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U.S. Supreme Court Update

SUPREME COURT HEARS ORAL ARGUMENT IN STATE SOVEREIGNTY CASE

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***43** In this issue of the JOURNAL, we discuss the oral argument in *Franchise Tax Board of the State of California v. Hyatt* (Docket No. 14-1175). At issue before the Court is the scope of sovereign immunity as between states—morespecifically, the Court is considering whether the California Franchise Tax Board is immune from a civil suit brought by a Nevada taxpayer in Nevada state court. Although the Court previously addressed a similar issue in *Nevada v. Hall*, 440 U.S.410 (1979), finding that sovereign immunity is not absolute when it comes to states vis-a-vis other states, California now asks the Court to revisit that holding and to find that Nevada has overstepped its jurisdiction.

Irony aside (*Nevada v. Hall* involved a California court asserting jurisdiction over the state of Nevada), the oral arguments before the Court focused primarily on whether the sovereign immunity that protects states is a right that both predates,and is therefore mandated under the Constitution, or, alternatively, whether one state's immunity to the legal processes of its sister states is merely a matter of comity (i.e., dependent on the consent of the home state).

The Court also set 1/20/16 as the date for oral argument in *Nebraska v. Parker* (Docket No. 14-1406). In *Parker*, the Court has agreed to hear a challenge by a Nebraska village, several of its residents, and the state, to an EighthCircuit ruling, which held that the village must comply with tribal liquor license and taxing regulations that impose a 10 percent sales tax on all liquor sales made on the Omaha Indian Reservation.

Finally, as we go to press, three previously reported petitions remain pending before the Court and one previously reported petition has been denied.

High Court Asked to Rule on the Scope of State Sovereign Immunity

On 12/7/15, the Court heard oral argument in *Franchise Tax Board of the State of California v. Hyatt*, Docket No. 14-1175, ruling below at 335 P.3d 125 (Nev. 2014). In the case below, the Supreme Court of Nevada largely reversed a jury awardof $139 million in tort damages and $250 million in punitive damages awarded in favor of inventor Gilbert P. Hyatt in his lawsuit against the California Franchise Tax Board (‘FTB‘). The decision of the lower court, however, was not a complete victoryfor the FTB.

****2** Despite the FTB's claims that all of Hyatt's causes of action were barred under principles of discretionary-function immunity and comity, the Nevada high court affirmed the district court's findings that the FTB committed fraud and intentional inflictionof emotional distress in its personal income tax audit of Hyatt. Accordingly—although the damages imposed against

the FTB were significantly reduced—the Nevada Supreme Court ruled that the FTB was not immune from suit in Nevada state court andwas therefore unable to escape all liability.

Sovereign immunity at the time of the Constitutional Convention.

At oral argument before the Court, Paul Clement, Esq., who appeared on behalf of the FTB, took issue with the Nevada court's ruling. ‘The States entered the Union saddled with substantial war debts,‘ began Mr. Clement as part of his opening remarks.‘As a result, critics of the Constitution were quick to point out any possibility that the States could be haled into court by individual citizens without their consent in order to secure potentially bankrupting judgments.‘ In other words, Mr. Clementargued that the states would never have ratified the Constitution if they believed it meant that they would become subject to jurisdiction in the courts of their sister states.

H. Bartow Farr, Esq., however, appearing for Mr. Hyatt, disagreed with Mr. Clement's reading of history. According to Mr. Farr, the concern of the states at the time of the Constitutional Convention was whether ratification would result in states being suedby individual citizens in federal courts, not whether they could be haled into the courts of sister states. And, as noted by Mr. Farr, the Eleventh Amendment alleviated this concern.

In response to Mr. Farr's argument, Justice Kagan wondered if this was a distinction without a difference. Paraphrasing Mr. Clement's argument, Justice Kagan asked if it was not ‘unthinkable that a State would be so concerned about being haled into Federalcourt but not just as concerned or even more so about being haled into suit of another State.‘ Mr. Farr responded that there is, in fact, an important difference between the relationship of two states and the relationship of a state and the federal government.

According to Mr. Farr, there is a ‘difference in the balance of power between the Federal government and State governments and between the State governments horizontally.‘ And in her earlier questioning of Mr. Clement, Justice Kagan herself seemedto recognize this difference, suggesting ‘there's a kind of mutuality‘ between the states. ‘So,‘ continued Justice Kagan, ‘if one state does something to you that you don't like, you can turn it around and do it to them.‘ ***44** Taking this argument to its logical conclusion, Justice Kagan seemed to suggest that the threat of jurisdictional retaliation protected states from frivolous lawsuits in the courts of other states. Thus, the need for the Court to judicially mandate absolutesovereign immunity was less vital in the state-to-state context.

****3** Mr. Clement was, unsurprisingly, not satisfied with this type of self-enforced version of sovereign immunity, which he referred to as a ‘race to the bottom.‘ Instead, Mr. Clement reiterated that sovereign immunity must be absolute because the statesenjoyed sovereign immunity before ratifying the Constitution, and there was, according to Mr. Clement, ‘no way they would have sacrificed their immunity‘ as part of the deal.

Instead, the Constitution preserved the immunity the states enjoyed before its enactment. Or, put differently, sovereign immunity was the ‘starting point‘ and the ‘default rule‘ for all jurisdictional issues at the time of the ConstitutionalConvention, and the states had no reason to believe that a different result would follow after ratification.

Justices worry about lack of protection in other states' courts.

In his argument before the Court, Mr. Farr claimed that there are really two sovereign interests at stake in the Court's decision: (1) California's interest in sovereign immunity; and (2) Nevada's sovereign interest in protecting its citizens from the harmfulacts of other states. And Mr. Farr argued that the second interest must trump the first. The justices, however, wondered aloud whether there was then any limit on Nevada's ability to impose its jurisdiction over another state.

Justice Breyer, in particular, was troubled by part of the outcome in the case below. Specifically, Justice Breyer, noted that he was bothered by how Nevada interpreted its immunity, whereby it insisted that its courts could try a citizen's lawsuit againstan agency of a neighboring state, but then refuse to give that agency the same legal protections that it gives to agencies in its own state (i.e., immunity). Mr. Clement agreed, finding this result ‘unbelievabl[e].‘

And Justice Alito, in his questioning of Mr. Farr, noted that he and Mr. Hyatt ‘seem[ed] to be arguing that no matter how hostile one State is to another, there would be no requirement . . . for equal treatment.‘ That argument, accordingto Justice Alito, ‘seem[ed] to point to the need to overrule *Nevada v. Hall.*‘

Will the justices overrule *Nevada v. Hall?*

As part of its grant of certiorari, the Court agreed to review whether *Nevada v. Hall*, which, as discussed above, permitted California to govern over a suit brought against Nevada without Nevada's consent, should be overruled.

In his opening remarks before the Court, Mr. Farr presented two main reasons for why *Nevada v. Hall* should not be overruled. First, Mr. Farr contended that the Court in *Hall* recognized that there have always been limits on statesovereignty and, therefore, Mr. Clement's argument that sovereignty is an absolute right that predates the Constitution is wrong.

Second, Mr. Farr argued that the FTB has ‘failed to show that the ordinary political process—in particular an agreement of 46 states, which are now represented before the Court‘ will not resolve the issue in this case. In addition to California,45 other states signed on as *amici* in support of the FTB's claim, saying they all agree there should be absolute immunity in each other's courts.

****4** Put differently, Mr. Farr claimed that comity, which he sees as the basis for state sovereign immunity, offers sufficient protection against unruly jurisdictional claims. Thus, according to Mr. Farr, there is no need for Court involvement to mandate absoluteimmunity.

Justice Ginsburg recognized a ‘certain irony‘ in California now arguing for absolute sovereign immunity, when, in *Nevada v. Hall*, California said ‘oh, yes, we can sue [Nevada] in our courts if they come into our State andhurt our people.‘ Mr. Clement referred to the FTB's current position as ‘buyer's remorse,‘ and, later in his argument, Mr. Clement argued that although the Court ‘doesn't lightly overrule its precedents,‘ the ruling of the lower court inthis case creates a dramatic inconsistency with the Founding Fathers' understanding of sovereign immunity. Thus, according to Mr. Clement, ‘it's time to overrule [*Nevada v. Hall*].‘

Whether the Court accepts this argument remains to be seen. And perhaps Justice Kagan put it best, noting, ‘I think this is a very hard case straight up. But it's not straight up, right?‘ Instead, in order for the FTB to prevail, Mr. Clement willhave to have convinced the Court that there exists a special justification for overruling its prior precedent. (For more background on this case, including a detailed discussion of the underlying audit of Mr. Hyatt, see U.S. Supreme Court Update, 25JMT 40 (July 2015).)

Court Sets Oral Argument Date in Nebraska Tribal Sales Tax Dispute

On 1/20/16, the Court hears oral argument in a challenge by a group of Nebraska alcoholic beverage dealers operating in or around the Village of Pender, Nebraska, in *Nebraska v. Parker*, Docket No. 14-1406, ruling below as *Smith v. Parker*,774 F.3d 1166 (8th Cir. 2014). In the case below, the U.S. Court of Appeals for the Eighth Circuit affirmed a lower court's ruling that the beverage dealers (who are joined by the village and the state) must comply with tribal taxing provisions that imposea 10 percent sales tax on the purchase of alcoholic beverages.

The tax at issue applies only to sales on tribal land, and the courts below found that because the Omaha Indian Reservation had not been diminished by an 1882 Act of Congress, the Village of Pender remained located on Omaha tribal land. Thus, the tax appliedto liquor sales in the village. This case will allow the Court to determine whether Congress intended to diminish

the boundaries of the Omaha Indian Reservation in Nebraska when it enacted an 1882 Act that ratified an agreement for the sale of Omaha triballands to non-Indian settlers. (For more background on this case, see U.S. Supreme Court Update, 25 JMT 43 (January 2016).)

Petitions Still Pending

The following three petitions remained pending as the JOURNAL went to press.

KY challenges federal court's ruling on fuel tax refund. In *Kentucky Department of Revenue v. Bulk Petroleum Corporation*, Docket No. 15-569, petition for cert. filed 10/29/15, ruling belowas *Bulk Petroleum Corporation v. Kentucky Department of Revenue*, 796 F.3d 667 (7th Cir. 2015), the U.S. Court of Appeals for the Seventh Circuit held that Bulk Petroleum Corporation (‘Bulk ‘) was entitled to a refund of Kentucky gasolineor special fuel taxes (‘Fuel Tax‘) paid on fuels delivered outside the state.

****5** In its petition for review, the Kentucky Department of Revenue (KDOR) argues ***45** that Kentucky's Fuel Tax did not place the legal incidence of the tax on Bulk—who, during the relevant times, was an unlicensed dealer—but, instead, on Bulk's suppliers.Accordingly, Kentucky argues that Bulk was not a ‘taxpayer‘ for purposes of Kentucky's Fuel Tax and, therefore, Bulk was not entitled to a refund under the state's tax statutes.

More specifically, the KDOR asks the Court to consider ‘whether the court below failed to apply this Court's precedent for determining the incidence of a state fuel tax developed in such cases as *American Oil Co.* v. *Neill*, 380U.S. 451 (1965), *Gurley v. Rhoden*, 421 U.S. 200 (1975) and *Wagnon v. Prairie Potawatomi Nation*, 546 U.S. 95 (2005), with respect to the State of Kentucky's gasoline and special fuels tax of KRS 138.220(1) and insteadeffectively resurrected the discarded rule of *Panhandle Oil Co. v. State of Mississippi ex. Rel. Knox*, 277 U.S. 218 (1928), and its progeny to the incorrect result. ‘ (For more background on this case, including a discussion of Kentucky's fueltax regime, see U.S. Supreme Court Update, 25 JMT 42 (February 2016).)

Due process challenge to CA's unclaimed property laws. In *Taylor v. Yee*, Docket No. 15-169, petition for cert. filed 8/5/15, ruling below at 780 F.3d 928 (9th Cir. 2015), a groupof California taxpayers ask the Court to review the constitutionality of California's Unclaimed Property Law (Cal. Civ. Proc. §§ 1300, et seq.; ‘UPL‘) on an as-applied basis. The U.S. Court of Appeals for the Ninth Circuit held that the CaliforniaController did not violate the Due Process Clause in administering the UPL. Specifically, it found that the taxpayers failed to sufficiently state an as-applied claim to support their argument that the Controller failed to provide constitutionally adequatenotice for the transfer of property under the UPL on a pre-escheat basis by failing to obtain information from all available state databases.

In their petition for certiorari, the taxpayers cite to the Supreme Court's recent decision in *Horne v. Department of Agriculture*, in which the Court held that the U.S. Government had violated a group of raisin growers' constitutional rightsunder the Takings Clause of the Fifth Amendment by requiring growers to set aside a certain portion of their raisins for government use without offering just compensation.

The taxpayers ask the Court whether, in light of that decision, the Ninth Circuit's ruling should be remanded for further proceedings. Alternatively, the taxpayers ask the Court to consider whether the UPL violates the Due Process Clause because it allegedly‘deprives owners of their property without affording constitutionally adequate notice.‘ (For more background on this case, including a discussion of the current notice requirements under California's UPL, see U.S. Supreme Court Update, 25JMT 41 (November/December 2015).)

****6 ERISA preemption provision challenge to MI health insurance tax.** In *Self-Insurance Institute of America, Inc. v. Snyder*, Docket No. 14-741, petition for cert. filed 12/18/14, ruling below at 761 F.3d 631,59 EBC 1406 (6th Cir. 2014), the U.S. Court of Appeals for the Sixth Circuit affirmed a district court's ruling that the Michigan Health Insurance Claims Assessment Act (Mich. Comp. Laws §§ 550.1731–1734; the ‘Michigan Act‘)—whichimposes a 1 percent tax, along with various reporting

and record-keeping requirements, on all paid claims by carriers and third party administrators to healthcare providers for services rendered in Michigan for Michigan residents—is not prohibited byERISA's preemption provision (29 U.S.C. § 1144(a)).

As explained by the Sixth Circuit in its decision upholding the Michigan Act, one of the purposes of ERISA is ‘to provide a uniform regulatory regime over employee benefit plans.‘ Accordingly, ‘ERISA contains a broad preemption provision that‘supersede[s] any and all State laws insofar as they . . . *relate* to any employee benefit plan’ that falls under the regulation of ERISA. (29 U.S.C. §1144(a))‘ (emphasis added). The Sixth Circuit interpreted this standard to mean that ‘[a] law ‘relates to’ an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan.‘

In the proceedings below, the Self-Insurance Institute of America, Inc. (‘SIIA ‘) argued that the Michigan Act has an impermissible connection with employee benefit plans inasmuch as the Michigan Act: ‘(1) interferes with the administration ofthe plans; (2) imposes administrative burdens in addition to those prescribed by ERISA; and (3) interferes with the relationships between ERISA-covered entities.‘ The Sixth Circuit disagreed with all three of SIIA's contentions, however.

In its petition for review, SIIA argues that ‘[t]he circuit court invoked a strong presumption against the preemption of state taxing powers to read [ERISA's preemption provisions] narrowly despite Congress's deliberate choice ofpreemptive language whose breadth has been repeatedly emphasized by this Court, and Congress's express recognition that ERISA can and does preempt state tax laws.‘ Accordingly, SIIA argues (as it did in the proceedings below) that the Supremacy Clauseof the U.S. Constitution (art. VI, § 2) and ERISA's preemption provision, prohibit the application of the Michigan Act to ERISA-covered entities. (For more background on this case, including a detailed discussion of the circuit court's response to SIIA'sspecific claims, see U.S. Supreme Court Update, 25 JMT 45 (May 2015).)

Petition Denied

On 1/11/16, the Court denied review in ***Sierra Pacific Power Company v. Nevada***, Docket No. 15-25, petition for cert. filed 7/2/15, ruling below at 338 P.3d 1244 (Nev. 2014). The Nevada Supreme Court, in an en banc opinion, had held that twosubsidiaries of NV Energy, Inc. were not entitled to refunds for use taxes paid under an admittedly unconstitutional tax provision.

****7** According to the Supreme Court of Nevada, the energy companies were not entitled to refunds for use taxes paid under the statute because they did not show the tax, as actually assessed, discriminated against interstate commerce. Specifically, the court foundthat the energy companies paid no higher tax than their competitors and that while an exemption granted under the statute was unconstitutional, the tax itself was not.

NV Energy had asked the U.S. Supreme Court to review the Nevada court's holding. Specifically, NV Energy had asked the Court to consider whether ‘a state court violate[s] the federal Due Process rights of a taxpayer to ‘meaningful backward-lookingrelief’ and a ‘clear and certain remedy’ for the exaction of an unconstitutional tax . . . by holding that even though a challenged tax scheme facially violates the dormant Commerce Clause, an affected taxpayer is not entitled to a refund absent proofthat an in-state competitor benefited from the discriminatory tax scheme.‘

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