

The extra charges for the attorney's gross revenue taxes on costs are disallowed. Gross revenue taxes are the attorney's responsibility and not the responsibility of the attorney's client or of an adverse party to whom the fee may be shifted. Cf. Bank of the FSM v. Truk Trading Co., 16 FSM Intrm. 467, 471 (Chk. 2009). Additionally, since the copying charges were for copying done in-house, the real effect of such a surcharge would be that the copy charge is raised from 20¢ to 20.6¢ a copy for the Board, while the client presumably paid only 20¢. The law office is presumed to have taken the tax into account when it set its charge for in-house copying.

III.

The clerk shall amend the judgment to show that the Board of Trustees of the Pohnpei State Public Lands Trust is also liable to the Carlos Etscheit Soap Company for \$9,470 in reasonable attorney's fees and \$135 in costs and that Erine McVey and Do It Best Hardware are also liable to the Carlos Etscheit Soap Company for \$30 in costs.

* * * *

FSM SUPREME COURT TRIAL DIVISION

CONTINENTAL MICRONESIA, INC.,)	CIVIL ACTION NO. 2010-1021
)	
Plaintiff,)	
)	
vs.)	
)	
CHUUK STATE GOVERNMENT and JESSE MORI,)	
Director of Administrative Services of the Chuuk)	
State Government, in his official capacity,)	
)	
Defendants.)	
)	

ORDER DENYING DISMISSAL AND GRANTING INJUNCTION

Dennis K. Yamase
Associate Justice

Hearing: May 12, 2010
Decided: June 17, 2010

APPEARANCES:

For the Plaintiff: Fredrick L. Ramp, Esq.
P.O. Box 1480
Kolonias, Pohnpei FM 96941

For the Defendants: Joses Gallen, Esq.
Attorney General
Office of the Chuuk Attorney General
P.O. Box 1050
Weno, Chuuk FM 96942

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HEADNOTES

Taxation

The Chuuk service tax is to be paid by the customer, person, company, or entity obtaining the services, and must be collected by the person, company, or entity providing the services. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 156 (Chk. 2010).

Jurisdiction – Arising under Nationality

When the parties are of diverse citizenship and when some of the plaintiff's claims arise under a treaty to which the FSM is a party, the FSM Supreme Court would, on either ground, have subject-matter jurisdiction over the case if an actual case or dispute exists. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 157 (Chk. 2010).

Jurisdiction – DiversityCivil Procedure – Declaratory Relief;

When Chuuk has warned Continental that it is required to collect a service tax as set forth in a regulation implementing a tax statute that criminal penalties may be imposed on Continental or its employees for failure to comply, the question of whether the Chuuk service tax on Continental passengers and freight shippers is sufficiently ripe to support a suit seeking declaratory judgment. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 157-58 (Chk. 2010).

Constitutional Law – Case or Dispute – Ripeness; TaxationTaxation – Recovery of Taxes

If a taxing authority chooses not to provide a pre-deprivation process, it must by way of a post-deprivation process provide a clear and certain remedy for any erroneous or unlawful tax collection to ensure that the opportunity to contest the tax is a meaningful one. A clear and certain remedy is one designed to render the opportunity to challenge a tax meaningful by preventing any permanent unlawful deprivation of property. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 158 (Chk. 2010).

Taxation – Recovery of Taxes

There is no meaningful clear and certain post-deprivation remedy available to a Chuuk taxpayer when Chuuk's financial situation and its general inability to satisfy any court judgment make any purported post-deprivation remedy very unlikely. Thus any unlawful deprivation of a taxpayer's property would essentially be permanent and the opportunity to later contest the service tax would not be a meaningful one. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 158 (Chk. 2010).

Constitutional Law – Case or Dispute

It is inconceivable that a party would be made to suffer criminal or civil penalties for the failure to collect a tax but would not have standing to challenge the tax's constitutionality (and thus the requirement that the party must collect the tax). The inability of a party required by law to collect a tax to challenge that tax's validity would constitute that party of its property (compliance costs, tax collection costs, remittance costs, etc.) without the due process of law. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 158-59 (Chk. 2010).

Standing; Constitutional Law – Due Process; TaxationConstitutional Law – Case or Dispute

If the requirement of standing is given a narrow construction when there is involved constitutional or important statutory rights, then there is, in effect, no practical remedy for anyone with an interest in enforcing the right – and the right becomes a mockery. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 159 (Chk. 2010).

Standing

Continental Micronesia, Inc. v. Chuuk
17 FSM Intrm. 152 (Chk. 2010)

Constitutional Law – Case or Dispute – Standing

Two factors are central to the determination of whether a party has standing: 1) the party must allege a sufficient stake in the dispute's outcome and it must have suffered some actual or threatened injury resulting from the allegedly illegal action, and 2) the injury must be such that it can be traced to the challenged action and must be of the kind a favorable decision will likely redress. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 159 (Chk. 2010).

Constitutional Law – Case or Dispute – Standing; Taxation – Constitutionality

When Continental has alleged a sufficient stake in the action's outcome and is threatened not only with substantial costs if it complies but also with civil and criminal penalties if it does not and these threatened injuries are all traceable to the Chuuk service tax and would be addressed by a favorable decision, it may therefore challenge the legal requirement that it collect the tax (and remit it to the State) even if technically, only the statutorily defined taxpayer has the legal ability to challenge the tax's validity. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 159 (Chk. 2010).

Civil Procedure – Injunctions

In exercising its broad discretion in considering whether to grant a preliminary injunction, the court will look to four factors: 1) the likelihood of success on the merits of the party seeking injunctive relief, 2) the possibility of irreparable injury to the movant, 3) the balance of possible injuries or inconvenience to the parties that would flow from granting or denying the relief, and 4) any impact on the public interest. A preliminary injunction's object is to preserve the status quo pending litigation on the merits. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 159-60 (Chk. 2010).

Taxation – Constitutionality

When Chuuk made the taxable incident the purchase of a plane ticket or of freight service and made the tax payable by the purchaser, it avoided one constitutional confrontation – the service tax is not an income tax since the service tax is a tax on the buyer, not the seller. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 160 (Chk. 2010).

Constitutional Law – Interstate and Foreign Commerce; Federalism – National/State Power

The Constitution grants the national government, not the state governments, the power to regulate foreign and interstate commerce and taxation is regulation just as prohibition is. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 160 (Chk. 2010).

Aviation; Constitutional Law – Interstate and Foreign Commerce; Federalism – National/State Power; Taxation – Constitutionality

A service tax on plane passengers does not have only an incidental effect on foreign commerce; its only effect is on foreign commerce. A tax on shipping cargo or freight affects only foreign commerce or interstate commerce since the airline does not fly to anywhere in Chuuk except Weno. Since state and local governments are prohibited from imposing taxes which restrict interstate commerce, to the extent that the tax is imposed on freight or cargo shipped from Chuuk to other FSM states, would appear to be specifically barred by the Constitution and to the extent it is imposed on cargo or freight shipped elsewhere, it would be regulation of foreign commerce – in effect, an export tax. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 160 (Chk. 2010).

Aviation

Although Chuuk may "own" the airport, airport runway, tarmac, and terminal buildings, and these are all services an airline uses, the airline already pays the State for the use of the various airport facilities through landing fees for its aircraft, rental fees for office space, and other service fees (and it also pays a 3% gross revenue tax to the national government, half of which is shared with the states), and its passengers departing Chuuk already pay for Chuuk's airport services through a \$20

Continental Micronesia, Inc. v. Chuuk
17 FSM Intrm. 152 (Chk. 2010)

departure fee collected at the airport. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 160-61 & n.1 (Chk. 2010).

Administrative Law

A regulation cannot impermissibly extend or limit the reach of the statute that authorizes it and an unconstitutional statute may not be redeemed by voluntary administrative action. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 161 (Chk. 2010).

Civil Procedure – Injunctions – Irreparable Harm

A movant faces irreparable injury when, if no injunction is issued the movant must then inform all of the world's computer passenger reservation systems of the special pricing requirements for paying passengers leaving Chuuk and must then compensate those reservation systems for their reprogramming expenses; when, for its cargo or freight shipping service, a new computer software, whose cost is very substantial, would need to be written and installed; when these costs are not recoverable if the movant should prevail (although new computer software for cargo may have some benefits of its own); and when other costs – compliance costs, tax collection costs, remittance costs – would also not be recoverable if it prevails. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 161 (Chk. 2010).

Civil Procedure – Injunctions – Irreparable Harm

Irreparable injury may include the loss of goodwill, loss of customers and potential customers, lost sales, and similar harms since they are not readily compensable by money damages, and thus are precisely the type of harm a preliminary injunction is intended to prevent because economic damages based on such harms are extremely difficult to calculate. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 162 (Chk. 2010).

Civil Procedure – Injunctions – Irreparable Harm

An irreparable and certainly unquantifiable harm would occur if Continental collected the service tax, the tax was ruled unlawful, and Continental was then faced with the difficult, if not insurmountable, task of refunding the tax charge to all the passengers from whom it had collected the unlawful tax, and it then would also face a second set of reprogramming costs to change the world's computer reservation systems back to their previous state by deleting the new special Chuuk tax codes. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 162 (Chk. 2010).

Civil Procedure – Injunctions – Irreparable Harm

If Continental does not comply with Chuuk's demands that it start collecting the tax immediately, it and its employees face civil and criminal penalties, which would constitute irreparable harm if imposed and if Continental then prevailed on the merits. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 162 (Chk. 2010).

Civil Procedure – Injunctions – Balance of Injuries

The balance of possible injuries favors the movant when its possible injuries are numerous and, in some respects, onerous and when the only possible injury to the State is that it would, during the pendency of the case, be precluded from creating a new source of revenue and this harm would be almost completely alleviated by the requirement of a bond in the approximate amount of what sums it would have collected on the tax while the case is pending and when such security will be required. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 162 (Chk. 2010).

Civil Procedure – Injunctions – Public Interest

When one strong public interest would favor the development of sound source of revenue for the state government to improve its financial condition and another public interest would favor keeping

Continental Micronesia, Inc. v. Chuuk
17 FSM Intrm. 152 (Chk. 2010)

the ticket prices lower so as to encourage travel and tourism to Chuuk to benefit the local economy and increase local tax revenue that way, it is difficult to tell which side the public interest would favor. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 162 (Chk. 2010).

Civil Procedure – Injunctions

Under Civil Procedure Rule 65(c), no preliminary injunction can issue except upon the giving of security by the applicant, in such sum, if any, as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained. The security, if ordered, may be in the form of a cash bond, or an irrevocable letter of credit, or an insurance company surety bond, or some other form of security if the defendants find that form acceptable, and if a cash bond is provided, the cash will be placed in an interest-bearing account with the interest to ultimately go to whoever receives the principal. Continental Micronesia, Inc. v. Chuuk, 17 FSM Intrm. 152, 162 (Chk. 2010).

* * * *

COURT'S OPINION

DENNIS K. YAMASE, Associate Justice:

On May 12, 2010, this came before the court for hearing on the defendants' Motion to Dismiss for Lack of Jurisdiction, filed April 26, 2010, and on the plaintiff's Motion for Temporary Restraining Order and Preliminary Injunction, filed April 12, 2010. The motion to dismiss is denied. The preliminary injunction sought by the plaintiff will issue as soon as the plaintiff provides acceptable security in the amount of \$157,500. The court's reasoning follows.

I. BACKGROUND

On November 9, 2009, the State of Chuuk enacted Chuuk State Law No. 10-09-11 (repealing and amending parts of Truk S.L. No. 5-119, as previously amended). This law was amended on December 10, 2009, by Chuuk State Law No. 10-09-13, which, by its terms, took effect on December 25, 2009. The state laws, as amended, imposed a 5% "service tax" on, among other things, "air . . . transportation services . . . for outgoing passengers of Chuuk where their final destination" would be "outside of the FSM irrespective of where payment of the service is made," Chk. S.L. No. 10-09-13, § 1(5) (to be codified at § 11(5)), and on "Courier Services," *id.* § 1(17) (to be codified at § 11(17)). The tax is to be paid "by the customer, person, company or entity obtaining the services, and which shall be collected by the person, company or entity providing the services." *Id.* § 2 (to be codified at § 11-A).

Under the Emergency Regulation to Implement Service Tax (promulgated Feb. 17, 2010), the 5% tax on outgoing passengers is calculated on the basis of what the regulation calls the "deemed service price" to the only four destinations outside of the FSM with direct scheduled air service from Chuuk – Guam, Kwajalein, Majuro, and Honolulu. The "deemed service price" was calculated from the average price of all tickets purchased anywhere in the world for air passenger service that departed Chuuk and terminated in or changed planes in any of those four destinations. The regulation adds to each paid ticket a flat rate charge, calculated as 5% of the "deemed service price," as the tax to be imposed – \$12.74 tax on each ticket to Guam, \$16.92 on tickets to Kwajalein, \$19.64 on tickets to Majuro, and \$42.86 on tickets to Honolulu. Emergency Reg. to Implement Serv. Tax pt. 3(i) (Feb. 17, 2010). Under the regulation, the "deemed service price," and thus the applicable tax, is to be recalculated annually. *Id.* The regulation defines the term "Courier Services" as "services for transport of goods by air, land or sea shipping, but does not include excess baggage or similar charges for accompanied

Continental Micronesia, Inc. v. Chuuk
17 FSM Intrm. 152 (Chk. 2010)

luggage." *Id.* pt. 3 (i). (The term is not defined in the statute.)

On February 19, 2010, Department of Administrative Services Director Jesse Mori informed Continental Micronesia, Inc. ("Continental") by letter to its Chuuk station manager that Continental was to start collecting and submitting the passenger service tax in the amounts as set forth in the emergency regulation. On March 10, 2010, Director Mori again wrote the Continental station manager reminding him of the criminal penalties imposed by the statute on those who failed to collect the tax and stating that to avoid the penalties Continental had to start collecting the outgoing passenger service tax no later than April 12, 2010.

On April 12, 2010, Continental filed this lawsuit seeking a declaratory judgment that the service tax that Chuuk was requiring Continental to collect is unlawful and also seeking injunctive relief restraining Chuuk from requiring Continental to collect the service tax and from imposing any penalties on it or its employees for its failure to collect.

II. MOTION TO DISMISS

The defendants move to dismiss this case on the ground that the court cannot exercise jurisdiction over it because the Chuuk tax statute precludes it. They rely on Truk State Law No. 5-119, section 22 which provides that:

1) No person shall have a right of action to challenge the validity of any tax levied by this act unless that person shall first pay the tax in question, under protest, to the State

2) No person shall have a right of action to challenge the validity of any tax levied by this act unless that person is the actual taxpayer having liability for payment of the tax.

The defendants contend that Continental cannot challenge the service tax's validity because 1) Continental is not the actual taxpayer, the passengers and freight shippers are, and 2) Continental has not paid the tax under protest.

The defendants acknowledge that the parties in this case are of diverse citizenship and that the FSM Supreme Court has jurisdiction over diversity cases. The defendants also do not dispute that some of Continental's claims arise under a treaty to which the FSM is a party. The FSM Supreme Court would, on either ground, have subject-matter jurisdiction over this case if an actual case or dispute exists. FSM Const. art. XI, § 6(b).

The defendants assert that the court has no jurisdiction because there is no case or dispute before it since Continental has not met the statutory standing and ripeness requirements for there to be an actual tax case or dispute. The defendants assert that, under Chuuk State Law No. 5-119, section 22, Continental does not have standing to bring this action since, under Chuuk State Law No. 10-09-13, § 2, Continental is not the taxpayer, and that this action is not ripe for resolution because Continental must first pay the tax before it can challenge its lawfulness.

A matter may be ripe for adjudication for there to be a case or dispute over which the court can exercise jurisdiction. See *Siops v. Crabtree*, 13 FSM Intrm. 355, 366 (Pon. 2005). In *Michelsen v. FSM*, 3 FSM Intrm. 416, 419-19 (Pon. 1988), the court held that when the FSM attorney general specifically warned a party that it was required to obtain a foreign investment permit under a national statute imposing criminal penalties for failure to comply, the question of whether a permit was required was sufficiently ripe to support a suit seeking declaratory judgment. Here, Chuuk has warned Continental

Continental Micronesia, Inc. v. Chuuk
17 FSM Intrm. 152 (Chk. 2010)

that it is required to collect the service tax as set forth in a regulation implementing a tax statute and that criminal penalties may be imposed on Continental or its employees for failure to comply. The question of whether the Chuuk service tax on Continental passengers and freight shippers is lawful is thus sufficiently ripe to support a suit seeking declaratory judgment.

In Weno v. Stinnett, 9 FSM Intrm. 200, 213 (App. 1999), the appellate court held that if a taxing authority chose not to provide a pre-deprivation process, it must by way of a post-deprivation process provide a clear and certain remedy for any erroneous or unlawful tax collection to ensure that the opportunity to contest the tax is a meaningful one. The Stinnett court defined a clear and certain remedy as one designed to render the opportunity to challenge a tax meaningful by preventing any permanent unlawful deprivation of property. *Id.*

Based on the presentation at the hearing, the court is satisfied that there is no meaningful clear and certain post deprivation remedy available to Continental. Chuuk's financial situation and its general inability to satisfy any court judgment make any purported post-deprivation remedy very unlikely. Thus any unlawful deprivation of Continental's property would essentially be permanent and the opportunity to contest the service tax would not be a meaningful one.

Under Chuuk State Law No. 10-09-13, Continental is not the taxpayer, only a tax collector, and therefore does not have the ability to "first pay the tax in question, under protest, to the State," Truk S.L. No. 5-119, § 22(1), as the defendants would require it to do before it could challenge the service tax. Continental does have the ability to collect the tax and could remit the tax "under protest" but would then be faced with the defendants' claim that subsection 22(2) precluded Continental from challenging the tax since it is not the "taxpayer." To further confuse matters, section 7 of Chuuk State Law No. 10-09-13 refers to "[t]axpayers providing services imposed by Section 11 of this Act who knowingly or unlawfully fail to collect the service tax or remit any service tax collected in accordance with this Act shall upon conviction . . ." and goes on to impose criminal penalties on the service-providers who fail to pay. Although in this one instance the statute refers to Continental as a "taxpayer," the rest of Chuuk State Law No. 10-09-13 clearly provides that Continental is not the entity upon which the tax is imposed, but is an entity which Chuuk requires to collect a tax for it.

It is inconceivable that a party could be made to suffer criminal or civil penalties for the failure to collect a tax but would not have standing to challenge the tax's constitutionality (and thus the requirement that the party must collect it). See, e.g., Sac & Fox Nation of Mo. v. LaFaver, 31 F. Supp. 2d 1298, 1302 (D. Kan. 1998) (tribes had standing to seek injunction and to challenge state tax on fuel distributors when distributors would pass state tax on to tribal retailers thus causing injury to tribes); Freni v. Collier County, 588 So. 2d 291, 293 (Fla. Dist. Ct. App. 1991) (hoteliers had standing to challenge validity of a tourist development tax "by virtue of their roles as collectors of a tax from their guests"); Bass v. South Cook County Mosquito Abatement Dist., 603 N.E.2d 749, 750-51 (Ill. App. Ct. 1992) (although statutory procedure of payment under protest and application for a refund is generally a taxpayer's exclusive remedy in tax cases, equitable injunctive relief is available without first following the statutory remedy when the tax is unauthorized by law or is levied on exempt property); Kaul v. State Dep't of Revenue, 970 P.2d 60, 67 (Kan. 1998) (although incidence of tax fell on fuel distributors, fuel retailers had standing to challenge tax and seek injunction when the tax was passed along); Ganser v. County of Lancaster, 338 N.W.2d 609, 611 (Nebr. 1983) (injunctive relief is available when the taxing body does not have jurisdiction or power to impose tax); cf. Chicago Park Dist. v. City of Chicago, 468 N.E.2d 1261, 1263 (Ill. App. Ct. 1984) (although Park District was not required to pay or collect a mooring tax it had standing to question the tax's constitutionality because the tax's impact on mooring benefit holders within the Park District would directly injure the District and its revenue planning); Society of the Plastic Indus. v. City of New York, 326 N.Y.S.2d 788, 791 (N.Y. Sup. Ct. 1971) (constitutionality of tax on plastic containers may be challenged by container manufacturers);

Texfi Indus., Inc. v. City of Fayetteville, 261 S.E.2d 21, 23 (N.C. Ct. App. 1979) (although general rule is that taxpayer has no standing to question matters of general public interest that affect all taxpayers equally, the rule does not apply when the taxpayer shows that the levied tax is unconstitutional; direct economic injury need not be shown to assert violation of constitutional rights). The inability of a party required by law to collect a tax to challenge that tax's validity would deprive that party of its property (compliance costs, tax collection costs, remittance costs, etc.) without any due process of law.

Chuuk would evidently permit only ticket-buying passengers, if they had paid the service tax "under protest, to the State," to challenge the service tax, a tax which most of them would be unaware that they were even paying. The ticket-buying passengers would not pay the tax directly to Chuuk, but would pay it to Continental or some other agency that would eventually pay Continental. Would Continental be required to transmit to Chuuk the protesting, tax-paying passenger's name before the passenger could challenge the tax and seek a refund of the \$12.74 to \$42.86 tax that the passenger had paid? Would Chuuk then contend that, since the passenger had not paid the tax to the State (since the passenger paid Continental), the passenger also had not complied with Truk S.L. No. 5-119, § 22(1) and could not challenge the tax? "If the requirement of standing is given a narrow construction when there is involved constitutional or important statutory rights . . . then there is, in effect, no practical remedy for anyone with an interest in enforcing the right—and the right becomes a mockery." Societ of the Plastic Indus., 326 N.Y.S.2d at 792. That would appear to be the result if the court followed the defendants' arguments.

The court therefore concludes that Truk State Law No. 5-119, section 22 does not preclude the pre-deprivation declaratory relief action by Continental if Continental has standing to seek a declaratory judgment concerning the service tax's validity. Two factors are central to the determination of whether a party has standing: 1) the party must allege a sufficient stake in the dispute's outcome and it must have suffered some actual or threatened injury resulting from the allegedly illegal action, and 2) the injury must be such that it can be traced to the challenged action and must be of the kind a favorable decision will likely redress. Urusemal v. Capelle, 12 FSM Intrm. 577, 583 (App. 2004). Continental has alleged a sufficient stake in this action's outcome and is threatened not only with substantial cost if it complies but also with civil and criminal penalties if it does not and these threatened injuries are all traceable to the Chuuk service tax and would be addressed by a favorable decision.

Continental may therefore challenge the legal requirement that it collect this tax (and remit it to the State) even if technically, only the statutorily defined taxpayer has the legal ability to challenge the tax's validity. Accordingly, the defendants' motion to dismiss is denied.

III. PRELIMINARY INJUNCTION MOTION

Continental asks that, until this case is resolved, the defendants be restrained and enjoined from requiring it to collect the service tax and from imposing any penalties on it or its employees for not collecting the tax. Since the parties have agreed to maintain the status quo while the court decides the pending motions and since both sides were able to prepare and present witness testimony and evidence during the hearing, the court considers Continental's pending motion to be whether a preliminary injunction should issue.

In exercising its broad discretion in considering whether to grant a preliminary injunction, the court will look to four factors: 1) the likelihood of success on the merits of the party seeking injunctive relief, 2) the possibility of irreparable injury to the movant, 3) the balance of possible injuries or inconvenience to the parties that would flow from granting or denying the relief, and 4) any impact on the public interest. *E.g.*, Carlos Etscheit Soap Co. v. McVey, 14 FSM Intrm. 458, 461 (Pon. 2006); Ruben v. Petewon, 13 FSM Intrm. 383, 386 (Chk. 2005). A preliminary injunction's object is

preserve the status quo pending litigation on the merits. *E.g.*, Ruben, 13 FSM Intrm. at 386.

A. *Likelihood of Success on the Merits*

Continental claims that it is likely that it will succeed on the merits because, in its view, the Chuuk service tax is obviously a disguised but unconstitutional income tax, an unconstitutional tax burdening interstate commerce, and an unconstitutional regulation of foreign commerce, and a violation of the international aviation treaty to which the FSM is a party. The defendants contend that the service tax was carefully crafted so as not to be an income tax and that the tax is not regulation of foreign or interstate commerce and is permissible because it only incidentally affects foreign and interstate commerce and directly taxes only a service performed in Chuuk – transportation of a person from Chuuk to a foreign destination and the shipping of freight or cargo to another destination.

Continental asserts that the Chuuk service tax is an unconstitutional income tax. The defendants, however, recognize the lessons of Truk Continental Hotel, Inc. v. Chuuk, 7 FSM Intrm. 117, 120 (App. 1995) ("[i]f a state wishes to obtain funding from a consumption tax, it can avoid a constitutional confrontation by making the taxable incident the sale or rental transaction, and by expressing the requirement that the tax be paid by the consumer"; otherwise a state tax on gross receipts is an unconstitutional tax on income). When Chuuk made the taxable incident the purchase of a plane ticket or of freight service and made the tax payable by the purchaser, it avoided one constitutional confrontation – the service tax is not an income tax. Continental is not likely to succeed on this argument since the service tax is a tax on the buyer, not the seller.

Continental's other claims are much more likely to succeed. The Constitution grants the national government, not the state governments, the power "to regulate . . . foreign and interstate commerce . . ." FSM Const. art. IX, § 2(g). "Taxation is regulation just as prohibition is." Compania General de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 87, 96, 48 S. Ct. 100, 103, 72 L. Ed. 177, 181 (1927). The defendants rely on United States authorities that hold that when a state tax is levied in a state and has only an incidental effect on interstate commerce, it is not regulation of or a burden on interstate commerce. The Chuuk service tax on plane passengers does not have only an incidental effect on foreign commerce. Its only effect is on foreign commerce. Likewise, the tax on shipping cargo or freight affects only foreign commerce or interstate commerce – Continental does not fly to anywhere in Chuuk except Weno. Since "[s]tate and local governments are prohibited from imposing taxes which restrict interstate commerce," FSM Const. art. VIII, § 3, to the extent that it is imposed on freight or cargo shipped from Chuuk to other FSM states, would appear to be specifically barred by the Constitution. To the extent it is imposed on cargo or freight shipped elsewhere, it would be regulation of foreign commerce – in effect, an export tax. Continental's likelihood of success on the merits of its foreign and interstate commerce regulation claims is probable.

Additionally, Continental relies on an international treaty to which the Federated States of Micronesia is a party and which either prohibits or strongly discourages taxes that burden international aviation. During the hearing, the defendants' expert tax witness was asked if he knew of anywhere in the world where a similar tax was imposed on aviation or airline passengers. The only example he could think of was on internal flights in Australia between two Australian states. Continental's witness testified that, to his knowledge, there were no such taxes on international aviation anywhere in the world. Although the international treaty argument was not heavily relied on or fully developed, it seems apparent that this ground enhances Continental's chances of success.

During the hearing the defendants emphasized the fact that the State "owned" the airport, airport runway, tarmac, and terminal buildings, and that these are all services Continental uses. The court can give no weight to this point. Continental already pays for the use of the various airport facilities

through landing fees for its aircraft, rental fees for office space, and other service fees.¹ And Continental passengers departing Chuuk already pay for Chuuk's airport services through a \$20 departure fee² collected at the airport. The Chuuk service tax would just add a further charge on those passengers departing to any destination except Kosrae, Pohnpei, and possibly, Yap.³

Another ground on which Continental has a fair chance of success and which was raised during the hearing, is the difference between the statutory language and the regulatory provisions. They appear to conflict. A regulation cannot impermissibly extend or limit the reach of the statute that authorizes it. Braicl v. National Election Dir., 9 FSM Intrm. 133, 138 (App. 1999); Klavasru v. Kosrae, 7 FSM Intrm. 86, 91 (Kos. 1995). "Courier services" in the statute would seem to be a much more limited concept than its regulatory definition which would include all freight and cargo. See DHL Corp. v. Civil Aeronautics Bd., 659 F.2d 941, 946 (9th Cir. 1981) ("Couriers receive a unique service, freight service with handling advantages enjoyed only by passengers."). And limiting the passenger tax to only four foreign destinations would seem to differ from the statutory language which applied to any foreign destination. The defendants' expert witness testified that this limitation was because they looked at what was the service provided in Chuuk that was being taxed and concluded that the taxed service could only extend as far as there was direct plane service. If, at Guam, Honolulu, Majuro, or Kwajalein, the passenger continued onward to a destination other than those four, the passenger would change planes; so the Chuuk-provided service would end there and a new service begin. This regulatory limitation was apparently done to limit the reach of the service tax statute to what was constitutionally permissible. But an unconstitutional statute may not be redeemed by voluntary administrative action. Suldan v. FSM (II), 1 FSM Intrm. 339, 357 (Pon. 1983). This point further increases Continental's likelihood of success.

In total, the issues that Continental has raised are serious, substantial, and non-frivolous, and Continental will probably succeed on the issues' merits.

B. *Possibility of Irreparable Injury to the Movant*

Continental faces irreparable injury. If no injunction is issued then Continental must inform all of the computer passenger reservation systems in the world of the special pricing requirements for paying passengers leaving Chuuk and must then compensate those reservation systems for their reprogramming expenses. For its cargo or freight shipping service, Continental's own computer system is so antiquated that, in order to handle the percentage surcharge required under the service tax and regulation, a new computer software, whose cost is very substantial, would need to be written and installed. These costs are not recoverable if Continental should prevail (although new computer software for cargo may have some benefits of its own). Other costs – compliance costs, tax collection costs, remittance costs – would also not be recoverable if Continental prevails. Since ticket prices would have to rise to cover these costs (Continental states that these costs would be spread over all

¹ Continental also pays a 3% gross revenue tax to the national government. Half of that is then shared with the states. FSM Const. art. IX, § 5.

² See Tafunsak v. Kosrae, 7 FSM Intrm. 344, 348-49 (App. 1995) for the legal character of passenger departure fees.

³ Although the state statute purports to levy the service tax on passengers leaving Chuuk for a non-FSM destination, the regulation (and perhaps the tax statute) would appear to tax travelers from Chuuk to Yap because those travelers must change planes in Guam and Chuuk-Guam tickets would be subject to the "deemed service price" and the \$12.74 tax thereon.

tickets on the Island Hopper between Guam and Honolulu or on all tickets in the Continental Micronesia service area) as well as the tax itself. An unquantifiable harm is the number of passengers who, because of the increased ticket costs, would choose to fly to a different vacation destination or who choose to forgo a vacation trip altogether. Irreparable injury may include the loss of goodwill, loss of customers and potential customers, lost sales, and similar harms since they are not readily compensable by money damages, and thus are precisely the type of harm a preliminary injunction is intended to prevent because economic damages based on such harms are extremely difficult to calculate. See Yang v. Western Sales Trading Co., 11 FSM Intrm. 607, 616 (Pon. 2003).

Another irreparable and certainly unquantifiable harm to Continental would occur if Continental collected the service tax, the tax was ruled unlawful, and Continental was then faced with the difficult, if not insurmountable, task of refunding the tax charge to all the passengers from whom it had collected the unlawful tax. It would also face a second set of reprogramming costs to change the world's computer reservation systems back to their previous state by deleting the new special Chuuk tax codes.

And, if Continental does not comply with Chuuk's demands that it start collecting the tax immediately, Continental and its employees face civil and criminal penalties, which would constitute irreparable harm if imposed and if Continental then prevailed on the merits.

C. *Balance of Possible Injuries to the Parties*

The balance of possible injuries favors Continental. Continental's possible injuries are described above and are numerous and, in some respects, onerous. The only possible injury to the State of Chuuk is that it would, during the pendency of this case, be precluded from creating a new source of revenue. This harm can be almost completely alleviated by the requirement of a bond in the approximate amount of what sums the State would collect on this tax while this case is pending. Such security will be required. FSM Civ. R. 65(c).

D. *Impact on the Public Interest*

It is difficult to tell which side the public interest would favor. One strong public interest would favor the development of sound source of revenue for the state government to improve its financial condition. Another public interest would favor keeping the ticket prices lower so as to encourage travel and tourism to Chuuk to benefit the local economy and increase local tax revenue that way. The public-interest factor may weigh in the defendants' favor.

E. *Security*

Since, under Civil Procedure Rule 65(c), no preliminary injunction can "issue except upon the giving of security by the applicant, in such sum, if any, as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained," the court will require that Continental post security. The defendants assert that, if in effect, the service tax should generate \$15,000 to \$20,000 a month in revenue to be collected by Continental. Taking the mean of those figures, \$17,500, and multiplying it by the nine months that it may reasonably take to resolve this case, the court hereby sets \$157,500 as a proper amount for security. Continental may provide this security in the form of a cash bond, or an irrevocable letter of credit, or an insurance company surety bond, or some other form of security if the defendants find that form acceptable. If Continental provides a cash bond, the cash shall be placed in an interest-bearing account with the interest to ultimately go to whoever receives the principal. The injunction will issue once the security has been posted.

Continental Micronesia, Inc. v. Chuuk
17 FSM Intrm. 152 (Chk. 2010)

F. Summary

Weighing the four factors and including the security requirement, the court concludes that, on balance, they favor the issuance of the preliminary injunction Continental seeks. Three factors favor Continental. The fourth factor favors the defendants. The preliminary injunction shall issue once Continental has provided security.

IV. CONCLUSION

The court has jurisdiction to hear this case and, upon receipt of the required security, will issue a preliminary injunction against the defendants from enforcing Chuuk State Law No. 10-09-13 against Continental Micronesia.

* * * *

CHUUK STATE SUPREME COURT APPELLATE DIVISION

EZIKIEL PETER, individual the Saporenong lineage	and on behalf of)	APPEAL CASE NO. 01-2003
)	
Appellant)	
)	
vs.)	
)	
REJOICE JESSY, HERSUBEN, RUBEN, and TONIS EPUBEN, MORIA (intervener),)	
)	
Appellee)	
_____	_____)	

OPINION

Argued: March 29, 2010
Decided: June 23, 2010

BEFORE:

Hon. Midasy O. Aisek, Associate Justice, Presiding
Hon. Dennis K. Yamas
Hon. George Z. Isom*

*Associate Justice, FSM Supreme Court, Pohnpei
**Attorney at Law, FSM Public Defender's Office, Chuuk Branch, Weno, Chuuk

For the Appellant: Derensio Konman, Esq. (argued)
Micronesian Legal Services Corporation
P.O. Box D
Weno, Chuuk FM 96942

Maketo Robert, Esq. (briefed)
P.O. Box 1100
Weno, Chuuk, FM 96942