGE LIPPMAN: But if it - - - if it
9 - - -

10 MR. WU: - - - completely ignored.

11 CHIEF JUDGE LIPPMAN: But - - - but here's
12 the question. We get it. You would like discovery
13 to further explore those issues. Let's say for the
14 sake of argument - - -

15 MR. WU: Right.

16 CHIEF JUDGE LIPPMAN: - - - putting aside
17 our case, that they have their position, you have
18 their position - - - your position; you go to high-
19 priced lawyers and they look at it and they say no,
20 no, the State - - - their interpretation is wrong.

21 MR. WU: Right.

22 CHIEF JUDGE LIPPMAN: This is what it
23 means. You're safe to go, and if they challenge it,
24 we're going to prevail. In that - - - putting aside
25 whether that's our case, is that good enough for

1 here showing that they were reckless. I mean, it - -
2 -

3 JUDGE STEIN: But - - - but - - - but all
4 I've heard you say in terms of recklessness is is
5 that you, the Tax Department, put out all kinds of
6 signals about what your interpretation was.

7 MR. WU: That's right.

8 JUDGE STEIN: So is that - - - that's what
9 makes it reckless?

10 MR. WU: It's not just that; it's also the
11 fact that Sprint never took the opportunity to
12 disclose this interpretation to anybody, even at the
13 cost of tens of millions of dollars in taxes that
14 they could - - -

15 JUDGE STEIN: But isn't that what - - -

16 MR. WU: - - - have obtained a refund for.

17 JUDGE STEIN: - - - a big corporation does
18 for its shareholders? I mean, why would they invite
19 an audit?

20 MR. WU: Well, let me put it more pointedly
21 which is that for several periods during this - - -
22 during this episode, Sprint actually did collect the
23 tax to the tune of something like thirty, forty,
24 fifty-million dollars, and they declined to seek a
25 refund from the Tax Department, which is actually

1 characterization of that, Judge Pigott, which is I
2 don't think it's a point in their favor that they are
3 acting as the trustees of the state in collecting
4 this tax. If anything, that role that they play only
5 highlights the degree to which they should have been
6 more forthright with tax authorities. At the end of
7 the day, this money does not come out of their
8 pocket, it comes out of their customers' pockets, and
9 so there was really no reason for them not to - - -

10 CHIEF JUDGE LIPPMAN: But if they're - - -
11 but - - -

12 MR. WU: - - - when they knew the Tax
13 Department thought otherwise.

14 CHIEF JUDGE LIPPMAN: But - - - but let me
15 ask you another question. If - - - if they were
16 convinced in their minds that they're right and this
17 was their strategy and let's say they didn't want to
18 reveal it earlier, is - - - is there some - - - is
19 that wrong? Is that - - -

20 MR. WU: I mean, it's - - - and I'll fall
21 back on my original answer which is it's evidence of
22 their underlying reckless behavior. At trial or in
23 discovery, Sprint is entitled to come forward and
24 say, look, here's our explanation for what we did and
25 let's put forward all the evidence - - -

1 CHIEF JUDGE LIPPMAN: Let's - - - let - - -

2 MR. WU: - - - showing our conduct - - -

3 CHIEF JUDGE LIPPMAN: Let's say for the
4 sake of argument - - - I'm not saying that's the case
5 here, that they're smarter than you are.

6 MR. WU: Right.

7 CHIEF JUDGE LIPPMAN: Right. They're
8 smarter than the State. They get it, they understand
9 it. You know, the State really doesn't - - - doesn't
10 understand it, and this is kind of their strategy,
11 like I said, they're going to outfox you, they're not
12 going to let it be known publicly what they're doing.
13 Something wrong?

14 MR. WU: Yeah. I mean - - - I'll say a
15 couple of things.

16 CHIEF JUDGE LIPPMAN: Is that scien-ter?
17 What is that?

18 MR. WU: One, it still - - -

19 CHIEF JUDGE LIPPMAN: Or is just smart
20 business strategy or whatever?

21 MR. WU: It still might be scien-ter, and
22 I'll point to this court's recent Caprio ruling,
23 which said the fact that a taxpayer, maybe even with
24 counsel, comes up with some reading of the statute
25 does not make it reasonable if it's contrary to every

1 other indication of what the statute is meant to do.

2 JUDGE ABDUS-SALAAM: But isn't that - - -
3 that's - - - we said that was a subjective view and
4 their - - - their claim here is that they have an
5 objective view and that the statute is ambiguous and
6 can be read two different ways, so they're not
7 relying on a subjective view, they're - - - they're
8 saying it's objective.

9 MR. WU: That - - - that's correct. But
10 first, I'm not sure if Caprio was just about a
11 subjective view. What this court pointed to was the
12 lack of support for the taxpayer's interpretation - -
13 -

14 CHIEF JUDGE LIPPMAN: You think the stat -
15 - -

16 MR. WU: - - - without questioning that
17 they actually held that interpretation.

18 CHIEF JUDGE LIPPMAN: Do you think the
19 statute's confusing?

20 MR. WU: No. And I think the statute here
21 is unambiguous and nobody, no source of authority - -
22 -

23 CHIEF JUDGE LIPPMAN: And so either case,
24 you both think it's unambiguous, so - - -

25 MR. WU: Well, I'm not sure if Sprint says

1 it unambiguous on their side, but no source of
2 authority supported - - -

3 CHIEF JUDGE LIPPMAN: They're saying that
4 at - - -

5 MR. WU: - - - Sprint's interpretation at
6 the time.

7 CHIEF JUDGE LIPPMAN: - - - worst, it's
8 unambig - - - it's ambiguous. Yeah.

9 MR. WU: But the other point that I point
10 that I want to make is that this objective
11 reasonableness test is a radical one from Sprint's
12 points of view, because it would say this whole
13 inquiry ends at the motion to dismiss stage just upon
14 looking at the text of the statute you have in front
15 of you, and we can disregard any evidence about what
16 Sprint did actually did at the time.

17 CHIEF JUDGE LIPPMAN: But if we look at it
18 and say - - -

19 MR. WU: The advice that it obtained.

20 CHIEF JUDGE LIPPMAN: If we look at it - -
21 - let's say for the sake of argument, if we look at
22 it and say it's ambiguous, what do we do?

23 MR. WU: Well, that's on the original tax
24 law question. I think you would resolve it in favor
25 of the Tax Department for the - - -

1 CHIEF JUDGE LIPPMAN: If it's ambiguous we
2 resolve it for the Tax Department?

3 MR. WU: Because we think the - - - the
4 other canons of statutory interpretation here favor
5 the Tax Department's view. But for False Claims Act
6 liability, the fact that this court might credit
7 Sprint's interpretation is not enough to end this
8 case at the outset, and the fact that somebody after
9 the fact can look at a test and read the statute in a
10 certain way doesn't necessarily dispose of
11 recklessness if, for instance, a taxpayer didn't
12 believe it at the time; never sought advice of
13 counsel; acted against contrary authority, both
14 general and specific, from the tax authorities; and
15 the other red flags that we have alleged Sprint
16 ignored here completely in reaching this practice.

17 I'd just like to comment briefly on the ex
18 post facto clause.

19 CHIEF JUDGE LIPPMAN: Yeah. Go ahead,
20 counsel.

21 MR. WU: The - - - the principle inquiry
22 under the ex post facto clause is whether the statute
23 has some legitimate non-punitive purpose, and - - -
24 and here treble damages are well recognized to have
25 legitimate compensatory purposes for the State, even

1 if there is some punitive purpose that can be
2 addressed as well.

3 I just want to make one point about Grupp
4 here, which is, Grupp - - -

5 CHIEF JUDGE LIPPMAN: Sure. Go ahead.

6 MR. WU: - - - did not actually identify an
7 ex post facto problem with a False Claims Act. It
8 was dealing with a very different doctrine, and the
9 specific punitive purpose that Grupp identified, and
10 the only one that it identified, was deterrence. But
11 deterrence is unique in the False Claims Act area and
12 for ex post facto purposes because the courts have
13 recognized that deterrence serves legitimate civil
14 purposes as well as punitive ones. It ensures that
15 people comply with the law, it enables the State to
16 collect the tax revenue they're entitled to. And
17 these - - -

18 JUDGE STEIN: Well, you would - - - you
19 would agree that this particular law has some indicia
20 of both, would you not?

21 MR. WU: Yeah. I mean it might be mixed,
22 and I think the Supreme Court has recognized that for
23 the federal False Claims Act as well. But the ex
24 post facto clause is not triggered just because
25 there's some indicia of punitive - - -

1 JUDGE STEIN: Well, it's a balancing.

2 MR. WU: - - - intent or purpose.

3 JUDGE STEIN: It's a balancing, right?

4 MR. WU: It's a balance, but the - - -

5 JUDGE STEIN: It's not all or nothing.

6 MR. WU: That's correct. It's a balance,
7 but the test is in favor of the State. What is
8 required is the clearest proof that the legislature
9 intended a punitive purpose or effect sufficient to
10 override their unambiguous intent here to make this a
11 civil remedy, which is a much higher standard of
12 proof than simply pointing to one or two punitive
13 components of the statute.

14 JUDGE STEIN: And by the way, I don't think
15 we said in Caprio that a taxpayer's view - - -
16 subjective view - - - is inherently unreasonable but
17 that's - - - that's for another day.

18 MR. WU: That - - - that's right. I mean
19 we just wanted to point out in Caprio that - - -

20 CHIEF JUDGE LIPPMAN: Okay.

21 MR. WU: - - - this court rejected their
22 argument that it was a reasonable interpretation
23 based on - - -

24 JUDGE STEIN: Well, we - - - no, no, no.

25 MR. WU: - - - many of the factors - - -

1 JUDGE STEIN: We said that their reliance
2 on that interpretation was not reasonable.

3 MR. WU: That's - - - well, we think it's
4 relevant for purposes of this - - -

5 CHIEF JUDGE LIPPMAN: Okay, counsel.

6 MR. WU: - - - this as well. Thank you.

7 CHIEF JUDGE LIPPMAN: Thanks, counsel.

8 Counsel, rebuttal.

9 MR. SHANMUGAM: Thank you, Chief Judge
10 Lippman. Just three quick points and of course I'd
11 be happy to answer any of the court's questions.
12 First with regard to the text of the statute here, I
13 think it is telling that while Mr. Wu covered a lot
14 of ground in his argument, he really didn't at any
15 point attempt to focus this court on the text of the
16 statute and to explain why the comma that supposedly
17 distinguishes voice services and non-voice services
18 renders the statute unambiguous.

19 And the upshot of the State's position, I
20 would respectfully submit, is that the legislature in
21 adding Section (b) (2) essentially abrogated this
22 decades-old distinction dating back to 1965 between
23 taxable intrastate services and nontaxable interstate
24 services and that it did so in a very odd way,
25 imposing that tax only on mobile voice services that

1 are bundled, and of course it is that last aspect of
2 the State's position that, in our view, gives rise to
3 the federal preemption problem.

4 JUDGE ABDUS-SALAAM: Counsel, your - - -
5 your adversary points out that they believe that you
6 had a different position before you started
7 unbundling and that you might have even supported the
8 statute at some point and they're entitled to some
9 discovery regarding that. If you had - - - assuming
10 that's true, if you had changed your position, were
11 you entitled to change your position, and - - - and
12 would you say that that change was a reasonable
13 interpretation?

14 MR. SHANMUGAM: Yes. And - - -

15 JUDGE ABDUS-SALAAM: Based on what?

16 MR. SHANMUGAM: Yes. Well, we think that
17 it is a reasonable interpretation based on the text
18 of the statute, notwithstanding the fact that the DTF
19 took a different view. And that really goes to the
20 question of objective reasonableness.

21 JUDGE ABDUS-SALAAM: Well, what if you took
22 a different view?

23 MR. SHANMUGAM: I'm sorry?

24 JUDGE ABDUS-SALAAM: What if you took a
25 different view - - -

1 MR. SHANMUGAM: Well - - -

2 JUDGE ABDUS-SALAAM: - - - of the statute
3 at some point?

4 MR. SHANMUGAM: - - - I don't think that
5 that is somehow binding on a taxpayer, particularly a
6 taxpayer who is not really a taxpayer, who is
7 collecting sales tax on behalf of its customers.

8 JUDGE PIGOTT: But they - - - but they
9 allege - - - they say because the fixed monthly
10 charge is not divisible based on customer use,
11 unbundling in the way that required - - - requires
12 Sprint to come up with an arbitrary method of
13 allocating the charge into subparts and that you - -
14 - you arbitrarily - - - because there's no - - -

15 MR. SHANMUGAM: Yes. And - - - and that is
16 the separate question of what would happen if this
17 court agrees with us that there is a preemption
18 problem and the issue of whether or not we
19 sufficiently kept books and records. And if this
20 court agrees that there is a preemption problem, the
21 court could remand to the trial court for a
22 determination of whether the State has sufficiently
23 pleaded such a claim and the case would go forward on
24 that much narrower ground, and it would go forward, I
25 would just respectfully submit, without the False

1 Claims Act claim.

2 And let me say just a word about the False
3 Claims Act because that was such the focus of the
4 argument with Mr. Wu. You may very well be wondering
5 why we are here on this issue, and as the amicus
6 briefs point out, there is only one case of which we
7 are aware in which the Attorney General has pursued
8 liability under the FCA for a tax violation, and that
9 was the case of the tailor who collected sales tax
10 that was unquestionably due from his customers and
11 then failed to pay that tax to the state. This case
12 is very different. This is a case involving a
13 dispute about the interpretation of the state tax
14 laws.

15 CHIEF JUDGE LIPPMAN: So why are you here?
16 Why are they going after you?

17 MR. SHANMUGAM: The Attorney General, I
18 would respectfully submit, is pursuing this
19 aggressive interpretation of the False Claims Act in
20 order to obtain an additional cudgel, the cudgel
21 being the threat of treble damages in cases where
22 there are disputes about tax statutes. And at this
23 point - - -

24 JUDGE PIGOTT: Well, they didn't start
25 this; somebody else did, right?

1 MR. SHANMUGAM: I'm sorry?

2 JUDGE PIGOTT: They didn't start this
3 someone else did?

4 MR. SHANMUGAM: Well, the Attorney General
5 - - - someone else did file a False Claims Act
6 action. At that time, the ordinary tax process was
7 playing out because, as the Attorney General
8 acknowledges in the complaint, the DTF had commenced
9 an audit on this very issue. And the upshot of expect
10 - - - accepting the Attorney General's position here
11 under which even a taxpayer who takes an objectively
12 reasonable position on a question of interpretation
13 could be subject to liability under the FCA would be
14 to force taxpayers to capitulate to the threat of
15 treble damages, to settle these cases, or, in the
16 alternative, to pursue a pay-to-play strategy whereby
17 a taxpayer would be obligated to pay a tax first or,
18 as is true under the Attorney General's view, be
19 subject to the threat of treble damages.

20 CHIEF JUDGE LIPPMAN: You - - - you think
21 that's why they superseded the complaint, to get
22 additional leverage in these kinds of situations?

23 MR. SHANMUGAM: We do believe that that is
24 what the Attorney General, with all due respect, is
25 doing in this case. The Attorney General is seeking

1 to establish the principle that where a taxpayer
2 fails to comply with the DTF's nonbinding
3 interpretation, that that mere failure to comply can
4 be evidence of recklessness so as to sustain a claim
5 under the FCA, and that would, we respectfully submit
6 - - -

7 CHIEF JUDGE LIPPMAN: Okay, counsel.

8 MR. SHANMUGAM: - - - force taxpayers to
9 capitulate to the DTF's interpretation - - -

10 CHIEF JUDGE LIPPMAN: Okay.

11 MR. SHANMUGAM: - - - and render those
12 nonbinding interpretations binding.

13 CHIEF JUDGE LIPPMAN: Thank you, counsel.

14 MR. SHANMUGAM: Thank you.

15 CHIEF JUDGE LIPPMAN: Thank you both.

16 Appreciate it.

17 (Court is adjourned)

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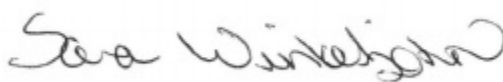
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C E R T I F I C A T I O N

I, Sara Winkeljohn, certify that the foregoing transcript of proceedings in the Court of Appeals of People of the State of New York v. Sprint Nextel Corp., No. 127 was prepared using the required transcription equipment and is a true and accurate record of the proceedings.



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Date: September 11, 2015