1	BILL LOCKYER Attorney General of the State of California	
2	RICHARD M. FRANK	
3	Chief Assistant Attorney General DENNIS ECKHART	
4	Senior Assistant Attorney General MICHELLE L. FOGLIANI	
5	Deputy Attorney General LAURA KAPLAN	
6	Deputy Attorney General State Bar No. 64264	
7	1300 I Street P.O. Box 944255	
8	Sacramento, CA 94244-2550	
9	Att C. Di.: (CC	
10	Attorneys for Plaintiff	
11	SUPERIOR COURT OF CALIFORNIA	
12	COUNTY OF SAN DIEGO	
13		
14	THE PEOPLE OF THE STATE OF CALIFORNIA, ex rel. BILL LOCKYER, ATTORNEY	Case No
15	GENERAL OF THE STATE OF CALIFORNIA,	COMPLAINT FOR INJUNCTION, CIVIL
16	Plaintiff,	PENALTIES, AND OTHER RELIEF (Bus. & Prof. Code, §§
17	v.	17200, 17500 and 22963 and Rev. and Tax. Code, § 30101.7)
18	S4L DISTRIBUTING, Inc., a Virginia corporation,	
19	doing business as SMOKIN4LESS/A-1 DISCOUNT CIGARETTES, WWW.SMOKIN4LESS.COM and	
20	WWW.A1DISCOUNTCIGARETTES.COM; WILLIAM C. BAKER III, an individual, and DOES	
21	1 through 15, inclusive,	
22	Defendants.	
23		
24	The People of the State of California, through Bill Lockyer, Attorney General of the	
25	State of California, hereby allege on information and belief as follows:	
26	<u>INTRODUCTION</u>	
27	Youth smoking is a serious pediatric health problem in California and the rest of the	
28	nation. More than 80% of regular smokers began smoking as children. Every day in the United	

7

8 9 10

11

12

13

15 16

17 18

19

21

22

20

23 24

27 28 States more than 2,000 children begin smoking cigarettes, and one-third of those children will die one day from tobacco-related disease. It has been shown that the younger a person begins smoking, the more likely it is that he or she will be unable to quit in later life and will suffer a disease attributable to tobacco use. Recent studies indicate that youth demonstrate signs of addiction after smoking only a few cigarettes. Exacerbating these problems, an estimated 690 million packs of cigarettes are sold illegally to children each year nationwide.

Defendants are cigarette sellers who advertise and sell cigarettes over the Internet to California consumers and consumers in other states. Defendants state on their web sites that potential purchasers must be 18 years old to purchase cigarettes from defendants and that by placing an order, potential purchasers certify that they are of legal age to purchase tobacco products. However, defendants in fact facilitate and promote purchase of cigarettes by children because neither defendants' web sites nor their delivery procedures require face-to-face delivery or otherwise adequate verification of age and identity of would-be purchasers. Defendants have sold cigarettes to children in California from their web sites on twelve occasions. The People have informed defendants several times that the People had documented sales to minors from their web sites. Defendants have been similarly informed of such sales to children by New York City on a another occasion. Notwithstanding the fact that they have been so notified, defendants have not taken adequate precautions to ensure that children cannot purchase and receive delivery of cigarettes from their web sites. Specifically, defendants fail or refuse to put in place effective safeguards so as to prevent or seriously discourage further sales to minors. By refusing to do so and completing sales of cigarettes to minors, defendants are encouraging and allowing children to purchase cigarettes from their web sites, thus undermining the State's efforts to reduce smoking by minors.

Defendants, in violation of state law, also fail or refuse to either pay taxes owed on cigarettes shipped into California or notify purchasers that they are responsible for taxes owed. In violation of federal law, defendants fail or refuse to report the shipments of cigarettes into the state, including the identity of the purchasers, to the California Board of Equalization ("BOE"), the entity responsible for collecting those taxes. Defendants' also induce consumers to purchase

their cigarettes by false and misleading statements concerning defendants' obligation to report to the BOE shipments of cigarettes into California and the obligation of California consumers to pay California taxes on cigarettes purchased from defendants over the Internet and shipped into California.

The People also bring this action pursuant to California's unfair competition statutes, to protect the public from defendants' misleading, unlawful, unfair and fraudulent business practices. These practices include selling cigarettes to children, failing or refusing to institute adequate procedures and safeguards to ensure children cannot buy cigarettes from their web sites and that cigarettes cannot be delivered to children, failing or refusing to comply with federal reporting requirements with respect to their Internet cigarette sales to California consumers, and making deceptive or misleading statements concerning defendants' obligation to comply with these federal reporting laws and consumers' obligation to pay California taxes on cigarettes purchased from defendants over the Internet. Defendants' unlawful conduct also includes violations of two statutes, which became effective January 1, 2003, enacted for the purpose of ensuring compliance with specific requirements concerning age verification and payment of applicable state taxes for cigarettes purchased over the Internet or by mail order.

PARTIES

1. Bill Lockyer is the duly elected Attorney General of the State of California and is the chief law enforcement officer of the state (Cal. Const., art. 5 § 13.) He is authorized by Business and Professions Code sections 17204 and 17206 to bring actions, in his official capacity, to enforce the state's statutes regulating unfair competition. He is also authorized by Revenue and Taxation Code section 30101.7, subdivision (e) to bring actions to facilitate the collection of all applicable state surtaxes and sales or use taxes on cigarettes sold to California residents over the Internet or by mail order. Additionally, he is authorized to assess civil penalties against any entity violating Business and Professions Code section 22963 which, among other things, prohibits both distribution of tobacco products directly or indirectly to persons under the age of 18 years old through common carriers, and delivery of tobacco products to an address other than the consumer's verified billing address.

- 2. Defendants, S4L Distributing, Inc., a Virginia corporation, doing business as SMOKIN4LESS/a-1 DISCOUNT CIGARETTES, SMOKIN4LESS.COM and A1DISCOUNTCIGARETTES.COM (collectively referred to as "Smokin4Less"), and WILLIAM C. BAKER III, an individual, are cigarette retailers who advertise and sell cigarettes over the Internet to California residents. Smokin4Less receives Internet orders from California residents and ships the orders by common carrier to California.
- 3. Smokin4Less is, and during the relevant time period was, a Virginia corporation with its principal place of business located at 1514 East 3rd Avenue, Big Stone Gap, Virginia. Smokin4Less sells cigarettes over the Internet by operating web sites at www.smokin4less.com and www.a1discountcigarettes.com through which cigarettes are advertised and sold to California residents.
- 4. Defendant William C. Baker III ("Baker") is and at all relevant times was, Chief Executive Officer of S4L Distributing, Inc. In such capacity, and as an individual, Baker controls, manages, supervises, and directs the operations and activities of S4L Distributing, Inc.
- 5. The true names and capacities of the defendants sued herein under the fictitious names of Does One through Fifteen, inclusive, are unknown to plaintiff who therefore sues defendants by such fictitious names. Plaintiff will amend its complaint to show the true names of such defendants when the same have been ascertained. Plaintiff is informed and believes and upon such information and belief alleges, that each of the defendants designated herein as a DOE is legally responsible in some manner for the events and happenings alleged in this complaint.

JURISDICTION AND VENUE

6. The violations of law alleged in this Complaint occurred in San Diego County and in other counties in California or occurred outside of California but were intended by defendants to influence prospective purchasers in California. Defendants purposefully and voluntarily directed their activities toward California consumers and purposefully availed themselves of the privilege of conducting business in California by both soliciting and transacting business in California. Defendants have intentionally targeted California and have sold cigarettes to consumers in San Diego and in other counties in the State of California.

FACTUAL ALLEGATIONS

Sales of cigarettes to minors

- 7. Pursuant to Penal Code section 308(a), every person, firm or corporation which knowingly or under circumstances in which it has knowledge, or should have grounds for knowledge, sells cigarettes to persons under the age of 18 years is subject either to a misdemeanor criminal action or to a civil action punishable by a fine.
- 8. Smokin4Less has knowledge, or grounds for knowledge that it is selling cigarettes to children from its web sites. Defendants were notified in writing by plaintiff's attorney that since on or before July 2001, Smokin4Less has sold cigarettes from its web sites to children in California on numerous occasions. Smokin4Less does not have adequate procedures and safeguards in place to ensure that minors cannot receive cigarettes purchased from its web sites.
- 9. The People, along with 39 other states, sent a letter to defendants on September 16, 2002, informing them that they had information documenting sales to minors from their web sites and asking defendants to immediately review their web sites in light of the legal requirements prohibiting the sales of cigarettes to minors. (A copy of this letter is attached as Exhibit "A" and incorporated herein by reference.) Defendant Baker responded to that letter by denying that defendants sold cigarettes to children. The People, sent defendants a second letter dated September 25, 2002, informing them that the People had verified multiple sales to minors in California from defendants' web sites since at least July, 2001. The People also notified defendants, in that letter, that as of January 1, 2003, California prohibits the sale of cigarettes over the Internet unless the seller complies with specified requirements including age verification (Bus and Prof. Code §22963) and payment of applicable taxes (Rev and Tax Code §30101.7). The People also provided defendants with copies of those newly enacted statutes. (A copy of this letter is attached as Exhibit "B" and incorporated herein by reference.) Defendants did not respond to that letter.
- 10. The People sent defendants a third letter on January 23, 2003, informing them that the California Attorney General had documented sales of cigarettes to minors from their web sites on eleven occasions since July, 2001, and that the New York City Department of Consumer

Affairs documented and notified Smokin4Less that a minor placed an order for and received delivery of cigarettes without being asked to provide independent age verification. (A copy of this letter is attached as Exhibit "C" and incorporated herein by reference.) The People also requested that Defendants enter into a settlement agreement ("agreement") between defendants and a significant number of concerned states. A copy of the proposed agreement setting forth procedures to ensure that children could not purchase cigarettes from their web sites was included in the January 2003 letter. Although defendants received this letter, defendants did not respond in any way.

11. The People documented yet another sale made to a minor by defendants from one of its web sites in February 2003.

Internet Cigarette Sales Tax Evasion

- 12. Pursuant to Revenue and Taxation Code section 30101.7(a), if an out-of-state retailer does not collect and remit the tax to the State, the purchaser of the cigarettes is obligated to pay the state tax. Because Smokin4Less does not collect and remit any of the applicable California taxes, California consumers who purchase cigarettes from Smokin4Less are responsible for paying these taxes directly to the State.
- 13. Pursuant to the Jenkins Act, 15 U.S.C. section 375 et seq. ("Jenkins Act"), vendors who sell and ship cigarettes in interstate commerce other than to a licensed distributor must register with the tobacco tax administrator of each state shipped to and on a monthly basis, report (1) the name and address of the persons to whom cigarette shipments were made, (2) the brands of cigarettes shipped, and (3) the quantities of cigarettes shipped. Reports must be filed no later than the 10th day of each calendar month, reporting each and every cigarette shipment made to the state during the previous calendar month. The seller's registration must list the seller's name, trade name, and the address of all business locations.
- 14. The Board of Equalization ("BOE"), the California taxing entity responsible for collecting cigarette taxes, sends letters to out-of-state distributors, companies or agencies selling cigarettes to California consumers when it learns that these entities have not reported sales of cigarettes in compliance with the Jenkins Act. Such a letter is referred to as a "Jenkins Act"

letter. If the BOE does not receive a response, it will routinely send a follow-up letter requesting compliance from the entities.

- 15. The BOE sent a Jenkins Act letter to Smokin4Less on at least one occasion requesting that the company report all its shipments of cigarettes to California consumers as required by the Jenkins Act. It sent a letter to the company's address in Roanoke, Virginia on October 7, 1999. (A copy of that letter is attached, as Exhibits "D" and incorporated herein by reference.) Smokin4Less did not respond to either of this letters.
- 16. The People in its January 23, 2003 letter to defendants (Exhibit C) also informed defendants of their obligation to comply with the Jenkins Act. Defendants did not respond to the People's letter.
- 17. Smokin4Less has failed or refused to file any reports with the BOE, at any time, of sales of cigarettes to California consumers as required by section 376 of the Jenkins Act.

Deceptive Advertising

- 18. At all times relevant to this action, defendants were and are required by the Jenkins Act to report shipments of cigarettes into California to the BOE so the BOE can collect state taxes on these cigarettes.
- 19. Defendants, through false and misleading statements on their web sites, misrepresent defendants' obligation to report shipments of cigarettes into California as required by the Jenkins Act. For example, in the privacy policy posted on defendants' web sites, defendants state:

"Privacy Policy and Tax Reporting: You are probably aware that a federal regulation known as the Jenkins Act requires cigarette vendors to report their sales to the appropriate state tax authorities. You may not know, however, that the Jenkins Act was passed more than 50 years ago. Long before the advent of electronic communications and e-commerce. Since that time the federal government and several states have passed legislation specifically relating to electronic communications. The Privacy Act of 1974 and the Electronics Communications act of 1986 are examples of this type of legislation. At this very moment Congress is debating additional legislation to protect privacy in electronic commerce. To this end we believe there is ample justification to state the following policy: We will not divulge your information to any third party without either your express consent or as directed by the lawful order of a court of proper jurisdiction. You should be aware that you could be liable for additional taxes to your local state and/or community tax authorities. We strongly suggest that each customer

(c) Pursuant to Revenue and Taxation Code sections 30008, 30009 and 30109,

California taxes are imposed and collected on the first distribution of untaxed cigarettes in the

state. This means that since Smokin4Less does not pay taxes on cigarettes purchased from its

Complaint For Injunction, Civil Penalties, and Other Relief

1

2

3

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

27

web sites and shipped to consumers in California, the California consumers must pay all taxes

- (d) Defendants' implication that California taxes need not be paid because all transactions take place in Virginia is erroneous and/or irrelevant because by law, consumers obligation to pay taxes on cigarettes purchased over the Internet from defendants is based on the shipments of cigarettes into California and not the alleged location of the transaction;
- (e) Defendants' representation concerning responsibility for tax law compliance implies that defendants are not responsible for ascertaining and complying with the relevant tax laws concerning cigarette products and that the burden of doing so rests with the purchaser. In fact, pursuant to the Jenkins Act, it is the responsibility of the seller to report shipments of
- (f) Defendants advertise Smokin4Less cigarettes at a stated price but fail to inform California consumers that the stated price does not include taxes.

Failure to Notify California Purchasers of Tax Obligations

- 23. Effective January 1, 2003, California Revenue and Taxation Code section 30101.7(d) requires that a person may engage in non-face-to-face sales of cigarettes to California consumers provided that either of the following conditions is met:
 - (1) All applicable California taxes on the cigarettes have been paid.
- (2) The seller includes, on the outside of the shipping container for any cigarettes shipped to a resident in California from any source in the United States, an externally visible and easily legible notice located on the same side of the shipped container as the address to which the

"IF THESE CIGARETTES HAVE BEEN SHIPPED TO YOU FROM A SELLER LOCATED OUTSIDE OF THE STATE IN WHICH YOU RESIDE, THE SELLER HAS REPORTED PURSUANT TO FEDERAL LAW THE SALE OF THESE CIGARETTES TO YOUR STATE TAX COLLECTION AGENCY, INCLUDING YOUR NAME AND ADDRESS. YOU ARE LEGALLY RESPONSIBLE FOR ALL APPLICABLE UNPAID STATE TAXES ON THESE CIGARETTES."

24. Although the People informed defendants of this new law, its effective date and sent defendants a copy of the law, since January 1, 2003, Smokin4Less has violated Revenue and Complaint For Injunction, Civil Penalties, and Other Relief

///

Taxation Code section 30101.7(d) by failing to pay applicable taxes or to clearly inform California consumers of their obligation to pay all applicable unpaid taxes on the cigarettes.

25. The failure of out-of-state-retailers, such as defendants, to comply with federal and state law by reporting shipments of cigarettes into California and the identity of the purchasers to the BOE and by notifying purchasers of their California tax obligations, has resulted in significant loss of tax revenue to the state. The BOE estimates for fiscal year 2001 - 2002, California has lost approximately \$53.9 million through sales of cigarettes to California consumers over the Internet, by mail order and cross-border sales. This figure represents the taxes owed on 61.9 million packs of cigarettes.

Failure to Verify Age and Deliver Tobacco Products to Purchasers' Verified Billing Address

26. Also effective January 1, 2003, Business and Professions Code section 22963 prohibits the distribution or sale of tobacco products directly or indirectly to any person under the age of 18. Section 22963(b)(1) requires that any person distributing tobacco products directly to a consumer in the state through any public or private postal service or package delivery service, including orders placed through the Internet must, inter alia, verify that the purchaser is at least 18 years old through a data base of government records or through an age-verification kit completed by the purchaser. Section (b)(3) requires that the seller confirm the sale by telephone call to the purchasers' home after 5:00 p.m., and section 22963(b)(1) requires the seller to deliver the tobacco product to the purchaser's verified billing address on the check or credit card used for payment.

27. Since January 1, 2003, defendants have violated Business and Professions Code section 22963(b)(1),(3) & (4) because they do not verify the age of the potential purchaser, confirm the sale by telephone as required by section 22963(b)(1) and (3) and defendants have been also representing to consumers on their web sites that they will deliver tobacco products to California purchasers at addresses other than their verified billing addresses, once they confirm that the order is valid, in violation of section 22963(b)(4).

FIRST CAUSE OF ACTION 1 2 **Business and Professions Code section 17500 False or Misleading Advertising** 3 28. The People reallege and incorporate herein by reference, paragraphs 1 through 27, 4 5 inclusive, as though fully set forth herein. 6 29. Within the past three (3) years from the date of the filing of this Complaint, 7 defendants and their agents and representatives, have made or caused to be made, untrue or 8 misleading statements to members of the public, including to potential customers purchasing 9 cigarettes from their web sites, in violation of section 17500 of the Business and Professions Code, in order to induce them to purchase cigarettes from defendants. Said untrue or misleading 10 statements include, but are not limited to the following: 11 12 (a) Representing that defendants are not required to comply with the Jenkins 13 Act's reporting requirements; 14 (b) Representing or implying that California consumers are not required to pay taxes in California on cigarettes purchased from Smokin4Less over the Internet. 15 16 (c) Advertising Smokin4Less' cigarettes at a stated price but failing to inform 17 California consumers that this stated price does not include California taxes. 18 30. Defendants knew, or by the exercise of reasonable care, should have known, that the statements set forth in paragraph 29 were untrue or misleading at the time such statements 19 20 were made. SECOND CAUSE OF ACTION 21 Business and Professions Code section 22963(b)(1),(3) & (4) 22 Age Verification and Delivery of Tobacco Products to Unverified Billing Address 23 31. The People reallege and incorporate by reference, paragraphs 1 through 30, 24 25 inclusive, as though fully set forth herein. 32. Since January 1, 2003, Smokin4Less does not verify the age of potential 26

purchasers, confirm Internet orders by telephone and delivers tobacco products to persons in

Complaint For Injunction, Civil Penalties, and Other Relief 11

California at an address other than the purchaser's verified billing address on the check or credit

27 28

card used for payment, as required by Business and Professions Code section 22963(b)(1),(3) & 2 (4).3 THIRD CAUSE OF ACTION Revenue and Taxation Code section 30101.7(d) 4 Failure to Notify California Purchasers of Their Tax Obligations 5 33. The People reallege and incorporate by reference, paragraphs 1 through 32, 6 7 inclusive, as though fully set forth herein. 8 34. Since January 1, 2003, Smokin4Less has engaged and continues to engages in 9 non-face-to-face sales of cigarettes to California consumers without satisfying either of the following conditions required by Revenue and Taxation Code section 30101.7: (1) paying all 10 applicable California taxes or (2) including on the outside of the shipping container for any 11 cigarettes shipped to a resident in California from any source in the United States an externally 12 13 visible and easily legible notice located on the same side of the shipped container as the address to which the package is delivered. 15 **FOURTH CAUSE OF ACTION** 16 **Business and Profession Code section 17200** 17 **Unfair or Unlawful Business Acts or Practices** 18 35. The People reallege and incorporate by reference paragraphs 1 through 34, 19 inclusive, as though fully set forth herein. 20 36. The People are informed and believe, and upon such information and belief allege that within the past four (4) years from the date of the filing of this Complaint, defendants, and 21 22 each of them, engaged in acts of unfair competition as defined in and prohibited by Business and 23 Professions Code section 17200 by engaging in conduct which includes, but is not limited to: 24 (a) Making untrue or misleading statements as referenced in paragraph 29 of this Complaint, in violation of Business and Professions Code section 17500; 25 (b) Selling cigarettes over the Internet and delivering them by common carrier to 26 27 California children since at least July 2001, in violation of Penal Code section 308(a); 28 ///

Complaint For Injunction, Civil Penalties, and Other Relief 12

Complaint For Injunction, Civil Penalties, and Other Relief 13

- (c) Failing to maintain adequate or effective safeguards or procedures to ensure that children cannot purchase cigarettes from their web site and that cigarettes will not be delivered to children, in violation of Penal Code section 308(a);
- (d) Failing to report to the BOE sales of cigarettes to California consumers as required by the Jenkins Act;
- (e) Representing or implying that potential purchasers may be required to report purchases of cigarettes from defendants' web sites to the BOE.
- (f) Failing to comply with age verification and delivery requirements in violation of Business and Professions Code section 22963(b)(1), (3) & (4); and
- (g) Failing to either pay the California taxes owed on cigarettes purchased by California consumers over the Internet from Smokin4Less or clearly notify such consumer that defendants have reported the sale of cigarettes to the BOE and the purchaser is responsible for the unpaid taxes, in violation of Revenue and Taxation Code section 30101.7(d).

WHEREFORE, the People respectfully pray that this Court grant the following relief:

- 1. Pursuant to Business and Professions Code section 17535, defendants, their successors, employees, agents and representatives, and all other persons who are acting in concert with them, be preliminarily and permanently enjoined from making untrue or misleading statements in violation of Business and Professions Code section 17500 and be specifically enjoined from making the untrue or misleading statements set forth in the First Cause of Action.
- 2. Pursuant to Business and Professions Code section 17203, defendants, their successors, employees, agents, representatives, and all other persons who are acting in concert with them, be preliminarily and permanently enjoined from engaging in unfair competition as defined in Business and Professions Code section 17200 and be specifically enjoined from engaging in the types of acts or practices set forth in the Fourth Cause of Action.
- 3. Pursuant to Revenue and Taxation Code section 30101.7(e), defendants, their successors, employees, agents, representatives, and all other persons who are acting in concert with them, be preliminarily and permanently enjoined from failing to comply with Revenue and Taxation Code§30101.7(d).

24

27

28