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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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Court Asked to Invoke Exclusive and Original Article III Jurisdiction Over Interstate Unclaimed Property Dispute

***42** In this issue of the JOURNAL, we discuss two recent motions for leave to file bills of complaint with the Supreme Court, both of which stem from an ongoing unclaimed property saga involving MoneyGram Payment Systems, Inc.'s uncashed 'official checks.' The underlying complaints involve several states' dueling claims over the proper classification of MoneyGram's uncashed checks, a determination that directly impacts which states are entitled to claim any abandoned funds. Several of the states involved in the litigation ask the Court to invoke its exclusive and original jurisdiction under Article III, Section 2, Clause 2, of the U.S. Constitution, over these lawsuits between the states.

The Court has also received one new petition for certiorari in *Huang v. City Of Los Angeles* (Docket No. 15-1507), a case involving the proper scope of the Tax Injunction Act. And, as we go to press, we also note that the previously reported petition in *Gillette v. California Franchise Tax Board* (Docket No. 15-1442), the latest development in the protracted litigation involving various states' attempts to override the Multistate Tax Compact, remains pending before the Court.

States Challenge Delaware's Right to Claim MoneyGram's Uncashed 'Official Checks'

In *Delaware v. Pennsylvania and Wisconsin* (motion for leave to file a bill of complaint filed 5/26/16) and *Arkansas et. al. v. Delaware* (motion for leave to file a bill of complaint filed 6/9/16), Delaware and, in a separate filing, Arkansas (along with 20 other states) ask the U.S. Supreme Court to grant leave to file a complaint and to exercise its exclusive and original jurisdiction over the states' complaints pursuant to Article III, Section 2, Clause 2 of the U.S. Constitution and Title 28, Section 1251(a) of the U.S. Code. (On 6/3/16, Wisconsin also filed a brief and motion for leave to file a counterclaim after Delaware submitted its complaint naming Pennsylvania and Wisconsin as defendants.)

The underlying complaints relate to an ongoing dispute over the proper classification of (and priority rules applicable to) MoneyGram's 'official checks.' In particular, the states disagree as to whether MoneyGram's official checks are properly classified as third-party bank checks (which would be subject to the federal common-law priority rules established in *Texas v. New Jersey*, 379 U.S. 674 (1965)) and escheat to MoneyGram's state of incorporation—Delaware—or, alternatively, whether the checks are more akin to money orders (which would be subject to special statutory priority rules under the Federal Disposition

of Abandoned Money Orders and Traveler's Checks Act of 1974) and escheat to the state of purchase—i.e., Pennsylvania, Wisconsin, Arkansas, Texas, etc.

**2 Although the dispute pits state against state over the proper classification of the official checks and the priority rules applicable thereto, the states do agree on one thing: The U.S. Supreme Court is the exclusive forum that can and should hear the case.

Priority rules for unclaimed intangible personal property.

As stated in Delaware's Bill of Complaint, '[a]ll 50 states have statutes regarding the States' ability to 'take title to certain abandoned intangible personal property through escheat, a procedure with ancient origins whereby a sovereign may acquire title to abandoned property if after a number of years no rightful owner appears.'' (quoting *Texas v. New Jersey*, 379 U.S. 674 (1965)). But this general escheat concept fails to address which state has a right of priority when multiple states seek to recover the same property.

Three times in the past, the U.S. Supreme Court has stepped in and addressed similar disputes. As explained in Delaware's Bill of Complaint, the first time, in *Texas v. New Jersey*, the Court 'initially established what have become known as the 'priority rules.'' Under these 'priority rules' (i.e., federal common-law priority rules), as detailed in Delaware's Bill of Complaint, 'the first opportunity to escheat the property belongs to the State of the last known address of the creditor as shown by the debtor's books and records (the 'primary rule'), and if there is no record of any address for a creditor, or because the creditor's last known address is in a State which does not provide for the escheat of abandoned property, the property escheats to the State in which the debtor is incorporated (the 'secondary rule').' Since MoneyGram did not track the addresses of purchasers of its official checks, under theCourt's *Texas* priority rules, any unclaimed checks would escheat to Delaware, MoneyGram's state of incorporation.

The priority rules established by the Court in *Texas*, however, are not the only method for escheating certain types of unclaimed property. Rather, as explained by Delaware in its Bill of Complaint, Congress adopted the Disposition of Abandoned Money Orders and Traveler's Checks Act of 1974 (the 'Act') (12 U.S.C. § 2503), following the Supreme Court's third decision in this area. Specifically, the Act 'had the effect of reversing the Supreme Court's holding in *Pennsylvania v. New York,* 407 U.S. 206 (1972) for certain *44 types of property.' The Act provides that for a 'money order, traveler's check, or other similar written instrument (other than a third-party bank check) on which a banking or financial organization or a business association is directly liable,' the state in which such an instrument was purchased has the exclusive right to escheat or take custody of the property. *See* 12 U.S.C. § 2503.

MoneyGram's 'official checks.'

Although not a party to the underlying complaints, MoneyGram finds itself at the center of this dispute. MoneyGram, according to Delaware's Bill of Complaint, is a Delaware corporation, with its principal place of business in Texas. As part of its money transferring business, MoneyGram offers 'official checks' to financial institutions. According to Delaware, these '[o]fficial [c]hecks are not money orders, traveler's checks, or other similar instruments ' and therefore they fall outside the scope of the Act. Arkansas, however, in its separate Bill of Complaint, alleges that '[b]ecause a MoneyGram official check operates like a money order and a traveler's check,' the Act applies, and that 'under the [Act], the State where a MoneyGram official check was purchased ' is entitled to escheat the property.

**3 MoneyGram, which finds itself stuck between these dueling interpretations, initially determined that its checks were not akin to money orders or traveler's checks and that the Act did not apply. Accordingly, MoneyGram has historically reported and remitted any unclaimed property related to its official checks to the State of Delaware, pursuant to the priority rules established in *Texas.* Delaware, which is alleged to have wrongly taken custody of over $160 million worth of unclaimed checks, agrees

with MoneyGram's methodology. Other states, however, believe they are entitled to those funds. Thus, MoneyGram finds itself facing potential double liability for the escheat of the same unclaimed property.

The third-party audit.

As explained in Arkansas's Bill of Complaint, the states in which customers purchase MoneyGram's official checks allege that MoneyGram and Delaware's interpretation of the escheat priority rules creates an improper windfall for Delaware. To support their claims, several states, including Pennsylvania and Wisconsin (the defendants in Delaware's Bill of Complaint) retained a third-party auditor, Treasury Services Group ('TSG'), to conduct a review of MoneyGram's official checks before bringing their initial complaints.

After its audit, TSG declared that MoneyGram's official checks were subject to the Act and that Delaware had therefore wrongly claimed the uncashed funds instead of the official checks properly escheating to the states where they were purchased. These audit findings, with which Delaware disagrees, led to a pair of lawsuits filed against Delaware in federal district court.

Pennsylvania and Wisconsin bring suit against Delaware in federal district court.

In the wake of TSG's audit findings, both Pennsylvania and Wisconsin sued Delaware in Pennsylvania and Wisconsin federal district courts. Both states sought from MoneyGram the return of any unclaimed funds wrongly claimed by Delaware and a declaration interpreting the Act so that all future amounts payable on abandoned MoneyGram official checks would remit to the state of purchase. Pennsylvania estimated in its complaint that, as a result of Delaware's improper claims, it was entitled to over $10 million worth of uncashed checks. Wisconsin estimated Delaware's liability at $13 million.

In response to the suits, Delaware filed a motion to dismiss Pennsylvania's action for lack of personal jurisdiction and lack of subject matter jurisdiction. On May 19, 2016, Pennsylvania sought an order by the district court to administratively suspend the case so that the U.S. Supreme Court could consider a motion for leave to file a bill of complaint and invoke the Court's original jurisdiction. Interestingly, Delaware, not Pennsylvania, was the first to submit a motion for leave to file a bill of complaint with the Supreme Court. (The Pennsylvania district court has placed the federal district court action in administrative suspension pending a ruling from the Supreme Court on a motion for leave to file a bill of complaint. And, although this action did not impact Wisconsin's initial lawsuit, Wisconsin has since announced that it intends to move to stay proceedings in its suit as well.)

The bills of complaint.

****4** The first state to file a motion for leave to file a bill of complaint was Delaware on 5/26/16. Delaware names Pennsylvania and Wisconsin as defendants in its suit and argues that it 'has no adequate remedy at law to enforce its superior right to that of the State of Wisconsin and the Commonwealth of Pennsylvania to receive abandoned property related to MoneyGram's Official Checks.' In other words, Delaware argues that it 'has no sufficient remedy except by invoking the Court's original jurisdiction in this proceeding.'

In its Bill of Complaint, Delaware asks the Court specifically to (1) '[d]eclare that MoneyGram Official Checks are not 'a money order, traveler's check, or other similar written instrument'' under the Act; (2) '[i]ssue its Decree commanding the State of Wisconsin and the Commonwealth of Pennsylvania not to assert any claim over abandoned and unclaimed property related to MoneyGram Official Checks;' and (3) '[i]ssue its Decree that all future sums payable on abandoned MoneyGram Official Checks should be remitted to the State of Delaware.'

On 6/3/16, Wisconsin was the next state to get its papers before the Court, responding to Delaware's Bill of Complaint by filing a motion for leave to file a ***46** counterclaim. In its counterclaim, Wisconsin agrees that the Court should exercise its exclusive jurisdiction but requests that the Court (1) '[d]eclare the rights of Wisconsin with regard to unclaimed funds from Official Checks

purchased in Wisconsin, which Delaware has wrongly seized;‘ (2) ‘[i]ssue an Order commanding Delaware to cease taking custody of funds from abandoned Official Checks purchased in Wisconsin;‘ and (3) ‘[i]ssue an Order commanding Delaware to pay Wisconsin damages in the amount of the unclaimed funds from abandoned Official Checks purchased in Wisconsin.‘

Wisconsin's counterclaim is a direct response to Delaware's Bill of Complaint. On 6/19/16, however, Arkansas, along with 20 other states (Arizona, Texas, Alabama, Colorado, Florida, Idaho, Indiana, Kansas, Kentucky, Louisiana, Michigan, Montana, Nebraska, Nevada, North Dakota, Ohio, Oklahoma, South Carolina, Utah, and West Virginia) filed a separate motion for leave to file a bill of complaint, together with the Bill of Complaint with the Court. These states also agree that the Court should exercise its original and exclusive jurisdiction over the dispute, but similar to Wisconsin's claims, the states allege that Delaware has wrongly claimed funds related to MoneyGram's official checks.

Specifically, Arkansas and its counterparts ask the Court to (1) ‘[d]eclare the rights of the Plaintiff States to the sums payable on unclaimed and abandoned MoneyGram official checks purchased in the Plaintiff States and unlawfully remitted to the State of Delaware;‘ (2) ‘[d]eclare the rights of the Plaintiff States to future sums payable on unclaimed and abandoned MoneyGram official checks purchased in the Plaintiff States;‘ and (3) ‘[i]ssue its decree commanding the State of Delaware, its officers, citizens, and subdivisions, to: (a) deliver to the Plaintiff States sums payable on unclaimed and abandoned MoneyGram official checks purchased in those States and unlawfully remitted to Delaware; [and] (b) cease-and-desist all actions which interfere with and impede the authority of the Plaintiff States to take custody of sums payable on unclaimed and abandoned MoneyGram official checks purchased in those States.‘

Will the Supreme Court exercise its original jurisdiction over the case?

****5** The U.S. Supreme Court has original jurisdiction over cases and controversies between states under Article III of the U.S. Constitution and under 28 U.S.C. § 1251(a), which provides that the Court ‘shall have original and exclusive jurisdiction of all controversies between two or more States.‘ Despite this language, however, the Court has historically viewed its jurisdiction in these matters as ‘obligatory only in appropriate cases.‘ *Illinois v. Milwaukee*, 406 U.S. 91 (1972). Procedurally, therefore, the Supreme Court must first determine whether it will invoke its original jurisdiction in any given case before reaching the merits.

Despite the competing claims discussed above, the states' reasons for why the Supreme Court should exercise its exclusive jurisdiction in this case are relatively consistent. First, the states argue that serious issues regarding state sovereignty are at stake. Delaware, for example, argues that ‘[t]he demands of Pennsylvania and Wisconsin that MoneyGram cease escheating unaddressed unclaimed Official Checks to Delaware is an attack on the sovereignty of Delaware to govern its corporate citizens.‘ Conversely, Arkansas alleges that ‘Delaware has violated—and directed MoneyGram to violate—the laws of the Plaintiff States,‘ and accordingly, Delaware has ‘seriously undermine[d] the Plaintiff States' sovereignty, impair[ed] the ability of the Plaintiff States to control their own finances, and interfere[d] with the right of the Plaintiff States to enforce their own laws.‘

Second, all of the states involved agree that there is ‘no alternative forum capable of fully resolving this dispute.‘ Whether the Supreme Court agrees may very well determine which state or states are entitled to the millions of dollars of uncashed official checks that are abandoned within the United States each year.

California Taxpayer Asks Court to Review Scope of Tax Injunction Act

In *Huang v. City of Los Angeles,* Docket No. 15-1507, ruling below at 2006 WL 683269 (9th Cir. 2016), the U.S. Court of Appeals for the Ninth Circuit largely affirmed a district court's ruling that (1) certain business impositions assessed by the City of Los Angeles, as well as penalties added thereto for delinquent payment, qualify as ‘taxes‘ under the Tax Injunction Act, such that the lower federal court lacked subject matter jurisdiction to hear a taxpayer's claim, and (2) that the Tax Injunction Act also deprived the lower court of jurisdiction to hear the taxpayer's challenge to the methods by which the City of Los Angeles obtains information during its audits.

The taxpayer, Roger Huang, a general partner of a partnership that owns an apartment building near Dodger Stadium, argues that the Court should grant his petition to (1) resolve a circuit split as to whether the Tax Injunction Act deprives federal courts of jurisdiction to hear challenges to a penalty imposed for failing to pay a tax, and (2) address the Ninth Circuit's failure to follow the Supreme Court's recent precedent announced in *Direct Marketing Association v. Brohl,* 135 S. Ct. 1124 (2015), which, according to Huang, held that 'the Tax Injunction Act does not bar federal jurisdiction for challenges to the methods by which the government gathers the information it uses to calculate tax liability.'

The Tax Injunction Act.

****6** As stated by the Ninth Circuit, the Tax Injunction Act ('TIA'), codified at 28 U.S.C. § 1341, 'bars a taxpayer from challenging the validity of a state tax in federal court where an adequate remedy is available in state court.' This jurisdictional bar, however, applies only to issues involving the 'assessment, levy or collection of any tax.' Huang argues that his challenge involves neither a tax nor the 'assessment, levy or collection' of any government fee and that, accordingly, the TIA does not bar his claims in federal court.

The Los Angeles business license tax.

According to the federal district court's ruling below, Huang asserts that in December 2012, Los Angeles conducted a business license tax audit of his real estate partnership. As part of the audit, the city demanded an opportunity to inspect the partnership's books and records. The partnership refused, however, arguing that without its consent or an administrative warrant, such an inspection would violate its Fourth Amendment rights against unlawful search and seizure.

In response, the city assessed the partnership an estimated license tax of $7,322.44, including interest and penalties. Huang filed an administrative appeal, which, in part, argued that the city's warrantless inspection had violated his Fourth ***48** Amendment rights. A City appeal officer upheld the assessment.

Ninth Circuit affirms that penalties for delinquent payment qualify as a 'tax' under TIA.

Huang filed a § 1983 claim on behalf of the partnership in federal district court. However, the lower court dismissed Huang's complaint on the ground that the Tax Injunction Act deprived the court of jurisdiction. In determining whether it lacked jurisdiction to hear Huang's complaint, both the lower court and the circuit court determined that the entire assessment, including penalties, qualified as taxes.

Both courts looked to the Ninth Circuit's three-factor test announced in *Bidart Brothers v. California Apple Commission*, 73 F.3d 925 (9th Cir. 1996) and held that (1) because the assessment is imposed directly by the legislature as opposed to by an administrative agency; (2) because the assessment is imposed upon a broad class of parties as opposed to on a narrow class; and (3) because the assessment is treated as a general revenue and is paid into the state's general fund, the assessment at issue qualifies as a 'tax' under the TIA.

According to Huang, the Supreme Court must address the issue of whether a penalty imposed for failing to pay a tax is itself a 'tax' under the TIA in order to address a lingering circuit split on a 'recurring question.' Huang notes in his petition that the 'Second, Sixth, Seventh, and Tenth Circuits hold that a penalty for nonpayment of a tax is a penalty, not a tax, for purposes of the Tax Injunction Act.' The Fifth and Ninth Circuits, however, take the opposite view, holding that 'a tax penalty is a tax, not a penalty, for purposes of the Tax Injunction Act.' Arguing that the majority view is correct, Huang urges the Supreme Court to reject the Ninth Circuit's ruling.

Courts find that Los Angeles's audit activities are part of the 'assessment, levy or collection' of a tax.

****7** The lower courts also addressed Huang's claim that the city conducted an unconstitutional search of his property when a city official 'entered onto the [partnership's] property without [its] consent or a warrant for the purposes of an investigation of the property.' Huang argues that this aspect of his claim is not barred by the TIA because any decision to dismiss his Fourth Amendment complaint under the TIA is contrary to the Court's recent ruling in *Direct Marketing Association v. Brohl*, 135 S. Ct. 1124 (2015).

In its opinion, the Ninth Circuit addressed Huang's *Direct Marketing* argument with a single line: 'Nor is the reasoning of *Direct Marketing* applicable to the facts of this case.' Huang, in his petition for certiorari, however, argues that in *Direct Marketing*, the Court held that the TIA does not deprive federal courts of jurisdiction to hear challenges to 'reporting requirements' and 'information gathering' because these are 'phase[s] of tax administration procedure that occur[] before assessment, levy, or collection.'

Huang argues that this same reasoning should apply to his case because his complaint is 'solely about the means by which the City gathers the information it uses to calculate tax liability.' Huang alleges that he is 'not contesting the City's authority to tax businesses or the lawfulness of the tax itself. ' Instead, he argues that Los Angeles must obtain a warrant before inspecting his books and records and that a federal court has jurisdiction to hear his claim, because he is not challenging an 'assessment, levy or collection' of tax.

Questions presented.

In his petition for certiorari, Huang asks the Court: '(1) Whether a penalty imposed for failing to pay a tax is itself a 'tax' under the Tax Injunction Act,' and '(2) Whether the Tax Injunction Act deprives federal courts of jurisdiction to hear a taxpayer's challenge to the method by which the government obtains the information it uses to calculate tax liability.'

Petition Still Pending

The following petition remained pending as the JOURNAL went to press.

Supreme Court receives amicus briefs in Multistate Tax Compact litigation. At press time, the Supreme Court had received at least eight new amicus briefs in *Gillette v. California Franchise Tax Board*, Docket No. 15-1442, petition for cert. filed 5/27/16, ruling below at 363 P.3d 94 (2015). In this case, which is the latest development in the protracted litigation involving various states' attempts to override the Multistate Tax Compact (the 'Compact '), Gillette, along with several other corporate taxpayers, asks the Court to review a decision by the California Supreme Court, in which California's highest court held that the Compact does not qualify as a binding reciprocal agreement.

The petition for certiorari argues, among other things, that review is warranted because the California Supreme Court erred in its holding that the Compact is not a binding contract and therefore subject to the U.S. Constitution's Contract Clause. According to Gillette, having 'held that the Compact is not binding, the California Supreme Court declined to decide whether a binding interstate compact that has not been approved by Congress takes precedence over other state law or whether California's departure from the Compact violates the Contract Clause.'

****8** Noting that the Compact is 'a multistate agreement that addresses significant aspects of the state taxation of multistate businesses,' Gillette and its counterparts now ask the U.S. Supreme Court whether 'the Multistate Tax Compact has the status of a contract that binds its signatory states.' (For more background on this case, including a detailed discussion of the California court's ruling, see U.S. Supreme Court Update, 26 JMT 43(Aug. 2016).)

The underlying complaints relate to an ongoing dispute over the proper classification of (and priority rules applicable to) MoneyGram's ‘official checks.‘

[T]he states in which customers purchase MoneyGram's official checks allege that MoneyGram and Delaware's interpretation of the escheat priority rules creates an improper windfall for Delaware.

According to [the taxpayer], the Supreme Court must address the issue of whether a penalty imposed for failing to pay a tax is itself a ‘tax‘ under the TIA in order to address a lingering circuit split on a ‘recurring question.‘

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